

**COMMONWEALTH OF KENTUCKY**

**BEFORE THE PUBLIC SERVICE COMMISSION**

**In the Matter of:**

AN ADJUSTMENT OF THE GAS )  
AND ELECTRIC RATES, TERMS )  
AND CONDITIONS OF LOUISVILLE )  
GAS AND ELECTRIC COMPANY )

**CASE NO: 2003-00433**

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**VOLUME 3 OF 7**

**RESPONSE TO FILING REQUIREMENTS listed in 807 KAR 5:001  
SECTION 10(6)(s) through 807 KAR 5:001 SECTION 10(7)(e)**

**Filed: December 29, 2003**

**Louisville Gas and Electric Company**  
**Case No. 2003-00433**  
**Historical Test Year Filing Requirements**  
**Table of Contents**

Volume Number	Description of Contents
1	Statutory Notice Application Table of Contents Financial Exhibit pursuant to 807 KAR 5:001 Section 6 Response to Filing Requirements listed in 807 KAR 5:001 Section 10(1)(a)1 through 807 KAR 5:001 Section 10(6)(k) Response to Filing Requirements listed in 807 KAR 5:001 Section 10(6)(l) through 807 KAR 5:001 Section 10(6)(r) Testimony
2	Seelye Exhibit - Cost-of-Service Study
3	Robinson Appendix C - Depreciation Study for Electric Division
4	Robinson Appendix D - Depreciation Study for Gas Division
5	Robinson Appendix E - Depreciation Study for Common Division
6	
7	



**Louisville Gas and Electric Company**  
**Case No. 2003-00433**  
**Historical Test Period Filing Requirements**

**Filing Requirement**  
**807 KAR 5:001 Section 10(6)(s)**  
**Sponsoring Witness: S. Bradford Rives**

**Description of Filing Requirement:**

*Securities and Exchange Commission's annual report for the most recent two (2) years, Form 10-Ks and any Form 8-Ks issued within the past two (2) years, and Form 10-Qs issued during the past six (6) quarters updated as current information becomes available.*

**Response:**

The following SEC Forms are attached:

- SEC Form 10-K – December 31, 2002
- SEC Form 10-K – December 31, 2001
- SEC Form 10-Q – September 30, 2003
- SEC Form 10-Q – June 30, 2003
- SEC Form 10-Q – March 31, 2003
- SEC Form 10-Q – September 30, 2002
- SEC Form 10-Q – June 30, 2002
- SEC Form 10-Q – March 31, 2002
- SEC Form 8-K – November 25, 2003
- SEC Form 8-K – November 12, 2003
- SEC Form 8-K – May 14, 2003
- SEC Form 8-K – March 25, 2003
- SEC Form 8-K – November 14, 2002
- SEC Form 8-K – August 14, 2002
- SEC Form 8-K – February 21, 2003

**SEC Form 10-K -- December 31, 2002**

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D. C. 20549**

**FORM 10-K**

(Mark One)

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934 (NO FEE REQUIRED)**

For the fiscal year ended **December 31, 2002**

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934 (NO FEE REQUIRED)**

<u>Commission File Number</u>	<u>Registrant, State of Incorporation, Address, and Telephone Number</u>	<u>IRS Employer Identification Number</u>
2-26720	<b>Louisville Gas and Electric Company</b> (A Kentucky Corporation) 220 West Main Street P. O. Box 32010 Louisville, Kentucky 40232 (502) 627-2000	61-0264150
1-3464	<b>Kentucky Utilities Company</b> (A Kentucky and Virginia Corporation) One Quality Street Lexington, Kentucky 40507-1428 (859) 255-2100	61-0247570

Securities registered pursuant to section 12(g) of the Act:

Louisville Gas and Electric Company  
5% Cumulative Preferred Stock, \$25 Par Value  
\$5.875 Cumulative Preferred Stock, Without Par Value  
Auction Rate Series A Preferred Stock, Without Par Value  
(Title of class)

Kentucky Utilities Company  
Preferred Stock, 6.53% cumulative, stated value \$100 per share  
Preferred Stock, 4.75% cumulative, stated value \$100 per share  
(Title of class)

Indicate by check mark whether the registrants (1) have filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrants were required to file such reports), and (2) have been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes No

As of June 28, 2002, the aggregate market value of the common stock of each of Louisville Gas and Electric Company and Kentucky Utilities Company held by non-affiliates was \$0. As of February 28, 2003, Louisville Gas and Electric Company had 21,294,223 shares of common stock outstanding, all held by LG&E Energy Corp. Kentucky Utilities Company had 37,817,878 shares of common stock outstanding, all held by LG&E Energy Corp.

This combined Form 10-K is separately filed by Louisville Gas and Electric Company and Kentucky Utilities Company. Information contained herein related to any individual registrant is filed by such registrant on its own behalf. Each registrant makes no representation as to information relating to the other registrants.

DOCUMENTS INCORPORATED BY REFERENCE

Not applicable.

TABLE OF CONTENTS

PART I

Item 1.	Business.....	6
	Louisville Gas and Electric Company	
	General.....	6
	Electric Operations.....	7
	Gas Operations.....	9
	Rates and Regulation .....	10
	Construction Program and Financing.....	11
	Coal Supply.....	12
	Gas Supply.....	12
	Environmental Matters.....	13
	Competition .....	14
	Kentucky Utilities Company	
	General.....	14
	Electric Operations.....	15
	Rates and Regulation .....	17
	Construction Program and Financing.....	18
	Coal Supply.....	19
	Environmental Matters.....	19
	Competition .....	19
	Employees and Labor Relations .....	20
	Executive Officers of the Companies .....	21
Item 2.	Properties.....	24
Item 3.	Legal Proceedings .....	27
Item 4.	Submission of Matters to a Vote of Security Holders .....	28

PART II

Item 5.	Market for the Registrant's Common Equity and Related Stockholder Matters.....	29
Item 6.	Selected Financial Data .....	30
Item 7.	Management's Discussion and Analysis of Financial Condition and Results of Operation:.....	31
	Louisville Gas and Electric Company .....	31
	Kentucky Utilities Company .....	50
Item 7A.	Quantitative and Qualitative Disclosures About Market Risk.....	68
Item 8.	Financial Statements and Supplementary Data:	
	Louisville Gas and Electric Company.....	69
	Kentucky Utilities Company.....	103
Item 9.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure .....	135

PART III

Item 10.	Directors and Executive Officers of the Registrant (a).....	135
Item 11.	Executive Compensation (a).....	135
Item 12.	Security Ownership of Certain Beneficial Owners and Management (a).....	135
Item 13.	Certain Relationships and Related Transactions (a) .....	135

PART IV

Item 14.	Controls and Procedures.....	135
Item 15.	Exhibits, Financial Statement Schedules, and Reports on Form 8-K .....	135
	Signatures .....	160

(a) Incorporated by reference.

## INDEX OF ABBREVIATIONS

Capital Corp.	LG&E Capital Corp.
Clean Air Act	The Clean Air Act, as amended in 1990
CCN	Certificate of Public Convenience and Necessity
CT	Combustion Turbines
DSM	Demand Side Management
ECR	Environmental Cost Recovery
EBI	Electric Energy, Inc.
EITF	Emerging Issues Task Force Issue
E.ON	E.ON AG
EPA	U.S. Environmental Protection Agency
ESM	Earnings Sharing Mechanism
F	Fahrenheit
FAC	Fuel Adjustment Clause
FERC	Federal Energy Regulatory Commission
FPA	Federal Power Act
FT and FT-A	Firm Transportation
GSC	Gas Supply Clause
IBEW	International Brotherhood of Electrical Workers
IMEA	Illinois Municipal Electric Agency
IMPA	Indiana Municipal Power Agency
Kentucky Commission	Kentucky Public Service Commission
KIUC	Kentucky Industrial Utility Consumers, Inc.
KU	Kentucky Utilities Company
KU Energy	KU Energy Corporation
KU R	KU Receivables LLC
kV	Kilovolts
Kva	Kilovolt-ampere
KW	Kilowatts
Kwh	Kilowatt hours
LEM	LG&E Energy Marketing Inc.
LG&E	Louisville Gas and Electric Company
LG&E Energy	LG&E Energy Corp.
LG&E R	LG&E Receivables LLC
LG&E Services	LG&E Energy Services Inc.
Mcf	Thousand Cubic Feet
MGP	Manufactured Gas Plant
MISO	Midwest Independent System Operator
Mmbtu	Million British thermal units
Moody's	Moody's Investor Services, Inc.
Mw	Megawatts
Mwh	Megawatt hours
NNS	No-Notice Service
NOPR	Notice of Proposed Rulemaking
NOx	Nitrogen Oxide
OATT	Open Access Transmission Tariff
OMU	Owensboro Municipal Utilities
OVEC	Ohio Valley Electric Corporation
PBR	Performance-Based Ratemaking
PJM	Pennsylvania, New Jersey, Maryland Interconnection
Powergen	Powergen Limited (formerly Powergen plc)
PUHCA	Public Utility Holding Company Act of 1935
ROE	Return on Equity
RTO	Regional Transmission Organization
S&P	Standard & Poor's Rating Services
SCR	Selective Catalytic Reduction

SEC  
SERP  
SFAS  
SIP  
SMD  
SO<sub>2</sub>  
Tennessee Gas  
Texas Gas  
TRA  
Trimble County  
USWA  
Utility Operations  
VDT  
Virginia Commission  
Virginia Staff

Securities and Exchange Commission  
Supplemental Employee Retirement Plan  
Statement of Financial Accounting Standards  
State Implementation Plan  
Standard Market Design  
Sulfur Dioxide  
Tennessee Gas Pipeline Company  
Texas Gas Transmission Corporation  
Tennessee Regulatory Authority  
LG&E's Trimble County Unit 1  
United Steelworkers of America  
Operations of LG&E and KU  
Value Delivery Team Process  
Virginia State Corporation Commission  
Virginia State Corporation Commission Staff

## PART I.

### Item 1. Business.

LG&E and KU are each subsidiaries of LG&E Energy. On December 11, 2000, LG&E Energy was acquired by Powergen plc, now known as Powergen Limited, for cash of approximately \$3.2 billion or \$24.85 per share and the assumption of all of LG&E Energy's debt. As a result of the acquisition, among other things, LG&E Energy became a wholly owned subsidiary of Powergen and, as a result, LG&E and KU became indirect subsidiaries of Powergen. The utility operations (LG&E and KU) of LG&E Energy have continued their separate identities and continue to serve customers in Kentucky, Virginia and Tennessee under their existing names. The preferred stock and debt securities of the utility operations were not affected by this transaction resulting in the utility operations' obligations to continue to file SEC reports. Following the acquisition, Powergen became a registered holding company under PUHCA, and LG&E and KU, as subsidiaries of a registered holding company, became subject to additional regulation under PUHCA.

As a result of the Powergen acquisition and in order to comply with PUHCA, LG&E Services was formed as a subsidiary of LG&E Energy effective on January 1, 2001. LG&E Services provides certain services to affiliated entities, including LG&E and KU, at cost as required under PUHCA. On January 1, 2001, approximately 1,000 employees, mainly from LG&E Energy, LG&E and KU, were moved to LG&E Services.

On July 1, 2002, E.ON, a German company, completed its acquisition of Powergen following receipt of all necessary regulatory approvals. E.ON had announced its pre-conditional cash offer of £5.1 billion (\$7.3 billion) for Powergen on April 9, 2001.

### LOUISVILLE GAS AND ELECTRIC COMPANY

#### General

Incorporated in 1913 in Kentucky, LG&E is a regulated public utility that supplies natural gas to approximately 310,000 customers and electricity to approximately 382,000 customers in Louisville and adjacent areas in Kentucky. LG&E's service area covers approximately 700 square miles in 17 counties and has an estimated population of one million. Included in this area is the Fort Knox Military Reservation, to which LG&E transports gas and provides electric service, but which maintains its own distribution systems. LG&E also provides gas service in limited additional areas. LG&E's coal-fired electric generating plants, all equipped with systems to reduce sulfur dioxide emissions, produce most of LG&E's electricity. The remainder is generated by a hydroelectric power plant and combustion turbines. Underground natural gas storage fields help LG&E provide economical and reliable gas service to customers. See Item 2, Properties.

LG&E has one wholly owned consolidated subsidiary, LG&E R. LG&E R is a special purpose entity formed in September 2000 to enter into accounts receivable securitization transactions with LG&E. LG&E R started operations in 2001. LG&E is considering unwinding its accounts receivable securitization arrangements involving LG&E R during 2003.

For the year ended December 31, 2002, 74% of total operating revenues were derived from electric operations and 26% from gas operations. Electric and gas operating revenues and the percentages by class of service on a combined basis for this period were as follows:

	(Thousands of \$)			
	<u>Electric</u>	<u>Gas</u>	<u>Combined</u>	<u>% Combined</u>
Residential	\$232,285	\$160,733	\$ 393,018	47%
Commercial	185,112	61,036	246,148	30%
Industrial	111,871	10,232	122,103	15%
Public authorities	<u>57,703</u>	<u>11,197</u>	<u>68,900</u>	<u>8%</u>
Total retail	586,971	243,198	830,169	<u>100%</u>
Wholesale sales	143,002	16,384	159,386	
Gas transported – net	-	6,232	6,232	
Provision for rate collections	12,267	-	12,267	
Miscellaneous	<u>16,251</u>	<u>1,879</u>	<u>18,130</u>	
Total	<u>\$758,491</u>	<u>\$267,693</u>	<u>\$1,026,184</u>	

See Note 13 of LG&E's Notes to Financial Statements under Item 8 for financial information concerning segments of business for the three years ended December 31, 2002.

#### Electric Operations

The sources of LG&E's electric operating revenues and the volumes of sales for the three years ended December 31, 2002, were as follows:

	<u>2002</u>	<u>2001</u>	<u>2000</u>
<b>ELECTRIC OPERATING REVENUES</b>			
(Thousands of \$)			
Residential	\$232,285	\$205,926	\$205,105
Commercial	185,112	171,540	171,414
Industrial	111,871	104,438	104,738
Public authorities	<u>57,703</u>	<u>53,725</u>	<u>54,270</u>
Total retail	586,971	535,629	535,527
Wholesale sales	143,002	159,406	165,080
Provision for rate collections (refunds)	12,267	(720)	(2,500)
Miscellaneous	<u>16,251</u>	<u>11,610</u>	<u>12,851</u>
Total	<u>\$758,491</u>	<u>\$705,925</u>	<u>\$710,958</u>
<b>ELECTRIC SALES (Thousands of Mwh):</b>			
Residential	4,036	3,782	3,722
Commercial	3,493	3,395	3,350
Industrial	3,028	2,976	3,043
Public authorities	<u>1,253</u>	<u>1,224</u>	<u>1,214</u>
Total retail	11,810	11,377	11,329
Wholesale sales	<u>7,262</u>	<u>6,957</u>	<u>6,834</u>
Total	<u>19,072</u>	<u>18,334</u>	<u>18,163</u>

LG&E uses efficient coal-fired boilers, fully equipped with sulfur dioxide removal systems, to generate most of its electricity. LG&E's weighted-average system-wide emission rate for sulfur dioxide in 2002 was approximately 0.55 lbs./Mmbtu of heat input, with every generating unit below its emission limit established by the Kentucky Division for Air Quality.

LG&E set a record local peak load of 2,623 Mw on Monday, August 5, 2002, when the peak daily temperature was 100 degrees F.

The electric utility business is affected by seasonal weather patterns. As a result, operating revenues (and associated operating expenses) are not generated evenly throughout the year. See LG&E's Results of Operations under Item 7.

LG&E currently maintains a 13 – 15% reserve margin range. At December 31, 2002, LG&E owned steam and combustion turbine generating facilities with a net summer capability of 2,882 Mw and an 80 Mw nameplate rated hydroelectric facility on the Ohio River with a summer capability rate of 48 Mw. At December 31, 2002, LG&E's system net summer capability, including purchases from others and excluding the hydroelectric facility, was 3,037 Mw. See Item 2, Properties.

LG&E and 11 other electric utilities are participating owners of OVEC located in Piketon, Ohio. OVEC owns and operates two power plants that burn coal to generate electricity, Kyger Creek Station in Ohio and Clifty Creek Station in Indiana. LG&E's share is 7%, representing approximately 155 Mw's of generation capacity. LG&E also has agreements with a number of entities throughout the United States for the purchase and/or sale of capacity and energy and for the utilization of their bulk transmission system.

On February 1, 2002, LG&E (along with KU) turned over operational control of its high voltage transmission facilities (100kV and above) to MISO. LG&E (along with KU) is a founding member of MISO. Such membership was obtained in 1998 in response to and consistent with federal policy initiatives. MISO operates a single OATT over the facilities under its control. Currently MISO controls over 100,000 miles of transmission over 1.1 million square miles located in the northern Midwest between Manitoba, Canada and Kentucky. On September 18, 2002, FERC granted a 12.88% ROE on transmission facilities for LG&E, KU and the rest of the MISO owners. This ROE includes a 50 basis point increase because of operational independence.

MISO plans to implement a Congestion Management System in December 2003, in compliance with FERC Order 2000. This system will be similar to the Locational Marginal Pricing (LMP) system currently used by the PJM RTO and contemplated in FERC's SMD NOPR, currently being discussed. MISO filed with FERC a mechanism for recovery of costs for the Congestion Management System, designated Schedule 16 and Schedule 17. The MISO transmission owners, including LG&E and KU, and others have objected to the allocation of costs between market participants and retail native load. This case is currently in a hearing at FERC.

In October 2001, the FERC issued an order requiring that the bundled retail load and grandfathered wholesale load of each member transmission owner (including LG&E) be included in the current calculation of MISO's "cost-adder," a charge designed to recover MISO's costs of operation, including start-up capital (debt) costs. LG&E, along with several other transmission owners, opposed the FERC's ruling in this regard, which opposition the FERC rejected in an order on rehearing issued in 2002. Later that year, MISO's transmission owners, including LG&E, appealed the FERC's decision to the United States Court of Appeals for the District of Columbia Circuit. In response, by petition filed November 25, 2002, the FERC requested that the Court issue a partial remand of its challenged orders to allow the FERC to revisit certain issues raised therein, and further requested that the case be held in abeyance pending the agency's resolution of such issues. The Court

granted the FERC's petition by order dated December 6, 2002. On February 24, 2003, FERC issued an order reaffirming its position concerning the calculation of the "cost-adder".

As a separate matter, MISO, its transmission owners and other interested industry segments reached a settlement in mid-2002 regarding the level of cost responsibility properly borne by bundled and grandfathered load under these FERC rulings (such settlement expressly not prejudicing the transmission owners' and LG&E's right to challenge the FERC's ruling imposing cost responsibility on bundled loads in the first instance). On February 24, 2003, FERC accepted a partial settlement between MISO and the transmission owners. FERC did not accept the only contested section of the settlement, which would have allowed the transmission owners to immediately treat unrecoverable Schedule 10 charges as regulatory assets. FERC will consider allowing regulatory asset treatment of unrecoverable Schedule 10 charges on a case-by-case basis.

### Gas Operations

The sources of LG&E's gas operating revenues and the volumes of sales for the three years ended December 31, 2002, were as follows:

	<u>2002</u>	<u>2001</u>	<u>2000</u>
<b>GAS OPERATING REVENUES</b>			
(Thousands of \$)			
Residential	\$160,733	\$177,387	\$159,670
Commercial	61,036	70,296	61,888
Industrial	10,232	15,750	15,898
Public authorities	<u>11,197</u>	<u>13,223</u>	<u>9,193</u>
Total retail	243,198	276,656	246,649
Wholesale sales	16,384	5,702	17,344
Gas transported – net	6,232	6,042	6,922
Miscellaneous	<u>1,879</u>	<u>2,375</u>	<u>1,574</u>
Total	<u>\$267,693</u>	<u>\$290,775</u>	<u>\$272,489</u>
<b>GAS SALES (Millions of cu. ft.):</b>			
Residential	22,124	20,429	24,274
Commercial	9,074	8,587	10,132
Industrial	1,783	2,160	3,089
Public authorities	<u>1,747</u>	<u>1,681</u>	<u>1,576</u>
Total retail	34,728	32,857	39,071
Wholesale sales	5,345	1,882	5,115
Gas transported	<u>13,939</u>	<u>13,108</u>	<u>14,729</u>
Total	<u>54,012</u>	<u>47,847</u>	<u>58,915</u>

The gas utility business is affected by seasonal weather patterns. As a result, operating revenues (and associated operating expenses) are not generated evenly throughout the year. See LG&E's Results of Operations under Item 7.

LG&E has five underground natural gas storage fields that help provide economical and reliable gas service to ultimate consumers. By using gas storage facilities, LG&E avoids the costs associated with typically more expensive pipeline transportation capacity to serve peak winter space-heating loads. LG&E stores gas in the summer season for withdrawal in the subsequent winter heating season. Without its storage capacity, LG&E would be forced to buy additional gas and pipeline transportation services when customer demand increases,

likely to be when the price for those items are typically at their highest. Currently, LG&E buys competitively priced gas from several large suppliers under contracts of varying duration. LG&E's underground storage facilities, in combination with its purchasing practices, enable it to offer gas sales service at rates lower than state and national averages. At December 31, 2002, LG&E had an inventory balance of gas stored underground of 12.6 million Mcf valued at \$50.3 million.

A number of industrial customers purchase their natural gas requirements directly from alternate suppliers for delivery through LG&E's distribution system. These large industrial customers account for about one-fourth of LG&E's annual throughput.

The all-time maximum day gas sendout of 545,000 Mcf occurred on Sunday, January 20, 1985, when the average temperature for the day was -11 degrees F. During 2002, maximum day gas sendout was approximately 418,000 Mcf, occurring on February 27, 2002, when the average temperature for the day was 21 degrees F. Supply on that day consisted of approximately 130,000 Mcf from purchases, approximately 221,000 Mcf delivered from underground storage, and approximately 67,000 Mcf transported for industrial customers. For a further discussion, see Gas Supply under Item 1.

### Rates and Regulation

Following the purchase of Powergen by E.ON, E.ON became a registered holding company under PUHCA. As a result, E.ON, its utility subsidiaries, including LG&E, and certain of its non-utility subsidiaries are subject to extensive regulation by the SEC under PUHCA with respect to issuances and sales of securities, acquisitions and sales of certain utility properties, and intra-system sales of certain goods and services. In addition, PUHCA generally limits the ability of registered holding companies to acquire additional public utility systems and to acquire and retain businesses unrelated to the utility operations of the holding company. LG&E believes that it has adequate authority (including financing authority) under existing SEC orders and regulations to conduct its business. LG&E will seek additional authorization when necessary.

No costs associated with the E.ON purchase of Powergen or the Powergen purchase of LG&E Energy nor any effects of purchase accounting have been reflected in the financial statements of LG&E.

The Kentucky Commission has regulatory jurisdiction over the rates and service of LG&E and over the issuance of certain of its securities. The Kentucky Commission has the ability to examine the rates LG&E charges its retail customers at any time. LG&E is a "public utility" as defined in the FPA, and is subject to the jurisdiction of the Department of Energy and FERC with respect to the matters covered in the FPA, including the sale of electric energy at wholesale in interstate commerce.

For a discussion of current regulatory matters, see Rates and Regulation for LG&E under Item 7 and Note 3 of LG&E's Notes to Financial Statements under Item 8.

LG&E's retail electric rates contain a FAC, whereby increases and decreases in the cost of fuel for electric generation are reflected in the rates charged to retail electric customers. 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. The Kentucky Commission also requires that electric utilities, including LG&E, file certain documents relating to fuel procurement and the purchase of power and energy from other utilities.

LG&E's retail electric rates are subject to an ESM. The ESM, initially in place for three years beginning in 2000, sets an upper and lower point for rate of return on equity, whereby if LG&E's rate of return for the calendar year falls within the range of 10.5% to 12.5%, no action is necessary. If earnings are above the upper limit, the excess earnings are shared 40% with ratepayers and 60% with shareholders; if earnings are below the lower limit, the earnings deficiency is recovered 40% from ratepayers and 60% from shareholders. By order of the Kentucky Commission, rate changes prompted by the ESM filing go into effect in April of each year subject to a balancing adjustment in successive periods. LG&E made its second ESM filing on March 1, 2002, for the calendar year 2001 reporting period. LG&E is in the process of refunding \$441,000 to customers for the 2001 reporting period. LG&E estimated that the rate of return will fall below the lower limit, subject to Kentucky Commission approval, for the year ended December 31, 2002. The 2002 financial statements include an accrual to reflect the earnings deficiency of \$12.5 million to be recovered from customers commencing in April 2003.

On November 27, 2002, LG&E filed a revised ESM tariff which proposed continuance of the existing ESM through 2005. The Kentucky Commission issued an Order suspending the ESM tariff one day making the effective date January 2, 2003. In addition, the Kentucky Commission is conducting a management audit to review the ESM plan and reassess its reasonableness in 2003. LG&E and interested parties will have the opportunity to provide recommendations for modification and continuance of the ESM or other forms of alternative or incentive regulation.

LG&E's retail rates contain an ECR surcharge which recovers certain costs incurred by LG&E that are required to comply with the Clean Air Act and other environmental regulations. See Note 3 of LG&E's Notes to Financial Statements under Item 8.

LG&E's gas rates contain a GSC, whereby increases or decreases in the cost of gas supply are reflected in LG&E's rates, subject to approval by the Kentucky Commission. The GSC procedure prescribed by order of the Kentucky Commission provides for quarterly rate adjustments to reflect the expected cost of gas supply in that quarter. In addition, the GSC contains a mechanism whereby any over- or under-recoveries of gas supply cost from prior quarters will be refunded to or recovered from customers through the adjustment factor determined for subsequent quarters.

Integrated resource planning regulations in Kentucky require LG&E and the other major utilities to make triennial filings with the Kentucky Commission of various historical and forecasted information relating to load, capacity margins and demand-side management techniques. LG&E filed its most recent integrated resource plan on October 1, 2002.

Pursuant to Kentucky law, the Kentucky Commission has established the boundaries of the service territory or area of each retail electric supplier in Kentucky (including LG&E), other than municipal corporations. Within this service territory each such supplier has the exclusive right to render retail electric service.

#### Construction Program and Financing

LG&E's construction program is designed to ensure that there will be adequate capacity and reliability to meet the electric and gas needs of its service area. These needs are continually being reassessed and appropriate revisions are made, when necessary, in construction schedules. LG&E's estimates of its construction expenditures can vary substantially due to numerous items beyond LG&E's control, such as changes in rates, economic conditions, construction costs, and new environmental or other governmental laws and regulations.

During the five years ended December 31, 2002, gross property additions amounted to approximately \$950 million. Internally generated funds and external financings for the five-year period were utilized to provide for these gross additions. The gross additions during this period amounted to approximately 26% of total utility plant at December 31, 2002, and consisted of \$798 million for electric properties and \$152 million for gas properties. Gross retirements during the same period were \$106 million, consisting of \$74 million for electric properties and \$32 million for gas properties.

### Coal Supply

Coal-fired generating units provided over 97% of LG&E's net kilowatt-hour generation for 2002. The remaining net generation was provided by a natural gas and oil fueled combustion turbine peaking units and a hydroelectric plant. Coal will be the predominant fuel used by LG&E in the foreseeable future, with natural gas and oil being used for peaking capacity and flame stabilization in coal-fired boilers or in emergencies. LG&E has no nuclear generating units and has no plans to build any in the foreseeable future. LG&E has entered into coal supply agreements with various suppliers for coal deliveries for 2003 and beyond. LG&E normally augments its coal supply agreements with spot market purchases. LG&E has a coal inventory policy which it believes provides adequate protection under most contingencies. LG&E had a coal inventory of approximately 1.5 million tons, or a 74-day supply, on hand at December 31, 2002.

LG&E expects to continue purchasing most of its coal, with sulfur content in the 2%-4.5% range, from western Kentucky, southwest Indiana, and West Virginia for the foreseeable future. This supply is relatively low priced coal, and in combination with its sulfur dioxide removal systems is expected to enable LG&E to continue to provide electric service in compliance with existing environmental laws and regulations.

Coal is delivered to LG&E's Mill Creek plant by rail and barge, Trimble County plant by barge and Cane Run plant by rail.

The historical average delivered costs of coal purchased and the percentage of spot coal purchases were as follows:

	<u>2002</u>	<u>2001</u>	<u>2000</u>
Per ton	\$25.30	\$21.27	\$20.96
Per Mmbtu	\$ 1.11	\$ .93	\$ .92
Spot purchases as % of all sources	2%	3%	1%

The delivered cost of coal is expected to remain relatively flat during 2003. Slight increases in the cost of coal in multi-year contracts signed for 2002 are expected to be offset by lower prices negotiated in contracts signed for 2003.

### Gas Supply

LG&E purchases natural gas supplies from multiple sources under contracts for varying periods of time, while transportation services are purchased from Texas Gas and Tennessee Gas.

On April 28, 2000, Texas Gas filed with FERC in Docket RP00-260 for an increase in its base rates effective June 1, 2000. This filing is part of a rate case Texas Gas was required to file pursuant to the settlement in its last rate case. On May 31, 2000, FERC issued an Order suspending the effectiveness of Texas Gas's proposed rates, subject to refund, until November 1, 2000, and establishing a hearing and settlement procedures. As the

result of reaching various FERC-approved settlements, Texas Gas's higher motion rates were not billed after July 31, 2002, and its lower prospective rates went into effect on August 1, 2002. Refunds covering the period from November 1, 2000, through July 31, 2002, were received on September 17, 2002, and are currently being refunded to customers through the GSC. LG&E participates in rate and other proceedings affecting its regulated interstate pipeline services, as appropriate.

LG&E transports on the Texas Gas system under NNS and FT rate schedules. During the winter months, LG&E has 184,900 Mmbtu/day in NNS service and 18,000 Mmbtu/day (increasing to 36,000 Mmbtu/day effective November 1, 2003) in FT service. LG&E's summer NNS levels are 60,000 Mmbtu/day and its summer FT levels are 54,000 Mmbtu/day. Each of these NNS and FT agreements with Texas Gas are subject to termination by LG&E in equal portions during 2005, 2006, and 2008. LG&E also transports on the Tennessee system under Tennessee's FT-A rate schedule. LG&E's contract levels with Tennessee are 51,000 Mmbtu/day throughout the year. The FT-A agreement with Tennessee, which was subject to termination by LG&E during 2002, has been successfully renegotiated for a minimum additional term of five years at a lower price.

LG&E also has a portfolio of supply arrangements with various suppliers in order to meet its firm sales obligations. These gas supply arrangements include pricing provisions that are market-responsive. These firm gas supplies, in tandem with pipeline transportation services, provide the reliability and flexibility necessary to serve LG&E's customers.

LG&E owns and operates five underground gas storage fields with a current working gas capacity of about 15.1 million Mcf. Gas is purchased and injected into storage during the summer season and is then withdrawn to supplement pipeline supplies to meet the gas-system load requirements during the winter heating season. See Gas Operations under Item 1.

The estimated maximum deliverability from storage during the early part of the heating season is typically about 373,000 Mcf/day. Deliverability decreases during the latter portion of the heating season as the storage inventory is reduced by seasonal withdrawals.

The average cost per Mcf of natural gas purchased by LG&E was \$4.19 in 2002, \$5.27 in 2001 and \$5.08 in 2000. Although natural gas prices in the unregulated wholesale market increased significantly throughout 2000 and early 2001, these prices decreased dramatically in early 2002 and then began to increase again. These increases in natural gas prices, caused in part by decreased natural gas production, decreased liquidity in the marketplace, increases in the price of oil, and increased reliance on natural gas as a fuel for electric generation were mitigated in part by higher national storage inventory levels, and decreased demand associated with a less robust economy.

## Environmental Matters

Protection of the environment is a major priority for LG&E. Federal, state, and local regulatory agencies have issued LG&E permits for various activities subject to air quality, water quality, and waste management laws and regulations. For the five-year period ending with 2002, expenditures for pollution control facilities represented \$253.8 million or 27% of total construction expenditures. LG&E estimates that construction expenditures for the installation of NOx control equipment from 2003 through 2004 will be approximately \$32 million. For a discussion of environmental matters, see Rates and Regulation for LG&E under Item 7 and Note 11 of LG&E's Notes to Financial Statements under Item 8.

## Competition

In the last several years, LG&E has taken many steps to prepare for the expected increase in competition in its industry, including a reduction in the number of employees; aggressive cost cutting; write-offs of previously deferred expenses; an increase in focus on commercial, industrial and residential customers; an increase in employee involvement and training; a major realignment and formation of new business units, and continuous modifications of its organizational structure. LG&E will continue to take additional steps to better position itself for competition in the future.

## KENTUCKY UTILITIES COMPANY

### General

KU, incorporated in Kentucky in 1912 and incorporated in Virginia in 1991, is a regulated public utility engaged in producing, transmitting and selling electric energy. KU provides electric service to approximately 477,000 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 to less than 10 customers in Tennessee. In Virginia, KU operates under the name Old Dominion Power Company. KU operates under appropriate franchises in substantially all of the 160 Kentucky incorporated municipalities served. No franchises are required in unincorporated Kentucky or Virginia communities. The lack of franchises is not expected to have a material adverse effect on KU's operations. KU also sells wholesale electric energy to 12 municipalities.

KU has one wholly owned consolidated subsidiary, KU R. KU R is a special purpose entity formed in September 2000 to enter into accounts receivable securitization transactions with KU. KU R began operations in 2001. KU is considering unwinding its accounts receivable securitization arrangements involving KU R during 2003.

## Electric Operations

The sources of KU's electric operating revenues and the volumes of sales for the three years ended December 31, 2002, were as follows:

	<u>2002</u>	<u>2001</u>	<u>2000</u>
<b>ELECTRIC OPERATING REVENUES</b>			
(Thousands of \$):			
Residential	\$275,869	\$244,004	\$241,783
Commercial	179,157	165,389	161,291
Industrial	163,206	146,968	153,017
Mine power	29,453	28,196	27,089
Public authorities	<u>62,649</u>	<u>58,770</u>	<u>57,979</u>
Total retail	710,334	643,327	641,159
Wholesale sales	143,807	203,181	198,073
Provision for rate collections (refunds)	13,027	(954)	-
Miscellaneous	<u>21,051</u>	<u>13,918</u>	<u>12,709</u>
Total	<u>\$888,219</u>	<u>\$859,472</u>	<u>\$851,941</u>
<b>ELECTRIC SALES (Thousands of Mwh):</b>			
Residential	6,198	5,678	5,714
Commercial	4,161	3,990	3,954
Industrial	4,975	4,716	5,044
Mine power	766	771	767
Public authorities	<u>1,533</u>	<u>1,481</u>	<u>1,495</u>
Total retail	17,633	16,636	16,974
Wholesale sales	<u>5,780</u>	<u>7,713</u>	<u>7,573</u>
Total	<u>23,413</u>	<u>24,349</u>	<u>24,547</u>

KU's weighted-average system-wide emission rate for sulfur dioxide in 2002 was approximately 1.24 lbs./Mmbtu of heat input, with every generating unit below its emission limit established by the Kentucky Division for Air Quality.

KU set a record local peak load of 3,899 Mw on Monday, August 5, 2002, when the peak daily temperature was 100 degrees F.

The electric utility business is affected by seasonal weather patterns. As a result, operating revenues (and associated operating expenses) are not generated evenly throughout the year. See KU's Results of Operations under Item 7.

KU currently maintains a 13-15% reserve margin range. At December 31, 2002, KU owned steam and combustion turbine generating facilities with a net summer capability of 4,111 Mw and a hydroelectric facility with a summer capability of 24 Mw. See Item 2, Properties. KU obtains power from other utilities under bulk power purchase and interchange contracts. At December 31, 2002, KU's system net summer capability, including purchases from others and excluding the hydroelectric facility, was 4,630 Mw.

Under a contract expiring in 2020 with OMU, KU has agreed to purchase from OMU the surplus output of the 150-Mw and 250-Mw generating units at OMU's Elmer Smith station. Purchases under the contract are made under a contractual formula which has resulted in costs which were and are expected to be comparable to the

cost of other power purchased or generated by KU. Such power equated to approximately 8% of KU's net generation system output during 2002. See Note 11 of KU's Notes to Financial Statements under Item 8.

KU owns 20% of the common stock of EEI, which owns and operates a 1,000-Mw generating station in southern Illinois. KU is entitled to take 20% of the available capacity of the station. Purchases from EEI are made under a contractual formula which has resulted in costs which were and are expected to be comparable to the cost of other power purchased or generated by KU. Such power equated to approximately 9% of KU's net generation system output in 2002. See Note 11 of KU's Notes to Financial Statements under Item 8.

KU and 11 other electric utilities are participating owners of OVEC located in Piketon, Ohio. OVEC owns and operates two power plants that burn coal to generate electricity, Kyger Creek Station in Ohio and Clifty Creek Station in Indiana. KU's share is 2.5%, approximately 55 Mws of generation capacity. KU also has agreements with a number of entities throughout the United States for the purchase and/or sale of capacity and energy and for the utilization of their bulk transmission systems.

On February 1, 2002, KU (along with LG&E) turned over operational control of its high voltage transmission facilities (100kV and above) to MISO. KU (along with LG&E) is a founding member of MISO. Such membership was obtained in 1998 in response to and consistent with federal policy initiatives. MISO operates a single OATT over the facilities under its control. Currently MISO controls over 100,000 miles of transmission over 1.1 million square miles located in the northern Midwest between Manitoba, Canada and Kentucky. On September 18, 2002, FERC granted a 12.88% ROE on transmission facilities for LG&E, KU and the rest of the MISO owners. This ROE includes a 50 basis point increase because of operational independence.

MISO plans to implement a Congestion Management System in December 2003, in compliance with FERC Order 2000. This system will be similar to the Locational Marginal Pricing (LMP) system currently used by the PJM RTO and contemplated in FERC's SMD NOPR currently being discussed. MISO filed with FERC a mechanism for recovery of costs for the Congestion Management System, designated Schedule 16 and Schedule 17. MISO transmission owners, including LG&E and KU, and others have objected to the allocation of costs between market participants and retail native load. This case is currently in a hearing at FERC.

In October 2001, the FERC issued an order requiring that the bundled retail load and grandfathered wholesale load of each member transmission owner (including KU) be included in the current calculation of MISO's "cost-adder," a charge designed to recover MISO's costs of operation, including start-up capital (debt) costs. KU, along with several other transmission owners, opposed the FERC's ruling in this regard, which opposition the FERC rejected in an order on rehearing issued in 2002. Later that year, MISO's transmission owners, including KU, appealed the FERC's decision to the United States Court of Appeals for the District of Columbia Circuit. In response, by petition filed November 25, 2002, FERC requested that the Court issue a partial remand of its challenged orders to allow the FERC to revisit certain issues raised therein, and further requested that the case be held in abeyance pending the agency's resolution of such issues. The Court granted the FERC's petition by order dated December 6, 2002. On February 24, 2003, FERC issued an order reaffirming its position concerning the calculation of the "cost-adder".

As a separate matter, MISO, its transmission owners and other interested industry segments reached a settlement in mid-2002 regarding the level of cost responsibility properly borne by bundled and grandfathered load under these FERC rulings (such settlement expressly not prejudicing the transmission owners' and KU's right to challenge the FERC's ruling imposing cost responsibility on bundled loads in the first instance). On February 24, 2003, FERC accepted a partial settlement between MISO and the transmission owners. FERC did not accept the only contested section of the settlement, which would have allowed the transmission owners to

immediately treat unrecoverable Schedule 10 charges as regulatory assets. FERC will consider allowing regulatory asset treatment of unrecoverable Schedule 10 charges on a case-by-case basis.

#### Rates and Regulation

Following the purchase of Powergen by E.ON, E.ON became a registered holding company under PUHCA. As a result, E.ON, its utility subsidiaries, including KU, and certain of its non-utility subsidiaries are subject to extensive regulation by the SEC under PUHCA with respect to issuances and sales of securities, acquisitions and sales of certain utility properties, and intra-system sales of certain goods and services. In addition, PUHCA generally limits the ability of registered holding companies to acquire additional public utility systems and to acquire and retain businesses unrelated to the utility operations of the holding company. KU believes that it has adequate authority (including financing authority) under existing SEC orders and regulations to conduct its business. KU will seek additional authorization when necessary.

No costs associated with the E.ON purchase of Powergen or the Powergen purchase of LG&E Energy nor any effects of purchase accounting have been reflected in the financial statements of KU.

The Kentucky Commission and the Virginia Commission have regulatory jurisdiction over KU's retail rates and service, and over the issuance of certain of its securities. By reason of owning and operating a small amount of electric utility property in one county in Tennessee (having a gross book value of approximately \$225,000) from which KU served five customers at December 31, 2002, KU is subject to the jurisdiction of the TRA. FERC has classified KU as a "public utility" as defined in the FPA. FERC has jurisdiction under the FPA over certain of the electric utility facilities and operations, wholesale sale of power and related transactions and accounting practices of KU, and in certain other respects as provided in the FPA.

For a discussion of current regulatory matters, see Rates and Regulation for KU under Item 7 and Note 3 of KU's Notes to the Financial Statements under Item 8.

KU's Kentucky retail electric rates contain a FAC, whereby increases and decreases in the cost of fuel for electric generation are reflected in the rates charged to retail electric customers. 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. The Kentucky Commission also requires that electric utilities, including KU, file certain documents relating to fuel procurement and the purchase of power and energy from other utilities. The FAC mechanism for Virginia customers uses an average fuel cost factor based primarily on projected fuel costs. The fuel cost factor may be adjusted annually for over or under collections of fuel costs from the previous year.

KU's Kentucky retail electric rates are subject to an ESM. The ESM, initially in place for three years beginning in 2000, sets an upper and lower point for rate of return on equity, whereby if KU's rate of return for the calendar year falls within the range of 10.5% to 12.5%, no action is necessary. If earnings are above the upper limit, the excess earnings are shared 40% with ratepayers and 60% with shareholders; if earnings are below the lower limit, the earnings deficiency is recovered 40% from ratepayers and 60% from shareholders. By order of the Kentucky Commission, rate changes prompted by the ESM filing go into effect in April of each year subject to a balancing adjustment in successive periods. KU made its second ESM filing on March 1, 2002 for the calendar year 2001 reporting period. KU is in the process of refunding \$1 million to customers for the 2001 reporting period. KU estimated that the rate of return will fall below the lower limit for the year ended December 31, 2002. The 2002 financial statements include an accrual to reflect the earnings, subject to Kentucky Commission approval, deficiency of \$13.5 million to be recovered from customers commencing in April 2003.

On November 27, 2002, KU filed a revised ESM tariff which proposed continuance of the existing ESM through 2005. The Kentucky Commission issued an Order suspending the ESM tariff one day making the effective date January 2, 2003. In addition, the Kentucky Commission is conducting a management audit to review the ESM plan and reassess its reasonableness in 2003. KU and interested parties will have the opportunity to provide recommendations for modification and continuance of the ESM or other forms of alternative or incentive regulation.

KU's Kentucky retail rates contain an ECR surcharge which recovers certain costs incurred by KU that are required to comply with the Clean Air Act and other environmental regulations. See Note 3 of KU's Notes to Financial Statements under Item 8.

Integrated resource planning regulations in Kentucky require KU and the other major utilities to make triennial filings with the Kentucky Commission of various historical and forecasted information relating to load, capacity margins and demand-side management techniques. KU filed its most recent integrated resource plan on October 1, 2002.

Pursuant to Kentucky law, the Kentucky Commission has established the boundaries of the service territory or area of each retail electric supplier in Kentucky (including KU), other than municipal corporations. Within this service territory each such supplier has the exclusive right to render retail electric service.

The state of Virginia passed the Virginia Electric Utility Restructuring Act in 1999. This act gives Virginia customers a choice for energy services. The change will be phased in gradually between January 2002 and January 2004. KU filed unbundled rates that became effective January 1, 2002. Rates are capped at current levels through June 2007. The Virginia Commission will continue to require each Virginia utility to make annual filings of either a base rate change or an Annual Informational Filing consisting of a set of standard financial schedules. The Virginia Staff will issue a Staff Report regarding the individual utility's financial performance during the historic 12-month period. The Staff Report can lead to an adjustment in rates, but through June 2007 will be limited to decreases. KU was granted a waiver from the Virginia Commission on October 29, 2002, exempting KU from retail choice through December 31, 2004. KU is also seeking a permanent legislative exemption from the Virginia Electric Utility Restructuring Act. The outcome of this legislative initiative is not expected to be known until mid-2003.

#### **Construction Program and Financing**

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. These needs are continually being reassessed and appropriate revisions are made, when necessary, in construction schedules. KU's estimates of its construction expenditures can vary substantially due to numerous items beyond KU's control, such as changes in rates, economic conditions, construction costs, and new environmental or other governmental laws and regulations.

During the five years ended December 31, 2002, gross property additions amounted to approximately \$754 million. Internally generated funds and external financings for the five-year period were utilized to provide for these gross additions. The gross additions during this period amounted to approximately 23% of total utility plant at December 31, 2002. Gross retirements during the same period were \$82 million.

## Coal Supply

Coal-fired generating units provided over 97% of KU's net kilowatt-hour generation for 2002. The remaining net generation for 2002 was provided by natural gas and oil fueled combustion turbine peaking units and hydroelectric plants. Coal will be the predominant fuel used by KU in the foreseeable future, with natural gas and oil being used for capacity and flame stabilization in coal-fired boilers or in emergencies. KU has no nuclear generating units and has no plans to build any in the foreseeable future.

KU maintains its fuel inventory at levels estimated to be necessary to avoid operational disruptions at its 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 labor issues and other supplier or transporter operating difficulties.

KU believes there are adequate reserves available to supply its existing base-load generating units with the quantity and quality of coal required for those units throughout their useful lives. KU intends to meet a portion of its coal requirements with three-year or shorter contracts. As part of this strategy, KU will continue to negotiate replacement contracts as contracts expire. KU does not anticipate any problems negotiating new contracts for future coal needs. The balance of coal requirements will be met through spot purchases. KU had a coal inventory of approximately 1.4 million tons, or a 67-day supply, on hand at December 31, 2002.

KU expects to continue purchasing most of its coal, which has a sulfur content in the 0.7% - 3.5% range, from western and eastern Kentucky, West Virginia, southwest Indiana, Wyoming and Pennsylvania for the foreseeable future.

Coal for Ghent is delivered by barge. Deliveries to the Tyrone and Green River locations are by truck. Delivery to E.W. Brown is by rail.

The historical average delivered cost of coal purchased and the percentage of spot coal purchases were as follows:

	<u>2002</u>	<u>2001</u>	<u>2000</u>
Per ton	\$31.44	\$27.84	\$25.63
Per Mmbtu	\$1.35	\$1.20	\$1.07
Spot purchases as % of all sources	18%	44%	51%

KU's historical average cost of coal purchased is higher than LG&E's due to the lower sulfur content of the coal KU purchases for use at its Ghent plant and higher cost to transport coal to the E.W. Brown plant. The delivered cost of coal is expected to increase during 2003.

## Environmental Matters

Protection of the environment is a major priority for KU. Federal, state, and local regulatory agencies have issued KU permits for various activities subject to air quality, water quality, and waste management laws and regulations. For the five-year period ending with 2002, expenditures for pollution control facilities represented \$63.5 million or 11% of total construction expenditures. KU estimates that construction expenditures for the installation of NOx control equipment from 2003 through 2004 will be approximately \$178 million. For a discussion of environmental matters, see Rates and Regulation for KU under Item 7 and Note 11 of KU's Notes to Financial Statements under Item 8.

## Competition

In the last several years, KU has taken many steps to prepare for the expected increase in competition in its industry, including a reduction in the number of employees; aggressive cost cutting; an increase in focus on commercial, industrial and residential customers; an increase in employee involvement and training; a major realignment and formation of new business units; and continuous modifications of its organizational structure. KU will continue to take additional steps to better position itself for competition in the future.

## EMPLOYEES AND LABOR RELATIONS

LG&E had 891 full-time regular employees and KU had 946 full-time regular employees at December 31, 2002. Of the LG&E total, 628 operating, maintenance, and construction employees were represented by IBEW Local 2100. LG&E and employees represented by IBEW Local 2100 signed a four-year collective bargaining agreement in November 2001. Of the KU total, 162 operating, maintenance, and construction employees were represented by IBEW Local 2100 and USWA Local 9447-01. In August 2001, KU and employees represented by IBEW Local 2100 entered into a two-year collective bargaining agreement. KU and employees represented by USWA Local 9447-01 entered into a three-year collective bargaining agreement effective August 2002 and expiring August 2005.

As a result of the Powergen acquisition and in order to comply with PUHCA, LG&E Services was formed effective on January 1, 2001. LG&E Services provides certain services to affiliated entities, including LG&E and KU, at cost as required under the Holding Company Act. On January 1, 2001, approximately 1,000 employees, mainly from LG&E Energy, LG&E and KU, were moved to LG&E Services.

See Note 3 of LG&E's Notes to Financial Statements and Note 3 of KU's Notes to Financial Statements under Item 8 for workforce separation program in effect for 2001.

Executive Officers of LG&E and KU at December 31, 2002:

<u>Name</u>	<u>Age</u>	<u>Position</u>	<u>Effective Date of Election to Present Position</u>
Victor A. Staffieri	47	Chairman of the Board, President and Chief Executive Officer	May 1, 2001
Richard Aitken-Davies	53	Chief Financial Officer	January 31, 2001
John R. McCall	59	Executive Vice President, General Counsel and Corporate Secretary	July 1, 1994
S. Bradford Rives	44	Senior Vice President - Finance and Controller	December 11, 2000
Paul W. Thompson	45	Senior Vice President - Energy Services	June 7, 2000
Chris Hermann	55	Senior Vice President - Distribution Operations	December 11, 2000
Wendy C. Welsh	48	Senior Vice President - Information Technology	December 11, 2000
Martyn Gallus	38	Senior Vice President - Energy Marketing	December 11, 2000
A. Roger Smith	49	Senior Vice President Project Engineering	December 11, 2000
David A. Vogel	36	Vice President – Retail Services	December 11, 2000
Daniel K. Arbough	41	Treasurer	December 11, 2000
Bruce D. Hamilton	47	Vice President Independent Power Operations	December 11, 2000
Robert E. Henriques	61	Vice President Regulated Generation	September 30, 2001
Michael S. Beer	44	Vice President-Rates and Regulatory	February 1, 2001
George R. Siemens	53	Vice President-External Affairs	January 11, 2001

Paula H. Pottinger	45	Vice President – Human Resources	June 1, 2002
D. Ralph Bowling	45	Vice President – Power Operations WKE	August 1, 2002
R. W. Chip Keeling	46	Vice President – Communications	March 18, 2002

The present term of office of each of the above executive officers extends to the meeting of the Board of Directors following the 2003 Annual Meeting of Shareholders.

There are no family relationships between or among executive officers of LG&E and KU. The above tables indicate officers serving as executive officers of both LG&E and KU at December 31, 2002. Each of the above officers serves in the same capacity for LG&E and KU.

Before he was elected to his current positions, Mr. Staffieri was President, Distribution Services Division of LG&E Energy Corp. from December 1995 to May 1997; Chief Financial Officer of LG&E Energy Corp. and LG&E from May 1997 to February 1999, (including Chief Financial Officer of KU from May 1998 to February 1999); President and Chief Operating Officer of LG&E Energy Corp. from March 1999 to April 2001 (including President of LG&E and KU from June 2000 to April 2001); Chairman, President and CEO of LG&E Energy Corp., LG&E and KU from May 2001 to present.

Before he was elected to his current positions, Mr. Aitken-Davies was Group Performance Director at Powergen from April 1998 to March 2000; Director - LG&E Transition Team at Powergen from March 2000 to January 2001.

Mr. McCall has been Executive Vice President, General Counsel and Corporate Secretary of LG&E Energy Corp. and LG&E since July 1994. He became Executive Vice President, General Counsel and Corporate Secretary of KU in May 1998.

Before he was elected to his current positions, Mr. Rives was Vice President – Finance and Controller of LG&E Energy Corp. from March 1996 to February 1999; and Senior Vice President – Finance and Business Development from February 1999 to December 2000.

Before he was elected to his current positions, Mr. Thompson was Vice President – Business Development for LG&E Energy Corp. from July 1994 to September 1996; Vice President, Retail Electric Business for LG&E from September 1996 to June 1998; Group Vice President for LG&E Energy Marketing, Inc. from June 1998 to August 1999; Vice President, Retail Electric Business for LG&E from December 1998 to August 1999; and Senior Vice President – Energy Services for LG&E Energy Corp. from August 1999 to June 2000.

Before he was elected to his current positions, Mr. Hermann was Vice President and General Manager, Wholesale Electric Business of LG&E from January 1993 to June 1997; Vice President, Business Integration of LG&E from June 1997 to May 1998; Vice President, Power Generation and Engineering Services, of LG&E from May 1998 to December 1999; and Vice President Supply Chain and Operating Services from December 1999 to December 2000.

Before she was elected to her current positions, Ms. Welsh was Vice President - Information Services of LG&E from January 1994 to May 1997; Vice President, Administration of LG&E Energy Corp. from May 1997 to

February 1998; and Vice President-Information Technology from February 1998 to December 2000.

Before he was elected to his current positions, Mr. Gallus was Director, Trading and Risk Management from January 1996 to September 1996; Director, Product Development from September 1996 to April 1997; Vice President, Structured Products from April 1997 to May 1998; Senior Vice President, Trading, from May 1998 to August 1998 for LG&E Energy Marketing Inc.; and Vice President, Energy Marketing from August 1998 to December 2000 for LG&E Energy Corp.

Before he was elected to his current positions, Mr. Smith was Head of Construction Projects - Powergen from January 1996 to May 1999; Director of Projects - Powergen from May 1999 to December 1999; and Director of Engineering Projects for Powergen International from January 2000 to December 2000.

Before he was elected to his current positions, Mr. Vogel served in management positions within the Distribution organization of LG&E and KU prior to December 2000. In his position prior to his current role he was responsible for statewide outage management and restoration of distribution network.

Before he was elected to his current positions, Mr. Arbough was Manager, Corporate Finance of LG&E Energy Corp., and LG&E from August 1996 to May 1998; and he has held the position of Director, Corporate Finance of LG&E Energy Corp., LG&E and KU from May 1998 to present.

Before he was elected to his current positions, Mr. Hamilton was Venture Manager from May 1992 to December 1995; Senior Venture Manager from December 1995 to September 1997 and Vice President, Asset Management from September 1997 to December 2000.

Before he was elected to his current positions, Mr. Henriques was Senior Venture Manager for LG&E Power Inc. from May 1993 to September 1995, and Vice President-Plant Operations from September 1995 to September 2001.

Before he was elected to his current positions, Mr. Beer was Director, Federal Regulatory Affairs, for Illinois Power Company in Decatur, Illinois, from February of 1997 to January of 1998; Senior Corporate Attorney from February 1998 to February 2000; and Senior Counsel Specialist, Regulatory from February 2000 to February 2001.

Before he was elected to his current positions, Mr. Siemens held the position of Director of External Affairs for LG&E from August 1982 to January 2001.

Before she was elected to her current positions as Vice President-Human Resources, Ms. Pottinger was Manager, Human Resources Development from May 1994 to May 1997; and Director, Human Resources from June 1997 to June 2002.

Before he was elected to his current positions, Mr. Bowling was Plant General Manager at Western Kentucky Energy Corp. from July 1998 to December 2001; and General Manager Black Fossil Operations for Powergen in the United Kingdom from January 2002 to August 2002.

Before he was elected to his current positions, Mr. Keeling was General Manager, Marketing Communications for General Electric Company from January 1998 to January 1999. He joined LG&E Energy Corp. and held the title Manager, Media Relations from January 1999 to February 2000; and Director, Corporate Communications for LG&E Energy from February 2000 to March 2002.

ITEM 2. Properties.

LG&E's power generating system consists of the coal-fired units operated at its three steam generating stations. Combustion turbines supplement the system during peak or emergency periods. LG&E owns and operates the following electric generating stations:

	Summer Capability Rating (Kw)
<b>Steam Stations:</b>	
<b>Mill Creek - Kosmosdale, KY</b>	
Unit 1	308,000
Unit 2	306,000
Unit 3	391,000
Unit 4	<u>480,000</u>
<b>Total Mill Creek</b>	<b>1,485,000</b>
<b>Cane Run - near Louisville, KY</b>	
Unit 4	155,000
Unit 5	168,000
Unit 6	<u>240,000</u>
<b>Total Cane Run</b>	<b>563,000</b>
<b>Trimble County - Bedford, KY (a)</b>	
Unit 1	386,000
<b>Combustion Turbine Generators (Peaking capability):</b>	
Zorn	14,000
Paddy's Run (b)	119,000
Cane Run	14,000
Waterside	22,000
E.W. Brown - Burgin, KY (c)	189,000
Trimble County - Bedford, KY (d)	<u>90,000</u>
<b>Total combustion turbine generators</b>	<b><u>448,000</u></b>
<b>Total capability rating</b>	<b><u>2,882,000</u></b>

- (a) Amount shown represents LG&E's 75% interest in Trimble County 1. See Notes 11 and 12 of LG&E's Notes to Financial Statements under Item 8 for further discussion on ownership.
- (b) Amount shown represents LG&E's 53% interest in Paddy's Run Unit 13 and 100% ownership of two other Paddy's Run CTs. See Notes 11 and 12 of LG&E's Notes to Financial Statement, under Item 8 for further discussion on ownership.
- (c) Amount shown represents LG&E's 53% interest in Unit 5 and 38% interest in Units 6 and 7 at E.W. Brown. See Notes 11 and 12 of LG&E's Notes to Financial Statements, under Item 8 for further discussion on ownership. KU operates the units on behalf of LG&E.
- (d) Amount shown represents LG&E's 29% interest in Units 5 and 6 at Trimble County. See Notes 11 and 12 of LG&E's Notes to Financial Statements, under Item 8 for further discussion on ownership.

LG&E also owns an 80 Mw nameplate rated hydroelectric generating station located in Louisville, with a summer capability rating of 48 Mw, operated under a license issued by the FERC.

At December 31, 2002, LG&E's electric transmission system included 21 substations with a total capacity of approximately 11,519,700 Kva and approximately 656 structure miles of lines. The electric distribution system included 84 substations with a total capacity of approximately 3,448,730 Kva, 3,761 structure miles of overhead lines and 379 miles of underground conduit.

LG&E's gas transmission system includes 212 miles of transmission mains, and the gas distribution system includes 4,066 miles of distribution mains.

LG&E operates underground gas storage facilities with a current working gas capacity of approximately 15.1 million Mcf. See Gas Supply under Item 1.

In 1990, LG&E entered into an operating lease for its corporate office building located in downtown Louisville, Kentucky. The lease was renegotiated in 2002 and is scheduled to expire July 31, 2015.

Other properties owned by LG&E include office buildings, service centers, warehouses, garages, and other structures and equipment, the use of which is common to both the electric and gas departments.

The trust indenture securing LG&E's First Mortgage Bonds constitutes a direct first mortgage lien upon much of the property owned by LG&E.

KU's power generating system consists of the coal-fired units operated at its four steam generating stations. Combustion turbines supplement the system during peak or emergency periods. KU owns and operates the following electric generating stations:

	Summer Capability Rating (Kw)
<b>Steam Stations:</b>	
<b>Tyrone - Tyrone, KY</b>	
Unit 1	27,000
Unit 2	31,000
Unit 3	<u>71,000</u>
Total Tyrone	129,000
<b>Green River - South Carrollton, KY</b>	
Unit 1	22,000
Unit 2	22,000
Unit 3	68,000
Unit 4	<u>100,000</u>
Total Green River	212,000
<b>E.W. Brown - Burgin, KY</b>	
Unit 1	104,000
Unit 2	168,000
Unit 3	<u>429,000</u>
Total E.W. Brown	701,000
<b>Ghent - Ghent, KY</b>	
Unit 1	509,000
Unit 2	494,000
Unit 3	496,000
Unit 4	<u>467,000</u>
Total Ghent	1,966,000
<b>Combustion Turbine Generators (Peaking capability):</b>	
E.W. Brown - Burgin, KY (Units 5-11) (a)	773,000
Haefling - Lexington, KY	36,000
Paddy's Run - Louisville, KY (b)	74,000
Trimble County-Bedford, KY (c)	<u>220,000</u>
Total combustion turbine generators	<u>1,103,000</u>
<b>Total capability rating</b>	<u><u>4,111,000</u></u>

- (a) Amount shown represents KU's 47% interest in Unit 5, 62% interest in Units 6 and 7 and 100% of four other units at E.W. Brown. See Notes 11 and 12 of KU's Notes to Financial Statements, under Item 8 for further discussion on ownership.
- (b) Amount shown represents KU's 47% interest in Unit 13 at Paddy's Run. See Notes 11 and 12 of KU's Notes to Financial Statements, under Item 8 for further discussion on ownership. LG&E operates this unit on behalf of KU.
- (c) Amount shown represents KU's 71% interest in Units 5 and 6 at Trimble County. See Notes 11 and 12 of KU's Notes to Financial Statements, under Item 8 for further discussion on ownership. LG&E operates these units on behalf of KU.

KU also owns a 24 Mw hydroelectric generating station located in Burgin, Kentucky (Dix Dam), operated under a license issued by the FERC.

At December 31, 2002, KU's electric transmission system included 112 substations with a total capacity of approximately 14,855,396 Kva and approximately 4,229 structure miles of lines. The electric distribution

system included 464 substations with a total capacity of approximately 5,046,335 Kva and 15,036 structure miles of lines.

Other properties owned by KU include office buildings, service centers, warehouses, garages, and other structures and equipment.

Substantially all properties are subject to the lien of KU's Mortgage Indenture.

### ITEM 3. Legal Proceedings.

#### Rates and Regulatory Matters

For a discussion of current rate and regulatory matters, including (a) environmental surcharge and cost recovery proceedings, (b) fuel adjustment and gas supply clause proceedings, (c) earnings sharing mechanism extension proceedings, (d) merger surcredit proceedings and (e) other rate or regulatory matters affecting LG&E and KU, see Rates and Regulation under Item 7 and Note 3 of LG&E's Notes to Financial Statements and Note 3 of KU's Notes to Financial Statements under Item 8.

#### Environmental

For a discussion of environmental matters including (a) currently proposed reductions in NOx emission limits, (b) items regarding LG&E's Mill Creek generating plant, KU's E.W. Brown plant, KU-related Tindall property and LG&E's and KU's manufactured gas plant sites and (c) other environmental items affecting LG&E and KU, see Environmental Matters under Item 7 and Note 11 of LG&E's Notes to Financial Statements and Note 11 of KU's Notes to Financial Statements under Item 8, respectively.

#### LG&E Employment Discrimination Case

In October 2001 approximately 30 employees or former employees filed a complaint against LG&E claiming past and current instances of employment discrimination against LG&E. LG&E has removed the case to the U.S. District Court for the Western District of Kentucky and filed an answer denying all plaintiff's claims. Discovery has commenced in the matter. The court has ordered mediation and certain plaintiffs have settled for non-material amounts as a result of that process. In addition, certain plaintiffs have sought administrative review before the U.S. Equal Employment Opportunity Commission which has, to date, declined to proceed to litigation on any claims reviewed. Amended pleadings have also reduced the size of the plaintiff and defendant groups and eliminated certain prior demands. The amended complaints included a reduced claimed damage amount of \$100 million as well as requests for injunctive relief. LG&E intends to defend itself vigorously in the action and management does not anticipate that the outcome will have a material impact on LG&E's operations or financial condition.

#### Combustion Turbine Litigation

In September 2002, LG&E and KU, or their affiliates, filed further amended complaints in litigation in the U.S. District Court for the Eastern District of Kentucky against Alstom Power, Inc. (formerly ABB Power Generation, Inc.) ("Alstom") regarding two combustion turbines supplied by Alstom in 1999. These units are installed at KU's E.W. Brown generating plant and are jointly owned by LG&E and KU. The original purchase price for the turbines was approximately \$91.8 million. The suit presents warranty, negligence, misrepresentation, fraud and other claims relating to numerous operational defects or deficiencies in connection therewith.

LG&E and KU have requested rescission of the contract and recovery of all expenditures relating to the turbines. As an alternative to rescission, LG&E and KU have requested relief for amounts incurred or expended to date in connection with operational repairs, cover damages or liquidated damages and other costs, with possible further damages and interest to be proven at trial. The matter is currently in discovery with a trial presently scheduled for the third quarter of 2003.

#### Preferred Stock Delisting

On April 16, 2002, the LG&E 5% Cumulative Preferred class of stock was delisted from the NASDAQ Small Capitalization Market. On June 3, 2002, the KU 4.75% Cumulative Preferred class of stock was delisted from the Philadelphia Stock Exchange. Delisting will enable the Companies to realize certain administrative and corporate governance efficiencies.

#### Other

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

#### ITEM 4. Submission of Matters to a Vote of Security Holders.

- a) LG&E's and KU's Annual Meetings of Shareholders were held on December 19, 2002.
- b) Not applicable.
- c) The matters voted upon and the results of the voting at the Annual Meetings are set forth below:

##### 1. LG&E

- i) The shareholders voted to elect LG&E's nominees for election to the Board of Directors, as follows:

Michael Söhlke - 21,294,223 common shares and 114,107 preferred shares cast in favor of election and 1,979 preferred shares withheld.

Victor A. Staffieri - 21,294,223 common shares and 113,207 preferred shares cast in favor of election and 2,879 preferred shares withheld.

Edmund A. Wallis - 21,294,223 common shares and 114,246 preferred shares cast in favor of election and 1,840 preferred shares withheld.

No holders of common or preferred shares abstained from voting on this matter.

- ii) The shareholders voted 21,294,223 common shares and 113,801 preferred shares in favor of and 331 preferred shares against the approval of PricewaterhouseCoopers LLP as independent accountants for 2002. Holders of 1,954 preferred shares abstained from voting on this matter.

## 2.KU

- i) The sole shareholder voted to elect KU's nominees for election to the Board of Directors, as follows:  
37,817,878 common shares cast in favor of election and no shares withheld for each of Michael Söhlke, Victor A. Staffieri and Edmund A. Wallis, respectively.
- ii) The sole shareholder voted 37,817,878 common shares in favor of and no shares withheld for approval of PricewaterhouseCoopers LLP as independent accountants for 2002.

No holders of common shares abstained from voting on these matters.

d) Not applicable.

## PART II.

### ITEM 5. Market for the Registrant's Common Equity and Related Stockholder Matters.

#### LG&E:

All LG&E common stock, 21,294,223 shares, is held by LG&E Energy. Therefore, there is no public market for LG&E's common stock.

The following table sets forth LG&E's cash distributions on common stock paid to LG&E Energy (in thousands of \$):

	<u>2002</u>	<u>2001</u>
First quarter	\$ 0	\$ 0
Second quarter	23,000	0
Third quarter	23,000	0
Fourth quarter	23,000	23,000

#### KU:

All KU common stock, 37,817,878 shares, is held by LG&E Energy. Therefore, there is no public market for KU's common stock.

The following table sets forth KU's cash distributions on common stock paid to LG&E Energy (in thousands of \$):

	<u>2002</u>	<u>2001</u>
First quarter	\$ 0	\$ 0
Second quarter	0	0
Third quarter	0	0
Fourth quarter	0	30,500

ITEM 6. Selected Financial Data.

The Consolidated Financial Statements for 1998 through 2000 for LG&E and KU were audited by Arthur Andersen LLP (Andersen) who has ceased operations. A copy of the report previously issued by Andersen on our financial statements for the year ended December 31, 2000, is included elsewhere in this report. Such report has not been reissued by Andersen.

	Years Ended December 31				
	<u>(Thousands of \$)</u>				
	<u>2002</u>	<u>2001</u>	<u>2000</u>	<u>1999</u>	<u>1998</u>
<b><u>LG&amp;E:</u></b>					
Operating revenues:					
Revenues	\$1,013,917	\$997,420	\$985,947	\$969,984	\$854,556
Provision for rate collections (refunds)	<u>12,267</u>	<u>(720)</u>	<u>(2,500)</u>	<u>(1,735)</u>	<u>(4,500)</u>
Total operating revenues	<u>1,026,184</u>	<u>996,700</u>	<u>983,447</u>	<u>968,249</u>	<u>850,056</u>
Net operating income	<u>117,914</u>	<u>141,773</u>	<u>148,870</u>	<u>140,091</u>	<u>135,523</u>
Net income	<u>88,929</u>	<u>106,781</u>	<u>110,573</u>	<u>106,270</u>	<u>78,120</u>
Net income available for common stock	<u>84,683</u>	<u>102,042</u>	<u>105,363</u>	<u>101,769</u>	<u>73,552</u>
Total assets	<u>2,561,078</u>	<u>2,448,354</u>	<u>2,226,084</u>	<u>2,171,452</u>	<u>2,104,637</u>
Long-term obligations (including amounts due within one year)	<u>\$ 616,904</u>	<u>\$ 616,904</u>	<u>\$ 606,800</u>	<u>\$ 626,800</u>	<u>\$ 626,800</u>

LG&E's Management's Discussion and Analysis of Financial Condition and Results of Operation and LG&E's Notes to Financial Statements should be read in conjunction with the above information.

Years Ended December 31  
(Thousands of \$)

<u>KU:</u>	<u>2002</u>	<u>2001</u>	<u>2000</u>	<u>1999</u>	<u>1998</u>
<b>Operating revenues:</b>					
Revenues	\$ 875,192	\$ 860,426	\$ 851,941	\$ 943,210	\$ 831,614
Provision for rate collections (refunds)	<u>13,027</u>	<u>(954)</u>	<u>-</u>	<u>(5,900)</u>	<u>(21,500)</u>
Total operating revenues	<u>888,219</u>	<u>859,472</u>	<u>851,941</u>	<u>937,310</u>	<u>810,114</u>
Net operating income	<u>108,643</u>	<u>121,370</u>	<u>128,136</u>	<u>136,016</u>	<u>125,388</u>
Net income	<u>93,384</u>	<u>96,414</u>	<u>95,524</u>	<u>106,558</u>	<u>72,764</u>
Net income available for common stock	<u>91,128</u>	<u>94,158</u>	<u>93,268</u>	<u>104,302</u>	<u>70,508</u>
Total assets	<u>1,998,383</u>	<u>1,826,902</u>	<u>1,739,518</u>	<u>1,785,090</u>	<u>1,761,201</u>
Long-term obligations (including amounts due within one year)	<u>\$ 500,492</u>	<u>\$ 488,506</u>	<u>\$ 484,830</u>	<u>\$ 546,330</u>	<u>\$ 546,330</u>

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

**ITEM 7. Management's Discussion and Analysis of Financial Condition and Results of Operation.**

**LG&E:**

**GENERAL**

The following discussion and analysis by management focuses on those factors that had a material effect on LG&E's financial results of operations and financial condition during 2002, 2001, and 2000 and should be read in connection with the financial statements and notes thereto.

Some of the following discussion may contain forward-looking statements that are subject to certain 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; 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 LG&E's reports to the SEC, including Exhibit No. 99.01 to this report on Form 10-K.

**MERGERS and ACQUISITIONS**

On December 11, 2000, LG&E Energy was acquired by Powergen for cash of approximately \$3.2 billion or \$24.85 per share and the assumption of all of LG&E Energy's debt. As a result of the acquisition, LG&E Energy became a wholly owned subsidiary of Powergen and, as a result, LG&E became an indirect subsidiary of Powergen. LG&E has continued its separate identity and serves customers in Kentucky under its existing

### LG&E (cont.):

name. The preferred stock and debt securities of LG&E were not affected by this transaction and LG&E continues to file SEC reports. Following the acquisition, Powergen became a registered holding company under PUHCA, and LG&E, as a subsidiary of a registered holding company, became subject to additional regulation under PUHCA. See "Rates and Regulation" under Item 1.

On July 1, 2002, E.ON, a German company, completed its acquisition of Powergen plc (now Powergen Limited). As a result, LG&E and KU became indirect subsidiaries of E.ON. E.ON had announced its pre-conditional cash offer of £5.1 billion (\$7.3 billion) for Powergen on April 9, 2001. Following the acquisition, E.ON became a registered holding company under PUHCA.

As contemplated in their regulatory filings in connection with the E.ON acquisition, E.ON, Powergen and LG&E Energy completed an administrative reorganization to move the LG&E Energy group from an indirect Powergen subsidiary to an indirect E.ON subsidiary. This reorganization was effective in March 2003.

## RESULTS OF OPERATIONS

### Net Income

LG&E's net income in 2002 decreased \$17.9 million as compared to 2001. The decrease resulted primarily from higher transmission operating expenses, an increase in amortization of VDT regulatory asset, and increased property insurance and pension expense, partially offset by an increase in electric sales to retail customers and lower interest expenses.

LG&E's net income decreased \$3.8 million for 2001, as compared to 2000. This decrease is mainly due to higher pension related expenses and amortization of VDT regulatory asset, partially offset by increased electric and gas net revenues (operating revenues less fuel for electric generation, power purchased and gas supply expenses) and decreased interest expenses.

## LG&E (cont.):

### Revenues

A comparison of operating revenues for the years 2002 and 2001, excluding the provisions recorded for rate collections (refunds), with the immediately preceding year reflects both increases and decreases, which have been segregated by the following principal causes (in thousands of \$):

<u>Cause</u>	Increase (Decrease) From Prior Period			
	Electric Revenues		Gas Revenues	
	<u>2002</u>	<u>2001</u>	<u>2002</u>	<u>2001</u>
Retail sales:				
Fuel and gas supply adjustments	\$ 19,449	\$ (394)	\$(58,003)	\$ 79,627
LG&E/KU Merger surcredit	(2,825)	(2,456)	-	-
Performance based rate	-	1,962	-	-
Environmental cost recovery surcharge	9,694	1,246	-	-
Demand side management	1,381	-	938	-
Electric rate reduction	-	(3,671)	-	-
VDT surcredit	(1,177)	(1,014)	(285)	(68)
Gas rate increase	-	-	-	15,265
Weather normalization	-	-	2,234	-
Variation in sales volumes and other	<u>24,819</u>	<u>4,429</u>	<u>21,658</u>	<u>(64,817)</u>
Total retail sales	51,341	102	(33,458)	30,007
Wholesale sales	(16,404)	(5,674)	10,683	(11,642)
Gas transportation-net	-	-	189	(880)
Other	<u>4,642</u>	<u>(1,241)</u>	<u>(496)</u>	<u>801</u>
Total	<u>\$ 39,579</u>	<u>\$ (6,813)</u>	<u>\$(23,082)</u>	<u>\$ 18,286</u>

Electric revenues increased in 2002 primarily due to an increase in retail sales due to warmer summer weather, an increase in the recovery of fuel costs passed through the FAC, partially offset by a decrease in wholesale sales due to lower market prices as compared to 2001. Cooling degree days increased 20% compared to 2001. Electric revenues decreased in 2001 primarily due to a decrease in brokered activity in the wholesale electric sales market, an electric rate reduction ordered by the Kentucky Commission and the effects of the LG&E/KU merger surcredit (See Note 2 of LG&E's Notes to Financial Statements under Item 8) partially offset by an increase in electric retail sales. In January 2000, the Kentucky Commission ordered an electric rate reduction and the termination of LG&E's proposed electric PBR mechanism.

Gas revenues in 2002 decreased due to a lower gas supply cost billed to customers through the gas supply clause offset partially by increased gas retail sales due to cooler winter weather and an increase in wholesale sales volume. Heating degree days increased 17% as compared to 2001. Gas revenues in 2001 increased primarily as a result of higher gas supply costs billed to customers through the gas supply clause and the effects of a gas rate increase ordered by the Kentucky Commission in September 2000. The gas revenue increase was partially offset by a decrease in retail and wholesale gas sales in 2001 due to warmer weather. Heating degree days decreased 10.2% compared to 2000.

### Expenses

Fuel for electric generation and gas supply expenses comprise a large component of LG&E's total operating costs. The retail electric rates contain a FAC and gas rates contain a GSC, whereby increases or decreases in the

LG&E (cont.):

cost of fuel and gas supply are reflected in the FAC and GSC factors, subject to approval by the Kentucky Commission, and passed through to LG&E's retail customers.

Fuel for electric generation increased \$35.7 million (22.4%) in 2002 due to increased generation (\$5.4 million) and higher cost of coal burned (\$30.3 million). Fuel for electric generation decreased \$0.2 million (.1%) in 2001 primarily due to decreased generation as a result of decreased electric sales (\$2.2 million) partially offset by a higher cost of coal burned (\$2.0 million). The average delivered cost per ton of coal purchased was \$25.30 in 2002, \$21.27 in 2001 and \$20.96 in 2000.

Power purchased increased \$2.9 million (3.5%) in 2002 due to an increase in purchases to meet requirements for native load and off-system sales partially offset by decreased brokered sales activity in the wholesale electric market. Power purchased decreased \$15.4 million (15.9%) in 2001 primarily due to decreased brokered sales activity in the wholesale electric market and a lower unit cost of the purchases partially offset by an increase in purchases to meet requirements for native load and off-system sales.

Gas supply expenses decreased \$24.1 million (11.7%) in 2002 due to a decrease in cost of net gas supply (\$36.6 million), partially offset by an increase in the volume of gas delivered to the distribution system (\$12.5 million). Gas supply expenses increased \$9.3 million (4.7%) in 2001 primarily due to an increase in cost of net gas supply (\$36.2 million), partially offset by a decrease in the volume of gas delivered to the distribution system (\$26.9 million). The average unit cost per Mcf of purchased gas was \$4.19 in 2002, \$5.27 in 2001 and \$5.08 in 2000.

Other operation expenses increased \$40.5 million (24.1%) in 2002 primarily due to a full year amortization in 2002 of a regulatory asset created as a result of the workforce reduction costs associated with LG&E's VDT (\$17.0 million), higher costs for electric transmission primarily resulting from increased MISO costs (\$13.9 million), an increase in property and other insurance costs (\$3.9 million), an increase in pension costs due to change in pension assumptions to reflect current market conditions and change in market value of plan assets at the measurement date (\$3.7 million), and an increase in steam production costs (\$3.4 million). Other operation expenses increased \$31.9 million (23.4%) in 2001 primarily due to amortization of a regulatory asset resulting from workforce reduction costs associated with LG&E's VDT (\$13.0 million), an increase in pension expense (\$10.3 million) and an increase in outside services (\$8.5 million). Outside services increased in part due to the reclassification of expenses as a result of the formation of LG&E Services, as required by the SEC to comply with PUHCA.

Maintenance expenses for 2002 increased \$1.5 million (2.6%) primarily due to gas distribution expenses for main remediation work (\$2.2 million). Maintenance expenses for 2001 decreased \$5.0 million (7.9%) primarily due to decreases in scheduled outages (\$2.8 million), and a decrease in software and communication equipment maintenance (\$2.8 million).

Depreciation and amortization increased \$5.5 million (5.5%) in 2002 and \$2.1 million (2.1%) in 2001 because of additional utility plant in service. The 2001 increase was offset by a decrease in depreciation rates resulting from a settlement order in December 2001 from the Kentucky Commission. Depreciation expenses decreased \$5.6 million as a result of the settlement order.

## LG&E (cont.):

Variations in income tax expenses are largely attributable to changes in pre-tax income. LG&E's 2002 effective income tax rate increased to 37.2% from the 36.5% rate in 2001. See Note 7 of LG&E's Notes to Financial Statements under Item 8.

Property and other taxes decreased \$0.3 million (1.6%) in 2002. Property and other taxes decreased \$1.2 million (6.5%) in 2001 primarily due to a reduction in payroll taxes related to fewer employees as a result of workforce reductions and transfers to LG&E Services.

Other income – net decreased \$2.1 million (72.0%) in 2002 primarily due to increased costs for non-utility areas, \$1.3 million and decreases in the gain on sale of property \$0.8 million. Other income – net decreased \$2.0 million (40.5%) in 2001 primarily due to lower interest and dividend income.

Interest charges for 2002 decreased \$8.1 million (21.4%) primarily due to lower interest rates on variable rate debt (\$5.6 million) a decrease in debt to associated companies (\$0.8 million) and an decrease in interest associated with LG&E's accounts receivable securitization program (\$1.5 million). Interest charges for 2001 decreased \$5.3 million (12.2%) primarily due to lower interest rates on variable rate debt (\$2.2 million) and the retirement of short-term borrowings (\$8.1 million) partially offset by an increase in debt to associated companies (\$2.5 million) and an increase in interest associated with LG&E's accounts receivable securitization program (\$2.5 million). See Note 9 of LG&E's Notes to Financial Statements under Item 8.

LG&E's weighted average cost of long-term debt, including amortization of debt expense and interest rate swaps, was 3.87% at December 31, 2002 compared to 4.17% at December 31, 2001. See Note 9 of LG&E's Notes to Financial Statements under Item 8.

The rate of inflation may have a significant impact on LG&E's operations, its ability to control costs and the need to seek timely and adequate rate adjustments. However, relatively low rates of inflation in the past few years have moderated the impact on current operating results.

## 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, in and of themselves, 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 following paragraphs. 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 forecast and the best estimates routinely require adjustment. See also Note 1 of LG&E's Notes to Financial Statements under Item 8.

Unbilled Revenue – At each month end LG&E prepares a financial estimate that projects electric and gas usage that has been used by customers, but not billed. The estimated usage is based on known weather and days not billed. At December 31, 2002, a 10% change in these estimated quantities would cause revenue and accounts

LG&E (cont.):

receivable to change by approximately \$5.0 million, including \$2.3 million for electric usage and \$2.7 million for gas usage. See also Note 1 of LG&E's Notes to Financial Statements under Item 8.

**Benefit Plan Accounting** - Judgments and uncertainties in benefit plan accounting include future rate of returns on pension plan assets, interest rates used in valuing benefit obligation, healthcare cost trend rates, and other actuarial assumptions.

LG&E's costs of providing defined-benefit pension retirement plans is dependent upon a number of factors, such as the rates of return on plan assets, discount rate, and contributions made to the plan. The market value of LG&E plan assets has been affected by declines in the equity market since the beginning of the fiscal year. As a result, at December 31, 2002, LG&E was required to recognize an additional minimum liability as prescribed by SFAS No. 87 *Employers' Accounting for Pensions*. The liability was recorded as a reduction to other comprehensive income, and did not affect net income for 2002. The amount of the liability depended upon the asset returns experienced in 2002 and contributions made by LG&E to the plan during 2002. Also, pension cost and cash contributions to the plan could increase in future years without a substantial recovery in the equity market. If the fair value of the plan assets exceeds the accumulated benefit obligation, the recorded liability will be reduced and other comprehensive income will be restored in the consolidated balance sheet.

The combination of poor market performance and a decrease in short-term corporate bond interest rates has created a divergence in the potential value of the pension liability and the actual value of the pension assets. These conditions could result in an increase in LG&E's funded accumulated benefit obligation and future pension expense. The primary assumptions that drive the value of the unfunded accumulated benefit obligation are the discount rate and expected return on plan assets.

LG&E made a contribution to the pension plan of \$83.1 million in January 2003.

A 1% increase or decrease in the assumed discount rate could have an approximate \$37.0 million positive or negative impact to the accumulated benefit obligation of LG&E.

See also Note 6 of LG&E's Notes to Financial Statements under Item 8.

**Regulatory Mechanisms** – Judgments and uncertainties include future regulatory decisions, impact of deregulation and competition on ratemaking process, and external regulator decisions.

Regulatory assets represent incurred costs that have been deferred because they are probable of future recovery in customer rates based upon Kentucky Commission orders. Regulatory liabilities generally represent obligations to make refunds to customers for previous collections based upon orders by the Kentucky Commission. Management believes, based on orders, the existing regulatory assets and liabilities are probable of recovery. This determination reflects the current regulatory climate in the state. If future recovery of costs ceases to be probable the assets would be required to be recognized in current period earnings.

LG&E has accrued in the financial statements an estimate of \$12.5 million for 2002 ESM, with collection from customer commencing in April 2003. The ESM is subject to Kentucky Commission approval.

See also Note 3 of LG&E's Notes to Financial Statements under Item 8.

LG&E (cont.):

NEW ACCOUNTING PRONOUNCEMENTS

The following accounting pronouncements were issued that affected LG&E in 2002:

SFAS No. 143, *Accounting for Asset Retirement Obligations* was issued in 2001. SFAS No. 143 establishes accounting and reporting standards for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs.

The effective implementation date for SFAS No. 143 is January 1, 2003. Management has calculated the impact of SFAS No. 143 and the recently released FERC NOPR No. RM02-7, *Accounting, Financial Reporting, and Rate Filing Requirements for Asset Retirement Obligations*. As of January 1, 2003, LG&E recorded asset retirement obligation (ARO) assets in the amount of \$4.6 million and liabilities in the amount of \$9.3 million. LG&E also recorded a cumulative effect adjustment in the amount of \$5.3 million to reflect the accumulated depreciation and accretion of ARO assets at the transition date less amounts previously accrued under regulatory depreciation. LG&E recorded offsetting regulatory assets of \$5.3 million, pursuant to regulatory treatment prescribed under SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*. Also pursuant to SFAS No. 71, LG&E recorded regulatory liabilities in the amount of \$60,000 offsetting removal costs previously accrued under regulatory accounting in excess of amounts allowed under SFAS No. 143.

LG&E also expects to record ARO accretion expense of approximately \$617,000, ARO depreciation expense of approximately \$117,000 and an offsetting regulatory credit in the income statement of approximately \$734,000 in 2003, pursuant to regulatory treatment prescribed under SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*. The accretion, depreciation and regulatory credit will be annual adjustments. SFAS No. 143 will have no impact on the results of the operation of LG&E.

LG&E asset retirement obligations are primarily related to the final retirement of generating units. LG&E transmission and distribution lines largely operate under perpetual property easement agreements which do not generally require restoration upon removal of the property. Therefore, under SFAS No. 143, no material asset retirement obligations will be recorded for transmission and distribution assets.

LG&E adopted EITF No. 98-10, *Accounting for Energy Trading and Risk Management Activities*, effective January 1, 1999. This pronouncement required that energy trading contracts be marked to market on the balance sheet, with the gains and losses shown net in the income statement. In October 2002, the Emerging Issues Task Force reached a consensus to rescind EITF 98-10. The effective date for the full rescission is for fiscal periods beginning after December 15, 2002. With the rescission of EITF No. 98-10, energy trading contracts that do not also meet the definition of a derivative under SFAS No. 133 must be accounted for as executory contracts. Contracts previously recorded at fair value under EITF No. 98-10 that are not also derivatives under SFAS No. 133 must be restated to historical cost through a cumulative effect adjustment. LG&E does not expect the rescission of this standard to have a material impact on financial position or results of operations.

In January 2003, the Financial Accounting Standards Board issued Financial Accounting Standards Board Interpretation No. 46, *Consolidation of Variable Interest Entities*, an Interpretation of ARB No. 51 (FIN 46). FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have

## LG&E (cont.):

sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 is effective immediately for all new variable interest entities created or acquired after January 31, 2003. For variable interest entities created or acquired prior to February 1, 2003, the provisions of FIN 46 must be applied for the first interim or annual period beginning after June 15, 2003. LG&E does not expect the adoption of this standard to have any impact on the financial position or results of operations.

## LIQUIDITY AND CAPITAL RESOURCES

LG&E uses net cash generated from its operations and external financing to fund construction of plant and equipment and the payment of dividends. LG&E believes that such sources of funds will be sufficient to meet the needs of its business in the foreseeable future.

### Operating Activities

Cash provided by operations was \$212.4 million, \$287.1 million and \$156.2 million in 2002, 2001, and 2000, respectively. The 2002 decrease compared to 2001 of \$74.7 million resulted primarily from the change in accounts receivable balances, including the sale of accounts receivable through the accounts receivable securitization program and a decrease in accounts payable and accrued taxes. The 2001 increase of \$130.9 million resulted primarily from an increase in accounts receivable, and a decrease in accrued taxes. See Note 1 of LG&E's Notes to Financial Statements under Item 8 for a discussion of accounts receivable securitization.

### Investing Activities

LG&E's primary use of funds for investing activities continues to be for capital expenditures. Capital expenditures were \$220.4 million, \$253.0 million and \$144.2 million in 2002, 2001, and 2000, respectively. LG&E expects its capital expenditures for 2003 and 2004 to total approximately \$340.0 million, which consists primarily of construction estimates associated with installation of NOx equipment as described in the section titled "Environmental Matters," purchase of jointly owned CTs with KU and on-going construction for the distribution systems.

Net cash used for investment activities decreased \$28.7 million in 2002 compared to 2001 primarily due to the level of construction expenditures. CT expenditures were approximately \$35.9 million in 2002 and \$57.8 million in 2001. The \$107.9 million increase in net cash used in 2001 as compared to 2000 was due to NOx expenditures and the purchase of CTs.

### Financing Activities

Net cash inflows for financing activities were \$22.5 million in 2002 and outflows of \$38.7 million and \$67.7 million in 2001 and 2000, respectively. In 2002, short-term borrowings increased \$98.9 million which were used in part for dividend payments of \$73.3 million. During 2001, short-term borrowings decreased \$20.4 million from 2000 and LG&E paid \$28.0 million in dividends.

During 2001, LG&E issued \$10.1 million of pollution control bonds resulting in net proceeds of \$9.7 million after issuance costs.

LG&E (cont.):

On March 6, 2002, LG&E refinanced its \$22.5 million and \$27.5 million unsecured pollution control bonds, both due September 1, 2026. The replacement bonds, due September 1, 2026, are variable rate bonds and are secured by first mortgage bonds.

On March 22, 2002, LG&E refinanced its two \$35 million unsecured pollution control bonds due November 1, 2027. The replacement variable rate bonds are secured by first mortgage bonds and will mature November 1, 2027.

In October 2002, LG&E issued \$41.7 million variable rate pollution bonds due October 1, 2032, and exercised its call option on \$41.7 million, 6.55% pollution control bonds due November 1, 2020.

Under the provisions for LG&E's variable-rate pollution control bonds totaling \$246.2 million, 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.

**Future Capital Requirements**

Future capital requirements may be affected in varying degrees by factors such as load growth, changes in construction expenditure levels, rate actions by regulatory agencies, new legislation, market entry of competing electric power generators, changes in environmental regulations and other regulatory requirements. LG&E anticipates funding future capital requirements through operating cash flow, debt, and/or infusions of capital from its parent.

LG&E's debt ratings as of December 31, 2002, were:

	<u>Moody's</u>	<u>S&amp;P</u>	<u>Fitch</u>
First mortgage bonds	A1	A	A+
Preferred stock	Baa1	BBB	A-
Commercial paper	P-1	A-2	F-1

These ratings reflect the views of Moody's, S&P and Fitch. 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.

## LG&E (cont.):

### Contractual Obligations

The following is provided to summarize LG&E's contractual cash obligations for periods after December 31, 2002 (in thousands of \$):

	<u>Payments Due by Period</u>				<u>Total</u>
	<u>2003</u>	<u>2004- 2005</u>	<u>2006- 2007</u>	<u>After 2007</u>	
<u>Contractual cash Obligations</u>					
Short-term debt (a)	\$193,053	\$ -	\$ -	\$ -	\$193,053
Long-term debt (b)	288,800	-	-	328,104	616,904
Operating lease (c)	3,371	6,866	7,143	29,794	47,174
Unconditional purchase obligations (d)	10,773	20,268	21,632	184,544	237,217
Other long-term obligations (e)	<u>28,401</u>	<u>95,151</u>	-	-	<u>123,552</u>
Total contractual cash obligations (f)	<u>\$524,398</u>	<u>\$122,285</u>	<u>\$28,775</u>	<u>\$542,442</u>	<u>\$1,217,900</u>

- (a) Represents borrowings from parent company due within one year.
- (b) Includes long-term debt of \$246.2 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 2017 to 2027.
- (c) Operating lease represents the lease of LG&E's administrative office building.
- (d) Represents future minimum payments under purchased power agreements through 2020.
- (e) Represents construction commitments.
- (f) LG&E does not expect to pay the \$246.2 million of long-term debt classified as a current liability in the consolidated balance sheets in 2003 as explained in (b) above. LG&E anticipates cash from operations and external financing will be sufficient to fund future obligations. LG&E anticipates refinancing a portion of its short-term debt with long-term debt in 2003.

### Market Risks

LG&E is exposed to market risks from changes in interest rates and commodity prices. To mitigate changes in cash flows attributable to these exposures, LG&E uses various financial instruments including derivatives. Derivative positions are monitored using techniques that include market value and sensitivity analysis. See Note 1 and 4 of LG&E's Notes to Financial Statements under Item 8.

### Interest Rate Sensitivity

LG&E has short-term and long-term variable rate debt obligations outstanding. At December 31, 2002, the potential change in interest expense associated with a 1% change in base interest rates of LG&E's unhedged debt is estimated at \$5.5 million after impact of interest rate swaps.

Interest rate swaps are used to hedge LG&E's underlying variable-rate debt obligations. These swaps hedge specific debt issuances and, consistent with management's designation, are accorded hedge accounting treatment. See Note 4 of LG&E's Notes to Financial Statements under Item 8.

## LG&E (cont.):

As of December 31, 2002, LG&E had swaps with a combined notional value of \$117.3 million. The swaps exchange floating-rate interest payments for fixed rate interest payments to reduce the impact of interest rate changes on LG&E's Pollution Control Bonds. The potential loss in fair value resulting from a hypothetical 1% adverse movement in base interest rates is estimated at \$10.8 million as of December 31, 2002. This estimate is derived from third party valuations. Changes in the market value of these swaps if held to maturity, as LG&E intends to do, will have no effect on LG&E's net income or cash flow. See Note 4 of LG&E's Notes to Financial Statements under Item 8.

### Commodity Price Sensitivity

LG&E has limited exposure to market price volatility in prices of fuel and electricity, since its retail tariffs include the FAC and GSC commodity price pass-through mechanisms. LG&E is exposed to market price volatility of fuel and electricity in its wholesale activities.

### Energy Trading & Risk Management Activities

LG&E conducts energy trading and risk management activities to maximize the value of power sales from physical assets it owns, in addition to the wholesale sale of excess asset capacity. Certain energy trading activities are accounted for on a mark-to-market basis in accordance with EITF 98-10, *Accounting for Contracts Involved in Energy Trading and Risk Management Activities*, SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities*. Wholesale sales of excess asset capacity and wholesale purchases are treated as normal sales and purchases under SFAS No. 133 and SFAS No. 138 and are not marked-to-market.

The rescission of EITF 98-10, effective for fiscal periods ending after December 15, 2002, will have no impact on LG&E's energy trading and risk management reporting as all contracts marked to market under EITF 98-10 are also within the scope of SFAS No. 133.

The table below summarizes LG&E's energy trading and risk management activities for 2002 and 2001 (in thousands of \$).

	<u>2002</u>	<u>2001</u>
Fair value of contracts at beginning of period, net liability	\$ (186)	\$ (17)
Fair value of contracts when entered into during the period	(65)	3,441
Contracts realized or otherwise settled during the period	448	(2,894)
Changes in fair values due to changes in assumptions	<u>(353)</u>	<u>(716)</u>
Fair value of contracts at end of period, net liability	<u>\$ (156)</u>	<u>\$ (186)</u>

No changes to valuation techniques for energy trading and risk management activities occurred during 2002. Changes in market pricing, interest rate and volatility assumptions were made during both years. All contracts outstanding at December 31, 2002, have a maturity of less than one year and are valued using prices actively quoted for proposed or executed transactions or quoted by brokers.

LG&E maintains policies intended to minimize credit risk and revalues credit exposures daily to monitor compliance with those policies. At December 31, 2002, 86% of the trading and risk management commitments were with counterparties rated BBB- equivalent or better.

## LG&E (cont.):

### Accounts Receivable Securitization

On February 6, 2001, LG&E implemented an accounts receivable securitization program. The purpose of this program is to enable LG&E to accelerate the receipt of cash from the collection of retail accounts receivable, thereby reducing dependence upon more costly sources of working capital. The securitization program allows for a percentage of eligible receivables to be sold. Eligible receivables are generally all receivables associated with retail sales that have standard terms and are not past due. LG&E is able to terminate the program at any time without penalty. If there is a significant deterioration in the payment record of the receivables by the retail customers or if LG&E fails to meet certain covenants regarding the program, the program may terminate at the election of the financial institutions. In this case, payments from retail customers would first be used to repay the financial institutions participating in the program, and would then be available for use by LG&E.

As part of the program, LG&E sold retail accounts receivables to a wholly owned subsidiary, LG&E R. Simultaneously, LG&E R entered into two separate three-year accounts receivable securitization facilities with two financial institutions and their affiliates whereby LG&E R can sell, on a revolving basis, an undivided interest in certain of its receivables and receive up to \$75 million from an unrelated third party purchaser. The effective cost of the receivables programs is comparable to LG&E's lowest cost source of capital, and is based on prime rated commercial paper. LG&E retains servicing rights of the sold receivables through two separate servicing agreements with the third party purchaser. LG&E has obtained an opinion from independent legal counsel indicating these transactions qualify as a true sale of receivables. As of December 31, 2002, the outstanding program balance was \$63.2 million. LG&E is considering unwinding its accounts receivable securitization arrangements involving LG&E R during 2003.

The allowance for doubtful accounts associated with the eligible securitized receivables was \$2.1 million at December 31, 2002. This allowance is based on historical experience of LG&E. Each securitization facility contains a fully funded reserve for uncollectible receivables.

### RATES AND REGULATION

Following the purchase of Powergen by E.ON, E.ON became a registered holding company under PUHCA. As a result, E.ON, its utility subsidiaries, including LG&E, and certain of its non-utility subsidiaries are subject to extensive regulation by the SEC under PUHCA with respect to issuances and sales of securities, acquisitions and sales of certain utility properties, and intra-system sales of certain goods and services. In addition, PUHCA generally limits the ability of registered holding companies to acquire additional public utility systems and to acquire and retain businesses unrelated to the utility operations of the holding company. LG&E believes that it has adequate authority (including financing authority) under existing SEC orders and regulations to conduct its business. LG&E will seek additional authorization when necessary.

LG&E is subject to the jurisdiction of the Kentucky Commission in virtually all matters related to electric and gas utility regulation, and as such, its accounting is subject to SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*. Given LG&E's competitive position in the marketplace and the status of regulation in the state of Kentucky, LG&E has no plans or intentions to discontinue its application of SFAS No. 71. See Note 3 of LG&E's Notes to Financial Statements under Item 8.

## LG&E (cont.):

### Kentucky Commission Settlement Order - VDT Costs, ESM and Depreciation

During the first quarter 2001, LG&E recorded a \$144 million charge for a workforce reduction program. Primary components of the charge were separation benefits, enhanced early retirement benefits, and health care benefits. The result of this workforce reduction was the elimination of approximately 700 positions, accomplished primarily through a voluntary enhanced severance program.

On June 1, 2001, LG&E filed an application (VDT case) with the Kentucky Commission to create a regulatory asset relating to these first quarter 2001 charges. The application requested permission to amortize these costs over a four-year period. The Kentucky Commission also opened a case to review a new depreciation study and resulting depreciation rates implemented in 2001.

LG&E reached a settlement in the VDT case as well as the other cases involving depreciation rates and ESM with all intervening parties. The settlement agreement was approved by Kentucky Commission Order on December 3, 2001. The order allowed LG&E to set up a regulatory asset of \$141 million for the workforce reduction costs and begin amortizing these costs over a five year period starting in April 2001. The first quarter 2001 charge of \$144 million represented all employees who had accepted a voluntary enhanced severance program. Some employees rescinded their participation in the voluntary enhanced severance program, thereby decreasing the original charge from \$144 million to \$141 million. The settlement will also reduce revenues approximately \$26 million through a surcredit on future bills to customers over the same five year period. The surcredit represents stipulated net savings LG&E is expected to realize from implementation of best practices through the VDT. The agreement also established LG&E's new depreciation rates in effect December 2001, retroactive to January 1, 2001. The new depreciation rates decreased depreciation expense by \$5.6 million in 2001.

### Environmental Cost Recovery

In June 2000, the Kentucky Commission approved LG&E's application for a CCN to construct up to three SCR NOx reduction facilities. The construction and subsequent operation of the SCRs is intended to reduce NOx emission levels to meet the EPA's mandated NOx emission level of 0.15 lbs./ Mmbtu by May 2004. In its order, the Kentucky Commission ruled that LG&E's proposed plan for construction was "reasonable, cost-effective and will not result in the wasteful duplication of facilities." In October 2000, LG&E filed an application with the Kentucky Commission to amend its Environmental Compliance Plan to reflect the addition of the proposed NOx reduction technology projects and to amend its Environmental Cost Recovery Tariff to include an overall rate of return on capital investments. Approval of LG&E's application in April 2001 allowed LG&E to begin to recover the costs associated with these new projects, subject to Kentucky Commission oversight during normal six-month and two-year reviews.

In May 2002, the Kentucky Commission initiated a periodic two year review of LG&E's environmental surcharge. The review included the operation of the surcharge mechanism, determination of the appropriateness of costs included in the surcharge mechanism, recalculation of the cost of debt to reflect actual costs for the period under review, final determination of the amount of environmental revenues over-collected from customers, and a final determination of the amount of environmental costs and revenues to be "rolled-in" to base rates. A final order was issued on October 22, 2002, in which LG&E was ordered to refund \$325,000 to customers over the four month period beginning November 2002 and ending February 2003. Additionally, LG&E was ordered to roll \$4.1 million into base rates and make corresponding adjustments to the monthly

### LG&E (cont.):

environmental surcharge filings to reflect that portion of environmental rate base now included in base rates on a going-forward basis.

In August 2002, LG&E filed an application with the Kentucky Commission to amend its compliance plan to allow recovery of the cost of new and additional environmental compliance facilities. The estimated capital cost of the additional facilities is \$71.1 million. The Kentucky Commission conducted a public hearing on the case on December 20, 2002, final briefs were filed on January 15, 2003, and a final order was issued February 11, 2003. The final order approved recovery of four new environmental compliance facilities totaling \$43.1 million. A fifth project, expansion of the land fill facility at the Mill Creek Station, was denied without prejudice with an invitation to reapply for recovery when required construction permits are approved. Cost recovery through the environmental surcharge of the four approved projects will begin with the bills rendered in April 2003.

### ESM

LG&E's electric rates are subject to an ESM. The ESM, initially in place for three years beginning in 2000, sets an upper and lower point for rate of return on equity, whereby if LG&E's rate of return for the calendar year falls within the range of 10.5% to 12.5%, no action is necessary. If earnings are above the upper limit, the excess earnings are shared 40% with ratepayers and 60% with shareholders; if earnings are below the lower limit, the earnings deficiency is recovered 40% from ratepayers and 60% from shareholders. By order of the Kentucky Commission, rate changes prompted by the ESM filing go into effect in April of each year subject to a balancing adjustment in successive periods. LG&E made its second ESM filing on March 1, 2002, for the calendar year 2001 reporting period. LG&E is in the process of refunding \$441,000 to customers for the 2001 reporting period. LG&E estimated that the rate of return will fall below the lower limit, subject to Kentucky Commission approval, for the year ended December 31, 2002. The 2002 financial statements include an accrual to reflect the earnings deficiency of \$12.5 million to be recovered from customers commencing in April 2003.

On November 27, 2002, LG&E filed a revised ESM tariff which proposed continuance of the existing ESM through December 2005. The Kentucky Commission issued an Order suspending the ESM tariff one day making the effective date January 2, 2003. In addition, the Kentucky Commission is conducting a management audit to review the ESM plan and reassess its reasonableness in 2003. LG&E and interested parties will have the opportunity to provide recommendations for modification and continuance of the ESM or other forms of alternative or incentive regulation.

### DSM

LG&E's rates contain a DSM provision. The provision includes a rate mechanism that provides concurrent recovery of DSM costs and provides an incentive for implementing DSM programs. This program had allowed LG&E to recover revenues from lost sales associated with the DSM program. In May 2001, the Kentucky Commission approved LG&E's plan to continue DSM programs. This filing called for the expansion of the DSM programs into the service territory served by KU and proposed a mechanism to recover revenues from lost sales associated with DSM programs based on program planning engineering estimates and post-implementation evaluation.

## LG&E (cont.):

### Gas PBR

Since November 1, 1997, LG&E has operated under an experimental PBR mechanism related to its gas procurement activities. For each of the last five years, LG&E's rates have been adjusted to recover its portion of the savings (or expenses) incurred during each of the five 12-month periods beginning November 1 and ending October 31. Since its implementation on November 1, 1997, through October 31, 2002, LG&E has achieved \$38.1 million in savings. Of the total savings, LG&E has retained \$16.5 million, and the remaining portion of \$21.6 million has been distributed to customers. In December 2000, LG&E filed an application reporting on the operation of the experimental PBR and requested the Kentucky Commission to extend the PBR as a result of the benefits provided to both LG&E and its customers during the experimental period. Following the discovery and hearing process, the Kentucky Commission issued an order effective November 1, 2001, extending the experimental PBR program for an additional four years, and making other modifications, including changes to the sharing levels applicable to savings or expenses incurred under the PBR. Specifically, the Kentucky Commission modified the sharing mechanism to a 25%/75% Company/Customer sharing for all savings (and expenses) up to 4.5% of the benchmarked gas costs. Savings (and expenses) in excess of 4.5% of the benchmarked gas costs are shared at a 50%/50% level.

### FAC

Prior to implementation of the electric PBR in July 1999, and following its termination in March 2000, LG&E employed an FAC mechanism, which under Kentucky law allowed LG&E to recover from customers the actual fuel costs associated with retail electric sales. In February 1999, LG&E received orders from the Kentucky Commission requiring a refund to retail electric customers of approximately \$3.9 million resulting from reviews of the FAC from November 1994, through April 1998. While legal challenges to the Kentucky Commission order were pending a comprehensive settlement was reached by all parties and approved by the Kentucky Commission on May 17, 2002. Thereunder, LG&E agreed to credit its fuel clause in the amount of \$720,000 (such credit provided over the course of June and July 2002), and the parties agreed on a prospective interpretation of the state's fuel adjustment clause regulation to ensure consistent and mutually acceptable application on a going-forward basis.

In December 2002, the Kentucky Commission initiated a two year review of the operation of LG&E's FAC for the period November 2000 through October 2002. Testimony in the review case was filed on January 20, 2003 and a public hearing was held February 18, 2003. Issues addressed at that time included the establishment of the current base fuel factor to be included in LG&E's base rates, verification of proper treatment of purchased power costs during unit outages, and compliance with fuel procurement policies and practices.

### Gas Rate Case

In March 2000, LG&E filed an application with the Kentucky Commission requesting an adjustment in LG&E's gas rates. In September 2000, the Kentucky Commission granted LG&E an annual increase in its base gas revenues of \$20.2 million effective September 28, 2000. The Kentucky Commission authorized a return on equity of 11.25%. The Kentucky Commission approved LG&E's proposal for a weather normalization billing adjustment mechanism that will normalize the effect of weather on base gas revenues from gas sales.

## LG&E (cont.):

### Wholesale Natural Gas Prices

On September 12, 2000, the Kentucky Commission issued an order establishing Administrative Case No. 384 -- "An Investigation of Increasing Wholesale Natural Gas Prices and the Impacts of such Increase on the Retail Customers Served by Kentucky's Jurisdictional Natural Gas Distribution Companies". The impetus for this administrative proceeding was the escalation of wholesale natural gas prices during the summer of 2000.

The Kentucky Commission directed Kentucky's natural gas distribution companies, including LG&E, to file selected information regarding the individual companies' natural gas purchasing practices, expectations for the then-approaching winter heating season of 2000-2001, and potential actions which these companies might take to mitigate price volatility. On July 17, 2001, the Kentucky Commission issued an order encouraging the natural gas distribution companies in Kentucky to take various actions, among them to propose a natural gas hedge plan, consider performance-based ratemaking mechanisms, and to increase the use of storage.

In April 2002, in Case No. 2002-00136, LG&E proposed a hedging plan for the 2002/2003 winter heating season with three alternatives, the first two using a combination of storage and financial hedge instruments and the third relying upon storage alone. LG&E and the Attorney General, who represents Kentucky consumers, entered into a settlement which selected the third option. In August 2002, the Kentucky Commission approved the plan contemplated in the settlement. The Kentucky Commission validated the effectiveness of storage to mitigate potentially high winter gas prices by approving this natural gas hedging plan.

The Kentucky Commission also decided in Administrative Case No. 384 to engage a consultant to conduct a forward-looking audit of the gas procurement and supply procedures of Kentucky's largest natural gas distribution companies. The Kentucky Commission completed its audit in late 2002. The audit recognized LG&E as "efficient and effective [in the] procurement and management of significant quantities of natural gas supplies." The auditors also recognized that "the Company's residential gas prices have long been below averages for the U. S. and for the Commonwealth of Kentucky" which "demonstrates [LG&E's] effectiveness in [the] procurement and management of natural gas supplies." The audit also stated that the "Company's very impressive record in keeping its rates down provides sound evidence on the excellent job done in the area of gas supply procurement and management."

### Kentucky Commission Administrative Case for Affiliate Transactions

In December 1997, the Kentucky Commission opened Administrative Case No. 369 to consider Kentucky Commission policy regarding cost allocations, affiliate transactions and codes of conduct governing the relationship between utilities and their non-utility operations and affiliates. The Kentucky Commission intended to address two major areas in the proceedings: the tools and conditions needed to prevent cost shifting and cross-subsidization between regulated and non-utility operations; and whether a code of conduct should be established to assure that non-utility segments of the holding company are not engaged in practices that could result in unfair competition caused by cost shifting from the non-utility affiliate to the utility. During the period September 1998 to February 2000, the Kentucky Commission issued draft codes of conduct and cost allocation guidelines. In early 2000, the Kentucky General Assembly enacted legislation, House Bill 897, which authorized the Kentucky Commission to require utilities who provide nonregulated activities to keep separate accounts and allocate costs in accordance with procedures established by the Kentucky Commission. In the same bill, the General Assembly set forth provisions to govern a utility's activities related to the sharing of information, databases, and resources between its employees or an affiliate involved in the marketing or the

### LG&E (cont.):

provision of nonregulated activities and its employees or an affiliate involved in the provision of regulated services. The legislation became law in July 2000 and LG&E has been operating pursuant thereto since that time. On February 14, 2001, the Kentucky Commission published notice of their intent to promulgate new administrative regulations under the auspices of the new law. This effort is still on going.

#### Kentucky Commission Administrative Case for System Adequacy

On June 19, 2001, Kentucky Governor Paul E. Patton issued Executive Order 2001-771, which directed the Kentucky Commission to review and study issues relating to the need for and development of new electric generating capacity in Kentucky. The issues to be considered included the impact of new power plants on the electric supply grid, facility siting issues, and economic development matters, with the goal of ensuring a continued, reliable source of supply of electricity for the citizens of Kentucky and the continued environmental and economic vitality of Kentucky and its communities. In response to that Executive Order, in July 2001 the Kentucky Commission opened Administrative Case No. 387 to review the adequacy of Kentucky's generation capacity and transmission system. Specifically, the items reviewed were the appropriate level of reliance on purchased power, the appropriate reserve margins to meet existing and future electric demand, the impact of spikes in natural gas prices on electric utility planning strategies, and the adequacy of Kentucky's electric transmission facilities. LG&E, as a party to this proceeding, filed written testimony and responded to two requests for information. Public hearings were held and in October 2001, LG&E filed a final brief in the case. In December 2001, the Kentucky Commission issued an order in which it noted that LG&E is responsibly addressing the long-term supply needs of native load customers and that current reserve margins are appropriate. However, due to the rapid pace of change in the industry, the order also requires LG&E to provide an annual assessment of supply resources, future demand, reserve margin, and the need for new resources.

Regarding the transmission system, the Kentucky Commission concluded that the transmission system within Kentucky can reliably serve native load and a significant portion of the proposed new unregulated power plants. However, it will not be able to handle the volume of transactions envisioned by FERC without future upgrades, the costs of which should be borne by those for whom the upgrades are required.

The Kentucky Commission pledged to continue to monitor all relevant issues and advocate Kentucky's interests at all opportunities.

#### FERC SMD NOPR

On July 31, 2002, FERC issued a NOPR in Docket No. RM01-12-000 which would substantially alter the regulations governing the nation's wholesale electricity markets by establishing a common set of rules -- SMD. The SMD NOPR would require each public utility that owns, operates, or controls interstate transmission facilities to become an Independent Transmission Provider (ITP), belong to an RTO that is an ITP, or contract with an ITP for operation of its transmission assets. It would also establish a standardized congestion management system, real-time and day-ahead energy markets, and a single transmission service for network and point-to-point transmission customers. Review of the proposed rulemaking is underway and a final rule is expected during 2003. While it is expected that the SMD final rule will affect LG&E revenues and expenses, the specific impact of the rulemaking is not known at this time.

## LG&E (cont.):

### MISO

LG&E is a member of the MISO, which began commercial operations on February 1, 2002. MISO now has operational control over LG&E's high-voltage transmission facilities (100 kV and greater), while LG&E continues to control and operate the lower voltage transmission subject to the terms and conditions of the MISO OATT. As a transmission-owning member of MISO, LG&E also incurs administrative costs of MISO pursuant to Schedule 10 of the MISO OATT.

MISO also proposed to implement a congestion management system. FERC directed the MISO to coordinate its efforts with FERC's Rulemaking on SMD. On September 24, 2002, the MISO filed new rate schedules designated as Schedules 16 and 17, which provide for the collection of costs incurred by the MISO to establish day-ahead and real-time energy markets. The MISO proposed to recover these costs under Schedules 16 and 17 once service commences. If approved by FERC, these schedules will cause LG&E to incur additional costs. LG&E opposes the establishment of Schedules 16 and 17. This effort is still on-going and the ultimate impact of the two schedules, if approved, is not known at this time.

### Merger Surcredit

As part of the LG&E Energy merger with KU Energy in 1998, LG&E Energy estimated non-fuel savings over a ten-year period following the merger. Costs to achieve these savings for LG&E of \$50.2 million were recorded in the second quarter of 1998, \$18.1 million of which was deferred and amortized over a five-year period pursuant to regulatory orders. Primary components of the merger costs were separation benefits, relocation costs, and transaction fees, the majority of which were paid by December 31, 1998. LG&E expensed the remaining costs associated with the merger (\$32.1 million) in the second quarter of 1998.

In approving the merger, the Kentucky Commission adopted LG&E's proposal to reduce its retail customers' bills based on one-half of the estimated merger-related savings, net of deferred and amortized amounts, over a five-year period. The surcredit mechanism provides that 50% of the net non-fuel cost savings estimated to be achieved from the merger be provided to ratepayers through a monthly bill credit, and 50% be retained by the Companies, over a five-year period. The surcredit was allocated 53% to KU and 47% to LG&E. In that same order, the Commission required LG&E and KU, after the end of the five-year period, to present a plan for sharing with customers the then-projected non-fuel savings associated with the merger. The Companies submitted this filing on January 13, 2003, proposing to continue to share with customers, on a 50%/50% basis, the estimated fifth-year gross level of non-fuel savings associated with the merger. The filing is currently under review.

Any fuel cost savings are passed to Kentucky customers through the fuel adjustment clause. See FAC above.

### Environmental Matters

The Clean Air Act imposed stringent new SO<sub>2</sub> and NO<sub>x</sub> emission limits on electric generating units. LG&E previously had installed scrubbers on all of its generating units. LG&E's strategy for Phase II SO<sub>2</sub> reductions, which commenced January 1, 2000, is to increase scrubber removal efficiency to delay additional capital expenditures and may also include fuel switching or upgrading scrubbers. LG&E met the NO<sub>x</sub> emission requirements of the Act through installation of low-NO<sub>x</sub> burner systems. LG&E's compliance plans are subject to many factors including developments in the emission allowance and fuel markets, future regulatory and

LG&E (cont.):

legislative initiatives, and advances in clean air control technology. LG&E will continue to monitor these developments to ensure that its environmental obligations are met in the most efficient and cost-effective manner.

In September 1998, the EPA announced its final "NOx SIP Call" rule requiring states to impose significant additional reductions in NOx emissions by May 2003, in order to mitigate alleged ozone transport impacts on the Northeast region. The Commonwealth of Kentucky is currently in the process of revising its SIP to require reductions in NOx emissions from coal-fired generating units to the 0.15 lb./Mmbtu level on a system-wide basis. In related proceedings in response to petitions filed by various Northeast states, in December 1999, EPA issued a final rule pursuant to Section 126 of the Clean Air Act directing similar NOx reductions from a number of specifically targeted generating units including all LG&E units. As a result of appeals to both rules, the compliance date was extended to May 2004. All LG&E generating units are subject to the May 2004 compliance date under these NOx emissions reduction rules.

LG&E is currently implementing a plan for adding significant additional NOx controls to its generating units. Installation of additional NOx controls will proceed on a phased basis, with installation of controls commencing in late 2000 and continuing through the final compliance date. LG&E estimates that it will incur total capital costs of approximately \$178 million to reduce its NOx emissions to the 0.15 lb./Mmbtu level on a company-wide basis. In addition, LG&E will incur additional operating and maintenance costs in operating new NOx controls. LG&E believes its costs in this regard to be comparable to those of similarly situated utilities with like generation assets. LG&E had anticipated that such capital and operating costs are the type of costs that are eligible for recovery from customers under its environmental surcharge mechanism and believed that a significant portion of such costs could be recovered. In April 2001, the Kentucky Commission granted recovery of these costs for LG&E.

LG&E is also monitoring several other air quality issues which may potentially impact coal-fired power plants, including the appeal of the D.C. Circuit's remand of the EPA's revised air quality standards for ozone and particulate matter, measures to implement EPA's regional haze rule, and EPA's December 2000 determination to regulate mercury emissions from power plants. In addition, LG&E is currently working with local regulatory authorities to review the effectiveness of remedial measures aimed at controlling particulate matter emissions from its Mill Creek Station. LG&E previously settled a number of property damage claims from adjacent residents and completed significant remedial measures as part of its ongoing capital construction program. LG&E is in the process of converting the Mill Creek Station to wet stack operation in an effort to resolve all outstanding issues related to particulate matter emissions.

LG&E owns or formerly owned three properties which are the location of past MGP operations. Various contaminants are typically found at such former MGP sites and environmental remediation measures are frequently required. With respect to the sites, LG&E has completed cleanups, obtained regulatory approval of site management plans, or reached agreements for other parties to assume responsibility for cleanup. Based on currently available information, management estimates that it will incur additional costs of \$400,000. Accordingly, an accrual of \$400,000 has been recorded in the accompanying financial statements at December 31, 2002 and 2001.

See Note 11 of LG&E's Notes to Financial Statements under Item 8 for an additional discussion of environmental issues.

## LG&E (cont.):

### Deferred Income Taxes

LG&E expects to have adequate levels of taxable income to realize its recorded deferred tax assets. At December 31, 2002, deferred tax assets totaled \$98.2 million and were principally related to expenses attributable to LG&E's pension plans and post retirement benefit obligations.

### FUTURE OUTLOOK

#### Competition and Customer Choice

LG&E has moved aggressively over the past decade to be positioned for the energy industry's shift to customer choice and a competitive market for energy services. Specifically, LG&E has taken many steps to prepare for the expected increase in competition in its business, including support for PBR structures; aggressive cost reduction activities; strategic acquisitions, dispositions and growth initiatives; write-offs of previously deferred expenses; an increase in focus on commercial and industrial customers; an increase in employee training; and necessary corporate and business unit realignments.

In December 1997, the Kentucky Commission issued a set of principles which was intended to serve as its guide in consideration of issues relating to industry restructuring. Among the issues addressed by these principles are: consumer protection and benefit, system reliability, universal service, environmental responsibility, cost allocation, stranded costs and codes of conduct. During 1998, the Kentucky Commission and a task force of the Kentucky General Assembly had each initiated proceedings, including meetings with representatives of utilities, consumers, state agencies and other groups in Kentucky, to discuss the possible structure and effects of energy industry restructuring in Kentucky.

In November 1999, the task force issued a report to the Governor of Kentucky and a legislative agency recommending no general electric industry restructuring actions during the 2000 legislative session. No general restructuring actions have been taken to date by the legislature.

Thus, at the time of this report, 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 LG&E, which may be significant, cannot currently be predicted.

While many states have moved forward in providing retail choice, many others have not. Some are reconsidering their initiatives and have even delayed implementation.

## KU

### GENERAL

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 2002, 2001, and 2000 and should be read in connection with the financial statements and notes thereto.

Some of the following discussion may contain forward-looking statements that are subject to certain risks,

## KU (Cont.):

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: 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 to the SEC, including Exhibit No. 99.01 to this report on Form 10-K.

### **MERGERS and ACQUISITIONS**

On December 11, 2000, LG&E Energy was acquired by Powergen for cash of approximately \$3.2 billion or \$24.85 per share and the assumption of all of LG&E Energy's debt. As a result of the acquisition, LG&E Energy became a wholly owned subsidiary of Powergen and, as a result, KU became an indirect subsidiary of Powergen. KU has continued its separate identity and serves customers in Kentucky, Virginia and Tennessee under its existing name. The preferred stock and debt securities of KU were not affected by this transaction and KU continued to file SEC reports. Following the acquisition, Powergen became a registered holding company under PUHCA and KU, as a subsidiary of a registered holding company, became subject to additional regulation under PUHCA. See "Rates and Regulation" under Item 1.

On July 1, 2002, E.ON, a German company, completed its acquisition of Powergen plc (now Powergen Limited). As a result, LG&E and KU became indirect subsidiaries of E.ON. E.ON had announced its pre-conditional cash offer of £5.1 billion (\$7.3 billion) for Powergen on April 9, 2001. Following the acquisition, E.ON became a registered holding company under PUHCA.

As contemplated in their regulatory filings in connection with the E.ON acquisition, E.ON, Powergen and LG&E Energy completed an administrative reorganization to move the LG&E Energy group from an indirect Powergen subsidiary to an indirect E.ON subsidiary. This reorganization was effective in March 2003.

### **RESULTS OF OPERATIONS**

#### **Net Income**

KU's net income in 2002 decreased \$3.0 million compared to 2001. The decrease resulted primarily from higher transmission operating expenses, an increase in amortization of regulatory assets, and increased property insurance, partially offset by an increase in sales to retail customers and lower interest expenses.

KU's net income in 2001 was relatively flat as compared to 2000 with an increase of \$.9 million. The increase resulted primarily from decreased depreciation, interest expenses and property and other taxes, partially offset by higher pension related expenses and amortization of regulatory assets.

## KU (Cont.):

### Revenues

A comparison of operating revenues for the years 2002 and 2001, excluding the provision for rate collections (refunds), with the immediately preceding year reflects both increases and decreases which have been segregated by the following principal causes (in thousands of \$):

<u>Cause</u>	<u>Increase (Decrease)</u> <u>From Prior Period</u>	
	<u>2002</u>	<u>2001</u>
<b>Retail sales:</b>		
Fuel clause adjustments	\$ 18,223	\$ 10,220
KU/LG&E Merger surcredit	(2,641)	(3,856)
Environmental cost recovery surcharge	3,781	1,458
Demand side management	1,570	-
Performance based rate	-	1,747
Electric rate reduction	-	(5,395)
VDT surcredit	(527)	(372)
Variation in sales volumes, and other	<u>46,601</u>	<u>(1,627)</u>
Total retail sales	67,007	2,175
Wholesale sales	(59,373)	5,108
Other	<u>7,132</u>	<u>1,202</u>
Total	<u>\$ 14,766</u>	<u>\$ 8,485</u>

Electric revenues increased in 2002 primarily due to an increase in retail sales due to warmer weather and an increase in the recovery of fuel costs passed through the FAC. Cooling degree days for 2002 increased 26% over 2001. The increase in retail sales was partially offset by a decrease in wholesale sales volumes. The decrease in wholesale sales was due in large part to fewer megawatts available due to increased retail sales. Electric revenues increased in 2001 primarily due to an increase in the recovery of fuel costs passed through the FAC and an increase in wholesale activity partially offset by a rate reduction ordered by Kentucky Commission in 2000 and lower sales volumes.

### Expenses

Fuel for electric generation comprises a large component of KU's total operating expenses. KU's Kentucky jurisdictional electric rates are subject to a FAC whereby increases or decreases are reflected in the FAC factor, subject to the approval of the Kentucky Commission. KU's wholesale and Virginia jurisdictional electric rates contain a fuel adjustment clause whereby increases or decreases in the cost of fuel are reflected in rates, subject to the approval of FERC and the Virginia Commission, respectively.

Fuel for electric generation increased \$13.1 million (5.5%) in 2002 because of an increase in the cost of coal burned (\$29.7 million), partially offset by a decrease in generation (\$16.5 million). Fuel for electric generation increased \$17.1 million (7.8%) in 2001 because of an increase in the cost of coal burned (\$21.8 million), partially offset by a decrease in generation (\$4.7 million). The average delivered cost per ton of coal purchased was \$31.44 in 2002, \$27.84 in 2001 and \$25.63 in 2000.

Power purchased expense in 2002 increased slightly over 2001, \$.8 million (.5%) primarily due to an increase in purchases to meet requirements for native load and off-system sales partially offset by a decrease in purchase

KU (Cont.):

price. Power purchased expense decreased \$9.8 million (5.9%) in 2001 primarily due to decreased brokered sales activity in the wholesale electric market and a lower unit cost of the purchases partially offset by an increase in purchases to meet requirements for native load and off-system sales.

Other operation expenses increased \$25.8 million (21.8%) in 2002. The primary cause for the increase was the full year amortization in 2002 of a regulatory asset created as a result of the workforce reduction associated with KU's VDT of \$6.5 million, higher costs for electric transmission primarily resulting from increased MISO costs of \$7.4 million, an increase in property insurance costs of \$2.8 million, an increase in employee benefit costs due to changes in pension assumptions to reflect current market conditions and changes in market value of plan assets at the measurement date of \$1.7 million, and an increase in outside services of \$4.9 million. Other operation expenses increased \$10.3 million (9.5%) in 2001. The primary cause for the increase was the amortization of a regulatory asset as a result of the workforce reduction associated with KU's VDT of \$5.0 million and an increase in pension expense of \$5.5 million.

Maintenance expenses increased \$5.9 million (10.3%) in 2002 primarily due to increases in steam maintenance of \$6.1 million related to annual outages at the Ghent, Green River, and Tyrone steam facilities. Maintenance expenses for 2001 decreased \$4.6 million (7.5%) primarily due to decreased repairs to steam facilities (\$6.5 million).

Depreciation and amortization increased \$5.2 million (5.7%) in 2002 primarily due to an increase in plant in service. Depreciation and amortization decreased \$8.0 million (8.1%) in 2001 primarily due to a reduction in depreciation rates as a result of a settlement order in December 2001 from the Kentucky Commission. Depreciation expenses decreased by \$6.0 million as a result of the settlement order.

Variations in income tax expense are largely attributable to changes in pre-tax income. The 2002 effective income tax rate decreased to 34.9% from the 35.9% rate in 2001. See Note 7 of KU's Notes to Financial Statements under Item 8.

Property and other taxes increased \$1.1 million (7.6%) in 2002 due to higher property taxes and payroll taxes. Property and other taxes decreased \$3.1 million (18.2%) in 2001 due to decreases in payroll taxes related to fewer employees as a result of workforce reductions and transfers to LG&E Energy Services Company.

Other income-net increased \$1.5 million (16.8%) in 2002 primarily due to a non-recurring increase in earnings from KU's equity earnings in a minority interest of \$5.2 million, partially offset by a gain on disposition of property in 2001, \$1.8 million, lower interest and dividend income from investments, \$0.7 million, and higher benefit and other costs, \$1.4 million. The increased equity earnings in 2002 are due to the gain on the sale of emissions allowances. Other income-net increased \$2.1 million (30.5%) in 2001 due to an increase in the gain on sale of assets.

Interest charges decreased \$8.3 million (24.5%) in 2002 as compared to 2001 due to lower interest rates on variable rate debt and refinancing of long term debt with lower interest rates, \$8.0 million. Interest charges decreased \$5.4 million (13.7%) in 2001 from 2000 due to lower interest rates on variable rate debt, \$4.6 million, the retirement of short-term borrowings, \$1.6 million, lower interest on debt to parent company, \$1.2 million, partially offset by an increase in interest associated with KU's accounts receivable securitization program, \$1.8 million.

## KU (Cont.):

KU's weighted average cost of long-term debt, including amortization of debt expense and interest rate swaps, was 3.30% at December 31, 2002 compared to 4.91% at December 31, 2001. See Note 9 of KU's Notes to Financial Statements under Item 8.

The rate of inflation may have a significant impact on KU's operations, its ability to control costs and the need to seek timely and adequate rate adjustments. However, relatively low rates of inflation in the past few years have moderated the impact on current operating results.

### 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, in and of themselves, 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 following paragraphs. 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 forecast and the best estimates routinely require adjustment. See also Note 1 of KU's Notes to Financial Statements under Item 8.

**Unbilled Revenue** – At each month end KU prepares a financial estimate that projects electric usage that has been used by customers, but not billed. The estimated usage is based on known weather and days not billed. At December 31, 2002, a 10% change in these estimated quantities would cause revenue and accounts receivable to change by approximately \$4.2 million. See also Note 1 of KU's Notes to Financial Statements under Item 8.

**Benefit Plan Accounting** - Judgments and uncertainties in benefit plan accounting include future rate of returns on pension plan assets, interest rates used in valuing benefit obligation, healthcare cost trend rates and other actuarial assumptions.

KU's costs of providing defined-benefit pension retirement plans is dependent upon a number of factors, such as the rates of return on plan assets, discount rate, and contributions made to the plan. The market value of KU plan assets has been affected by declines in the equity market since the beginning of the fiscal year. As a result, at December 31, 2002, KU was required to recognize an additional minimum liability as prescribed by SFAS No. 87 *Employers' Accounting for Pensions*. The liability was recorded as a reduction to other comprehensive income, and did not affect net income for 2002. The amount of the liability depended upon the asset returns experienced in 2002 and contributions made by KU to the plan during 2002. Also, pension cost and cash contributions to the plan could increase in future years without a substantial recovery in the equity market. If the fair value of the plan assets exceeds the accumulated benefit obligation, the recorded liability will be reduced and other comprehensive income will be restored in the consolidated balance sheet.

## KU (Cont.):

The combination of poor market performance and a decrease in short-term corporate bond interest rates has created a divergence in the potential value of the pension liability and the actual value of the pension assets. These conditions could result in an increase in KU's funded accumulated benefit obligation and future pension expense. The primary assumptions that drive the value of the unfunded accumulated benefit obligation are the discount rate and expected return on plan assets.

KU made a contribution to the pension plan of \$3.5 million in January 2003.

A 1% increase or decrease in the assumed discount rate could have an approximate \$26.0 million positive or negative impact to the accumulated benefit obligation of KU.

See also Note 6 of KU's Notes to Financial Statements under Item 8.

**Regulatory Mechanisms** – Judgments and uncertainties include future regulatory decisions, the impact of deregulation and competition on the ratemaking process and external regulator decisions.

Regulatory assets represent incurred costs that have been deferred because they are probable of future recovery in customer rates based upon Kentucky Commission orders. Regulatory liabilities generally represent obligations to make refunds to customers for previous collections based upon orders by the Kentucky Commission. Management believes, based on orders, the existing regulatory assets and liabilities are probable of recovery. This determination reflects the current regulatory climate in the state. If future recovery of costs ceases to be probable the assets would be required to be recognized in current period earnings.

KU has accrued in the financial statements, an estimate of \$13.5 million for 2002 ESM, with collection from customers commencing in April 2003. The ESM is subject to Kentucky Commission approval.

See also Note 3 of KU's Notes to Financial Statements under Item 8.

## **NEW ACCOUNTING PRONOUNCEMENTS**

The following accounting pronouncements were issued that affected KU in 2002:

SFAS No. 143, *Accounting for Asset Retirement Obligations* was issued in 2001. SFAS No. 143 establishes accounting and reporting standards for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs.

The effective implementation date for SFAS No. 143 is January 1, 2003. Management has calculated the impact of SFAS No. 143 and the recently released FERC NOPR No. RM02-7, *Accounting, Financial Reporting, and Rate Filing Requirements for Asset Retirement Obligations*. As of January 1, 2003, KU recorded asset retirement obligation (ARO) assets in the amount of \$8.6 million and liabilities in the amount of \$18.5 million. KU also recorded a cumulative effect adjustment in the amount of \$9.9 million to reflect the accumulated depreciation and accretion of ARO assets at the transition date less amounts previously accrued under regulatory depreciation. KU recorded offsetting regulatory assets of \$9.9 million, pursuant to regulatory

## KU (Cont.):

treatment prescribed under SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*. Also pursuant to SFAS No. 71, KU recorded regulatory liabilities in the amount of \$888,000 offsetting removal costs previously accrued under regulatory accounting in excess of amounts allowed under SFAS No. 143.

KU also expects to record ARO accretion expense of approximately \$1.2 million, ARO depreciation expense of approximately \$176,000 and an offsetting regulatory credit in the income statement of approximately \$1.4 million in 2003, pursuant to regulatory treatment prescribed under SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*. The accretion, depreciation and regulatory credit will be annual adjustments. SFAS No. 143 will have no impact on the results of the operation of KU.

KU asset retirement obligations are primarily related to the final retirement of generating units. KU transmission and distribution lines largely operate under perpetual property easement agreements which do not generally require restoration upon removal of the property. Therefore, under SFAS No. 143, no material asset retirement obligations will be recorded for transmission and distribution assets.

KU adopted EITF No. 98-10, *Accounting for Energy Trading and Risk Management Activities*, effective January 1, 1999. This pronouncement required that energy trading contracts be marked to market on the balance sheet, with the gains and losses shown net in the income statement. In October 2002, the Emerging Issues Task Force reached a consensus to rescind EITF 98-10. The effective date for the full rescission is for fiscal periods beginning after December 15, 2002. With the rescission of EITF No. 98-10, energy trading contracts that do not also meet the definition of a derivative under SFAS No. 133 must be accounted for as executory contracts. Contracts previously recorded at fair value under EITF No. 98-10 that are not also derivatives under SFAS No. 133 must be restated to historical cost through a cumulative effect adjustment. KU does not expect the rescission of this standard to have a material impact on financial position or results of operations.

In January 2003, the Financial Accounting Standards Board issued Financial Accounting Standards Board Interpretation No. 46, *Consolidation of Variable Interest Entities*, an Interpretation of ARB No. 51 (FIN 46). FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 is effective immediately for all new variable interest entities created or acquired after January 31, 2003. For variable interest entities created or acquired prior to February 1, 2003, the provisions of FIN 46 must be applied for the first interim or annual period beginning after June 15, 2003. KU does not expect the adoption of this standard to have any impact on the financial position or results of operations.

## LIQUIDITY AND CAPITAL RESOURCES

KU uses net cash generated from its operations and external financing to fund construction of plant and equipment and the payment of dividends. KU believes that such sources of funds will be sufficient to meet the needs of its business in the foreseeable future.

## KU (Cont.):

### Operating Activities

Cash provided by operations was \$175.8 million, \$188.1 million and \$176.3 million in 2002, 2001 and 2000, respectively. The 2002 decrease from 2001 of \$12.3 million was primarily the result of a decrease in accrued taxes and changes in accounts receivable. The 2001 increase resulted from sale of accounts receivable through a securitization program. See Note 1 of KU's Notes to Financial Statements under Item 8 for a discussion of accounts receivable securitization.

### Investing Activities

KU's primary use of funds for investing activities continues to be for capital expenditures. Capital expenditures were \$237.9 million, \$142.4 million and \$100.3 million in 2002, 2001 and 2000, respectively. KU expects its capital expenditures for 2003 and 2004 will total approximately \$550.0 million, which consists primarily of construction costs associated with installation of NOx equipment as described in the section titled "Environmental Matters," purchase of jointly owned CTs with LG&E and on going construction for the distribution system.

Net cash used for investment activities increased \$99.0 million in 2002 compared to 2001 and \$38.6 million in 2001 compared to 2000 primarily due to the level of construction expenditures. NOx expenditures increased \$50.6 million and CT expenditures increased \$27.0 million in 2002.

### Financing Activities

Net cash inflows from financing activities were \$64.2 million in 2002 and outflows of \$46.2 million and \$82.4 million in 2001 and 2000, respectively. In 2002, short-term debt increased \$72.0 million from 2001. In 2001, short-term debt decreased \$13.4 million from 2000 and KU paid \$32.8 million in dividends.

In May 2002, KU issued \$37.93 million variable rate pollution control Series 12, 13, 14 and 15 due February 1, 2032, and exercised its call option on \$37.93 million, 6.25% pollution control Series 1B, 2B, 3B, and 4B due February 1, 2018.

In September 2002, KU issued \$96 million variable rate pollution control Series 16 due October 1, 2032, and exercised its call option on \$96 million, 7.45% pollution control Series 8 due September 15, 2016.

### Future Capital Requirements

Future capital requirements may be affected in varying degrees by factors such as load growth, changes in construction expenditure levels, rate actions by regulatory agencies, new legislation, market entry of competing electric power generators, changes in environmental regulations and other regulatory requirements. KU anticipates funding future capital requirements through operating cash flow, debt, and/or infusion of capital from its parent.

## KU (Cont.):

KU's debt ratings as of December 31, 2002, were:

	<u>Moody's</u>	<u>S&amp;P</u>	<u>Fitch</u>
First mortgage bonds	A1	A	A+
Preferred stock	Baa1	BBB	A-
Commercial paper	P-1	A-2	F-1

These ratings reflect the views of Moody's, S&P and Fitch. 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.

## Contractual Obligations

The following is provided to summarize KU's contractual cash obligations for periods after December 31, 2002 (in thousands of \$):

<u>Contractual cash Obligations</u>	<u>Payments Due by Period</u>				<u>Total</u>
	<u>2003</u>	<u>2004-2005</u>	<u>2006-2007</u>	<u>After 2007</u>	
Short-term debt (a)	\$119,490	\$ -	\$ -	\$ -	\$119,490
Long-term debt (b)	153,930	-	89,000	257,562	500,492
Unconditional purchase obligations (c)	34,317	79,306	79,878	643,946	837,447
Other long-term obligations (d)	<u>128,199</u>	<u>201,249</u>	-	-	<u>329,448</u>
Total contractual cash obligations (e)	<u>\$435,936</u>	<u>\$280,555</u>	<u>\$168,878</u>	<u>\$901,508</u>	<u>\$1,786,877</u>

- (a) Represents borrowings from parent company due within one year.
- (b) Includes long-term debt of \$91.9 million is classified as a current liability because 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. Maturity dates for the bonds range from 2024 to 2032.
- (c) Represents future minimum payments under purchased power agreements through 2020.
- (d) Represents construction commitments.
- (e) KU does not expect to pay the \$91.9 million of long-term debt classified as a current liability in the consolidated balance sheets in 2003 as explained in (b) above. KU anticipates cash from operations and external financing will be sufficient to fund future obligations. KU anticipates refinancing a portion of its short-term debt with long-term debt in 2003.

## Market Risks

KU is exposed to market risks from changes in interest rates and commodity prices. To mitigate changes in cash flows attributable to these exposures, KU uses various financial instruments including derivatives. Derivative positions are monitored using techniques that include market value and sensitivity analysis. See Notes 1 and 4 of KU's Notes to Financial Statements under Item 8.

## KU (Cont.):

### Interest Rate Sensitivity

KU has short-term and long-term variable rate debt obligations outstanding. At December 31, 2002, the potential change in interest expense associated with a 1% change in base interest rates of KU's variable rate debt is estimated at \$5.2 million after impact of interest rate swaps.

Interest rate swaps are used to hedge KU's underlying debt obligations. These swaps hedge specific debt issuances and, consistent with management's designation, are accorded hedge accounting treatment.

As of December 31, 2002, KU has swaps with a combined notional value of \$153 million. The swaps exchange fixed-rate interest payments for floating rate interest payments on KU's Series P, R, and PCS-9 Bonds. The potential loss in fair value resulting from a hypothetical 1% adverse movement in base interest rates is estimated at \$6.9 million as of December 31, 2002. This estimate is derived from third party valuations. Changes in the market value of these swaps if held to maturity, as KU intends to do, will have no effect on KU's net income or cash flow. See Note 4 of KU's Notes to Financial Statements under Item 8.

### Commodity Price Sensitivity

KU has limited exposure to market price volatility in prices of fuel and electricity, since its retail tariffs include the FAC commodity price pass-through mechanism. KU is exposed to market price volatility of fuel and electricity in its wholesale activities.

### Energy Trading & Risk Management Activities

KU conducts energy trading and risk management activities to maximize the value of power sales from physical assets it owns, in addition to the wholesale sale of excess asset capacity. Certain energy trading activities are accounted for on a mark-to-market basis in accordance with EITF 98-10, *Accounting for Contracts Involved in Energy Trading and Risk Management Activities*, SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities*. Wholesale sales of excess asset capacity and wholesale purchases are treated as normal sales and purchases under SFAS No. 133 and SFAS No. 138 and are not marked-to-market.

The rescission of EITF 98-10, effective for fiscal years ending after December 15, 2002, will have no impact on KU's energy trading and risk management reporting as all contracts marked to market under EITF 93-10 are also within the scope of SFAS No. 133.

The table below summarizes KU's energy trading and risk management activities for 2002 and 2001 (in thousands of \$).

	<u>2002</u>	<u>2001</u>
Fair value of contracts at beginning of period, net liability	\$ (186)	\$ (17)
Fair value of contracts when entered into during the period	(65)	3,441
Contracts realized or otherwise settled during the period	448	(2,894)
Changes in fair values due to changes in assumptions	<u>(353)</u>	<u>(716)</u>
Fair value of contracts at end of period, net liability	<u>\$ (156)</u>	<u>\$ (186)</u>

## KU (Cont.):

No changes to valuation techniques for energy trading and risk management activities occurred during 2002. Changes in market pricing, interest rate and volatility assumptions were made during both years. All contracts outstanding at December 31, 2002 have a maturity of less than one year and are valued using prices actively quoted for proposed or executed transactions or quoted by brokers.

KU maintains policies intended to minimize credit risk and revalues credit exposures daily to monitor compliance with those policies. At December 31, 2002, 86% of the trading and risk management commitments were with counterparties rated BBB- equivalent or better.

### Accounts Receivable Securitization

On February 6, 2001, KU implemented an accounts receivable securitization program. The purpose of this program is to enable KU to accelerate the receipt of cash from the collection of retail accounts receivable, thereby reducing dependence upon more costly sources of working capital. The securitization program allows for a percentage of eligible receivables to be sold. Eligible receivables are generally all receivables associated with retail sales that have standard terms and are not past due. KU is able to terminate this program at any time without penalty. If there is a significant deterioration in the payment record of the receivables by the retail customers or if KU fails to meet certain covenants regarding the program, the program may terminate at the election of the financial institutions. In this case, payments from retail customers would first be used to repay the financial institutions participating in the program, and would then be available for use by KU.

As part of the program, KU sold retail accounts receivables to a wholly owned subsidiary KU R. Simultaneously, KU R entered into two separate three-year accounts receivable securitization facilities with two financial institutions and their affiliates whereby KU R can sell, on a revolving basis, an undivided interest in certain of their receivables and receive up to \$50 million from an unrelated third party purchaser. The effective cost of the receivables programs is comparable to KU's lowest cost source of capital, and is based on prime rated commercial paper. KU retains servicing rights of the sold receivables through two separate servicing agreements with the third party purchaser. KU has obtained an opinion from independent legal counsel indicating these transactions qualify as a true sale of receivables. As of December 31, 2002, the outstanding program balance was \$49.3 million. KU is considering unwinding the accounts receivable securitization arrangements involving KU R during 2003.

The allowance for doubtful accounts associated with the eligible securitized receivables was \$520,000 at December 31, 2002. This allowance is based on historical experience of KU. Each securitization facility contains a fully funded reserve for uncollectible receivables.

### RATES AND REGULATION

Following the purchase of Powergen by E.ON, E.ON became a registered holding company under PUHCA. As a result, E.ON, its utility subsidiaries, including KU, and certain of its non-utility subsidiaries are subject to extensive regulation by the SEC under PUHCA with respect to issuances and sales of securities, acquisitions and sales of certain utility properties, and intra-system sales of certain goods and services. In addition, PUHCA generally limits the ability of registered holding companies to acquire additional public utility systems and to

## KU (Cont.):

acquire and retain businesses unrelated to the utility operations of the holding company. KU believes that it has adequate authority (including financing authority) under existing SEC orders and regulations to conduct its business. KU will seek additional authorization when necessary.

KU is subject to the jurisdiction of the Kentucky Commission, the Virginia Commission and FERC in virtually all matters related to electric utility regulation, and as such, its accounting is subject to SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*. Given KU's competitive position in the market and the status of regulation in the states of Kentucky and Virginia, KU has no plans or intentions to discontinue its application of SFAS No. 71. See Note 3 of KU's Notes to Financial Statements under Item 8.

### Kentucky Commission Settlement Order - VDT Costs, ESM and Depreciation

During the first quarter 2001, KU recorded a \$64 million charge for a workforce reduction program. Primary components of the charge were separation benefits, enhanced early retirement benefits, and health care benefits. The result of this workforce reduction was the elimination of approximately 300 positions, accomplished primarily through a voluntary enhanced severance program.

On June 1, 2001, KU filed an application (VDT case) with the Kentucky Commission to create a regulatory asset relating to these first quarter 2001 charges. The application requested permission to amortize these costs over a four-year period. The Kentucky Commission also opened a case to review the new depreciation study and resulting depreciation rates implemented in 2001.

KU reached a settlement in the VDT case as well as the other cases involving depreciation rates and ESM with all intervening parties. The settlement agreement was approved by the Kentucky Commission on December 3, 2001. The order allowed KU to set up a regulatory asset of \$54 million for the workforce reduction costs and begin amortizing these costs over a five year period starting in April 2001. The first quarter 2001 charge of \$64 million represented all employees who had accepted a voluntary enhanced severance program. Some employees rescinded their participation in the voluntary enhanced severance program and, along with the non-recurring charge of \$6.9 million for FERC and Virginia jurisdictions, thereby decreasing the original charge of the regulatory asset from \$64 million to \$54 million. The settlement will also reduce revenues approximately \$11 million through a surcredit on future bills to customers over the same five year period. The surcredit represents stipulated net savings KU is expected to realize from implementation of best practices through the VDT. The agreement also established KU's new depreciation rates in effect December 2001, retroactive to January 1, 2001. The new depreciation rates decreased depreciation expense by \$6.0 million in 2001.

### Environmental Cost Recovery

In June 2000, the Kentucky Commission approved KU's application for a CCN to construct up to four SCR NOx reduction facilities. The construction and subsequent operation of the SCRs is intended to reduce NOx emission levels to meet the EPA's mandated NOx emission level of 0.15 lbs./ Mmbtu by May 2004. In its order, the Kentucky Commission ruled that KU's proposed plan for construction was "reasonable, cost-effective and will not result in the wasteful duplication of facilities". In October 2000, KU filed an application with the Kentucky Commission to amend its Environmental Compliance Plan to reflect the addition of the proposed NOx reduction technology projects and to amend its Environmental Cost Recovery Tariff to include an overall

## KU (Cont.):

rate of return on capital investments. Approval of KU's application in April 2001, allowed KU to begin to recover the costs associated with these new projects, subject to Kentucky Commission oversight during normal six-month and two-year reviews.

In August 2002, KU filed an application with the Kentucky Commission to amend its compliance plan to allow recovery of the cost of a new and additional environmental compliance facility. The estimated capital cost of the additional facilities is \$17.3 million. The Kentucky Commission conducted a public hearing on the case on December 20, 2002, final briefs were filed on January 15, 2003, and a final order was issued February 11, 2003. The final order approved recovery of the new environmental compliance facility totaling \$17.3 million. Cost recovery through the environmental surcharge of the approved project will begin with bills rendered in April 2003.

## ESM

KU's electric rates are subject to an ESM. The ESM, initially in place for three years beginning in 2000, sets an upper and lower point for rate of return on equity, whereby if KU's rate of return for the calendar year falls within the range of 10.5% to 12.5%, no action is necessary. If earnings are above the upper limit, the excess earnings are shared 40% with ratepayers and 60% with shareholders; if earnings are below the lower limit, the earnings deficiency is recovered 40% from ratepayers and 60% from shareholders. By order of the Kentucky Commission, rate changes prompted by the ESM filing go into effect in April of each year subject to a balancing adjustment in successive periods. KU made its second ESM filing on March 1, 2002 for the calendar year 2001 reporting period. KU is in the process of refunding \$1 million to customers for the 2001 reporting period. KU estimated that the rate of return will fall below the lower limit, subject to Kentucky Commission approval, for the year ended December 31, 2002. The 2002 financial statements include an accrual to reflect the earnings deficiency of \$13.5 million to be recovered from customers commencing in April 2003.

On November 27, 2002, KU filed a revised ESM tariff which proposed continuance of the existing ESM through December 2005. The Kentucky Commission issued an Order suspending the ESM tariff one day making the effective date January 2, 2003. In addition, the Kentucky Commission is conducting a management audit to review the ESM plan and reassess its reasonableness in 2003. KU and interested parties will have the opportunity to provide recommendations for modification and continuance of the ESM or other forms of alternative or incentive regulation.

## DSM

In May 2001, the Kentucky Commission approved a plan that would expand LG&E's current DSM programs into the service territory served by KU. The filing included a rate mechanism that provided for concurrent recovery of DSM costs, provided an incentive for implementing DSM programs, and recovered revenues from lost sales associated with the DSM program based on program planning engineering estimates and post-implementation evaluations.

## FAC

KU employs an FAC mechanism, which allows KU to recover from customers the actual fuel costs associated with retail electric sales. In July 1999, the Kentucky Commission issued a series of orders requiring KU to

### KU (Cont.):

refund approximately \$10.1 million resulting from reviews of the FAC from November 1994 to October 1998. In August 1999, after a rehearing request by KU, the Kentucky Commission issued a final order that reduced the refund obligation to \$ 6.7 million (\$5.8 million on Kentucky jurisdictional basis) from the original order amount of \$10.1 million. KU implemented the refund from October 1999 through September 2000. Both KU and the KIUC appealed the order. Pending a decision on this appeal, a comprehensive settlement was reached by all parties and approved by the Kentucky Commission on May 17, 2002. Thereunder, KU agreed to credit its fuel clause in the amount of \$954,000 (refund made in June and July 2002), and the parties agreed on a prospective interpretation of the state's fuel adjustment clause regulation to ensure consistent and mutually acceptable application on a going-forward basis.

In December 2002, the Kentucky Commission initiated a two year review of the operation of KU's fuel adjustment clause for the period November 2000 through October 2002. Testimony in the review case was filed on January 20, 2003 and a public hearing was held February 18, 2003. Issues addressed at that time included the establishment of the current base fuel factor to be included in KU's base rates, verification of proper treatment of purchased power costs during unit outages, and compliance with fuel procurement policies and practices.

In January 2003, the Kentucky Commission reviewed the FAC of KU for the six month period ended October 31, 2001. The Kentucky Commission ordered KU to reduce its fuel costs for purposes of calculating its FAC by \$673,000. At issue was the purchase of approximately 102,000 tons of coal from Western Kentucky Energy Corporation, a non-regulated affiliate, for use at KU's Ghent Facility. The Kentucky Commission further ordered that an independent audit be conducted to examine operational and management aspects of KU's fuel procurement functions.

### Kentucky Commission Administrative Case for Affiliate Transactions

In December 1997, the Kentucky Commission opened Administrative Case No. 369 to consider Kentucky Commission policy regarding cost allocations, affiliate transactions and codes of conduct governing the relationship between utilities and their non-utility operations and affiliates. The Kentucky Commission intended to address two major areas in the proceedings: the tools and conditions needed to prevent cost shifting and cross-subsidization between regulated and non-utility operations; and whether a code of conduct should be established to assure that non-utility segments of the holding company are not engaged in practices that could result in unfair competition caused by cost shifting from the non-utility affiliate to the utility. During the period September 1998 to February 2000, the Kentucky Commission issued draft codes of conduct and cost allocation guidelines. In early 2000, the Kentucky General Assembly enacted legislation, House Bill 897, which authorized the Kentucky Commission to require utilities that provide nonregulated activities to keep separate accounts and allocate costs in accordance with procedures established by the Kentucky Commission. In the same bill, the General Assembly set forth provisions to govern a utility's activities related to the sharing of information, databases, and resources between its employees or an affiliate involved in the marketing or the provision of nonregulated activities and its employees or an affiliate involved in the provision of regulated services. The legislation became law in July 2000 and KU has been operating pursuant thereto since that time. On February 14, 2001, the Kentucky Commission published notice of their intent to promulgate new administrative regulation under the auspices of the new law. This effort is still on going.

## KU (Cont.):

### Kentucky Commission Administrative Case for System Adequacy

On June 19, 2001, Kentucky Governor Paul E. Patton issued Executive Order 2001-771, which directed the Kentucky Commission to review and study issues relating to the need for and development of new electric generating capacity in Kentucky. The issues to be considered included the impact of new power plants on the electric supply grid, facility siting issues, and economic development matters, with the goal of ensuring a continued, reliable source of supply of electricity for the citizens of Kentucky and the continued environmental and economic vitality of Kentucky and its communities. In response to that Executive Order, in July 2001 the Kentucky Commission opened Administrative Case No. 387 to review the adequacy of Kentucky's generation capacity and transmission system. Specifically, the items reviewed were the appropriate level of reliance on purchased power, the appropriate reserve margins to meet existing and future electric demand, the impact of spikes in natural gas prices on electric utility planning strategies, and the adequacy of Kentucky's electric transmission facilities. KU, as a party to this proceeding, filed written testimony and responded to two requests for information. Public hearings were held and in October 2001, KU filed a final brief in the case. In December 2001, the Kentucky Commission issued an order in which it noted that KU is responsibly addressing the long-term supply needs of native load customers and that current reserve margins are appropriate. However, due to the rapid pace of change in the industry, the order also requires KU to provide an annual assessment of supply resources, future demand, reserve margin, and the need for new resources.

Regarding the transmission system, the Kentucky Commission concluded that the transmission system within Kentucky can reliably serve native load and a significant portion of the proposed new unregulated power plants. However, it will not be able to handle the volume of transactions envisioned by FERC without future upgrades the costs of which should be borne by those for whom the upgrades are required.

The Kentucky Commission pledged to continue to monitor all relevant issues and advocate Kentucky's interests at all opportunities.

### FERC SMD NOPR

On July 31, 2002, the FERC issued a NOPR in Docket No. RM01-12-000 which would substantially alter the regulations governing the nation's wholesale electricity markets by establishing a common set of rules -- SMD. The SMD NOPR would require each public utility that owns, operates, or controls interstate transmission facilities to become an Independent Transmission Provider (ITP), belong to an RTO that is an ITP, or contract with an ITP for operation of its transmission assets. It would also establish a standardized congestion management system, real-time and day-ahead energy markets, and a single transmission service for network and point-to-point transmission customers. Review of the proposed rulemaking is underway and a final rule is expected during 2003. While it is expected that the SMD final rule will affect KU revenues and expenses, the specific impact of the rulemaking is not known at this time.

### MISO

KU is a member of the MISO, which began commercial operations on February 1, 2002. MISO now has operational control over KU's high-voltage transmission facilities (100 kV and greater), while KU continues to

## KU (Cont.):

control and operate the lower voltage transmission subject to the terms and conditions of the MISO OATT. As a transmission-owning member of MISO, KU also incurs administrative costs of MISO pursuant to Schedule 10 of the MISO OATT.

MISO also proposed to implement a congestion management system. FERC directed the MISO to coordinate its efforts with FERC's Rulemaking on SMD. On September 24, 2002, the MISO filed new rate schedules designated as Schedules 16 and 17, which provide for the collection of costs incurred by the MISO to establish day-ahead and real-time energy markets. The MISO proposed to recover these costs under Schedules 16 and 17 once service commences. If approved by FERC, these schedules will cause KU to incur additional costs. KU opposes the establishment of Schedules 16 and 17. This effort is still on-going and the ultimate impact of the two schedules, if approved, is not known at this time.

### Merger Surcredit

As part of the LG&E Energy merger with KU Energy in 1998, LG&E Energy estimated non-fuel savings over a ten-year period following the merger. Costs to achieve these savings for KU of \$42.3 million were recorded in the second quarter of 1998, \$20.5 million of which was deferred and amortized over a five-year period pursuant to regulatory orders. Primary components of the merger costs were separation benefits, relocation costs, and transaction fees, the majority of which were paid by December 31, 1998. KU expensed the remaining costs associated with the merger (\$21.8 million) in the second quarter of 1998.

In approving the merger, the Kentucky Commission adopted KU's proposal to reduce its retail customers' bills based on one-half of the estimated merger-related savings, net of deferred and amortized amounts, over a five-year period. The surcredit mechanism provides that 50% of the net non-fuel cost savings estimated to be achieved from the merger be provided to ratepayers through a monthly bill credit, and 50% be retained by the Companies, over a five-year period. The surcredit was allocated 53% to KU and 47% to LG&E. In that same order, the Commission required LG&E and KU, after the end of the five-year period, to present a plan for sharing with customers the then-projected non-fuel savings associated with the merger. The Companies submitted this filing on January 13, 2003, proposing to continue to share with customers, on a 50%/50% basis, the estimated fifth-year gross level of non-fuel savings associated with the merger. The filing is currently under review.

Any fuel cost savings are passed to Kentucky customers through the fuel adjustment clause. See FAC above.

### Environmental Matters

The Clean Air Act imposed stringent new SO<sub>2</sub> and NO<sub>x</sub> emission limits on electric generating units. KU met its Phase I SO<sub>2</sub> requirements primarily through installation of a scrubber on Ghent Unit 1. KU's strategy for Phase II SO<sub>2</sub> reductions, which commenced January 1, 2000, is to use accumulated emissions allowances to delay additional capital expenditures and may also include fuel switching or the installation of additional scrubbers. KU met the NO<sub>x</sub> emission requirements of the Act through installation of low-NO<sub>x</sub> burner systems. KU's compliance plans are subject to many factors including developments in the emission allowance and fuel markets, future regulatory and legislative initiatives, and advances in clean air control technology. KU will continue to monitor these developments to ensure that its environmental obligations are met in the most efficient and cost-effective manner.

KU (Cont.):

In September 1998, the EPA announced its final "NOx SIP Call" rule requiring states to impose significant additional reductions in NOx emissions by May 2003, in order to mitigate alleged ozone transport impacts on the Northeast region. The Commonwealth of Kentucky is currently in the process of revising its SIP to require reductions in NOx emissions from coal-fired generating units to the 0.15 lb./Mmbtu level on a system-wide basis. In related proceedings in response to petitions filed by various Northeast states, in December 1999, EPA issued a final rule pursuant to Section 126 of the Clean Air Act directing similar NOx reductions from a number of specifically targeted generating units including all KU units in the eastern half of Kentucky. Additional petitions currently pending before EPA may potentially result in rules encompassing KU's remaining generating units. As a result of appeals to both rules, the compliance date was extended to May 2004. All KU generating units are subject to the May 2004 compliance date under these NOx emissions reduction rules.

KU is currently implementing a plan for adding significant additional NOx controls to its generating units. Installation of additional NOx controls will proceed on a phased basis, with installation of controls commencing in late 2000 and continuing through the final compliance date. KU estimates that it will incur total capital costs of approximately \$232 million to reduce its NOx emissions to the 0.15 lb./Mmbtu level on a company-wide basis. In addition, KU will incur additional operating and maintenance costs in operating new NOx controls. KU believes its costs in this regard to be comparable to those of similarly situated utilities with like generation assets. KU had anticipated that such capital and operating costs are the type of costs that are eligible for recovery from customers under its environmental surcharge mechanism and believed that a significant portion of such costs could be recovered. In April 2001, the Kentucky Commission granted recovery of these costs for KU.

KU is also monitoring several other air quality issues which may potentially impact coal-fired power plants, including the appeal of the D.C. Circuit's remand of the EPA's revised air quality standards for ozone and particulate matter, measures to implement EPA's regional haze rule, and EPA's December 2000 determination to regulate mercury emissions from power plants.

KU owns or formerly owned several properties that contained past MGP operations. Various contaminants are typically found at such former MGP sites and environmental remediation measures are frequently required. KU has completed the cleanup of a site owned by KU. With respect to other former MGP sites no longer owned by KU, KU is unaware of what, if any, additional exposure or liability it may have.

In October 1999, approximately 38,000 gallons of diesel fuel leaked from a cracked valve in an underground pipeline at KU's E.W. Brown Station. Under the oversight of EPA and state officials, KU commenced immediate spill containment and recovery measures which prevented the spill from reaching the Kentucky River. KU ultimately recovered approximately 34,000 gallons of diesel fuel. In November 1999, the Kentucky Division of Water issued a notice of violation for the incident. KU is currently negotiating with the state in an effort to reach a complete resolution of this matter. KU incurred costs of approximately \$1.8 million and received insurance reimbursement of \$1.2 million. In December 2002, the Department of Justice (DOJ) sent correspondence to KU regarding a potential per-day fine for failure to timely submit a spill control plan and a per-gallon fine for the amount of oil discharged. KU and the DOJ have commenced settlement discussions using existing DOJ settlement guidelines on this matter.

## KU (Cont.):

In April 2002, the EPA sent correspondence to KU regarding potential exposure in connection with \$1.5 million in completed remediation costs associated with a transformer scrap-yard. KU believes it is one of the more remote among a number of potentially responsible parties and has entered into settlement discussions with the EPA on this matter.

See Note 11 of KU's Notes to Financial Statements under Item 8 for an additional discussion of environmental issues.

### Deferred Income Taxes

KU expects to have adequate levels of taxable income to realize its recorded deferred tax assets. At December 31, 2002, deferred tax assets totaled \$61 million and were principally related to expenses attributable to KU's pension plans and post retirement benefit obligations.

## FUTURE OUTLOOK

### Competition and Customer Choice

KU has moved aggressively over the past decade to be positioned for the energy industry's shift to customer choice and a competitive market for energy services. Specifically, KU has taken many steps to prepare for the expected increase in competition in its business, including support for PBR structures, aggressive cost reduction activities; strategic acquisitions, dispositions and growth initiatives; write-offs of previously deferred expenses; an increase in focus on commercial and industrial customers; an increase in employee training; and necessary corporate and business unit realignments.

In December 1997, the Kentucky Commission issued a set of principles which was intended to serve as its guide in consideration of issues relating to industry restructuring. Among the issues addressed by these principles are: consumer protection and benefit, system reliability, universal service, environmental responsibility, cost allocation, stranded costs and codes of conduct. During 1998, the Kentucky Commission and a task force of the Kentucky General Assembly each initiated proceedings, including meetings with representatives of utilities, consumers, state agencies and other groups in Kentucky, to discuss the possible structure and effects of energy industry restructuring in Kentucky.

In November 1999, the task force issued a report to the Governor of Kentucky and a legislative agency recommending no general electric industry restructuring actions during the 2000 legislative session. No general industry restructuring actions have been taken to date by the legislature.

Thus, at the time of this report, 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.

While many states have moved forward in providing retail choice, many others have not. Some are reconsidering their initiatives and have even delayed implementation.

KU (Cont.):

Virginia has enacted a phase-in of customer choice through the Virginia Electric Restructuring Act. The Virginia Commission is promulgating regulations to govern the various activities required by the Act. KU filed unbundled rates that became effective January 1, 2002. KU was granted a waiver from the Virginia Commission on October 29, 2002, exempting KU from retail choice through December 31, 2004. KU is also seeking a permanent legislative exemption to the Virginia Electric Restructuring Act. The outcome of such legislative initiatives will not be known until mid-2003.

ITEM 7A. Quantitative and Qualitative Disclosure About Market Risk.

See LG&E's and KU's Management's Discussion and Analysis of Results of Operations and Financial Condition, Market Risks, under Item 7.

## ITEM 8. Financial Statements and Supplementary Data.

### INDEX OF ABBREVIATIONS

Capital Corp.	LG&E Capital Corp.
Clean Air Act	The Clean Air Act, as amended in 1990
CCN	Certificate of Public Convenience and Necessity
CT	Combustion Turbines
DSM	Demand Side Management
ECR	Environmental Cost Recovery
EEl	Electric Energy, Inc.
EITF	Emerging Issues Task Force Issue
E.ON	E.ON AG
EPA	U.S. Environmental Protection Agency
ESM	Earnings Sharing Mechanism
F	Fahrenheit
FAC	Fuel Adjustment Clause
FERC	Federal Energy Regulatory Commission
FPA	Federal Power Act
FT and FT-A	Firm Transportation
GSC	Gas Supply Clause
IBEW	International Brotherhood of Electrical Workers
IMEA	Illinois Municipal Electric Agency
IMPA	Indiana Municipal Power Agency
Kentucky Commission	Kentucky Public Service Commission
KIUC	Kentucky Industrial Utility Consumers, Inc.
KU	Kentucky Utilities Company
KU Energy	KU Energy Corporation
KU R	KU Receivables LLC
kV	Kilovolts
Kva	Kilovolt-ampere
KW	Kilowatts
Kwh	Kilowatt hours
LEM	LG&E Energy Marketing Inc.
LG&E	Louisville Gas and Electric Company
LG&E Energy	LG&E Energy Corp.
LG&E R	LG&E Receivables LLC
LG&E Services	LG&E Energy Services Inc.
Mcf	Thousand Cubic Feet
MGP	Manufactured Gas Plant
MISO	Midwest Independent System Operator
Mmbtu	Million British thermal units
Moody's	Moody's Investor Services, Inc.
Mw	Megawatts
Mwh	Megawatt hours
NNS	No-Notice Service
NOPR	Notice of Proposed Rulemaking
NOx	Nitrogen Oxide
OATT	Open Access Transmission Tariff
OMU	Owensboro Municipal Utilities
OVEC	Ohio Valley Electric Corporation
PBR	Performance-Based Ratemaking
PJM	Pennsylvania, New Jersey, Maryland Interconnection
Powergen	Powergen Limited (formerly Powergen plc)

PJM	Pennsylvania, New Jersey, Maryland Interconnection
Powergen	Powergen Limited (formerly Powergen plc)
PUHCA	Public Utility Holding Company Act of 1935
ROE	Return on Equity
RTO	Regional Transmission Organization
S&P	Standard & Poor's Rating Services
SCR	Selective Catalytic Reduction
SEC	Securities and Exchange Commission
SERP	Supplemental Employee Retirement Plan
SFAS	Statement of Financial Accounting Standards
SIP	State Implementation Plan
SMD	Standard Market Design
SO <sub>2</sub>	Sulfur Dioxide
Tennessee Gas	Tennessee Gas Pipeline Company
Texas Gas	Texas Gas Transmission Corporation
TRA	Tennessee Regulatory Authority
Trimble County	LG&E's Trimble County Unit 1
USWA	United Steelworkers of America
Utility Operations	Operations of LG&E and KU
VDT	Value Delivery Team Process
Virginia Commission	Virginia State Corporation Commission
Virginia Staff	Virginia State Corporation Commission Staff

Louisville Gas and Electric Company and Subsidiary  
Consolidated Statements of Income  
(Thousands of \$)

	Years Ended December 31		
	<u>2002</u>	<u>2001</u>	<u>2000</u>
<b>OPERATING REVENUES:</b>			
Electric .....	\$ 746,224	\$ 706,645	\$ 713,458
Gas.....	267,693	290,775	272,489
Provision for rate collections (refunds) (Note 3) .....	12,267	(720)	(2,500)
<b>Total operating revenues (Note 1) .....</b>	<b><u>1,026,184</u></b>	<b><u>996,700</u></b>	<b><u>983,447</u></b>
<b>OPERATING EXPENSES:</b>			
Fuel for electric generation.....	194,900	159,231	159,418
Power purchased.....	84,330	81,475	96,894
Gas supply expenses.....	182,108	206,165	196,912
Other operation expenses .....	208,322	167,818	135,943
Maintenance .....	60,210	58,687	63,709
Depreciation and amortization (Note 1) .....	105,906	100,356	98,291
Federal and state income taxes (Note 7).....	55,035	63,452	64,425
Property and other taxes .....	17,459	17,743	18,985
<b>Total operating expenses .....</b>	<b><u>908,270</u></b>	<b><u>854,927</u></b>	<b><u>834,577</u></b>
Net operating income .....	117,914	141,773	148,870
Other income - net (Note 8) .....	820	2,930	4,921
Interest charges.....	<u>29,805</u>	<u>37,922</u>	<u>43,218</u>
Net income .....	88,929	106,781	110,573
Preferred stock dividends .....	<u>4,246</u>	<u>4,739</u>	<u>5,210</u>
Net income available for common stock.....	<b><u>\$ 84,683</u></b>	<b><u>\$ 102,042</u></b>	<b><u>\$ 105,363</u></b>

Consolidated Statements of Retained Earnings  
(Thousands of \$)

	Years Ended December 31		
	<u>2002</u>	<u>2001</u>	<u>2000</u>
Balance January 1.....	\$393,636	\$314,594	\$259,231
Add net income .....	<u>88,929</u>	<u>106,781</u>	<u>110,573</u>
	<u>482,565</u>	<u>421,375</u>	<u>369,804</u>
Deduct: Cash dividends declared on stock:			
5% cumulative preferred.....	1,075	1,075	1,075
Auction rate cumulative preferred .....	1,702	2,195	2,666
\$5.875 cumulative preferred .....	1,469	1,469	1,469
Common .....	<u>69,000</u>	<u>23,000</u>	<u>50,000</u>
	<u>73,246</u>	<u>27,739</u>	<u>55,210</u>
Balance December 31.....	<b><u>\$409,319</u></b>	<b><u>\$393,636</u></b>	<b><u>\$314,594</u></b>

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

Louisville Gas and Electric Company and Subsidiary  
 Consolidated Statements of Comprehensive Income  
 (Thousands of \$)

	Years Ended December 31		
	<u>2002</u>	<u>2001</u>	<u>2000</u>
Net income .....	\$88,929	\$106,781	\$110,573
Cumulative effect of change in accounting principle – Accounting for derivative instruments and hedging activities.....	-	(5,998)	-
Losses on derivative instruments and hedging activities (Note 1).....	(8,511)	(2,606)	-
Additional minimum pension liability adjustment (Note 6).....	(25,999)	(24,712)	-
Income tax benefit related to items of other comprehensive income .....	<u>13,898</u>	<u>13,416</u>	<u>-</u>
Other comprehensive loss, net of tax .....	<u>(20,612)</u>	<u>(19,900)</u>	<u>-</u>
Comprehensive income .....	<u>\$68,317</u>	<u>\$86,881</u>	<u>\$110,573</u>

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

Louisville Gas and Electric Company and Subsidiary  
Consolidated Balance Sheets  
(Thousands of \$)

	2002	December 31 2001
<b>ASSETS:</b>		
Utility plant, at original cost (Note 1):		
Electric .....	\$2,717,187	\$2,598,152
Gas .....	435,235	409,994
Common .....	<u>169,577</u>	<u>159,817</u>
	3,321,999	3,167,963
Less: reserve for depreciation .....	<u>1,463,674</u>	<u>1,381,874</u>
	1,858,325	1,786,089
Construction work in progress .....	<u>300,986</u>	<u>255,074</u>
	<u>2,159,311</u>	<u>2,041,163</u>
Other property and investments – less reserve of \$63 in 2002 and 2001 .....	<u>764</u>	<u>1,176</u>
<b>Current assets:</b>		
Cash .....	17,015	2,112
Accounts receivable - less reserve of \$2,125 in 2002 and \$1,575 in 2001 .....	68,440	85,667
Materials and supplies - at average cost:		
Fuel (predominantly coal) (Note 1) .....	36,600	22,024
Gas stored underground (Note 1) .....	50,266	46,395
Other .....	25,651	29,050
Prepayments and other .....	<u>5,298</u>	<u>4,688</u>
	<u>203,270</u>	<u>189,936</u>
<b>Deferred debits and other assets:</b>		
Unamortized debt expense (Note 1) .....	6,532	5,921
Regulatory assets (Note 3) .....	153,446	197,142
Other .....	<u>37,755</u>	<u>13,016</u>
	<u>197,733</u>	<u>216,079</u>
	<u>\$2,561,078</u>	<u>\$2,448,354</u>
<b>CAPITAL AND LIABILITIES:</b>		
<b>Capitalization (see statements of capitalization):</b>		
Common equity .....	\$ 833,141	\$ 838,070
Cumulative preferred stock .....	95,140	95,140
Long-term debt (Note 9) .....	<u>328,104</u>	<u>370,704</u>
	<u>1,256,385</u>	<u>1,303,914</u>
<b>Current liabilities:</b>		
Current portion of long-term debt (Note 9) .....	288,800	246,200
Notes payable (Note 10) .....	193,053	94,197
Accounts payable .....	122,771	149,070
Accrued taxes .....	1,450	20,257
Other .....	<u>19,536</u>	<u>18,658</u>
	<u>625,610</u>	<u>528,382</u>
<b>Deferred credits and other liabilities:</b>		
Accumulated deferred income taxes (Notes 1 and 7) .....	313,225	298,143
Investment tax credit, in process of amortization .....	54,536	58,689
Accumulated provision for pensions and related benefits (Note 6) .....	224,703	167,526
Regulatory liabilities (Note 3) .....	52,424	65,349
Other .....	<u>34,195</u>	<u>26,351</u>
	<u>679,083</u>	<u>616,058</u>
Commitments and contingencies (Note 11)		
	<u>\$2,561,078</u>	<u>\$2,448,354</u>

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

Louisville Gas and Electric Company and Subsidiary  
Consolidated Statements of Cash Flows  
(Thousands of \$)

	Years Ended December 31		
	<u>2002</u>	<u>2001</u>	<u>2000</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net income .....	\$ 88,929	\$ 106,781	\$ 110,573
Items not requiring cash currently:			
Depreciation and amortization.....	105,906	100,356	98,291
Deferred income taxes - net.....	11,915	3,021	31,020
Investment tax credit - net .....	(4,153)	(4,290)	(4,274)
Other.....	37,260	(528)	8,481
Change in certain net current assets:			
Accounts receivable.....	(3,973)	43,185	(56,993)
Materials and supplies .....	(15,048)	(2,018)	(4,311)
Accounts payable.....	(26,299)	14,678	21,384
Accrued taxes .....	(18,807)	12,184	(15,686)
Prepayments and other.....	321	(10,500)	(7,816)
Sale of accounts receivable (Note 1) .....	21,200	42,000	-
Other.....	15,130	(17,806)	(24,431)
Net cash flows from operating activities .....	<u>212,381</u>	<u>287,063</u>	<u>156,238</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Purchases of securities.....	-	-	(708)
Proceeds from sales of securities.....	412	4,237	4,089
Construction expenditures .....	(220,416)	(252,958)	(144,216)
Net cash flows from investing activities .....	<u>(220,004)</u>	<u>(248,721)</u>	<u>(140,835)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Short-term borrowings and repayments.....	98,856	(20,392)	(5,508)
Issuance of pollution control bonds.....	158,635	9,662	106,545
Retirement of first mortgage bonds and pollution control bonds .....	(161,665)	-	(130,627)
Additional paid-in capital .....	-	-	40,000
Payment of dividends .....	(73,300)	(27,995)	(78,079)
Net cash flows from financing activities .....	<u>22,526</u>	<u>(38,725)</u>	<u>(67,669)</u>
Change in cash and temporary cash investments .....	14,903	(383)	(52,266)
Cash and temporary cash investments at beginning of year .....	<u>2,112</u>	<u>2,495</u>	<u>54,761</u>
Cash and temporary cash investments at end of year .....	<u>\$ 17,015</u>	<u>\$ 2,112</u>	<u>\$ 2,495</u>
<b>Supplemental disclosures of cash flow information:</b>			
Cash paid during the year for:			
Income taxes .....	\$51,540	\$ 35,546	\$ 46,562
Interest on borrowed money .....	25,673	30,989	42,958

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

Louisville Gas and Electric Company and Subsidiary  
Consolidated Statements of Capitalization  
(Thousands of \$)

December 31

	<u>2002</u>	<u>2001</u>
<b>COMMON EQUITY:</b>		
Common stock, without par value -		
Authorized 75,000,000 shares, outstanding 21,294,223 shares .....	\$ 425,170	\$ 425,170
Common stock expense .....	(836)	(836)
Additional paid-in capital .....	40,000	40,000
Accumulated other comprehensive income .....	(40,512)	(19,900)
Retained earnings .....	<u>409,319</u>	<u>393,636</u>
	<u>833,141</u>	<u>838,070</u>
<b>CUMULATIVE PREFERRED STOCK:</b>		
Redeemable on 30 days notice by LG&E		
	<u>Shares</u>	<u>Current</u>
	<u>Outstanding</u>	<u>Redemption Price</u>
\$25 par value, 1,720,000 shares authorized -		
5% series .....	860,287	\$28.00
Without par value, 6,750,000 shares authorized -		
Auction rate .....	500,000	100.00
\$5.875 series .....	250,000	101.18
Preferred stock expense .....	<u>(1,367)</u>	<u>(1,367)</u>
	<u>95,140</u>	<u>95,140</u>
<b>LONG-TERM DEBT (Note 9):</b>		
First mortgage bonds -		
Series due August 15, 2003, 6% .....	42,600	42,600
Pollution control series:		
R due November 1, 2020, 6.55 % .....	-	41,665
S due September 1, 2017, variable % .....	31,000	31,000
T due September 1, 2017, variable % .....	60,000	60,000
U due August 15, 2013, variable % .....	35,200	35,200
V due August 15, 2019, 5.625% .....	102,000	102,000
W due October 15, 2020, 5.45% .....	26,000	26,000
X due April 15, 2023, 5.90% .....	40,000	40,000
Y due May 1, 2027, variable % .....	25,000	25,000
Z due August 1, 2030, variable % .....	83,335	83,335
AA due September 1, 2027, variable % .....	10,104	10,104
BB due September 1, 2026, variable % .....	22,500	-
CC due September 1, 2026, variable % .....	27,500	-
DD due November 1, 2027, variable % .....	35,000	-
EE due November 1, 2027, variable % .....	35,000	-
FF due October 1, 2032, variable % .....	<u>41,665</u>	<u>-</u>
Total first mortgage bonds .....	616,904	496,904
Pollution control bonds (unsecured) -		
Series due September 1, 2026, variable % .....	-	22,500
Series due September 1, 2026, variable % .....	-	27,500
Series due November 1, 2027, variable % .....	-	35,000
Series due November 1, 2027, variable % .....	-	<u>35,000</u>
Total unsecured pollution control bonds .....	<u>-</u>	<u>120,000</u>
Total bonds outstanding .....	616,904	616,904
Less current portion of long-term debt .....	<u>288,800</u>	<u>246,200</u>
Long-term debt .....	<u>328,104</u>	<u>370,704</u>
Total capitalization .....	<u>\$1,256,385</u>	<u>\$1,303,914</u>

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

Louisville Gas and Electric Company and Subsidiary  
Notes to Consolidated Financial Statements

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

LG&E, a subsidiary of LG&E Energy and an indirect subsidiary of Powergen and E.ON, is a regulated public utility engaged in the generation, transmission, distribution, and sale of electric energy and the storage, distribution, and sale of natural gas in Louisville and adjacent areas in Kentucky. LG&E Energy is an exempt public utility holding company with wholly owned subsidiaries including LG&E, KU, Capital Corp., LEM, and LG&E Services. All of the LG&E's Common Stock is held by LG&E Energy. LG&E has one wholly owned consolidated subsidiary, LG&E R.

On December 11, 2000, LG&E Energy was acquired by Powergen. On July 1, 2002, E.ON, a German company, completed its acquisition of Powergen plc (now Powergen Limited). E.ON had announced its pre-conditional cash offer of £5.1 billion (\$7.3 billion) for Powergen on April 9, 2001. E.ON and Powergen are registered public utility holding companies under PUHCA. No costs associated with these acquisitions nor any of the effects of purchase accounting have been reflected in the financial statements of LG&E.

Certain reclassification entries have been made to the previous year's financial statements to conform to the 2002 presentation with no impact on the balance sheet totals or previously reported income.

**Utility Plant.** LG&E's 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. LG&E has not recorded any 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, plus removal expense less salvage value, 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. Pursuant to a final order of the Kentucky Commission dated December 3, 2001, LG&E implemented new depreciation rates effective January 1, 2001. The amounts provided were approximately 3.1% in 2002 (2.9% electric, 2.8% gas and 6.6% common); 3.0% for 2001 (2.9% electric, 2.9% gas and 5.7% common); and 3.6% for 2000 (3.3% electric, 3.8% gas and 7.3% common), of average depreciable plant. Of the amount provided for depreciation, at December 31, 2002, 2001 and 2000, respectively, approximately 0.4 % electric, 0.9 % gas and 0.04% common were related to the retirement, removal and disposal costs of long lived assets.

**Fuel Inventory.** Fuel inventories of \$36.6 million and \$22.0 million at December 31, 2002, and 2001, respectively, are included in Fuel in the balance sheet. The inventory is accounted for using the average-cost method.

**Gas Stored Underground.** Gas inventories of \$50.3 million and \$46.4 million at December 31, 2002, and 2001, respectively, are included in gas stored underground in the balance sheet. The inventory is accounted for using the average-cost method.

**Financial Instruments.** LG&E uses over-the-counter interest-rate swap agreements to hedge its exposure to fluctuations in the interest rates it pays on variable-rate debt. Gains and losses on interest-rate swaps used to

hedge interest rate risk are reflected in other comprehensive income. In 2000, LG&E used exchange traded U.S. Treasury note and bond futures to hedge its exposure to fluctuations in the value of its investments in the preferred stocks of other companies. Gains and losses on U.S. Treasury note and bond futures were charged or credited to other income-net. See Note 4 - Financial Instruments.

**Unamortized Debt Expense.** Debt expense is capitalized in deferred debits and amortized over the lives of the related bond issues, consistent with regulatory practices.

**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 basis of assets and liabilities.

**Investment Tax Credits.** Investment tax credits resulted from provisions of the tax law that permitted a reduction of LG&E's tax liability based on credits for certain 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. LG&E accrues an estimate for unbilled revenues from each meter reading date to the end of the accounting period. The unbilled revenue estimates included in accounts receivable were approximately \$40.7 million and \$37.3 million, at December 31, 2002 and 2001, respectively. See Note 3, Rates and Regulatory Matters. LG&E recorded electric revenues that resulted from sales to a related party, KU, of \$46.5 million, \$28.5 million and \$20.9 million for years ended December 31, 2002, 2001 and 2000, respectively.

**Fuel and Gas Costs.** The cost of fuel for electric generation is charged to expense as used, and the cost of gas supply is charged to expense as delivered to the distribution system. LG&E implemented a Kentucky Commission-approved performance-based ratemaking mechanism related to gas procurement and off-system gas sales activity. See Note 3, Rates and Regulatory Matters.

**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. Actual results could differ from those estimates. See Note 11, Commitments and Contingencies, for a further discussion.

**Accounts Receivable Securitization.** SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, revises the standards for accounting for securitizations and other transfers of financial assets and collateral and requires certain disclosures, and provides accounting and reporting standards for transfers and servicing of financial assets and extinguishments of liabilities. SFAS No. 140 was adopted in the first quarter of 2001, when LG&E entered into an accounts receivable securitization transaction.

On February 6, 2001, LG&E implemented an accounts receivable securitization program. The purpose of this program is to enable LG&E to accelerate the receipt of cash from the collection of retail accounts receivable, thereby reducing dependence upon more costly sources of working capital. The securitization program allows for a percentage of eligible receivables to be sold. Eligible receivables are generally all receivables associated with retail sales that have standard terms and are not past due. LG&E is able to terminate this program at any time without penalty. If there is a significant deterioration in the payment record of the receivables by the retail customers or if LG&E fails to meet certain covenants regarding the program, the program may terminate at the

election of the financial institutions. In this case, payments from retail customers would first be used to repay the financial institutions participating in the program, and would then be available for use by LG&E.

As part of the program, LG&E sold retail accounts receivables to a wholly owned subsidiary, LG&E R. Simultaneously, LG&E R entered into two separate three-year accounts receivable securitization facilities with two financial institutions and their affiliates whereby LG&E R can sell, on a revolving basis, an undivided interest in certain of its receivables and receive up to \$75 million from an unrelated third party purchaser. The effective cost of the receivables programs is comparable to LG&E's lowest cost source of capital, and is based on prime rated commercial paper. LG&E retains servicing rights of the sold receivables through two separate servicing agreements with the third party purchaser. LG&E has obtained an opinion from independent legal counsel indicating these transactions qualify as true sale of receivables. As of December 31, 2002, the outstanding program balance was \$63.2 million. LG&E is considering unwinding its accounts receivable securitization arrangements involving LG&E R during 2003.

The allowance for doubtful accounts associated with the eligible securitized receivables was \$2.125 million at December 31, 2002. This allowance is based on historical experience of LG&E. Each securitization facility contains a fully funded reserve for uncollectible receivables.

**New Accounting Pronouncements.** The following accounting pronouncements were issued that affected LG&E in 2002:

SFAS No. 143, *Accounting for Asset Retirement Obligations* was issued in 2001. SFAS No. 143 establishes accounting and reporting standards for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs.

The effective implementation date for SFAS No. 143 is January 1, 2003. Management has calculated the impact of SFAS No. 143 and the recently released FERC NOPR No. RM02-7, *Accounting, Financial Reporting, and Rate Filing Requirements for Asset Retirement Obligations*. As of January 1, 2003, LG&E recorded asset retirement obligation (ARO) assets in the amount of \$4.6 million and liabilities in the amount of \$9.3 million. LG&E also recorded a cumulative effect adjustment in the amount of \$5.3 million to reflect the accumulated depreciation and accretion of ARO assets at the transition date less amounts previously accrued under regulatory depreciation. LG&E recorded offsetting regulatory assets of \$5.3 million, pursuant to regulatory treatment prescribed under SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*. Also pursuant to SFAS No. 71, LG&E recorded regulatory liabilities in the amount of \$60,000 offsetting removal costs previously accrued under regulatory accounting in excess of amounts allowed under SFAS No. 143.

LG&E also expects to record ARO accretion expense of approximately \$617,000, ARO depreciation expense of approximately \$117,000 and an offsetting regulatory credit in the income statement of approximately \$734,000 in 2003, pursuant to regulatory treatment prescribed under SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*. The accretion, depreciation and regulatory credit will be annual adjustments. SFAS No. 143 will have no impact on the results of the operation of LG&E.

LG&E asset retirement obligations are primarily related to the final retirement of generating units. LG&E transmission and distribution lines largely operate under perpetual property easement agreements which do not generally require restoration upon removal of the property. Therefore, under SFAS No. 143, no material asset retirement obligations will be recorded for transmission and distribution assets.

LG&E adopted EITF No. 98-10, *Accounting for Energy Trading and Risk Management Activities*, effective January 1, 1999. This pronouncement required that energy trading contracts be marked to market on the balance sheet, with the gains and losses shown net in the income statement. In October 2002, the Emerging Issues Task Force reached a consensus to rescind EITF 98-10. The effective date for the full rescission is for fiscal periods beginning after December 15, 2002. With the recession of EITF No. 98-10, energy trading contracts that do not also meet the definition of a derivative under SFAS No. 133 must be accounted for as executory contracts. Contracts previously recorded at fair value under EITF No. 98-10 that are not also derivatives under SFAS No. 133 must be restated to historical cost through a cumulative effect adjustment. LG&E does not expect the rescission of this standard to have a material impact on financial position or results of operations.

In January 2003, the Financial Accounting Standards Board issued Financial Accounting Standards Board Interpretation No. 46, *Consolidation of Variable Interest Entities*, an Interpretation of ARB No. 51 (FIN 46). FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 is effective immediately for all new variable interest entities created or acquired after January 31, 2003. For variable interest entities created or acquired prior to February 1, 2003, the provisions of FIN 46 must be applied for the first interim or annual period beginning after June 15, 2003. LG&E does not expect the adoption of this standard to have any impact on the financial position or results of operations.

## **Note 2 – Mergers and Acquisitions**

On July 1, 2002, E.ON completed its acquisition of Powergen, including LG&E Energy, for approximately £5.1 billion (\$7.3 billion). As a result of the acquisition, LG&E Energy became a wholly owned subsidiary (through Powergen) of E.ON and, as a result, LG&E also became an indirect subsidiary of E.ON. LG&E has continued its separate identity and serves customers in Kentucky under its existing name. The preferred stock and debt securities of LG&E were not affected by this transaction and the utilities continue to file SEC reports. Following the acquisition, E.ON became, and Powergen remained, a registered holding company under PUHCA. LG&E, as a subsidiary of a registered holding company, is subject to additional regulations under PUHCA. As contemplated in their regulatory filings in connection with the E.ON acquisition, E.ON, Powergen and LG&E Energy completed an administrative reorganization to move the LG&E Energy group from an indirect Powergen subsidiary to an indirect E.ON subsidiary. This reorganization was effective in March 2003.

LG&E Energy and KU Energy merged on May 4, 1998, with LG&E Energy as the surviving corporation. Management accounted for the merger as a pooling of interests and as a tax-free reorganization under the Internal Revenue Code. Following the acquisition, LG&E has continued to maintain its separate corporate identity and serve customers in Kentucky under its present name.

## **Note 3 - Rates and Regulatory Matters**

Accounting for the regulated utility business conforms with generally accepted accounting principles as applied to regulated public utilities and as prescribed by FERC and the Kentucky Commission. LG&E is subject to SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*, under which certain costs that would otherwise be charged to expense are deferred as regulatory assets based on expected recovery from customers in future rates. Likewise, certain credits that would otherwise be reflected as income are deferred as regulatory liabilities based on expected return to customers in future rates. LG&E's current or expected recovery of

deferred costs and expected return of deferred credits is generally based on specific ratemaking decisions or precedent for each item. The following regulatory assets and liabilities were included in LG&E's balance sheets as of December 31 (in thousands of \$):

	<u>2002</u>	<u>2001</u>
VDT Costs	\$ 98,044	\$127,529
Gas supply adjustments due from customers	13,714	30,135
Unamortized loss on bonds	18,843	17,902
ESM provision	12,500	-
LGE/KU merger costs	1,815	5,444
Manufactured gas sites	1,757	2,062
One utility costs	954	3,643
Other	<u>5,819</u>	<u>10,427</u>
Total regulatory assets	<u>153,446</u>	<u>197,142</u>
Deferred income taxes - net	(45,536)	(48,703)
Gas supply adjustments due to customers	(3,154)	(15,702)
Other	<u>(3,734)</u>	<u>(944)</u>
Total regulatory liabilities	<u>(52,424)</u>	<u>(65,349)</u>
Regulatory assets - net	<u>\$101,022</u>	<u>\$131,793</u>

**Kentucky Commission Settlement - VDT Costs.** During the first quarter 2001, LG&E recorded a \$144 million charge for a workforce reduction program. Primary components of the charge were separation benefits, enhanced early retirement benefits, and health care benefits. The result of this workforce reduction was the elimination of approximately 700 positions, accomplished primarily through a voluntary enhanced severance program.

On June 1, 2001, LG&E filed an application (VDT case) with the Kentucky Commission to create a regulatory asset relating to these first quarter 2001 charges. The application requested permission to amortize these costs over a four-year period. The Kentucky Commission also opened a case to review a new depreciation study and resulting depreciation rates implemented in 2001.

LG&E reached a settlement in the VDT case as well as the other cases involving depreciation rates and ESM with all intervening parties. The settlement agreement was approved by the Kentucky Commission on December 3, 2001. The order allowed LG&E to set up a regulatory asset of \$141 million for the workforce reduction costs and begin amortizing these costs over a five year period starting in April 2001. The first quarter 2001 charge of \$144 million represented all employees who had accepted a voluntary enhanced severance program. Some employees rescinded their participation in the voluntary enhanced severance program, thereby decreasing the original charge from \$144 million to \$141 million. The settlement will also reduce revenues approximately \$26 million through a surcredit on future bills to customers over the same five year period. The surcredit represents net savings stipulated by LG&E. The agreement also established LG&E's new depreciation rates in effect December 2001, retroactive to January 1, 2001. The new depreciation rates decreased depreciation expense by \$5.6 million in 2001.

**PUHCA.** LG&E Energy was purchased by Powergen on December 11, 2000. Effective July 1, 2002, Powergen was acquired by E.ON, which became a registered holding company under PUHCA. As a result, E.ON, its utility subsidiaries, including LG&E, and certain of its non-utility subsidiaries are subject to extensive regulation by the SEC under PUHCA with respect to issuances and sales of securities, acquisitions and sales of certain utility properties, and intra-system sales of certain goods and services. In addition, PUHCA generally

limits the ability of registered holding companies to acquire additional public utility systems and to acquire and retain businesses unrelated to the utility operations of the holding company. LG&E believes that it has adequate authority (including financing authority) under existing SEC orders and regulations to conduct its business. LG&E will seek additional authorization when necessary.

**Environmental Cost Recovery.** In June 2000, the Kentucky Commission approved LG&E's application for a CCN to construct up to three SCR NOx reduction facilities. The construction and subsequent operation of the SCRs is intended to reduce NOx emission levels to meet the EPA's mandated NOx emission level of 0.15 lbs./Mmbtu by May 2004. In its order, the Kentucky Commission ruled that LG&E's proposed plan for construction was "reasonable, cost-effective and will not result in the wasteful duplication of facilities." In October 2000, LG&E filed an application with the Kentucky Commission to amend its Environmental Compliance Plan to reflect the addition of the proposed NOx reduction technology projects and to amend its ECR Tariff to include an overall rate of return on capital investments. Approval of LG&E's application in April 2001 allowed LG&E to begin to recover the costs associated with these new projects, subject to Kentucky Commission oversight during normal six-month and two-year reviews.

In August 2002, LG&E filed an application with the Kentucky Commission to amend its compliance plan to allow recovery of the cost of new and additional environmental compliance facilities. The estimated capital cost of the additional facilities is \$71.1 million. The Kentucky Commission conducted a public hearing on the case on December 20, 2002, final briefs were filed on January 15, 2003, and a final order was issued February 11, 2003. The final order approved recovery of four new environmental compliance facilities totaling \$43.1 million. A fifth project, expansion of the land fill facility at the Mill Creek Station, was denied without prejudice with an invitation to reapply for recovery when required construction permits are approved. Cost recovery through the environmental surcharge of the four approved projects will begin with the bills rendered in April 2003.

**ESM.** LG&E's electric rates are subject to an ESM. The ESM, initially in place for three years beginning in 2000, sets an upper and lower point for rate of return on equity, whereby if LG&E's rate of return for the calendar year falls within the range of 10.5% to 12.5%, no action is necessary. If earnings are above the upper limit, the excess earnings are shared 40% with ratepayers and 60% with shareholders; if earnings are below the lower limit, the earnings deficiency is recovered 40% from ratepayers and 60% from shareholders. By order of the Kentucky Commission, rate changes prompted by the ESM filing go into effect in April of each year subject to a balancing adjustment in successive periods. LG&E made its second ESM filing on March 1, 2002 for the calendar year 2001 reporting period. LG&E is in the process of refunding \$441,000 to customers for the 2001 reporting period. LG&E estimated that the rate of return will fall below the lower limit, subject to Kentucky Commission approval, for the year ended December 31, 2002. The 2002 financial statements include an accrual to reflect the earnings deficiency of \$12.5 million to be recovered from customers commencing in April 2003.

On November 27, 2002, LG&E filed a revised ESM tariff which proposed continuance of the existing ESM through December 2005. The Kentucky Commission issued an Order suspending the ESM tariff one day making the effective date January 2, 2003. In addition, the Kentucky Commission is conducting a management audit to review the ESM plan and reassess its reasonableness in 2003. LG&E and interested parties will have the opportunity to provide recommendations for modification and continuance of the ESM or other forms of alternative or incentive regulation.

**DSM.** LG&E's rates contain a DSM provision. The provision includes a rate mechanism that provides concurrent recovery of DSM costs and provides an incentive for implementing DSM programs. This program had allowed LG&E to recover revenues from lost sales associated with the DSM program. In May 2001, the

Kentucky Commission approved LG&E's plan to continue DSM programs. This filing called for the expansion of the DSM programs into the service territory served by KU and proposed a mechanism to recover revenues from lost sales associated with DSM programs based on program planning engineering estimates and post-implementation evaluation.

**Gas PBR.** Since November 1, 1997, LG&E has operated under an experimental PBR mechanism related to its gas procurement activities. For each of the last five years, LG&E's rates have been adjusted to recover its portion of the savings (or expenses) incurred during each of the five 12-month periods beginning November 1 and ending October 31. Since its implementation on November 1, 1997, through October 31, 2001, LG&E has achieved \$38.1 million in savings. Of the total savings, LG&E has retained \$16.5 million, and the remaining portion of \$21.6 million has been distributed to customers. In December 2000, LG&E filed an application reporting on the operation of the experimental PBR and requested the Kentucky Commission to extend the PBR as a result of the benefits provided to both LG&E and its customers during the experimental period. Following the discovery and hearing process, the Kentucky Commission issued an order effective November 1, 2001, extending the experimental PBR program for an additional four years, and making other modifications, including changes to the sharing levels applicable to savings or expenses incurred under the PBR. Specifically, the Kentucky Commission modified the savings mechanism to a 25%/75% Company/Customer sharing for all savings (and expenses) up to 4.5% of the benchmarked gas costs. Savings (and expenses) in excess of 4.5% of the benchmarked gas costs are shared at a 50%/50% level.

**FAC.** Prior to implementation of the electric PBR in July 1999, and following its termination in March 2000, LG&E employed an FAC mechanism, which under Kentucky law allowed LG&E to recover from customers the actual fuel costs associated with retail electric sales. In February 1999, LG&E received orders from the Kentucky Commission requiring a refund to retail electric customers of approximately \$3.9 million resulting from reviews of the FAC from November 1994, through April 1998. While legal challenges to the Kentucky Commission order were pending, a comprehensive settlement was reached by all parties and approved by the Kentucky Commission on May 17, 2002. Thereunder, LG&E agreed to credit its fuel clause in the amount of \$720,000 (such credit provided over the course of June and July 2002), and the parties agreed on a prospective interpretation of the state's FAC regulation to ensure consistent and mutually acceptable application on a going-forward basis.

In December 2002, the Kentucky Commission initiated a two year review of the operation of LG&E's FAC for the period November 2000 through October 2002. Testimony in the review case was filed on January 20, 2003 and a public hearing was held February 18, 2003. Issues addressed at that time included the establishment of the current base fuel factor to be included in LG&E's base rates, verification of proper treatment of purchased power costs during unit outages, and compliance with fuel procurement policies and practices.

**Gas Rate Case.** In March 2000, LG&E filed an application with the Kentucky Commission requesting an adjustment in LG&E's gas rates. In September 2000, the Kentucky Commission granted LG&E an annual increase in its base gas revenues of \$20.2 million effective September 28, 2000. The Kentucky Commission authorized a return on equity of 11.25%. The Kentucky Commission approved LG&E's proposal for a weather normalization billing adjustment mechanism that will normalize the effect of weather on base gas revenues from gas sales.

**Wholesale Natural Gas Prices.** On September 12, 2000, the Kentucky Commission issued an order establishing Administrative Case No. 384 – "An Investigation of Increasing Wholesale Natural Gas Prices and the Impacts of such Increase on the Retail Customers Served by Kentucky's Jurisdictional Natural Gas

Distribution Companies". The impetus for this administrative proceeding was the escalation of wholesale natural gas prices during the summer of 2000.

The Kentucky Commission directed Kentucky's natural gas distribution companies, including LG&E, to file selected information regarding the individual companies' natural gas purchasing practices, expectations for the then-approaching winter heating season of 2000-2001, and potential actions which these companies might take to mitigate price volatility. On July 17, 2001, the Kentucky Commission issued an order encouraging the natural gas distribution companies in Kentucky to take various actions, among them to propose a natural gas hedge plan, consider performance-based ratemaking mechanisms, and to increase the use of storage.

In April 2002, in Case No. 2002-00136, LG&E proposed a hedging plan for the 2002/2003 winter heating season with three alternatives, the first two using a combination of storage and financial hedge instruments and the third relying upon storage alone. LG&E and the Attorney General, who represents Kentucky consumers, entered into a settlement which selected the third option. In August 2002, the Kentucky Commission approved the plan contemplated in the settlement. The Kentucky Commission validated the effectiveness of storage to mitigate potentially high winter gas prices by approving this natural gas hedging plan.

The Kentucky Commission also decided in Administrative Case No. 384 to engage a consultant to conduct a forward-looking audit of the gas procurement and supply procedures of Kentucky's largest natural gas distribution companies. The Kentucky Commission completed its audit in late 2002. The audit recognized LG&E as "efficient and effective [in the] procurement and management of significant quantities of natural gas supplies." The auditors also recognized that "the Company's residential gas prices have long been below averages for the U. S. and for the Commonwealth of Kentucky" which "demonstrates [LG&E's] effectiveness in [the] procurement and management of natural gas supplies." The audit also stated that the "Company's very impressive record in keeping its rates down provides sound evidence on the excellent job done in the area of gas supply procurement and management."

**Kentucky Commission Administrative Case for Affiliate Transactions.** In December 1997, the Kentucky Commission opened Administrative Case No. 369 to consider Kentucky Commission policy regarding cost allocations, affiliate transactions and codes of conduct governing the relationship between utilities and their non-utility operations and affiliates. The Kentucky Commission intended to address two major areas in the proceedings: the tools and conditions needed to prevent cost shifting and cross-subsidization between regulated and non-utility operations; and whether a code of conduct should be established to assure that non-utility segments of the holding company are not engaged in practices that could result in unfair competition caused by cost shifting from the non-utility affiliate to the utility. During the period September 1998 to February 2000, the Kentucky Commission issued draft codes of conduct and cost allocation guidelines. In early 2000, the Kentucky General Assembly enacted legislation, House Bill 897, which authorized the Kentucky Commission to require utilities that provide nonregulated activities to keep separate accounts and allocate costs in accordance with procedures established by the Kentucky Commission. In the same bill, the General Assembly set forth provisions to govern a utility's activities related to the sharing of information, databases, and resources between its employees or an affiliate involved in the marketing or the provision of nonregulated activities and its employees or an affiliate involved in the provision of regulated services. The legislation became law in July 2000 and LG&E has been operating pursuant thereto since that time. On February 14, 2001, the Kentucky Commission published notice of its intent to promulgate new administrative regulations under the auspices of this new law. This effort is still on going.

**Kentucky Commission Administrative Case for System Adequacy.** On June 19, 2001, Kentucky Governor Paul E. Patton issued Executive Order 2001-771, which directed the Kentucky Commission to review and study

issues relating to the need for and development of new electric generating capacity in Kentucky. The issues to be considered included the impact of new power plants on the electric supply grid, facility siting issues, and economic development matters, with the goal of ensuring a continued, reliable source of supply of electricity for the citizens of Kentucky and the continued environmental and economic vitality of Kentucky and its communities. In response to that Executive Order, in July 2001 the Kentucky Commission opened Administrative Case No. 387 to review the adequacy of Kentucky's generation capacity and transmission system. Specifically, the items reviewed were the appropriate level of reliance on purchased power, the appropriate reserve margins to meet existing and future electric demand, the impact of spikes in natural gas prices on electric utility planning strategies, and the adequacy of Kentucky's electric transmission facilities. LG&E, as a party to this proceeding, filed written testimony and responded to two requests for information. Public hearings were held and in October 2001, LG&E filed a final brief in the case. In December 2001, the Kentucky Commission issued an order in which it noted that LG&E is responsibly addressing the long-term supply needs of native load customers and that current reserve margins are appropriate. However, due to the rapid pace of change in the industry, the order also requires LG&E to provide an annual assessment of supply resources, future demand, reserve margin, and the need for new resources.

Regarding the transmission system, the Kentucky Commission concluded that the transmission system within Kentucky can reliably serve native load and a significant portion of the proposed new unregulated power plants. However, it will not be able to handle the volume of transactions envisioned by FERC without future upgrades, the costs of which should be borne by those for whom the upgrades are required.

The Kentucky Commission pledged to continue to monitor all relevant issues and advocate Kentucky's interests at all opportunities.

**FERC SMD NOPR.** On July 31, 2002, FERC issued a NOPR in Docket No. RM01-12-000 which would substantially alter the regulations governing the nation's wholesale electricity markets by establishing a common set of rules -- SMD. The SMD NOPR would require each public utility that owns, operates, or controls interstate transmission facilities to become an Independent Transmission Provider (ITP), belong to an RTO that is an ITP, or contract with an ITP for operation of its transmission assets. It would also establish a standardized congestion management system, real-time and day-ahead energy markets, and a single transmission service for network and point-to-point transmission customers. Review of the proposed rulemaking is underway and a final rule is expected during 2003. While it is expected that the SMD final rule will affect LG&E revenues and expenses, the specific impact of the rulemaking is not known at this time.

**MISO.** LG&E is a member of the MISO, which began commercial operations on February 1, 2002. MISO now has operational control over LG&E's high-voltage transmission facilities (100 kV and greater), while LG&E continues to control and operate the lower voltage transmission subject to the terms and conditions of the MISO OATT. As a transmission-owning member of MISO, LG&E also incurs administrative costs of MISO pursuant to Schedule 10 of the MISO OATT.

MISO also proposed to implement a congestion management system. FERC directed the MISO to coordinate its efforts with FERC's Rulemaking on SMD. On September 24, 2002, the MISO filed new rate schedules designated as Schedules 16 and 17, which provide for the collection of costs incurred by the MISO to establish day-ahead and real-time energy markets. The MISO proposed to recover these costs under Schedules 16 and 17 once service commences. If approved by FERC, these schedules will cause LG&E to incur additional costs. LG&E opposes the establishment of Schedules 16 and 17. This effort is still on-going and the ultimate impact of the two schedules, if approved, is not known at this time.

**ARO.** In 2003, LG&E expects to record approximately \$6.0 million in regulatory assets and approximately \$60,000 in regulatory liabilities related to SFAS No. 143, *Accounting for Asset Retirement Obligations*.

**Merger Surcredit.** As part of the LG&E Energy merger with KU Energy in 1998, LG&E Energy estimated non-fuel savings over a ten-year period following the merger. Costs to achieve these savings for LG&E of \$50.2 million were recorded in the second quarter of 1998, \$18.1 million of which was deferred and amortized over a five-year period pursuant to regulatory orders. Primary components of the merger costs were separation benefits, relocation costs, and transaction fees, the majority of which were paid by December 31, 1998. LG&E expensed the remaining costs associated with the merger (\$32.1 million) in the second quarter of 1998.

In approving the merger, the Kentucky Commission adopted LG&E's proposal to reduce its retail customers' bills based on one-half of the estimated merger-related savings, net of deferred and amortized amounts, over a five-year period. The surcredit mechanism provides that 50% of the net non-fuel cost savings estimated to be achieved from the merger be provided to ratepayers through a monthly bill credit, and 50% be retained by the Companies, over a five-year period. The surcredit was allocated 53% to KU and 47% to LG&E. In that same order, the Commission required LG&E and KU, after the end of the five-year period, to present a plan for sharing with customers the then-projected non-fuel savings associated with the merger. The Companies submitted this filing on January 13, 2003, proposing to continue to share with customers, on a 50%/50% basis, the estimated fifth-year gross level of non-fuel savings associated with the merger. The filing is currently under review.

Any fuel cost savings are passed to Kentucky customers through the fuel adjustment clause. See FAC above.

#### **Note 4 - Financial Instruments**

The cost and estimated fair values of LG&E's non-trading financial instruments as of December 31, 2002, and 2001 follow (in thousands of \$):

	<u>2002</u>		<u>2001</u>	
	<u>Cost</u>	<u>Fair Value</u>	<u>Cost</u>	<u>Fair Value</u>
Preferred stock subject to mandatory redemption	\$ 25,000	\$ 25,188	\$ 25,000	\$ 25,125
Long-term debt (including current portion)	616,904	623,325	616,904	620,504
Interest-rate swaps	-	(17,115)	-	(8,604)

All of the above valuations reflect prices quoted by exchanges except for the swaps. The fair values of the swaps reflect price quotes from dealers or amounts calculated using accepted pricing models.

**Interest Rate Swaps.** LG&E uses interest rate swaps to hedge exposure to market fluctuations in certain of its debt instruments. Pursuant to policy, use of these financial instruments is intended to mitigate risk and earnings volatility and is not speculative in nature. Management has designated all of the interest rate swaps as hedge instruments. Financial instruments designated as cash flow hedges have resulting gains and losses recorded within other comprehensive income and stockholders' equity. To the extent a financial instrument or the underlying item being hedged is prematurely terminated or the hedge becomes ineffective, the resulting gains or losses are reclassified from other comprehensive income to net income. Financial instruments designated as fair

value hedges are periodically marked to market with the resulting gains and losses recorded directly into net income to correspond with income or expense recognized from changes in market value of the items being hedged.

As of December 31, 2002 and 2001, LG&E was party to various interest rate swap agreements with aggregate notional amounts of \$117.3 million. Under these swap agreements, LG&E paid fixed rates averaging 5.13% and received variable rates based on the Bond Market Association's municipal swap index averaging 1.52% and 1.61% at December 31, 2002 and 2001, respectively. The swap agreements in effect at December 31, 2002 have been designated as cash flow hedges and mature on dates ranging from 2003 to 2020. The hedges have been deemed to be fully effective resulting in a pretax loss of \$8.5 million for 2002, recorded in other comprehensive income. Upon expiration of these hedges, the amount recorded in other comprehensive income will be reclassified into earnings. The amounts expected to be reclassified from other comprehensive income to earnings in the next twelve months is immaterial.

**Energy Trading & Risk Management Activities.** LG&E conducts energy trading and risk management activities to maximize the value of power sales from physical assets it owns, in addition to the wholesale sale of excess asset capacity. Certain energy trading activities are accounted for on a mark-to-market basis in accordance with EITF 98-10, *Accounting for Contracts Involved in Energy Trading and Risk Management Activities*, SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities*. Wholesale sales of excess asset capacity and wholesale purchases are treated as normal sales and purchases under SFAS No. 133 and SFAS No. 138 and are not marked-to-market.

The rescission of EITF 98-10, effective for fiscal years after December 15, 2002, will have no impact on LG&E's energy trading and risk management reporting as all contracts marked to market under EITF 98-10 are also within the scope of SFAS No. 133.

The table below summarizes LG&E's energy trading and risk management activities for 2002 and 2001 (in thousands of \$).

	<u>2002</u>	<u>2001</u>
Fair value of contracts at beginning of period, net liability	\$ (186)	\$ (17)
Fair value of contracts when entered into during the period	(65)	3,441
Contracts realized or otherwise settled during the period	448	(2,894)
Changes in fair values due to changes in assumptions	<u>(353)</u>	<u>(716)</u>
Fair value of contracts at end of period, net liability	<u>\$ (156)</u>	<u>\$ (186)</u>

No changes to valuation techniques for energy trading and risk management activities occurred during 2002. Changes in market pricing, interest rate and volatility assumptions were made during both years. All contracts outstanding at December 31, 2002, have a maturity of less than one year and are valued using prices actively quoted for proposed or executed transactions or quoted by brokers.

LG&E maintains policies intended to minimize credit risk and revalues credit exposures daily to monitor compliance with those policies. At December 31, 2002, 86% of the trading and risk management commitments were with counterparties rated BBB- equivalent or better.

## **Note 5 - 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.

LG&E's customer receivables and gas and electric revenues arise from deliveries of natural gas to approximately 310,000 customers and electricity to approximately 382,000 customers in Louisville and adjacent areas in Kentucky. For the year ended December 31, 2002, 74% of total revenue was derived from electric operations and 26% from gas operations.

In November 2001, LG&E and IBEW Local 2100 employees, which represent approximately 70% of LG&E's workforce, entered into a four-year collective bargaining agreement.

## Note 6 - Pension Plans and Retirement Benefits

LG&E sponsors several qualified and non-qualified pension plans and other postretirement benefit plans for its employees. The following tables provide a reconciliation of the changes in the plans' benefit obligations and fair value of assets over the three-year period ending December 31, 2002, and a statement of the funded status as of December 31 for each of the last three years (in thousands of \$):

	<u>2002</u>	<u>2001</u>	<u>2000</u>
<u>Pension Plans:</u>			
Change in benefit obligation			
Benefit obligation at beginning of year	\$ 356,293	\$ 310,822	\$ 283,267
Service cost	1,484	1,311	3,408
Interest cost	24,512	25,361	22,698
Plan amendments	576	1,550	17,042
Curtailment loss	-	24,563	-
Special termination benefits	-	53,610	-
Benefits paid	(34,823)	(53,292)	(16,656)
Actuarial (gain) or loss and other	<u>16,752</u>	<u>(7,632)</u>	<u>1,063</u>
Benefit obligation at end of year	<u>\$ 364,794</u>	<u>\$ 356,293</u>	<u>\$ 310,822</u>
Change in plan assets			
Fair value of plan assets at beginning of year	\$ 233,944	\$ 333,378	\$ 360,095
Actual return on plan assets	(15,648)	(27,589)	(6,150)
Employer contributions and plan transfers	14,150	(17,134)	(1,804)
Benefits paid	(34,824)	(53,292)	(16,656)
Administrative expenses	<u>(1,308)</u>	<u>(1,419)</u>	<u>(2,107)</u>
Fair value of plan assets at end of year	<u>\$ 196,314</u>	<u>\$ 233,944</u>	<u>\$ 333,378</u>
Reconciliation of funded status			
Funded status	\$(168,480)	\$(122,349)	\$ 22,556
Unrecognized actuarial (gain) or loss	60,313	18,800	(74,086)
Unrecognized transition (asset) or obligation	(3,199)	(4,215)	(5,853)
Unrecognized prior service cost	<u>32,265</u>	<u>35,435</u>	<u>47,984</u>
Net amount recognized at end of year	<u>\$ (79,101)</u>	<u>\$ (72,329)</u>	<u>\$ (9,399)</u>
<u>Other Benefits:</u>			
Change in benefit obligation			
Benefit obligation at beginning of year	\$ 89,946	\$ 56,981	\$ 44,997
Service cost	444	358	822
Interest cost	5,956	5,865	4,225
Plan amendments	-	1,487	5,826
Curtailment loss	-	8,645	-
Special termination benefits	-	18,089	-
Benefits paid	(4,988)	(4,877)	(4,889)
Actuarial (gain) or loss	<u>1,875</u>	<u>3,398</u>	<u>6,000</u>
Benefit obligation at end of year	<u>\$ 93,233</u>	<u>\$ 89,946</u>	<u>\$ 56,981</u>

<b>Change in plan assets</b>			
Fair value of plan assets at beginning of year	\$ 2,802	\$ 7,166	\$ 10,526
Actual return on plan assets	(533)	(765)	(92)
Employer contributions and plan transfers	4,213	1,282	1,621
Benefits paid	<u>(5,004)</u>	<u>(4,881)</u>	<u>(4,889)</u>
Fair value of plan assets at end of year	<u>\$ 1,478</u>	<u>\$ 2,802</u>	<u>\$ 7,166</u>
<b>Reconciliation of funded status</b>			
Funded status	\$(91,755)	\$(87,144)	\$(49,815)
Unrecognized actuarial (gain) or loss	16,971	15,947	5,623
Unrecognized transition (asset) or obligation	6,697	7,346	13,374
Unrecognized prior service cost	<u>5,995</u>	<u>5,302</u>	<u>8,960</u>
Net amount recognized at end of year	<u>\$(62,092)</u>	<u>\$(58,549)</u>	<u>\$(21,858)</u>

There are no plan assets in the nonqualified plans due to the nature of the plans.

LG&E made a contribution to the pension plan of \$83.1 million in January 2003.

The following tables provide the amounts recognized in the balance sheet and information for plans with benefit obligations in excess of plan assets as of December 31, 2002, 2001 and 2000 (in thousands of \$):

	<u>2002</u>	<u>2001</u>	<u>2000</u>
<b><u>Pension Plans:</u></b>			
Amounts recognized in the balance sheet consisted of:			
Prepaid benefits cost	\$ -	\$ -	\$ 18,880
Accrued benefit liability	(162,611)	(108,977)	(28,279)
Intangible asset	32,799	11,936	-
Accumulated other comprehensive income	<u>50,711</u>	<u>24,712</u>	<u>-</u>
Net amount recognized at year-end	<u>\$ (79,101)</u>	<u>\$ (72,329)</u>	<u>\$ (9,399)</u>
Additional year-end information for plans with accumulated benefit obligations in excess of plan assets (1):			
Projected benefit obligation	\$ 364,794	\$ 356,293	\$ 4,088
Accumulated benefit obligation	358,956	352,477	3,501
Fair value of plan assets	196,314	233,944	

(1) 2002 and 2001 includes all plans. 2000 includes SERPs only.

**Other Benefits:**

Amounts recognized in the balance sheet consisted of:

Accrued benefit liability	<u>\$(62,092)</u>	<u>\$(58,549)</u>	<u>\$(21,858)</u>
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Additional year-end information for plans with benefit obligations in excess of plan assets:

Projected benefit obligation	\$ 93,233	\$ 89,946	\$ 56,981
Fair value of plan assets	1,478	2,802	7,166

The following table provides the components of net periodic benefit cost for the plans for 2002, 2001 and 2000 (in thousands of \$):

	<u>2002</u>	<u>2001</u>	<u>2000</u>
<u>Pension Plans:</u>			
Components of net periodic benefit cost			
Service cost	\$ 1,484	\$ 1,311	\$ 3,408
Interest cost	24,512	25,361	22,698
Expected return on plan assets	(21,639)	(26,360)	(33,025)
Amortization of prior service cost	3,777	3,861	4,646
Amortization of transition (asset) or obligation	(1,016)	(1,000)	(1,112)
Recognized actuarial (gain) or loss	<u>21</u>	<u>(777)</u>	<u>(6,856)</u>
Net periodic benefit cost	<u>\$ 7,139</u>	<u>\$ 2,396</u>	<u>\$(10,241)</u>
Special charges			
Prior service cost recognized	\$ -	\$ 10,237	\$ -
Special termination benefits	-	53,610	-
Settlement loss	-	<u>(2,244)</u>	-
Total charges	<u>\$ -</u>	<u>\$ 61,603</u>	<u>\$ -</u>
<u>Other Benefits:</u>			
Components of net periodic benefit cost			
Service cost	\$ 444	\$ 358	\$ 822
Interest cost	5,956	5,865	4,225
Expected return on plan assets	(204)	(420)	(683)
Amortization of prior service cost	920	951	1,158
Amortization of transition (asset) or obligation	650	719	1,114
Recognized actuarial (gain) or loss	<u>116</u>	<u>(32)</u>	<u>(485)</u>
Net periodic benefit cost	<u>\$ 7,882</u>	<u>\$ 7,441</u>	<u>\$ 6,151</u>
Special charges			
Curtailment loss	\$ -	\$ 6,671	\$ -
Prior service cost recognized	-	2,391	-
Transition obligation recognized	-	4,743	-
Special termination benefits	-	<u>18,089</u>	-
Total charges	<u>\$ -</u>	<u>\$ 31,894</u>	<u>\$ -</u>

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

	<u>2002</u>	<u>2001</u>	<u>2000</u>
Weighted-average assumptions as of December 31:			
Discount rate	6.75%	7.25%	7.75%
Expected long-term rate of return on plan assets	9.00%	9.50%	9.50%
Rate of compensation increase	3.75%	4.25%	4.75%

For measurement purposes, a 12.00% annual increase in the per capita cost of covered health care benefits was assumed for 2003. The rate was assumed to decrease gradually to 5.00% for 2014 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 the following effects (in thousands of \$):

	<u>1% Decrease</u>	<u>1% Increase</u>
Effect on total of service and interest cost components for 2002	(201)	227
Effect on year-end 2002 postretirement benefit obligations	(3,001)	3,347

**Thrift Savings Plans.** LG&E 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. LG&E makes contributions to the plan by matching a portion of the employee contributions. The costs of this matching were approximately \$1.7 million for 2002, \$1.2 million for 2001 and \$2.7 million for 2000.

### Note 7 - Income Taxes

Components of income tax expense are shown in the table below (in thousands of \$):

	<u>2002</u>	<u>2001</u>	<u>2000</u>
Included in operating expenses:			
Current			
- federal	\$26,231	\$42,997	\$32,612
- state	8,083	8,668	5,018
Deferred			
- federal - net	20,464	12,310	24,272
- state - net	4,410	3,767	6,797
Amortization of investment tax credit	<u>(4,153)</u>	<u>(4,290)</u>	<u>(4,274)</u>
Total	<u>\$5,035</u>	<u>\$63,452</u>	<u>\$64,425</u>
Included in other income - net:			
Current			
- federal	(1,667)	(1,870)	(2,187)
- state	(430)	(483)	(568)
Deferred			
- federal - net	(206)	285	(39)
- state - net	<u>(53)</u>	<u>73</u>	<u>(10)</u>
Total	<u>(2,356)</u>	<u>(1,995)</u>	<u>(2,804)</u>
Total income tax expense	<u>\$52,679</u>	<u>\$61,457</u>	<u>\$61,621</u>

Components of net deferred tax liabilities included in the balance sheet are shown below (in thousands of \$):

	<u>2002</u>	<u>2001</u>
Deferred tax liabilities:		
Depreciation and other plant-related items	\$346,737	\$334,914
Other liabilities	<u>64,734</u>	<u>77,611</u>
	<u>411,471</u>	<u>412,525</u>
Deferred tax assets:		
Investment tax credit	22,012	23,713
Income taxes due to customers	18,431	19,709
Pensions	21,056	6,621
Accrued liabilities not currently deductible and other	<u>36,747</u>	<u>64,339</u>
	<u>98,246</u>	<u>114,382</u>
Net deferred income tax liability	<u>\$313,225</u>	<u>\$298,143</u>

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

	<u>2002</u>	<u>2001</u>	<u>2000</u>
Statutory federal income tax rate	35.0%	35.0%	35.0%
State income taxes, net of federal benefit	5.6	4.7	4.3
Amortization of investment tax credit	(2.9)	(2.6)	(2.6)
Other differences – net	<u>(0.5)</u>	<u>(0.6)</u>	<u>(0.9)</u>
Effective income tax rate	<u>37.2%</u>	<u>36.5%</u>	<u>35.8%</u>

**Note 8 - Other Income - net**

Other income – net consisted of the following at December 31 (in thousands of \$):

	<u>2002</u>	<u>2001</u>	<u>2000</u>
Interest and dividend income	\$457	\$ 748	\$3,103
Gains on fixed asset disposals	421	1,217	1,014
Income taxes and other	<u>(58)</u>	<u>965</u>	<u>804</u>
Other income – net	<u>\$820</u>	<u>\$2,930</u>	<u>\$4,921</u>

## Note 9 - First Mortgage Bonds and Pollution Control Bonds

Long-term debt and the current portion of long-term debt, summarized below (in thousands of \$), consists primarily of first mortgage bonds and pollution control bonds. Interest rates and maturities in the table below are for the amounts outstanding at December 31, 2002.

	<u>Stated Interest Rates</u>	<u>Weighted Average Interest Rate</u>	<u>Maturities</u>	<u>Principal Amounts</u>
Noncurrent portion	Variable - 5.90%	3.53%	2019-2032	\$ 328,104
Current portion	Variable - 6.00%	2.08%	2003-2027	288,800

Under the provisions for some of LG&E'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 consolidated balance sheets. The average annualized interest rate for these bonds during 2002 was 1.61%.

LG&E's First Mortgage Bond, 6% Series of \$42.6 million is scheduled to mature in 2003. There are no other scheduled maturities of pollution control bonds for the five years subsequent to December 31, 2002.

In October 2002, LG&E issued \$41.7 million variable rate pollution bonds due October 1, 2032, and exercised its call option on \$41.7 million, 6.55% pollution control bonds due November 1, 2020.

In March 2002, LG&E refinanced four unsecured pollution control bonds with an aggregate principal balance of \$120 million and replaced them with secured pollution control bonds. The new bonds and the previous bonds were all variable rate bonds, and the maturity dates remained unchanged.

In September 2001, LG&E issued \$10.1 million variable rate tax-exempt environmental facility revenue bonds due September 1, 2027.

In January 2000, LG&E exercised its call option on its \$20 million 7.50% First Mortgage Bonds due July 1, 2002. The bonds were redeemed utilizing proceeds from issuance of commercial paper.

In May 2000, LG&E issued \$25 million variable rate pollution control bonds due May 1, 2027 and exercised its call option on \$25 million, 7.45%, pollution control bonds due June 15, 2015. In August 2000, LG&E issued \$83 million in variable rate pollution control bonds due August 1, 2030 and exercised its call option on its \$83 million, 7.625%, pollution control bonds due November 1, 2020.

Annual requirements for the sinking funds of LG&E's First Mortgage Bonds (other than the First Mortgage Bonds issued in connection with certain Pollution Control Bonds) are the amounts necessary to redeem 1% of the highest principal amount of each series of bonds at any time outstanding. Property additions (166 2/3% of principal amounts of bonds otherwise required to be so redeemed) have been applied in lieu of cash.

Substantially all of LG&E's utility plants are pledged as security for its first mortgage bonds. LG&E's indenture, as supplemented, provides that portions of retained earnings will not be available for the payment of

dividends on common stock, under certain specified conditions. No portion of retained earnings is restricted by this provision as of December 31, 2002.

#### **Note 10 - Notes Payable**

LG&E participates in an intercompany money pool agreement wherein LG&E Energy can make funds available to LG&E at market based rates up to \$400 million. The balance of the money pool loan from LG&E Energy was \$193.1 million at a rate of 1.61% and \$64.2 million at an average rate of 2.37%, at December 31, 2002 and 2001, respectively. LG&E also had outstanding commercial paper of \$30 million at an average rate of 2.54% at December 31, 2001. The remaining money pool availability at December 31, 2002, was \$206.9 million. LG&E Energy maintains facilities of \$450 million with affiliates to ensure funding availability for the money pool. The outstanding balance under these facilities as of December 31, 2002 was \$230 million, and availability of \$220 million remained.

#### **Note 11 - Commitments and Contingencies**

**Construction Program.** LG&E had approximately \$15.1 million of commitments in connection with its construction program at December 31, 2002. Construction expenditures for the years 2003 and 2004 are estimated to total approximately \$340.0 million, although all of this amount is not currently committed, including the purchase of four jointly owned CTs, \$89.0 million, and construction of NOx equipment, \$34.0 million.

**Operating Lease.** LG&E leases office space and accounts for its office space lease as an operating lease. Total lease expense for 2002, 2001, and 2000, less amounts contributed by the parent company, was \$1.6 million, \$1.1 million, and \$0.9 million, respectively. The future minimum annual lease payments under this lease agreement for years subsequent to December 31, 2002, are as follows (in thousands of \$):

2003	\$ 3,371
2004	3,399
2005	3,467
2006	3,536
2007	3,607
Thereafter	<u>29,794</u>
Total	<u>\$47,174</u>

In December 1999, LG&E and KU entered into an 18-year cross-border lease of its two jointly owned combustion turbines recently installed at KU's Brown facility (Units 6 and 7). LG&E's obligation was defeased upon consummation of the cross-border lease. The transaction produced a pre-tax gain of approximately \$1.2 million which was recorded in other income on the income statement in 2000, pursuant to a Kentucky Commission order.

**Environmental.** The Clean Air Act imposed stringent new SO<sub>2</sub> and NOx emission limits on electric generating units. LG&E previously had installed scrubbers on all of its generating units. LG&E's strategy for Phase II SO<sub>2</sub> reductions, which commenced January 1, 2000, is to increase scrubber removal efficiency to delay additional capital expenditures and may also include fuel switching or upgrading scrubbers. LG&E met the NOx emission requirements of the Act through installation of low-NOx burner systems. LG&E's compliance plans are subject to many factors including developments in the emission allowance and fuel markets, future regulatory and

legislative initiatives, and advances in clean air control technology. LG&E will continue to monitor these developments to ensure that its environmental obligations are met in the most efficient and cost-effective manner.

In September 1998, the EPA announced its final "NOx SIP Call" rule requiring states to impose significant additional reductions in NOx emissions by May 2003, in order to mitigate alleged ozone transport impacts on the Northeast region. The Commonwealth of Kentucky is currently in the process of revising its SIP to require reductions in NOx emissions from coal-fired generating units to the 0.15 lb./Mmbtu level on a system-wide basis. In related proceedings in response to petitions filed by various Northeast states, in December 1999, EPA issued a final rule pursuant to Section 126 of the Clean Air Act directing similar NOx reductions from a number of specifically targeted generating units including all LG&E units. As a result of appeals to both rules, the compliance date was extended to May 2004. All LG&E generating units are subject to the May 2004 compliance date under these NOx emissions reduction rules.

LG&E is currently implementing a plan for adding significant additional NOx controls to its generating units. Installation of additional NOx controls will proceed on a phased basis, with installation of controls commencing in late 2000 and continuing through the final compliance date. In addition, LG&E will incur additional operation and maintenance costs in operating new NOx controls. LG&E believes its costs in this regard to be comparable to those of similarly situated utilities with like generation assets. LG&E had anticipated that such capital and operating costs are the type of costs that are eligible for recovery from customers under its environmental surcharge mechanism and believed that a significant portion of such costs could be recovered. In April 2001, the Kentucky Commission granted recovery of these costs for LG&E.

LG&E is also monitoring several other air quality issues which may potentially impact coal-fired power plants, including the appeal of the D.C. Circuit's remand of the EPA's revised air quality standards for ozone and particulate matter, measures to implement EPA's regional haze rule, and EPA's December 2000 determination to regulate mercury emissions from power plants. In addition, LG&E is currently working with local regulatory authorities to review the effectiveness of remedial measures aimed at controlling particulate matter emissions from its Mill Creek Station. LG&E previously settled a number of property damage claims from adjacent residents and completed significant remedial measures as part of its ongoing capital construction program. LG&E is in the process of converting the Mill Creek Station to wet stack operation in an effort to resolve all outstanding issues related to particulate matter emissions.

LG&E owns or formerly owned three properties which are the location of past MGP operations. Various contaminants are typically found at such former MGP sites and environmental remediation measures are frequently required. With respect to the sites, LG&E has completed cleanups, obtained regulatory approval of site management plans, or reached agreements for other parties to assume responsibility for cleanup. Based on currently available information, management estimates that it will incur additional costs of \$400,000. Accordingly, an accrual of \$400,000 has been recorded in the accompanying financial statements at December 31, 2002 and 2001.

**Purchased Power.** LG&E has a contract for purchased power with OVEC for various Mw capacities. The estimated future minimum annual payments under purchased power agreements for the years subsequent to December 31, 2002, are as follows (in thousands of \$):

2003	\$10,773
2004	10,116
2005	10,152
2006	10,816
2007	10,816
Thereafter	<u>184,544</u>
Total	<u>\$237,217</u>

**Note 12 - Jointly Owned Electric Utility Plant**

LG&E owns a 75% undivided interest in Trimble County Unit 1 which the Kentucky Commission has allowed to be reflected in customer rates.

Of the remaining 25% of the Unit, IMEA owns a 12.12% undivided interest, and IMPA owns a 12.88% undivided interest. Each company is responsible for its proportionate ownership share of fuel cost, operation and maintenance expenses, and incremental assets.

The following data represent shares of the jointly owned property:

	Trimble County			
	<u>LG&amp;E</u>	<u>IMPA</u>	<u>IMEA</u>	<u>Total</u>
Ownership interest	75%	12.88%	12.12%	100%
Mw capacity	386.2	66.4	62.4	515.0
LG&E's 75% ownership (in thousands of \$):				
Cost	\$595,747			
Accumulated depreciation	<u>182,711</u>			
Net book value	<u>\$413,036</u>			
Construction work in progress (included above)	\$12,867			

LG&E and KU jointly own the following combustion turbines (in thousands of \$):

		<u>LG&amp;E</u>	<u>KU</u>	<u>Total</u>
Paddy's Run 13	Ownership %	53%	47%	100%
	Mw capacity	84	74	158
	Cost	\$33,919	\$29,973	\$63,892
	Depreciation	<u>1,711</u>	<u>1,499</u>	<u>3,210</u>
	Net book value	<u>\$32,208</u>	<u>\$28,474</u>	<u>\$60,682</u>
E.W. Brown 5	Ownership %	53%	47%	100%
	Mw capacity	71	63	134
	Cost	\$23,973	\$21,106	\$45,079
	Depreciation	<u>1,206</u>	<u>1,052</u>	<u>2,258</u>
	Net book value	<u>\$22,767</u>	<u>\$20,054</u>	<u>\$42,821</u>
E.W. Brown 6	Ownership %	38%	62%	100%
	Mw capacity	59	95	154
	Cost	\$23,696	\$36,957	\$60,653
	Depreciation	<u>1,770</u>	<u>4,201</u>	<u>5,971</u>
	Net book value	<u>\$21,926</u>	<u>\$32,756</u>	<u>\$54,682</u>
E.W. Brown 7	Ownership %	38%	62%	100%
	Mw capacity	59	95	154
	Cost	\$23,607	\$44,792	\$68,399
	Depreciation	<u>4,054</u>	<u>4,502</u>	<u>8,556</u>
	Net book value	<u>\$19,553</u>	<u>\$40,290</u>	<u>\$59,843</u>
Trimble 5	Ownership %	29%	71%	100%
	Mw capacity	45	110	155
	Cost	\$15,970	\$39,045	\$55,015
	Depreciation	<u>251</u>	<u>614</u>	<u>865</u>
	Net book value	<u>\$15,719</u>	<u>\$38,431</u>	<u>\$54,150</u>
Trimble 6	Ownership %	29%	71%	100%
	Mw capacity	45	110	155
	Cost	\$15,961	\$39,025	\$54,986
	Depreciation	<u>251</u>	<u>614</u>	<u>865</u>
	Net book value	<u>\$15,710</u>	<u>\$38,411</u>	<u>\$54,121</u>
Trimble CT Pipeline	Ownership %	29%	71%	100%
	Cost	\$1,835	\$4,475	\$6,310
	Depreciation	<u>39</u>	<u>96</u>	<u>135</u>
	Net book value	<u>\$1,796</u>	<u>\$4,379</u>	<u>\$6,175</u>

See also Note 11, Construction Program, for LG&E's planned purchase of four jointly owned CTs in 2004.

### Note 13 - Segments of Business and Related Information

Effective December 31, 1998, LG&E adopted SFAS No. 131, *Disclosure About Segments of an Enterprise and Related Information*. LG&E is a regulated public utility engaged in the generation, transmission, distribution, and sale of electricity and the storage, distribution, and sale of natural gas. Financial data for business segments, follow (in thousands of \$):

	<u>Electric</u>	<u>Gas</u>	<u>Total</u>
<u>2002</u>			
Operating revenues	\$758,491(a)	\$267,693	\$1,026,184
Depreciation and amortization	90,248	15,658	105,906
Interest income	381	76	457
Interest expense	24,837	4,968	29,805
Operating income taxes	49,010	6,025	55,035
Net income	79,246	9,683	88,929
Total assets	2,105,956	455,122	2,561,078
Construction expenditures	195,662	24,754	220,416
<u>2001</u>			
Operating revenues	\$705,925(b)	\$290,775	\$996,700
Depreciation and amortization	85,572	14,784	100,356
Interest income	616	132	748
Interest expense	31,295	6,627	37,922
Operating income taxes	55,527	7,925	63,452
Net income	95,103	11,768	106,781
Total assets	1,985,252	463,102	2,448,354
Construction expenditures	227,107	25,851	252,958
<u>2000</u>			
Operating revenues	\$710,958(c)	\$272,489	\$983,447
Depreciation and amortization	84,761	13,530	98,291
Interest income	2,551	552	3,103
Interest expense	35,604	7,614	43,218
Operating income taxes	57,869	6,556	64,425
Net income	100,395	10,178	110,573
Total assets	1,760,305	465,779	2,226,084
Construction expenditures	109,798	34,418	144,216

(a) Net of provision for rate collections of \$12.3 million.

(b) Net of provision for rate refunds of \$.7 million.

(c) Net of provision for rate refunds of \$2.5 million.

#### Note 14 - Selected Quarterly Data (Unaudited)

Selected financial data for the four quarters of 2002 and 2001 are shown below. Because of seasonal fluctuations in temperature and other factors, results for quarters may fluctuate throughout the year.

	<u>March</u>	<u>Quarters Ended</u>		<u>December</u>
		<u>June</u>	<u>September</u>	
		<u>(Thousands of \$)</u>		
<u>2002</u>				
Operating revenues	\$283,365	\$222,751	\$245,817	\$274,251
Net operating income	28,748	22,410	41,652	25,104
Net income	20,943	15,256	34,204	18,526
Net income available for common stock	19,878	14,207	33,129	17,469
<u>2001</u>				
Operating revenues	\$313,271	\$228,841	\$231,885	\$222,703
Net operating income (loss) (a)	(43,732)	37,624	49,092	98,789
Net income (loss) (a)	(54,115)	28,467	40,270	92,159
Net income (loss) available for common stock (a)	(55,413)	27,247	39,160	91,048

(a) Loss resulted from the VDT pre-tax charge of \$144.0 million in March 2001, which was reversed in December 2001. See Note 3.

#### Note 15 - Subsequent Events

LG&E made a contribution to the pension plan of \$83.1 million in January 2003.

On March 18, 2003, the Kentucky Commission approved LG&E and KU's joint application for the acquisition of four CTs from an unregulated affiliate, LG&E Capital Corp. The total projected construction cost for the turbines, expected to be available for June 2004 in-service, is \$227.4 million. The requested ownership share of the turbines is 63% for KU and 37% for LG&E.

Louisville Gas and Electric Company  
REPORT OF MANAGEMENT

The management of Louisville Gas and Electric Company is responsible for the preparation and integrity of the financial statements and related information included in this Annual Report. These statements have been prepared in accordance with accounting principles generally accepted in the United States applied on a consistent basis and, necessarily, include amounts that reflect the best estimates and judgment of management.

LG&E's 2002 and 2001 financial statements have been audited by PricewaterhouseCoopers LLP, independent accountants, and the 2000 financial statements were audited by Arthur Andersen LLP. Management made available to PricewaterhouseCoopers LLP and Arthur Andersen LLP (in prior years) all LG&E's financial records and related data as well as the minutes of shareholders' and directors' meetings.

Management has established and maintains a system of internal controls that provides reasonable assurance that transactions are completed in accordance with management's authorization, that assets are safeguarded and that financial statements are prepared in conformity with generally accepted accounting principles. Management believes that an adequate system of internal controls is maintained through the selection and training of personnel, appropriate division of responsibility, establishment and communication of policies and procedures and by regular reviews of internal accounting controls by LG&E's internal auditors. Management reviews and modifies its system of internal controls in light of changes in conditions and operations, as well as in response to recommendations from the internal and external auditors. These recommendations for the year ended December 31, 2002, did not identify any material weaknesses in the design and operation of LG&E's internal control structure.

In carrying out its oversight role for the financial reporting and internal controls of LG&E, the Board of Directors meets regularly with LG&E's independent public accountants, internal auditors and management. The Board of Directors reviews the results of the independent accountants' audit of the financial statements and their audit procedures, and discusses the adequacy of internal accounting controls. The Board of Directors also approves the annual internal auditing program and reviews the activities and results of the internal auditing function. Both the independent public accountants and the internal auditors have access to the Board of Directors at any time.

Louisville Gas and Electric Company maintains and internally communicates a written code of business conduct that addresses, among other items, potential conflicts of interest, compliance with laws, including those relating to financial disclosure, and the confidentiality of proprietary information.

S. Bradford Rives  
Senior Vice President-Finance and Controller

Louisville Gas and Electric Company  
Louisville, Kentucky

**Louisville Gas and Electric Company and Subsidiary  
REPORT OF INDEPENDENT ACCOUNTANTS**

To the Shareholders of Louisville Gas and Electric Company and Subsidiary:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of capitalization, income, retained earnings, cash flows and comprehensive income present fairly, in all material respects, the financial position of Louisville Gas and Electric Company and Subsidiary (the "Company"), a wholly-owned subsidiary of LG&E Energy Corp., at December 31, 2002 and 2001, and the results of their operations and their cash flows for each of the two years in the period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

/s/ PricewaterhouseCoopers LLP  
January 21, 2003  
Louisville, Kentucky

Louisville Gas and Electric Company  
REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Shareholders of Louisville Gas and Electric Company:

We have audited the accompanying balance sheet and statement of capitalization of Louisville Gas and Electric Company (a Kentucky corporation and a wholly-owned subsidiary of LG&E Energy Corp.) as of December 31, 2000, and the related statements of income, retained earnings, cash flows and comprehensive income for each of the two years in the period ended December 31, 2000. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Louisville Gas and Electric Company as of December 31, 2000, and the results of its operations and its cash flows for each of the two years in the period ended December 31, 2000, in conformity with accounting principles generally accepted in the United States.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The schedule listed under Item 14(a)2 is presented for purposes of complying with the Securities and Exchange Commission's rules and is not part of the basic financial statements. This schedule has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, fairly states in all material respects the financial data required to be set forth therein in relation to the basic financial statements taken as a whole.

Louisville, Kentucky  
January 26, 2001

Arthur Andersen LLP

THIS IS A COPY OF A PREVIOUSLY ISSUED REPORT OF ARTHUR ANDERSEN LLP ("ANDERSEN") RELATING TO A PRIOR PERIOD FOR WHICH ANDERSEN WAS ENGAGED AS INDEPENDENT PUBLIC ACCOUNTANTS. THE REPORT HAS NOT BEEN REISSUED BY ANDERSEN.

## INDEX OF ABBREVIATIONS

Capital Corp.	LG&E Capital Corp.
Clean Air Act	The Clean Air Act, as amended in 1990
CCN	Certificate of Public Convenience and Necessity
CT	Combustion Turbines
DSM	Demand Side Management
ECR	Environmental Cost Recovery
EEl	Electric Energy, Inc.
EITF	Emerging Issues Task Force Issue
E.ON	E.ON AG
EPA	U.S. Environmental Protection Agency
ESM	Earnings Sharing Mechanism
F	Fahrenheit
FAC	Fuel Adjustment Clause
FERC	Federal Energy Regulatory Commission
FPA	Federal Power Act
FT and FT-A	Firm Transportation
GSC	Gas Supply Clause
IBEW	International Brotherhood of Electrical Workers
IMEA	Illinois Municipal Electric Agency
IMPA	Indiana Municipal Power Agency
Kentucky Commission	Kentucky Public Service Commission
KIUC	Kentucky Industrial Utility Consumers, Inc.
KU	Kentucky Utilities Company
KU Energy	KU Energy Corporation
KU R	KU Receivables LLC
kV	Kilovolts
Kva	Kilovolt-ampere
KW	Kilowatts
Kwh	Kilowatt hours
LEM	LG&E Energy Marketing Inc.
LG&E	Louisville Gas and Electric Company
LG&E Energy	LG&E Energy Corp.
LG&E R	LG&E Receivables LLC
LG&E Services	LG&E Energy Services Inc.
Mcf	Thousand Cubic Feet
MGP	Manufactured Gas Plant
MISO	Midwest Independent System Operator
Mmbtu	Million British thermal units
Moody's	Moody's Investor Services, Inc.
Mw	Megawatts
Mwh	Megawatt hours
NNS	No-Notice Service
NOPR	Notice of Proposed Rulemaking
NOx	Nitrogen Oxide
OATT	Open Access Transmission Tariff
OMU	Owensboro Municipal Utilities
OVEC	Ohio Valley Electric Corporation
PBR	Performance-Based Rate-making
PJM	Pennsylvania, New Jersey, Maryland Interconnection
Powergen	Powergen Limited (formerly Powergen plc)
PUHCA	Public Utility Holding Company Act of 1935
ROE	Return on Equity
RTO	Regional Transmission Organization

S&P	Standard & Poor's Rating Services
SCR	Selective Catalytic Reduction
SEC	Securities and Exchange Commission
SERP	Supplemental Employee Retirement Plan
SFAS	Statement of Financial Accounting Standards
SIP	State Implementation Plan
SMD	Standard Market Design
SO <sub>2</sub>	Sulfur Dioxide
Tennessee Gas	Tennessee Gas Pipeline Company
Texas Gas	Texas Gas Transmission Corporation
TRA	Tennessee Regulatory Authority
Trimble County	LG&E's Trimble County Unit 1
USWA	United Steelworkers of America
Utility Operations	Operations of LG&E and KU
VDT	Value Delivery Team Process
Virginia Commission	Virginia State Corporation Commission
Virginia Staff	Virginia State Corporation Commission Staff

**Kentucky Utilities Company and Subsidiary**  
**Consolidated Statements of Income**  
(Thousands of \$)

	Years Ended December 31		
	<u>2002</u>	<u>2001</u>	<u>2000</u>
<b>OPERATING REVENUES:</b>			
Electric (Note 1) .....	\$875,192	\$860,426	\$851,941
Provision for rate collections (refunds) (Note 3) .....	<u>13,027</u>	<u>(954)</u>	<u>-</u>
Total operating revenues .....	<u>888,219</u>	<u>859,472</u>	<u>851,941</u>
<b>OPERATING EXPENSES:</b>			
Fuel for electric generation .....	250,117	236,985	219,923
Power purchased .....	157,955	157,161	166,918
Other operation expenses .....	144,118	118,359	108,072
Non-recurring charge (Note 3) .....	-	6,867	-
Maintenance .....	62,909	57,021	61,643
Depreciation and amortization (Note 1) .....	95,462	90,299	98,256
Federal and state income taxes (Note 7) .....	54,032	57,482	51,963
Property and other taxes .....	<u>14,983</u>	<u>13,928</u>	<u>17,030</u>
Total operating expenses .....	<u>779,576</u>	<u>738,102</u>	<u>723,805</u>
Net operating income .....	108,643	121,370	128,136
Other income – net (Note 8) .....	10,429	8,932	6,843
Interest charges .....	<u>25,688</u>	<u>34,024</u>	<u>39,455</u>
Net income before cumulative effect of a change in accounting principle ..	93,384	96,278	95,524
Cumulative effect of a change in accounting principle-accounting for Derivative instruments and hedging activities, net of tax .....	<u>-</u>	<u>136</u>	<u>-</u>
Net income .....	93,384	96,414	95,524
Preferred stock dividends .....	<u>2,256</u>	<u>2,256</u>	<u>2,256</u>
Net income available for common stock .....	<u>\$ 91,128</u>	<u>\$ 94,158</u>	<u>\$ 93,268</u>

**Consolidated Statements of Retained Earnings**  
(Thousands of \$)

	Years Ended December 31		
	<u>2002</u>	<u>2001</u>	<u>2000</u>
Balance January 1 .....	\$410,896	\$347,238	\$329,470
Add net income .....	<u>93,384</u>	<u>96,414</u>	<u>95,524</u>
	<u>504,280</u>	<u>443,652</u>	<u>424,994</u>
Deduct: Cash dividends declared on stock:			
4.75% cumulative preferred .....	950	950	950
6.53% cumulative preferred .....	1,306	1,306	1,306
Common .....	<u>-</u>	<u>30,500</u>	<u>75,500</u>
	<u>2,256</u>	<u>32,756</u>	<u>77,756</u>
Balance December 31 .....	<u>\$502,024</u>	<u>\$410,896</u>	<u>\$347,238</u>

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

**Kentucky Utilities Company and Subsidiary**  
**Consolidated Statements of Comprehensive Income**  
(Thousands of \$)

	Years Ended December 31		
	<u>2002</u>	<u>2001</u>	<u>2000</u>
Net income .....	\$ 93,384	\$ 96,414	\$ 95,524
Cumulative effect of change in accounting principle – Accounting for derivative instruments and hedging activities .....	-	2,647	-
Losses on derivative instruments and hedging activities .....	(2,647)	-	-
Additional minimum pension liability adjustment (Note 6) .....	(17,543)	-	-
Income tax benefit (expense) related to items of other comprehensive income .....	<u>8,140</u>	<u>(1,059)</u>	<u>-</u>
Other comprehensive (loss) income, net of tax .....	<u>(12,050)</u>	<u>1,588</u>	<u>-</u>
Comprehensive income .....	<u>\$ 81,334</u>	<u>\$ 98,002</u>	<u>\$ 95,524</u>

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

**Kentucky Utilities Company and Subsidiary**  
**Consolidated Balance Sheets**  
(Thousands of \$)

	December 31 <u>2002</u>	<u>2001</u>
<b>ASSETS:</b>		
Utility plant, at original cost (Note 1).....	\$3,089,529	\$2,960,818
Less: reserve for depreciation.....	<u>1,536,658</u>	<u>1,457,754</u>
	1,552,871	1,503,064
Construction work in progress .....	<u>191,233</u>	<u>103,402</u>
	<u>1,744,104</u>	<u>1,606,466</u>
Other property and investments - less reserve of \$130 in 2002 and 2001 .....	<u>14,358</u>	<u>9,629</u>
<b>Current assets:</b>		
Cash and temporary cash investments (Note 1).....	5,391	3,295
Accounts receivable-less reserve of \$800 in 2002 and 2001 .....	49,588	45,291
Materials and supplies - at average cost:		
Fuel (predominantly coal) (Note 1) .....	46,090	43,382
Other .....	26,408	26,188
Prepayments and other .....	<u>6,584</u>	<u>4,942</u>
	<u>134,061</u>	<u>123,098</u>
<b>Deferred debits and other assets:</b>		
Unamortized debt expense (Note 1) .....	4,991	4,316
Regulatory assets (Note 3).....	65,404	66,467
Other .....	<u>35,465</u>	<u>16,926</u>
	<u>105,860</u>	<u>87,709</u>
	<u>\$1,998,383</u>	<u>\$1,826,902</u>
<b>CAPITAL AND LIABILITIES:</b>		
<b>Capitalization (see statements of capitalization):</b>		
Common equity .....	\$ 814,107	\$ 735,029
Cumulative preferred stock .....	40,000	40,000
Long-term debt (Note 9).....	<u>346,562</u>	<u>434,506</u>
	<u>1,200,669</u>	<u>1,209,535</u>
<b>Current liabilities:</b>		
Current portion of long-term debt (Note 9) .....	153,930	54,000
Notes payable to parent (Note 10) .....	119,490	47,790
Accounts payable .....	95,374	85,149
Accrued taxes .....	4,955	20,520
Other .....	<u>21,442</u>	<u>22,150</u>
	<u>395,191</u>	<u>229,609</u>
<b>Deferred credits and other liabilities:</b>		
Accumulated deferred income taxes (Notes 1 and 7) .....	241,184	239,204
Investment tax credit, in process of amortization .....	8,500	11,455
Accumulated provision for pensions and related benefits (Note 6) .....	110,927	91,235
Regulatory liabilities (Note 3) .....	29,876	33,889
Other .....	<u>12,036</u>	<u>11,975</u>
	<u>402,523</u>	<u>387,758</u>
Commitments and contingencies (Note 11)	<u>\$1,998,383</u>	<u>\$1,826,902</u>

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

Kentucky Utilities Company and Subsidiary  
Consolidated Statements of Cash Flows  
(Thousands of \$)

	Years Ended December 31		
	<u>2002</u>	<u>2001</u>	<u>2000</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net income .....	\$ 93,384	\$ 96,414	\$ 95,524
Items not requiring cash currently:			
Depreciation and amortization .....	95,462	90,299	98,256
Deferred income taxes - net .....	(2,038)	(12,088)	(2,449)
Investment tax credit - net .....	(2,955)	(3,446)	(3,674)
Other .....	(1,267)	11,776	(8,136)
Change in certain net current assets:			
Accounts receivable .....	(8,497)	28	(1,870)
Materials and supplies .....	(2,928)	(31,263)	18,131
Accounts payable .....	10,225	8,810	(60,774)
Accrued taxes .....	(15,565)	898	9,120
Prepayments and other .....	(2,350)	(6,033)	850
Sale of accounts receivable (Note 1) .....	4,200	45,100	-
Other .....	8,086	(12,364)	31,272
Net cash flows from operating activities .....	<u>175,757</u>	<u>188,131</u>	<u>176,250</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Proceeds from sales of securities .....	-	3,480	-
Construction expenditures .....	(237,909)	(142,425)	(100,328)
Net cash flows from investing activities .....	<u>(237,909)</u>	<u>(138,945)</u>	<u>(100,328)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Short-term borrowings and repayments .....	71,700	(13,449)	61,239
Retirement of long-term debt .....	(133,930)	-	(74,784)
Issuance of long-term debt .....	128,734	-	12,900
Additional paid-in capital .....	-	-	15,000
Payment of dividends .....	(2,256)	(32,756)	(96,756)
Net cash flows used for financing activities .....	<u>64,248</u>	<u>(46,205)</u>	<u>(82,401)</u>
Change in cash and temporary cash investments .....	2,096	2,981	(6,479)
Cash and temporary cash investments at beginning of year .....	<u>3,295</u>	<u>314</u>	<u>6,793</u>
Cash and temporary cash investments at end of year .....	<u>\$ 5,391</u>	<u>\$ 3,295</u>	<u>\$ 314</u>
<b>Supplemental disclosures of cash flow information:</b>			
Cash paid during the year for:			
Income taxes .....	\$59,580	\$ 72,432	\$ 49,871
Interest on borrowed money .....	37,866	39,829	35,196

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

Kentucky Utilities Company and Subsidiary  
Consolidated Statements of Capitalization  
(Thousands of \$)

December 31

	<u>2002</u>	<u>2001</u>	
<b>COMMON EQUITY:</b>			
Common stock, without par value - authorized 80,000,000 shares, outstanding 37,817,878 shares .....	\$ 308,140	\$ 308,140	
Additional paid-in-capital .....	15,000	15,000	
Accumulated other comprehensive income .....	(10,462)	1,588	
Other .....	(595)	(595)	
Retained earnings .....	<u>502,024</u>	<u>410,896</u>	
	<u>814,107</u>	<u>735,029</u>	
 <b>CUMULATIVE PREFERRED STOCK:</b>			
	<u>Shares</u> <u>Outstanding</u>	<u>Current</u> <u>Redemption Price</u>	
Without par value, 5,300,000 shares authorized - 4.75% series, \$100 stated value Redeemable on 30 days notice by KU .....	200,000	\$101.00	20,000
6.53% series, \$100 stated value .....	200,000	Not redeemable	<u>20,000</u>
			<u>40,000</u>
 <b>LONG-TERM DEBT (Note 9):</b>			
First mortgage bonds -			62,000
Q due June 15, 2003, 6.32% .....			36,000
S due January 15, 2006, 5.99% .....			53,000
P due May 15, 2007, 7.92% .....			50,000
R due June 1, 2025, 7.55% .....			33,000
P due May 15, 2027, 8.55% .....			-
Pollution control series:			20,930
1B due February 1, 2018, 6.25% .....			2,400
2B due February 1, 2018, 6.25% .....			7,200
3B due February 1, 2018, 6.25% .....			7,400
4B due February 1, 2018, 6.25% .....			96,000
8, due September 15, 2016, 7.45% .....			50,000
9, due December 1, 2023, 5.75% .....			54,000
10, due November 1, 2024, variable % .....			12,900
11, due May 1, 2023, variable % .....			20,930
12, due February 1, 2032, variable % .....			2,400
13, due February 1, 2032, variable % .....			7,400
14, due February 1, 2032, variable % .....			7,200
15, due February 1, 2032, variable % .....			96,000
16, due October 1, 2032, variable % .....			15,662
Long-term debt marked to market (Note 4) .....			<u>3,676</u>
Total bonds outstanding .....			500,492
Less current portion of long-term debt .....			<u>153,930</u>
Long-term debt .....			<u>346,562</u>
Total capitalization .....			<u>\$1,209,669</u>
			<u>\$1,209,535</u>

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

Kentucky Utilities Company and Subsidiary  
Notes to Consolidated Financial Statements

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

KU, a subsidiary of LG&E Energy and an indirect subsidiary of Powergen and E.ON, is a regulated public utility engaged in the generation, transmission, distribution, and sale of electric energy. LG&E Energy is an exempt public utility holding company with wholly owned subsidiaries including LG&E, KU, Capital Corp., LEM, and LG&E Services. All of the KU's Common Stock is held by LG&E Energy. KU has one wholly owned consolidated subsidiary, KU R.

On December 11, 2000, LG&E Energy was acquired by Powergen. On July 1, 2002, E.ON, a German company, completed its acquisition of Powergen plc (now Powergen Limited). E.ON had announced its pre-conditional cash offer of £5.1 billion (\$7.3 billion) for Powergen on April 9, 2001. Powergen and E.ON are registered public utility holding companies under PUHCA. No costs associated with these acquisitions nor any of the effects of purchase accounting have been reflected in the financial statements of KU.

Certain reclassification entries have been made to the previous year's financial statements to conform to the 2002 presentation with no impact on the balance sheet totals or previously reported income.

**Utility Plant.** KU's 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. KU has not recorded any 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, plus removal expense less salvage value, 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. Pursuant to a final order of the Kentucky Commission dated December 3, 2001, KU implemented new depreciation rates effective January 1, 2001. The amounts provided were approximately 3.1% in 2002, 3.1% in 2001 and 3.5% in 2000, of average depreciable plant. Of the amount provided for depreciation at December 31, 2002, 2001 and 2000, respectively, approximately 0.7% was related to the retirement, removal and disposal costs of long lived assets.

**Cash and Temporary Cash Investments.** KU considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents. Temporary cash investments are carried at cost, which approximates fair value.

**Fuel Inventories.** Fuel inventories of \$46.1 million and \$43.4 million at December 31, 2002 and 2001, respectively, are included in Fuel in the balance sheet. The inventory is accounted for using the average-cost method.

**Financial Instruments.** KU uses over-the-counter interest-rate swap agreements to hedge its exposure to interest rates. Gains and losses on interest-rate swaps used to hedge interest rate risk are reflected in interest charges monthly. See Note 4 - Financial Instruments.

**Unamortized Debt Expense.** Debt expense is capitalized in deferred debits and amortized over the lives of the related bond issues, consistent with regulatory practices.

**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 basis of assets and liabilities.

**Investment Tax Credits.** Investment tax credits resulted from provisions of the tax law that permitted a reduction of KU's tax liability based on credits for certain 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. The unbilled revenue estimates included in accounts receivable were approximately \$36.4 million and \$33.4 million at December 31, 2002, and 2001, respectively. KU recorded electric revenues that resulted from sales to a related party, LG&E, of \$34.6 million, \$31.1 million and \$22.1 million for years ended December 31, 2002, 2001 and 2000, respectively. See Note 3, Rates and Regulatory Matters.

**Fuel Costs.** The cost of fuel for electric generation is charged to expense as used.

**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. Actual results could differ from those estimates. See Note 11, Commitments and Contingencies, for a further discussion.

**Accounts Receivable Securitization.** SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, revises the standards for accounting for securitizations and other transfers of financial assets and collateral and requires certain disclosures, and provides accounting and reporting standards for transfers and servicing of financial assets and extinguishments of liabilities. SFAS No. 140 was adopted in the first quarter of 2001, when KU entered into an accounts receivable securitization transaction.

On February 6, 2001, KU implemented an accounts receivable securitization program. The purpose of this program is to enable KU to accelerate the receipt of cash from the collection of retail accounts receivable, thereby reducing dependence upon more costly sources of working capital. The securitization program allows for a percentage of eligible receivables to be sold. Eligible receivables are generally all receivables associated with retail sales that have standard terms and are not past due. KU is able to terminate this program at any time without penalty. If there is a significant deterioration in the payment record of the receivables by the retail customers or if KU fails to meet certain covenants regarding the program, the program may terminate at the election of the financial institutions. In this case, payments from retail customers would first be used to repay the financial institutions participating in the program, and would then be available for use by KU.

As part of the program, KU sold retail accounts receivables to a wholly owned subsidiary, KU R. Simultaneously, KU R entered into two separate three-year accounts receivable securitization facilities with two financial institutions and their affiliates whereby KU R can sell, on a revolving basis, an undivided interest in certain of its receivables and receive up to \$50 million from an unrelated third party purchaser. The effective cost of the receivables programs is comparable to KU's lowest cost source of capital, and is based on prime rated commercial paper. KU retains servicing rights of the sold receivables through two separate servicing agreements with the third party purchaser. KU has obtained an opinion from independent legal counsel indicating these transactions qualify as a true sale of receivables. As of December 31, 2002, the outstanding program balance was \$49.3 million. KU is considering unwinding its accounts receivable securitization arrangements involving KU R during 2003.

The allowance for doubtful accounts associated with the eligible securitized receivables was \$520,000 at December 31, 2002. This allowance is based on historical experience of KU. Each securitization facility contains a fully funded reserve for uncollectible receivables.

**New Accounting Pronouncements.** The following accounting pronouncements were issued that affected KU in 2002:

SFAS No. 143, *Accounting for Asset Retirement Obligations* was issued in 2001. SFAS No. 143 establishes accounting and reporting standards for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs.

The effective implementation date for SFAS No. 143 is January 1, 2003. Management has calculated the impact of SFAS No. 143 and the recently released FERC NOPR No. RM02-7, *Accounting, Financial Reporting, and Rate Filing Requirements for Asset Retirement Obligations*. As of January 1, 2003, KU recorded asset retirement obligation (ARO) assets in the amount of \$8.6 million and liabilities in the amount of \$18.5 million. KU also recorded a cumulative effect adjustment in the amount of \$9.9 million to reflect the accumulated depreciation and accretion of ARO assets at the transition date less amounts previously accrued under regulatory depreciation. KU recorded offsetting regulatory assets of \$9.9 million, pursuant to regulatory treatment prescribed under SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*. Also pursuant to SFAS No. 71, KU recorded regulatory liabilities in the amount of \$888,000 offsetting removal costs previously accrued under regulatory accounting in excess of amounts allowed under SFAS No. 143.

KU also expects to record ARO accretion expense of approximately \$1.2 million, ARO depreciation expense of approximately \$176,000 and an offsetting regulatory credit in the income statement of approximately \$1.4 million in 2003, pursuant to regulatory treatment prescribed under SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*. The accretion, depreciation and regulatory credit will be annual adjustments. SFAS No. 143 will have no impact on the results of the operation of KU.

KU asset retirement obligations are primarily related to the final retirement of generating units. KU transmission and distribution lines largely operate under perpetual property easement agreements which do not generally require restoration upon removal of the property. Therefore, under SFAS No. 143, no material asset retirement obligations will be recorded for transmission and distribution assets.

KU adopted EITF No. 98-10, *Accounting for Energy Trading and Risk Management Activities*, effective January 1, 1999. This pronouncement required that energy trading contracts be marked to market on the balance sheet, with the gains and losses shown net in the income statement. In October 2002, the Emerging

Issues Task Force reached a consensus to rescind EITF 98-10. The effective date for the full rescission will be for fiscal periods beginning after December 15, 2002. With the recession of EITF No. 98-10, energy trading contracts that do not also meet the definition of a derivative under SFAS No. 133 must be accounted for as executory contracts. Contracts previously recorded at fair value under EITF No. 98-10 that are not also derivatives under SFAS No. 133 must be restated to historical cost through a cumulative effect adjustment. KU does not expect the rescission of this standard to have a material impact on financial position or results of operations.

In January 2003, the Financial Accounting Standards Board issued Financial Accounting Standards Board Interpretation No. 46, *Consolidation of Variable Interest Entities*, an Interpretation of ARB No. 51 (FIN 46). FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 is effective immediately for all new variable interest entities created or acquired after January 31, 2003. For variable interest entities created or acquired prior to February 1, 2003, the provisions of FIN 46 must be applied for the first interim or annual period beginning after June 15, 2003. KU does not expect the adoption of this standard to have any impact on the financial position or results of operations.

#### **Note 2 – Mergers and Acquisitions**

On July 1, 2002, E.ON completed its acquisition of Powergen, including LG&E Energy, for approximately £5.1 billion (\$7.3 billion). As a result of the acquisition, LG&E Energy became a wholly owned subsidiary (through Powergen) of E.ON and, as a result, KU also became an indirect subsidiary of E.ON. KU has continued its separate identity and serves customers in Kentucky, Virginia and Tennessee under its existing names. The preferred stock and debt securities of KU were not affected by this transaction and the utilities continue to file SEC reports. Following the acquisition, E.ON became, and Powergen remained, a registered holding company under PUHCA. KU, as a subsidiary of a registered holding company, is subject to additional regulations under PUHCA. As contemplated in their regulatory filings in connection with the E.ON acquisition, E.ON, Powergen and LG&E Energy completed an administrative reorganization to move the LG&E Energy group from an indirect Powergen subsidiary to an indirect E.ON subsidiary. This reorganization was effective in March 2003.

LG&E Energy and KU Energy merged on May 4, 1998, with LG&E Energy as the surviving corporation. Management accounted for the merger as a pooling of interests and as a tax-free reorganization under the Internal Revenue Code. Following these acquisitions, KU has continued to maintain its separate identity and serve customers under its present name.

#### **Note 3 - Rates and Regulatory Matters**

Accounting for the regulated utility business conforms with generally accepted accounting principles as applied to regulated public utilities and as prescribed by FERC, the Kentucky Commission and the Virginia Commission. KU is subject to SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*, under which certain costs that would otherwise be charged to expense are deferred as regulatory assets based on expected recovery from customers in future rates. Likewise, certain credits that would otherwise be reflected as income

are deferred as regulatory liabilities based on expected return to customers in future rates. KU's current or expected recovery of deferred costs and expected return of deferred credits is generally based on specific ratemaking decisions or precedent for each item. The following regulatory assets and liabilities were included in KU's balance sheets as of December 31 (in thousands of \$):

	<u>2002</u>	<u>2001</u>
VDT costs		
Unamortized loss on bonds	\$ 38,375	\$ 48,811
LG&E/KU merger costs	9,456	6,142
One utility costs	2,046	6,139
ESM provision	873	4,365
Other	13,500	-
Total regulatory assets	<u>1,154</u>	<u>1,010</u>
	<u>65,404</u>	<u>66,467</u>
Deferred income taxes - net		
Other	(28,854)	(32,872)
Total regulatory liabilities	<u>(1,022)</u>	<u>(1,017)</u>
Regulatory assets - net	<u>(29,876)</u>	<u>(33,889)</u>
	<u>\$ 35,528</u>	<u>\$ 32,578</u>

**Kentucky Commission Settlement Order - VDT Costs.** During the first quarter 2001, KU recorded a \$64 million charge for a workforce reduction program. Primary components of the charge were separation benefits, enhanced early retirement benefits, and health care benefits. The result of this workforce reduction was the elimination of approximately 300 positions, accomplished primarily through a voluntary enhanced severance program.

On June 1, 2001, KU filed an application (VDT case) with the Kentucky Commission to create a regulatory asset relating to these first quarter 2001 charges. The application requested permission to amortize these costs over a four-year period. The Kentucky Commission also opened a case to review a new depreciation study and resulting depreciation rates implemented in 2001.

KU reached a settlement in the VDT case as well as the other cases involving depreciation rates and ESM with all intervening parties. The settlement agreement was approved by the Kentucky Commission on December 3, 2001. The order allowed KU to set up a regulatory asset of \$54 million for the workforce reduction costs and begin amortizing these costs over a five year period starting in April 2001. The first quarter 2001 charge of \$64 million represented all employees who had accepted a voluntary enhanced severance program. Some employees rescinded their participation in the voluntary enhanced severance program and, along with the non-recurring charge of \$6.9 million for FERC and Virginia jurisdictions, thereby decreasing the original charge of the regulatory asset from \$64 million to \$54 million. The settlement will also reduce revenues approximately \$11 million through a surcredit on future bills to customers over the same five year period. The surcredit represents net savings stipulated by KU. The agreement also established KU's new depreciation rates in effect December 2001, retroactive to January 1, 2001. The new depreciation rates decreased depreciation expense by \$6.0 million in 2001.

**PUHCA.** LG&E Energy was purchased by Powergen on December 11, 2000. Effective July 1, 2002, Powergen was acquired by E.ON, which became a registered holding company under PUHCA. As a result, E.ON, its utility subsidiaries, including KU, and certain of its non-utility subsidiaries are subject to extensive regulation by the SEC under PUHCA with respect to issuances and sales of securities, acquisitions and sales of certain utility properties, and intra-system sales of certain goods and services. In addition, PUHCA generally

limits the ability of registered holding companies to acquire additional public utility systems and to acquire and retain businesses unrelated to the utility operations of the holding company. KU believes that it has adequate authority (including financing authority) under existing SEC orders and regulations to conduct its business. KU will seek additional authorization when necessary.

**Environmental Cost Recovery.** In June 2000, the Kentucky Commission approved KU's application for a CCN to construct up to four SCR NOx reduction facilities. The construction and subsequent operation of the SCRs is intended to reduce NOx emission levels to meet the EPA's mandated NOx emission level of 0.15 lbs./Mmbtu by May 2004. In its order, the Kentucky Commission ruled that KU's proposed plan for construction was "reasonable, cost-effective and will not result in the wasteful duplication of facilities." In October 2000, KU filed an application with the Kentucky Commission to amend its Environmental Compliance Plan to reflect the addition of the proposed NOx reduction technology projects and to amend its ECR Tariff to include an overall rate of return on capital investments. Approval of KU's application in April 2001 allowed KU to begin to recover the costs associated with these new projects, subject to Kentucky Commission oversight during normal six-month and two-year reviews.

In August 2002, KU filed an application with the Kentucky Commission to amend its compliance plan to allow recovery of the cost of a new and additional environmental compliance facility. The estimated capital cost of the additional facilities is \$17.3 million. The Kentucky Commission conducted a public hearing on the case on December 20, 2002, final briefs were filed on January 15, 2003, and a final order was issued February 11, 2003. The final order approved recovery of the new environmental compliance facility totaling \$17.3 million. Cost recovery through the environmental surcharge of the approved project will begin with bills rendered in April 2003.

**ESM.** KU's electric rates are subject to an ESM. The ESM, initially in place for three years beginning in 2000, sets an upper and lower point for rate of return on equity, whereby if KU's rate of return for the calendar year falls within the range of 10.5% to 12.5%, no action is necessary. If earnings are above the upper limit, the excess earnings are shared 40% with ratepayers and 60% with shareholders; if earnings are below the lower limit, the earnings deficiency is recovered 40% from ratepayers and 60% from shareholders. By order of the Kentucky Commission, rate changes prompted by the ESM filing go into effect in April of each year subject to a balancing adjustment in successive periods. KU made its second ESM filing on March 1, 2002 for the calendar year 2001 reporting period. KU is in the process of refunding \$1 million to customers for the 2001 reporting period. KU estimated that the rate of return will fall below the lower limit, subject to Kentucky Commission approval, for the year ended December 31, 2002. The 2002 financial statements include an accrual to reflect the earnings deficiency of \$13.5 million to be recovered from customers commencing in April 2003.

On November 27, 2002, KU filed a revised ESM tariff which proposed continuance of the existing ESM through December 2005. The Kentucky Commission issued an order suspending the ESM tariff one day making the effective date January 2, 2003. In addition, the Kentucky Commission is conducting a management audit to review the ESM plan and reassess its reasonableness in 2003. KU and interested parties will have the opportunity to provide recommendations for modification and continuance of the ESM or other forms of alternative or incentive regulation.

**DSM.** In May 2001, the Kentucky Commission approved a plan that would expand LG&E's current DSM programs into the service territory served by KU. The filing included a rate mechanism that provided for

concurrent recovery of DSM costs, provided an incentive for implementing DSM programs, and recovered revenues from lost sales associated with the DSM program based on program planning engineering estimates and post-implementation evaluation.

**FAC.** KU employs a FAC mechanism which allows KU to recover from customers' fuel costs associated with retail electric sales. In July 1999, the Kentucky Commission issued a series of orders requiring KU to refund approximately \$10.1 million resulting from reviews of the FAC from November 1994 to October 1998. In August 1999, after a rehearing request by KU, the Kentucky Commission issued a final order that reduced the refund obligation to \$6.7 million (\$5.8 million on a Kentucky jurisdictional basis) from the original order amount of \$10.1 million. KU implemented the refund from October 1999 through September 2000. Both KU and the KIUC appealed the order. Pending a decision on this appeal, a comprehensive settlement was reached by all parties and approved by the Kentucky Commission on May 17, 2002. Thereunder, KU agreed to credit its fuel clause in the amount of \$954,000 (refund made in June and July 2002), and the parties agreed on a prospective interpretation of the state's FAC regulation to ensure consistent and mutually acceptable application on a going-forward basis.

In December 2002, the Kentucky Commission initiated a two year review of the operation of KU's FAC for the period November 2000 through October 2002. Testimony in the review case was filed on January 20, 2003 and a public hearing was held February 18, 2003. Issues addressed at that time included the establishment of the current base fuel factor to be included in KU's base rates, verification of proper treatment of purchased power costs during unit outages, and compliance with fuel procurement policies and practices.

**Kentucky Commission Administrative Case for Affiliate Transactions.** In December 1997, the Kentucky Commission opened Administrative Case No. 369 to consider Kentucky Commission policy regarding cost allocations, affiliate transactions and codes of conduct governing the relationship between utilities and their non-utility operations and affiliates. The Kentucky Commission intended to address two major areas in the proceedings: the tools and conditions needed to prevent cost shifting and cross-subsidization between regulated and non-utility operations; and whether a code of conduct should be established to assure that non-utility segments of the holding company are not engaged in practices that could result in unfair competition caused by cost shifting from the non-utility affiliate to the utility. During the period September 1998 to February 2000, the Kentucky Commission issued draft codes of conduct and cost allocation guidelines. In early 2000, the Kentucky General Assembly enacted legislation, House Bill 897, which authorized the Kentucky Commission to require utilities that provide nonregulated activities to keep separate accounts and allocate costs in accordance with procedures established by the Kentucky Commission. In the same Bill, the General Assembly set forth provisions to govern a utility's activities related to the sharing of information, databases, and resources between its employees or an affiliate involved in the marketing or the provision of nonregulated activities and its employees or an affiliate involved in the provision of regulated services. The legislation became law in July 2000 and KU has been operating pursuant thereto since that time. On February 14, 2001, the Kentucky Commission published notice of their intent to promulgate new administrative regulations under the auspices of this new law. This effort is still on-going.

**Kentucky Commission Administrative Case for System Adequacy.** On June 19, 2001, Kentucky Governor Paul E. Patton issued Executive Order 2001-771, which directed the Kentucky Commission to review and study issues relating to the need for and development of new electric generating capacity in Kentucky. The issues to be considered included the impact of new power plants on the electric supply grid, facility siting issues, and economic development matters, with the goal of ensuring a continued, reliable source of supply of electricity for the citizens of Kentucky and the continued environmental and economic vitality of Kentucky and its communi-

ties. In response to that Executive Order, in July 2001 the Kentucky Commission opened Administrative Case No. 387 to review the adequacy of Kentucky's generation capacity and transmission system. Specifically, the items reviewed were the appropriate level of reliance on purchased power, the appropriate reserve margins to meet existing and future electric demand, the impact of spikes in natural gas prices on electric utility planning strategies, and the adequacy of Kentucky's electric transmission facilities. KU, as a party to this proceeding, filed written testimony and responded to two requests for information. Public hearings were held October 2001 and KU filed a final brief in the case. In December 2001, the Kentucky Commission issued an order in which it noted that KU is responsibly addressing the long-term supply needs of native load customers and that current reserve margins are appropriate. However, due to the rapid pace of change in the industry, the order also requires KU to provide an annual assessment of supply resources, future demand, reserve margin, and the need for new resources.

Regarding the transmission system, the Kentucky Commission concluded that the transmission system within Kentucky can reliably serve native load and a significant portion of the proposed new unregulated power plants. However, it will not be able to handle the volume of transactions envisioned by FERC without future upgrades, the costs of which should be borne by those for whom the upgrades are required.

The Kentucky Commission pledged to continue to monitor all relevant issues and advocate Kentucky's interests at all opportunities.

**FERC SMD NOPR.** On July 31, 2002, the FERC issued a NOPR in Docket No. RM01-12-000 which would substantially alter the regulations governing the nation's wholesale electricity markets by establishing a common set of rules -- SMD. The SMD NOPR would require each public utility that owns, operates, or controls interstate transmission facilities to become an Independent Transmission Provider (ITP), belong to an RTO that is an ITP, or contract with an ITP for operation of its transmission assets. It would also establish a standardized congestion management system, real-time and day-ahead energy markets, and a single transmission service for network and point-to-point transmission customers. Review of the proposed rulemaking is underway and a final rule is expected during 2003. While it is expected that the SMD final rule will affect KU revenues and expenses, the specific impact of the rulemaking is not known at this time.

**MISO.** KU is a member of the MISO, which began commercial operations on February 1, 2002. MISO now has operational control over KU's high-voltage transmission facilities (100 kV and greater), while KU continues to control and operate the lower voltage transmission subject to the terms and conditions of the MISO OATT. As a transmission-owning member of MISO, KU also incurs administrative costs of MISO pursuant to Schedule 10 of the MISO OATT.

MISO also proposed to implement a congestion management system. FERC directed the MISO to coordinate its efforts with FERC's Rulemaking on SMD. On September 24, 2002, the MISO filed new rate schedules designated as Schedules 16 and 17, which provide for the collection of costs incurred by the MISO to establish day-ahead and real-time energy markets. The MISO proposed to recover these costs under Schedules 16 and 17 once service commences. If approved by FERC, these schedules will cause KU to incur additional costs. KU opposes the establishment of Schedules 16 and 17. This effort is still on-going and the ultimate impact of the two schedules, if approved, is not known at this time.

**ARO.** In 2003, KU expects to record approximately \$11.3 million in regulatory assets and approximately \$888,000 in regulatory liabilities related to SFAS No. 143, *Accounting for Asset Retirement Obligations*.

**Merger Surcredit.** As part of the LG&E Energy merger with KU Energy, KU estimated non-fuel savings over a ten-year period following the merger. Costs to achieve these savings for KU of \$42.3 million were recorded in the second quarter of 1998, \$20.5 million of which was deferred and amortized over a five-year period pursuant to regulatory orders. Primary components of the merger costs were separation benefits, relocation costs, and transaction fees, the majority of which were paid by December 31, 1998. KU expensed the remaining costs associated with the merger (\$21.8 million) in the second quarter of 1998.

In approving the merger, the Kentucky Commission adopted KU's proposal to reduce its retail customers' bills based on one-half of the estimated merger-related savings, net of deferred and amortized amounts, over a five year period. The surcredit mechanism provides that 50% of the net non-fuel cost savings estimated to be achieved from the merger would be provided to ratepayers through a monthly bill credit, and 50% retained by the Companies, over a five-year period. The surcredit was allocated 53% to KU and 47% to LG&E. In that same order, the Commission required LG&E and KU, after the end of the five-year period, to present a plan for sharing with customers the then-projected non-fuel savings associated with the merger. The Companies submitted this filing on January 13, 2003, proposing to continue to share with customers, on a 50%/50% basis, the estimated fifth-year gross level of non-fuel savings associated with the merger. The filing is currently under review.

Any fuel cost savings are passed to Kentucky customers through the fuel adjustment clauses. See FAC above.

**Note 4 - Financial Instruments**

The cost and estimated fair values of the KU's non-trading financial instruments as of December 31, 2002, and 2001 follow (in thousands of \$):

	<u>2002</u>		<u>2001</u>	
	<u>Cost</u>	<u>Fair Value</u>	<u>Cost</u>	<u>Fair Value</u>
Long-term debt (including current portion)	\$484,830	\$503,194	\$484,830	\$499,618
Interest-rate swaps	-	16,928	-	6,906

All of the above valuations reflect prices quoted by exchanges except for the swaps. The fair values of the swaps reflect price quotes from dealers or amounts calculated using accepted pricing models.

**Interest Rate Swaps.** KU uses interest rate swaps to hedge exposure to market fluctuations in certain of its debt instruments. Pursuant to policy, use of these financial instruments is intended to mitigate risk and earnings volatility and is not speculative in nature. Management has designated all of the interest rate swaps as hedge instruments. Financial instruments designated as fair value hedges are periodically marked to market with the resulting gains and losses recorded directly into net income to correspond with income or expense recognized from changes in market value of the items being hedged.

As of December 31, 2002 and 2001, KU was party to various interest rate swap agreements with aggregate notional amounts of \$153 million in 2002 and 2001. Under these swap agreements, KU paid variable rates based on either LIBOR or the Bond Market Association's municipal swap index averaging 2.36% and 2.54%, and received fixed rates averaging 7.13% and 7.13% at December 31, 2002 and 2001, respectively. The swap agreements in effect at December 31, 2002 have been designated as fair value hedges and mature on dates

ranging from 2007 to 2025. For 2002, the effect of marking these financial instruments and the underlying debt to market resulted in immaterial pretax gains recorded in interest expense.

Interest rate swaps hedge interest rate risk on the underlying debt under SFAS 133, in addition to swaps being marked to market, the item being hedged must also be marked to market, consequently at December 31, 2002, KU's debt reflects a \$15.7 million mark to market adjustment.

**Energy Trading & Risk Management Activities.** KU conducts energy trading and risk management activities to maximize the value of power sales from physical assets it owns, in addition to the wholesale sale of excess asset capacity. Certain energy trading activities are accounted for on a mark-to-market basis in accordance with EITF 98-10, *Accounting for Contracts Involved in Energy Trading and Risk Management Activities*, SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities*. Wholesale sales of excess asset capacity and wholesale purchases are treated as normal sales and purchases under SFAS No. 133 and SFAS No. 138 and are not marked-to-market.

The rescission of EITF 98-10, effective for fiscal years after December 15, 2002, will have no impact on KU's energy trading and risk management reporting as all contracts marked to market under EITF 98-10 are also within the scope of SFAS No. 133.

The table below summarizes KU's energy trading and risk management activities for 2002 and 2001 (in thousands of \$).

	<u>2002</u>	<u>2001</u>
Fair value of contracts at beginning of period, net liability	\$ (186)	\$ (17)
Fair value of contracts when entered into during the period	(65)	3,441
Contracts realized or otherwise settled during the period	448	(2,894)
Changes in fair values due to changes in assumptions	<u>(353)</u>	<u>(716)</u>
Fair value of contracts at end of period, net liability	<u>\$ (156)</u>	<u>\$ (186)</u>

No changes to valuation techniques for energy trading and risk management activities occurred during 2002. Changes in market pricing, interest rate and volatility assumptions were made during both years. All contracts outstanding at December 31, 2002, have a maturity of less than one year and are valued using prices actively quoted for proposed or executed transactions or quoted by brokers.

KU maintains policies intended to minimize credit risk and revalues credit exposures daily to monitor compliance with those policies. At December 31, 2002, 86% of the trading and risk management commitments were with counterparties rated BBB- equivalent or better.

#### **Note 5 - 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 477,000 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 five counties in southwestern Virginia and less than ten customers in Tennessee. For the year ended December 31, 2002, 100% of total utility revenue was derived from electric operations.

In August 2001, KU and its employees represented by IBEW Local 2100 entered into a two-year collective bargaining agreement. KU and its employees represented by USWA Local 9447-01 entered into a three-year collective bargaining agreement effective August 2002 and expiring August 2005. The employees represented by these two bargaining units comprise approximately 17% of KU's workforce.

#### Note 6 - Pension Plans and Retirement Benefits

KU sponsors qualified and non-qualified pension plans and other postretirement benefit plans for its employees. The following tables provide a reconciliation of the changes in the plans' benefit obligations and fair value of assets over the three-year period ending December 31, 2002, and a statement of the funded status as of December 31 for each of the last three years (in thousands of \$):

<u>Pension Plans:</u>	<u>2002</u>	<u>2001</u>	<u>2000</u>
Change in benefit obligation			
Benefit obligation at beginning of year	\$244,472	\$233,034	\$219,628
Service cost	2,637	2,761	4,312
Interest cost	16,598	17,534	17,205
Plan amendment	28	4	11,757
Change due to transfers	-	(16,827)	-
Curtailement loss	-	1,400	-
Special termination benefits	-	24,274	-
Benefits paid	(23,291)	(29,166)	(16,512)
Actuarial (gain) or loss and other	7,283	11,458	(3,356)
Benefit obligation at end of year	<u>\$247,727</u>	<u>\$244,472</u>	<u>\$233,034</u>
Change in plan assets			
Fair value of plan assets at beginning of year	\$216,947	\$244,677	\$274,109
Actual return on plan assets	(13,767)	18,155	(10,943)
Employer contributions and plan transfers	(99)	(15,300)	(994)
Benefits paid	(23,291)	(29,166)	(16,512)
Administrative expenses	(1,256)	(1,419)	(983)
Fair value of plan assets at end of year	<u>\$178,534</u>	<u>\$216,947</u>	<u>\$244,677</u>
Reconciliation of funded status			
Funded status			
Unrecognized actuarial (gain) or loss	\$ (69,193)	\$ (27,525)	\$ 11,643
Unrecognized transition (asset) or obligation	36,233	(20,581)	(36,435)
Unrecognized prior service cost	(532)	(664)	(847)
Net amount recognized at end of year	<u>10,106</u>	<u>11,027</u>	<u>14,176</u>
	<u>\$ (23,386)</u>	<u>\$ (37,743)</u>	<u>\$ (11,463)</u>

<u>Other Benefits:</u>			
Change in benefit obligation	\$ 83,223	\$ 64,213	\$ 54,201
Benefit obligation at beginning of year	610	495	757
Service cost	6,379	5,433	4,781
Interest cost	-	-	7,127
Plan amendments	-	6,381	-
Curtailment loss	-	3,824	-
Special termination benefits	(4,640)	(5,446)	(4,318)
Benefits paid net of retiree contributions	<u>19,030</u>	<u>8,323</u>	<u>1,665</u>
Actuarial (gain) or loss	<u>\$104,602</u>	<u>\$ 83,223</u>	<u>\$ 64,213</u>
Benefit obligation at end of year			
Change in plan assets	\$ 14,330	\$ 23,762	\$ 28,720
Fair value of plan assets at beginning of year	(2,698)	(4,404)	(1,162)
Actual return on plan assets	1,648	473	522
Employer contributions and plan transfers	<u>(5,337)</u>	<u>(5,501)</u>	<u>(4,318)</u>
Benefits paid net of retiree contributions	<u>\$ 7,943</u>	<u>\$ 14,330</u>	<u>\$ 23,762</u>
Fair value of plan assets at end of year			
Reconciliation of funded status	\$ (96,659)	\$ (68,893)	\$ (40,451)
Funded status	22,667	(437)	(23,561)
Unrecognized actuarial (gain) or loss	11,209	12,290	21,871
Unrecognized transition (asset) or obligation	<u>2,891</u>	<u>3,548</u>	<u>6,109</u>
Unrecognized prior service cost	<u>\$(59,892)</u>	<u>\$(53,492)</u>	<u>\$(36,032)</u>
Net amount recognized at end of year			

There are no plan assets in the non-qualified plan due to the nature of the plan.

KU made a contribution to the pension plan of \$3.5 million in January 2003.

The following tables provide the amounts recognized in the balance sheet and information for plans with benefit obligations in excess of plan assets as of December 31, 2002, 2001 and 2000 (in thousands of \$):

	<u>2002</u>	<u>2001</u>	<u>2000</u>
<u>Pension Plans:</u>			
Amounts recognized in the balance sheet consisted of:			
Accrued benefit liability	\$ (51,035)	\$(37,743)	\$(11,463)
Intangible asset	10,106	-	-
Accumulated other comprehensive income	<u>17,543</u>	<u>-</u>	<u>-</u>
Net amount recognized at year-end	<u><u>\$(23,386)</u></u>	<u><u>\$(37,743)</u></u>	<u><u>\$(11,463)</u></u>
Additional year-end information for plans with accumulated benefit obligations in excess of plan assets (1):			
Projected benefit obligation	\$247,727	\$244,472	\$ 1,505
Accumulated benefit obligation	229,569	224,261	336
Fair value of plan assets	178,534	216,947	-

(1) 2002 and 2001 includes all plans. 2000 includes SERPs only.

<u>Other Benefits:</u>			
Amounts recognized in the balance sheet consisted of:			
Accrued benefit liability	<u>\$(59,892)</u>	<u>\$(53,492)</u>	<u>\$(36,032)</u>
Additional year-end information for plans with benefit obligations in excess of plan assets:			
Projected benefit obligation	\$104,602	\$ 83,223	\$ 64,213
Fair value of plan assets	7,943	14,330	23,762

The following table provides the components of net periodic benefit cost for the plans for 2002, 2001 and 2000 (in thousands of \$):

	<u>2002</u>	<u>2001</u>	<u>2000</u>
<b><u>Pension Plans:</u></b>			
Components of net periodic benefit cost			
Service cost	\$ 2,637	\$ 2,761	\$ 4,312
Interest cost	16,598	17,534	17,205
Expected return on plan assets	(18,406)	(19,829)	(25,170)
Amortization of transition (asset) or obligation	(133)	(136)	(141)
Amortization of prior service cost	956	962	1,145
Recognized actuarial (gain) or loss	<u>1</u>	<u>(120)</u>	<u>(3,410)</u>
Net periodic benefit cost	<u>\$ 1,653</u>	<u>\$ 1,172</u>	<u>\$ (6,059)</u>
<b>Special charges</b>			
Prior service cost recognized	\$ -	\$ 1,238	\$ -
Special termination benefits	<u>-</u>	<u>24,274</u>	<u>-</u>
Total charges	<u>\$ -</u>	<u>\$ 25,512</u>	<u>\$ -</u>
<b><u>Other Benefits:</u></b>			
Components of net periodic benefit cost			
Service cost	\$ 610	\$ 495	\$ 757
Interest cost	6,379	5,433	4,781
Expected return on plan assets	(1,022)	(1,313)	(1,768)
Amortization of prior service cost	691	740	1,018
Amortization of transition (asset) or obligation	1,081	1,193	1,823
Recognized actuarial (gain) or loss	<u>343</u>	<u>(40)</u>	<u>(820)</u>
Net periodic benefit cost	<u>\$ 8,082</u>	<u>\$ 6,508</u>	<u>\$ 5,791</u>
<b>Special charges</b>			
Transition obligation recognized	\$ -	\$ 7,638	\$ -
Prior service cost recognized	<u>-</u>	<u>1,613</u>	<u>-</u>
Special termination benefits	<u>-</u>	<u>3,824</u>	<u>-</u>
Total charges	<u>\$ -</u>	<u>\$ 13,075</u>	<u>\$ -</u>

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

	<u>2002</u>	<u>2001</u>	<u>2000</u>
<b>Weighted-average assumptions as of December 31:</b>			
Discount rate	6.75%	7.25%	7.75%
Expected long-term rate of return on plan assets	9.00%	9.50%	9.50%
Rate of compensation increase	3.75%	4.25%	4.75%

For measurement purposes, a 12.00% annual increase in the per capita cost of covered health care benefits was assumed for 2003. The rate was assumed to decrease gradually to 5.00% for 2014 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 the following effects (in thousands of \$):

	<u>1% Decrease</u>	<u>1% Increase</u>
Effect on total of service and interest cost components for 2002	(422)	479
Effect on year-end 2002 postretirement benefit obligations	(7,010)	7,972

**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 approximately \$1.5 million for 2002, \$1.4 million for 2001 and \$2.5 million for 2000.

### Note 7 - Income Taxes

Components of income tax expense are shown in the table below (in thousands of \$):

	<u>2002</u>	<u>2001</u>	<u>2000</u>
Included in operating expenses:			
Current			
- federal	\$38,524	\$58,337	\$44,927
- state	10,494	13,465	9,333
Deferred			
- federal - net	3,467	(12,980)	(3,254)
- state - net	<u>1,547</u>	<u>(1,340)</u>	<u>957</u>
Total	<u>54,032</u>	<u>57,482</u>	<u>51,963</u>
Included in other income - net:			
Current			
- federal	(685)	(948)	349
- state	15	(268)	67
Deferred			
- federal - net	(195)	863	(122)
- state - net	(88)	222	(30)
Amortization of investment tax credit	<u>(2,955)</u>	<u>(3,446)</u>	<u>(3,674)</u>
Total	<u>(3,908)</u>	<u>(3,577)</u>	<u>(3,410)</u>
Total income tax expense	<u>\$50,124</u>	<u>\$53,905</u>	<u>\$48,553</u>

Components of net deferred tax liabilities included in the balance sheet are shown below (in thousands of \$):

	<u>2002</u>	<u>2001</u>
Deferred tax liabilities:		
Depreciation and other	\$271,792	\$269,752
plant-related items	<u>30,378</u>	<u>33,376</u>
Other liabilities	<u>302,170</u>	<u>303,128</u>
Deferred tax assets:		
Investment tax credit	3,431	4,623
Income taxes due to customers	11,609	13,263
Pensions	15,861	4,595
Accrued liabilities not currently		
deductible and other	<u>30,085</u>	<u>41,443</u>
	<u>60,986</u>	<u>63,924</u>
Net deferred income tax liability	<u>\$241,184</u>	<u>\$239,204</u>

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

	<u>2002</u>	<u>2001</u>	<u>2000</u>
Statutory federal income tax rate	35.0%	35.0%	35.0%
State income taxes, net of federal benefit	5.5	5.4	4.9
Amortization of investment tax credit	(2.4)	(2.3)	(2.6)
Other differences - net	<u>(3.2)</u>	<u>(2.2)</u>	<u>(3.6)</u>
Effective income tax rate	<u>34.9%</u>	<u>35.9%</u>	<u>33.7%</u>

The change in other differences is due to increased non-taxable earnings from an unconsolidated KU investment.

#### Note 8 - Other Income - net

Other income - net consisted of the following at December 31 (in thousands of \$):

	<u>2002</u>	<u>2001</u>	<u>2000</u>
Equity in earnings - subsidiary company	\$ 6,697	\$ 1,803	\$ 2,242
Interest and dividend income	641	1,368	1,206
Gains on fixed asset disposals	157	1,844	5
Income taxes and other	<u>2,934</u>	<u>3,917</u>	<u>3,390</u>
Other income - net	<u>\$10,429</u>	<u>\$ 8,932</u>	<u>\$ 6,843</u>

### Note 9 - First Mortgage Bonds and Pollution Control Bonds

Long-term debt and the current portion of long-term debt, summarized below (in thousands of \$), consists primarily of first mortgage bonds and pollution control bonds. Interest rates and maturities in the table below are for the amounts outstanding at December 31, 2002.

	<u>Stated Interest Rates</u>	<u>Weighted Average Interest Rate</u>	<u>Maturities</u>	<u>Principal Amounts</u>
Noncurrent portion	Variable - 8.55%	5.21%	2006-2032	\$346,562
Current portion	Variable - 6.32%	3.58%	2003-2032	\$153,930

Under the provisions for KU's variable-rate pollution control bonds Series PCS 10, 12, 13, 14, and 15, 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 consolidated balance sheets. The average annualized interest rate for these bonds during 2002 was 1.58%.

In September 2002, KU issued \$96 million variable rate pollution control Series 16 due October 1, 2032, and exercised its call option on \$96 million, 7.45% pollution control Series 8 due September 15, 2016.

In May 2002, KU issued \$37.9 million variable rate pollution control Series 12, 13, 14 and 15 due February 1, 2032, and exercised its call option on \$37.9 million, 6.25% pollution control Series 1B, 2B, 3B, and 4B due February 1, 2018.

In May 2000, KU issued the Mercer County Solid Waste Disposal Facility Revenue Bonds, 2000 Series A variable rate debt, for \$12.9 million. These proceeds were used to redeem \$4 million PCB Series 7, 7.38% bonds and \$8.9 million of PCB Series 7, 7.6% bonds. In June 2000, \$61.5 million Series Q, 5.95% First Mortgage Bond matured and was paid in full.

KU's First Mortgage Bond, 6.32% Series Q of \$62 million is scheduled to mature in June 2003, KU's First Mortgage Bond, 5.99% Series S of \$36 million matures in 2006, and KU's First Mortgage Bond, 7.92% Series P of \$53 million matures in 2007. There are no scheduled maturities of Pollution Control Bonds for the five years subsequent to December 31, 2002.

Substantially all of KU's utility plant is pledged as security for its First Mortgage Bonds.

### Note 10 - Notes Payable to Parent

KU participates in an intercompany money pool agreement wherein LG&E Energy can make funds available to KU at market based rates up to \$400 million. The balance of the money pool loan from LG&E Energy was \$119.5 million at a rate of 1.61% and \$47.8 million at an average rate of 2.37% at December 31, 2002 and 2001, respectively. The remaining money pool availability at December 31, 2002, was \$280.5 million. LG&E Energy maintains facilities of \$450 million with affiliates to ensure funding availability for the money pool. The outstanding balance under these facilities as of December 31, 2002 was \$230 million, and availability of \$220 million remained.

## Note 11 - Commitments and Contingencies

**Construction Program.** KU had approximately \$6.2 million of commitments in connection with its construction program at December 31, 2002. Construction expenditures for the years 2003 and 2004 are estimated to total approximately \$550.0 million; although all of this is not currently committed, including the purchase of four jointly owned CTs, \$152.0 million, and construction of NOx equipment, \$177.0 million.

**Operating Leases.** KU leases office space, office equipment, and vehicles. KU accounts for these leases as operating leases. Total lease expense for 2002, 2001, and 2000, was \$2.6 million, \$2.8 million and \$2.3 million, respectively.

In December 1999, LG&E and KU entered into an 18-year cross-border lease of its two jointly owned combustion turbines recently installed at KU's Brown facility (units 6 and 7). KU's obligation was defeased upon consummation of the cross-border lease. The transaction produced a pre-tax gain of approximately \$1.9 million which was recorded in other income on the income statement in 2000, pursuant to a Kentucky Commission order.

**Environmental.** The Clean Air Act imposed stringent new SO<sub>2</sub> and NOx emission limits on electric generating units. KU met its Phase I SO<sub>2</sub> requirements primarily through installation of a scrubber on Ghent Unit 1. KU's strategy for Phase II SO<sub>2</sub> reductions, which commenced January 1, 2000, is to use accumulated emissions allowances to delay additional capital expenditures and may also include fuel switching or the installation of additional scrubbers. KU met the NOx emission requirements of the Act through installation of low-NOx burner systems. KU's compliance plans are subject to many factors including developments in the emission allowance and fuel markets, future regulatory and legislative initiatives, and advances in clean air control technology. KU will continue to monitor these developments to ensure that its environmental obligations are met in the most efficient and cost-effective manner.

In September 1998, the EPA announced its final "NOx SIP Call" rule requiring states to impose significant additional reductions in NOx emissions by May 2003, in order to mitigate alleged ozone transport impacts on the Northeast region. The Commonwealth of Kentucky is currently in the process of revising its SIP to require reductions in NOx emissions from coal-fired generating units to the 0.15 lb./Mmbtu level on a system-wide basis. In related proceedings in response to petitions filed by various Northeast states, in December 1999, EPA issued a final rule pursuant to Section 126 of the Clean Air Act directing similar NOx reductions from a number of specifically targeted generating units including all KU units in the eastern half of Kentucky. Additional petitions currently pending before EPA may potentially result in rules encompassing KU's remaining generating units. As a result of appeals to both rules, the compliance date was extended to May 2004. All KU generating units are subject to the May 2004 compliance date under these NOx emissions reduction rules.

KU is currently implementing a plan for adding significant additional NOx controls to its generating units. Installation of additional NOx controls will proceed on a phased basis, with installation of controls commencing in late 2000 and continuing through the final compliance date. In addition, KU will incur additional operation and maintenance costs in operating new NOx controls. KU believes its costs in this regard to be comparable to those of similarly situated utilities with like generation assets. KU had anticipated that such capital and operating costs are the type of costs that are eligible for recovery from customers under its environmental surcharge mechanism and believed that a significant portion of such costs could be recovered. In April 2001, the Kentucky Commission granted recovery of these costs for KU.

KU is also monitoring several other air quality issues which may potentially impact coal-fired power plants, including the appeal of the D.C. Circuit's remand of the EPA's revised air quality standards for ozone and particulate matter, measures to implement EPA's regional haze rule, and EPA's December 2000 determination to regulate mercury emissions from power plants.

KU owns or formerly owned several properties that contained past MGP operations. Various contaminants are typically found at such former MGP sites and environmental remediation measures are frequently required. KU has completed the cleanup of a site owned by KU. With respect to other former MGP sites no longer owned by KU, KU is unaware of what, if any, additional exposure or liability it may have.

In October 1999, approximately 38,000 gallons of diesel fuel leaked from a cracked valve in an underground pipeline at KU's E.W. Brown Station. Under the oversight of EPA and state officials, KU commenced immediate spill containment and recovery measures which prevented the spill from reaching the Kentucky River. KU ultimately recovered approximately 34,000 gallons of diesel fuel. In November 1999, the Kentucky Division of Water issued a notice of violation for the incident. KU is currently negotiating with the state in an effort to reach a complete resolution of this matter. KU incurred costs of approximately \$1.8 million and received insurance reimbursement of \$1.2 million. In December 2002, the Department of Justice (DOJ) sent correspondence to KU regarding a potential per-day fine for failure to timely submit a spill control plan and a per-gallon fine for the amount of oil discharged. KU and the DOJ have commenced settlement discussions using existing DOJ settlement guidelines on this matter.

In April 2002, the EPA sent correspondence to KU regarding potential exposure in connection with \$1.5 million in completed remediation costs associated with a transformer scrap-yard. KU believes it is one of the more remote among a number of potentially responsible parties and has entered into settlement discussions with the EPA on this matter.

**Purchased Power.** KU has purchase power arrangements with OMU, EEI and other parties. Under the OMU agreement, which expires on January 1, 2020, KU purchases all of the output of a 400-Mw generating station not required by OMU. The amount of purchased power available to KU during 2003-2007, which is expected to be approximately 8% of KU's total kWh native load energy requirements, is dependent upon a number of factors including the 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, which generally follow delivered kWh. Included in the total costs is KU's proportionate share of debt service requirements on \$149.6 million of OMU bonds outstanding at December 31, 2002. The debt service is allocated to KU based on its annual allocated share of capacity, which averaged approximately 50% in 2002.

KU has a 20% equity ownership in EEI, which is accounted for on the equity method of accounting. KU's entitlement is 20% of the available capacity of a 1,000 Mw station. Payments are based on the total costs of the station allocated per terms of an agreement among the owners, which generally follow delivered kWh.

KU has several other contracts for purchased power of various Mw capacities.

The estimated future minimum annual payments under purchased power agreements for the years subsequent to December 31, 2002, are as follows (in thousands of \$):

	\$ 34,317
2003	39,653
2004	39,653
2005	39,884
2006	39,994
2007	<u>643,946</u>
Thereafter	<u>\$837,447</u>
Total	

## Note 12 – Jointly Owned Electric Utility Plant

LG&E and KU jointly own the following combustion turbines (in thousands of \$):

		<u>LG&amp;E</u>	<u>KU</u>	<u>Total</u>
Paddy's Run 13	Ownership %	53%	47%	100%
	Mw capacity	84	74	158
	Cost	\$33,919	\$29,973	\$63,892
	Depreciation	<u>1,711</u>	<u>1,499</u>	<u>3,210</u>
	Net book value	<u>\$32,208</u>	<u>\$28,474</u>	<u>\$60,682</u>
E.W. Brown 5	Ownership %	53%	47%	100%
	Mw capacity	71	63	134
	Cost	\$23,973	\$21,106	\$45,079
	Depreciation	<u>1,206</u>	<u>1,052</u>	<u>2,258</u>
	Net book value	<u>\$22,767</u>	<u>\$20,054</u>	<u>\$42,821</u>
E.W. Brown 6	Ownership %	38%	62%	100%
	Mw capacity	59	95	154
	Cost	\$23,696	\$36,957	\$60,653
	Depreciation	<u>1,770</u>	<u>4,201</u>	<u>5,971</u>
	Net book value	<u>\$21,926</u>	<u>\$32,756</u>	<u>\$54,682</u>
E.W. Brown 7	Ownership %	38%	62%	100%
	Mw capacity	59	95	154
	Cost	\$23,607	\$44,792	\$68,399
	Depreciation	<u>4,054</u>	<u>4,502</u>	<u>8,556</u>
	Net book value	<u>\$19,553</u>	<u>\$40,290</u>	<u>\$59,843</u>
Trimble 5	Ownership %	29%	71%	100%
	Mw capacity	45	110	155
	Cost	\$15,970	\$39,045	\$55,015
	Depreciation	<u>251</u>	<u>614</u>	<u>865</u>
	Net book value	<u>\$15,719</u>	<u>\$38,431</u>	<u>\$54,150</u>
Trimble 6	Ownership %	29%	71%	100%
	Mw capacity	45	110	155
	Cost	\$15,961	\$39,025	\$54,986
	Depreciation	<u>251</u>	<u>614</u>	<u>865</u>
	Net book value	<u>\$15,710</u>	<u>\$38,411</u>	<u>\$54,121</u>
Trimble CT Pipeline	Ownership %	29%	71%	100%
	Cost	\$1,835	\$4,475	\$6,310
	Depreciation	<u>39</u>	<u>96</u>	<u>135</u>
	Net book value	<u>\$1,796</u>	<u>\$4,379</u>	<u>\$6,175</u>

See also Note 11, Construction Program, for KU's planned purchase of four jointly owned CTs in 2004.

### Note 13 - Selected Quarterly Data (Unaudited)

Selected financial data for the four quarters of 2002 and 2001 are shown below. Because of seasonal fluctuations in temperature and other factors, results for quarters may fluctuate throughout the year.

	<u>March</u>	<u>Quarters Ended</u>		
		<u>June</u>	<u>September</u>	<u>December</u>
	(Thousands of \$)			
<u>2002</u>				
Revenues	\$215,168	\$203,555	\$239,020	\$230,476
Net operating income	28,200	20,047	31,028	29,368
Net income	24,357	12,752	31,085	25,190
Net income available for common stock	23,793	12,188	30,521	24,626
<u>2001</u>				
Revenues	\$211,793	\$219,360	\$216,370	\$211,949
Net operating income (loss) (a)	(344)	28,422	30,253	63,039
Net income (loss) (a)	(7,995)	22,080	26,340	55,989
Net income (loss) available for common stock (a)	(8,559)	21,516	25,776	55,425

(a) Loss resulted from the VDT pre-tax charge of \$64.0 million in March 2001, which \$57.1 million was reversed in December 2001. See Note 3.

### Note 14 - Subsequent Events

In January 2003, the Kentucky Commission reviewed the FAC of KU for the six month period ended October 31, 2001. The Kentucky Commission ordered KU to reduce its fuel costs for purposes of calculating its FAC by \$673,000. At issue was the purchase of approximately 102,000 tons of coal from Western Kentucky Energy Corporation, a non-regulated affiliate, for use at KU's Ghent Facility. The Kentucky Commission further ordered that an independent audit be conducted to examine operational and management aspects of KU's fuel procurement functions.

On February 15, 2003, KU experienced a severe ice storm in Lexington, Kentucky, and surrounding service area causing over 140,000 customers to lose power. KU is still in the process of accumulating the costs of the storm. Costs relate to repair of transmission and distribution system, property damage, and significant labor costs, including contractor costs. A portion of the costs may be offset by insurance proceeds.

On March 18, 2003, the Kentucky Commission approved LG&E and KU's joint application for the acquisition of four CTs from an unregulated affiliate, LG&E Capital Corp. The total projected construction cost for the turbines, expected to be available for June 2004 in-service, is \$227.4 million. The requested ownership share of the turbines is 63% for KU and 37% for LG&E.

Kentucky Utilities Company  
REPORT OF MANAGEMENT

The management of Kentucky Utilities Company is responsible for the preparation and integrity of the financial statements and related information included in this Annual Report. These statements have been prepared in accordance with accounting principles generally accepted in the United States applied on a consistent basis and, necessarily, include amounts that reflect the best estimates and judgment of management.

KU's 2002 and 2001 financial statements have been audited by PricewaterhouseCoopers LLP, independent accountants and the 2000 financial statements were audited by Arthur Andersen LLP. Management made available to PricewaterhouseCoopers LLP and to Arthur Andersen LLP (in prior years) all KU's financial records and related data as well as the minutes of shareholders' and directors' meetings.

Management has established and maintains a system of internal controls that provide reasonable assurance that transactions are completed in accordance with management's authorization, that assets are safeguarded and that financial statements are prepared in conformity with generally accepted accounting principles. Management believes that an adequate system of internal controls is maintained through the selection and training of personnel, appropriate division of responsibility, establishment and communication of policies and procedures and by regular reviews of internal accounting controls by KU's internal auditors. Management reviews and modifies its system of internal controls in light of changes in conditions and operations, as well as in response to recommendations from the internal and external auditors. These recommendations for the year ended December 31, 2002, did not identify any material weaknesses in the design and operation of KU's internal control structure.

In carrying out its oversight role for the financial reporting and internal controls of KU, the Board of Directors meets regularly with KU's independent public accountants, internal auditors and management. The Board of Directors reviews the results of the independent accountants' audit of the financial statements and their audit procedures, and discusses the adequacy of internal accounting controls. The Board of Directors also approves the annual internal auditing program, and reviews the activities and results of the internal auditing function. Both the independent public accountants and the internal auditors have access to the Board of Directors at any time.

Kentucky Utilities Company maintains and internally communicates a written code of business conduct that addresses, among other items, potential conflicts of interest, compliance with laws, including those relating to financial disclosure, and the confidentiality of proprietary information.

S. Bradford Rives  
Senior Vice President-Finance and Controller

Kentucky Utilities Company  
Louisville, Kentucky

**Kentucky Utilities Company and Subsidiary  
REPORT OF INDEPENDENT ACCOUNTANTS**

To the Shareholders of Kentucky Utilities Company and Subsidiary:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of capitalization, income, retained earnings, cash flows and comprehensive income present fairly, in all material respects, the financial position of Kentucky Utilities Company and Subsidiary (the "Company"), a wholly-owned subsidiary of LG&E Energy Corp., at December 31, 2002 and 2001, and the results of their operations and their cash flows for each of the two years in the period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

/s/ PricewaterhouseCoopers LLP  
January 21, 2003  
Louisville, Kentucky

Kentucky Utilities Company  
REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Shareholders of Kentucky Utilities Company:

We have audited the accompanying balance sheet and statement of capitalization of Kentucky Utilities Company (a Kentucky and Virginia corporation and a wholly-owned subsidiary of LG&E Energy Corp.) as of December 31, 2000, and the related statements of income, retained earnings and cash flows for each of the two years in the period ended December 31, 2000. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Kentucky Utilities Company as of December 31, 2000, and the results of its operations and its cash flows for each of the two years in the period ended December 31, 2000, in conformity with accounting principles generally accepted in the United States.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The schedule listed under Item 14(a)2 is presented for purposes of complying with the Securities and Exchange Commission's rules and is not part of the basic financial statements. This schedule has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, fairly states in all material respects the financial data required to be set forth therein in relation to the basic financial statements taken as a whole.

Louisville, Kentucky  
January 26, 2001

Arthur Andersen LLP

THIS IS A COPY OF A PREVIOUSLY ISSUED REPORT OF ARTHUR ANDERSEN LLP ("ANDERSEN") RELATING TO A PRIOR PERIOD FOR WHICH ANDERSEN WAS ENGAGED AS INDEPENDENT PUBLIC ACCOUNTANTS. THE REPORT HAS NOT BEEN REISSUED BY ANDERSEN.

**ITEM 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.**

Not applicable.

**PART III**

ITEMS 10, 11, 12 and 13 are omitted pursuant to General Instruction G of Form 10-K. The information required by ITEMS 10, 11, 12 and 13 for LG&E and KU are set forth in Exhibit 99.2 filed herewith and incorporated herein by reference. Additionally, in accordance with General Instruction G, the information required by ITEM 10 relating to executive officers of LG&E and KU has been included in Part I of this Form 10-K.

**PART IV**

**ITEM 14. Controls and Procedures**

LG&E and KU maintain a system of disclosure controls and procedures designed to ensure that information required to be disclosed by the companies in reports they file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission rules and forms. During the 90 day period preceding the filing of this report, LG&E and KU conducted an evaluation of such controls and procedures under the supervision and the participation of the companies' Management, including the Chairman, President and Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO"). Based upon that evaluation, the CEO and CFO are of the conclusion that the companies' disclosure controls and procedures are effective. With respect to LG&E's and KU's internal controls, there have been no significant changes in internal controls or in other factors that could significantly affect these controls subsequent to the date of their most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

**ITEM 15. Exhibits, Financial Statement Schedules, and Reports on Form 8-K.**

(a) 1. Financial Statements (included in Item 8):

LG&E:

Consolidated statements of income for the three years ended December 31, 2002 (page 71).

Consolidated statements of retained earnings for the three years ended December 31, 2002 (page 71).

Consolidated statements of comprehensive income for the three years ended December 31, 2002 (page 72).

Consolidated balance sheets-December 31, 2002, and 2001 (page 73).

Consolidated statements of cash flows for the three years ended December 31, 2002 (page 74).

Consolidated statements of capitalization-December 31, 2002, and 2001 (page 75).

Notes to consolidated financial statements (pages 76-99).

Report of management (page 100).

Reports of independent accountants (pages 101-102).

KU:

Consolidated statements of income for the three years ended December 31, 2002 (page 105).

Consolidated statements of retained earnings for the three years ended December 31, 2002 (page 105).

Consolidated statements of comprehensive income for the three years ended December 31, 2002 (page 106).

Consolidated balance sheets-December 31, 2002, and 2001 (page 107).

Consolidated statements of cash flows for the three years ended December 31, 2002 (page 108).

Consolidated statements of capitalization-December 31, 2002, and 2001 (page 109).

Notes to consolidated financial statements (pages 110-131).

Report of management (page 132).

Reports of independent accountants (pages 133-134).

2. Financial Statement Schedules (included in Part IV):

Schedule II Valuation and Qualifying Accounts for the three years ended December 31, 2002, for LG&E (page 157), and KU (page 159).

All other schedules have been omitted as not applicable or not required or because the information required to be shown is included in the Financial Statements or the accompanying Notes to Financial Statements.

3. Exhibits:

Exhibit No.	Applicable to Form 10-K of		Description
	LG&E	KU	
2.01	x	x	Copy of Agreement and Plan of Merger, dated as of February 27, 2000, by and among Powergen plc, LG&E Energy Corp., US Subholdco2 and Merger Sub, including certain exhibits thereto. [Filed as Exhibit 1 to LG&E's and KU's Current Report on Form 8-K filed February 29, 2000 and incorporated by reference herein]
2.02	x	x	Amendment No. 1 to Agreement and Plan of Merger, dated as of December 8, 2000, among LG&E Energy Corp., Powergen plc, Powergen US Investments Corp. and Powergen Acquisition Corp. [Filed as Exhibit 2.01 to LG&E's and KU's Current Report on Form 8-K filed December 11, 2000 and incorporated by reference herein]
2.03	x	x	Copy of Agreement and Plan of Merger, dated as of May 20, 1997, by and between LG&E Energy and KU Energy, including certain exhibits thereto. [Filed as Exhibit 2 to LG&E's and KU's Current Report on Form 8-K filed May 30, 1997 and incorporated by reference herein]
3.01	x		Copy of Restated Articles of Incorporation of LG&E, dated November 6, 1996. [Filed as Exhibit 3.06 to LG&E Quarterly Report on Form 10-Q for the quarter ended September 30, 1996, and incorporated by reference herein]
3.02	x		Copy of By-Laws of LG&E, as amended through June 2, 1999 [Filed as

<u>Exhibit No.</u>	<u>Applicable to Form 10-K of</u>		<u>Description</u>
	<u>LG&amp;E</u>	<u>KU</u>	
			Exhibit 3.02 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1999, and incorporated by reference herein]
3.03		x	Copy of Amended and Restated Articles of Incorporation of KU [Filed as Exhibits 4.03 and 4.04 to Form 8-K Current Report of KU, dated December 10, 1993, and incorporated by reference herein]
3.04		x	Copy of By-Laws of KU, as amended through June 2, 1999. [Filed as Exhibit 3.04 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1999, and incorporated by reference herein]
4.01	x		Copy of Trust Indenture dated November 1, 1949, from LG&E to Harris Trust and Savings Bank, Trustee. [Filed as Exhibit 7.01 to LG&E's Registration Statement 2-8283 and incorporated by reference herein]
4.02	x		Copy of Supplemental Indenture dated February 1, 1952, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 4.05 to LG&E's Registration Statement 2-9371 and incorporated by reference herein]
4.03	x		Copy of Supplemental Indenture dated February 1, 1954, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 4.03 to LG&E's Registration Statement 2-11923 and incorporated by reference herein]
4.04	x		Copy of Supplemental Indenture dated September 1, 1957, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 2.04 to LG&E's Registration Statement 2-17047 and incorporated by reference herein]
4.05	x		Copy of Supplemental Indenture dated October 1, 1960, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 2.05 to LG&E's Registration Statement 2-24920 and incorporated by reference herein]
4.06	x		Copy of Supplemental Indenture dated June 1, 1966, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 2.06 to LG&E's Registration Statement 2-28865 and incorporated by reference herein]
4.07	x		Copy of Supplemental Indenture dated June 1, 1968, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 2.07 to LG&E's Registration Statement 2-37368 and incorporated by reference

Applicable to Form  
10-K of

<u>Exhibit No.</u>	<u>LG&amp;E</u>	<u>KU</u>	<u>Description</u>
			herein]
4.08	x		Copy of Supplemental Indenture dated June 1, 1970, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 2.08 to LG&E's Registration Statement 2-37368 and incorporated by reference herein]
4.09	x		Copy of Supplemental Indenture dated August 1, 1971, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 2.09 to LG&E's Registration Statement 2-44295 and incorporated by reference herein]
4.10	x		Copy of Supplemental Indenture dated June 1, 1972, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 2.10 to LG&E's Registration Statement 2-52643 and incorporated by reference herein]
4.11	x		Copy of Supplemental Indenture dated February 1, 1975, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 2.11 to LG&E's Registration Statement 2-57252 and incorporated by reference herein]
4.12	x		Copy of Supplemental Indenture dated September 1, 1975, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 2.12 to LG&E's Registration Statement 2-57252 and incorporated by reference herein]
4.13	x		Copy of Supplemental Indenture dated September 1, 1976, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 2.13 to LG&E's Registration Statement 2-57252 and incorporated by reference herein]
4.14	x		Copy of Supplemental Indenture dated October 1, 1976, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 2.14 to LG&E's Registration Statement 2-65271 and incorporated by reference herein]
4.15	x		Copy of Supplemental Indenture dated June 1, 1978, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 2.15 to LG&E's Registration Statement 2-65271 and incorporated by reference herein]
4.16	x		Copy of Supplemental Indenture dated February 15, 1979, which is a

<u>Exhibit No.</u>	<u>Applicable to Form 10-K of</u>		<u>Description</u>
	<u>LG&amp;E</u>	<u>KU</u>	
			supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 2.16 to LG&E's Registration Statement 2-65271 and incorporated by reference herein]
4.17	x		Copy of Supplemental Indenture dated September 1, 1979, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 4.17 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1980, and incorporated by reference herein]
4.18	x		Copy of Supplemental Indenture dated September 15, 1979, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 4.18 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1980, and incorporated by reference herein]
4.19	x		Copy of Supplemental Indenture dated September 15, 1981, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 4.19 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1981, and incorporated by reference herein]
4.20	x		Copy of Supplemental Indenture dated March 1, 1982, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 4.20 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1982, and incorporated by reference herein]
4.21	x		Copy of Supplemental Indenture dated March 15, 1982, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 4.21 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1982, and incorporated by reference herein]
4.22	x		Copy of Supplemental Indenture dated September 15, 1982, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 4.22 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1982, and incorporated by reference herein]
4.23	x		Copy of Supplemental Indenture dated February 15, 1984, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 4.23 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1984, and incorporated by reference herein]
4.24	x		Copy of Supplemental Indenture dated July 1, 1985, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 4.24 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1985, and incorporated by reference herein]

Exhibit No.	Applicable to Form 10-K of		<u>Description</u>
	<u>LG&amp;E</u>	<u>KU</u>	
4.25	x		Copy of Supplemental Indenture dated November 15, 1986, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 4.25 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1986, and incorporated by reference herein]
4.26	x		Copy of Supplemental Indenture dated November 16, 1986, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 4.26 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1986, and incorporated by reference herein]
4.27	x		Copy of Supplemental Indenture dated August 1, 1987, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 4.27 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1987, and incorporated by reference herein]
4.28	x		Copy of Supplemental Indenture dated February 1, 1989, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 4.28 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1988, and incorporated by reference herein]
4.29	x		Copy of Supplemental Indenture dated February 2, 1989, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 4.29 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1988, and incorporated by reference herein]
4.30	x		Copy of Supplemental Indenture dated June 15, 1990, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 4.30 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1990, and incorporated by reference herein]
4.31	x		Copy of Supplemental Indenture dated November 1, 1990, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 4.31 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1990, and incorporated by reference herein]
4.32	x		Copy of Supplemental Indenture dated September 1, 1992, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 4.32 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1992, and incorporated by reference herein]
4.33	x		Copy of Supplemental Indenture dated September 2, 1992, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 4.33 to

Exhibit No.	Applicable to Form 10-K of		<u>Description</u>
	<u>LG&amp;E</u>	<u>KU</u>	
			LG&E's Annual Report on Form 10-K for the year ended December 31, 1992, and incorporated by reference herein]
4.34	x		Copy of Supplemental Indenture dated August 15, 1993, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 4.34 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1993, and incorporated by reference herein]
4.35	x		Copy of Supplemental Indenture dated August 16, 1993, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 4.35 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1993, and incorporated by reference herein]
4.36	x		Copy of Supplemental Indenture dated October 15, 1993, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 4.36 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1993, and incorporated by reference herein]
4.37	x		Copy of Supplemental Indenture dated May 1, 2000, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 4.37 to LG&E's Annual Report on Form 10-K/A for the year ended December 31, 2000, and incorporated by reference herein]
4.38	x		Copy of Supplemental Indenture dated August 1, 2000, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 4.38 to LG&E's Annual report on Form 10-K/A for the year ended December 31, 2000, and incorporated by reference herein]
4.39	x		Copy of Supplemental Indenture dated March 1, 2002, which is a supplemental instrument to Exhibit 4.01 hereto.
4.40	x		Copy of Supplemental Indenture dated March 15, 2002, which is a supplemental instrument to Exhibit 4.01 hereto.
4.41	x		Copy of Supplemental Indenture dated October 1, 2002, which is a supplemental instrument to Exhibit 4.01 hereto.
4.42		x	Indenture of Mortgage or Deed of Trust dated May 1, 1947, between KU and First Trust National Association (successor Trustee) and a successor individual co-trustee, as Trustees (the Trustees) (Amended Exhibit 7(a) in File No. 2-7061), and Supplemental Indentures thereto dated, respectively, January 1, 1949 (Second Amended Exhibit 7.02 in File No. 2-7802), July 1, 1950 (Amended Exhibit 7.02 in File No. 2-8499), June 15,

Applicable to Form  
10-K of

Exhibit No.	LG&E	KU	Description
			<p>1951 (Exhibit 7.02(a) in File No. 2-8499), June 1, 1952 (Amended Exhibit 4.02 in File No. 2-9658), April 1, 1953 (Amended Exhibit 4.02 in File No. 2-10120), April 1, 1955 (Amended Exhibit 4.02 in File No. 2-11476), April 1, 1956 (Amended Exhibit 2.02 in File No. 2-12322), May 1, 1969 (Amended Exhibit 2.02 in File No. 2-32602), April 1, 1970 (Amended Exhibit 2.02 in File No. 2-36410), September 1, 1971 (Amended Exhibit 2.02 in File No. 2-41467), December 1, 1972 (Amended Exhibit 2.02 in File No. 2-46161), April 1, 1974 (Amended Exhibit 2.02 in File No. 2-50344), September 1, 1974 (Exhibit 2.04 in File No. 2-59328), July 1, 1975 (Exhibit 2.05 in File No. 2-59328), May 15, 1976 (Amended Exhibit 2.02 in File No. 2-56126), April 15, 1977 (Exhibit 2.06 in File No. 2-59328), August 1, 1979 (Exhibit 2.04 in File No. 2-64969), May 1, 1980 (Exhibit 2 to Form 10-Q Quarterly Report of KU for the quarter ended June 30, 1980), September 15, 1982 (Exhibit 4.04 in File No. 2-79891), August 1, 1984 (Exhibit 4B to Form 10-K Annual Report of KU for the year ended December 31, 1984), June 1, 1985 (Exhibit 4 to Form 10-Q Quarterly Report of KU for the quarter ended June 30, 1985), May 1, 1990 (Exhibit 4 to Form 10-Q Quarterly Report of KU for the quarter ended June 30, 1990), May 1, 1991 (Exhibit 4 to Form 10-Q Quarterly Report of KU for the quarter ended June 30, 1991), May 15, 1992 (Exhibit 4.02 to Form 8-K of KU dated May 14, 1992), August 1, 1992 (Exhibit 4 to Form 10-Q Quarterly Report of KU for the quarter ended September 30, 1992), June 15, 1993 (Exhibit 4.02 to Form 8-K of KU dated June 15, 1993) and December 1, 1993 (Exhibit 4.01 to Form 8-K of KU dated December 10, 1993), November 1, 1994 (Exhibit 4.C to Form 10-K Annual Report of KU for the year ended December 31, 1994), June 1, 1995 (Exhibit 4 to Form 10-Q Quarterly Report of KU for the quarter ended June 30, 1995) and January 15, 1996 [Filed as Exhibit 4.E to Form 10-K Annual Report of KU for the year ended December 31, 1995, and incorporated by reference herein]</p>
4.43		x	<p>Copy of Supplemental Indenture dated March 1, 1992 between KU and the Trustees, providing for the conveyance of properties formerly held by Old Dominion Power Company [Filed as Exhibit 4B to Form 10-K Annual Report of KU for the year ended December 31, 1992, and incorporated by reference herein]</p>
4.44		x	<p>Copy of Supplemental Indenture dated May 1, 2000, which is a supplemental instrument to Exhibit 4.42 hereto. [Filed as Exhibit 4.41 to KU's Annual Report on Form 10-K for the year ended December 31, 2000, and incorporated by reference herein]</p>
4.45	x		<p>Copy of Supplemental Indenture dated September 1, 2001, which is a</p>

Applicable to Form  
10-K of

<u>Exhibit No.</u>	<u>LG&amp;E</u>	<u>KU</u>	<u>Description</u>
			supplemental instrument to Exhibit 4.42 hereto. [Filed as Exhibit 4.42 to KU's Annual Report on Form 10-K for the year ended December 31, 2001, and incorporated by reference herein]
4.46		x	Receivables Purchase Agreement dated as of February 6, 2001 among KU Receivables LLC, Kentucky Utilities Company as Servicer, the Various Purchaser Groups From Time to Time Party Hereto and PNC Bank, National Association, as Administrator. [Filed as Exhibit 4.43 to KU's Annual Report on Form 10-K for the year ended December 31, 2001, and incorporated by reference herein]
4.47		x	Purchase and Sale Agreement dated as of February 6, 2001 between KU Receivables LLC and Kentucky Utilities Company. [Filed as Exhibit 4.44 to KU's Annual Report on Form 10-K for the year ended December 31, 2001, and incorporated by reference herein]
4.48	x		Receivables Purchase Agreement dated as of February 6, 2001 among LG&E Receivables LLC, Louisville Gas and Electric Company as Servicer, the Various Purchaser Groups From Time to Time Party Hereto and PNC Bank, National Association, as Administrator. [Filed as Exhibit 4.45 to KU's Annual Report on Form 10-K for the year ended December 31, 2001, and incorporated by reference herein]
4.49	x		Purchase and Sale Agreement dated as of February 6, 2001 between LG&E Receivables LLC and Louisville Gas and Electric Company. [Filed as Exhibit 4.46 to KU's Annual Report on Form 10-K for the year ended December 31, 2001, and incorporated by reference herein]
4.50		x	Copy of Supplemental Indenture dated May 1, 2002, which is a supplemental instrument to Exhibit 4.42 hereto.
4.51		x	Copy of Supplemental Indenture dated September 1, 2002, which is a supplemental instrument to Exhibit 4.42 hereto.
10.01	x		Copies of Agreement between Sponsoring Companies re: Project D of Atomic Energy Commission, dated May 12, 1952, Memorandums of Understanding between Sponsoring Companies re: Project D of Atomic Energy Commission, dated September 19, 1952 and October 28, 1952, and Power Agreement between Ohio Valley Electric Corporation and Atomic Energy Commission, dated October 15, 1952. [Filed as Exhibit 13(y) to LG&E's Registration Statement 2-9975 and incorporated by reference herein]

Applicable to Form  
10-K of

<u>Exhibit No.</u>	<u>LG&amp;E</u>	<u>KU</u>	<u>Description</u>
10.02	x		Copy of Modification No. 1 dated July 23, 1953, to the Power Agreement between Ohio Valley Electric Corporation and Atomic Energy Commission. [Filed as Exhibit 4.03(b) to LG&E's Registration Statement 2-24920 and incorporated by reference herein]
10.03	x		Copy of Modification No. 2 dated March 15, 1964, to the Power Agreement between Ohio Valley Electric Corporation and Atomic Energy Commission. [Filed as Exhibit 5.02c to LG&E's Registration Statement 2-61607 and incorporated by reference herein]
10.04	x		Copy of Modification No. 3 and No. 4 dated May 12, 1966 and January 7, 1967, respectively, to the Power Agreement between Ohio Valley Electric Corporation and Atomic Energy Commission. [Filed as Exhibits 4(a)(13) and 4(a)(14) to LG&E's Registration Statement 2-26063 and incorporated by reference herein]
10.05	x		Copy of Modification No. 5 dated August 15, 1967, to the Power Agreement between Ohio Valley Electric Corporation and Atomic Energy Commission. [Filed as Exhibit 13(c) to LG&E's Registration Statement 2-27316 and incorporated by reference herein]
10.06	x	x	Copies of (i) Inter-Company Power Agreement, dated July 10, 1953, between Ohio Valley Electric Corporation and Sponsoring Companies (which Agreement includes as Exhibit A the Power Agreement, dated July 10, 1953, between Ohio Valley Electric Corporation and Indiana-Kentucky Electric Corporation); (ii) First Supplementary Transmission Agreement, dated July 10, 1953, between Ohio Valley Electric Corporation and Sponsoring Companies; (iii) Inter-Company Bond Agreement, dated July 10, 1953, between Ohio Valley Electric Corporation and Sponsoring Companies; (iv) Inter-Company Bank Credit Agreement, dated July 10, 1953, between Ohio Valley Electric Corporation and Sponsoring Companies. [Filed as Exhibit 5.02f to LG&E's Registration Statement 2-61607 and incorporated by reference herein]
10.07	x	x	Copy of Modification No. 1 and No. 2 dated June 3, 1966 and January 7, 1967, respectively, to Inter-Company Power Agreement dated July 10, 1953. [Filed as Exhibits 4(a)(8) and 4(a)(10) to LG&E's Registration Statement 2-26063 and incorporated by reference herein]
10.08	x		Copies of Amendments to Agreements (iii) and (iv) referred to under 10.06 above as follows: (i) Amendment to Inter-Company Bond Agreement and (ii) Amendment to Inter-Company Bank Credit Agreement. [Filed as Exhibit 5.02h to LG&E's Registration Statement 2-

<u>Exhibit No.</u>	<u>Applicable to Form 10-K of</u>		<u>Description</u>
	<u>LG&amp;E</u>	<u>KU</u>	
			61607 and incorporated by reference herein]
10.09	x		Copy of Modification No. 1, dated August 20, 1958, to First Supplementary Transmission Agreement, dated July 10, 1953, among Ohio Valley Electric Corporation and the Sponsoring Companies. [Filed as Exhibit 5.02i to LG&E's Registration Statement 2-61607 and incorporated by reference herein]
10.10	x		Copy of Modification No. 2, dated April 1, 1965, to the First Supplementary Transmission Agreement, dated July 10, 1953, among Ohio Valley Electric Corporation and the Sponsoring Companies. [Filed as Exhibit 5.02j to LG&E's Registration Statement 2-61607 and incorporated by reference herein]
10.11	x		Copy of Modification No. 3, dated January 20, 1967, to First Supplementary Transmission Agreement, dated July 10, 1953, among Ohio Valley Electric Corporation and the Sponsoring Companies. [Filed as Exhibit 4(a)(7) to LG&E's Registration Statement 2-26063 and incorporated by reference herein]
10.12	x		Copy of Modification No. 6 dated November 15, 1967, to the Power Agreement between Ohio Valley Electric Corporation and Atomic Energy Commission. [Filed as Exhibit 4(g) to LG&E's Registration Statement 2-28524 and incorporated by reference herein]
10.13	x	x	Copy of Modification No. 3 dated November 15, 1967, to the Inter-Company Power Agreement dated July 10, 1953. [Filed as Exhibit 4.02m to LG&E's Registration Statement 2-37368 and incorporated by reference herein]
10.14	x		Copy of Modification No. 7 dated November 5, 1975, to the Power Agreement between Ohio Valley Electric Corporation and Atomic Energy Commission. [Filed as Exhibit 5.02n to LG&E's Registration Statement 2-56357 and incorporated by reference herein]
10.15	x	x	Copy of Modification No. 4 dated November 5, 1975, to the Inter-Company Power Agreement dated July 10, 1953. [Filed as Exhibit 5.02o to LG&E's Registration Statement 2-56357 and incorporated by reference herein]
10.16	x		Copy of Modification No. 4 dated April 30, 1976, to First Supplementary Transmission Agreement, dated July 10, 1953, among Ohio Valley Electric Corporation and the Sponsoring Companies. [Filed as Exhibit

Exhibit No.	Applicable to Form 10-K of		Description
	LG&E	KU	
			5.02p to LG&E's Registration Statement 2-61607 and incorporated by reference herein]
10.17	x		Copy of Modification No. 8 dated June 23, 1977, to the Power Agreement between Ohio Valley Electric Corporation and Atomic Energy Commission. [Filed as Exhibit 5.02q to LG&E's Registration Statement 2-61607 and incorporated by reference herein]
10.18	x		Copy of Modification No. 9 dated July 1, 1978, to the Power Agreement between Ohio Valley Electric Corporation and Atomic Energy Commission. [Filed as Exhibit 5.02r to LG&E's Registration Statement 2-63149 and incorporated by reference herein]
10.19	x		Copy of Modification No. 10 dated August 1, 1979, to the Power Agreement between Ohio Valley Electric Corporation and Atomic Energy Commission. [Filed as Exhibit 2 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1979, and incorporated by reference herein]
10.20	x		Copy of Modification No. 11 dated September 1, 1979, to the Power Agreement between Ohio Valley Electric Corporation and Atomic Energy Commission. [Filed as Exhibit 3 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1979, and incorporated by reference herein]
10.21	x	x	Copy of Modification No. 5 dated September 1, 1979, to Inter-Company Power Agreement dated July 5, 1953, among Ohio Valley Electric Corporation and Sponsoring Companies. [Filed as Exhibit 4 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1979, and incorporated by reference herein]
10.22	x		Copy of Modification No. 12 dated August 1, 1981, to the Power Agreement between Ohio Valley Electric Corporation and Atomic Energy Commission. [Filed as Exhibit 10.25 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1981, and incorporated by reference herein]
10.23	x	x	Copy of Modification No. 6 dated August 1, 1981, to Inter-Company Power Agreement dated July 5, 1953, among Ohio Valley Electric Corporation and Sponsoring Companies. [Filed as Exhibit 10.26 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1981, and incorporated by reference herein]

Exhibit No.	Applicable to Form 10-K of		<u>Description</u>
	<u>LG&amp;E</u>	<u>KU</u>	
10.24	x		* Copy of Non-Qualified Savings Plan covering officers of the Company, effective January 1, 1992. [Filed as Exhibit 10.43 to the Company's Annual Report on Form 10-K for the year ended December 31, 1992, and incorporated by reference herein]
10.25	x		Copy of Modification No. 13 dated September 1, 1989, to the Power Agreement between Ohio Valley Electric Corporation and Atomic Energy Commission. [Filed as Exhibit 10.42 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1993, and incorporated by reference herein]
10.26	x		Copy of Modification No. 14 dated January 15, 1992, to the Power Agreement between Ohio Valley Electric Corporation and Atomic Energy Commission. [Filed as Exhibit 10.43 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1993, and incorporated by reference herein]
10.27	x	x	Copy of Modification No. 7 dated January 15, 1992, to Inter-Company Power Agreement dated July 10, 1953, among Ohio Valley Electric Corporation and Sponsoring Companies. [Filed as Exhibit 10.44 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1993, and incorporated by reference herein]
10.28	x		Copy of Modification No. 15 dated February 15, 1993, to the Power Agreement between Ohio Valley Electric Corporation and Atomic Energy Commission. [Filed as Exhibit 10.45 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1993, and incorporated by reference herein]
10.29	x		Copies of Firm No-Notice Transportation Agreements each effective November 1, 1993, between Texas Gas Transmission Corporation and LG&E (expiring October 31, 2000, 2001 and 2003) covering the transmission of natural gas. [All filed as Exhibit 10.47 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1993, and incorporated by reference herein]
10.30	x	x	Copy of Modification No. 8 dated January 19, 1994, to Inter-Company Power Agreement, dated July 10, 1953, among Ohio Valley Electric Corporation and the Sponsoring Companies. [Filed as Exhibit 10.43 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1995, and incorporated by reference herein]
10.31	x		Copy of Amendment dated March 1, 1995, to Firm No-Notice Transpor-

Applicable to Form  
10-K of

Exhibit No.	<u>LG&amp;E</u>	<u>KU</u>	<u>Description</u>
			tation Agreements dated November 1, 1993 (2-Year, 5-Year and 8-Year), between Texas Gas Transmission Corporation and LG&E covering the transmission of natural gas. [Filed as Exhibit 10.44 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1995, and incorporated by reference herein]
10.32	x	x	Copy of Modification No. 9, dated August 17, 1995, to the Inter-Company Power Agreement dated July 10, 1953, among Ohio Valley Electric Corporation and the Sponsoring Companies. [Filed as Exhibit 10.39 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1996, and incorporated by reference herein]
10.34	x		Copies of Firm Transportation Agreements, each dated March 1, 1995, between Texas Gas Transmission Corporation and LG&E (expiring October 31, 2001 and 2003) covering the transportation of natural gas. [Both filed as Exhibit 10.45 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1995, and incorporated by reference herein]
10.35	x		Copy of Firm Transportation Agreement, dated March 1, 1995, between Texas Gas Transmission Corporation and LG&E (expires October 31, 2000) covering the transportation of natural gas. [Filed as Exhibit 10.41 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1996, and incorporated by reference herein]
10.36	x		* Copy of Amendment to the Non-Qualified Savings Plan, effective January 1, 1992. [Filed as Exhibit 10.55 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1995, and incorporated by reference herein]
10.37	x		* Copy of Amendment to the Non-Qualified Savings Plan, effective January 1, 1995. [Filed as Exhibit 10.56 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1995, and incorporated by reference herein]
10.38	x		* Copy of Amendment to the Non-Qualified Savings Plan, effective January 1, 1995. [Filed as Exhibit 10.57 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1995, and incorporated by reference herein]
10.39	x	x	* Copy of Supplemental Executive Retirement Plan as amended through January 1, 1998, covering officers of LG&E Energy. [Filed as Exhibit 10.74 to LG&E Energy's Annual Report on Form 10-K for the year ended December 31, 1997, and incorporated by reference herein]

<u>Exhibit No.</u>	<u>Applicable to Form 10-K of</u>		<u>Description</u>
	<u>LG&amp;E</u>	<u>KU</u>	
10.40	x		Copy of Coal Supply Agreement between LG&E and Kindill Mining, Inc., dated July 1, 1997. [Filed as Exhibit 10.76 to LG&E Energy's Annual Report on Form 10-K for the year ended December 31, 1997, and incorporated by reference herein]
10.41	x		Copies of Amendments dated September 23, 1997, to Firm No-Notice Transportation Agreements dated November 1, 1993, between Texas Gas Transmission Corporation and LG&E, as amended. [Filed as Exhibit 10.81 to LG&E Energy's Annual Report on Form 10-K for the year ended December 31, 1997, and incorporated by reference herein]
10.42	x		Copies of Amendments dated September 23, 1997, to Firm Transportation Agreements dated March 1, 1995, between Texas Gas Transmission Corporation and LG&E, as amended. [Filed as Exhibit 10.82 to LG&E Energy's Annual Report on Form 10-K for the year ended December 31, 1997, and incorporated by reference herein]
10.43	x	x	Copy of Coal Supply Agreement between LG&E and KU and Black Beauty Coal Company, dated as of January 1, 2002, covering the purchase of coal. [Filed as Exhibit 10.51 to LG&E's and KU's Annual Report on Form 10-K for the year ended December 31, 2001, and incorporated by reference herein]
10.44	x	x	Copy of Coal Supply Agreement between LG&E and KU and McElroy Coal Company, Consolidation Coal Company, Consol Pennsylvania Coal Company, Greenon Coal Company, Nineveh Coal Company, Eighty Four Mining Company and Island Creek Coal Company, dated as of January 1, 2000, and Amendment No. 1 dated as of January 1, 2002, for the purchase of coal. [Filed as Exhibit 10.52 to LG&E's and KU's Annual Report on Form 10-K for the year ended December 31, 2001, and incorporated by reference herein]
10.45		x	Copy of Coal Supply Agreement between KU and Arch Coal Sales Company, Inc., as agent for the independent operating subsidiaries of Arch Coal, Inc., dated as of July 22, 2001, for the purchase of coal. [Filed as Exhibit 10.53 to KU's Annual Report on Form 10-K for the year ended December 31, 2001, and incorporated by reference herein]
10.46	x		Copy of Coal Supply Agreement between LG&E and Hopkins County Coal, LLC and Alliance Coal Sales, a division of Alliance Coal, LLC, dated as of January 1, 2002, for the purchase of coal. [Filed as Exhibit 10.54 to LG&E's Annual Report on Form 10-K for the year ended

Applicable to Form  
10-K of

<u>Exhibit No.</u>	<u>LG&amp;E</u>	<u>KU</u>	<u>Description</u>
			December 31, 2001, and incorporated by reference herein]
10.47		x	Copy of Coal Supply Agreement between KU and Arch Coal Sales Company, Inc., as agent for the independent operating subsidiaries of Arch Coal, Inc., dated as of August 12, 2001, for the purchase of coal. [Filed as Exhibit 10.55 to KU's Annual Report on Form 10-K for the year ended December 31, 2001, and incorporated by reference herein]
10.48		x	Copy of Purchase Order dated December 26, 2000, by and between Kentucky Utilities Company and AEI Coal Sales Company, Inc., for the purchase of coal, commencing January 1, 2001. [Filed as Exhibit 10.56 to KU's Annual Report on Form 10-K for the year ended December 31, 2001, and incorporated by reference herein]
10.49	x		Copy of Amendment dated November 6, 2000, to Firm Transportation Agreement between LG&E and Texas Gas Transmission Corporation covering the transmission of natural gas (expires October 31, 2006). [Filed as Exhibit 10.57 to LG&E's Annual Report on Form 10-K for the year ended December 31, 2001, and incorporated by reference herein]
10.50	x		Copy of Amendment dated November 6, 2000, to Firm Transportation Agreement between LG&E and Texas Gas Transmission Corporation covering the transmission of natural gas (expires October 31, 2008). [Filed as Exhibit 10.58 to LG&E's Annual Report on Form 10-K for the year ended December 31, 2001, and incorporated by reference herein]
10.51	x		Copy of Amendment dated November 6, 2000, to Firm No-Notice Transportation Agreement between LG&E and Texas Gas Transmission Corporation covering the transmission of natural gas (expires October 31, 2006). [Filed as Exhibit 10.59 to LG&E's Annual Report on Form 10-K for the year ended December 31, 2001, and incorporated by reference herein]
10.52	x		Copy of Amendment dated September 15, 1999, to Firm Transportation Agreement between LG&E and Texas Gas Transmission Corporation covering the transmission of natural gas (expires October 31, 2006). [Filed as Exhibit 10.60 to LG&E's Annual Report on Form 10-K for the year ended December 31, 2001, and incorporated by reference herein]
10.53	x	x	* Copy of Amendment to LG&E Energy's Supplemental Executive Retirement Plan, effective September 2, 1998. [Filed as Exhibit 10.90 to LG&E Energy's Annual Report on Form 10-K for the year ended December 31, 1998 and incorporated by reference herein]

Applicable to Form  
10-K of

<u>Exhibit No.</u>	<u>LG&amp;E</u>	<u>KU</u>	<u>Description</u>
10.54	x	x	* Copy of Employment and Severance Agreement, dated as of February 25, 2000, by and among LG&E Energy, Powergen plc and an executive officer of the Company.
10.55	x	x	* Copy of Amendment, effective October 1, 1999, to LG&E Energy's Non-Qualified Savings Plan. [Filed as Exhibit 10.96 to LG&E's and KU's Annual Report on Form 10-K for the year ended December 31, 1999, and incorporated by reference herein]
10.56	x	x	* Copy of Amendment, effective December 1, 1999, to LG&E Energy's Non-Qualified Savings Plan. [Filed as Exhibit 10.97 to LG&E's and KU's Annual Report on Form 10-K for the year ended December 31, 1999, and incorporated by reference herein]
10.57	x	x	Copy of Modification No. 10, dated January 1, 1998, to the Inter-Company Power Agreement dated July 10, 1953, among Ohio Valley Electric Corporation and the Sponsoring Companies. [Filed as Exhibit 10.102 to LG&E's and KU's Annual Report on Form 10-K for the year ended December 31, 1999, and incorporated by reference herein]
10.58	x	x	Copy of Modification No. 11, dated April 1, 1999, to the Inter-Company Power Agreement dated July 10, 1953, among Ohio Valley Electric Corporation and the Sponsoring Companies. [Filed as Exhibit 10.103 to LG&E's and KU's Annual Report on Form 10-K for the year ended December 31, 1999, and incorporated by reference herein]
10.59	x		Copy of Letter Amendment, dated September 15, 1999, to Transportation Agreement, dated November 1, 1993, between LG&E and Texas Gas Transmission Corporation. [Filed as Exhibit 10.106 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1999, and incorporated by reference herein]
10.60	x	x	* Copy of Powergen Short-Term Incentive Plan, effective January 1, 2001, applicable to certain employees of LG&E Energy Corp. and its subsidiaries. [Filed as Exhibit 10.109 to LG&E's Annual Report on Form 10-K for the year ended December 31, 2000, and incorporated by reference herein]
10.61	x	x	* Copy of two forms of Change-In-Control Agreement applicable to certain employees of LG&E Energy Corp. and its subsidiaries. [Filed as Exhibit 10.110 to LG&E's Annual Report on Form 10-K for the year

Exhibit No.	Applicable to Form 10-K of		<u>Description</u>
	<u>LG&amp;E</u>	<u>KU</u>	
			ended December 31, 2000, and incorporated by reference herein]
10.62	x	x	* Copy of Employment and Severance Agreement, dated as of February 25, 2000, and amendments thereto dated December 8, 2000 and April 30, 2001, by and among LG&E Energy, Powergen plc and Victor A. Staffieri. [Filed as Exhibit 10.74 to LG&E's and KU's Annual Report on Form 10-K/A for the year ended December 31, 2001, and incorporated by reference herein]
10.63	x	x	* Copy of Amendment, dated as of December 8, 2000, to Employment and Severance Agreement dated as of February 25, 2000, by and among LG&E Energy, Powergen plc and an executive officer of the Company.
10.64	x		Copy of Amendment dated June 5, 2002, to Firm No-Notice Transportation Agreement dated November 1, 1993, between LG&E and Texas Gas Transmission Corporation covering the transmission of natural gas (expires October 31, 2008).
10.65	x		Copy of Firm Transportation Service Agreement dated November 1, 2002, between LG&E and Tennessee Gas Pipeline Company covering the transmission of natural gas (expires October 31, 2012).
10.66	x		Copy of Amendment No. 1 dated January 1, 2001, to Coal Supply Agreement dated July 1, 1997, between LG&E and Kindill Mining, Inc.
10.67	x		Copy of Amendment No. 2 dated January 1, 2002, to Coal Supply Agreement dated July 1, 1997, between LG&E and Kindill Mining, Inc.
10.68	x	x	Copy of Amendment No. 2 dated January 1, 2003, to Coal Supply Agreement dated January 1, 2000, between LG&E and KU and McElroy Coal Company, Consolidation Coal Company, Consol Pennsylvania Coal Company, Greenon Coal Company, Nineveh Coal Company, Eighty Four Mining Company and Island Creek Coal Company.
10.69	x		Copy of Coal Supply Agreement dated January 1, 2003, between LG&E and Peabody Coalsales Company.
10.70	x		Copy of Coal Supply Agreement dated January 1, 2002, between LG&E and Peabody Coalsales Company.
10.71	x		Copy of Amendment No. 1 dated June 1, 2002, to Coal Supply Agreement dated January 1, 2002, between LG&E and Peabody Coalsales Company.

Exhibit No.	Applicable to Form 10-K of		Description
	LG&E	KU	
10.72	x		Copy of Amendment No. 2 dated January 1, 2003, to Coal Supply Agreement dated January 1, 2002, between LG&E and Peabody Coalsales Company.
10.73		x	Copy of Coal Supply Agreement dated January 1, 2002, between KU and Massey Coal Sales Company, Inc.
10.74	x	x	*Copy of Third Amendment dated July 1, 2002, to Employment and Severance Agreement dated as of February 25, 2000 by and among LG&E Energy, Powergen and Victor A. Staffieri.
10.75	x	x	*Copy of form of Retention and Severance Agreement dated April/May, 2002, by and among LG&E Energy, E.ON AG and certain executive officers of the Companies.
10.76	x	x	*Copy of Second Amendment, dated May 20, 2002, to Employment and Severance Agreement, dated February 25, 2000, by and among E.ON AG, LG&E Energy Corp., Powergen plc and an executive of the Companies.
10.77	x	x	*Copies of Contract of Employment, dated June 22, 1999, Terms of Condition of Assignment, dated December 19, 2000, and Amendment to the Terms and Conditions of Assignment, dated June 27, 2002, by and among, as applicable, Powergen UK plc, Powergen plc, LG&E Energy Corp. and an executive officer of the Companies.
10.78	x	x	*Copy of Powergen UK Long Term Incentive Plan, November 2002, applicable to certain executive officers of the Companies.
10.79	x	x	*Copy of Terms and Conditions for Stock Options Issued as part of E.ON Group's Stock Option Programs, applicable to certain executive officers of the Companies.
12	x	x	Computation of Ratio of Earnings to Fixed Charges for LG&E and KU.
21	x	x	Subsidiaries of the Registrants.
23.01	x		Consents of Independent Accountants for LG&E.
23.02		x	Consents of Independent Accountants for KU.
24	x	x	Powers of Attorney.

Exhibit No.	Applicable to Form 10-K of		<u>Description</u>
	<u>LG&amp;E</u>	<u>KU</u>	
99.01	x	x	Cautionary Statement for purposes of the "Safe Harbor" provisions of the Private Securities Litigation Reform Act of 1995.
99.02	x	x	LG&E and KU Director and Officer Information.

(b) Executive Compensation Plans and Arrangements:

Exhibits preceded by an asterisk ("\*") above are management contracts, compensation plans or arrangements required to be filed as an exhibit pursuant to Item 14(c) of Form 10-K.

(c) Reports on Form 8-K:

On November 14, 2002, LG&E and KU filed a current report on Form 8-K, submitting certifications of the Chairman, President, and Chief Executive Officer and the Chief Financial Officer of each company, respectively, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 regarding the companies' Quarterly Reports on Form 10-Q for the period ended September 30, 2002.

(d) The following instruments defining the rights of holders of certain long-term debt of KU have not been filed with the Securities and Exchange Commission but will be furnished to the Commission upon request.

1. Loan Agreement dated as of May 1, 1990, between KU and the County of Mercer, Kentucky, in connection with \$12,900,000 County of Mercer, Kentucky, Collateralized Solid Waste Disposal Facility Revenue Bonds (KU Project) 1990 Series A, due May 1, 2010 and May 1, 2020.
2. Loan Agreement dated as of May 1, 1991, between KU and the County of Carroll, Kentucky, in connection with \$96,000,000 County of Carroll, Kentucky, Collateralized Pollution Control Revenue Bonds (KU Project) 1992 Series A, due September 15, 2016.
3. Loan Agreement dated as of August 1, 1992, between KU and the County of Carroll, Kentucky, in connection with \$2,400,000 County of Carroll, Kentucky, Collateralized Pollution Control Revenue Bonds (KU Project) 1992 Series C, due February 1, 2018.
4. Loan Agreement dated as of August 1, 1992, between KU and the County of Muhlenberg, Kentucky, in connection with \$7,200,000 County of Muhlenberg, Kentucky, Collateralized Pollution Control Revenue Bonds (KU Project) 1992 Series A, due February 1, 2018.
5. Loan Agreement dated as of August 1, 1992, between KU and the County of Mercer, Kentucky, in connection with \$7,400,000 County of Mercer, Kentucky, Collateralized Pollution Control Revenue Bonds (KU Project) 1992 Series A, due February 1, 2018.

6. **Loan Agreement dated as of August 1, 1992, between KU and the County of Carroll, Kentucky, in connection with \$20,930,000 County of Carroll, Kentucky, Collateralized Pollution Control Revenue Bonds (KU Project) 1992 Series B, due February 1, 2018.**
7. **Loan Agreement dated as of December 1, 1993, between KU and the County of Carroll, Kentucky, in connection with \$50,000,000 County of Carroll, Kentucky, Collateralized Solid Waste Disposal Facilities Revenue Bonds (KU Project) 1993 Series A, due December 1, 2023.**
8. **Loan Agreement dated as of November 1, 1994, between KU and the County of Carroll, Kentucky, in connection with \$54,000,000 County of Carroll, Kentucky, Collateralized Solid Waste Disposal Facilities Revenue Bonds (KU Project) 1994 Series A, due November 1, 2024.**

Report of Independent Accountants  
on Financial Statement Schedules

To the Shareholders of Louisville Gas and Electric Company and Subsidiary:

Our audits of the consolidated financial statements of Louisville Gas and Electric Company and Subsidiary as of December 31, 2002 and for each of the two years in the period ended December 31, 2002, referred to in our report dated January 21, 2003 also included an audit of the financial statement schedule listed in Item 14(a)2 of this Form 10-K. In our opinion, this financial statement schedule presents fairly, in all material respects, the information set forth therein as of December 31, 2002 and for the year then ended when read in conjunction with the related consolidated financial statements.

/s/ PricewaterhouseCoopers LLP  
January 21, 2003  
Louisville, Kentucky

Louisville Gas and Electric Company  
Schedule II - Valuation and Qualifying Accounts  
For the Three Years Ended December 31, 2002  
(Thousands of \$)

Schedule II

	<u>Other Property and Investments</u>	<u>Accounts Receivable (Uncollectible Accounts)</u>
Balance December 31, 1999	\$ 63	\$ 1,233
Additions:	-	2,803
Charged to costs and expenses		
Deductions:		
Net charges of nature for which reserves were created	-	<u>2,750</u>
Balance December 31, 2000	63	1,286
Additions:	-	4,953
Charged to costs and expenses		
Deductions:		
Net charges of nature for which reserves were created	-	<u>4,664</u>
Balance December 31, 2001	63	1,575
Additions:	-	4,459
Charged to costs and expenses		
Deductions:		
Net charges of nature for which reserves were created	-	<u>3,909</u>
Balance December 31, 2002	<u>\$ 63</u>	<u>\$2,125</u>

**Report of Independent Accountants  
on Financial Statement Schedules**

To the Shareholders of Kentucky Utilities Company and Subsidiary:

Our audits of the consolidated financial statements of Kentucky Utilities Company and Subsidiary as of December 31, 2002 and for each of the two years in the period ended December 31, 2002, referred to in our report dated January 21, 2003 also included an audit of the financial statement schedule listed in Item 14(a)2 of this Form 10-K. In our opinion, this financial statement schedule presents fairly, in all material respects, the information set forth therein as of December 31, 2002 and for the year then ended when read in conjunction with the related consolidated financial statements.

/s/ PricewaterhouseCoopers LLP  
January 21, 2003  
Louisville, Kentucky

**Kentucky Utilities Company**  
**Schedule II - Valuation and Qualifying Accounts**  
**For the Three Years Ended December 31, 2002**  
**(Thousands of \$)**

Schedule II

	<u>Other Property and Investments</u>	<u>Accounts Receivable (Uncollectible Accounts)</u>
Balance December 31, 1999	\$ 687	\$ 800
Additions:		
Charged to costs and expenses	64	1,430
Deductions:		
Net charges of nature for which reserves were created	-	<u>1,430</u>
Balance December 31, 2000	751	800
Additions:		
Charged to costs and expenses	9	1,528
Deductions:		
Net charges of nature for which reserves were created	<u>630</u>	<u>1,528</u>
Balance December 31, 2001	130	800
Additions:		
Charged to costs and expenses	-	1,314
Deductions:		
Net charges of nature for which reserves were created	-	<u>1,314</u>
Balance December 31, 2002	<u>\$ 130</u>	<u>\$ 800</u>

SIGNATURES – LOUISVILLE GAS AND ELECTRIC COMPANY

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

LOUISVILLE GAS AND ELECTRIC COMPANY  
Registrant

March 25, 2003  
(Date)

/s/ S. Bradford Rives

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the date indicated.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
Victor A. Staffieri	Chairman of the Board, President and Chief Executive Officer (Principal Executive Officer);	
Richard Aitken-Davies	Chief Financial Officer (Principal Financial Officer);	
S. Bradford Rives	Senior Vice President – Finance and Controller (Principal Accounting Officer);	
Michael Söhlke	Director;	
Edmund A. Wallis	Director.	

By /s/ S. Bradford Rives  
(Attorney-In-Fact)

March 25, 2003

SIGNATURES – KENTUCKY UTILITIES COMPANY

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

KENTUCKY UTILITIES COMPANY  
Registrant

March 25, 2003  
(Date)

/s/ S. Bradford Rives

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the date indicated.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
Victor A. Staffieri	Chairman of the Board, President and Chief Executive Officer (Principal Executive Officer);	
Richard Aitken-Davies	Chief Financial Officer (Principal Financial Officer);	
S. Bradford Rives	Senior Vice President – Finance and Controller (Principal Accounting Officer);	
Michael Söhlke	Director;	
Edmund A. Wallis	Director.	

By /s/ S. Bradford Rives  
(Attorney-In-Fact)

March 25, 2003

## CERTIFICATIONS

Louisville Gas and Electric Company

I, Victor A. Staffieri, Chairman of the Board, President and Chief Executive Officer, certify that:

1. I have reviewed this annual report on Form 10-K of Louisville Gas and Electric Company;
2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and
  - c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this annual report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: March 25, 2003

/s/ Victor A. Staffieri

Victor A. Staffieri

Chairman of the Board, President and Chief Executive Officer

Louisville Gas and Electric Company

I, Richard Aitken-Davies, Chief Financial Officer, certify that:

1. I have reviewed this annual report on Form 10-K of Louisville Gas and Electric Company;

2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;

3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and

c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this annual report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: March 25, 2003

/s/ Richard Aitken-Davies  
Richard Aitken-Davies  
Chief Financial Officer

Kentucky Utilities Company

I, Victor A. Staffieri, Chairman of the Board, President and Chief Executive Officer, certify that:

1. I have reviewed this annual report on Form 10-K of Kentucky Utilities Company;
2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and
  - c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this annual report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: March 25, 2003

/s/ Victor A. Staffieri

Victor A. Staffieri

Chairman of the Board, President and Chief Executive Officer

## Kentucky Utilities Company

I, Richard Aitken-Davies, Chief Financial Officer, certify that:

1. I have reviewed this annual report on Form 10-K of Kentucky Utilities Company;

2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;

3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and

c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

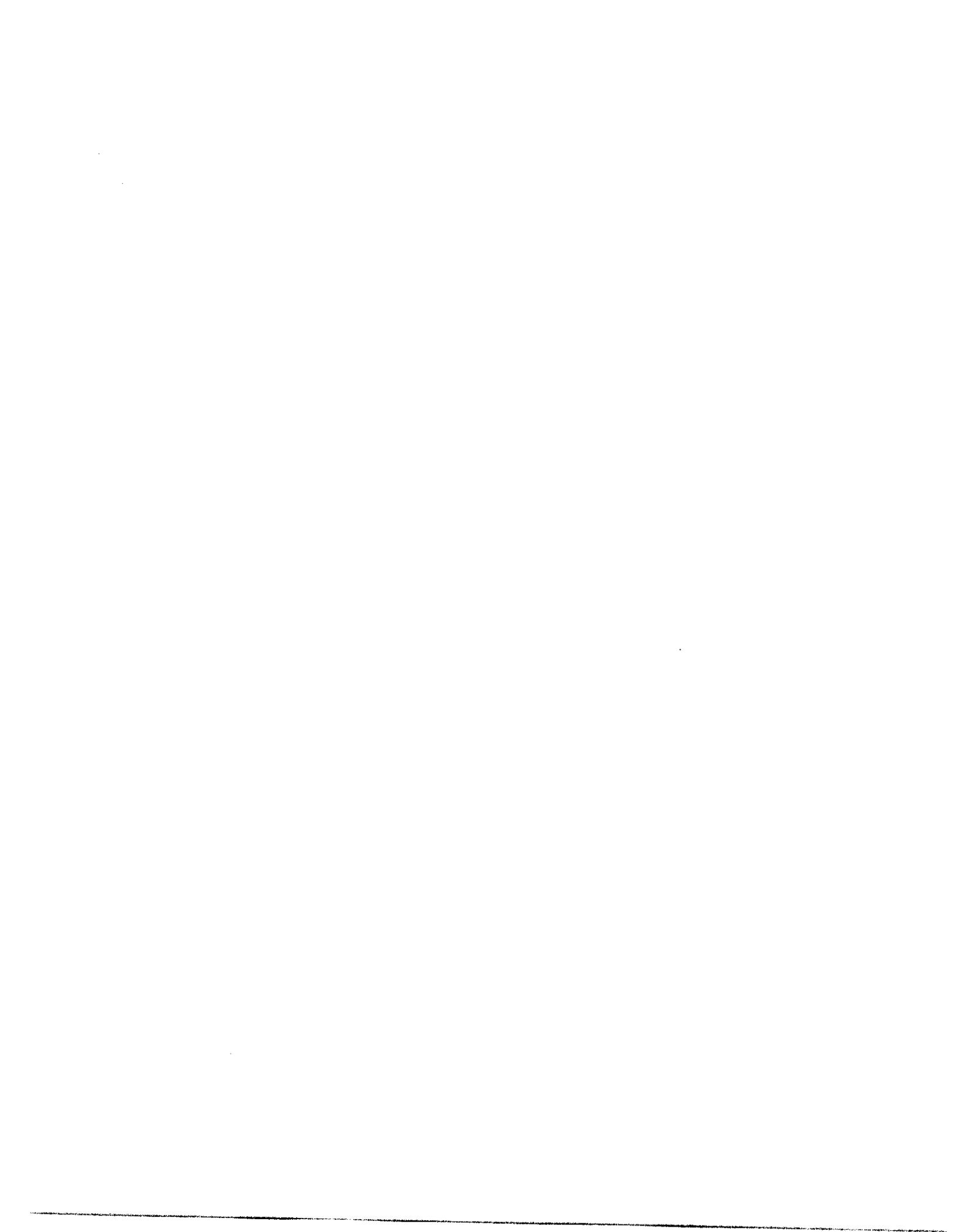
a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this annual report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: March 25, 2003

/s/ Richard Aitken-Davies  
Richard Aitken-Davies  
Chief Financial Officer







**SEC Form 10-K -- December 31, 2001**



UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D. C. 20549

FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934 (NO FEE REQUIRED)

For the fiscal year ended December 31, 2001

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934 (NO FEE REQUIRED)

<u>Commission File Number</u>	<u>Registrant, State of Incorporation, Address, and Telephone Number</u>	<u>IRS Employer Identification Number</u>
2-26720	<b>Louisville Gas and Electric Company</b> (A Kentucky Corporation) 220 West Main Street P. O. Box 32010 Louisville, Kentucky 40232 (502) 627-2000	61-0264150
1-3464	<b>Kentucky Utilities Company</b> (A Kentucky and Virginia Corporation) One Quality Street Lexington, Kentucky 40507-1428 (859) 255-2100	61-0247570

Securities registered pursuant to section 12(b) of the Act:

<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
Preferred Stock, 4.75% cumulative, stated value \$100 per share	Philadelphia Stock Exchange

Securities registered pursuant to section 12(g) of the Act:

Louisville Gas and Electric Company  
5% Cumulative Preferred Stock, \$25 Par Value  
\$5.875 Cumulative Preferred Stock, Without Par Value  
Auction Rate Series A Preferred Stock, Without Par Value  
(Title of class)

Kentucky Utilities Company  
Preferred Stock, cumulative, stated value \$100 per share  
(Title of class)

Indicate by check mark whether the registrants (1) have filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange

Act of 1934 during the preceding 12 months (or for such shorter period that the registrants were required to file such reports), and (2) have been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

As of February 28, 2002, 860,287 shares of voting preferred stock of Louisville Gas and Electric Company, with an aggregate market value of \$16,027,000, were outstanding and held by non-affiliates. Additionally, Louisville Gas and Electric Company had 21,294,223 shares of common stock outstanding, all held by LG&E Energy Corp. Kentucky Utilities Company had 37,817,878 shares of common stock outstanding, all held by LG&E Energy Corp.

This combined Form 10-K is separately filed by Louisville Gas and Electric Company and Kentucky Utilities Company. Information contained herein related to any individual registrant is filed by such registrant on its own behalf. Each registrant makes no representation as to information relating to the other registrants.

#### DOCUMENTS INCORPORATED BY REFERENCE

Proxy statements for Louisville Gas and Electric Company and Kentucky Utilities Company, currently anticipated to be prepared and filed with the Commission during April 2002, are incorporated by reference into Part III of this Form 10-K.

## TABLE OF CONTENTS

### PART I

Item 1.	Business.....	6
	Louisville Gas and Electric Company	
	General.....	6
	Electric Operations.....	7
	Gas Operations.....	9
	Rates and Regulation.....	10
	Construction Program and Financing.....	11
	Coal Supply.....	11
	Gas Supply.....	12
	Environmental Matters.....	13
	Competition.....	13
	Kentucky Utilities Company	
	General.....	13
	Electric Operations.....	14
	Rates and Regulation.....	15
	Construction Program and Financing.....	17
	Coal Supply.....	17
	Environmental Matters.....	18
	Competition.....	18
	Employees and Labor Relations.....	18
	Executive Officers of the Companies.....	19
Item 2.	Properties.....	22
Item 3.	Legal Proceedings.....	25
Item 4.	Submission of Matters to a Vote of Security Holders.....	27

### PART II

Item 5.	Market for the Registrant's Common Equity and Related Stockholder Matters.....	28 29
Item 6.	Selected Financial Data.....	29
Item 7.	Management's Discussion and Analysis of Financial Condition and Results of Operation:.....	
	Louisville Gas and Electric Company.....	30
	Kentucky Utilities Company.....	47
Item 7A.	Quantitative and Qualitative Disclosures About Market Risk.....	63
Item 8.	Financial Statements and Supplementary Data:	
	Louisville Gas and Electric Company.....	64
	Kentucky Utilities Company.....	96
Item 9.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.....	124

### PART III

Item 10.	Directors and Executive Officers of the Registrant (a).....	124
Item 11.	Executive Compensation (a).....	124
Item 12.	Security Ownership of Certain Beneficial Owners and Management (a).....	124
Item 13.	Certain Relationships and Related Transactions (a).....	124

### PART IV

Item 14.	Exhibits, Financial Statement Schedules, and Reports on Form 8-K.....	124
	Signatures.....	148
	(a) Incorporated by reference.	

## INDEX OF ABBREVIATIONS

Capital Corp.	LG&E Capital Corp.
Clean Air Act	The Clean Air Act, as amended in 1990
CCN	Certificate of Public Convenience and Necessity
CT	Combustion Turbines
DSM	Demand Side Management
ECR	Environmental Cost Recovery
EEl	Electric Energy, Inc.
EITF	Emerging Issues Task Force Issue
EPA	U.S. Environmental Protection Agency
ESM	Earnings Sharing Mechanism
FAC	Fuel Adjustment Clause
FERC	Federal Energy Regulatory Commission
FPA	Federal Power Act
FT and FT-A	Firm Transportation
GSC	Gas Supply Clause
Holding Company Act	Public Utility Holding Company Act of 1935
IBEW	International Brotherhood of Electrical Workers
IMEA	Illinois Municipal Electric Agency
IMPA	Indiana Municipal Power Agency
Kentucky Commission	Kentucky Public Service Commission
KIUC	Kentucky Industrial Utility Consumers, Inc.
KU	Kentucky Utilities Company
KU Energy	KU Energy Corporation
KU R	KU Receivables LLC
Kva	Kilovolt-ampere
LEM	LG&E Energy Marketing Inc.
LG&E	Louisville Gas and Electric Company
LG&E Energy	LG&E Energy Corp.
LG&E R	LG&E Receivables LLC
LG&E Services	LG&E Energy Services Inc.
Mcf	Thousand Cubic Feet
Merger Agreement	Agreement and Plan of Merger dated May 20, 1997
MGP	Manufactured Gas Plant
MISO	Midwest Independent System Operator
Mmbtu	Million British thermal units
Moody's	Moody's Investor Services, Inc.
Mw	Megawatts
Mwh	Megawatt hours
NNS	No-Notice Service
NOx	Nitrogen Oxide
OMU	Owensboro Municipal Utilities
OVEC	Ohio Valley Electric Corporation
PBR	Performance-Based Ratemaking
Powergen	Powergen plc
PUHCA	Public Utility Holding Company Act of 1935
S&P	Standard & Poor's Rating Services
SCR	Selective Catalytic Reduction
SEC	Securities And Exchange Commission
SERP	Supplemental Employee Retirement Plan
SFAS	Statement of Financial Accounting Standards
SIP	State Implementation Plan
SO <sub>2</sub>	Sulfur Dioxide

Tennessee Gas  
Texas Gas  
TRA  
Trimble County  
USWA  
Utility Operations  
VDT  
Virginia Commission  
Virginia Staff

Tennessee Gas Pipeline Company  
Texas Gas Transmission Corporation  
Tennessee Regulatory Authority  
LG&E's Trimble County Unit 1  
United Steelworkers of America  
Operations of LG&E and KU  
Value Delivery Team Process  
Virginia State Corporation Commission  
Virginia Commission Staff

## PART I.

### Item 1. Business.

On December 11, 2000, LG&E Energy Corp. was acquired by Powergen plc. for cash of approximately \$3.2 billion or \$24.85 per share and the assumption of all of LG&E Energy's debt. As a result of the acquisition, among other things, LG&E Energy became a wholly owned subsidiary of Powergen and, as a result, LG&E and KU became indirect subsidiaries of Powergen. The utility operations (LG&E and KU) of LG&E Energy have continued their separate identities and continue to serve customers in Kentucky and Virginia under their existing names. The preferred stock and debt securities of the utility operations were not affected by this transaction resulting in the utility operations' obligations to continue to file SEC reports. Following the acquisition, Powergen became a registered holding company under PUHCA, and LG&E and KU, as subsidiaries of a registered holding company, became subject to additional regulation under PUHCA.

As a result of the Powergen acquisition and in order to comply with the Public Utility Holding Company Act of 1935, LG&E Services was formed as a subsidiary of LG&E Energy and became effective on January 1, 2001. LG&E Services provides certain services to affiliated entities, including LG&E and KU, at cost as required under the Holding Company Act. On January 1, 2001, approximately 1,000 employees, mainly from LG&E Energy, LG&E and KU, were moved to LG&E Services.

On April 9, 2001, a German power company, E.ON AG, announced a preconditional cash offer of £5.1 billion (\$7.3 billion) for Powergen. The offer is subject to a number of conditions, including the receipt of certain European and United States regulatory approvals. The Kentucky Public Service Commission, the Federal Energy Regulatory Commission, the Virginia State Corporation Commission, and the Tennessee Regulatory Authority have all approved the acquisition of Powergen and LG&E Energy by E.ON. The parties expect to obtain the remaining regulatory approvals and to complete the transaction in the first half of 2002. See Powergen's schedule 14D-9, and associated schedules to such filings, filed with the SEC on April 9, 2001.

## LOUISVILLE GAS AND ELECTRIC COMPANY

### General

Incorporated on July 2, 1913, LG&E is a regulated public utility that supplies natural gas to approximately 305,000 customers and electricity to approximately 378,000 customers in Louisville and adjacent areas in Kentucky. LG&E's service area covers approximately 700 square miles in 17 counties and has an estimated population of one million. Included in this area is the Fort Knox Military Reservation, to which LG&E transports gas and provides electric service, but which maintains its own distribution systems. LG&E also provides gas service in limited additional areas. LG&E's coal-fired electric generating plants, which are all equipped with systems to reduce sulfur dioxide emissions, produce most of LG&E's electricity. The remainder is generated by a hydroelectric power plant and combustion turbines. Underground natural gas storage fields help LG&E provide economical and reliable gas service to customers. See Item 2, Properties.

LG&E has one wholly owned consolidated subsidiary, LG&E R. LG&E R is a special purpose entity formed in September 2000 to enter into accounts receivable securitization transactions with LG&E. LG&E R started operations in 2001.

For the year ended December 31, 2001, 71% of total operating revenues were derived from electric operations and 29% from gas operations. Electric and gas operating revenues and the percentages by classes of service on a combined basis for this period were as follows:

	(Thousands of \$)			
	<u>Electric</u>	<u>Gas</u>	<u>Combined</u>	<u>% Combined</u>
Residential	\$205,926	\$177,387	\$383,313	47%
Commercial	171,540	70,296	241,836	30
Industrial	104,438	15,750	120,188	15
Public authorities	<u>53,725</u>	<u>13,223</u>	<u>66,948</u>	<u>8</u>
Total retail	535,629	276,656	812,285	<u>100%</u>
Wholesale sales	159,406	5,702	165,108	
Gas transported - net	-	6,042	6,042	
Provision for rate refunds	(720)	-	(720)	
Miscellaneous	<u>11,610</u>	<u>2,375</u>	<u>13,985</u>	
Total	<u>\$705,925</u>	<u>\$290,775</u>	<u>\$996,700</u>	

See Note of LG&E's Notes to Financial Statements under Item 8 for financial information concerning segments of business for the three years ended December 31, 2001.

### Electric Operations

The sources of LG&E's electric operating revenues and the volumes of sales for the three years ended December 31, 2001, were as follows:

	<u>2001</u>	<u>2000</u>	<u>1999</u>
<b>ELECTRIC OPERATING REVENUES</b>			
<b>(Thousands of \$):</b>			
Residential	\$205,926	\$205,105	\$214,733
Commercial	171,540	171,414	176,457
Industrial	104,438	104,738	111,889
Public authorities	<u>53,725</u>	<u>54,270</u>	<u>55,968</u>
Total retail	535,629	535,527	559,047
Wholesale sales	159,406	165,080	221,336
Provision for rate refunds	(720)	(2,500)	(1,735)
Miscellaneous	<u>11,610</u>	<u>12,851</u>	<u>12,022</u>
Total	<u>\$705,925</u>	<u>\$710,958</u>	<u>\$790,670</u>
<b>ELECTRIC SALES (Thousands of Mwh):</b>			
Residential	3,782	3,722	3,680
Commercial	3,395	3,350	3,290
Industrial	2,976	3,043	3,047
Public authorities	<u>1,224</u>	<u>1,214</u>	<u>1,187</u>
Total retail	11,377	11,329	11,204
Wholesale sales	<u>6,957</u>	<u>6,834</u>	<u>8,428</u>
Total	<u>18,334</u>	<u>18,163</u>	<u>19,632</u>

LG&E uses efficient coal-fired boilers, fully equipped with sulfur dioxide removal systems, to generate most of its electricity. LG&E's weighted-average system-wide emission rate for sulfur dioxide in 2001 was approximately 0.54 lbs./Mmbtu of heat input, with every unit below its emission limit established by the Kentucky Division for

## Air Quality.

The 2001 maximum local peak load of 2,522 Mw occurred on Wednesday, August 8, 2001. The record local peak load of 2,612 Mw occurred on Friday, July 30, 1999, when the temperature was 106 degrees F.

The electric utility business is affected by seasonal weather patterns. As a result, operating revenues (and associated operating expenses) are not generated evenly throughout the year. See LG&E's Results of Operations under Item 7.

LG&E currently maintains an 11-14% reserve margin range. At December 31, 2001, LG&E owned steam and combustion turbine generating facilities with a capacity of 2,791 Mw and an 80 Mw hydroelectric facility on the Ohio River. At December 31, 2001, LG&E's system capability, including purchases from others and excluding the hydroelectric facility, was 2,883 Mw. See Item 2, Properties.

LG&E is a participating owner with 14 other electric utilities of Ohio Valley Electric Corporation located in Piketon, Ohio. LG&E has direct interconnections with 11 utility companies in the area and has agreements with each interconnected utility for the purchase and sale of capacity and energy. LG&E also has agreements with an increasing number of entities throughout the United States for the purchase and/or sale of capacity and energy and for the utilization of their bulk transmission system.

LG&E (along with KU) is a founding member of the MISO, such membership obtained in 1998 in response to and consistent with federal policy initiatives. As a MISO member, LG&E filed for and received authorization from the FERC to transfer control of its transmission facilities (100 kV and above) to the MISO, the first step in allowing the latter to assume responsibility for all tariff-related transmission functions (e.g., scheduling through and on LG&E's transmission system) as well as non-tariff related regional transmission activities (e.g., operations planning, maintenance coordination, long-term regional planning and market monitoring). The FERC approved the MISO as the nation's first Regional Transmission Organization on December 19, 2001, after which LG&E submitted a filing at FERC to cancel all services under its Open Access Transmission Tariff except those that will not be provided by the MISO (certain ancillary services). The MISO became operational on February 1, 2002.

In October 2001, the FERC issued an order requiring that the bundled retail load and grandfathered wholesale load of each member transmission owner (including LG&E) be included in the current calculation of MISO's "cost-adder," a charge designed to recover MISO's costs of operation, including start-up capital (debt) costs. LG&E, along with several other transmission owners, opposed the FERC's ruling in this regard, which opposition the FERC rejected in an order on rehearing issued in 2002. As of the end of 2001, negotiations were continuing between MISO, its transmission owners and other interested industry segments regarding the level of cost responsibility properly borne by bundled and grandfathered load under these FERC rulings. Absent settlement, this issue is expected to go to hearing in 2002.

At the end of 2001, in response to an earlier FERC ruling, MISO and its transmission owning members (including LG&E) filed to increase MISO's rate of return on equity from 10.5% (a stipulated percentage agreed to in 1998) to 13.0%, to compensate MISO's transmission owners for the inherent risks and uncertainties associated with transferring control of their facilities to the MISO. This issue is expected to go to hearing in 2002.

## Gas Operations

The sources of LG&E's gas operating revenues and the volumes of sales for the three years ended December 31, 2001, were as follows:

	<u>2001</u>	<u>2000</u>	<u>1999</u>
<b>GAS OPERATING REVENUES</b>			
(Thousands of \$):			
Residential	\$177,387	\$159,670	\$103,655
Commercial	70,296	61,888	38,627
Industrial	15,750	15,898	10,401
Public authorities	<u>13,223</u>	<u>9,193</u>	<u>9,013</u>
Total retail	276,656	246,649	161,696
Wholesale sales	5,702	17,344	8,118
Gas transported - net	6,042	6,922	6,350
Miscellaneous	<u>2,375</u>	<u>1,574</u>	<u>1,415</u>
Total	<u>\$290,775</u>	<u>\$272,489</u>	<u>\$177,579</u>
<b>GAS SALES (Millions of cu. ft.):</b>			
Residential	20,429	24,274	21,565
Commercial	8,587	10,132	9,033
Industrial	2,160	3,089	2,781
Public authorities	<u>1,681</u>	<u>1,576</u>	<u>2,228</u>
Total retail	32,857	39,071	35,607
Wholesale sales	1,882	5,115	3,881
Gas transported	<u>13,108</u>	<u>14,729</u>	<u>14,014</u>
Total	<u>47,847</u>	<u>58,915</u>	<u>53,502</u>

The gas utility business is affected by seasonal weather patterns. As a result, operating revenues (and associated operating expenses) are not generated evenly throughout the year. See LG&E's Results of Operations under Item 7.

LG&E has five underground natural gas storage fields that help provide economical and reliable gas service to ultimate consumers. By using gas storage facilities, LG&E avoids the costs associated with typically more expensive pipeline transportation capacity to serve peak winter space-heating loads. LG&E stores gas in the summer season for withdrawal in the subsequent winter heating season. Without its on-system storage capacity, LG&E would be forced to buy additional gas and pipeline transportation services when customer demand increases, which may be when the price for those items are at their highest. Currently, LG&E buys competitively priced gas from several large suppliers under contracts of varying duration. LG&E's underground storage facilities, in combination with its purchasing practices, enable it to offer gas sales service at rates which are among the lowest in the nation.

A number of industrial customers purchase their natural gas requirements directly from alternate suppliers for delivery through LG&E's distribution system. These large industrial customers account for about one-fourth of LG&E's annual throughput.

The all-time maximum day gas sendout of 545,000 Mcf occurred on Sunday, January 20, 1985, when the average temperature for the day was -11 degrees F. During 2001, maximum day gas sendout was 423,000 Mcf, occurring on January 2, when the average temperature for the day was 17 degrees F. Supply on that day consisted of 287,000 Mcf from purchases, 66,000 Mcf delivered from underground storage, and 70,000 Mcf transported for industrial customers. For a further discussion, see Gas Supply under Item 1.

## Rates and Regulation

Following the purchase of LG&E Energy by Powergen, Powergen became a registered holding company under PUHCA. As a result, Powergen, its utility subsidiaries, including LG&E, and certain of its non-utility subsidiaries are subject to extensive regulation by the SEC under PUHCA with respect to issuances and sales of securities, acquisitions and sales of certain utility properties, and intra-system sales of certain goods and services. In addition, PUHCA generally limits the ability of registered holding companies to acquire additional public utility systems and to acquire and retain businesses unrelated to the utility operations of the holding company. Powergen believes that it has adequate authority (including financing authority) under existing SEC orders and regulations for it and its subsidiaries to conduct their businesses and will seek additional authorization when necessary.

The Kentucky Commission has regulatory jurisdiction over the rates and service of LG&E and over the issuance of certain of its securities. The Kentucky Commission has the ability to examine the rates LG&E charges its retail customers at any time. LG&E is a "public utility" as defined in the FPA, and is subject to the jurisdiction of the Department of Energy and FERC with respect to the matters covered in the FPA, including the sale of electric energy at wholesale in interstate commerce. In addition, FERC has sole jurisdiction over the issuance by LG&E of short-term securities.

For a discussion of current regulatory matters, see Rates and Regulation for LG&E under Item 7 and Note 3 of LG&E's Notes to Financial Statements under Item 8.

LG&E's electric rates contain a FAC, whereby increases and decreases in the cost of fuel for electric generation are reflected in the rates charged to all electric customers. 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. The Kentucky Commission also requires that electric utilities, including LG&E, file certain documents relating to fuel procurement and the purchase of power and energy from other utilities.

LG&E's electric rates are subject to an ESM. The ESM, in place for three years beginning in 2000, sets an upper and lower point for rate of return on equity, whereby if LG&E's rate of return for the calendar year falls within the range of 10.5% to 12.5%, no action is necessary. If earnings are above the upper limit, then excess earnings are shared 40% with ratepayers and 60% with shareholders; if earnings are below the lower limit, then earnings deficiency is recovered 40% from ratepayers and 60% from shareholders. The first ESM filing was made on March 1, 2001, for year ended December 31, 2000. By order of the Kentucky Commission, rate changes prompted by the ESM filing go into effect in April of each year. At December 31, 2001, LG&E estimated the rate of return to fall within the 10.5% to 12.5% range, subject to Kentucky Commission approval; therefore, no adjustment to the financial statements was made.

LG&E's rates contain an ECR surcharge which recovers certain costs incurred by LG&E that are required to comply with the Clean Air Act and other environmental regulations. See Note 3 of LG&E's Notes to Financial Statements under Item 8.

LG&E's gas rates contain a GSC, whereby increases or decreases in the cost of gas supply are reflected in LG&E's rates, subject to approval by the Kentucky Commission. The GSC procedure prescribed by order of the Kentucky Commission provides for quarterly rate adjustments to reflect the expected cost of gas supply in that quarter. In addition, the GSC contains a mechanism whereby any over- or under-recoveries of gas supply cost from prior quarters will be refunded to or recovered from customers through the adjustment factor determined for subsequent quarters. In February 2001, the Kentucky Commission in response to unusually high gas prices ordered LG&E to

make monthly GSC filings. In July 2001, the Kentucky Commission ordered LG&E to return to making quarterly GSC filings.

Integrated resource planning regulations in Kentucky require LG&E and the other major utilities to make triennial filings with the Kentucky Commission of various historical and forecasted information relating to load, capacity margins and demand-side management techniques. LG&E filed its last integrated resource plan in 1999, and anticipates filing a new plan in October 2002.

Pursuant to Kentucky law, the Kentucky Commission has established the boundaries of the service territory or area of each retail electric supplier in Kentucky (including LG&E), other than municipal corporations. Within this service territory each such supplier has the exclusive right to render retail electric service.

#### Construction Program and Financing

LG&E's construction program is designed to ensure that there will be adequate capacity and reliability to meet the electric and gas needs of its service area. These needs are continually being reassessed and appropriate revisions are made, when necessary, in construction schedules. LG&E's estimates of its construction expenditures can vary substantially due to numerous items beyond LG&E's control, such as changes in rates, economic conditions, construction costs, and new environmental or other governmental laws and regulations.

During the five years ended December 31, 2001, gross property additions amounted to \$841 million. Internally generated funds and external financings for the five-year period were sufficient to provide for all of these gross additions. The gross additions during this period amounted to approximately 25% of total utility plant at December 31, 2001, and consisted of \$683 million for electric properties and \$158 million for gas properties. Gross retirements during the same period were \$103 million, consisting of \$73 million for electric properties and \$30 million for gas properties.

#### Coal Supply

Coal-fired generating units provided approximately 98% of LG&E's net kilowatt-hour generation for 2001. The remainder of 2001 net generation was made up of a hydroelectric plant and natural gas and oil fueled combustion turbine peaking units. Coal will be the predominant fuel used by LG&E in the foreseeable future, with natural gas and oil being used for peaking capacity and flame stabilization in coal-fired boilers or in emergencies. LG&E has no nuclear generating units and has no plans to build any in the foreseeable future. LG&E has entered into coal supply agreements with various suppliers for coal deliveries for 2002 and beyond. LG&E normally augments its coal supply agreements with spot market purchases. LG&E has a coal inventory policy which it believes provides adequate protection under most contingencies. LG&E had a coal inventory of approximately 1,042,864 tons, or a 53-day supply, on hand at December 31, 2001.

LG&E expects to continue purchasing most of its coal, which has a sulfur content in the 2%-4.5% range, from western Kentucky, southwest Indiana, and West Virginia for the foreseeable future. This supply is relatively low priced coal, and in combination with its sulfur dioxide removal systems is expected to enable LG&E to continue to provide adequate electric service in compliance with existing environmental laws and regulations.

Coal is delivered to LG&E's Mill Creek plant by rail and barge; Trimble County plant by barge and Cane Run plant by rail.

The historical average delivered costs of coal purchased by LG&E were as follows:

	<u>2001</u>	<u>2000</u>	<u>1999</u>
Per ton	\$21.27	\$20.96	\$21.49
Per Mmbtu	\$ .93	\$ .92	\$ .95
Spot purchases as % of all sources	3%	1%	5%

The delivered cost of coal is expected to increase during 2002 due to the replacement of contracts that expired in 2001 at higher current market prices.

### Gas Supply

LG&E purchases natural gas supplies from multiple sources under contracts for varying periods of time, while transportation services are purchased from Texas Gas Transmission Corporation and Tennessee Gas Pipeline Company.

During 2000, Texas Gas filed with FERC for a change in its rates as required under the settlement in its last rate case. After a series of settlement conferences during 2001, the intervening parties reached a settlement that is supported or not opposed by essentially all of Texas Gas' local distribution company customers and the state commissions that regulate them. Texas Gas filed a Stipulation and Agreement with FERC on August 14, 2001. The settlement will resolve all issues set for hearing in these proceedings. It provides significant benefits to consumers in the form of lower rates, refunds with interest, and a three-year rate increase moratorium that will provide a measure of rate certainty to the Texas Gas system. As a result, FERC should be in a position to approve the settlement in 2002. LG&E will receive a refund from Texas Gas if FERC approves the Stipulation and Agreement in Docket No. RP00-260. LG&E participates in that and other proceedings, as appropriate.

LG&E transports on the Texas Gas system under NNS and FT rate schedules. During the winter months, LG&E has 184,900 Mmbtu/day in NNS and 18,000 Mmbtu/day in FT. LG&E's summer NNS levels are 60,000 Mmbtu/day and its summer FT levels are 54,000 Mmbtu/day. Each of these NNS and FT agreements with Texas Gas are subject to termination by LG&E in equal portions during 2005, 2006, and 2008. LG&E also transports on the Tennessee Gas system under Tennessee's Gas FT-A rate schedule. LG&E's contract levels with Tennessee Gas are 51,000 Mmbtu/day throughout the year. The FT-A agreement with Tennessee Gas is subject to termination by LG&E during 2002.

LG&E also has a portfolio of supply arrangements with various suppliers in order to meet its firm sales obligations. These gas supply arrangements include pricing provisions that are market-responsive. These firm gas supplies, in tandem with pipeline transportation services, provide the reliability and flexibility necessary to serve LG&E's customers.

LG&E owns and operates five underground gas storage fields with a current working gas capacity of about 15.1 million Mcf. Gas is purchased and injected into storage during the summer season and is then withdrawn to supplement pipeline supplies to meet the gas-system load requirements during the winter heating season. See Gas Supply under Item 1.

The estimated maximum deliverability from storage during the early part of the 2000-2001 heating season was approximately 373,000 Mcf/day. Deliverability decreases during the latter portion of the heating season as the storage inventory is reduced by seasonal withdrawals.

The average cost per Mcf of natural gas purchased by LG&E was \$5.27 in 2001, \$5.08 in 2000 and \$2.99 in 1999. Although natural gas prices in the unregulated wholesale market increased significantly throughout 2000 and early 2001, these prices have decreased dramatically since then. Decreasing natural gas prices have been brought about by increased natural gas exploration activity, excess gas in national storage inventories, decreased demand associated with a less robust economy, and warmer than normal winter weather.

## Environmental Matters

Protection of the environment is a major priority for LG&E. Federal, state, and local regulatory agencies have issued LG&E permits for various activities subject to air quality, water quality, and waste management laws and regulations. For the five-year period ending with 2001, expenditures for pollution control facilities represented \$186 million or 22% of total construction expenditures. LG&E estimates that construction expenditures for the installation of NOx control equipment from 2002 through 2004 will be approximately \$84 million. For a discussion of environmental matters, see Rates and Regulation for LG&E under Item 7 and Note 12 of LG&E's Notes to Financial Statements under Item 8.

## Competition

In the last several years, LG&E has taken many steps to prepare for the expected increase in competition in its industry, including a reduction in the number of employees; aggressive cost cutting; write-offs of previously deferred expenses; an increase in focus on commercial, industrial and residential customers; an increase in employee involvement and training; a major realignment and formation of new business units, and continuous modifications of its organizational structure. LG&E will continue to take additional steps to better position itself for competition in the future. See Note 16 of LG&E's Notes to Financial Statements under Item 8.

# KENTUCKY UTILITIES COMPANY

## General

KU, incorporated in Kentucky in 1912 and incorporated in Virginia in 1991, is a regulated public utility engaged in producing, transmitting and selling electric energy. KU provides electric service to approximately 469,000 customers in over 600 communities and adjacent suburban and rural areas in 77 counties in central, southeastern and western Kentucky, and to approximately 30,000 customers in 5 counties in southwestern Virginia. In Virginia, KU operates under the name Old Dominion Power Company. KU operates under appropriate franchises in substantially all of the 160 Kentucky incorporated municipalities served. No franchises are required in unincorporated Kentucky or Virginia communities. The lack of franchises is not expected to have a material adverse effect on KU's operations. KU also sells wholesale electric energy to 12 municipalities.

KU has one wholly owned consolidated subsidiary, KU R. KU R is a special purpose entity formed in September 2000 to enter into accounts receivable securitization transactions with KU. KU R began operations in 2001.

## Electric Operations

The sources of KU's electric operating revenues and the volumes of sales for the three years ended December 31, 2001, were as follows:

	<u>2001</u>	<u>2000</u>	<u>1999</u>
<b>ELECTRIC OPERATING REVENUES</b>			
(Thousands of \$):			
Residential	\$244,004	\$241,783	\$242,304
Commercial	165,389	161,291	160,895
Industrial	146,968	153,017	154,460
Mine Power	28,196	27,089	28,792
Public authorities	58,770	57,979	58,500
Total retail	<u>643,327</u>	<u>641,159</u>	<u>644,951</u>
Wholesale sales	203,181	198,073	286,595
Provision for rate refunds	(954)	-	(5,900)
Miscellaneous	13,918	12,709	11,664
Total	<u>\$859,472</u>	<u>\$851,941</u>	<u>\$937,310</u>
<b>ELECTRIC SALES (Thousands of Mwh):</b>			
Residential	5,678	5,714	5,447
Commercial	3,990	3,954	3,760
Industrial	4,716	5,044	4,911
Mine Power	771	767	752
Public authorities	<u>1,481</u>	<u>1,495</u>	<u>1,437</u>
Total retail	<u>16,636</u>	<u>16,974</u>	<u>16,307</u>
Wholesale sales	<u>7,713</u>	<u>7,573</u>	<u>10,188</u>
Total	<u>24,349</u>	<u>24,547</u>	<u>26,495</u>

The electric utility business is affected by seasonal weather patterns. As a result, operating revenues (and associated operating expenses) are not generated evenly throughout the year. See KU's Results of Operations under Item 7.

KU's weighted-average system-wide emission rate for sulfur dioxide in 2001 was approximately 1.3 lbs./Mmbtu of heat input, with every unit below its emission limit established by the Kentucky Division for Air Quality.

KU currently maintains an 11-14% reserve margin range. At December 31, 2001, KU owned steam and combustion turbine generating facilities with a capacity of 3,968 Mw and a 24 Mw hydroelectric facility. See Item 2, Properties. KU obtains power from other utilities under bulk power purchase and interchange contracts. At December 31, 2001, KU's system capability, including purchases from others and excluding the hydroelectric facility, was 4,458 Mw. The 2001 maximum local peak load of 3,699 Mw occurred on Wednesday, August 8, 2001. The record local peak load of 3,775 Mw occurred on August 9, 2000.

Under a contract expiring in 2020 with OMU, KU has agreed to purchase from OMU the surplus output of the 150-Mw and 250-Mw generating units at OMU's Elmer Smith station. Purchases under the contract are made under a contractual formula which has resulted in costs which were and are expected to be comparable to the cost of other power purchased or generated by KU. Such power constituted about 7% of KU's net system output during 2001. See Note 11 of KU's Notes to Financial Statements under Item 8.

KU owns 20% of the common stock of EEI, which owns and operates a 1,000-Mw generating station in southern Illinois. KU is entitled to take 20% of the available capacity of the station. Purchases from EEI are made under a contractual formula which has resulted in costs which were and are expected to be comparable to the cost of other power purchased or generated by KU. Such power constituted about 6% of KU's net system output in 2001. See Note 11 of KU's Notes to Financial Statements under Item 8.

KU is a participating owner with 14 other electric utilities of Ohio Valley Electric Corporation located in Piketon, Ohio.

KU (along with LG&E) is a founding member of MISO, such membership obtained in 1998 in response to and consistent with federal policy initiatives. As a MISO member, KU filed for and received authorization from FERC to transfer control of its transmission facilities (100 kV and above) to the MISO, the first step in allowing the latter to assume responsibility for all tariff-related transmission functions (e.g., scheduling through and on KU's transmission system) as well as non-tariff related regional transmission activities (e.g., operations planning, maintenance coordination, long-term regional planning and market monitoring). The FERC approved the MISO as the nation's first Regional Transmission Organization on December 19, 2001, after which KU submitted a filing at FERC to cancel all services under its Open Access Transmission Tariff except those that will not be provided by the MISO (certain ancillary services). The MISO became operational on February 1, 2002.

In October 2001, the FERC issued an order requiring that the bundled retail load and grandfathered wholesale load of each member transmission owner (including KU) be included in the current calculation of MISO's "cost-adder," a charge designed to recover MISO's costs of operation, including start-up capital (debt) costs. KU, along with several other transmission owners, opposed the FERC's ruling in this regard, which opposition the FERC rejected in an order on rehearing issued in 2002. As of the end of 2001, negotiations were continuing between MISO, its transmission owners and other interested industry segments regarding the level of cost responsibility properly borne by bundled and grandfathered load under these FERC rulings. Absent settlement, this issue is expected to go to hearing in 2002.

At the end of 2001, in response to an earlier FERC ruling, MISO and its transmission owning members (including KU) filed to increase MISO's rate of return on equity from 10.5% (a stipulated percentage agreed to in 1998) to 13.0%, to compensate MISO's transmission owners for the inherent risks and uncertainties associated with transferring control of their facilities to the MISO. This issue is expected to go to hearing in 2002.

#### **Rates and Regulation**

Following the purchase of LG&E Energy by Powergen, Powergen became a registered holding company under PUHCA. As a result, Powergen, its utility subsidiaries, including KU, and certain of its non-utility subsidiaries are subject to extensive regulation by the SEC under PUHCA with respect to issuances and sales of securities, acquisitions and sales of certain utility properties, and intra-system sales of certain goods and services. In addition, PUHCA generally limits the ability of registered holding companies to acquire additional public utility systems and to acquire and retain businesses unrelated to the utility operations of the holding company. Powergen believes that it has adequate authority (including financing authority) under existing SEC orders and regulations for it and its subsidiaries to conduct their businesses and will seek additional authorization when necessary.

The Kentucky Commission and the Virginia Commission have regulatory jurisdiction over KU's retail rates and service, and over the issuance of certain of its securities. By reason of owning and operating a small amount of electric utility property in one county in Tennessee (having a gross book value of approximately \$225,000)

from which KU serves five customers, KU is subject to the jurisdiction of the TRA. FERC has classified KU as a "public utility" as defined in the FPA. FERC has jurisdiction under the FPA over certain of the electric utility facilities and operations, wholesale sale of power and related transactions and accounting practices of KU, and in certain other respects as provided in the FPA. In addition, the FERC has sole jurisdiction over the issuance by KU of short-term securities.

For a discussion of current regulatory matters, see Rates and Regulation for KU under Item 7 and Note 3 of KU's Notes to the Financial Statements under Item 8.

KU's Kentucky retail electric rates contain a FAC, whereby increases and decreases in the cost of fuel for electric generation are reflected in the rates charged to all electric customers. 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. The Kentucky Commission also requires that electric utilities, including KU, file certain documents relating to fuel procurement and the purchase of power and energy from other utilities. The FAC mechanism for Virginia customers uses an average fuel cost factor based primarily on projected fuel costs. The fuel cost factor may be adjusted annually for over- or under collections of fuel costs from the previous year.

KU's Kentucky retail electric rates are subject to an ESM. The ESM, in place for three years beginning in 2000, sets an upper and lower point for rate of return on equity, whereby if KU's rate of return for the calendar year falls within the range of 10.5% to 12.5%, no action is necessary. If earnings are above the upper limit, then excess earnings are shared 40% with ratepayers and 60% with shareholders; if earnings are below the lower limit, then earnings deficiency is recovered 40% from ratepayers and 60% from shareholders. The first ESM filing was made on March 1, 2001, for year ended December 31, 2000. By order of the Kentucky Commission, rate changes prompted by the ESM filing go into effect in April of each year. At December 31, 2001, KU estimated the rate of return to fall within the range, subject to Kentucky Commission approval; therefore, no adjustment was made to the financial statements.

KU's Kentucky rates contain an ECR surcharge which recovers certain costs incurred by KU that are required to comply with the Clean Air Act and other environmental regulations. See Note 3 of KU's Notes to Financial Statements under Item 8.

Integrated resource planning regulations in Kentucky require KU and the other major utilities to make triennial filings with the Kentucky Commission of various historical and forecasted information relating to load, capacity margins and demand-side management techniques. KU filed its last integrated resource plan in 1999, and anticipates filing a new plan in October 2002.

Pursuant to Kentucky law, the Kentucky Commission has established the boundaries of the service territory or area of each retail electric supplier in Kentucky (including KU), other than municipal corporations. Within this service territory each such supplier has the exclusive right to render retail electric service.

The state of Virginia passed the Virginia Electric Utility Restructuring Act in 1999. This act gives Virginia customers a choice for energy services. The change will be phased in gradually between January 2002 and January 2004. KU customers will have retail choice beginning January 1, 2004. KU filed unbundled rates that became effective January 1, 2002. Rates are capped at current levels through June 2007. The Virginia Commission will continue to require each Virginia utility to make annual filings of either a base rate change or an Annual Informational Filing consisting of a set of standard financial schedules. The Virginia Staff will issue a Staff Report regarding the individual utility's financial performance during the historic 12-month period. The Staff Report can lead to an adjustment in rates, but through June 2007 will be limited to decreases. Because KU has a small number of customers in Virginia, all of which are served at competitive rates, KU shall seek an

exemption from the Virginia Commission Rules Governing Retail Access to Competitive Energy Services by applying for a waiver to exempt KU from modifying the current billing infrastructure.

### Construction Program and Financing

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. These needs are continually being reassessed and appropriate revisions are made, when necessary, in construction schedules. KU's estimates of its construction expenditures can vary substantially due to numerous items beyond KU's control, such as changes in rates, economic conditions, construction costs, and new environmental or other governmental laws and regulations.

During the five years ended December 31, 2001, gross property additions amounted to \$610 million. Internally generated funds and external financings for the five-year period were sufficient to provide for all of these gross additions. The gross additions during this period amounted to approximately 20% of total utility plant at December 31, 2001. Gross retirements during the same period were \$90 million.

### Coal Supply

Coal-fired generating units provided approximately 99% of KU's net kilowatt-hour generation for 2001. The remainder of KU's net generation for 2001 was provided by oil and natural gas burning units and hydroelectric plants. The historical average delivered cost of coal purchased and the percentage of spot coal purchases were as follows:

	<u>2001</u>	<u>2000</u>	<u>1999</u>
Per ton	\$27.84	\$25.63	\$26.65
Per Mmbtu	\$1.20	\$1.07	\$1.11
Spot purchases as % of all sources	44%	51%	53%

KU's historical average cost of coal purchased is higher than LG&E's due to the lower sulfur content of the coal KU purchases for use at its Ghent plant and higher cost to transport coal to the E.W. Brown plant. The delivered cost of coal is expected to increase during 2002.

KU maintains its fuel inventory at levels estimated to be necessary to avoid operational disruptions at its 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 labor issues and other supplier or transporter operating difficulties.

KU believes there are adequate reserves available to supply its existing base-load generating units with the quantity and quality of coal required for those units throughout their useful lives. KU intends to meet a portion of its coal requirements with three-year or shorter contracts. As part of this strategy, KU will continue to negotiate replacement contracts as contracts expire. KU does not anticipate any problems negotiating new contracts for future coal needs. The balance of coal requirements will be met through spot purchases. KU had a coal inventory of approximately 1,361,781 tons, or a 60-day supply, on hand at December 31, 2001.

KU expects to continue purchasing most of its coal, which has a sulfur content in the .7% - 3.5% range, from western and eastern Kentucky, West Virginia, southwest Indiana, Wyoming and Pennsylvania for the foreseeable future.

Coal for Ghent is delivered by barge. Deliveries to the Tyrone, Green River and Pineville locations are by truck. Delivery to E.W. Brown is by rail.

## Environmental Matters

Protection of the environment is a major priority for KU. Federal, state, and local regulatory agencies have issued KU permits for various activities subject to air quality, water quality, and waste management laws and regulations. For the five-year period ending with 2001, expenditures for pollution control facilities represented \$24 million or 4% of total construction expenditures. KU estimates that construction expenditures for the installation of nitrogen oxide control equipment from 2002 through 2004 will be approximately \$181 million. See Note 11 of KU's Notes to Financial Statements under Item 8.

## Competition

KU has taken many steps to prepare for the expected increase in competition in its industry, including a reduction in the number of employees; aggressive cost cutting; an increase in focus on not only commercial and industrial customers, but residential customers as well; an increase in employee involvement and training; and continuous modifications of its organizational structure. KU will continue to take additional steps to better position itself for competition in the future. See Note 14 of KU's Notes to Financial Statements under Item 8.

## EMPLOYEES AND LABOR RELATIONS

LG&E had 907 full-time employees and KU had 1,008 full-time employees at December 31, 2001. Of the LG&E total, 647 operating, maintenance, and construction employees were members of IBEW Local 2100. LG&E and IBEW Local 2100 signed a four-year contract in November 2001. Of the KU total, 171 operating, maintenance, and construction employees were members of IBEW Local 2100 and USWA Local 9447-01. In August 2001, KU and employees represented by IBEW Local 2100 entered into a two-year collective bargaining agreement. KU and employees represented by USWA entered into a two-year collective bargaining agreement effective August 2000 and expiring July 31, 2002. In July 2001, KU and employees represented by USWA entered into a wage reopener whereby higher wages were negotiated.

As a result of the Powergen acquisition and in order to comply with the Public Utility Holding Company Act of 1935, LG&E Services was formed and became effective on January 1, 2001. LG&E Services provides certain services to affiliated entities, including LG&E and KU, at cost as required under the Holding Company Act. On January 1, 2001, approximately 1,000 employees, mainly from LG&E Energy, LG&E and KU, were moved to LG&E Services.

See Note 3 of LG&E's Notes to Financial Statements and Note 3 of KU's Notes to Financial Statements under Item 8 for workforce separation program in effect for 2001.

Executive Officers of LG&E and KU at December 31, 2001:

<u>Name</u>	<u>Age</u>	<u>Position</u>	<u>Effective Date of Election to Present Position</u>
Victor A. Staffieri	46	Chairman of the Board, President and Chief Executive Officer	May 1, 2001
Richard Aitken-Davies	52	Chief Financial Officer	January 31, 2001
John R. McCall	58	Executive Vice President, General Counsel and Corporate Secretary	July 1, 1994
Frederick J. Newton III	46	Senior Vice President and Chief Administrative Officer	January 2, 1999
S. Bradford Rives	43	Senior Vice President - Finance and Controller	December 11, 2000
Paul W. Thompson	45	Senior Vice President - Energy Services	June 7, 2000
Chris Hermann	54	Senior Vice President - Distribution Operations	December 11, 2000
Wendy C. Welsh	48	Senior Vice President - Information Technology	December 11, 2000
Martyn Gallus	37	Senior Vice President - Energy Marketing	December 11, 2000
Roger A. Smith	49	Senior Vice President Project Engineering	December 11, 2000
David A. Vogel	36	Vice President - Retail Services	December 11, 2000
Daniel K. Arbough	40	Treasurer	December 11, 2000
Bruce D. Hamilton	46	Vice President Power Operations	December 11, 2000
Robert E. Henriques	60	Vice President Plant Operations	December 11, 2000
Michael S. Beer	43	Vice President-Rates and Regulatory	February 1, 2001
George R. Siemens	52	Vice President-External Affairs	January 11, 2001

The present term of office of each of the above executive officers extends to the meeting of the Board of Directors following the 2002 Annual Meeting of Shareholders.

There are no family relationships between or among executive officers of LG&E and KU. The above tables indicate officers serving as executive officers of both LG&E and KU at December 31, 2001. Each of the above officers serves in the same capacity for LG&E and KU.

Before he was elected to his current positions, Mr. Staffieri was President of LG&E from January 1994 to May 1997; President-Distribution Services of LG&E Energy Corp. from December 1995 to May 1997; Chief Financial Officer of LG&E Energy Corp. and LG&E from May 1997 to February 2000; Chief Financial Officer of KU from May 1998 to February 2000; and President and Chief Operating Officer of LG&E Energy Corp., LG&E and KU from June 2000 to May 2001.

Before he was elected to his current position, Mr. Aitken-Davies was Director - LG&E Transition Team at Powergen from March 2000 to December 2000; Group Performance Director at Powergen from April 1998 to March 2000.

Before he was elected to his current positions, Mr. McCall was Executive Vice President, General Counsel and Corporate Secretary of LG&E Energy Corp. and LG&E from July 1994 to the present. He became Executive Vice President, General Counsel and Corporate Secretary of KU on May 4, 1998.

Before he was elected to his current positions, Mr. Newton was Director of Human Resources, Manufacturing and Engineering at Unilever from October 1993 to July 1995; Senior Director, Human Resources, Supply Chain, at Unilever from August 1995 to July 1996; Vice President, Human Resources, at Venator Group from August 1996 to July 1997; Senior Vice President, Human Resources, at Venator Group's Champs Sports Division from August 1997 to April 1998; and Senior Vice President - Human Resources and Administration of LG&E Energy Corp., LG&E and KU from May 1998 to January 1999.

Before he was elected to his current positions, Mr. Rives was Vice President and Treasurer of LG&E Power Inc. from June 1994 to March 1995; Vice President, Controller and Treasurer of LG&E Power Inc. from March 1995 to December 1995; Vice President - Finance, Non-Utility Businesses of LG&E Energy Corp. from January 1996 to March 1996; Vice President - Finance and Controller of LG&E Energy Corp. from March 1996 to February 1999; and Senior Vice President - Finance and Business Development from February 1999 to December 2000.

Before he was elected to his current positions, Mr. Thompson was Vice President - Business Development for LG&E Energy Corp. from July 1994 to September 1996; Vice President, Retail Electric Business for LG&E from September 1996 to June 1998; Group Vice President for LG&E Energy Marketing, Inc. from June 1998 to August 1999; Vice President, Retail Electric Business for LG&E from December 1998 to August 1999; and Senior Vice President - Energy Services for LG&E Energy Corp. since August 1999.

Before he was elected to his current positions, Mr. Hermann was Vice President and General Manager, Wholesale Electric Business of LG&E from January 1993 to June 1997; Vice President, Business Integration of LG&E from June 1997 to May 1998; and Vice President, Power Generation and Engineering Services, of LG&E from May 1998 to December 1999; Vice President Supply Chain and Operating Services from December 1999 to December 2000.

Before she was elected to her current positions, Ms. Welsh was Vice President - Information Services of LG&E from January 1994 to May 1997; and Vice President, Administration of LG&E Energy Corp. from May 1997 to

February 1998; and Vice President-Information Technology from February 1998 to December 2000.

Before he was elected to his current positions, Mr. Gallus was Director, Trading and Risk Management from January 1996 to September 1996; Director, Product Development from September 1996 to April 1997; Vice President, Structured Products from April 1997 to May 1998; Senior Vice President, Trading, from May 1998 to August 1998 for LG&E Energy Marketing Inc., respectively; Vice President, Energy Marketing from August 1998 to December 2000 for LG&E Energy Corp.

Before he was elected to his current positions, Mr. Smith was Head of Construction Projects - Powergen from January 1996 to May 1999; Director of Projects - Powergen from May 1999 to December 1999; and Director of Engineering Projects for Powergen International from January 2000 to December 2000.

Before he was elected to his current positions, Mr. Vogel served in management positions within the Distribution Department of LG&E and KU during the five prior years to this report. In his position prior to his current role he was responsible for statewide outage management and restoration of distribution network.

Before he was elected to his current position, Mr. Arbough was Manager, Corporate Finance of LG&E Energy Corp., and LG&E from August 1996 to May 1998; Director, Corporate Finance of LG&E Energy Corp., LG&E and KU from May 1998 to present.

Before he was elected to his current position, Mr. Hamilton was Venture Manager from May 1992 to 1994; Senior Venture Manager from 1994 to 1996, Vice President, Asset Management from 1996 to 2000 and Vice President, Independent Power Operations, January 2001 to present.

Before he was elected to his current position, Mr. Henriques was Vice President-Plant Operations from September 1995 to September 2001; and Senior Venture Manager for LG&E Power Inc from May 1993 to September 1995.

Before he was elected to his current position in February of 2001, Mr. Beer was Senior Counsel Specialist, Regulatory from February 2000 to February 2001; and Senior Corporate Attorney from February 1998 to February 2000. Prior to joining LG&E Energy Corp., Mr. Beer was Director, Federal Regulatory Affairs, for Illinois Power Company in Decatur, Illinois, from February of 1997 to January of 1998.

Before he was elected to his current position as Vice President of External Affairs for LG&E Energy, which he has held since January 2001, Mr. Siemens held the position of Director of External Affairs for LG&E from August 1982 to December 2000.

ITEM 2. Properties.

LG&E's power generating system consists of the coal-fired units operated at its three steam generating stations. Combustion turbines supplement the system during peak or emergency periods. LG&E owns and operates the following electric generating stations:

	<u>Capability Rating (Kw)</u>
<b>Steam Stations:</b>	
<b>Mill Creek - Kosmosdale, KY</b>	
Unit 1	303,000
Unit 2	301,000
Unit 3	386,000
Unit 4	<u>480,000</u>
<b>Total Mill Creek</b>	<b>1,470,000</b>
<b>Cane Run - near Louisville, KY</b>	
Unit 4	155,000
Unit 5	168,000
Unit 6	<u>240,000</u>
<b>Total Cane Run</b>	<b>563,000</b>
<b>Trimble County - Bedford, KY (a)</b>	
Unit 1	371,000
<b>Combustion Turbine Generators (Peaking capability):</b>	
Zorn	16,000
Paddy's Run (b)	127,000
Cane Run	16,000
Waterside	33,000
E.W. Brown (c)	<u>195,000</u>
<b>Total combustion turbine generators</b>	<b><u>387,000</u></b>
<b>Total capability rating</b>	<b><u>2,791,000</u></b>

- (a) Amount shown represents LG&E's 75% interest in Trimble County. See Notes 12 and 13 of LG&E's Notes to Financial Statements, Jointly Owned Electric Utility Plant, under Item 8 for further discussion on ownership.
- (b) Amount shown represents LG&E's 53% interest in Paddy's Run Unit 13 and 100% ownership of two other Paddy's Run CTs. See Notes 12 and 13 of LG&E's Notes to Financial Statement, under Item 8 for further discussion on ownership.
- (c) Amount shown represents LG&E's 38% interest in Units 6 and 7 and LG&E's 53% interest in Unit 5 at E.W. Brown. See Notes 12 and 13 of LG&E's Notes to Financial Statements, under Item 8 for further discussion on ownership.

LG&E also owns an 80 Mw hydroelectric generating station located in Louisville, operated under license issued by the FERC.

At December 31, 2001, LG&E's electric transmission system included 21 substations with a total capacity of approximately 11,519,700 Kva and approximately 656 structure miles of lines. The electric distribution system included 84 substations with a total capacity of approximately 3,448,730 Kva, 3,718 structure miles of overhead lines, 379 miles of underground conduit, and 5,827 miles of underground conductors.

LG&E's gas transmission system includes 212 miles of transmission mains, and the gas distribution system includes 3,914 miles of distribution mains.

LG&E operates underground gas storage facilities with a current working gas capacity of approximately 15.1 million Mcf. See Gas Supply under Item 1.

In 1990, LG&E entered into an operating lease for its corporate office building located in downtown Louisville, Kentucky. The lease is for a period of 15 years and is scheduled to expire June 2005.

Other properties owned by LG&E include office buildings, service centers, warehouses, garages, and other structures and equipment, the use of which is common to both the electric and gas departments.

The trust indenture securing LG&E's First Mortgage Bonds constitutes a direct first mortgage lien upon much of the property owned by LG&E.

KU's power generating system consists of the coal-fired units operated at its five steam generating stations. Combustion turbines supplement the system during peak or emergency periods. KU owns and operates the following electric generating stations:

	<u>Capability Rating (Kw)</u>
<b>Steam Stations:</b>	
<b>Tyrone - Tyrone, KY</b>	
Unit 1	27,000
Unit 2	31,000
Unit 3	<u>71,000</u>
<b>Total Tyrone</b>	<b>129,000</b>
<b>Green River – South Carrollton, KY</b>	
Unit 1	26,000
Unit 2	27,000
Unit 3	71,000
Unit 4	<u>103,000</u>
<b>Total Green River</b>	<b>227,000</b>
<b>E.W. Brown – Burgin, KY</b>	
Unit 1	104,000
Unit 2	168,000
Unit 3	<u>439,000</u>
<b>Total E.W. Brown</b>	<b>711,000</b>
<b>Pineville – Four Mile, KY (a)</b>	
Unit 3	34,000
<b>Ghent – Ghent, KY.</b>	
Unit 1	483,000
Unit 2	492,000
Unit 3	493,000
Unit 4	<u>494,000</u>
<b>Total Ghent</b>	<b>1,962,000</b>
<b>Combustion Turbine Generators (Peaking capability):</b>	
E.W. Brown – Burgin, KY (Units 6-11) (b)	786,000
Haefling – Lexington, KY	45,000
Paddys Run – Louisville, KY (c)	<u>74,000</u>
<b>Total combustion turbine generators</b>	<b>905,000</b>
<b>Total capability rating</b>	<b><u>3,968,000</u></b>

- (a) Pineville Unit 3 has been taken out of active service as of January 31, 2002 and will be retired in 2002.
- (b) Amount shown represents KU's 62% interest in Units 6 and 7 at E.W. Brown, KU's 47% interest in Unit 5 at E.W. Brown and 100% of four other units. See Notes 11 and 12 of KU's Notes to Financial Statements, under Item 8 for further discussion on ownership.
- (c) Amount shown represents KU's 47% interest in Unit 13 at Paddy's Run. See Notes 11 and 12 of KU's Notes to Financial Statements, under Item 8 for further discussion on ownership.

Substantially all properties are subject to the lien of KU's Mortgage Indenture.

KU also owns a 24 Mw hydroelectric generating station located in Burgin, Kentucky (Dix Dam), operated under a license issued by the FERC.

At December 31, 2001, KU's electric transmission system included 112 substations with a total capacity of approximately 14,855,396 Kva and approximately 4,409 structure miles of lines. The electric distribution system included 438 substations with a total capacity of approximately 5,046,307 Kva and 14,924 structure miles of lines.

### ITEM 3. Legal Proceedings.

#### Rates and Regulatory Matters

For a discussion of current regulatory matters, including, among others, a discussion of settlement agreements with the Kentucky Commission regarding rate matters related to LG&E's and KU's environmental cost recovery surcharge refunds, fuel adjustment clause proceedings and regulatory assets, depreciation and amortization matters, see Rates and Regulation under Item 7 and Note 3 of LG&E's Notes to Financial Statements and Note 3 of KU's Notes to Financial Statements under Item 8.

#### Alternative Ratemaking

In October 1998, LG&E and KU filed applications with the Kentucky Commission for approval of the PBR proposal for determining electric rates. In January 2000, the Kentucky Commission issued orders requiring LG&E and KU to reduce annual base rates, effective March 1, 2000. The orders also eliminated the temporary effectiveness of the PBR proposal, reinstated the FAC mechanism and offered the utilities a three year ESM program whereby incremental annual earnings above or below a range of 10.5% to 12.5% would be shared 60% with shareholders and 40% with ratepayers. In February 2000, LG&E and KU filed tariffs incorporating the ESM. In June 2000, the Kentucky Commission issued orders reducing the original January 2000 base rate reductions to now require reductions in base rates of approximately \$26.3 million at LG&E and \$30.4 million at KU, effective June 1, 2000. The orders implemented LG&E's and KU's ESM tariffs, with certain modifications, for a three year term. No parties filed appeals from the Kentucky Commission's orders within the time allowed by statute. See Rates and Regulations under Item 7 and Note 3 to LG&E's Notes to Financial Statements and Note 3 to KU's Notes to Financial Statements under Item 8.

#### Fuel Adjustment Clause Proceedings

Pursuant to Kentucky statute, LG&E and KU operate under six-month and two-year reviews by the Kentucky Commission of the fuel cost incurred to serve their customers. Both LG&E and KU have participated in proceedings in front of the Kentucky Commission concerning the recovery of fuel costs associated with wholesale sales and recovery of purchased power energy costs. As a result of these proceedings, the Kentucky Commission issued an order in July 1999 requiring KU to refund a total of \$10.1 million to ratepayers. The amount was reduced to \$6.7 million in August 1999, which amount was refunded over the 12-month period beginning October 1999; the period covered by the order was November 1994 through October 1998. The Kentucky Commission issued an order in February 1999 requiring LG&E to refund \$3.9 million to ratepayers, of which \$1.9 million was refunded in April 1999. As a result of a rehearing, the Kentucky Commission ordered a refund totaling \$800,000 for the period November 1996 through April 1998. This refund was paid in January 2000. The PSC orders from February 1999 (LG&E) and August 1999 (KU) were each appealed by KU and LG&E and the intervenor group in 2000. Pending a decision on these appeals, a comprehensive settlement was reached by all parties, which settlement was filed with the Kentucky Commission on December 21, 2001. Under that settlement, LG&E and KU agreed to credit their respective fuel clauses in the amount of \$720,000

and \$954,000, respectively (such credit provided over the course of two monthly billing periods), and the parties agreed on a prospective interpretation of Kentucky's fuel adjustment clause regulation to ensure consistent and mutually acceptable application on a going-forward basis. All pending FAC proceedings before the court were resolved by the parties to the agreement and all parties requested the Court of Appeals remand the case to the Kentucky Commission for final approval. The Kentucky Commission is expected to approve the settlement in 2002. See also Note 3 to LG&E's Notes to Financial Statements and Note 3 to KU's Notes to Financial Statements under Item 8.

#### Environmental

For a discussion of environmental matters concerning (a) currently proposed reductions in NOx emission limits, (b) issues at LG&E's Mill Creek generating plant and LG&E's and KU's manufactured gas plant sites, and (c) other environmental items affecting LG&E and KU, see Environmental Matters under Item 7 and Note 12 of LG&E's Notes to Financial Statements and Note 11 of KU's Notes to Financial Statements under Item 8, respectively.

#### E.ON – Powergen Transaction

In April 2001, E.ON AG announced a conditional offer to purchase all the common shares of Powergen plc, the indirect corporate parent of LG&E and KU. The transaction is subject to a number of conditions precedent, including the receipt of regulatory approvals from European and United States governmental bodies, in form satisfactory to the parties. Regulatory orders approving the E.ON transaction were received from the Kentucky Commission in August 2001 and from the Virginia State Corporation Commission, the Federal Energy Regulatory Commission and the TRA, respectively, in October 2001. The parties anticipate that remaining approvals may be received in the near future to permit completion of the transaction during the first half of 2002. However, there can be no assurance that such approvals will be obtained in form or timing sufficient for such dates. For further discussion also see Business under Item 1.

#### Preferred Stock

In October 2001, the Boards of Directors of LG&E and KU authorized the delisting of LG&E's 5% Preferred Stock, par value \$25 per share, from the NASDAQ Small Capitalization Market and KU's 4.75% Preferred Stock, stated value \$100 per share, from the Philadelphia Stock Exchange, respectively. The delistings could occur following applications to the relevant exchanges and applicable regulatory agencies, if any. Delisting does not constitute a change in the terms and conditions of the respective preferred stock series nor the rights and privileges of their shareholders. The delistings are proposed in order to enable LG&E and KU to realize certain administrative and corporate governance efficiencies.

#### Other

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

**ITEM 4. Submission of Matters to a Vote of Security Holders.**

- a) LG&E's and KU's Annual Meetings of Shareholders were held on December 19, 2001.
- b) Not Applicable
- c) The matters voted upon and the results of the voting at the Annual Meetings are set forth below:

**1.LG&E**

- i) The shareholders voted to elect LG&E's nominees for election to the Board of Directors as follows:

Sydney Gillibrand CBE - 21,294,223 common shares and 125,955 preferred shares cast in favor of election and 4,118 preferred shares withheld.

Nicholas P. Baldwin - 21,294,223 common shares and 127,114 preferred shares cast in favor of election and 2,959 preferred shares withheld.

Victor A. Staffieri - 21,294,223 common shares and 126,596 preferred shares cast in favor of election and 3,477 preferred shares withheld.

Edmund A. Wallis - 21,294,223 common shares and 125,850 preferred shares cast in favor of election and 4,223 preferred shares withheld.

Dr. David K-P Li - 21,294,223 common shares and 125,813 preferred shares cast in favor of election and 4,260 preferred shares withheld.

Sir Frederick Crawford - 21,294,223 common shares and 125,285 preferred shares cast in favor of election and 4,788 preferred shares withheld.

David J. Jackson - 21,294,223 common shares and 126,935 preferred shares cast in favor of election and 3,138 preferred shares withheld.

No holders of common or preferred shares abstained from voting on this matter.

- ii) The shareholders voted 21,294,223 common shares and 126,532 preferred shares in favor of and 896 preferred shares against the approval of PricewaterhouseCoopers LLP as independent accountants for 2001. Holders of 2,645 preferred shares abstained from voting on this matter.

**2.KU**

- i) The sole shareholder voted to elect KU's nominees for election to the Board of Directors as follows:

37,817,878 common shares cast in favor of election and no shares withheld for each of Sydney Gillibrand CBE, Nicholas P. Baldwin, Victor A. Staffieri, Edmund A. Wallis, Dr. David K-P Li, Sir Frederick Crawford and David J. Jackson, respectively.

- ii) The sole shareholder voted 37,817,878 common shares in favor of and no shares withheld for approval of PricewaterhouseCoopers LLP as independent accountants for 2001.

No holders of common shares abstained from voting on these matters.

d) Not applicable.

## PART II.

### ITEM 5. Market for the Registrant's Common Equity and Related Stockholder Matters.

#### LG&E:

All LG&E common stock, 21,294,223 shares, is held by LG&E Energy. Therefore, there is no public market for LG&E's common stock.

The following table sets forth LG&E's cash distributions on common stock paid to LG&E Energy (in thousands of \$):

	<u>2001</u>	<u>2000</u>
First quarter	\$ 0	\$23,000
Second quarter	0	16,500
Third quarter	0	16,500
Fourth quarter	23,000	17,000

#### KU:

All KU common stock, 37,817,878 shares, is held by LG&E Energy. Therefore, there is no public market for KU's common stock.

The following table sets forth KU's cash distributions on common stock paid to LG&E Energy (in thousands of \$):

	<u>2001</u>	<u>2000</u>
First quarter	\$ 0	\$19,000
Second quarter	0	25,000
Third quarter	0	25,000
Fourth quarter	30,500	25,500

ITEM 6. Selected Financial Data.

	Years Ended December 31				
	(Thousands of \$)				
	<u>2001</u>	<u>2000</u>	<u>1999</u>	<u>1998</u>	<u>1997</u>
<b>LG&amp;E:</b>					
<b>Operating revenues:</b>					
Revenues	\$997,420	\$985,947	\$969,984	\$854,556	\$845,543
Provision for rate refunds	<u>(720)</u>	<u>(2,500)</u>	<u>(1,735)</u>	<u>(4,500)</u>	<u>-</u>
Total operating revenues	<u>996,700</u>	<u>983,447</u>	<u>968,249</u>	<u>850,056</u>	<u>845,543</u>
Net operating income	<u>141,773</u>	<u>148,870</u>	<u>140,091</u>	<u>135,523</u>	<u>148,186</u>
<b>Net income:</b>					
Before unusual items	106,781	110,573	106,270	101,697	113,273
Merger costs	<u>-</u>	<u>-</u>	<u>-</u>	<u>(23,577)</u>	<u>-</u>
Net income	<u>106,781</u>	<u>110,573</u>	<u>106,270</u>	<u>78,120</u>	<u>113,273</u>
Net income available for common stock	<u>102,042</u>	<u>105,363</u>	<u>101,769</u>	<u>73,552</u>	<u>108,688</u>
Total assets	<u>2,448,354</u>	<u>2,226,084</u>	<u>2,171,452</u>	<u>2,104,637</u>	<u>2,055,641</u>
Long-term obligations (including amounts due within one year)	<u>\$616,904</u>	<u>\$606,800</u>	<u>\$626,800</u>	<u>\$626,800</u>	<u>\$646,800</u>

LG&E's Management's Discussion and Analysis of Financial Condition and Results of Operation and LG&E's Notes to Financial Statements should be read in conjunction with the above information.

	Years Ended December 31				
	(Thousands of \$)				
	<u>2001</u>	<u>2000</u>	<u>1999</u>	<u>1998</u>	<u>1997</u>
<u>KU:</u>					
Operating revenues:					
Revenues	\$860,426	\$851,941	\$943,210	\$831,614	\$716,437
Provision for rate refunds	(954)	-	(5,900)	(21,500)	-
Total operating revenues	<u>859,472</u>	<u>851,941</u>	<u>937,310</u>	<u>810,114</u>	<u>716,437</u>
Net operating income:					
Before unusual items	125,465	128,136	136,016	125,388	118,408
Non-recurring charge	(4,095)	-	-	-	-
Net operating income	<u>121,370</u>	<u>128,136</u>	<u>136,016</u>	<u>125,388</u>	<u>118,408</u>
Net income:					
Before unusual items	100,509	95,524	106,558	94,428	85,713
Non-recurring charge	(4,095)	-	-	-	-
Merger costs	-	-	-	(21,664)	-
Net income	<u>96,414</u>	<u>95,524</u>	<u>106,558</u>	<u>72,764</u>	<u>85,713</u>
Net income available for common stock					
	<u>94,158</u>	<u>93,268</u>	<u>104,302</u>	<u>70,508</u>	<u>83,457</u>
Total assets	<u>1,826,902</u>	<u>1,739,518</u>	<u>1,785,090</u>	<u>1,761,201</u>	<u>1,679,880</u>
Long-term obligations (including amounts due within one year)					
	<u>\$488,506</u>	<u>\$484,830</u>	<u>\$546,330</u>	<u>\$546,330</u>	<u>\$546,351</u>

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

## ITEM 7. Management's Discussion and Analysis of Financial Condition and Results of Operation.

### LG&E:

#### GENERAL

The following discussion and analysis by management focuses on those factors that had a material effect on LG&E's financial results of operations and financial condition during 2001, 2000, and 1999 and should be read in connection with the financial statements and notes thereto.

Some of the following discussion may contain forward-looking statements that are subject to certain 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 vary materially. Factors that could cause actual results to differ materially include; 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; and other factors described from time to time in LG&E's reports to the Securities and Exchange Commission, including Exhibit No. 99.01 to this report on Form 10-K.

## MERGERS and ACQUISITIONS

On April 9, 2001, a German power company, E.ON AG, announced a preconditional cash offer of £5.1 billion (\$7.3 billion) for Powergen. The offer is subject to a number of conditions, including the receipt of certain European and United States regulatory approvals. The Kentucky Public Service Commission, the Federal Energy Regulatory Commission, the Virginia State Corporation Commission, and the Tennessee Regulatory Authority have all approved the acquisition of Powergen and LG&E Energy by E.ON. The parties expect to obtain the remaining regulatory approvals and to complete the transaction in the first half of 2002. See Powergen's schedule 14D-9, and associated schedules to such filings, filed with the SEC on April 9, 2001.

On December 11, 2000, LG&E Energy Corp. was acquired by Powergen plc. for cash of approximately \$3.2 billion or \$24.85 per share and the assumption of all of LG&E Energy's debt. As a result of the acquisition, LG&E Energy became a wholly owned subsidiary of Powergen and, as a result, LG&E became an indirect subsidiary of Powergen. LG&E has continued its separate identity and serves customers in Kentucky under its existing name. The preferred stock and debt securities of LG&E were not affected by this transaction and LG&E continues to file SEC reports. Following the acquisition, Powergen became a registered holding company under PUHCA, and LG&E, as a subsidiary of a registered holding company, became subject to additional regulation under PUHCA. See "Rates and Regulation" under Item 1.

## RESULTS OF OPERATIONS

### Net Income

LG&E's net income decreased \$3.8 million for 2001, as compared to 2000. This decrease is mainly due to higher pension related expenses and amortization of regulatory assets, partially offset by increased electric and gas net revenues (operating revenues less fuel for electric generation, power purchased and gas supply expenses) and decreased interest expenses.

LG&E's net income increased \$4.3 million for 2000, as compared to 1999. This increase is mainly due to higher gas sales resulting from the colder winter weather experienced in 2000, lower administrative costs and operating expenses at the electric generating stations, partially offset by decreased electric revenues due to a rate reduction ordered by the Kentucky Commission, higher maintenance and interest expenses.

## LG&E (cont.):

### Revenues

A comparison of operating revenues for the years 2001 and 2000, excluding the provisions recorded for refunds in 2001 and in 2000, with the immediately preceding year reflects both increases and decreases, which have been segregated by the following principal causes (in thousands of \$):

<u>Cause</u>	Increase (Decrease) From Prior Period			
	Electric Revenues		Gas Revenues	
	<u>2001</u>	<u>2000</u>	<u>2001</u>	<u>2000</u>
<b>Retail sales:</b>				
Fuel and gas supply adjustments, etc.	\$ (394)	\$ (9,027)	\$ 79,627	\$ 57,156
LG&E/KU Merger surcredit	(2,456)	(2,331)	-	-
ESM/Performance based rate	1,962	4,114	-	-
Environmental cost recovery surcharge	1,246	(1,308)	-	-
Electric rate reduction	(3,671)	(20,727)	-	-
VDT surcredit	(1,014)	-	(68)	-
Gas rate increase	-	-	15,265	4,221
Variation in sales volumes, etc.	<u>4,429</u>	<u>5,759</u>	<u>(64,817)</u>	<u>23,576</u>
Total retail sales	102	(23,520)	30,007	84,953
Wholesale sales	(5,674)	(56,256)	(11,642)	9,226
Gas transportation-net	-	-	(880)	572
Other	<u>(1,241)</u>	<u>829</u>	<u>801</u>	<u>159</u>
Total	<u>\$ (6,813)</u>	<u>\$ (78,947)</u>	<u>\$ 18,286</u>	<u>\$ 94,910</u>

Electric revenues decreased in 2001 primarily due to a decrease in brokered activity in the wholesale electric sales market, an electric rate reduction ordered by the Kentucky Commission and the effects of the LG&E/KU merger surcredit (See Note 2 of LG&E's Notes to Financial Statements under Item 8) partially offset by an increase in electric retail sales. In January 2000, the Kentucky Commission ordered an electric rate reduction and the termination of LG&E's proposed electric PBR mechanism. Gas revenues in 2001 increased primarily as a result of higher gas supply costs billed to customers through the gas supply clause and the effects of a gas rate increase ordered by the Kentucky Commission in September 2000. The gas revenue increase was partially offset by a decrease in retail and wholesale gas sales in 2001 due to warmer weather; heating degree days decreased 10.2% as compared to 2000.

Electric revenues decreased in 2000 primarily due to a decrease in brokered activity in the wholesale electric sales market and the electric rate reduction ordered by the Kentucky Commission. In January 2000, the Kentucky Commission ordered an electric rate reduction and the termination of LG&E's proposed electric PBR mechanism. Gas revenues increased in 2000 primarily as a result of higher gas supply costs billed to customers through the gas supply clause, coupled with increased gas sales in 2000 due to colder weather, as heating degree days increased 15% over 1999. Increased wholesale gas sales, and the effects of a gas rate increase ordered by the Kentucky Commission in September 2000 also contributed to increased gas revenues.

### Expenses

Fuel for electric generation and gas supply expenses comprises a large component of LG&E's total operating costs. LG&E's electric rates contain a FAC and gas rates contain a GSC, whereby increases or decreases in the cost of fuel and gas supply are reflected in the FAC and GSC factors, subject to approval by the Kentucky Commission. In July 1999, the Kentucky Commission implemented rates proposed in LG&E's PBR filing

LG&E (cont.):

resulting in the discontinuance of the FAC. In January 2000, the Kentucky Commission rescinded the PBR rates and ordered the reinstatement of the FAC. See Note 3 of LG&E's Notes to Financial Statements under Item 8 for a further discussion of the PBR and the FAC.

Fuel for electric generation decreased \$.2 million (.1%) in 2001 primarily due to decreased generation as a result of decreased electric sales (\$2.2 million) partially offset by a higher cost of coal burned (\$2.0 million). Fuel for electric generation increased \$.3 million (.2%) in 2000 because of an increase in generation to support increased electric sales (\$7.6 million), offset partially by a lower cost of coal burned (\$7.3 million). The average delivered cost per ton of coal purchased was \$21.27 in 2001, \$20.96 in 2000, and \$21.49 in 1999.

Power purchased decreased \$15.4 million (15.9%) in 2001 primarily due to decreased brokered sales activity in the wholesale electric market and a lower unit cost of the purchases partially offset by an increase in purchases to meet requirements for native load and off-system sales. Power purchased decreased \$72.7 million (42.9%) in 2000 primarily due to decreased brokered sales activity in the wholesale electric market.

Gas supply expenses increased \$9.3 million (4.7%) in 2001 primarily due to an increase in cost of net gas supply (\$36.2 million), partially offset by a decrease in the volume of gas delivered to the distribution system (\$26.9 million). Gas supply expenses increased \$82.2 million (71.6%) in 2000 primarily due to an increase in cost of net gas supply (\$70.4 million), and due to an increase in the volume of gas delivered to the distribution system (\$11.8 million). The average unit cost per Mcf of purchased gas was \$5.26 in 2001, \$5.08 in 2000, and \$2.99 in 1999.

Other operation expenses increased \$31.9 million (23.4%) in 2001 primarily due to amortization of a regulatory asset resulting from workforce reduction costs associated with LG&E's Value Delivery initiative (\$13 million), an increase in pension expense (\$10.3 million) and an increase in outside services (\$8.5 million). Outside services increased in part due to the reclassification of expenses as a result of the formation of LG&E Services, as required by the SEC to comply with PUHCA. Operation expenses decreased \$18.7 million (12.1%) in 2000 primarily due to lower administrative costs, \$13.8 million, (due to decreases in pension expense, \$5.4 million, year 2000 Information Technology expenses, \$4.0 million, and decreased salaries due to fewer employees in 2000, \$2.0 million) and a decrease in steam production costs primarily at the Mill Creek generating station (\$5.0 million).

Maintenance expenses for 2001 decreased \$5.0 million (7.9%) primarily due to decreases in scheduled outages (\$2.8 million), and a decrease in software and communication equipment maintenance (\$2.8 million). Maintenance expenses for 2000 increased \$5.6 million (9.6%) primarily due to an increase in software maintenance agreements (\$3.9 million), and maintenance of communications equipment (\$1.5 million).

Depreciation and amortization increased \$2.1 million (2.1%) in 2001 and increased \$1.1 million (1.1%) in 2000 because of additional utility plant in service in both years. The 2001 increase was offset by a decrease in depreciation rates resulting from a settlement order in December 2001 from the Kentucky Commission. Depreciation expenses decreased by \$5.6 million as a result of the settlement order.

Property and other taxes decreased \$1.2 million (6.5%) in 2001 primarily due to a reduction in payroll taxes related to fewer employees as a result of workforce reductions and transfers to LG&E Services. Property and other taxes increased \$2.1 million (12.1%) in 2000 primarily due to increased payroll and property taxes.

Other income – net decreased \$2.0 million (40.5%) in 2001 primarily due to lower interest and dividend income. Other income – net increased \$.8 million (18.9%) in 2000 primarily due to increased tax benefits

LG&E (cont.):

recorded associated with increased non-debt related interest expenses.

Interest charges for 2001 decreased \$5.3 million (12.2%) primarily due to lower interest rates on variable rate debt (\$2.2 million) and the retirement of short-term borrowings (\$8.1 million) partially offset by an increase in debt to associated companies (\$2.5 million) and an increase in interest associated with LG&E's accounts receivable securitization program (\$2.5 million). Interest charges for 2000 increased \$5.3 million (13.9%) due to having short-term borrowings for entire 2000 as compared to two months in 1999 (\$7.1 million), partially offset by a decrease in interest on debt to associated companies (\$1.0 million) and lower interest rates on variable rate debt (\$1.0 million). See Note 10 of LG&E's Notes to Financial Statements under Item 8.

LG&E's weighted average cost of long-term debt was 4.17% at December 31, 2001. See Note 10 of LG&E's Notes to Financial Statements under Item 8.

Variations in income tax expenses are largely attributable to changes in pre-tax income. The increase in LG&E's 2001 effective income tax rate to 36.5% from the 35.8% rate in 2000 was largely the result of lost tax benefits attributable to LG&E's Employee Stock Ownership Plan. These benefits ceased as a result of the December 2000 acquisition of LG&E Energy Corp. by Powergen.

The rate of inflation may have a significant impact on LG&E's operations, its ability to control costs and the need to seek timely and adequate rate adjustments. However, relatively low rates of inflation in the past few years have moderated the impact on current operating results.

## CRITICAL ACCOUNTING POLICIES

Preparation of financial statements and related disclosures in compliance with generally accepted accounting principles (GAAP) 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 the likelihood of success of particular projects, legal and regulatory challenges and anticipated recovery of costs. These judgments, in and of themselves, 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. The following list represents accounting policies that are most significant to LG&E's financial condition and results, and that require management judgments. Each of these has a higher likelihood of resulting in materially different reported amounts under different conditions or using different assumptions. See also Note 1 of LG&E's Notes to Financial Statements under Item 8.

<u>Accounting Policy</u>	<u>Judgment/Uncertainties</u>	<u>See Also Under Item 8</u>
Unbilled Revenue	Projecting customer electric and gas usage Estimating impact of weather	Note 1
Benefit Plan Accounting	Future rate of returns on pension plan assets Interest rates used in valuing benefit obligation Health care cost trend rates Other actuarial assumptions	Note 7
Derivative Financial Instruments	Market conditions in energy industry Price volatility	Note 4
Income Tax	Application of tax statutes and regulations to transactions Future decisions of tax authorities	Note 8
Regulatory Mechanisms	Future regulatory decisions Impact of deregulation and competition on ratemaking process External regulator decisions	Note 3

## NEW ACCOUNTING PRONOUNCEMENTS

During 2001 and 2000, the following accounting pronouncements were issued that affect LG&E:

SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities*, establishes accounting and reporting

standards requiring that every derivative instrument (including certain derivative instruments embedded in other contracts) be recorded on the balance sheet as either an asset or a liability measured at its fair value. SFAS No. 133 requires that changes in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. Special accounting for qualifying hedges allows a derivative's gains and losses to offset related results on the hedged item in the income statement, and requires that LG&E must formally document, designate, and assess the effectiveness of transactions that receive hedge accounting. SFAS No. 133 could increase the volatility in earnings and other comprehensive income. SFAS No. 137, *Accounting for Derivative Instruments and Hedging Activities -- Deferral of the Effective Date of SFAS No. 133*, deferred the effective date of SFAS No. 133 until January 1, 2001. LG&E adopted SFAS No. 133 and SFAS No. 138 on January 1, 2001. The effect of adopting these statements resulted in a \$3.6 million decrease in other comprehensive income from a cumulative effect of change in accounting principle (net of tax of \$2.4 million).

The Financial Accounting Standards Board created the Derivatives Implementation Group (DIG) to provide guidance for implementation of SFAS No. 133. DIG Issue C15, *Normal Purchases and Normal Sales Exception for Option Type Contracts and Forward Contracts in Electricity* was adopted in 2001 and had no impact on results of operations and financial positions. DIG Issue C16, *Applying the Normal Purchases and Normal Sales Exception to Contracts that Combine a Forward Contract and a Purchased Option Contract*, was cleared in 2001 and stated that option contracts do not meet the normal purchases and normal sales exception and should follow SFAS No. 133. DIG C16 will be effective in the second quarter of 2002. LG&E has not determined the impact this issue will have on its results of operations and financial position.

SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, revises the standards for accounting for securitizations and other transfers of financial assets and collateral and requires certain disclosures, and provides accounting and reporting standards for transfers and servicing of financial assets and extinguishments of liabilities. SFAS No. 140 was adopted in the first quarter of 2001, when LG&E entered into an accounts receivable securitization transaction.

SFAS No. 141, *Business Combinations* and SFAS No. 142, *Goodwill and Other Intangible Assets* were issued in 2001. SFAS No. 141 requires all business combinations initiated after June 30, 2001, to be accounted for using the purchase method. SFAS No. 142 requires goodwill to be recorded, but not amortized. Further, goodwill will now be subject to a periodic assessment for impairment. The provisions of these new pronouncements were effective July 1, 2001, for LG&E. The adoption of these standards did not have a material impact on the results of operations or financial position of LG&E.

SFAS No. 143, *Accounting for Asset Retirement Obligations* and SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, were issued 2001. SFAS No. 143 establishes accounting and reporting standards for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. SFAS No. 144 supersedes SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of* and the accounting and reporting provisions of APB Opinion No. 30, *Reporting the Results of Operations -- Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*. SFAS No. 144, among other provisions, eliminates the requirement of SFAS No. 121 to allocate goodwill to long-lived assets to be tested for impairment. The effective implementation date for SFAS No. 144 is 2002 and SFAS No. 143 is 2003. Based on current regulatory accounting practices, management does not expect SFAS No. 143 or SFAS No. 144 to have a material impact on results of operations or financial position of LG&E.

## LIQUIDITY AND CAPITAL RESOURCES

LG&E uses net cash generated from its operations and external financing to fund construction of plant and equipment and the payment of dividends. LG&E believes that such sources of funds will be sufficient to meet the needs of its business in the foreseeable future.

### Operating Activities

Cash provided by operations was \$287 million, \$156 million and \$180 million in 2001, 2000, and 1999, respectively. The 2001 increase resulted primarily from the change in accounts receivable including the sale of accounts receivable through the accounts receivable securitization program. See Note 1 of LG&E's Notes to Financial Statements under Item 8. The 2000 decrease resulted primarily from an increase in accounts receivable, and a decrease in accrued taxes. 1999 showed a lower level of non-cash income statement items and a net decrease in net current assets, primarily resulting from decreases in accounts payable and accrued taxes.

### Investing Activities

LG&E's primary use of funds for investing activities continues to be for capital expenditures. Capital expenditures were \$253 million, \$144 million and \$195 million in 2001, 2000, and 1999, respectively. LG&E expects its capital expenditures for 2002 and 2003 to total approximately \$334 million, which consists primarily of construction estimates associated with installation of NOx equipment as described in the section titled "Environmental Matters," purchase of two jointly owned CTs with KU and on-going construction for the distribution systems.

Net cash used for investment activities increased \$108 million in 2001 as compared to 2000, and decreased by \$43 million in 2000 as compared to 1999, primarily due to the level of construction expenditures. NOx expenditures in 2001 were approximately \$75 million.

### Financing Activities

Net cash outflows for financing activities were \$39 million and \$68 million in 2001 and 2000, respectively. Net cash inflow from financing activities in 1999 was \$26.7 million. During 2001, LG&E issued \$10.1 million of pollution control bonds resulting in net proceeds of \$9.7 million after issuance costs. Dividend payments also decreased in 2001. In 2000, total debt was reduced by \$20 million to \$606.8 million. LG&E also refinanced \$108.3 million (\$106.5 million net of issuance costs) of its pollution control bonds in 2000. LG&E received \$40 million in contributed capital from its parent company in December 2000.

LG&E participates in an intercompany money pool agreement whereby LG&E Energy can make funds available to LG&E at market based rates up to \$200 million. At December 31, 2001, the balance of the money pool loan from LG&E Energy was \$64.2 million at an average rate of 2.37%, and LG&E had outstanding commercial paper of \$30 million at an average rate of 2.54%. The resulting remaining money pool availability at December 31, 2001, was \$105.8 million. LG&E Energy maintains a facility of \$200 million with an affiliate to ensure funding availability for the money pool. There was no outstanding balance under this facility as of December 31, 2001, and availability of \$170 million remains after considering the \$30 million of commercial paper outstanding at LG&E.

At December 31, 2000, the money pool loan balance was \$114.6 million at an average rate of 6.84%

LG&E (cont.):

had no commercial paper outstanding.

Under the provisions for LG&E's variable-rate pollution control bonds totaling \$242.6 million, 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.

On March 6, 2002, LG&E refinanced its \$22.5 million and \$27.5 million unsecured pollution control bonds, both due September 1, 2026. The replacement bonds, due September 1, 2026, are variable rate bonds and are secured by first mortgage bonds.

On March 22, 2002, LG&E refinanced its two \$35 million unsecured pollution control bonds due November 1, 2027. The replacement variable rate bonds are secured by first mortgage bonds and will mature November 1, 2027.

**Future Capital Requirements**

Future capital requirements may be affected in varying degrees by factors such as load growth, changes in construction expenditure levels, rate actions by regulatory agencies, new legislation, market entry of competing electric power generators, changes in environmental regulations and other regulatory requirements. LG&E anticipates funding future capital requirements through operating cash flow, debt, and/or infusions of capital from its parent.

LG&E's debt ratings as of January 31, 2002, were:

	<u>Moody's</u>	<u>S&amp;P</u>	<u>Fitch</u>
First mortgage bonds	A1	A-	A+
Unsecured debt	A2	BBB	A
Preferred stock	a2	BBB-	A-
Commercial paper	P-1	A-2	F-1

The S&P ratings are on Credit Watch with positive implications. The Fitch ratings are on Credit Watch – Evolving status. These ratings reflect the views of Moody's, S & P and Fitch. 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.

## LG&E (cont.):

### Contractual Obligations

The following is provided to summarize LG&E's contractual cash obligations for periods after December 31, 2001 (in thousands of \$):

Contractual cash Obligations	Payments Due by Period				Total
	2002	2003- 2004	2005- 2006	After 2006	
Long-term debt (a)	\$246,200	\$42,600	\$ -	\$328,104	\$ 616,904
Operating leases	3,594	7,014	1,754	-	12,362
Unconditional					
Purchase obligations (b)	12,805	25,997	26,518	201,164	266,484
Other long-term					
Obligations (c)	<u>112,900</u>	<u>10,000</u>	<u>-</u>	<u>-</u>	<u>122,900</u>
Total contractual cash obligations	<u>\$375,499</u>	<u>\$85,611</u>	<u>\$28,272</u>	<u>\$529,268</u>	<u>\$1,018,650</u>

- (a) Long-term debt of \$246.2 million is 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 2017 to 2027.
- (b) Represents future minimum payments under purchased power agreements through 2020.
- (c) Represents construction commitments.

### Market Risks

LG&E is exposed to market risks from changes in interest rates and commodity prices. To mitigate changes in cash flows attributable to these exposures, LG&E uses various financial instruments including derivatives. Derivative positions are monitored using techniques that include market value and sensitivity analysis. See Note 1 and 4 of LG&E's Notes to Financial Statements under Item 8.

### Interest Rate Sensitivity

LG&E has short-term and long-term variable rate debt obligations outstanding. At December 31, 2001, the potential change in interest expense associated with a 1% change in base interest rates of LG&E's unhedged debt was estimated at \$2.8 million.

Interest rate swaps are used to hedge LG&E's underlying variable-rate debt obligations. These swaps hedge specific debt issuance and, consistent with management's designation, are accorded hedge accounting treatment.

As of December 31, 2001, LG&E had swaps with a combined notional value of \$117.3 million. The swaps exchange floating-rate interest payments for fixed interest payments to reduce the impact of interest rate changes on LG&E's Pollution Control Bonds. As of December 31, 2001, 30% of the outstanding variable interest rate borrowings were converted to fixed interest rates through swaps. The potential loss in fair value resulting from a hypothetical 1% adverse movement in base interest rates is estimated at \$9.1 million as of December 31, 2001. This estimate is derived from third party valuations. Changes in the market value of these

## LG&E (cont.):

swaps if held to maturity, as LG&E intends to do, are not expected to have any effect on LG&E's net income or cash flow. See Note 4 of LG&E's Notes to Financial Statements under Item 8.

### Energy Trading & Risk Management Activities

LG&E conducts energy trading and risk management activities to maximize the value of power sales from physical assets it owns, in addition to the wholesale sale of excess asset capacity. Certain energy trading activities are accounted for on a mark-to-market basis in accordance with *EITF 98-10 Accounting for Contracts Involved in Energy Trading and Risk Management Activities*, *SFAS No. 133 Accounting for Derivative Instruments and Hedging Activities*, and *SFAS No. 138 Accounting for Certain Derivative Instruments and Certain Hedging Activities*. Wholesale sales of excess asset capacity and wholesale purchases are treated as normal sales and purchases under *SFAS No. 133* and *SFAS No. 138* and are not marked to market.

The table below summarizes LG&E's energy trading and risk management activities in 2001 (in thousands of \$).

Fair value of contracts at 12/31/00, net liability	\$ (17)
Fair value of contracts when entered into during 2001	3,441
Contracts realized or otherwise settled during 2001	(2,894)
Changes in fair values due to changes in assumptions	(716)
Fair value of contracts at 12/31/01, net liability	<u>\$(186)</u>

No changes to valuation techniques for energy trading and risk management activities occurred during 2001. All contracts outstanding at December 31, 2001 have a maturity of less than one year and are valued using prices actively quoted for proposed or executed transactions or quoted by brokers.

LG&E maintains policies intended to minimize credit risk and revalues credit exposures daily to monitor compliance with those policies. As December 31, 2001, 100% of the trading and risk management commitments were with counterparties rated BBB equivalent or better.

### Commodity Price Sensitivity

LG&E has limited exposure to market price volatility in prices of fuel and electricity, since its retail tariffs include the FAC and GSC commodity price pass-through mechanisms. LG&E is exposed to market price volatility of fuel and electricity in its wholesale activities.

### Accounts Receivable Securitization

On February 6, 2001, LG&E implemented an accounts receivable securitization program. The purpose of this program is to enable LG&E to accelerate the receipt of cash from the collection of retail accounts receivable, thereby reducing dependence upon more costly sources of working capital. The securitization program allows for a percentage of eligible receivables to be sold. Eligible receivables are generally all receivables associated with retail sales that have standard terms and are not past due. LG&E is able to terminate these programs at any time without penalty. If there is a significant deterioration in the payment record of the receivables by the retail customers or if LG&E fails to meet certain covenants regarding the program, the program may terminate at the election of the financial institutions. In this case, payments from retail customers would first be used to repay the financial institutions participating in the program, and would then be available for use by LG&E.

## LG&E (cont.):

As part of the program, LG&E sold retail accounts receivables to a wholly owned subsidiary, LG&E R. Simultaneously, LG&E R entered into two separate three-year accounts receivable securitization facilities with two financial institutions and their affiliates whereby LG&E R can sell, on a revolving basis, an undivided interest in certain of their receivables and receive up to \$75 million from an unrelated third party purchaser. The effective cost of the receivables programs is comparable to LG&E's lowest cost source of capital, and is based on prime rated commercial paper. LG&E retains servicing rights of the sold receivables through two separate servicing agreements with the third party purchaser. LG&E has obtained an opinion from independent legal counsel indicating these transactions qualify as true sale of receivables. As of December 31, 2001, the outstanding program balance was \$42 million.

Management expects to renew these facilities when they expire.

The allowance for doubtful accounts associated with the eligible securitized receivables was \$1.3 million at December 31, 2001. This allowance is based on historical experience of LG&E. Each securitization facility contains a fully funded reserve for uncollectible receivables.

## RATES AND REGULATION

Following the purchase of LG&E Energy by Powergen, Powergen became a registered holding company under PUHCA. As a result, Powergen, its utility subsidiaries, including LG&E, and certain of its non-utility subsidiaries are subject to extensive regulation by the SEC under PUHCA with respect to issuances and sales of securities, acquisitions and sales of certain utility properties, and intra-system sales of certain goods and services. In addition, PUHCA generally limits the ability of registered holding companies to acquire additional public utility systems and to acquire and retain businesses unrelated to the utility operations of the holding company. Powergen believes that it has adequate authority (including financing authority) under existing SEC orders and regulations for it and its subsidiaries to conduct their businesses and will seek additional authorization when necessary.

LG&E is subject to the jurisdiction of the Kentucky Commission in virtually all matters related to electric and gas utility regulation, and as such, their accounting is subject to SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*. Given LG&E's competitive position in the marketplace and the status of regulation in the state of Kentucky, LG&E has no plans or intentions to discontinue its application of SFAS No. 71. See Note 3 of LG&E's Notes to Financial Statements under Item 8.

### Kentucky Commission Settlement Order - Value Delivery Costs, ESM and Depreciation

During the first quarter 2001, LG&E recorded a \$144 million charge for a workforce reduction program. Primary components of the charge were separation benefits, enhanced early retirement benefits, and health care benefits. The result of this workforce reduction was the elimination of over 700 positions, accomplished primarily through a voluntary enhanced severance program.

On June 1, 2001, LG&E filed an application (VDT case) with the Kentucky Commission to create a regulatory asset relating to these first quarter 2001 charges. The application requested permission to amortize these costs over a four-year period. The Kentucky Commission also opened a case to review the new depreciation study and resulting depreciation rates implemented in 2001.

LG&E reached a settlement in the VDT case as well as the other cases involving depreciation rates and ESM

## LG&E (cont.):

with all intervening parties. The settlement agreement was approved by the Kentucky Commission on December 3, 2001.

The Kentucky Commission December 3, 2001, order allowed LG&E to set up a regulatory asset of \$141 million for the workforce reduction costs and begin amortizing these costs over a five year period starting in April 2001. The first quarter charge of \$144 million represented all employees who had accepted a voluntary enhanced severance program. Some employees rescinded their participation in the voluntary enhanced severance program, thereby decreasing the original charge from \$144 million to \$141 million. The settlement will also reduce revenues approximately \$26 million through a surcredit on future bills to customers over the same five year period. The surcredit represents stipulated net savings LG&E is expected to realize from implementation of best practices through the value delivery process. The agreement also established LG&E's new depreciation rates in effect December 2001, retroactive to January 1, 2001. The new depreciation rates decreased depreciation expense by \$5.6 million in 2001.

### Environmental Cost Recovery

In August 1999, a final order of the Kentucky Commission approved LG&E's settlement agreement concerning the refund of the recovery of costs associated with pre-1993 environmental projects. LG&E began applying the refund to customers' bills in October 1999, and completed the refund process in November 2000. All aspects of the original litigation of this issue have now been resolved.

In June 2000, the Kentucky Commission approved LG&E's application for a CCN to construct up to three SCR NOx reduction facilities. The construction and subsequent operation of the SCRs is intended to reduce NOx emission levels to meet the EPA's mandated NOx emission level of 0.15 lbs./ Mmbtu by May 2004. In its order, the Kentucky Commission ruled that LG&E's proposed plan for construction was "reasonable, cost-effective and will not result in the wasteful duplication of facilities." In October 2000, LG&E filed an application with the Kentucky Commission to amend its Environmental Compliance Plan to reflect the addition of the proposed NOx reduction technology projects and to amend its Environmental Cost Recovery Tariff to include an overall rate of return on capital investments. Following the completion of hearings in March 2001, a ruling was issued in April 2001 granting LG&E's application. Such approval has allowed LG&E to begin to recover the costs associated with these new projects, subject to Kentucky Commission oversight during normal six-month and two-year reviews.

### ESM

LG&E's electric rates are subject to an ESM. The ESM, in place for three years beginning in 2000, sets an upper and lower point for rate of return on equity, whereby if LG&E's rate of return for the calendar year falls within the range of 10.5% to 12.5%, no action is necessary. If earnings are above the upper limit, then excess earnings are shared 40% with ratepayers and 60% with shareholders; if earnings are below the lower limit, then earnings deficiency is recovered 40% from ratepayers and 60% from shareholders. The first ESM filing was made on March 1, 2001, for year ended December 31, 2000, which resulted in a refund to customers of \$618,000. By order of the Kentucky Commission, rate changes prompted by the ESM filing go into effect in April of each year. LG&E estimated that the rate of return will fall within the deadband range, subject to Kentucky Commission approval, for the year ended December 31, 2001; therefore, no adjustment to the financial statements was made.

## DSM

LG&E's rates contain a DSM provision. The provision includes a rate mechanism that provides concurrent recovery of DSM costs and provides an incentive for implementing DSM programs. This program had allowed LG&E to recover revenues from lost sales associated with the DSM program. In May 2001, the Kentucky Commission approved LG&E's plan to continue DSM programs. This filing called for the expansion of the DSM programs into the service territory served by KU and proposes a mechanism to recover revenues from lost sales associated with DSM programs based on program planning engineering estimates and post-implementation evaluation.

## Gas PBR

Since November 1, 1997, LG&E has operated under an experimental performance-based ratemaking mechanism related to its gas procurement activities. For each of the last four years, LG&E's rates have been adjusted to recover its portion of the savings (or expenses) incurred during each of the four 12-month periods beginning November 1 and ending October 31. Since its implementation on November 1, 1997, through October 31, 2001, LG&E has achieved \$32.1 million in savings. Of the total savings, LG&E has retained \$15.0 million, and the remaining portion of \$17.1 million has been distributed to customers. In December 2000, LG&E filed an Application reporting on the operation of the experimental PBR and requested the Kentucky Commission to extend the PBR as a result of the benefits provided to both LG&E and its customers during the experimental period. Following the discovery and hearing process, the Kentucky Commission issued an order effective November 1, 2001, extending the experimental PBR program for an additional four years, and making other modifications, including changes to the sharing levels applicable to savings or expenses incurred under the PBR. Specifically, the Kentucky Commission modified the sharing mechanism to a 25%/75% Company/Customer sharing for all savings (and expenses) up to 4.5% of the benchmarked gas costs. Savings (and expenses) in excess of 4.5% of the benchmarked gas costs are shared at the 50%/50% level.

## FAC

Prior to implementation of the PBR in July 1999, and following its termination in March 2000, LG&E employed an FAC mechanism, which under Kentucky law allowed LG&E to recover from customers the actual fuel costs associated with retail electric sales. In February 1999, LG&E received orders from the Kentucky Commission requiring a refund to retail electric customers of approximately \$3.9 million resulting from reviews of the FAC from November 1994, through April 1998, of which \$1.9 million was refunded in April 1999, for the period beginning November 1994, and ending October 1996. The orders changed LG&E's method of computing fuel costs associated with electric line losses on wholesale sales appropriate for recovery through the FAC. Following rehearing in December 1999, the Kentucky Commission agreed with LG&E's position on the appropriate loss factor to use in the FAC computation and issued an order reducing the refund level for the 18-month period under review to approximately \$800,000. LG&E enacted the refund with billings in the month of January 2000. LG&E and KIUC each filed separate appeals from the Kentucky Commission's February 1999 orders with the Franklin County, Kentucky Circuit Court and in May 2000, the Court affirmed the Kentucky Commission's orders regarding the amounts disallowed and ordered the case remanded as to the Kentucky Commission's denial of interest, directing the Kentucky Commission to determine whether interest should be awarded to LG&E's ratepayers. In June 2000, LG&E appealed the Circuit Court's decision to the Kentucky Court of Appeals. Pending a decision on this appeal, a comprehensive settlement was reached by all parties, which settlement was filed with the Kentucky Commission on December 21, 2001. Thereunder, LG&E agreed to credit its fuel clause in the amount of \$720,000 (such credit provided over the course of two monthly billing

## LG&E (cont.):

periods), and the parties agreed on a prospective interpretation of the state's fuel adjustment clause regulation to ensure consistent and mutually acceptable application on a going-forward basis. All pending FAC proceedings before the court were resolved by the parties to the agreement and all parties requested the Court of Appeals remand the case to the Kentucky Commission. The Kentucky Commission is expected to approve the settlement in 2002.

### Gas Rate Case

In March 2000, LG&E filed an application with the Kentucky Commission requesting an adjustment in LG&E's gas rates. In September 2000, the Kentucky Commission granted LG&E an annual increase in its base gas revenues of \$20.2 million effective September 28, 2000. The Kentucky Commission authorized a return on equity of 11.25%. The Kentucky Commission approved LG&E's proposal for a weather normalization billing adjustment mechanism that will normalize the effect of weather on revenues from gas sales.

### Wholesale Natural Gas Prices

On September 12, 2000, the Kentucky Commission issued an order establishing Administrative Case No. 384 – "An Investigation of Increasing Wholesale Natural Gas Prices and the Impacts of such Increase on the Retail Customers Served by Kentucky's Jurisdictional Natural Gas Distribution Companies". The impetus for this administrative proceeding was the escalation of wholesale natural gas prices during the summer of 2000.

The Kentucky Commission directed Kentucky's natural gas distribution companies, including LG&E, to file selected information regarding the individual companies' natural gas purchasing practices, expectations for the then-approaching winter heating season of 2000-2001, and potential actions which these companies might take to mitigate price volatility. On July 17, 2001, the Kentucky Commission issued an order encouraging the natural gas distribution companies in Kentucky to take various actions, among them to propose a natural gas hedge plan, consider performance-based ratemaking mechanisms, and to increase the use of storage.

On August 12, 2001, LG&E submitted a natural gas hedge plan in Case No. 2001-253. However, due to significantly decreased wholesale natural gas prices during the Summer of 2001, the Kentucky Commission ultimately rejected LG&E's proposed gas hedging plan as "untimely" in its Order dated October 5, 2001. The Kentucky Commission encouraged LG&E to file another hedge plan for its consideration in 2002.

Another result from that Administrative Case was the Kentucky Commission's decision to engage a consultant to conduct a forward-looking audit of the gas procurement and supply procedures in order to assist both the Kentucky Commission and each of Kentucky's largest natural gas distribution companies. This audit is underway.

### Kentucky Commission Administrative Case for Affiliate Transactions

In December 1997, the Kentucky Commission opened Administrative Case No. 369 to consider Kentucky Commission policy regarding cost allocations, affiliate transactions and codes of conduct governing the relationship between utilities and their non-utility operations and affiliates. The Kentucky Commission intended to address two major areas in the proceedings: the tools and conditions needed to prevent cost shifting and cross-subsidization between regulated and non-utility operations; and whether a code of conduct should be established to assure that non-utility segments of the holding company are not engaged in practices that could result in unfair competition caused by cost shifting from the non-utility affiliate to the utility. During the period September 1998 to February 2000, the Kentucky Commission issued draft codes of conduct and cost allocation

## LG&E (cont.):

guidelines. In early 2000, the Kentucky General Assembly enacted legislation, House Bill 897, which authorized the Kentucky Commission to require utilities who provide nonregulated activities to keep separate accounts and allocate costs in accordance with procedures established by the Kentucky Commission. In the same Bill, the General Assembly set forth provisions to govern a utilities activities related to the sharing of information, databases, and resources between its employees or an affiliate involved in the marketing or the provision of nonregulated activities and its employees or an affiliate involved in the provision of regulated services. The legislation became law in July 2000 and LG&E has been operating pursuant thereto since that time. On February 14, 2001, the Kentucky Commission published notice of their intent to promulgate new administrative regulations under the auspices of the new law. This effort is still on going.

### Kentucky Commission Administrative Case for System Adequacy

On June 19, 2001, Kentucky Governor Paul E. Patton issued Executive Order 2001-771, which directed the Kentucky Commission to review and study issues relating to the need for and development of new electric generating capacity in Kentucky. The issues to be considered included the impact of new power plants on the electric supply grid, facility siting issues, and economic development matters, with the goal of ensuring a continued, reliable source of supply of electricity for the citizens of Kentucky and the continued environmental and economic vitality of the Commonwealth and its communities. In response to that Executive Order, in July 2001 the Kentucky Commission opened Administrative Case No. 387 to review the adequacy of Kentucky's generation capacity and transmission system. Specifically, the items reviewed were the appropriate level of reliance on purchased power, the appropriate reserve margins to meet existing and future electric demand, the impact of spikes in natural gas prices on electric utility planning strategies, and the adequacy of Kentucky's electric transmission facilities. LG&E, as a party to this proceeding, filed written testimony and responded to two requests for information. Public hearings were held in August, September, and October 2001. In October 2001, LG&E filed a final brief in the case. In December 2001 the Kentucky Commission issued an order in which they noted that LG&E is responsibly addressing the long-term supply needs of native load customers and that current reserve margins are appropriate. However, due to the rapid pace of change in the industry, the order also requires LG&E to provide an annual assessment of supply resources, future demand, reserve margin, and the need for new resources.

Regarding the transmission system, the Kentucky Commission concluded that the transmission system within the Commonwealth can reliably serve native load and a significant portion of the proposed new unregulated power plants. However, it will not be able to handle the volume of transactions envisioned by FERC without future upgrades, the costs of which should be borne by those for whom the upgrades are required.

The Kentucky Commission pledged to continue to monitor all relevant issues and advocate Kentucky's interests at all opportunities.

### Environmental Matters

The Clean Air Act imposed stringent new SO<sub>2</sub> and NO<sub>x</sub> emission limits on electric generating units. LG&E previously had installed scrubbers on all of its generating units. LG&E's strategy for Phase II SO<sub>2</sub> reductions, which commenced January 1, 2000, is to increase scrubber removal efficiency to delay additional capital expenditures and may also include fuel switching or upgrading scrubbers. LG&E met the NO<sub>x</sub> emission requirements of the Act through installation of low-NO<sub>x</sub> burner systems. LG&E's compliance plans are subject to many factors including developments in the emission allowance and fuel markets, future regulatory and legislative initiatives, and advances in clean air control technology. LG&E will continue to monitor these developments to ensure that its environmental obligations are met in the most efficient and cost-effective

LG&E (cont.):

manner.

In September 1998, the EPA announced its final "NOx SIP Call" rule requiring states to impose significant additional reductions in NOx emissions by May 2003, in order to mitigate alleged ozone transport impacts on the Northeast region. The Commonwealth of Kentucky is currently in the process of revising its State Implementation Plan or "SIP" to require reductions in NOx emissions from coal-fired generating units to the 0.15 lb./Mmbtu level on a system-wide basis. In related proceedings in response to petitions filed by various Northeast states, in December 1999, EPA issued a final rule pursuant to Section 126 of the Clean Air Act directing similar NOx reductions from a number of specifically targeted generating units including all LG&E units. As a result of appeals to both rules, the compliance date was extended to May 2004. All LG&E generating units are subject to the May 2004 compliance date under these NOx emissions reduction rules.

LG&E is currently implementing a plan for adding significant additional NOx controls to its generating units. Installation of additional NOx controls will proceed on a phased basis, with installation of controls commencing in late 2000 and continuing through the final compliance date. LG&E estimates that it will incur total capital costs of approximately \$160 million to reduce its NOx emissions to the 0.15 lb./Mmbtu level on a company-wide basis. In addition, LG&E will incur additional operating and maintenance costs in operating new NOx controls. LG&E believes its costs in this regard to be comparable to those of similarly situated utilities with like generation assets. LG&E had anticipated that such capital and operating costs are the type of costs that are eligible for recovery from customers under its environmental surcharge mechanism and believed that a significant portion of such costs could be recovered. In April 2001, the Kentucky Commission granted recovery of these costs for LG&E.

LG&E is also monitoring several other air quality issues which may potentially impact coal-fired power plants, including the appeal of the D.C. Circuit's remand of the EPA's revised air quality standards for ozone and particulate matter, measures to implement EPA's regional haze rule, and EPA's December 2000 determination to regulate mercury emissions from power plants. In addition, LG&E is currently working with local regulatory authorities to review the effectiveness of remedial measures aimed at controlling particulate matter emissions from its Mill Creek Station. LG&E previously settled a number of property damage claims from adjacent residents and completed significant remedial measures as part of its ongoing capital construction program. LG&E is in the process of converting the Mill Creek Station to wet stack operation in an effort to resolve all outstanding issues related to particulate matter emissions.

LG&E owns or formerly owned three properties which are the location of past MGP operations. Various contaminants are typically found at such former MGP sites and environmental remediation measures are frequently required. With respect to the sites, LG&E has completed cleanups, obtained regulatory approval of site management plans, or reached agreements for other parties to assume responsibility for cleanup. Based on currently available information, management estimates that it will incur additional costs of \$400,000. Accordingly, an accrual of \$400,000 has been recorded in the accompanying financial statements at December 31, 2001 and 2000.

See Note 12 of LG&E's Notes to Financial Statements under Item 8 for an additional discussion of environmental issues.

#### Deferred Income Taxes

LG&E expects to have adequate levels of taxable income to realize its recorded deferred tax assets. At December 31, 2001, deferred tax assets totaled \$114.4 million and were principally related to expenses

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attributable to LG&E's pension plans and post retirement benefit obligations.

## FUTURE OUTLOOK

### Competition and Customer Choice

LG&E has moved aggressively over the past decade to be positioned for, and to help promote, the energy industry's shift to customer choice and a competitive market for energy services. Specifically, LG&E has taken many steps to prepare for the expected increase in competition in its business, including support for performance-based ratemaking structures; aggressive cost reduction activities; strategic acquisitions, dispositions and growth initiatives; write-offs of previously deferred expenses; an increase in focus on commercial and industrial customers; an increase in employee training; and necessary corporate and business unit realignments. LG&E continues to be active in the national debate surrounding the restructuring of the energy industry and the move toward a competitive, market-based environment.

In December 1997, the Kentucky Commission issued a set of principles which was intended to serve as its guide in consideration of issues relating to industry restructuring. Among the issues addressed by these principles are: consumer protection and benefit, system reliability, universal service, environmental responsibility, cost allocation, stranded costs and codes of conduct. During 1998, the Kentucky Commission and a task force of the Kentucky General Assembly had each initiated proceedings, including meetings with representatives of utilities, consumers, state agencies and other groups in Kentucky, to discuss the possible structure and effects of energy industry restructuring in Kentucky.

In November 1999, the task force issued a report to the Governor of Kentucky and a legislative agency recommending no general electric industry restructuring actions during the 2000 legislative session. No general restructuring actions were taken during the 2001 legislative session.

Thus, at the time of this report, 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 LG&E, which may be significant, cannot currently be predicted.

While many states have moved forward in providing retail choice, many others have not. Some are reconsidering their initiatives and have even delayed implementation. Recent activities in California that have resulted in extremely high wholesale (and in some cases, consumer) electric prices are becoming significant factors in the deliberations by other states.

## KU

### GENERAL

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 2001, 2000, and 1999 and should be read in connection with the financial statements and notes thereto.

Some of the following discussion may contain forward-looking statements that are subject to certain 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 vary materially. Factors that could cause actual results to differ materially include; 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; and other factors described from time to time in KU's reports to the Securities and Exchange Commission, including Exhibit No. 99.01 to this report on Form 10-K.

## **MERGERS and ACQUISITIONS**

On April 9, 2001, a German power company, E.ON AG, announced a preconditional cash offer of £5.1 billion (\$7.3 billion) for Powergen. The offer is subject to a number of conditions, including the receipt of certain European and United States regulatory approvals. The Kentucky Public Service Commission, the Federal Energy Regulatory Commission, the Virginia State Corporation Commission, and the Tennessee Regulatory Authority have all approved the acquisition of Powergen and LG&E Energy by E.ON. The parties expect to obtain the remaining regulatory approvals and to complete the transaction in the first half of 2002. See Powergen's schedule 14D-9, and associated schedules to such filings, filed with the SEC on April 9, 2001.

On December 11, 2000, LG&E Energy Corp. was acquired by Powergen plc for cash of approximately \$3.2 billion or \$24.85 per share and the assumption of all of LG&E Energy's debt. As a result of the acquisition, LG&E Energy became a wholly owned subsidiary of Powergen and, as a result, KU became an indirect subsidiary of Powergen. KU has continued its separate identity and serves customers in Kentucky and Virginia under its existing name. The preferred stock and debt securities of KU were not affected by this transaction and KU continued to file SEC reports. Following the acquisition, Powergen became a registered holding company under PUHCA and KU, as a subsidiary of a registered holding company, became subject to additional regulation under PUHCA. See "Rates and Regulation" under Item 1.

## **RESULTS OF OPERATIONS**

### **Net Income**

KU's net income in 2001 was relatively flat as compared to 2000 with an increase of \$.9 million. The increase resulted primarily from decreased depreciation, interest expenses and property and other taxes, partially offset by higher pension related expenses and amortization of regulatory assets.

KU's net income decreased \$11 million for 2000, as compared to 1999, primarily due to retail rate reductions ordered by the Kentucky Commission. The rate reduction resulted in reduced retail revenues of \$28.3 million. Excluding the impact of the rate reduction, net income would have increased approximately \$6.0 million. The increase was due to higher retail electric sales and lower purchased power and operation expenses, offset by lower off-system sales and increased depreciation and amortization.

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### Revenues

A comparison of operating revenues for the years 2001 and 2000, excluding the provision for rate refund, \$1.0 million in 2001, with the immediately preceding year reflects both increases and decreases which have been segregated by the following principal causes (in thousands of \$):

<u>Cause</u>	Increase (Decrease) From Prior Period	
	<u>2001</u>	<u>2000</u>
<b>Retail sales:</b>		
Fuel clause adjustments, etc.	\$ 10,220	\$ 6,893
KU/LG&E Merger surcredit	(3,856)	(2,327)
Environmental cost recovery surcharge	1,458	(4,994)
Performance based rate	1,747	3,439
Electric rate reduction	(5,395)	(28,343)
VDT surcredit	(372)	-
Variation in sales volumes, etc.	<u>(1,627)</u>	<u>20,187</u>
Total retail sales	2,175	(5,145)
Wholesale sales	5,108	(88,522)
Other	<u>1,202</u>	<u>2,398</u>
Total	<u>\$ 8,485</u>	<u>\$ (91,269)</u>

Electric revenues increased in 2001 primarily due to an increase in the recovery of fuel costs passed through the FAC and an increase in wholesale activity partially offset by a rate reduction ordered by Kentucky Commission in 2000 and lower sales volumes.

Electric revenues decreased in 2000 primarily due to a decrease in brokered activity in the wholesale electric sales market and the electric rate reduction ordered by the Kentucky Commission. In January 2000, the Kentucky Commission ordered the termination of KU's proposed electric PBR mechanism and an electric rate reduction.

### Expenses

Fuel for electric generation comprises a large component of KU's total operating expenses. KU's Kentucky jurisdictional electric rates were subject to a FAC whereby increases or decreases would be reflected in the FAC factor, subject to the approval of the Kentucky Commission. Effective July 2, 1999, the FAC was discontinued and replaced with an amended electric PBR. In January 2000, the Kentucky Commission rescinded KU's PBR rates and ordered the reinstatement of the FAC. See Note 3 of KU's Notes to Financial Statements under Item 8 for a further discussion of the PBR and the FAC. KU's wholesale and Virginia jurisdictional electric rates contain a fuel adjustment clause whereby increases or decreases in the cost of fuel are reflected in rates, subject to the approval of the Virginia Commission and the FERC.

Fuel for electric generation increased \$17.1 million (7.8%) in 2001 because of an increase in the cost of coal burned (\$21.8 million), partially offset by a decrease in generation (\$4.7 million). Fuel for electric generation was approximately the same in 2000 as compared to 1999. An increase in volume burned (\$5.1 million) was offset by decreases in the cost of fuel (\$5.1 million). KU's average delivered cost per ton of coal purchased was \$27.84 in 2001, \$25.63 in 2000, and \$26.65 in 1999.

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Power purchased expense decreased \$9.8 million (5.9%) in 2001 primarily due to decreased brokered sales activity in the wholesale electric market and a lower unit cost of the purchases partially offset by an increase in purchases to meet requirements for native load and off-system sales. Power purchased expense decreased \$75.4 million in 2000 primarily due to the decrease in wholesale sales.

Other operation expenses increased \$10.3 million (9.5%) in 2001. The primary cause for the increase was the amortization of a regulatory assets as a result of the workforce reduction associated with KU's Value Delivery initiative of \$5.0 million and an increase in pension expense of \$5.5 million. Operation expenses decreased \$8.4 million (7.3%) in 2000 primarily because of decreased administrative and general expenses of \$10 million offset by increased transmission expenses (\$2.1 million). The administrative and general expenses decrease was primarily due to decreased medical expense (\$3.4 million) and pension expense (\$3.9 million).

Maintenance expenses decreased \$4.6 million (7.5%) primarily due to decreases in steam maintenance (\$6.5 million). Maintenance expense increased \$4.3 million (7.5%) in 2000 due to increases in maintenance at the steam generating plants, primarily due to a scheduled turbine outage at Ghent Unit 1.

Depreciation and amortization decreased \$8 million (8.1%) in 2001 primarily due to a reduction in depreciation rates as a result of a settlement order in December 2001 from the Kentucky Commission. Depreciation expenses decreased by \$6.0 million as a result of the settlement order. Depreciation and amortization increased \$8.3 million (9.3%) in 2000 because of additional utility plant in service.

Property and other taxes decreased \$3.1 million (18.2%) in 2001 due to decreases in payroll taxes related to fewer employees as a result of workforce reductions and transfers to LG&E Energy Services Company. Property and other taxes increased \$2.1 million in 2000 over 1999 (13.8%) due to increases in payroll taxes (\$1.4 million), property tax (\$.4 million) and Kentucky Commission fees (\$.3 million).

Other income-net increased \$2.1 million (30.5%) in 2001 due to an increase in gain on sale of assets. Other income-net decreased \$2.6 million (27.5%) in 2000 as a result of a decrease in interest and dividend income.

Interest charges decreased \$5.4 million (13.7%) in 2001 as compared to the 2000 due to lower interest rates on variable rate debt (\$4.6 million), the retirement of short-term borrowings (\$1.6 million), lower interest on debt to parent company (\$1.2 million), partially offset by an increase in interest associated with KU's accounts receivable securitization program (\$1.8 million).

KU's weighted average cost of long-term debt was 4.91% at December 31, 2001. See Note 9 of KU's Notes to Financial Statements under Item 8.

Variations in income tax expense are largely attributable to changes in pre-tax income. The increase in KU's 2001 effective income tax rate to 35.9% from the 33.7% rate in 2000 was largely the result of lost tax benefits attributable to KU's Employee Stock Ownership Plan. These benefits ceased as a result of the December 2000 acquisition of LG&E Energy Corp. by Powergen.

The rate of inflation may have a significant impact on KU's operations, its ability to control costs and the need to seek timely and adequate rate adjustments. However, relatively low rates of inflation in the past few years have moderated the impact on current operating results.

**CRITICAL ACCOUNTING POLICIES**

Preparation of financial statements and related disclosures in compliance with generally accepted accounting principles (GAAP) 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 the likelihood of success of particular projects, legal and regulatory challenges and anticipated recovery of costs. These judgments, in and of themselves, 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. The following list represents accounting policies that are most significant to KU's financial condition and results, and that require management judgments. Each of these has a higher likelihood of resulting in materially different reported amounts under different conditions or using different assumptions. See also Note 1 of KU's Notes to Financial Statements under Item 8.

<u>Accounting Policy</u>	<u>Judgment/Uncertainties</u>	<u>See Also Under Item 8</u>
Unbilled Revenue	Projecting customer electric and gas usage Estimating impact of weather	Note 1
Benefit Plan Accounting	Future rate of returns on pension plan assets Interest rates used in valuing benefit obligation Health care cost trend rates Other actuarial assumptions	Note 6
Derivative Financial Instruments	Market conditions in energy industry Price volatility	Note 4
Income Tax	Application of tax statutes and regulations to transactions Future decisions of tax authorities	Note 7
Regulatory Mechanisms	Future regulatory decisions Impact of deregulation and competition on ratemaking process External regulator decisions	Note 3

**NEW ACCOUNTING PRONOUNCEMENTS**

During 2001 and 2000, the following accounting pronouncements were issued that affect KU:

SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities*, establishes accounting and reporting

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standards requiring that every derivative instrument (including certain derivative instruments embedded in other contracts) be recorded on the balance sheet as either an asset or a liability measured at its fair value. SFAS No. 133 requires that changes in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. Special accounting for qualifying hedges allows a derivative's gains and losses to offset related results on the hedged item in the income statement, and requires that LG&E must formally document, designate, and assess the effectiveness of transactions that receive hedge accounting. SFAS No. 133 could increase the volatility in earnings and other comprehensive income. SFAS No. 137, *Accounting for Derivative Instruments and Hedging Activities -- Deferral of the Effective Date of SFAS No. 133*, deferred the effective date of SFAS No. 133 until January 1, 2001. KU adopted SFAS No. 133 and SFAS No. 138 on January 1, 2001. The effect of adopting these statements resulted in a \$1.6 million increase in other comprehensive income from a cumulative effect of change in accounting principle (net of tax of \$1.1 million).

The Financial Accounting Standards Board created the Derivatives Implementation Group (DIG) to provide guidance for implementation of SFAS No. 133. DIG Issue C15, *Normal Purchases and Normal Sales Exception for Option Type Contracts and Forward Contracts in Electricity*, was adopted in 2001 and had no impact on results of operations and financial position. DIG Issue C16, *Applying the Normal Purchases and Normal Sales Exception to Contracts that Combine a Forward Contract and a Purchased Option Contract*, was cleared in 2001 and stated that option contracts do not meet the normal purchases and normal sales exception and should follow SFAS No. 133. DIG C16 will be effective in the second quarter of 2002. KU has not determined the impact this issue will have on its results of operations and financial position.

SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, revises the standards for accounting for securitizations and other transfers of financial assets and collateral and requires certain disclosures, and provides accounting and reporting standards for transfers and servicing of financial assets and extinguishments of liabilities. SFAS No. 140 was adopted in the first quarter of 2001, when KU entered into an accounts receivable securitization transaction.

SFAS No. 141, *Business Combinations* and SFAS No. 142, *Goodwill and Other Intangible Assets* were issued in 2001. SFAS No. 141 requires all business combinations initiated after June 30, 2001, to be accounted for using the purchase method. SFAS No. 142 requires goodwill to be recorded, but not amortized. Further, goodwill will now be subject to a periodic assessment for impairment. The provisions of these new pronouncements were effective July 1, 2001, for KU. The adoption of these standards did not have a material impact on the results of operations or financial position of KU.

SFAS No. 143, *Accounting for Asset Retirement Obligations* and SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, were issued 2001. SFAS No. 143 establishes accounting and reporting standards for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. SFAS No. 144 supersedes SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of* and the accounting and reporting provisions of APB Opinion No. 30, *Reporting the Results of Operations -- Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*. SFAS No. 144, among other provisions, eliminates the requirement of SFAS No. 121 to allocate goodwill to long-lived assets to be tested for impairment. The effective implementation date for SFAS No. 143 is 2003 and SFAS No. 144 is 2002. Based on current regulatory accounting practices, management does not expect SFAS No. 143 or SFAS No. 144 to have a material impact on results of operations or financial position of KU.

## LIQUIDITY AND CAPITAL RESOURCES

KU uses net cash generated from its operations and external financing to fund construction of plant and equipment and the payment of dividends. KU believes that such sources of funds will be sufficient to meet the needs of its business in the foreseeable future.

### Operating Activities

Cash provided by operations was \$188 million, \$176 million and \$204 million in 2001, 2000 and 1999, respectively. The 2001 increase resulted from sale of accounts receivable through a securitization program. See Note 1 of KU's Notes to Financial Statements under Item 8. The 2000 decrease resulted from a decrease in net income caused by the aforementioned electric rate reduction ordered by the Kentucky Commission. The decrease was further caused by a net increase in net current assets, including increases in accounts receivable and decreases in accounts payable, and provision for rate refunds, partially offset by decreases in inventory. The 1999 decrease resulted from an increase in net income and a net decrease in net current assets.

### Investing Activities

KU's primary use of funds for investing activities continues to be for capital expenditures. Capital expenditures were \$142 million, \$101 million and \$181 million in 2001, 2000 and 1999, respectively. The higher amount in 1999 capital expenditures was primarily due to the purchase of a 62% interest in two combustion turbines. KU expects its capital expenditures for 2002 and 2003 will total approximately \$459 million which consists primarily of construction costs associated with installation of nitrogen oxide control equipment as described in the section titled "Environmental Matters," purchase of two jointly owned CTs with LG&E and on going construction for the distribution system.

Net cash used for investment activities increased by \$39 million in 2001 compared to 2000, and decreased by \$81 million in 2000 compared to 1999, primarily due to the level of construction expenditures.

### Financing Activities

Net cash outflows from financing activities were \$46 million, \$82 million and \$75 million in 2001, 2000 and 1999, respectively. In 2000, KU retired a \$61.5 million first mortgage bond and refinanced \$12.9 million of its pollution control bonds. The long-term debt balance as of December 31, 2001, was \$434.5 million. Short-term debt declined \$13.4 million in 2001. KU received \$15 million in contributed capital from its parent company in December 2000.

KU participates in an intercompany money pool agreement wherein LG&E Energy can make funds available to KU at market based rates up to \$200 million. At December 31, 2001, the balance of the money pool loan from LG&E Energy was \$47.8 million at an average rate of 2.37% and the remaining money pool availability was \$152.2 million. In addition, KU maintains an uncommitted borrowing facility totaling \$60 million that was undrawn at December 31, 2001. LG&E Energy maintains a facility of \$200 million with an affiliate to ensure funding availability for the money pool. There was no outstanding balance under this facility as of December 31, 2001, and availability of \$170 million remains after considering the \$30 million of commercial paper outstanding at LG&E.

At December 31, 2000, KU had \$61.2 million outstanding under the money pool at an average rate of 6.84%.

Under the provisions for KU's variable-rate pollution control bonds Series PCS 10, 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.

**Future Capital Requirements**

Future capital requirements may be affected in varying degrees by factors such as load growth, changes in construction expenditure levels, rate actions by regulatory agencies, new legislation, market entry of competing electric power generators, changes in environmental regulations and other regulatory requirements. KU anticipates funding future capital requirements through operating cash flow, debt, and/or infusion of capital from parent.

KU's debt ratings as of January 31, 2002, were:

	<u>Moody's</u>	<u>S&amp;P</u>	<u>Fitch</u>
First mortgage bonds	A1	A-	A+
Preferred stock	a2	BBB-	A-
Commercial paper	P-1	A-2	F-1

The S&P ratings are on Credit Watch with positive implications. The Fitch ratings are on Credit Watch – Evolving status. These ratings reflect the views of Moody's, S&P and Fitch. 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.

## KU (Cont.):

### Contractual Obligations

The following is provided to summarize KU's contractual cash obligations for periods after December 31, 2001 (in thousands of \$):

Contractual cash Obligations	Payments Due by Period				Total
	2002	2003- 2004	2005- 2006	After 2006	
Long-term debt (a)	\$ 54,000	\$ 62,000	\$ 36,000	\$332,830	\$ 484,830
Unconditional Purchase obligations (b)	37,788	76,401	83,584	603,286	801,059
Other long-term Obligations (c)	<u>144,000</u>	<u>125,000</u>	<u>-</u>	<u>-</u>	<u>269,000</u>
Total contractual cash obligations	<u>\$235,788</u>	<u>\$263,401</u>	<u>\$119,584</u>	<u>\$936,116</u>	<u>\$1,554,889</u>

(a) Long-term debt of \$54 million is classified as a current liability because the bond is subject to tender for purchase at the option of the holder and to mandatory tender for purchase upon the occurrence of certain events. Maturity date for this bond is 2024.

(b) Represents future minimum payments under purchased power agreements through 2020.

(c) Represents construction commitments.

### Market Risks

KU is exposed to market risks from changes in interest rates and commodity prices. To mitigate changes in cash flows attributable to these exposures, KU uses various financial instruments including derivatives. Derivative positions are monitored using techniques that include market value and sensitivity analysis. See Notes 1 and 4 of KU's Notes to Financial Statements under Item 8.

### Interest Rate Sensitivity

KU has short-term and long-term variable rate debt obligations outstanding. At December 31, 2001, the potential change in interest expense associated with a 1% change in base interest rates of KU's variable rate debt is estimated at \$2.2 million.

Interest rate swaps are used to hedge KU's underlying debt obligations. These swaps hedge specific debt issuances and, consistent with management's designation, are accorded hedge accounting treatment.

As of December 31, 2001, KU has swaps with a notional value of \$153 million. The swaps exchange fixed-rate interest payments for floating interest payments on KU's Series P, R, and PCS-9 Bonds. The potential loss in fair value from these positions resulting from a hypothetical 1% adverse movement in base interest rates is estimated at \$8.2 million as of December 31, 2001. This estimate is derived from third party valuations. Changes in the market value of these swaps if held to maturity, as KU intends to do, will have no effect on KU's net income or cash flow. See Note 4 of KU's Notes to Financial Statements under Item 8.

KU (Cont.):

Energy Trading & Risk Management Activities

KU conducts energy trading and risk management activities to maximize the value of power sales from physical assets it owns, in addition to the wholesale sale of excess asset capacity. Certain energy trading activities are accounted for on a mark-to-market basis in accordance with *EITF 98-10 Accounting for Contracts Involved in Energy Trading and Risk Management Activities*, *SFAS No. 133 Accounting for Derivative Instruments and Hedging Activities*, and *SFAS No. 138 Accounting for Certain Derivative Instruments and Certain Hedging Activities*. Wholesale sales of excess asset capacity and wholesale purchases are treated as normal sales and purchases under *SFAS No. 133* and *SFAS No. 138* and are not marked to market.

The table below summarizes KU's energy trading and risk management activities in 2001 (in thousands of \$).

Fair value of contracts at 12/31/00, net liability	\$ (17)
Fair value of contracts when entered into during 2001	3,441
Contracts realized or otherwise settled during 2001	(2,894)
Changes in fair values due to changes in assumptions	(716)
Fair value of contracts at 12/31/01, net liability	<u>\$(186)</u>

No changes to valuation techniques for energy trading and risk management activities occurred during 2001. All contracts outstanding at December 31, 2001 have a maturity of less than one year and are valued using prices actively quoted for proposed or executed transactions or quoted by brokers.

KU maintains policies intended to minimize credit risk and revalues credit exposures daily to monitor compliance with those policies. As December 31, 2001, 100% of the trading and risk management commitments were with counterparties rated BBB equivalent or better.

Commodity Price Sensitivity

KU has limited exposure to market price volatility in prices of fuel and electricity, since its retail tariffs include the FAC and GSC commodity price pass-through mechanisms. KU is exposed to market price volatility of fuel and electricity in its wholesale activities.

Accounts Receivable Securitization

On February 6, 2001, KU implemented an accounts receivable securitization program. The purpose of this program is to enable KU to accelerate the receipt of cash from the collection of retail accounts receivable, thereby reducing dependence upon more costly sources of working capital. The securitization program allows for a percentage of eligible receivables to be sold. Eligible receivables are generally all receivables associated with retail sales that have standard terms and are not past due. KU is able to terminate this program at any time without penalty. If there is a significant deterioration in the payment record of the receivables by the retail customers or if KU fails to meet certain covenants regarding the program, the program may terminate at the election of the financial institutions. In this case, payments from retail customers would first be used to repay the financial institutions participating in the program, and would then be available for use by KU.

As part of the program, KU sold retail accounts receivables to a wholly owned subsidiary KU R. Simultaneously, KU R entered into two separate three-year accounts receivable securitization facilities with two financial institutions and their affiliates whereby KU R can sell, on a revolving basis, an undivided interest in certain of

## KU (Cont.):

their receivables and receive up to \$50 million from an unrelated third party purchaser. The effective cost of the receivables programs is comparable to KU's lowest cost source of capital, and is based on prime rated commercial paper. KU retains servicing rights of the sold receivables through two separate servicing agreements with the third party purchaser. KU has obtained an opinion from independent legal counsel indicating these transactions qualify as a true sale of receivables. As of December 31, 2001, the outstanding program balance was \$45.1 million.

Management expects to renew these facilities when they expire.

The allowance for doubtful accounts associated with the eligible securitized receivables was \$520,000 at December 31, 2001. This allowance is based on historical experience of KU. Each securitization facility contains a fully funded reserve for uncollectible receivables.

## RATES AND REGULATION

Following the purchase of LG&E Energy by Powergen, Powergen became a registered holding company under PUHCA. As a result, Powergen, its utility subsidiaries, including KU, and certain of its non-utility subsidiaries are subject to extensive regulation by the SEC under PUHCA with respect to issuances and sales of securities, acquisitions and sales of certain utility properties, and intra-system sales of certain goods and services. In addition, PUHCA generally limits the ability of registered holding companies to acquire additional public utility systems and to acquire and retain businesses unrelated to the utility operations of the holding company. Powergen believes that it has adequate authority (including financing authority) under existing SEC orders and regulations for it and its subsidiaries to conduct their businesses and will seek additional authorization when necessary.

KU is subject to the jurisdiction of the Kentucky Commission, the Virginia Commission and FERC in virtually all matters related to electric utility regulation, and as such, its accounting is subject to SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*. Given KU's competitive position in the market and the status of regulation in the states of Kentucky and Virginia, KU has no plans or intentions to discontinue its application of SFAS No. 71. See Note 3 of KU's Notes to Financial Statements under Item 8.

### Kentucky Commission Settlement Order - Value Delivery Costs, ESM and Depreciation

During the first quarter 2001, KU recorded a \$64 million charge for a workforce reduction program. Primary components of the charge were separation benefits, enhanced early retirement benefits, and health care benefits. The result of this workforce reduction was the elimination of over 300 positions, accomplished primarily through a voluntary enhanced severance program.

On June 1, 2001, KU filed an application (VDT case) with the Kentucky Commission to create a regulatory asset relating to these first quarter 2001 charges. The application requested permission to amortize these costs over a four-year period. The Kentucky Commission also opened a case to review the new depreciation study and resulting depreciation rates implemented in 2001.

KU reached a settlement in the VDT case as well as the other cases involving depreciation rates and ESM with all intervening parties. The settlement agreement was approved by the Kentucky Commission on December 3, 2001.

## KU (Cont.):

The Kentucky Commission December 3, 2001, order allowed KU to set up a regulatory asset of \$54 million for the workforce reduction costs and begin amortizing these costs over a five year period starting in April 2001. The first quarter charge of \$64 million represented all employees who had accepted a voluntary enhanced severance program. Some employees rescinded their participation in the voluntary enhanced severance program and, along with the non-recurring charge of \$6.9 million for FERC and Virginia jurisdictions, thereby decreasing the original charge from \$64 million to \$54 million. The settlement will also reduce revenues approximately \$11 million through a surcredit on future bills to customers over the same five year period. The surcredit represents stipulated net savings KU is expected to realize from implementation of best practices through the value delivery process. The agreement also established KU's new depreciation rates in effect December 2001, retroactive to January 1, 2001. The new depreciation rates decreased depreciation expense by \$6.0 million in 2001.

### Environmental Cost Recovery

In August 1999, a final order of the Kentucky Commission approved KU's settlement agreement concerning the refund of the recovery of costs associated with pre-1993 environmental projects. KU began applying the refund to customers' bills in October 1999, and completed the refund process in November 2000. All aspects of the original litigation of this issue have now been resolved.

In June 2000, the Kentucky Commission approved KU's application for a CCN to construct up to four SCR NOx reduction facilities. The construction and subsequent operation of the SCRs is intended to reduce NOx emission levels to meet the EPA's mandated NOx emission level of 0.15 lbs./ Mmbtu by May 2004. In its order, the Kentucky Commission ruled that KU's proposed plan for construction was "reasonable, cost-effective and will not result in the wasteful duplication of facilities". In October 2000, KU filed an application with the Kentucky Commission to amend its Environmental Compliance Plan to reflect the addition of the proposed NOx reduction technology projects and to amend its Environmental Cost Recovery Tariff to include an overall rate of return on capital investments. Following the completion of hearings in March 2001, a ruling was issued in April 2001, approving KU's application. Such approval has allowed KU to begin to recover the costs associated with these new projects, subject to Kentucky Commission oversight during normal six-month and two-year reviews.

### ESM

KU's electric rates are subject to an Earnings Sharing Mechanism. The ESM, in place for three years beginning in 2000, sets an upper and lower point for rate of return on equity, whereby if KU's rate of return for the calendar year falls within the range of 10.5% to 12.5%, no action is necessary. If earnings are above the upper limit, then excess earnings are shared 40% with ratepayers and 60% with shareholders; if earnings are below the lower limit, then earnings deficiency is recovered 40% from ratepayers and 60% from shareholders. The first ESM filing was made on March 1, 2001, for year ended December 31, 2000. By order of the Kentucky Commission, rate changes prompted by the ESM filing go into effect in April of each year. KU estimated that the rate of return will fall within the deadband range, subject to Kentucky Commission approval, for the year ended December 31, 2001; therefore, no adjustment to the financial statements was made.

### DSM

In May 2001, the Kentucky Commission approved a plan that would expand LG&E's current DSM programs into the service territory served by KU. The filing includes a rate mechanism that provides for concurrent recovery of DSM costs, provides an incentive for implementing DSM programs, and recovers revenues from

## KU (Cont.):

lost sales associated with the DSM program.

### FAC

Prior to implementation of the PBR in July 1999, and following its termination in March 2000, KU employed an FAC mechanism, which under Kentucky law allowed the utilities to recover from customers the actual fuel costs associated with retail electric sales.

In July 1999, the Kentucky Commission issued a series of orders requiring KU to refund approximately \$10.1 million resulting from reviews of the FAC from November 1994 to October 1998. The orders changed KU's method of computing fuel costs associated with electric line losses on off-system sales appropriate for recovery through the FAC, and KU's method for computing system line losses for the purpose of calculating the system sales component of the FAC charge. At KU's request, in July 1999, the Kentucky Commission stayed the refund requirement pending the Kentucky Commission's final determination of any rehearing request that KU may file. In August 1999, KU filed its request for rehearing of the July orders.

In August 1999, the Kentucky Commission issued a final order in the KU proceedings, agreeing, in part, with KU's arguments outlined in its petition for rehearing. While the Kentucky Commission confirmed that KU should change its method of computing the fuel costs associated with electric line losses, it agreed with KU that the line loss percentage should be based on KU's actual line losses incurred in making wholesale sales rather than the percentage used in its Open Access Transmission Tariff. The Kentucky Commission also upheld its previous ruling concerning the computation of system line losses in the calculation of the FAC. The net effect of the Kentucky Commission's final order was to reduce the refund obligation to \$ 6.7 million (\$5.8 million on Kentucky jurisdictional basis) from the original order amount of \$10.1 million. In August 1999, KU recorded its estimated share of anticipated FAC refunds. KU began implementing the refund in October and completed the refund in September 2000. Both KU and the KIUC appealed the order to the Franklin Circuit Court. In October 2000, the Court affirmed the Kentucky Commission's orders concerning all issues except interest, with respect to which it held that KU will be required to pay interest on the amount disallowed "if the Commission within its discretion so determines", and ordered the case be remanded to the Kentucky Commission on that issue. In November 2000, KU appealed the Circuit Court's decision to the Kentucky Court of Appeals. Pending a decision on this appeal, a comprehensive settlement was reached by all parties, which settlement was filed with the Kentucky Commission on December 21, 2001. Thereunder, KU agreed to credit its fuel clause in the amount of \$954,000 (such credit provided over the course of two monthly billing periods), and the parties agreed on a prospective interpretation of the state's fuel adjustment clause regulation to ensure consistent and mutually acceptable application on a going-forward basis. All pending FAC proceedings before the court were resolved by the parties to the agreement and all parties requested the Court of Appeals remand the case to the Kentucky Commission. The Kentucky Commission is expected to approve the settlement in 2002.

### Kentucky Commission Administrative Case for Affiliate Transactions

In December 1997, the Kentucky Commission opened Administrative Case No. 369 to consider Kentucky Commission policy regarding cost allocations, affiliate transactions and codes of conduct governing the relationship between utilities and their non-utility operations and affiliates. The Kentucky Commission intended to address two major areas in the proceedings: the tools and conditions needed to prevent cost shifting and cross-subsidization between regulated and non-utility operations; and whether a code of conduct should be established to assure that non-utility segments of the holding company are not engaged in practices that could result in unfair competition caused by cost shifting from the non-utility affiliate to the utility. During the period September 1998 to February 2000, the Kentucky Commission issued draft codes of conduct and cost allocation

## KU (Cont.):

guidelines. In early 2000, the Kentucky General Assembly enacted legislation, House Bill 897, which authorized the Kentucky Commission to require utilities that provide nonregulated activities to keep separate accounts and allocate costs in accordance with procedures established by the Kentucky Commission. In the same Bill, the General Assembly set forth provisions to govern a utilities activities related to the sharing of information, databases, and resources between its employees or an affiliate involved in the marketing or the provision of nonregulated activities and its employees or an affiliate involved in the provision of regulated services. The legislation became law in July 2000 and KU has been operating pursuant thereto since that time. On February 14, 2001, the Kentucky Commission published notice of their intent to promulgate new administrative regulation under the auspices of the new law. This effort is still on going.

### **Kentucky Commission Administrative Case for System Adequacy**

On June 19, 2001, Kentucky Governor Paul E. Patton issued Executive Order 2001-771, which directed the Kentucky Commission to review and study issues relating to the need for and development of new electric generating capacity in Kentucky. The issues to be considered included the impact of new power plants on the electric supply grid, facility siting issues, and economic development matters, with the goal of ensuring a continued, reliable source of supply of electricity for the citizens of Kentucky and the continued environmental and economic vitality of the Commonwealth and its communities. In response to that Executive Order, in July 2001 the Kentucky Commission opened Administrative Case No. 387 to review the adequacy of Kentucky's generation capacity and transmission system. Specifically, the items reviewed were the appropriate level of reliance on purchased power, the appropriate reserve margins to meet existing and future electric demand, the impact of spikes in natural gas prices on electric utility planning strategies, and the adequacy of Kentucky's electric transmission facilities. KU, as a party to this proceeding, filed written testimony and responded to two requests for information. Public hearings were held in August, September, and October 2001. In October 2001, KU filed a final brief in the case. In December 2001 the Kentucky Commission issued an order in which they noted that KU is responsibly addressing the long-term supply needs of native load customers and that current reserve margins are appropriate. However, due to the rapid pace of change in the industry, the order also requires KU to provide an annual assessment of supply resources, future demand, reserve margin, and the need for new resources.

Regarding the transmission system, the Kentucky Commission concluded that the transmission system within the Commonwealth can reliably serve native load and a significant portion of the proposed new unregulated power plants. However, it will not be able to handle the volume of transactions envisioned by FERC without future upgrades, the costs of which should be borne by those for whom the upgrades are required.

The Kentucky Commission pledged to continue to monitor all relevant issues and advocate Kentucky's interests at all opportunities.

### **Environmental Matters**

The Clean Air Act imposed stringent new SO<sub>2</sub> and NO<sub>x</sub> emission limits on electric generating units. KU met its Phase I SO<sub>2</sub> requirements primarily through installation of a scrubber on Ghent Unit 1. KU's strategy for Phase II SO<sub>2</sub> reductions, which commenced January 1, 2000, is to use accumulated emissions allowances to delay additional capital expenditures and may also include fuel switching or the installation of additional scrubbers. KU met the NO<sub>x</sub> emission requirements of the Act through installation of low-NO<sub>x</sub> burner systems. KU's compliance plans are subject to many factors including developments in the emission allowance and fuel markets, future regulatory and legislative initiatives, and advances in clean air control technology. KU will continue to monitor these developments to ensure that its environmental obligations are met in the most

KU (Cont.):

efficient and cost-effective manner.

In September 1998, the EPA announced its final "NOx SIP Call" rule requiring states to impose significant additional reductions in NOx emissions by May 2003, in order to mitigate alleged ozone transport impacts on the Northeast region. The Commonwealth of Kentucky is currently in the process of revising its State Implementation Plan or "SIP" to require reductions in NOx emissions from coal-fired generating units to the 0.15 lb./Mmbtu level on a system-wide basis. In related proceedings in response to petitions filed by various Northeast states, in December 1999, EPA issued a final rule pursuant to Section 126 of the Clean Air Act directing similar NOx reductions from a number of specifically targeted generating units including all KU units in the eastern half of Kentucky. Additional petitions currently pending before EPA may potentially result in rules encompassing KU's remaining generating units. As a result of appeals to both rules, the compliance date was extended to May 2004. All KU generating units are subject to the May 2004 compliance date under these NOx emissions reduction rules.

KU is currently implementing a plan for adding significant additional NOx controls to its generating units. Installation of additional NOx controls will proceed on a phased basis, with installation of controls commencing in late 2000 and continuing through the final compliance date. KU estimates that it will incur total capital costs of approximately \$196 million to reduce its NOx emissions to the 0.15 lb./Mmbtu level on a company-wide basis. In addition, KU will incur additional operating and maintenance costs in operating new NOx controls. KU believes its costs in this regard to be comparable to those of similarly situated utilities with like generation assets. KU had anticipated that such capital and operating costs are the type of costs that are eligible for recovery from customers under its environmental surcharge mechanism and believed that a significant portion of such costs could be recovered. In April 2001, the Kentucky Commission granted recovery of these costs for KU.

KU is also monitoring several other air quality issues which may potentially impact coal-fired power plants, including the appeal of the D.C. Circuit's remand of the EPA's revised air quality standards for ozone and particulate matter, measures to implement EPA's regional haze rule, and EPA's December 2000 determination to regulate mercury emissions from power plants.

KU owns or formerly owned several properties that contained past MGP operations. Various contaminants are typically found at such former MGP sites and environmental remediation measures are frequently required. KU has completed the cleanup of a site owned by KU. With respect to other former MGP sites no longer owned by KU, KU is unaware of what, if any, additional exposure or liability it may have.

In October 1999, approximately 38,000 gallons of diesel fuel leaked from a cracked valve in an underground pipeline at KU's E.W. Brown Station. Under the oversight of EPA and state officials, KU commenced immediate spill containment and recovery measures which prevented the spill from reaching the Kentucky River. KU ultimately recovered approximately 34,000 gallons of diesel fuel. In November 1999, the Kentucky Division of Water issued a notice of violation for the incident. KU is currently negotiating with the state in an effort to reach a complete resolution of this matter. KU incurred costs of approximately \$1.8 million and received insurance reimbursement of \$1.2 million.

See Note 11 of KU's Notes to Financial Statements under Item 8 for an additional discussion of environmental issues.

## KU (Cont.):

### Deferred Income Taxes

KU expects to have adequate levels of taxable income to realize its recorded deferred tax assets. At December 31, 2001, deferred tax assets totaled \$63.9 million and were principally related to expenses attributable to KU's pension plans and post retirement benefit obligations.

### FUTURE OUTLOOK

#### Competition and Customer Choice

KU has moved aggressively over the past decade to be positioned for, and to help promote the energy industry's shift to customer choice and a competitive market for energy services. Specifically, KU has taken many steps to prepare for the expected increase in competition in its business, including support for PBR structures, aggressive cost reduction activities; strategic acquisitions, dispositions and growth initiatives; write-offs of previously deferred expenses; an increase in focus on commercial and industrial customers; an increase in employee training; and necessary corporate and business unit realignments. KU continues to be active in the national debate surrounding the restructuring of the energy industry and the move toward a competitive, market-based environment.

In December 1997, the Kentucky Commission issued a set of principles which was intended to serve as its guide in consideration of issues relating to industry restructuring. Among the issues addressed by these principles are: consumer protection and benefit, system reliability, universal service, environmental responsibility, cost allocation, stranded costs and codes of conduct. During 1998, the Kentucky Commission and a task force of the Kentucky General Assembly each initiated proceedings, including meetings with representatives of utilities, consumers, state agencies and other groups in Kentucky, to discuss the possible structure and effects of energy industry restructuring in Kentucky.

In November 1999, the task force issued a report to the Governor of Kentucky and a legislative agency recommending no general electric industry restructuring actions during the 2000 legislative session. No general industry restructuring actions were taken during the 2001 legislative session.

Thus, at the time of this report, 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.

While many states have moved forward in providing retail choice, many others have not. Some are reconsidering their initiatives and have even delayed implementation. Recent activities in California that have resulted in extremely high wholesale (and in some cases, consumer) electric prices are becoming significant factors in the deliberations by other states.

KU's customers in Virginia will have retail choice beginning January 2002, pursuant to the Virginia Electric Restructuring Act. The Virginia Commission is promulgating regulations to govern the various activities required by the Act. KU filed unbundled rates that became effective January 1, 2002. KU anticipates seeking an exemption from the Virginia Electric Restructuring Act.

**ITEM 7A. Quantitative and Qualitative Disclosure About Market Risk.**

**See LG&E's and KU's Management's Discussion and Analysis of Results of Operations and Financial Condition, Market Risks, under Item 7.**

## ITEM 8. Financial Statements and Supplementary Data.

### INDEX OF ABBREVIATIONS

Capital Corp.	LG&E Capital Corp.
Clean Air Act	The Clean Air Act, as amended in 1990
CCN	Certificate of Public Convenience and Necessity
CT	Combustion Turbines
DSM	Demand Side Management
ECR	Environmental Cost Recovery
EEI	Electric Energy, Inc.
EITF	Emerging Issues Task Force Issue
EPA	U.S. Environmental Protection Agency
ESM	Earnings Sharing Mechanism
FAC	Fuel Adjustment Clause
FERC	Federal Energy Regulatory Commission
FPA	Federal Power Act
FT and FT-A	Firm Transportation
GSC	Gas Supply Clause
Holding Company Act	Public Utility Holding Company Act of 1935
IBEW	International Brotherhood of Electrical Workers
IMEA	Illinois Municipal Electric Agency
IMPA	Indiana Municipal Power Agency
Kentucky Commission	Kentucky Public Service Commission
KIUC	Kentucky Industrial Utility Consumers, Inc.
KU	Kentucky Utilities Company
KU Energy	KU Energy Corporation
KU R	KU Receivables LLC
Kva	Kilovolt-ampere
LEM	LG&E Energy Marketing Inc.
LG&E	Louisville Gas and Electric Company
LG&E Energy	LG&E Energy Corp.
LG&E R	LG&E Receivables LLC
LG&E Services	LG&E Energy Services Inc.
Mcf	Thousand Cubic Feet
Merger Agreement	Agreement and Plan of Merger dated May 20, 1997
MGP	Manufactured Gas Plant
MISO	Midwest Independent System Operator
Mmbtu	Million British thermal units
Moody's	Moody's Investor Services, Inc.
Mw	Megawatts
Mwh	Megawatt hours
NNS	No-Notice Service
NOx	Nitrogen Oxide
OMU	Owensboro Municipal Utilities
OVEC	Ohio Valley Electric Corporation
PBR	Performance-Based Ratemaking
Powergen	Powergen plc
PUHCA	Public Utility Holding Company Act of 1935
S&P	Standard & Poor's Rating Services
SCR	Selective Catalytic Reduction
SEC	Securities And Exchange Commission
SERP	Supplemental Employee Retirement Plan
SFAS	Statement of Financial Accounting Standards

SIP  
SO<sub>2</sub>  
Tennessee Gas  
Texas Gas  
TRA  
Trimble County  
USWA  
Utility Operations  
VDT  
Virginia Commission  
Virginia Staff

State Implementation Plan  
Sulfur Dioxide  
Tennessee Gas Pipeline Company  
Texas Gas Transmission Corporation  
Tennessee Regulatory Authority  
LG&E's Trimble County Unit 1  
United Steelworkers of America  
Operations of LG&E and KU  
Value Delivery Team Process  
Virginia State Corporation Commission  
Virginia Commission Staff

**Louisville Gas and Electric Company and Subsidiary**  
**Consolidated Statements of Income**  
(Thousands of \$)

	Years Ended December 31		
	<u>2001</u>	<u>2000</u>	<u>1999</u>
<b>OPERATING REVENUES:</b>			
Electric .....	\$ 706,645	\$ 713,458	\$ 792,405
Gas .....	290,775	272,489	177,579
Provision for rate refunds (Note 3) .....	(720)	(2,500)	(1,735)
<b>Total operating revenues (Note 1) .....</b>	<b><u>996,700</u></b>	<b><u>983,447</u></b>	<b><u>968,249</u></b>
<b>OPERATING EXPENSES:</b>			
Fuel for electric generation .....	159,231	159,418	159,129
Power purchased .....	81,475	96,894	169,573
Gas supply expenses .....	206,165	196,912	114,745
Other operation expenses .....	167,818	135,943	154,667
Maintenance .....	58,687	63,709	58,119
Depreciation and amortization (Note 1) .....	100,356	98,291	97,221
Federal and state income taxes (Note 8) .....	63,452	64,425	57,774
Property and other taxes .....	17,743	18,985	16,930
<b>Total operating expenses .....</b>	<b><u>854,927</u></b>	<b><u>834,577</u></b>	<b><u>828,158</u></b>
Net operating income .....	141,773	148,870	140,091
Other income - net (Note 9) .....	2,930	4,921	4,141
Interest charges .....	37,922	43,218	37,962
Net income .....	106,781	110,573	106,270
Preferred stock dividends .....	4,739	5,210	4,501
Net income available for common stock .....	<b><u>\$ 102,042</u></b>	<b><u>\$ 105,363</u></b>	<b><u>\$ 101,769</u></b>

**Consolidated Statements of Retained Earnings**  
(Thousands of \$)

	Years Ended December 31		
	<u>2001</u>	<u>2000</u>	<u>1999</u>
Balance January 1 .....	\$314,594	\$259,231	\$247,462
Add net income .....	106,781	110,573	106,270
	<u>421,375</u>	<u>369,804</u>	<u>353,732</u>
Deduct: Cash dividends declared on stock:			
5% cumulative preferred .....	1,075	1,075	1,075
Auction rate cumulative preferred .....	2,195	2,666	1,957
\$5.875 cumulative preferred .....	1,469	1,469	1,469
Common .....	23,000	50,000	90,000
	<u>27,739</u>	<u>55,210</u>	<u>94,501</u>
Balance December 31 .....	<b><u>\$393,636</u></b>	<b><u>\$314,594</u></b>	<b><u>\$259,231</u></b>

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

Louisville Gas and Electric Company and Subsidiary  
 Consolidated Statements of Comprehensive Income  
 (Thousands of \$)

	Years Ended December 31		
	<u>2001</u>	<u>2000</u>	<u>1999</u>
Net income .....	\$106,781	\$110,573	\$106,270
Cumulative effect of change in accounting principle – Accounting for derivative instruments and hedging activities (Note 1) .....	(5,998)	-	-
Losses on derivative instruments and hedging activities (Note 1).....	(2,606)	-	-
Additional minimum pension liability adjustment (Note 7).....	(24,712)	-	-
Unrealized holding losses on available-for-sale securities arising during the period.....	-	-	(402)
Income tax benefit related to items of other comprehensive income .....	<u>13,416</u>	<u>-</u>	<u>163</u>
Comprehensive income .....	<u>\$86,881</u>	<u>\$110,573</u>	<u>\$106,031</u>

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

Louisville Gas and Electric Company and Subsidiary  
Consolidated Balance Sheets  
(Thousands of \$)

	December 31, 2001	2000
<b>ASSETS:</b>		
Utility plant, at original cost (Note 1):		
Electric .....	\$2,598,152	\$2,459,206
Gas .....	409,994	389,371
Common .....	159,817	148,530
	<u>3,167,963</u>	<u>2,997,107</u>
Less: reserve for depreciation .....	1,381,874	1,296,865
	<u>1,786,089</u>	<u>1,700,242</u>
Construction work in progress .....	255,074	189,218
	<u>2,041,163</u>	<u>1,889,460</u>
Other property and investments – less reserve .....	1,176	1,357
Current assets:		
Cash and temporary cash investments .....	2,112	2,495
Marketable securities (Note 6) .....	-	4,056
Accounts receivable - less reserve of \$1,575 in 2001 and \$1,286 in 2000 .....	85,667	170,852
Materials and supplies - at average cost:		
Fuel (predominantly coal) .....	22,024	9,325
Gas stored underground (Note 1) .....	46,395	54,441
Other .....	29,050	31,685
Prepayments and other .....	4,688	1,317
	<u>189,936</u>	<u>274,171</u>
Deferred debits and other assets:		
Unamortized debt expense (Note 1) .....	5,921	5,784
Regulatory assets (Note 3) .....	197,142	54,439
Other .....	13,016	873
	<u>216,079</u>	<u>61,096</u>
	<u>\$2,448,354</u>	<u>\$2,226,084</u>
<b>CAPITAL AND LIABILITIES:</b>		
Capitalization (see statements of capitalization):		
Common equity .....	\$ 838,070	\$ 778,928
Cumulative preferred stock .....	95,140	95,140
Long-term debt (Note 10) .....	370,704	360,600
	<u>1,303,914</u>	<u>1,234,668</u>
Current liabilities:		
Current portion of long-term debt (Note 10) .....	246,200	246,200
Notes payable (Note 11) .....	94,197	114,589
Accounts payable .....	149,070	134,392
Accrued taxes .....	20,257	8,073
Accrued interest .....	5,818	6,350
Other .....	12,840	19,693
	<u>528,382</u>	<u>529,297</u>
Deferred credits and other liabilities:		
Accumulated deferred income taxes (Notes 1 and 8) .....	298,143	289,232
Investment tax credit, in process of amortization .....	58,689	62,979
Accumulated provision for pensions and related benefits (Note 7) .....	167,526	31,257
Customers' advances for construction .....	9,745	9,578
Regulatory liabilities (Note 3) .....	65,349	61,013
Other .....	16,606	8,060
	<u>616,058</u>	<u>462,119</u>
Commitments and contingencies (Note 12)	<u>\$2,448,354</u>	<u>\$2,226,084</u>

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

Louisville Gas and Electric Company and Subsidiary  
Consolidated Statements of Cash Flows  
(Thousands of \$)

	Years Ended December 31		
	2001	2000	1999
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net income .....	\$ 106,781	\$ 110,573	\$ 106,270
Items not requiring cash currently:			
Depreciation and amortization .....	100,356	98,291	97,221
Deferred income taxes - net .....	3,021	31,020	(5,279)
Investment tax credit - net .....	(4,290)	(4,274)	(4,289)
Other .....	(528)	8,481	6,924
Change in certain net current assets:			
Accounts receivable .....	43,185	(56,993)	28,721
Materials and supplies .....	(2,018)	(4,311)	(559)
Accounts payable .....	14,678	21,384	(20,665)
Accrued taxes .....	12,184	(15,686)	(8,170)
Accrued interest .....	(532)	(2,915)	1,227
Prepayments and other .....	(9,968)	(4,901)	(4,306)
Sale of accounts receivable (Note 1) .....	42,000	-	-
Other .....	(17,806)	(24,431)	(16,602)
Net cash flows from operating activities .....	287,063	156,238	180,493
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Purchases of securities .....	-	(708)	(1,144)
Proceeds from sales of securities .....	4,237	4,089	11,662
Construction expenditures .....	(252,958)	(144,216)	(194,644)
Net cash flows used for investing activities .....	(248,721)	(140,835)	(184,126)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Short-term borrowings and repayments .....	(20,392)	(5,508)	120,097
Issuance of pollution control bonds .....	9,662	106,545	-
Retirement of first mortgage bonds and pollution control bonds .....	-	(130,627)	-
Additional paid-in capital .....	-	40,000	-
Payment of dividends .....	(27,995)	(78,079)	(93,433)
Net cash flows from financing activities .....	(38,725)	(67,669)	26,664
Change in cash and temporary cash investments .....	(383)	(52,266)	23,031
Cash and temporary cash investments at beginning of year .....	2,495	54,761	31,730
Cash and temporary cash investments at end of year .....	\$ 2,112	\$ 2,495	\$ 54,761
<b>Supplemental disclosures of cash flow information:</b>			
Cash paid during the year for:			
Income taxes .....	\$ 35,546	\$ 46,562	\$ 76,761
Interest on borrowed money .....	30,989	42,958	33,507

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

Louisville Gas and Electric Company and Subsidiary  
Consolidated Statements of Capitalization  
(Thousands of \$)

	2001	December 31 2000
<b>COMMON EQUITY:</b>		
Common stock, without par value -		
Authorized 75,000,000 shares, outstanding 21,294,223 shares .....	\$ 425,170	\$ 425,170
Common stock expense .....	(836)	(836)
Additional paid-in capital .....	40,000	40,000
Accumulated other comprehensive income .....	(19,900)	-
Retained earnings .....	<u>393,636</u>	<u>314,594</u>
	<u>838,070</u>	<u>778,928</u>
<b>CUMULATIVE PREFERRED STOCK:</b>		
Redeemable on 30 days notice by LG&E		
	<u>Shares</u> <u>Outstanding</u>	<u>Current</u> <u>Redemption Price</u>
\$25 par value, 1,720,000 shares authorized -		
5% series .....	860,287	\$28.00
Without par value, 6,750,000 shares authorized -		
Auction rate .....	500,000	100.00
\$5.875 series .....	250,000	102.35
Preferred stock expense .....		<u>(1,367)</u>
		<u>95,140</u>
		<u>95,140</u>
<b>LONG-TERM DEBT (Note 10):</b>		
First mortgage bonds -		
Series due August 15, 2003, 6% .....		42,600
Pollution control series:		
R due November 1, 2020, 6.55% .....		41,665
S due September 1, 2017, variable .....		31,000
T due September 1, 2017, variable .....		60,000
U due August 15, 2013, variable .....		35,200
V due August 15, 2019, 5 5/8% .....		102,000
W due October 15, 2020, 5.45% .....		26,000
X due April 15, 2023, 5.90% .....		40,000
Y due May 1, 2027, variable .....		25,000
Z due August 1, 2030, variable .....		83,335
AA due September 1, 2027, variable .....		10,104
Total first mortgage bonds .....		<u>496,904</u>
Pollution control bonds (unsecured) -		
Series due September 1, 2026, variable .....		22,500
Series due September 1, 2026, variable .....		27,500
Series due November 1, 2027, variable .....		35,000
Series due November 1, 2027, variable .....		35,000
Total unsecured pollution control bonds .....		<u>120,000</u>
Total bonds outstanding .....		<u>616,904</u>
Less current portion of long-term debt .....		<u>246,200</u>
Long-term debt .....		<u>370,704</u>
Total capitalization .....		<u>\$1,303,914</u>
		<u>\$1,234,668</u>

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

Louisville Gas and Electric Company and Subsidiary  
Notes to Consolidated Financial Statements

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

LG&E, a subsidiary of LG&E Energy and an indirect subsidiary of Powergen, is a regulated public utility engaged in the generation, transmission, distribution, and sale of electric energy and the storage, distribution, and sale of natural gas in Louisville and adjacent areas in Kentucky. LG&E Energy is an exempt public utility holding company with wholly owned subsidiaries including LG&E, KU, Capital Corp., LEM, and LG&E Services. All of the LG&E's Common Stock is held by LG&E Energy. LG&E has one wholly owned consolidated subsidiary, LG&E Receivable.

On December 11, 2000, LG&E Energy Corp. was acquired by Powergen. Powergen is a registered public utility holding company under PUHCA. No costs associated with the Powergen acquisition nor any of the effects of purchase accounting have been reflected in the financial statements of LG&E.

Certain reclassification entries have been made to the 2000 financial statements to conform to the 2001 presentation with no impact on the balance sheet totals or previously reported income.

**Utility Plant.** LG&E's 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. LG&E has not recorded any 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, plus removal expense less salvage value, 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.** Depreciation is provided on the straight-line method over the estimated service lives of depreciable plant. Pursuant to a final order of the Kentucky Commission dated December 3, 2001, LG&E implemented new depreciation rates effective as of January 1, 2001. The amounts provided for 2001 were 3.0% (2.9% electric, 2.9% gas and 5.7% common); for 2000 were 3.6% (3.3% electric, 3.8% gas and 7.3% common); and for 1999 were 3.4% (3.2% electric, 3.2% gas, and 7.1% common) of average depreciable plant.

**Cash and Temporary Cash Investments.** LG&E considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents. Temporary cash investments are carried at cost, which approximates fair value.

**Gas Stored Underground.** Gas inventories of \$46.4 million and \$54.4 million at December 31, 2001, and 2000, respectively, are included in gas stored underground in the balance sheet. The inventory is accounted for using the average-cost method.

**Financial Instruments.** LG&E uses over-the-counter interest-rate swap agreements to hedge its exposure to fluctuations in the interest rates it pays on variable-rate debt. Gains and losses on interest-rate swaps used to hedge interest rate risk are reflected in other comprehensive income. In 2000, LG&E used exchange traded U.S. Treasury note and bond futures to hedge its exposure to fluctuations in the value of its investments in the preferred stocks of other companies. Gains and losses on U.S. Treasury note and bond futures were charged or credited to other income-net. See Note 4 - Financial Instruments.

**Debt Expense.** Debt expense is capitalized in deferred debits and amortized over the lives of the related bond issues, consistent with regulatory practices.

**Deferred Income Taxes.** Deferred income taxes have been provided for all material book-tax temporary differences.

**Investment Tax Credits.** Investment tax credits resulted from provisions of the tax law that permitted a reduction of LG&E's tax liability based on credits for certain 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. LG&E accrues an estimate for unbilled revenues from each meter reading date to the end of the accounting period. The unbilled revenue estimates included in accounts receivable for LG&E at December 31, 2001 and 2000, were approximately \$37.3 million and \$62.8 million, respectively. See Note 3, Rates and Regulatory Matters. LG&E recorded electric revenues that resulted from sales to a related party, KU, of \$28.5 million, \$20.9 million and \$20.2 million for years ended December 31, 2001, 2000 and 1999, respectively.

**Fuel and Gas Costs.** The cost of fuel for electric generation is charged to expense as used, and the cost of gas supply is charged to expense as delivered to the distribution system. LG&E implemented a Kentucky Commission-approved performance-based ratemaking mechanism related to gas procurement and off-system gas sales activity. See Note 3, Rates and Regulatory Matters.

**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. Actual results could differ from those estimates. See Note 12, Commitments and Contingencies, for a further discussion.

**Accounts Receivable Securitization.** SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, revises the standards for accounting for securitizations and other transfers of financial assets and collateral and requires certain disclosures, and provides accounting and reporting standards for transfers and servicing of financial assets and extinguishments of liabilities. SFAS No. 140 was adopted in the first quarter of 2001, when LG&E entered into an accounts receivable securitization transaction.

On February 6, 2001, LG&E implemented an accounts receivable securitization program. The purpose of this program is to enable LG&E to accelerate the receipt of cash from the collection of retail accounts receivable, thereby reducing dependence upon more costly sources of working capital. The securitization program allows for a percentage of eligible receivables to be sold. Eligible receivables are generally all receivables associated with retail sales that have standard terms and are not past due. LG&E is able to terminate these programs at any time without penalty. If there is a significant deterioration in the payment record of the receivables by the retail customers or if LG&E fails to meet certain covenants regarding the program, the program may terminate at the election of the financial institutions. In this case, payments from retail customers would first be used to repay the financial institutions participating in the program, and would then be available for use by LG&E.

As part of the program, LG&E sold retail accounts receivables to a wholly owned subsidiary, LG&E R. Simultaneously, LG&E R entered into two separate three-year accounts receivable securitization facilities with two financial institutions and their affiliates whereby LG&E R can sell, on a revolving basis, an undivided interest in certain of their receivables and receive up to \$75 million from an unrelated third party purchaser.

The effective cost of the receivables programs is comparable to LG&E's lowest cost source of capital, and is based on prime rated commercial paper. LG&E retains servicing rights of the sold receivables through two separate servicing agreements with the third party purchaser. LG&E has obtained an opinion from independent legal counsel indicating these transactions qualify as true sale of receivables. As of December 31, 2001, the outstanding program balance was \$42 million.

Management expects to renew these facilities when they expire.

The allowance for doubtful accounts associated with the eligible securitized receivables was \$1.3 million at December 31, 2001. This allowance is based on historical experience of LG&E. Each securitization facility contains a fully funded reserve for uncollectible receivables.

**New Accounting Pronouncements.** During 2001 and 2000, the following accounting pronouncements were issued that affect LG&E:

SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities*, establishes accounting and reporting standards requiring that every derivative instrument (including certain derivative instruments embedded in other contracts) be recorded on the balance sheet as either an asset or a liability measured at its fair value. SFAS No. 133 requires that changes in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. Special accounting for qualifying hedges allows a derivative's gains and losses to offset related results on the hedged item in the income statement, and requires that LG&E must formally document, designate, and assess the effectiveness of transactions that receive hedge accounting. SFAS No. 133 could increase the volatility in earnings and other comprehensive income. SFAS No. 137, *Accounting for Derivative Instruments and Hedging Activities -- Deferral of the Effective Date of SFAS No. 133*, deferred the effective date of SFAS No. 133 until January 1, 2001. LG&E adopted SFAS No. 133 and SFAS No. 138 on January 1, 2001. The effect of adopting these statements resulted in a \$3.6 million decrease in other comprehensive income from a cumulative effect of change in accounting principle (net of tax of \$2.4 million).

The Financial Accounting Standards Board created the Derivatives Implementation Group (DIG) to provide guidance for implementation of SFAS No. 133. DIG Issue C15, *Normal Purchases and Normal Sales Exception for Option Type Contracts and Forward Contracts in Electricity* was adopted in 2001 and had no impact on results of operations and financial position. DIG Issue C16, *Applying the Normal Purchases and Normal Sales Exception to Contracts that Combine a Forward Contract and a Purchased Option Contract*, was cleared in 2001 and stated that option contracts do not meet the normal purchases and normal sales exception and should follow SFAS No. 133. DIG C16 will be effective in the second quarter of 2002. Management has not determined the impact this issue will have on its results of operations and financial position.

SFAS No. 141, *Business Combinations* and SFAS No. 142, *Goodwill and Other Intangible Assets* were issued in 2001. SFAS No. 141 requires all business combinations initiated after June 30, 2001, to be accounted for using the purchase method. SFAS No. 142 requires goodwill to be recorded, but not amortized. Further, goodwill will now be subject to a periodic assessment for impairment. The provisions of these new pronouncements were effective July 1, 2001, for LG&E. The adoption of these standards did not have a material impact on the results of operations or financial position of LG&E.

SFAS No. 143, *Accounting for Asset Retirement Obligations* and SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, were issued 2001. SFAS No. 143 establishes accounting and reporting standards for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. SFAS No. 144 supersedes SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of* and the accounting and reporting provisions of APB

Opinion No. 30, *Reporting the Results of Operations – Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*. SFAS No. 144, among other provisions, eliminates the requirement of SFAS No. 121 to allocate goodwill to long-lived assets to be tested for impairment. The effective implementation date for SFAS No. 144 is 2002 and SFAS No. 143 is 2003. Based on current regulatory accounting practices, management does not expect SFAS No. 143 or SFAS No. 144 to have a material impact on results of operations or financial position of LG&E.

## **Note 2 – Mergers and Acquisitions**

On December 11, 2000, LG&E Energy Corp. was acquired by Powergen plc. for cash of approximately \$3.2 billion or \$24.85 per share and the assumption of all of LG&E Energy's debt. As a result of the acquisition, LG&E Energy became a wholly owned subsidiary of Powergen and, as a result, LG&E became an indirect subsidiary of Powergen. LG&E has continued its separate identity and serves customers in Kentucky under its existing name. The preferred stock and debt securities of LG&E were not affected by this transaction resulting in the utility operations' obligation to continue to file SEC reports. Following the acquisition, Powergen became a registered holding company under PUHCA, and LG&E, as a subsidiary of a registered holding company, became subject to additional regulations under PUHCA.

LG&E Energy and KU Energy merged on May 4, 1998, with LG&E Energy as the surviving corporation. As a result of the merger, LG&E Energy, which is the parent of LG&E, became the parent company of KU. The operating utility subsidiaries (LG&E and KU) have continued to maintain their separate corporate identities and serve customers in Kentucky and Virginia under their present names. LG&E Energy estimated non-fuel savings over a ten year period following the merger. Costs to achieve these savings for LG&E of \$50.2 million were recorded in the second quarter of 1998, \$18.1 million of which were initially deferred and are being amortized over a five-year period pursuant to regulatory orders. Primary components of the merger costs were separation benefits, relocation costs, and transaction fees, the majority of which were paid by December 31, 1998. LG&E expensed the remaining costs associated with the merger (\$32.1 million) in the second quarter of 1998. In regulatory filings associated with approval of the merger, LG&E committed not to seek increases in existing base rates and proposed reductions in their retail customers' bills in amounts based on one-half of the savings, net of the deferred and amortized amount, over a five-year period. The preferred stock and debt securities of LG&E were not affected by the merger.

Management has accounted for the KU/LG&E merger as a pooling of interests and as a tax-free reorganization under the Internal Revenue Code.

As part of its merger order, the Kentucky Commission approved a surcredit whereby 50% of the net non-fuel cost savings estimated to be achieved from the merger, less \$18.1 million or 50% of the originally estimated costs to achieve such savings, be applied to reduce customer rates through a surcredit on customers' bills and the remaining 50% be retained by the companies. The surcredit is allocated 53% to KU and 47% to LG&E pursuant to Kentucky Commission order. The surcredit will be about 2% of customer bills through mid 2003 and will amount to approximately \$55 million in net non-fuel savings to LG&E. Any fuel cost savings are passed to Kentucky customers through the companies' fuel adjustment clauses. See Note 3 for more information about LG&E's rates and regulatory matters.

## **Note 3 - Rates and Regulatory Matters**

Accounting for the regulated utility business conforms with generally accepted accounting principles as applied to regulated public utilities and as prescribed by FERC and the Kentucky Commission. LG&E is subject to SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*, under which certain costs that would otherwise be charged to expense are deferred as regulatory assets based on expected recovery from customers in

future rates. Likewise, certain credits that would otherwise be reflected as income are deferred as regulatory liabilities based on expected return to customers in future rates. LG&E's current or expected recovery of deferred costs and expected return of deferred credits is generally based on specific ratemaking decisions or precedent for each item. The following regulatory assets and liabilities were included in LG&E's balance sheets as of December 31 (in thousands of \$):

	<u>2001</u>	<u>2000</u>
VDT Costs	\$127,529	\$ -
Gas supply adjustments due from customers	30,135	12,324
Unamortized loss on bonds	17,902	19,036
LGE/KU merger costs	5,444	9,073
Manufactured gas sites	2,062	2,368
One utility costs	3,643	6,331
Other	<u>10,427</u>	<u>5,307</u>
Total regulatory assets	<u>197,142</u>	<u>54,439</u>
Deferred income taxes - net	(48,703)	(54,593)
Gas supply adjustments due to customers	(15,702)	(2,209)
Other	<u>(944)</u>	<u>(4,391)</u>
Total regulatory liabilities	<u>(65,349)</u>	<u>(61,013)</u>
Regulatory assets (liabilities) - net	<u>\$131,793</u>	<u>\$(6,574)</u>

**Kentucky Commission Settlement - Value Delivery Costs.** During the first quarter 2001, LG&E recorded a \$144 million charge for a workforce reduction program. Primary components of the charge were separation benefits, enhanced early retirement benefits, and health care benefits. The result of this workforce reduction was the elimination of over 700 positions, accomplished primarily through a voluntary enhanced severance program.

On June 1, 2001, LG&E filed an application (VDT case) with the Kentucky Commission to create a regulatory asset relating to these first quarter 2001 charges. The application requested permission to amortize these costs over a four-year period. The Kentucky Commission also opened a case to review the new depreciation study and resulting depreciation rates implemented in 2001.

LG&E reached a settlement in the VDT case as well as the other cases involving depreciation rates and ESM with all intervening parties. The settlement agreement was approved by the Kentucky Commission on December 3, 2001.

The Kentucky Commission December 3, 2001, order allowed LG&E to set up a regulatory asset of \$141 million for the workforce reduction costs and begin amortizing these costs over a five year period starting in April 2001. The first quarter charge of \$144 million represented all employees who had accepted a voluntary enhanced severance program. Some employees rescinded their participation in the voluntary enhanced severance program, thereby decreasing the original charge from \$144 million to \$141 million. The settlement will also reduce revenues approximately \$26 million through a surcredit on future bills to customers over the same five year period. The surcredit represents net savings stipulated by LG&E. The agreement also established LG&E's new depreciation rates in effect December 2001, retroactive to January 1, 2001. The new depreciation rates decreased depreciation expense by \$5.6 million in 2001.

**PUHCA.** Following the purchase of LG&E Energy by Powergen, Powergen became a registered holding company under PUHCA. As a result, Powergen, its utility subsidiaries, including LG&E, and certain of its non-utility subsidiaries are subject to extensive regulation by the SEC under PUHCA with respect to issuances and

sales of securities, acquisitions and sales of certain utility properties, and intra-system sales of certain goods and services. In addition, PUHCA generally limits the ability of registered holding companies to acquire additional public utility systems and to acquire and retain businesses unrelated to the utility operations of the holding company. Powergen believes that it has adequate authority (including financing authority) under existing SEC orders and regulations for it and its subsidiaries to conduct their businesses and will seek additional authorization when necessary.

**Environmental Cost Recovery.** In June 2000, the Kentucky Commission approved LG&E's application for a CCN to construct up to three SCR NOx reduction facilities. The construction and subsequent operation of the SCRs is intended to reduce NOx emission levels to meet the EPA's mandated NOx emission level of 0.15 lbs./Mmbtu by May 2004. In its order, the Kentucky Commission ruled that LG&E's proposed plan for construction was "reasonable, cost-effective and will not result in the wasteful duplication of facilities." In October 2000, LG&E filed an application with the Kentucky Commission to amend its Environmental Compliance Plan to reflect the addition of the proposed NOx reduction technology projects and to amend its Environmental Cost Recovery Tariff to include an overall rate of return on capital investments. Approval of LG&E's application will allow LG&E to begin to recover the costs associated with these new projects, subject to Kentucky Commission oversight during normal six-month and two-year reviews. Following the completion of hearings in March 2001, a ruling was issued in April 2001 approving LG&E's application.

**ESM.** LG&E's electric rates are subject to an ESM. The ESM, in place for three years beginning in 2000, sets an upper and lower point for rate of return on equity, whereby if LG&E's rate of return for the calendar year falls within the range of 10.5% to 12.5%, no action is necessary. If earnings are above the upper limit, then excess earnings are shared 40% with ratepayers and 60% with shareholders; if earnings are below the lower limit, then earnings deficiency is recovered 40% from ratepayers and 60% from shareholders. The first ESM filing was made on March 1, 2001, for year ended December 31, 2000 that resulted in a refund to customers of \$618,000. By order of the Kentucky Commission, rate changes prompted by the ESM filing go into effect in April of each year. LG&E estimated that the rate of return will fall within the deadband range, subject to Kentucky Commission approval, for the year ended December 31, 2001; therefore, no adjustment to the financial statements was made.

**DSM.** LG&E's rates contain a DSM provision. The provision includes a rate mechanism that provides concurrent recovery of DSM costs and provides an incentive for implementing DSM programs. This program had allowed LG&E to recover revenues from lost sales associated with the DSM program. In May 2001, the Kentucky Commission approved LG&E's plan to continue DSM programs. This filing called for the expansion of the DSM programs into the service territory served by KU and proposes a mechanism to recover revenues from lost sales associated with DSM programs based on program planning engineering estimates and post-implementation evaluation.

**Gas PBR.** Since November 1, 1997, LG&E has operated under an experimental performance-based ratemaking mechanism related to its gas procurement activities. For each of the last four years, LG&E's rates have been adjusted to recover its portion of the savings (or expenses) incurred during each of the four 12-month periods beginning November 1 and ending October 31. Since its implementation on November 1, 1997, through October 31, 2001, LG&E has achieved \$32.1 million in savings. Of the total savings, LG&E has retained \$15.0 million, and the remaining portion of \$17.1 million has been distributed to customers. In December 2000, LG&E filed an Application reporting on the operation of the experimental PBR and requested the Kentucky Commission to extend the PBR as a result of the benefits provided to both LG&E and its customers during the experimental period. Following the discovery and hearing process, the Kentucky Commission issued an order effective November 1, 2001, extending the experimental PBR program for an additional four years, and making other modifications, including changes to the sharing levels applicable to savings or expenses incurred under the PBR. Specifically, the Kentucky Commission substituted a 25%/75% Company/Customer sharing for all savings (and expenses) up to 4.5% of the benchmarked gas costs. Savings (and expenses) in excess of 4.5% of

the benchmarked gas costs are shared at a 50%/50% level.

**FAC.** Prior to implementation of the PBR in July 1999, and following its termination in March 2000, LG&E employed an FAC mechanism, which under Kentucky law allowed LG&E to recover from customers the actual fuel costs associated with retail electric sales.

In February 1999, LG&E received orders from the Kentucky Commission requiring a refund to retail electric customers of approximately \$3.9 million resulting from reviews of the FAC from November 1994, through April 1998, of which \$1.9 million was refunded in April 1999, for the period beginning November 1994, and ending October 1996. The orders changed LG&E's method of computing fuel costs associated with electric line losses on wholesale sales appropriate for recovery through the FAC. Following rehearing in December 1999, the Kentucky Commission agreed with LG&E's position on the appropriate loss factor to use in the FAC computation and issued an order reducing the refund level for the 18-month period under review to approximately \$800,000 for the period November 1996 through April 1998. LG&E enacted the refund with billings in the month of January 2000. LG&E and KIUC each filed separate appeals from the Kentucky Commission's February 1999 orders with the Franklin County, Kentucky Circuit Court and in May 2000, the Court affirmed the Kentucky Commission's orders regarding the amounts disallowed and ordered the case remanded as to the Kentucky Commission's denial of interest, directing the Kentucky Commission to determine whether interest should be awarded to LG&E's ratepayers. In June 2000, LG&E appealed the Circuit Court's decision to the Kentucky Court of Appeals. Pending a decision on this appeal, a comprehensive settlement was reached by all parties, which settlement was filed with the Kentucky Commission on December 21, 2001. Thereunder, LG&E agreed to credit its fuel clause in the amount of \$720,000 (such credit provided over the course of two monthly billing periods), and the parties agreed on a prospective interpretation of the state's fuel adjustment clause regulation to ensure consistent and mutually acceptable application on a going-forward basis. All pending FAC proceedings before the court were resolved by the parties to the agreement and all parties requested the Court of Appeals remand the case to the Kentucky Commission. The Kentucky Commission is expected to approve the settlement in 2002.

**Gas Rate Case.** In March 2000, LG&E filed an application with the Kentucky Commission requesting an adjustment in LG&E's gas rates. In September 2000, the Kentucky Commission granted LG&E an annual increase in its base gas revenues of \$20.2 million effective September 28, 2000. The Kentucky Commission authorized a return on equity of 11.25%. The Kentucky Commission approved LG&E's proposal for a weather normalization billing adjustment mechanism that will normalize the effect of weather on revenues from gas sales.

**Wholesale Natural Gas Prices.** On September 12, 2000, the Kentucky Commission issued an order establishing Administrative Case No. 384 – "An Investigation of Increasing Wholesale Natural Gas Prices and the Impacts of such Increase on the Retail Customers Served by Kentucky's Jurisdictional Natural Gas Distribution Companies". The impetus for this administrative proceeding was the escalation of wholesale natural gas prices during the summer of 2000.

The Kentucky Commission directed Kentucky's natural gas distribution companies, including LG&E, to file selected information regarding the individual companies' natural gas purchasing practices, expectations for the then-approaching winter heating season of 2000-2001, and potential actions which these companies might take to mitigate price volatility. On July 17, 2001, the Kentucky Commission issued an Order encouraging the natural gas distribution companies in Kentucky to take various actions, among them to propose a natural gas hedge plan, consider performance-based ratemaking mechanisms, and to increase the use of storage.

On August 12, 2001, LG&E submitted a natural gas hedge plan in Case No. 2001-253. However, due to significantly decreased wholesale natural gas prices during the Summer of 2001, the Kentucky Commission

ultimately rejected LG&E's proposed gas hedging plan as "untimely" in its order dated October 5, 2001.

Another result from that Administrative Case was the Kentucky Commission's decision to engage a consultant to conduct a forward-looking audit of the gas procurement and supply procedures in order to assist both the Kentucky Commission and each of Kentucky's largest natural gas distribution companies. This audit is underway.

**Kentucky Commission Administrative Case for Affiliate Transactions.** In December 1997, the Kentucky Commission opened Administrative Case No. 369 to consider Kentucky Commission policy regarding cost allocations, affiliate transactions and codes of conduct governing the relationship between utilities and their non-utility operations and affiliates. The Kentucky Commission intended to address two major areas in the proceedings: the tools and conditions needed to prevent cost shifting and cross-subsidization between regulated and non-utility operations; and whether a code of conduct should be established to assure that non-utility segments of the holding company are not engaged in practices that could result in unfair competition caused by cost shifting from the non-utility affiliate to the utility. During the period September 1998 to February 2000, the Kentucky Commission issued draft codes of conduct and cost allocation guidelines. In early 2000, the Kentucky General Assembly enacted legislation, House Bill 897, which authorized the Kentucky Commission to require utilities that provide nonregulated activities to keep separate accounts and allocate costs in accordance with procedures established by the Kentucky Commission. In the same Bill, the General Assembly set forth provisions to govern a utilities activities related to the sharing of information, databases, and resources between its employees or an affiliate involved in the marketing or the provision of nonregulated activities and its employees or an affiliate involved in the provision of regulated services. The legislation became law in July 2000 and LG&E has been operating pursuant thereto since that time. On February 14, 2001, the Kentucky Commission published notice of their intent to promulgate new administrative regulations under the auspices of this new law. This effort is still on going.

#### Note 4 - Financial Instruments

The cost and estimated fair values of LG&E's non-trading financial instruments as of December 31, 2001, and 2000 follow (in thousands of \$):

	<u>2001</u>		<u>2000</u>	
	<u>Cost</u>	<u>Fair Value</u>	<u>Cost</u>	<u>Fair Value</u>
Marketable securities	\$ -	\$ -	\$ 4,403	\$ 4,056
Long-term investments - Not practicable to estimate fair value	490	490	564	564
Preferred stock subject to mandatory redemption	25,000	25,125	25,000	25,275
Long-term debt (including current portion)	616,904	620,504	606,800	606,236
Interest-rate swaps	-	(8,604)	-	(5,998)

All of the above valuations reflect prices quoted by exchanges except for the swaps and the long-term investments. The fair values of the swaps reflect price quotes from dealers or amounts calculated using accepted pricing models. The fair values of the long-term investments reflect cost, since LG&E cannot reasonably estimate fair value.

**Interest Rate Swaps.** LG&E uses interest rate swaps to hedge exposure to market fluctuations in certain of its debt instruments. Pursuant to policy, use of these financial instruments is intended to mitigate risk and earnings

volatility and is not speculative in nature. Management has designated all of the interest rate swaps as hedge instruments. Financial instruments designated as cash flow hedges have resulting gains and losses recorded within other comprehensive income and stockholders' equity. To the extent a financial instrument or the underlying item being hedged is prematurely terminated or the hedge becomes ineffective, the resulting gains or losses are reclassified from other comprehensive income to net income. Financial instruments designated as fair value hedges are periodically marked to market with the resulting gains and losses recorded directly into net income to correspond with income or expense recognized from changes in market value of the items being hedged.

As of December 31, 2001 and 2000, LG&E was party to various interest rate swap agreements with aggregate notional amounts of \$117.3 million and \$234.3 million, respectively. Under these swap agreements, LG&E paid fixed rates averaging 5.13% and 4.40%, and received variable rates based on the Bond Market Association's municipal swap index averaging 1.61% and 4.84% at December 31, 2001 and 2000, respectively. The swap agreements in effect at December 31, 2001 have been designated as cash flow hedges and mature on dates ranging from 2003 to 2020. The hedges have been deemed to be fully effective resulting in a pretax loss of \$2.6 million for 2001, recorded in other comprehensive income. Upon expiration of these hedges, the amount recorded in other comprehensive income will be reclassified into earnings. The amounts expected to be reclassified from other comprehensive income to earnings in the next twelve months is immaterial.

**Energy Trading.** LG&E conducts energy trading and risk management activities to maximize the value of power sales from physical assets it owns, in addition to the wholesale sale of excess asset capacity. Certain energy trading activities are accounted for on a mark-to-market basis in accordance with *EITF 98-10 Accounting for Contracts Involved in Energy Trading and Risk Management Activities*, *SFAS No. 133 Accounting for Derivative Instruments and Hedging Activities*, and *SFAS No. 138 Accounting for Certain Derivative Instruments and Certain Hedging Activities*. Wholesale sales of excess asset capacity and wholesale purchases are treated as normal sales and purchases under *SFAS No. 133* and *SFAS No. 138* and are not marked to market.

LG&E has recorded a net liability of \$186,000 and \$17,000 at December 31, 2001 and 2000, respectively.

No changes to valuation techniques for energy trading and risk management activities occurred during 2001. All contracts outstanding at December 31, 2001 have a maturity of less than one year and are valued using prices actively quoted for proposed or executed transactions or quoted by brokers.

#### **Note 5 - 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.

LG&E's customer receivables and gas and electric revenues arise from deliveries of natural gas to approximately 305,000 customers and electricity to approximately 378,000 customers in Louisville and adjacent areas in Kentucky. For the year ended December 31, 2001, 71% of total revenue was derived from electric operations and 29% from gas operations.

In November 2001, LG&E and IBEW Local 2100 employees, which represent approximately 70% of LG&E's workforce, entered into a four-year collective bargaining agreement.

## Note 6 - Marketable Securities

In 2000, LG&E classified marketable securities as "trading securities" under the provisions of SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. Prior to that, LG&E's marketable securities had been determined to be "available-for-sale." All unrealized holding gains and losses were immediately recognized in earnings on the date of transfer. Proceeds from sales of trading securities in 2000 were approximately \$4.1 million. Proceeds from sales of available-for-sale securities in 1999 were approximately \$11.7 million. Sales of securities resulted in immaterial net realized gains and losses, calculated using the specific identification method.

LG&E has no trading securities at December 31, 2001. Approximate cost, fair value, and other required information pertaining to LG&E's securities by major security type, as of December 31, 2000, follow (in thousands of \$):

	<u>Equity</u>
<u>2000:</u>	
Cost	\$4,403
Realized losses	<u>(347)</u>
Fair values	<u>\$4,056</u>
Fair values:	
No maturity	<u>\$4,056</u>
Total fair values	<u>\$4,056</u>

## Note 7 - Pension Plans and Retirement Benefits

**Pension Plans.** LG&E sponsors several qualified and non-qualified pension plans and other postretirement benefit plans for its employees. The following tables provide a reconciliation of the changes in the plans' benefit obligations and fair value of assets over the three-year period ending December 31, 2001, and a statement of the funded status as of December 31 for each of the last three years (in thousands of \$):

	<u>2001</u>	<u>2000</u>	<u>1999</u>
<b><u>Pension Plans:</u></b>			
<b>Change in benefit obligation</b>			
Benefit obligation at beginning of year	\$310,822	\$283,267	\$311,935
Service cost	1,311	3,408	5,005
Interest cost	25,361	22,698	21,014
Plan amendments	1,550	17,042	(2,397)
Curtailement loss	24,563	-	-
Special termination benefits	53,610	-	-
Benefits paid	(53,292)	(16,656)	(15,471)
Actuarial (gain) or loss and other	(7,632)	1,063	(36,819)
Benefit obligation at end of year	<u>\$356,293</u>	<u>\$310,822</u>	<u>\$283,267</u>
<b>Change in plan assets</b>			
Fair value of plan assets at beginning of year	\$333,378	\$360,095	\$308,660
Actual return on plan assets	(27,589)	(6,150)	51,995
Employer contributions and plan transfers	(17,134)	(1,804)	16,142
Benefits paid	(53,292)	(16,656)	(15,471)
Administrative expenses	(1,419)	(2,107)	(1,231)
Fair value of plan assets at end of year	<u>\$233,944</u>	<u>\$333,378</u>	<u>\$360,095</u>
<b>Reconciliation of funded status</b>			
Funded status	\$(122,349)	\$22,556	\$ 76,828
Unrecognized actuarial (gain) or loss	18,800	(74,086)	(126,554)
Unrecognized transition (asset) or obligation	(4,215)	(5,853)	(6,965)
Unrecognized prior service cost	35,435	47,984	35,588
Net amount recognized at end of year	<u>\$ (72,329)</u>	<u>\$ (9,399)</u>	<u>\$ (21,103)</u>

Other Benefits:

Change in benefit obligation

Benefit obligation at beginning of year	\$56,981	\$44,997	\$44,964
Service cost	358	822	1,205
Interest cost	5,865	4,225	3,270
Plan amendments	1,487	5,826	2,377
Curtailment loss	8,645	-	-
Special termination benefits	18,089	-	-
Benefits paid	(4,877)	(4,889)	(3,050)
Actuarial (gain) or loss	<u>3,398</u>	<u>6,000</u>	<u>(3,769)</u>
Benefit obligation at end of year	<u>\$89,946</u>	<u>\$56,981</u>	<u>\$44,997</u>

Change in plan assets

Fair value of plan assets at beginning of year	\$ 7,166	\$10,526	\$ 6,062
Actual return on plan assets	(765)	(92)	1,776
Employer contributions and plan transfers	1,282	1,621	4,681
Benefits paid	<u>(4,881)</u>	<u>(4,889)</u>	<u>(1,993)</u>
Fair value of plan assets at end of year	<u>\$ 2,802</u>	<u>\$ 7,166</u>	<u>\$10,526</u>

Reconciliation of funded status

Funded status	\$(87,144)	\$(49,815)	\$(34,471)
Unrecognized actuarial (gain) or loss	15,947	5,623	(1,638)
Unrecognized transition (asset) or obligation	7,346	13,374	14,489
Unrecognized prior service cost	<u>5,302</u>	<u>8,960</u>	<u>4,292</u>
Net amount recognized at end of year	<u>\$(58,549)</u>	<u>\$(21,858)</u>	<u>\$(17,328)</u>

There are no plan assets in the nonqualified plan due to the nature of the plan.

The following tables provide the amounts recognized in the balance sheet and information for plans with benefit obligations in excess of plan assets as of December 31, 2001, 2000 and 1999 (in thousands of \$):

	<u>2001</u>	<u>2000</u>	<u>1999</u>
<u>Pension Plans:</u>			
Amounts recognized in the balance sheet consisted of:			
Prepaid benefits cost	\$ -	\$ 18,880	\$ 6,466
Accrued benefit liability	(108,977)	(28,279)	(27,569)
Intangible asset	11,936	-	-
Accumulated other comprehensive income	<u>24,712</u>	<u>-</u>	<u>-</u>
Net amount recognized at year-end	<u>\$ (72,329)</u>	<u>\$ (9,399)</u>	<u>\$ (21,103)</u>
Additional year-end information for plans with accumulated benefit obligations in excess of plan assets (1):			
Projected benefit obligation	\$ 356,293	\$ 4,088	\$ 4,845
Accumulated benefit obligation	352,477	3,501	4,327
Fair value of plan assets	233,944	-	-

(1) 2001 includes all plans. 2000 and 1999 include SERPs only.

**Other Benefits:**

Amounts recognized in the balance sheet consisted of:

Accrued benefit liability	<u>\$ (58,549)</u>	<u>\$ (21,858)</u>	<u>\$ (17,328)</u>
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Additional year-end information for plans with benefit obligations in excess of plan assets:

Projected benefit obligation	\$89,946	\$56,981	\$44,997
Fair value of plan assets	2,802	7,166	10,526

The following table provides the components of net periodic benefit cost for the plans for 2001, 2000 and 1999 (in thousands of \$):

	<u>2001</u>	<u>2000</u>	<u>1999</u>
<b><u>Pension Plans:</u></b>			
Components of net periodic benefit cost			
Service cost	\$ 1,311	\$ 3,408	\$ 5,005
Interest cost	25,361	22,698	21,014
Expected return on plan assets	(26,360)	(33,025)	(28,946)
Amortization of prior service cost	3,861	4,646	3,462
Amortization of transition (asset) or obligation	(1,000)	(1,112)	(1,112)
Recognized actuarial (gain) or loss	<u>(777)</u>	<u>(6,856)</u>	<u>(2,621)</u>
Net periodic benefit cost	<u>\$ 2,396</u>	<u>\$(10,241)</u>	<u>\$ (3,198)</u>
Special charges			
Prior service cost recognized	\$10,237	\$ -	\$ -
Special termination benefits	53,610	-	-
Settlement loss	<u>(2,244)</u>	-	-
Total charges	<u>\$61,603</u>	<u>\$ -</u>	<u>\$ -</u>
<b><u>Other Benefits:</u></b>			
Components of net periodic benefit cost			
Service cost	\$ 358	\$ 822	\$ 1,205
Interest cost	5,865	4,225	3,270
Expected return on plan assets	(420)	(683)	(401)
Amortization of prior service cost	951	1,158	473
Amortization of transition (asset) or obligation	719	1,114	1,114
Recognized actuarial gain	<u>(32)</u>	<u>(485)</u>	<u>(183)</u>
Net periodic benefit cost	<u>\$ 7,441</u>	<u>\$ 6,151</u>	<u>\$ 5,478</u>
Special charges			
Curtailment loss	\$ 6,671	\$ -	\$ -
Prior service cost recognized	2,391	-	-
Transition obligation recognized	4,743	-	-
Special termination benefits	<u>18,089</u>	-	-
Total charges	<u>\$31,894</u>	<u>\$ -</u>	<u>\$ -</u>

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

	<u>2001</u>	<u>2000</u>	<u>1999</u>
Weighted-average assumptions as of December 31:			
Discount rate	7.25%	7.75%	8.00%
Expected long-term rate of return on plan assets	9.50%	9.50%	9.50%
Rate of compensation increase	4.25%	4.75%	5.00%

For measurement purposes, a 10.00% annual increase in the per capita cost of covered health care benefits was assumed for 2002. The rate was assumed to decrease gradually to 5.00% for 2011 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 the following effects (in thousands of \$):

	<u>1% Decrease</u>	<u>1% Increase</u>
Effect on total of service and interest cost components for 2001	\$ (189)	\$ 212
Effect on year-end 2001 postretirement benefit obligations	(3,025)	3,073

**Thrift Savings Plans.** LG&E 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. LG&E makes contributions to the plan by matching a portion of the employee contributions. The costs were approximately \$1.2 million for 2001, and \$2.7 million for 2000 and 1999, respectively.

#### Note 8 - Income Taxes

Components of income tax expense are shown in the table below (in thousands of \$):

	<u>2001</u>	<u>2000</u>	<u>1999</u>
Included in operating expenses:			
Current			
- federal	\$42,997	\$32,612	\$53,981
- state	8,668	5,018	13,680
Deferred			
- federal - net	12,310	24,272	(4,818)
- state - net	3,767	6,797	(780)
Amortization of investment tax credit	(4,290)	(4,274)	(4,289)
Total	<u>63,452</u>	<u>64,425</u>	<u>57,774</u>
Included in other income - net:			
Current			
- federal	(1,870)	(2,187)	217
- state	(483)	(568)	(30)
Deferred			
- federal - net	285	(39)	254
- state - net	73	(10)	65
Total	<u>(1,995)</u>	<u>(2,804)</u>	<u>506</u>
Total income tax expense	<u>\$61,457</u>	<u>\$61,621</u>	<u>\$58,280</u>

Net deferred tax liabilities resulting from book-tax temporary differences are shown below (in thousands of \$):

	<u>2001</u>	<u>2000</u>
Deferred tax liabilities:		
Depreciation and other plant-related items	\$334,914	\$329,836
Other liabilities	<u>77,611</u>	<u>22,621</u>
	<u>412,525</u>	<u>352,457</u>
Deferred tax assets:		
Investment tax credit	23,713	25,444
Income taxes due to customers	19,709	22,086
Pension overfunding	6,621	5,595
Accrued liabilities not currently deductible and other	<u>64,339</u>	<u>10,100</u>
	<u>114,382</u>	<u>63,225</u>
Net deferred income tax liability	<u>\$298,143</u>	<u>\$289,232</u>

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

	<u>2001</u>	<u>2000</u>	<u>1999</u>
Statutory federal income tax rate	35.0%	35.0%	35.0%
State income taxes, net of federal benefit	4.7	4.3	5.1
Amortization of investment tax credit	(2.6)	(2.6)	(2.8)
Other differences – net	<u>(0.6)</u>	<u>(0.9)</u>	<u>(1.9)</u>
Effective income tax rate	<u>36.5%</u>	<u>35.8%</u>	<u>35.4%</u>

#### Note 9 - Other Income - net

Other income – net consisted of the following at December 31 (in thousands of \$):

	<u>2001</u>	<u>2000</u>	<u>1999</u>
Interest and dividend income	\$ 748	\$3,103	\$ 4,086
Gains on fixed asset disposals	1,217	1,014	2,394
Income taxes and other	<u>965</u>	<u>804</u>	<u>(2,339)</u>
Other income – net	<u>\$2,930</u>	<u>\$4,921</u>	<u>\$ 4,141</u>

## Note 10 - First Mortgage Bonds and Pollution Control Bonds

Long-term debt and the current portion of long-term debt, summarized below (in thousands of \$), consists primarily of first mortgage bonds and pollution control bonds. Interest rates and maturities in the table below are for the amounts outstanding at December 31, 2001.

	<u>Stated Interest Rates</u>	<u>Weighted Average Interest Rate</u>	<u>Maturities</u>	<u>Principal Amounts</u>
Noncurrent portion	Variable - 6.55%	5.40%	2003 - 2030	\$370,704
Current portion (pollution control bonds)	Variable	2.33%	2013 - 2027	246,200

Under the provisions for LG&E'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. The average annualized interest rate for these bonds during 2001 was 4.00%.

LG&E's First Mortgage Bonds, 6% Series of \$42.6 million is scheduled to mature in 2003. There are no other scheduled maturities of Pollution Control Bonds for the five years subsequent to December 31, 2001.

In September 2001, LG&E issued \$10.1 million variable rate tax-exempt environmental facility revenue bonds due September 1, 2027.

In January 2000, LG&E exercised its call option on its \$20 million 7.50% First Mortgage Bonds due July 1, 2002. The bonds were redeemed utilizing proceeds from issuance of commercial paper.

In May 2000, LG&E issued \$25 million variable rate pollution control bonds due May 1, 2027 and exercised its call option on \$25 million, 7.45%, pollution control bonds due June 15, 2015. In August 2000, LG&E issued \$83 million in variable rate pollution control bonds due August 1, 2030 and exercised its call option on its \$83 million, 7 5/8%, pollution control bonds due November 1, 2020.

Annual requirements for the sinking funds of LG&E's First Mortgage Bonds (other than the First Mortgage Bonds issued in connection with certain Pollution Control Bonds) are the amounts necessary to redeem 1% of the highest principal amount of each series of bonds at any time outstanding. Property additions (166 2/3% of principal amounts of bonds otherwise required to be so redeemed) have been applied in lieu of cash.

Substantially all of LG&E's utility plants are pledged as security for its first mortgage bonds. LG&E's indenture, as supplemented, provides that portions of retained earnings will not be available for the payment of dividends on common stock, under certain specified conditions. No portion of retained earnings is presently restricted by this provision as of December 31, 2001.

## Note 11 - Notes Payable

LG&E participates in an intercompany money pool agreement wherein LG&E Energy can make funds available to LG&E at market based rates up to \$200 million. At December 31, 2001, the balance of the money pool loan from LG&E Energy was \$64.2 million at an average rate of 2.37%, and LG&E had outstanding commercial paper of \$30 million at an average rate of 2.54%. The resulting remaining money pool availability at December

31, 2001, was \$105.8 million. LG&E Energy maintains a facility of \$200 million with an affiliate to ensure funding availability for the money pool. There was no outstanding balance under this facility as of December 31, 2001, and availability of \$170 million remains after considering the \$30 million of commercial paper outstanding at LG&E.

At December 31, 2000, the money pool loan balance was \$114.6 million at an average rate of 6.84% and LG&E had no commercial paper outstanding.

#### **Note 12 - Commitments and Contingencies**

**Construction Program.** LG&E had commitments in connection with its construction program aggregating approximately \$22.3 million at December 31, 2001. Construction expenditures for the years 2002 and 2003 are estimated to total approximately \$334 million, although all of this amount is not currently committed. Included in 2002 is \$38 million for the purchase of 29% of two CTs currently under construction by LG&E Capital Corp. at LG&E's Trimble County location. KU will own 71% of the two CTs. LG&E is waiting for approval from the Kentucky Commission for the purchase of the CTs.

**Operating Lease.** LG&E leases office space and accounts for all of its office space leases as operating leases. Total lease expense for 2001, 2000, and 1999, less amounts contributed by the parent company, was \$1.1 million, \$9 million, and \$1.5 million, respectively. The future minimum annual lease payments under this lease agreement for years subsequent to December 31, 2001, are as follows (in thousands of \$):

2002	\$ 3,594
2003	3,507
2004	3,507
2005	<u>1,754</u>
Total	<u>\$12,362</u>

In December 1999, LG&E and KU entered into an 18-year cross-border lease of its two jointly owned combustion turbines recently installed at KU's Brown facility (Units 6 and 7). LG&E's obligation was defeased upon consummation of the cross-border lease. The transaction produced a pre-tax gain of approximately \$1.2 million which was recorded in other income on the income statement in 2000, pursuant to a Kentucky Commission order.

**Environmental.** The Clean Air Act imposed stringent new SO<sub>2</sub> and NO<sub>x</sub> emission limits on electric generating units. LG&E previously had installed scrubbers on all of its generating units. LG&E's strategy for Phase II SO<sub>2</sub> reductions, which commenced January 1, 2000, is to increase scrubber removal efficiency to delay additional capital expenditures and may also include fuel switching or upgrading scrubbers. LG&E met the NO<sub>x</sub> emission requirements of the Act through installation of low-NO<sub>x</sub> burner systems. LG&E's compliance plans are subject to many factors including developments in the emission allowance and fuel markets, future regulatory and legislative initiatives, and advances in clean air control technology. LG&E will continue to monitor these developments to ensure that its environmental obligations are met in the most efficient and cost-effective manner.

In September 1998, the EPA announced its final "NO<sub>x</sub> SIP Call" rule requiring states to impose significant additional reductions in NO<sub>x</sub> emissions by May 2003, in order to mitigate alleged ozone transport impacts on the Northeast region. The Commonwealth of Kentucky is currently in the process of revising its State Implementation Plan or "SIP" to require reductions in NO<sub>x</sub> emissions from coal-fired generating units to the 0.15 lb./Mmbtu level on a system-wide basis. In related proceedings in response to petitions filed by various Northeast states, in December 1999, EPA issued a final rule pursuant to Section 126 of the Clean Air Act

directing similar NOx reductions from a number of specifically targeted generating units including all LG&E units. As a result of appeals to both rules, the compliance date was extended to May 2004. All LG&E generating units are subject to the May 2004 compliance date under these NOx emissions reduction rules.

LG&E is currently implementing a plan for adding significant additional NOx controls to its generating units. Installation of additional NOx controls will proceed on a phased basis, with installation of controls commencing in late 2000 and continuing through the final compliance date. In addition, LG&E will incur additional operating and maintenance costs in operating new NOx controls. LG&E believes its costs in this regard to be comparable to those of similarly situated utilities with like generation assets. LG&E anticipated that such capital and operating costs are the type of costs that are eligible for recovery from customers under its environmental surcharge mechanism and believed that a significant portion of such costs could be recovered. In April 2001, the Kentucky Commission granted recovery of these costs.

LG&E is also monitoring several other air quality issues which may potentially impact coal-fired power plants, including the appeal of the D.C. Circuit's remand of the EPA's revised air quality standards for ozone and particulate matter, measures to implement EPA's regional haze rule, and EPA's December 2000 determination to regulate mercury emissions from power plants. In addition, LG&E is currently working with local regulatory authorities to review the effectiveness of remedial measures aimed at controlling particulate matter emissions from its Mill Creek Station. LG&E previously settled a number of property damage claims from adjacent residents and completed significant remedial measures as part of its ongoing capital construction program. LG&E is in the process of converting the Mill Creek Station to wet stack operation in an effort to resolve all outstanding issues related to particulate matter emissions.

LG&E owns or formerly owned three properties which are the location of past MGP operations. Various contaminants are typically found at such former MGP sites and environmental remediation measures are frequently required. With respect to the sites, LG&E has completed cleanups, obtained regulatory approval of site management plans, or reached agreements for other parties to assume responsibility for cleanup. Based on currently available information, management estimates that it will incur additional costs of \$400,000. Accordingly, an accrual of \$400,000 has been recorded in the accompanying financial statements at December 31, 2001 and 2000.

**Purchased Power.** LG&E has a contract for purchased power during 2002-2006 with OVEC for various MW capacities. The estimated future minimum annual payments under purchased power agreements for the five years ended December 31, 2006, are as follows (in thousands of \$):

2002	\$ 12,805
2003	12,934
2004	13,063
2005	13,193
2006	<u>13,325</u>
Total	<u>\$ 65,320</u>

### **Note 13 - Jointly Owned Electric Utility Plant**

LG&E owns a 75% undivided interest in Trimble County Unit 1 which the Kentucky Commission has allowed to be reflected in customer rates.

Of the remaining 25% of the Unit, IMEA owns a 12.12% undivided interest, and IMPA owns a 12.88% undivided interest. Each company is responsible for its proportionate ownership share of fuel cost, operation

and maintenance expenses, and incremental assets.

The following data represent shares of the jointly owned property:

	Trimble County			
	<u>LG&amp;E</u>	<u>IMPA</u>	<u>IMEA</u>	<u>Total</u>
Ownership interest	75%	12.88%	12.12%	100%
Mw capacity	371.25	63.75	60.00	495.00
LG&E's 75% ownership (in thousands of \$):				
Cost	\$560,381			
Accumulated depreciation	<u>170,875</u>			
Net book value	<u>\$389,506</u>			
Construction work in progress				
(included above)	\$12,842			

LG&E and KU jointly own the following combustion turbines (in thousands of \$):

		<u>LG&amp;E</u>	<u>KU</u>	<u>Total</u>
Paddy's Run 13	Ownership %	53%	47%	100%
	Mw capacity	84	74	158
	Cost	\$33,844	\$29,908	\$63,752
	Depreciation	<u>563</u>	<u>491</u>	<u>1,054</u>
	Net book value	<u>\$33,281</u>	<u>\$29,417</u>	<u>\$62,698</u>
E.W. Brown 5	Ownership %	53%	47%	100%
	Mw capacity	70	63	133
	Cost	\$23,941	\$21,078	\$45,019
	Depreciation	<u>394</u>	<u>342</u>	<u>736</u>
	Net book value	<u>\$23,547</u>	<u>\$20,736</u>	<u>\$44,283</u>
E.W. Brown 6	Ownership %	38%	62%	100%
	Mw capacity	62	102	164
	Cost	\$23,696	\$36,253	\$59,949
	Depreciation	<u>953</u>	<u>2,955</u>	<u>3,908</u>
	Net book value	<u>\$22,743</u>	<u>\$33,298</u>	<u>\$56,041</u>
E.W. Brown 7	Ownership %	38%	62%	100%
	Mw capacity	62	102	164
	Cost	\$23,607	\$44,785	\$68,392
	Depreciation	<u>3,268</u>	<u>3,033</u>	<u>6,301</u>
	Net book value	<u>\$20,339</u>	<u>\$41,752</u>	<u>\$62,091</u>

See also Note 12, Construction Program, for LG&E's planned purchase of two jointly owned CTs in 2002.

## Note 14 - Segments of Business and Related Information

Effective December 31, 1998, LG&E adopted SFAS No. 131, *Disclosure About Segments of an Enterprise and Related Information*. LG&E is a regulated public utility engaged in the generation, transmission, distribution, and sale of electricity and the storage, distribution, and sale of natural gas. Financial data for business segments, follow (in thousands of \$):

	<u>Electric</u>	<u>Gas</u>	<u>Total</u>
2001			
Operating revenues	\$705,925(a)	\$290,775	\$996,700
Depreciation and amortization	85,572	14,784	100,356
Interest income	616	132	748
Interest expense	31,295	6,627	37,922
Operating income taxes	55,527	7,925	63,452
Net income	94,996	11,768	106,764
Total assets	1,985,252	463,102	2,448,354
Construction expenditures	227,107	25,851	252,958
2000			
Operating revenues	\$710,958(b)	\$272,489	\$983,447
Depreciation and amortization	84,761	13,530	98,291
Interest income	2,551	552	3,103
Interest expense	35,604	7,614	43,218
Operating income taxes	57,869	6,556	64,425
Net income	100,395	10,178	110,573
Total assets	1,760,305	465,779	2,226,084
Construction expenditures	109,798	34,418	144,216
1999			
Operating revenues	\$ 790,670(c)	\$177,579	\$ 968,249
Depreciation and amortization	83,619	13,602	97,221
Interest income	3,435	651	4,086
Interest expense	31,558	6,404	37,962
Operating income taxes	56,883	891	57,774
Net income	104,853	1,417	106,270
Total assets	1,775,498	395,954	2,171,452
Construction expenditures	160,844	33,800	194,644

(a) Net of provision for rate refunds of \$.7 million.

(b) Net of provision for rate refunds of \$2.5 million.

(c) Net of provision for rate refunds of \$1.7 million.

## Note 15 - Selected Quarterly Data (Unaudited)

Selected financial data for the four quarters of 2001 and 2000 are shown below. Because of seasonal fluctuations in temperature and other factors, results for quarters may fluctuate throughout the year.

	<u>March</u>	<u>Quarters Ended</u>		<u>December</u>
		<u>June</u>	<u>September</u>	
		(Thousands of \$)		
<u>2001</u>				
Operating revenues	\$313,271	\$228,841	\$231,885	\$222,703
Net operating income (loss)	(43,732)	37,624	49,092	98,789
Net income (loss)	(54,115)	28,467	40,270	92,159
Net income (loss) available for common stock	(55,413)	27,247	39,160	91,048
<u>2000</u>				
Operating revenues	\$249,642	\$209,731	\$229,640	\$294,434
Net operating income	26,592	37,285	48,161	36,832
Net income	17,421	28,009	38,117	27,026
Net income available for common stock	16,256	26,692	36,756	25,659

## Note 16 - Subsequent Events

On April 9, 2001, a German power company, E.ON AG, announced a preconditional cash offer of £5.1 billion (\$7.3 billion) for Powergen. The offer is subject to a number of conditions, including the receipt of certain European and United States regulatory approvals. The Kentucky Public Service Commission, the Federal Energy Regulatory Commission, the Virginia State Corporation Commission, and the Tennessee Regulatory Authority have all approved the acquisition of Powergen and LG&E Energy by E.ON. The parties expect to obtain the remaining regulatory approvals and to complete the transaction in the first half of 2002. See Powergen's schedule 14D-9, and associated schedules to such filings, filed with the SEC on April 9, 2001.

LG&E (along with KU) is a founding member of the MISO, such membership obtained in 1998 in response to and consistent with federal policy initiatives. As a MISO member, LG&E filed for and received authorization from FERC to transfer control of its transmission facilities (100 kV and above) to the MISO, the first step in allowing the latter to assume responsibility for all tariff-related transmission functions (e.g., scheduling through and on LG&E's transmission system) as well as non-tariff related regional transmission activities (e.g., operations planning, maintenance coordination, long-term regional planning and market monitoring). The FERC approved the MISO as the nation's first Regional Transmission Organization on December 19, 2001, after which LG&E submitted a filing at FERC to cancel all services under its Open Access Transmission Tariff except those that will not be provided by the MISO (certain ancillary services). The MISO became operational on February 1, 2002.

In October 2001, the FERC issued an order requiring that the bundled retail load and grandfathered wholesale load of each member transmission owner (including LG&E) be included in the current calculation of MISO's "cost-adder," a charge designed to recover MISO's costs of operation, including start-up capital (debt) costs. LG&E, along with several other transmission owners, opposed the FERC's ruling in this regard, which opposition the FERC rejected in an order on rehearing issued in 2002. As of the end of 2001, negotiations were

continuing between MISO, its transmission owners and other interested industry segments regarding the level of cost responsibility properly borne by bundled and grandfathered load under these FERC rulings. Absent settlement, this issue is expected to go to hearing in 2002.

At the end of 2001, in response to an earlier FERC ruling, MISO and its transmission owning members (including LG&E) filed to increase MISO's rate of return on equity from 10.5% (a stipulated percentage agreed to in 1998) to 13.0%, to compensate MISO's transmission owners for the inherent risks and uncertainties associated with transferring control of their facilities to the MISO. This issue is expected to go to hearing in 2002.

Louisville Gas and Electric Company  
REPORT OF MANAGEMENT

The management of Louisville Gas and Electric Company is responsible for the preparation and integrity of the financial statements and related information included in this Annual Report. These statements have been prepared in accordance with accounting principles generally accepted in the United States applied on a consistent basis and, necessarily, include amounts that reflect the best estimates and judgment of management.

LG&E's current year financial statements have been audited by PricewaterhouseCoopers LLP, independent accountants, and prior years financial statements were audited by Arthur Andersen LLP. Management made available to PricewaterhouseCoopers LLP and Arthur Andersen LLP (in prior years) all LG&E's financial records and related data as well as the minutes of shareholders' and directors' meetings.

Management has established and maintains a system of internal controls that provides reasonable assurance that transactions are completed in accordance with management's authorization, that assets are safeguarded and that financial statements are prepared in conformity with generally accepted accounting principles. Management believes that an adequate system of internal controls is maintained through the selection and training of personnel, appropriate division of responsibility, establishment and communication of policies and procedures and by regular reviews of internal accounting controls by LG&E's internal auditors. Management reviews and modifies its system of internal controls in light of changes in conditions and operations, as well as in response to recommendations from the internal auditors. These recommendations for the year ended December 31, 2001, did not identify any material weaknesses in the design and operation of LG&E's internal control structure.

The Audit Committee of the Board of Directors is composed entirely of outside directors. In carrying out its oversight role for the financial reporting and internal controls of LG&E, the Audit Committee meets regularly with LG&E's independent public accountants, internal auditors and management. The Audit Committee reviews the results of the independent accountants' audit of the financial statements and their audit procedures, and discusses the adequacy of internal accounting controls. The Audit Committee also approves the annual internal auditing program and reviews the activities and results of the internal auditing function. Both the independent public accountants and the internal auditors have access to the Audit Committee at any time.

Louisville Gas and Electric Company maintains and internally communicates a written code of business conduct that addresses, among other items, potential conflicts of interest, compliance with laws, including those relating to financial disclosure, and the confidentiality of proprietary information.

S. Bradford Rives  
Senior Vice President-Finance and Controller

Louisville Gas and Electric Company  
Louisville, Kentucky

Louisville Gas and Electric Company and Subsidiary  
REPORT OF INDEPENDENT ACCOUNTANTS

To the Shareholders of Louisville Gas and Electric Company and Subsidiary:

In our opinion, the accompanying consolidated balance sheet as of December 31, 2001 and the related consolidated statements of capitalization, income, retained earnings, cash flows and comprehensive income present fairly, in all material respects, the financial position of Louisville Gas and Electric Company and Subsidiary (the "Company"), a wholly-owned subsidiary of LG&E Energy Corp., at December 31, 2001, and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

/s/ PricewaterhouseCoopers LLP  
January 25, 2002  
Louisville, Kentucky

Louisville Gas and Electric Company  
REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Shareholders of Louisville Gas and Electric Company:

We have audited the accompanying balance sheet and statement of capitalization of Louisville Gas and Electric Company (a Kentucky corporation and a wholly-owned subsidiary of LG&E Energy Corp.) as of December 31, 2000, and the related statements of income, retained earnings, cash flows and comprehensive income for each of the two years in the period ended December 31, 2000. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Louisville Gas and Electric Company as of December 31, 2000, and the results of its operations and its cash flows for each of the two years in the period ended December 31, 2000, in conformity with accounting principles generally accepted in the United States.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The schedule listed under Item 14(a)2 is presented for purposes of complying with the Securities and Exchange Commission's rules and is not part of the basic financial statements. This schedule has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, fairly states in all material respects the financial data required to be set forth therein in relation to the basic financial statements taken as a whole.

Louisville, Kentucky  
January 26, 2001

Arthur Andersen LLP

## INDEX OF ABBREVIATIONS

Capital Corp.	LG&E Capital Corp.
Clean Air Act	The Clean Air Act, as amended in 1990
CCN	Certificate of Public Convenience and Necessity
CT	Combustion Turbines
DSM	Demand Side Management
ECR	Environmental Cost Recovery
EEl	Electric Energy, Inc.
EITF	Emerging Issues Task Force Issue
EPA	U.S. Environmental Protection Agency
ESM	Earnings Sharing Mechanism
FAC	Fuel Adjustment Clause
FERC	Federal Energy Regulatory Commission
FPA	Federal Power Act
FT and FT-A	Firm Transportation
GSC	Gas Supply Clause
Holding Company Act	Public Utility Holding Company Act of 1935
IBEW	International Brotherhood of Electrical Workers
IMEA	Illinois Municipal Electric Agency
IMPA	Indiana Municipal Power Agency
Kentucky Commission	Kentucky Public Service Commission
KIUC	Kentucky Industrial Utility Consumers, Inc.
KU	Kentucky Utilities Company
KU Energy	KU Energy Corporation
KU R	KU Receivables LLC
Kva	Kilovolt-ampere
LEM	LG&E Energy Marketing Inc.
LG&E	Louisville Gas and Electric Company
LG&E Energy	LG&E Energy Corp.
LG&E R	LG&E Receivables LLC
LG&E Services	LG&E Energy Services Inc.
Mcf	Thousand Cubic Feet
Merger Agreement	Agreement and Plan of Merger dated May 20, 1997
MGP	Manufactured Gas Plant
MISO	Midwest Independent System Operator
Mmbtu	Million British thermal units
Moody's	Moody's Investor Services, Inc.
Mw	Megawatts
Mwh	Megawatt hours
NNS	No-Notice Service
NOx	Nitrogen Oxide
OMU	Owensboro Municipal Utilities
OVEC	Ohio Valley Electric Corporation
PBR	Performance-Based Ratemaking
Powergen	Powergen plc
PUHCA	Public Utility Holding Company Act of 1935
S&P	Standard & Poor's Rating Services
SCR	Selective Catalytic Reduction
SEC	Securities And Exchange Commission
SERP	Supplemental Employee Retirement Plan
SFAS	Statement of Financial Accounting Standards
SIP	State Implementation Plan
SO <sub>2</sub>	Sulfur Dioxide
Tennessee Gas	Tennessee Gas Pipeline Company
Texas Gas	Texas Gas Transmission Corporation
TRA	Tennessee Regulatory Authority

**Trimble County  
USWA  
Utility Operations  
VDT  
Virginia Commission  
Virginia Staff**

**LG&E's Trimble County Unit 1  
United Steelworkers of America  
Operations of LG&E and KU  
Value Delivery Team Process  
Virginia State Corporation Commission  
Virginia Commission Staff**

**Kentucky Utilities Company and Subsidiary**  
**Consolidated Statements of Income**  
(Thousands of \$)

	Years Ended December 31		
	<u>2001</u>	<u>2000</u>	<u>1999</u>
<b>OPERATING REVENUES:</b>			
Electric (Note 1) .....	\$860,426	\$851,941	\$943,210
Provision for rate refunds (Note 3) .....	(954)	-	(5,900)
Total operating revenues .....	<u>859,472</u>	<u>851,941</u>	<u>937,310</u>
<b>OPERATING EXPENSES:</b>			
Fuel for electric generation .....	236,985	219,923	219,883
Power purchased .....	157,161	166,918	242,315
Other operation expenses .....	118,359	108,072	116,521
Non-recurring charge (Note 3) .....	6,867	-	-
Maintenance .....	57,021	61,643	57,318
Depreciation and amortization (Note 1) .....	90,299	98,256	89,922
Federal and state income taxes (Note 7) .....	57,482	51,963	60,380
Property and other taxes .....	13,928	17,030	14,955
Total operating expenses .....	<u>738,102</u>	<u>723,805</u>	<u>801,294</u>
Net operating income .....	121,370	128,136	136,016
Other income – net (Note 8) .....	8,932	6,843	9,437
Interest charges .....	<u>34,024</u>	<u>39,455</u>	<u>38,895</u>
Net income before cumulative effect of a change in accounting principle ..	96,278	95,524	106,558
Cumulative effect of a change in accounting principle-accounting for Derivative instruments and hedging activities, net of tax (Note 1) .....	<u>136</u>	-	-
Net income .....	96,414	95,524	106,558
Preferred stock dividends .....	<u>2,256</u>	<u>2,256</u>	<u>2,256</u>
Net income available for common stockholders .....	<u>\$ 94,158</u>	<u>\$ 93,268</u>	<u>\$ 104,302</u>

**Consolidated Statements of Retained Earnings**  
(Thousands of \$)

	Years Ended December 31		
	<u>2001</u>	<u>2000</u>	<u>1999</u>
Balance January 1 .....	\$347,238	\$329,470	\$299,167
Add net income .....	96,414	95,524	106,558
	<u>443,652</u>	<u>424,994</u>	<u>405,725</u>
Deduct: Cash dividends declared on stock:			
4.75% cumulative preferred .....	950	950	950
6.53% cumulative preferred .....	1,306	1,306	1,306
Common .....	30,500	75,500	73,999
	<u>32,756</u>	<u>77,756</u>	<u>76,255</u>
Balance December 31 .....	<u>\$410,896</u>	<u>\$347,238</u>	<u>\$329,470</u>

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

**Kentucky Utilities Company and Subsidiary**  
**Consolidated Statements of Comprehensive Income**  
**(Thousands of \$)**

	Years Ended December 31		
	2001	2000	1999
Net income .....	\$ 96,414	\$ 95,524	\$106,558
Cumulative effect of change in accounting principle – Accounting for derivative instruments and hedging activities (Note 1).....	2,647	-	-
Income tax expense related to items of other comprehensive income .....	<u>(1,059)</u>	<u>-</u>	<u>-</u>
Comprehensive income .....	<u>\$ 98,002</u>	<u>\$ 95,524</u>	<u>\$106,558</u>

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

**Kentucky Utilities Company and Subsidiary**  
**Consolidated Balance Sheets**  
(Thousands of \$)

	December 31	
	<u>2001</u>	<u>2000</u>
<b>ASSETS:</b>		
Utility plant, at original cost (Note 1) .....	\$2,960,818	\$2,826,383
Less: reserve for depreciation .....	1,457,754	1,378,283
	<u>1,503,064</u>	<u>1,448,100</u>
Construction work in progress .....	103,402	106,380
	<u>1,606,466</u>	<u>1,554,480</u>
Other property and investments - less reserve .....	9,629	14,538
<b>Current assets:</b>		
Cash and temporary cash investments .....	3,295	314
Accounts receivable-less reserve of \$800 in 2001 and 2000 .....	45,291	90,419
Materials and supplies - at average cost:		
Fuel (predominantly coal) .....	43,382	12,495
Other .....	26,188	25,812
Prepayments and other .....	4,942	1,899
	<u>123,098</u>	<u>130,939</u>
<b>Deferred debits and other assets:</b>		
Unamortized debt expense (Note 1) .....	4,316	4,651
Regulatory assets (Note 3) .....	66,467	26,441
Other .....	16,926	8,469
	<u>87,709</u>	<u>39,561</u>
	<u>\$ 1,826,902</u>	<u>\$1,739,518</u>
<b>CAPITAL AND LIABILITIES:</b>		
<b>Capitalization (see statements of capitalization):</b>		
Common equity .....	\$ 735,029	\$ 669,783
Cumulative preferred stock .....	40,000	40,000
Long-term debt (Note 9) .....	434,506	430,830
	<u>1,209,535</u>	<u>1,140,613</u>
<b>Current liabilities:</b>		
Current portion of long-term debt (Note 9) .....	54,000	54,000
Notes payable to parent (Note 10) .....	47,790	61,239
Accounts payable .....	85,149	76,339
Accrued taxes .....	20,520	19,622
Accrued interest .....	5,668	6,373
Other .....	16,482	18,767
	<u>229,609</u>	<u>236,340</u>
<b>Deferred credits and other liabilities:</b>		
Accumulated deferred income taxes (Notes 1 and 7) .....	239,204	246,680
Investment tax credit, in process of amortization .....	11,455	14,901
Accumulated provision for pensions and related benefits (Note 6) .....	91,235	47,495
Customers' advances for construction .....	1,526	1,540
Regulatory liabilities (Note 3) .....	33,889	38,392
Other .....	10,449	13,557
	<u>387,758</u>	<u>362,565</u>
Commitments and contingencies (Note 11)	<u>\$1,826,902</u>	<u>\$1,739,518</u>

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

**Kentucky Utilities Company and Subsidiary**  
**Consolidated Statements of Cash Flows**  
(Thousands of \$)

	Years Ended December 31		
	<u>2001</u>	<u>2000</u>	<u>1999</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net income .....	\$ 96,414	\$ 95,524	\$ 106,558
Items not requiring cash currently:			
Depreciation and amortization .....	90,299	98,256	89,922
Deferred income taxes - net .....	(12,088)	(2,449)	(3,763)
Investment tax credit - net .....	(3,446)	(3,674)	(3,727)
Other .....	11,776	(8,136)	(8,010)
Change in certain net current assets and liabilities:			
Accounts receivable .....	28	(1,870)	17,576
Materials and supplies .....	(31,263)	18,131	(8,263)
Accounts payable .....	8,810	(40,207)	6,514
Provision for rate refunds .....	-	(20,567)	(933)
Accrued taxes .....	898	9,120	(6,231)
Accrued interest .....	(705)	(956)	(781)
Prepayments and other .....	(5,328)	1,806	(3,042)
Sale of accounts receivable (Note 1) .....	45,100	-	-
Other .....	(12,364)	31,272	18,356
Net cash flows from operating activities .....	<u>188,131</u>	<u>176,250</u>	<u>204,176</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Proceeds from sales of securities .....	3,480	-	-
Construction expenditures .....	(142,425)	(100,328)	(181,135)
Net cash flows used for investing activities .....	<u>(138,945)</u>	<u>(100,328)</u>	<u>(181,135)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Short-term borrowings and repayments .....	(13,449)	61,239	-
Retirement of long-term debt .....	-	(74,784)	-
Issuance of long-term debt .....	-	12,900	-
Additional paid-in capital .....	-	15,000	-
Payment of dividends .....	(32,756)	(96,756)	(75,197)
Net cash flows used for financing activities .....	<u>(46,205)</u>	<u>(82,401)</u>	<u>(75,197)</u>
Change in cash and temporary cash investments .....	2,981	(6,479)	(52,156)
Cash and temporary cash investments at beginning of year .....	314	6,793	58,949
Cash and temporary cash investments at end of year .....	<u>\$ 3,295</u>	<u>\$ 314</u>	<u>\$ 6,793</u>
<b>Supplemental disclosures of cash flow information:</b>			
Cash paid during the year for:			
Income taxes .....	\$ 72,432	\$ 49,871	\$ 71,258
Interest on borrowed money .....	39,829	35,196	35,508

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

**Kentucky Utilities Company and Subsidiary**  
**Consolidated Statements of Capitalization**  
(Thousands of \$)

	<u>2001</u>	December 31	<u>2000</u>
<b>COMMON EQUITY:</b>			
Common stock, without par value - outstanding 37,817,878 shares .....	\$ 308,140		\$ 308,140
Additional paid-in-capital .....	15,000		15,000
Retained earnings .....	410,896		347,238
Accumulated other comprehensive income .....	1,588		-
Other .....	<u>(595)</u>		<u>(595)</u>
	<u>735,029</u>		<u>669,783</u>
<b>CUMULATIVE PREFERRED STOCK:</b>			
	<u>Shares</u>	<u>Current</u>	
	<u>Outstanding</u>	<u>Redemption Price</u>	
Without par value, 5,300,000 shares authorized -			
4.75% series, \$100 stated value Redeemable on 30 days notice by KU .....	200,000	\$101.00	20,000
6.53% series, \$100 stated value .....	200,000	Not redeemable	20,000
			<u>40,000</u>
			<u>40,000</u>
<b>LONG-TERM DEBT -- first mortgage bonds (Note 9):</b>			
Q due June 15, 2003, 6.32% .....		62,000	62,000
S due January 15, 2006, 5.99% .....		36,000	36,000
P due May 15, 2007, 7.92% .....		53,000	53,000
R due June 1, 2025, 7.55% .....		50,000	50,000
P due May 15, 2027, 8.55% .....		33,000	33,000
Pollution control series:			
1B due February 1, 2018, 6.25% .....		20,930	20,930
2B due February 1, 2018, 6.25% .....		2,400	2,400
3B due February 1, 2018, 6.25% .....		7,200	7,200
4B due February 1, 2018, 6.25% .....		7,400	7,400
8, due September 15, 2016, 7.45% .....		96,000	96,000
9, due December 1, 2023, 5.75% .....		50,000	50,000
10, due November 1, 2024, variable .....		54,000	54,000
A, due May 1, 2023, variable .....		12,900	12,900
Long-term debt marked to market (Note 4) .....		<u>3,676</u>	<u>-</u>
Total bonds outstanding .....		488,506	484,830
Less current portion of long-term debt .....		<u>54,000</u>	<u>54,000</u>
Long-term debt .....		<u>434,506</u>	<u>430,830</u>
Total capitalization .....		<u>\$1,209,535</u>	<u>\$1,140,613</u>

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

Kentucky Utilities Company and Subsidiary  
Notes to Consolidated Financial Statements

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

KU, a subsidiary of LG&E Energy and an indirect subsidiary of Powergen, is a regulated public utility engaged in the generation, transmission, distribution, and sale of electric energy. LG&E Energy is an exempt public utility holding company with wholly owned subsidiaries including LG&E, KU, Capital Corp., LEM, and LG&E Services. All of the KU's Common Stock is held by LG&E Energy. KU has one wholly owned consolidated subsidiary, KU Receivables.

On December 11, 2000, LG&E Energy Corp. was acquired by Powergen plc. Powergen is a registered public utility holding company under PUHCA. No costs associated with the Powergen acquisition nor any of the effects of purchase accounting have been reflected in the financial statements of KU.

Certain reclassification entries have been made to the previous year financial statements to conform to the 2001 presentation with no impact on the balance sheet totals or previously reported income.

**Cash and Temporary Cash Investments.** KU considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents. Temporary cash investments are carried at cost, which approximates fair value.

**Utility Plant.** KU's 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. KU has not recorded any 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, plus removal expense less salvage value, 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. Pursuant to a final order of the Kentucky Commission dated December 3, 2001, KU implemented new depreciation rates effective January 1, 2001. The amounts provided for KU approximated 3.1% in 2001, 3.5% in 2000 and 1999.

**Financial Instruments.** KU uses over-the-counter interest-rate swap agreements to hedge its exposure to interest rates. Gains and losses on interest-rate swaps used to hedge interest rate risk are reflected in interest charges monthly. See Note 4 - Financial Instruments.

**Debt Expense.** Debt expense is capitalized in deferred debits and amortized over the lives of the related bond issues, consistent with regulatory practices.

**Deferred Income Taxes.** Deferred income taxes have been provided for all material book-tax temporary differences.

**Investment Tax Credits.** Investment tax credits resulted from provisions of the tax law that permitted a reduction of KU's tax liability based on credits for certain 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. The unbilled revenue estimates included in accounts receivable for KU equaled approximately \$33.4 million and \$34.8 million at December 31, 2001, and 2000, respectively.

KU recorded electric revenues that resulted from sales to a related party, LG&E, of \$31.1 million, \$22.1 million and 22.4 million for years ended December 31, 2001, 2000 and 1999, respectively.

**Fuel Costs.** The cost of fuel for electric generation is charged to expense as used.

**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. Actual results could differ from those estimates. See Note 11, Commitments and Contingencies, for a further discussion.

**Accounts Receivable Securitization.** SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, revises the standards for accounting for securitizations and other transfers of financial assets and collateral and requires certain disclosures, and provides accounting and reporting standards for transfers and servicing of financial assets and extinguishments of liabilities. SFAS No. 140 was adopted in the first quarter of 2001, when KU entered into an accounts receivable securitization transaction.

On February 6, 2001, KU implemented an accounts receivable securitization program. The purpose of this program is to enable KU to accelerate the receipt of cash from the collection of retail accounts receivable, thereby reducing dependence upon more costly sources of working capital. The securitization program allows for a percentage of eligible receivables to be sold. Eligible receivables are generally all receivables associated with retail sales that have standard terms and are not past due. KU is able to terminate this program at any time without penalty. If there is a significant deterioration in the payment record of the receivables by the retail customers or if KU fails to meet certain covenants regarding the program, the program may terminate at the election of the financial institutions. In this case, payments from retail customers would first be used to repay the financial institutions participating in the program, and would then be available for use by KU.

As part of the program, KU sold retail accounts receivables to a wholly owned subsidiary KU R. Simultaneously, KU R entered into two separate three-year accounts receivable securitization facilities with two financial institutions and their affiliates whereby KU R can sell, on a revolving basis, an undivided interest in certain of their receivables and receive up to \$50 million from an unrelated third party purchaser. The effective cost of the receivables programs is comparable to KU's lowest cost source of capital, and is based on prime rated commercial paper. KU retains servicing rights of the sold receivables through two separate servicing agreements with the third party purchaser. KU has obtained an opinion from independent legal counsel indicating these transactions qualify as a true sale of receivables. As of December 31, 2001, the outstanding program balance was \$45.1 million.

Management expects to renew these facilities when they expire.

The allowance for doubtful accounts associated with the eligible securitized receivables was \$520,000 at December 31, 2001. This allowance is based on historical experience of KU. Each securitization facility contains a fully funded reserve for uncollectible receivables.

**New Accounting Pronouncements.** During 2001 and 2000, the following accounting pronouncements were issued that affect KU:

SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities*, establishes accounting and reporting standards requiring that every derivative instrument (including certain derivative instruments embedded in other contracts) be recorded on the balance sheet as either an asset or a liability measured at its fair value. SFAS No. 133 requires that changes in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. Special accounting for qualifying hedges allows a derivative's gains and losses to offset related results on the hedged item in the income statement, and requires that KU must formally document, designate, and assess the effectiveness of transactions that receive hedge accounting. SFAS No. 133 could increase the volatility in earnings and other comprehensive income. SFAS No. 137, *Accounting for Derivative Instruments and Hedging Activities -- Deferral of the Effective Date of SFAS No. 133*, deferred the effective date of SFAS No. 133 until January 1, 2001. KU adopted SFAS No. 133 and SFAS No. 138 on January 1, 2001. The effect of adopting these statements resulted in a \$1.6 million increase in other comprehensive income from a cumulative effect of change in accounting principle (net of tax of \$1.1 million).

The Financial Accounting Standards Board created the Derivatives Implementation Group (DIG) to provide guidance for implementation of SFAS No. 133. DIG Issue C15, *Normal Purchases and Normal Sales Exception for Option Type Contracts and Forward Contracts in Electricity* was adopted in 2001 and had no impact on results of operations and financial position. DIG Issue C16, *Applying the Normal Purchases and Normal Sales Exception to Contracts that Combine a Forward Contract and a Purchased Option Contract*, was cleared in 2001 and stated that option contracts do not meet the normal purchases and normal sales exception and should follow SFAS No. 133. DIG C16 will be effective in the second quarter of 2002. Management has not determined the impact this issue will have on its results of operations and financial position.

SFAS No. 141, *Business Combinations* and SFAS No. 142, *Goodwill and Other Intangible Assets* were issued in 2001. SFAS No. 141 requires all business combinations initiated after June 30, 2001, to be accounted for using the purchase method. SFAS No. 142 requires goodwill to be recorded, but not amortized. Further, goodwill will now be subject to a periodic assessment for impairment. The provisions of these new pronouncements were effective July 1, 2001, for KU. The adoption of these standards did not have a material impact on the results of operations or financial position of KU.

SFAS No. 143, *Accounting for Asset Retirement Obligations* and SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, was issued in 2001. SFAS No. 143 establishes accounting and reporting standards for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. SFAS No. 144 supersedes SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of* and the accounting and reporting provisions of APB Opinion No. 30, *Reporting the Results of Operations -- Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*. SFAS No. 144, among other provisions, eliminates the requirement of SFAS No. 121 to allocate goodwill to long-lived assets to be tested for impairment. The effective implementation date for SFAS No. 144 is 2002 and SFAS No. 143 is 2003. Based on current regulatory practices, management does not expect SFAS No. 143 or SFAS No. 144 to have a material impact on KU's financial position or results of operations.

## **Note 2 – Mergers and Acquisitions**

On December 11, 2000, LG&E Energy Corp. was acquired by Powergen plc. for cash of approximately \$3.2 billion or \$24.85 per share and the assumption of all of LG&E Energy's debt. As a result of the acquisition, LG&E Energy became a wholly owned subsidiary of Powergen and, as a result, KU became an indirect

subsidiary of Powergen. KU has continued its separate identity and serves customers in Kentucky and Virginia under its existing name. The preferred stock and debt securities of KU were not affected by this transaction resulting in the utility operations' obligation to continue to file SEC reports. Following the acquisition, Powergen became a registered holding company under PUHCA and KU, as a subsidiary of a registered holding company, became subject to additional regulations under PUHCA.

LG&E Energy and KU Energy merged on May 4, 1998, with LG&E Energy as the surviving corporation. As a result of the merger, LG&E Energy, which is the parent of LG&E, became the parent company of KU. The operating utility subsidiaries (LG&E and KU) have continued to maintain their separate corporate identities and serve customers in Kentucky and Virginia under their present names. LG&E Energy estimated non-fuel savings over a ten-year period following the merger. Costs to achieve these savings for KU of \$42.3 million were recorded in the second quarter of 1998, \$20.5 million of which were initially deferred and are being amortized over a five-year period pursuant to regulatory orders. Primary components of the merger costs were separation benefits, relocation costs, and transaction fees, the majority of which were paid by December 31, 1998. KU expensed the remaining costs associated with the merger (\$21.8 million) at the time of the merger in the second quarter of 1998. In regulatory filings associated with approval of the merger, KU committed not to seek increases in existing base rates and proposed reductions in their retail customers' bills in amounts based on one-half of the savings, net of the deferred and amortized amount, over a five-year period. The preferred stock and debt securities of KU were not affected by the merger.

Management has accounted for the KU/LG&E merger as a pooling of interests and as a tax-free reorganization under the Internal Revenue Code.

As part of its merger order, the Kentucky Commission approved a surcredit whereby 50% of the net non-fuel cost savings estimated to be achieved from the merger, less \$38.6 million or 50% of the originally estimated costs to achieve such savings, be applied to reduce customer rates through a surcredit on customers' bills and the remaining 50% be retained by the companies. The surcredit is allocated 53% to KU and 47% to LG&E pursuant to Kentucky Commission order. The surcredit will be about 2% of customer bills through mid 2003 and will amount to approximately \$63 million in net non-fuel savings to KU. Any fuel cost savings are passed to Kentucky customers through the companies' fuel adjustment clauses. See Note 3 for more information about KU's rates and regulatory matters.

### Note 3 - Utility Rates and Regulatory Matters

Accounting for the regulated utility business conforms with generally accepted accounting principles as applied to regulated public utilities and as prescribed by FERC, the Kentucky Commission and the Virginia Commission. KU is subject to SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*, under which certain costs that would otherwise be charged to expense are deferred as regulatory assets based on expected recovery from customers in future rates. Likewise, certain credits that would otherwise be reflected as income are deferred as regulatory liabilities based on expected return to customers in future rates. KU's current or expected recovery of deferred costs and expected return of deferred credits is generally based on specific ratemaking decisions or precedent for each item. The following regulatory assets and liabilities were included in KU's balance sheets as of December 31 (in thousands of \$):

	<u>2001</u>	<u>2000</u>
VDT costs	\$ 48,811	\$ -
Unamortized loss on bonds	6,142	7,011
LG&E/KU merger costs	6,139	10,232
One utility costs	4,365	8,273
Other	1,010	925
Total regulatory assets	<u>66,467</u>	<u>26,441</u>
Deferred income taxes - net	(32,872)	(37,484)
Other	(1,017)	(908)
Total regulatory liabilities	<u>(33,889)</u>	<u>(38,392)</u>
Regulatory assets/(liabilities) - net	<u>\$ 32,578</u>	<u>\$(11,951)</u>

**Kentucky Commission Settlement Order - Value Delivery Costs.** During the first quarter 2001, KU recorded a \$64 million charge for a workforce reduction program. Primary components of the charge were separation benefits, enhanced early retirement benefits, and health care benefits. The result of this workforce reduction was the elimination of over 300 positions, accomplished primarily through a voluntary enhanced severance program.

On June 1, 2001, KU filed an application (VDT case) with the Kentucky Commission to create a regulatory asset relating to these first quarter 2001 charges. The application requested permission to amortize these costs over a four-year period. The Kentucky Commission also opened a case to review the new depreciation study and resulting depreciation rates implemented in 2001.

KU reached a settlement in the VDT case as well as the other cases involving depreciation rates and ESM with all intervening parties. The settlement agreement was approved by the Kentucky Commission on December 3, 2001.

The Kentucky Commission December 3, 2001, order allowed KU to set up a regulatory asset of \$54 million for the workforce reduction costs and begin amortizing these costs over a five year period starting in April 2001. The first quarter charge of \$64 million represented all employees who had accepted a voluntary enhanced severance program. Some employees rescinded their participation in the voluntary enhanced severance program and, along with the non-recurring charge of \$6.9 million for FERC and Virginia jurisdictions, thereby decreasing the original charge from \$64 million to \$54 million. The settlement will also reduce revenues approximately \$11 million through a surcredit on future bills to customers over the same five year period. The surcredit represents net savings stipulated by KU. The agreement also established KU's new depreciation rates in effect December 2001, retroactive to January 1, 2001. The new depreciation rates decreased depreciation

expense by \$6.0 million in 2001.

**PUHCA.** Following the purchase of LG&E Energy by Powergen, Powergen became a registered holding company under PUHCA. As a result, Powergen, its utility subsidiaries, including KU, and certain of its non-utility subsidiaries are subject to extensive regulation by the SEC under PUHCA with respect to issuances and sales of securities, acquisitions and sales of certain utility properties, and intra-system sales of certain goods and services. In addition, PUHCA generally limits the ability of registered holding companies to acquire additional public utility systems and to acquire and retain businesses unrelated to the utility operations of the holding company. Powergen believes that it has adequate authority (including financing authority) under existing SEC orders and regulations for it and its subsidiaries to conduct their businesses and will seek additional authorization when necessary.

**Environmental Cost Recovery.** In June 2000, the Kentucky Commission approved KU's application for a CCN to construct up to four SCR NOx reduction facilities. The construction and subsequent operation of the SCRs is intended to reduce NOx emission levels to meet the EPA's mandated NOx emission level of 0.15 lbs./Mmbtu by May 2004. In its order, the Kentucky Commission ruled that KU's proposed plan for construction was "reasonable, cost-effective and will not result in the wasteful duplication of facilities." In October 2000, KU filed an application with the Kentucky Commission to amend its Environmental Compliance Plan to reflect the addition of the proposed NOx reduction technology projects and to amend its Environmental Cost Recovery Tariff to include an overall rate of return on capital investments. Following the completion of hearings in March 2001, a ruling was issued in April 2001 granting KU's application. Such approval has allowed KU to begin to recover the costs associated with these new projects, subject to Kentucky Commission oversight during normal six-month and two-year reviews.

**ESM.** KU's electric rates are subject to an ESM. The ESM, in place for three years beginning in 2000, sets an upper and lower point for rate of return on equity, whereby if KU's rate of return for the calendar year falls within the range of 10.5% to 12.5%, no action is necessary. If earnings are above the upper limit, then excess earnings are shared 40% with ratepayers and 60% with shareholders; if earnings are below the lower limit, then earnings deficiency is recovered 40% from ratepayers and 60% from shareholders. The first ESM filing was made on March 1, 2001, for year ended December 31, 2000. By order of the Kentucky Commission, rate changes prompted by the ESM filing go into effect in April of each year. KU estimated that the rate of return will fall within the deadband range, subject to Kentucky Commission approval, for the year ended December 31, 2001; therefore, no adjustment to the financial statements was made.

**DSM.** In May 2001, the Kentucky Commission approved a plan that would expand LG&E's current DSM programs into the service territory served by KU. The filing includes a rate mechanism that provides for concurrent recovery of DSM costs, provides an incentive for implementing DSM programs, and recovers revenues from lost sales associated with the DSM program.

**FAC.** Prior to implementation of the PBR in July 1999, and following its termination in March 2000, KU employed an FAC mechanism, which under Kentucky law allowed the utilities to recover from customers the actual fuel costs associated with retail electric sales.

In July 1999, the Kentucky Commission issued a series of orders requiring KU to refund approximately \$10.1 million resulting from reviews of the FAC from November 1994 to October 1998. The orders changed KU's method of computing fuel costs associated with electric line losses on off-system sales appropriate for recovery through the FAC, and KU's method for computing system line losses for the purpose of calculating the system sales component of the FAC charge. At KU's request, in July 1999, the Kentucky Commission stayed the refund requirement pending the Kentucky Commission's final determination of any rehearing request that KU may file. In August 1999, KU filed its request for rehearing of the July orders.

In August 1999, the Kentucky Commission issued a final order in the KU proceedings, agreeing, in part, with KU's arguments outlined in its petition for rehearing. While the Kentucky Commission confirmed that KU should change its method of computing the fuel costs associated with electric line losses, it agreed with KU that the line loss percentage should be based on KU's actual line losses incurred in making wholesale sales rather than the percentage used in its Open Access Transmission Tariff. The Kentucky Commission also upheld its previous ruling concerning the computation of system line losses in the calculation of the FAC. The net effect of the Kentucky Commission's final order was to reduce the refund obligation to \$ 6.7 million (\$5.8 million on Kentucky jurisdictional basis) from the original order amount of \$10.1 million. In August 1999, KU recorded its estimated share of anticipated FAC refunds. KU began implementing the refund in October and completed the refund in September 2000. Both KU and the KIUC appealed the order to the Franklin Circuit Court. In October 2000, the Court affirmed the Kentucky Commission's orders concerning all issues except interest, with respect to which it held that KU will be required to pay interest on the amount disallowed "if the Commission within its discretion so determines", and ordered the case be remanded to the Kentucky Commission on that issue. In November 2000, KU appealed the Circuit Court's decision to the Kentucky Court of Appeals. Pending a decision on this appeal, a comprehensive settlement was reached by all parties, which settlement was filed with the Kentucky Commission on December 21, 2001. Thereunder, KU agreed to credit its fuel clause in the amount of \$954,000 (such credit provided over the course of two monthly billing periods), and the parties agreed on a prospective interpretation of the state's fuel adjustment clause regulation to ensure consistent and mutually acceptable application on a going-forward basis. All pending FAC proceedings before the court were resolved by the parties to the agreement and all parties requested the Court of Appeals remand the case to the Kentucky Commission. The Kentucky Commission is expected to approve the settlement in 2002.

**Kentucky Commission Administrative Case for Affiliate Transactions.** In December 1997, the Kentucky Commission opened Administrative Case No. 369 to consider Kentucky Commission policy regarding cost allocations, affiliate transactions and codes of conduct governing the relationship between utilities and their non-utility operations and affiliates. The Kentucky Commission intended to address two major areas in the proceedings: the tools and conditions needed to prevent cost shifting and cross-subsidization between regulated and non-utility operations; and whether a code of conduct should be established to assure that non-utility segments of the holding company are not engaged in practices that could result in unfair competition caused by cost shifting from the non-utility affiliate to the utility. During the period September 1998 to February 2000, the Kentucky Commission issued draft codes of conduct and cost allocation guidelines. In early 2000, the Kentucky General Assembly enacted legislation, House Bill 897, which authorized the Kentucky Commission to require utilities that provide nonregulated activities to keep separate accounts and allocate costs in accordance with procedures established by the Kentucky Commission. In the same Bill, the General Assembly set forth provisions to govern a utilities activities related to the sharing of information, databases, and resources between its employees or an affiliate involved in the marketing or the provision of nonregulated activities and its employees or an affiliate involved in the provision of regulated services. The legislation became law in July 2000 and KU has been operating pursuant thereto since that time. On February 14, 2001, the Kentucky Commission published notice of their intent to promulgate new administrative regulations under the auspices of this new law. This effort is still on-going.

#### Note 4 - Financial Instruments

The cost and estimated fair values of the KU's non-trading financial instruments as of December 31, 2001, and 2000 follow (in thousands of \$):

	<u>2001</u>		<u>2000</u>	
	<u>Cost</u>	<u>Fair Value</u>	<u>Cost</u>	<u>Fair Value</u>
Long-term debt (including current portion)	\$484,830	\$499,618	\$484,830	\$491,277
Interest-rate swaps	-	6,906	-	3,559

All of the above valuations reflect prices quoted by exchanges except for the swaps. The fair values of the swaps reflect price quotes from dealers or amounts calculated using accepted pricing models.

**Interest Rate Swaps.** KU uses interest rate swaps to hedge exposure to market fluctuations in certain of its debt instruments. Pursuant to policy, use of these financial instruments is intended to mitigate risk and earnings volatility and is not speculative in nature. Management has designated all of the interest rate swaps as hedge instruments. Financial instruments designated as fair value hedges are periodically marked to market with the resulting gains and losses recorded directly into net income to correspond with income or expense recognized from changes in market value of the items being hedged.

As of December 31, 2001 and 2000, KU was party to various interest rate swap agreements with aggregate notional amounts of \$153 million in each year. Under these swap agreements, KU paid variable rates based on either LIBOR or the Bond Market Association's municipal swap index averaging 2.54% and 6.69%, and received fixed rates averaging 7.13% and 7.13% at December 31, 2001 and 2000, respectively. The swap agreements in effect at December 31, 2001 have been designated as fair value hedges and mature on dates ranging from 2007 to 2025. For 2001, the effective of marking these financial instruments and the underlying debt to market resulted in immaterial pretax gains recorded in interest expense.

Interest rate swaps hedge interest rate risk on the underlying debt under SFAS 133, in addition to swaps being marked to market, the item being hedged must also be marked to market, consequently at December 31, 2001, KU's debt reflects a \$3.6 million mark to market adjustment.

**Energy Trading.** KU conducts energy trading and risk management activities to maximize the value of power sales from physical assets it owns, in addition to the wholesale sale of excess asset capacity. Certain energy trading activities are accounted for on a mark-to-market basis in accordance with *EITF 98-10 Accounting for Contracts Involved in Energy Trading and Risk Management Activities*, *SFAS No. 133 Accounting for Derivative Instruments and Hedging Activities*, and *SFAS No. 138 Accounting for Certain Derivative Instruments and Certain Hedging Activities*. Wholesale sales of excess asset capacity and wholesale purchases are treated as normal sales and purchases under *SFAS No. 133* and *SFAS No. 138* and are not marked to market.

KU has recorded a net liability of \$186,000 and \$17,000 at December 31, 2001 and 2000, respectively.

No changes to valuation techniques for energy trading and risk management activities occurred during 2001. All contracts outstanding at December 31, 2001 have a maturity of less than one year and are valued using prices actively quoted for proposed or executed transactions or quoted by brokers.

## Note 5 - 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 about 469,000 customers in over 600 communities and adjacent suburban and rural areas in 77 counties in central, southeastern and western Kentucky and to about 30,000 customers in five counties in southwestern Virginia. For the year ended December 31, 2001, 100% of total utility revenue was derived from electric operations.

In August 2001, KU and their employees represented by IBEW Local 2100 entered into a two-year collective bargaining agreement. KU and their employees represented by USWA Local 9447-01 entered into a two year collective bargaining agreement effective August 2000 and expiring July 31, 2002. In July 2001, KU and employees represented by USWA entered into a wage reopener whereby higher wages were negotiated. The employees represented by these two bargaining units comprise approximately 17% of KU's workforce.

## Note 6 - Pension Plans and Retirement Benefits

**Pension Plans.** KU sponsors qualified and non-qualified pension plans and other postretirement benefit plans for its employees. The following tables provide a reconciliation of the changes in the plans' benefit obligations and fair value of assets over the three-year period ending December 31, 2001, and a statement of the funded status as of December 31 for each of the last three years (in thousands of \$):

	<u>2001</u>	<u>2000</u>	<u>1999</u>
<b><u>Pension Plans:</u></b>			
Change in benefit obligation			
Benefit obligation at beginning of year	\$233,034	\$219,628	\$233,288
Service cost	2,761	4,312	6,210
Interest cost	17,534	17,205	15,564
Plan amendment	4	11,757	-
Change due to transfers	(16,827)	-	-
Curtailment loss	1,400	-	-
Special termination benefits	24,274	-	-
Benefits paid	(29,166)	(16,512)	(12,822)
Actuarial (gain) or loss and other	11,458	(3,356)	(22,612)
Benefit obligation at end of year	<u>\$ 244,472</u>	<u>\$233,034</u>	<u>\$219,628</u>
Change in plan assets			
Fair value of plan assets at beginning of year	\$244,677	\$274,109	\$238,124
Actual return on plan assets	18,155	(10,943)	49,883
Employer contributions and plan transfers	(15,300)	(994)	-
Benefits paid	(29,166)	(16,512)	(12,822)
Administrative expenses	(1,419)	(983)	(1,076)
Fair value of plan assets at end of year	<u>\$216,947</u>	<u>\$244,677</u>	<u>\$274,109</u>
Reconciliation of funded status			
Funded status	\$ (27,525)	\$ 11,643	\$ 54,481
Unrecognized actuarial (gain) or loss	(20,581)	(36,435)	(74,579)
Unrecognized transition (asset) or obligation	(664)	(847)	(988)
Unrecognized prior service cost	11,027	14,176	3,564
Net amount recognized at end of year	<u>\$ (37,743)</u>	<u>\$ (11,463)</u>	<u>\$ (17,522)</u>

Other Benefits:

## Change in benefit obligation

Benefit obligation at beginning of year	\$ 64,213	\$ 54,201	\$ 79,650
Service cost	495	757	1,596
Interest cost	5,433	4,781	3,837
Plan amendments	-	7,127	(24,488)
Curtailment loss	6,381	-	-
Special termination benefits	3,824	-	-
Benefits paid net of retiree contributions	(5,446)	(4,318)	(4,646)
Actuarial (gain) or loss	8,323	1,665	(1,748)
Benefit obligation at end of year	<u>\$ 83,223</u>	<u>\$ 64,213</u>	<u>\$ 54,201</u>

## Change in plan assets

Fair value of plan assets at beginning of year	\$ 23,762	\$ 28,720	\$ 24,337
Actual return on plan assets	(4,404)	(1,162)	5,322
Employer contributions and plan transfers	473	522	3,520
Benefits paid net of retiree contributions	(5,501)	(4,318)	(4,459)
Fair value of plan assets at end of year	<u>\$ 14,330</u>	<u>\$ 23,762</u>	<u>\$ 28,720</u>

## Reconciliation of funded status

Funded status	\$(68,893)	\$(40,451)	\$(25,481)
Unrecognized actuarial (gain) or loss	(437)	(23,561)	(28,976)
Unrecognized transition (asset) or obligation	12,290	21,871	23,694
Unrecognized prior service cost	3,548	6,109	-
Net amount recognized at end of year	<u>\$(53,492)</u>	<u>\$(36,032)</u>	<u>\$(30,763)</u>

There are no plan assets in the non-qualified plan due to the nature of the plan.

The following tables provide the amounts recognized in the balance sheet and information for plans with benefit obligations in excess of plan assets as of December 31, 2001, 2000 and 1999 (in thousands of \$):

	<u>2001</u>	<u>2000</u>	<u>1999</u>
<u>Pension Plans:</u>			
Amounts recognized in the balance sheet consisted of:			
Accrued benefit liability	<u>\$ (37,743)</u>	<u>\$ (11,463)</u>	<u>\$ (17,522)</u>
Additional year-end information for plans with accumulated benefit obligations in excess of plan assets (1):			
Projected benefit obligation	\$ 244,472	\$ 1,505	\$ 1,132
Accumulated benefit obligation	224,261	336	40
Fair value of plan assets	216,947	-	-
(1) 2001 includes all plans. 2000 and 1999 include SERPs only.			
<u>Other Benefits:</u>			
Amounts recognized in the balance sheet consisted of:			
Accrued benefit liability	<u>\$ (53,492)</u>	<u>\$ (36,032)</u>	<u>\$ (30,763)</u>
Additional year-end information for plans with benefit obligations in excess of plan assets:			
Projected benefit obligation	\$ 83,223	\$ 64,213	\$ 54,201
Fair value of plan assets	14,330	23,762	28,720

The following table provides the components of net periodic benefit cost for the plans for 2001, 2000 and 1999 (in thousands of \$):

	<u>2001</u>	<u>2000</u>	<u>1999</u>
<b><u>Pension Plans:</u></b>			
<b>Components of net periodic benefit cost</b>			
Service cost	\$ 2,761	\$ 4,312	\$ 6,211
Interest cost	17,534	17,205	15,564
Expected return on plan assets	(19,829)	(25,170)	(21,957)
Amortization of transition (asset) or obligation	(136)	(141)	(141)
Amortization of prior service cost	962	1,145	410
Recognized actuarial (gain) or loss	(120)	(3,410)	(319)
Net periodic benefit cost	<u>\$ 1,172</u>	<u>\$ (6,059)</u>	<u>\$ (232)</u>
<b>Special charges</b>			
Prior service cost recognized	\$ 1,238	\$ -	\$ -
Special termination benefits	24,274	-	-
Total charges	<u>\$ 25,512</u>	<u>\$ -</u>	<u>\$ -</u>
<b><u>Other Benefits:</u></b>			
<b>Components of net periodic benefit cost</b>			
Service cost	\$ 495	\$ 757	\$ 1,596
Interest cost	5,433	4,781	3,837
Expected return on plan assets	(1,313)	(1,768)	(1,897)
Amortization of prior service cost	740	1,018	-
Amortization of transition (asset) or obligation	1,193	1,823	1,823
Recognized actuarial (gain) or loss	(40)	(820)	(445)
Net periodic benefit cost	<u>\$ 6,508</u>	<u>\$ 5,791</u>	<u>\$ 4,914</u>
<b>Special charges</b>			
Transition obligation recognized	\$ 7,638	\$ -	\$ -
Prior service cost	1,613	-	-
Special termination benefits	3,824	-	-
Total charges	<u>\$ 13,075</u>	<u>\$ -</u>	<u>\$ -</u>

KU provides nonpension postretirement benefits for eligible retired employees.

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

	<u>2001</u>	<u>2000</u>	<u>1999</u>
<b>Weighted-average assumptions as of December 31:</b>			
Discount rate	7.25%	7.75%	8.00%
Expected long-term rate of return on plan assets	9.50%	9.50%	9.50%
Rate of compensation increase	4.25%	4.75%	5.00%

For measurement purposes, a 10.00% annual increase in the per capita cost of covered health care benefits was assumed for 2002. The rate was assumed to decrease gradually to 5.00% for 2011 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 the following effects (in thousands of \$):

	<u>1% Decrease</u>	<u>1% Increase</u>
Effect on total of service and interest cost components for 2001	\$ (340)	\$ 385
Effect on year-end 2001 postretirement benefit obligations	(5,297)	6,010

**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 approximately \$1.4 million for 2001, \$2.5 million for 2000 and \$2.3 million for 1999.

## Note 7 - Income Taxes

Components of income tax expense are shown in the table below (in thousands of \$):

	<u>2001</u>	<u>2000</u>	<u>1999</u>
Included in operating expenses:			
Current			
- federal	\$58,337	\$44,927	\$50,969
- state	13,465	9,333	13,459
Deferred			
- federal - net	(12,980)	(3,254)	(4,833)
- state - net	(1,340)	957	785
Total	<u>57,482</u>	<u>51,963</u>	<u>60,380</u>
Included in other income - net:			
Current			
- federal	(948)	349	1,028
- state	(268)	67	54
Deferred			
- federal - net	863	(122)	182
- state - net	222	(30)	102
Amortization of investment tax credit	(3,446)	(3,674)	(3,727)
Total	<u>(3,577)</u>	<u>(3,410)</u>	<u>(2,361)</u>
Total income tax expense	<u>\$53,905</u>	<u>\$48,553</u>	<u>\$58,019</u>

Net deferred tax liabilities resulting from book-tax temporary differences are shown below (in thousands of \$):

	<u>2001</u>	<u>2000</u>
Deferred tax liabilities:		
Depreciation and other		
plant-related items	\$269,752	\$279,047
Other liabilities	33,376	13,718
	<u>303,128</u>	<u>292,765</u>
Deferred tax assets:		
Investment tax credit	4,623	6,014
Income taxes due to customers	13,263	15,124
Pension overfunding	4,595	3,974
Accrued liabilities not currently		
deductible and other	41,443	20,973
	<u>63,924</u>	<u>46,085</u>
Net deferred income tax liability	<u>\$239,204</u>	<u>\$246,680</u>

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

	<u>2001</u>	<u>2000</u>	<u>1999</u>
Statutory federal income tax rate	35.0%	35.0%	35.0%
State income taxes, net of federal benefit	5.4	4.9	5.7
Amortization of investment tax credit	(2.3)	(2.6)	(2.9)
Other differences – net	<u>(2.2)</u>	<u>(3.6)</u>	<u>(2.5)</u>
Effective income tax rate	<u>35.9%</u>	<u>33.7%</u>	<u>35.3%</u>

#### Note 8 - Other Income - net

Other income – net consisted of the following at December 31 (in thousands of \$):

	<u>2001</u>	<u>2000</u>	<u>1999</u>
Equity in earnings - subsidiary company	\$ 1,803	\$ 2,242	\$ 2,334
Interest and dividend income	1,368	1,206	4,293
Gains on fixed asset disposals	1,844	5	759
Income taxes and other	<u>3,917</u>	<u>3,390</u>	<u>2,051</u>
Other income - net	<u>\$ 8,932</u>	<u>\$ 6,843</u>	<u>\$ 9,437</u>

#### Note 9 - First Mortgage Bonds and Pollution Control Bonds

Long-term debt and the current portion of long-term debt, summarized below (in thousands of \$), consists primarily of first mortgage bonds and pollution control bonds. Interest rates and maturities in the table below are for the amounts outstanding at December 31, 2001.

Stated interest rates	Variable, 5.75% - 8.55%
Weighted-average interest rate	4.91%
Maturities	2003 - 2027
Noncurrent portion	\$434,506
Current portion	\$54,000

Under the provisions for KU's variable-rate pollution control bonds Series PCS 10, 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. The average annualized interest rate for these bonds during 2001 was 2.99%.

In May 2000, KU issued the Mercer County Solid Waste Disposal Facility Revenue Bonds, 2000 Series A variable rate debt, for \$12.9 million. These proceeds were used to redeem \$4 million PCB Series 7, 7.38% bonds and \$8.9 million of PCB Series 7, 7.6% bonds. In June 2000, \$61.5 million Series Q, 5.95% First Mortgage Bonds matured and was paid in full.

KU's First Mortgage Bond, 6.32% Series Q of \$62 million is scheduled to mature in 2003 and KU's First Mortgage Bond, 5.99% Series S of \$36 million matures in 2006. There are no scheduled maturities of Pollution Control Bonds for the five years subsequent to December 31, 2001.

Substantially all of KU's utility plant is pledged as security for its First Mortgage Bonds.

## **Note 10 - Notes Payable**

KU participates in an intercompany money pool agreement wherein LG&E Energy can make funds available to KU at market based rates up to \$200 million. At December 31, 2001, the balance of the money pool loan from LG&E Energy was \$47.8 million at an average rate of 2.37% and the remaining money pool availability was \$152.2 million. In addition, KU maintains an uncommitted borrowing facility totaling \$60 million that was undrawn at December 31, 2001. LG&E Energy maintains a facility of \$200 million with an affiliate to ensure funding availability for the money pool. There was no outstanding balance under this facility as of December 31, 2001, and availability of \$170 million remains after considering the \$30 million of commercial paper outstanding at LG&E.

At December 31, 2000, KU had \$61.2 million outstanding under the money pool at an average rate of 6.84%.

## **Note 11 - Commitments and Contingencies**

**Construction Program.** KU had \$8 million of commitments in connection with its construction program at December 31, 2001. Construction expenditures for the years 2002 and 2003 are estimated to total approximately \$459 million; although all of this is not currently committed. Included in 2002 is \$89 million for the purchase of 71% of two CTs currently under construction by Capital Corp. at LG&E's Trimble County location. LG&E will own 29% of the two CTs. KU is waiting for approval from the Kentucky and Virginia Commissions.

**Operating Leases.** KU leases office space, office equipment, and vehicles. KU accounts for these leases as operating leases. Total lease expense for 2001, 2000, and 1999, was \$2.8 million, \$2.3 million, and \$1.7 million, respectively.

In December 1999, LG&E and KU entered into an 18-year cross-border lease of its two jointly owned combustion turbines recently installed at KU's Brown facility (units 6 and 7). KU's obligation was defeased upon consummation of the cross-border lease. The transaction produced a pre-tax gain of approximately \$1.9 million which was recorded in other income on the income statement in 2000, pursuant to a Kentucky Commission order.

**Environmental.** The Clean Air Act imposed stringent new SO<sub>2</sub> and NO<sub>x</sub> emission limits on electric generating units. KU met its Phase I SO<sub>2</sub> requirements primarily through installation of a scrubber on Ghent Unit 1. KU's strategy for Phase II SO<sub>2</sub> reductions, which commenced January 1, 2000, is to use accumulated emissions allowances to delay additional capital expenditures and may also include fuel switching or the installation of additional scrubbers. KU met the NO<sub>x</sub> emission requirements of the Act through installation of low-NO<sub>x</sub> burner systems. KU's compliance plans are subject to many factors including developments in the emission allowance and fuel markets, future regulatory and legislative initiatives, and advances in clean air control technology. KU will continue to monitor these developments to ensure that its environmental obligations are met in the most efficient and cost-effective manner.

In September 1998, the EPA announced its final "NO<sub>x</sub> SIP Call" rule requiring states to impose significant additional reductions in NO<sub>x</sub> emissions by May 2003, in order to mitigate alleged ozone transport impacts on the Northeast region. The Commonwealth of Kentucky is currently in the process of revising its State Implementation Plan or "SIP" to require reductions in NO<sub>x</sub> emissions from coal-fired generating units to the 0.15 lb./Mmbtu level on a system-wide basis. In related proceedings in response to petitions filed by various Northeast states, in December 1999, EPA issued a final rule pursuant to Section 126 of the Clean Air Act directing similar NO<sub>x</sub> reductions from a number of specifically targeted generating units including all KU units in the eastern half of Kentucky. Additional petitions currently pending before EPA may potentially result in

rules encompassing KU's remaining generating units. As a result of appeals to both rules, the compliance date was extended to May 2004. All KU generating units are subject to the May 2004 compliance date under these NOx emissions reduction rules.

KU is currently implementing a plan for adding significant additional NOx controls to its generating units. Installation of additional NOx controls will proceed on a phased basis, with installation of controls commencing in late 2000 and continuing through the final compliance date. In addition, KU will incur additional operation and maintenance costs in operating new NOx controls. KU believes its costs in this regard to be comparable to those of similarly situated utilities with like generation assets. KU anticipated that such capital and operating costs are the type of costs that are eligible for recovery from customers under its environmental surcharge mechanism and believed that a significant portion of such costs could be recovered. In April 2001, the Kentucky Commission granted recovery of these costs for KU.

KU is also monitoring several other air quality issues which may potentially impact coal-fired power plants, including the appeal of the D.C. Circuit's remand of the EPA's revised air quality standards for ozone and particulate matter, measures to implement EPA's regional haze rule, and EPA's December 2000 determination to regulate mercury emissions from power plants.

KU owns or formerly owned several properties that contained past MGP operations. Various contaminants are typically found at such former MGP sites and environmental remediation measures are frequently required. KU has completed the cleanup of a site owned by KU. With respect to other former MGP sites no longer owned by KU, KU is unaware of what, if any, additional exposure or liability it may have.

In October 1999, approximately 38,000 gallons of diesel fuel leaked from a cracked valve in an underground pipeline at KU's E.W. Brown Station. Under the oversight of EPA and state officials, KU commenced immediate spill containment and recovery measures which prevented the spill from reaching the Kentucky River. KU ultimately recovered approximately 34,000 gallons of diesel fuel. In November 1999, the Kentucky Division of Water issued a notice of violation for the incident. KU is currently negotiating with the state in an effort to reach a complete resolution of this matter. KU incurred costs of approximately \$1.8 million and received insurance reimbursement of \$1.2 million.

**Purchased Power.** KU has purchase power arrangements with OMU, EEI and other parties. Under the OMU agreement, which expires on January 1, 2020, KU purchases all of the output of a 400-Mw generating station not required by OMU. The amount of purchased power available to KU during 2002-2006, which is expected to be approximately 9% of KU's total kWh requirements, is dependent upon a number of factors including the 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, which generally follows delivered kWh. Included in the total costs is KU's proportionate share of debt service requirements on \$153 million of OMU bonds outstanding at December 31, 2001. The debt service is allocated to KU based on its annual allocated share of capacity, which averaged approximately 48% in 2001.

KU has a 20% equity ownership in EEI, which is accounted for on the equity method of accounting. KU's entitlement is 20% of the available capacity of a 1,000 Mw station. Payments are based on the total costs of the station allocated per terms of an agreement among the owners, which generally follows delivered kWh.

KU has several other contracts for purchased power during 2002 - 2006 of various Mw capacities and for varying periods with a maximum entitlement at any time of 62 Mw.

The estimated future minimum annual payments under purchased power agreements for the five years ended December 31, 2006, are as follows (in thousands of \$):

2002	\$ 37,788
2003	34,665
2004	41,736
2005	41,777
2006	41,807
Total	<u>\$ 197,773</u>

#### Note 12 – Jointly Owned Electric Utility Plant

LG&E and KU jointly own the following combustion turbines (in thousands of \$):

		<u>LG&amp;E</u>	<u>KU</u>	<u>Total</u>
Paddy's Run 13	Ownership %	53%	47%	100%
	Mw capacity	84	74	158
	Cost	\$33,844	\$29,908	\$63,752
	Depreciation	<u>563</u>	<u>491</u>	<u>1,054</u>
	Net book value	<u>\$33,281</u>	<u>\$29,417</u>	<u>\$62,698</u>
E.W. Brown 5	Ownership %	53%	47%	100%
	Mw capacity	70	63	133
	Cost	\$23,941	\$21,078	\$45,019
	Depreciation	<u>394</u>	<u>342</u>	<u>736</u>
	Net book value	<u>\$23,547</u>	<u>\$20,736</u>	<u>\$44,283</u>
E.W. Brown 6	Ownership %	38%	62%	100%
	Mw capacity	62	102	164
	Cost	\$23,696	\$36,253	\$59,949
	Depreciation	<u>953</u>	<u>2,955</u>	<u>3,908</u>
	Net book value	<u>\$22,743</u>	<u>\$33,298</u>	<u>\$56,041</u>
E.W. Brown 7	Ownership %	38%	62%	100%
	Mw capacity	62	102	164
	Cost	\$23,607	\$44,785	\$68,392
	Depreciation	<u>3,268</u>	<u>3,033</u>	<u>6,301</u>
	Net book value	<u>\$20,339</u>	<u>\$41,752</u>	<u>\$62,091</u>

See also Note 11, Construction Program, for KU's planned purchase of two jointly owned CTs in 2002.

### Note 13 - Selected Quarterly Data (Unaudited)

Selected financial data for the four quarters of 2001 and 2000 are shown below. Because of seasonal fluctuations in temperature and other factors, results for quarters may fluctuate throughout the year.

	<u>March</u>	<u>Quarters Ended</u>		
		<u>June</u>	<u>September</u>	<u>December</u>
		<u>(Thousands of \$)</u>		
<u>2001</u>				
Revenues	\$211,793	\$219,360	\$216,370	\$211,949
Operating income (loss)	(344)	28,422	30,253	63,039
Net income (loss)	(7,995)	22,080	26,340	55,989
Net income (loss) available for common stock	(8,559)	21,516	25,776	55,425
<u>2000</u>				
Revenues	\$217,778	\$205,324	\$215,984	\$212,855
Operating income	28,753	28,912	37,161	33,310
Net income	20,174	21,532	28,483	25,335
Net income available for common stock	19,610	20,968	27,919	24,771

### Note 14 - Subsequent Events

On April 9, 2001, a German power company, E.ON AG, announced a preconditional cash offer of £5.1 billion (\$7.3 billion) for Powergen. The offer is subject to a number of conditions, including the receipt of certain European and United States regulatory approvals. The Kentucky Public Service Commission, the Federal Energy Regulatory Commission, the Virginia State Corporation Commission, and the Tennessee Regulatory Authority have all approved the acquisition of Powergen and LG&E Energy by E.ON. The parties expect to obtain the remaining regulatory approvals and to complete the transaction in the first half of 2002. See Powergen's schedule 14D-9, and associated schedules to such filings, filed with the SEC on April 9, 2001.

KU (along with LG&E) is a founding member of the MISO, such membership obtained in 1998 in response to and consistent with federal policy initiatives. As a MISO member, KU filed for and received authorization from FERC to transfer control of its transmission facilities (100 kV and above) to the MISO, the first step in allowing the latter to assume responsibility for all tariff-related transmission functions (e.g., scheduling through and on KU's transmission system) as well as non-tariff related regional transmission activities (e.g., operations planning, maintenance coordination, long-term regional planning and market monitoring). The FERC approved the MISO as the nation's first Regional Transmission Organization on December 19, 2001, after which KU submitted a filing at FERC to cancel all services under its Open Access Transmission Tariff except those that will not be provided by the MISO (certain ancillary services). The MISO became operational on February 1, 2002.

In October 2001, the FERC issued an order requiring that the bundled retail load and grandfathered wholesale load of each member transmission owner (including KU) be included in the current calculation of MISO's "cost-adder," a charge designed to recover MISO's costs of operation, including start-up capital (debt) costs. KU, along with several other transmission owners, opposed the FERC's ruling in this regard, which opposition the FERC rejected in an order on rehearing issued in 2002. As of the end of 2001, negotiations were continuing

between MISO, its transmission owners and other interested industry segments regarding the level of cost responsibility properly borne by bundled and grandfathered load under these FERC rulings. Absent settlement, this issue is expected to go to hearing in 2002.

At the end of 2001, in response to an earlier FERC ruling, MISO and its transmission owning members (including KU) filed to increase MISO's rate of return on equity from 10.5% (a stipulated percentage agreed to in 1998) to 13.0%, to compensate MISO's transmission owners for the inherent risks and uncertainties associated with transferring control of their facilities to the MISO. This issue is expected to go to hearing in 2002.

**Kentucky Utilities Company  
REPORT OF MANAGEMENT**

The management of Kentucky Utilities Company is responsible for the preparation and integrity of the financial statements and related information included in this Annual Report. These statements have been prepared in accordance with accounting principles generally accepted in the United States applied on a consistent basis and, necessarily, include amounts that reflect the best estimates and judgment of management.

KU's current year financial statements have been audited by PricewaterhouseCoopers LLP, independent accountants and prior years financial statements were audited by Arthur Andersen LLP. Management made available to PricewaterhouseCoopers LLP and to Arthur Andersen LLP (in prior years) all KU's financial records and related data as well as the minutes of shareholders' and directors' meetings.

Management has established and maintains a system of internal controls that provide reasonable assurance that transactions are completed in accordance with management's authorization, that assets are safeguarded and that financial statements are prepared in conformity with generally accepted accounting principles. Management believes that an adequate system of internal controls is maintained through the selection and training of personnel, appropriate division of responsibility, establishment and communication of policies and procedures and by regular reviews of internal accounting controls by KU's internal auditors. Management reviews and modifies its system of internal controls in light of changes in conditions and operations, as well as in response to recommendations from the internal auditors. These recommendations for the year ended December 31, 2001, did not identify any material weaknesses in the design and operation of KU's internal control structure.

The Audit Committee of the Board of Directors is composed entirely of outside directors. In carrying out its oversight role for the financial reporting and internal controls of KU, the Audit Committee meets regularly with KU's independent public accountants, internal auditors and management. The Audit Committee reviews the results of the independent accountants' audit of the financial statements and their audit procedures, and discusses the adequacy of internal accounting controls. The Audit Committee also approves the annual internal auditing program, and reviews the activities and results of the internal auditing function. Both the independent public accountants and the internal auditors have access to the Audit Committee at any time.

Kentucky Utilities Company maintains and internally communicates a written code of business conduct that addresses, among other items, potential conflicts of interest, compliance with laws, including those relating to financial disclosure, and the confidentiality of proprietary information.

S. Bradford Rives  
Senior Vice President-Finance and Controller

Kentucky Utilities Company  
Louisville, Kentucky

Kentucky Utilities Company and Subsidiary  
REPORT OF INDEPENDENT ACCOUNTANTS

To the Shareholders of Kentucky Utilities Company and Subsidiary:

In our opinion, the accompanying consolidated balance sheet as of December 31, 2001 and the related consolidated statements of capitalization, income, retained earnings, cash flows and comprehensive income present fairly, in all material respects, the financial position of Kentucky Utilities Company and Subsidiary (the "Company"), a wholly-owned subsidiary of LG&E Energy Corp., at December 31, 2001, and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

/s/ PricewaterhouseCoopers LLP  
January 25, 2002  
Louisville, Kentucky

Kentucky Utilities Company  
REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Shareholders of Kentucky Utilities Company:

We have audited the accompanying balance sheet and statement of capitalization of Kentucky Utilities Company (a Kentucky and Virginia corporation and a wholly-owned subsidiary of LG&E Energy Corp.) as of December 31, 2000, and the related statements of income, retained earnings and cash flows for each of the two years in the period ended December 31, 2000. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Kentucky Utilities Company as of December 31, 2000, and the results of its operations and its cash flows for each of the two years in the period ended December 31, 2000, in conformity with accounting principles generally accepted in the United States.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The schedule listed under Item 14(a)2 is presented for purposes of complying with the Securities and Exchange Commission's rules and is not part of the basic financial statements. This schedule has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, fairly states in all material respects the financial data required to be set forth therein in relation to the basic financial statements taken as a whole.

Louisville, Kentucky  
January 26, 2001

Arthur Andersen LLP

**ITEM 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.**

Effective April 30, 2001, PricewaterhouseCoopers LLP was appointed as certifying accountants for the year ended December 31, 2001, for LG&E and KU. PricewaterhouseCoopers LLP was the independent accountant of Powergen prior to the acquisition of LG&E Energy and has continued in such engagement. Arthur Andersen LLP was the certifying account for LG&E Energy and its subsidiaries. Arthur Andersen LLP was notified of their dismissal in April 2001. For further information see LG&E and KU's 8-K dated May 7, 2001.

**PART III**

ITEMS 10, 11, 12 and 13 are omitted pursuant to General Instruction G of Form 10-K. The information required by ITEMS 10, 11, 12 and 13 for LG&E and KU are incorporated herein by reference to their definitive proxy statements anticipated to be filed during April 2002 with the Commission pursuant to Regulation 14A of the Securities and Exchange Act of 1934. Additionally, in accordance with General Instruction G, the information required by ITEM 10 relating to executive officers of LG&E and KU has been included in Part I of this Form 10-K.

**PART IV**

**ITEM 14. Exhibits, Financial Statement Schedules, and Reports on Form 8-K.**

**(a) 1. Financial Statements (included in Item 8):**

**LG&E:**

Consolidated statements of income for the three years ended December 31, 2001 (page 66).

Consolidated statements of retained earnings for the three years ended December 31, 2001 (page 66).

Consolidated statements of comprehensive income for the three years ended December 31, 2001 (page 67).

Consolidated balance sheets-December 31, 2001, and 2000 (page 68).

Consolidated statements of cash flows for the three years ended December 31, 2001 (page 69).

Consolidated statements of capitalization-December 31, 2001, and 2000 (page 70).

Notes to consolidated financial statements (pages 71-92).

Report of management (page 93).

Reports of independent accountants (pages 94-95).

**KU:**

Consolidated statements of income for the three years ended December 31, 2001 (page 98).

Consolidated statements of retained earnings for the three years ended December 31, 2001 (page 98).

Consolidated statements of comprehensive income for the three years ended December 31, 2001 (page 99).

Consolidated balance sheets-December 31, 2001, and 2000 (page 100).

Consolidated statements of cash flows for the three years ended December 31, 2001 (page 101).

Consolidated statements of capitalization-December 31, 2001, and 2000 (page 102).

Notes to consolidated financial statements (pages 103-120).

Report of management (page 121).

Reports of independent accountants (pages 122-123).

**2. Financial Statement Schedules (included in Part IV):**

Schedule II Valuation and Qualifying Accounts for the three years ended December 31, 2001, for LG&E (page 145), and KU (page 147).

All other schedules have been omitted as not applicable or not required or because the information required to be shown is included in the Financial Statements or the accompanying Notes to Financial Statements.

3. Exhibits:

Exhibit No.	Applicable to Form 10-K of		Description
	LG&E	KU	
2.01	x	x	Copy of Agreement and Plan of Merger, dated as of February 27, 2000, by and among Powergen plc, LG&E Energy Corp., US Subholdco2 and Merger Sub, including certain exhibits thereto. [Filed as Exhibit 1 to LG&E's and KU's Current Report on Form 8-K filed February 29, 2000 and incorporated by reference herein]
2.02	x	x	Amendment No. 1 to Agreement and Plan of merger, dated as of December 8, 2000, among LG&E Energy Corp., Powergen plc, Powergen US Investments Corp. and Powergen Acquisition Corp. [Filed as Exhibit 2.01 to LG&E's and KU's Current Report on Form 8-K filed December 11, 2000 and incorporated by reference herein]
2.03	x	x	Copy of Agreement and Plan of Merger, dated as of May 20, 1997, by and between LG&E Energy and KU Energy, including certain exhibits thereto. [Filed as Exhibit 2 to LG&E's and KU's Current Report on Form 8-K filed May 30, 1997 and incorporated by reference herein]
3.01	x		Copy of Restated Articles of Incorporation of LG&E, dated November 6, 1996. [Filed as Exhibit 3.06 to LG&E Quarterly Report on Form 10-Q for the quarter ended September 30, 1996, and incorporated by reference herein]
3.02	x		Copy of By-Laws of LG&E, as amended through June 2, 1999 [Filed as Exhibit 3.02 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1999, and incorporated by reference herein]
3.03		x	Copy of Amended and Restated Articles of Incorporation of KU [Filed as Exhibits 4.03 and 4.04 to Form 8-K Current Report of KU, dated December 10, 1993, and incorporated by reference herein]
3.04		x	Copy of By-laws of KU, as amended through June 2, 1999. [Filed as Exhibit 3.04 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1999, and incorporated by reference herein]

<u>Exhibit No.</u>	<u>Applicable to Form 10-K of</u>		<u>Description</u>
	<u>LG&amp;E</u>	<u>KU</u>	
4.01	x		Copy of Trust Indenture dated November 1, 1949, from LG&E to Harris Trust and Savings Bank, Trustee. [Filed as Exhibit 7.01 to LG&E's Registration Statement 2-8283 and incorporated by reference herein]
4.02	x		Copy of Supplemental Indenture dated February 1, 1952, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 4.05 to LG&E's Registration Statement 2-9371 and incorporated by reference herein]
4.03	x		Copy of Supplemental Indenture dated February 1, 1954, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 4.03 to LG&E's Registration Statement 2-11923 and incorporated by reference herein]
4.04	x		Copy of Supplemental Indenture dated September 1, 1957, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 2.04 to LG&E's Registration Statement 2-17047 and incorporated by reference herein]
4.05	x		Copy of Supplemental Indenture dated October 1, 1960, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 2.05 to LG&E's Registration Statement 2-24920 and incorporated by reference herein]
4.06	x		Copy of Supplemental Indenture dated June 1, 1966, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 2.06 to LG&E's Registration Statement 2-28865 and incorporated by reference herein]
4.07	x		Copy of Supplemental Indenture dated June 1, 1968, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 2.07 to LG&E's Registration Statement 2-37368 and incorporated by reference herein]
4.08	x		Copy of Supplemental Indenture dated June 1, 1970, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 2.08 to LG&E's Registration Statement 2-37368 and incorporated by reference herein]
4.09	x		Copy of Supplemental Indenture dated August 1, 1971, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 2.09 to

Applicable to Form  
10-K of

<u>Exhibit No.</u>	<u>LG&amp;E</u>	<u>KU</u>	<u>Description</u>
			LG&E's Registration Statement 2-44295 and incorporated by reference herein]
4.10	x		Copy of Supplemental Indenture dated June 1, 1972, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 2.10 to LG&E's Registration Statement 2-52643 and incorporated by reference herein]
4.11	x		Copy of Supplemental Indenture dated February 1, 1975, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 2.11 to LG&E's Registration Statement 2-57252 and incorporated by reference herein]
4.12	x		Copy of Supplemental Indenture dated September 1, 1975, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 2.12 to LG&E's Registration Statement 2-57252 and incorporated by reference herein]
4.13	x		Copy of Supplemental Indenture dated September 1, 1976, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 2.13 to LG&E's Registration Statement 2-57252 and incorporated by reference herein]
4.14	x		Copy of Supplemental Indenture dated October 1, 1976, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 2.14 to LG&E's Registration Statement 2-65271 and incorporated by reference herein]
4.15	x		Copy of Supplemental Indenture dated June 1, 1978, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 2.15 to LG&E's Registration Statement 2-65271 and incorporated by reference herein]
4.16	x		Copy of Supplemental Indenture dated February 15, 1979, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 2.16 to LG&E's Registration Statement 2-65271 and incorporated by reference herein]
4.17	x		Copy of Supplemental Indenture dated September 1, 1979, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 4.17 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1980, and incorporated by reference herein]

Exhibit No.	Applicable to Form 10-K of		Description
	LG&E	KU	
4.18	x		Copy of Supplemental Indenture dated September 15, 1979, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 4.18 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1980, and incorporated by reference herein]
4.19	x		Copy of Supplemental Indenture dated September 15, 1981, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 4.19 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1981, and incorporated by reference herein]
4.20	x		Copy of Supplemental Indenture dated March 1, 1982, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 4.20 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1982, and incorporated by reference herein]
4.21	x		Copy of Supplemental Indenture dated March 15, 1982, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 4.21 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1982, and incorporated by reference herein]
4.22	x		Copy of Supplemental Indenture dated September 15, 1982, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 4.22 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1982, and incorporated by reference herein]
4.23	x		Copy of Supplemental Indenture dated February 15, 1984, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 4.23 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1984, and incorporated by reference herein]
4.24	x		Copy of Supplemental Indenture dated July 1, 1985, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 4.24 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1985, and incorporated by reference herein]
4.25	x		Copy of Supplemental Indenture dated November 15, 1986, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 4.25 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1986, and incorporated by reference herein]
4.26	x		Copy of Supplemental Indenture dated November 16, 1986, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 4.26 to LG&E's Annual Report on Form 10-K for the year ended December 31,

Exhibit No.	Applicable to Form 10-K of		Description
	LG&E	KU	
			1986, and incorporated by reference herein]
4.27	x		Copy of Supplemental Indenture dated August 1, 1987, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 4.27 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1987, and incorporated by reference herein]
4.28	x		Copy of Supplemental Indenture dated February 1, 1989, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 4.28 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1988, and incorporated by reference herein]
4.29	x		Copy of Supplemental Indenture dated February 2, 1989, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 4.29 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1988, and incorporated by reference herein]
4.30	x		Copy of Supplemental Indenture dated June 15, 1990, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 4.30 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1990, and incorporated by reference herein]
4.31	x		Copy of Supplemental Indenture dated November 1, 1990, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 4.31 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1990, and incorporated by reference herein]
4.32	x		Copy of Supplemental Indenture dated September 1, 1992, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 4.32 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1992, and incorporated by reference herein]
4.33	x		Copy of Supplemental Indenture dated September 2, 1992, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 4.33 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1992, and incorporated by reference herein]
4.34	x		Copy of Supplemental Indenture dated August 15, 1993, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 4.34 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1993, and incorporated by reference herein]
4.35	x		Copy of Supplemental Indenture dated August 16, 1993, which is a

Applicable to Form  
10-K of

<u>Exhibit No.</u>	<u>LG&amp;E</u>	<u>KU</u>	<u>Description</u>
			supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 4.35 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1993, and incorporated by reference herein]
4.36	x		Copy of Supplemental Indenture dated October 15, 1993, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 4.36 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1993, and incorporated by reference herein]
4.37	x		Copy of Supplemental Indenture dated May 1, 2000, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 4.37 to LG&E's Annual Report on Form 10-K/A for the year ended December 31, 2000, and incorporated by reference herein]
4.38	x		Copy of Supplemental Indenture dated August 1, 2000, which is a supplemental instrument to Exhibit 4.01 hereto. [Filed as Exhibit 4.38 to LG&E's Annual report on Form 10-K/A for the year ended December 31, 2000, and incorporated by reference herein]
4.39		x	Indenture of Mortgage or Deed of Trust dated May 1, 1947, between KU and First Trust National Association (successor Trustee) and a successor individual co-trustee, as Trustees (the Trustees) (Amended Exhibit 7(a) in File No. 2-7061), and Supplemental Indentures thereto dated, respectively, January 1, 1949 (Second Amended Exhibit 7.02 in File No. 2-7802), July 1, 1950 (Amended Exhibit 7.02 in File No. 2-8499), June 15, 1951 (Exhibit 7.02(a) in File No. 2-8499), June 1, 1952 (Amended Exhibit 4.02 in File No. 2-9658), April 1, 1953 (Amended Exhibit 4.02 in File No. 2-10120), April 1, 1955 (Amended Exhibit 4.02 in File No. 2-11476), April 1, 1956 (Amended Exhibit 2.02 in File No. 2-12322), May 1, 1969 (Amended Exhibit 2.02 in File No. 2-32602), April 1, 1970 (Amended Exhibit 2.02 in File No. 2-36410), September 1, 1971 (Amended Exhibit 2.02 in File No. 2-41467), December 1, 1972 (Amended Exhibit 2.02 in File No. 2-46161), April 1, 1974 (Amended Exhibit 2.02 in File No. 2-50344), September 1, 1974 (Exhibit 2.04 in File No. 2-59328), July 1, 1975 (Exhibit 2.05 in File No. 2-59328), May 15, 1976 (Amended Exhibit 2.02 in File No. 2-56126), April 15, 1977 (Exhibit 2.06 in File No. 2-59328), August 1, 1979 (Exhibit 2.04 in File No. 2-64969), May 1, 1980 (Exhibit 2 to Form 10-Q Quarterly Report of KU for the quarter ended June 30, 1980), September 15, 1982 (Exhibit 4.04 in File No. 2-79891), August 1, 1984 (Exhibit 4B to Form 10-K Annual Report of KU for the year ended December 31, 1984), June 1, 1985 (Exhibit 4 to Form 10-Q Quarterly Report of KU for the quarter ended June 30, 1985), May 1, 1990 (Exhibit 4 to Form 10-Q Quarterly

Applicable to Form  
10-K of

<u>Exhibit No.</u>	<u>LG&amp;E</u>	<u>KU</u>	<u>Description</u>
			Report of KU for the quarter ended June 30, 1990), May 1, 1991 (Exhibit 4 to Form 10-Q Quarterly Report of KU for the quarter ended June 30, 1991), May 15, 1992 (Exhibit 4.02 to Form 8-K of KU dated May 14, 1992), August 1, 1992 (Exhibit 4 to Form 10-Q Quarterly Report of KU for the quarter ended September 30, 1992), June 15, 1993 (Exhibit 4.02 to Form 8-K of KU dated June 15, 1993) and December 1, 1993 (Exhibit 4.01 to Form 8-K of KU dated December 10, 1993), November 1, 1994 (Exhibit 4.C to Form 10-K Annual Report of KU for the year ended December 31, 1994), June 1, 1995 (Exhibit 4 to Form 10-Q Quarterly Report of KU for the quarter ended June 30, 1995) and January 15, 1996 (Exhibit 4.E to Form 10-K Annual Report of KU for the year ended December 31, 1995). Incorporated by reference.
4.40		x	Supplemental Indenture dated March 1, 1992 between KU and the Trustees, providing for the conveyance of properties formerly held by Old Dominion Power Company [Filed as Exhibit 4B to Form 10-K Annual Report of KU for the year ended December 31, 1992, and incorporated by reference herein]
4.41		x	Copy of Supplemental Indenture dated May 1, 2000, which is a supplemental instrument to Exhibit 4.39 hereto. [Filed as Exhibit 4.41 to KU's Annual Report on Form 10-K/A for the year ended December 31, 2000, and incorporated by reference herein]
4.42	x		Copy of Supplemental Indenture dated September 1, 2001, which is a supplemental instrument to Exhibit 4.01 hereto.
4.43		x	Receivables Purchase Agreement dated as of February 6, 2001 among KU Receivables LLC, Kentucky Utilities Company as Servicer, the Various Purchaser Groups From Time to Time Party Hereto and PNC Bank, National Association, as Administrator.
4.44		x	Purchase and Sale Agreement dated as of February 6, 2001 between KU Receivables LLC and Kentucky Utilities Company.
4.45	x		Receivables Purchase Agreement dated as of February 6, 2001 among LG&E Receivables LLC, Louisville Gas and Electric Company as Servicer, the Various Purchaser Groups From Time to Time Party Hereto and PNC Bank, National Association, as Administrator.
4.46	x		Purchase and Sale Agreement dated as of February 6, 2001 between LG&E Receivables LLC and Louisville Gas and Electric Company.

Exhibit No.	Applicable to Form 10-K of		Description
	LG&E	KU	
10.01	x		Copies of Agreement between Sponsoring Companies re: Project D of Atomic Energy Commission, dated May 12, 1952, Memorandums of Understanding between Sponsoring Companies re: Project D of Atomic Energy Commission, dated September 19, 1952 and October 28, 1952, and Power Agreement between Ohio Valley Electric Corporation and Atomic Energy Commission, dated October 15, 1952. [Filed as Exhibit 13(y) to LG&E's Registration Statement 2-9975 and incorporated by reference herein]
10.02	x		Copy of Modification No. 1 dated July 23, 1953, to the Power Agreement between Ohio Valley Electric Corporation and Atomic Energy Commission. [Filed as Exhibit 4.03(b) to LG&E's Registration Statement 2-24920 and incorporated by reference herein]
10.03	x		Copy of Modification No. 2 dated March 15, 1964, to the Power Agreement between Ohio Valley Electric Corporation and Atomic Energy Commission. [Filed as Exhibit 5.02c to LG&E's Registration Statement 2-61607 and incorporated by reference herein]
10.04	x		Copy of Modification No. 3 and No. 4 dated May 12, 1966 and January 7, 1967, respectively, to the Power Agreement between Ohio Valley Electric Corporation and Atomic Energy Commission. [Filed as Exhibits 4(a)(13) and 4(a)(14) to LG&E's Registration Statement 2-26063 and incorporated by reference herein]
10.05	x		Copy of Modification No. 5 dated August 15, 1967, to the Power Agreement between Ohio Valley Electric Corporation and Atomic Energy Commission. [Filed as Exhibit 13(c) to LG&E's Registration Statement 2-27316 and incorporated by reference herein]
10.06	x	x	Copies of (i) Inter-Company Power Agreement, dated July 10, 1953, between Ohio Valley Electric Corporation and Sponsoring Companies (which Agreement includes as Exhibit A the Power Agreement, dated July 10, 1953, between Ohio Valley Electric Corporation and Indiana-Kentucky Electric Corporation); (ii) First Supplementary Transmission Agreement, dated July 10, 1953, between Ohio Valley Electric Corporation and Sponsoring Companies; (iii) Inter-Company Bond Agreement, dated July 10, 1953, between Ohio Valley Electric Corporation and Sponsoring Companies; (iv) Inter-Company Bank Credit Agreement, dated July 10, 1953, between Ohio Valley Electric Corporation and Sponsoring Companies. [Filed as Exhibit 5.02f to LG&E's Registration Statement 2-61607 and incorporated by reference herein]

Applicable to Form  
10-K of

<u>Exhibit No.</u>	<u>LG&amp;E</u>	<u>KU</u>	<u>Description</u>
10.07	x	x	Copy of Modification No. 1 and No. 2 dated June 3, 1966 and January 7, 1967, respectively, to Inter-Company Power Agreement dated July 10, 1953. [Filed as Exhibits 4(a)(8) and 4(a)(10) to LG&E's Registration Statement 2-26063 and incorporated by reference herein]
10.08	x		Copies of Amendments to Agreements (iii) and (iv) referred to under 10.06 above as follows: (i) Amendment to Inter-Company Bond Agreement and (ii) Amendment to Inter-Company Bank Credit Agreement. [Filed as Exhibit 5.02h to LG&E's Registration Statement 2-61607 and incorporated by reference herein]
10.09	x		Copy of Modification No. 1, dated August 20, 1958, to First Supplementary Transmission Agreement, dated July 10, 1953, among Ohio Valley Electric Corporation and the Sponsoring Companies. [Filed as Exhibit 5.02i to LG&E's Registration Statement 2-61607 and incorporated by reference herein]
10.10	x		Copy of Modification No. 2, dated April 1, 1965, to the First Supplementary Transmission Agreement, dated July 10, 1953, among Ohio Valley Electric Corporation and the Sponsoring Companies. [Filed as Exhibit 5.02j to LG&E's Registration Statement 2-61607 and incorporated by reference herein]
10.11	x		Copy of Modification No. 3, dated January 20, 1967, to First Supplementary Transmission Agreement, dated July 10, 1953, among Ohio Valley Electric Corporation and the Sponsoring Companies. [Filed as Exhibit 4(a)(7) to LG&E's Registration Statement 2-26063 and incorporated by reference herein]
10.12	x		Copy of Modification No. 6 dated November 15, 1967, to the Power Agreement between Ohio Valley Electric Corporation and Atomic Energy Commission. [Filed as Exhibit 4(g) to LG&E's Registration Statement 2-28524 and incorporated by reference herein]
10.13	x	x	Copy of Modification No. 3 dated November 15, 1967, to the Inter-Company Power Agreement dated July 10, 1953. [Filed as Exhibit 4.02m to LG&E's Registration Statement 2-37368 and incorporated by reference herein]
10.14	x		Copy of Modification No. 7 dated November 5, 1975, to the Power Agreement between Ohio Valley Electric Corporation and Atomic Energy Commission. [Filed as Exhibit 5.02n to LG&E's Registration Statement 2-56357 and incorporated by reference herein]

<u>Exhibit No.</u>	<u>Applicable to Form 10-K of</u>		<u>Description</u>
	<u>LG&amp;E</u>	<u>KU</u>	
10.15	x	x	Copy of Modification No. 4 dated November 5, 1975, to the Inter-Company Power Agreement dated July 10, 1953. [Filed as Exhibit 5.02o to LG&E's Registration Statement 2-56357 and incorporated by reference herein]
10.16	x		Copy of Modification No. 4 dated April 30, 1976, to First Supplementary Transmission Agreement, dated July 10, 1953, among Ohio Valley Electric Corporation and the Sponsoring Companies. [Filed as Exhibit 5.02p to LG&E's Registration Statement 2-61607 and incorporated by reference herein]
10.17	x		Copy of Modification No. 8 dated June 23, 1977, to the Power Agreement between Ohio Valley Electric Corporation and Atomic Energy Commission. [Filed as Exhibit 5.02q to LG&E's Registration Statement 2-61607 and incorporated by reference herein]
10.18	x		Copy of Modification No. 9 dated July 1, 1978, to the Power Agreement between Ohio Valley Electric Corporation and Atomic Energy Commission. [Filed as Exhibit 5.02r to LG&E's Registration Statement 2-63149 and incorporated by reference herein]
10.19	x		Copy of Modification No. 10 dated August 1, 1979, to the Power Agreement between Ohio Valley Electric Corporation and Atomic Energy Commission. [Filed as Exhibit 2 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1979, and incorporated by reference herein]
10.20	x		Copy of Modification No. 11 dated September 1, 1979, to the Power Agreement between Ohio Valley Electric Corporation and Atomic Energy Commission. [Filed as Exhibit 3 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1979, and incorporated by reference herein]
10.21	x	x	Copy of Modification No. 5 dated September 1, 1979, to Inter-Company Power Agreement dated July 5, 1953, among Ohio Valley Electric Corporation and Sponsoring Companies. [Filed as Exhibit 4 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1979, and incorporated by reference herein]
10.22	x		Copy of Modification No. 12 dated August 1, 1981, to the Power Agreement between Ohio Valley Electric Corporation and Atomic Energy Commission. [Filed as Exhibit 10.25 to LG&E's Annual Report on Form

<u>Exhibit No.</u>	<u>Applicable to Form 10-K of</u>		<u>Description</u>
	<u>LG&amp;E</u>	<u>KU</u>	
			10-K for the year ended December 31, 1981, and incorporated by reference herein]
10.23	x	x	Copy of Modification No.6 dated August 1, 1981, to Inter-Company Power Agreement dated July 5, 1953, among Ohio Valley Electric Corporation and Sponsoring Companies. [Filed as Exhibit 10.26 to LG&E's Annual Report on Form 10K for the year ended December 31, 1981, and incorporated by reference herein]
10.24	x		* Copy of Nonqualified Savings Plan covering officers of the Company, effective January 1, 1992. [Filed as Exhibit 10.43 to the Company's Annual Report on Form 10-K for the year ended December 31, 1992, and incorporated by reference herein]
10.25	x		Copy of Modification No. 13 dated September 1, 1989, to the Power Agreement between Ohio Valley Electric Corporation and Atomic Energy Commission. [Filed as Exhibit 10.42 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1993, and incorporated by reference herein]
10.26	x		Copy of Modification No. 14 dated January 15, 1992, to the Power Agreement between Ohio Valley Electric Corporation and Atomic Energy Commission. [Filed as Exhibit 10.43 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1993, and incorporated by reference herein]
10.27	x	x	Copy of Modification No. 7 dated January 15, 1992, to Inter-Company Power Agreement dated July 10, 1953, among Ohio Valley Electric Corporation and Sponsoring Companies. [Filed as Exhibit 10.44 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1993, and incorporated by reference herein]
10.28	x		Copy of Modification No. 15 dated February 15, 1993, to the Power Agreement between Ohio Valley Electric Corporation and Atomic Energy Commission. [Filed as Exhibit 10.45 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1993, and incorporated by reference herein]
10.29	x		Copies of Firm No Notice Transportation Agreements each effective November 1, 1993, between Texas Gas Transmission Corporation and LG&E (expiring October 31, 2000, 2001 and 2003) covering the transmission of natural gas.

Exhibit No.	Applicable to Form 10-K of		<u>Description</u>
	<u>LG&amp;E</u>	<u>KU</u>	
			[All filed as Exhibit 10.47 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1993, and incorporated by reference herein]
10.30	x	x	Copy of Modification No. 8 dated January 19, 1994, to Intercompany Power Agreement, dated July 10, 1953, among Ohio Valley Electric Corporation and the Sponsoring Companies. [Filed as Exhibit 10.43 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1995, and incorporated by reference herein]
10.31	x		Copy of Amendment dated March 1, 1995, to Firm No-Notice Transportation Agreements dated November 1, 1993 (2-Year, 5-Year and 8-Year), between Texas Gas Transmission Corporation and LG&E covering the transmission of natural gas. [Filed as Exhibit 10.44 of LG&E's Annual Report on Form 10-K for the year ended December 31, 1995, and incorporated by reference herein]
10.32	x	x	Copy of Modification No. 9, dated August 17, 1995, to the Inter-Company Power Agreement dated July 10, 1953, among Ohio Valley Electric Corporation and the Sponsoring Companies. [Filed as Exhibit 10.39 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1996, and incorporated by reference herein]
10.33	x		Copy of Agreement and Plan of Merger, dated February 10, 1995, between LG&E Natural Inc., formerly known as Hadson Corporation, Carousel Acquisition Corporation and the Company. [Filed as Exhibit 2 of Schedule 13D by the Company on February 21, 1995, and incorporated by reference herein]
10.34	x		Copies of Firm Transportation Agreements, each dated March 1, 1995, between Texas Gas Transmission Corporation and LG&E (expiring October 31, 2001 and 2003) covering the transportation of natural gas. [Both filed as Exhibit 10.45 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1995, and incorporated by reference herein]
10.35	x		Copy of Firm Transportation Agreement, dated March 1, 1995, between Texas Gas Transmission Corporation and LG&E (expires October 31, 2000) covering the transportation of natural gas [Filed as Exhibit 10.41 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1996, and incorporated by reference herein]

Exhibit No.	Applicable to Form 10-K of		Description
	LG&E	KU	
10.36	x		* Copy of Amendment to the Non-Qualified Savings Plan, effective January 1, 1992. [Filed as Exhibit 10.55 to the Company's Annual Report on Form 10-K for the year ended December 31, 1995, and incorporated by reference herein]
10.37	x		* Copy of Amendment to the Non-Qualified Savings Plan, effective January 1, 1995. [Filed as Exhibit 10.56 to the Company's Annual Report on Form 10-K for the year ended December 31, 1995, and incorporated by reference herein]
10.38	x		* Copy of Amendment to the Non-Qualified Savings Plan, effective January 1, 1995. [Filed as Exhibit 10.57 to the Company's Annual Report on Form 10-K for the year ended December 31, 1995, and incorporated by reference herein]
10.39	x		Copy of Form of Master Gas Purchase Agreement, dated December 14, 1993, among Santa Fe, SFEOP and AGPC. [Filed as Exhibit 10.23 to LG&E Natural Inc.'s, formerly known as Hadson Corporation, Registration Statement on Form S-4, File No. 33-68224, and incorporated by reference herein]
10.40	x		Copy of Credit Agreement, dated as of December 18, 1995, among LG&E, as Borrower, the Banks named therein, PNC Bank, Kentucky, Inc. as Agent and Bank of Montreal as Co-Agent. [Filed as Exhibit 10.01 to the LG&E's Quarterly Report on Form 10-Q/A for the quarter ended March 31, 1996, and incorporated by reference herein]
10.41	x		Copy of Firm Transportation Agreement, dated November 1, 1996, between LG&E and Tennessee Gas Pipeline Company for 30,000 Mmbtu per day in Firm Transportation Service under Tennessee's Rate FT-A (expires October 31, 2001). [Filed as Exhibit 10.42 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1996, and incorporated by reference herein]
10.42	x		Copy of Amendment No. 1, dated as of November 5, 1996, to Credit Agreement dated as of December 18, 1995, by and among Louisville Gas and Electric Company, the Banks party thereto, and PNC Bank, Kentucky, Inc. as Agent and Bank of Montreal as Co-Agent. [Filed as Exhibit 10.59 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1996, and incorporated by reference herein]
10.43	x		* Copy of LG&E Energy Corp. and Louisville Gas and Electric

Exhibit No.	Applicable to Form 10-K of		<u>Description</u>
	<u>LG&amp;E</u>	<u>KU</u>	
			Company Non-Officer Senior Management Pension Restoration Plan, effective May 1, 1996. [Filed as Exhibit 10.69 to LG&E Energy's Annual Report on Form 10-K for the year ended December 31, 1996, and incorporated by reference herein]
10.44	x	x	* Copy of Supplemental Executive Retirement Plan as amended through January 1, 1998, covering officers of LG&E Energy. [Filed as Exhibit 10.74 to LG&E Energy's Annual Report on Form 10-K for the year ended December 31, 1997, and incorporated by reference herein]
10.45	x		Copy of Coal Supply Agreement between LG&E and Kindill Mining, Inc., dated July 1, 1997. [Filed as Exhibit 10.76 to LG&E Energy's Annual Report on Form 10-K for the year ended December 31, 1997, and incorporated by reference herein]
10.46	x		Copy of Coal Supply Agreement between LG&E and Warrior Coal Corp. dated January 1, 1997, and Amendments #1 and #2 dated May 1, 1997, and December 1, 1997, thereto. [Filed as Exhibit 10.79 to LG&E Energy's Annual Report on Form 10-K for the year ended December 31, 1997, and incorporated by reference herein]
10.47	x		Copies of Amendments dated September 23, 1997, to Firm No-Notice Transportation Agreements dated November 1, 1993, between Texas Gas Transmission Corporation and LG&E, as amended. [Filed as Exhibit 10.81 to LG&E Energy's Annual Report on Form 10-K for the year ended December 31, 1997, and incorporated by reference herein]
10.48	x		Copies of Amendments dated September 23, 1997, to Firm Transportation Agreements dated March 1, 1995, between Texas Gas Transmission Corporation and LG&E, as amended. [Filed as Exhibit 10.82 to LG&E Energy's Annual Report on Form 10-K for the year ended December 31, 1997, and incorporated by reference herein]
10.49	x		Copy of Gas Transportation Agreement dated November 1, 1996, between Tennessee Gas Pipeline Company and LG&E and amendments dated February 4, 1997, thereto. [Filed as Exhibit 10.83 to LG&E Energy's Annual Report on Form 10-K for the year ended December 31, 1997, and incorporated by reference herein] [Certain portions of this exhibit have been omitted pursuant to a confidential treatment request filed with the Securities and Exchange Commission]
10.50	x		Copy of Coal Supply Agreement dated January 1, 1999 between LG&E and Peabody COALSALES Company. [Filed as Exhibit 10.77 to

Exhibit No.	Applicable to Form 10-K of		<u>Description</u>
	<u>LG&amp;E</u>	<u>KU</u>	
			LG&E's Annual Report on Form 10-K for the year ended December 31, 1998 and incorporated by reference herein]
10.51	x	x	Copy of Coal Supply Agreement between LG&E and KU and Black Beauty Coal Company, dated as of January 1, 2002, covering the purchase of coal.
10.52	x	x	Copy of Coal Supply Agreement between LG&E and KU and McElroy Coal Company, Consolidation Coal Company, Consol Pennsylvania Coal Company, Greenon Coal Company, Nineveh Coal Company, Eighty Four Mining Company and Island Creek Coal Company, dated as of January 1, 2000, and Amendment No. 1 dated as of January 1, 2002, for the purchase of coal.
10.53		x	Copy of Coal Supply Agreement between KU and Arch Coal Sales Company, Inc., as agent for the independent operating subsidiaries of Arch Coal, Inc. dated as of July 22, 2001, for the purchase of coal.
10.54	x		Copy of Coal Supply Agreement between LG&E and Hopkins County Coal, LLC and Alliance Coal Sales, a division of Alliance Coal, LLC, dated as of January 1, 2002, for the purchase of coal.
10.55		x	Copy of Coal Supply Agreement between KU and Arch Coal Sales Company, Inc., as agent for the independent operating subsidiaries of Arch Coal, Inc., dated as of August 12, 2001, for the purchase of coal.
10.56		x	Copy of Purchase Order dated December 26, 2000, by and between Kentucky Utilities Company and AEI Coal Sales Company, Inc., for the purchase of coal, commencing January 1, 2001
10.57	x		Copy of Amendment dated November 6, 2000 to Firm No-Notice Transportation Agreement between LG&E and Texas Gas Transmission Corporation covering the transmission of natural gas (expires October 31, 2006)
10.58	x		Copy of Amendment dated November 6, 2000 to Firm No-Notice Transportation Agreement between LG&E and Texas Gas Transmission Corporation covering the transmission of natural gas (expires October 31, 2008)
10.59	x		Copy of Amendment dated November 6, 2000 to Firm No-Notice Transportation Agreement between LG&E and Texas Gas Transmission Corporation covering the transmission of natural gas (expires October 31,

Exhibit No.	Applicable to Form 10-K of		Description
	LG&E	KU	
			2006)
10.60	x		Copy of Amendment dated September 15, 1999 to Firm No-Notice Transportation Agreement between LG&E and Texas Gas Transmission Corporation covering the transmission of natural gas (expires October 31, 2006)
10.61	x	x	* Copy of Amendment to LG&E Energy's Supplemental Executive Retirement Plan, effective September 2, 1998. [Filed as Exhibit 10.90 to LG&E Energy's Annual Report on Form 10-K for the year ended December 31, 1998 and incorporated by reference herein]
10.62	x	x	* Copy of Employment Agreement dated as of February 25, 2000, by and among LG&E Energy, Powergen plc and Roger W. Hale. [Filed as Exhibit 1 to Appendix A of LG&E Energy's Preliminary Proxy Statement on Schedule 14A on March 13, 2000 and incorporated by reference herein]
10.63	x	x	* Copy of form of Employment and Severance Agreement, dated as of February 25, 2000, by and among LG&E Energy, Powergen plc and certain executive officers of the Company. [Filed as Exhibit 10.94 to LG&E's and KU's Annual Report on Form 10-K for the year ended December 31, 1999, and incorporated by reference herein]
10.64	x	x	* Copy of Amendment, effective October 1, 1999, to LG&E Energy's Non-Qualified Savings Plan. [Filed as Exhibit 10.96 to LG&E's and KU's Annual Report on Form 10-K for the year ended December 31, 1999, and incorporated herein by reference]
10.65	x	x	* Copy of Amendment, effective December 1, 1999, to LG&E Energy's Non-Qualified Savings Plan. [Filed as Exhibit 10.97 to LG&E's and KU's Annual Report on Form 10-K for the year ended December 31, 1999, and incorporated herein by reference]
10.66	x	x	Copy of Modification No. 10., dated January 1, 1998, to the Inter-Company Power Agreement dated July 10, 1953, among Ohio Valley Electric Corporation and the Sponsoring Companies. [Filed as Exhibit 10.102 to LG&E's and KU's Annual Report on Form 10-K for the year ended December 31, 1999, and incorporated herein by reference]
10.67	x	x	Copy of Modification No. 11, dated April 1, 1999, to the Inter-Company Power Agreement dated July 10, 1953, among Ohio Valley Electric Corporation and the Sponsoring Companies. [Filed as Exhibit 10.103 to LG&E's and KU's Annual report on Form 10-K for the year ended

Exhibit No.	Applicable to Form 10-K of		Description
	LG&E	KU	
			December 31, 1999, and incorporated herein by reference]
10.68	x		Copy of Amendment No. 1, dated January 1, 2000, to Amended and Restated Coal Supply Agreement, dated April 1, 1998, among LG&E, Hopkins County Coal, LLC and Webster County Coal, LLC.[Filed as Exhibit 10.104 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1999, and incorporated herein by reference]
10.69	x		Copy of Amendment No. 1, dated January 1, 2000, to Coal Supply Contract, dated January 1, 1999, between LG&E and Peabody Coal Sales Company.[Filed as Exhibit 10.105 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1999, and incorporated herein by reference]
10.70	x		Copy of Letter Amendment, dated September 15, 1999, to Transportation Agreement, dated November 1, 1993, between LG&E and Texas Gas Transmission Corporation.[Filed as Exhibit 10.106 to LG&E's Annual Report on Form 10-K for the year ended December 31, 1999, and incorporated herein by reference]
10.71	x	x	* Copy of Powergen Long-Term Incentive Plan, effective December 11, 2000, applicable to certain employees of LG&E Energy Corp. and its subsidiaries [Filed as Exhibit 10.107 to LG&E's Annual Report on Form 10-K for the year ended December 31, 2000, and incorporated herein by reference]
10.72	x	x	* Copy of Powergen Short-Term Incentive Plan, effective January 1, 2001, applicable to certain employees of LG&E Energy Corp. and its subsidiaries [Filed as Exhibit 10.109 to LG&E's Annual Report on Form 10-K for the year ended December 31, 2000, and incorporated herein by reference]
10.73	x	x	* Copy of two forms of Change-In-Control Agreement applicable to certain employees of LG&E Energy Corp. and its subsidiaries. [Filed as Exhibit 10.110 to LG&E's Annual Report on Form 10-K for the year ended December 31, 2000, and incorporated herein by reference]
10.74	x	x	* Copy of Employment and Severance Agreement, dated as of February 25, 2000, and amendments thereto dated December 8, 2000 and April 30, 2001, by and among LG&E Energy, Powergen plc and Victor A. Staffieri [To be filed by amendment]

Exhibit No.	Applicable to Form 10-K of		Description
	LG&E	KU	
10.75	x	x	* Copy of form of Amendments, dated as of December 8, 2000, to Employment and Severance Agreements dated as of February 25, 2000, by and among LG&E Energy, Powergen plc and certain executive officers of the Company. [To be filed by amendment]
10.76	x	x	* Copy of form of offer letter, dated as of November 29, 2000, by and among LG&E Energy and certain executive officers of the Company. [To be filed by amendment]
12	x	x	Computation of Ratio of Earnings to Fixed Charges for LG&E and KU.
21	x	x	Subsidiaries of the Registrants.
23.01	x		Consents of Independent Accountants for LG&E.
23.02		x	Consents of Independent Accountants for KU.
24	x	x	Powers of Attorney.
99.01	x	x	Cautionary Statement for purposes of the "Safe Harbor" provisions of the Private Securities Litigation Reform Act of 1995.
99.02	x	x	LG&E and KU Director and Officer Information [To be filed by amendment if necessary. See Part III above.]

(b) Executive Compensation Plans and Arrangements:

Exhibits preceded by an asterisk ("\*") above are management contracts, compensation plans or arrangements required to be filed as an exhibit pursuant to Item 14(c) of Form 10-K.

(c) Reports on Form 8-K:

On May 7, 2001, a report on Form 8-K was filed announcing a change in certifying accountants.

On February 21, 2002, a report on Form 8-K was filed announcing LG&E's and KU's financial results for year ended December 31, 2001.

There were no Form 8-K filings during the fourth quarter of 2001.

(d) The following instruments defining the rights of holders of certain long-term debt of KU have not been filed with the Securities and Exchange Commission but will be furnished to the Commission upon request.

1. Loan Agreement dated as of May 1, 1990, between KU and the County of Mercer, Kentucky, in connection with \$12,900,000 County of Mercer, Kentucky, Collateralized Solid Waste Disposal Facility Revenue Bonds (KU Project) 1990 Series A, due May 1, 2010 and May 1, 2020.
2. Loan Agreement dated as of May 1, 1991, between KU and the County of Carroll, Kentucky, in connection with \$96,000,000 County of Carroll, Kentucky, Collateralized Pollution Control Revenue Bonds (KU Project) 1992 Series A, due September 15, 2016.
3. Loan Agreement dated as of August 1, 1992, between KU and the County of Carroll, Kentucky, in connection with \$2,400,000 County of Carroll, Kentucky, Collateralized Pollution Control Revenue Bonds (KU Project) 1992 Series C, due February 1, 2018.
4. Loan Agreement dated as of August 1, 1992, between KU and the County of Muhlenberg, Kentucky, in connection with \$7,200,000 County of Muhlenberg, Kentucky, Collateralized Pollution Control Revenue Bonds (KU Project) 1992 Series A, due February 1, 2018.
5. Loan Agreement dated as of August 1, 1992, between KU and the County of Mercer, Kentucky, in connection with \$7,400,000 County of Mercer, Kentucky, Collateralized Pollution Control Revenue Bonds (KU Project) 1992 Series A, due February 1, 2018.
6. Loan Agreement dated as of August 1, 1992, between KU and the County of Carroll, Kentucky, in connection with \$20,930,000 County of Carroll, Kentucky, Collateralized Pollution Control Revenue Bonds (KU Project) 1992 Series B, due February 1, 2018.
7. Loan Agreement dated as of December 1, 1993, between KU and the County of Carroll, Kentucky, in connection with \$50,000,000 County of Carroll, Kentucky, Collateralized Solid Waste Disposal Facilities Revenue Bonds (KU Project) 1993 Series A, due December 1, 2023.
8. Loan Agreement dated as of November 1, 1994, between KU and the County of Carroll, Kentucky, in connection with \$54,000,000 County of Carroll, Kentucky, Collateralized Solid Waste Disposal Facilities Revenue Bonds (KU Project) 1994 Series A, due November 1, 2024.

**Report of Independent Accountants  
on Financial Statement Schedules**

**To the Shareholders of Louisville Gas and Electric Company and Subsidiary:**

**Our audit of the consolidated financial statements of Louisville Gas and Electric Company and Subsidiary as of December 31, 2001 and for the year then ended referred to in our report dated January 25, 2002 also included an audit of the financial statement schedule listed in Item 14(a)2 of this Form 10-K. In our opinion, this financial statement schedule presents fairly, in all material respects, the information set forth therein as of December 31, 2001 and for the year then ended when read in conjunction with the related consolidated financial statements.**

**/s/ PricewaterhouseCoopers LLP  
January 25, 2002  
Louisville, Kentucky**

Louisville Gas and Electric Company  
Schedule II - Valuation and Qualifying Accounts  
For the Three Years Ended December 31, 2001  
(Thousands of \$)

Schedule II

	<u>Other Property and Investments</u>	<u>Accounts Receivable (Uncollectible Accounts)</u>
Balance December 31, 1998	\$ 63	\$ 1,399
Additions:		
Charged to costs and expenses	-	1,925
Deductions:		
Net charges of nature for which reserves were created	<u>-</u>	<u>2,091</u>
Balance December 31, 1999	63	1,233
Additions:		
Charged to costs and expenses	-	2,803
Deductions:		
Net charges of nature for which reserves were created	<u>-</u>	<u>2,750</u>
Balance December 31, 2000	63	1,286
Additions:		
Charged to costs and expenses	-	4,953
Deductions:		
Net charges of nature for which reserves were created	<u>-</u>	<u>4,664</u>
Balance December 31, 2001	<u>\$ 63</u>	<u>\$ 1,575</u>

**Report of Independent Accountants  
on Financial Statement Schedules**

To the Shareholders of Kentucky Utilities Company and Subsidiary:

Our audit of the consolidated financial statements of Kentucky Utilities Company and Subsidiary as of December 31, 2001 and for the year then ended referred to in our report dated January 25, 2002 also included an audit of the financial statement schedule listed in Item 14(a)2 of this Form 10-K. In our opinion, this financial statement schedule presents fairly, in all material respects, the information set forth therein as of December 31, 2001 and for the year then ended when read in conjunction with the related consolidated financial statements.

/s/ PricewaterhouseCoopers LLP  
January 25, 2002  
Louisville, Kentucky

Kentucky Utilities Company  
Schedule II - Valuation and Qualifying Accounts  
For the Three Years Ended December 31, 2001  
(Thousands of \$)

Schedule II

	<u>Other Property and Investments</u>	<u>Accounts Receivable (Uncollectible Accounts)</u>
Balance December 31, 1998	\$ 576	\$ 520
Additions:		
Charged to costs and expenses	111	1,707
Deductions:		
Net charges of nature for which reserves were created	-	1,427
Balance December 31, 1999	687	800
Additions:		
Charged to costs and expenses	64	1,430
Deductions:		
Net charges of nature for which reserves were created	-	1,430
Balance December 31, 2000	751	800
Additions:		
Charged to costs and expenses	9	1,528
Deductions:		
Net charges of nature for which reserves were created	630	1,528
Balance December 31, 2001	<u>\$ 130</u>	<u>\$ 800</u>

SIGNATURES – LOUISVILLE GAS AND ELECTRIC COMPANY

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

LOUISVILLE GAS AND ELECTRIC COMPANY  
Registrant

March 28, 2002  
(Date)

/s/ S. Bradford Rives

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the date indicated.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
Victor A. Staffieri	Chairman of the Board, President and Chief Executive Officer (Principal Executive Officer);	
Richard Aitken-Davies	Chief Financial Officer (Principal Financial Officer);	
S. Bradford Rives	Senior Vice President – Finance and Controller (Principal Accounting Officer);	
David J. Jackson	Director;	
Nicholas Baldwin	Director;	
Edmund Wallis	Director.	

By /s/ S. Bradford Rives  
(Attorney-In-Fact)

March 28, 2002

SIGNATURES – KENTUCKY UTILITIES COMPANY

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

KENTUCKY UTILITIES COMPANY  
Registrant

March 28, 2002  
(Date)

/s/ S. Bradford Rives

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the date indicated.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
Victor A. Staffieri	Chairman of the Board, President and Chief Executive Officer (Principal Executive Officer);	
Richard Aitken-Davies	Chief Financial Officer (Principal Financial Officer);	
S. Bradford Rives	Senior Vice President – Finance and Controller (Principal Accounting Officer);	
David J. Jackson	Director;	
Nicholas Baldwin	Director;	
Edmund Wallis	Director.	

By /s/ S. Bradford Rives  
(Attorney-In-Fact)

March 28, 2002

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**SEC Form 10-Q – September 30, 2003**

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2003

Or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

Commission  
File Number

2-26720

Registrant, State of Incorporation  
Address, and Telephone Number

**Louisville Gas and Electric Company**  
(A Kentucky Corporation)  
220 West Main Street  
P.O. Box 32010  
Louisville, KY 40232  
(502) 627-2000

IRS Employer  
Identification No.

61-0264150

1-3464

**Kentucky Utilities Company**  
(A Kentucky and Virginia Corporation)  
One Quality Street  
Lexington, KY 40507-1428  
(859) 255-2100

61-0247570

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

Louisville Gas and Electric Company  
21,294,223 shares, without par value, as of October 31, 2003,  
all held by LG&E Energy Corp.

Kentucky Utilities Company  
37,817,878 shares, without par value, as of October 31, 2003,  
all held by LG&E Energy Corp.

This combined Form 10-Q is separately filed by Louisville Gas and Electric Company and Kentucky Utilities Company. Information contained herein related to any individual registrant is filed by such registrant on its own behalf. Each registrant makes no representation as to information related to the other registrants.

TABLE OF CONTENTS

PART I

Item 1. Consolidated Financial Statements

Louisville Gas and Electric Company and Subsidiary

Statements of Income ..... 1

Balance Sheets ..... 2

Statement of Cash Flows ..... 4

Statement of Retained Earnings ..... 5

Statements of Other Comprehensive Income ..... 6

Kentucky Utilities Company and Subsidiary

Statements of Income ..... 7

Balance Sheets ..... 8

Statement of Cash Flows ..... 10

Statement of Retained Earnings ..... 11

Statements of Other Comprehensive Income ..... 12

Notes to Consolidated Financial Statements ..... 13

Item 2 Management's Discussion and Analysis of Financial Condition  
and Results of Operations ..... 21

Item 3 Quantitative and Qualitative Disclosures About Market Risk ..... 31

Item 4 Controls and Procedures ..... 33

PART II

Item 1 Legal Proceedings ..... 34

Item 6 Exhibits and Reports on Form 8-K ..... 34

Signatures ..... 36

Exhibits ..... 37

Part I. Financial Information - Item 1. Financial Statements

**Louisville Gas and Electric Company and Subsidiary**  
 Consolidated Statements of Income  
 (Unaudited)  
 (Thousands of \$)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
<b>OPERATING REVENUES (Note 5 and Note 8):</b>				
Electric.....	\$230,174	\$220,274	\$591,110	\$566,385
Gas.....	32,659	22,800	213,939	170,856
Total operating revenues .....	<u>262,833</u>	<u>243,074</u>	<u>805,049</u>	<u>737,241</u>
<b>OPERATING EXPENSES:</b>				
Fuel for electric generation.....	55,628	52,827	151,382	147,484
Power purchased (Note 8).....	18,805	12,579	60,245	46,276
Gas supply expenses.....	19,509	11,098	151,579	112,911
Other operation expenses.....	51,890	51,269	158,797	154,486
Maintenance.....	12,526	18,869	42,109	46,441
Depreciation and amortization (Note 8) .....	28,429	28,196	85,866	79,363
Federal and state income taxes.....	23,707	22,083	45,062	43,655
Property and other taxes.....	4,659	4,501	12,848	13,815
Total operating expenses .....	<u>215,153</u>	<u>201,422</u>	<u>707,888</u>	<u>644,431</u>
NET OPERATING INCOME.....	47,680	41,652	97,161	92,810
Other income (expense) - net.....	287	156	(43)	90
Interest charges (Note 3).....	8,096	7,604	22,227	22,497
NET INCOME.....	<u>\$ 39,871</u>	<u>\$ 34,204</u>	<u>\$ 74,891</u>	<u>\$ 70,403</u>

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

**Louisville Gas and Electric Company and Subsidiary**  
**Consolidated Balance Sheets**  
(Unaudited)  
(Thousands of \$)

ASSETS

	September 30, <u>2003</u>	December 31, <u>2002</u>
UTILITY PLANT:		
At original cost.....	\$3,752,179	\$3,622,985
Less: reserve for depreciation.....	<u>1,522,825</u>	<u>1,463,674</u>
Net utility plant (Note 7) .....	<u>2,229,354</u>	<u>2,159,311</u>
OTHER PROPERTY AND INVESTMENTS -		
less reserve of \$63 as of September 30, 2003 and December 31, 2002 .....	<u>611</u>	<u>764</u>
CURRENT ASSETS:	3,400	17,015
Cash.....		
Accounts receivable -		
less reserve of \$1,415 as of September 30, 2003 and \$2,125 as of December 31, 2002 (Note 4) .....	55,241	68,440
Materials and supplies - at average cost:		
Fuel (predominantly coal) .....	25,099	36,600
Gas stored underground .....	69,634	50,266
Other .....	24,342	25,651
Prepayments and other.....	<u>2,662</u>	<u>5,298</u>
Total current assets .....	<u>180,378</u>	<u>203,270</u>
DEFERRED DEBITS AND OTHER ASSETS:		
Unamortized debt expense.....	6,334	6,532
Regulatory assets (Note 6).....	139,829	153,446
Other.....	<u>33,164</u>	<u>37,755</u>
Total deferred debits and other assets .....	<u>179,327</u>	<u>197,733</u>
Total assets.....	<u>\$2,589,670</u>	<u>\$2,561,078</u>

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

**Louisville Gas and Electric Company and Subsidiary**  
**Consolidated Balance Sheets**  
(Unaudited)  
(Thousands of \$)

**CAPITALIZATION AND LIABILITIES**

	<u>September 30,</u> <u>2003</u>	<u>December 31,</u> <u>2002</u>
<b>CAPITALIZATION:</b>		
Common stock, without par value -		
Outstanding 21,294,223 shares .....	\$ 425,170	\$ 425,170
Common stock expense.....	(836)	(836)
Additional paid-in capital.....	40,000	40,000
Retained earnings.....	481,926	409,319
Accumulated other comprehensive loss.....	(39,939)	(40,512)
Total common equity .....	<u>906,321</u>	<u>833,141</u>
Cumulative preferred stock.....	70,140	70,140
Mandatorily redeemable preferred stock.....	22,500	23,750
Long-term debt.....	328,104	328,104
Long-term debt to associated company (Note 9).....	200,000	-
Total capitalization .....	<u>1,527,065</u>	<u>1,255,135</u>
<b>CURRENT LIABILITIES:</b>		
Current portion of mandatorily		
redeemable preferred stock .....	1,250	1,250
Current portion of long-term debt.....	246,200	288,800
Notes payable to parent (Note 9).....	75,132	193,053
Accounts payable.....	84,252	122,771
Accrued taxes.....	12,940	1,450
Other.....	20,245	19,536
Total current liabilities .....	<u>440,019</u>	<u>626,860</u>
<b>DEFERRED CREDITS AND OTHER LIABILITIES:</b>		
Accumulated deferred income taxes - net.....	344,281	313,225
Investment tax credit, in process of amortization.....	51,380	54,536
Accumulated provision for pensions		
and related benefits .....	127,496	224,703
Customer advances for construction.....	9,700	10,260
Asset retirement obligation (Note 8).....	9,793	-
Regulatory liabilities (Note 6).....	43,715	52,424
Long-term derivative liability.....	16,464	17,115
Other.....	19,757	6,820
Total deferred credits and other liabilities .....	<u>622,586</u>	<u>679,083</u>
Total capital and liabilities.....	<u>\$2,589,670</u>	<u>\$2,561,078</u>

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

**Louisville Gas and Electric Company and Subsidiary**  
**Consolidated Statement of Cash Flows**  
(Unaudited)  
(Thousands of \$)

	Nine Months Ended September 30,	
	<u>2003</u>	<u>2002</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income .....	\$ 74,891	\$ 70,403
Items not requiring cash currently:		
Depreciation and amortization .....	85,866	79,363
Deferred income taxes - net .....	24,589	7,748
Investment tax credit - net .....	(3,156)	(3,100)
Asset retirement obligations (Note 8) .....	4,108	-
Other .....	26,104	33,595
Changes in current assets and liabilities.....	(28,028)	(63,348)
Changes in accounts receivable securitization-net (Note 4)	11,600	32,200
Pension funding (Note 9).....	(89,125)	-
Gas supply clause.....	(14,970)	5,331
Other.....	12,086	8,331
Net cash flows from operating activities .....	<u>\$103,965</u>	<u>170,523</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Long-term investments.....	153	(239)
Construction expenditures.....	(153,064)	(141,855)
Net cash flows from investing activities .....	<u>(152,911)</u>	<u>(142,094)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Long-term borrowings from associated company (Note 9).....	200,000	-
Short-term borrowings from parent (Note 9).....	478,800	896,456
Repayment of short-term borrowings from parent.....	(596,721)	(861,500)
Retirement of preferred stock.....	(1,250)	-
Retirement of first mortgage bonds.....	(42,600)	-
Issuance of pollution control bonds.....	-	118,876
Retirement of pollution control bonds.....	-	(120,000)
Issuance of pollution control bonds.....	(2,898)	(49,225)
Payment of dividends.....	35,331	(15,393)
Net cash flows from financing activities .....	<u>(13,615)</u>	<u>13,036</u>
<b>CHANGE IN CASH .....</b>	<u>17,015</u>	<u>2,112</u>
<b>CASH AT BEGINNING OF PERIOD.....</b>	<u>\$ 3,400</u>	<u>\$ 15,148</u>
<b>CASH AT END OF PERIOD.....</b>		
<b>SUPPLEMENTAL DISCLOSURES:</b>		
Cash paid during the period for:		
Income taxes .....	\$ 12,968	\$ 46,925
Interest on borrowed money .....	\$ 17,204	\$ 22,523

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

Louisville Gas and Electric Company and Subsidiary  
Consolidated Statement of Retained Earnings  
(Unaudited)  
(Thousands of \$)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	<u>2003</u>	<u>2002</u>	<u>2003</u>	<u>2002</u>
Balance at beginning of period.....	\$442,498	\$404,721	\$409,319	\$393,636
Net income.....	<u>39,871</u>	<u>34,204</u>	<u>74,891</u>	<u>70,403</u>
Subtotal .....	<u>482,369</u>	<u>438,925</u>	<u>484,210</u>	<u>464,039</u>
Cash dividends declared on stock:				
5% cumulative preferred.....	269	269	807	807
Auction rate cumulative preferred...	174	439	743	1,281
\$5.875 cumulative preferred .....	-	367	734	1,101
Common.....	-	<u>23,000</u>	-	<u>46,000</u>
Subtotal .....	<u>443</u>	<u>24,075</u>	<u>2,284</u>	<u>49,189</u>
Balance at end of period.....	<u>\$481,926</u>	<u>\$414,850</u>	<u>\$481,926</u>	<u>\$414,850</u>

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

**Louisville Gas and Electric Company and Subsidiary**  
**Consolidated Statements of Other Comprehensive Income**  
(Unaudited)  
(Thousands of \$)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	<u>2003</u>	<u>2002</u>	<u>2003</u>	<u>2002</u>
Net income.....	\$39,871	\$34,204	\$74,891	\$70,403
Gains (losses) on derivative instruments and hedging activities (Note 3) ..	3,539	(7,691)	955	(10,121)
Income tax benefit (expense) related to items of other comprehensive income .....	<u>(1,416)</u>	<u>3,076</u>	<u>(382)</u>	<u>4,049</u>
Other comprehensive income (loss), net of tax .....	<u>2,123</u>	<u>(4,615)</u>	<u>573</u>	<u>(6,072)</u>
Comprehensive income.....	<u>\$41,994</u>	<u>\$29,589</u>	<u>\$75,464</u>	<u>\$64,331</u>

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

**Kentucky Utilities Company and Subsidiary**  
**Consolidated Statements of Income**  
(Unaudited)  
(Thousands of \$)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	<u>2003</u>	<u>2002</u>	<u>2003</u>	<u>2002</u>
OPERATING REVENUES (Note 5 and Note 8) ..	\$235,426	\$235,059	\$657,583	\$640,103
OPERATING EXPENSES:				
Fuel for electric generation.....	75,300	80,380	201,264	196,018
Power purchased (Note 8).....	31,702	27,912	106,550	95,203
Other operation expenses.....	35,603	38,151	112,622	108,874
Maintenance.....	13,031	12,439	49,400	39,385
Depreciation and amortization (Note 8) ..	24,751	24,449	76,663	71,023
Federal and state income taxes.....	18,196	17,011	32,263	38,759
Property and other taxes.....	4,067	3,689	12,230	11,565
Total operating expenses .....	<u>202,650</u>	<u>204,031</u>	<u>590,992</u>	<u>560,827</u>
NET OPERATING INCOME.....	32,776	31,028	66,591	79,276
Other income - net.....	2,145	5,466	6,948	8,789
Interest charges (Note 3).....	<u>4,611</u>	<u>5,409</u>	<u>17,209</u>	<u>19,871</u>
NET INCOME.....	<u>\$ 30,310</u>	<u>\$ 31,085</u>	<u>\$ 56,330</u>	<u>\$ 68,194</u>

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

**Kentucky Utilities Company and Subsidiary**  
**Consolidated Balance Sheets**  
(Unaudited)  
(Thousands of \$)

ASSETS

	September 30, <u>2003</u>	December 31, <u>2002</u>
UTILITY PLANT:		
At original cost.....	\$3,527,901	\$3,280,762
Less: reserve for depreciation.....	<u>1,600,258</u>	<u>1,536,658</u>
Net utility plant (Note 7) .....	<u>1,927,643</u>	<u>1,744,104</u>
OTHER PROPERTY AND INVESTMENTS -		
less reserve of \$130 as of September 30, 2003 and December 31, 2002 .....	<u>17,176</u>	<u>14,358</u>
CURRENT ASSETS:		
Cash.....	9,332	5,391
Accounts receivable - less reserve of \$953 and \$800 as of September 30, 2003 and December 31, 2002, respectively (Note 4) .....	51,082	49,588
Materials and supplies - at average cost:		
Fuel (predominantly coal) .....	33,560	46,090
Other .....	27,230	26,408
Prepayments and other.....	<u>3,432</u>	<u>6,584</u>
Total current assets .....	<u>124,636</u>	<u>134,061</u>
DEFERRED DEBITS AND OTHER ASSETS:		
Unamortized debt expense.....	4,832	4,991
Regulatory assets (Note 6).....	53,676	63,776
Long-term derivative asset.....	15,917	16,928
Other.....	<u>23,449</u>	<u>20,165</u>
Total deferred debits and other assets .....	<u>97,874</u>	<u>105,860</u>
Total assets.....	<u>\$2,167,329</u>	<u>\$1,998,383</u>

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

**Kentucky Utilities Company and Subsidiary**  
**Consolidated Balance Sheets (cont.)**  
(Unaudited)  
(Thousands of \$)

**CAPITALIZATION AND LIABILITIES**

	<u>September 30,</u> <u>2003</u>	<u>December 31,</u> <u>2002</u>
<b>CAPITALIZATION:</b>		
Common stock, without par value -	\$ 308,140	\$ 308,140
Outstanding 37,817,878 shares .....	(322)	(322)
Common stock expense.....	15,000	15,000
Additional paid-in capital.....	556,662	502,024
Retained earnings.....	(10,280)	(10,462)
Accumulated other comprehensive loss.....	<u>869,200</u>	<u>814,380</u>
Total common equity .....	39,727	39,727
Cumulative preferred stock.....	346,782	346,562
Long-term debt (Note 9).....	175,000	-
Long-term debt to associated company (Note 9).....	<u>1,430,709</u>	<u>1,200,669</u>
Total capitalization .....		
<b>CURRENT LIABILITIES:</b>		
Current portion of long-term debt.....	91,930	153,930
Notes payable to parent (Note 9).....	98,730	119,490
Accounts payable.....	68,193	95,374
Accrued taxes.....	10,558	4,955
Other.....	24,765	21,442
Total current liabilities .....	<u>294,176</u>	<u>395,191</u>
<b>DEFERRED CREDITS AND OTHER LIABILITIES:</b>		
Accumulated deferred income taxes - net.....	260,488	241,184
Investment tax credit, in process of amortization.....	6,519	8,500
Accumulated provision for pensions and related benefits .....	96,995	110,927
Asset retirement obligation (Note 8).....	19,393	-
Regulatory liabilities (Note 6).....	21,003	29,876
Other.....	38,046	12,036
Total deferred credits and other liabilities .....	<u>442,444</u>	<u>402,523</u>
Total capital and liabilities.....	<u>\$2,167,329</u>	<u>\$1,998,383</u>

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

**Kentucky Utilities Company and Subsidiary**  
**Consolidated Statement of Cash Flows**  
(Unaudited)  
(Thousands of \$)

	Nine Months Ended September 30,	
	<u>2003</u>	<u>2002</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income .....	\$ 56,330	\$ 68,194
Items not requiring cash currently:		
Depreciation and amortization .....	76,663	71,023
Deferred income taxes - net .....	10,277	(2,180)
Investment tax credit - net .....	(1,981)	(2,216)
Asset retirement obligations (Note 8) .....	9,460	-
Other .....	16,074	18,358
Changes in current assets and liabilities.....	(4,888)	(23,631)
Changes in accounts receivable securitization-net (Note 4)	-	4,900
Pension funding (Note 9).....	(9,515)	(16,011)
Other.....	27,690	16,870
Net cash flows from operating activities .....	<u>180,110</u>	<u>135,307</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Long-term investments.....	(2,818)	(4,137)
Construction expenditures.....	(263,899)	(164,766)
Net cash flows from investing activities .....	<u>(266,717)</u>	<u>(168,903)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Long-term borrowings from associated company (Note 9).....	175,000	-
Short-term borrowings from parent (Note 9).....	520,840	390,200
Repayment of short-term borrowings from parent.....	(541,600)	(350,300)
Retirement of first mortgage bonds.....	(62,000)	-
Issuance of pollution control bonds.....	-	36,813
Retirement of pollution control bonds.....	-	(37,930)
Payment of dividends.....	(1,692)	(1,692)
Net cash flows from financing activities .....	<u>90,548</u>	<u>37,091</u>
CHANGE IN CASH.....	3,941	3,495
CASH AT BEGINNING OF PERIOD.....	<u>5,391</u>	<u>3,295</u>
CASH AT END OF PERIOD.....	<u>\$ 9,332</u>	<u>\$ 6,790</u>
<b>SUPPLEMENTAL DISCLOSURES:</b>		
Cash paid during the period for:		
Income taxes .....	\$ 19,012	\$ 59,070
Interest on borrowed money .....	\$ 12,681	\$ 22,419

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

**Kentucky Utilities Company and Subsidiary**  
**Consolidated Statement of Retained Earnings**  
(Unaudited)  
(Thousands of \$)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	<u>2003</u>	<u>2002</u>	<u>2003</u>	<u>2002</u>
Balance at beginning of period.....	\$526,916	\$446,877	\$502,024	\$410,896
Net income.....	<u>30,310</u>	<u>31,085</u>	<u>56,330</u>	<u>68,194</u>
Subtotal .....	<u>557,226</u>	<u>477,962</u>	<u>558,354</u>	<u>479,090</u>
Cash dividends declared on stock:				
4.75% cumulative preferred.....	237	237	711	711
6.53% cumulative preferred .....	<u>327</u>	<u>327</u>	<u>981</u>	<u>981</u>
Subtotal .....	<u>564</u>	<u>564</u>	<u>1,692</u>	<u>1,692</u>
Balance at end of period.....	<u>\$556,662</u>	<u>\$477,398</u>	<u>\$556,662</u>	<u>\$477,398</u>

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

**Kentucky Utilities Company and Subsidiary**  
**Consolidated Statements of Other Comprehensive Income**  
(Unaudited)  
(Thousands of \$)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	<u>2003</u>	<u>2002</u>	<u>2003</u>	<u>2002</u>
Net income.....	\$30,310	\$31,085	\$56,330	\$68,194
Gains (losses) on derivative instruments and hedging activities (Note 3) .....	303	(4,475)	303	(2,647)
Income tax benefit (expense) related to Items of other comprehensive income ..	<u>(121)</u>	<u>1,790</u>	<u>(121)</u>	<u>1,059</u>
Other comprehensive income (loss), net of tax .....	<u>182</u>	<u>(2,685)</u>	<u>182</u>	<u>(1,588)</u>
Comprehensive income .....	<u>\$30,492</u>	<u>\$28,400</u>	<u>\$56,512</u>	<u>\$66,606</u>

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

**Louisville Gas and Electric Company and Subsidiary**  
**Kentucky Utilities Company and Subsidiary**

Notes to Consolidated Financial Statements  
(Unaudited)

1. The unaudited consolidated financial statements include the accounts of Louisville Gas and Electric Company and Subsidiary and Kentucky Utilities Company and Subsidiary ("LG&E" and "KU" or the "Companies"). The common stock of each of LG&E and KU is wholly-owned by LG&E Energy Corp. ("LG&E Energy"). In the opinion of management, the unaudited interim data includes all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of consolidated financial position, results of operations, comprehensive income and cash flows for the periods indicated. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to Securities and Exchange Commission ("SEC") rules and regulations, although the Companies believe that the disclosures are adequate to make the information presented not misleading.

See LG&E's and KU's current report on Form 8-K dated November 12, 2003, for information relevant to the accompanying financial statements, including information as to the significant accounting policies of the Companies.

The accompanying financial statements for the three months and nine months ended September 30, 2002, have been revised to conform with certain reclassifications in the current three months and nine months ended September 30, 2003. These reclassifications had no effect on net income, total assets, or total capital and liabilities as previously reported.

2. On December 11, 2000, LG&E Energy was acquired by Powergen plc, now known as Powergen Limited ("Powergen"), for cash of approximately \$3.2 billion or \$24.85 per share and the assumption of all of LG&E Energy's debt. As a result of the acquisition, LG&E Energy became a wholly-owned indirect subsidiary of Powergen and LG&E and KU became indirect subsidiaries of Powergen. The utility operations (LG&E and KU) of LG&E Energy continued their separate identities and continue to serve customers in Kentucky, Virginia and Tennessee under their existing names. The preferred stock and debt securities of the utility operations were not affected by this transaction and the utilities continue to file SEC reports. Following the acquisition, Powergen became a registered holding company under the Public Utility Holding Company Act of 1935 ("PUHCA"), and LG&E and KU, as subsidiaries of a registered holding company, became subject to additional regulation under PUHCA.

As a result of the Powergen acquisition and in order to comply with PUHCA, LG&E Energy Services Inc. ("LG&E Services") was formed as a subsidiary of LG&E Energy and became operational on January 1, 2001. LG&E Services provides certain services to affiliated entities, including LG&E and KU, at cost, as required under PUHCA. On January 1, 2001, approximately 1,000 employees, primarily from LG&E Energy, LG&E and KU, were moved to LG&E Services.

On July 1, 2002, a German company, E.ON AG ("E.ON"), completed its acquisition of Powergen. E.ON had announced its pre-conditional cash offer of 5.1 billion pounds sterling (\$7.3 billion) for Powergen on April 9, 2001. Following the acquisition, LG&E and KU became indirect subsidiaries of E.ON and E.ON became a registered holding company under PUHCA. As contemplated in their regulatory filings in connection with the E.ON acquisition, E.ON, Powergen and LG&E Energy have completed an administrative reorganization to move the LG&E Energy group from an indirect Powergen subsidiary to an indirect E.ON subsidiary. This reorganization was effective in March 2003.

No costs associated with the Powergen acquisition or the E.ON acquisition nor any of the effects of purchase accounting have been reflected in the financial statements of LG&E or KU.

3. The Companies use interest rate swaps to hedge exposure to market fluctuations in certain of their debt instruments. Pursuant to the Companies' policies, use of these financial instruments is intended to mitigate risk, earnings and cash flow volatility and is not speculative in nature. Management has designated all of the Companies' interest rate swaps as hedge instruments. Financial instruments designated as cash flow hedges have resulting gains and losses recorded within other comprehensive income and stockholders' equity. To the extent a financial instrument or the underlying item being hedged is prematurely terminated or the hedge becomes ineffective, the resulting gains or losses are reclassified from other comprehensive income to net income. Financial instruments designated as fair value hedges are periodically marked to market with the resulting gains and losses recorded directly into net income to correspond with income or expense recognized from changes in market value of the items being hedged.

As of September 30, 2003, LG&E had fixed rate swaps covering \$100.3 million in notional amounts of variable rate debt and with fixed rates ranging from 4.309% to 5.495%. The average variable rate on the debt during the three months and nine months ended September 30, 2003 was .93% and 1.09%, respectively. The swaps have been designated as cash flow hedges and expire on various dates from February 2005 through November 2020. The hedges were deemed to be fully effective resulting in a pretax gain for the three months and nine months ended September 30, 2003 of \$3.2 million and \$.7 million, respectively, recorded in other comprehensive income. Upon expiration of these hedges, the amount recorded in other comprehensive income will be reclassified into earnings. The amount expected to be reclassified from other comprehensive income to earnings in the next twelve months is immaterial due to the long-term nature of the swaps.

As of September 30, 2003, KU had variable rate swaps covering \$153.0 million in notional amounts of fixed rate debt. The average variable rate on these swaps during the three months and nine months ended September 30, 2003 was 1.76% and 1.88%, respectively. The underlying debt has fixed rates ranging from 5.75% to 7.92%. The swaps have been designated as fair value hedges and expire on various dates from May 2007 through September 2025. During the three months and nine months ended September 30, 2003, the effect of marking these financial instruments and the underlying debt to market resulted in a pretax gain of \$0.8 million and a pretax loss of \$1.2 million, respectively, recorded as a decrease/increase in interest expense.

4. LG&E and KU participate in accounts receivable securitization programs. The purpose of these programs is to enable the utilities to accelerate the receipt of cash from the collection of retail accounts receivable, thereby reducing dependence upon more costly sources of working capital. The securitization programs allow for a percentage of eligible receivables to be sold. Eligible receivables are generally all receivables associated with retail sales that have standard terms and are not past due. LG&E and KU are able to terminate these programs at any time without penalty. If there is a significant deterioration in the payment record of the receivables by retail customers or if the Companies fail to meet certain covenants of the programs, the programs may terminate at the election of the financial institutions. In this case, payments from retail customers would first be used to repay the financial institutions participating in the programs, and would then be available for use by the Companies.

As part of these programs, in February 2001, LG&E and KU sold retail accounts receivables to wholly-owned subsidiaries, LG&E Receivables LLC ("LG&E R") and KU Receivables LLC ("KU R"). Simultaneously, LG&E R and KU R entered into two separate three-year accounts receivable securitization facilities with two financial institutions and their affiliates whereby LG&E R and KU R can sell, on a revolving basis, an undi-

vided interest in certain of their receivables and receive up to \$75 million and \$50 million, respectively, from an unrelated third party purchaser. The effective cost of the receivables programs is comparable to the Companies' lowest cost source of capital, and is based on prime rated commercial paper. LG&E and KU retain servicing rights of the sold receivables through separate servicing agreements with the third party purchasers. LG&E and KU have obtained opinions from independent legal counsel indicating these transactions qualify as true sales of receivables. As of September 30, 2003 and December 31, 2002, LG&E's outstanding program balances were \$74.8 million and \$63.2 million, respectively, and KU's balance for both periods was \$49.3 million. These programs expire in February 2004.

The allowance for doubtful accounts associated with the eligible securitized receivables was \$1.4 million at September 30, 2003 and \$2.1 million at December 31, 2002 for LG&E, and \$0.5 million for KU at September 30, 2003 and December 31, 2002. Management believes that the risk of uncollectibility associated with the sold receivables is minimal.

5. External and intersegment revenues (related party transactions between LG&E and KU) and income by business segment for the three and nine months ended September 30, 2003, follow (in thousands of \$):

Three Months Ended September 30, 2003

	<u>External Revenues</u>	<u>Intersegment Revenues</u>	<u>Net Income (Loss)</u>
LG&E electric	\$218,194	\$11,980	\$41,924
LG&E gas	32,659	-	(2,053)
Total	<u>\$250,853</u>	<u>\$11,980</u>	<u>\$39,871</u>
KU electric	<u>\$224,426</u>	<u>\$11,000</u>	<u>\$30,310</u>

Nine Months Ended September 30, 2003

	<u>External Revenues</u>	<u>Intersegment Revenues</u>	<u>Net Income</u>
LG&E electric	\$549,630	\$41,480	\$69,413
LG&E gas	213,939	-	5,478
Total	<u>\$763,569</u>	<u>\$41,480</u>	<u>\$74,891</u>
KU electric	<u>\$624,334</u>	<u>\$33,249</u>	<u>\$56,330</u>

External and intersegment revenues (related party transactions between LG&E and KU) and income by business segment for the three and nine months ended September 30, 2002, follow (in thousands of \$):

Three Months Ended September 30, 2002

	<u>External Revenues</u>	<u>Intersegment Revenues</u>	<u>Net Income (Loss)</u>
LG&E electric	\$215,458	\$ 4,816	\$38,024
LG&E gas	22,800	-	(3,820)
Total	<u>\$238,258</u>	<u>\$ 4,816</u>	<u>\$34,204</u>
KU electric	<u>\$228,776</u>	<u>\$ 6,283</u>	<u>\$31,085</u>

Nine Months Ended September 30, 2002

	<u>External Revenues</u>	<u>Intersegment Revenues</u>	<u>Net Income</u>
LG&E electric	\$538,666	\$27,719	\$66,774
LG&E gas	<u>170,856</u>	<u>-</u>	<u>3,629</u>
Total	<u>\$709,522</u>	<u>\$27,719</u>	<u>\$70,403</u>
KU electric	<u>\$610,944</u>	<u>\$29,159</u>	<u>\$68,194</u>

6. The following regulatory assets and liabilities were included in the balance sheet of LG&E and KU as of September 30, 2003 and December 31, 2002 (in thousands of \$):

Louisville Gas and Electric  
(Unaudited)

	September 30, <u>2003</u>	December 31, <u>2002</u>
REGULATORY ASSETS:		
Value Delivery Team (VDT) costs .....	\$ 75,344	\$ 98,044
Unamortized loss on bonds .....	18,004	18,843
Gas supply adjustments due from customers .....	29,086	13,714
Earnings sharing mechanism provision .....	6,311	12,500
Asset retirement obligation .....	5,772	-
LG&E/KU merger costs .....	-	1,815
One utility costs .....	-	954
Manufactured gas sites .....	1,530	1,757
Other .....	<u>3,782</u>	<u>5,819</u>
Total .....	<u>\$139,829</u>	<u>\$153,446</u>
REGULATORY LIABILITIES:		
Deferred income taxes - net .....	\$ 39,191	\$ 45,536
Gas supply adjustments due to customers .....	3,555	3,154
Other .....	969	3,734
Total .....	<u>\$ 43,715</u>	<u>\$ 52,424</u>

Kentucky Utilities  
(Unaudited)

	September 30, <u>2003</u>	December 31, <u>2002</u>
REGULATORY ASSETS:		
Value Delivery Team (VDT) costs .....	\$29,389	\$38,375
Unamortized loss on bonds .....	8,835	9,456
Earnings sharing mechanism provision .....	5,792	13,500
Asset retirement obligation .....	10,064	-
LG&E/KU merger costs .....	-	2,046
One utility costs .....	-	873
Other .....	<u>(404)</u>	<u>(474)</u>
Total .....	<u>\$53,676</u>	<u>\$63,776</u>
REGULATORY LIABILITIES:		
Deferred income taxes - net .....	19,949	28,854
Other .....	<u>1,054</u>	<u>1,022</u>
Total .....	<u>\$21,003</u>	<u>\$29,876</u>

Merger Surcredit

As part of the LG&E Energy merger with KU Energy in 1998, LG&E Energy estimated non-fuel savings over a ten-year period following the merger. Costs to achieve these

savings of \$50.2 million for LG&E and \$42.3 million for KU were recorded in the second quarter of 1998. Of these amounts \$18.1 million for LG&E and \$20.5 million for KU was deferred and amortized over a five-year period pursuant to regulatory orders. Primary components of the merger costs were separation benefits, relocation costs, and transaction fees, the majority of which were paid by December 31, 1998. LG&E and KU expensed the remaining costs associated with the merger (\$32.1 million and \$21.8 million, respectively) in the second quarter of 1998.

In approving the merger, the Kentucky Commission adopted the Companies' proposal to reduce its retail customers' bills based on one-half of the estimated merger-related savings, net of deferred and amortized amounts, over a five-year period. The surcredit mechanism provided that 50% of the net non-fuel cost savings estimated to be achieved from the merger be provided to ratepayers through a monthly bill credit, and 50% be retained by the Companies, over a five-year period. The surcredit was allocated 53% to KU and 47% to LG&E. In that same order, the Kentucky Commission required LG&E and KU, after the end of the five-year period, to present a plan for sharing with customers the then-projected non-fuel savings associated with the merger. The Companies submitted this filing on January 13, 2003, proposing to continue to share with customers, on a 50%/50% basis, the estimated fifth-year gross level of non-fuel savings associated with the merger.

On October 16, 2003, the Kentucky Commission approved a merger surcredit settlement whereby the surcredit mechanism will remain in place for an additional five-year period at a levelized amount per year calculated from the originally estimated non-fuel savings for years six through ten. Customers and shareholders will continue to equally share merger savings on a 50%/50% basis and LG&E's customers will continue to be allocated 47%, and KU's customers will continue to be allocated 53%, of the customers' portion of the merger savings. As a part of the settlement, certain customers, in lieu of receiving monthly credits, will receive the present value of their estimated surcredits in up-front payments. These payments, \$6.9 million for LG&E and \$5.3 million for KU, will be deferred and amortized over the five-year period starting July 1, 2003, pursuant to the order. Remaining LG&E and KU customers will receive credits totaling \$18.0 million and \$17.9 million, respectively, in each of the five years beginning July 1, 2003.

7. The following data represent shares of jointly owned additions to the Trimble County plant for four combustion turbines as of September 30, 2003:

	<u>LG&amp;E</u>	<u>KU</u>	<u>Total</u>
Ownership %	37%	63%	100%
Mw capacity	237	403	640
Plant under construction (\$mill)	\$63	\$108	\$171
Depreciation	-	-	-
Net book value	<u>\$63</u>	<u>\$108</u>	<u>\$171</u>

8. Statement of Financial Accounting Standard (SFAS) No. 143, *Accounting for Asset Retirement Obligations*, was issued in 2001. SFAS No. 143 establishes accounting and reporting standards for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs.

The effective implementation date for SFAS No. 143 was January 1, 2003 and the associated FERC final rule, *Accounting, Financial Reporting, and Rate Filing Requirements for Asset Retirement Obligations*, was issued April 9, 2003. As of September 30, 2003, LG&E recorded asset retirement obligation (ARO) assets in the amount of \$4.5 million and liabilities of \$9.8 million. LG&E recorded offsetting regulatory assets of \$5.8 million, pursuant to regulatory treatment prescribed under SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*. As of September 30, 2003, KU recorded ARO assets in the amount of \$8.6 million and liabilities of \$19.4 million. KU recorded offsetting regulatory assets of \$10.0 million, pursuant to regula-

tory treatment prescribed under SFAS No. 71. LG&E and KU AROs are primarily related to final retirement of assets associated with generating units. Assets with associated AROs will no longer include a cost of removal component within their depreciation rate. Assets without associated AROs will continue to be depreciated including a cost of removal component within the depreciation rate. The Companies are in the process of calculating the amount of the costs of removal embedded in accumulated depreciation.

Had SFAS No. 143 been in effect for the 2002 reporting period, the Companies would have established asset retirement obligations as described in the following table (in thousands of \$):

	<u>LG&amp;E</u>	<u>KU</u>
Provision at January 1, 2002 .....	\$8,752	\$17,331
Accretion expense .....	578	1,146
Provision at December 31, 2002 .....	<u>\$9,330</u>	<u>\$18,477</u>

For the three months and nine months ended September 30, 2003, LG&E recorded ARO accretion expense of \$154,000 and \$462,000, respectively, ARO depreciation expense of \$29,000 and \$88,000, respectively, and an offsetting regulatory credit in the income statement of \$185,000 and \$550,000, respectively. For the three months and nine months ended September 30, 2003, KU recorded ARO accretion expense of \$306,000 and \$916,000, respectively, ARO depreciation expense of \$44,000 and \$131,000, respectively, and an offsetting regulatory credit in the income statement of \$350,000 and \$1.0 million, respectively. The recording of the regulatory credit is pursuant to regulatory treatment prescribed under SFAS No. 71. SFAS No. 143 has no impact on the results of the operation of the Companies.

The Companies adopted EITF No. 98-10, *Accounting for Energy Trading and Risk Management Activities*, effective January 1, 1999. This pronouncement required that energy trading contracts be marked to market on the balance sheet, with the gains and losses shown net in the income statement.

Effective January 1, 2003, the Companies adopted EITF No. 02-03, *Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities*. EITF No. 02-03 established the following:

- Rescinded EITF No. 98-10,
- Contracts that do not meet the definition of a derivative under SFAS No. 133 should not be marked to fair market value, and
- Revenues should be shown in the income statement net of costs associated with trading activities, whether or not the trades are physically settled.

With the rescission of EITF No. 98-10, energy trading contracts that do not also meet the definition of a derivative under SFAS No. 133 must be accounted for as executory contracts. Contracts previously recorded at fair value under EITF No. 98-10 that are not also derivatives under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, must be restated to historical cost through a cumulative effect adjustment. The rescission of this standard had no impact on financial position or results of operations of the Companies since all contracts marked to market under EITF No. 98-10 are also within the scope of SFAS No. 133.

As a result of EITF No. 02-03, the Companies have netted the power purchased expense for trading activities against electric operating revenue to reflect this accounting change. The Companies applied this guidance to all prior periods, which had no impact on previously reported net income or common equity.

Three Months Ended	Nine Months Ended
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	September 30,		September 30,	
	2003	2002	2003	2002
LG&E:				
Gross electric operating revenues ....	\$230,174	\$223,017	\$591,110	\$581,076
Less costs reclassified from power purchased .....	-	2,743	-	14,691
Net electric operating revenues reported .....	<u>\$230,174</u>	<u>\$220,274</u>	<u>\$591,110</u>	<u>\$566,385</u>

KU:				
Gross electric operating revenues ....	\$235,426	\$239,020	\$657,583	\$657,744
Less costs reclassified from power purchased .....	-	3,961	-	17,641
Net electric operating revenues reported .....	<u>\$235,426</u>	<u>\$235,059</u>	<u>\$657,583</u>	<u>\$640,103</u>

	Three Months Ended		Nine Months Ended	
	September 30, 2003	2002	September 30, 2003	2002
LG&E:				
Gross power purchased .....	\$ 18,805	\$ 15,322	\$ 60,245	\$ 60,967
Less costs reclassified to revenues ..	-	2,743	-	14,691
Net power purchased reported .....	<u>\$ 18,805</u>	<u>\$ 12,579</u>	<u>\$ 60,245</u>	<u>\$ 46,276</u>
KU:				
Gross power purchased .....	\$ 31,702	\$ 31,873	\$106,550	\$112,844
Less costs reclassified to revenues ..	-	3,961	-	17,641
Net power purchased reported .....	<u>\$ 31,702</u>	<u>\$ 27,912</u>	<u>\$106,550</u>	<u>\$ 95,203</u>

In May 2003, the Financial Accounting Standards Board issued SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*. SFAS No. 150 is effective immediately for financial instruments entered into or modified after May 31, 2003, and otherwise is effective for interim reporting periods beginning after June 15, 2003, except for certain instruments and certain entities which have been deferred by the FASB. Such deferrals do not affect LG&E and KU.

LG&E has existing \$5.875 series mandatorily redeemable preferred stock outstanding having a current redemption price of \$100 per share. The preferred stock has a sinking fund requirement sufficient to retire a minimum of 12,500 shares on July 15 of each year commencing with July 15, 2003, and a minimum of 187,500 shares on July 15, 2008 at \$100 per share. LG&E redeemed 12,500 shares in accordance with these provisions on July 15, 2003, leaving 237,500 shares currently outstanding. Beginning with the three months ended September 30, 2003, LG&E reclassified, at fair value, its \$5.875 series preferred stock as long-term debt with the minimum shares mandatorily redeemable within one year classified as current portion of long-term debt. Dividends accrued beginning July 1, 2003 are charged as interest expense.

KU has no financial instruments that fall within the scope of SFAS No. 150.

- In October 2003, KU issued a redemption notice to holders of Series P, 8.55% first mortgage bonds (\$33.0 million). These bonds will be redeemed on November 25, 2003. The redemption will be funded with long-term loans from an E.ON affiliate.

On August 15, 2003, LG&E borrowed \$100 million from an E.ON affiliate for a ten-year term at 5.31%. The loan is secured by a second lien on substantially all of LG&E's assets. The proceeds were used to repay a maturing first mortgage bond of \$42.6 million and to repay notes payable to affiliates.

On August 15, 2003, KU borrowed \$75 million from an E.ON affiliate for a ten-year term at 5.31%. The loan is secured by a second lien on substantially all of KU's assets. The proceeds were used to repay notes payable to affiliates, some of which were the result of the repayment of a \$62 million first mortgage bond.

During July 2003, LG&E entered into five revolving lines of credit with third-party financial institutions totaling \$185 million. These credit facilities expire in June 2004, and there was no outstanding balance under any of these facilities at September 30, 2003.

The Companies participate in a money pool whereby LG&E Energy can make available up to \$400 million at market-based rates for each of LG&E and KU. LG&E Energy maintains a facility totaling \$150 million with an E.ON affiliate to ensure funding availability for the money pool. There was \$46.0 million outstanding under E.ON affiliates' line as of September 30, 2003, leaving \$104.0 million available. LG&E Energy had outstanding loans to LG&E and KU through the money pool that totaled \$75.1 million and \$98.7 million, respectively, as of September 30, 2003. These borrowings carried a thirty-day average interest rate of 1.06% at September 30, 2003, based on an index of highly rated commercial paper issuers as of the prior month end. LG&E and KU had available under the money pool, \$324.9 million and \$301.3 million, respectively, as of September 30, 2003.

In August 2003, LG&E and KU contributed an additional \$6.0 million each to their respective pension plans.

10. In the normal course of business, lawsuits, claims, environmental actions, and various non-ratemaking governmental proceedings arise against LG&E and KU. To the extent that damages are assessed in any of these lawsuits, LG&E and KU believe that their insurance coverage is adequate. Management, after consultation with legal counsel, and based upon the present status of these items, does not anticipate that liabilities arising out of other currently pending or threatened lawsuits and claims of the type referenced above will have a material adverse effect on LG&E's or KU's consolidated financial position or results of operations.

#### LG&E Employment Discrimination Case

As previously reported, in October 2001, approximately 30 employees or former employees filed a complaint against LG&E claiming past and current instances of employment discrimination. LG&E has moved the case to the U.S. District Court for the Western District of Kentucky and filed an answer denying all plaintiffs' claims. Discovery has commenced in the matter. The court has ordered mediation and certain plaintiffs have settled for immaterial amounts as a result of that process. In addition, certain other plaintiffs have sought administrative review before the U.S. Equal Employment Opportunity Commission which has, to date, declined to proceed to litigation on any claims reviewed. Previously amended pleadings, while reducing the size of the plaintiff and defendant groups and eliminating certain prior demands, contain a claimed damage amount of \$100 million as well as requests for injunctive relief. During mediation in 2003, additional settlements for immaterial amounts were reached with a number of plaintiffs, including a settlement with the lead plaintiff, which reduced the number of remaining plaintiffs to nine. LG&E intends to continue to defend itself vigorously in the remaining action and management does not anticipate that the outcome will have a material impact on LG&E's operations or financial condition.

#### Combustion Turbine Litigation

In October 2003, LG&E and KU and third parties completed a settlement agreement to dismiss the Companies' previously reported lawsuit in the U.S. District Court for the Eastern District of Kentucky against Alstom Power, Inc. (formerly ABB Power Generation, Inc.). The suit concerned operational deficiencies of two combustion turbines

supplied by Alstom during 1999, installed at KU's E.W. Brown plant and jointly owned by LG&E and KU. The settlement agreement provides for \$20 million reimbursement in two installments to be paid in January and April 2004 to LG&E and KU for the Companies' expenditures incurred regarding the turbines. The parties also entered into a long-term service agreement, whereby Alstom will provide to LG&E and KU certain future inspections, repairs and services for the turbines.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

General

The following discussion and analysis by management focuses on those factors that had a material effect on LG&E's and KU's financial results of operations and financial condition during the three and nine month periods ended September 30, 2003, and should be read in connection with the financial statements and notes thereto.

Some of the following discussion may contain forward-looking statements that are subject to certain 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 vary materially. Factors that could cause actual results to differ materially include: 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; and other factors described from time to time in LG&E's and KU's reports to the Securities and Exchange Commission, including the current report on Form 8-K dated November 12, 2003.

Results of Operations

The results of operations for LG&E and KU are affected by seasonal fluctuations in temperature and other weather-related factors. Because of these and other factors, the results of one interim period are not necessarily indicative of results or trends to be expected for the full year.

Three Months Ended September 30, 2003, Compared to  
Three Months Ended September 30, 2002

LG&E Results:

LG&E's net income increased \$5.7 million (17%) for the three months ended September 30, 2003, as compared to the three months ended September 30, 2002 primarily because of increased wholesale electric sales offset by decreased retail electric sales.

A comparison of LG&E's revenues for the three months ended September 30, 2003, with the three months ended September 30, 2002, reflects increases and (decreases) which have been segregated by the following principal causes (in thousands of \$):

<u>Cause</u>	<u>Electric Revenues</u>	<u>Gas Revenues</u>
Retail sales:		
Fuel and gas supply adjustments .....	\$ 3,481	\$ 7,171
Environmental cost recovery surcharge .....	(2,560)	-
Demand side management cost recovery .....	398	(17)
LG&E/KU merger surcredit .....	(947)	-
Value delivery surcredit .....	(1,111)	(127)
Variation in sales volume and other .....	<u>(10,339)</u>	<u>2,737</u>
Total retail sales .....	(11,078)	9,764
Wholesale sales .....	20,793	-

Gas transportation - net.....	-	(71)
Other.....	<u>185</u>	<u>166</u>
Total .....	<u>\$ 9,900</u>	<u>\$ 9,859</u>

Electric revenues increased primarily due an increase in wholesale sales (volumes increased 135%, resulting in \$24.4 million higher revenues) and higher fuel supply cost billed to customers, partially offset by a decrease in retail volumes sold due to a 29% decrease in cooling degree days. Gas revenues increased primarily as a result of higher gas supply costs billed to customers through the gas supply clause and increased volumes sold.

Fuel for electric generation and gas supply expenses comprise a large component of LG&E's total operating expenses. LG&E's electric and gas rates contain a fuel adjustment clause and a gas supply clause, respectively, whereby increases or decreases in the cost of fuel and gas supply are reflected in retail rates, subject to the approval of the Kentucky Public Service Commission (Kentucky Commission). Fuel for electric generation increased \$2.8 million (5%) for the three months ended September 30, 2003, due to an increase in the quantity of fuel consumed for generation to supply wholesale sales (\$5.0 million), partially offset by a decrease in the cost of coal burned (\$2.2 million). Gas supply expenses increased \$8.4 million (76%) due to an increase in net gas supply cost (\$7.8 million) and an increase in the volume of retail gas delivered to the distribution system (\$0.6 million).

Power purchased increased \$6.2 million (49%) due to increased purchases for higher off-system sales (49% higher volumes resulted in a \$6.2 million volume variance).

Maintenance expense decreased \$6.3 million (34%) due to a decrease in expenses related to steam power production as a result of decreased plant outages (\$4.3 million) and fewer gas main repairs (\$2.0 million) in 2003 as compared to 2002.

Although income tax expense increased due to higher pre-tax income, prior year adjustments booked in the third quarter of 2003 reduced tax expense in the period and lowered the effective tax rate.

	Three Months Ended <u>September 30, 2003</u>	Three Months Ended <u>September 30, 2002</u>
Effective Rate		
Statutory federal income tax rate .....	35.0%	35.0%
State income taxes net of federal benefit .....	4.9	5.5
Amortization of investment and other tax credits .....	(1.7)	(1.8)
Other differences .....	<u>(2.4)</u>	<u>(0.1)</u>
Effective income tax rate .....	<u>35.8%</u>	<u>38.6%</u>

Interest charges increased \$.5 million (6%) in 2003 primarily due to \$.3 million in additional interest expense related to preferred dividends reclassified as debt in accordance with SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity*. The weighted average interest rate on variable-rate bonds for the three months ended September 30, 2003, was 0.99%, compared to 1.42% for the comparable period in 2002.

#### KU Results:

KU's net income decreased \$.8 million (2%) for the three months ended September 30, 2003, as compared to the three months ended September 30, 2002. The decrease was primarily due to decreased other income, partially offset by decreased other operation expenses.

A comparison of KU's revenues for the three months ended September 30, 2003, with the three months ended September 30, 2002, reflects increases and (decreases) which have been segregated by the following principal causes (in thousands of \$):

<u>Cause</u>	<u>Electric Revenues</u>
Retail sales:	
Fuel supply adjustments .....	\$ 4,167
Environmental cost recovery surcharge .....	840
LG&E/KU merger surcredit .....	(491)
Value delivery surcredit .....	(464)
Variation in sales volume and other .....	<u>(8,956)</u>
Total retail sales .....	(4,904)
Wholesale sales .....	4,182
Other .....	<u>1,089</u>
Total .....	<u>\$ 367</u>

Higher wholesale revenues, due to an increase in wholesale sales volumes, and higher fuel costs billed to customers, were offset by lower retail sales volumes due to a 33% decrease in cooling degree days.

Fuel for electric generation comprises a large component of KU's total operating expenses. KU's electric rates contain a fuel adjustment clause, whereby increases or decreases in the cost of fuel are reflected in retail rates, subject to the approval of the Kentucky Commission, the Virginia State Corporation Commission, and the Federal Energy Regulatory Commission. Fuel for electric generation decreased \$5.1 million (6%) for the quarter because of a 7% decrease in the quantity of fuel consumed for generation (\$6.0 million) due to a decrease in native load requirements, partially offset by an increase in the cost of coal burned (\$.9 million) due to higher purchases of compliance coal.

Power purchased increased \$3.8 million (14%) due to a 34% increase in the volume purchased (\$9.5 million), partially offset by a decrease in the price of power purchased (\$5.7 million). The increase in volumes is attributable to higher intercompany purchases from LG&E.

Other operation expenses decreased \$2.5 million (7%) due primarily to a decrease in the amortization of prior "KU/LG&E Merger" and "One Utility" workforce reduction programs expenses (\$1.9 million) and lower injury and liability claims from third parties (\$.6 million).

Variations in income tax expense are largely attributable to changes in pretax income. The change in other differences is due to the change in KU's equity earnings from a minority interest.

	Three Months Ended <u>September 30, 2003</u>	Three Months Ended <u>September 30, 2002</u>
Effective Rate		
Statutory federal income tax rate .....	35.0%	35.0%
State income taxes net of federal benefit .....	5.0	4.9
Amortization of investment and other tax credits .....	(1.4)	(1.6)
Other differences .....	<u>(2.9)</u>	<u>(4.3)</u>
Effective income tax rate .....	<u>35.7%</u>	<u>34.0%</u>

Other income - net decreased \$3.3 million (61%) in 2003 primarily due to a decrease in minority interest earnings, \$3.8 million, partially offset by lower taxes.

Interest charges decreased \$.8 million (15%) for the three months ended September 30, 2003 as compared to the three months ended September 30, 2002, due primarily to lower interest rates on variable-rate debt and the replacement of fixed-rate debt with variable-rate debt. The weighted average interest rate on variable-rate bonds for the three months ended September 30, 2003, was 0.91% and the corresponding rate for the three months ended September 30, 2002, was 1.57%.

Nine Months Ended September 30, 2003, Compared to  
Nine Months Ended September 30, 2002

LG&E Results:

LG&E's net income increased \$4.5 million (6%) for the nine months ended September 30, 2003, as compared to the nine months ended September 30, 2002, primarily because of an increase in wholesale electric sales and gas retail sales partially offset by a decrease in retail electric sales and an increase in purchased power costs.

A comparison of LG&E's revenues for the nine months ended September 30, 2003, with the nine months ended September 30, 2002, reflects increases and (decreases) which have been segregated by the following principal causes (in thousands of \$):

<u>Cause</u>	<u>Electric Revenues</u>	<u>Gas Revenues</u>
Retail sales:		
Fuel and gas supply adjustments .....	\$ 8,071	\$32,005
Environmental cost recovery surcharge .....	(1,283)	-
Demand side management cost recovery .....	1,068	380
LG&E/KU merger surcredit .....	(1,396)	-
Value delivery surcredit .....	(2,627)	(956)
Earnings sharing mechanism .....	972	-
Weather normalization .....	-	(2,509)
Variation in sales volume and other .....	<u>(16,114)</u>	<u>20,357</u>
Total retail sales .....	(11,309)	49,277
Wholesale sales .....	34,381	(6,141)
Gas transportation - net .....	-	(82)
Other .....	<u>1,653</u>	<u>29</u>
Total .....	<u>\$24,725</u>	<u>\$43,083</u>

Electric revenues increased primarily due to an increase in wholesale sales prices (\$16.2 million), an increase in wholesale sales volumes (\$18.2 million) and higher fuel supply costs billed to customers. Retail volumes decreased due to a 33% decrease in cooling degree days. Gas revenues increased primarily as a result of higher gas supply costs billed to customers through the gas supply clause and increased volumes sold due to an increase in heating degree days (20%), partially offset by a decrease in wholesale sales.

Fuel for electric generation increased \$3.9 million (3%) for the nine months due to an increase in the quantity of fuel consumed for generation (\$4.8 million) partially offset by a decrease in the cost of coal burned (\$.9 million). Gas supply expenses increased \$38.7 million (34%) due to an increase in net gas supply cost (\$33.5 million) and an increase in the volume of retail gas delivered to the distribution system (\$9.9 million), partially offset by decreased wholesale gas expenses (\$4.7 million).

Power purchased increased \$14.0 million (30%) due to an increase in the price of power purchased (\$10.3 million) and an increase in the volume of purchases (\$3.7 million) related to wholesale sales.

Other operation expenses increased \$4.3 million (3%) primarily due to higher costs of demand side management programs (\$2.1 million) and increased benefit costs (\$2.2 million).

Maintenance expenses decreased \$4.3 million (9%) due to a decrease in expenses related to steam power production as a result of decreased plant outages (\$3.9 million), fewer transmission and distribution line repairs (\$1.1 million), and fewer gas main repairs (\$1.4 million) partially offset by an increase in communications maintenance expense (\$2.5 million).

Depreciation and amortization expense increased \$6.5 million (8%) due to additional utility plant in service.

Although income tax expense increased due to higher pre-tax income, prior year adjustments booked in the third quarter of 2003 reduced tax expense in the period and lowered the effective tax rate.

	Nine Months Ended September 30, 2003	Nine Months Ended September 30, 2002
Effective Rate		
Statutory federal income tax rate .....	35.0%	35.0%
State income taxes net of federal benefit .....	5.3	5.3
Amortization of investment and other tax credits ..	(2.7)	(2.8)
Other differences .....	<u>(1.6)</u>	<u>(0.1)</u>
Effective income tax rate .....	<u>36.0%</u>	<u>37.4%</u>

Interest charges decreased \$3 million (1%) due primarily to lower interest rates on variable-rate debt. The weighted average interest rate on variable-rate bonds for the nine months ended September 30, 2003 was 1.12%, compared to 1.55% for the comparable period in 2002.

KU Results:

KU's net income decreased \$11.9 million (17%) for the nine months ended September 30, 2003, as compared to the nine months ended September 30, 2002. The decrease was primarily due to an increase in operations, maintenance, and depreciation expenses partially offset by increased sales to retail and wholesale customers.

A comparison of KU's revenues for the nine months ended September 30, 2003, with the nine months ended September 30, 2002, reflects increases and (decreases) which have been segregated by the following principal causes (in thousands of \$):

<u>Cause</u>	<u>Electric Revenues</u>
Retail sales:	\$17,317
Fuel supply adjustments .....	(49)
Environmental cost recovery surcharge .....	350
Demand side management cost recovery .....	(856)
LG&E/KU merger surcredit .....	(1,323)
Value delivery surcredit .....	(1,901)
Earnings sharing mechanism .....	<u>(3,296)</u>
Variation in sales volume and other .....	
Total retail sales .....	10,242
Wholesale sales .....	4,693
Other .....	<u>2,545</u>
Total .....	<u>\$17,480</u>

Electric revenues increased primarily due to higher fuel supply costs billed to customers and higher wholesale sales due to 12% higher volumes (\$6.0 million).

Fuel for electric generation increased \$5.2 million (3%) for the nine months ended September 30, 2003, due to an increase in the cost of coal burned (\$14.2 million), offset by a decrease in the quantity of fuel consumed for generation (\$9.0 million).

Power purchased increased \$11.3 million (12%) due to an increase in the volume purchased (\$13.6 million) as a result of temporary plant outages, partially offset by the price of power purchased (\$2.3 million).

Other operation expenses increased \$3.7 million (3%) due to increased benefit costs (\$2.6 million), and increased property insurance (\$1.1 million).

Maintenance expenses increased \$10.0 million (25%) due to repairs to electric distribution equipment due to an ice storm (\$4.1 million, net of \$8.9 million in insurance recoveries), timing of annual maintenance of steam production equipment occurring in second quarter 2003 vs. fourth quarter 2002 (\$2.0 million), an insurance recovery in 2002 (\$.9 million), a major unit outage in 2003 (\$1.0 million), and an increase in communications maintenance expense (\$2.0 million).

Depreciation and amortization expense increased \$5.6 million (8%) due to additional utility plant in service.

Variations in income tax expense are largely attributable to changes in pretax income.

	<u>Nine Months Ended</u> <u>September 30, 2003</u>	<u>Nine Months Ended</u> <u>September 30, 2002</u>
Effective Rate		
Statutory federal income tax rate .....	35.0	35.0%
State income taxes net of federal benefit .....	5.8	5.7
Amortization of investment and other tax credits .....	(2.3)	(2.6)
Other differences .....	<u>(3.6)</u>	<u>(3.6)</u>
Effective income tax rate .....	<u>34.9%</u>	<u>34.5%</u>

Other income - net decreased \$1.8 million (21%) primarily due to a decrease in minority interest earnings (\$3.3 million), partially offset by higher allowance for funds used during construction (\$.9 million).

Interest charges decreased \$2.7 million (13%) due primarily to lower interest rates on variable-rate debt and the replacement of fixed-rate debt with variable-rate debt. The weighted average interest rate on variable-rate bonds for the nine months ended September 30, 2003, was 1.08% and the corresponding rate for the nine months ended September 30, 2002, was 1.57%.

#### Liquidity and Capital Resources

LG&E and KU's needs for capital funds are largely related to the construction of plant and equipment necessary to meet the needs of electric and gas utility customers. Internal and external lines of credit and the accounts receivable securitization programs are maintained to fund short-term capital requirements. LG&E and KU believe that such sources of funds will be sufficient to meet the needs of the business in the foreseeable future.

Construction expenditures for the nine months ended September 30, 2003 for LG&E and KU amounted to \$153.1 million and \$264 million, respectively. Such expenditures related primarily to construction to meet nitrogen oxide (NOx) emission standards and the acquisition of combustion turbines to meet peak power demands. Expenditures for the nine months ended September 30, 2003, by LG&E and KU for NOx construction were \$23.7 million

and \$78.5 million, respectively. Expenditures for the nine months ended September 30, 2003, for Trimble County combustion turbines, Units 7 through 10, by LG&E and KU were \$63.5 million and \$108.4 million, respectively. The expenditures were financed with internally generated funds, intercompany loans from affiliates, and accounts receivable securitization program funds. See Note 4 of Notes to Financial Statements concerning accounts receivable securitization.

LG&E's cash balance decreased \$13.6 million during the nine months ended September 30, 2003, primarily due to a pension contribution and the purchase of an interest in the four Trimble County combustion turbines financed with intercompany loans. KU's cash balance increased \$3.9 million during the nine months ended September 30, 2003. The increase reflects cash flows from operations and intercompany loans, partially offset by construction expenditures, including the purchase of an interest in the four Trimble County combustion turbines.

Variations in accounts receivable, accounts payable and materials and supplies are generally not significant indicators of LG&E's and KU's liquidity. Such variations are primarily attributable to seasonal fluctuations in weather, which have a direct effect on sales of electricity and natural gas. The decrease in accounts receivable at LG&E resulted primarily from lower gas sales. The increase in accounts receivable for KU resulted primarily from timing of payments. The increase in LG&E's gas stored underground relates to higher prices on injections to inventory. The decrease in the fuel inventory at both LG&E and KU resulted from seasonal fluctuations.

On August 15, 2003, LG&E borrowed \$100 million from an E.ON affiliate for a ten-year term at 5.31%. The loan is secured by a second lien on substantially all of LG&E's assets. The proceeds were used to repay a maturing first mortgage bond of \$42.6 million and to repay notes payable to affiliates.

On August 15, 2003, KU borrowed \$75 million from an E.ON affiliate for a ten-year term at 5.31%. The loan is secured by a second lien on substantially all of KU's assets. The proceeds were used to repay notes payable to affiliates, some of which were the results of the repayment of a \$62 million first mortgage bond.

During July 2003, LG&E entered into five revolving lines of credit totaling \$185 million. These credit facilities expire in June 2004, and there was no outstanding balance under any of these facilities at September 30, 2003.

The Companies participate in a money pool whereby LG&E Energy can make up to \$400 million available at market-based rates for each of LG&E and KU. LG&E Energy maintains a facility totaling \$150.0 million with an E.ON affiliate to ensure funding availability for the money pool. There was \$46.0 million outstanding under the E.ON affiliates' line as of September 30, 2003, leaving \$104.0 million available. LG&E Energy had outstanding loans to LG&E and KU through the money pool that totaled \$75.1 million and \$98.7 million, respectively, as of September 30, 2003. These borrowings carried a thirty-day average interest rate of 1.06% at September 30, 2003, based on an index of highly rated commercial paper issuers as of the prior month end. LG&E and KU had available, under the money pool, \$324.9 million and \$301.3 million, respectively, as of September 30, 2003.

In October 2003, KU issued a redemption notice to holders of Series P, 8.55% first mortgage bonds (\$33.0 million). These bonds will be redeemed on November 25, 2003. The redemption will be funded with long-term loans from an E.ON affiliate.

Under the provisions of variable-rate pollution control bonds totaling \$246.2 million for LG&E and \$91.9 million for KU, 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. Should any of the bonds be put to LG&E or KU, funds from the money pool could be used to reacquire the bonds.

LG&E's security ratings as of September 30, 2003, were:

	<u>Moody's</u>	<u>S&amp;P</u>	<u>Fitch</u>
First mortgage bonds	A1	A-	A+
Preferred stock	Baa1	BBB-	A-
Commercial paper	P-1	A-2	F-1

KU's security ratings as of September 30, 2003, were:

	<u>Moody's</u>	<u>S&amp;P</u>	<u>Fitch</u>
First mortgage bonds	A1	A	A+
Preferred stock	Baa1	BBB-	A-
Commercial paper	P-1	A-2	F-1

These ratings reflect the views of Moody's, S&P and Fitch. 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. Fitch withdrew its ratings on LG&E and KU securities effective October 14, 2003.

LG&E's capitalization ratios at September 30, 2003, and December 31, 2002, follow:

	Sept. 30, <u>2003</u>	Dec. 31, <u>2002</u>
Long-term debt (including current portion)	43.1%	35.5%
Notes payable	4.1	11.1
Preferred stock	3.8	5.5
Common equity	<u>49.0</u>	<u>47.9</u>
Total	<u>100.0%</u>	<u>100.0%</u>

KU's capitalization ratios at September 30, 2003, and December 31, 2002, follow:

	Sept. 30, <u>2003</u>	Dec. 31, <u>2002</u>
Long-term debt (including current portion)	37.8%	34.0%
Notes payable	6.1	8.1
Preferred stock	2.5	2.7
Common equity	<u>53.6</u>	<u>55.2</u>
Total	<u>100.0%</u>	<u>100.0%</u>

#### New Accounting Pronouncements

SFAS No. 143, *Accounting for Asset Retirement Obligations*, was issued in 2001. SFAS No. 143 establishes accounting and reporting standards for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs.

The effective implementation date for SFAS No. 143 was January 1, 2003, and the associated FERC final rule, *Accounting, Financial Reporting, and Rate Filing Requirements for Asset Retirement Obligations*, was issued April 9, 2003. As of September 30, 2003, LG&E recorded asset retirement obligation (ARO) assets in the amount of \$4.5 million and liabilities of \$9.8 million. LG&E recorded offsetting regulatory assets of \$5.8 million, pursuant to regulatory treatment prescribed under SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*. As of September 30, 2003, KU recorded ARO assets in the amount of \$8.6 million and liabilities of \$19.4 million. KU recorded offsetting regulatory assets of \$10.0 million, pursuant to regulatory treatment prescribed under SFAS No.

71. LG&E and KU AROs are primarily related to the final retirement of assets associated with generating units. Assets with associated AROs will no longer include a cost of removal component within their depreciation rate. Assets without associated AROs will continue to be depreciated including a cost of removal component within the depreciation rate. The Companies are in the process of calculating the amount of the costs of removal embedded in accumulated depreciation.

Had SFAS No. 143 been in effect for the 2002 reporting period, the Companies would have established asset retirement obligations as described in the following table (\$000):

	<u>LG&amp;E</u>	<u>KU</u>
Provision at January 1, 2002.....	\$8,752	\$17,331
Accretion expense.....	578	1,146
Provision at December 31, 2002.....	<u>\$9,330</u>	<u>\$18,477</u>

For the three months and nine months ended September 30, 2003, LG&E recorded ARO accretion expense of \$154,000 and \$462,000, respectively, ARO depreciation expense of \$29,000 and \$88,000, respectively, and an offsetting regulatory credit in the income statement of \$185,000 and \$550,000, respectively. For the three months and nine months ended September 30, 2003, KU recorded ARO accretion expense of \$306,000 and \$916,000, respectively, ARO depreciation expense of \$44,000 and \$131,000, respectively, and an offsetting regulatory credit in the income statement of \$350,000 and \$1.0 million, respectively. The recording of the regulatory credit is pursuant to regulatory treatment prescribed under SFAS No. 71. SFAS No. 143 has no impact on the results of the operation of the Companies.

The Companies adopted EITF No. 98-10, *Accounting for Energy Trading and Risk Management Activities*, effective January 1, 1999. This pronouncement required that energy trading contracts be marked to market on the balance sheet, with the gains and losses shown net in the income statement.

Effective January 1, 2003, the Companies adopted EITF No. 02-03, *Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities*. EITF No. 02-03 established the following:

- Rescinded EITF No. 98-10,
- Contracts that do not meet the definition of a derivative under SFAS No. 133 should not be marked to fair market value, and
- Revenues should be shown in the income statement net of costs associated with trading activities, whether or not the trades are physically settled.

With the rescission of EITF No. 98-10, energy trading contracts that do not also meet the definition of a derivative under SFAS No. 133 must be accounted for as executory contracts. Contracts previously recorded at fair value under EITF No. 98-10 that are not also derivatives under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, must be restated to historical cost through a cumulative effect adjustment. The rescission of this standard had no impact on financial position or results of operations of the Companies since all contracts marked to market under EITF No. 98-10 are also within the scope of SFAS No. 133.

As a result of EITF No. 02-03, the Companies have netted the power purchased expense for trading activities against electric operating revenue to reflect this accounting change. The Companies applied this guidance to all prior periods, which had no impact on previously reported net income or shareholders' equity. The following tables present the impact of this reclassification (in thousands of \$):

Three Months Ended September 30,		Nine Months Ended September 30,	
<u>2003</u>	<u>2002</u>	<u>2003</u>	<u>2002</u>

LG&E:				
Gross electric operating revenues ....	\$230,174	\$223,017	\$591,110	\$581,076
Less costs reclassified from power purchased .....	-	2,743	-	14,691
Net electric operating revenues reported .....	<u>\$230,174</u>	<u>\$220,274</u>	<u>\$591,110</u>	<u>\$566,385</u>

KU:				
Gross electric operating revenues ....	\$235,426	\$239,020	\$657,583	\$657,744
Less costs reclassified from power purchased .....	-	3,961	-	17,641
Net electric operating revenues reported .....	<u>\$235,426</u>	<u>\$235,059</u>	<u>\$657,583</u>	<u>\$640,103</u>

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
LG&E:				
Gross power purchased .....	\$ 18,805	\$ 15,322	\$ 60,245	\$ 60,967
Less costs reclassified to revenues ..	-	2,743	-	14,691
Net power purchased reported .....	<u>\$ 18,805</u>	<u>\$ 12,579</u>	<u>\$ 60,245</u>	<u>\$ 46,276</u>
KU:				
Gross power purchased .....	\$ 31,702	\$ 31,873	\$106,550	\$112,844
Less costs reclassified to revenues ..	-	3,961	-	17,641
Net power purchased reported .....	<u>\$ 31,702</u>	<u>\$ 27,912</u>	<u>\$106,550</u>	<u>\$ 95,203</u>

In May 2003, the Financial Accounting Standards Board issued Statement of SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*. SFAS No. 150 is effective immediately for financial instruments entered into or modified after May 31, 2003, and otherwise is effective for interim reporting periods beginning after September 15, 2003.

LG&E has existing \$5.875 series mandatorily redeemable preferred stock with 250,000 shares outstanding having a current redemption price of \$100 per share. The preferred stock has a sinking fund requirement sufficient to retire a minimum of 12,500 shares on July 15 of each year commencing with July 15, 2003, and a minimum of 187,500 shares on July 15, 2008 at \$100 per share. Beginning with the three months ended September 30, 2003, LG&E reclassified, at fair value, its \$5.875 series preferred stock as long-term debt with the minimum shares mandatorily redeemable within one year classified as current portion of long-term debt. Dividends accrued beginning July 1, 2003 are charged as interest expense.

KU has no financial instruments that fall within the scope of SFAS No. 150.

#### Contingencies

For a description of significant contingencies that may affect LG&E and KU, reference is made to Part I, Item 3, Legal Proceedings in LG&E's and KU's Annual Reports on Form 10-K for the year ended December 31, 2002; and Note 11 to the financial statements contained in LG&E's and KU's current report on Form 8-K dated November 12, 2003; and to Part II - Item 1, Legal Proceedings herein.

#### Merger Surcredit

As part of the LG&E Energy merger with KU Energy in 1998, LG&E Energy estimated non-fuel savings over a ten-year period following the merger. Costs to achieve these savings of \$50.2 million for LG&E and of \$42.3 million for KU were recorded in the second quarter of 1998. Of these amounts \$18.1 million for LG&E and \$20.5 million for KU was deferred and

amortized over a five-year period pursuant to regulatory orders. Primary components of the merger costs were separation benefits, relocation costs, and transaction fees, the majority of which were paid by December 31, 1998. LG&E and KU expensed the remaining costs associated with the merger (\$32.1 million and \$21.8 million, respectively) in the second quarter of 1998.

In approving the merger, the Kentucky Commission adopted the Companies' proposal to reduce its retail customers' bills based on one-half of the estimated merger-related savings, net of deferred and amortized amounts, over a five-year period. The surcredit mechanism provided that 50% of the net non-fuel cost savings estimated to be achieved from the merger be provided to ratepayers through a monthly bill credit, and 50% be retained by the Companies, over a five-year period. The surcredit was allocated 53% to KU and 47% to LG&E. In that same order, the Kentucky Commission required LG&E and KU, after the end of the five-year period, to present a plan for sharing with customers the then-projected non-fuel savings associated with the merger. The Companies submitted this filing on January 13, 2003, proposing to continue to share with customers, on a 50%/50% basis, the estimated fifth-year gross level of non-fuel savings associated with the merger.

On October 16, 2003, the Kentucky Commission approved a merger surcredit settlement whereby the surcredit mechanism will remain in place for an additional five-year period at a levelized amount per year calculated from the originally estimated non-fuel savings for years six through ten. Customers and shareholders will continue to equally share merger savings on a 50%/50% basis and LG&E's customers will continue to be allocated 47%, and KU's customers will continue to be allocated 53%, of the customers' portion of the merger savings. As a part of the settlement, certain customers, in lieu of receiving monthly credits, will receive the present value of their estimated surcredits in up-front payments. These payments, \$6.9 million for LG&E and \$5.3 million for KU, will be deferred and amortized over the five-year period starting July 1, 2003, pursuant to the order. Remaining LG&E and KU customers will receive credits totaling \$18.0 million and \$17.9 million, respectively, in each of the five years beginning July 1, 2003.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk.

LG&E and KU are exposed to market risks. Both operations are exposed to market risks from changes in interest rates and commodity prices. To mitigate changes in cash flows attributable to these exposures, the Companies have entered into various derivative instruments. Derivative positions are monitored using techniques that include market value and sensitivity analysis.

The Companies use interest rate swaps to hedge exposure to market fluctuations in certain of their debt instruments. Pursuant to the Companies' policies, use of these financial instruments is intended to mitigate risk and earnings volatility and is not speculative in nature. Management has designated all of the Companies' interest rate swaps as hedge instruments. Financial instruments designated as cash flow hedges have resulting gains and losses recorded within other comprehensive income and stockholders' equity. To the extent a financial instrument or the underlying item being hedged is prematurely terminated or the hedge becomes ineffective, the resulting gains or losses are reclassified from other comprehensive income to net income. Financial instruments designated as fair value hedges are periodically marked to market with the resulting gains and losses recorded directly into net income to correspond with income or expense recognized from changes in market value of the items being hedged.

The potential change in interest expense associated with a 1% change in base interest rates of LG&E's and KU's unswapped debt is estimated at \$4.6 million and \$5.0 million, respectively, at September 30, 2003. LG&E's exposure to floating interest rates decreased \$89.3 million and KU's exposure to floating interest rates decreased \$20.8 million during the first nine months of 2003. The potential changes in the fair values of the Companies' interest-rate swaps resulting from changes in interest rates and the yield curve also did not change materially during the first nine months of 2003.

## Pension Risk

LG&E's and KU's costs of providing defined-benefit pension retirement plans are dependent upon a number of factors, such as the rates of return on plan assets, discount rate, and contributions made to the plans. The market value of LG&E and KU plan assets is affected by increases and decreases in the equity market. As a result, at December 31, 2002, LG&E and KU were required to recognize an additional minimum liability as prescribed by SFAS No. 87, *Employers' Accounting for Pensions*. The liability was recorded as a reduction to other comprehensive income, and did not affect net income for 2002. The amount of the liabilities depended upon the asset returns experienced in 2002 and contributions made by LG&E and KU to the plans during 2002. Also, pension cost and cash contributions to the plans could increase in future years without a substantial recovery in the equity markets. If the fair value of the plans' assets exceeds the accumulated benefit obligation, the recorded liabilities will be reduced and other comprehensive income will be restored in the consolidated balance sheets.

During 2002, the combination of poor market performance and historically low corporate bond rates created a divergence in the potential value of the pension liabilities and the actual value of the pension assets. Year-to-date 2003 market performance has been favorable. Should poor market conditions return, these conditions could result in an increase in LG&E's and KU's funded accumulated benefit obligations and future pension expense. The primary assumptions that drive the value of the unfunded accumulated benefit obligations are the discount rate and expected return on plan assets.

In January 2003, LG&E and KU made contributions to their pension plans of \$83.1 million and \$3.5 million, respectively. In August 2003, LG&E and KU contributed an additional \$6.0 million each to their respective pension plans.

## Energy Trading & Risk Management Activities

LG&E and KU conduct energy trading and risk management activities to maximize the value of power sales from physical assets they own, in addition to the wholesale sale of excess asset capacity. Certain energy trading activities are accounted for on a mark-to-market basis in accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities*. Wholesale sales of excess asset capacity are treated as normal sales under SFAS No. 133 and SFAS No. 138 and are not marked to market.

The rescission of EITF No. 98-10 for fiscal periods ending after December 15, 2002, had no impact on LG&E's or KU's energy trading and risk management reporting as all contracts marked to market under EITF No. 98-10 are also within the scope of SFAS No. 133.

The table below summarizes LG&E's and KU's energy trading and risk management activities for the three months and nine months ended September 30, 2003, and 2002 (in thousands of \$). Trading volumes are allocated evenly between LG&E and KU.

	Three Months Ended September 30, <u>2003</u> <u>2002</u>		Nine Months Ended September 30, <u>2003</u> <u>2002</u>	
Fair value of contracts at beginning of period, net asset/(liability)	\$318	\$ 26	\$ (156)	\$ (186)
Fair value of contracts when entered into during the period	(30)	(5)	2,590	(62)
Contracts realized or otherwise settled during the period	(356)	6	(639)	341
Changes in fair value due to changes in assumptions	<u>148</u>	<u>(193)</u>	<u>(1,715)</u>	<u>(259)</u>
Fair value of contracts at end of period,				



Part II. Other Information

Item 1. Legal Proceedings.

For a description of the significant legal proceedings involving LG&E and KU, reference is made to the information under the following items and captions of LG&E's and KU's (A) respective combined Annual Report on Form 10-K for the year ended December 31, 2002: Item 1, Business; Item 3, Legal Proceedings; Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations; and (B) current report on Form 8-K dated November 12, 2003: Notes 3 and 11 of LG&E's Notes to Financial Statements under Item 8 and Notes 3 and 11 of KU's Notes to Financial Statements under Item 8; and (C) respective combined Quarterly Report on Form 10-Q for the quarter ended June 30, 2003: Item 1 of Part II Legal Proceedings. Except as described herein, to date, the proceedings reported in LG&E's and KU's respective combined Annual Report on Form 10-K have not changed materially.

LG&E Employment Discrimination Case

As previously reported, in October 2001, approximately 30 employees or former employees filed a complaint against LG&E claiming past and current instances of employment discrimination. LG&E has removed the case to the U.S. District Court for the Western District of Kentucky and filed an answer denying all plaintiffs' claims. Discovery has commenced in the matter. The court has ordered mediation and certain plaintiffs have settled for immaterial amounts as a result of that process. In addition, certain other plaintiffs have sought administrative review before the U.S. Equal Employment Opportunity Commission which has, to date, declined to proceed to litigation on any claims reviewed. Previously amended pleadings, while reducing the size of the plaintiff and defendant groups and eliminating certain prior demands, contain a claimed damage amount of \$100 million as well as requests for injunctive relief. During mediation in 2003, additional settlements for immaterial amounts were reached with a number of plaintiffs, including a settlement with the lead plaintiff, which reduced the number of remaining plaintiffs to nine. LG&E intends to continue to defend itself vigorously in the remaining action and management does not anticipate that the outcome will have a material impact on LG&E's operations or financial condition.

Combustion Turbine Litigation

In October 2003, LG&E and KU and third parties completed a settlement agreement to dismiss the Companies' previously reported lawsuit in the U.S. District Court for the Eastern District of Kentucky against Alstom Power, Inc. (formerly ABB Power Generation, Inc.). The suit concerned operational deficiencies of two combustion turbines supplied by Alstom during 1999, installed at KU's E.W. Brown plant and jointly owned by LG&E and KU. The settlement agreement provides for \$20 million reimbursement in two installments to be paid in January and April 2004 to LG&E and KU for the Companies' expenditures incurred regarding the turbines. The parties also entered into a long-term service agreement, whereby Alstom will provide to LG&E and KU certain future inspections, repairs and services for the turbines.

Item 6. Exhibits and Reports on Form 8-K.

6(a) Applicable to Form  
10-Q of

<u>Exhibit</u>			<u>Description</u>
<u>No.</u>	<u>LG&amp;E</u>	<u>KU</u>	
31	X	X	Certification - Section 302 of Sarbanes-Oxley Act of 2002
31.1	X		Certification of Chairman of the Board, President and Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	X		Certification of Chief Financial Officer, pursuant to Section 302 of

			the Sarbanes-Oxley Act of 2002
31.3	X		Certification of Chairman of the Board, President and Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.4	X		Certification of Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32	X	X	Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

6(b). Reports on Form 8-K.

None

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Louisville Gas and Electric Company  
Registrant

Date: November 12, 2003

/s/ S. Bradford Rives  
S. Bradford Rives  
Chief Financial Officer  
(On behalf of the registrant in his capacities as  
Principal Financial Officer and Principal  
Accounting Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Kentucky Utilities Company  
Registrant

Date: November 12, 2003

/s/ S. Bradford Rives  
S. Bradford Rives  
Chief Financial Officer  
(On behalf of the registrant in his capacities as  
Principal Financial Officer and Principal  
Accounting Officer)

Exhibit 31 - CERTIFICATIONS

Exhibit 31.1

Louisville Gas and Electric Company

I, Victor A. Staffieri, Chairman of the Board, President and Chief Executive Officer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Louisville Gas and Electric Company;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 12, 2003

/s/ Victor A. Staffieri  
Victor A. Staffieri  
Chairman of the Board, President and Chief Executive Officer

Louisville Gas and Electric Company

I, S. Bradford Rives, Chief Financial Officer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Louisville Gas and Electric Company;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 12, 2003

/s/ S. Bradford Rives  
S. Bradford Rives  
Chief Financial Officer

Kentucky Utilities Company

I, Victor A. Staffieri, Chairman of the Board, President and Chief Executive Officer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Kentucky Utilities Company;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 12, 2003

/s/ Victor A. Staffieri  
Victor A. Staffieri  
Chairman of the Board, President and Chief Executive Officer

Kentucky Utilities Company

I, S. Bradford Rives, Chief Financial Officer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Kentucky Utilities Company;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 12, 2003

/s/ S. Bradford Rives  
S. Bradford Rives  
Chief Financial Officer

Certification Pursuant to 18 U.S.C. Section 1350  
As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

In connection with the Quarterly Report of Louisville Gas and Electric Company and Kentucky Utilities Company (the "Companies") on Form 10-Q for the period ended September 30, 2003, as filed with the Securities and Exchange Commission (the "Report"), each of the undersigned does hereby certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to such officer's knowledge,

- 1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- 2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Companies as of the dates and for the period expressed in the Report.

November 12, 2003

/s/ Victor A. Staffieri  
Chairman of the Board, President  
and Chief Executive Officer  
Louisville Gas and Electric Company  
Kentucky Utilities Company

/s/ S. Bradford Rives  
Chief Financial Officer  
Louisville Gas and Electric Company  
Kentucky Utilities Company

The foregoing certification is being furnished solely pursuant to 18 U.S.C. Section 1350 and is not being filed as part of the Report or as a separate disclosure document.

**SEC Form 10-Q – June 30, 2003**

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2003

Or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

<u>Commission File Number</u>	<u>Registrant, State of Incorporation Address, and Telephone Number</u>	<u>IRS Employer Identification No.</u>
2-26720	<b>Louisville Gas and Electric Company</b> (A Kentucky Corporation) 220 West Main Street P.O. Box 32010 Louisville, KY 40232 (502) 627-2000	61-0264150
1-3464	<b>Kentucky Utilities Company</b> (A Kentucky and Virginia Corporation) One Quality Street Lexington, KY 40507-1428 (859) 255-2100	61-0247570

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

Louisville Gas and Electric Company  
21,294,223 shares, without par value, as of July 31, 2003,  
all held by LG&E Energy Corp.  
Kentucky Utilities Company  
37,817,878 shares, without par value, as of July 31, 2003,  
all held by LG&E Energy Corp.

This combined Form 10-Q is separately filed by Louisville Gas and Electric Company and Kentucky Utilities Company. Information contained herein related to any individual registrant is filed by such registrant on its own behalf. Each registrant makes no representation as to information related to the other registrants.

TABLE OF CONTENTS

PART I

Item 1 Consolidated Financial Statements

Louisville Gas and Electric Company and Subsidiary	
Statements of Income .....	1
Balance Sheets .....	2
Statements of Cash Flow .....	4
Statements of Retained Earnings .....	5
Statements of Other Comprehensive Income .....	6

Kentucky Utilities Company and Subsidiary	
Statements of Income .....	7
Balance Sheets .....	8
Statements of Cash Flow .....	10
Statements of Retained Earnings .....	11
Statements of Other Comprehensive Income .....	12

Notes to Consolidated Financial Statements.....	13
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Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations.....	20
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Item 3 Quantitative and Qualitative Disclosures About Market Risk.....	30
--	----

Item 4 Controls and Procedures.....	32
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PART II

Item 1 Legal Proceedings.....	33
Item 6 Exhibits and Reports on Form 8-K.....	33
Signatures.....	35
Exhibits.....	36

Part I. Financial Information - Item 1. Financial Statements

**Louisville Gas and Electric Company and Subsidiary**  
**Consolidated Statements of Income**  
(Unaudited)  
(Thousands of \$)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
OPERATING REVENUES (Note 5 and Note 8):				
Electric.....	\$173,917	\$185,225	\$360,936	\$346,111
Gas.....	41,456	30,938	181,280	148,056
Total operating revenues .....	<u>215,373</u>	<u>216,163</u>	<u>542,216</u>	<u>494,167</u>
OPERATING EXPENSES:				
Fuel for electric generation.....	46,277	50,550	95,754	94,657
Power purchased (Note 8).....	17,313	15,476	41,440	33,697
Gas supply expenses.....	25,963	18,346	132,070	101,813
Other operation expenses.....	53,379	54,807	106,907	103,216
Maintenance.....	17,690	15,572	29,583	27,573
Depreciation and amortization (Note 8) .....	30,293	25,889	57,437	51,167
Federal and state income taxes.....	4,714	8,335	21,355	21,572
Property and other taxes.....	3,454	4,778	8,189	9,314
Total operating expenses .....	<u>199,083</u>	<u>193,753</u>	<u>492,735</u>	<u>443,009</u>
NET OPERATING INCOME.....	16,290	22,410	49,481	51,158
Other expense - net.....	(1,394)	(67)	(330)	(66)
Interest charges (Note 3).....	<u>7,141</u>	<u>7,087</u>	<u>14,131</u>	<u>14,893</u>
NET INCOME.....	<u>\$ 7,755</u>	<u>\$ 15,256</u>	<u>\$ 35,020</u>	<u>\$ 36,199</u>

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

**Louisville Gas and Electric Company and Subsidiary**  
**Consolidated Balance Sheets**  
(Unaudited)  
(Thousands of \$)

ASSETS

	June 30, <u>2003</u>	December 31, <u>2002</u>
<b>UTILITY PLANT:</b>		
At original cost.....	\$3,730,273	\$3,622,985
Less: reserve for depreciation.....	<u>1,507,498</u>	<u>1,463,674</u>
Net utility plant (Note 7) .....	<u>2,222,775</u>	<u>2,159,311</u>
<b>OTHER PROPERTY AND INVESTMENTS -</b>		
less reserve of \$63 as of June 30, 2003 and December 31, 2002 .....	<u>602</u>	<u>764</u>
<b>CURRENT ASSETS:</b>		
Cash.....	3,073	17,015
Accounts receivable - less reserve of \$2,125 as of June 30, 2003 and December 31, 2002 (Note 4) .....	71,045	68,440
Materials and supplies - at average cost:		
Fuel (predominantly coal) .....	35,953	36,600
Gas stored underground .....	21,745	50,266
Other .....	23,493	25,651
Prepayments and other.....	<u>6,235</u>	<u>5,298</u>
Total current assets .....	<u>161,544</u>	<u>203,270</u>
<b>DEFERRED DEBITS AND OTHER ASSETS:</b>		
Unamortized debt expense.....	6,385	6,532
Regulatory assets (Note 6).....	154,520	153,446
Other.....	<u>33,079</u>	<u>37,755</u>
Total deferred debits and other assets .....	<u>193,984</u>	<u>197,733</u>
Total assets.....	<u>\$2,578,905</u>	<u>\$2,561,078</u>

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

**Louisville Gas and Electric Company and Subsidiary**  
**Consolidated Balance Sheets**  
(Unaudited)  
(Thousands of \$)

**CAPITALIZATION AND LIABILITIES**

	<u>June 30,</u> <u>2003</u>	<u>December 31,</u> <u>2002</u>
<b>CAPITALIZATION:</b>		
Common stock, without par value -		
Outstanding 21,294,223 shares .....	\$ 425,170	\$ 425,170
Common stock expense.....	(836)	(836)
Additional paid-in capital.....	40,000	40,000
Retained earnings.....	442,498	409,319
Accumulated other comprehensive loss.....	(42,063)	(40,512)
Total common equity .....	<u>864,769</u>	<u>833,141</u>
Cumulative preferred stock.....	95,140	95,140
Long-term debt.....	328,104	328,104
Long-term debt to associated company (Note 9).....	100,000	-
Total capitalization .....	<u>1,388,013</u>	<u>1,256,385</u>
<b>CURRENT LIABILITIES:</b>		
Current portion of long-term debt.....	288,800	288,800
Notes payable to parent (Note 9).....	171,732	193,053
Accounts payable.....	96,699	122,771
Accrued taxes.....	-	1,450
Other.....	20,077	19,536
Total current liabilities .....	<u>577,308</u>	<u>625,610</u>
<b>DEFERRED CREDITS AND OTHER LIABILITIES:</b>		
Accumulated deferred income taxes - net.....	329,833	313,225
Investment tax credit, in process of amortization.....	52,431	54,536
Accumulated provision for pensions and related benefits .....	134,096	224,703
Customer advances for construction.....	9,835	10,260
Asset retirement obligation (Note 8).....	9,639	-
Regulatory liabilities (Note 6).....	44,719	52,424
Long-term derivative liability.....	19,700	17,115
Other.....	13,331	6,820
Total deferred credits and other liabilities .....	<u>613,584</u>	<u>679,083</u>
<b>Total capital and liabilities.....</b>	<b><u>\$2,578,905</u></b>	<b><u>\$2,561,078</u></b>

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

**Louisville Gas and Electric Company and Subsidiary**  
**Consolidated Statement of Cash Flows**  
(Unaudited)  
(Thousands of \$)

	Six Months Ended June 30,	
	<u>2003</u>	<u>2002</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income .....	\$ 35,020	\$ 36,199
Items not requiring cash currently:		
Depreciation and amortization .....	57,437	51,167
Deferred income taxes - net .....	12,876	9,507
Investment tax credit - net .....	(2,105)	(2,108)
Asset retirement obligations (Note 8) .....	4,108	-
Other .....	22,332	20,917
Changes in current assets and liabilities.....	14,956	(21,917)
Changes in accounts receivable securitization-net (Note 4)	(14,000)	16,100
Pension funding.....	(83,100)	-
Gas supply clause.....	(18,386)	13,793
Other.....	(501)	(6,938)
Net cash flows from operating activities .....	<u>28,637</u>	<u>116,720</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of securities.....	-	(101)
Proceeds from sales of securities.....	163	-
Construction expenditures.....	(119,412)	(69,524)
Net cash flows from investing activities .....	<u>(119,249)</u>	<u>(69,625)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Long-term borrowing from associated company (Note 9).....	100,000	-
Short-term borrowings from parent (Note 9).....	349,400	278,100
Repayment of short-term borrowings from parent.....	(370,737)	(280,744)
Issuance of pollution control bonds.....	-	119,067
Retirement of pollution control bonds.....	-	(120,000)
Payment of dividends.....	(1,993)	(25,176)
Net cash flows from financing activities .....	<u>76,670</u>	<u>(28,753)</u>
CHANGE IN CASH .....	(13,942)	18,342
CASH AT BEGINNING OF PERIOD.....	<u>17,015</u>	<u>2,112</u>
CASH AT END OF PERIOD.....	<u>\$ 3,073</u>	<u>\$ 20,454</u>
<b>SUPPLEMENTAL DISCLOSURES:</b>		
Cash paid during the period for:		
Income taxes .....	\$15,947	\$ 16,681
Interest on borrowed money .....	10,705	13,019

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

**Louisville Gas and Electric Company and Subsidiary**  
**Consolidated Statement of Retained Earnings**  
(Unaudited)  
(Thousands of \$)

	Three Months		Six Months	
	Ended		Ended	
	June 30,		June 30,	
	<u>2003</u>	<u>2002</u>	<u>2003</u>	<u>2002</u>
Balance at beginning of period.....	\$435,647	\$413,514	\$409,319	\$393,636
Net income.....	<u>7,755</u>	<u>15,256</u>	<u>35,020</u>	<u>36,199</u>
Subtotal .....	<u>443,402</u>	<u>428,770</u>	<u>444,339</u>	<u>429,835</u>
Cash dividends declared on stock:				
5% cumulative preferred.....	269	269	538	538
Auction rate cumulative preferred...	268	413	569	842
\$5.875 cumulative preferred .....	367	367	734	734
Common.....	-	23,000	-	23,000
Subtotal .....	<u>904</u>	<u>24,049</u>	<u>1,841</u>	<u>25,114</u>
Balance at end of period.....	<u>\$442,498</u>	<u>\$404,721</u>	<u>\$442,498</u>	<u>\$404,721</u>

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

**Louisville Gas and Electric Company and Subsidiary**  
**Consolidated Statements of Other Comprehensive Income**  
(Unaudited)  
(Thousands of \$)

	Three Months		Six Months	
	Ended		Ended	
	June 30,		June 30,	
	<u>2003</u>	<u>2002</u>	<u>2003</u>	<u>2002</u>
Net income.....	\$ 7,755	\$15,256	\$35,020	\$36,199
Losses on derivative instruments and hedging activities (Note 3) ..	(2,552)	(3,939)	(2,585)	(2,430)
Income tax benefit related to items of other comprehensive loss .....	<u>1,021</u>	<u>1,576</u>	<u>1,034</u>	<u>973</u>
Other comprehensive loss, net of tax .....	<u>(1,531)</u>	<u>(2,363)</u>	<u>(1,551)</u>	<u>(1,457)</u>
Other comprehensive income.....	<u>\$ 6,224</u>	<u>\$12,893</u>	<u>\$33,469</u>	<u>\$34,742</u>

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

**Kentucky Utilities Company and Subsidiary**  
**Consolidated Statements of Income**  
(Unaudited)  
(Thousands of \$)

	Three Months		Six Months	
	Ended		Ended	
	June 30,		June 30,	
	<u>2003</u>	<u>2002</u>	<u>2003</u>	<u>2002</u>
OPERATING REVENUES (Note 5 and Note 8) ..	\$197,174	\$196,020	\$422,157	\$405,044
OPERATING EXPENSES:				
Fuel for electric generation.....	59,641	57,368	125,964	115,639
Power purchased (Note 8).....	33,648	32,376	74,848	67,292
Other operation expenses.....	38,130	36,201	77,019	70,723
Maintenance.....	7,403	15,386	36,369	26,945
Depreciation and amortization (Note 8) ..	27,762	23,515	51,912	46,574
Federal and state income taxes.....	7,467	7,365	14,067	21,748
Property and other taxes.....	3,968	3,762	8,163	7,876
Total operating expenses .....	<u>178,019</u>	<u>175,973</u>	<u>388,342</u>	<u>356,797</u>
NET OPERATING INCOME.....	19,155	20,047	33,815	48,247
Other income - net.....	2,694	1,685	4,803	3,324
Interest charges (Note 3).....	<u>7,690</u>	<u>8,980</u>	<u>12,598</u>	<u>14,462</u>
NET INCOME.....	<u>\$ 14,159</u>	<u>\$ 12,752</u>	<u>\$ 26,020</u>	<u>\$ 37,109</u>

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

**Kentucky Utilities Company and Subsidiary**  
**Consolidated Balance Sheets**  
(Unaudited)  
(Thousands of \$)

ASSETS

	June 30, <u>2003</u>	December 31, <u>2002</u>
<b>UTILITY PLANT:</b>		
At original cost.....	\$3,450,964	\$3,280,762
Less: reserve for depreciation.....	<u>1,581,895</u>	<u>1,536,658</u>
Net utility plant (Note 7) .....	<u>1,869,069</u>	<u>1,744,104</u>
<b>OTHER PROPERTY AND INVESTMENTS -</b>		
less reserve of \$130 as of June 30, 2003 and December 31, 2002 .....	<u>16,144</u>	<u>14,358</u>
<b>CURRENT ASSETS:</b>		
Cash.....	6,698	5,391
Accounts receivable - less reserve of \$939 and \$800 as of June 30, 2003 and December 31, 2002, respectively (Note 4) .....	46,251	49,588
Materials and supplies - at average cost:		
Fuel (predominantly coal) .....	41,438	46,090
Other .....	27,888	26,408
Prepayments and other.....	<u>6,132</u>	<u>6,584</u>
Total current assets .....	<u>128,407</u>	<u>134,061</u>
<b>DEFERRED DEBITS AND OTHER ASSETS:</b>		
Unamortized debt expense.....	4,868	4,991
Regulatory assets (Note 6).....	61,398	65,404
Long-term derivative asset.....	17,108	16,928
Other.....	<u>16,973</u>	<u>18,537</u>
Total deferred debits and other assets .....	<u>100,347</u>	<u>105,860</u>
Total assets.....	<u>\$2,113,967</u>	<u>\$1,998,383</u>

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

**Kentucky Utilities Company and Subsidiary**  
**Consolidated Balance Sheets (cont.)**  
(Unaudited)  
(Thousands of \$)

**CAPITALIZATION AND LIABILITIES**

	<u>June 30,</u> <u>2003</u>	<u>December 31,</u> <u>2002</u>
<b>CAPITALIZATION:</b>		
Common stock, without par value -		
Outstanding 37,817,878 shares .....	\$ 308,140	\$ 308,140
Common stock expense.....	(322)	(322)
Additional paid-in capital.....	15,000	15,000
Retained earnings.....	526,916	502,024
Accumulated other comprehensive loss.....	<u>(10,462)</u>	<u>(10,462)</u>
Total common equity .....	839,272	814,380
Cumulative preferred stock.....	39,727	39,727
Long-term debt.....	348,758	346,562
Long-term debt to associated company (Note 9).....	100,000	-
Total capitalization .....	<u>1,327,757</u>	<u>1,200,669</u>
<b>CURRENT LIABILITIES:</b>		
Current portion of long-term debt.....	91,930	153,930
Notes payable to parent (Note 9).....	146,430	119,490
Accounts payable.....	85,963	95,374
Accrued taxes.....	8,696	4,955
Other.....	<u>24,779</u>	<u>21,442</u>
Total current liabilities .....	357,798	395,191
<b>DEFERRED CREDITS AND OTHER LIABILITIES:</b>		
Accumulated deferred income taxes - net.....	250,948	241,184
Investment tax credit, in process of amortization.....	7,179	8,500
Accumulated provision for pensions and related benefits .....	104,376	110,927
Asset retirement obligation (Note 8).....	19,087	-
Regulatory liabilities (Note 6).....	21,623	29,876
Other.....	<u>25,199</u>	<u>12,036</u>
Total deferred credits and other liabilities .....	428,412	402,523
Total capital and liabilities.....	<u>\$2,113,967</u>	<u>\$1,998,383</u>

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

**Kentucky Utilities Company and Subsidiary**  
**Consolidated Statement of Cash Flows**  
(Unaudited)  
(Thousands of \$)

	Six Months Ended June 30,	
	<u>2003</u>	<u>2002</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income .....	\$ 26,020	\$ 37,109
Items not requiring cash currently:		
Depreciation and amortization .....	51,912	46,574
Deferred income taxes - net .....	1,485	(3,106)
Investment tax credit - net .....	(1,321)	(1,478)
Asset retirement obligations (Note 8) .....	9,460	-
Other .....	13,257	13,237
Changes in current assets and liabilities.....	4,628	(24,551)
Changes in accounts receivable securitization-net (Note 4)	-	2,300
Pension funding.....	(3,515)	-
Other.....	<u>12,862</u>	<u>8,208</u>
Net cash flows provided by operating activities .....	<u>114,788</u>	<u>78,293</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchase of securities.....	(1,786)	-
Construction expenditures.....	(175,507)	(47,844)
Net cash flows from investing activities .....	<u>(177,293)</u>	<u>(47,844)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Long-term borrowings from associated company (Note 9).....	100,000	-
Short-term borrowings from parent (Note 9).....	360,640	505,938
Repayment of short-term borrowings from parent.....	(333,700)	(534,138)
Issuance of pollution control bonds.....	-	37,027
Retirement of pollution control bonds.....	(62,000)	(37,930)
Payment of dividends.....	(1,128)	(1,128)
Net cash flows from financing activities .....	<u>63,812</u>	<u>(30,231)</u>
CHANGE IN CASH.....	1,307	218
CASH AT BEGINNING OF PERIOD.....	<u>5,391</u>	<u>3,295</u>
CASH AT END OF PERIOD.....	<u>\$ 6,698</u>	<u>\$ 3,513</u>
<b>SUPPLEMENTAL DISCLOSURES:</b>		
Cash paid during the period for:		
Income taxes .....	\$13,763	\$27,905
Interest on borrowed money .....	\$11,045	\$16,120

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

**Kentucky Utilities Company and Subsidiary**  
**Consolidated Statement of Retained Earnings**  
(Unaudited)  
(Thousands of \$)

	Three Months Ended June 30,		Six Months Ended June 30,	
	<u>2003</u>	<u>2002</u>	<u>2003</u>	<u>2002</u>
Balance at beginning of period.....	\$513,321	\$434,689	\$502,024	\$410,896
Net income.....	<u>14,159</u>	<u>12,752</u>	<u>26,020</u>	<u>37,109</u>
Subtotal .....	<u>527,480</u>	<u>447,441</u>	<u>528,044</u>	<u>448,005</u>
Cash dividends declared on stock:				
4.75% cumulative preferred.....	237	237	475	475
6.53% cumulative preferred .....	<u>327</u>	<u>327</u>	<u>653</u>	<u>653</u>
Subtotal .....	<u>564</u>	<u>564</u>	<u>1,128</u>	<u>1,128</u>
Balance at end of period.....	<u>\$526,916</u>	<u>\$446,877</u>	<u>\$526,916</u>	<u>\$446,877</u>

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

**Kentucky Utilities Company and Subsidiary**  
**Consolidated Statements of Other Comprehensive Income**  
(Unaudited)  
(Thousands of \$)

	Three Months Ended June 30,		Six Months Ended June 30,	
	<u>2003</u>	<u>2002</u>	<u>2003</u>	<u>2002</u>
Net income.....	<u>\$14,159</u>	<u>\$12,752</u>	<u>\$26,020</u>	<u>\$37,109</u>
Gains on derivative instruments and hedging activities (Note 3) .....	-	1,828	-	1,828
Income tax expense related to items of other comprehensive income .....	<u>-</u>	<u>(731)</u>	<u>-</u>	<u>(731)</u>
Other comprehensive gain, net of tax .....	<u>-</u>	<u>1,097</u>	<u>-</u>	<u>1,097</u>
Other comprehensive income .....	<u>\$14,159</u>	<u>\$13,849</u>	<u>\$26,020</u>	<u>\$38,206</u>

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

**Louisville Gas and Electric Company and Subsidiary**  
**Kentucky Utilities Company and Subsidiary**

Notes to Consolidated Financial Statements  
(Unaudited)

1. The unaudited consolidated financial statements include the accounts of Louisville Gas and Electric Company and Subsidiary and Kentucky Utilities Company and Subsidiary ("LG&E" and "KU" or the "Companies"). The common stock of each of LG&E and KU is wholly-owned by LG&E Energy Corp. ("LG&E Energy"). In the opinion of management, the unaudited interim data includes all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of consolidated financial position, results of operations, comprehensive income and cash flows for the periods indicated. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to Securities and Exchange Commission ("SEC") rules and regulations, although the Companies believe that the disclosures are adequate to make the information presented not misleading.

See LG&E's and KU's Annual Reports on Form 10-K for the year ended December 31, 2002 for information relevant to the accompanying financial statements, including information as to the significant accounting policies of the Companies.

The accompanying financial statements for the three months and six months ended June 30, 2002, have been revised to conform with certain reclassifications in the current three months and six months ended June 30, 2003. These reclassifications had no effect on net income, total assets, or total capital and liabilities as previously reported.

2. On December 11, 2000, LG&E Energy was acquired by Powergen plc, now known as Powergen Limited, ("Powergen") for cash of approximately \$3.2 billion or \$24.85 per share and the assumption of all of LG&E Energy's debt. As a result of the acquisition, LG&E Energy became a wholly-owned indirect subsidiary of Powergen and LG&E and KU became indirect subsidiaries of Powergen. The utility operations (LG&E and KU) of LG&E Energy continued their separate identities and continue to serve customers in Kentucky, Virginia and Tennessee under their existing names. The preferred stock and debt securities of the utility operations were not affected by this transaction resulting in the utility operations' obligations to continue to file SEC reports. Following the acquisition, Powergen became a registered holding company under the Public Utility Holding Company Act of 1935 ("PUHCA"), and LG&E and KU, as subsidiaries of a registered holding company, became subject to additional regulation under PUHCA.

As a result of the Powergen acquisition and in order to comply with PUHCA, LG&E Energy Services Inc. ("LG&E Services") was formed as a subsidiary of LG&E Energy and became operational on January 1, 2001. LG&E Services provides certain services to affiliated entities, including LG&E and KU, at cost, as required under PUHCA. On January 1, 2001, approximately 1,000 employees, primarily from LG&E Energy, LG&E and KU, were moved to LG&E Services.

On July 1, 2002, a German company, E.ON AG ("E.ON"), completed its acquisition of Powergen. E.ON had announced its pre-conditional cash offer of 5.1 billion pounds sterling (\$7.3 billion) for Powergen on April 9, 2001. Following the acquisition, LG&E and KU became indirect subsidiaries of E.ON and E.ON became a registered holding company under PUHCA. As contemplated in their regulatory filings in connection with the E.ON acquisition, E.ON, Powergen and LG&E Energy have completed an administrative reorganization to move the LG&E Energy group from an indirect Powergen subsidiary to an indirect E.ON subsidiary. This reorganization was effective March 2003.

No costs associated with the Powergen acquisition or the E.ON acquisition nor any of the effects of purchase accounting have been reflected in the financial statements of LG&E or KU.

3. The Companies use interest rate swaps to hedge exposure to market fluctuations in certain of their debt instruments. Pursuant to the Companies' policies, use of these financial instruments is intended to mitigate risk and earnings volatility and is not speculative in nature. Management has designated all of the Companies' interest rate swaps as hedge instruments. Financial instruments designated as cash flow hedges have resulting gains and losses recorded within other comprehensive income and stockholders' equity. To the extent a financial instrument or the underlying item being hedged is prematurely terminated or the hedge becomes ineffective, the resulting gains or losses are reclassified from other comprehensive income to net income. Financial instruments designated as fair value hedges are periodically marked to market with the resulting gains and losses recorded directly into net income to correspond with income or expense recognized from changes in market value of the items being hedged.

As of June 30, 2003, LG&E had fixed rate swaps covering \$100.3 million in notional amounts of variable rate debt and with fixed rates ranging from 4.309% to 5.495%. The average variable rate on the debt during the three months and six months ended June 30, 2003 was 1.13% and 1.16%, respectively. The swaps have been designated as cash flow hedges and expire on various dates from February 2005 through November 2020. The hedges were deemed to be fully effective resulting in a pretax loss for the three months and six months ended June 30, 2003 of \$2.6 million and \$2.6 million, respectively, recorded in other comprehensive income. Upon expiration of these hedges, the amount recorded in other comprehensive income will be reclassified into earnings. The amount expected to be reclassified from other comprehensive income to earnings in the next twelve months is immaterial due to the long-term nature of the swaps.

As of June 30, 2003, KU had variable rate swaps covering \$153 million in notional amounts of fixed rate debt. The average variable rate on these swaps during the three months and six months ended June 30, 2003 was 1.93% and 1.94%, respectively. The underlying debt has fixed rates ranging from 5.75% to 7.92%. The swaps have been designated as fair value hedges and expire on various dates from May 2007 through June 2025. During the three months and six months ended June 30, 2003, the effect of marking these financial instruments and the underlying debt to market resulted in a pretax loss of \$2.2 million and \$2.0 million, respectively, recorded as an increase in interest expense.

4. LG&E and KU participate in accounts receivable securitization programs. The purpose of these programs is to enable the utilities to accelerate the receipt of cash from the collection of retail accounts receivable, thereby reducing dependence upon more costly sources of working capital. The securitization programs allow for a percentage of eligible receivables to be sold. Eligible receivables are generally all receivables associated with retail sales that have standard terms and are not past due. LG&E and KU are able to terminate these programs at any time without penalty. If there is a significant deterioration in the payment record of the receivables by retail customers or if the Companies fail to meet certain covenants of the programs, the programs may terminate at the election of the financial institutions. In this case, payments from retail customers would first be used to repay the financial institutions participating in the programs, and would then be available for use by the Companies.

As part of these programs, LG&E and KU sold retail accounts receivables to wholly owned subsidiaries, LG&E Receivables LLC ("LG&E R") and KU Receivables LLC ("KU R"). Simultaneously, LG&E R and KU R entered into two separate three-year accounts receivable securitization facilities with two financial institutions and their affiliates whereby LG&E R and KU R can sell, on a revolving basis, an undivided interest in certain of their receivables and receive up to \$75 million and \$50 million,

□respectively, from an unrelated third party purchaser. The effective cost of the receivables programs is comparable to the Companies' lowest cost source of capital, and is based on prime rated commercial paper. LG&E and KU retain servicing rights of the sold receivables through separate servicing agreements with the third party purchasers. LG&E and KU have obtained opinions from independent legal counsel indicating these transactions qualify as true sales of receivables. As of June 30, 2003 and December 31, 2002, LG&E's outstanding program balances were \$49.2 million and \$63.2 million, respectively, and KU's balance for both periods was \$49.3 million.

The allowance for doubtful accounts associated with the eligible securitized receivables was \$2.1 million and \$1.8 million for LG&E at June 30, 2003 and December 31, 2002 and \$0.7 million and \$0.5 million for KU at June 30, 2003 and December 31, 2002. Charge offs were immaterial for LG&E and KU. Management believes that the risk of uncollectibility associated with the sold receivables is minimal.

5. External and intersegment revenues (related party transactions between LG&E and KU) and income by business segment for the three and six months ended June 30, 2003, follow (in thousands of \$):

Three Months Ended June 30, 2003

	<u>External Revenues</u>	<u>Intersegment Revenues</u>	<u>Net Income (Loss)</u>
LG&E electric	\$163,067	\$10,850	\$ 9,457
LG&E gas	41,456	-	(1,682)
Total	<u>\$204,523</u>	<u>\$10,850</u>	<u>\$ 7,775</u>
KU electric	<u>\$187,963</u>	<u>\$ 9,211</u>	<u>\$14,159</u>

Six Months Ended June 30, 2003

	<u>External Revenues</u>	<u>Intersegment Revenues</u>	<u>Net Income</u>
LG&E electric	\$333,116	\$27,820	\$27,489
LG&E gas	181,280	-	7,531
Total	<u>\$514,396</u>	<u>\$27,820</u>	<u>\$35,020</u>
KU electric	<u>\$398,482</u>	<u>\$23,675</u>	<u>\$26,020</u>

External and intersegment revenues (related party transactions between LG&E and KU) and income by business segment for the three and six months ended June 30, 2002, follow (in thousands of \$):

Three Months Ended June 30, 2002

	<u>External Revenues</u>	<u>Intersegment Revenues</u>	<u>Net Income (Loss)</u>
LG&E electric	\$175,375	\$ 9,850	\$17,658
LG&E gas	30,938	-	(2,402)
Total	<u>\$206,313</u>	<u>\$ 9,850</u>	<u>\$15,256</u>
KU electric	<u>\$187,925</u>	<u>\$ 8,095</u>	<u>\$12,752</u>

Six Months Ended June 30, 2002

External	Intersegment
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	<u>Revenues</u>	<u>Revenues</u>	<u>Net Income</u>
LG&E electric	\$323,208	\$22,903	\$28,750
LG&E gas	148,056	-	7,449
Total	<u>\$471,264</u>	<u>\$22,903</u>	<u>\$36,199</u>
KU electric	<u>\$382,168</u>	<u>\$22,876</u>	<u>\$37,109</u>

6. The following regulatory assets and liabilities were included in the balance sheet of LG&E and KU as of June 30, 2003 and December 31, 2002 (in thousands of \$):

Louisville Gas and Electric  
(Unaudited)

	June 30, <u>2003</u>	December 31, <u>2002</u>
REGULATORY ASSETS:		
VDT costs .....	\$ 82,870	\$ 98,044
Unamortized loss on bonds .....	18,267	18,843
Gas supply adjustments due from customers .....	32,100	13,714
Earnings sharing mechanism provision .....	10,728	12,500
Asset retirement obligation .....	5,589	-
LG&E/KU merger costs .....	-	1,815
One utility costs .....	141	954
Manufactured gas sites .....	1,605	1,757
Other .....	3,220	5,819
Total .....	<u>\$154,520</u>	<u>\$153,446</u>
REGULATORY LIABILITIES:		
Deferred income taxes - net .....	\$ 41,804	\$ 45,536
Gas supply adjustments due to customers .....	1,555	3,154
Other .....	1,360	3,734
Total .....	<u>\$ 44,719</u>	<u>\$ 52,424</u>

Kentucky Utilities  
(Unaudited)

	June 30, <u>2003</u>	December 31, <u>2002</u>
REGULATORY ASSETS:		
VDT costs .....	\$ 32,322	\$38,375
Unamortized loss on bonds .....	9,018	9,456
Earnings sharing mechanism provision .....	9,036	13,500
Asset retirement obligation .....	9,714	-
LG&E/KU merger costs .....	-	2,046
One utility costs .....	-	873
Other .....	1,308	1,154
Total .....	<u>\$ 61,398</u>	<u>65,404</u>
REGULATORY LIABILITIES:		
Deferred income taxes - net .....	\$ 20,575	28,854
Other .....	1,048	1,022
Total .....	<u>\$ 21,623</u>	<u>\$29,876</u>

7. The following data represent shares of jointly owned additions to the Trimble County plant for four combustion turbines as of June 30, 2003:

	<u>LG&amp;E</u>	<u>KU</u>	<u>Total</u>
Ownership %	37%	63%	100%

Mw capacity	237	403	640
Plant under construction	\$52	\$92	\$144
Depreciation	-	-	-
Net book value	<u>\$52</u>	<u>\$92</u>	<u>\$144</u>

8. Statement of Financial Accounting Standard (SFAS) No. 143, *Accounting for Asset Retirement Obligations*, was issued in 2001. SFAS No. 143 establishes accounting and reporting standards for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs.

The effective implementation date for SFAS No. 143 was January 1, 2003. Management has calculated the impact of SFAS No. 143 and the recently released FERC final rule, *Accounting, Financial Reporting, and Rate Filing Requirements for Asset Retirement Obligations*. As of June 30, 2003, LG&E recorded asset retirement obligation (ARO) assets in the amount of \$4.5 million and liabilities of \$9.6 million. LG&E recorded offsetting regulatory assets of \$5.6 million, pursuant to regulatory treatment prescribed under SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*. As of June 30, 2003, KU recorded ARO assets in the amount of \$8.6 million and liabilities of \$19.1 million. KU recorded offsetting regulatory assets of \$9.7 million, pursuant to regulatory treatment prescribed under SFAS No. 71. LG&E and KU AROs are primarily related to final retirement of generating units. Assets with associated AROs will no longer include a cost of removal component within their depreciation rate. Assets without associated AROs will continue to be depreciated including a cost of removal component within the depreciation rate.

Had SFAS No. 143 been in effect for the 2002 reporting period, the Companies would have established asset retirement obligations as described in the following table (in thousands of \$):

	<u>LG&amp;E</u>	<u>KU</u>
Provision at January 1, 2002 .....	\$8,752	\$17,331
Accretion expense .....	578	1,146
Provision at December 31, 2002 .....	<u>\$9,330</u>	<u>\$18,477</u>

For the three months and six months ended June 30, 2003, LG&E recorded ARO accretion expense of \$154,000 and \$308,000, respectively, ARO depreciation expense of \$29,000 and \$58,000, respectively, and an offsetting regulatory credit in the income statement of \$183,000 and \$366,000, respectively. For the three months and six months ended June 30, 2003, KU recorded ARO accretion expense of \$306,000 and \$612,000, respectively, ARO depreciation expense of \$44,000 and \$88,000, respectively, and an offsetting regulatory credit in the income statement of \$350,000 and \$700,000, respectively. The recording of the regulatory credit is pursuant to regulatory treatment prescribed under SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*. SFAS No. 143 has no impact on the results of the operation of the Companies.

The Companies adopted EITF No. 98-10, *Accounting for Energy Trading and Risk Management Activities*, effective January 1, 1999. This pronouncement required that energy trading contracts be marked to market on the balance sheet, with the gains and losses shown net in the income statement.

Effective January 1, 2003, the Companies adopted EITF No. 02-03, *Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities*. EITF No. 02-03 established the following:

- Rescinded EITF No. 98-10,
- Contracts that do not meet the definition of a derivative under SFAS No. 133 should not be marked to fair market value, and
- Revenues should be shown in the income statement net of costs associated

with trading activities, whether or not the trades are physically settled.

With the rescission of EITF No. 98-10, energy trading contracts that do not also meet the definition of a derivative under SFAS No. 133 must be accounted for as executory contracts. Contracts previously recorded at fair value under EITF No. 98-10 that are not also derivatives under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, must be restated to historical cost through a cumulative effect adjustment. The rescission of this standard had no impact on financial position or results of operations of the Companies since all contracts marked to market under EITF No. 98-10 are also within the scope of SFAS No. 133.

As a result of EITF No. 02-03, the Companies have netted the power purchased expense for trading activities against electric operating revenue to reflect this accounting change. The Companies applied this guidance to all prior periods, which had no impact on previously reported net income or common equity.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
	LG&E:			
Gross electric operating revenues ....	\$180,637	\$191,813	\$375,930	\$358,059
Less costs reclassified from power purchased .....	<u>6,720</u>	<u>6,588</u>	<u>14,994</u>	<u>11,948</u>
Net electric operating revenues reported .....	<u>\$173,917</u>	<u>\$185,225</u>	<u>\$360,936</u>	<u>\$346,111</u>

KU:				
Gross electric operating revenues ....	\$204,675	\$203,555	\$438,822	\$418,723
Less costs reclassified from power purchased .....	<u>7,501</u>	<u>7,535</u>	<u>16,665</u>	<u>13,679</u>
Net electric operating revenues reported .....	<u>\$197,174</u>	<u>\$196,020</u>	<u>\$422,157</u>	<u>\$405,044</u>

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
	LG&E:			
Gross power purchased .....	\$ 24,033	\$ 22,064	\$ 56,434	\$ 45,645
Less costs reclassified to revenues ..	<u>6,720</u>	<u>6,588</u>	<u>14,994</u>	<u>11,948</u>
Net power purchased reported .....	<u>\$ 17,313</u>	<u>\$ 15,476</u>	<u>\$ 41,440</u>	<u>\$ 33,697</u>

KU:				
Gross power purchased .....	\$ 41,149	\$ 39,911	\$ 91,513	\$ 80,971
Less costs reclassified to revenues ..	<u>7,501</u>	<u>7,535</u>	<u>16,665</u>	<u>13,679</u>
Net power purchased reported .....	<u>\$ 33,648</u>	<u>\$ 32,376</u>	<u>\$ 74,848</u>	<u>\$ 67,292</u>

In May 2003, the Financial Accounting Standards Board issued SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*. SFAS No. 150 is effective immediately for financial instruments entered into or modified after May 31, 2003, and otherwise is effective for interim reporting periods beginning after June 15, 2003.

LG&E has existing \$5.875 series mandatorily redeemable preferred stock with 250,000 shares outstanding having a current redemption price of \$100 per share. The preferred stock has a sinking fund requirement sufficient to retire a minimum of 12,500 shares on July 15<sup>th</sup> of each year commencing with July 15, 2003, and a minimum of 187,500 shares on July 15, 2008 at \$100 per share. LG&E redeemed 12,500 shares in accordance with these provisions on July 15, 2003. Beginning with the three months ended Sep-

tember 30, 2003, LG&E will reclassify, at fair value, its \$5.875 series preferred stock as long-term debt with the minimum shares mandatorily redeemable within one year classified as current portion of long-term debt. Dividends accrued beginning July 1, 2003 will be charged as interest expense.

KU has no financial instruments that fall within the scope of SFAS No. 150.

9. On April 30, 2003, LG&E and KU each borrowed \$100 million from an E.ON affiliate. The term of each loan is ten years and the interest rate is 4.55%. KU had a first mortgage bond of \$62 million that matured in June 2003 and LG&E has a first mortgage bond of \$42.6 million maturing in August 2003. The Companies expect to refinance these bonds, along with a portion of the notes payable to parent, with additional long-term intercompany loans.

The Companies participate in a money pool whereby LG&E Energy can make funds available up to \$400 million at market-based rates for each of LG&E and KU. LG&E Energy maintains facilities of \$200 million with a Powergen subsidiary and \$150 million with an E.ON affiliate to ensure funding availability for the money pool. There was \$82 million outstanding under the Powergen line of credit and the balance under E.ON affiliates' line totaled \$74.9 million as of June 30, 2003. LG&E Energy has provided loans to LG&E and KU through the money pool that total \$171.7 million and \$146.4 million, respectively, as of June 30, 2003. These borrowings carried an interest rate based on an index of highly rated commercial paper issuers as of the prior month end of 1.21% at June 30, 2003.

10. In the normal course of business, lawsuits, claims, environmental actions, and various non-ratemaking governmental proceedings arise against LG&E and KU. To the extent that damages are assessed in any of these lawsuits, LG&E and KU believe that their insurance coverage is adequate. Management, after consultation with legal counsel, and based upon the present status of these items, does not anticipate that liabilities arising out of other currently pending or threatened lawsuits and claims of the type referenced above will have a material adverse effect on LG&E's or KU's consolidated financial position or results of operations.

#### LG&E Employment Discrimination Case

As previously reported, in October 2001, approximately 30 employees or former employees filed a complaint against LG&E claiming past and current instances of employment discrimination against LG&E. LG&E has removed the case to the U.S. District Court for the Western District of Kentucky and filed an answer denying all plaintiffs' claims. Discovery has commenced in the matter. The court has ordered mediation and certain plaintiffs have settled for non-material amounts as a result of that process. In addition, certain other plaintiffs have sought administrative review before the U.S. Equal Employment Opportunity Commission which has, to date, declined to proceed to litigation on any claims reviewed. Previously amended pleadings, while reducing the size of the plaintiff and defendant groups and eliminating certain prior demands, contain a claimed damage amount of \$100 million as well as requests for injunctive relief. During mediation in the first quarter 2003, additional settlements were reached with a number of plaintiffs, including a settlement with the lead plaintiff, which reduced the number of remaining plaintiffs to approximately nine. LG&E intends to continue to defend itself vigorously in the action and management does not anticipate that the outcome will have a material impact on LG&E's operations or financial condition.

#### Combustion Turbine Litigation

LG&E and KU have filed a lawsuit in the U.S. District Court for the Eastern District of Kentucky against Alstom Power, Inc. (formerly ABB Power Generation, Inc.) ("Alstom") regarding two combustion turbines supplied by Alstom during 1999. These units are installed at KU's E.W. Brown generating plant and beneficial ownership of the

the combustion turbines is jointly vested in LG&E and KU. The original purchase price for the turbines was approximately \$91.8 million. The suit presents warranty, negligence, misrepresentation, fraud and other claims relating to numerous operational defects or deficiencies of the turbines. LG&E and KU have requested rescission of the contract and recovery of all expenditures relating to the turbines. Recently, the court ruled that LG&E and KU cannot pursue rescission on the breach of contract claim, but has not ruled on whether they can seek rescission on the fraud count. In addition, LG&E and KU seek punitive damages. As an alternative to rescission, LG&E and KU have requested relief for amounts incurred or expended to date in connection with operational repairs, cover damages or liquidated damages and other costs, with possible further damages and interest to be proven at trial. The matter is currently in discovery with a trial re-scheduled for the fourth quarter of 2003.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

General

The following discussion and analysis by management focuses on those factors that had a material effect on LG&E's and KU's financial results of operations and financial condition during the three and six month periods ended June 30, 2003, and should be read in connection with the financial statements and notes thereto.

Some of the following discussion may contain forward-looking statements that are subject to certain 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 vary materially. Factors that could cause actual results to differ materially include: 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; and other factors described from time to time in LG&E's and KU's reports to the Securities and Exchange Commission, including the report on Form 10-K for year ended December 31, 2002.

Results of Operations

The results of operations for LG&E and KU are affected by seasonal fluctuations in temperature and other weather-related factors. Because of these and other factors, the results of one interim period are not necessarily indicative of results or trends to be expected for the full year.

Three Months Ended June 30, 2003, Compared to  
Three Months Ended June 30, 2002

LG&E Results:

LG&E's net income decreased \$7.5 million (49%) for the three months ended June 30, 2003, as compared to the three months ended June 30, 2002, primarily because of a decrease in sales to electric retail consumers due to milder weather experienced in 2003 and a decrease in the price of retail electric sales and higher depreciation and maintenance expenses.

A comparison of LG&E's revenues for the three months ended June 30, 2003, with the three months ended June 30, 2002, reflects increases and (decreases) which have been segregated by the following principal causes (in thousands of \$):

<u>Cause</u>	<u>Electric Revenues</u>	<u>Gas Revenues</u>
Retail sales:		
Fuel and gas supply adjustments .....	\$ (5,438)	\$ 8,733

Environmental cost recovery surcharge .....	(89)	-
Demand side management cost recovery .....	279	(51)
LG&E/KU merger surcredit .....	227	-
Value delivery surcredit .....	(731)	(186)
Weather normalization .....	-	588
Variation in sales volume and other .....	<u>(8,286)</u>	<u>1,944</u>
Total retail sales .....	(14,038)	11,028
Wholesale sales .....	1,527	(428)
Gas transportation - net .....	-	(28)
Other .....	<u>1,203</u>	<u>(54)</u>
Total .....	<u>\$ (11,308)</u>	<u>\$ 10,518</u>

Electric revenues decreased primarily due to lower fuel costs billed to customers and a decrease in retail volumes sold due to a 42% decrease in cooling degree days. These decreases were partially offset by an increase in wholesale sales volumes. Gas revenues increased primarily as a result of higher gas supply costs billed to customers through the gas supply clause and increased volumes sold, partially offset by a decrease in volume of wholesale sales.

Fuel for electric generation and gas supply expenses comprise a large component of LG&E's total operating expenses. LG&E's electric and gas rates contain a fuel adjustment clause and a gas supply clause, respectively, whereby increases or decreases in the cost of fuel and gas supply are reflected in retail rates, subject to the approval of the Kentucky Public Service Commission (Kentucky Commission). Fuel for electric generation decreased \$4.3 million (8%) for the three months ended due to a decrease in generation (\$2.5 million) and a decrease in the cost of coal burned (\$1.8 million). Gas supply expenses increased \$7.6 million (42%) due to an increase in net gas supply cost (\$9.7 million), partially offset by a decrease in the volume of retail gas delivered to the distribution system (\$2.1 million).

Power purchased increased \$1.8 million (12%) due to an increase in the price of power purchased.

Other operations expenses decreased \$1.4 million (3%), as compared to 2002, primarily due to lower injury and damage liability claims from third parties, \$1.9 million.

Maintenance expenses increased \$2.1 million (14%) primarily due to increased maintenance of gas distribution mains and maintenance of electric distribution lines, \$1.9 million.

Depreciation and amortization increased \$4.4 million (17%) because of additional utility plant in service.

Variations in income tax expense are largely attributable to changes in pre-tax income.

Effective Rate	Three Months Ended <u>June 30, 2003</u>	Three Months Ended <u>June 30, 2002</u>
Statutory federal income tax rate .....	35.0%	35.0%
State income taxes net of federal benefit .....	6.5	4.3
Amortization of investment tax credit & R&D .....	(9.5)	(4.5)
Other differences .....	<u>(2.2)</u>	<u>(0.4)</u>
Effective income tax rate .....	<u>29.8%</u>	<u>34.4%</u>

The amortization of investment tax credit and other differences were approximately the same in both periods, but lower pretax income for the three months ended June 30, 2003, caused the percentage changes to be greater in the 2003 period.

KU Results:

KU's net income increased \$1.4 million (11%) for the three months ended June 30, 2003, as compared to the three months ended June 30, 2002. The increase was mainly due to decreased maintenance expenses due to insurance recovery for expenses associated with a severe ice storm experienced in February 2003 partially offset by increases in depreciation, other operation expenses, power purchased, and fuel.

A comparison of KU's revenues for the three months ended June 30, 2003, with the three months ended June 30, 2002, reflects increases and (decreases) which have been segregated by the following principal causes (in thousands of \$):

Retail sales:

Fuel supply adjustments .....	\$ (116)
Environmental cost recovery surcharge .....	(826)
LG&E/KU merger surcredit .....	76
Value delivery surcredit .....	(403)
Earnings sharing mechanism .....	1,109
Variation in sales volume and other .....	<u>282</u>
Total retail sales .....	122
Wholesale sales .....	2,962
Other .....	<u>(1,930)</u>
Total .....	<u>\$ 1,154</u>

Electric revenue increased primarily due to an increase in wholesale sales volume.

Fuel for electric generation comprises a large component of KU's total operating expenses. KU's electric rates contain a fuel adjustment clause, whereby increases or decreases in the cost of fuel are reflected in retail rates, subject to the approval of the Kentucky Commission, the Virginia State Corporation Commission, and the Federal Energy Regulatory Commission. Fuel for electric generation increased \$2.3 million (4%) for the quarter because of an increase in the cost of coal burned (\$4.4 million) partially offset by a decrease in generation (\$2.1 million) due to temporary plant outages.

Power purchased increased \$1.3 million (4%) due to an increase in the price of power purchased (\$.3 million) and an increase in the volume purchased (\$1.0 million).

Other operation expenses increased \$1.9 million (5%) as compared to 2002, due to increased pension (the market value of plan assets has been affected by declines in the equity market) and post-retirement medical expenses (\$1.2 million), and increased property insurance (\$.5 million).

Maintenance expenses decreased \$8.0 million (52%) primarily due to an insurance reimbursement of costs incurred in the first quarter of 2003 for repairs to electric distribution equipment due to an ice storm in February 2003 (\$8.9 million).

Depreciation and amortization increased \$4.3 million (18%) because of additional utility plant in service.

Variations in income tax expense are largely attributable to changes in pretax income.

	Three Months Ended <u>June 30, 2003</u>	Three Months Ended <u>June 30, 2002</u>
Effective Rate		
Statutory federal income tax rate .....	35.0%	35.0%

State income taxes net of federal benefit .....	6.5	6.8
Amortization of investment tax credit & R&D .....	(3.1)	(3.9)
Other differences .....	(4.6)	(4.5)
Effective income tax rate .....	<u>33.8%</u>	<u>33.4%</u>

Other income - net increased \$1.0 million (60%) in 2003 primarily due to an increase in subsidiary earnings, \$.6 million, and a decrease in benefit costs, \$0.2 million, partially offset by taxes.

Interest charges decreased \$1.3 million (14%) for the three months ended June 30, 2003 as compared to the three months ended 2002 due primarily to lower interest rates on variable rate debt. The weighted average interest rate on variable-rate bonds for the three months ended June 30, 2003, was 1.14% and the corresponding rate for the three months ended June 30, 2002, was 1.64%.

Six Months Ended June 30, 2003, Compared to  
Six Months Ended June 30, 2002

LG&E Results:

LG&E's net income decreased \$1.2 million (3%) for the six months ended June 30, 2003, as compared to the six months ended June 30, 2002, primarily because of an increase in operations, maintenance, and depreciation expenses partially offset by an increase in sales to gas retail consumers, due to the colder winter experienced in 2003, and increased electric wholesale sales.

A comparison of LG&E's revenues for the six months ended June 30, 2003, with the six months ended June 30, 2002, reflects increases and (decreases) which have been segregated by the following principal causes (in thousands of \$):

<u>Cause</u>	<u>Electric Revenues</u>	<u>Gas Revenues</u>
Retail sales:		
Fuel and gas supply adjustments .....	\$ 611	\$24,834
Environmental cost recovery surcharge .....	1,278	-
Demand side management cost recovery .....	671	397
LG&E/KU merger surcredit .....	(449)	-
Value delivery surcredit .....	(1,517)	(830)
Weather normalization .....	-	(2,262)
Variation in sales volume and other .....	<u>(825)</u>	<u>17,374</u>
Total retail sales .....	(231)	39,513
Wholesale sales .....	13,596	(6,141)
Gas transportation - net .....	-	(12)
Other .....	<u>1,460</u>	<u>(136)</u>
Total .....	<u>\$14,825</u>	<u>\$33,224</u>

Electric revenues increased primarily because of an increase in wholesale sales prices (\$14.4 million), partially offset by a decrease in wholesale sales volumes (\$.8 million). Gas revenues increased primarily as a result of higher gas supply costs billed to customers through the gas supply clause and increased volumes sold due to an increase in heating degree days (19%), partially offset by a decrease in volume of wholesale sales.

Fuel for electric generation increased \$1.1 million (1%) for the six months because of an increase in the cost of coal burned (\$1.1 million). Gas supply expenses increased \$30.3 million (30%) due to an increase in net gas supply cost (\$21.5 million) and an increase in the volume of retail gas delivered to the distribution system (\$13.6 million), partially offset by decreased wholesale gas expenses (\$4.8 million).

Power purchased increased \$7.7 million (23%) because of an increase in the price of power purchased (\$9.0 million) partially offset by a decrease in the volume of the purchases (\$1.3 million).

Other operations expenses increased \$3.7 million (4%) in 2003, as compared to 2002, primarily due to higher costs of customer assistance programs (\$1.5 million), and increased pension (the market value of plan assets has been affected by declines in the equity market), post-retirement and medical benefits (\$2.2 million).

Maintenance expenses increased \$2.0 million (7%) primarily due to increased maintenance of gas distribution mains and maintenance of electric distribution lines, \$1.7 million.

Depreciation and amortization increased \$6.3 million (12%) because of additional utility plant in service.

Variations in income tax expense are largely attributable to changes in pre-tax income.

	Six Months Ended June 30, 2003	Six Months Ended June 30, 2002
Effective Rate		
Statutory federal income tax rate .....	35.0%	35.0%
State income taxes net of federal benefit .....	5.8	5.0
Amortization of investment tax credit & R&D .....	(3.8)	(3.7)
Other differences .....	(0.8)	(0.2)
Effective income tax rate .....	<u>36.2%</u>	<u>36.1%</u>

Interest charges decreased \$.8 million (5%) due primarily to lower interest rates on variable rate debt. The weighted average interest rate on variable-rate bonds for the six months ended June 30, 2003 was 1.19%, compared to 1.61% for the comparable period in 2002.

#### KU Results:

KU's net income decreased \$11.1 million (30%) for the six months ended June 30, 2003, as compared to the six months ended June 30, 2002. The decrease was mainly due to expenses associated with a severe ice storm experienced in February 2003, in excess of insurance reimbursements received in June 2003, timing of the performance of annual steam production maintenance and depreciation expense.

A comparison of KU's revenues for the six months ended June 30, 2003, with the six months ended June 30, 2002, reflects increases and (decreases) which have been segregated by the following principal causes (in thousands of \$):

#### Retail sales:

Fuel supply adjustments .....	\$ 7,147
Environmental cost recovery surcharge .....	(889)
Demand side management cost recovery .....	337
LG&E/KU merger surcredit .....	(366)
Value delivery surcredit .....	(860)
Earnings sharing mechanism .....	(1,900)
Variation in sales volume and other .....	<u>11,677</u>
Total retail sales .....	15,146

Wholesale sales .....	510
Other .....	<u>1,457</u>
Total .....	<u>\$17,113</u>

Electric revenues increased primarily due to an increase in retail volumes sold due to a 13% increase in heating degree days and higher fuel costs billed to customers.

Fuel for electric generation increased \$10.3 million (9%) for the six months due to an increase in the cost of coal burned (\$11.5 million), offset by a decrease in generation (\$1.2 million).

Power purchased increased \$7.6 million (11%) due to an increase in price of power purchased (\$2.8 million) and an increase in volume purchased (\$4.8 million) partially as a result of temporary plant outages.

Other operation expenses increased \$6.3 million (9%), primarily due to costs associated with an ice storm (\$2.5 million), increased pension (the market value of plan assets has been affected by declines in the equity market) and post-retirement medical expenses (\$2.6 million), increased property insurance (\$.9 million), and higher electric transmis-

sion costs resulting from increased Midwest Independent System Operator (MISO) costs (\$.3 million).

Maintenance expenses increased \$9.4 million (35%) primarily due to repairs to electric distribution equipment due to an ice storm (\$4.1 million, net of \$8.9 million in insurance reimbursements), and timing of annual maintenance of steam production equipment (\$5.7 million).

Depreciation and amortization increased \$5.3 million (11%) because of additional utility plant in service.

Variations in income tax expense are largely attributable to changes in pretax income.

	Six Months Ended June 30, 2003	Six Months Ended June 30, 2002
Effective Rate		
Statutory federal income tax rate .....	35.0%	35.0%
State income taxes net of federal benefit .....	6.7	6.3
Amortization of investment tax credit & R&D .....	(3.4)	(3.5)
Other differences .....	(4.4)	(3.0)
Effective income tax rate .....	<u>33.9%</u>	<u>34.8%</u>

Other income - net increased \$1.5 million (45%) primarily due to an increase in subsidiary earnings, \$.5 million, decreased benefit costs, \$.4 million, and gain on energy trading contracts marked to market \$.5 million, partially offset by an increase in taxes.

Interest charges decreased \$1.9 million (13%) due primarily to lower interest rates on variable rate debt. The weighted average interest rate on variable-rate bonds for the six months ended June 30, 2003, was 1.16% and the corresponding rate for the six months ended June 30, 2002, was 1.57%.

#### Liquidity and Capital Resources

LG&E and KU's need for capital funds are largely related to the construction of plant and equipment necessary to meet the needs of electric and gas utility customers. Internal and external lines of credit, the accounts receivable securitization programs, and commercial paper programs are maintained to fund short-term capital requirements.

Construction expenditures for the six months ended June 30, 2003 for LG&E and KU amounted to \$119.4 million and \$175.5 million, respectively. Such expenditures related primarily to construction to meet nitrogen oxide (NOx) emission standards and the acquisition of combustion turbines to meet peak power demands. LG&E and KU combustion turbine expenditures for the six months ended June 30, 2003, were \$53.3 million and \$90.9 million, respectively. The expenditures were financed with internally generated funds, intercompany loans from affiliates, and accounts receivable securitization program funds. See Note 4 of Notes to Financial Statements concerning accounts receivable securitization.

LG&E's cash balance decreased \$13.9 million during the six months ended June 30, 2003, primarily due to a pension contribution and the purchase of an interest in four combustion turbines financed with intercompany loans. KU's cash balance increased \$1.3 million during the six months ended June 30, 2003. The increase reflects cash flows from operations and intercompany loans, partially offset by construction expenditures, including the purchase of an interest in four combustion turbines.

Variations in accounts receivable, accounts payable and materials and supplies are generally not significant indicators of LG&E's and KU's liquidity. Such variations are primarily attributable to seasonal fluctuations in weather, which have a direct effect on sales of electricity and natural gas. The increase in accounts receivable at LG&E resulted primarily from timing of payments. The decrease in accounts receivable for KU resulted primarily from timing of payments. The decrease in LG&E's gas stored underground

relates to seasonal usage of gas. The decrease in the fuel inventory at LG&E resulted from seasonal fluctuations partially offset by increased pricing. The decrease in fuel inventory at KU resulted from seasonal fluctuations.

The Companies participate in a money pool whereby LG&E Energy can make funds available up to \$400 million at market-based rates for each of LG&E and KU. LG&E Energy maintains facilities of \$200 million with a Powergen subsidiary and \$150 million with an E.ON affiliate to ensure funding availability for the money pool. There was \$82 million outstanding under the Powergen line of credit and the balance under E.ON affiliates' line totaled \$74.9 million as of June 30, 2003. LG&E Energy has provided loans to LG&E and KU through the money pool that total \$171.7 million and \$146.4 million, respectively, as of June 30, 2003. These borrowings carried an interest rate based on an index of highly rated commercial paper issuers as of the prior month end of 1.21% at June 30, 2003.

During July 2003, LG&E entered into five 364 day revolving lines of credit that total \$185 million. The facilities mature in June and July 2004.

On April 30, 2003, a \$250 million line of credit of LG&E Energy with an E.ON affiliate expired and was not renewed.

On April 30, 2003, LG&E and KU each borrowed \$100 million from an E.ON affiliate. The term of each loan is ten years and the interest rate is 4.55%. KU had a first mortgage bond of \$62 million that matured in June 2003 and LG&E has a first mortgage bond of \$42.6 million maturing in August 2003. The Companies expect to refinance these bonds, along with a portion of the notes payable to parent, with additional long-term intercompany loans.

Under the provisions of variable-rate pollution control bonds totaling \$246.2 million for LG&E and \$91.9 million for KU, 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. Should any of the bonds be put to LG&E or KU, funds from the money pool could be used to reacquire the bonds.

LG&E's security ratings as of August 4, 2003, were:

	<u>Moody's</u>	<u>S&amp;P</u>	<u>Fitch</u>
First mortgage bonds	A1	A-	A+
Preferred stock	Baa1	BBB-	A-
Commercial paper	P-1	A-2	F-1

KU's security ratings as of August 4, 2003, were:

	<u>Moody's</u>	<u>S&amp;P</u>	<u>Fitch</u>
First mortgage bonds	A1	A	A+
Preferred stock	Baa1	BBB-	A-
Commercial paper	P-1	A-2	F-1

These ratings reflect the views of Moody's, S&P and Fitch. 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.

LG&E's capitalization ratios at June 30, 2003, and December 31, 2002, follow:

	June 30, <u>2003</u>	Dec. 31, <u>2002</u>
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Long-term debt (including current portion)	38.8%	35.5%
Notes payable	9.3	11.1
Preferred stock	5.1	5.5
Common equity	46.8	47.9
Total	<u>100.0%</u>	<u>100.0%</u>

KU's capitalization ratios at June 30, 2003, and December 31, 2002, follow:

	June 30, <u>2003</u>	Dec. 31, <u>2002</u>
Long-term debt (including current portion)	34.5%	34.0%
Notes payable	9.4	8.1
Preferred stock	2.5	2.7
Common equity	53.6	55.2
Total	<u>100.0%</u>	<u>100.0%</u>

#### New Accounting Pronouncements

SFAS No. 143, *Accounting for Asset Retirement Obligations*, was issued in 2001. SFAS No. 143 establishes accounting and reporting standards for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs.

The effective implementation date for SFAS No. 143 was January 1, 2003. Management has calculated the impact of SFAS No. 143 and the recently released FERC final rule, *Accounting, Financial Reporting, and Rate Filing Requirements for Asset Retirement Obligations*. As of June 30, 2003, LG&E recorded asset retirement obligation (ARO) assets in the amount of \$4.5 million and liabilities of \$9.6 million. LG&E recorded offsetting regulatory assets of \$5.6 million, pursuant to regulatory treatment prescribed under SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*. As of June 30, 2003, KU recorded ARO assets in the amount of \$8.6 million and liabilities of \$19.1 million. KU recorded offsetting regulatory assets of \$9.7 million, pursuant to regulatory treatment prescribed under SFAS No. 71. LG&E and KU AROs are primarily related to final retirement of generating units. Assets with associated AROs will no longer include a cost of removal component within their depreciation rate. Assets without associated AROs will continue to be depreciated including a cost of removal component within the depreciation rate.

Had SFAS No. 143 been in effect for the 2002 reporting period, the Companies would have established asset retirement obligations as described in the following table (\$000):

	<u>LG&amp;E</u>	<u>KU</u>
Provision at January 1, 2002.....	\$8,752	\$17,331
Accretion expense.....	578	1,146
Provision at December 31, 2002.....	<u>\$9,330</u>	<u>\$18,477</u>

The Companies adopted EITF No. 98-10, *Accounting for Energy Trading and Risk Management Activities*, effective January 1, 1999. This pronouncement required that energy trading contracts be marked to market on the balance sheet, with the gains and losses shown net in the income statement.

Effective January 1, 2003, the Companies adopted EITF No. 02-03, *Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities*. EITF No. 02-03 established the following:

- Rescinded EITF No. 98-10,
- Contracts that do not meet the definition of a derivative under SFAS No. 133 should not be marked to fair market value, and
- Revenues should be shown in the income statement net of costs associated

with trading activities, whether or not the trades are physically settled.

With the rescission of EITF No. 98-10, energy trading contracts that do not also meet the definition of a derivative under SFAS No. 133 must be accounted for as executory contracts. Contracts previously recorded at fair value under EITF No. 98-10 that are not also derivatives under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, must be restated to historical cost through a cumulative effect adjustment. The rescission of this standard had no impact on financial position or results of operations of the Companies since all contracts marked to market under EITF No. 98-10 are also within the scope of SFAS No. 133.

As a result of EITF No. 02-03, the Companies have netted the power purchased expense for trading activities against electric operating revenue to reflect this accounting change. The Companies applied this guidance to all prior periods, which had no impact on previously reported net income or shareholders' equity. The following tables present the impact of this reclassification (in thousands of \$):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
	LG&E:			
Gross electric operating revenues ....	\$180,637	\$191,813	\$375,930	\$358,059
Less costs reclassified .....	<u>6,720</u>	<u>6,588</u>	<u>14,994</u>	<u>11,948</u>
Net electric operating revenues reported .....	<u>\$173,917</u>	<u>\$185,225</u>	<u>\$360,936</u>	<u>\$346,111</u>

KU:				
Gross electric operating revenues ....	\$204,675	\$203,555	\$438,822	\$418,723
Less costs reclassified .....	<u>7,501</u>	<u>7,535</u>	<u>16,665</u>	<u>13,679</u>
Net electric operating revenues reported .....	<u>\$197,174</u>	<u>\$196,020</u>	<u>\$422,157</u>	<u>\$405,044</u>

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
	LG&E:			
Gross power purchased .....	\$ 24,033	\$ 22,064	\$ 56,434	\$ 45,645
Less costs reclassified .....	<u>6,720</u>	<u>6,588</u>	<u>14,994</u>	<u>11,948</u>
Net power purchased reported .....	<u>\$ 17,313</u>	<u>\$ 15,476</u>	<u>\$ 41,440</u>	<u>\$ 33,697</u>

KU:				
Gross power purchased .....	\$ 41,149	\$ 39,911	\$ 91,513	\$ 80,971
Less costs reclassified .....	<u>7,501</u>	<u>7,535</u>	<u>16,665</u>	<u>13,679</u>
Net power purchased reported .....	<u>\$ 33,648</u>	<u>\$ 32,376</u>	<u>\$ 74,848</u>	<u>\$ 67,292</u>

In May 2003, the Financial Accounting Standards Board issued Statement of SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*. SFAS No. 150 is effective immediately for financial instruments entered into or modified after May 31, 2003, and otherwise is effective for interim reporting periods beginning after June 15, 2003.

LG&E has existing \$5.875 series mandatorily redeemable preferred stock with 250,000 shares outstanding having a current redemption price of \$100 per share. The preferred stock has a sinking fund requirement sufficient to retire a minimum of 12,500 shares on July 15<sup>th</sup> of each year commencing with July 15, 2003, and a minimum of 187,500 shares on July 15, 2008 at \$100 per share. Beginning with the three months ended September 30, 2003, LG&E will reclassify, at fair value, its \$5.875 series preferred stock as long-term

debt with the minimum shares mandatorily redeemable within one year classified as current portion of long-term debt. Dividends accrued beginning July 1, 2003 will be charged as interest expense.

KU has no financial instruments that fall within the scope of SFAS No. 150.

### Contingencies

For a description of significant contingencies that may affect LG&E and KU, reference is made to Part I, Item 3, Legal Proceedings, and Note 11 to the financial statements contained in LG&E's and KU's Annual Reports on Form 10-K for the year ended December 31, 2002 and to Part II - Item 1, Legal Proceedings herein.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk.

LG&E and KU are exposed to market risks. Both operations are exposed to market risks from changes in interest rates and commodity prices. To mitigate changes in cash flows attributable to these exposures, the Companies have entered into various derivative instruments. Derivative positions are monitored using techniques that include market value and sensitivity analysis.

The Companies use interest rate swaps to hedge exposure to market fluctuations in certain of their debt instruments. Pursuant to the Companies' policies, use of these financial instruments is intended to mitigate risk and earnings volatility and is not speculative in nature. Management has designated all of the Companies' interest rate swaps as hedge instruments. Financial instruments designated as cash flow hedges have resulting gains and losses recorded within other comprehensive income and stockholders' equity. To the extent a financial instrument or the underlying item being hedged is prematurely terminated or the hedge becomes ineffective, the resulting gains or losses are reclassified from other comprehensive income to net income. Financial instruments designated as fair value hedges are periodically marked to market with the resulting gains and losses recorded directly into net income to correspond with income or expense recognized from changes in market value of the items being hedged.

The potential change in interest expense associated with a 1% change in base interest rates of LG&E's and KU's unswapped debt is estimated at \$5.3 million and \$5.5 million, respectively, at June 30, 2003. LG&E's exposure to floating interest rates decreased \$18.3 million and KU's exposure to floating interest rates increased \$4.3 million during the first six months of 2003. The potential changes in the fair values of the Companies' interest-rate swaps resulting from changes in interest rates and the yield curve also did not change materially during the first six months of 2003.

### Pension Risk

LG&E's and KU's costs of providing defined-benefit pension retirement plans are dependent upon a number of factors, such as the rates of return on plan assets, discount rate, and contributions made to the plans. The market value of LG&E and KU plan assets has been affected by declines in the equity market. As a result, at December 31, 2002, LG&E and KU were required to recognize an additional minimum liability as prescribed by SFAS No. 87 *Employers' Accounting for Pensions*. The liability was recorded as a reduction to other comprehensive income, and did not affect net income for 2002. The amount of the liability depended upon the asset returns experienced in 2002 and contributions made by LG&E and KU to the plan during 2002. Also, pension cost and cash contributions to the plans could increase in future years without a substantial recovery in the equity markets. If the fair value of the plans assets exceeds the accumulated benefit obligation, the recorded liability will be reduced and other comprehensive income will be restored in the consolidated balance sheet.

During 2002, the combination of poor market performance and historically low corporate bond rates created a divergence in the potential value of the pension liability and the

actual value of the pension assets. However, year-to-date 2003 market performance has been quite strong. Should poor market conditions return these conditions could result in an increase in LG&E's and KU's funded accumulated benefit obligation and future pension expense. The primary assumptions that drive the value of the unfunded accumulated benefit obligation are the discount rate and expected return on plan assets.

In January 2003, LG&E and KU made contributions to the pension plan of \$83.1 million and \$3.5 million, respectively.

Energy Trading & Risk Management Activities

LG&E and KU conduct energy trading and risk management activities to maximize the value of power sales from physical assets they own, in addition to the wholesale sale of excess asset capacity. Certain energy trading activities are accounted for on a mark-to-market basis in accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities*. Wholesale sales of excess asset capacity are treated as normal sales under SFAS No. 133 and SFAS No. 138 and are not marked to market.

The rescission of EITF No. 98-10 for fiscal periods ending after December 15, 2002, had no impact on LG&E's or KU's energy trading and risk management reporting as all contracts marked to market under EITF No. 98-10 are also within the scope of SFAS No. 133.

The table below summarizes each LG&E's and KU's energy trading and risk management activities for the three months and six months ended June 30, 2003, and 2002 (in thousands of \$). Trading volumes are evenly divided between LG&E and KU.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
Fair value of contracts at beginning of period, net asset/(liability).....	\$ 403	\$ 12	\$ (156)	\$ (186)
Fair value of contracts when entered into during the period.....	-	104	2,620	(57)
Contracts realized or otherwise settled during the period.....	(226)	(31)	(283)	335
Changes in fair value due to changes in assumptions.....	141	(59)	(1,863)	(66)
Fair value of contracts at end of period, net asset/(liability) .....	<u>\$ 318</u>	<u>\$ 26</u>	<u>\$ 318</u>	<u>\$ 26</u>

No changes to valuation techniques for energy trading and risk management activities occurred during 2003 or 2002. Changes in market pricing, interest rate and volatility assumptions were made during all periods. All contracts outstanding at June 30, 2003, have a maturity of less than one year and are valued using prices actively quoted for proposed or executed transactions or quoted by brokers.

LG&E and KU maintain policies intended to minimize credit risk and revalue credit exposures daily to monitor compliance with those policies. As of June 30, 2003, 100% of the trading and risk management commitments were with counterparties rated BBB-/Baa3 equivalent or better.

Deregulation

The electricity industry in Virginia is currently undergoing deregulation which will enable customers to choose their own energy suppliers after January 2004. On March 19, 2003, the Governor of Virginia signed House Bill 2367, the "Electric Utility Restructuring Suspension," which suspends Kentucky Utilities/Old Dominion Power from Virginia elec-

tric utility restructuring until such time as retail choice is offered to other customers in the United States.

Item 4. Controls and Procedures.

LG&E and KU maintain a system of disclosure controls and procedures designed to ensure that information required to be disclosed by the Companies in reports they file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission rules and forms. LG&E and KU conducted an evaluation of such controls and procedures under the supervision and with the participation of the Companies' management, including the Chairman, President and Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO"). Based upon that evaluation, the CEO and CFO are of the conclusion that the Companies' disclosure controls and procedures are effective as of the end of the period covered by this report. There has been no change in the Companies' internal control over financial reporting that occurred during the fiscal quarter ended June 30, 2003, that has materially affected, or is reasonably likely to materially affect, the Companies' internal control over financial reporting.

Part II. Other Information

Item 1. Legal Proceedings.

For a description of the significant legal proceedings involving LG&E and KU, reference is made to the information under the following items and captions of LG&E's and KU's (A) respective combined Annual Report on Form 10-K for the year ended December 31, 2002: Item 1, Business; Item 3, Legal Proceedings; Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations; Notes 3 and 11 of LG&E's Notes to Financial Statements under Item 8 and Notes 3 and 11 of KU's Notes to Financial Statements under Item 8; and (B) respective combined Quarterly Report on Form 10Q for the quarter ended March 31, 2003: Item 1 of Part II Legal Proceedings. Except as described herein, to date, the proceedings reported in LG&E's and KU's respective combined Annual Report on Form 10-K have not changed materially.

LG&E Employment Discrimination Case

As previously reported, in October 2001, approximately 30 employees or former employees filed a complaint against LG&E claiming past and current instances of employment discrimination against LG&E. LG&E has removed the case to the U.S. District Court for the Western District of Kentucky and filed an answer denying all plaintiffs' claims. Discovery has commenced in the matter. The court has ordered mediation and certain plaintiffs have settled for non-material amounts as a result of that process. In addition, certain other plaintiffs have sought administrative review before the U.S. Equal Employment Opportunity Commission which has, to date, declined to proceed to litigation on any claims reviewed. Previously amended pleadings, while reducing the size of the plaintiff and defendant groups and eliminating certain prior demands, contain a claimed damage amount of \$100 million as well as requests for injunctive relief. During mediation in the first quarter 2003, additional settlements were reached with a number of plaintiffs, including a settlement with the lead plaintiff, which reduced the number of remaining plaintiffs to approximately nine. LG&E intends to continue to defend itself vigorously in the action and management does not anticipate that the outcome will have a material impact on LG&E's operations or financial condition.

Combustion Turbine Litigation

LG&E and KU have filed a lawsuit in the U.S. District Court for the Eastern District of Kentucky against Alstom Power, Inc. (formerly ABB Power Generation, Inc.) ("Alstom") regarding two combustion turbines supplied by Alstom during 1999. These units are installed at KU's E.W. Brown generating plant and beneficial ownership of the combustion turbines is vested in LG&E and KU. The original purchase price for the turbines was approximately \$91.8 million. The suit presents warranty, negligence, misrepresentation, fraud and other claims relating to numerous operational defects or deficiencies of the turbines. LG&E and KU have requested rescission of the contract and recovery of all expenditures relating to the turbines. Recently, the court ruled that LG&E and KU cannot pursue rescission on the breach of contract claim, but has not ruled on whether they can seek rescission on the fraud count. In addition, LG&E and KU seek punitive damages. As an alternative to rescission, LG&E and KU have requested relief for amounts incurred or expended to date in connection with operational repairs, cover damages or liquidated damages and other costs, with possible further damages and interest to be proven at trial. The matter is currently in discovery with a trial re-scheduled for the fourth quarter of 2003.

Item 6(a). Exhibits.

Applicable to Form  
10-Q of

Exhibit

<u>No.</u>	<u>LG&amp;E</u>	<u>KU</u>	<u>Description</u>
------------	-----------------	-----------	--------------------

31	X	X	Certification - Section 302 of Sarbanes-Oxley Act of 2002
31.1	X		Certification of Chairman of the Board, President and Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	X		Certification of Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.3		X	Certification of Chairman of the Board, President and Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.4		X	Certification of Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32	X	X	Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Item 6(b). Reports on Form 8-K.

On May 14, 2003, LG&E and KU filed a Current Report on Form 8-K, submitting certifications of the Chairman, President and Chief Executive Officer and the Chief Financial Officer of each company, respectively, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 regarding the Companies' Quarterly Reports on Form 10-Q for the period ended March 31, 2003.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Louisville Gas and Electric Company  
Registrant

Date: August 13, 2003

/s/ S. Bradford Rives  
S. Bradford Rives  
Senior Vice President, Finance and Controller  
(On behalf of the registrant in his capacity as  
Principal Accounting Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Kentucky Utilities Company  
Registrant

Date: August 13, 2003

/s/ S. Bradford Rives  
S. Bradford Rives  
Senior Vice President, Finance and Controller  
(On behalf of the registrant in his capacity as  
Principal Accounting Officer)

**Exhibit 31 - CERTIFICATIONS**

**Exhibit 31.1**

***Louisville Gas and Electric Company***

I, Victor A. Staffieri, Chairman of the Board, President and Chief Executive Officer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Louisville Gas and Electric Company;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 13, 2003

Victor A. Staffieri  
Chairman of the Board, President and Chief Executive Officer

**Exhibit 31.2**

**Louisville Gas and Electric Company**

I, Richard Aitken-Davies, Chief Financial Officer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Louisville Gas and Electric Company;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 13, 2003

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Richard Aitken-Davies  
Chief Financial Officer

**Exhibit 31.3**

**Kentucky Utilities Company**

I, Victor A. Staffieri, Chairman of the Board, President and Chief Executive Officer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Kentucky Utilities Company;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 13, 2003

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Victor A. Staffieri  
Chairman of the Board, President and Chief Executive Officer

**Exhibit 31.4**

**Kentucky Utilities Company**

I, Richard Aitken-Davies, Chief Financial Officer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Kentucky Utilities Company;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 13, 2003

Richard Aitken-Davies  
Chief Financial Officer

Certification Pursuant to 18 U.S.C. Section 1350  
As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

In connection with the Quarterly Report of Louisville Gas and Electric Company and Kentucky Utilities Company (the "Companies") on Form 10-Q for the period ended June 30, 2003, as filed with the Securities and Exchange Commission (the "Report"), each of the undersigned does hereby certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to such officer's knowledge,

- 1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- 2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Companies as of the dates and for the period expressed in the Report.

August 13, 2003

/s/ Victor A. Staffieri  
Chairman of the Board, President  
and Chief Executive Officer  
Louisville Gas and Electric Company  
Kentucky Utilities Company

/s/ Richard Aitken-Davies  
Chief Financial Officer  
Louisville Gas and Electric Company  
Kentucky Utilities Company

The foregoing certification is being furnished solely pursuant to 18 U.S.C. Section 1350 and is not being filed as part of the Report or as a separate disclosure document.

**SEC Form 10-Q – March 31, 2003**

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2003

Or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

<u>Commission File Number</u>	<u>Registrant, State of Incorporation Address, and Telephone Number</u>	<u>IRS Employer Identification No.</u>
2-26720	<b>Louisville Gas and Electric Company</b> (A Kentucky Corporation) 220 West Main Street P.O. Box 32010 Louisville, KY 40232 (502) 627-2000	61-0264150
1-3464	<b>Kentucky Utilities Company</b> (A Kentucky and Virginia Corporation) One Quality Street Lexington, KY 40507-1428 (859) 255-2100	61-0247570

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No .

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes  No .

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

Louisville Gas and Electric Company  
21,294,223 shares, without par value, as of April 30, 2003,  
all held by LG&E Energy Corp.  
Kentucky Utilities Company  
37,817,878 shares, without par value, as of April 30, 2003,  
all held by LG&E Energy Corp.

This combined Form 10-Q is separately filed by Louisville Gas and Electric Company and Kentucky Utilities Company. Information contained herein related to any individual registrant is filed by such registrant on its own behalf. Each registrant makes no representation as to information related to the other registrants.

TABLE OF CONTENTS

PART I

Item 1 Consolidated Financial Statements

Louisville Gas and Electric Company and Subsidiary	
Statements of Income .....	1
Balance Sheets .....	2
Statements of Cash Flow .....	4
Statements of Retained Earnings .....	5
Statements of Other Comprehensive Income .....	6
Kentucky Utilities Company and Subsidiary	
Statements of Income .....	7
Balance Sheets .....	8
Statements of Cash Flow .....	10
Statements of Retained Earnings .....	11
Statements of Other Comprehensive Income .....	12
Notes to Consolidated Financial Statements.....	13

Item 2	Management's Discussion and Analysis of Financial Condition and Results of Operations.....	18
Item 3	Quantitative and Qualitative Disclosures About Market Risk.....	23
Item 4	Controls and Procedures.....	25

PART II

Item 1	Legal Proceedings.....	26
Item 6	Exhibits and Reports on Form 8-K.....	26
	Signatures.....	27
	Certifications.....	28

Part I. Financial Information - Item 1. Financial Statements

**Louisville Gas and Electric Company and Subsidiary**  
 Consolidated Statements of Income  
 (Unaudited)  
 (Thousands of \$)

	Three Months Ended March 31,	
	<u>2003</u>	<u>2002</u>
<b>OPERATING REVENUES (Note 5):</b>		
Electric.....	\$195,293	\$166,246
Gas.....	<u>139,824</u>	<u>117,119</u>
Total operating revenue .....	<u>335,117</u>	<u>283,365</u>
<b>OPERATING EXPENSES:</b>		
Fuel for electric generation.....	49,477	44,107
Power purchased.....	32,401	23,581
Gas supply expenses.....	106,107	83,467
Other operation expenses.....	53,528	48,410
Maintenance.....	11,893	12,001
Depreciation and amortization.....	27,145	25,278
Federal and state income taxes.....	16,641	13,237
Property and other taxes.....	4,735	4,536
Total operating expenses .....	<u>301,927</u>	<u>254,617</u>
<b>NET OPERATING INCOME.....</b>	<b>33,190</b>	<b>28,748</b>
Other income - net.....	1,064	1
Interest charges (Note 3).....	<u>6,990</u>	<u>7,806</u>
<b>NET INCOME.....</b>	<b>27,264</b>	<b>20,943</b>
Preferred stock dividends.....	<u>936</u>	<u>1,065</u>
<b>NET INCOME AVAILABLE FOR COMMON STOCK.....</b>	<b><u>\$ 26,328</u></b>	<b><u>\$ 19,878</u></b>

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

Louisville Gas and Electric Company and Subsidiary  
Consolidated Balance Sheets  
(Unaudited)  
(Thousands of \$)

ASSETS

	March 31, <u>2003</u>	December 31, <u>2002</u>
UTILITY PLANT:		
At original cost.....	\$3,688,926	\$3,622,985
Less: reserve for depreciation.....	<u>1,485,616</u>	<u>1,463,674</u>
Net utility plant .....	<u>2,203,310</u>	<u>2,159,311</u>
OTHER PROPERTY AND INVESTMENTS -		
less reserve of \$63 as of March 31, 2003 and December 31, 2002 .....	<u>602</u>	<u>764</u>
CURRENT ASSETS:		
Cash.....	5,778	17,015
Accounts receivable - less reserve of \$2,125 as of March 31, 2003 and December 31, 2002 (Note 4) .....	71,391	68,440
Materials and supplies - at average cost:		
Fuel (predominantly coal) .....	33,468	36,600
Gas stored underground .....	19,404	50,266
Other .....	25,994	25,651
Prepayments and other.....	<u>5,765</u>	<u>5,298</u>
Total current assets .....	<u>161,800</u>	<u>203,270</u>
DEFERRED DEBITS AND OTHER ASSETS:		
Unamortized debt expense.....	6,466	6,532
Regulatory assets (Note 6).....	163,578	153,446
Other.....	<u>33,214</u>	<u>37,755</u>
Total deferred debits and other assets .....	<u>203,258</u>	<u>197,733</u>
Total assets.....	<u>\$2,568,970</u>	<u>\$2,561,078</u>

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

Louisville Gas and Electric Company and Subsidiary  
Consolidated Balance Sheets  
(Unaudited)  
(Thousands of \$)

CAPITALIZATION AND LIABILITIES

	March 31, <u>2003</u>	December 31, <u>2002</u>
<b>CAPITALIZATION:</b>		
Common stock, without par value -		
Outstanding 21,294,223 shares .....	\$ 425,170	\$ 425,170
Additional paid-in capital.....	40,000	40,000
Retained earnings.....	435,647	409,319
Accumulated other comprehensive loss.....	(40,532)	(40,512)
Other.....	(836)	(836)
Total common equity .....	<u>859,449</u>	<u>833,141</u>
Cumulative preferred stock.....	95,140	95,140
Long-term debt.....	328,104	328,104
Total capitalization .....	<u>1,282,693</u>	<u>1,256,385</u>
<b>CURRENT LIABILITIES:</b>		
Current portion of long-term debt.....	288,800	288,800
Notes payable to parent.....	248,512	193,053
Accounts payable.....	109,872	122,771
Accrued taxes.....	18,490	1,450
Other.....	19,255	19,536
Total current liabilities .....	<u>684,929</u>	<u>625,610</u>
<b>DEFERRED CREDITS AND OTHER LIABILITIES:</b>		
Accumulated deferred income taxes.....	323,338	313,225
Investment tax credit, in process of amortization.....	53,484	54,536
Accumulated provision for pensions and related benefits .....	136,872	224,703
Customer advances for construction.....	9,780	10,260
Asset retirement obligation (Note 7).....	9,484	-
Regulatory liabilities (Note 6).....	44,425	52,424
Other.....	23,965	23,935
Total deferred credits and other liabilities .....	<u>601,348</u>	<u>679,083</u>
Total capital and liabilities.....	<u>\$2,568,970</u>	<u>\$2,561,078</u>

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

**Louisville Gas and Electric Company and Subsidiary**  
**Consolidated Statement of Cash Flows**  
(Unaudited)  
(Thousands of \$)

	Three Months Ended March 31,	
	<u>2003</u>	<u>2002</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income .....	\$ 27,264	\$ 20,943
Items not requiring cash currently:		
Depreciation and amortization .....	27,145	25,278
Deferred income taxes - net .....	5,510	290
Investment tax credit - net .....	(1,052)	(1,054)
Other .....	13,302	10,893
Changes in current assets and liabilities.....	22,413	(32,199)
Changes in accounts receivable securitization-net (Note 4)	11,800	(22,000)
Pension funding.....	(83,100)	-
Other.....	(17,828)	9,775
Net cash flows from operating activities .....	<u>5,454</u>	<u>11,926</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of securities.....	-	(180)
Proceeds from sales of securities.....	162	-
Construction expenditures.....	(71,255)	(24,947)
Net cash flows from investing activities .....	<u>(71,093)</u>	<u>(25,127)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Issuance of pollution control bonds.....	-	119,926
Retirement of pollution control bonds.....	-	(120,000)
Short-term borrowings from parent.....	229,200	58,300
Repayment of short-term borrowings from parent.....	(173,741)	(29,944)
Payment of dividends.....	(1,057)	(1,111)
Net cash flows from financing activities .....	<u>54,402</u>	<u>27,171</u>
CHANGE IN CASH .....	(11,237)	13,970
CASH AT BEGINNING OF PERIOD.....	<u>17,015</u>	<u>2,112</u>
CASH AT END OF PERIOD.....	<u>\$ 5,778</u>	<u>\$ 16,082</u>
<b>SUPPLEMENTAL DISCLOSURES:</b>		
Cash paid during the period for:		
Interest on borrowed money .....	\$ 6,700	\$ 8,356

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

**Louisville Gas and Electric Company and Subsidiary**  
**Consolidated Statement of Retained Earnings**  
(Unaudited)  
(Thousands of \$)

	Three Months Ended March 31,	
	<u>2003</u>	<u>2002</u>
Balance at beginning of period.....	\$409,319	\$393,636
Net income.....	<u>27,264</u>	<u>20,943</u>
Subtotal .....	<u>436,583</u>	<u>414,579</u>
Cash dividends declared on stock:		
5% cumulative preferred.....	269	269
Auction rate cumulative preferred.....	300	429
\$5.875 cumulative preferred .....	<u>367</u>	<u>367</u>
Subtotal .....	<u>936</u>	<u>1,065</u>
Balance at end of period.....	<u>\$435,647</u>	<u>\$413,514</u>

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

**Louisville Gas and Electric Company and Subsidiary**  
**Consolidated Statements of Other Comprehensive Income**  
(Unaudited)  
(Thousands of \$)

	Three Months Ended March 31,	
	<u>2003</u>	<u>2002</u>
Net income.....	\$27,264	\$20,943
Gains (Losses) on derivative instruments and hedging activities (Note 3) .....	(33)	1,509
Income tax (expense) benefit related to items of other comprehensive income (loss) .....	<u>13</u>	<u>(603)</u>
Other comprehensive gain (loss), net of tax.....	<u>(20)</u>	<u>906</u>
Other comprehensive income.....	<u>\$27,244</u>	<u>\$21,849</u>

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

**Kentucky Utilities Company and Subsidiary**  
**Consolidated Statements of Income**  
(Unaudited)  
(Thousands of \$)

	Three Months Ended March 31,	
	<u>2003</u>	<u>2002</u>
OPERATING REVENUES (Note 5).....	\$234,147	\$215,168
OPERATING EXPENSES:		
Fuel for electric generation.....	66,323	58,271
Power purchased.....	50,363	41,060
Other operation expenses.....	38,889	34,522
Maintenance.....	28,966	11,559
Depreciation and amortization.....	24,150	23,059
Federal and state income taxes.....	6,601	14,383
Property and other taxes.....	4,195	4,114
Total operating expenses .....	<u>219,487</u>	<u>186,968</u>
NET OPERATING INCOME.....	14,660	28,200
Other income - net.....	2,109	1,639
Interest charges (Note 3).....	<u>4,908</u>	<u>5,482</u>
NET INCOME.....	11,861	24,357
Preferred stock dividends.....	<u>564</u>	<u>564</u>
NET INCOME AVAILABLE FOR COMMON STOCK.....	<u>\$ 11,297</u>	<u>\$ 23,793</u>

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

**Kentucky Utilities Company and Subsidiary**  
**Consolidated Balance Sheets**  
(Unaudited)  
(Thousands of \$)

ASSETS

	March 31, <u>2003</u>	December 31, <u>2002</u>
UTILITY PLANT:		
At original cost.....	\$3,380,256	\$3,280,762
Less: reserve for depreciation.....	<u>1,556,389</u>	<u>1,536,658</u>
Net utility plant .....	<u>1,823,869</u>	<u>1,744,104</u>
OTHER PROPERTY AND INVESTMENTS -		
less reserve of \$130 as of March 31, 2003 and December 31, 2002 .....	<u>14,842</u>	<u>14,358</u>
CURRENT ASSETS:		
Cash.....	7,177	5,391
Accounts receivable - less reserve of \$800 as of March 31, 2003 and December 31, 2002 (Note 4) .....	60,700	49,588
Materials and supplies - at average cost:		
Fuel (predominantly coal) .....	43,229	46,090
Other .....	26,641	26,408
Prepayments and other.....	<u>8,019</u>	<u>6,584</u>
Total current assets .....	<u>145,766</u>	<u>134,061</u>
DEFERRED DEBITS AND OTHER ASSETS:		
Unamortized debt expense.....	4,944	4,991
Regulatory assets (Note 6).....	66,704	65,404
Other.....	<u>35,240</u>	<u>35,465</u>
Total deferred debits and other assets .....	<u>106,888</u>	<u>105,860</u>
Total assets.....	<u>\$2,091,365</u>	<u>\$1,998,383</u>

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

**Kentucky Utilities Company and Subsidiary**  
**Consolidated Balance Sheets (cont.)**  
(Unaudited)  
(Thousands of \$)

CAPITALIZATION AND LIABILITIES

	March 31, <u>2003</u>	December 31, <u>2002</u>
<b>CAPITALIZATION:</b>		
Common stock, without par value -		
Outstanding 37,817,878 shares .....	\$ 308,140	\$ 308,140
Additional paid-in capital .....	15,000	15,000
Retained earnings .....	513,321	502,024
Accumulated other comprehensive loss .....	(10,462)	(10,462)
Other .....	(595)	(595)
Total common equity .....	<u>825,404</u>	<u>814,107</u>
Cumulative preferred stock .....	40,000	40,000
Long-term debt .....	347,874	346,562
Total capitalization .....	<u>1,213,278</u>	<u>1,200,669</u>
<b>CURRENT LIABILITIES:</b>		
Current portion of long-term debt .....	153,930	153,930
Notes payable to parent .....	174,531	119,490
Accounts payable .....	84,347	95,374
Accrued taxes .....	17,889	4,955
Other .....	23,083	21,442
Total current liabilities .....	<u>453,780</u>	<u>395,191</u>
<b>DEFERRED CREDITS AND OTHER LIABILITIES:</b>		
Accumulated deferred income taxes - net .....	249,751	241,184
Investment tax credit, in process of amortization .....	7,840	8,500
Accumulated provision for pensions and related benefits .....	106,101	110,927
Asset retirement obligation (Note 7) .....	18,782	-
Regulatory liabilities (Note 6) .....	22,224	29,876
Other .....	19,609	12,036
Total deferred credits and other liabilities .....	<u>424,307</u>	<u>402,523</u>
Total capital and liabilities .....	<u>\$2,091,365</u>	<u>\$1,998,383</u>

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

**Kentucky Utilities Company and Subsidiary**  
**Consolidated Statement of Cash Flows**  
(Unaudited)  
(Thousands of \$)

	Three Months Ended March 31,	
	<u>2003</u>	<u>2002</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income .....	\$ 11,861	\$ 24,357
Items not requiring cash currently:		
Depreciation and amortization .....	24,150	23,059
Deferred income taxes - net .....	913	(2,406)
Investment tax credit - net .....	(660)	(739)
Other .....	18,156	1,233
Changes in current assets and liabilities.....	(6,371)	(19,020)
Changes in accounts receivable securitization-net (Note 4)	-	(25,100)
Other.....	3,062	8,388
Net cash flows provided by operating activities .....	<u>51,111</u>	<u>9,772</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Construction expenditures.....	(103,802)	(23,611)
Net cash flows from investing activities .....	<u>(103,802)</u>	<u>(23,611)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Short-term borrowings from parent.....	444,011	174,869
Repayment of short-term borrowings from parent.....	(388,970)	(158,469)
Payment of dividends.....	(564)	(564)
Net cash flows from financing activities .....	<u>54,477</u>	<u>15,836</u>
CHANGE IN CASH.....	1,786	1,997
CASH AT BEGINNING OF PERIOD.....	<u>5,391</u>	<u>3,295</u>
CASH AT END OF PERIOD.....	<u>\$ 7,177</u>	<u>\$ 5,292</u>
<b>SUPPLEMENTAL DISCLOSURES:</b>		
Cash paid during the period for:		
Interest on borrowed money .....	\$ 1,764	\$ 6,101

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

**Kentucky Utilities Company and Subsidiary**  
**Consolidated Statement of Retained Earnings**  
(Unaudited)  
(Thousands of \$)

	Three Months Ended March 31,	
	<u>2003</u>	<u>2002</u>
Balance at beginning of period.....	\$502,024	\$410,896
Net income.....	11,861	24,357
Subtotal .....	<u>513,885</u>	<u>435,253</u>
Cash dividends declared on stock:		
4.75% preferred.....	237	237
6.53% preferred .....	327	327
Subtotal .....	<u>564</u>	<u>564</u>
Balance at end of period.....	<u>\$513,321</u>	<u>\$434,689</u>

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

**Kentucky Utilities Company and Subsidiary**  
**Consolidated Statements of Other Comprehensive Income**  
(Unaudited)  
(Thousands of \$)

	Three Months Ended March 31,	
	<u>2003</u>	<u>2002</u>
Net income.....	\$11,861	\$24,357
Income tax benefit related to items of other comprehensive income (loss) .....	-	-
Other comprehensive income .....	<u>\$11,861</u>	<u>\$24,357</u>

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

**Louisville Gas and Electric Company and Subsidiary**  
**Kentucky Utilities Company and Subsidiary**

Notes to Consolidated Financial Statements  
(Unaudited)

1. The unaudited consolidated financial statements include the accounts of Louisville Gas and Electric Company and Subsidiary and Kentucky Utilities Company and Subsidiary ("LG&E" and "KU" or the "Companies"). The common stock of each of LG&E and KU is wholly-owned by LG&E Energy Corp. ("LG&E Energy"). In the opinion of management, the unaudited interim data includes all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of consolidated financial position, results of operations, comprehensive income and cash flows for the periods indicated. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to Securities and Exchange Commission ("SEC") rules and regulations, although the Companies believe that the disclosures are adequate to make the information presented not misleading.

See LG&E's and KU's Annual Reports on Form 10-K for the year ended December 31, 2002 for information relevant to the accompanying financial statements, including information as to the significant accounting policies of the Companies.

2. On December 11, 2000, LG&E Energy was acquired by Powergen plc, now known as Powergen Limited, ("Powergen") for cash of approximately \$3.2 billion or \$24.85 per share and the assumption of all of LG&E Energy's debt. As a result of the acquisition, LG&E Energy became a wholly-owned indirect subsidiary of Powergen and LG&E and KU became indirect subsidiaries of Powergen. The utility operations (LG&E and KU) of LG&E Energy continued their separate identities and continue to serve customers in Kentucky, Virginia and Tennessee under their existing names. The preferred stock and debt securities of the utility operations were not affected by this transaction resulting in the utility operations' obligations to continue to file SEC reports. Following the acquisition, Powergen became a registered holding company under the Public Utility Holding Company Act of 1935 ("PUHCA"), and LG&E and KU, as subsidiaries of a registered holding company, became subject to additional regulation under PUHCA.

As a result of the Powergen acquisition and in order to comply with PUHCA, LG&E Energy Services Inc. ("LG&E Services") was formed as a subsidiary of LG&E Energy and became operational on January 1, 2001. LG&E Services provides certain services to affiliated entities, including LG&E and KU, at cost, as required under PUHCA. On January 1, 2001, approximately 1,000 employees, primarily from LG&E Energy, LG&E and KU, were moved to LG&E Services.

On July 1, 2002, a German company, E.ON AG ("E.ON"), completed its acquisition of Powergen. E.ON had announced its pre-conditional cash offer of £5.1 billion (\$7.3 billion) for Powergen on April 9, 2001. Following the acquisition, LG&E and KU became indirect subsidiaries of E.ON and E.ON became a registered holding company under PUHCA. As contemplated in their regulatory filings in connection with the E.ON acquisition, E.ON, Powergen and LG&E Energy have completed an administrative reorganization to move the LG&E Energy group from an indirect Powergen subsidiary to an indirect E.ON subsidiary. This reorganization was effective March 2003.

No costs associated with the Powergen acquisition or the E.ON acquisition nor any of the effects of purchase accounting have been reflected in the financial statements of LG&E or KU.

3. The Companies use interest rate swaps to hedge exposure to market fluctuations in certain of their debt instruments. Pursuant to the Companies' policies, use of these financial instruments is intended to mitigate risk and earnings volatility and is not speculative in nature. Management has designated all of the Companies' interest rate swaps as hedge instruments. Financial instruments designated as cash flow hedges

have resulting gains and losses recorded within other comprehensive income and stockholders' equity. To the extent a financial instrument or the underlying item being hedged is prematurely terminated or the hedge becomes ineffective, the resulting gains or losses are reclassified from other comprehensive income to net income. Financial instruments designated as fair value hedges are periodically marked to market with the resulting gains and losses recorded directly into net income to correspond with income or expense recognized from changes in market value of the items being hedged.

As of March 31, 2003, LG&E had fixed rate swaps covering \$100.3 million in notional amounts of variable rate debt and with fixed rates ranging from 4.309% to 5.495%. The average variable rate on the debt during the quarter ended March 31, 2003 was 1.20%. The swaps have been designated as cash flow hedges and expire on various dates from February 2005 through November 2020. The hedges were deemed to be fully effective resulting in a pretax loss for the quarter ended March 31, 2003 of \$33,000 recorded in other comprehensive income. Upon expiration of these hedges, the amount recorded in other comprehensive income will be reclassified into earnings. The amount expected to be reclassified from Other Comprehensive Income to earnings in the next twelve months is immaterial due to the long-term nature of the swaps.

As of March 31, 2003, KU had variable rate swaps covering \$153 million in notional amounts of fixed rate debt. The average variable rate on these swaps during the quarter ended March 31, 2003 was 1.95%. The underlying debt has fixed rates ranging from 5.75% to 7.92%. The swaps have been designated as fair value hedges and expire on various dates from May 2007 through June 2025. During the quarter ended March 31, 2003, the effect of marking these financial instruments and the underlying debt to market resulted in pretax gains of \$190,000 recorded as a reduction in interest expense.

4. LG&E and KU participate in accounts receivable securitization programs. The purpose of these programs is to enable the utilities to accelerate the receipt of cash from the collection of retail accounts receivable, thereby reducing dependence upon more costly sources of working capital. The securitization programs allow for a percentage of eligible receivables to be sold. Eligible receivables are generally all receivables associated with retail sales that have standard terms and are not past due. LG&E and KU are able to terminate these programs at any time without penalty. If there is a significant deterioration in the payment record of the receivables by retail customers or if the Companies fail to meet certain covenants of the programs, the programs may terminate at the election of the financial institutions. In this case, payments from retail customers would first be used to repay the financial institutions participating in the programs, and would then be available for use by the Companies.

As part of these programs, LG&E and KU sold retail accounts receivables to wholly owned subsidiaries, LG&E Receivables LLC ("LG&E R") and KU Receivables LLC ("KU R"). Simultaneously, LG&E R and KU R entered into two separate three-year accounts receivable securitization facilities with two financial institutions and their affiliates whereby LG&E R and KU R can sell, on a revolving basis, an undivided interest in certain of their receivables and receive up to \$75 million and \$50 million, respectively, from an unrelated third party purchaser. The effective cost of the receivables programs is comparable to the Companies' lowest cost source of capital, and is based on prime rated commercial paper. LG&E and KU retain servicing rights of the sold receivables through separate servicing agreements with the third party purchasers. LG&E and KU have obtained opinions from independent legal counsel indicating these transactions qualify as true sales of receivables. As of March 31, 2003 and December 31, 2002, LG&E's outstanding program balances were \$75.0 million and \$63.2 million, respectively, and KU's balance for both periods was \$49.3 million.

The allowance for doubtful accounts associated with the eligible securitized receivables was \$2.1 million and \$1.8 million for LG&E at March 31, 2003 and December 31, 2002 and \$0.5 million for KU for both March 31, 2003 and December 31, 2002. Charge

offs were immaterial for LG&E and KU. Management believes that the risk of uncollectibility associated with the sold receivables is minimal.

5. External and intersegment revenues (related party transactions between LG&E and KU) and income by business segment for the three months ended March 31, 2003, follow (in thousands of \$):

Three Months Ended March 31, 2003

	<u>External Revenues</u>	<u>Intersegment Revenues</u>	<u>Net Income Available For Common Stock</u>
LG&E electric	\$171,175	\$24,118	\$17,266
LG&E gas	<u>139,824</u>	<u>-</u>	<u>9,062</u>
Total	<u>\$310,999</u>	<u>\$24,118</u>	<u>\$26,328</u>
KU electric	<u>\$217,901</u>	<u>\$16,246</u>	<u>\$11,297</u>

External and intersegment revenues (related party transactions between LG&E and KU) and income by business segment for the three months ended March 31, 2002, follow (in thousands of \$):

Three Months Ended March 31, 2002

	<u>External Revenues</u>	<u>Intersegment Revenues</u>	<u>Net Income Available For Common Stock</u>
LG&E electric	\$153,193	\$13,053	\$10,178
LG&E gas	<u>117,119</u>	<u>-</u>	<u>9,700</u>
Total	<u>\$270,312</u>	<u>\$13,053</u>	<u>\$19,878</u>
KU electric	<u>\$200,387</u>	<u>\$14,781</u>	<u>\$23,793</u>

6. The following regulatory assets and liabilities were included in the balance sheet of LG&E and KU as of March 31, 2003 and December 31, 2002 (in thousands of \$):

Louisville Gas and Electric  
(Unaudited)

	<u>March 31, 2003</u>	<u>December 31, 2002</u>
<u>REGULATORY ASSETS:</u>		
VDT costs .....	\$ 90,493	\$ 98,044
Unamortized loss on bonds .....	18,555	18,843
Gas supply adjustments due from customers .....	30,022	13,714
Earnings Sharing Mechanism provision .....	13,647	12,500
Asset retirement obligation .....	5,405	-
LG&E/KU merger costs .....	907	1,815
One utility costs .....	282	954
Manufactured gas sites .....	1,681	1,757
Other .....	<u>2,586</u>	<u>5,819</u>
Total .....	<u>\$163,578</u>	<u>\$153,446</u>
<u>REGULATORY LIABILITIES:</u>		
Deferred income taxes - net .....	\$ 40,933	\$ 45,536
Gas supply adjustments due to customers .....	270	3,154
Other .....	<u>3,222</u>	<u>3,734</u>
Total .....	<u>\$ 44,425</u>	<u>\$ 52,424</u>

Kentucky Utilities  
(Unaudited)

	March 31, <u>2003</u>	December 31, <u>2002</u>
<u>REGULATORY ASSETS:</u>		
VDT costs .....	\$35,363	\$38,375
Unamortized loss on bonds .....	9,234	9,456
Earnings Sharing Mechanism provision .....	10,490	13,500
Asset retirement obligation .....	9,365	-
LG&E/KU merger costs .....	1,023	2,046
One utility costs .....	-	873
Other .....	<u>1,229</u>	<u>1,154</u>
Total .....	<u>66,704</u>	<u>65,404</u>
<u>REGULATORY LIABILITIES:</u>		
Deferred income taxes - net .....	21,200	28,854
Other .....	<u>1,024</u>	<u>1,022</u>
Total .....	<u>\$22,224</u>	<u>\$29,876</u>

7. SFAS No. 143, *Accounting for Asset Retirement Obligations*, was issued in 2001. SFAS No. 143 establishes accounting and reporting standards for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs.

The effective implementation date for SFAS No. 143 was January 1, 2003. Management has calculated the impact of SFAS No. 143 and the recently released FERC final rule, *Accounting, Financial Reporting, and Rate Filing Requirements for Asset Retirement Obligations*. As of March 31, 2003, LG&E recorded asset retirement obligation (ARO) assets in the amount of \$5.3 million and liabilities of \$9.5 million. LG&E recorded offsetting regulatory assets of \$5.4 million, pursuant to regulatory treatment prescribed under SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*. As of March 31, 2003, KU recorded ARO assets in the amount of \$9.9 million and liabilities of \$18.8 million. KU recorded offsetting regulatory assets of \$9.4 million, pursuant to regulatory treatment prescribed under SFAS No. 71. LG&E and KU AROs are primarily related to final retirement of generating units. Assets with associated AROs will no longer include a cost of removal component within their depreciation rate. Assets without associated AROs will continue to be depreciated including a cost of removal component within the depreciation rate.

Had SFAS No. 143 been in effect for the 2002 reporting period, the Companies would have established asset retirement obligations as described in the following table (in thousands of \$):

	<u>LG&amp;E</u>	<u>KU</u>
Provision at January 1, 2002 .....	\$8,752	\$17,331
Accretion expense .....	578	1,146
Provision at December 31, 2002 .....	<u>\$9,330</u>	<u>\$18,477</u>

The Companies adopted EITF No. 98-10, *Accounting for Energy Trading and Risk Management Activities*, effective January 1, 1999. This pronouncement required that energy trading contracts be marked to market on the balance sheet, with the gains and losses shown net in the income statement. In October 2002, the Emerging Issues Task Force (EITF) reached a consensus to rescind EITF 98-10. The effective date for the full rescission was for fiscal periods beginning after December 15, 2002. With the rescission of EITF No. 98-10, energy trading contracts that do not also meet the definition of a derivative under SFAS No. 133 must be accounted for as executory contracts. Contracts previously recorded at fair value under EITF No. 98-10 that are not also derivatives under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, must be restated to historical cost through a cumulative effect

adjustment. The rescission of this standard had no impact on financial position or results of operations of the Companies.

8. On April 30, LG&E and KU each borrowed \$100 million from an E.ON affiliate and used the proceeds to repay notes payable to the parent. The term of each loan is ten years and the interest rate is 4.55%. LG&E has a first mortgage bond of \$42.6 million maturing in August and KU has a first mortgage bond of \$62 million maturing in June. The Companies expect to refinance these bonds at maturity, along with a portion of the notes payable to parent, with additional long-term intercompany loans.
9. In the normal course of business, lawsuits, claims, environmental actions, and various non-ratemaking governmental proceedings arise against LG&E and KU. To the extent that damages are assessed in any of these lawsuits, LG&E and KU believe that their insurance coverage is adequate. Management, after consultation with legal counsel, and based upon the present status of these items, does not anticipate that liabilities arising out of other currently pending or threatened lawsuits and claims of the type referenced above will have a material adverse effect on LG&E's or KU's consolidated financial position or results of operations.

#### LG&E Employment Discrimination Case

As previously reported, in October 2001, approximately 30 employees or former employees filed a complaint against LG&E claiming past and current instances of employment discrimination against LG&E. LG&E has removed the case to the U.S. District Court for the Western District of Kentucky and filed an answer denying all plaintiff's claims. Discovery has commenced in the matter. The court has ordered mediation and certain plaintiffs have settled for non-material amounts as a result of that process. In addition, certain plaintiffs have sought administrative review before the U.S. Equal Employment Opportunity Commission which has, to date, declined to proceed to litigation on any claims reviewed. Previously amended pleadings, while reducing the size of the plaintiff and defendant groups and eliminating certain prior demands, contain a claimed damage amount of \$100 million as well as requests for injunctive relief. During mediation in the first quarter 2003, additional settlements were reached with a number of plaintiffs, including a proposed settlement with the lead plaintiff, which will reduce the number of remaining plaintiffs to approximately one dozen. LG&E intends to continue to defend itself vigorously in the action and management does not anticipate that the outcome will have a material impact on LG&E's operations or financial condition.

#### Combustion Turbine Litigation

In September 2002, LG&E and KU, and their affiliates, filed a further amended complaint in litigation in the U.S. District Court for the Eastern District of Kentucky against Alstom Power, Inc. (formerly ABB Power Generation, Inc.) ("Alstom") regarding two combustion turbines supplied by Alstom during 1999. These units are installed at KU's E.W. Brown generating plant and jointly owned by LG&E and KU. The original purchase price for the turbines was approximately \$91.8 million. The suit presents warranty, negligence, misrepresentation, fraud and other claims relating to numerous operational defects or deficiencies of the turbines. LG&E and KU have requested rescission of the contract and recovery of all expenditures relating to the turbines. As an alternative to rescission, LG&E and KU have requested relief for amounts incurred or expended to date in connection with operational repairs, cover damages or liquidated damages and other costs, with possible further damages and interest to be proven at trial. The matter is currently in discovery with a trial re-scheduled for the fourth quarter of 2003.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

General

The following discussion and analysis by management focuses on those factors that had a material effect on LG&E's and KU's financial results of operations and financial condition during the three month period ended March 31, 2003, and should be read in connection with the financial statements and notes thereto.

Some of the following discussion may contain forward-looking statements that are subject to certain 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 vary materially. Factors that could cause actual results to differ materially include: 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; and other factors described from time to time in LG&E's and KU's reports to the Securities and Exchange Commission, including the report on Form 10-K for year ended December 31, 2002.

Results of Operations

The results of operations for LG&E and KU are affected by seasonal fluctuations in temperature and other weather-related factors. Because of these and other factors, the results of one interim period are not necessarily indicative of results or trends to be expected for the full year.

Three Months Ended March 31, 2003, Compared to  
Three Months Ended March 31, 2002

LG&E Results:

LG&E's net income increased \$6.3 million (30%) for the quarter ended March 31, 2003, as compared to the quarter ended March 31, 2002, primarily because of an increase in sales to electric retail and wholesale consumers due to the colder winter experienced in 2003 and an increase in price of wholesale sales.

A comparison of LG&E's revenues for the quarter ended March 31, 2003, with the quarter ended March 31, 2002, reflects increases and (decreases) which have been segregated by the following principal causes (in thousands of \$):

<u>Cause</u>	<u>Electric Revenues</u>	<u>Gas Revenues</u>
Retail sales:		
Fuel and gas supply adjustments .....	\$ 6,017	\$ 16,102
Environmental cost recovery surcharge .....	849	-
Demand side management cost recovery .....	391	448
LG&E/KU merger surcredit .....	(676)	-
Value delivery surcredit .....	(788)	(643)
Weather normalization .....	-	(3,097)
Variation in sales volume and other .....	<u>8,014</u>	<u>15,675</u>
Total retail sales .....	13,807	28,485
Wholesale sales .....	14,983	(5,714)
Gas transportation - net .....	-	16
Other .....	<u>257</u>	<u>(82)</u>
Total .....	<u>\$ 29,047</u>	<u>\$ 22,705</u>

Electric revenues increased primarily because of an increase in wholesale sales prices (\$16.9 million) and increased retail volumes sold due to a 24% increase in heating degree days and higher fuel costs billed to customers. These increases were partially offset by a decrease in wholesale sales volumes (\$1.9 million). Gas revenues increased primarily as a result of higher gas supply costs billed to customers through the gas supply clause and increased volumes sold due to the colder weather, partially offset by a decrease in volume of wholesale sales.

Fuel for electric generation and gas supply expenses comprise a large component of LG&E's total operating expenses. LG&E's electric and gas rates contain a fuel adjustment clause and a gas supply clause, respectively, whereby increases or decreases in the cost of fuel and gas supply are reflected in retail rates, subject to the approval of the Kentucky Public Service Commission (Kentucky Commission). Fuel for electric generation increased \$5.4 million (12%) for the quarter because of an increase in generation (\$2.2 million) and an increase in the cost of coal burned (\$3.2 million). Gas supply expenses increased \$22.6 million (27%) due to an increase in net gas supply cost (\$12.1 million) and an increase in the volume of retail gas delivered to the distribution system (\$14.8 million), partially offset by decreased wholesale gas expenses (\$4.3 million).

Power purchased increased \$8.8 million (37%) because of an increase in price of power purchased (\$10.8 million) partially offset by a decrease in volume of purchases (\$2 million).

Other operations expenses increased \$5.1 million (11%) in 2003, as compared to 2002, primarily due to higher electric transmission costs resulting from increased MISO costs (\$1.9 million), increased costs of customer assistance programs (\$1.2 million), and increased pension and post-retirement medical benefits (\$1.5 million).

Depreciation and amortization increased \$1.9 million (8%) because of additional utility plant in service.

Variations in income tax expense are largely attributable to changes in pre-tax income.

	<u>Quarter Ended</u> <u>March 31, 2003</u>	<u>Quarter Ended</u> <u>March 31, 2002</u>
Effective Rate		
Statutory federal income tax rate .....	35.0%	35.0%
State income taxes net of federal benefit .....	5.6	5.4
Amortization of investment tax credit & R&D .....	(2.4)	(3.2)
Other differences .....	<u>(0.4)</u>	<u>-</u>
Effective income tax rate .....	<u>37.8%</u>	<u>37.2%</u>

Other income - net increased \$1.1 million in 2003 primarily due to decreased merchandising costs (\$.5 million), decreased benefit costs (\$.5 million), and a gain on energy trading contracts marked to market (\$.6 million), partially offset by an increase in taxes (\$.7 million).

Interest charges decreased \$.8 million (10%) due primarily to lower interest rates on variable rate debt. The average variable interest rate for the three months ended March 31, 2003 and 2002 was 1.20% and 2.08%, respectively.

#### KU Results:

KU's net income decreased \$12.5 million (51%) for the quarter ended March 31, 2003, as compared to the quarter ended March 31, 2002. The decrease was mainly due to expenses associated with a severe ice storm experienced in February 2003.

A comparison of KU's revenues for the quarter ended March 31, 2003, with the quarter ended March 31, 2002, reflects increases and (decreases) which have been segregated by the following principal causes (in thousands of \$):

Retail sales:

Fuel supply adjustments .....	\$ 7,385
Environmental cost recovery surcharge .....	1,915
Demand side management cost recovery .....	336
LG&E/KU merger surcredit .....	(442)
Value delivery surcredit .....	(457)
Variation in sales volume and other .....	<u>6,287</u>
 Total retail sales .....	 15,024
 Wholesale sales.....	 568
Other.....	<u>3,387</u>
 Total	 <u>\$ 18,979</u>

Electric revenues increased primarily because of higher fuel and environmental costs billed to customers and an increase in retail volumes sold due to a 19% increase in heating degree days.

Fuel for electric generation comprise a large component of KU's total operating expenses. KU's electric rates contain a fuel adjustment clause, whereby increases or decreases in the cost of fuel are reflected in retail rates, subject to the approval of the Kentucky Commission, the Virginia State Corporation Commission, and the Federal Energy Regulatory Commission. Fuel for electric generation increased \$8.1 million (14%) for the quarter because of an increase in the cost of coal burned (\$7.3 million) and an increase in generation (\$.8 million).

Power purchased increased \$9.3 million (23%) due to an increase in price of power purchased (\$6.2 million) and an increase in volume purchased (\$3.1 million).

Other operation expenses increased \$4.4 million (13%) as compared to 2002, primarily due to costs associated with an ice storm (\$1.9 million), increased pension and post-retirement medical expenses (\$1.2 million), increased property insurance (\$.4 million), and higher electric transmission costs resulting from increased MISO costs (\$.3 million).

Maintenance expenses for 2003 increased \$17.4 million (150%) primarily due to repairs to electric distribution equipment due to an ice storm (\$15.9 million), and timing of annual maintenance of steam production equipment (\$2.3 million).

Depreciation and amortization increased \$1.1 million (5%) because of additional utility plant in service.

Variations in income tax expense are largely attributable to changes in pretax income.

Effective Rate	Quarter Ended March 31, 2003	Quarter Ended March 31, 2002
Statutory federal income tax rate .....	35.0%	35.0%
State income taxes net of federal benefit .....	6.9	6.1
Amortization of investment tax credit & R&D .....	(3.7)	(3.3)
Other differences .....	<u>(4.1)</u>	<u>(2.3)</u>
Effective income tax rate .....	<u>34.1%</u>	<u>35.5%</u>

Other income - net increased \$.5 million (29%) in 2003 primarily due to decreased benefit costs (\$.4 million), and gain on energy trading contracts marked to market (\$.6 million), partially offset by an increase in taxes (\$.5 million).

Interest charges decreased \$.6 million (11%) for the first quarter 2003 as compared to the first quarter 2002 due primarily to lower interest rates on variable rate debt. The average variable interest rate for the three months ended March 31, 2003, was 1.16% and the corresponding debt for the three months ended March 31, 2002, was 5.23%.

## Liquidity and Capital Resources

LG&E and KU's need for capital funds are largely related to the construction of plant and equipment necessary to meet the needs of electric and gas utility customers. Internal and external lines of credit, the accounts receivable securitization programs, and commercial paper programs are maintained to fund short-term capital requirements.

Construction expenditures for the three months ended March 31, 2003 for LG&E and KU amounted to \$71.3 million and \$103.8 million, respectively. Such expenditures related primarily to construction to meet nitrogen oxide (NOx) emission standards and the acquisition of new combustion turbines to meet peak power demands. LG&E and KU combustion turbine expenditures for the three months ended March 31, 2003, was \$40.1 million and \$68.2 million, respectively. The expenditures were financed with internally generated funds, intercompany loans from affiliates, and accounts receivable securitization program funds. See Note 4 of Notes to Financial Statements concerning accounts receivable securitization.

LG&E's cash balance decreased \$11.2 million during the three months ended March 31, 2003, primarily due to a pension contribution and the purchase of an interest in four combustion turbines financed with intercompany loans. KU's cash balance increased \$1.8 million during the three months ended March 31, 2003. The increase reflects cash flows from operations and increased short-term borrowings, partially offset by construction expenditures, including the purchase of four combustion turbines.

Variations in accounts receivable, accounts payable and materials and supplies are generally not significant indicators of LG&E's and KU's liquidity. Such variations are primarily attributable to seasonal fluctuations in weather, which have a direct effect on sales of electricity and natural gas. The increase in accounts receivable at LG&E resulted primarily from the increased electric and gas sales. The increase in accounts receivable for KU resulted primarily from increased electric sales. The decrease in LG&E's gas stored underground relates to seasonal uses of gas. The decrease in the fuel inventory at LG&E and KU resulted from seasonal fluctuations partially offset by increased pricing.

The Companies participate in a money pool whereby LG&E Energy can make funds available up to \$400 million at market-based rates for each of LG&E and KU. LG&E Energy maintains facilities of \$200 million with a Powergen subsidiary and \$400 million with an E.ON affiliate to ensure funding availability for the money pool. There was no balance outstanding under the Powergen line of credit and the balance under E.ON affiliates' line totaled \$185 million as of March 31, 2003. LG&E Energy has provided loans to LG&E and KU through the money pool that total \$248.5 million and \$174.5 million, respectively, as of March 31, 2003. These borrowings carried an interest rate based on an index of highly rated commercial paper issuers as of the prior month end of 1.25% at March 31, 2003.

On April 30, 2003, a \$250 million line of credit with an E.ON affiliate expired and was not renewed.

On April 30, LG&E and KU each borrowed \$100 million from an E.ON affiliate and used the proceeds to repay notes payable to the parent. The term of each loan is ten years and the interest rate is 4.55%. LG&E has a first mortgage bond of \$42.6 million maturing in August and KU has a first mortgage bond of \$62 million maturing in June. The Companies expect to refinance these bonds at maturity, along with a portion of the notes payable to parent, with additional long-term intercompany loans.

Under the provisions of variable-rate pollution control bonds totaling \$246.2 million for LG&E and \$91.9 million for KU, 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. Should any of the bonds be put to LG&E or KU, funds from the money pool could be used to reacquire the bonds.

LG&E's security ratings as of March 31, 2003, were:

	<u>Moody's</u>	<u>S&amp;P</u>	<u>Fitch</u>
First mortgage bonds	A1	A	A+
Preferred stock	Baa1	BBB	A-
Commercial paper	P-1	A-2	F-1

KU's security ratings as of March 31, 2003, were:

	<u>Moody's</u>	<u>S&amp;P</u>	<u>Fitch</u>
First mortgage bonds	A1	A	A+
Preferred stock	Baa1	BBB	A-
Commercial paper	P-1	A-2	F-1

During the third quarter 2002 S&P raised the ratings of LG&E and KU by one notch and assigned a stable outlook to all of the ratings. Moody's and Fitch confirmed the ratings of LG&E and KU during the quarter and assigned a stable outlook to the ratings.

These ratings reflect the views of Moody's, S&P and Fitch. 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.

LG&E's capitalization ratios at March 31, 2003, and December 31, 2002, follow:

	March 31, <u>2003</u>	Dec. 31, <u>2002</u>
Long-term debt (including current portion)	33.9%	35.5%
Notes payable	13.7	11.1
Preferred stock	5.2	5.5
Common equity	<u>47.2</u>	<u>47.9</u>
Total	<u>100.0%</u>	<u>100.0%</u>

KU's capitalization ratios at March 31, 2003, and December 31, 2002, follow:

	March 31, <u>2003</u>	Dec. 31, <u>2002</u>
Long-term debt (including current portion)	32.6%	34.0%
Notes payable	11.3	8.1
Preferred stock	2.6	2.7
Common equity	<u>53.5</u>	<u>55.2</u>
Total	<u>100.0%</u>	<u>100.0%</u>

#### New Accounting Pronouncements

SFAS No. 143, *Accounting for Asset Retirement Obligations*, was issued in 2001. SFAS No. 143 establishes accounting and reporting standards for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs.

The effective implementation date for SFAS No. 143 was January 1, 2003. Management has calculated the impact of SFAS No. 143 and the recently released FERC final rule, *Accounting, Financial Reporting, and Rate Filing Requirements for Asset Retirement Obligations*. As of March 31, 2003, LG&E recorded asset retirement obligation (ARO) assets in the amount of \$5.3 million and liabilities of \$9.5 million. LG&E recorded offsetting regulatory assets of \$5.4 million, pursuant to regulatory treatment prescribed under SFAS No.

71, *Accounting for the Effects of Certain Types of Regulation*. As of March 31, 2003, KU recorded ARO assets in the amount of \$9.9 million and liabilities of \$18.8 million. KU recorded offsetting regulatory assets of \$9.4 million, pursuant to regulatory treatment prescribed under SFAS No. 71. LG&E and KU AROs are primarily related to final retirement of generating units. Assets with associated AROs will no longer include a cost of removal component within their depreciation rate. Assets without associated AROs will continue to be depreciated including a cost of removal component within the depreciation rate.

Had SFAS No. 143 been in effect for the 2002 reporting period, the Companies would have established asset retirement obligations as described in the following table (\$000):

	<u>LG&amp;E</u>	<u>KU</u>
Provision at January 1, 2002.....	\$8,752	\$17,331
Accretion expense.....	578	1,146
Provision at December 31, 2002.....	<u>\$9,330</u>	<u>\$18,477</u>

The Companies adopted EITF No. 98-10, *Accounting for Energy Trading and Risk Management Activities*, effective January 1, 1999. This pronouncement required that energy trading contracts be marked to market on the balance sheet, with the gains and losses shown net in the income statement. In October 2002, the EITF reached a consensus to rescind EITF 98-10. The effective date for the full rescission was for fiscal periods beginning after December 15, 2002. With the rescission of EITF No. 98-10, energy trading contracts that do not also meet the definition of a derivative under SFAS No. 133 must be accounted for as executory contracts. Contracts previously recorded at fair value under EITF No. 98-10 that are not also derivatives under SFAS No. 133 must be restated to historical cost through a cumulative effect adjustment. The rescission of this standard had no impact on financial position or results of operations of the Companies.

### Contingencies

For a description of significant contingencies that may affect LG&E and KU, reference is made to Part I, Item 3, Legal Proceedings, and Note 11 to the financial statements contained in LG&E's and KU's Annual Reports on Form 10-K for the year ended December 31, 2002 and to Part II - Item 1, Legal Proceedings herein.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk.

LG&E and KU are exposed to market risks. Both operations are exposed to market risks from changes in interest rates and commodity prices. To mitigate changes in cash flows attributable to these exposures, the Companies have entered into various derivative instruments. Derivative positions are monitored using techniques that include market value and sensitivity analysis.

The Companies use interest rate swaps to hedge exposure to market fluctuations in certain of their debt instruments. Pursuant to the Companies' policies, use of these financial instruments is intended to mitigate risk and earnings volatility and is not speculative in nature. Management has designated all of the Companies' interest rate swaps as hedge instruments. Financial instruments designated as cash flow hedges have resulting gains and losses recorded within other comprehensive income and stockholders' equity. To the extent a financial instrument or the underlying item being hedged is prematurely terminated or the hedge becomes ineffective, the resulting gains or losses are reclassified from other comprehensive income to net income. Financial instruments designated as fair value hedges are periodically marked to market with the resulting gains and losses recorded directly into net income to correspond with income or expense recognized from changes in market value of the items being hedged.

The potential change in interest expense associated with a 1% change in base interest rates of LG&E's and KU's unswapped debt is estimated at \$6.3 million and \$5.8 million, respectively, at March 31, 2003. LG&E's and KU's exposure to floating interest rates increased \$84.3 million and \$55.0 million, respectively, during the first three months of

2003. The potential changes in the fair values of the Companies' interest-rate swaps resulting from changes in interest rates and the yield curve also did not change materially during the first three months of 2003.

#### Pension Risk

LG&E's and KU's costs of providing defined-benefit pension retirement plans are dependent upon a number of factors, such as the rates of return on plan assets, discount rate, and contributions made to the plans. The market value of LG&E and KU plan assets has been affected by declines in the equity market. As a result, at December 31, 2002, LG&E and KU were required to recognize an additional minimum liability as prescribed by SFAS No. 87 *Employers' Accounting for Pensions*. The liability was recorded as a reduction to other comprehensive income, and did not affect net income for 2002. The amount of the liability depended upon the asset returns experienced in 2002 and contributions made by LG&E and KU to the plan during 2002. Also, pension cost and cash contributions to the plans could increase in future years without a substantial recovery in the equity markets. If the fair value of the plans assets exceeds the accumulated benefit obligation, the recorded liability will be reduced and other comprehensive income will be restored in the consolidated balance sheet.

The combination of poor market performance and historically low corporate bond rates has created a divergence in the potential value of the pension liability and the actual value of the pension assets. These conditions could result in an increase in LG&E's and KU's funded accumulated benefit obligation and future pension expense. The primary assumptions that drive the value of the unfunded accumulated benefit obligation are the discount rate and expected return on plan assets.

In January 2003, LG&E and KU made contributions to the pension plan of \$83.1 million and \$3.5 million, respectively.

#### Energy Trading & Risk Management Activities

LG&E and KU conduct energy trading and risk management activities to maximize the value of power sales from physical assets they own, in addition to the wholesale sale of excess asset capacity. Certain energy trading activities are accounted for on a mark-to-market basis in accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities*. Wholesale sales of excess asset capacity are treated as normal sales under SFAS No. 133 and SFAS No. 138 and are not marked to market.

The rescission of EITF 98-10 for fiscal periods ending after December 15, 2002, had no impact on LG&E's or KU's energy trading and risk management reporting as all contracts marked to market under EITF 98-10 are also within the scope of SFAS No. 133.

The table below summarizes each LG&E's and KU's energy trading and risk management activities for the first quarter of 2003 and 2002 (in thousands of \$). Trading volumes are evenly divided between LG&E and KU.

	Three Months Ended <u>March 31, 2003</u>	Three Months Ended <u>March 31, 2002</u>
Fair value of contracts at beginning of period, net asset/(liability).....	\$ (156)	\$ (186)
Fair value of contracts when entered into during the period.....	2,620	(26)
Contracts realized or otherwise settled during the period.....	(57)	231
Changes in fair value due to changes in assumptions..	<u>(2,004)</u>	<u>(7)</u>
Fair value of contracts at end of period, net asset/(liability) .....	<u>\$ 403</u>	<u>\$ 12</u>

No changes to valuation techniques for energy trading and risk management activities occurred during 2003 or 2002. Changes in market pricing, interest rate and volatility assumptions were made during both quarters. All contracts outstanding at March 31, 2003, have a maturity of less than one year and are valued using prices actively quoted for proposed or executed transactions or quoted by brokers.

LG&E and KU maintain policies intended to minimize credit risk and revalue credit exposures daily to monitor compliance with those policies. As of March 31, 2003, 100% of the trading and risk management commitments were with counterparties rated BBB-/Baa3 equivalent or better.

#### Deregulation

The electricity industry in Virginia is currently undergoing deregulation which will enable customers to choose their own energy suppliers after January 2004. On March 19, 2003, the Governor of Virginia signed House Bill 2367, the "Electric Utility Restructuring Suspension," which suspends Kentucky Utilities/Old Dominion Power from Virginia Electric Utility Restructuring.

#### Item 4. Controls and Procedures.

LG&E and KU maintain a system of disclosure controls and procedures designed to ensure that information required to be disclosed by the Companies in reports they file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission rules and forms. During the 90 day period preceding the filing of this report, LG&E and KU conducted an evaluation of such controls and procedures under the supervision and with the participation of the Companies' management, including the Chairman, President and Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO"). Based upon that evaluation, the CEO and CFO are of the conclusion that the companies' disclosure controls and procedures are effective. With respect to LG&E's and KU's internal controls, there have been no significant changes in internal controls or in other factors that could significantly affect these controls subsequent to the date of their most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

## Part II. Other Information

### Item 1. Legal Proceedings.

For a description of the significant legal proceedings involving LG&E and KU, reference is made to the information under the following items and captions of LG&E's and KU's respective combined Annual Report on Form 10-K for the year ended December 31, 2002: Item 1, Business; Item 3, Legal Proceedings; Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations; Notes 3 and 11 of LG&E's Notes to Financial Statements under Item 8 and Notes 3 and 11 of KU's Notes to Financial Statements under Item 8. Except as described herein, to date, the proceedings reported in LG&E's and KU's respective combined Annual Report on Form 10-K have not changed materially.

#### LG&E Employment Discrimination Case

As previously reported, in October 2001, approximately 30 employees or former employees filed a complaint against LG&E claiming past and current instances of employment discrimination against LG&E. LG&E has removed the case to the U.S. District Court for the Western District of Kentucky and filed an answer denying all plaintiff's claims. Discovery has commenced in the matter. The court has ordered mediation and certain plaintiffs have settled for non-material amounts as a result of that process. In addition, certain plaintiffs have sought administrative review before the U.S. Equal Employment Opportunity Commission which has, to date, declined to proceed to litigation on any claims reviewed. Previously amended pleadings, while reducing the size of the plaintiff and defendant groups and eliminating certain prior demands, contain a claimed damage amount of \$100 million as well as requests for injunctive relief. During mediation in the first quarter 2003, additional settlements were reached with a number of plaintiffs, including a proposed settlement with the lead plaintiff, which will reduce the number of remaining plaintiffs to approximately one dozen. LG&E intends to continue to defend itself vigorously in the action and management does not anticipate that the outcome will have a material impact on LG&E's operations or financial condition.

#### Combustion Turbine Litigation

In September 2002, LG&E and KU, and their affiliates, filed a further amended complaint in litigation in the U.S. District Court for the Eastern District of Kentucky against Alstom Power, Inc. (formerly ABB Power Generation, Inc.) ("Alstom") regarding two combustion turbines supplied by Alstom during 1999. These units are installed at KU's E.W. Brown generating plant and jointly owned by LG&E and KU. The original purchase price for the turbines was approximately \$91.8 million. The suit presents warranty, negligence, misrepresentation, fraud and other claims relating to numerous operational defects or deficiencies of the turbines. LG&E and KU have requested rescission of the contract and recovery of all expenditures relating to the turbines. As an alternative to rescission, LG&E and KU have requested relief for amounts incurred or expended to date in connection with operational repairs, cover damages or liquidated damages and other costs, with possible further damages and interest to be proven at trial. The matter is currently in discovery with a trial re-scheduled for the fourth quarter of 2003.

### Item 6(a). Exhibits.

None.

### Item 6(b). Reports on Form 8-K.

On March 25, 2003 LG&E and KU filed a Current Report on Form 8-K, submitting certifications of the Chairman, President and Chief Executive Officer and the Chief Financial Officer of each company, respectively, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 regarding the companies' Annual Reports on Form 10-K for the period ended December 31, 2002.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Louisville Gas and Electric Company  
Registrant

Date: May 14, 2003

/s/ S. Bradford Rives  
S. Bradford Rives  
Senior Vice President, Finance and Controller  
(On behalf of the registrant in his capacity as  
Principal Accounting Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Kentucky Utilities Company  
Registrant

Date: May 14, 2003

/s/ S. Bradford Rives  
S. Bradford Rives  
Senior Vice President, Finance and Controller  
(On behalf of the registrant in his capacity as  
Principal Accounting Officer)

## CERTIFICATIONS

### *Louisville Gas and Electric Company*

I, Victor A. Staffieri, Chairman of the Board, President and Chief Executive Officer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Louisville Gas and Electric Company;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 14, 2003

/s/ Victor A. Staffieri

Victor A. Staffieri

Chairman of the Board, President and Chief Executive Officer

*Louisville Gas and Electric Company*

I, Richard Aitken-Davies, Chief Financial Officer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Louisville Gas and Electric Company;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 14, 2003

/s/ Richard Aitken-Davies  
Richard Aitken-Davies  
Chief Financial Officer

**Kentucky Utilities Company**

I, Victor A. Staffieri, Chairman of the Board, President and Chief Executive Officer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Kentucky Utilities Company;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I am responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 14, 2003

/s/ Victor A. Staffieri

Victor A. Staffieri

Chairman of the Board, President and Chief Executive Officer

**Kentucky Utilities Company**

I, Richard Aitken-Davies, Chief Financial Officer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Kentucky Utilities Company;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 14, 2003

/s/ Richard Aitken-Davies  
Richard Aitken-Davies  
Chief Financial Officer

**SEC Form 10-Q – September 30, 2002**

SECURITIES AND EXCHANGE COMMISSION  
Washington, D. C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2002

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

<u>Commission File Number</u>	<u>Registrant, State of Incorporation, Address, and Telephone Number</u>	<u>IRS Employer Identification No.</u>
2-26720	<b>Louisville Gas and Electric Company</b> (A Kentucky Corporation) 220 West Main Street P.O. Box 32010 Louisville, Ky. 40232 (502) 627-2000	61-0264150
1-3464	<b>Kentucky Utilities Company</b> (A Kentucky and Virginia Corporation) One Quality Street Lexington, Kentucky 40507-1428 (859) 255-2100	61-0247570

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes . No .

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

Louisville Gas and Electric Company  
21,294,223 shares, without par value, as of October 31, 2002,  
all held by LG&E Energy Corp.

Kentucky Utilities Company  
37,817,878 shares, without par value, as of October 31, 2002,  
all held by LG&E Energy Corp.

This combined Form 10-Q is separately filed by Louisville Gas and Electric Company and Kentucky Utilities Company. Information contained herein related to any individual registrant is filed by such registrant on its own behalf. Each registrant makes no representation as to information relating to the other registrants.

TABLE OF CONTENTS

PART I

Item 1	Consolidated Financial Statements	
	Louisville Gas and Electric Company and Subsidiary	
	Statements of Income.....	1
	Balance Sheets.....	2
	Statements of Cash Flows.....	4
	Statements of Retained Earnings.....	5
	Statements of Other Comprehensive Income.....	6
	Kentucky Utilities Company and Subsidiary	
	Statements of Income.....	7
	Balance Sheets.....	8
	Statements of Cash Flows.....	10
	Statements of Retained Earnings.....	11
	Statements of Other Comprehensive Income .....	12
	Notes to Consolidated Financial Statements.....	13
Item 2	Management's Discussion and Analysis of Financial Condition and Results of Operations.....	21
Item 3	Quantitative and Qualitative Disclosures About Market Risk.....	29
Item 4	Controls and Procedures.....	31

PART II

Item 1	Legal Proceedings.....	32
Item 6	Exhibits and Reports on Form 8-K.....	32
	Signatures.....	33
	Certifications.....	34

Part I. Financial Information - Item 1. Financial Statements

**Louisville Gas and Electric Company and Subsidiary**  
 Consolidated Statements of Income  
 (Unaudited)  
 (Thousands of \$)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2002	2001	2002	2001
<b>OPERATING REVENUES (Note 7):</b>				
Electric.....	\$223,017	\$206,228	\$581,076	\$557,891
Gas .....	22,800	25,657	170,856	216,106
Total operating revenue.....	<u>245,817</u>	<u>231,885</u>	<u>751,932</u>	<u>773,997</u>
<b>OPERATING EXPENSES:</b>				
Fuel for electric generation.....	52,827	44,338	147,484	124,571
Power purchased.....	15,322	15,566	60,967	59,651
Gas supply expenses.....	11,098	13,533	112,911	157,591
Non-recurring charges (Note 4).....	-	-	-	144,385
Other operation expenses.....	51,269	39,441	154,486	111,122
Maintenance.....	18,869	13,680	46,441	37,918
Depreciation and amortization (Note 4).....	28,196	26,344	79,363	77,183
Federal and state income taxes.....	22,083	25,821	43,655	5,639
Property and other taxes.....	4,501	4,070	13,815	12,953
Total operating expenses.....	<u>204,165</u>	<u>182,793</u>	<u>659,122</u>	<u>731,013</u>
NET OPERATING INCOME.....	41,652	49,092	92,810	42,984
Other income - net .....	156	360	90	1,718
Interest charges (Note 5).....	<u>7,604</u>	<u>9,182</u>	<u>22,497</u>	<u>30,080</u>
NET INCOME.....	34,204	40,270	70,403	14,622
Preferred stock dividends.....	<u>1,075</u>	<u>1,110</u>	<u>3,189</u>	<u>3,628</u>
NET INCOME AVAILABLE FOR COMMON STOCK.....	<u>\$ 33,129</u>	<u>\$ 39,160</u>	<u>\$ 67,214</u>	<u>\$ 10,994</u>

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

**Louisville Gas and Electric Company and Subsidiary**  
**Consolidated Balance Sheets**  
(Unaudited)  
(Thousands of \$)

ASSETS

	<u>Sept. 30,</u> <u>2002</u>	<u>Dec. 31,</u> <u>2001</u>
<b>UTILITY PLANT:</b>		
At original cost.....	\$3,554,543	\$3,423,037
Less: reserve for depreciation.....	<u>1,449,059</u>	<u>1,381,874</u>
Net utility plant .....	<u>2,105,484</u>	<u>2,041,163</u>
<b>OTHER PROPERTY AND INVESTMENTS -</b>		
less reserve of \$63 as of Sept. 30, 2002 and Dec. 31, 2001.....	<u>1,415</u>	<u>1,176</u>
<b>CURRENT ASSETS:</b>		
Cash .....	15,148	2,112
Accounts receivable - less reserve of \$1,575 as of Sept. 30, 2002 and Dec. 31, 2001 (Note 6).....	42,375	85,667
Materials and supplies - at average cost:		
Fuel (predominantly coal) .....	35,057	22,024
Gas stored underground .....	49,516	46,395
Other.....	27,586	29,050
Prepayments and other.....	<u>2,504</u>	<u>4,688</u>
Total current assets .....	<u>172,186</u>	<u>189,936</u>
<b>DEFERRED DEBITS AND OTHER ASSETS:</b>		
Unamortized debt expense.....	6,146	5,921
Regulatory assets (Note 8).....	150,915	197,142
Other.....	<u>12,380</u>	<u>13,016</u>
Total deferred debits and other assets .....	<u>169,441</u>	<u>216,079</u>
<b>Total assets.....</b>	<b><u>\$2,448,526</u></b>	<b><u>\$2,448,354</u></b>

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

**Louisville Gas and Electric Company and Subsidiary**  
Consolidated Balance Sheets (cont.)  
(Unaudited)  
(Thousands of \$)

CAPITALIZATION AND LIABILITIES

	Sept. 30, <u>2002</u>	Dec. 31, <u>2001</u>
<b>CAPITALIZATION:</b>		
Common stock, without par value -		
Outstanding 21,294,223 shares .....	\$ 425,170	\$ 425,170
Additional paid-in capital .....	40,000	40,000
Retained earnings .....	414,850	393,636
Accumulated other comprehensive income .....	(25,972)	(19,900)
Other .....	(836)	(836)
Total common equity .....	<u>853,212</u>	<u>838,070</u>
Cumulative preferred stock .....	95,140	95,140
Long-term debt (Notes 10 and 11) .....	328,104	370,704
Total capitalization .....	<u>1,276,456</u>	<u>1,303,914</u>
<b>CURRENT LIABILITIES:</b>		
Current portion of long-term debt .....	288,800	246,200
Notes payable to parent .....	129,153	94,197
Accounts payable .....	86,425	149,070
Accrued taxes .....	21,118	20,257
Accrued interest .....	4,045	5,818
Other .....	14,463	12,840
Total current liabilities .....	<u>544,004</u>	<u>528,382</u>
<b>DEFERRED CREDITS AND OTHER LIABILITIES:</b>		
Accumulated deferred income taxes .....	307,489	298,143
Investment tax credit, in process of amortization .....	55,589	58,689
Accumulated provision for pensions and related benefits .....	165,365	167,526
Customer advances for construction .....	10,350	9,745
Regulatory liabilities (Note 8) .....	54,906	65,349
Other .....	34,367	16,606
Total deferred credits and other liabilities .....	<u>628,066</u>	<u>616,058</u>
<b>Total capital and liabilities .....</b>	<b><u>\$2,448,526</u></b>	<b><u>\$2,448,354</u></b>

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

**Louisville Gas and Electric Company and Subsidiary**  
**Consolidated Statements of Cash Flows**  
(Unaudited)  
(Thousands of \$)

	Nine Months Ended September 30, <u>2002</u> <u>2001</u>	
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income (loss).....	\$ 70,403	\$ 14,622
Items not requiring cash currently:		
Depreciation and amortization .....	79,363	77,183
Deferred income taxes - net .....	7,748	(45,886)
Investment tax credit - net .....	(3,100)	(3,186)
Non-recurring charges (Note 4) .....	-	107,919
Other .....	33,595	11,977
Changes in current assets and liabilities.....	(63,348)	4,754
Changes in accounts receivable securitization-net (Note 6)...	32,200	37,900
Other.....	<u>13,662</u>	<u>(14,122)</u>
Net cash flows from operating activities .....	<u>170,523</u>	<u>191,161</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of securities.....	(239)	-
Proceeds from sales of securities.....	-	4,231
Construction expenditures.....	<u>(141,855)</u>	<u>(143,844)</u>
Net cash flows from investing activities .....	<u>(142,094)</u>	<u>(139,613)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Issuance of pollution control bonds (Note 10).....	118,876	10,104
Retirement of pollution control bonds (Note 10).....	(120,000)	-
Short-term borrowings.....	896,456	61,564
Repayment of short-term borrowings.....	(861,500)	(121,000)
Payment of dividends.....	<u>(49,225)</u>	<u>(3,885)</u>
Net cash flows from financing activities .....	<u>(15,393)</u>	<u>(53,217)</u>
CHANGE IN CASH AND TEMPORARY CASH INVESTMENTS.....	13,036	(1,669)
CASH AND TEMPORARY CASH INVESTMENTS		
AT BEGINNING OF PERIOD.....	<u>2,112</u>	<u>2,495</u>
CASH AND TEMPORARY CASH INVESTMENTS		
AT END OF PERIOD.....	<u>\$ 15,148</u>	<u>\$ 826</u>
<b>SUPPLEMENTAL DISCLOSURES:</b>		
Cash paid during the period for:		
Income taxes .....	\$ 46,925	\$ 16,517
Interest on borrowed money .....	\$ 22,523	\$ 25,554

For the purposes of these statements, all temporary cash investments purchased with a maturity of three months or less are considered cash equivalents.

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

**Louisville Gas and Electric Company and Subsidiary**  
**Consolidated Statements of Retained Earnings**  
(Unaudited)  
(Thousands of \$)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	<u>2002</u>	<u>2001</u>	<u>2002</u>	<u>2001</u>
Balance at beginning of period .....	\$404,721	\$286,428	\$393,636	\$314,594
Net income .....	<u>34,204</u>	<u>40,270</u>	<u>70,403</u>	<u>14,622</u>
Subtotal .....	<u>438,925</u>	<u>326,698</u>	<u>464,039</u>	<u>329,216</u>
Cash dividends declared on stock:				
5% cumulative preferred .....	269	269	807	807
Auction rate cumulative preferred .....	439	474	1,281	1,720
\$5.875 cumulative preferred .....	367	367	1,101	1,101
Common .....	<u>23,000</u>	<u>-</u>	<u>46,000</u>	<u>-</u>
Subtotal .....	<u>24,075</u>	<u>1,110</u>	<u>49,189</u>	<u>3,628</u>
Balance at end of period .....	<u>\$414,850</u>	<u>\$325,588</u>	<u>\$414,850</u>	<u>\$325,588</u>

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

**Louisville Gas and Electric Company and Subsidiary**  
**Consolidated Statements of Other Comprehensive Income**  
(Unaudited)  
(Thousands of \$)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	<u>2002</u>	<u>2001</u>	<u>2002</u>	<u>2001</u>
Net income.....	\$34,204	\$40,270	\$70,403	\$14,622
Cumulative effect of change in accounting principle - accounting for derivative instruments and hedging activities (Note 5) .....	-	-	-	(5,998)
Losses on derivative instruments and hedging activities (Note 5) ...	<u>(7,691)</u>	<u>(4,663)</u>	<u>(10,121)</u>	<u>(5,721)</u>
Other comprehensive income (loss) before tax.....	(7,691)	(4,663)	(10,121)	(11,719)
Income tax benefit related to items of other comprehensive income (loss).....	<u>3,076</u>	<u>1,865</u>	<u>4,049</u>	<u>4,688</u>
Other comprehensive income.....	<u>\$29,589</u>	<u>\$37,472</u>	<u>\$64,331</u>	<u>\$ 7,591</u>

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

**Kentucky Utilities Company and Subsidiary**  
**Consolidated Statements of Income**  
(Unaudited)  
(Thousands of \$)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2002	2001	2002	2001
OPERATING REVENUES (Note 7).....	\$239,020	\$216,370	\$657,744	\$647,522
OPERATING EXPENSES:				
Fuel for electric generation.....	80,380	65,646	196,018	177,096
Power purchased.....	31,873	31,139	112,844	116,046
Non-recurring charges (Note 4).....	-	-	-	63,788
Other operation expenses.....	38,151	30,937	108,874	84,898
Maintenance.....	12,439	14,143	39,385	41,663
Depreciation and amortization (Note 4).....	24,449	24,158	71,023	71,805
Federal and state income taxes.....	17,011	16,236	38,759	21,606
Property and other taxes.....	3,689	3,857	11,565	12,289
Total operating expenses.....	<u>207,992</u>	<u>186,116</u>	<u>578,468</u>	<u>589,191</u>
NET OPERATING INCOME.....	31,028	30,254	79,276	58,331
Other income - net .....	5,466	1,284	8,789	5,698
Interest charges (Note 5).....	<u>5,409</u>	<u>5,198</u>	<u>19,871</u>	<u>23,740</u>
NET INCOME before cumulative effect of accounting change .....	31,085	26,340	68,194	40,289
Cumulative effect of change in accounting for derivative instruments and hedging activities, net of tax	<u>-</u>	<u>-</u>	<u>-</u>	<u>136</u>
NET INCOME.....	31,085	26,340	68,194	40,425
Preferred stock dividends.....	<u>564</u>	<u>564</u>	<u>1,692</u>	<u>1,692</u>
NET INCOME AVAILABLE FOR COMMON STOCK.....	<u>\$ 30,521</u>	<u>\$ 25,776</u>	<u>\$ 66,502</u>	<u>\$ 38,733</u>

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

**Kentucky Utilities Company and Subsidiary**  
**Consolidated Balance Sheets**  
(Unaudited)  
(Thousands of \$)

ASSETS

	<u>Sept. 30,</u> <u>2002</u>	<u>Dec. 31,</u> <u>2001</u>
<b>UTILITY PLANT:</b>		
At original cost.....	\$3,224,034	\$3,064,220
Less: reserve for depreciation.....	<u>1,528,492</u>	<u>1,457,754</u>
Net utility plant .....	<u>1,695,542</u>	<u>1,606,466</u>
<b>OTHER PROPERTY AND INVESTMENTS -</b>		
less reserve of \$129 as of Sept. 30, 2002 and Dec. 31, 2001	<u>13,766</u>	<u>9,629</u>
<b>CURRENT ASSETS:</b>		
Cash and temporary cash investments.....	6,790	3,295
Accounts receivable - less reserve of \$520 as of Sept. 30, 2002, and Dec. 31, 2001 (Note 6).....	54,605	45,291
<b>Materials and supplies - at average cost:</b>		
Fuel (predominantly coal) .....	33,981	43,382
Other .....	26,796	26,188
Prepayments and other.....	<u>4,505</u>	<u>4,942</u>
Total current assets .....	<u>126,677</u>	<u>123,098</u>
<b>DEFERRED DEBITS AND OTHER ASSETS:</b>		
Unamortized debt expense.....	3,977	4,316
Regulatory assets (Note 8).....	52,821	66,467
Other.....	<u>26,686</u>	<u>16,926</u>
Total deferred debits and other assets .....	<u>83,484</u>	<u>87,709</u>
<b>Total assets.....</b>	<b><u>\$1,919,469</u></b>	<b><u>\$1,826,902</u></b>

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

**Kentucky Utilities Company and Subsidiary**  
**Consolidated Balance Sheets (cont.)**  
(Unaudited)  
(Thousands of \$)

**CAPITALIZATION AND LIABILITIES**

	<u>Sept. 30,</u> <u>2002</u>	<u>Dec. 31,</u> <u>2001</u>
<b>CAPITALIZATION:</b>		
Common stock, without par value -		
Outstanding 37,817,878 shares .....	\$ 308,140	\$ 308,140
Additional paid-in capital .....	15,000	15,000
Retained earnings .....	477,398	410,896
Accumulated other comprehensive income .....	-	1,588
Other .....	(595)	(595)
Total common equity .....	<u>799,943</u>	<u>735,029</u>
Cumulative preferred stock .....	40,000	40,000
Long-term debt (Note 10) .....	<u>347,839</u>	<u>434,506</u>
Total capitalization .....	<u>1,187,782</u>	<u>1,209,535</u>
<b>CURRENT LIABILITIES:</b>		
Current portion of long-term debt .....	153,930	54,000
Notes payable to parent .....	87,690	47,790
Accounts payable .....	73,328	85,149
Dividends declared .....	188	-
Accrued taxes .....	12,655	20,520
Accrued interest .....	4,767	5,668
Other .....	<u>18,234</u>	<u>16,482</u>
Total current liabilities .....	<u>350,792</u>	<u>229,609</u>
<b>DEFERRED CREDITS AND OTHER LIABILITIES:</b>		
Accumulated deferred income		
taxes .....	240,001	239,204
Investment tax credit, in		
process of amortization .....	9,239	11,455
Accumulated provision for pensions		
and related benefits .....	77,445	91,235
Customer advances for construction .....	1,492	1,526
Regulatory liabilities (Note 8) .....	32,242	33,889
Other .....	<u>20,476</u>	<u>10,449</u>
Total deferred credits and other liabilities .....	<u>380,895</u>	<u>387,758</u>
Total capital and liabilities .....	<u>\$1,919,469</u>	<u>\$1,826,902</u>

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

**Kentucky Utilities Company and Subsidiary**  
**Consolidated Statements of Cash Flows**  
(Unaudited)  
(Thousands of \$)

	Nine Months Ended September 30, <u>2002</u> <u>2001</u>	
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income.....	\$ 68,194	\$ 40,425
Items not requiring cash currently:		
Depreciation and amortization.....	71,023	71,805
Deferred income taxes - net.....	(2,180)	(31,980)
Investment tax credit - net.....	(2,216)	(2,585)
Non-recurring charges (Note 4).....	-	48,504
Other.....	18,358	5,489
Changes in current assets and liabilities.....	(23,631)	(20,671)
Changes in accounts receivable securitization-net (Note 6)..	4,900	30,000
Other.....	(3,278)	(147)
Net cash flows from operating activities.....	<u>131,170</u>	<u>140,840</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Construction expenditures.....	(164,766)	(102,329)
Net cash flows from investing activities.....	<u>(164,766)</u>	<u>(102,329)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Issuance of pollution control bonds (Note 10).....	36,813	-
Retirement of pollution control bonds (Note 10).....	(37,930)	-
Short-term borrowings.....	390,200	348,963
Repayment of short-term borrowings.....	(350,300)	(385,912)
Payment of dividends.....	(1,692)	(1,692)
Net cash flows from financing activities.....	<u>37,091</u>	<u>(38,641)</u>
<b>CHANGE IN CASH AND TEMPORARY</b>		
CASH INVESTMENTS.....	3,495	(130)
<b>CASH AND TEMPORARY CASH INVESTMENTS AT</b>		
BEGINNING OF PERIOD.....	<u>3,295</u>	<u>314</u>
<b>CASH AND TEMPORARY CASH INVESTMENTS AT</b>		
END OF PERIOD.....	<u>\$ 6,790</u>	<u>\$ 184</u>
<b>SUPPLEMENTAL DISCLOSURES:</b>		
Cash paid during the period for:		
Income taxes.....	\$ 59,070	\$ 52,280
Interest on borrowed money.....	\$ 22,419	\$ 23,017

For the purposes of these statements, all temporary cash investments purchased with a maturity of three months or less are considered cash equivalents.

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

**Kentucky Utilities Company and Subsidiary**  
**Consolidated Statements of Retained Earnings**  
(Unaudited)  
(Thousands of \$)

	Three Months		Nine Months	
	Ended September 30,		Ended September 30,	
	<u>2002</u>	<u>2001</u>	<u>2002</u>	<u>2001</u>
Balance at beginning of period .....	\$446,877	\$360,195	\$410,896	\$347,238
Net income .....	<u>31,085</u>	<u>26,340</u>	<u>68,194</u>	<u>40,425</u>
Subtotal .....	<u>477,962</u>	<u>386,535</u>	<u>479,090</u>	<u>387,663</u>
Cash dividends declared on stock:				
4.75% preferred .....	237	237	711	711
6.53% preferred .....	<u>327</u>	<u>327</u>	<u>981</u>	<u>981</u>
Subtotal .....	<u>564</u>	<u>564</u>	<u>1,692</u>	<u>1,692</u>
Balance at end of period .....	<u>\$477,398</u>	<u>\$385,971</u>	<u>\$477,398</u>	<u>\$385,971</u>

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

**Kentucky Utilities Company and Subsidiary**  
**Consolidated Statements of Other Comprehensive Income**  
(Unaudited)  
(Thousands of \$)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	<u>2002</u>	<u>2001</u>	<u>2002</u>	<u>2001</u>
Net income.....	\$31,085	\$26,340	\$68,194	\$40,425
Cumulative effect of change in accounting principle-accounting for derivative instruments and hedging activities (Note 5).....	-	-	-	2,647
Losses on derivative instruments and hedging activities (Note 5).....	<u>(4,475)</u>	<u>-</u>	<u>(2,647)</u>	<u>-</u>
Other comprehensive income (loss) before tax.....	(4,475)	-	(2,647)	2,647
Income tax benefit (expense) related to items of other comprehensive income (loss).....	<u>1,790</u>	<u>-</u>	<u>1,059</u>	<u>(1,059)</u>
Other comprehensive income.....	<u>\$28,400</u>	<u>\$26,340</u>	<u>\$66,606</u>	<u>\$42,013</u>

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

**Louisville Gas and Electric Company and Subsidiary**  
**Kentucky Utilities Company and Subsidiary**

Notes to Consolidated Financial Statements  
(Unaudited)

1. The unaudited consolidated financial statements include the accounts of Louisville Gas and Electric Company and Subsidiary and Kentucky Utilities Company and Subsidiary ("LG&E" and "KU" or the "Companies"). The common stock of each of LG&E and KU is wholly-owned by LG&E Energy Corp. ("LG&E Energy"). In the opinion of management, the unaudited interim data includes all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of consolidated financial position, results of operations, comprehensive income and cash flows for the periods indicated. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to Securities and Exchange Commission ("SEC") rules and regulations, although the Companies believe that the disclosures are adequate to make the information presented not misleading.

See LG&E's and KU's Annual Reports on Form 10-K for the year ended December 31, 2001 for information relevant to the accompanying financial statements, including information as to the significant accounting policies of the Companies.

2. On December 11, 2000, LG&E Energy was acquired by Powergen plc ("Powergen") for cash of approximately \$3.2 billion or \$24.85 per share and the assumption of all of LG&E Energy's debt. As a result of the acquisition, among other things, LG&E Energy became a wholly-owned indirect subsidiary of Powergen and, as a result, LG&E and KU became indirect subsidiaries of Powergen. The utility operations (LG&E and KU) of LG&E Energy continued their separate identities and continue to serve customers in Kentucky and Virginia under their existing names. The preferred stock and debt securities of the utility operations were not affected by this transaction resulting in the utility operations' obligations to continue to file SEC reports. Following the acquisition, Powergen became a registered holding company under the Public Utility Holding Company Act of 1935 ("PUHCA"), and LG&E and KU, as subsidiaries of a registered holding company, became subject to additional regulation under PUHCA. No costs associated with the Powergen acquisition nor any of the effects of purchase accounting have been reflected in the financial statements of LG&E or KU.

As a result of the Powergen acquisition and in order to comply with PUHCA, LG&E Energy Services Inc. ("LG&E Services") was formed and became operational on January 1, 2001. LG&E Services provides certain services to affiliated entities, including LG&E and KU, at cost, as required under PUHCA. On January 1, 2001, approximately 1,000 employees, primarily from LG&E Energy, LG&E and KU, were moved to LG&E Services.

3. On April 9, 2001, a German company, E.ON AG ("E.ON"), announced a pre-conditional cash offer of 5.1 billion pounds sterling (\$7.3 billion) to acquire Powergen. The final regulatory approval needed was received on June 14, 2002 from the SEC. Effective July 1, 2002, the acquisition of Powergen was completed by E.ON. Following this acquisition, LG&E and KU became indirect subsidiaries of E.ON and E.ON became a registered holding company under PUHCA, and subject to regulation thereunder. No costs associated with the E.ON acquisition nor any of the effects of purchase accounting have been reflected in the financial statements of LG&E or KU.
4. During the first quarter 2001, LG&E recorded a \$144 million charge and KU recorded a \$64 million charge for a workforce reduction program. Primary components of the charge were separation benefits, enhanced early retirement benefits, and health care benefits. The result of this workforce reduction was the net elimination of approximately 950 positions, accomplished primarily through a voluntary enhanced severance program.

On June 1, 2001, LG&E and KU filed an application ("VDT case") with the Kentucky Public Service Commission (the "Kentucky Commission") to create a regulatory asset relating to these first quarter 2001 charges. The application requested permission to amortize these costs over a four-year period. The Kentucky Commission also opened a

case to review a depreciation study and resulting depreciation rates implemented in 2001.

LG&E and KU reached a settlement in the VDT case as well as the other cases involving depreciation rates and the Earnings Sharing Mechanism with all intervening parties. The settlement agreement was approved by the Kentucky Commission on December 3, 2001.

The Kentucky Commission's December 3, 2001 order allowed LG&E to set up a regulatory asset of \$141 million for the workforce reduction costs and begin amortizing these costs over a five year period starting in April 2001. The first quarter charge of \$144 million represented all employees who had accepted the voluntary enhanced severance program. Between the time of the original filing and the December 3, 2001 order, some employees rescinded their participation in the voluntary enhanced severance program, thereby decreasing the original charge from \$144 million to \$141 million. The settlement will also reduce revenues by approximately \$26 million through a surcredit on bills to customers over the same five year period. The surcredit represents stipulated net savings LG&E anticipates realizing from implementation of best practices through the value delivery process. The agreement also established LG&E's new depreciation rates in effect retroactive to January 1, 2001. The new depreciation rates decreased depreciation expense by \$5.6 million in 2001.

The Kentucky Commission's December 3, 2001 order allowed KU to set up a regulatory asset of \$54 million for the workforce reduction costs and begin amortizing these costs over a five year period starting in April 2001. The first quarter charge of \$64 million represented all employees who had accepted the voluntary enhanced severance program. Some employees rescinded their participation in the voluntary enhanced severance program and, along with the non-recurring charge of \$6.9 million for FERC and Virginia jurisdictions, decreased the original charge from \$64 million to \$54 million. The settlement will also reduce revenues by approximately \$11 million through a surcredit on bills to customers over the same five year period. The surcredit represents stipulated net savings KU anticipates realizing from implementation of best practices through the value delivery process. The agreement also established KU's new depreciation rates in effect retroactive to January 1, 2001. The new depreciation rates decreased depreciation expense by \$6.0 million in 2001.

5. Statement of Financial Accounting Standards ("SFAS") No. 133, *Accounting for Derivative Instruments and Hedging Activities*, establishes accounting and reporting standards requiring that every derivative instrument (including certain derivative instruments embedded in other contracts) be recorded on the balance sheet as either an asset or a liability measured at its fair value. SFAS No. 133 requires that changes in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. Special accounting for qualifying hedges allows a derivative's gains and losses to offset related results on the hedged item in the income statement, and requires that LG&E and KU must formally document, designate, and assess the effectiveness of transactions that receive hedge accounting. SFAS No. 133 could increase the volatility in earnings and other comprehensive income. LG&E and KU adopted SFAS No. 133 on January 1, 2001. The effect of adopting this statement in 2001 resulted in a \$3.6 million (net of tax of \$2.4 million) decrease in other comprehensive income from a cumulative effect of change in accounting principle for LG&E and a \$1.6 million (net of tax of \$1.1 million) increase in other comprehensive income from a cumulative effect of change in accounting principle for KU.

The Companies use interest rate swaps to hedge exposure to market fluctuations in certain of their debt instruments. Pursuant to Company policy, use of these financial instruments is intended to mitigate risk and earnings volatility and is not speculative in nature. Management has designated all of the Companies' interest rate swaps as hedge instruments. Financial instruments designated as cash flow hedges have resulting gains and losses recorded within other comprehensive income and stockholders' equity. To the extent a financial instrument or the underlying item being hedged is prematurely terminated or the hedge becomes ineffective, the resulting gains or losses are reclassified from other comprehensive income to net income. Financial instruments designated as fair value hedges are periodically marked to market with the resulting gains and losses recorded directly into net income to correspond with income or expense recognized from changes in market value of the items being hedged.

As of September 30, 2002, LG&E had fixed rate swaps covering \$117,335,000 in notional amounts of variable rate debt and with fixed rates ranging from 4.184% to 5.495%. The average variable rate on the debt during the quarter and nine months ended September 30, 2002 was 1.38% and 1.44%. The swaps have been designated as cash flow hedges and expire on various dates from February 2003 through November 2020. The hedges were deemed to be fully effective resulting in a pretax loss for the quarter and nine months ended September 30, 2002 of \$7.7 million and \$10.1 million, respectively, recorded in Other Comprehensive Income. Upon expiration of these hedges, the amount recorded in Other Comprehensive Income will be reclassified into earnings. The amount expected to be reclassified from Other Comprehensive Income to earnings in the next twelve months is immaterial due to the long-term nature of the swaps.

As of September 30, 2002, KU had variable rate swaps covering \$153,000,000 in notional amounts of fixed rate debt. The average variable rate on these swaps during the quarter and nine months ended September 30, 2002 was 2.37% and 2.40%. The underlying debt has fixed rates ranging from 5.75% to 7.92%. The swaps have been designated as fair value hedges and expire on various dates from May 2007 through June 2025. During the quarter and nine months ended September 30, 2002, the effect of marking these financial instruments and the underlying debt to market resulted in pretax gains of \$1.6 million and \$1.2 million, respectively, recorded as a reduction in interest expense.

The Financial Accounting Standards Board created the Derivatives Implementation Group ("DIG") to provide guidance for implementation of SFAS No. 133. DIG Issue C15, *Normal Purchases and Normal Sales Exception for Option Type Contracts and Forward Contracts in Electricity* was adopted in 2001 and had no impact on results of operations and financial position of the Companies. DIG Issue C16, *Applying the Normal Purchase and Normal Sales Exception to Contracts that Combine a Forward Contract and a Purchased Option Contract*, was cleared in the third quarter 2001 and stated that option contracts do not meet the normal purchases and normal sales exception and should follow SFAS No. 133. DIG Issue C16 was effective in the second quarter of 2002. The adoption of DIG Issue C16 did not have a material impact on the financial position or results of operations of the Companies pursuant to regulatory treatment prescribed by SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*. LG&E recorded a mark to market liability and a corresponding regulatory asset of \$0.2 million at September 30, 2002. KU recorded a mark to market asset and corresponding regulatory liability of \$1.3 million at September 30, 2002. The notional amounts of these options as of September 30, 2002, is \$5.0 million for LG&E and \$9.8 million for KU.

6. SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, revises the standards for accounting for securitizations and other transfers of financial assets and collateral and requires certain disclosures, and provides accounting and reporting standards for transfers and servicing of financial assets and extinguishments of liabilities. The Companies adopted SFAS No. 140 in the first quarter of 2001, when LG&E and KU entered into accounts receivable securitization programs.

On February 6, 2001, LG&E and KU implemented an accounts receivable securitization program. The purpose of this program is to enable the utilities to accelerate the receipt of cash from the collection of retail accounts receivable, thereby reducing dependence upon more costly sources of working capital. The securitization program allows for a percentage of eligible receivables to be sold. Eligible receivables are generally all receivables associated with retail sales that have standard terms and are not past due. LG&E and KU are able to terminate these programs at any time without penalty. If there is a significant deterioration in the payment record of the receivables by retail customers or if the Companies fail to meet certain covenants of the program, the program may terminate at the election of the financial institutions. In this case, payments from retail customers would first be used to repay the financial institutions participating in the program, and would then be available for use by the Companies.

As part of the program, LG&E and KU sold retail accounts receivables to wholly owned subsidiaries, LG&E Receivables LLC ("LG&E R") and KU Receivables LLC ("KU R"). Simultaneously, LG&E R and KU R entered into two separate three-year accounts receivable securitization facilities with two financial institutions and their affiliates whereby LG&E R and KU R can sell, on a revolving basis, an undivided interest in certain of their receivables and receive up to \$75 million and \$50 million, respectively, from an unrelated third party purchaser. The effective cost of the receivables programs is comparable to the Companies' lowest cost source of capital, and is based on prime rated commercial paper. LG&E and KU retain servicing rights of the sold receivables through separate servicing agreements with the third party purchasers. LG&E and KU have obtained opinions from independent legal counsel indicating these transactions qualify as true sales of receivables. As of September 30, 2002 and December 31, 2001, LG&E's outstanding program balances were \$74.2 million and \$42.0 million, respectively, and KU's balances were \$50.0 million and \$45.1 million, respectively.

The allowance for doubtful accounts associated with the eligible securitized receivables was \$1.5 million for LG&E and \$0.5 million for KU for both September 30, 2002 and December 31, 2001. Charge offs were immaterial for LG&E and KU. Management believes that the risk of uncollectibility associated with the sold receivables is minimal.

7. External and intersegment revenues (related party transactions between LG&E and KU) and income by business segment for the three and nine months ended September 30, 2002, follow (in thousands of \$):

Three Months Ended September 30, 2002

	External Revenues	Inter- segment Revenues	Net Income/ (Loss) Avail. For Common Stock
LG&E electric	\$218,201	\$ 4,816	\$ 37,501
LG&E gas	22,800	-	(4,372)
Total	<u>\$241,001</u>	<u>\$ 4,816</u>	<u>\$ 33,129</u>
KU electric	<u>\$232,738</u>	<u>\$ 6,283</u>	<u>\$ 30,521</u>

Nine Months Ended September 30, 2002

	External Revenues	Inter- segment Revenues	Net Income/ (Loss) Avail. For Common Stock
LG&E electric	\$553,357	\$ 27,719	\$ 64,572
LG&E gas	170,856	-	2,642
Total	<u>\$724,213</u>	<u>\$ 27,719</u>	<u>\$ 67,214</u>
KU electric	<u>\$628,585</u>	<u>\$ 29,159</u>	<u>\$ 66,502</u>

External and intersegment revenues (related party transactions between LG&E and KU) and income by business segment for the three and nine months ended September 30, 2001, follow (in thousands of \$):

Three Months Ended September 30, 2001

	External Revenues	Inter- segment Revenues	Net Income/ (Loss) Avail. For Common Stock
LG&E electric	\$ 199,740	\$ 6,488	\$ 41,139
LG&E gas	25,657	-	(1,979)
Total	<u>\$ 225,397</u>	<u>\$ 6,488</u>	<u>\$ 39,160</u>
KU electric	<u>\$ 208,263</u>	<u>\$ 8,107</u>	<u>\$ 25,776</u>

Nine Months Ended September 30, 2001

	External Revenues	Inter- segment Revenues	Net Income/ (Loss) Avail. For Common Stock
LG&E electric	\$ 535,574	\$ 22,317	\$ 24,564
LG&E gas	216,106	-	(13,570)
Total	<u>\$ 751,680</u>	<u>\$ 22,317</u>	<u>\$ 10,994</u>
KU electric	<u>\$ 623,873</u>	<u>\$ 23,649</u>	<u>\$ 38,733</u>

8. The following regulatory assets and liabilities were included in the balance sheet of LG&E and KU as of September 30, 2002 and December 31, 2001 (in thousands of \$):

Louisville Gas and Electric

	(Unaudited)	
	Sept. 30, <u>2002</u>	Dec. 31, <u>2001</u>
<u>REGULATORY ASSETS:</u>		
VDT costs.....	\$105,029	\$127,529
Unamortized loss on bonds.....	17,695	17,902
Gas supply adjustments due from customers.....	15,167	30,135
Gas performance based ratemaking.....	4,957	7,708
LG&E/KU merger costs.....	2,722	5,444
One utility costs.....	1,626	3,643
Demand-side management.....	1,885	2,719
Manufactured gas sites.....	1,834	2,062
Total.....	<u>150,915</u>	<u>197,142</u>
<u>REGULATORY LIABILITIES:</u>		
Deferred income taxes - net.....	47,105	48,703
Gas supply adjustments due to customers.....	6,392	15,702
Other.....	1,409	944
Total.....	<u>\$ 54,906</u>	<u>\$ 65,349</u>

Kentucky Utilities

	(Unaudited)	
	Sept. 30, <u>2002</u>	Dec. 31, <u>2001</u>
<u>REGULATORY ASSETS:</u>		
VDT costs.....	\$40,186	\$48,811
Unamortized loss on bonds.....	6,693	6,142
LG&E/KU merger costs.....	3,070	6,139
One utility costs.....	1,746	4,365
Other.....	1,126	1,010
Total.....	<u>52,821</u>	<u>66,467</u>
<u>REGULATORY LIABILITIES:</u>		
Deferred income taxes - net.....	29,896	32,872
Mark to market coal supply option contracts.....	1,314	-
Other.....	1,032	1,017
Total.....	<u>\$32,242</u>	<u>\$33,889</u>

9. SFAS No. 143, *Accounting for Asset Retirement Obligations* and SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, were issued during 2001. SFAS No. 143 establishes accounting and reporting standards for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. SFAS No. 144 supersedes SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of* and the accounting and reporting provisions of APB Opinion No. 30, *Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*. SFAS No. 144, among other provisions, eliminates the requirement of SFAS No. 121 to allocate goodwill to long-lived assets to be tested for impairment. The effective implementation date for SFAS No. 144 was January 1, 2002 and SFAS No. 143 is January 1, 2003. SFAS No. 144 had no impact on the financial position or results of operations of LG&E or KU. Management is currently conducting an analysis and review of SFAS No. 143 and the recently released FERC Notice of Proposed Rulemaking No. RM02-7, *Accounting, Financial Reporting, and Rate Filing Requirements for Asset Retirement Obligations* (NOPR RM02-7).

Although a final determination has not been made, management believes there will be no material impact on the financial position or results of operations pursuant to regulatory treatment prescribed under SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*.

SFAS No. 145, *Rescission of SFAS Nos. 4, 44 and 64, Amendment of SFAS No. 13, and Technical Corrections* was issued in the second quarter 2002. The rescinded pronouncements were as follows: SFAS No. 4, *Reporting Gains and Losses from Extinguishment of Debt*; SFAS No. 44, *Accounting for Intangible Assets of Motor Carriers*; SFAS No. 64, *Extinguishment of Debt Made to Satisfy Sinking-Fund Requirements*; and, SFAS No. 13, *Accounting for Leases*. The provisions related to SFAS No. 13 were effective for fiscal years beginning after May 15, 2002. All other provisions of SFAS No. 145 shall be effective for financial statements issued on or after May 15, 2002. The adoption of this standard will not have a material impact on financial position or results of operations of the Companies.

SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*, was issued in July 2002. SFAS No. 146 requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. The provisions of this Statement are effective for exit or disposal activities that are initiated after December 31, 2002. The Companies do not expect the adoption of this standard to have an impact on financial position or results of operations of the Companies.

The Company adopted EITF No. 98-10, *Accounting for Energy Trading and Risk Management Activities*, effective January 1, 1999. This pronouncement required that energy trading contracts be marked to market on the balance sheet, with the gains and losses shown net in the income statement. In October 2002, the Emerging Issues Task Force reached a consensus to rescind EITF 98-10. The effective date for the full rescission will be for fiscal periods beginning after December 15, 2002. With the rescission of EITF No. 98-10, energy trading contracts that do not also meet the definition of a derivative under SFAS No. 133 must be accounted for as executory contracts. Contracts previously recorded at fair value under EITF No. 98-10 that are not also derivatives under SFAS No. 133 must be restated to historical cost through a cumulative effect adjustment. The Companies do not expect the rescission of this standard to have a material impact on financial position or results of operations of the Companies.

SFAS No. 147, *Acquisitions of Certain Financial Institutions* was issued in November 2002. This standard provides guidance on the accounting for the acquisition of a financial institution. SFAS No. 147 had no impact on the financial position or results of operations of LG&E or KU.

10. On October 23, 2002, LG&E refinanced its pollution control series R bond with a variable rate bond of the same \$41.665 million principal amount. The interest rate on the new bond will be reset every 35 days via an auction process. The new bonds are secured by first mortgage bonds and by bond insurance. The new bonds will mature on October 1, 2032.

On October 3, 2002, KU refinanced its pollution control series 8 bond with a variable rate bond of the same \$96 million principal amount. The interest rate will be reset every 35 days via an auction process. The bonds are secured by first mortgage bonds and by bond insurance. The new bonds will mature on October 1, 2032.

On May 23, 2002 KU refinanced its pollution control series 1B, 2B, 3B, and 4B bonds, totaling \$37.9 million. The new bonds, series 12, 13, 14 and 15 are due in February 2032 and bear interest at a variable rate. The new bonds are secured by first mortgage bonds and have the same principal amount as the prior bonds. The variable rate will be established by the remarketing agent based on conditions in the tax-exempt debt market.

On March 22, 2002, LG&E refinanced two \$35 million unsecured pollution control bonds due November 1, 2027. The replacement variable rate bonds are secured by first mortgage bonds and will mature November 1, 2027. The variable rate will be established

by the remarketing agent taking into account market conditions in the commercial paper market.

On March 6, 2002, LG&E refinanced \$22.5 million and \$27.5 million in unsecured pollution control bonds, both due September 1, 2026. The replacement bonds, due September 1, 2026, are variable rate bonds and are secured by first mortgage bonds. The variable rate will be established by the remarketing agent taking into account market conditions in the commercial paper market.

11. As of June 30, 2002, LG&E Energy owned \$104.6 million in varying portions of LG&E's outstanding variable rate pollution control bonds. The bonds were acquired during May 2002 by LG&E Energy as an investment and were sold in their entirety during the first half of July 2002 to unaffiliated third parties.
12. In the normal course of business, lawsuits, claims, environmental actions, and various non-ratemaking governmental proceedings arise against LG&E and KU. To the extent that damages are assessed in any of these lawsuits, LG&E and KU believe that their insurance coverage is adequate. Management, after consultation with legal counsel, and based upon the present status of these items, does not anticipate that liabilities arising out of other currently pending or threatened lawsuits and claims of the type referenced above will have a material adverse effect on LG&E's or KU's consolidated financial position or results of operations, respectively.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

General

The following discussion and analysis by management focuses on those factors that had a material effect on LG&E's and KU's financial results of operations and financial condition during the three and nine month periods ended September 30, 2002 and should be read in connection with the financial statements and notes thereto.

Some of the following discussion may contain forward-looking statements that are subject to certain 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 vary materially. Factors that could cause actual results to differ materially include: general economic conditions; business and competitive conditions in the energy and fuel industry or markets; changes in federal or state legislation; unusual weather; actions by state or federal regulatory agencies; and other factors described from time to time in LG&E's and KU's reports to the Securities and Exchange Commission, including Exhibit No. 99.01 to their Annual Report on Form 10-K for year ended December 31, 2001.

Results of Operations

The results of operations for LG&E and KU are affected by seasonal fluctuations in temperature and other weather-related factors. Because of these and other factors, the results of one interim period are not necessarily indicative of results or trends to be expected for the full year.

Three Months Ended September 30, 2002, Compared to  
Three Months Ended September 30, 2001

LG&E Results:

LG&E's net income decreased \$6.1 million for the quarter ended September 30, 2002, as compared to the quarter ended September 30, 2001. Higher electric retail sales were offset by amortization expenses associated with LG&E's workforce reduction program (See Note 4) and increased repairs to steam production and gas distribution systems.

A comparison of LG&E's revenues for the quarter ended September 30, 2002, with the quarter ended September 30, 2001, reflects increases and (decreases) which have been segregated by the following principal causes (in thousands of \$):

<u>Cause</u>	<u>Electric Revenues</u>	<u>Gas Revenues</u>
Retail sales:		
Fuel and gas supply adjustments .....	\$ 9,235	\$ (4,542)
Environmental cost recovery surcharge .....	4,233	-
Demand side management cost recovery .....	723	39
LG&E/KU merger surcredit .....	(1,093)	-
Value delivery surcredit .....	(411)	(26)
Variation in sales volume, etc. ....	<u>10,905</u>	<u>(167)</u>
Total retail sales .....	23,592	(2,696)
Wholesale sales .....	(7,970)	-
Gas transportation - net .....	-	19
Other .....	<u>1,167</u>	<u>(180)</u>
Total .....	<u>\$16,789</u>	<u>\$ (2,857)</u>

Electric revenues increased primarily because of an increase in retail sales partially offset by a decrease in wholesale sales. The decrease in wholesale sales is attributable

to lower sales volumes (\$12.2 million), partially offset by an increase in wholesale sales prices (\$4.2 million). The retail sales increase was due in part to warmer weather experienced this period. Cooling degree days increased 26% for the three months ended September 2002 as compared to three months ended September 2001.

Fuel for electric generation and gas supply expenses comprise a large portion of LG&E's total operating expenses. LG&E's electric and gas rates contain a Fuel Adjustment Clause and a Gas Supply Clause, respectively, whereby increases or decreases in the cost of fuel and gas supply may be reflected in retail rates, subject to the approval of the Kentucky Commission. Fuel for electric generation increased \$8.5 million (19%) for the quarter because of an increase in the cost of coal burned (\$10.9 million), offset by a decrease in quantity of coal burned (\$2.4 million). Gas supply expenses decreased \$2.4 million (18%) due to a decrease in net gas supply cost (\$2.8 million), partially offset by an increase in the volume of retail gas delivered to the distribution system (\$.4 million).

Other operation expenses increased \$11.8 million (30%) in 2002, as compared to 2001, primarily due to amortization expenses associated with LG&E's workforce reduction program (\$7.5 million), increased costs for pension expenses (\$1.3 million) and increased electric transmission expenses (\$2.0 million). Transmission expenses increased during 2002, primarily as a result of the Company joining the Midwest Independent System Operators (MISO) to meet regulatory requirements for regional transmission.

Maintenance expenses increased \$5.2 million (38%) in 2002 primarily due to increased outages at the steam production plants (\$3.1 million) and gas main repairs (\$2.1 million).

A reconciliation of differences between the U.S. statutory federal income tax rate and effective income tax rate for the three months ended September follows:

Effective rate	<u>Sept. 2002</u>	<u>Sept. 2001</u>
Statutory federal income tax rate	35.0%	35.0%
State income taxes net of federal benefit	5.5%	5.4%
Amortization of investment tax credit & R&D	(1.8)%	(1.6)%
Other differences	(0.1)%	(0.3)%
Effective income tax rate	<u>38.6%</u>	<u>38.5%</u>

Interest charges decreased \$1.6 million (17%) due to lower interest rates on variable rate long-term debt (\$1.4 million) and a decrease in interest associated with the accounts receivable securitization program (\$.2 million). (See Note 10.) The weighted average interest rate on variable-rate tax-exempt debt for the three months ended September 30, 2002 was 1.42%, compared to 3.02% for the comparable period in 2001.

#### KU Results:

KU's net income increased \$4.7 million for the quarter ended September 30, 2002, as compared to the quarter ended September 30, 2001. The increase was primarily due to increased retail electric revenues and increased equity earnings from a minority interest partially offset by increased operation expense.

A comparison of KU's revenues for the quarter ended September 30, 2002, with the quarter ended September 30, 2001, reflects increases and (decreases) which have been segregated by the following principal causes (in thousands of \$):

Retail sales:	
Fuel supply adjustments .....	\$ 8,864
Environmental cost recovery surcharge .....	1,238
Demand side management cost recovery .....	274
LG&E/KU merger surcredit .....	(480)
Value delivery surcredit .....	(189)
Variation in sales volume, etc. ....	<u>16,291</u>
Total retail sales .....	25,998
Wholesale sales .....	(4,863)
Other .....	<u>1,515</u>

Total

\$22,650

Electric revenues increased primarily due to an increase in retail sales. Cooling degree days increased 36% for the quarter ended September 30, 2002 compared to the same period in 2001.

Fuel for electric generation comprises a large portion of KU's total operating expenses. KU's electric rates contain a Fuel Adjustment Clause, whereby increases or decreases in the cost of fuel are reflected in retail rates, subject to the approval of the Kentucky Public Service Commission, the Virginia State Corporation Commission, and the Federal Energy Regulatory Commission. Fuel for electric generation increased \$14.7 million (22%) for the quarter due to an increase in the cost of coal burned (\$13.4 million) and an increase in volume burned (\$1.3 million).

Other operation expenses increased \$7.2 million (23%) compared to 2001, primarily due to amortization expenses associated with KU's workforce reduction program (\$2.8 million), increased operation of the electric transmission system primarily resulting from increased MISO costs (\$2.6 million), increased property insurance (\$0.8 million), and claims (\$0.7 million).

Maintenance expenses decreased \$1.7 million (12%) primarily due to decreased maintenance of steam production plant (\$1.3 million).

A reconciliation of differences between the U.S. statutory federal income tax rate and effective income tax rate for the three months ended September follows:

Effective rate	<u>Sept. 2002</u>	<u>Sept. 2001</u>
Statutory federal income tax rate	35.0%	35.0%
State income taxes net of federal benefit	4.9%	5.6%
Amortization of investment tax credit & R&D	(1.6)%	(2.1)%
Other differences	(4.3)%	(1.2)%
Effective income tax rate	<u>34.0%</u>	<u>37.3%</u>

The change in other differences is due to higher dividends received deduction related to the increased earnings from KU's equity earnings from a minority interest.

Other income-net increased \$4.2 million as a result of increased earnings from KU's equity earnings from a minority interest. The increased earnings are due to the gain on the sale of emissions allowances.

Interest charges increased \$.2 million (4%) for the third quarter 2002 compared to the third quarter 2001 due to higher intercompany balances, partially offset by lower rates on variable rate debt. (See Note 10.) The weighted average interest rate on variable-rate tax-exempt debt for the three months ended September 30, 2002 was 1.57%, compared to 2.62% for the comparable period in 2001.

Nine Months Ended September 30, 2002, Compared to  
Nine Months Ended September 30, 2001

LG&E Results:

LG&E's net income increased \$55.8 million for the nine months ended September 30, 2002, as compared to the nine months ended September 30, 2001, primarily because of a non-recurring charge of \$86.1 million, net of tax, for LG&E's workforce reduction program incurred in 2001. Excluding this one-time charge, LG&E's net income would have decreased \$30.3 million primarily due to amortization expenses associated with LG&E's workforce reduction program (See Note 4) and higher transmission and pension expenses, partially offset by lower interest expense.

A comparison of LG&E's revenues for the nine months ended September 30, 2002, with the nine months ended September 30, 2001, reflects increases and (decreases) which have been segregated by the following principal causes (in thousands of \$):

<u>Cause</u>	<u>Electric Revenues</u>	<u>Gas Revenues</u>
Retail sales:		
Fuel and gas supply adjustments .....	\$12,939	\$(60,700)
Environmental cost recovery surcharge .....	7,918	-
Demand side management cost recovery .....	926	721
LG&E/KU merger surcredit .....	(2,127)	-
Value delivery surcredit .....	(922)	(196)
Variation in sales volume, etc. ....	<u>20,681</u>	<u>5,173</u>
Total retail sales .....	39,415	(55,002)
Wholesale sales .....	(18,794)	9,978
Gas transportation - net .....	-	94
Other .....	<u>2,564</u>	<u>(320)</u>
Total .....	<u>\$23,185</u>	<u>\$(45,250)</u>

Electric revenues increased primarily because of an increase in sales to retail customers, partially offset by decreased wholesale sales. The increase in retail sales was due in part to warmer weather experienced in the period. Cooling degree days increased 20% for the nine months ended September 2002 as compared to the nine months ended September 2001. Wholesale sales decreased due to lower market prices (\$21.9 million) partially offset by increased volume sold (\$3.1 million). Gas revenues decreased primarily as a result of lower gas supply costs billed to customers through the gas supply clause.

Fuel for electric generation increased \$22.9 million (18%) for the nine months because of an increase in the cost of coal burned (\$23.8 million) partially offset by a decrease in quantity of coal burned (\$.9 million). Gas supply expenses decreased \$44.7 million (28%) due to a decrease in net gas supply cost (\$47.4 million), and a decrease in the volume of retail gas delivered to the distribution system (\$5.2 million), partially offset by increased wholesale gas expenses (\$7.9 million).

The decrease in non-recurring charges of \$144.4 million (\$86.1 million after tax) is due to the costs associated with LG&E's workforce reduction initiative which were recorded in the first quarter of 2001 (See Note 4).

Other operation expenses increased \$43.4 million (39%) in 2002, compared to 2001, primarily due to amortization expenses associated with LG&E's workforce reduction program (\$22.5 million), increased costs for electric transmission primarily resulting from increased MISO costs (\$7.8 million), pension expenses (\$5.8 million), and property insurance (\$1.7 million).

Maintenance expenses increased \$8.5 million (22%) in 2002 primarily due to increased repairs to steam production (\$4.7 million) and maintenance to the gas distribution system (\$2.7 million).

Other income-net decreased \$1.6 million in 2002 primarily due to an increase in non-utility expenses (\$0.8 million) and an increase in the tax provision related to other income (\$0.8 million).

A reconciliation of differences between the U.S. statutory federal income tax rate and effective income tax rate for the nine months ended September 30 follows:

Effective rate	<u>Sept. 2002</u>	<u>Sept. 2001</u>
Statutory federal income tax rate	35.0%	35.0%
State income taxes net of federal benefit	5.3%	5.0%
Amortization of investment tax credit & R&D	(2.8)%	(17.9)%
Other differences	(0.1)%	(4.1)%
Effective income tax rate	<u>37.4%</u>	<u>18.0%</u>

The amortization of investment tax credit and other differences were approximately the same in both periods, but lower pretax income for the nine months ended September 30, 2001 (resulting from the workforce reduction charge) caused the percentage changes to be greater.

Interest charges decreased \$7.6 million (25%) due to lower interest rates on variable rate long term debt (\$5.1 million), a decrease in interest on debt to parent company (\$1.0 million), and a decrease in interest associated with the accounts receivable securitization program (\$1.8 million). (See Note 10.) The weighted average interest rate on variable-rate tax-exempt debt for the nine months ended September 30, 2002 was 1.58%, compared to 3.82% for the comparable period in 2001.

#### KU Results:

KU's net income increased \$27.8 million for the nine months ended September 30, 2002, as compared to the nine months ended September 30, 2001. The increase was primarily due a non-recurring charge of \$38.0 million, net of tax, made in the first quarter of 2001 for costs associated with KU's workforce reduction program. Excluding this one-time charge, net income decreased \$10.2 million, due largely to increased operation expenses, partially offset by increased equity earnings from a minority interest and lower interest expense.

A comparison of KU's revenues for the nine months ended September 30, 2002, with the nine months ended September 30, 2001, reflects increases and (decreases) which have been segregated by the following principal causes (in thousands of \$):

Retail sales:	
Fuel supply adjustments .....	\$18,223
Environmental cost recovery surcharge .....	3,781
Demand side management cost recovery .....	1,570
LG&E/KU merger surcredit .....	(2,641)
Value delivery surcredit .....	(527)
Variation in sales volume, etc. ....	<u>21,073</u>
Total retail sales .....	41,479
Wholesale sales .....	(35,913)
Other .....	<u>4,656</u>
Total	<u>\$10,222</u>

Electric revenues increased primarily due to an increase in sales to retail customers, partially offset by decreased wholesale sales. The decrease in wholesale sales is primarily due to lower prices (\$14.7 million) and a decrease in volume sold (\$21.2 million). The increase in retail sales is due to an increase in cooling degree days of 25%.

Fuel for electric generation increased \$18.9 million (11%) for the nine months due to an increase in the cost of coal burned (\$26.2 million) partially offset by a decrease of volume burned (\$7.3 million)

Non-recurring charges decreased \$63.8 million (\$38.0 million after tax). These costs were due to KU's workforce reduction program which were recorded in the first quarter of 2001 (See Note 4).

Other operation expenses increased \$24.0 million (28%) compared to 2001, primarily due to amortization expenses associated with KU's workforce reduction program (\$10.7 million), higher pension expenses (\$2.0 million), property insurance (\$2.0 million) and outside services (\$2.4 million), and higher costs for electric transmission primarily resulting from increased MISO costs (\$6.0 million).

Other income-net increased \$3.1 million (54%) in 2002 primarily due to increased earnings from KU's equity earnings from a minority interest (\$4.6 million), partially offset by a gain on disposition of property in 2001 of \$1.3 million. The increased equity earnings in 2002 are due to the gain on the sale of emissions allowances.

A reconciliation of differences between the U.S. statutory federal income tax rate and effective income tax rate for the nine months ended September follows:

Effective rate	<u>Sept. 2002</u>	<u>Sept. 2001</u>
Statutory federal income tax rate	35.0%	35.0%
State income taxes net of federal benefit	5.7%	6.2%
Amortization of investment tax credit & R&D	(2.6)%	(4.4)%
Other differences	(3.6)%	(4.2)%
Effective income tax rate	<u>34.5%</u>	<u>32.6%</u>

Interest charges decreased \$3.9 million (16%) for the first nine months of 2002 as compared to the nine months of 2001 primarily due to lower rates on variable rate debt (\$2.9 million) (see Note 10) and a decrease in interest associated with the accounts receivable securitization program (\$1.0 million). The weighted average interest rate on variable-rate tax-exempt debt for the nine months ended September 30, 2002 was 1.66%, compared to 3.37% for the comparable period in 2001.

#### Liquidity and Capital Resources

LG&E's and KU's need for capital funds are largely related to the construction of plant and equipment necessary to meet the needs of electric and gas utility customers. Internal and external lines of credit, the accounts receivable securitization programs, and commercial paper programs are maintained to fund short-term capital requirements.

Construction expenditures for the nine months ended September 30, 2002 for LG&E and KU amounted to \$141.8 million and \$164.8 million, respectively. Such expenditures related primarily to construction to meet nitrogen oxide (NOx) emission standards and the acquisition of new combustion turbines to meet peak power demands. The expenditures were financed with internally generated funds, intercompany loans from affiliates, and accounts receivable securitization program funds. Also, common stock dividends of \$46 million were paid by LG&E. See Note 6 of Notes to Financial Statements concerning accounts receivable securitization.

LG&E's and KU's cash and temporary cash investment balance increased \$13.0 million and \$3.5 million, respectively during the nine months ended September 30, 2002. The increases reflect cash flows from operations and short-term borrowings, partially offset by construction expenditures and LG&E's common dividend payments.

Variations in accounts receivable, accounts payable and materials and supplies are generally not significant indicators of LG&E's and KU's liquidity. Such variations are primarily attributable to fluctuations in weather, which have a direct effect on sales of electricity and natural gas. The decrease in accounts receivable at LG&E resulted primarily from the increased sale of accounts receivable through the accounts receivable securitization program. The increase in accounts receivable for KU resulted primarily from seasonal fluctuations, increased intercompany receivables partially offset by the increased sale of accounts receivable through the accounts receivable securitization program. (See Note 6

of Notes to Financial Statements). The increase in fuel inventory at LG&E resulted from reduced fuel consumption due to outages and increased pricing. The decrease in the fuel inventory at KU resulted from seasonal fluctuations partially offset by increased pricing.

LG&E and KU participate in a money pool whereby LG&E Energy can make funds available to LG&E and KU at market-based rates up to \$400 million for LG&E and \$250 million for KU. LG&E Energy maintains a facility of \$200 million with a Powergen subsidiary to ensure funding availability for the money pool. There was no balance outstanding under the Powergen line of credit as of September 30, 2002 and no outstanding commercial paper program balance. LG&E Energy has provided loans to LG&E and KU through the money pool that total \$129.2 million and \$87.7 million, respectively, as of September 30, 2002. These borrowings carried an interest rate based on an index of highly rated commercial paper issuers as of the prior month end of 1.71% at September 30, 2002.

On March 6, 2002, LG&E refinanced \$22.5 million and \$27.5 million unsecured pollution control bonds, both due September 1, 2026. The replacement bonds, due September 1, 2026, are variable rate bonds and are secured by first mortgage bonds.

On March 22, 2002, LG&E refinanced two \$35 million unsecured pollution control bonds due November 1, 2027. The replacement variable rate bonds are secured by first mortgage bonds and will mature November 1, 2027.

On May 23, 2002 KU refinanced pollution control series 1B, 2B, 3B, and 4B bonds, totaling \$37.9 million. The new bonds, series 12, 13, 14 and 15 are due in February 2032 and bear interest at a variable rate. The new bonds are secured by first mortgage bonds and have the same principal amount as the prior bonds.

On October 3, 2002, KU refinanced its pollution control series 8 bond with a variable rate bond of the same \$96 million principal amount. The bonds are secured by first mortgage bonds and by bond insurance. The new bonds will mature on October 1, 2032.

On October 23, 2002, LG&E refinanced its pollution control series R bond with a variable rate bond of the same \$41.667 million principal amount. The new bonds are secured by first mortgage bonds and by bond insurance. The new bonds will mature on October 1, 2032.

As of June 30, 2002, LG&E Energy owned \$104.6 million in varying portions of LG&E's outstanding variable rate pollution control bonds. The bonds were acquired during May 2002 by LG&E Energy as an investment and were sold in their entirety during the first half of July 2002 to unaffiliated third parties.

LG&E's security ratings as of October 8, 2002, were:

	<u>Moody's</u>	<u>S&amp;P</u>	<u>Fitch</u>
First mortgage bonds	A1	A	A+
Preferred stock	Baa1	BBB	A-
Commercial paper	P-1	A-2	F-1

KU's security ratings as of October 8, 2002, were:

	<u>Moody's</u>	<u>S&amp;P</u>	<u>Fitch</u>
First mortgage bonds	A1	A	A+
Preferred stock	Baa1	BBB	A-
Commercial paper	P-1	A-2	F-1

During the third quarter S&P raised the ratings of LG&E and KU by one notch and assigned a stable outlook to all of the ratings. Moody's and Fitch confirmed the ratings of LG&E and KU during the quarter and assigned a stable outlook to the ratings.

These ratings reflect the views of Moody's, S&P and Fitch. 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.

LG&E's capitalization ratios at September 30, 2002, and December 31, 2001, follow:

	<u>Sept. 30,</u> <u>2002</u>	<u>Dec. 31,</u> <u>2001</u>
Long-term debt (including current portion)	36.4%	37.5%
Notes payable	7.6	5.7
Preferred stock	5.6	5.8
Common equity	<u>50.4</u>	<u>51.0</u>
Total	<u>100.0%</u>	<u>100.0%</u>

KU's capitalization ratios at September 30, 2002, and December 31, 2001, follow:

	<u>Sept. 30,</u> <u>2002</u>	<u>Dec. 31,</u> <u>2001</u>
Long-term debt (including current portion)	35.1%	37.2%
Notes payable	6.1	3.6
Preferred stock	2.8	3.1
Common equity	<u>56.0</u>	<u>56.1</u>
Total	<u>100.0%</u>	<u>100.0%</u>

#### New Accounting Pronouncements

SFAS No. 143, *Accounting for Asset Retirement Obligations* and SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, were issued during 2001. SFAS No. 143 establishes accounting and reporting standards for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. SFAS No. 144 supersedes SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of* and the accounting and reporting provisions of APB Opinion No. 30, *Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*. SFAS No. 144, among other provisions, eliminates the requirement of SFAS No. 121 to allocate goodwill to long-lived assets to be tested for impairment. The effective implementation date for SFAS No. 144 was January 1, 2002 and SFAS No. 143 is January 1, 2003. SFAS No. 144 had no impact on the financial position or results of operations of LG&E or KU. Management is currently conducting an analysis and review of SFAS No. 143 and the recently released FERC Notice of Proposed Rulemaking No. RM02-7, *Accounting, Financial Reporting, and Rate Filing Requirements for Asset Retirement Obligations* (NOPR RM02-7). Although a final determination has not been made, management believes there will be no material impact on the financial position or results of operations pursuant to regulatory treatment prescribed under SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*.

The Financial Accounting Standards Board created the Derivatives Implementation Group ("DIG") to provide guidance for implementation of SFAS No. 133. DIG Issue C15, *Normal Purchases and Normal Sales Exception for Option Type Contracts and Forward Contracts in Electricity* was adopted in 2001 and had no impact on results of operations and financial position of the Companies. DIG Issue C16, *Applying the Normal Purchase and Normal Sales Exception to Contracts that Combine a Forward Contract and a Purchased Option Contract*, was cleared in the third quarter 2001 and stated that option contracts do not meet the normal purchases and normal sales exception and should follow SFAS No. 133. DIG Issue C16 was effective in the second quarter of 2002. The adoption of DIG Issue C16 did not have a material impact on the financial position or results of operations of the Companies pursuant to regulatory treatment prescribed by SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*. LG&E recorded a mark to market liability and a corresponding regulatory asset of \$0.2 million at September 30, 2002. KU recorded a mark to market asset and corresponding regulatory liability of \$1.3 million at September 30, 2002. The notional amounts of these options, as of September 30, 2002, is \$5.0 million for LG&E and \$9.8 million for KU.

SFAS No. 145, *Rescission of SFAS Nos. 4, 44 and 64, Amendment of SFAS No. 13, and Technical Corrections* was issued in the second quarter 2002. The rescinded pronouncements were as follows: SFAS No. 4, *Reporting Gains and Losses from Extinguishment of Debt*; SFAS No. 44, *Accounting for Intangible Assets of Motor Carriers*; SFAS No. 64, *Extinguishment of Debt Made to Satisfy Sinking-Fund Requirements*; and, SFAS No. 13, *Accounting for Leases*. The provisions related to SFAS No. 13 were effective for fiscal years beginning after May 15, 2002. All other provisions of SFAS No. 145 shall be effective for financial statements issued on or after May 15, 2002. The adoption of this standard will not have a material impact on financial position or results of operations of the Companies.

SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*, was issued in July 2002. SFAS No. 146 requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. The provisions of this Statement are effective for exit or disposal activities that are initiated after December 31, 2002. The Companies do not expect the adoption of this standard to have an impact on financial position or results of operations of the Companies.

The Company adopted EITF No. 98-10, *Accounting for Energy Trading and Risk Management Activities*, effective January 1, 1999. This pronouncement required that energy trading contracts be marked to market on the balance sheet, with the gains and losses shown net in the income statement. In October 2002, the Emerging Issues Task Force reached a consensus to rescind EITF 98-10. The effective date for the full rescission will be for fiscal periods beginning after December 15, 2002. With the rescission of EITF No. 98-10, energy trading contracts that do not also meet the definition of a derivative under SFAS No. 133 must be accounted for as executory contracts. Contracts previously recorded at fair value under EITF No. 98-10 that are not also derivatives under SFAS No. 133 must be restated to historical cost through a cumulative effect adjustment. The Companies do not expect the rescission of this standard to have a material impact on financial position or results of operations of the Companies.

SFAS No. 147, *Acquisitions of Certain Financial Institutions* was issued in November 2002. This standard provides guidance on the accounting for the acquisition of a financial institution. SFAS No. 147 had no impact on the financial position or results of operations of LG&E or KU.

### Contingencies

For a description of significant contingencies that may affect LG&E and KU, reference is made to Part I, Item 3, *Legal Proceedings*, and Notes 12 (LG&E) and 11 (KU) to the financial statements contained in LG&E's and KU's Annual Reports on Form 10-K for the year ended December 31, 2001 and to Part II - Item 1, *Legal Proceedings* herein.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk.

LG&E and KU are exposed to market risks. Both operations are exposed to market risks from changes in interest rates and commodity prices. To mitigate changes in cash flows attrib-

utable to these exposures, the Companies have entered into various derivative instruments. Derivative positions are monitored using techniques that include market value and sensitivity analysis.

The Companies use interest rate swaps to hedge exposure to market fluctuations in certain of their debt instruments. Pursuant to Company policy, use of these financial instruments is intended to mitigate risk and earnings volatility and is not speculative in nature. Management has designated all of the Companies' interest rate swaps as hedge instruments. Financial instruments designated as cash flow hedges have resulting gains and losses recorded within other comprehensive income and stockholders' equity. To the extent a financial instrument or the underlying item being hedged is prematurely terminated or the hedge becomes ineffective, the resulting gains or losses are reclassified from other comprehensive income to net income. Financial instruments designated as fair value hedges are periodically marked to market with the resulting gains and losses recorded directly into net income to correspond with income or expense recognized from changes in market value of the items being hedged.

The potential change in interest expense resulting from changes in base interest rates of the Companies' unswapped debt did not change materially during the first nine months of 2002. However, during October 2002, KU refinanced a \$96 million bond at a floating rate and LG&E refinanced a \$41.665 million bond at a floating rate. The interest rates on the new bonds will be reset every 35 days via an auction process. Prior to the refinancing, the LG&E bond had been at a 6.55% fixed rate and the KU bond had been at a 7.45% fixed rate. The potential changes in the fair values of the Company's interest-rate swaps resulting from changes in interest rates and the yield curve also did not change materially during the first nine months of 2002.

The Companies have entered into fuel purchase contracts that contain options which allow the Companies to purchase additional tons of coal, as needed, or purchase less coal than contractually required, as needed. The potential changes resulting from variations in coal commodity prices of the Companies' coal supply contracts containing option features were not material during the first nine months of 2002. The Companies' exposure to market risks from changes in commodity prices were immaterial during the first nine months of 2002.

#### Pension Risk

LG&E's and KU's costs of providing defined-benefit pension retirement plans are dependent upon a number of factors, such as the rates of return on plan assets, discount rate, and contributions made to the plan. The market value of LG&E and KU plan assets has been affected by declines in the equity market since the beginning of this fiscal year. As a result, at December 31, 2002, LG&E and KU could be required to recognize an additional minimum liability as prescribed by SFAS No. 87 *Employers' Accounting for Pensions*. The liability would be recorded as a reduction to other comprehensive income, and would not affect net income for 2002. The amount of the liability, if any, will depend upon the asset returns experienced in 2002 and contributions made by LG&E and KU to the plan during 2002. Also, pension cost and cash contributions to the plans could increase in future years without a substantial recovery in the equity markets. If the fair value of the plan assets exceeds the accumulated benefit obligation, the recorded liability will be reduced and other comprehensive income will be restored in the consolidated balance sheet.

The combination of poor market performance and historically low corporate bond rates has created a divergence in the potential value of the pension liability and the actual value of the pension assets. These conditions could result in an increase in LG&E's and KU's funded accumulated benefit obligation and future pension expense. The primary assumptions that drive the value of the unfunded accumulated benefit obligation are the discount rate and expected return on plan assets.

The value of the pension assets as of December 31, 2001, was \$234 million and \$217 million, for LG&E and KU, respectively. The value of the accumulated benefit obligation as of December 31, 2001, was \$352 million and \$224 million, for LG&E and KU, respectively. As of September 30, 2002, the asset values were approximately \$191 million and \$176 million for LG&E and KU, respectively. This decline is a result of the conditions mentioned above. A one-percentage point increase or decrease in the assumed discount rate could have approximately a negative or positive \$36 million and \$26 million impact to the accu-

mulated benefit obligation of LG&E and KU, respectively. LG&E and KU are currently unable to determine the impact of these changes until an updated actuarial valuation of the pension liability is performed, and asset value is determined, as of December 31, 2002. If LG&E and KU elect not to make a contribution to plan assets equal to the unfunded accumulated benefit obligation, there could be an adjustment to other comprehensive income.

Energy Trading & Risk Management Activities

LG&E and KU conduct energy trading and risk management activities to maximize the value of power sales from physical assets it owns, in addition to the wholesale sale of excess asset capacity. Certain energy trading activities are currently accounted for on a mark-to-market basis in accordance with EITF 98-10 *Accounting for Contracts Involved in Energy Trading and Risk Management Activities*, SFAS No. 133 *Accounting for Derivative Instruments and Hedging Activities*, and SFAS No. 138 *Accounting for Certain Derivative Instruments and Certain Hedging Activities*. Wholesale sales of excess asset capacity and wholesale purchases are treated as normal sales and purchases under SFAS No. 133 and SFAS No. 138 and are not marked to market.

The table below summarizes both LG&E and KU's energy trading and risk management activities during quarter and nine months ended September 30, 2002 (in thousands of \$), as trading volumes are evenly divided between the two regulated utilities.

	Quarter ended Sept. 30, 2002	Nine Months ended Sept. 30, 2002
Fair value of contracts at beginning of period, net asset/(liability).....	\$ 26	\$(186)
Fair value of contracts when entered into during the period.....	(5)	(62)
Contracts realized or otherwise settled during the period.....	6	341
Changes in fair value due to changes in assumptions	<u>(193)</u>	<u>(259)</u>
Fair value of contracts at end of period, net asset/(liability) .....	<u>\$ (166)</u>	<u>\$(166)</u>

No changes to valuation techniques for energy trading and risk management activities occurred during 2002. All contracts outstanding at September 30, 2002 have a maturity of less than one year and are valued using prices actively quoted for proposed or executed transactions or quoted by brokers. The Companies do not expect the rescission of EITF 98-10 will have a material impact on valuation techniques for energy trading and risk management activities.

LG&E and KU maintain policies intended to minimize credit risk and revalues credit exposures daily to monitor compliance with those policies. As of September 30, 2002, 88% of the trading and risk management commitments were with counterparties rated BBB- equivalent or better.

Item 4. Controls and Procedures.

LG&E and KU maintain a system of disclosure controls and procedures designed to ensure that information required to be disclosed by the companies in reports they file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission rules and forms. During the 90 day period preceding the filing of this report, LG&E and KU conducted an evaluation of such controls and procedures under the supervision and the participation of the companies' management, including the Chairman, President and Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO"). Based upon that evaluation, the CEO and CFO are of the conclusion that the companies' disclosure controls and procedures are effective.

With respect to LG&E's and KU's internal controls, there have been no significant changes in internal controls or in other factors that could significantly affect these controls subsequent to the date of their most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

## Part II. Other Information

### Item 1. Legal Proceedings.

For a description of the significant legal proceedings involving LG&E and KU, reference is made to the information under the following items and captions of LG&E's and KU's (A) respective combined Annual Report on Form 10-K for the year ended December 31, 2001: Item 1, Business; Item 3, Legal Proceedings; Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations; Notes 3, 12 and 16 of LG&E's Notes to Financial Statements under Item 8 and Notes 3, 11 and 14 of KU's Notes to Financial Statements under Item 8 and (B) respective combined Quarterly Reports on Form 10-Q for the quarters ended March 31, 2002 and June 30, 2002: Item I of Part II, Legal Proceedings. Except as described herein, to date, the proceedings reported in LG&E's and KU's respective combined Annual Report on Form 10-K have not changed materially.

#### LG&E Employment Discrimination Case

As previously disclosed, complaints were filed against LG&E and certain related and unrelated parties whereby approximately 30 employees or former employees claimed past and current instances of employment discrimination. LG&E has removed the case to the U.S. District Court for the Western District of Kentucky and filed an answer denying all plaintiffs' claims. In October 2002, following discussions among plaintiffs' representatives and LG&E as defendant, further amended complaints were filed in this case involving claims by certain current or former employees of instances of employment discrimination. The amended complaints establish the population of named plaintiffs, delete the prior request for class certification, delete the prior naming of LG&E's president as a defendant and reduce the named damage amount to \$100 million. Discovery has commenced in the matter, as well as required mediation or administrative review, including before the U.S. Equal Employment Opportunity Commission which has, to date, declined to proceed on any claims reviewed. LG&E intends to defend itself vigorously in the action and management does not anticipate that the outcome will have a material impact on LG&E's operations or financial condition.

#### Combustion Turbine Litigation

In September 2002, LG&E and KU, or their affiliates, filed a further amended complaint in litigation in the U.S. District Court for the Eastern District of Kentucky against Alstom Power, Inc. (formerly ABB Power Generation, Inc.) ("Alstom") regarding two combustion turbines supplied by Alstom during 1999, installed at KU's E.W. Brown generating plant and now jointly owned by LG&E and KU. The original purchase price for the turbines was approximately \$91.8 million. The suit presents warranty, negligence, misrepresentation and fraud and other claims relating to numerous operational defects or deficiencies of the turbines and various damages incurred by LG&E and KU in connection therewith. LG&E and KU have requested rescission of the contract and recovery of all expenditures relating to the turbines. In the alternative to rescission, LG&E and KU have requested relief for amounts incurred or expended to date in connection with operational repairs, cover damages or liquidated damages and other costs, with possible further damages and interest to be proven at trial. The matter is currently in discovery with a trial presently scheduled for the third quarter of 2003.

#### Item 6(a). Exhibits.

None.

#### Item 6(b). Reports on Form 8-K.

On August 14, 2002 LG&E and KU filed a Current Report on Form 8-K, submitting certifications of the Chairman, President and Chief Executive Officer and the Chief Financial Officer of each company, respectively, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 regarding the companies' Quarterly Reports on Form 10-Q for the period ended June 30, 2002.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Louisville Gas and Electric Company  
Registrant

Date: November 14, 2002

/s/ S. Bradford Rives  
S. Bradford Rives  
Senior Vice President - Finance and Controller  
(On behalf of the registrant in his capacity as  
Principal Accounting Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Kentucky Utilities Company  
Registrant

Date: November 14, 2002

/s/ S. Bradford Rives  
S. Bradford Rives  
Senior Vice President - Finance and Controller  
(On behalf of the registrant in his capacity as  
Principal Accounting Officer)

CERTIFICATIONS

Louisville Gas and Electric Company

I, Victor A. Staffieri, Chairman of the Board, President and Chief Executive Officer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Louisville Gas and Electric Company;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 14, 2002

/s/ Victor A. Staffieri  
Victor A. Staffieri  
Chairman of the Board, President and Chief Executive Officer

Louisville Gas and Electric Company

I, Richard Aitken-Davies, Chief Financial Officer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Louisville Gas and Electric Company;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
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5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 14, 2002

/s/ Richard Aitken-Davies  
Richard Aitken-Davies  
Chief Financial Officer

Kentucky Utilities Company

I, Victor A. Staffieri, Chairman of the Board, President and Chief Executive Officer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Kentucky Utilities Company;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 14, 2002

/s/ Victor A. Staffieri

Victor A. Staffieri

Chairman of the Board, President and Chief Executive Officer

Kentucky Utilities Company

I, Richard Aitken-Davies, Chief Financial Officer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Kentucky Utilities Company;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 14, 2002

/s/ Richard Aitken-Davies  
Richard Aitken-Davies  
Chief Financial Officer

**SEC Form 10-Q – June 30, 2002**

SECURITIES AND EXCHANGE COMMISSION  
Washington, D. C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2002

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

<u>Commission File Number</u>	<u>Registrant, State of Incorporation, Address, and Telephone Number</u>	<u>IRS Employer Identification No.</u>
2-26720	<b>Louisville Gas and Electric Company</b> (A Kentucky Corporation) 220 West Main Street P.O. Box 32010 Louisville, Ky. 40232 (502) 627-2000	61-0264150
1-3464	<b>Kentucky Utilities Company</b> (A Kentucky and Virginia Corporation) One Quality Street Lexington, Kentucky 40507-1428 (859) 255-2100	61-0247570

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes . No .

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

Louisville Gas and Electric Company  
21,294,223 shares, without par value, as of July 31, 2002,  
all held by LG&E Energy Corp.

Kentucky Utilities Company  
37,817,878 shares, without par value, as of July 31, 2002,  
all held by LG&E Energy Corp.

This combined Form 10-Q is separately filed by Louisville Gas and Electric Company and Kentucky Utilities Company. Information contained herein related to any individual registrant is filed by such registrant on its own behalf. Each registrant makes no representation as to information relating to the other registrants.

TABLE OF CONTENTS

PART I

Item 1	Consolidated Financial Statements	
	Louisville Gas and Electric Company and Subsidiary	
	Statements of Income.....	1
	Balance Sheets.....	2
	Statements of Cash Flows.....	4
	Statements of Retained Earnings.....	5
	Statements of Other Comprehensive Income.....	6
	Kentucky Utilities Company and Subsidiary	
	Statements of Income.....	7
	Balance Sheets.....	8
	Statements of Cash Flows.....	10
	Statements of Retained Earnings.....	11
	Statements of Other Comprehensive Income .....	12
	Notes to Consolidated Financial Statements.....	13
Item 2	Management's Discussion and Analysis of Financial Condition and Results of Operations.....	20
Item 3	Quantitative and Qualitative Disclosures About Market Risk.....	28

PART II

Item 1	Legal Proceedings.....	30
Item 6	Exhibits and Reports on Form 8-K.....	30
	Signatures.....	31

Part I. Financial Information - Item 1. Financial Statements

Louisville Gas and Electric Company and Subsidiary  
 Consolidated Statements of Income  
 (Unaudited)  
 (Thousands of \$)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2002	2001	2002	2001
OPERATING REVENUES:				
Electric (Note 7).....	\$191,813	\$196,290	\$358,059	\$351,664
Gas (Note 7).....	<u>30,938</u>	<u>32,551</u>	<u>148,056</u>	<u>190,448</u>
Total operating revenues.....	<u>222,751</u>	<u>228,841</u>	<u>506,115</u>	<u>542,112</u>
OPERATING EXPENSES:				
Fuel for electric generation.....	50,550	41,749	94,657	80,233
Power purchased.....	22,064	32,744	45,645	44,085
Gas supply expenses.....	18,346	18,822	101,813	144,058
Non-recurring charges (Note 4).....	-	-	-	144,385
Other operation expenses.....	54,807	36,398	103,216	71,681
Maintenance.....	15,572	13,683	27,573	24,238
Depreciation and amortization.....	25,889	25,572	51,167	50,840
Federal and state income taxes.....	8,335	17,828	21,572	(20,183)
Property and other taxes.....	<u>4,778</u>	<u>4,421</u>	<u>9,314</u>	<u>8,883</u>
Total operating expenses.....	<u>200,341</u>	<u>191,217</u>	<u>454,957</u>	<u>548,220</u>
NET OPERATING INCOME (LOSS) .....	22,410	37,624	51,158	(6,108)
Other income (deduction) - net.....	(67)	363	(66)	1,358
Interest charges (Note 5).....	<u>7,087</u>	<u>9,520</u>	<u>14,893</u>	<u>20,898</u>
NET INCOME (LOSS) .....	15,256	28,467	36,199	(25,648)
Preferred stock dividends.....	<u>1,049</u>	<u>1,220</u>	<u>2,114</u>	<u>2,518</u>
NET INCOME (LOSS) AVAILABLE FOR COMMON STOCK.....	<u>\$ 14,207</u>	<u>\$ 27,247</u>	<u>\$ 34,085</u>	<u>\$ (28,166)</u>

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

**Louisville Gas and Electric Company and Subsidiary**  
**Consolidated Balance Sheets**  
(Unaudited)  
(Thousands of \$)

ASSETS

	<u>June 30,</u> <u>2002</u>	<u>Dec. 31,</u> <u>2001</u>
UTILITY PLANT:		
At original cost.....	\$3,486,441	\$3,423,037
Less: reserve for depreciation.....	<u>1,426,609</u>	<u>1,381,874</u>
Net utility plant .....	<u>2,059,832</u>	<u>2,041,163</u>
OTHER PROPERTY AND INVESTMENTS -		
less reserve of \$63 as of June 30, 2002 and Dec. 31, 2001 .	<u>1,277</u>	<u>1,176</u>
CURRENT ASSETS:		
Cash .....	20,454	2,112
Accounts receivable - less reserve of \$1,575 as of June 30, 2002 and Dec. 31, 2001 (Note 6) .....	61,856	85,667
Materials and supplies - at average cost:		
Fuel (predominantly coal) .....	34,974	22,024
Gas stored underground .....	16,226	46,395
Other .....	28,896	29,050
Prepayments and other.....	<u>4,119</u>	<u>4,688</u>
Total current assets .....	<u>166,525</u>	<u>189,936</u>
DEFERRED DEBITS AND OTHER ASSETS:		
Unamortized debt expense.....	6,042	5,921
Regulatory assets (Note 8).....	161,949	197,142
Other.....	<u>13,996</u>	<u>13,016</u>
Total deferred debits and other assets .....	<u>181,987</u>	<u>216,079</u>
Total assets.....	<u>\$2,409,621</u>	<u>\$2,448,354</u>

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

**Louisville Gas and Electric Company and Subsidiary**  
**Consolidated Balance Sheets (cont.)**  
(Unaudited)  
(Thousands of \$)

**CAPITALIZATION AND LIABILITIES**

	<u>June 30,</u> <u>2002</u>	<u>Dec. 31,</u> <u>2001</u>
<b>CAPITALIZATION:</b>		
Common stock, without par value - Outstanding 21,294,223 shares .....	\$ 425,170	\$ 425,170
Additional paid-in capital.....	40,000	40,000
Retained earnings.....	404,721	393,636
Accumulated other comprehensive income.....	(21,357)	(19,900)
Other.....	(836)	(836)
Total common equity .....	847,698	838,070
Cumulative preferred stock.....	95,140	95,140
Long-term debt (Notes 10 and 11) .....	370,704	370,704
Total capitalization .....	1,313,542	1,303,914
<b>CURRENT LIABILITIES:</b>		
Current portion of long-term debt.....	246,200	246,200
Notes payable to parent.....	91,553	94,197
Accounts payable.....	100,446	149,070
Accrued taxes.....	21,105	20,257
Accrued interest.....	5,421	5,818
Other.....	13,380	12,840
Total current liabilities .....	478,105	528,382
<b>DEFERRED CREDITS AND OTHER LIABILITIES:</b>		
Accumulated deferred income taxes .....	308,769	298,143
Investment tax credit, in process of amortization.....	56,581	58,689
Accumulated provision for pensions and related benefits .....	165,364	167,526
Customer advances for construction.....	10,072	9,745
Regulatory liabilities (Note 8).....	54,720	65,349
Other.....	22,468	16,606
Total deferred credits and other liabilities .....	617,974	616,058
<b>Total capital and liabilities.....</b>	<b>\$2,409,621</b>	<b>\$2,448,354</b>

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

**Louisville Gas and Electric Company and Subsidiary**  
**Consolidated Statements of Cash Flows**  
(Unaudited)  
(Thousands of \$)

	Six Months Ended June 30,	
	2002	2001
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income (loss).....	\$ 36,199	\$ (25,648)
Items not requiring cash currently:		
Depreciation and amortization .....	51,167	50,840
Deferred income taxes - net .....	9,507	(41,833)
Investment tax credit - net .....	(2,108)	(2,133)
Non-recurring charges (Note 4) .....	-	113,645
Other .....	20,917	7,466
Changes in current assets and liabilities.....	(21,917)	16,670
Changes in accounts receivable securitization-net (Note 6)...	16,100	52,900
Other.....	6,855	(18,568)
Net cash flows from operating activities .....	116,720	153,339
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of securities.....	(101)	-
Proceeds from sales of securities.....	-	4,350
Construction expenditures.....	(69,524)	(96,050)
Net cash flows from investing activities .....	(69,625)	(91,700)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Issuance of pollution control bonds.....	119,067	-
Retirement of pollution control bonds.....	(120,000)	-
Short-term borrowings.....	278,100	35,763
Repayment of short-term borrowings.....	(280,744)	(89,600)
Payment of dividends.....	(25,176)	(2,665)
Net cash flows from financing activities .....	(28,753)	(56,502)
CHANGE IN CASH.....	18,342	5,137
CASH AT BEGINNING OF PERIOD.....	2,112	2,495
CASH AT END OF PERIOD.....	\$ 20,454	\$ 7,632
<b>SUPPLEMENTAL DISCLOSURES:</b>		
Cash paid during the period for:		
Income taxes .....	\$ 16,681	\$ 15,882
Interest on borrowed money .....	\$ 13,019	\$ 16,090

For the purposes of these statements, all temporary cash investments purchased with a maturity of three months or less are considered cash equivalents.

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

**Louisville Gas and Electric Company and Subsidiary**  
**Consolidated Statements of Retained Earnings**  
(Unaudited)  
(Thousands of \$)

	Three Months Ended June 30,		Six Months Ended June 30,	
	<u>2002</u>	<u>2001</u>	<u>2002</u>	<u>2001</u>
Balance at beginning				
of period .....	\$413,514	\$259,181	\$393,636	\$314,594
Net income (loss) .....	<u>15,256</u>	<u>28,467</u>	<u>36,199</u>	<u>(25,648)</u>
Subtotal .....	<u>428,770</u>	<u>287,648</u>	<u>429,835</u>	<u>288,946</u>
Cash dividends declared on stock:				
5% cumulative preferred .....	269	269	538	538
Auction rate cumulative				
preferred .....	413	584	842	1,246
\$5.875 cumulative preferred .....	367	367	734	734
Common .....	<u>23,000</u>	-	<u>23,000</u>	-
Subtotal .....	<u>24,049</u>	<u>1,220</u>	<u>25,114</u>	<u>2,518</u>
Balance at end of period .....	<u>\$404,721</u>	<u>\$286,428</u>	<u>\$404,721</u>	<u>\$286,428</u>

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

**Louisville Gas and Electric Company and Subsidiary**  
**Consolidated Statements of Other Comprehensive Income**  
(Unaudited)  
(Thousands of \$)

	Three Months Ended June 30,		Six Months Ended June 30,	
	<u>2002</u>	<u>2001</u>	<u>2002</u>	<u>2001</u>
Net income (loss).....	\$15,256	\$28,467	\$36,199	\$(25,648)
Cumulative effect of change in..... Accounting principle - Accounting For Derivative Instruments and Hedging Activities (Note 5) .....	-	-	-	(5,998)
Gains (losses) on derivative instruments and hedging activities (Note 5) .....	<u>(3,939)</u>	<u>977</u>	<u>(2,430)</u>	<u>(1,058)</u>
Other comprehensive income (loss)... before tax.....	11,317	29,444	33,769	(32,704)
Income tax benefit (expense) related to items of other comprehensive income (loss) .....	<u>1,576</u>	<u>(391)</u>	<u>973</u>	<u>2,822</u>
Other comprehensive income (loss)...	<u>\$12,893</u>	<u>\$29,053</u>	<u>\$ 34,742</u>	<u>\$ (29,882)</u>

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

**Kentucky Utilities Company and Subsidiary**  
**Consolidated Statements of Income**  
(Unaudited)  
(Thousands of \$)

	Three Months Ended June 30,		Six Months Ended June 30,	
	<u>2002</u>	<u>2001</u>	<u>2002</u>	<u>2001</u>
OPERATING REVENUES (Note 7).....	\$203,555	\$219,360	\$418,723	\$431,153
OPERATING EXPENSES:				
Fuel for electric generation.....	57,368	55,523	115,639	111,451
Power purchased.....	39,911	52,023	80,971	84,908
Non-recurring charges (Note 4).....	-	-	-	63,788
Other operation expenses.....	36,201	27,343	70,723	53,961
Maintenance.....	15,386	15,549	26,945	27,519
Depreciation and amortization.....	23,515	23,818	46,574	47,646
Federal and state income taxes.....	7,365	11,821	21,748	5,371
Property and other taxes.....	3,762	4,277	7,876	8,432
Total operating expenses.....	<u>183,508</u>	<u>190,354</u>	<u>370,476</u>	<u>403,076</u>
NET OPERATING INCOME.....	20,047	29,006	48,247	28,077
Other income - net.....	1,685	2,621	3,324	4,414
Interest charges (Note 5).....	<u>8,980</u>	<u>10,425</u>	<u>14,462</u>	<u>18,542</u>
NET INCOME before Cumulative Effect of Accounting Change.....	12,752	21,202	37,109	13,949
Cumulative Effect of Change in Accounting for Derivative Instruments and Hedging Activities, net of tax	<u>-</u>	<u>-</u>	<u>-</u>	<u>136</u>
NET INCOME.....	12,752	21,202	37,109	14,085
Preferred stock dividends.....	<u>564</u>	<u>564</u>	<u>1,128</u>	<u>1,128</u>
NET INCOME AVAILABLE FOR COMMON STOCK.....	<u>\$ 12,188</u>	<u>\$ 20,638</u>	<u>\$ 35,981</u>	<u>\$ 12,957</u>

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

**Kentucky Utilities Company and Subsidiary**  
**Consolidated Balance Sheets**  
(Unaudited)  
(Thousands of \$)

ASSETS

	June 30, <u>2002</u>	Dec. 31, <u>2001</u>
UTILITY PLANT:		
At original cost.....	\$3,108,339	\$3,064,220
Less: reserve for depreciation.....	<u>1,501,947</u>	<u>1,457,754</u>
Net utility plant.....	<u>1,606,392</u>	<u>1,606,466</u>
OTHER PROPERTY AND INVESTMENTS -		
less reserve of \$129 as of June 30, 2002 and Dec. 31, 2001	<u>10,089</u>	<u>9,629</u>
CURRENT ASSETS:		
Cash and temporary cash investments.....	3,513	3,295
Accounts receivable - less reserve of \$520 as of June 30, 2002, and Dec. 31, 2001 (Note 6).....	54,047	45,291
Materials and supplies - at average cost:		
Fuel (predominantly coal).....	42,238	43,382
Other.....	27,060	26,188
Prepayments and other.....	<u>6,522</u>	<u>4,942</u>
Total current assets.....	<u>133,380</u>	<u>123,098</u>
DEFERRED DEBITS AND OTHER ASSETS:		
Unamortized debt expense.....	3,843	4,316
Regulatory assets (Note 8).....	57,768	66,467
Other.....	<u>17,162</u>	<u>16,926</u>
Total deferred debits and other assets.....	<u>78,773</u>	<u>87,709</u>
Total assets.....	<u>\$1,828,634</u>	<u>\$1,826,902</u>

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

**Kentucky Utilities Company and Subsidiary**  
**Consolidated Balance Sheets (cont.)**  
(Unaudited)  
(Thousands of \$)

**CAPITALIZATION AND LIABILITIES**

	<u>June 30,</u> <u>2002</u>	<u>Dec. 31,</u> <u>2001</u>
<b>CAPITALIZATION:</b>		
Common stock, without par value -		
Outstanding 37,817,878 shares .....	\$ 308,140	\$ 308,140
Additional paid-in capital .....	15,000	15,000
Retained earnings .....	446,877	410,896
Accumulated other comprehensive income .....	2,685	1,588
Other .....	(595)	(595)
Total common equity .....	<u>772,107</u>	<u>735,029</u>
Cumulative preferred stock .....	40,000	40,000
Long-term debt (Notes 10 and 11) .....	336,323	434,506
Total capitalization .....	<u>1,148,430</u>	<u>1,209,535</u>
<b>CURRENT LIABILITIES:</b>		
Current portion of long-term debt .....	153,930	54,000
Notes payable to parent .....	19,590	47,790
Accounts payable .....	77,502	85,149
Accrued taxes .....	16,868	20,520
Accrued interest .....	4,452	5,668
Other .....	16,810	16,482
Total current liabilities .....	<u>289,152</u>	<u>229,609</u>
<b>DEFERRED CREDITS AND OTHER LIABILITIES:</b>		
Accumulated deferred income		
taxes .....	238,680	239,204
Investment tax credit, in		
process of amortization .....	9,977	11,455
Accumulated provision for pensions		
and related benefits .....	91,827	91,235
Customer advances for construction .....	1,511	1,526
Regulatory liabilities (Note 8) .....	33,475	33,889
Other .....	15,582	10,449
Total deferred credits and other liabilities .....	<u>391,052</u>	<u>387,758</u>
Total capital and liabilities .....	<u>\$1,828,634</u>	<u>\$1,826,902</u>

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

**Kentucky Utilities Company and Subsidiary**  
**Consolidated Statements of Cash Flows**  
(Unaudited)  
(Thousands of \$)

	Six Months Ended June 30,	
	2002	2001
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income.....	\$ 37,109	\$ 14,085
Items not requiring cash currently:		
Depreciation and amortization.....	46,574	47,646
Deferred income taxes - net.....	(3,106)	(28,061)
Investment tax credit - net.....	(1,478)	(1,723)
Non-recurring charges (Note 4).....	-	50,078
Other.....	13,237	5,169
Changes in current assets and liabilities.....	(24,551)	(23,032)
Changes in accounts receivable securitization-net (Note 6)..	2,300	40,000
Other.....	8,208	(1,545)
Net cash flows from operating activities.....	78,293	102,617
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Construction expenditures.....	(47,844)	(80,170)
Net cash flows from investing activities.....	(47,844)	(80,170)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Short-term borrowings.....	505,938	229,094
Repayment of short-term borrowings.....	(534,138)	(250,543)
Issuance of pollution control bonds.....	37,027	-
Retirement of pollution control bonds.....	(37,930)	-
Payment of dividends.....	(1,128)	(1,128)
Net cash flows from financing activities.....	(30,231)	(22,577)
<b>CHANGE IN CASH AND TEMPORARY</b>		
CASH INVESTMENTS.....	218	(130)
<b>CASH AND TEMPORARY CASH INVESTMENTS AT</b>		
BEGINNING OF PERIOD.....	3,295	314
<b>CASH AND TEMPORARY CASH INVESTMENTS AT</b>		
END OF PERIOD.....	\$ 3,513	\$ 184
<b>SUPPLEMENTAL DISCLOSURES:</b>		
Cash paid during the period for:		
Income taxes.....	\$ 27,905	\$ 34,994
Interest on borrowed money.....	\$ 16,120	\$ 16,735

For the purposes of these statements, all temporary cash investments purchased with a maturity of three months or less are considered cash equivalents.

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

**Kentucky Utilities Company and Subsidiary**  
**Consolidated Statements of Retained Earnings**  
(Unaudited)  
(Thousands of \$)

	Three Months Ended June 30,		Six Months Ended June 30,	
	<u>2002</u>	<u>2001</u>	<u>2002</u>	<u>2001</u>
Balance at beginning of period .....				
	\$434,689	\$339,557	\$410,896	\$347,238
Net income.....	<u>12,752</u>	<u>21,202</u>	<u>37,109</u>	<u>14,085</u>
Subtotal .....	<u>447,441</u>	<u>360,759</u>	<u>448,005</u>	<u>361,323</u>
Cash dividends declared on stock:				
4.75% preferred.....	237	237	475	475
6.53% preferred.....	<u>327</u>	<u>327</u>	<u>653</u>	<u>653</u>
Subtotal .....	<u>564</u>	<u>564</u>	<u>1,128</u>	<u>1,128</u>
Balance at end of period.....	<u>\$446,877</u>	<u>\$360,195</u>	<u>\$446,877</u>	<u>\$360,195</u>

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

**Kentucky Utilities Company and Subsidiary**  
**Consolidated Statements of Other Comprehensive Income**  
(Unaudited)  
(Thousands of \$)

	Three Months Ended June 30,		Six Months Ended June 30,	
	<u>2002</u>	<u>2001</u>	<u>2002</u>	<u>2001</u>
Net income.....	\$12,752	\$21,202	\$37,109	\$14,085
Cumulative effect of change in accounting principle-Accounting for Derivative Instruments and Hedging activities (Note 5).....	-	-	-	2,647
Gains on derivative instruments and hedging activities .....	<u>1,828</u>	<u>-</u>	<u>1,828</u>	<u>-</u>
Other comprehensive income, before tax	14,580	21,202	38,937	16,732
Income tax (expense) related to items of other comprehensive income.....	<u>(731)</u>	<u>-</u>	<u>(731)</u>	<u>(1,059)</u>
Other comprehensive income.....	<u>\$13,849</u>	<u>\$21,202</u>	<u>\$38,206</u>	<u>\$15,673</u>

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

**Louisville Gas and Electric Company and Subsidiary  
Kentucky Utilities Company and Subsidiary**

**Notes to Consolidated Financial Statements  
(Unaudited)**

1. The unaudited consolidated financial statements include the accounts of Louisville Gas and Electric Company and Subsidiary and Kentucky Utilities Company and Subsidiary ("LG&E" and "KU" or the "Companies"). The common stock of each of LG&E and KU is wholly-owned by LG&E Energy Corp. ("LG&E Energy"). In the opinion of management, the unaudited interim data includes all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of consolidated financial position, results of operations, comprehensive income and cash flows for the periods indicated. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to Securities and Exchange Commission ("SEC") rules and regulations, although the Companies believe that the disclosures are adequate to make the information presented not misleading.

See LG&E's and KU's Annual Reports on Form 10-K for the year ended December 31, 2001 for information relevant to the accompanying financial statements, including information as to the significant accounting policies of the Companies.

2. On December 11, 2000, LG&E Energy was acquired by Powergen plc ("Powergen") for cash of approximately \$3.2 billion or \$24.85 per share and the assumption of all of LG&E Energy's debt. As a result of the acquisition, among other things, LG&E Energy became a wholly-owned indirect subsidiary of Powergen and, as a result, LG&E and KU became indirect subsidiaries of Powergen. The utility operations (LG&E and KU) of LG&E Energy have continued their separate identities and continue to serve customers in Kentucky and Virginia under their existing names. The preferred stock and debt securities of the utility operations were not affected by this transaction resulting in the utility operations' obligations to continue to file SEC reports. Following the acquisition, Powergen became a registered holding company under the Public Utility Holding Company Act of 1935 ("PUHCA"), and LG&E and KU, as subsidiaries of a registered holding company, became subject to additional regulation under PUHCA.

As a result of the Powergen acquisition and in order to comply with PUHCA, LG&E Energy Services Inc. ("LG&E Services") was formed and became operational on January 1, 2001. LG&E Services provides certain services to affiliated entities, including LG&E and KU, at cost, as required under PUHCA. On January 1, 2001, approximately 1,000 employees, primarily from LG&E Energy, LG&E and KU, were moved to LG&E Services.

3. On April 9, 2001, a German company, E.ON AG ("E.ON"), announced a pre-conditional cash offer of £5.1 billion (\$7.3 billion) to acquire Powergen. The final regulatory approval needed was received on June 14, 2002 from the SEC. Effective July 1, 2002, the acquisition of Powergen was completed by E.ON. Following this acquisition, E.ON became a registered holding company under PUHCA and subject to regulation thereunder.
4. During the first quarter 2001, LG&E recorded a \$144 million charge and KU recorded a \$64 million charge for a workforce reduction program. Primary components of the charge were separation benefits, enhanced early retirement benefits, and health care benefits. The result of this workforce reduction was the net elimination of approximately 950 positions, accomplished primarily through a voluntary enhanced severance program.

On June 1, 2001, LG&E and KU filed an application ("VDT case") with the Kentucky Public Service Commission (the "Kentucky Commission") to create a regulatory asset relating to these first quarter 2001 charges. The application requested permission to amortize these costs over a four-year period. The Kentucky Commission also opened a case to review a depreciation study and resulting depreciation rates implemented in 2001.

LG&E and KU reached a settlement in the VDT case as well as the other cases involving depreciation rates and the Earnings Sharing Mechanism with all intervening parties. The settlement agreement was approved by the Kentucky Commission on December 3, 2001.

The Kentucky Commission's December 3, 2001 order allowed LG&E to set up a regulatory asset of \$141 million for the workforce reduction costs and begin amortizing these costs over a five year period starting in April 2001. The first quarter charge of \$144 million represented all employees who had accepted the voluntary enhanced severance program. Between the time of the original filing and the December 3, 2001 order, some employees rescinded their participation in the voluntary enhanced severance program, thereby decreasing the original charge from \$144 million to \$141 million. The settlement will also reduce revenues by approximately \$26 million through a surcredit on bills to customers over the same five year period. The surcredit represents stipulated net savings LG&E anticipates realizing from implementation of best practices through the value delivery process. The agreement also established LG&E's new depreciation rates in effect retroactive to January 1, 2001. The new depreciation rates decreased depreciation expense by \$5.6 million in 2001.

The Kentucky Commission's December 3, 2001 order allowed KU to set up a regulatory asset of \$54 million for the workforce reduction costs and begin amortizing these costs over a five year period starting in April 2001. The first quarter charge of \$64 million represented all employees who had accepted the voluntary enhanced severance program. Some employees rescinded their participation in the voluntary enhanced severance program and, along with the non-recurring charge of \$6.9 million for FERC and Virginia jurisdictions, decreased the original charge from \$64 million to \$54 million. The settlement will also reduce revenues by approximately \$11 million through a surcredit on bills to customers over the same five year period. The surcredit represents stipulated net savings KU anticipates realizing from implementation of best practices through the value delivery process. The agreement also established KU's new depreciation rates in effect retroactive to January 1, 2001. The new depreciation rates decreased depreciation expense by \$6.0 million in 2001.

5. Statement of Financial Accounting Standards ("SFAS") No. 133, *Accounting for Derivative Instruments and Hedging Activities*, establishes accounting and reporting standards requiring that every derivative instrument (including certain derivative instruments embedded in other contracts) be recorded on the balance sheet as either an asset or a liability measured at its fair value. SFAS No. 133 requires that changes in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. Special accounting for qualifying hedges allows a derivative's gains and losses to offset related results on the hedged item in the income statement, and requires that LG&E and KU must formally document, designate, and assess the effectiveness of transactions that receive hedge accounting. SFAS No. 133 could increase the volatility in earnings and other comprehensive income. LG&E and KU adopted SFAS No. 133 on January 1, 2001. The effect of adopting this statement in 2001 resulted in a \$3.6 million (net of tax of \$2.4 million) decrease in other comprehensive income from a cumulative effect of change in accounting principle for LG&E and a \$1.6 million (net of tax of \$1.1 million) increase in other comprehensive income from a cumulative effect of change in accounting principle for KU.

The Companies use interest rate swaps to hedge exposure to market fluctuations in certain of their debt instruments. Pursuant to Company policy, use of these financial instruments is intended to mitigate risk and earnings volatility and is not speculative in nature. Management has designated all of the Companies' interest rate swaps as hedge instruments. Financial instruments designated as cash flow hedges have resulting gains and losses recorded within other comprehensive income and stockholders' equity. To the extent a financial instrument or the underlying item being hedged is prematurely terminated or the hedge becomes ineffective, the resulting gains or losses are reclassified from other comprehensive income to net income. Financial instruments designated as fair value hedges are periodically marked to market with the resulting gains and losses recorded directly into net income to correspond with income or expense recognized from changes in market value of the items being hedged.

As of June 30, 2002, LG&E had fixed rate swaps covering \$117,335,000 in notional amounts of variable rate debt and with fixed rates ranging from 4.184% to 5.495%.

The average variable rate on the debt during the quarter and six months ended June 30, 2002 was 1.53% and 1.47%. The swaps have been designated as cash flow hedges and expire on various dates from September 2003 through November 2020. The hedges were deemed to be fully effective resulting in a pretax loss for the quarter and six months ended June 30, 2002 of \$3.9 million and \$2.4 million, respectively, recorded in Other Comprehensive Income. Upon expiration of these hedges, the amount recorded in Other Comprehensive Income will be reclassified into earnings. The amount expected to be reclassified from Other Comprehensive Income to earnings in the next twelve months is immaterial.

As of June 30, 2002, KU had variable rate swaps covering \$153,000,000 in notional amounts of fixed rate debt. The average variable rate on these swaps during both the quarter and six months ended June 30, 2002 was 2.43%. The underlying debt has fixed rates ranging from 5.75% to 7.92%. The swaps have been designated as fair value hedges and expire on various dates from May 2007 through June 2025. During the quarter and six months ended June 30, 2002, the effect of marking these financial instruments and the underlying debt to market resulted in pretax losses of \$2.2 million and \$0.4 million, respectively, recorded as an increase in interest expense.

The Financial Accounting Standards Board created the Derivatives Implementation Group ("DIG") to provide guidance for implementation of SFAS No. 133. DIG Issue C15, *Normal Purchases and Normal Sales Exception for Option Type Contracts and Forward Contracts in Electricity* was adopted in 2001 and had no impact on results of operations and financial position of the Companies. DIG Issue C16, *Applying the Normal Purchase and Normal Sales Exception to Contracts that Combine a Forward Contract and a Purchased Option Contract*, was cleared in the third quarter 2001 and stated that option contracts do not meet the normal purchases and normal sales exception and should follow SFAS No. 133. DIG Issue C16 was effective in the second quarter of 2002. The adoption of DIG Issue C16 did not have a material impact on the financial position or results of operations of the Companies pursuant to regulatory treatment prescribed by SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*. KU recorded a mark to market asset and corresponding regulatory liability of \$1.4 million in the second quarter of 2002.

6. SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, revises the standards for accounting for securitizations and other transfers of financial assets and collateral and requires certain disclosures, and provides accounting and reporting standards for transfers and servicing of financial assets and extinguishments of liabilities. The Companies adopted SFAS No. 140 in the first quarter of 2001, when LG&E and KU entered into accounts receivable securitization programs.

On February 6, 2001, LG&E and KU implemented an accounts receivable securitization program. The purpose of this program is to enable the utilities to accelerate the receipt of cash from the collection of retail accounts receivable, thereby reducing dependence upon more costly sources of working capital. The securitization program allows for a percentage of eligible receivables to be sold. Eligible receivables are generally all receivables associated with retail sales that have standard terms and are not past due. LG&E and KU are able to terminate these programs at any time without penalty. If there is a significant deterioration in the payment record of the receivables by retail customers or if the Companies fail to meet certain covenants of the program, the program may terminate at the election of the financial institutions. In this case, payments from retail customers would first be used to repay the financial institutions participating in the program, and would then be available for use by the Companies.

As part of the program, LG&E and KU sold retail accounts receivables to wholly owned subsidiaries, LG&E Receivables LLC ("LG&E R") and KU Receivables LLC ("KU R"). Simultaneously, LG&E R and KU R entered into two separate three-year accounts receivable securitization facilities with two financial institutions and their affiliates whereby LG&E R and KU R can sell, on a revolving basis, an undivided interest in certain of their receivables and receive up to \$75 million and \$50 million, respectively, from an unrelated third party purchaser. The effective cost of the receivables programs is comparable to the Companies' lowest cost source of capital, and is

based on prime rated commercial paper. LG&E and KU retain servicing rights of the sold receivables through separate servicing agreements with the third party purchasers. LG&E and KU have obtained opinions from independent legal counsel indicating these transactions qualify as true sales of receivables. As of June 30, 2002 and December 31, 2001, LG&E's outstanding program balances were \$58.1 million and \$42.0 million, respectively, and KU's balances were \$47.4 million and \$45.1 million, respectively.

Management expects to renew these facilities when they expire.

The allowance for doubtful accounts associated with the eligible securitized receivables was \$1.6 million for LG&E and \$0.5 million for KU for both June 30, 2002 and December 31, 2001, respectively. Charge offs were immaterial for LG&E and KU. The risk of uncollectibility associated with the sold receivables is minimal.

7. External and intersegment revenues (related party transactions between LG&E and KU) and income by business segment for the three and six months ended June 30, 2002, follow (in thousands of \$):

Three Months Ended June 30, 2002

	Net		
	External	Inter-	Income/ (Loss)
	Revenues	segment	Avail.
		Revenues	For
			Common Stock
LG&E electric	\$ 181,963	\$ 9,850	\$ 16,893
LG&E gas	30,938	-	(2,686)
Total	<u>\$ 212,901</u>	<u>\$ 9,850</u>	<u>\$ 14,207</u>
KU electric	<u>\$ 195,460</u>	<u>\$ 8,095</u>	<u>\$ 12,188</u>

Six Months Ended June 30, 2002

	Net		
	External	Inter-	Income/ (Loss)
	Revenues	segment	Avail.
		Revenues	For
			Common Stock
LG&E electric	\$ 335,156	\$ 22,903	\$ 27,071
LG&E gas	148,056	-	7,014
Total	<u>\$ 483,212</u>	<u>\$ 22,903</u>	<u>\$ 34,085</u>
KU electric	<u>\$ 395,847</u>	<u>\$ 22,876</u>	<u>\$ 35,981</u>

External and intersegment revenues (related party transactions between LG&E and KU) and income by business segment for the three and six months ended June 30, 2001, follow (in thousands of \$):

Three Months Ended June 30, 2001

	External Revenues	Inter- segment Revenues	Net Income/ (Loss) Avail. For Common Stock
LG&E electric	\$ 187,472	\$ 8,818	\$ 27,867
LG&E gas	32,551	-	(620)
Total	<u>\$ 220,023</u>	<u>\$ 8,818</u>	<u>\$ 27,247</u>
KU electric	<u>\$ 209,507</u>	<u>\$ 9,853</u>	<u>\$ 20,638</u>

Six Months Ended June 30, 2001

	External Revenues	Inter- segment Revenues	Net Income/ (Loss) Avail. For- Common Stock
LG&E electric	\$ 335,833	\$ 15,831	\$ (16,575)
LG&E gas	190,448	-	(11,591)
Total	<u>\$ 526,281</u>	<u>\$ 15,831</u>	<u>\$ (28,166)</u>
KU electric	<u>\$ 415,618</u>	<u>\$ 15,535</u>	<u>\$ 12,957</u>

8. The following regulatory assets and liabilities were included in the balance sheet of LG&E and KU as of June 30, 2002 and December 31, 2001 (in thousands of \$):

Louisville Gas and Electric

	(Unaudited)	
	Jun. 30, <u>2002</u>	Dec. 31, <u>2001</u>
<u>REGULATORY ASSETS:</u>		
VDT costs.....	\$ 112,529	\$ 127,529
Unamortized loss on bonds.....	17,972	17,902
Gas supply adjustments due from customers.....	16,342	30,135
LG&E/KU merger costs.....	3,629	5,444
One utility costs.....	2,299	3,643
Manufactured gas sites.....	1,911	2,062
Other.....	7,267	10,427
Total.....	<u>161,949</u>	<u>197,142</u>
<u>REGULATORY LIABILITIES:</u>		
Deferred income taxes - net.....	47,584	48,703
Gas supply adjustments due to customers.....	6,207	15,702
Other.....	929	944
Total.....	<u>\$ 54,720</u>	<u>\$ 65,349</u>

Kentucky Utilities

	(Unaudited)	
	Jun. 30, <u>2002</u>	Dec. 31, <u>2001</u>
<u>REGULATORY ASSETS:</u>		
VDT costs.....	\$ 43,061	\$ 48,811
Unamortized loss on bonds.....	6,916	6,142
LG&E/KU merger costs.....	4,093	6,139
One utility costs.....	2,619	4,365
Other.....	1,079	1,010
Total.....	<u>57,768</u>	<u>66,467</u>
<u>REGULATORY LIABILITIES:</u>		
Deferred income taxes - net.....	31,021	32,872
Mark to market coal supply option contracts.....	1,419	-
Other.....	1,035	1,017
Total.....	<u>\$ 33,475</u>	<u>\$ 33,889</u>

9. SFAS No. 141, *Business Combinations* and No. 142, *Goodwill and Other Intangible Assets* were issued in the second quarter of 2001. Therefore, the provisions of these new pronouncements were effective July 1, 2001, for LG&E and KU. SFAS No. 141 requires all business combinations initiated after June 30, 2001, to be accounted for using the purchase method. SFAS No. 142 requires goodwill to be recorded, but not amortized. Furthermore, goodwill will now be subject to a periodic assessment for impairment. LG&E and KU have no recorded goodwill and have no merger or acquisitions in progress. Accordingly, the Companies experienced no impact on the financial position or results of operation as a result of adopting these standards.

SFAS No. 143, *Accounting for Asset Retirement Obligations* and SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, were also issued during 2001. SFAS No. 143 establishes accounting and reporting standards for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. SFAS No. 144 supersedes SFAS No. 121, *Accounting for the Impair-*

ment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of and the accounting and reporting provisions of APB Opinion No. 30, Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions. SFAS No. 144, among other provisions, eliminates the requirement of SFAS No. 121 to allocate goodwill to long-lived assets to be tested for impairment. The effective implementation date for SFAS No. 144 is January 1, 2002 and SFAS No. 143 is January 1, 2003. SFAS No. 144 had no impact on the financial position or results of operations of LG&E or KU. Management is currently conducting an analysis and has not determined what impact SFAS No. 143 will have on the financial position or results of operations of the Companies.

SFAS No. 145, Rescission of SFAS Nos. 4, 44 and 64, amendment of SFAS No. 13, and technical corrections was issued in the second quarter 2002. The provisions related to SFAS No. 13 were effective for fiscal years beginning after May 15, 2002. All other provisions of SFAS No. 145 shall be effective for financial statements issued on or after May 15, 2002. The adoption of this standard will not have a material impact on financial position or results of operations of the Companies.

SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities, was issued in July 2002. SFAS No. 146 requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. The provisions of this Statement are effective for exit or disposal activities that are initiated after December 31, 2002. The Companies do not expect the adoption of this standard to have a material impact on financial position or results of operations of the Companies.

10. On May 23, 2002 KU refinanced its pollution control series 1B, 2B, 3B, and 4B bonds, totaling \$37.9 million. The new bonds, series 12, 13, 14 and 15 are due in February 2032 and bear interest at a variable rate. The new bonds are secured by first mortgage bonds and have the same principal amount as the prior bonds. The variable rate will be established by the remarketing agent based on conditions in the tax-exempt debt market.

On March 22, 2002, LG&E refinanced two \$35 million unsecured pollution control bonds due November 1, 2027. The replacement variable rate bonds are secured by first mortgage bonds and will mature November 1, 2027. The variable rate will be established by the remarketing agent taking into account market conditions in the commercial paper market.

On March 6, 2002, LG&E refinanced \$22.5 million and \$27.5 million in unsecured pollution control bonds, both due September 1, 2026. The replacement bonds, due September 1, 2026, are variable rate bonds and are secured by first mortgage bonds. The variable rate will be established by the remarketing agent taking into account market conditions in the commercial paper market.

11. As of June 30, 2002, LG&E Energy owned \$104.6 million in varying portions of LG&E's outstanding variable rate pollution control bonds. The bonds were acquired during May 2002 by LG&E Energy as an investment and were sold in their entirety during the first half of July 2002 to unaffiliated third parties.
12. In the normal course of business, lawsuits, claims, environmental actions, and various non-ratemaking governmental proceedings arise against LG&E and KU. To the extent that damages are assessed in any of these lawsuits, LG&E and KU believe that their insurance coverage is adequate. Management, after consultation with legal counsel, and based upon the present status of these items, does not anticipate that liabilities arising out of other currently pending or threatened lawsuits and claims of the type referenced above will have a material adverse effect on LG&E's or KU's consolidated financial position or results of operations, respectively.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

General

The following discussion and analysis by management focuses on those factors that had a material effect on LG&E's and KU's financial results of operations and financial condition during the three and six month periods ended June 30, 2002 and should be read in connection with the financial statements and notes thereto.

Some of the following discussion may contain forward-looking statements that are subject to certain risks, uncertainties and assumptions. Such forward-looking statements are intended to be identified in this document by the words "anticipate," "expect," "estimate," "objectively," "possible," "potential" and similar expressions. Actual results may vary materially. Factors that could cause actual results to differ materially include: general economic conditions; business and competitive conditions in the energy and fuel industry or markets; changes in federal or state legislation; unusual weather; actions by state or federal regulatory agencies; and other factors described from time to time in LG&E's and KU's reports to the Securities and Exchange Commission, including Exhibit No. 99.01 to their Annual Report on Form 10-K for year ended December 31, 2001.

Results of Operations

The results of operations for LG&E and KU are affected by seasonal fluctuations in temperature and other weather-related factors. Because of these and other factors, the results of one interim period are not necessarily indicative of results or trends to be expected for the full year.

Three Months Ended June 30, 2002, Compared to  
Three Months Ended June 30, 2001

LG&E Results:

LG&E's net income decreased \$13.2 million for the quarter ended June 30, 2002, as compared to the quarter ended June 30, 2001, primarily due to amortization expenses associated with LG&E's workforce reduction program (See Note 4) and higher employee benefit-related costs caused by lower investment returns.

A comparison of LG&E's revenues for the quarter ended June 30, 2002, with the quarter ended June 30, 2001, reflects increases and decreases which have been segregated by the following principal causes (in thousands of \$):

<u>Cause</u>	<u>Electric Revenues</u>	<u>Gas Revenues</u>
Retail sales:		
Fuel and gas supply adjustments .....	\$ 5,972	\$ (17,227)
Environmental cost recovery surcharge .....	2,039	-
Demand side management cost recovery .....	151	253
LG&E/KU merger surcredit .....	(830)	-
Value delivery surcredit .....	(274)	(48)
Variation in sales volume, etc. ....	<u>10,547</u>	<u>15,643</u>
Total retail sales .....	17,605	(1,379)
Wholesale sales .....	(23,925)	(44)
Gas transportation - net .....	-	(114)
Other .....	<u>1,843</u>	<u>(76)</u>
Total .....	<u>\$ (4,477)</u>	<u>\$ (1,613)</u>

Electric revenues decreased primarily because of a decrease in wholesale sales, partially offset by increased retail sales. The decrease in wholesale sales is attributable to

lower sales volumes (\$12.5 million) and a decrease in wholesale sales prices (\$11.4 million). The retail sales increase was due in part to warmer weather experienced this period. Cooling degree days increased 8% for the three months ended June 2002 as compared to three months ended June 2001. Gas revenues decreased primarily as a result of lower gas supply costs billed to customers through the gas supply clause, partially offset by an increase in gas sales volume.

Fuel for electric generation and gas supply expenses comprise a large portion of LG&E's total operating expenses. LG&E's electric and gas rates contain a Fuel Adjustment Clause and a Gas Supply Clause, respectively, whereby increases or decreases in the cost of fuel and gas supply may be reflected in retail rates, subject to the approval of the Kentucky Commission. Fuel for electric generation increased \$8.8 million (21%) for the quarter because of an increase in the cost of coal burned (\$10.4 million), partially offset by a decrease in quantity of coal burned (\$1.6 million). Gas supply expenses decreased \$0.5 million (3%) due to a decrease in net gas supply cost (\$4.4 million), partially offset by an increase in the volume of retail gas delivered to the distribution system (\$3.9 million).

Power purchased decreased \$10.7 million (33%) primarily because of a decrease in volume of purchases to support wholesale sales (\$4.0 million) and a decrease in cost of power purchased (\$6.7 million).

Other operation expenses increased \$18.4 million (51%) in 2002, as compared to 2001, primarily due to amortization expenses associated with LG&E's workforce reduction program (\$7.5 million), increased costs for pension expenses (\$2.2 million), electric transmission expenses (\$3.8 million), post-retirement medical expenses (\$1.3 million), and steam operation expenses (\$1.8 million).

Maintenance expenses increased \$1.9 million (14%) in 2002 primarily due to increased repairs to steam production (\$0.7 million) and maintenance to the electric distribution plant (\$0.8 million).

A reconciliation of differences between the U.S. statutory federal income tax rate and effective income tax rate for the three months ended June follows:

Effective Rate	June	June
	2002	2001
Statutory federal income tax rate	35.0%	35.0%
State income taxes net of federal benefit	4.3%	5.5%
Amortization of investment tax credit & R&D	-4.5%	-2.3%
Other differences	-0.4%	-0.5%
Effective Income Tax Rate	<u>34.4%</u>	<u>37.7%</u>

Interest charges decreased \$2.4 million (26%) due to lower interest rates on variable rate long-term debt (\$1.7 million) and a decrease in interest associated with the accounts receivable securitization program (\$0.5 million). The weighted average interest rate on variable-rate tax-exempt debt for the three months ended June 30, 2002 was 1.63%, compared to 3.96% for the comparable period in 2001.

#### KU Results:

KU's net income decreased \$8.4 million for the quarter ended June 30, 2002, as compared to the quarter ended June 30, 2001. The decrease was primarily due to increased other operation expense and decreased electric revenues partially offset by decreased interest expense.

A comparison of KU's revenues for the quarter ended June 30, 2002, with the quarter ended June 30, 2001, reflects increases and decreases which have been segregated by the following principal causes (in thousands of \$):

Retail sales:

Fuel supply adjustments .....	\$ 4,226
Environmental cost recovery surcharge .....	1,033
Demand side management cost recovery .....	512
LG&E/KU merger surcredit .....	(1,136)
Value delivery surcredit .....	(149)
Variation in sales volume, etc. ....	<u>8,595</u>
Total retail sales .....	13,081
Wholesale sales.....	(30,745)
Other.....	<u>1,859</u>
Total	<u>\$ (15,805)</u>

Electric revenues decreased primarily due to a decrease in volume (\$25.3 million) and price (\$5.4 million) of wholesale sales, partially offset by increased retail sales.

Fuel for electric generation comprises a large portion of KU's total operating expenses. KU's electric rates contain a Fuel Adjustment Clause, whereby increases or decreases in the cost of fuel are reflected in retail rates, subject to the approval of the Kentucky Public Service Commission, the Virginia State Corporation Commission, and the Federal Energy Regulatory Commission. Fuel for electric generation increased \$1.8 million (3%) for the quarter due to an increase in the cost of coal burned (\$7.1 million) partially offset by a decrease in volume burned (\$5.3 million).

Power purchased decreased \$12.1 million (23%) in 2002 primarily because of a decrease in volumes purchased (\$7.6 million) and a decrease in unit cost of purchases (\$4.5 million).

Other operation expenses increased \$8.9 million (32%) compared to 2001, primarily due to amortization expenses associated with KU's workforce reduction program (\$2.9 million), higher pension expenses (\$0.9 million), outside services (\$0.8 million), property insurance (\$0.5 million), post-retirement medical expenses (\$0.5 million), and increased operation of the electric transmission system (\$2.0 million) and distribution system (\$0.7 million).

A reconciliation of differences between the U.S. statutory federal income tax rate and effective income tax rate for the three months ended June follows:

Effective Rate	June	June
	<u>2002</u>	<u>2001</u>
Statutory federal income tax rate	35.0%	35.0%
State income taxes net of federal benefit	6.8%	5.9%
Amortization of investment tax credit & R&D	-3.9%	-2.5%
Other differences	<u>-4.5%</u>	<u>-3.3%</u>
Effective Income Tax Rate	<u>33.4%</u>	<u>35.1%</u>

Interest charges decreased \$1.4 million (14%) for the second quarter 2002 compared to the second quarter 2001 due to lower rates on variable rate debt (\$0.8 million) and a decrease in interest associated with the accounts receivable securitization program (\$0.6 million). The weighted average interest rate on variable-rate tax-exempt debt for the three months ended June 30, 2002 was 1.64%, compared to 3.55% for the comparable period in 2001.

Six Months Ended June 30, 2002, Compared to  
Six Months Ended June 30, 2001

LG&E Results:

LG&E's net income increased \$61.8 million for the six months ended June 30, 2002, as compared to the six months ended June 30, 2001, primarily because of a non-recurring charge of \$86.1 million, net of tax, for LG&E's workforce reduction program incurred in 2001. Excluding this one-time charge, LG&E's net income would have decreased \$24.3 million primarily due to amortization expenses associated with LG&E's workforce reduction program (See Note 4), lower wholesale margins expenses and higher pension expenses caused by lower investment returns partially offset by lower interest expense.

A comparison of LG&E's revenues for the six months ended June 30, 2002, with the six months ended June 30, 2001, reflects increases and decreases which have been segregated by the following principal causes (in thousands of \$):

<u>Cause</u>	<u>Electric Revenues</u>	<u>Gas Revenues</u>
Retail sales:		
Fuel and gas supply adjustments .....	\$ 3,704	\$ (58,158)
Environmental cost recovery surcharge .....	3,685	-
Demand side management cost recovery .....	203	675
LG&E/KU merger surcredit .....	(1,035)	-
Value delivery surcredit .....	(510)	(169)
Variation in sales volume, etc. ....	<u>9,776</u>	<u>5,345</u>
Total retail sales .....	15,823	(52,307)
Wholesale sales .....	(10,825)	9,979
Gas transportation - net .....	-	75
Other .....	<u>1,397</u>	<u>(139)</u>
Total .....	<u>\$ 6,395</u>	<u>\$ (42,392)</u>

Electric revenues increased primarily because of an increase in sales to retail customers, partially offset by decreased wholesale sales. The increase in sales to retail customers, in part to warmer weather experienced in the period. Cooling degree days increased 8% for the six months ended June 2002 as compared to the six months ended June 2001. Wholesale sales decreased due to lower unit prices (\$29.1 million) partially offset by increased volume sold (\$18.3 million). Gas revenues decreased primarily as a result of lower gas supply costs billed to customers through the gas supply clause.

Fuel for electric generation increased \$14.4 million (18%) for the six months because of an increase in the cost of coal burned (\$12.9 million) and an increase in quantity of coal burned (\$1.5 million). Gas supply expenses decreased \$42.2 million (29%) due to a decrease in net gas supply cost (\$44.0 million), and a decrease in the volume of retail gas delivered to the distribution system (\$6.4 million), partially offset by increased wholesale gas expenses (\$8.2 million).

The decrease in non-recurring charges of \$144.4 million (\$86.1 million after tax) is due to the costs associated with LG&E's workforce reduction initiative which were recorded in the first quarter of 2001 (See Note 4).

Other operation expenses increased \$31.5 million (44%) in 2002, compared to 2001, primarily due to amortization expenses associated with LG&E's workforce reduction program (\$15.0 million), increased costs for electric transmission (\$5.9 million), pension expenses (\$4.9 million), post-retirement medical expenses (\$1.8 million), and property insurance (\$1.3 million).

Maintenance expenses increased \$3.3 million (14%) in 2002 primarily due to increased repairs to steam production (\$1.6 million) and maintenance to the electric distribution system (\$1.1 million).

Other income (deduction) - net decreased \$1.4 million in 2002 primarily due to an increase in repairs to non-utility property (\$0.6 million), a decrease in gains recorded on the sale of non-utility property (\$0.3 million) and an increase in the tax provision related to other income (\$0.6 million).

A reconciliation of differences between the U.S. statutory federal income tax rate and effective income tax rate for the six months ended June 30 follows:

Effective Rate	June	June
	<u>2002</u>	<u>2001</u>
Statutory federal income tax rate	35.0%	-35.0%
State income taxes net of federal benefit	5.0%	-5.5%
Amortization of investment tax credit & R&D	-3.7%	-4.5%
Other differences	<u>-0.2%</u>	<u>-1.2%</u>
Effective Income Tax Rate	<u>36.1%</u>	<u>-46.2%</u>

The six months ended June 2001 included a net pretax loss because of the workforce reduction charge.

Interest charges decreased \$6.0 million (29%) due to lower interest rates on variable rate long term debt (\$3.7 million), a decrease in interest on debt to parent company (\$0.9 million), and a decrease in interest associated with the accounts receivable securitization program (\$1.5 million). The weighted average interest rate on variable-rate tax-exempt debt for the six months ended June 30, 2002 was 1.66%, compared to 4.23% for the comparable period in 2001.

#### KU Results:

KU's net income increased \$23.0 million for the six months ended June 30, 2002, as compared to the six months ended June 30, 2001. The increase was primarily due a non-recurring charge of \$38.0 million, net of tax, made in the first quarter of 2001 for costs associated with KU's workforce reduction program. Excluding this one-time charge, net income decreased \$15.0 million, due largely to increased operation expenses and lower electric revenues, partially offset by lower interest expense.

A comparison of KU's revenues for the six months ended June 30, 2002, with the six months ended June 30, 2001, reflects increases and decreases which have been segregated by the following principal causes (in thousands of \$):

Retail sales:	
Fuel supply adjustments .....	\$ 9,359
Environmental cost recovery surcharge .....	2,543
Demand side management cost recovery .....	1,296
LG&E/KU merger surcredit .....	(2,161)
Value delivery surcredit .....	(338)
Variation in sales volume, etc. ....	<u>4,782</u>
Total retail sales .....	15,481
Wholesale sales .....	(31,050)
Other .....	<u>3,139</u>
Total	<u>\$ (12,430)</u>

Electric revenues decreased primarily due to a decrease in wholesale sales, partially offset by increased sales to retail customers. The decrease in wholesale sales is primarily

due to a decrease in the price of wholesale sales (\$21.4 million) and a decrease in volume sold (\$9.7 million).

Fuel for electric generation increased \$4.2 million (4%) for the six months due to a \$12.6 million increase in the cost of coal burned partially offset by a decrease of \$8.4 million in volume burned.

Power purchased decreased \$3.9 million (5%) in 2002 primarily because of a decrease in unit cost (\$10.2 million), partially offset by an increase in KWH purchased (\$6.3 million).

Non-recurring charges decreased \$63.8 million (\$38.0 million after tax). These costs were due to KU's workforce reduction program which were recorded in the first quarter of 2001 (See Note 4).

Other operation expenses increased \$16.8 million (31%) compared to 2001, primarily due to amortization expenses associated with KU's workforce reduction program (\$5.8 million), higher pension expenses (\$2.1 million), property insurance (\$1.3 million) and outside services (\$1.9), higher costs for electric transmission (\$3.4 million) and increases in uncollectible accounts and customer assistance programs (\$1.3 million).

Other income-net decreased \$1.1 million (25%) in 2002 primarily due to a gain on disposition of property in 2001 of \$1.3 million.

A reconciliation of differences between the U.S. statutory federal income tax rate and effective income tax rate for the six months ended June follows:

	June <u>2002</u>	June <u>2001</u>
Effective Rate		
Statutory federal income tax rate	35.0%	35.0%
State income taxes net of federal benefit	6.3%	7.7%
Amortization of investment tax credit & R&D	-3.5%	-9.7%
Other differences	-3.0%	-11.4%
Effective Income Tax Rate	<u>34.8%</u>	<u>21.6%</u>

The amortization of investment tax credit and other differences were approximately the same in both periods, but lower pretax income for the six months ended June 30, 2001 (resulting from the workforce reduction charge) caused the percentage changes to be greater in the 2001 period.

Interest charges decreased \$4.1 million (22%) for the first six months of 2002 as compared to the six months of 2001 primarily due to lower rates on variable rate debt (\$2.7 million) and a decrease in interest associated with the accounts receivable securitization program (\$1.0 million). The weighted average interest rate on variable-rate tax-exempt debt for the six months ended June 30, 2002 was 1.66%, compared to 3.76% for the comparable period in 2001.

### Liquidity and Capital Resources

LG&E's and KU's need for capital funds are largely related to the construction of plant and equipment necessary to meet the needs of electric and gas utility customers. Internal and external lines of credit, the accounts receivable securitization programs, and commercial paper programs are maintained to fund short-term capital requirements.

Construction expenditures for the six months ended June 30, 2002 for LG&E and KU amounted to \$69.5 million and \$47.8 million, respectively. Such expenditures related primarily to construction to meet nitrogen oxide (NOx) emission standards, and were financed with internally generated funds and accounts receivable securitization program funds. Also, a common stock dividend of \$23 million was paid by LG&E. See Note 6 of Notes to Financial Statements concerning accounts receivable securitization.

LG&E's and KU's cash and temporary cash investment balance increased \$18.3 million and \$0.2 million, respectively during the six months ended June 30, 2002. The increases reflect cash flows from operations, partially offset by construction expenditures and LG&E's common dividend payment. KU also reduced notes payable by \$28.2 million.

Variations in accounts receivable, accounts payable and materials and supplies are generally not significant indicators of LG&E's and KU's liquidity. Such variations are primarily attributable to fluctuations in weather, which have a direct effect on sales of electricity and natural gas. The increases in accounts receivable for KU resulted primarily from seasonal fluctuations. The decrease in accounts receivable at LG&E resulted primarily from the increased sale of accounts receivable through the accounts receivable securitization program. (See Note 6 of Notes to Financial Statements). The increase in fuel inventory at LG&E and the decrease in LG&E's gas stored underground resulted from seasonal fluctuations.

LG&E and KU participate in a money pool whereby LG&E Energy can make funds available to LG&E and KU at market-based rates up to \$200 million each. LG&E Energy maintains a facility of \$200 million with a Powergen subsidiary to ensure funding availability for the money pool. There is no balance outstanding under the Powergen line of credit as of June 30, 2002 and no outstanding commercial paper program balance. LG&E Energy has provided loans to LG&E and KU through the money pool that total \$91.6 million and \$19.6 million, respectively, as of June 30, 2002. These borrowings carried a commercial paper grade interest rate of 1.82% at June 30, 2002.

On March 6, 2002, LG&E refinanced its \$22.5 million and \$27.5 million unsecured pollution control bonds, both due September 1, 2026. The replacement bonds, due September 1, 2026, are variable rate bonds and are secured by first mortgage bonds.

On March 22, 2002, LG&E refinanced its two \$35 million unsecured pollution control bonds due November 1, 2027. The replacement variable rate bonds are secured by first mortgage bonds and will mature November 1, 2027.

On May 23, 2002 KU refinanced its pollution control series 1B, 2B, 3B, and 4B bonds, totaling \$37.9 million. The new bonds, series 12, 13, 14 and 15 are due in February 2032 and bear interest at a variable rate. The new bonds are secured by first mortgage bonds and have the same principal amount as the prior bonds. The variable rate will be established by the remarketing agent based on conditions in the tax-exempt debt market.

As of June 30, 2002, LG&E Energy owned \$104.6 million in varying portions of LG&E's outstanding variable rate pollution control bonds. The bonds were acquired during May 2002 by LG&E Energy as an investment and were sold in their entirety during the first half of July 2002 to unaffiliated third parties.

LG&E's security ratings as of June 30, 2002, were:

	<u>Moody's</u>	<u>S&amp;P</u>	<u>Fitch</u>
First mortgage bonds	A1	A-	A+
Preferred stock	a2	BBB-	A-
Commercial paper	P-1	A-2	F-1

KU's security ratings as of June 30, 2002, were:

	<u>Moody's</u>	<u>S&amp;P</u>	<u>Fitch</u>
First mortgage bonds	A1	A-	A+
Preferred stock	a2	BBB-	A-
Commercial paper	P-1	A-2	F-1

The S&P ratings of LG&E's and KU's debt securities are on Credit Watch for upgrade as the result of the E.ON acquisition. Fitch has placed LG&E and KU on credit watch evolving as a result of the acquisition by E.ON. These ratings reflect the views of Moody's, S&P and Fitch. 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.

LG&E's capitalization ratios at June 30, 2002, and December 31, 2001, follow:

	<u>Jun. 30,</u> <u>2002</u>	<u>Dec. 31,</u> <u>2001</u>
Long-term debt (including current portion)	37.4%	37.5%
Notes payable	5.5	5.7
Preferred stock	5.8	5.8
Common equity	51.3	51.0
Total	<u>100.0%</u>	<u>100.0%</u>

KU's capitalization ratios at June 30, 2002, and December 31, 2001, follow:

	<u>Jun. 30,</u> <u>2002</u>	<u>Dec. 31,</u> <u>2001</u>
Long-term debt (including current portion)	37.1%	37.2%
Notes payable	1.5	3.6
Preferred stock	3.0	3.1
Common equity	58.4	56.1
Total	<u>100.0%</u>	<u>100.0%</u>

#### New Accounting Pronouncements

SFAS No. 141, *Business Combinations* and No. 142, *Goodwill and Other Intangible Assets* were issued in the second quarter of 2001. Therefore, the provisions of these new pronouncements were effective July 1, 2001, for LG&E and KU. SFAS No. 141 requires all business combinations initiated after June 30, 2001, to be accounted for using the purchase method. SFAS No. 142 requires goodwill to be recorded, but not amortized. Furthermore, goodwill will now be subject to a periodic assessment for impairment. LG&E and KU have no recorded goodwill and have no merger or acquisitions in progress. Accordingly, the Companies experienced no impact on the financial position or results of operation as a result of adopting these standards.

SFAS No. 143, *Accounting for Asset Retirement Obligations* and SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, were issued during 2001. SFAS No. 143 establishes accounting and reporting standards for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. SFAS No. 144 supersedes SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of* and the accounting and reporting provisions of APB Opinion No. 30, *Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*. SFAS No. 144, among other provisions, eliminates the requirement of SFAS No. 121 to allocate goodwill to long-lived assets to be tested for impairment. The effective implementation date for SFAS No. 144 is January 1, 2002 and SFAS No. 143 is January

1, 2003. SFAS No. 144 had no impact on the financial position or results of operations of LG&E or KU. Management is currently conducting an analysis and has not determined what impact SFAS No. 143 will have on the financial position or results of operations of the Companies.

The Financial Accounting Standards Board created the Derivatives Implementation Group ("DIG") to provide guidance for implementation of SFAS No. 133. DIG Issue C15, *Normal Purchases and Normal Sales Exception for Option Type Contracts and Forward Contracts in Electricity* was adopted in 2001 and had no impact on results of operations and financial position of the Companies. DIG Issue C16, *Applying the Normal Purchase and Normal Sales Exception to Contracts that Combine a Forward Contract and a Purchased Option Contract*, was cleared in the third quarter 2001 and stated that option contracts do not meet the normal purchases and normal sales exception and should follow SFAS No. 133. DIG Issue C16 was effective in the second quarter of 2002. The adoption of DIG Issue C16 did not have a material impact on the financial position or results of operations of the Companies pursuant to regulatory treatment prescribed by SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*. KU recorded a mark to market asset and corresponding regulatory liability of \$1.4 million in the second quarter of 2002.

SFAS No. 145, *Rescission of SFAS Nos. 4, 44 and 64, amendment of SFAS No. 13, and technical corrections* was issued in the second quarter 2002. The provisions related to SFAS No. 13 were effective for fiscal years beginning after May 15, 2002. All other provisions of SFAS No. 145 shall be effective for financial statements issued on or after May 15, 2002. The adoption of this standard will not have a material impact on financial position or results of operations of the Companies.

SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*, was issued in July 2002. SFAS No. 146 requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. The provisions of this Statement are effective for exit or disposal activities that are initiated after December 31, 2002. The Companies do not expect the adoption of this standard to have a material impact on financial position or results of operations of the Companies.

#### Contingencies

For a description of significant contingencies that may affect LG&E and KU, reference is made to Part I, Item 3, Legal Proceedings, and Notes 12 (LG&E) and 11 (KU) to the financial statements contained in LG&E's and KU's Annual Reports on Form 10-K for the year ended December 31, 2001 and to Part II - Item 1, Legal Proceedings herein.

#### Item 3. Quantitative and Qualitative Disclosures About Market Risk.

LG&E and KU are exposed to market risks. Both operations are exposed to market risks from changes in interest rates and commodity prices. To mitigate changes in cash flows attributable to these exposures, the Companies have entered into various derivative instruments. Derivative positions are monitored using techniques that include market value and sensitivity analysis.

The Companies use interest rate swaps to hedge exposure to market fluctuations in certain of their debt instruments. Pursuant to Company policy, use of these financial instruments is intended to mitigate risk and earnings volatility and is not speculative in nature. Management has designated all of the Companies' interest rate swaps as hedge instruments. Financial instruments designated as cash flow hedges have resulting gains and losses recorded within other comprehensive income and stockholders' equity. To the extent a financial instrument or the underlying item being hedged is prematurely terminated or the hedge becomes ineffective, the resulting gains or losses are reclassified from other comprehensive income to net income. Financial instruments designated as fair value hedges are periodically marked to market with the resulting gains and losses recorded directly into net income to correspond with income or expense recognized from changes in market value of the items being hedged.

The potential change in interest expense resulting from changes in base interest rates of the Companies' unswapped debt did not change materially during the first six months of

2002. The potential changes in the fair values of the Company's interest-rate swaps resulting from changes in interest rates and the yield curve also did not change materially during the first six months of 2002. The Companies' exposure to market risks from changes in commodity prices remained immaterial during the first six months of 2002.

The Companies have entered into fuel purchase contracts that contain options which allow the Companies to purchase additional tons of coal, as needed, or purchase less coal that contractually required, as needed. The potential change resulting from variations in coal commodity prices of the Companies' coal supply contracts containing option features are not material during the first six months of 2002. The Companies' exposure to market risks from changes in commodity prices are immaterial during the first six months of 2002.

#### Energy Trading & Risk Management Activities

LG&E and KU conduct energy trading and risk management activities to maximize the value of power sales from physical assets it owns, in addition to the wholesale sale of excess asset capacity. Certain energy trading activities are accounted for on a mark-to-market basis in accordance with EITF 98-10 *Accounting for Contracts Involved in Energy Trading and Risk Management Activities*, SFAS No. 133 *Accounting for Derivative Instruments and Hedging Activities*, and SFAS No. 138 *Accounting for Certain Derivative Instruments and Certain Hedging Activities*. Wholesale sales of excess asset capacity and wholesale purchases are treated as normal sales and purchases under SFAS No. 133 and SFAS No. 138 and are not marked to market.

The table below summarizes both LG&E and KU's energy trading and risk management activities during January through June of 2002 (in thousands of \$), as trading volumes are evenly divided between the two regulated utilities.

Fair value of contracts at 12/31/01, net liability	\$ (186)
Fair value of contracts when entered into during Jan- Jun 2002	(57)
Contracts realized or otherwise settled during Jan-Jun 2002	335
Changes in fair values due to changes in assumptions	(66)
Fair value of contracts at 6/30/02, net asset	<u>\$ 26</u>

No changes to valuation techniques for energy trading and risk management activities occurred during January through June of 2002. All contracts outstanding at June 30, 2002 have a maturity of less than one year and are valued using prices actively quoted for proposed or executed transactions or quoted by brokers.

LG&E and KU maintain policies intended to minimize credit risk and revalues credit exposures daily to monitor compliance with those policies. As June 30, 2002, 100% of the trading and risk management commitments were with counterparties rated BBB- equivalent or better.

## Part II. Other Information

### Item 1. Legal Proceedings.

For a description of the significant legal proceedings involving LG&E and KU, reference is made to the information under the following items and captions of LG&E's and KU's (A) respective combined Annual Report on Form 10-K for the year ended December 31, 2001: Item 1, Business; Item 3, Legal Proceedings; Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations; Notes 3, 12 and 16 of LG&E's Notes to Financial Statements under Item 8 and Notes 3, 11 and 14 of KU's Notes to Financial Statements under Item 8 and (B) respective combined Quarterly Report on Form 10-Q for the quarter ended March 31, 2002: Item I of Part II, Legal Proceedings. Except as described herein, to date, the proceedings reported in LG&E's and KU's respective combined Annual Report on Form 10-K have not changed materially.

#### E.ON-Powergen Transaction

Effective July 1, 2002, E.ON, a Germany company, completed its acquisition of Powergen, following receipt of the final necessary regulatory approval on June 14, 2002 from the Securities and Exchange Commission. E.ON had announced its pre-conditional cash offer of £5.1 billion (\$7.3 billion) for Powergen on April 9, 2001.

#### LG&E Employment Discrimination Claim

In June 2002, alternative amended complaints were filed against LG&E and certain related and unrelated parties whereby approximately 30 employees or former employees claimed past and current instances of employment discrimination. The complaints demand various forms of declarative, injunctive and class action relief, as well as a claim of \$150 million in monetary damages. LG&E has removed the case to the U.S. District Court for the Western District of Kentucky and filed an answer denying all plaintiffs' claims. Certain plaintiffs' claims have completed a process of preliminary administrative review before the U.S. Equal Employment Opportunity Commission, which has, to date, declined to proceed on any of the claims reviewed. LG&E intends to vigorously defend itself in the action and management does not anticipate that the outcome will have a material impact on LG&E's operations or financial condition.

#### Fuel Adjustment Clause Proceedings

In May 2002 the Kentucky Commission granted final approval to the December 21, 2001 comprehensive settlement regarding fuel adjustment clause proceedings involving LG&E and KU and in July 2002 the Kentucky Court of Appeals dismissed the associated appeal. Pursuant to such settlement, LG&E and KU credited customers approximately \$720,000 and \$954,000, respectively, during June and July 2002. See Legal Proceedings under Item 3 of LG&E's and KU's Annual Report on Form 10-K for the year ended December 31, 2001.

#### Other

On April 16, 2002, the LG&E 5% Cumulative Preferred class of stock was delisted from the NASDAQ Small Capitalization Market. On June 3, 2002, the KU 4.75% Cumulative Preferred class of stock was delisted from the Philadelphia Stock Exchange. Delisting will enable the Companies to realize certain administrative and corporate governance efficiencies.

### Item 6(a). Exhibits.

None.

### Item 6(b). Reports on Form 8-K.

None.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Louisville Gas and Electric Company  
Registrant

Date: August 14, 2002

/s/ S. Bradford Rives  
S. Bradford Rives  
Senior Vice President - Finance and Controller  
(On behalf of the registrant in his capacity as  
Principal Accounting Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Kentucky Utilities Company  
Registrant

Date: August 14, 2002

/s/ S. Bradford Rives  
S. Bradford Rives  
Senior Vice President - Finance and Controller  
(On behalf of the registrant in his capacity as  
Principal Accounting Officer)

**SEC Form 10-Q – March 31, 2002**

SECURITIES AND EXCHANGE COMMISSION  
Washington, D. C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2002

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

<u>Commission File Number</u>	<u>Registrant, State of Incorporation, Address, and Telephone Number</u>	<u>IRS Employer Identification No.</u>
2-26720	<b>Louisville Gas and Electric Company</b> (A Kentucky Corporation) 220 West Main Street P.O. Box 32010 Louisville, Ky. 40232 (502) 627-2000	61-0264150
1-3464	<b>Kentucky Utilities Company</b> (A Kentucky and Virginia Corporation) One Quality Street Lexington, Kentucky 40507-1428 (859) 255-2100	61-0247570

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes . No .

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

Louisville Gas and Electric Company  
21,294,223 shares, without par value, as of April 30, 2002,  
all held by LG&E Energy Corp.

Kentucky Utilities Company  
37,817,878 shares, without par value, as of April 30, 2002,  
all held by LG&E Energy Corp.

This combined Form 10-Q is separately filed by Louisville Gas and Electric Company and Kentucky Utilities Company. Information contained herein related to any individual registrant is filed by such registrant on its own behalf. Each registrant makes no representation as to information relating to the other registrants.

TABLE OF CONTENTS

PART I

Item 1	Consolidated Financial Statements	
	Louisville Gas and Electric Company and Subsidiary	
	Statements of Income.....	1
	Balance Sheets.....	2
	Statements of Cash Flows.....	4
	Statements of Retained Earnings.....	5
	Statements of Other Comprehensive Income.....	6
	Kentucky Utilities Company and Subsidiary	
	Statements of Income.....	7
	Balance Sheets.....	8
	Statements of Cash Flows.....	10
	Statements of Retained Earnings.....	11
	Statements of Other Comprehensive Income .....	12
	Notes to Consolidated Financial Statements.....	13
Item 2	Management's Discussion and Analysis of Financial Condition and Results of Operations.....	20
Item 3	Quantitative and Qualitative Disclosures About Market Risk.....	25
PART II		
Item 1	Legal Proceedings.....	26
Item 6	Exhibits and Reports on Form 8-K.....	26
	Signatures.....	27

Part I. Financial Information - Item 1. Financial Statements

**Louisville Gas and Electric Company and Subsidiary**  
 Consolidated Statements of Income  
 (Unaudited)  
 (Thousands of \$)

	Three Months Ended March 31,	
	<u>2002</u>	<u>2001</u>
<b>OPERATING REVENUES:</b>		
Electric (Note 7).....	\$166,246	\$155,374
Gas (Note 7).....	<u>117,119</u>	<u>157,897</u>
Total operating revenues.....	<u>283,365</u>	<u>313,271</u>
<b>OPERATING EXPENSES:</b>		
Fuel for electric generation.....	44,107	38,484
Power purchased.....	23,581	11,341
Gas supply expenses.....	83,467	125,237
Non-recurring charges (Note 4).....	-	144,385
Other operation expenses.....	48,410	35,283
Maintenance.....	12,001	10,555
Depreciation and amortization.....	25,278	25,267
Federal and state income taxes.....	13,237	(38,011)
Property and other taxes.....	<u>4,536</u>	<u>4,462</u>
Total operating expenses.....	<u>254,617</u>	<u>357,003</u>
NET OPERATING INCOME (LOSS).....	28,748	(43,732)
Other income - net.....	1	996
Interest charges.....	<u>7,806</u>	<u>11,379</u>
NET INCOME (LOSS).....	20,943	(54,115)
Preferred stock dividends.....	<u>1,065</u>	<u>1,299</u>
NET INCOME (LOSS) AVAILABLE FOR COMMON STOCK.....	<u>\$ 19,878</u>	<u>\$ (55,414)</u>

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

**Louisville Gas and Electric Company and Subsidiary**  
**Consolidated Balance Sheets**  
(Unaudited)  
(Thousands of \$)  
**ASSETS**

	<u>Mar. 31,</u> <u>2002</u>	<u>Dec. 31,</u> <u>2001</u>
<b>UTILITY PLANT:</b>		
At original cost.....	\$3,444,952	\$3,423,037
Less: reserve for depreciation.....	<u>1,404,277</u>	<u>1,381,874</u>
Net utility plant .....	<u>2,040,675</u>	<u>2,041,163</u>
<b>OTHER PROPERTY AND INVESTMENTS -</b>		
less reserve .....	<u>1,356</u>	<u>1,176</u>
<b>CURRENT ASSETS:</b>		
Cash .....	16,082	2,112
Accounts receivable - less reserve (Note 6).....	120,576	85,667
Materials and supplies - at average cost:		
Fuel (predominantly coal) .....	28,715	22,024
Gas stored underground .....	15,278	46,395
Other .....	28,176	29,050
Prepayments and other.....	<u>4,071</u>	<u>4,688</u>
Total current assets .....	<u>212,898</u>	<u>189,936</u>
<b>DEFERRED DEBITS AND OTHER ASSETS:</b>		
Unamortized debt expense.....	5,269	5,921
Regulatory assets (Note 8).....	169,544	197,142
Other.....	<u>13,686</u>	<u>13,016</u>
Total deferred debits and other assets .....	<u>188,499</u>	<u>216,079</u>
<b>Total assets.....</b>	<u>\$2,443,428</u>	<u>\$2,448,354</u>

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

**Louisville Gas and Electric Company and Subsidiary**  
**Consolidated Balance Sheets (cont.)**  
(Unaudited)  
(Thousands of \$)  
**CAPITALIZATION AND LIABILITIES**

	<u>Mar. 31,</u> <u>2002</u>	<u>Dec. 31,</u> <u>2001</u>
<b>CAPITALIZATION:</b>		
Common stock, without par value -		
Outstanding 21,294,223 shares .....	\$ 425,170	\$ 425,170
Additional paid-in capital .....	40,000	40,000
Retained earnings .....	413,514	393,636
Accumulated other comprehensive income .....	(18,994)	(19,900)
Other .....	(836)	(836)
Total common equity .....	<u>858,854</u>	<u>838,070</u>
Cumulative preferred stock .....	95,140	95,140
Long-term debt (Note 10) .....	370,704	370,704
Total capitalization .....	<u>1,324,698</u>	<u>1,303,914</u>
<b>CURRENT LIABILITIES:</b>		
Current portion of long-term debt .....	246,200	246,200
Notes payable to parent .....	122,553	94,197
Accounts payable .....	87,689	149,070
Dividends declared .....	1,065	1,111
Accrued taxes .....	38,451	20,257
Accrued interest .....	3,819	5,818
Other .....	11,708	11,729
Total current liabilities .....	<u>511,485</u>	<u>528,382</u>
<b>DEFERRED CREDITS AND OTHER LIABILITIES:</b>		
Accumulated deferred income		
taxes .....	299,366	298,143
Investment tax credit, in		
process of amortization .....	57,635	58,689
Accumulated provision for pensions		
and related benefits .....	168,043	167,526
Customer advances for construction .....	9,758	9,745
Regulatory liabilities (Note 8) .....	57,419	65,349
Other .....	15,024	16,606
Total deferred credits and other liabilities .....	<u>607,245</u>	<u>616,058</u>
<b>Total capital and liabilities .....</b>	<b><u>\$2,443,428</u></b>	<b><u>\$2,448,354</u></b>

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

**Louisville Gas and Electric Company and Subsidiary**  
**Consolidated Statements of Cash Flows**  
(Unaudited)  
(Thousands of \$)

	Three Months Ended Mar. 31,	
	<u>2002</u>	<u>2001</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income (loss).....	\$ 20,943	\$ (54,115)
Items not requiring cash currently:		
Depreciation and amortization .....	25,278	25,267
Deferred income taxes - net .....	290	(50,358)
Investment tax credit - net .....	(1,054)	(1,067)
Other .....	10,893	5,074
Changes in current assets and liabilities.....	(32,199)	12,199
Changes in accounts receivable securitization-net (Note 6)..	(22,000)	74,550
Other.....	9,775	79,455
Net cash flows from operating activities .....	<u>11,926</u>	<u>91,005</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of securities.....	(180)	-
Proceeds from sales of securities.....	-	4,225
Construction expenditures.....	(24,947)	(66,227)
Net cash flows from investing activities .....	<u>(25,127)</u>	<u>(62,002)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Issuance of pollution control bonds.....	119,926	-
Retirement of pollution control bonds.....	(120,000)	-
Short-term borrowings.....	58,300	-
Repayment of short-term borrowings.....	(29,944)	(23,136)
Payment of dividends.....	(1,111)	(1,367)
Net cash flows from financing activities .....	<u>27,171</u>	<u>(24,503)</u>
CHANGE IN CASH.....	13,970	4,500
CASH AT BEGINNING OF PERIOD.....	<u>2,112</u>	<u>2,495</u>
CASH AT END OF PERIOD.....	<u>\$ 16,082</u>	<u>\$ 6,995</u>
<b>SUPPLEMENTAL DISCLOSURES:</b>		
Cash paid during the period for:		
Income taxes .....	\$ -	\$ (4,226)
Interest on borrowed money .....	8,356	9,963

For the purposes of these statements, all temporary cash investments purchased with a maturity of three months or less are considered cash equivalents.

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

**Louisville Gas and Electric Company and Subsidiary**  
**Consolidated Statements of Retained Earnings**  
(Unaudited)  
(Thousands of \$)

	Three Months Ended March 31,	
	<u>2002</u>	<u>2001</u>
Balance at beginning of period .....	\$393,636	\$314,594
Net income (loss) .....	<u>20,943</u>	<u>(54,115)</u>
Subtotal .....	<u>414,579</u>	<u>260,479</u>
Cash dividends declared on stock:		
5% cumulative preferred .....	269	269
Auction rate cumulative preferred .....	429	663
\$5.875 cumulative preferred .....	<u>367</u>	<u>367</u>
Subtotal .....	<u>1,065</u>	<u>1,299</u>
Balance at end of period .....	<u>\$413,514</u>	<u>\$259,180</u>

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

**Louisville Gas and Electric Company and Subsidiary**  
**Consolidated Statements of Other Comprehensive Income**  
(Unaudited)  
(Thousands of \$)

	Three Months Ended March 31,	
	<u>2002</u>	<u>2001</u>
Net income (loss).....	\$20,943	\$(54,115)
Cumulative effect of change in accounting principle - Accounting For Derivative Instruments and Hedging Activities (Note 5) .....	-	(5,998)
Gains (Losses) on derivative instruments and hedging activities (Note 5).....	<u>1,509</u>	<u>(2,035)</u>
Other comprehensive income (loss), before tax.....	1,509	(8,033)
Income tax benefit (expense) related to items of other comprehensive income (loss) .....	<u>(603)</u>	<u>3,213</u>
Other comprehensive income (loss).....	<u>\$ 21,849</u>	<u>\$(58,935)</u>

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

**Kentucky Utilities Company and Subsidiary**  
Consolidated Statements of Income  
(Unaudited)  
(Thousands of \$)

	Three Months Ended March 31,	
	<u>2002</u>	<u>2001</u>
OPERATING REVENUES (Note 7).....	\$215,168	\$211,793
OPERATING EXPENSES:		
Fuel for electric generation.....	58,271	55,928
Power purchased.....	41,060	32,885
Non-recurring charges (Note 4).....	-	63,788
Other operation expenses.....	34,522	26,618
Maintenance.....	11,559	11,970
Depreciation and amortization.....	23,059	23,828
Federal and state income taxes.....	14,383	(6,450)
Property and other taxes.....	4,114	4,155
Total operating expenses.....	<u>186,968</u>	<u>212,722</u>
NET OPERATING INCOME (LOSS).....	28,200	(929)
Other income - net.....	1,639	1,793
Interest charges (Note 5).....	<u>5,482</u>	<u>8,117</u>
NET INCOME (LOSS)before Cumulative Effect of Accounting Change.....	24,357	(7,253)
Cumulative Effect of Change in Accounting for Derivative Instruments and Hedging Activities, net of tax.....	<u>-</u>	<u>136</u>
NET INCOME (LOSS).....	24,357	(7,117)
Preferred stock dividends.....	<u>564</u>	<u>564</u>
NET INCOME (LOSS) AVAILABLE FOR COMMON STOCK.....	<u>\$ 23,793</u>	<u>\$ (7,681)</u>

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

**Kentucky Utilities Company and Subsidiary**  
**Consolidated Balance Sheets**  
(Unaudited)  
(Thousands of \$)  
**ASSETS**

	<u>Mar. 31,</u> <u>2002</u>	<u>Dec. 31,</u> <u>2001</u>
<b>UTILITY PLANT:</b>		
At original cost.....	\$3,087,542	\$3,064,220
Less: reserve for depreciation.....	<u>1,481,695</u>	<u>1,457,754</u>
Net utility plant .....	<u>1,605,847</u>	<u>1,606,466</u>
<b>OTHER PROPERTY AND INVESTMENTS -</b>		
less reserve .....	<u>9,859</u>	<u>9,629</u>
<b>CURRENT ASSETS:</b>		
Cash and temporary cash investments.....	5,292	3,295
Accounts receivable - less reserve (Note 6).....	79,070	45,291
<b>Materials and supplies - at average cost:</b>		
Fuel (predominantly coal) .....	46,034	43,382
Other .....	26,729	26,188
Prepayments and other.....	<u>6,057</u>	<u>4,942</u>
Total current assets .....	<u>163,182</u>	<u>123,098</u>
<b>DEFERRED DEBITS AND OTHER ASSETS:</b>		
Unamortized debt expense.....	4,233	4,316
Regulatory assets (Note 8).....	61,511	66,467
Other.....	<u>15,701</u>	<u>16,926</u>
Total deferred debits and other assets .....	<u>81,445</u>	<u>87,709</u>
<b>Total assets.....</b>	<b><u>\$1,860,333</u></b>	<b><u>\$1,826,902</u></b>

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

**Kentucky Utilities Company and Subsidiary**  
**Consolidated Balance Sheets (cont.)**  
(Unaudited)  
(Thousands of \$)  
**CAPITALIZATION AND LIABILITIES**

	<u>Mar. 31,</u> <u>2002</u>	<u>Dec. 31,</u> <u>2001</u>
<b>CAPITALIZATION:</b>		
Common stock, without par value - Outstanding 37,817,878 shares .....	\$ 308,140	\$ 308,140
Additional paid-in capital.....	15,000	15,000
Retained earnings.....	434,689	410,896
Accumulated other comprehensive income.....	1,588	1,588
Other.....	(595)	(595)
Total common equity .....	<u>758,822</u>	<u>735,029</u>
Cumulative preferred stock.....	40,000	40,000
Long-term debt (Note 5).....	<u>432,892</u>	<u>434,506</u>
Total capitalization.....	<u>1,231,714</u>	<u>1,209,535</u>
<b>CURRENT LIABILITIES:</b>		
Current portion of long-term debt.....	54,000	54,000
Notes payable to parent.....	64,190	47,790
Accounts payable.....	64,132	85,149
Accrued taxes.....	36,249	20,520
Accrued interest.....	4,947	5,668
Other.....	16,458	16,482
Total current liabilities .....	<u>239,976</u>	<u>229,609</u>
<b>DEFERRED CREDITS AND OTHER LIABILITIES:</b>		
Accumulated deferred income taxes .....	237,723	239,204
Investment tax credit, in process of amortization.....	10,716	11,455
Accumulated provision for pensions and related benefits .....	91,824	91,235
Customer advances for construction.....	1,498	1,526
Regulatory liabilities (Note 8).....	32,972	33,889
Other.....	13,910	10,449
Total deferred credits and other liabilities .....	<u>388,643</u>	<u>387,758</u>
<b>Total capital and liabilities.....</b>	<b><u>\$1,860,333</u></b>	<b><u>\$1,826,902</u></b>

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

**Kentucky Utilities Company and Subsidiary**  
**Consolidated Statements of Cash Flows**  
(Unaudited)  
(Thousands of \$)

	Three Months Ended March 31,	
	<u>2002</u>	<u>2001</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income (loss).....	\$ 24,357	\$ (7,117)
Items not requiring cash currently:		
Depreciation and amortization.....	23,059	23,828
Deferred income taxes - net.....	(2,406)	(28,166)
Investment tax credit - net.....	(739)	(862)
Other.....	1,233	1,654
Changes in current assets and liabilities.....	(19,020)	(1,502)
Changes in accounts receivable securitization-net (Note 6)..	(25,100)	50,000
Other.....	8,388	41,947
Net cash flows from operating activities.....	<u>9,772</u>	<u>79,782</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Construction expenditures.....	(23,611)	(60,302)
Net cash flows from investing activities.....	<u>(23,611)</u>	<u>(60,302)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Short-term borrowings.....	174,869	99,325
Repayment of short-term borrowings.....	(158,469)	(114,375)
Payment of dividends.....	(564)	(564)
Net cash flows from financing activities.....	<u>15,836</u>	<u>(15,614)</u>
<b>CHANGE IN CASH AND TEMPORARY</b>		
<b>CASH INVESTMENTS</b> .....	1,997	3,866
<b>CASH AND TEMPORARY CASH INVESTMENTS AT</b>		
<b>BEGINNING OF PERIOD</b> .....	<u>3,295</u>	<u>314</u>
<b>CASH AND TEMPORARY CASH INVESTMENTS AT</b>		
<b>END OF PERIOD</b> .....	<u>\$ 5,292</u>	<u>\$ 4,180</u>
<b>SUPPLEMENTAL DISCLOSURES:</b>		
Cash paid during the period for:		
Income taxes.....	\$ -	\$ 3,894
Interest on borrowed money.....	6,101	7,116

For the purposes of these statements, all temporary cash investments purchased with a maturity of three months or less are considered cash equivalents.

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

**Kentucky Utilities Company and Subsidiary**  
**Consolidated Statements of Retained Earnings**  
(Unaudited)  
(Thousands of \$)

Three Months  
Ended March 31,

	<u>2002</u>	<u>2001</u>
Balance at beginning of period .....	\$410,896	\$347,238
Net income (loss) .....	<u>24,357</u>	<u>(7,117)</u>
Subtotal .....	<u>435,253</u>	<u>340,121</u>
Cash dividends declared on stock:		
4.75% preferred .....	237	237
6.53% preferred .....	<u>327</u>	<u>327</u>
Subtotal .....	<u>564</u>	<u>564</u>
Balance at end of period .....	<u>\$434,689</u>	<u>\$339,557</u>

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

**Kentucky Utilities Company and Subsidiary**  
**Consolidated Statements of Other Comprehensive Income**  
(Unaudited)  
(Thousands of \$)

	Three Months Ended March 31,	
	<u>2002</u>	<u>2001</u>
Net income (loss).....	\$24,357	\$(7,117)
Cumulative effect of change in accounting principle-Accounting for Derivative Instruments and Hedging activities (Note 5).....	-	<u>2,647</u>
Other comprehensive income, before tax.....	-	2,647
Income tax (expense) related to items of other comprehensive income.....	-	<u>(1,059)</u>
Other comprehensive income (loss).....	<u>\$24,357</u>	<u>\$(5,529)</u>

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

**Louisville Gas and Electric Company and Subsidiary  
Kentucky Utilities Company and Subsidiary**

**Notes to Consolidated Financial Statements  
(Unaudited)**

1. The unaudited consolidated financial statements include the accounts of Louisville Gas and Electric Company and Subsidiary and Kentucky Utilities Company and Subsidiary ("LG&E" and "KU" or the "Companies"). The common stock of each of LG&E and KU is wholly owned by LG&E Energy Corp. ("LG&E Energy"). In the opinion of management, the unaudited interim data includes all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of consolidated financial position, results of operations, comprehensive income and cash flows for the periods indicated. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to SEC rules and regulations, although the Companies believe that the disclosures are adequate to make the information presented not misleading.

See LG&E's and KU's Reports on Form 10-K for 2001 for information relevant to the accompanying financial statements, including information as to the significant accounting policies of the Companies.

2. On December 11, 2000, LG&E Energy Corp. was acquired by Powergen plc for cash of approximately \$3.2 billion or \$24.85 per share and the assumption of all of LG&E Energy's debt. As a result of the acquisition, among other things, LG&E Energy became a wholly-owned indirect subsidiary of Powergen and, as a result, LG&E and KU became indirect subsidiaries of Powergen. The utility operations (LG&E and KU) of LG&E Energy have continued their separate identities and continue to serve customers in Kentucky and Virginia under their existing names. The preferred stock and debt securities of the utility operations were not affected by this transaction resulting in the utility operations' obligations to continue to file SEC reports. Following the acquisition, Powergen became a registered holding company under the Public Utility Holding Company Act (PUHCA), and LG&E and KU, as subsidiaries of a registered holding company, became subject to additional regulation under PUHCA.

As a result of the Powergen acquisition and in order to comply with PUHCA, LG&E Energy Services Inc. ("LG&E Services") was formed and became operational on January 1, 2001. LG&E Services provides certain services to affiliated entities, including LG&E and KU, at cost, as required under PUHCA. On January 1, 2001, approximately 1,000 employees, primarily from LG&E Energy, LG&E and KU, were moved to LG&E Services.

3. On April 9, 2001, a German power company, E.ON AG ("E.ON"), announced a pre-conditional cash offer of £5.1 billion (\$7.3 billion) for Powergen. The offer is subject to a number of conditions, including the receipt of certain European and United States regulatory approvals. The Kentucky Public Service Commission ("Kentucky Commission"), the Federal Regulatory Energy Commission ("FERC"), the Virginia State Corporation Commission, and the Tennessee Regulatory Authority have all approved the acquisition of Powergen and LG&E Energy by E.ON. The parties expect to obtain the remaining regulatory approvals during the first half of 2002 and they expect to complete the transaction during this time frame.

On April 19, 2002, Powergen plc shareholders voted in favor of the acquisition of Powergen by E.ON. The vote in favor of such resolutions enables the deal to proceed by way of a scheme of arrangement. Such procedure is anticipated to allow E.ON to obtain full equity in Powergen upon completion.

4. During the first quarter 2001, LG&E recorded a \$144 million charge and KU recorded a \$64 million charge for a workforce reduction program. Primary components of the charge were separation benefits, enhanced early retirement benefits, and health care benefits. The result of this workforce reduction was the elimination of over 1,100 positions, accomplished primarily through a voluntary enhanced severance program.

On June 1, 2001, LG&E and KU filed an application (VDT case) with the Kentucky Commission to create a regulatory asset relating to these first quarter 2001 charges. The application requested permission to amortize these costs over a four-year period. The Kentucky Commission also opened a case to review the new depreciation study and resulting depreciation rates implemented in 2001.

LG&E and KU reached a settlement in the VDT case as well as the other cases involving depreciation rates and the Earnings Sharing Mechanism with all intervening parties. The settlement agreement was approved by the Kentucky Commission on December 3, 2001.

The Kentucky Commission December 3, 2001 order allowed LG&E to set up a regulatory asset of \$141 million for the workforce reduction costs and begin amortizing these costs over a five year period starting in April 2001. The first quarter charge of \$144 million represented all employees who had accepted a voluntary enhanced severance program. Between the time of the original filing and the December 3, 2001 order, some employees rescinded their participation in the voluntary enhanced severance program, thereby decreasing the original charge from \$144 million to \$141 million. The settlement will also reduce revenues by approximately \$26 million through a surcredit on future bills to customers over the same five year period. The surcredit represents stipulated net savings LG&E is expected to realize from implementation of best practices through the value delivery process. The agreement also established LG&E's new depreciation rates in effect retroactive to January 1, 2001. The new depreciation rates decreased depreciation expense by \$5.6 million in 2001.

The Kentucky Commission December 3, 2001, order allowed KU to set up a regulatory asset of \$54 million for the workforce reduction costs and begin amortizing these costs over a five year period starting in April 2001. The first quarter charge of \$64 million represented all employees who had accepted a voluntary enhanced severance program. Some employees rescinded their participation in the voluntary enhanced severance program and, along with the non-recurring charge of \$6.9 million for FERC and Virginia jurisdictions, thereby decreasing the original charge from \$64 million to \$54 million. The settlement will also reduce revenues by approximately \$11 million through a surcredit on future bills to customers over the same five year period. The surcredit represents stipulated net savings KU is expected to realize from implementation of best practices through the value delivery process. The agreement also established KU's new depreciation rates in effect December 2001, retroactive to January 1, 2001. The new depreciation rates decreased depreciation expense by \$6.0 million in 2001.

5. Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities*, establishes accounting and reporting standards requiring that every derivative instrument (including certain derivative instruments embedded in other contracts) be recorded on the balance sheet as either an asset or a liability measured at its fair value. SFAS No. 133 requires that changes in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. Special accounting for qualifying hedges allows a derivative's gains and losses to offset related results on the hedged item in the income statement, and requires that LG&E and KU must formally document, designate, and assess the effectiveness of transactions that receive hedge accounting. SFAS No. 133 could increase the volatility in earnings and other comprehensive income. LG&E and KU adopted SFAS No. 133 on January 1, 2001. The effect of adopting this statement in 2001 resulted in a \$3.6 million (net of tax of \$2.4 million) decrease in other comprehensive income from a cumulative effect of change in accounting principle for LG&E and a \$1.6 million (net of tax of \$1.1 million) increase in other comprehensive income from a cumulative effect of change in accounting principle for KU.

The Companies use interest rate swaps to hedge exposure to market fluctuations in certain of their debt instruments. Pursuant to Company policy, use of these financial instruments is intended to mitigate risk and earnings volatility and is not speculative in nature. Management has designated all of the Companies' interest rate swaps as hedge instruments. Financial instruments designated as cash flow hedges have resulting gains and losses recorded within other comprehensive income and stockholders' equity. To the extent a financial instrument or the underlying item being hedged is prematurely terminated or the hedge becomes ineffective, the resulting gains or losses are reclassified from other comprehensive income to net income. Financial instruments designated as fair value hedges are periodically marked to market

with the resulting gains and losses recorded directly into net income to correspond with income or expense recognized from changes in market value of the items being hedged.

As of March 31, 2002, LG&E had fixed rate swaps covering \$117,335,000 in notional amounts of variable rate debt and with fixed rates ranging from 4.184% to 5.495%. The average variable rate on the debt during the quarter was 1.41%. The swaps have been designated as cash flow hedges and expire on various dates from September 2003 through November 2020. The hedges were deemed to be fully effective resulting in pre-tax gain for the quarter ended March 31, 2002 of \$1.5 million, recorded in Other Comprehensive Income. Upon expiration of these hedges, the amount recorded in Other Comprehensive Income will be reclassified into earnings. The amount expected to be reclassified from Other Comprehensive Income to earnings in the next twelve months is immaterial.

As of March 31, 2002, KU had variable rate swaps covering \$153,000,000 in notional amounts of fixed rate debt. The average variable rate on these swaps during the quarter was 2.42%. The underlying debt has fixed rates ranging from 5.75% to 7.92%. The swaps have been designated as fair value hedges and expire on various dates from May 2007 through June 2025. During the quarter ended March 31, 2002, the effect of marking these financial instruments and the underlying debt to market resulted in pretax gains of \$1.8 million, recorded as a reduction in interest expense.

6. SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, revises the standards for accounting for securitizations and other transfers of financial assets and collateral and requires certain disclosures, and provides accounting and reporting standards for transfers and servicing of financial assets and extinguishments of liabilities. The Companies adopted SFAS No. 140 in the first quarter of 2001, when LG&E and KU entered into an accounts receivable securitization transaction.

On February 6, 2001, LG&E and KU implemented an accounts receivable securitization program. The purpose of this program is to enable the utilities to accelerate the receipt of cash from the collection of retail accounts receivable, thereby reducing dependence upon more costly sources of working capital. The securitization program allows for a percentage of eligible receivables to be sold. Eligible receivables are generally all receivables associated with retail sales that have standard terms and are not past due. LG&E and KU are able to terminate these programs at any time without penalty. If there is a significant deterioration in the payment record of the receivables by retail customers or if the Companies fail to meet certain covenants of the program, the program may terminate at the election of the financial institutions. In this case, payments from retail customers would first be used to repay the financial institutions participating in the program, and would then be available for use by the Companies.

As part of the program, LG&E and KU sold retail accounts receivables to wholly owned subsidiaries, LG&E Receivables LLC ("LG&E R") and KU Receivables LLC ("KU R"). Simultaneously, LG&E R and KU R entered into two separate three-year accounts receivable securitization facilities with two financial institutions and their affiliates whereby LG&E R and KU R can sell, on a revolving basis, an undivided interest in certain of their receivables and receive up to \$75 million and \$50 million, respectively, from an unrelated third party purchaser. The effective cost of the receivables programs is comparable to LG&E and KU's lowest cost source of capital, and is based on prime rated commercial paper. LG&E and KU retain servicing rights of the sold receivables through separate servicing agreements with the third party purchasers. LG&E and KU have obtained opinions from independent legal counsel indicating these transactions qualify as true sales of receivables. As of March 31, 2002 and December 31, 2001, LG&E's outstanding program balance was \$20.0 million and \$42.0 million, respectively, and KU's balance at March 31, 2002 and December 31, 2001 was \$20.0 million and \$45.1 million, respectively.

Management expects to renew these facilities when they expire.

The allowance for doubtful accounts associated with the eligible securitized receivables was \$1.6 million and \$1.3 million for LG&E and \$0.5 million and \$0.5 million for KU

at March 31, 2002 and December 31, 2001, respectively. Charge offs were immaterial for LG&E and KU. The risk of uncollectibility associated with the sold receivables is minimal. Moreover, each securitization facility contains a fully funded reserve for uncollectible receivables.

7. External and intersegment revenues (related parties transactions between LG&E and KU) and income by business segment for the three months ended March 31, 2002, follow (in thousands of \$):

	External Revenues	Inter- segment Revenues	Net Income/ (Loss) Avail. For Common
LG&E electric	\$ 153,193	\$ 13,053	\$ 10,178
LG&E gas	117,119	-	9,700
Total	<u>\$ 270,312</u>	<u>\$ 13,053</u>	<u>\$ 19,878</u>
 KU electric	 <u>\$ 200,387</u>	 <u>\$ 14,781</u>	 <u>\$ 23,793</u>

External and intersegment revenues (related parties transactions between LG&E and KU) and income by business segment for the three months ended March 31, 2001, follow (in thousands of \$):

	External Revenues	Inter- segment Revenues	Net Income/ (Loss), Avail. For Common
LG&E electric	\$ 148,361	\$ 7,013	\$ (44,443)
LG&E gas	157,897	-	(10,971)
Total	<u>\$ 306,258</u>	<u>\$ 7,013</u>	<u>\$ (55,414)</u>
 KU electric	 <u>\$ 206,111</u>	 <u>\$ 5,682</u>	 <u>\$ (7,681)</u>

8. The following regulatory assets and liabilities were included in the balance sheet of LG&E and KU as of March 31, 2002 and December 31, 2001 (in thousands of \$):

Louisville Gas and Electric

	(Unaudited)	
	Mar. 31, 2002	Dec. 31, 2001
<u>REGULATORY ASSETS:</u>		
VDT costs.....	\$ 120,029	\$ 127,529
Unamortized loss on bonds.....	18,262	17,902
Gas supply adjustments due from customers.....	13,772	30,135
LG&E/KU merger costs.....	4,537	5,444
One utility costs.....	2,971	3,643
Manufactured gas sites.....	1,987	2,062
Other.....	7,986	10,427
Total .....	<u>169,544</u>	<u>197,142</u>
<u>REGULATORY LIABILITIES:</u>		
Deferred income taxes - net.....	47,770	48,703
Gas supply adjustments due to customers.....	8,879	15,702
Other.....	770	944
Total .....	<u>\$ 57,419</u>	<u>\$ 65,349</u>

Kentucky Utilities

	(Unaudited)	
	Mar. 31, 2002	Dec. 31, 2001

REGULATORY ASSETS:

VDT costs.....	\$ 45,936	\$ 48,811
Unamortized loss on bonds.....	5,925	6,142
LG&E/KU merger costs.....	5,116	6,139
One utility costs.....	3,492	4,365
Other.....	1,042	1,010
Total.....	<u>61,511</u>	<u>66,467</u>

REGULATORY LIABILITIES:

Deferred income taxes - net.....	31,947	32,872
Other.....	1,025	1,017
Total.....	<u>\$ 32,972</u>	<u>\$ 33,889</u>

9. Statements of Financial Accounting Standards ("SFAS") No. 141, *Business Combinations* and No. 142, *Goodwill and Other Intangible Assets* were issued in the second quarter of 2001. SFAS No. 141 requires all business combinations initiated after June 30, 2001, to be accounted for using the purchase method. SFAS No. 142 requires goodwill to be recorded, but not amortized. Further, goodwill will now be subject to a periodic assessment for impairment. LG&E and KU have no recorded goodwill and have no merger or acquisitions in progress. Accordingly, the provisions of these new pronouncements were effective July 1, 2001, for LG&E and KU. The Companies experienced no impact on financial position or results of operations as a result of adopting these standards.

SFAS No. 143, *Accounting for Asset Retirement Obligations* and SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, were also issued during 2001. SFAS No. 143 establishes accounting and reporting standards for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. SFAS No. 144 supersedes SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of* and the accounting and reporting provisions of APB Opinion No. 30, *Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*. SFAS No. 144, among other provisions, eliminates the requirement of SFAS No. 121 to allocate goodwill to long-lived assets to be tested for impairment. The effective implementation date as it relates to the Companies for SFAS No. 144 is January 1, 2002 and SFAS No. 143 is January 1, 2003. SFAS No. 144 had no current impact on the financial position or results of operations of LG&E or KU. Management has not determined what impact SFAS No. 143 will have on the financial position or results of operations of the Companies.

The Financial Accounting Standards Board created the Derivatives Implementation Group ("DIG") to provide guidance for implementation of SFAS No. 133. DIG Issue C15, *Normal Purchases and Normal Sales Exception for Option Type Contracts and Forward Contracts in Electricity* was adopted in 2001 and had no impact on results of operations and financial position. DIG Issue C16, *Applying the Normal Purchase and Normal Sales Exception to Contracts that Combine a Forward Contract and a Purchased Option Contract*, was cleared in the third quarter 2001 and stated that option contracts do not meet the normal purchases and normal sales exception and should follow SFAS No. 133. DIG Issue C16 will be effective in the second quarter of 2002. The Companies have reviewed their contracts for options and determined that DIG Issue C16 does apply, but the adoption of DIG Issue C16 will not have a material impact on the financial position or results of operations of the Companies pursuant to regulatory treatment prescribed by SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*.

10. On March 22, 2002, LG&E refinanced two \$35 million unsecured pollution control bonds due November 1, 2027. The replacement variable rate bonds are secured by first mortgage bonds and will mature November 1, 2027. The variable rate will be established by the remarketing agent taking into account market conditions in the commercial paper market.

On March 6, 2002, LG&E refinanced \$22.5 million and \$27.5 million in unsecured pollution control bonds, both due September 1, 2026. The replacement bonds, due September 1, 2026, are variable rate bonds and are secured by first mortgage bonds. The vari-

able rate will be established by the remarketing agent taking into account market conditions in the commercial paper market.

11. In the normal course of business, lawsuits, claims, environmental actions, and various non-ratemaking governmental proceedings arise against LG&E and KU. To the extent that damages are assessed in any of these lawsuits, LG&E and KU believe that their insurance coverage is adequate. Management, after consultation with legal counsel, does not anticipate that liabilities arising out of other currently pending or threatened lawsuits and claims of the type referenced above will have a material adverse effect on LG&E's or KU's consolidated financial position or results of operations, respectively.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

General

The following discussion and analysis by management focuses on those factors that had a material effect on LG&E's and KU's financial results of operations and financial condition during the three month period ended March 31, 2002 and should be read in connection with the financial statements and notes thereto.

Some of the following discussion may contain forward-looking statements that are subject to certain 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 vary materially. Factors that could cause actual results to differ materially include: 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; and other factors described from time to time in LG&E's and KU's reports to the Securities and Exchange Commission, including Exhibit No. 99.01 to the report on Form 10-K for year ended December 31, 2001.

Results of Operations

The results of operations for LG&E and KU are affected by seasonal fluctuations in temperature and other weather-related factors. Because of these and other factors, the results of one interim period are not necessarily indicative of results or trends to be expected for the full year.

Three Months Ended March 31, 2002, Compared to  
Three Months Ended March 31, 2001

LG&E Results:

LG&E's net income increased \$75.1 million for the quarter ended March 31, 2002, as compared to the quarter ended March 31, 2001, primarily because of a non-recurring charge of \$86.1 million, net of tax, for LG&E's workforce reduction program incurred in 2001. Excluding this one-time charge, LG&E's net income would have decreased \$11.0 million primarily due to amortization expenses associated with LG&E's workforce reduction program and higher pension and fuel costs.

A comparison of LG&E's revenues for the quarter ended March 31, 2002, with the quarter ended March 31, 2001, reflects increases and (decreases) which have been segregated by the following principal causes (in thousands of \$):

<u>Cause</u>	<u>Electric Revenues</u>	<u>Gas Revenues</u>
Retail sales:		
Fuel and gas supply adjustments .....	\$ (698)	\$ (40,932)
Environmental cost recovery surcharge .....	1,646	-
Demand side management cost recovery .....	52	422
LG&E/KU merger surcredit .....	(204)	-
Value delivery surcredit .....	(237)	(122)
Variation in sales volume, etc. ....	<u>(2,341)</u>	<u>(10,296)</u>
Total retail sales .....	(1,782)	(50,928)
Wholesale sales.....	13,101	10,022
Gas transportation - net.....	-	189
Other.....	<u>(447)</u>	<u>(61)</u>
Total .....	<u>\$ 10,872</u>	<u>\$ (40,778)</u>

Electric revenues increased primarily because of an increase in wholesale sales volumes (\$27.6 million) partially offset by a decrease in wholesale sales prices (\$14.5 million). Gas revenues decreased primarily as a result of lower gas supply costs billed to customers through the gas supply clause and decreased volumes sold in the first quarter of 2002 due to an 18% decrease in heating-degree days.

Fuel for electric generation and gas supply expenses comprise a large portion of LG&E's total operating expenses. LG&E's electric and gas rates contain a fuel adjustment clause and a gas supply clause, respectively, whereby increases or decreases in the cost of fuel and gas supply may be reflected in retail rates, subject to the approval of the Kentucky Commission. Fuel for electric generation increased \$5.6 million (15%) for the quarter because of an increase in volume of generation (\$3.2 million) and an increase in the cost of coal burned (\$2.4 million). Gas supply expenses decreased \$41.8 million (33%) due to a decrease in net gas supply cost (\$36.4 million), and a decrease in the volume of retail gas delivered to the distribution system (\$13.6 million), partially offset by increased wholesale gas expenses (\$8.2 million).

Power purchased increased \$12.2 million (108%) primarily because of an increase in volume of purchases to support increased wholesale sales (\$14 million) partially offset by a decrease in cost of power purchased (\$1.8 million).

The decrease in non-recurring charges of \$144.4 million, \$86.1 million after tax is due to the costs associated with LG&E's workforce reduction initiative. (See Note 4).

Other operations expenses increased \$13.1 million (37%) in 2002, as compared to 2001, primarily due to amortization expenses associated with LG&E's workforce reduction program (\$7.5 million), higher pension expenses (\$2.7 million), and higher costs for electric transmission (\$1.7 million).

Maintenance expenses increased \$1.4 million (14%) in 2002 primarily due to increased repairs to steam production (\$0.9 million) and maintenance to electric distribution plant (\$0.3 million).

Other income-net decreased \$1 million (100%) in 2002 primarily due to increases in repairs to non-utility property(\$0.5 million), and a decrease in gains recorded on the sale of non-utility property (\$0.4 million).

Variations in income tax expense are largely attributable to changes in pre-tax income.

Interest charges decreased \$3.6 million (31%) due to lower interest rates on variable rate long term debt (\$2.0 million), a decrease in interest on debt to parent company (\$0.6 million) and a decrease in interest associated with LG&E's accounts receivable securitization program (\$1.1 million).

#### KU Results:

KU's net income increased \$31.5 million for the quarter ended March 31, 2002, as compared to the quarter ended March 31, 2001. The increase was primarily due to a non-recurring charge of \$38.0 million, net of tax, made in the first quarter of 2001 for costs associated with KU's workforce reduction program. Excluding this one-time charge, net income decreased \$6.5 million, due largely to increased operations and purchased power expense, partially offset by decreased interest expense.

A comparison of KU's revenues for the quarter ended March 31, 2002, with the quarter ended March 31, 2001, reflects increases and (decreases) which have been segregated by the following principal causes (in thousands of \$):

#### Retail sales:

Fuel supply adjustments .....	\$ 5,133
Environmental cost recovery surcharge .....	1,510
Demand side management cost recovery .....	784
LG&E/KU merger surcredit .....	(1,025)
Value delivery surcredit .....	(189)

Variation in sales volume, etc. ....	<u>(3,814)</u>
Total retail sales .....	2,399
Wholesale sales.....	(305)
Other.....	<u>1,281</u>
Total	<u>\$ 3,375</u>

Electric revenues increased primarily due to increased price of sales to retail customers.

Fuel for electric generation comprises a large portion of KU's total operating expenses. KU's electric rates contain a Fuel Adjustment Clause, whereby increases or decreases in the cost of fuel are reflected in retail rates, subject to the approval of the Kentucky Public Service Commission, the Virginia State Corporation Commission, and the Federal Energy Regulatory Commission. Fuel for electric generation increased \$2.3 million (4%) for the quarter due to a \$5.3 million increase in the cost of coal burned partially offset by a decrease of \$3.0 million in volume burned.

Power purchased increased \$8.2 million (25%) in 2002 primarily because of an increase in volumes purchased (\$11.6 million) partially offset by a decrease in price (\$3.4 million).

Non-recurring charges decreased \$63.8 million, \$38.0 million after tax. These costs were due to KU's workforce reduction program. (See Note 4).

Other operations expenses increased \$7.9 million (30%) as compared to 2001, primarily due to amortization expenses associated with KU's workforce reduction program (\$2.9 million), higher pension expenses (\$1.2 million), higher costs for electric transmission (\$1.4 million) and increases in uncollectible accounts and customer assistance programs (\$1.9 million).

Variations in income tax expense are largely attributable to changes in pretax income.

Interest charges decreased \$2.6 million (32%) for the first quarter 2002 as compared to the first quarter 2001 due to lower rates on variable rate debt (\$2.2 million) and a decrease in interest associated with KU's accounts receivable securitization program (\$0.6 million).

#### Liquidity and Capital Resources

LG&E's and KU's need for capital funds are largely related to the construction of plant and equipment necessary to meet the needs of electric and gas utility customers. Lines of credit, the accounts receivable securitization programs, and commercial paper programs are maintained to fund short-term capital requirements.

Construction expenditures for the three months ended March 31, 2002 for LG&E and KU amounted to \$24.9 million and \$23.6 million, respectively. Such expenditures related primarily to construction to meet nitrogen oxide (NOx) emission standards, and were financed with internally generated funds and accounts receivable securitization program funds. Also, no common dividends have been paid by LG&E or KU for the three months ended March 31, 2002. See Note 6 of Notes to Financial Statements concerning accounts receivable securitization.

LG&E's and KU's combined cash and temporary cash investment balance increased \$16.0 million (LG&E \$14.0 million, KU \$2.0 million) during the three months ended March 31, 2002. The increase reflects cash flows from operations and short term borrowings, partially offset by construction expenditures.

Variations in accounts receivable, accounts payable and materials and supplies are generally not significant indicators of LG&E's and KU's liquidity. Such variations are primarily attributable to fluctuations in weather, which have a direct effect on sales of electricity and natural gas. The increases in accounts receivable resulted primarily from seasonal fluctuations and the reduced sales of accounts receivable through LG&E and KU's

accounts receivable securitization program. See Note 6 of Notes to Financial Statements. The increase in fuel inventory resulted from seasonal fluctuations at LG&E and KU, and the decrease in LG&E's gas stored underground resulted from seasonal fluctuations.

LG&E and KU participate in a money pool whereby LG&E Energy can make funds available to LG&E and KU at market-based rates up to \$200 million each. LG&E Energy maintains a facility of \$200 million with a Powergen subsidiary to ensure funding availability for the money pool. There is no balance outstanding under the Powergen line of credit as of March 31, 2002 and no outstanding commercial paper program balance. LG&E Energy has provided loans to LG&E and KU through the money pool that total \$122.6 million and \$64.2 million, respectively, as of March 31, 2002. These borrowings carried a commercial paper grade interest rate of 1.80% at March 31, 2002.

On March 6, 2002, LG&E refinanced its \$22.5 million and \$27.5 million unsecured pollution control bonds, both due September 1, 2026. The replacement bonds, due September 1, 2026, are variable rate bonds and are secured by first mortgage bonds.

On March 22, 2002, LG&E refinanced its two \$35 million unsecured pollution control bonds due November 1, 2027. The replacement variable rate bonds are secured by first mortgage bonds and will mature November 1, 2027.

LG&E's security ratings as of March 31, 2002, were:

	<u>Moody's</u>	<u>S&amp;P</u>	<u>Fitch</u>
First mortgage bonds	A1	A-	A+
Preferred stock	a2	BBB-	A-
Commercial paper	P-1	A-2	F-1

KU's security ratings as of March 31, 2002, were:

	<u>Moody's</u>	<u>S&amp;P</u>	<u>Fitch</u>
First mortgage bonds	A1	A-	A+
Preferred stock	a2	BBB-	A-
Commercial paper	P-1	A-2	F-1

The S&P ratings of LG&E's and KU's debt securities are on Credit Watch for upgrade as the result of the E.ON bid. Fitch has placed LG&E and KU on credit watch evolving following the E.ON bid. These ratings reflect the views of Moody's, S&P and Fitch. 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.

LG&E's capitalization ratios at March 31, 2002, and December 31, 2001, follow:

	<u>Mar. 31,</u> <u>2002</u>	<u>Dec. 31,</u> <u>2001</u>
Long-term debt (including current portion)	36.5%	37.5%
Notes payable	7.2	5.7
Preferred stock	5.6	5.8
Common equity	<u>50.7</u>	<u>51.0</u>
Total	<u>100.0%</u>	<u>100.0%</u>

KU's capitalization ratios at March 31, 2002, and December 31, 2001, follow:

	Mar. 31, 2001	Dec. 31, 2001
Long-term debt (including current portion)	36.0%	37.2%
Notes payable	4.8	3.6
Preferred stock	3.0	3.1
Common equity	56.2	56.1
Total	<u>100.0%</u>	<u>100.0%</u>

Statements of Financial Accounting Standards ("SFAS") No. 141, *Business Combinations* and No. 142, *Goodwill and Other Intangible Assets* were issued in the second quarter of 2001. Therefore, the provisions of these new pronouncements were effective July 1, 2001, for LG&E and KU. SFAS No. 141 requires all business combinations initiated after June 30, 2001, to be accounted for using the purchase method. SFAS No. 142 requires goodwill to be recorded, but not amortized. Furthermore, goodwill will now be subject to a periodic assessment for impairment. LG&E and KU have no recorded goodwill and have no merger or acquisitions in progress. Accordingly, these pronouncements have no effect on the financial condition and results of operations for LG&E or KU. The Companies experienced no impact on the financial position or results of operation as a result of adopting these standards.

SFAS No. 143, *Accounting for Asset Retirement Obligations* and SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, were issued during 2001. SFAS No. 143 establishes accounting and reporting standards for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. SFAS No. 144 supersedes SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of* and the accounting and reporting provisions of APB Opinion No. 30, *Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*. SFAS No. 144, among other provisions, eliminates the requirement of SFAS No. 121 to allocate goodwill to long-lived assets to be tested for impairment. The effective implementation date for SFAS No. 144 is January 1, 2002 and SFAS No. 143 is January 1, 2003. SFAS No. 144 had no current impact on the financial position or results of operations of LG&E or KU. Management has not determined what impact SFAS No. 143 will have on the financial position or results of operations of the Companies.

The Financial Accounting Standards Board created the Derivatives Implementation Group (DIG) to provide guidance for implementation of SFAS No. 133. DIG Issue C15, *Normal Purchases and Normal Sales Exception for Option Type Contracts and Forward Contracts in Electricity* was adopted in 2001 and had no impact on results of operations or financial condition. DIG Issue C16, *Applying the Normal Purchase and Normal Sales Exception to Contracts that Combine a Forward Contract and a Purchased Option Contract*, was cleared in the third quarter 2001 and stated that option contracts do not meet the normal purchases and normal sales exception and should follow SFAS No. 133. DIG Issue C16 will become effective in the second quarter of 2002. The Companies have reviewed their contracts for options and determined that DIG Issue C16 does apply, but the adoption of DIG Issue C16 will not have a material impact on the financial position or results of operations of the Companies pursuant to regulatory treatment prescribed by SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*.

For a description of significant contingencies that may affect LG&E and KU, reference is made to Part I, Item 3, *Legal Proceedings*, and Notes 12 (LG&E) and 11 (KU) to the financial statements of LG&E's and KU's Annual Reports on form 10-K. For the year ended December 31, 2001 and to Part II herein - Item 1, *Legal Proceedings*.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk.

LG&E and KU are exposed to market risks. Both operations are exposed to market risks from changes in interest rates and commodity prices. To mitigate changes in cash flows attributable to these exposures, the Companies have entered into various derivative instruments. Derivative positions are monitored using techniques that include market value and sensitivity analysis.

The Companies use interest rate swaps to hedge exposure to market fluctuations in certain of their debt instruments. Pursuant to Company policy, use of these financial instruments is intended to mitigate risk and earnings volatility and is not speculative in nature. Management has designated all of the Companies' interest rate swaps as hedge instruments. Financial instruments designated as cash flow hedges have resulting gains and losses recorded within other comprehensive income and stockholders' equity. To the extent a financial instrument or the underlying item being hedged is prematurely terminated or the hedge becomes ineffective, the resulting gains or losses are reclassified from other comprehensive income to net income. Financial instruments designated as fair value hedges are periodically marked to market with the resulting gains and losses recorded directly into net income to correspond with income or expense recognized from changes in market value of the items being hedged.

The potential change in interest expense resulting from changes in base interest rates of the Companies' unswapped debt did not change materially in 2002. The potential changes in the fair values of the Company's interest-rate swaps resulting from changes in interest rates and the yield curve also did not change materially in 2002. The Company's exposure to market risks from changes in commodity prices remained immaterial in 2002.

## Part II. Other Information

### Item 1. Legal Proceedings.

For a description of the significant legal proceedings involving LG&E and KU, reference is made to the information under the following items and captions of LG&E's and KU's respective combined Annual Report on Form 10-K for the year ended December 31, 2001: Item 1, Business; Item 3, Legal Proceedings; Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations; Notes 3, 11 and 14 of LG&E's Notes to Financial Statements under Item 8 and Notes 3, 12 and 16 of KU's Notes to Financial Statements under Item 8. Except as described herein, to date, the proceedings reported in LG&E's and KU's respective combined Annual Report on Form 10-K have not changed materially.

#### E.ON-Powergen Transaction

On April 9, 2001, E.ON AG announced a conditional offer to purchase all the common shares of Powergen plc, the indirect corporate parent of LG&E and KU. The transaction is subject to a number of conditions precedent, including the receipt of regulatory approvals from European and United States governmental bodies, in form satisfactory to the parties. Among the primary United States regulatory approvals are: the Kentucky Public Service Commission, the Virginia State Corporation Commission, the Securities and Exchange Commission, and the Federal Energy Regulatory Commission. The parties anticipate that the remaining approvals may be received by mid-2002 to permit completion of the transaction in 2002. However, there can be no assurance that such approvals will be obtained in form or timing sufficient for such dates.

Regulatory orders approving the E.ON transaction were received from the Kentucky Commission on August 6, 2001, from the Virginia State Corporation Commission on October 5, 2001, the Federal Energy Regulatory Commission on October 11, 2001, and the Tennessee Regulatory Authority on October 23, voted in an open hearing to approve the transaction with an affirmative order issued shortly thereafter. On November 15, 2001, the Commission of the European Communities granted E.ON AG and Powergen plc transaction approval.

On April 19, 2002, Powergen plc shareholders voted in favor of certain resolutions to approve the acquisition of Powergen plc by E.ON AG by means of a scheme of arrangement under United Kingdom law.

#### Other

On April 16, 2002, the LG&E 5% Cumulative Preferred class of stock was delisted from the NASDAQ Small Capitalization Market. Delisting will enable the Companies to realize certain administrative and corporate governance efficiencies.

In May 2002, KU filed a request with the Philadelphia Stock Exchange seeking delisting of its 4.75% Cumulative Preferred class of stock, which delisting may become effective shortly. Delisting will enable the Companies to realize certain administrative and corporate governance efficiencies.

### Item 6(a). Exhibits.

None.

### Item 6(b). Reports on Form 8-K.

None.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Louisville Gas and Electric Company  
Registrant

Date: May 14, 2002

/s/ S. Bradford Rives  
S. Bradford Rives  
Senior Vice President - Finance and Controller  
(On behalf of the registrant in his capacity as  
Principal Accounting Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Kentucky Utilities Company  
Registrant

Date: May 14, 2002

/s/ S. Bradford Rives  
S. Bradford Rives  
Senior Vice President - Finance and Controller  
(On behalf of the registrant in his capacity as  
Principal Accounting Officer)

**SEC Form 8-K – November 25, 2003**

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CONFORMED SUBMISSION TYPE: 8-K

PUBLIC DOCUMENT COUNT: 3

CONFORMED PERIOD OF REPORT: 20031125

ITEM INFORMATION: Other events

FILED AS OF DATE: 20031125

FILER:

COMPANY DATA:

COMPANY CONFORMED NAME:	KENTUCKY UTILITIES CO
CENTRAL INDEX KEY:	0000055387
STANDARD INDUSTRIAL CLASSIFICATION:	ELECTRIC SERVICES [4911]
IRS NUMBER:	610247570
STATE OF INCORPORATION:	KY
FISCAL YEAR END:	1229

FILING VALUES:

FORM TYPE:	8-K
SEC ACT:	1934 Act
SEC FILE NUMBER:	001-03464
FILM NUMBER:	031023402

BUSINESS ADDRESS:

STREET 1:	ONE QUALITY ST
CITY:	LEXINGTON
STATE:	KY
ZIP:	40507
BUSINESS PHONE:	6062552100

FILER:

COMPANY DATA:

COMPANY CONFORMED NAME:	LOUISVILLE GAS & ELECTRIC CO
CENTRAL INDEX KEY:	0000060549
STANDARD INDUSTRIAL CLASSIFICATION:	ELECTRIC & OTHER SERVICES CO
IRS NUMBER:	610264150
STATE OF INCORPORATION:	KY
FISCAL YEAR END:	1231

FILING VALUES:

FORM TYPE:	8-K
SEC ACT:	1934 Act
SEC FILE NUMBER:	001-02893
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BUSINESS ADDRESS:

STREET 1: 220 W MAIN ST  
 STREET 2: P O BOX 32030  
 CITY: LOUISVILLE  
 STATE: KY  
 ZIP: 40232  
 BUSINESS PHONE: 5026272000

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SECURITIES AND EXCHANGE COMMISSION  
 Washington, D.C. 20549

FORM 8-K

## CURRENT REPORT

Pursuant to Section 13 or 15(d) of  
 the Securities Exchange Act of 1934

Date of Report (Date of earliest event reported): November 25, 2003

Commission File Number	Registrant, State of Incorporation, Address, and Telephone Number	IRS Employer Identification No.
2-26720	Louisville Gas and Electric Company (A Kentucky Corporation) 220 West Main Street P.O. Box 32010 Louisville, Ky. 40232 (502) 627-2000	61-0264150
1-3464	Kentucky Utilities Company (A Kentucky and Virginia Corporation) One Quality Street Lexington, Kentucky 40507-1428 (859) 255-2100	61-0247570

This combined Form 8-K is separately filed by Louisville Gas and Electric Company and Kentucky Utilities Company. Information contained herein relating to any individual registrant is filed by such registrant on its own behalf and each registrant makes no representation as to information relating to the other registrant.

Item 5. Other Events and Regulation FD Disclosure

On November 25, 2003, Louisville Gas and Electric Company ("LG&E") and Kentucky Utilities Company ("KU") announced their intentions to pursue

increases in base rates. LG&E is expected to seek increases of approximately 12 percent (\$67 million per year) in electric rates and 6 percent (\$20 million per year) in gas rates. KU is expected to seek an increase of approximately 9 percent (\$62 million per year) in electric rates. These will be the first requested electric rate increases by LG&E and KU in 13 and 20 years, respectively. Final details will be available in the companies' rate filings currently planned for late December.

The companies' press releases regarding this matter are attached as Exhibits 99.01 and 99.02, respectively, and are incorporated herein by reference.

Statements made in this report that state the companies' or management's intentions, expectations or predictions of the future are forward-looking statements. The companies' actual results could differ materially from those projected in the forward-looking statements, and there can be no assurance that estimates of future results will be achieved. The companies' SEC filings contain additional information concerning factors that could cause actual results to differ materially from those in the forward-looking statements.

#### Item 7. Final Statements and Exhibits

- (a) None
- (b) None.
- (c) Exhibits

99.01 LG&E Press Release dated November 25, 2003

99.02 KU Press Release dated November 25, 2003.

#### SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

Louisville Gas and Electric Company

Dated: November 25, 2003

By: /s/ John R. McCall  
John R. McCall  
Executive Vice President, General  
Counsel and Corporate Secretary

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

Kentucky Utilities Company

Dated: November 25, 2003

By: /s/ John R. McCall  
 John R. McCall  
 Executive Vice President, General  
 Counsel and Corporate Secretary

## EXHIBIT INDEX

Louisville Gas and Electric Company  
 Kentucky Utilities Company

Current Report on Form 8-K  
 Dated November 25, 2003

## Exhibits

Exhibit Number	Applicable to		Description
	LG&E	KU	
99.01	x		Press Release dated November 25, 2003
99.02		x	Press Release dated November 25, 2003

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 LG&E  
 Press Release

220 West Main Street  
 Louisville, KY 40232

Media Contact: Chip Keeling  
 24-Hour Media Hotline: 502.627.4999 Toll-free: 888.627.4999

## LG&amp;E Seeks First Base Electric Rate Increase In 13 Years

(LOUISVILLE, Ky. - Nov. 25, 2003) Louisville Gas and Electric Company announced today it intends to pursue increases in its base electric rates for the first time in more than a decade. Although the company has only preliminary numbers, LG&E is expected to seek a 12 percent increase in its electric rates, for approximately \$67 million per year. The company will also seek a 6 percent increase in its gas rates, for about \$20 million per year. LG&E last sought a base electric rate increase in 1990. LG&E lowered its rates in 2000 by more than \$26 million. As a result, today's electric rates are lower than they were in 1990.

A representative residential LG&E electric customer, using 1,000 kwh, is expected to see an increase of about \$7 per month, while a representative residential LG&E gas customer, using 90 ccf, is expected to see an increase of about \$6.

The amount of the increase LG&E will seek will be based on a test year which ended in September. Final details will be available by year end.

The increase in rates is caused, in large part, by the need to meet growing demand, particularly from new business. In the last decade, customers have increased by 62,285, or 20 percent, while their actual bills have decreased about \$3 per month, or 4 percent.

"When you look at the rate of inflation and the economic situation we are in today, our electric rates are actually lower today than they were when we last requested increases," said Vic Staffieri, LG&E's and LG&E Energy's Chairman, CEO and President.

Even with the proposed increase, the company's electric rates will remain lower than those of the seven states bordering Kentucky, and the company will still have some of the lowest rates in the nation. The gas and electric increases are necessary because LG&E's costs of doing business, including safely and reliably delivering service, have increased dramatically over the past decade.

During the last three years alone, LG&E has made \$33 million in capital investments to meet the needs of new gas customers coming onto the system and to replace aging gas mains. LG&E and its sister company, Kentucky Utilities Company, have spent \$285 million in the last three years, adding new generating capacity, and are expected to install additional capacity over the next two years to meet electric demand growth. The companies have invested roughly \$18 million per year in their transmission system. Significant increases have also occurred in administrative and general expenses - in particular pension, post retirement, health care, and insurance expenses. For example, the companies have encountered an approximately 140 percent increase in property insurance since the terrorist attacks of September 11, 2001.

"We're proud that - despite a lot of turmoil in our industry - -- our employees have been able to hold electric rates steady for more than a decade through their hard work, efficiencies and ingenuity," said Staffieri. "But there comes a time when you must react to the economic situation you face, regardless of your best efforts.

"Obviously, decisions such as this don't come easily to us, as evidenced by the fact that we haven't filed for an increase in some time," he added. "However, we're at a point now where additional resources are necessary in order for us to continue to provide the quality service our customers have come to expect."

KU also is requesting an increase. The utilities will file the increases in late December. The Kentucky Public Service Commission has traditionally suspended the implementation of the rates for five months in order to hold public hearings. A

decision likely will not be reached until next summer.

LG&E is a wholly owned subsidiary of LG&E Energy Corp. that serves 310,000 natural gas and 382,000 electric customers in Louisville, Ky., and 16 surrounding counties.

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KU

For Immediate Release

Contact: Cliff Feltham  
 Communications Dept.  
 859-367-1105

#### KU Seeks First Base Electric Rate Increase In 20 Years

(LEXINGTON, Ky. - Nov. 25, 2003) Kentucky Utilities Company announced today it intends to pursue increases in its base rates for the first time in two decades. Although the company has only preliminary numbers, KU is expected to seek an overall increase of 9 percent, for approximately \$62 million per year. KU last sought a base rate increase in 1983. KU lowered its rates in 2000 by more than \$30 million. As a result, today's electric rates are lower than they were in 1983. A representative residential customer, using 1,000 kwh, is expected to see an increase of approximately \$5 per month.

The amount of the increase KU will seek will be based on a test year which ended in September. Final details will be available by year end.

The increase in rates is caused, in large part, by the need to meet growing demand, particularly from new business. In the last two decades, customers have increased by 205,510, or 60 percent.

"When you look at the rate of inflation and the economic situation we are in today, our electric rates are actually lower today than they were when we last requested an increase," said Vic Staffieri, KU's and LG&E Energy's Chairman, CEO and President.

Even with the proposed increases, the company's electric rates will remain lower than those of the seven states bordering Kentucky, and among the lowest in the nation. The increase is necessary because KU's costs of doing business, including safely and reliably delivering service, have increased dramatically over the past two decades.

KU and its sister company, Louisville Gas and Electric Company, have spent \$285 million in the last three years, adding new generating capacity, and are expected to install additional capacity over the next two years to meet electric demand growth. The companies have invested roughly \$18 million per year in their transmission system. Significant increases have also occurred in administrative and general expenses - in particular pension, post retirement, health care, and insurance expenses. For example, the companies have encountered an approximately 140 percent increase in property insurance since the terrorist attacks of September 11, 2001.

"We're proud that - despite a lot of turmoil in our industry -- our employees have been able to hold electric rates steady for more than two decades through their hard work, efficiencies and ingenuity," said Staffieri. "But there comes a time when you must react to the economic situation you face, regardless of your best efforts.

"Obviously, decisions such as this don't come easily to us, as evidenced by the fact that we haven't filed for an increase in some time," he added. "However, we're at a point now where additional resources are necessary in order for us to continue to provide the quality service our customers have come to expect."

LG&E also is requesting increases in electric and gas rates. The utilities will file the increases in late December. The Kentucky Public Service Commission has traditionally suspended the implementation of the rates for five months in order to hold public hearings. A decision likely will not be reached until next summer.

KU, based in Lexington, Ky., provides reliable, low-priced electric energy to more than 477,000 customers in 77 Kentucky counties and 30,000 five counties in southwestern Virginia. KU is a subsidiary of LG&E Energy Corp., headquartered in Louisville, Ky.

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**SEC Form 8-K – November 12, 2003**

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PUBLIC DOCUMENT COUNT: 1

CONFORMED PERIOD OF REPORT: 20021231

ITEM INFORMATION: Regulation FD Disclosure

FILED AS OF DATE: 20031113

FILER:

COMPANY DATA:

COMPANY CONFORMED NAME:	KENTUCKY UTILITIES CO
CENTRAL INDEX KEY:	0000055387
STANDARD INDUSTRIAL CLASSIFICATION:	ELECTRIC SERVICES [4911]
IRS NUMBER:	610247570
STATE OF INCORPORATION:	KY
FISCAL YEAR END:	1229

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SEC FILE NUMBER:	001-03464
FILM NUMBER:	03995254

BUSINESS ADDRESS:

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CITY:	LEXINGTON
STATE:	KY
ZIP:	40507
BUSINESS PHONE:	6062552100

FILER:

COMPANY DATA:

COMPANY CONFORMED NAME:	LOUISVILLE GAS & ELECTRIC CO
CENTRAL INDEX KEY:	0000060549
STANDARD INDUSTRIAL CLASSIFICATION:	ELECTRIC & OTHER SERVICES CO
IRS NUMBER:	610264150
STATE OF INCORPORATION:	KY
FISCAL YEAR END:	1231

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FORM TYPE:	8-K
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SEC FILE NUMBER:	001-02893
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BUSINESS ADDRESS:

STREET 1: 220 W MAIN ST  
 STREET 2: P O BOX 32030  
 CITY: LOUISVILLE  
 STATE: KY  
 ZIP: 40232  
 BUSINESS PHONE: 5026272000

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SECURITIES AND EXCHANGE COMMISSION  
 Washington, D.C. 20549

## FORM 8-K

## CURRENT REPORT

Pursuant to Section 13 or 15(d) of  
 the Securities Exchange Act of 1934

Date of Report (Date of earliest event reported): November 12, 2003

Commission File Number	Registrant, Address, and Telephone Number	IRS Employer Identification No.
---------------------------	--	------------------------------------

2-26720	Louisville Gas and Electric Company (A Kentucky Corporation) 220 West Main Street P.O. Box 32010 Louisville, Ky. 40232 (502) 627-2000	61-0264150
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1-3464	Kentucky Utilities Company (A Kentucky and Virginia Corporation) One Quality Street Lexington, Kentucky 40507-1428 (859) 255-2100	61-0247570
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This combined Form 8-K is separately filed by Louisville Gas and Electric Company and Kentucky Utilities Company. Information contained herein relating to any individual registrant is filed by such registrant on its own behalf and each registrant makes no representation as to information relating to the other registrant.

Item 5. Other Events and Regulation FD Disclosure

In the Annual Report for the year ended December 31, 2002 on Form 10-K ("2002 Annual Report") Louisville Gas and Electric Company ("LG&E") and Kentucky Utilities Company ("KU") reported revenues and related cost of sales in compliance with required accounting that was in effect at that time. LG&E and KU were required to adopt the net reporting requirements of Emerging Issues Task Force Issue No. 02-03, Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities ("EITF 02-03") on January 1, 2003. Therefore, to comply with the net reporting requirements of EITF 02-03, LG&E and KU have reclassified revenues and related expenses previously reported in the 2002 Annual Report.

EITF 02-03 rescinded EITF 98-10 and requires that revenue related to derivative instruments classified as trading, including certain energy sales transactions, be reported net of related cost of sales for all periods presented. EITF 02-03 also requires companies to retroactively reclassify previously reported revenues to conform with the new net reporting requirements.

LG&E and KU are filing this Current Report on Form 8-K to present reclassified financial statements and other related information in response to the requirements of EITF 02-03. The reclassified financial statements are set forth in the attached exhibits to this Form 8-K. These exhibits contain information identical to the corresponding items of the 2002 Annual Report, except that the information contained in the exhibits has been updated to the extent necessary to report energy-trading contracts net of related cost of sales in the income statements for all periods presented. Accordingly, information in the corresponding items in the Companies' 2002 Annual Report should be considered in light of the updated information for such items as provided in this Current Report, which reflects the reclassification of financial data as explained above. No attempt has been made in this report to modify or update other disclosures except as required to reflect the effects of the reclassifications described above. These other disclosures are included in our annual, quarterly and current reports and other information filed with the SEC. Neither reported net operating income, net income, common equity, nor cash flows were impacted by the reclassification of revenue upon adoption of EITF 02-03.

The Companies' 2000 consolidated financial statements were audited by Arthur Andersen LLP, independent public accountants, who expressed an unqualified opinion on those financial statements in their report dated January 26, 2001, excluding the revisions described above. Arthur Andersen LLP has ceased operations and, accordingly, LG&E and KU have been unable to obtain their consent to the use of their report. Therefore, 2000 consolidated financial statements, as reclassified, are omitted.

The following are defined terms used in the Exhibits:

Abbreviation or Acronym Definition

Capital Corp.	LG&E Capital Corp.
Clean Air Act	The Clean Air Act, as amended in 1990
CCN	Certificate of Public Convenience and Necessity
CT	Combustion Turbines
DSM	Demand Side Management
ECR	Environmental Cost Recovery
EEL	Electric Energy, Inc.
EITF	Emerging Issues Task Force Issue
E.ON	E.ON AG
EPA	U.S. Environmental Protection Agency

ESM	Earnings Sharing Mechanism
F	Fahrenheit
FAC	Fuel Adjustment Clause
FERC	Federal Energy Regulatory Commission

Page 3

FPA	Federal Power Act
FT and FT-A	Firm Transportation
GSC	Gas Supply Clause
IBEW	International Brotherhood of Electrical Workers
IMEA	Illinois Municipal Electric Agency
IMPA	Indiana Municipal Power Agency
Kentucky Commission	Kentucky Public Service Commission
KIUC	Kentucky Industrial Utility Consumers, Inc.
KU	Kentucky Utilities Company
KU Energy	KU Energy Corporation
KU R	KU Receivables LLC
kV	Kilovolts
Kva	Kilovolt-ampere
KW	Kilowatts
Kwh	Kilowatt hours
LEM	LG&E Energy Marketing Inc.
LG&E	Louisville Gas and Electric Company
LG&E Energy	LG&E Energy Corp.
LG&E R	LG&E Receivables LLC
LG&E Services	LG&E Energy Services Inc.
Mcf	Thousand Cubic Feet
MGP	Manufactured Gas Plant
MISO	Midwest Independent System Operator
Mmbtu	Million British thermal units
Moody's	Moody's Investor Services, Inc.
Mw	Megawatts
Mwh	Megawatt hours
NNS	No-Notice Service
NOPR	Notice of Proposed Rulemaking
NOx	Nitrogen Oxide
OATT	Open Access Transmission Tariff
OMU	Owensboro Municipal Utilities
OVEC	Ohio Valley Electric Corporation
PBR	Performance-Based Ratemaking
PJM	Pennsylvania, New Jersey, Maryland Interconnection
Powergen	Powergen Limited (formerly Powergen plc)
PUHCA	Public Utility Holding Company Act of 1935
ROE	Return on Equity
RTO	Regional Transmission Organization
S&P	Standard & Poor's Rating Services
SCR	Selective Catalytic Reduction
SEC	Securities and Exchange Commission
SERP	Supplemental Employee Retirement Plan
SFAS	Statement of Financial Accounting Standards
SIP	State Implementation Plan
SMD	Standard Market Design
SO2	Sulfur Dioxide
Tennessee Gas	Tennessee Gas Pipeline Company
Texas Gas	Texas Gas Transmission Corporation
TRA	Tennessee Regulatory Authority
Trimble County	LG&E's Trimble County Unit 1
USWA	United Steelworkers of America
Utility Operations	Operations of LG&E and KU

VDT Value Delivery Team Process  
Virginia Commission Virginia State Corporation Commission  
Virginia Staff Virginia State Corporation Commission Staff

Page 4

Item 7. Financial Statements and Exhibits

(a) None

(b) None

(c) Exhibits

99(a) Form 10-K Item 1. Business

99(b) Form 10-K Item 6. Selected Financial Data

99(c) Form 10-K Item 7. Management's Discussion and Analysis of  
Financial Condition and Results of Operations

99(d) Form 10-K Item 8. Financial Statements and Supplementary Data

Page 5

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

Louisville Gas and Electric Company

Dated: November 12, 2003

By: /s/ S. Bradford Rives  
Chief Financial Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

Kentucky Utilities Company

Dated: November 12, 2003

By: /s/ S. Bradford Rives  
Chief Financial Officer

Exhibit Index to Current Report on Form 8-K  
Dated November 12, 2003

Exhibit  
Number

99(a) Form 10-K Item 1. Business

99(b) Form 10-K Item 6. Selected Financial Data

99(c) Form 10-K Item 7. Management's Discussion and

Analysis of Financial Condition and Results  
of Operations

99(d) Form 10-K Item 8. Financial Statements and Data

Page 5

Exhibit 99(a)

LG&E and KU are filing this Current Report on Form 8-K to present reclassified financial statements and other related information in response to the requirements of EITF 02-03. The reclassified financial statements are set forth in the other attached exhibits to this Form 8-K. The information set forth below from Item 1 from the 2002 Annual Report has been included because certain information presented therein was affected by the reclassifications. This exhibit, and the other exhibits to the Form 8-K, contain information identical to the corresponding items of the 2002 Annual Report, except that the information contained in the exhibits has been updated to the extent necessary to report revenues from energy-trading contracts net of related cost of sales for all activities that are trading and involved derivative instruments as defined by Financial Accounting Standards Board Statement No. 133, Accounting for Derivative Instruments and Hedging Activities and to conform the related disclosures for all periods presented. No attempt has been made in this report to modify or update other disclosures except as required to reflect the effects of the reclassifications described above. These other disclosures are included in our annual, quarterly and current reports and other information filed with the SEC. Neither reported net operating income, net income, common equity, nor cash flows were impacted by the reclassification of revenue upon adoption of EITF 02-03.

## ITEM 1. Business.

LG&E and KU are each subsidiaries of LG&E Energy. On December 11, 2000, LG&E Energy was acquired by Powergen plc, now known as Powergen Limited, for cash of approximately \$3.2 billion or \$24.85 per share and the assumption of all of LG&E Energy's debt. As a result of the acquisition, among other things, LG&E Energy became a wholly owned subsidiary of Powergen and, as a result, LG&E and KU became indirect subsidiaries of Powergen. The utility operations (LG&E and KU) of LG&E Energy have continued their separate identities and continue to serve customers in Kentucky, Virginia and Tennessee under their existing names. The preferred stock and debt securities of the utility operations were not affected by this transaction resulting in the utility operations' obligations to continue to file SEC reports. Following the acquisition, Powergen became a registered holding company under PUHCA, and LG&E and KU, as subsidiaries of a registered holding company, became subject to additional regulation under PUHCA.

As a result of the Powergen acquisition and in order to comply with PUHCA, LG&E Services was formed as a subsidiary of LG&E Energy effective on January 1, 2001. LG&E Services provides certain services to affiliated entities, including LG&E and KU, at cost as required under PUHCA. On January 1, 2001, approximately 1,000 employees, mainly from LG&E Energy, LG&E and KU, were moved to LG&E Services.

On July 1, 2002, E.ON, a German company, completed its acquisition of Powergen following receipt of all necessary regulatory approvals. E.ON had announced its pre-conditional cash offer of 5.1 billion pounds sterling (\$7.3 billion) for Powergen on April 9, 2001.

## LOUISVILLE GAS AND ELECTRIC COMPANY

## General

Incorporated in 1913 in Kentucky, LG&E is a regulated public utility that supplies natural gas to approximately 310,000 customers and electricity to approximately 382,000 customers in Louisville and adjacent areas in Kentucky. LG&E's service area covers approximately 700 square miles in 17 counties and has an estimated population of one million. Included in this area is the Fort Knox Military Reservation, to which LG&E transports gas and provides electric service, but which maintains its own distribution

## Page 1

systems. LG&E also provides gas service in limited additional areas. LG&E's coal-fired electric generating plants, all equipped with systems to reduce sulfur dioxide emissions, produce most of LG&E's electricity. The remainder is generated by a hydroelectric power plant and combustion turbines. Underground natural gas storage fields help LG&E provide economical and reliable gas service to customers. See Item 2, Properties. LG&E has one wholly owned consolidated subsidiary, LG&E R. LG&E R is a special purpose entity formed in September 2000 to enter into accounts receivable securitization transactions with LG&E. LG&E R started operations in 2001. LG&E is considering unwinding its accounts receivable securitization arrangements involving LG&E R during 2003.

For the year ended December 31, 2002, 73% of total operating revenues were derived from electric operations and 27% from gas operations. Electric and gas operating revenues and the percentages by class of service on a combined basis for this period were as follows:

	(Thousands of \$)			
	Electric	Gas	Combined	% Combined
Residential	\$232,285	\$160,733	\$ 393,018	47%
Commercial	185,112	61,036	246,148	30%
Industrial	111,871	10,232	122,103	15%
Public authorities	57,703	11,197	68,900	8%
Total retail	586,971	243,198	830,169	100%
Wholesale sales	120,553	16,384	136,937	
Gas transported - net	-	6,232	6,232	
Provision for rate collections	12,267	-	12,267	
Miscellaneous	16,251	1,879	18,130	
Total	\$736,042	\$267,693	\$1,003,735	

See Note 13 of LG&E's Notes to Financial Statements under Item 8 for financial information concerning segments of business for the three years ended December 31, 2002.

## Electric Operations

The sources of LG&E's electric operating revenues and the volumes of sales for the three years ended December 31, 2002, were as follows:

	2002	2001	2000
ELECTRIC OPERATING REVENUES			
(Thousands of \$)			
Residential	\$232,285	\$205,926	\$205,105
Commercial	185,112	171,540	171,414

Industrial	111,871	104,438	104,738
Public authorities	57,703	53,725	54,270
Total retail	586,971	535,629	535,527
Wholesale sales	120,553	127,253	113,337
Provision for rate collections (refunds)	12,267	(720)	(2,500)
Miscellaneous	16,251	11,610	12,851
Total	\$736,042	\$673,772	\$659,215

Page 2

## ELECTRIC SALES (Thousands of Mwh):

Residential	4,036	3,782	3,722
Commercial	3,493	3,395	3,350
Industrial	3,028	2,976	3,043
Public authorities	1,253	1,224	1,214
Total retail	11,810	11,377	11,329
Wholesale sales	6,387	5,989	5,343
Total	18,197	17,366	16,672

LG&E uses efficient coal-fired boilers, fully equipped with sulfur dioxide removal systems, to generate most of its electricity. LG&E's weighted-average system-wide emission rate for sulfur dioxide in 2002 was approximately 0.55 lbs./Mmbtu of heat input, with every generating unit below its emission limit established by the Kentucky Division for Air Quality.

LG&E set a record local peak load of 2,623 Mw on Monday, August 5, 2002, when the peak daily temperature was 100 degrees F.

The electric utility business is affected by seasonal weather patterns. As a result, operating revenues (and associated operating expenses) are not generated evenly throughout the year. See LG&E's Results of Operations under Item 7.

LG&E currently maintains a 13 - 15% reserve margin range. At December 31, 2002, LG&E owned steam and combustion turbine generating facilities with a net summer capability of 2,882 Mw and an 80 Mw nameplate rated hydroelectric facility on the Ohio River with a summer capability rate of 48 Mw. At December 31, 2002, LG&E's system net summer capability, including purchases from others and excluding the hydroelectric facility, was 3,037 Mw. See Item 2, Properties.

LG&E and 11 other electric utilities are participating owners of OVEC located in Piketon, Ohio. OVEC owns and operates two power plants that burn coal to generate electricity, Kyger Creek Station in Ohio and Clifty Creek Station in Indiana. LG&E's share is 7%, representing approximately 155 Mw's of generation capacity. LG&E also has agreements with a number of entities throughout the United States for the purchase and/or sale of capacity and energy and for the utilization of their bulk transmission system.

On February 1, 2002, LG&E (along with KU) turned over operational control of its high voltage transmission facilities (100kV and above) to MISO. LG&E (along with KU) is a founding member of MISO. Such membership was obtained in 1998 in response to and consistent with federal policy initiatives. MISO operates a single OATT over the facilities under its control. Currently MISO controls over 100,000 miles of transmission over 1.1 million square miles located in the northern Midwest between Manitoba, Canada and Kentucky. On September 18, 2002, FERC granted a 12.88% ROE on

transmission facilities for LG&E, KU and the rest of the MISO owners. This ROE includes a 50 basis point increase because of operational independence.

MISO plans to implement a Congestion Management System in December 2003, in compliance with FERC Order 2000. This system will be similar to the Locational Marginal Pricing (LMP) system currently used by the PJM RTO and contemplated in FERC's SMD NOPR, currently being discussed. MISO filed with FERC a mechanism for recovery of costs for the Congestion Management System, designated Schedule 16 and Schedule 17. The MISO transmission owners, including LG&E and KU, and others have objected to the allocation of costs between market participants and retail native load. This case is currently in a hearing at FERC.

In October 2001, the FERC issued an order requiring that the bundled retail load and grandfathered wholesale load of each member transmission owner (including LG&E) be included in the current calculation of MISO's "cost-adder," a charge designed to recover MISO's costs of operation, including

Page 3

start-up capital (debt) costs. LG&E, along with several other transmission owners, opposed the FERC's ruling in this regard, which opposition the FERC rejected in an order on rehearing issued in 2002. Later that year, MISO's transmission owners, including LG&E, appealed the FERC's decision to the United States Court of Appeals for the District of Columbia Circuit. In response, by petition filed November 25, 2002, the FERC requested that the Court issue a partial remand of its challenged orders to allow the FERC to revisit certain issues raised therein, and further requested that the case be held in abeyance pending the agency's resolution of such issues. The Court granted the FERC's petition by order dated December 6, 2002. On February 24, 2003, FERC issued an order reaffirming its position concerning the calculation of the "cost-adder".

As a separate matter, MISO, its transmission owners and other interested industry segments reached a settlement in mid-2002 regarding the level of cost responsibility properly borne by bundled and grandfathered load under these FERC rulings (such settlement expressly not prejudicing the transmission owners' and LG&E's right to challenge the FERC's ruling imposing cost responsibility on bundled loads in the first instance). On February 24, 2003, FERC accepted a partial settlement between MISO and the transmission owners. FERC did not accept the only contested section of the settlement, which would have allowed the transmission owners to immediately treat unrecoverable Schedule 10 charges as regulatory assets. FERC will consider allowing regulatory asset treatment of unrecoverable Schedule 10 charges on a case-by-case basis.

#### Gas Operations

The sources of LG&E's gas operating revenues and the volumes of sales for the three years ended December 31, 2002, were as follows:

	2002	2001	2000
GAS OPERATING REVENUES			
(Thousands of \$)			
Residential	\$160,733	\$177,387	\$159,670
Commercial	61,036	70,296	61,888
Industrial	10,232	15,750	15,898
Public authorities	11,197	13,223	9,193
Total retail	243,198	276,656	246,649
Wholesale sales	16,384	5,702	17,344

Gas transported - net	6,232	6,042	6,922
Miscellaneous	1,879	2,375	1,574
Total	\$267,693	\$290,775	\$272,489

GAS SALES (Millions of cu. ft.):

Residential	22,124	20,429	24,274
Commercial	9,074	8,587	10,132
Industrial	1,783	2,160	3,089
Public authorities	1,747	1,681	1,576
Total retail	34,728	32,857	39,071
Wholesale sales	5,345	1,882	5,115
Gas transported	13,939	13,108	14,729
Total	54,012	47,847	58,915

The gas utility business is affected by seasonal weather patterns. As a result, operating revenues (and associated operating expenses) are not generated evenly throughout the year. See LG&E's Results of Operations under Item 7.

LG&E has five underground natural gas storage fields that help provide economical and reliable gas service to ultimate consumers. By using gas

Page 4

storage facilities, LG&E avoids the costs associated with typically more expensive pipeline transportation capacity to serve peak winter space-heating loads. LG&E stores gas in the summer season for withdrawal in the subsequent winter heating season. Without its storage capacity, LG&E would be forced to buy additional gas and pipeline transportation services when customer demand increases, likely to be when the price for those items are typically at their highest. Currently, LG&E buys competitively priced gas from several large suppliers under contracts of varying duration. LG&E's underground storage facilities, in combination with its purchasing practices, enable it to offer gas sales service at rates lower than state and national averages. At December 31, 2002, LG&E had an inventory balance of gas stored underground of 12.6 million Mcf valued at \$50.3 million.

A number of industrial customers purchase their natural gas requirements directly from alternate suppliers for delivery through LG&E's distribution system. These large industrial customers account for about one-fourth of LG&E's annual throughput.

The all-time maximum day gas sendout of 545,000 Mcf occurred on Sunday, January 20, 1985, when the average temperature for the day was -11 degrees F. During 2002, maximum day gas sendout was approximately 418,000 Mcf, occurring on February 27, 2002, when the average temperature for the day was 21 degrees F. Supply on that day consisted of approximately 130,000 Mcf from purchases, approximately 221,000 Mcf delivered from underground storage, and approximately 67,000 Mcf transported for industrial customers. For a further discussion, see Gas Supply under Item 1.

#### Rates and Regulation

Following the purchase of Powergen by E.ON, E.ON became a registered holding company under PUHCA. As a result, E.ON, its utility subsidiaries, including LG&E, and certain of its non-utility subsidiaries are subject to extensive regulation by the SEC under PUHCA with respect to issuances and sales of securities, acquisitions and sales of certain utility properties, and intra-system sales of certain goods and services. In addition, PUHCA generally limits the ability of registered holding companies to acquire

additional public utility systems and to acquire and retain businesses unrelated to the utility operations of the holding company. LG&E believes that it has adequate authority (including financing authority) under existing SEC orders and regulations to conduct its business. LG&E will seek additional authorization when necessary.

No costs associated with the E.ON purchase of Powergen or the Powergen purchase of LG&E Energy nor any effects of purchase accounting have been reflected in the financial statements of LG&E.

The Kentucky Commission has regulatory jurisdiction over the rates and service of LG&E and over the issuance of certain of its securities. The Kentucky Commission has the ability to examine the rates LG&E charges its retail customers at any time. LG&E is a "public utility" as defined in the FPA, and is subject to the jurisdiction of the Department of Energy and FERC with respect to the matters covered in the FPA, including the sale of electric energy at wholesale in interstate commerce.

For a discussion of current regulatory matters, see Rates and Regulation for LG&E under Item 7 and Note 3 of LG&E's Notes to Financial Statements under Item 8.

LG&E's retail electric rates contain a FAC, whereby increases and decreases in the cost of fuel for electric generation are reflected in the rates charged to retail electric customers. 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. The Kentucky Commission also requires that electric utilities, including LG&E, file certain documents relating to fuel procurement and the purchase of power and energy from other utilities.

Page 5

LG&E's retail electric rates are subject to an ESM. The ESM, initially in place for three years beginning in 2000, sets an upper and lower point for rate of return on equity, whereby if LG&E's rate of return for the calendar year falls within the range of 10.5% to 12.5%, no action is necessary. If earnings are above the upper limit, the excess earnings are shared 40% with ratepayers and 60% with shareholders; if earnings are below the lower limit, the earnings deficiency is recovered 40% from ratepayers and 60% from shareholders. By order of the Kentucky Commission, rate changes prompted by the ESM filing go into effect in April of each year subject to a balancing adjustment in successive periods. LG&E made its second ESM filing on March 1, 2002, for the calendar year 2001 reporting period. LG&E is in the process of refunding \$441,000 to customers for the 2001 reporting period. LG&E estimated that the rate of return will fall below the lower limit, subject to Kentucky Commission approval, for the year ended December 31, 2002. The 2002 financial statements include an accrual to reflect the earnings deficiency of \$12.5 million to be recovered from customers commencing in April 2003.

On November 27, 2002, LG&E filed a revised ESM tariff which proposed continuance of the existing ESM through 2005. The Kentucky Commission issued an Order suspending the ESM tariff one day making the effective date January 2, 2003. In addition, the Kentucky Commission is conducting a management audit to review the ESM plan and reassess its reasonableness in 2003. LG&E and interested parties will have the opportunity to provide recommendations for modification and continuance of the ESM or other forms of alternative or incentive regulation.

LG&E's retail rates contain an ECR surcharge which recovers certain costs incurred by LG&E that are required to comply with the Clean Air Act and other environmental regulations. See Note 3 of LG&E's Notes to Financial Statements under Item 8.

LG&E's gas rates contain a GSC, whereby increases or decreases in the cost of gas supply are reflected in LG&E's rates, subject to approval by the Kentucky Commission. The GSC procedure prescribed by order of the Kentucky Commission provides for quarterly rate adjustments to reflect the expected cost of gas supply in that quarter. In addition, the GSC contains a mechanism whereby any over- or under-recoveries of gas supply cost from prior quarters will be refunded to or recovered from customers through the adjustment factor determined for subsequent quarters.

Integrated resource planning regulations in Kentucky require LG&E and the other major utilities to make triennial filings with the Kentucky Commission of various historical and forecasted information relating to load, capacity margins and demand-side management techniques. LG&E filed its most recent integrated resource plan on October 1, 2002.

Pursuant to Kentucky law, the Kentucky Commission has established the boundaries of the service territory or area of each retail electric supplier in Kentucky (including LG&E), other than municipal corporations. Within this service territory each such supplier has the exclusive right to render retail electric service.

#### Construction Program and Financing

LG&E's construction program is designed to ensure that there will be adequate capacity and reliability to meet the electric and gas needs of its service area. These needs are continually being reassessed and appropriate revisions are made, when necessary, in construction schedules. LG&E's estimates of its construction expenditures can vary substantially due to numerous items beyond LG&E's control, such as changes in rates, economic conditions, construction costs, and new environmental or other governmental laws and regulations.

During the five years ended December 31, 2002, gross property additions amounted to approximately \$950 million. Internally generated funds and external financings for the five-year period were utilized to provide for these gross additions. The gross additions during this period amounted to approximately 26% of total utility plant at December 31, 2002, and consisted of \$798 million for electric properties and \$152 million for gas properties. Gross retirements during the same period were \$106 million, consisting of \$74 million for electric properties and \$32 million for gas properties.

Page 6

#### Coal Supply

Coal-fired generating units provided over 97% of LG&E's net kilowatt-hour generation for 2002. The remaining net generation was provided by a natural gas and oil fueled combustion turbine peaking units and a hydroelectric plant. Coal will be the predominant fuel used by LG&E in the foreseeable future, with natural gas and oil being used for peaking capacity and flame stabilization in coal-fired boilers or in emergencies. LG&E has no nuclear generating units and has no plans to build any in the foreseeable future. LG&E has entered into coal supply agreements with

various suppliers for coal deliveries for 2003 and beyond. LG&E normally augments its coal supply agreements with spot market purchases. LG&E has a coal inventory policy which it believes provides adequate protection under most contingencies. LG&E had a coal inventory of approximately 1.5 million tons, or a 74-day supply, on hand at December 31, 2002.

LG&E expects to continue purchasing most of its coal, with sulfur content in the 2%-4.5% range, from western Kentucky, southwest Indiana, and West Virginia for the foreseeable future. This supply is relatively low priced coal, and in combination with its sulfur dioxide removal systems is expected to enable LG&E to continue to provide electric service in compliance with existing environmental laws and regulations.

Coal is delivered to LG&E's Mill Creek plant by rail and barge, Trimble County plant by barge and Cane Run plant by rail.

The historical average delivered costs of coal purchased and the percentage of spot coal purchases were as follows:

	2002	2001	2000
Per ton	\$25.30	\$21.27	\$20.96
Per Mmbtu	\$ 1.11	\$ .93	.92
Spot purchases as % of all sources	2%	3%	1%

The delivered cost of coal is expected to remain relatively flat during 2003. Slight increases in the cost of coal in multi-year contracts signed for 2002 are expected to be offset by lower prices negotiated in contracts signed for 2003.

#### Gas Supply

LG&E purchases natural gas supplies from multiple sources under contracts for varying periods of time, while transportation services are purchased from Texas Gas and Tennessee Gas.

On April 28, 2000, Texas Gas filed with FERC in Docket RP00-260 for an increase in its base rates effective June 1, 2000. This filing is part of a rate case Texas Gas was required to file pursuant to the settlement in its last rate case. On May 31, 2000, FERC issued an Order suspending the effectiveness of Texas Gas's proposed rates, subject to refund, until November 1, 2000, and establishing a hearing and settlement procedures. As the result of reaching various FERC-approved settlements, Texas Gas's higher motion rates were not billed after July 31, 2002, and its lower prospective rates went into effect on August 1, 2002. Refunds covering the period from November 1, 2000, through July 31, 2002, were received on September 17, 2002, and are currently being refunded to customers through the GSC. LG&E participates in rate and other proceedings affecting its regulated interstate pipeline services, as appropriate.

LG&E transports on the Texas Gas system under NNS and FT rate schedules. During the winter months, LG&E has 184,900 Mmbtu/day in NNS service and

Page 7

18,000 Mmbtu/day (increasing to 36,000 Mmbtu/day effective November 1, 2003) in FT service. LG&E's summer NNS levels are 60,000 Mmbtu/day and its summer FT levels are 54,000 Mmbtu/day. Each of these NNS and FT agreements with Texas Gas are subject to termination by LG&E in equal portions during 2005, 2006, and 2008. LG&E also transports on the Tennessee system under Tennessee's FT-A rate schedule. LG&E's contract levels with Tennessee are

51,000 Mmbtu/day throughout the year. The FT-A agreement with Tennessee, which was subject to termination by LG&E during 2002, has been successfully renegotiated for a minimum additional term of five years at a lower price.

LG&E also has a portfolio of supply arrangements with various suppliers in order to meet its firm sales obligations. These gas supply arrangements include pricing provisions that are market-responsive. These firm gas supplies, in tandem with pipeline transportation services, provide the reliability and flexibility necessary to serve LG&E's customers.

LG&E owns and operates five underground gas storage fields with a current working gas capacity of about 15.1 million Mcf. Gas is purchased and injected into storage during the summer season and is then withdrawn to supplement pipeline supplies to meet the gas-system load requirements during the winter heating season. See Gas Operations under Item 1.

The estimated maximum deliverability from storage during the early part of the heating season is typically about 373,000 Mcf/day. Deliverability decreases during the latter portion of the heating season as the storage inventory is reduced by seasonal withdrawals.

The average cost per Mcf of natural gas purchased by LG&E was \$4.19 in 2002, \$5.27 in 2001 and \$5.08 in 2000. Although natural gas prices in the unregulated wholesale market increased significantly throughout 2000 and early 2001, these prices decreased dramatically in early 2002 and then began to increase again. These increases in natural gas prices, caused in part by decreased natural gas production, decreased liquidity in the marketplace, increases in the price of oil, and increased reliance on natural gas as a fuel for electric generation were mitigated in part by higher national storage inventory levels, and decreased demand associated with a less robust economy.

#### Environmental Matters

Protection of the environment is a major priority for LG&E. Federal, state, and local regulatory agencies have issued LG&E permits for various activities subject to air quality, water quality, and waste management laws and regulations. For the five-year period ending with 2002, expenditures for pollution control facilities represented \$253.8 million or 27% of total construction expenditures. LG&E estimates that construction expenditures for the installation of NOx control equipment from 2003 through 2004 will be approximately \$32 million. For a discussion of environmental matters, see Rates and Regulation for LG&E under Item 7 and Note 11 of LG&E's Notes to Financial Statements under Item 8.

#### Competition

In the last several years, LG&E has taken many steps to prepare for the expected increase in competition in its industry, including a reduction in the number of employees; aggressive cost cutting; write-offs of previously deferred expenses; an increase in focus on commercial, industrial and residential customers; an increase in employee involvement and training; a major realignment and formation of new business units, and continuous modifications of its organizational structure. LG&E will continue to take additional steps to better position itself for competition in the future.

## General

KU, incorporated in Kentucky in 1912 and incorporated in Virginia in 1991, is a regulated public utility engaged in producing, transmitting and selling electric energy. KU provides electric service to approximately 477,000 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 to less than 10 customers in Tennessee. In Virginia, KU operates under the name Old Dominion Power Company. KU operates under appropriate franchises in substantially all of the 160 Kentucky incorporated municipalities served. No franchises are required in unincorporated Kentucky or Virginia communities. The lack of franchises is not expected to have a material adverse effect on KU's operations. KU also sells wholesale electric energy to 12 municipalities.

KU has one wholly owned consolidated subsidiary, KU R. KU R is a special purpose entity formed in September 2000 to enter into accounts receivable securitization transactions with KU. KU R began operations in 2001. KU is considering unwinding its accounts receivable securitization arrangements involving KU R during 2003.

## Electric Operations

The sources of KU's electric operating revenues and the volumes of sales for the three years ended December 31, 2002, were as follows:

	2002	2001	2000
ELECTRIC OPERATING REVENUES			
(Thousands of \$):			
Residential	\$275,869	\$244,004	\$241,783
Commercial	179,157	165,389	161,291
Industrial	163,206	146,968	153,017
Mine power	29,453	28,196	27,089
Public authorities	62,649	58,770	57,979
Total retail	710,334	643,327	641,159
Wholesale sales	117,252	164,430	139,541
Provision for rate collections (refunds)	13,027	(954)	-
Miscellaneous	21,051	13,918	12,709
Total	\$861,664	\$820,721	\$793,409
ELECTRIC SALES (Thousands of Mwh):			
Residential	6,198	5,678	5,714
Commercial	4,161	3,990	3,954
Industrial	4,975	4,716	5,044
Mine power	766	771	767
Public authorities	1,533	1,481	1,495
Total retail	17,633	16,636	16,974
Wholesale sales	4,793	6,634	5,942
Total	22,426	23,270	22,916

KU's weighted-average system-wide emission rate for sulfur dioxide in 2002 was approximately 1.24 lbs./Mmbtu of heat input, with every generating unit below its emission limit established by the Kentucky Division for Air Quality.

Page 9

KU set a record local peak load of 3,899 Mw on Monday, August 5, 2002, when the peak daily temperature was 100 degrees F.

The electric utility business is affected by seasonal weather patterns. As a result, operating revenues (and associated operating expenses) are not generated evenly throughout the year. See KU's Results of Operations under Item 7.

KU currently maintains a 13-15% reserve margin range. At December 31, 2002, KU owned steam and combustion turbine generating facilities with a net summer capability of 4,111 Mw and a hydroelectric facility with a summer capability of 24 Mw. See Item 2, Properties. KU obtains power from other utilities under bulk power purchase and interchange contracts. At December 31, 2002, KU's system net summer capability, including purchases from others and excluding the hydroelectric facility, was 4,630 Mw.

Under a contract expiring in 2020 with OMU, KU has agreed to purchase from OMU the surplus output of the 150-Mw and 250-Mw generating units at OMU's Elmer Smith station. Purchases under the contract are made under a contractual formula which has resulted in costs which were and are expected to be comparable to the cost of other power purchased or generated by KU. Such power equated to approximately 8% of KU's net generation system output during 2002. See Note 11 of KU's Notes to Financial Statements under Item 8.

KU owns 20% of the common stock of EEI, which owns and operates a 1,000-Mw generating station in southern Illinois. KU is entitled to take 20% of the available capacity of the station. Purchases from EEI are made under a contractual formula which has resulted in costs which were and are expected to be comparable to the cost of other power purchased or generated by KU. Such power equated to approximately 9% of KU's net generation system output in 2002. See Note 11 of KU's Notes to Financial Statements under Item 8.

KU and 11 other electric utilities are participating owners of OVEC located in Piketon, Ohio. OVEC owns and operates two power plants that burn coal to generate electricity, Kyger Creek Station in Ohio and Clifty Creek Station in Indiana. KU's share is 2.5%, approximately 55 Mws of generation capacity. KU also has agreements with a number of entities throughout the United States for the purchase and/or sale of capacity and energy and for the utilization of their bulk transmission systems.

On February 1, 2002, KU (along with LG&E) turned over operational control of its high voltage transmission facilities (100kV and above) to MISO. KU (along with LG&E) is a founding member of MISO. Such membership was obtained in 1998 in response to and consistent with federal policy initiatives. MISO operates a single OATT over the facilities under its control. Currently MISO controls over 100,000 miles of transmission over 1.1 million square miles located in the northern Midwest between Manitoba, Canada and Kentucky. On September 18, 2002, FERC granted a 12.88% ROE on transmission facilities for LG&E, KU and the rest of the MISO owners. This ROE includes a 50 basis point increase because of operational independence.

MISO plans to implement a Congestion Management System in December 2003, in compliance with FERC Order 2000. This system will be similar to the Locational Marginal Pricing (LMP) system currently used by the PJM RTO and contemplated in FERC's SMD NOPR currently being discussed. MISO filed with FERC a mechanism for recovery of costs for the Congestion Management System, designated Schedule 16 and Schedule 17. MISO transmission owners, including LG&E and KU, and others have objected to the allocation of costs between market participants and retail native load. This case is currently in a hearing at FERC.

In October 2001, the FERC issued an order requiring that the bundled retail load and grandfathered wholesale load of each member transmission owner (including KU) be included in the current calculation of MISO's "cost-adder," a charge designed to recover MISO's costs of operation, including start-up capital (debt) costs. KU, along with several other transmission

Page 10

owners, opposed the FERC's ruling in this regard, which opposition the FERC rejected in an order on rehearing issued in 2002. Later that year, MISO's transmission owners, including KU, appealed the FERC's decision to the United States Court of Appeals for the District of Columbia Circuit. In response, by petition filed November 25, 2002, FERC requested that the Court issue a partial remand of its challenged orders to allow the FERC to revisit certain issues raised therein, and further requested that the case be held in abeyance pending the agency's resolution of such issues. The Court granted the FERC's petition by order dated December 6, 2002. On February 24, 2003, FERC issued an order reaffirming its position concerning the calculation of the "cost-adder".

As a separate matter, MISO, its transmission owners and other interested industry segments reached a settlement in mid-2002 regarding the level of cost responsibility properly borne by bundled and grandfathered load under these FERC rulings (such settlement expressly not prejudicing the transmission owners' and KU's right to challenge the FERC's ruling imposing cost responsibility on bundled loads in the first instance). On February 24, 2003, FERC accepted a partial settlement between MISO and the transmission owners. FERC did not accept the only contested section of the settlement, which would have allowed the transmission owners to immediately treat unrecoverable Schedule 10 charges as regulatory assets. FERC will consider allowing regulatory asset treatment of unrecoverable Schedule 10 charges on a case-by-case basis.

#### Rates and Regulation

Following the purchase of Powergen by E.ON, E.ON became a registered holding company under PUHCA. As a result, E.ON, its utility subsidiaries, including KU, and certain of its non-utility subsidiaries are subject to extensive regulation by the SEC under PUHCA with respect to issuances and sales of securities, acquisitions and sales of certain utility properties, and intra-system sales of certain goods and services. In addition, PUHCA generally limits the ability of registered holding companies to acquire additional public utility systems and to acquire and retain businesses unrelated to the utility operations of the holding company. KU believes that it has adequate authority (including financing authority) under existing SEC orders and regulations to conduct its business. KU will seek additional authorization when necessary.

No costs associated with the E.ON purchase of Powergen or the Powergen purchase of LG&E Energy nor any effects of purchase accounting have been reflected in the financial statements of KU.

The Kentucky Commission and the Virginia Commission have regulatory jurisdiction over KU's retail rates and service, and over the issuance of certain of its securities. By reason of owning and operating a small amount of electric utility property in one county in Tennessee (having a gross book value of approximately \$225,000) from which KU served five customers at December 31, 2002, KU is subject to the jurisdiction of the TRA. FERC has classified KU as a "public utility" as defined in the FPA. FERC has jurisdiction under the FPA over certain of the electric utility facilities

and operations, wholesale sale of power and related transactions and accounting practices of KU, and in certain other respects as provided in the FPA.

For a discussion of current regulatory matters, see Rates and Regulation for KU under Item 7 and Note 3 of KU's Notes to the Financial Statements under Item 8.

KU's Kentucky retail electric rates contain a FAC, whereby increases and decreases in the cost of fuel for electric generation are reflected in the rates charged to retail electric customers. 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. The Kentucky Commission also requires that electric utilities, including KU, file certain documents relating to fuel procurement and the purchase of power and energy from other utilities. The FAC mechanism for Virginia customers uses an average fuel cost factor based primarily on projected fuel costs. The fuel cost factor may be adjusted annually for over or under collections of fuel costs from the previous year.

Page 11

KU's Kentucky retail electric rates are subject to an ESM. The ESM, initially in place for three years beginning in 2000, sets an upper and lower point for rate of return on equity, whereby if KU's rate of return for the calendar year falls within the range of 10.5% to 12.5%, no action is necessary. If earnings are above the upper limit, the excess earnings are shared 40% with ratepayers and 60% with shareholders; if earnings are below the lower limit, the earnings deficiency is recovered 40% from ratepayers and 60% from shareholders. By order of the Kentucky Commission, rate changes prompted by the ESM filing go into effect in April of each year subject to a balancing adjustment in successive periods. KU made its second ESM filing on March 1, 2002 for the calendar year 2001 reporting period. KU is in the process of refunding \$1 million to customers for the 2001 reporting period. KU estimated that the rate of return will fall below the lower limit for the year ended December 31, 2002. The 2002 financial statements include an accrual to reflect the earnings, subject to Kentucky Commission approval, deficiency of \$13.5 million to be recovered from customers commencing in April 2003.

On November 27, 2002, KU filed a revised ESM tariff which proposed continuance of the existing ESM through 2005. The Kentucky Commission issued an Order suspending the ESM tariff one day making the effective date January 2, 2003. In addition, the Kentucky Commission is conducting a management audit to review the ESM plan and reassess its reasonableness in 2003. KU and interested parties will have the opportunity to provide recommendations for modification and continuance of the ESM or other forms of alternative or incentive regulation.

KU's Kentucky retail rates contain an ECR surcharge which recovers certain costs incurred by KU that are required to comply with the Clean Air Act and other environmental regulations. See Note 3 of KU's Notes to Financial Statements under Item 8.

Integrated resource planning regulations in Kentucky require KU and the other major utilities to make triennial filings with the Kentucky Commission of various historical and forecasted information relating to load, capacity margins and demand-side management techniques. KU filed its

most recent integrated resource plan on October 1, 2002.

Pursuant to Kentucky law, the Kentucky Commission has established the boundaries of the service territory or area of each retail electric supplier in Kentucky (including KU), other than municipal corporations. Within this service territory each such supplier has the exclusive right to render retail electric service.

The state of Virginia passed the Virginia Electric Utility Restructuring Act in 1999. This act gives Virginia customers a choice for energy services. The change will be phased in gradually between January 2002 and January 2004. KU filed unbundled rates that became effective January 1, 2002. Rates are capped at current levels through June 2007. The Virginia Commission will continue to require each Virginia utility to make annual filings of either a base rate change or an Annual Informational Filing consisting of a set of standard financial schedules. The Virginia Staff will issue a Staff Report regarding the individual utility's financial performance during the historic 12-month period. The Staff Report can lead to an adjustment in rates, but through June 2007 will be limited to decreases. KU was granted a waiver from the Virginia Commission on October 29, 2002, exempting KU from retail choice through December 31, 2004. KU is also seeking a permanent legislative exemption from the Virginia Electric Utility Restructuring Act. The outcome of this legislative initiative is not expected to be known until mid-2003.

#### Construction Program and Financing

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. These needs are continually being reassessed and appropriate revisions are made, when necessary, in construction schedules. KU's estimates of its construction expenditures can vary substantially due to numerous items beyond KU's control, such as changes in rates, economic conditions, construction costs, and new environmental or other governmental laws and regulations.

Page 12

During the five years ended December 31, 2002, gross property additions amounted to approximately \$754 million. Internally generated funds and external financings for the five-year period were utilized to provide for these gross additions. The gross additions during this period amounted to approximately 23% of total utility plant at December 31, 2002. Gross retirements during the same period were \$82 million.

#### Coal Supply

Coal-fired generating units provided over 97% of KU's net kilowatt-hour generation for 2002. The remaining net generation for 2002 was provided by natural gas and oil fueled combustion turbine peaking units and hydroelectric plants. Coal will be the predominant fuel used by KU in the foreseeable future, with natural gas and oil being used for capacity and flame stabilization in coal-fired boilers or in emergencies. KU has no nuclear generating units and has no plans to build any in the foreseeable future.

KU maintains its fuel inventory at levels estimated to be necessary to avoid operational disruptions at its 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 labor issues

and other supplier or transporter operating difficulties.

KU believes there are adequate reserves available to supply its existing base-load generating units with the quantity and quality of coal required for those units throughout their useful lives. KU intends to meet a portion of its coal requirements with three-year or shorter contracts. As part of this strategy, KU will continue to negotiate replacement contracts as contracts expire. KU does not anticipate any problems negotiating new contracts for future coal needs. The balance of coal requirements will be met through spot purchases. KU had a coal inventory of approximately 1.4 million tons, or a 67-day supply, on hand at December 31, 2002.

KU expects to continue purchasing most of its coal, which has a sulfur content in the 0.7% - 3.5% range, from western and eastern Kentucky, West Virginia, southwest Indiana, Wyoming and Pennsylvania for the foreseeable future.

Coal for Ghent is delivered by barge. Deliveries to the Tyrone and Green River locations are by truck. Delivery to E.W. Brown is by rail.

The historical average delivered cost of coal purchased and the percentage of spot coal purchases were as follows:

	2002	2001	2000
Per ton	\$31.44	\$27.84	\$25.63
Per Mmbtu	\$1.35	\$1.20	\$1.07
Spot purchases as % of all sources	18%	44%	51%

KU's historical average cost of coal purchased is higher than LG&E's due to the lower sulfur content of the coal KU purchases for use at its Ghent plant and higher cost to transport coal to the E.W. Brown plant. The delivered cost of coal is expected to increase during 2003.

#### Environmental Matters

Protection of the environment is a major priority for KU. Federal, state, and local regulatory agencies have issued KU permits for various activities subject to air quality, water quality, and waste management laws and regulations. For the five-year period ending with 2002, expenditures for

Page 13

pollution control facilities represented \$63.5 million or 11% of total construction expenditures. KU estimates that construction expenditures for the installation of NOx control equipment from 2003 through 2004 will be approximately \$178 million. For a discussion of environmental matters, see Rates and Regulation for KU under Item 7 and Note 11 of KU's Notes to Financial Statements under Item 8.

#### Competition

In the last several years, KU has taken many steps to prepare for the expected increase in competition in its industry, including a reduction in the number of employees; aggressive cost cutting; an increase in focus on commercial, industrial and residential customers; an increase in employee involvement and training; a major realignment and formation of new business units; and continuous modifications of its organizational structure. KU will continue to take additional steps to better position itself for competition in the future.

## EMPLOYEES AND LABOR RELATIONS

LG&E had 891 full-time regular employees and KU had 946 full-time regular employees at December 31, 2002. Of the LG&E total, 628 operating, maintenance, and construction employees were represented by IBEW Local 2100. LG&E and employees represented by IBEW Local 2100 signed a four-year collective bargaining agreement in November 2001. Of the KU total, 162 operating, maintenance, and construction employees were represented by IBEW Local 2100 and USWA Local 9447-01. In August 2001, KU and employees represented by IBEW Local 2100 entered into a two-year collective bargaining agreement. KU and employees represented by USWA Local 9447-01 entered into a three-year collective bargaining agreement effective August 2002 and expiring August 2005.

As a result of the Powergen acquisition and in order to comply with PUHCA, LG&E Services was formed effective on January 1, 2001. LG&E Services provides certain services to affiliated entities, including LG&E and KU, at cost as required under the Holding Company Act. On January 1, 2001, approximately 1,000 employees, mainly from LG&E Energy, LG&E and KU, were moved to LG&E Services.

See Note 3 of LG&E's Notes to Financial Statements and Note 3 of KU's Notes to Financial Statements under Item 8 for workforce separation program in effect for 2001.

Page 14

Executive Officers of LG&E and KU at December 31, 2002:

Name	Age	Position	Effective Date of Election to Present Position
Victor A. Staffieri	47	Chairman of the Board, President and Chief Executive Officer	May 1, 2001
Richard Aitken-Davies	53	Chief Financial Officer	January 31, 2001
John R. McCall	59	Executive Vice President, General Counsel and Corporate Secretary	July 1, 1994
S. Bradford Rives	44	Senior Vice President - Finance and Controller	December 11, 2000
Paul W. Thompson	45	Senior Vice President - Energy Services	June 7, 2000
Chris Hermann	55	Senior Vice President - Distribution Operations	December 11, 2000
Wendy C. Welsh	48	Senior Vice President - Information Technology	December 11, 2000
Martyn Gallus	38	Senior Vice President - Energy Marketing	December 11, 2000
A. Roger Smith	49	Senior Vice President Project Engineering	December 11, 2000

David A. Vogel	36	Vice President - Retail Services	December 11, 2000
Daniel K. Arbough	41	Treasurer	December 11, 2000
Bruce D. Hamilton	47	Vice President Independent Power Operations	December 11, 2000
Robert E. Henriques	61	Vice President Regulated Generation	September 30, 2001
Michael S. Beer	44	Vice President-Rates and Regulatory	February 1, 2001
George R. Siemens	53	Vice President-External Affairs	January 11, 2001
Paula H. Pottinger	45	Vice President - Human Resources	June 1, 2002
D. Ralph Bowling	45	Vice President - Power Operations WKE	August 1, 2002

Page 15

R. W. Chip Keeling	46	Vice President - Communications	March 18, 2002
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The present term of office of each of the above executive officers extends to the meeting of the Board of Directors following the 2003 Annual Meeting of Shareholders.

There are no family relationships between or among executive officers of LG&E and KU. The above tables indicate officers serving as executive officers of both LG&E and KU at December 31, 2002. Each of the above officers serves in the same capacity for LG&E and KU.

Before he was elected to his current positions, Mr. Staffieri was President, Distribution Services Division of LG&E Energy Corp. from December 1995 to May 1997; Chief Financial Officer of LG&E Energy Corp. and LG&E from May 1997 to February 1999, (including Chief Financial Officer of KU from May 1998 to February 1999); President and Chief Operating Officer of LG&E Energy Corp. from March 1999 to April 2001 (including President of LG&E and KU from June 2000 to April 2001); Chairman, President and CEO of LG&E Energy Corp., LG&E and KU from May 2001 to present.

Before he was elected to his current positions, Mr. Aitken-Davies was Group Performance Director at Powergen from April 1998 to March 2000; Director - LG&E Transition Team at Powergen from March 2000 to January 2001.

Mr. McCall has been Executive Vice President, General Counsel and Corporate Secretary of LG&E Energy Corp. and LG&E since July 1994. He became Executive Vice President, General Counsel and Corporate Secretary of KU in May 1998.

Before he was elected to his current positions, Mr. Rives was Vice President - Finance and Controller of LG&E Energy Corp. from March 1996 to February 1999; and Senior Vice President - Finance and Business Development

from February 1999 to December 2000.

Before he was elected to his current positions, Mr. Thompson was Vice President - Business Development for LG&E Energy Corp. from July 1994 to September 1996; Vice President, Retail Electric Business for LG&E from September 1996 to June 1998; Group Vice President for LG&E Energy Marketing, Inc. from June 1998 to August 1999; Vice President, Retail Electric Business for LG&E from December 1998 to August 1999; and Senior Vice President - Energy Services for LG&E Energy Corp. from August 1999 to June 2000.

Before he was elected to his current positions, Mr. Hermann was Vice President and General Manager, Wholesale Electric Business of LG&E from January 1993 to June 1997; Vice President, Business Integration of LG&E from June 1997 to May 1998; Vice President, Power Generation and Engineering Services, of LG&E from May 1998 to December 1999; and Vice President Supply Chain and Operating Services from December 1999 to December 2000.

Before she was elected to her current positions, Ms. Welsh was Vice President - Information Services of LG&E from January 1994 to May 1997; Vice President, Administration of LG&E Energy Corp. from May 1997 to February 1998; and Vice President-Information Technology from February 1998 to December 2000.

Before he was elected to his current positions, Mr. Gallus was Director, Trading and Risk Management from January 1996 to September 1996; Director, Product Development from September 1996 to April 1997; Vice President, Structured Products from April 1997 to May 1998; Senior Vice President, Trading, from May 1998 to August 1998 for LG&E Energy Marketing Inc.; and Vice President, Energy Marketing from August 1998 to December 2000 for LG&E Energy Corp.

Page 16

Before he was elected to his current positions, Mr. Smith was Head of Construction Projects - Powergen from January 1996 to May 1999; Director of Projects - Powergen from May 1999 to December 1999; and Director of Engineering Projects for Powergen International from January 2000 to December 2000.

Before he was elected to his current positions, Mr. Vogel served in management positions within the Distribution organization of LG&E and KU prior to December 2000. In his position prior to his current role he was responsible for statewide outage management and restoration of distribution network.

Before he was elected to his current positions, Mr. Arbough was Manager, Corporate Finance of LG&E Energy Corp., and LG&E from August 1996 to May 1998; and he has held the position of Director, Corporate Finance of LG&E Energy Corp., LG&E and KU from May 1998 to present.

Before he was elected to his current positions, Mr. Hamilton was Venture Manager from May 1992 to December 1995; Senior Venture Manager from December 1995 to September 1997 and Vice President, Asset Management from September 1997 to December 2000.

Before he was elected to his current positions, Mr. Henriques was Senior Venture Manager for LG&E Power Inc. from May 1993 to September 1995, and Vice President-Plant Operations from September 1995 to September 2001.

Before he was elected to his current positions, Mr. Beer was Director, Federal Regulatory Affairs, for Illinois Power Company in Decatur, Illinois, from February of 1997 to January of 1998; Senior Corporate Attorney from February 1998 to February 2000; and Senior Counsel Specialist, Regulatory from February 2000 to February 2001.

Before he was elected to his current positions, Mr. Siemens held the position of Director of External Affairs for LG&E from August 1982 to January 2001.

Before she was elected to her current positions as Vice President-Human Resources, Ms. Pottinger was Manager, Human Resources Development from May 1994 to May 1997; and Director, Human Resources from June 1997 to June 2002.

Before he was elected to his current positions, Mr. Bowling was Plant General Manager at Western Kentucky Energy Corp. from July 1998 to December 2001; and General Manager Black Fossil Operations for Powergen in the United Kingdom from January 2002 to August 2002.

Before he was elected to his current positions, Mr. Keeling was General Manager, Marketing Communications for General Electric Company from January 1998 to January 1999. He joined LG&E Energy Corp. and held the title Manager, Media Relations from January 1999 to February 2000; and Director, Corporate Communications for LG&E Energy from February 2000 to March 2002.

Page 17

Exhibit 99(b)

LG&E and KU are filing this Current Report on Form 8-K to present reclassified financial statements and other related information in response to the requirements of EITF 02-03. The reclassified financial statements are set forth in the other attached exhibits to this Form 8-K. The information set forth below from Item 6 from the 2002 Annual Report has been included because certain information presented therein was affected by the reclassifications. This exhibit, and the other exhibits to the Form 8-K, contain information identical to the corresponding items of the 2002 Annual Report, except that the information contained in the exhibits has been updated to the extent necessary to report revenues from energy-trading contracts net of related cost of sales for all activities that are trading and involved derivative instruments as defined by Financial Accounting Standards Board Statement No. 133, Accounting for Derivative Instruments and Hedging Activities and to conform the related disclosures for all periods presented. No attempt has been made in this report to modify or update other disclosures except as required to reflect the effects of the reclassifications described above. These other disclosures are included in our annual, quarterly and current reports and other information filed with the SEC. Neither reported net operating income, net income, common equity, nor cash flows were impacted by the reclassification of revenue upon adoption of EITF 02-03.

The 2000, 1999 and 1998 consolidated financial data were derived from financial statements audited by Arthur Andersen LLP, independent public accountants, who expressed an unqualified opinion on those financial statements in their report dated January 26, 2001, before the revisions described in Note 1 to the Notes to Financial Statements filed as Exhibit 99(d). Arthur Andersen LLP has ceased operations. The amounts shown below

for such periods, reclassified pursuant to the adoption of EITF 02-03, are unaudited.

ITEM 6. Selected Financial Data.

	Years Ended December 31				
	(Thousands of \$)				
	2002	2001	2000	1999	1998
LG&E:					
Operating revenues:					
Revenues	\$991,468	\$965,267	\$934,204	\$847,879	\$854,556
Provision for rate collections (refunds)	12,267	(720)	(2,500)	(1,735)	(4,500)
Total operating revenues	1,003,735	964,547	931,704	846,144	850,056
Net operating income	117,914	141,773	148,870	140,091	135,523
Net income	88,929	106,781	110,573	106,270	78,120
Net income available for common stock	84,683	102,042	105,363	101,769	73,552
Total assets	2,561,078	2,448,354	2,226,084	2,171,452	2,104,637
Long-term obligations (including amounts due within one year)	\$ 616,904	\$ 616,904	\$ 606,800	\$ 626,800	\$ 626,800

LG&E's Management's Discussion and Analysis of Financial Condition and Results of Operation and LG&E's Notes to Financial Statements should be read in conjunction with the above information.

Page 1

	Years Ended December 31				
	(Thousands of \$)				
	2002	2001	2000	1999	1998
KU:					
Operating revenues:					
Revenues	\$ 848,637	\$ 821,675	\$ 793,409	\$ 815,532	\$ 807,786
Provision for rate collections (refunds)	13,027	(954)	-	(5,900)	(21,500)
Total operating revenues	861,664	820,721	793,409	809,632	786,286
Net operating income	108,643	121,370	128,136	136,016	125,388
Net income	93,384	96,414	95,524	106,558	72,764
Net income available for common stock	91,128	94,158	93,268	104,302	70,508
Total assets	1,998,383	1,826,902	1,739,518	1,785,090	1,761,201
Long-term obligations					

(including amounts due  
within one year) \$ 500,492 \$ 488,506 \$ 484,830 \$ 546,330 \$ 546,330

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

Page 2

Exhibit 99(c)

LG&E and KU are filing this Current Report on Form 8-K to present reclassified financial statements and other related information in response to the requirements of EITF 02-03. The reclassified financial statements are set forth in the other attached exhibits to this Form 8-K. The information set forth below from Item 7 from the 2002 Annual Report has been included because certain information presented therein was affected by the reclassifications. This exhibit, and the other exhibits to the Form 8-K, contain information identical to the corresponding items of the 2002 Annual Report, except that the information contained in the exhibits has been updated to the extent necessary to report revenues from energy-trading contracts net of related cost of sales for all activities that are trading and involved derivative instruments as defined by Financial Accounting Standards Board Statement No. 133, Accounting for Derivative Instruments and Hedging Activities and to conform the related disclosures for all periods presented. No attempt has been made in this report to modify or update other disclosures except as required to reflect the effects of the reclassifications described above. These other disclosures are included in our annual, quarterly and current reports and other information filed with the SEC. Neither reported net operating income, net income, common equity, nor cash flows were impacted by the reclassification of revenue upon adoption of EITF 02-03.

ITEM 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

LG&E:

#### GENERAL

The following discussion and analysis by management focuses on those factors that had a material effect on LG&E's financial results of operations and financial condition during 2002, 2001, and 2000 and should be read in connection with the financial statements and notes thereto.

Some of the following discussion may contain forward-looking statements that are subject to certain 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; 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 LG&E's reports to the SEC, including Exhibit No. 99.01 to the Annual Report.

#### MERGERS and ACQUISITIONS

On December 11, 2000, LG&E Energy was acquired by Powergen for cash of approximately \$3.2 billion or \$24.85 per share and the assumption of all of LG&E Energy's debt. As a result of the acquisition, LG&E Energy became a wholly owned subsidiary of Powergen and, as a result, LG&E became an indirect subsidiary of Powergen. LG&E has continued its separate identity and serves customers in Kentucky under its existing name. The preferred stock and debt securities of LG&E were not affected by this transaction and LG&E continues to file SEC reports. Following the acquisition, Powergen became a registered holding company under PUHCA, and LG&E, as a subsidiary of a registered holding company, became subject to additional regulation under PUHCA. See "Rates and Regulation" under Item 1.

On July 1, 2002, E.ON, a German company, completed its acquisition of Powergen plc (now Powergen Limited). As a result, LG&E and KU became indirect subsidiaries of E.ON. E.ON had announced its pre-conditional cash offer of 5.1 billion pounds sterling (\$7.3 billion) for Powergen on April 9, 2001. Following the acquisition, E.ON became a registered holding company under PUHCA.

Page 1

As contemplated in their regulatory filings in connection with the E.ON acquisition, E.ON, Powergen and LG&E Energy completed an administrative reorganization to move the LG&E Energy group from an indirect Powergen subsidiary to an indirect E.ON subsidiary. This reorganization was effective in March 2003.

#### RESULTS OF OPERATIONS

##### Net Income

LG&E's net income in 2002 decreased \$17.9 million as compared to 2001. The decrease resulted primarily from higher transmission operating expenses, an increase in amortization of VDT regulatory asset, and increased property insurance and pension expense, partially offset by an increase in electric sales to retail customers and lower interest expenses.

LG&E's net income decreased \$3.8 million for 2001, as compared to 2000. This decrease is mainly due to higher pension related expenses and amortization of VDT regulatory asset, partially offset by increased electric and gas net revenues (operating revenues less fuel for electric generation, power purchased and gas supply expenses) and decreased interest expenses.

##### Revenues

A comparison of operating revenues for the years 2002 and 2001, excluding the provisions recorded for rate collections (refunds), with the immediately preceding year reflects both increases and decreases, which have been segregated by the following principal causes (in thousands of \$):

Cause	Increase (Decrease) From Prior Period			
	Electric Revenues		Gas Revenues	
	2002	2001	2002	2001
Retail sales:				
Fuel and gas supply adjustments	\$ 19,449	\$ (394)	\$ (58,003)	\$ 79,627
LG&E/KU Merger surcredit	(2,825)	(2,456)	-	-

Performance based rate	-	1,962	-	-
Environmental cost				
recovery surcharge	9,694	1,246	-	-
Demand side management	1,381	-	938	-
Electric rate reduction	-	(3,671)	-	-
VDT surcredit	(1,177)	(1,014)	(285)	(68)
Gas rate increase	-	-	-	15,265
Weather normalization	-	-	2,234	-
Variation in sales volumes				
and other	24,819	4,429	21,658	(64,817)
Total retail sales	51,341	102	(33,458)	30,007
Wholesale sales	(6,700)	13,916	10,683	(11,642)
Gas transportation-net	-	-	189	(880)
Other	4,642	(1,241)	(496)	801
Total	\$ 49,283	\$ 12,777	\$(23,082)	\$ 18,286

Electric revenues increased in 2002 primarily due to an increase in retail sales due to warmer summer weather, an increase in the recovery of fuel costs passed through the FAC, partially offset by a decrease in wholesale sales due to lower market prices as compared to 2001. Cooling degree days

Page 2

increased 20% compared to 2001. Electric revenues increased in 2001 primarily due to an increase in wholesale sales and retail sales volume, partially offset by the effects of an electric rate reduction ordered by the Kentucky Commission, and the LG&E/KU merger surcredit (See Note 2 of LG&E's Notes to Financial Statements under Item 8). In January 2000, the Kentucky Commission ordered an electric rate reduction and the termination of LG&E's proposed electric PBR mechanism.

Gas revenues in 2002 decreased due to a lower gas supply cost billed to customers through the gas supply clause offset partially by increased gas retail sales due to cooler winter weather and an increase in wholesale sales volume. Heating degree days increased 17% as compared to 2001. Gas revenues in 2001 increased primarily as a result of higher gas supply costs billed to customers through the gas supply clause and the effects of a gas rate increase ordered by the Kentucky Commission in September 2000. The gas revenue increase was partially offset by a decrease in retail and wholesale gas sales in 2001 due to warmer weather. Heating degree days decreased 10.2% compared to 2000.

#### Expenses

Fuel for electric generation and gas supply expenses comprise a large component of LG&E's total operating costs. The retail electric rates contain a FAC and gas rates contain a GSC, whereby increases or decreases in the cost of fuel and gas supply are reflected in the FAC and GSC factors, subject to approval by the Kentucky Commission, and passed through to LG&E's retail customers.

Fuel for electric generation increased \$35.7 million (22.4%) in 2002 due to increased generation (\$5.4 million) and higher cost of coal burned (\$30.3 million). Fuel for electric generation decreased \$0.2 million (.1%) in 2001 primarily due to decreased generation as a result of decreased electric sales (\$2.2 million) partially offset by a higher cost of coal burned (\$2.0 million). The average delivered cost per ton of coal purchased was \$25.30 in 2002, \$21.27 in 2001 and \$20.96 in 2000.

Power purchased expense increased \$12.6 million (25.5%) in 2002 due to an

increase in purchases to meet requirements for native load partially offset by a decrease in purchase price. Power purchased increased \$4.2 million (9.2%) in 2001 primarily due to an increase in purchases to meet requirements for native load partially offset by a lower unit cost of the purchases.

Gas supply expenses decreased \$24.1 million (11.7%) in 2002 due to a decrease in cost of net gas supply (\$36.6 million), partially offset by an increase in the volume of gas delivered to the distribution system (\$12.5 million). Gas supply expenses increased \$9.3 million (4.7%) in 2001 primarily due to an increase in cost of net gas supply (\$36.2 million), partially offset by a decrease in the volume of gas delivered to the distribution system (\$26.9 million). The average unit cost per Mcf of purchased gas was \$4.19 in 2002, \$5.27 in 2001 and \$5.08 in 2000.

Other operation expenses increased \$40.5 million (24.1%) in 2002 primarily due to a full year amortization in 2002 of a regulatory asset created as a result of the workforce reduction costs associated with LG&E's VDT (\$17.0 million), higher costs for electric transmission primarily resulting from increased MISO costs (\$13.9 million), an increase in property and other insurance costs (\$3.9 million), an increase in pension costs due to change in pension assumptions to reflect current market conditions and change in market value of plan assets at the measurement date (\$3.7 million), and an increase in steam production costs (\$3.4 million). Other operation expenses increased \$31.9 million (23.4%) in 2001 primarily due to amortization of a regulatory asset resulting from workforce reduction costs associated with LG&E's VDT (\$13.0 million), an increase in pension expense (\$10.3 million) and an increase in outside services (\$8.5 million). Outside services increased in part due to the reclassification of expenses as a result of the formation of LG&E Services, as required by the SEC to comply with PUHCA.

Page 3

Maintenance expenses for 2002 increased \$1.5 million (2.6%) primarily due to gas distribution expenses for main remediation work (\$2.2 million). Maintenance expenses for 2001 decreased \$5.0 million (7.9%) primarily due to decreases in scheduled outages (\$2.8 million), and a decrease in software and communication equipment maintenance (\$2.8 million).

Depreciation and amortization increased \$5.5 million (5.5%) in 2002 and \$2.1 million (2.1%) in 2001 because of additional utility plant in service. The 2001 increase was offset by a decrease in depreciation rates resulting from a settlement order in December 2001 from the Kentucky Commission. Depreciation expenses decreased \$5.6 million as a result of the settlement order.

Variations in income tax expenses are largely attributable to changes in pre-tax income. LG&E's 2002 effective income tax rate increased to 37.2% from the 36.5% rate in 2001. See Note 7 of LG&E's Notes to Financial Statements under Item 8.

Property and other taxes decreased \$0.3 million (1.6%) in 2002. Property and other taxes decreased \$1.2 million (6.5%) in 2001 primarily due to a reduction in payroll taxes related to fewer employees as a result of workforce reductions and transfers to LG&E Services.

Other income - net decreased \$2.1 million (72.0%) in 2002 primarily due to increased costs for non-utility areas, \$1.3 million and decreases in the gain on sale of property \$0.8 million. Other income - net decreased \$2.0

million (40.5%) in 2001 primarily due to lower interest and dividend income.

Interest charges for 2002 decreased \$8.1 million (21.4%) primarily due to lower interest rates on variable rate debt (\$5.6 million) a decrease in debt to associated companies (\$0.8 million) and a decrease in interest associated with LG&E's accounts receivable securitization program (\$1.5 million). Interest charges for 2001 decreased \$5.3 million (12.2%) primarily due to lower interest rates on variable rate debt (\$2.2 million) and the retirement of short-term borrowings (\$8.1 million) partially offset by an increase in debt to associated companies (\$2.5 million) and an increase in interest associated with LG&E's accounts receivable securitization program (\$2.5 million). See Note 9 of LG&E's Notes to Financial Statements under Item 8.

LG&E's weighted average cost of long-term debt, including amortization of debt expense and interest rate swaps, was 3.87% at December 31, 2002 compared to 4.17% at December 31, 2001. See Note 9 of LG&E's Notes to Financial Statements under Item 8.

The rate of inflation may have a significant impact on LG&E's operations, its ability to control costs and the need to seek timely and adequate rate adjustments. However, relatively low rates of inflation in the past few years have moderated the impact on current operating results.

#### 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

Page 4

judgments regarding future events, including legal and regulatory challenges and anticipated recovery of costs. These judgments, in and of themselves, 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 following paragraphs. 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 forecast and the best estimates routinely require adjustment. See also Note 1 of LG&E's Notes to Financial Statements under Item 8.

**Unbilled Revenue** - At each month end LG&E prepares a financial estimate that projects electric and gas usage that has been used by customers, but not billed. The estimated usage is based on known weather and days not billed. At December 31, 2002, a 10% change in these estimated quantities would cause revenue and accounts receivable to change by approximately \$5.0 million, including \$2.3 million for electric usage and \$2.7 million for gas usage. See also Note 1 of LG&E's Notes to Financial Statements under Item 8.

**Benefit Plan Accounting** - Judgments and uncertainties in benefit plan

accounting include future rate of returns on pension plan assets, interest rates used in valuing benefit obligation, healthcare cost trend rates, and other actuarial assumptions.

LG&E's costs of providing defined-benefit pension retirement plans is dependent upon a number of factors, such as the rates of return on plan assets, discount rate, and contributions made to the plan. The market value of LG&E plan assets has been affected by declines in the equity market since the beginning of the fiscal year. As a result, at December 31, 2002, LG&E was required to recognize an additional minimum liability as prescribed by SFAS No. 87 Employers' Accounting for Pensions. The liability was recorded as a reduction to other comprehensive income, and did not affect net income for 2002. The amount of the liability depended upon the asset returns experienced in 2002 and contributions made by LG&E to the plan during 2002. Also, pension cost and cash contributions to the plan could increase in future years without a substantial recovery in the equity market. If the fair value of the plan assets exceeds the accumulated benefit obligation, the recorded liability will be reduced and other comprehensive income will be restored in the consolidated balance sheet.

The combination of poor market performance and a decrease in short-term corporate bond interest rates has created a divergence in the potential value of the pension liability and the actual value of the pension assets. These conditions could result in an increase in LG&E's funded accumulated benefit obligation and future pension expense. The primary assumptions that drive the value of the unfunded accumulated benefit obligation are the discount rate and expected return on plan assets.

LG&E made a contribution to the pension plan of \$83.1 million in January 2003.

A 1% increase or decrease in the assumed discount rate could have an approximate \$37.0 million positive or negative impact to the accumulated benefit obligation of LG&E.

See also Note 6 of LG&E's Notes to Financial Statements under Item 8.

Regulatory Mechanisms - Judgments and uncertainties include future regulatory decisions, impact of deregulation and competition on ratemaking process, and external regulator decisions.

Regulatory assets represent incurred costs that have been deferred because they are probable of future recovery in customer rates based upon Kentucky Commission orders. Regulatory liabilities generally represent obligations to make refunds to customers for previous collections based upon orders by the Kentucky Commission. Management believes, based on orders, the existing regulatory assets and liabilities are probable of recovery. This determination reflects the current regulatory climate in the state. If future recovery of costs ceases to be probable the assets would be required to be recognized in current period earnings.

Page 5

LG&E has accrued in the financial statements an estimate of \$12.5 million for 2002 ESM, with collection from customer commencing in April 2003. The ESM is subject to Kentucky Commission approval.

See also Note 3 of LG&E's Notes to Financial Statements under Item 8.

## NEW ACCOUNTING PRONOUNCEMENTS

SFAS No. 143, Accounting for Asset Retirement Obligations was issued in 2001. SFAS No. 143 establishes accounting and reporting standards for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs.

The effective implementation date for SFAS No. 143 is January 1, 2003. Management has calculated the impact of SFAS No. 143 and the recently released FERC NOPR No. RM02-7, Accounting, Financial Reporting, and Rate Filing Requirements for Asset Retirement Obligations. As of January 1, 2003, LG&E recorded asset retirement obligation (ARO) assets in the amount of \$4.6 million and liabilities in the amount of \$9.3 million. LG&E also recorded a cumulative effect adjustment in the amount of \$5.3 million to reflect the accumulated depreciation and accretion of ARO assets at the transition date less amounts previously accrued under regulatory depreciation. LG&E recorded offsetting regulatory assets of \$5.3 million, pursuant to regulatory treatment prescribed under SFAS No. 71, Accounting for the Effects of Certain Types of Regulation. Also pursuant to SFAS No. 71, LG&E recorded regulatory liabilities in the amount of \$60,000 offsetting removal costs previously accrued under regulatory accounting in excess of amounts allowed under SFAS No. 143.

LG&E also expects to record ARO accretion expense of approximately \$617,000, ARO depreciation expense of approximately \$117,000 and an offsetting regulatory credit in the income statement of approximately \$734,000 in 2003, pursuant to regulatory treatment prescribed under SFAS No. 71, Accounting for the Effects of Certain Types of Regulation. The accretion, depreciation and regulatory credit will be annual adjustments. SFAS No. 143 will have no impact on the results of the operation of LG&E.

LG&E asset retirement obligations are primarily related to the final retirement of generating units. LG&E transmission and distribution lines largely operate under perpetual property easement agreements which do not generally require restoration upon removal of the property. Therefore, under SFAS No. 143, no material asset retirement obligations will be recorded for transmission and distribution assets.

LG&E adopted EITF No. 98-10, Accounting for Energy Trading and Risk Management Activities, effective January 1, 1999. This pronouncement required that energy trading contracts be marked to market on the balance sheet, with the gains and losses shown net in the income statement.

The EITF clarified accounting standards related to energy trading activities under EITF Issue 02-03, Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities. EITF No. 02-03 established the following:

- - Rescinded EITF No. 98-10,
- - Contracts that do not meet the definition of a derivative under SFAS No. 133 should not be marked to fair market value, and
- - Revenues should be shown in the income statement net of costs associated with trading activities, whether or not the trades are physically settled.

Page 6

With the rescission of EITF No. 98-10, energy trading contracts that do not

also meet the definition of a derivative under SFAS No. 133 must be accounted for as executory contracts. Contracts previously recorded at fair value under EITF No. 98-10 that are not also derivatives under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, must be restated to historical cost through a cumulative effect adjustment. The rescission of this standard had no impact on financial position or results of operations of LG&E since all contracts marked to market under EITF No. 98-10 are also within the scope of SFAS No. 133.

As a result of EITF No. 02-03, LG&E has netted the power purchased expense for trading activities against electric operating revenue to reflect this accounting change. LG&E applied this guidance to all prior periods, which had no impact on previously reported net income or common equity.

	2002	2001
Gross electric operating revenues	\$746,224	\$706,645
Less costs reclassified from power purchased	22,449	32,153
Net electric operating revenues reported	\$723,775	\$674,492
Gross power purchased	\$ 84,330	\$ 81,475
Less costs reclassified to revenues	22,449	32,153
Net power purchased reported	\$ 61,881	\$ 49,332

In January 2003, the Financial Accounting Standards Board issued Financial Accounting Standards Board Interpretation No. 46, Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51 (FIN 46). FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 is effective immediately for all new variable interest entities created or acquired after January 31, 2003. For variable interest entities created or acquired prior to February 1, 2003, the provisions of FIN 46 must be applied for the first interim or annual period beginning after June 15, 2003. LG&E does not expect the adoption of this standard to have any impact on the financial position or results of operations.

#### LIQUIDITY AND CAPITAL RESOURCES

LG&E uses net cash generated from its operations and external financing to fund construction of plant and equipment and the payment of dividends. LG&E believes that such sources of funds will be sufficient to meet the needs of its business in the foreseeable future.

#### Operating Activities

Cash provided by operations was \$212.4 million, \$287.1 million and \$156.2 million in 2002, 2001, and 2000, respectively. The 2002 decrease compared to 2001 of \$74.7 million resulted primarily from the change in accounts receivable balances, including the sale of accounts receivable through the accounts receivable securitization program and a decrease in accounts payable and accrued taxes. The 2001 increase of \$130.9 million resulted primarily from an increase in accounts receivable, and a decrease in accrued taxes. See Note 1 of LG&E's Notes to Financial Statements under Item 8 for a discussion of accounts receivable securitization.

#### Investing Activities

LG&E's primary use of funds for investing activities continues to be for

capital expenditures. Capital expenditures were \$220.4 million, \$253.0 million and \$144.2 million in 2002, 2001, and 2000, respectively. LG&E expects its capital expenditures for 2003 and 2004 to total approximately \$340.0 million, which consists primarily of construction estimates associated with installation of NOx equipment as described in the section titled "Environmental Matters," purchase of jointly owned CTs with KU and on-going construction for the distribution systems.

Page 7

Net cash used for investment activities decreased \$28.7 million in 2002 compared to 2001 primarily due to the level of construction expenditures. CT expenditures were approximately \$35.9 million in 2002 and \$57.8 million in 2001. The \$107.9 million increase in net cash used in 2001 as compared to 2000 was due to NOx expenditures and the purchase of CTs.

#### Financing Activities

Net cash inflows for financing activities were \$22.5 million in 2002 and outflows of \$38.7 million and \$67.7 million in 2001 and 2000, respectively. In 2002, short-term borrowings increased \$98.9 million which were used in part for dividend payments of \$73.3 million. During 2001, short-term borrowings decreased \$20.4 million from 2000 and LG&E paid \$28.0 million in dividends.

During 2001, LG&E issued \$10.1 million of pollution control bonds resulting in net proceeds of \$9.7 million after issuance costs.

On March 6, 2002, LG&E refinanced its \$22.5 million and \$27.5 million unsecured pollution control bonds, both due September 1, 2026. The replacement bonds, due September 1, 2026, are variable rate bonds and are secured by first mortgage bonds.

On March 22, 2002, LG&E refinanced its two \$35 million unsecured pollution control bonds due November 1, 2027. The replacement variable rate bonds are secured by first mortgage bonds and will mature November 1, 2027.

In October 2002, LG&E issued \$41.7 million variable rate pollution bonds due October 1, 2032, and exercised its call option on \$41.7 million, 6.55% pollution control bonds due November 1, 2020.

Under the provisions for LG&E's variable-rate pollution control bonds totaling \$246.2 million, 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.

#### Future Capital Requirements

Future capital requirements may be affected in varying degrees by factors such as load growth, changes in construction expenditure levels, rate actions by regulatory agencies, new legislation, market entry of competing electric power generators, changes in environmental regulations and other regulatory requirements. LG&E anticipates funding future capital requirements through operating cash flow, debt, and/or infusions of capital from its parent.

LG&E's debt ratings as of December 31, 2002, were:

	Moody's	S&P	Fitch
First mortgage bonds	A1	A	A+
Preferred stock	Baa1	BBB	A-
Commercial paper	P-1	A-2	F-1

These ratings reflect the views of Moody's, S&P and Fitch. 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.

Page 8

#### Contractual Obligations

The following is provided to summarize LG&E's contractual cash obligations for periods after December 31, 2002 (in thousands of \$):

		Payments Due by Period				
	2003	2004- 2005	2006- 2007	After 2007	Total	
Contractual cash Obligations						
Short-term debt (a)	\$193,053	\$ -	\$ -	\$ -	\$193,053	
Long-term debt (b)	288,800	-	-	328,104	616,904	
Operating lease (c)	3,371	6,866	7,143	29,794	47,174	
Unconditional purchase obligations (d)	10,773	20,268	21,632	184,544	237,217	
Other long-term obligations (e)	28,401	95,151	-	-	123,552	
Total contractual cash obligations (f)	\$524,398	\$122,285	\$28,775	\$542,442	\$1,217,900	

- (a) Represents borrowings from parent company due within one year.
- (b) Includes long-term debt of \$246.2 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 2017 to 2027.
- (c) Operating lease represents the lease of LG&E's administrative office building.
- (d) Represents future minimum payments under purchased power agreements through 2020.
- (e) Represents construction commitments.
- (f) LG&E does not expect to pay the \$246.2 million of long-term debt classified as a current liability in the consolidated balance sheets in 2003 as explained in (b) above. LG&E anticipates cash from operations and external financing will be sufficient to fund future obligations. LG&E anticipates refinancing a portion of its short-term debt with long-term debt in 2003.

#### Market Risks

LG&E is exposed to market risks from changes in interest rates and commodity prices. To mitigate changes in cash flows attributable to these exposures, LG&E uses various financial instruments including derivatives. Derivative positions are monitored using techniques that include market value and sensitivity analysis.

See Note 1 and 4 of LG&E's Notes to Financial Statements under Item 8.

#### Interest Rate Sensitivity

LG&E has short-term and long-term variable rate debt obligations outstanding. At December 31, 2002, the potential change in interest expense associated with a 1% change in base interest rates of LG&E's unhedged debt is estimated at \$5.5 million after impact of interest rate swaps.

Interest rate swaps are used to hedge LG&E's underlying variable-rate debt obligations. These swaps hedge specific debt issuances and, consistent with management's designation, are accorded hedge accounting treatment. See Note 4 of LG&E's Notes to Financial Statements under Item 8.

Page 9

As of December 31, 2002, LG&E had swaps with a combined notional value of \$117.3 million. The swaps exchange floating-rate interest payments for fixed rate interest payments to reduce the impact of interest rate changes on LG&E's Pollution Control Bonds. The potential loss in fair value resulting from a hypothetical 1% adverse movement in base interest rates is estimated at \$10.8 million as of December 31, 2002. This estimate is derived from third party valuations. Changes in the market value of these swaps if held to maturity, as LG&E intends to do, will have no effect on LG&E's net income or cash flow. See Note 4 of LG&E's Notes to Financial Statements under Item 8.

#### Commodity Price Sensitivity

LG&E has limited exposure to market price volatility in prices of fuel and electricity, since its retail tariffs include the FAC and GSC commodity price pass-through mechanisms. LG&E is exposed to market price volatility of fuel and electricity in its wholesale activities.

#### Energy Trading & Risk Management Activities

LG&E conducts energy trading and risk management activities to maximize the value of power sales from physical assets it owns, in addition to the wholesale sale of excess asset capacity. Certain energy trading activities are accounted for on a mark-to-market basis in accordance with EITF 98-10, Accounting for Contracts Involved in Energy Trading and Risk Management Activities, SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, and SFAS No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities. Wholesale sales of excess asset capacity and wholesale purchases are treated as normal sales and purchases under SFAS No. 133 and SFAS No. 138 and are not marked-to-market.

The consensus reached by the EITF on EITF No. 02-03, Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities, to rescind EITF 98-10, effective for fiscal years after December 15, 2002, had no impact on LG&E's energy trading and risk management reporting as all contracts marked to market under EITF 98-10 are also within the scope of SFAS No. 133

The table below summarizes LG&E's energy trading and risk management activities for 2002 and 2001 (in thousands of \$).

	2002	2001
Fair value of contracts at beginning of period, net liability	\$ (186)	\$ (17)
Fair value of contracts when entered into during the period	(65)	3,441

Contracts realized or otherwise settled during the period	448	(2,894)
Changes in fair values due to changes in assumptions	(353)	(716)
Fair value of contracts at end of period, net liability	\$ (156)	\$ (186)

No changes to valuation techniques for energy trading and risk management activities occurred during 2002. Changes in market pricing, interest rate and volatility assumptions were made during both years. All contracts outstanding at December 31, 2002, have a maturity of less than one year and are valued using prices actively quoted for proposed or executed transactions or quoted by brokers.

LG&E maintains policies intended to minimize credit risk and revalues credit exposures daily to monitor compliance with those policies. At December 31, 2002, 86% of the trading and risk management commitments were with counterparties rated BBB- equivalent or better.

Page 10

#### Accounts Receivable Securitization

On February 6, 2001, LG&E implemented an accounts receivable securitization program. The purpose of this program is to enable LG&E to accelerate the receipt of cash from the collection of retail accounts receivable, thereby reducing dependence upon more costly sources of working capital. The securitization program allows for a percentage of eligible receivables to be sold. Eligible receivables are generally all receivables associated with retail sales that have standard terms and are not past due. LG&E is able to terminate the program at any time without penalty. If there is a significant deterioration in the payment record of the receivables by the retail customers or if LG&E fails to meet certain covenants regarding the program, the program may terminate at the election of the financial institutions. In this case, payments from retail customers would first be used to repay the financial institutions participating in the program, and would then be available for use by LG&E.

As part of the program, LG&E sold retail accounts receivables to a wholly owned subsidiary, LG&E R. Simultaneously, LG&E R entered into two separate three-year accounts receivable securitization facilities with two financial institutions and their affiliates whereby LG&E R can sell, on a revolving basis, an undivided interest in certain of its receivables and receive up to \$75 million from an unrelated third party purchaser. The effective cost of the receivables programs is comparable to LG&E's lowest cost source of capital, and is based on prime rated commercial paper. LG&E retains servicing rights of the sold receivables through two separate servicing agreements with the third party purchaser. LG&E has obtained an opinion from independent legal counsel indicating these transactions qualify as a true sale of receivables. As of December 31, 2002, the outstanding program balance was \$63.2 million. LG&E is considering unwinding its accounts receivable securitization arrangements involving LG&E R during 2003.

The allowance for doubtful accounts associated with the eligible securitized receivables was \$2.1 million at December 31, 2002. This allowance is based on historical experience of LG&E. Each securitization facility contains a fully funded reserve for uncollectible receivables.

#### RATES AND REGULATION

Following the purchase of Powergen by E.ON, E.ON became a registered holding company under PUHCA. As a result, E.ON, its utility subsidiaries, including LG&E, and certain of its non-utility subsidiaries are subject to extensive regulation by the SEC under PUHCA with respect to issuances and sales of securities, acquisitions and sales of certain utility properties, and intra-system sales of certain goods and services. In addition, PUHCA generally limits the ability of registered holding companies to acquire additional public utility systems and to acquire and retain businesses unrelated to the utility operations of the holding company. LG&E believes that it has adequate authority (including financing authority) under existing SEC orders and regulations to conduct its business. LG&E will seek additional authorization when necessary.

LG&E is subject to the jurisdiction of the Kentucky Commission in virtually all matters related to electric and gas utility regulation, and as such, its accounting is subject to SFAS No. 71, Accounting for the Effects of Certain Types of Regulation. Given LG&E's competitive position in the marketplace and the status of regulation in the state of Kentucky, LG&E has no plans or intentions to discontinue its application of SFAS No. 71. See Note 3 of LG&E's Notes to Financial Statements under Item 8.

Page 11

#### Kentucky Commission Settlement Order - VDT Costs, ESM and Depreciation

During the first quarter 2001, LG&E recorded a \$144 million charge for a workforce reduction program. Primary components of the charge were separation benefits, enhanced early retirement benefits, and health care benefits. The result of this workforce reduction was the elimination of approximately 700 positions, accomplished primarily through a voluntary enhanced severance program.

On June 1, 2001, LG&E filed an application (VDT case) with the Kentucky Commission to create a regulatory asset relating to these first quarter 2001 charges. The application requested permission to amortize these costs over a four-year period. The Kentucky Commission also opened a case to review a new depreciation study and resulting depreciation rates implemented in 2001.

LG&E reached a settlement in the VDT case as well as the other cases involving depreciation rates and ESM with all intervening parties. The settlement agreement was approved by Kentucky Commission Order on December 3, 2001. The order allowed LG&E to set up a regulatory asset of \$141 million for the workforce reduction costs and begin amortizing these costs over a five-year period starting in April 2001. The first quarter 2001 charge of \$144 million represented all employees who had accepted a voluntary enhanced severance program. Some employees rescinded their participation in the voluntary enhanced severance program, thereby decreasing the original charge from \$144 million to \$141 million. The settlement will also reduce revenues approximately \$26 million through a surcredit on future bills to customers over the same five-year period. The surcredit represents stipulated net savings LG&E is expected to realize from implementation of best practices through the VDT. The agreement also established LG&E's new depreciation rates in effect December 2001, retroactive to January 1, 2001. The new depreciation rates decreased depreciation expense by \$5.6 million in 2001.

#### Environmental Cost Recovery

In June 2000, the Kentucky Commission approved LG&E's application for a CCN

to construct up to three SCR NOx reduction facilities. The construction and subsequent operation of the SCRs is intended to reduce NOx emission levels to meet the EPA's mandated NOx emission level of 0.15 lbs./ Mmbtu by May 2004. In its order, the Kentucky Commission ruled that LG&E's proposed plan for construction was "reasonable, cost-effective and will not result in the wasteful duplication of facilities." In October 2000, LG&E filed an application with the Kentucky Commission to amend its Environmental Compliance Plan to reflect the addition of the proposed NOx reduction technology projects and to amend its Environmental Cost Recovery Tariff to include an overall rate of return on capital investments. Approval of LG&E's application in April 2001 allowed LG&E to begin to recover the costs associated with these new projects, subject to Kentucky Commission oversight during normal six-month and two-year reviews.

In May 2002, the Kentucky Commission initiated a periodic two-year review of LG&E's environmental surcharge. The review included the operation of the surcharge mechanism, determination of the appropriateness of costs included in the surcharge mechanism, recalculation of the cost of debt to reflect actual costs for the period under review, final determination of the amount of environmental revenues over-collected from customers, and a final determination of the amount of environmental costs and revenues to be "rolled-in" to base rates. A final order was issued on October 22, 2002, in which LG&E was ordered to refund \$325,000 to customers over the four-month period beginning November 2002 and ending February 2003. Additionally, LG&E was ordered to roll \$4.1 million into base rates and make corresponding adjustments to the monthly environmental surcharge filings to reflect that portion of environmental rate base now included in base rates on a going-forward basis.

In August 2002, LG&E filed an application with the Kentucky Commission to amend its compliance plan to allow recovery of the cost of new and additional environmental compliance facilities. The estimated capital cost of the additional facilities is \$71.1 million. The Kentucky Commission

Page 12

conducted a public hearing on the case on December 20, 2002, final briefs were filed on January 15, 2003, and a final order was issued February 11, 2003. The final order approved recovery of four new environmental compliance facilities totaling \$43.1 million. A fifth project, expansion of the land fill facility at the Mill Creek Station, was denied without prejudice with an invitation to reapply for recovery when required construction permits are approved. Cost recovery through the environmental surcharge of the four approved projects will begin with the bills rendered in April 2003.

#### ESM

LG&E's electric rates are subject to an ESM. The ESM, initially in place for three years beginning in 2000, sets an upper and lower point for rate of return on equity, whereby if LG&E's rate of return for the calendar year falls within the range of 10.5% to 12.5%, no action is necessary. If earnings are above the upper limit, the excess earnings are shared 40% with ratepayers and 60% with shareholders; if earnings are below the lower limit, the earnings deficiency is recovered 40% from ratepayers and 60% from shareholders. By order of the Kentucky Commission, rate changes prompted by the ESM filing go into effect in April of each year subject to a balancing adjustment in successive periods. LG&E made its second ESM filing on March 1, 2002, for the calendar year 2001 reporting period. LG&E is in the process of refunding \$441,000 to customers for the 2001 reporting

period. LG&E estimated that the rate of return will fall below the lower limit, subject to Kentucky Commission approval, for the year ended December 31, 2002. The 2002 financial statements include an accrual to reflect the earnings deficiency of \$12.5 million to be recovered from customers commencing in April 2003.

On November 27, 2002, LG&E filed a revised ESM tariff which proposed continuance of the existing ESM through December 2005. The Kentucky Commission issued an Order suspending the ESM tariff one day making the effective date January 2, 2003. In addition, the Kentucky Commission is conducting a management audit to review the ESM plan and reassess its reasonableness in 2003. LG&E and interested parties will have the opportunity to provide recommendations for modification and continuance of the ESM or other forms of alternative or incentive regulation.

#### DSM

LG&E's rates contain a DSM provision. The provision includes a rate mechanism that provides concurrent recovery of DSM costs and provides an incentive for implementing DSM programs. This program had allowed LG&E to recover revenues from lost sales associated with the DSM program. In May 2001, the Kentucky Commission approved LG&E's plan to continue DSM programs. This filing called for the expansion of the DSM programs into the service territory served by KU and proposed a mechanism to recover revenues from lost sales associated with DSM programs based on program planning engineering estimates and post-implementation evaluation.

#### Gas PBR

Since November 1, 1997, LG&E has operated under an experimental PBR mechanism related to its gas procurement activities. For each of the last five years, LG&E's rates have been adjusted to recover its portion of the savings (or expenses) incurred during each of the five 12-month periods beginning November 1 and ending October 31. Since its implementation on November 1, 1997, through October 31, 2002, LG&E has achieved \$38.1 million in savings. Of the total savings, LG&E has retained \$16.5 million, and the remaining portion of \$21.6 million has been distributed to customers. In December 2000, LG&E filed an application reporting on the operation of the experimental PBR and requested the Kentucky Commission to extend the PBR as a result of the benefits provided to both LG&E and its customers during the experimental period. Following the discovery and hearing process, the Kentucky Commission issued an order effective November 1, 2001, extending the experimental PBR program for an additional four years, and making other modifications, including changes to the sharing levels applicable to

#### Page 13

savings or expenses incurred under the PBR. Specifically, the Kentucky Commission modified the sharing mechanism to a 25%/75% Company/Customer sharing for all savings (and expenses) up to 4.5% of the benchmarked gas costs. Savings (and expenses) in excess of 4.5% of the benchmarked gas costs are shared at a 50%/50% level.

#### FAC

Prior to implementation of the electric PBR in July 1999, and following its termination in March 2000, LG&E employed an FAC mechanism, which under Kentucky law allowed LG&E to recover from customers the actual fuel costs associated with retail electric sales. In February 1999, LG&E received orders from the Kentucky Commission requiring a refund to retail electric

customers of approximately \$3.9 million resulting from reviews of the FAC from November 1994, through April 1998. While legal challenges to the Kentucky Commission order were pending a comprehensive settlement was reached by all parties and approved by the Kentucky Commission on May 17, 2002. Thereunder, LG&E agreed to credit its fuel clause in the amount of \$720,000 (such credit provided over the course of June and July 2002), and the parties agreed on a prospective interpretation of the state's fuel adjustment clause regulation to ensure consistent and mutually acceptable application on a going-forward basis.

In December 2002, the Kentucky Commission initiated a two-year review of the operation of LG&E's FAC for the period November 2000 through October 2002. Testimony in the review case was filed on January 20, 2003 and a public hearing was held February 18, 2003. Issues addressed at that time included the establishment of the current base fuel factor to be included in LG&E's base rates, verification of proper treatment of purchased power costs during unit outages, and compliance with fuel procurement policies and practices.

#### Gas Rate Case

In March 2000, LG&E filed an application with the Kentucky Commission requesting an adjustment in LG&E's gas rates. In September 2000, the Kentucky Commission granted LG&E an annual increase in its base gas revenues of \$20.2 million effective September 28, 2000. The Kentucky Commission authorized a return on equity of 11.25%. The Kentucky Commission approved LG&E's proposal for a weather normalization billing adjustment mechanism that will normalize the effect of weather on base gas revenues from gas sales.

#### Wholesale Natural Gas Prices

On September 12, 2000, the Kentucky Commission issued an order establishing Administrative Case No. 384 - "An Investigation of Increasing Wholesale Natural Gas Prices and the Impacts of such Increase on the Retail Customers Served by Kentucky's Jurisdictional Natural Gas Distribution Companies". The impetus for this administrative proceeding was the escalation of wholesale natural gas prices during the summer of 2000.

The Kentucky Commission directed Kentucky's natural gas distribution companies, including LG&E, to file selected information regarding the individual companies' natural gas purchasing practices, expectations for the then-approaching winter heating season of 2000-2001, and potential actions which these companies might take to mitigate price volatility. On July 17, 2001, the Kentucky Commission issued an order encouraging the natural gas distribution companies in Kentucky to take various actions, among them to propose a natural gas hedge plan, consider performance-based ratemaking mechanisms, and to increase the use of storage.

In April 2002, in Case No. 2002-00136, LG&E proposed a hedging plan for the 2002/2003 winter heating season with three alternatives, the first two using a combination of storage and financial hedge instruments and the third relying upon storage alone. LG&E and the Attorney General, who represents Kentucky consumers, entered into a settlement which selected the third option. In August 2002, the Kentucky Commission approved the plan contemplated in the settlement. The Kentucky Commission validated the effectiveness of storage to mitigate potentially high winter gas prices by approving this natural gas hedging plan.

The Kentucky Commission also decided in Administrative Case No. 384 to engage a consultant to conduct a forward-looking audit of the gas procurement and supply procedures of Kentucky's largest natural gas distribution companies. The Kentucky Commission completed its audit in late 2002. The audit recognized LG&E as "efficient and effective [in the] procurement and management of significant quantities of natural gas supplies." The auditors also recognized that "the Company's residential gas prices have long been below averages for the U. S. and for the Commonwealth of Kentucky" which "demonstrates [LG&E's] effectiveness in [the] procurement and management of natural gas supplies." The audit also stated that the "Company's very impressive record in keeping its rates down provides sound evidence on the excellent job done in the area of gas supply procurement and management."

#### Kentucky Commission Administrative Case for Affiliate Transactions

In December 1997, the Kentucky Commission opened Administrative Case No. 369 to consider Kentucky Commission policy regarding cost allocations, affiliate transactions and codes of conduct governing the relationship between utilities and their non-utility operations and affiliates. The Kentucky Commission intended to address two major areas in the proceedings: the tools and conditions needed to prevent cost shifting and cross-subsidization between regulated and non-utility operations; and whether a code of conduct should be established to assure that non-utility segments of the holding company are not engaged in practices that could result in unfair competition caused by cost shifting from the non-utility affiliate to the utility. During the period September 1998 to February 2000, the Kentucky Commission issued draft codes of conduct and cost allocation guidelines. In early 2000, the Kentucky General Assembly enacted legislation, House Bill 897, which authorized the Kentucky Commission to require utilities who provide nonregulated activities to keep separate accounts and allocate costs in accordance with procedures established by the Kentucky Commission. In the same bill, the General Assembly set forth provisions to govern a utility's activities related to the sharing of information, databases, and resources between its employees or an affiliate involved in the marketing or the provision of nonregulated activities and its employees or an affiliate involved in the provision of regulated services. The legislation became law in July 2000 and LG&E has been operating pursuant thereto since that time. On February 14, 2001, the Kentucky Commission published notice of their intent to promulgate new administrative regulations under the auspices of the new law. This effort is still on going.

#### Kentucky Commission Administrative Case for System Adequacy

On June 19, 2001, Kentucky Governor Paul E. Patton issued Executive Order 2001-771, which directed the Kentucky Commission to review and study issues relating to the need for and development of new electric generating capacity in Kentucky. The issues to be considered included the impact of new power plants on the electric supply grid, facility siting issues, and economic development matters, with the goal of ensuring a continued, reliable source of supply of electricity for the citizens of Kentucky and the continued environmental and economic vitality of Kentucky and its communities. In response to that Executive Order, in July 2001 the Kentucky Commission opened Administrative Case No. 387 to review the adequacy of Kentucky's generation capacity and transmission system. Specifically, the items reviewed were the appropriate level of reliance on purchased power, the appropriate reserve margins to meet existing and future electric demand, the impact of spikes in natural gas prices on

electric utility planning strategies, and the adequacy of Kentucky's electric transmission facilities. LG&E, as a party to this proceeding, filed written testimony and responded to two requests for information. Public hearings were held and in October 2001, LG&E filed a final brief in the case. In December 2001, the Kentucky Commission issued an order in which it noted that LG&E is responsibly addressing the long-term supply needs of native load customers and that current reserve margins are appropriate. However, due to the rapid pace of change in the industry, the order also requires LG&E to provide an annual assessment of supply resources, future demand, reserve margin, and the need for new resources.

Page 15

Regarding the transmission system, the Kentucky Commission concluded that the transmission system within Kentucky can reliably serve native load and a significant portion of the proposed new unregulated power plants. However, it will not be able to handle the volume of transactions envisioned by FERC without future upgrades, the costs of which should be borne by those for whom the upgrades are required.

The Kentucky Commission pledged to continue to monitor all relevant issues and advocate Kentucky's interests at all opportunities.

#### FERC SMD NOPR

On July 31, 2002, FERC issued a NOPR in Docket No. RM01-12-000 which would substantially alter the regulations governing the nation's wholesale electricity markets by establishing a common set of rules -- SMD. The SMD NOPR would require each public utility that owns, operates, or controls interstate transmission facilities to become an Independent Transmission Provider (ITP), belong to an RTO that is an ITP, or contract with an ITP for operation of its transmission assets. It would also establish a standardized congestion management system, real-time and day-ahead energy markets, and a single transmission service for network and point-to-point transmission customers. Review of the proposed rulemaking is underway and a final rule is expected during 2003. While it is expected that the SMD final rule will affect LG&E revenues and expenses, the specific impact of the rulemaking is not known at this time.

#### MISO

LG&E is a member of the MISO, which began commercial operations on February 1, 2002. MISO now has operational control over LG&E's high-voltage transmission facilities (100 kV and greater), while LG&E continues to control and operate the lower voltage transmission subject to the terms and conditions of the MISO OATT. As a transmission-owning member of MISO, LG&E also incurs administrative costs of MISO pursuant to Schedule 10 of the MISO OATT.

MISO also proposed to implement a congestion management system. FERC directed the MISO to coordinate its efforts with FERC's Rulemaking on SMD. On September 24, 2002, the MISO filed new rate schedules designated as Schedules 16 and 17, which provide for the collection of costs incurred by the MISO to establish day-ahead and real-time energy markets. The MISO proposed to recover these costs under Schedules 16 and 17 once service commences. If approved by FERC, these schedules will cause LG&E to incur additional costs. LG&E opposes the establishment of Schedules 16 and 17. This effort is still on-going and the ultimate impact of the two schedules, if approved, is not known at this time.

## Merger Surcredit

As part of the LG&E Energy merger with KU Energy in 1998, LG&E Energy estimated non-fuel savings over a ten-year period following the merger. Costs to achieve these savings for LG&E of \$50.2 million were recorded in the second quarter of 1998, \$18.1 million of which was deferred and amortized over a five-year period pursuant to regulatory orders. Primary components of the merger costs were separation benefits, relocation costs, and transaction fees, the majority of which were paid by December 31, 1998. LG&E expensed the remaining costs associated with the merger (\$32.1 million) in the second quarter of 1998.

In approving the merger, the Kentucky Commission adopted LG&E's proposal to reduce its retail customers' bills based on one-half of the estimated merger-related savings, net of deferred and amortized amounts, over a five-year period. The surcredit mechanism provides that 50% of the net non-fuel cost savings estimated to be achieved from the merger be provided to ratepayers through a monthly bill credit, and 50% be retained by the Companies, over a five-year period. The surcredit was allocated 53% to KU and 47% to LG&E. In that same order, the Commission required LG&E and KU,

Page 16

after the end of the five-year period, to present a plan for sharing with customers the then-projected non-fuel savings associated with the merger. The Companies submitted this filing on January 13, 2003, proposing to continue to share with customers, on a 50%/50% basis, the estimated fifth-year gross level of non-fuel savings associated with the merger. The filing is currently under review.

Any fuel cost savings are passed to Kentucky customers through the fuel adjustment clause. See FAC above.

## Environmental Matters

The Clean Air Act imposed stringent new SO<sub>2</sub> and NO<sub>x</sub> emission limits on electric generating units. LG&E previously had installed scrubbers on all of its generating units. LG&E's strategy for Phase II SO<sub>2</sub> reductions, which commenced January 1, 2000, is to increase scrubber removal efficiency to delay additional capital expenditures and may also include fuel switching or upgrading scrubbers. LG&E met the NO<sub>x</sub> emission requirements of the Act through installation of low-NO<sub>x</sub> burner systems. LG&E's compliance plans are subject to many factors including developments in the emission allowance and fuel markets, future regulatory and legislative initiatives, and advances in clean air control technology. LG&E will continue to monitor these developments to ensure that its environmental obligations are met in the most efficient and cost-effective manner.

In September 1998, the EPA announced its final "NO<sub>x</sub> SIP Call" rule requiring states to impose significant additional reductions in NO<sub>x</sub> emissions by May 2003, in order to mitigate alleged ozone transport impacts on the Northeast region. The Commonwealth of Kentucky is currently in the process of revising its SIP to require reductions in NO<sub>x</sub> emissions from coal-fired generating units to the 0.15 lb./Mmbtu level on a system-wide basis. In related proceedings in response to petitions filed by various Northeast states, in December 1999, EPA issued a final rule pursuant to Section 126 of the Clean Air Act directing similar NO<sub>x</sub> reductions from a number of specifically targeted generating units including all LG&E units. As a result of appeals to both rules, the compliance date was extended to May 2004. All LG&E generating units are subject to the May 2004 compliance

date under these NOx emissions reduction rules.

LG&E is currently implementing a plan for adding significant additional NOx controls to its generating units. Installation of additional NOx controls will proceed on a phased basis, with installation of controls commencing in late 2000 and continuing through the final compliance date. LG&E estimates that it will incur total capital costs of approximately \$178 million to reduce its NOx emissions to the 0.15 lb./Mmbtu level on a company-wide basis. In addition, LG&E will incur additional operating and maintenance costs in operating new NOx controls. LG&E believes its costs in this regard to be comparable to those of similarly situated utilities with like generation assets. LG&E had anticipated that such capital and operating costs are the type of costs that are eligible for recovery from customers under its environmental surcharge mechanism and believed that a significant portion of such costs could be recovered. In April 2001, the Kentucky Commission granted recovery of these costs for LG&E.

LG&E is also monitoring several other air quality issues which may potentially impact coal-fired power plants, including the appeal of the D.C. Circuit's remand of the EPA's revised air quality standards for ozone and particulate matter, measures to implement EPA's regional haze rule, and EPA's December 2000 determination to regulate mercury emissions from power plants. In addition, LG&E is currently working with local regulatory authorities to review the effectiveness of remedial measures aimed at controlling particulate matter emissions from its Mill Creek Station. LG&E previously settled a number of property damage claims from adjacent residents and completed significant remedial measures as part of its ongoing capital construction program. LG&E is in the process of converting the Mill Creek Station to wet stack operation in an effort to resolve all outstanding issues related to particulate matter emissions.

Page 17

LG&E owns or formerly owned three properties which are the location of past MGP operations. Various contaminants are typically found at such former MGP sites and environmental remediation measures are frequently required. With respect to the sites, LG&E has completed cleanups, obtained regulatory approval of site management plans, or reached agreements for other parties to assume responsibility for cleanup. Based on currently available information, management estimates that it will incur additional costs of \$400,000. Accordingly, an accrual of \$400,000 has been recorded in the accompanying financial statements at December 31, 2002 and 2001.

See Note 11 of LG&E's Notes to Financial Statements under Item 8 for an additional discussion of environmental issues.

#### Deferred Income Taxes

LG&E expects to have adequate levels of taxable income to realize its recorded deferred tax assets. At December 31, 2002, deferred tax assets totaled \$98.2 million and were principally related to expenses attributable to LG&E's pension plans and post retirement benefit obligations.

#### FUTURE OUTLOOK

##### Competition and Customer Choice

LG&E has moved aggressively over the past decade to be positioned for the energy industry's shift to customer choice and a competitive market for energy services. Specifically, LG&E has taken many steps to prepare for

the expected increase in competition in its business, including support for PBR structures; aggressive cost reduction activities; strategic acquisitions, dispositions and growth initiatives; write-offs of previously deferred expenses; an increase in focus on commercial and industrial customers; an increase in employee training; and necessary corporate and business unit realignments.

In December 1997, the Kentucky Commission issued a set of principles which was intended to serve as its guide in consideration of issues relating to industry restructuring. Among the issues addressed by these principles are: consumer protection and benefit, system reliability, universal service, environmental responsibility, cost allocation, stranded costs and codes of conduct. During 1998, the Kentucky Commission and a task force of the Kentucky General Assembly had each initiated proceedings, including meetings with representatives of utilities, consumers, state agencies and other groups in Kentucky, to discuss the possible structure and effects of energy industry restructuring in Kentucky.

In November 1999, the task force issued a report to the Governor of Kentucky and a legislative agency recommending no general electric industry restructuring actions during the 2000 legislative session. No general restructuring actions have been taken to date by the legislature.

Thus, at the time of this report, 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 LG&E, which may be significant, cannot currently be predicted.

While many states have moved forward in providing retail choice, many others have not. Some are reconsidering their initiatives and have even delayed implementation.

Page 18

KU:

#### GENERAL

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 2002, 2001, and 2000 and should be read in connection with the financial statements and notes thereto.

Some of the following discussion may contain forward-looking statements that are subject to certain 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: 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 to the SEC, including Exhibit No. 99.01 to the Annual Report.

#### MERGERS and ACQUISITIONS

On December 11, 2000, LG&E Energy was acquired by Powergen for cash of

approximately \$3.2 billion or \$24.85 per share and the assumption of all of LG&E Energy's debt. As a result of the acquisition, LG&E Energy became a wholly owned subsidiary of Powergen and, as a result, KU became an indirect subsidiary of Powergen. KU has continued its separate identity and serves customers in Kentucky, Virginia and Tennessee under its existing name. The preferred stock and debt securities of KU were not affected by this transaction and KU continued to file SEC reports. Following the acquisition, Powergen became a registered holding company under PUHCA and KU, as a subsidiary of a registered holding company, became subject to additional regulation under PUHCA. See "Rates and Regulation" under Item 1.

On July 1, 2002, E.ON, a German company, completed its acquisition of Powergen plc (now Powergen Limited). As a result, LG&E and KU became indirect subsidiaries of E.ON. E.ON had announced its pre-conditional cash offer of 5.1 billion pounds sterling (\$7.3 billion) for Powergen on April 9, 2001. Following the acquisition, E.ON became a registered holding company under PUHCA.

As contemplated in their regulatory filings in connection with the E.ON acquisition, E.ON, Powergen and LG&E Energy completed an administrative reorganization to move the LG&E Energy group from an indirect Powergen subsidiary to an indirect E.ON subsidiary. This reorganization was effective in March 2003.

#### RESULTS OF OPERATIONS

##### Net Income

KU's net income in 2002 decreased \$3.0 million compared to 2001. The decrease resulted primarily from higher transmission operating expenses, an increase in amortization of regulatory assets, and increased property insurance, partially offset by an increase in sales to retail customers and lower interest expenses.

Page 19

KU's net income in 2001 was relatively flat as compared to 2000 with an increase of \$.9 million. The increase resulted primarily from decreased depreciation, interest expenses and property and other taxes, partially offset by higher pension related expenses and amortization of regulatory assets.

##### Revenues

A comparison of operating revenues for the years 2002 and 2001, excluding the provision for rate collections (refunds), with the immediately preceding year reflects both increases and decreases which have been segregated by the following principal causes (in thousands of \$):

Cause	Increase (Decrease) From Prior Period	
	2002	2001
Retail sales:		
Fuel clause adjustments	\$ 18,223	\$ 10,220
KU/LG&E Merger surcredit	(2,641)	(3,856)
Environmental cost recovery surcharge	3,781	1,458
Demand side management	1,570	-
Performance based rate	-	1,747
Electric rate reduction	-	(5,395)

VDT surcredit	(527)	(372)
Variation in sales volumes, and other	46,601	(1,627)
Total retail sales	67,007	2,175
Wholesale sales	(47,178)	24,889
Other	7,132	1,202
Total	\$ 26,961	\$ 28,266

Electric revenues increased in 2002 primarily due to an increase in retail sales due to warmer weather and an increase in the recovery of fuel costs passed through the FAC. Cooling degree days for 2002 increased 26% over 2001. The increase in retail sales was partially offset by a decrease in wholesale sales volumes. The decrease in wholesale sales was due in large part to fewer megawatts available due to increased retail sales. Electric revenues increased in 2001 primarily due to an increase in wholesale activity and an increase in the recovery of fuel costs passed through the FAC partially offset by a rate reduction ordered by Kentucky Commission in 2000 and lower sales volumes.

#### Expenses

Fuel for electric generation comprises a large component of KU's total operating expenses. KU's Kentucky jurisdictional electric rates are subject to a FAC whereby increases or decreases are reflected in the FAC factor, subject to the approval of the Kentucky Commission. KU's wholesale and Virginia jurisdictional electric rates contain a fuel adjustment clause whereby increases or decreases in the cost of fuel are reflected in rates, subject to the approval of FERC and the Virginia Commission, respectively.

Fuel for electric generation increased \$13.1 million (5.5%) in 2002 because of an increase in the cost of coal burned (\$29.7 million), partially offset by a decrease in generation (\$16.5 million). Fuel for electric generation increased \$17.1 million (7.8%) in 2001 because of an increase in the cost of coal burned (\$21.8 million), partially offset by a decrease in generation (\$4.7 million). The average delivered cost per ton of coal purchased was \$31.44 in 2002, \$27.84 in 2001 and \$25.63 in 2000.

Power purchased expense increased \$13.0 million (11.0%) in 2002 primarily due to an increase in purchases to meet requirements for native load partially offset by a decrease in purchase price. Power purchased expense increased \$10.0 million (9.3%) in 2001 primarily due to an increase in purchases to meet requirements for native load partially offset by a decrease in purchase price.

Page 20

Other operation expenses increased \$25.8 million (21.8%) in 2002. The primary cause for the increase was the full year amortization in 2002 of a regulatory asset created as a result of the workforce reduction associated with KU's VDT of \$6.5 million, higher costs for electric transmission primarily resulting from increased MISO costs of \$7.4 million, an increase in property insurance costs of \$2.8 million, an increase in employee benefit costs due to changes in pension assumptions to reflect current market conditions and changes in market value of plan assets at the measurement date of \$1.7 million, and an increase in outside services of \$4.9 million. Other operation expenses increased \$10.3 million (9.5%) in 2001. The primary cause for the increase was the amortization of a regulatory asset as a result of the workforce reduction associated with KU's VDT of \$5.0 million and an increase in pension expense of \$5.5 million.

Maintenance expenses increased \$5.9 million (10.3%) in 2002 primarily due to increases in steam maintenance of \$6.1 million related to annual outages at the Ghent, Green River, and Tyrone steam facilities. Maintenance expenses for 2001 decreased \$4.6 million (7.5%) primarily due to decreased repairs to steam facilities (\$6.5 million).

Depreciation and amortization increased \$5.2 million (5.7%) in 2002 primarily due to an increase in plant in service. Depreciation and amortization decreased \$8.0 million (8.1%) in 2001 primarily due to a reduction in depreciation rates as a result of a settlement order in December 2001 from the Kentucky Commission. Depreciation expenses decreased by \$6.0 million as a result of the settlement order.

Variations in income tax expense are largely attributable to changes in pre-tax income. The 2002 effective income tax rate decreased to 34.9% from the 35.9% rate in 2001. See Note 7 of KU's Notes to Financial Statements under Item 8.

Property and other taxes increased \$1.1 million (7.6%) in 2002 due to higher property taxes and payroll taxes. Property and other taxes decreased \$3.1 million (18.2%) in 2001 due to decreases in payroll taxes related to fewer employees as a result of workforce reductions and transfers to LG&E Energy Services Company.

Other income-net increased \$1.5 million (16.8%) in 2002 primarily due to a non-recurring increase in earnings from KU's equity earnings in a minority interest of \$5.2 million, partially offset by a gain on disposition of property in 2001, \$1.8 million, lower interest and dividend income from investments, \$0.7 million, and higher benefit and other costs, \$1.4 million. The increased equity earnings in 2002 are due to the gain on the sale of emissions allowances. Other income-net increased \$2.1 million (30.5%) in 2001 due to an increase in the gain on sale of assets.

Interest charges decreased \$8.3 million (24.5%) in 2002 as compared to 2001 due to lower interest rates on variable rate debt and refinancing of long term debt with lower interest rates, \$8.0 million. Interest charges decreased \$5.4 million (13.7%) in 2001 from 2000 due to lower interest rates on variable rate debt, \$4.6 million, the retirement of short-term borrowings, \$1.6 million, lower interest on debt to parent company, \$1.2 million, partially offset by an increase in interest associated with KU's accounts receivable securitization program, \$1.8 million.

KU's weighted average cost of long-term debt, including amortization of debt expense and interest rate swaps, was 3.30% at December 31, 2002 compared to 4.91% at December 31, 2001. See Note 9 of KU's Notes to Financial Statements under Item 8.

The rate of inflation may have a significant impact on KU's operations, its ability to control costs and the need to seek timely and adequate rate adjustments. However, relatively low rates of inflation in the past few years have moderated the impact on current operating results.

Page 21

#### 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, in and of themselves, 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 following paragraphs. 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 forecast and the best estimates routinely require adjustment. See also Note 1 of KU's Notes to Financial Statements under Item 8.

Unbilled Revenue - At each month end KU prepares a financial estimate that projects electric usage that has been used by customers, but not billed. The estimated usage is based on known weather and days not billed. At December 31, 2002, a 10% change in these estimated quantities would cause revenue and accounts receivable to change by approximately \$4.2 million. See also Note 1 of KU's Notes to Financial Statements under Item 8.

Benefit Plan Accounting - Judgments and uncertainties in benefit plan accounting include future rate of returns on pension plan assets, interest rates used in valuing benefit obligation, healthcare cost trend rates and other actuarial assumptions.

KU's costs of providing defined-benefit pension retirement plans is dependent upon a number of factors, such as the rates of return on plan assets, discount rate, and contributions made to the plan. The market value of KU plan assets has been affected by declines in the equity market since the beginning of the fiscal year. As a result, at December 31, 2002, KU was required to recognize an additional minimum liability as prescribed by SFAS No. 87 Employers' Accounting for Pensions. The liability was recorded as a reduction to other comprehensive income, and did not affect net income for 2002. The amount of the liability depended upon the asset returns experienced in 2002 and contributions made by KU to the plan during 2002. Also, pension cost and cash contributions to the plan could increase in future years without a substantial recovery in the equity market. If the fair value of the plan assets exceeds the accumulated benefit obligation, the recorded liability will be reduced and other comprehensive income will be restored in the consolidated balance sheet.

The combination of poor market performance and a decrease in short-term corporate bond interest rates has created a divergence in the potential value of the pension liability and the actual value of the pension assets. These conditions could result in an increase in KU's funded accumulated benefit obligation and future pension expense. The primary assumptions that drive the value of the unfunded accumulated benefit obligation are the discount rate and expected return on plan assets.

KU made a contribution to the pension plan of \$3.5 million in January 2003.

A 1% increase or decrease in the assumed discount rate could have an approximate \$26.0 million positive or negative impact to the accumulated benefit obligation of KU.

See also Note 6 of KU's Notes to Financial Statements under Item 8.

Page 22

Regulatory Mechanisms - Judgments and uncertainties include future regulatory decisions, the impact of deregulation and competition on the ratemaking process and external regulator decisions.

Regulatory assets represent incurred costs that have been deferred because they are probable of future recovery in customer rates based upon Kentucky Commission orders. Regulatory liabilities generally represent obligations to make refunds to customers for previous collections based upon orders by the Kentucky Commission. Management believes, based on orders, the existing regulatory assets and liabilities are probable of recovery. This determination reflects the current regulatory climate in the state. If future recovery of costs ceases to be probable the assets would be required to be recognized in current period earnings.

KU has accrued in the financial statements, an estimate of \$13.5 million for 2002 ESM, with collection from customers commencing in April 2003. The ESM is subject to Kentucky Commission approval.

See also Note 3 of KU's Notes to Financial Statements under Item 8.

#### NEW ACCOUNTING PRONOUNCEMENTS

SFAS No. 143, Accounting for Asset Retirement Obligations was issued in 2001. SFAS No. 143 establishes accounting and reporting standards for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs.

The effective implementation date for SFAS No. 143 is January 1, 2003. Management has calculated the impact of SFAS No. 143 and the recently released FERC NOPR No. RM02-7, Accounting, Financial Reporting, and Rate Filing Requirements for Asset Retirement Obligations. As of January 1, 2003, KU recorded asset retirement obligation (ARO) assets in the amount of \$8.6 million and liabilities in the amount of \$18.5 million. KU also recorded a cumulative effect adjustment in the amount of \$9.9 million to reflect the accumulated depreciation and accretion of ARO assets at the transition date less amounts previously accrued under regulatory depreciation. KU recorded offsetting regulatory assets of \$9.9 million, pursuant to regulatory treatment prescribed under SFAS No. 71, Accounting for the Effects of Certain Types of Regulation. Also pursuant to SFAS No. 71, KU recorded regulatory liabilities in the amount of \$888,000 offsetting removal costs previously accrued under regulatory accounting in excess of amounts allowed under SFAS No. 143.

KU also expects to record ARO accretion expense of approximately \$1.2 million, ARO depreciation expense of approximately \$176,000 and an offsetting regulatory credit in the income statement of approximately \$1.4 million in 2003, pursuant to regulatory treatment prescribed under SFAS No. 71, Accounting for the Effects of Certain Types of Regulation. The accretion, depreciation and regulatory credit will be annual adjustments. SFAS No. 143 will have no impact on the results of the operation of KU.

KU asset retirement obligations are primarily related to the final retirement of generating units. KU transmission and distribution lines largely operate under perpetual property easement agreements which do not generally require restoration upon removal of the property. Therefore, under SFAS No. 143, no material asset retirement obligations will be recorded for transmission and distribution assets.

KU adopted EITF No. 98-10, Accounting for Energy Trading and Risk Management Activities, effective January 1, 1999. This pronouncement required that energy trading contracts be marked to market on the balance sheet, with the gains and losses shown net in the income statement.

Page 23

The EITF clarified accounting standards related to energy trading activities under EITF Issue 02-03, Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities. EITF No. 02-03 established the following:

- - Rescinded EITF No. 98-10,
- - Contracts that do not meet the definition of a derivative under SFAS No.133 should not be marked to fair market value, and
- - Revenues should be shown in the income statement net of costs associated with trading activities, whether or not the trades are physically settled.

With the rescission of EITF No. 98-10, energy trading contracts that do not also meet the definition of a derivative under SFAS No. 133 must be accounted for as executory contracts. Contracts previously recorded at fair value under EITF No. 98-10 that are not also derivatives under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, must be restated to historical cost through a cumulative effect adjustment. The rescission of this standard had no impact on financial position or results of operations of KU since all contracts marked to market under EITF No. 98-10 are also within the scope of SFAS No. 133.

As a result of EITF No. 02-03, KU has netted the power purchased expense for trading activities against electric operating revenue to reflect this accounting change. KU applied this guidance to all prior periods, which had no impact on previously reported net income or common equity.

	2002	2001
Gross electric operating revenues	\$875,192	\$860,426
Less costs reclassified from power purchased	26,555	38,751
Net electric operating revenues reported	\$848,637	\$821,675
Gross power purchased	\$157,955	\$157,161
Less costs reclassified to revenues	26,555	38,751
Net power purchased reported	\$131,400	\$118,410

In January 2003, the Financial Accounting Standards Board issued Financial Accounting Standards Board Interpretation No. 46, Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51 (FIN 46). FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 is effective immediately for all new variable interest entities created or acquired after January 31, 2003. For variable interest entities created or acquired prior to February 1, 2003, the provisions of FIN 46 must be applied for the first interim or annual period beginning after June 15, 2003. KU does not expect the adoption of this standard to have any impact on the financial position or results of operations.

## LIQUIDITY AND CAPITAL RESOURCES

KU uses net cash generated from its operations and external financing to fund construction of plant and equipment and the payment of dividends. KU believes that such sources of funds will be sufficient to meet the needs of its business in the foreseeable future.

## Operating Activities

Cash provided by operations was \$175.8 million, \$188.1 million and \$176.3 million in 2002, 2001 and 2000, respectively. The 2002 decrease from 2001 of \$12.3 million was primarily the result of a decrease in accrued taxes and changes in accounts receivable. The 2001 increase resulted from sale of accounts receivable through a securitization program. See Note 1 of KU's Notes to Financial Statements under Item 8 for a discussion of accounts receivable securitization.

Page 24

## Investing Activities

KU's primary use of funds for investing activities continues to be for capital expenditures. Capital expenditures were \$237.9 million, \$142.4 million and \$100.3 million in 2002, 2001 and 2000, respectively. KU expects its capital expenditures for 2003 and 2004 will total approximately \$550.0 million, which consists primarily of construction costs associated with installation of NOx equipment as described in the section titled "Environmental Matters," purchase of jointly owned CTs with LG&E and on going construction for the distribution system.

Net cash used for investment activities increased \$99.0 million in 2002 compared to 2001 and \$38.6 million in 2001 compared to 2000 primarily due to the level of construction expenditures. NOx expenditures increased \$50.6 million and CT expenditures increased \$27.0 million in 2002.

## Financing Activities

Net cash inflows from financing activities were \$64.2 million in 2002 and outflows of \$46.2 million and \$82.4 million in 2001 and 2000, respectively. In 2002, short-term debt increased \$72.0 million from 2001. In 2001, short-term debt decreased \$13.4 million from 2000 and KU paid \$32.8 million in dividends.

In May 2002, KU issued \$37.93 million variable rate pollution control Series 12, 13, 14 and 15 due February 1, 2032, and exercised its call option on \$37.93 million, 6.25% pollution control Series 1B, 2B, 3B, and 4B due February 1, 2018.

In September 2002, KU issued \$96 million variable rate pollution control Series 16 due October 1, 2032, and exercised its call option on \$96 million, 7.45% pollution control Series 8 due September 15, 2016.

## Future Capital Requirements

Future capital requirements may be affected in varying degrees by factors such as load growth, changes in construction expenditure levels, rate actions by regulatory agencies, new legislation, market entry of competing electric power generators, changes in environmental regulations and other regulatory requirements. KU anticipates funding future capital

requirements through operating cash flow, debt, and/or infusion of capital from its parent.

KU's debt ratings as of December 31, 2002, were:

	Moody's	S&P	Fitch
First mortgage bonds	A1	A	A+
Preferred stock	Baa1	BBB	A-
Commercial paper	P-1	A-2	F-1

These ratings reflect the views of Moody's, S&P and Fitch. 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.

Page 25

#### Contractual Obligations

The following is provided to summarize KU's contractual cash obligations for periods after December 31, 2002 (in thousands of \$):

Contractual cash Obligations	Payments Due by Period				
	2003-2005 2007	2004- 2007	2006- Total	After	
Short-term debt (a)	\$119,490	\$ -	\$ -	\$ -	\$ 119,490
Long-term debt (b)	153,930	-	89,000	257,562	500,492
Unconditional purchase obligations (c)	34,317	79,306	79,878	643,946	837,447
Other long-term obligations (d)	128,199	201,249	-	-	329,448
Total contractual cash obligations (e)	\$435,936	\$280,555	\$168,878	\$901,508	\$1,786,877

- (a) Represents borrowings from parent company due within one year.
- (b) Includes long-term debt of \$91.9 million is classified as a current liability because 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. Maturity dates for the bonds range from 2024 to 2032.
- (c) Represents future minimum payments under purchased power agreements through 2020.
- (d) Represents construction commitments.
- (e) KU does not expect to pay the \$91.9 million of long-term debt classified as a current liability in the consolidated balance sheets in 2003 as explained in (b) above. KU anticipates cash from operations and external financing will be sufficient to fund future obligations. KU anticipates refinancing a portion of its short-term debt with long-term debt in 2003.

#### Market Risks

KU is exposed to market risks from changes in interest rates and commodity prices. To mitigate changes in cash flows attributable to these exposures, KU uses various financial instruments including derivatives. Derivative positions are monitored using techniques that include market value and sensitivity analysis.

See Notes 1 and 4 of KU's Notes to Financial Statements under Item 8.

### Interest Rate Sensitivity

KU has short-term and long-term variable rate debt obligations outstanding. At December 31, 2002, the potential change in interest expense associated with a 1% change in base interest rates of KU's variable rate debt is estimated at \$5.2 million after impact of interest rate swaps.

Interest rate swaps are used to hedge KU's underlying debt obligations. These swaps hedge specific debt issuances and, consistent with management's designation, are accorded hedge accounting treatment.

As of December 31, 2002, KU has swaps with a combined notional value of \$153 million. The swaps exchange fixed-rate interest payments for floating rate interest payments on KU's Series P, R, and PCS-9 Bonds. The potential loss in fair value resulting from a hypothetical 1% adverse movement in base interest rates is estimated at \$6.9 million as of December 31, 2002. This estimate is derived from third party valuations. Changes in the market value of these swaps if held to maturity, as KU intends to do, will have no effect on KU's net income or cash flow. See Note 4 of KU's Notes to Financial Statements under Item 8.

### Commodity Price Sensitivity

KU has limited exposure to market price volatility in prices of fuel and electricity, since its retail tariffs include the FAC commodity price pass-through mechanism. KU is exposed to market price volatility of fuel and electricity in its wholesale activities.

Page 26

### Energy Trading & Risk Management Activities

KU conducts energy trading and risk management activities to maximize the value of power sales from physical assets it owns, in addition to the wholesale sale of excess asset capacity. Certain energy trading activities are accounted for on a mark-to-market basis in accordance with EITF 98-10, Accounting for Contracts Involved in Energy Trading and Risk Management Activities, SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, and SFAS No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities. Wholesale sales of excess asset capacity and wholesale purchases are treated as normal sales and purchases under SFAS No. 133 and SFAS No. 138 and are not marked-to-market.

The consensus reached by the EITF on EITF No. 02-03, Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities, to rescind EITF 98-10, effective for fiscal years after December 15, 2002, had no impact on KU's energy trading and risk management reporting as all contracts marked to market under EITF 98-10 are also within the scope of SFAS No. 133.

The table below summarizes KU's energy trading and risk management activities for 2002 and 2001 (in thousands of \$).

	2002	2001
Fair value of contracts at beginning of period, net liability	\$ (186)	\$ (17)
Fair value of contracts when entered into during the period	(65)	3,441
Contracts realized or otherwise settled		

during the period	448	(2,894)
Changes in fair values due to changes in assumptions	(353)	(716)
Fair value of contracts at end of period, net liability	\$ (156)	\$ (186)

No changes to valuation techniques for energy trading and risk management activities occurred during 2002. Changes in market pricing, interest rate and volatility assumptions were made during both years. All contracts outstanding at December 31, 2002 have a maturity of less than one year and are valued using prices actively quoted for proposed or executed transactions or quoted by brokers.

KU maintains policies intended to minimize credit risk and revalues credit exposures daily to monitor compliance with those policies. At December 31, 2002, 86% of the trading and risk management commitments were with counterparties rated BBB- equivalent or better.

#### Accounts Receivable Securitization

On February 6, 2001, KU implemented an accounts receivable securitization program. The purpose of this program is to enable KU to accelerate the receipt of cash from the collection of retail accounts receivable, thereby reducing dependence upon more costly sources of working capital. The securitization program allows for a percentage of eligible receivables to be sold. Eligible receivables are generally all receivables associated with retail sales that have standard terms and are not past due. KU is able to terminate this program at any time without penalty. If there is a significant deterioration in the payment record of the receivables by the retail customers or if KU fails to meet certain covenants regarding the program, the program may terminate at the election of the financial institutions. In this case, payments from retail customers would first be used to repay the financial institutions participating in the program, and would then be available for use by KU.

Page 27

As part of the program, KU sold retail accounts receivables to a wholly owned subsidiary KU R. Simultaneously, KU R entered into two separate three-year accounts receivable securitization facilities with two financial institutions and their affiliates whereby KU R can sell, on a revolving basis, an undivided interest in certain of their receivables and receive up to \$50 million from an unrelated third party purchaser. The effective cost of the receivables programs is comparable to KU's lowest cost source of capital, and is based on prime rated commercial paper. KU retains servicing rights of the sold receivables through two separate servicing agreements with the third party purchaser. KU has obtained an opinion from independent legal counsel indicating these transactions qualify as a true sale of receivables. As of December 31, 2002, the outstanding program balance was \$49.3 million. KU is considering unwinding the accounts receivable securitization arrangements involving KU R during 2003.

The allowance for doubtful accounts associated with the eligible securitized receivables was \$520,000 at December 31, 2002. This allowance is based on historical experience of KU. Each securitization facility contains a fully funded reserve for uncollectible receivables.

#### RATES AND REGULATION

Following the purchase of Powergen by E.ON, E.ON became a registered

holding company under PUHCA. As a result, E.ON, its utility subsidiaries, including KU, and certain of its non-utility subsidiaries are subject to extensive regulation by the SEC under PUHCA with respect to issuances and sales of securities, acquisitions and sales of certain utility properties, and intra-system sales of certain goods and services. In addition, PUHCA generally limits the ability of registered holding companies to acquire additional public utility systems and to acquire and retain businesses unrelated to the utility operations of the holding company. KU believes that it has adequate authority (including financing authority) under existing SEC orders and regulations to conduct its business. KU will seek additional authorization when necessary.

KU is subject to the jurisdiction of the Kentucky Commission, the Virginia Commission and FERC in virtually all matters related to electric utility regulation, and as such, its accounting is subject to SFAS No. 71, Accounting for the Effects of Certain Types of Regulation. Given KU's competitive position in the market and the status of regulation in the states of Kentucky and Virginia, KU has no plans or intentions to discontinue its application of SFAS No. 71. See Note 3 of KU's Notes to Financial Statements under Item 8.

#### Kentucky Commission Settlement Order - VDT Costs, ESM and Depreciation

During the first quarter 2001, KU recorded a \$64 million charge for a workforce reduction program. Primary components of the charge were separation benefits, enhanced early retirement benefits, and health care benefits. The result of this workforce reduction was the elimination of approximately 300 positions, accomplished primarily through a voluntary enhanced severance program.

On June 1, 2001, KU filed an application (VDT case) with the Kentucky Commission to create a regulatory asset relating to these first quarter 2001 charges. The application requested permission to amortize these costs over a four-year period. The Kentucky Commission also opened a case to review the new depreciation study and resulting depreciation rates implemented in 2001.

KU reached a settlement in the VDT case as well as the other cases involving depreciation rates and ESM with all intervening parties. The settlement agreement was approved by the Kentucky Commission on December 3, 2001. The order allowed KU to set up a regulatory asset of \$54 million for the workforce reduction costs and begin amortizing these costs over a five year period starting in April 2001. The first quarter 2001 charge of \$64 million represented all employees who had accepted a voluntary enhanced severance program. Some employees rescinded their participation in the voluntary enhanced severance program and, along with the non-recurring charge of \$6.9 million for FERC and Virginia jurisdictions, thereby decreasing the original charge of the regulatory asset from \$64 million to \$54 million. The settlement will also reduce revenues approximately \$11 million through a surcredit on future bills to customers over the same five year period. The surcredit represents stipulated net savings KU is expected to realize from implementation of best practices through the VDT. The agreement also established KU's new depreciation rates in effect December 2001, retroactive to January 1, 2001. The new depreciation rates decreased depreciation expense by \$6.0 million in 2001.

Page 28

Environmental Cost Recovery

In June 2000, the Kentucky Commission approved KU's application for a CCN to construct up to four SCR NOx reduction facilities. The construction and subsequent operation of the SCRs is intended to reduce NOx emission levels to meet the EPA's mandated NOx emission level of 0.15 lbs./ Mmbtu by May 2004. In its order, the Kentucky Commission ruled that KU's proposed plan for construction was "reasonable, cost-effective and will not result in the wasteful duplication of facilities". In October 2000, KU filed an application with the Kentucky Commission to amend its Environmental Compliance Plan to reflect the addition of the proposed NOx reduction technology projects and to amend its Environmental Cost Recovery Tariff to include an overall rate of return on capital investments. Approval of KU's application in April 2001, allowed KU to begin to recover the costs associated with these new projects, subject to Kentucky Commission oversight during normal six-month and two-year reviews.

In August 2002, KU filed an application with the Kentucky Commission to amend its compliance plan to allow recovery of the cost of a new and additional environmental compliance facility. The estimated capital cost of the additional facilities is \$17.3 million. The Kentucky Commission conducted a public hearing on the case on December 20, 2002, final briefs were filed on January 15, 2003, and a final order was issued February 11, 2003. The final order approved recovery of the new environmental compliance facility totaling \$17.3 million. Cost recovery through the environmental surcharge of the approved project will begin with bills rendered in April 2003.

#### ESM

KU's electric rates are subject to an ESM. The ESM, initially in place for three years beginning in 2000, sets an upper and lower point for rate of return on equity, whereby if KU's rate of return for the calendar year falls within the range of 10.5% to 12.5%, no action is necessary. If earnings are above the upper limit, the excess earnings are shared 40% with ratepayers and 60% with shareholders; if earnings are below the lower limit, the earnings deficiency is recovered 40% from ratepayers and 60% from shareholders. By order of the Kentucky Commission, rate changes prompted by the ESM filing go into effect in April of each year subject to a balancing adjustment in successive periods. KU made its second ESM filing on March 1, 2002 for the calendar year 2001 reporting period. KU is in the process of refunding \$1 million to customers for the 2001 reporting period. KU estimated that the rate of return will fall below the lower limit, subject to Kentucky Commission approval, for the year ended December 31, 2002. The 2002 financial statements include an accrual to reflect the earnings deficiency of \$13.5 million to be recovered from customers commencing in April 2003.

On November 27, 2002, KU filed a revised ESM tariff which proposed continuance of the existing ESM through December 2005. The Kentucky Commission issued an Order suspending the ESM tariff one day making the effective date January 2, 2003. In addition, the Kentucky Commission is conducting a management audit to review the ESM plan and reassess its reasonableness in 2003. KU and interested parties will have the opportunity to provide recommendations for modification and continuance of the ESM or other forms of alternative or incentive regulation.

#### DSM

In May 2001, the Kentucky Commission approved a plan that would expand LG&E's current DSM programs into the service territory served by KU. The filing included a rate mechanism that provided for concurrent recovery of

DSM costs, provided an incentive for implementing DSM programs, and recovered revenues from lost sales associated with the DSM program based on program planning engineering estimates and post-implementation evaluations.

Page 29

#### FAC

KU employs an FAC mechanism, which allows KU to recover from customers the actual fuel costs associated with retail electric sales. In July 1999, the Kentucky Commission issued a series of orders requiring KU to refund approximately \$10.1 million resulting from reviews of the FAC from November 1994 to October 1998. In August 1999, after a rehearing request by KU, the Kentucky Commission issued a final order that reduced the refund obligation to \$ 6.7 million (\$5.8 million on Kentucky jurisdictional basis) from the original order amount of \$10.1 million. KU implemented the refund from October 1999 through September 2000. Both KU and the KIUC appealed the order. Pending a decision on this appeal, a comprehensive settlement was reached by all parties and approved by the Kentucky Commission on May 17, 2002. Thereunder, KU agreed to credit its fuel clause in the amount of \$954,000 (refund made in June and July 2002), and the parties agreed on a prospective interpretation of the state's fuel adjustment clause regulation to ensure consistent and mutually acceptable application on a going-forward basis.

In December 2002, the Kentucky Commission initiated a two year review of the operation of KU's fuel adjustment clause for the period November 2000 through October 2002. Testimony in the review case was filed on January 20, 2003 and a public hearing was held February 18, 2003. Issues addressed at that time included the establishment of the current base fuel factor to be included in KU's base rates, verification of proper treatment of purchased power costs during unit outages, and compliance with fuel procurement policies and practices.

In January 2003, the Kentucky Commission reviewed the FAC of KU for the six month period ended October 31, 2001. The Kentucky Commission ordered KU to reduce its fuel costs for purposes of calculating its FAC by \$673,000. At issue was the purchase of approximately 102,000 tons of coal from Western Kentucky Energy Corporation, a non-regulated affiliate, for use at KU's Ghent Facility. The Kentucky Commission further ordered that an independent audit be conducted to examine operational and management aspects of KU's fuel procurement functions.

Page 30

#### Kentucky Commission Administrative Case for Affiliate Transactions

In December 1997, the Kentucky Commission opened Administrative Case No. 369 to consider Kentucky Commission policy regarding cost allocations, affiliate transactions and codes of conduct governing the relationship between utilities and their non-utility operations and affiliates. The Kentucky Commission intended to address two major areas in the proceedings: the tools and conditions needed to prevent cost shifting and cross-subsidization between regulated and non-utility operations; and whether a code of conduct should be established to assure that non-utility segments of the holding company are not engaged in practices that could result in unfair competition caused by cost shifting from the non-utility affiliate to the utility. During the period September 1998 to February 2000, the Kentucky Commission issued draft codes of conduct and cost allocation guidelines. In early 2000, the Kentucky General Assembly enacted

legislation, House Bill 897, which authorized the Kentucky Commission to require utilities that provide nonregulated activities to keep separate accounts and allocate costs in accordance with procedures established by the Kentucky Commission. In the same bill, the General Assembly set forth provisions to govern a utility's activities related to the sharing of information, databases, and resources between its employees or an affiliate involved in the marketing or the provision of nonregulated activities and its employees or an affiliate involved in the provision of regulated services. The legislation became law in July 2000 and KU has been operating pursuant thereto since that time. On February 14, 2001, the Kentucky Commission published notice of their intent to promulgate new administrative regulation under the auspices of the new law. This effort is still on going.

#### Kentucky Commission Administrative Case for System Adequacy

On June 19, 2001, Kentucky Governor Paul E. Patton issued Executive Order 2001-771, which directed the Kentucky Commission to review and study issues relating to the need for and development of new electric generating capacity in Kentucky. The issues to be considered included the impact of new power plants on the electric supply grid, facility siting issues, and economic development matters, with the goal of ensuring a continued, reliable source of supply of electricity for the citizens of Kentucky and the continued environmental and economic vitality of Kentucky and its communities. In response to that Executive Order, in July 2001 the Kentucky Commission opened Administrative Case No. 387 to review the adequacy of Kentucky's generation capacity and transmission system. Specifically, the items reviewed were the appropriate level of reliance on purchased power, the appropriate reserve margins to meet existing and future electric demand, the impact of spikes in natural gas prices on electric utility planning strategies, and the adequacy of Kentucky's electric transmission facilities. KU, as a party to this proceeding, filed written testimony and responded to two requests for information. Public hearings were held and in October 2001, KU filed a final brief in the case. In December 2001, the Kentucky Commission issued an order in which it noted that KU is responsibly addressing the long-term supply needs of native load customers and that current reserve margins are appropriate. However, due to the rapid pace of change in the industry, the order also requires KU to provide an annual assessment of supply resources, future demand, reserve margin, and the need for new resources.

Regarding the transmission system, the Kentucky Commission concluded that the transmission system within Kentucky can reliably serve native load and a significant portion of the proposed new unregulated power plants. However, it will not be able to handle the volume of transactions envisioned by FERC without future upgrades, the costs of which should be borne by those for whom the upgrades are required.

The Kentucky Commission pledged to continue to monitor all relevant issues and advocate Kentucky's interests at all opportunities.

#### FERC SMD NOPR

On July 31, 2002, the FERC issued a NOPR in Docket No. RM01-12-000 which would substantially alter the regulations governing the nation's wholesale electricity markets by establishing a common set of rules -- SMD. The SMD NOPR would require each public utility that owns, operates, or controls interstate transmission facilities to become an Independent Transmission Provider (ITP), belong to an RTO that is an ITP, or contract with an ITP for operation of its transmission assets. It would also establish a

standardized congestion management system, real-time and day-ahead energy markets, and a single transmission service for network and point-to-point transmission customers. Review of the proposed rulemaking is underway and a final rule is expected during 2003. While it is expected that the SMD final rule will affect KU revenues and expenses, the specific impact of the rulemaking is not known at this time.

#### MISO

KU is a member of the MISO, which began commercial operations on February 1, 2002. MISO now has operational control over KU's high-voltage transmission facilities (100 kV and greater), while KU continues to control and operate the lower voltage transmission subject to the terms and conditions of the MISO OATT. As a transmission-owning member of MISO, KU also incurs administrative costs of MISO pursuant to Schedule 10 of the MISO OATT.

MISO also proposed to implement a congestion management system. FERC directed the MISO to coordinate its efforts with FERC's Rulemaking on SMD. On September 24, 2002, the MISO filed new rate schedules designated as Schedules 16 and 17, which provide for the collection of costs incurred by the MISO to establish day-ahead and real-time energy markets. The MISO proposed to recover these costs under Schedules 16 and 17 once service commences. If approved by FERC, these schedules will cause KU to incur additional costs. KU opposes the establishment of Schedules 16 and 17. This effort is still on-going and the ultimate impact of the two schedules, if approved, is not known at this time.

Page 31

#### Merger Surcredit

As part of the LG&E Energy merger with KU Energy in 1998, LG&E Energy estimated non-fuel savings over a ten-year period following the merger. Costs to achieve these savings for KU of \$42.3 million were recorded in the second quarter of 1998, \$20.5 million of which was deferred and amortized over a five-year period pursuant to regulatory orders. Primary components of the merger costs were separation benefits, relocation costs, and transaction fees, the majority of which were paid by December 31, 1998. KU expensed the remaining costs associated with the merger (\$21.8 million) in the second quarter of 1998.

In approving the merger, the Kentucky Commission adopted KU's proposal to reduce its retail customers' bills based on one-half of the estimated merger-related savings, net of deferred and amortized amounts, over a five-year period. The surcredit mechanism provides that 50% of the net non-fuel cost savings estimated to be achieved from the merger be provided to ratepayers through a monthly bill credit, and 50% be retained by the Companies, over a five-year period. The surcredit was allocated 53% to KU and 47% to LG&E. In that same order, the Commission required LG&E and KU, after the end of the five-year period, to present a plan for sharing with customers the then-projected non-fuel savings associated with the merger. The Companies submitted this filing on January 13, 2003, proposing to continue to share with customers, on a 50%/50% basis, the estimated fifth-year gross level of non-fuel savings associated with the merger. The filing is currently under review.

Any fuel cost savings are passed to Kentucky customers through the fuel adjustment clause. See FAC above.

## Environmental Matters

The Clean Air Act imposed stringent new SO<sub>2</sub> and NO<sub>x</sub> emission limits on electric generating units. KU met its Phase I SO<sub>2</sub> requirements primarily through installation of a scrubber on Ghent Unit 1. KU's strategy for Phase II SO<sub>2</sub> reductions, which commenced January 1, 2000, is to use accumulated emissions allowances to delay additional capital expenditures and may also include fuel switching or the installation of additional scrubbers. KU met the NO<sub>x</sub> emission requirements of the Act through installation of low-NO<sub>x</sub> burner systems. KU's compliance plans are subject to many factors including developments in the emission allowance and fuel markets, future regulatory and legislative initiatives, and advances in clean air control technology. KU will continue to monitor these developments to ensure that its environmental obligations are met in the most efficient and cost-effective manner.

In September 1998, the EPA announced its final "NO<sub>x</sub> SIP Call" rule requiring states to impose significant additional reductions in NO<sub>x</sub> emissions by May 2003, in order to mitigate alleged ozone transport impacts on the Northeast region. The Commonwealth of Kentucky is currently in the process of revising its SIP to require reductions in NO<sub>x</sub> emissions from coal-fired generating units to the 0.15 lb./Mmbtu level on a system-wide basis. In related proceedings in response to petitions filed by various Northeast states, in December 1999, EPA issued a final rule pursuant to Section 126 of the Clean Air Act directing similar NO<sub>x</sub> reductions from a number of specifically targeted generating units including all KU units in the eastern half of Kentucky. Additional petitions currently pending before EPA may potentially result in rules encompassing KU's remaining generating units. As a result of appeals to both rules, the compliance date was extended to May 2004. All KU generating units are subject to the May 2004 compliance date under these NO<sub>x</sub> emissions reduction rules.

Page 32

KU is currently implementing a plan for adding significant additional NO<sub>x</sub> controls to its generating units. Installation of additional NO<sub>x</sub> controls will proceed on a phased basis, with installation of controls commencing in late 2000 and continuing through the final compliance date. KU estimates that it will incur total capital costs of approximately \$232 million to reduce its NO<sub>x</sub> emissions to the 0.15 lb./Mmbtu level on a company-wide basis. In addition, KU will incur additional operating and maintenance costs in operating new NO<sub>x</sub> controls. KU believes its costs in this regard to be comparable to those of similarly situated utilities with like generation assets. KU had anticipated that such capital and operating costs are the type of costs that are eligible for recovery from customers under its environmental surcharge mechanism and believed that a significant portion of such costs could be recovered. In April 2001, the Kentucky Commission granted recovery of these costs for KU.

KU is also monitoring several other air quality issues which may potentially impact coal-fired power plants, including the appeal of the D.C. Circuit's remand of the EPA's revised air quality standards for ozone and particulate matter, measures to implement EPA's regional haze rule, and EPA's December 2000 determination to regulate mercury emissions from power plants.

KU owns or formerly owned several properties that contained past MGP operations. Various contaminants are typically found at such former MGP sites and environmental remediation measures are frequently required. KU has completed the cleanup of a site owned by KU. With respect to other

former MGP sites no longer owned by KU, KU is unaware of what, if any, additional exposure or liability it may have.

In October 1999, approximately 38,000 gallons of diesel fuel leaked from a cracked valve in an underground pipeline at KU's E.W. Brown Station. Under the oversight of EPA and state officials, KU commenced immediate spill containment and recovery measures which prevented the spill from reaching the Kentucky River. KU ultimately recovered approximately 34,000 gallons of diesel fuel. In November 1999, the Kentucky Division of Water issued a notice of violation for the incident. KU is currently negotiating with the state in an effort to reach a complete resolution of this matter. KU incurred costs of approximately \$1.8 million and received insurance reimbursement of \$1.2 million. In December 2002, the Department of Justice (DOJ) sent correspondence to KU regarding a potential per-day fine for failure to timely submit a spill control plan and a per-gallon fine for the amount of oil discharged. KU and the DOJ have commenced settlement discussions using existing DOJ settlement guidelines on this matter.

In April 2002, the EPA sent correspondence to KU regarding potential exposure in connection with \$1.5 million in completed remediation costs associated with a transformer scrap-yard. KU believes it is one of the more remote among a number of potentially responsible parties and has entered into settlement discussions with the EPA on this matter.

See Note 11 of KU's Notes to Financial Statements under Item 8 for an additional discussion of environmental issues.

#### Deferred Income Taxes

KU expects to have adequate levels of taxable income to realize its recorded deferred tax assets. At December 31, 2002, deferred tax assets totaled \$61 million and were principally related to expenses attributable to KU's pension plans and post retirement benefit obligations.

Page 33

#### FUTURE OUTLOOK

##### Competition and Customer Choice

KU has moved aggressively over the past decade to be positioned for the energy industry's shift to customer choice and a competitive market for energy services. Specifically, KU has taken many steps to prepare for the expected increase in competition in its business, including support for PBR structures, aggressive cost reduction activities; strategic acquisitions, dispositions and growth initiatives; write-offs of previously deferred expenses; an increase in focus on commercial and industrial customers; an increase in employee training; and necessary corporate and business unit realignments.

In December 1997, the Kentucky Commission issued a set of principles which was intended to serve as its guide in consideration of issues relating to industry restructuring. Among the issues addressed by these principles are: consumer protection and benefit, system reliability, universal service, environmental responsibility, cost allocation, stranded costs and codes of conduct. During 1998, the Kentucky Commission and a task force of the Kentucky General Assembly each initiated proceedings, including meetings with representatives of utilities, consumers, state agencies and other groups in Kentucky, to discuss the possible structure and effects of energy industry restructuring in Kentucky.

In November 1999, the task force issued a report to the Governor of Kentucky and a legislative agency recommending no general electric industry restructuring actions during the 2000 legislative session. No general industry restructuring actions have been taken to date by the legislature.

Thus, at the time of this report, 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.

While many states have moved forward in providing retail choice, many others have not. Some are reconsidering their initiatives and have even delayed implementation.

Virginia has enacted a phase-in of customer choice through the Virginia Electric Restructuring Act. The Virginia Commission is promulgating regulations to govern the various activities required by the Act. KU filed unbundled rates that became effective January 1, 2002. KU was granted a waiver from the Virginia Commission on October 29, 2002, exempting KU from retail choice through December 31, 2004. KU is also seeking a permanent legislative exemption to the Virginia Electric Restructuring Act. The outcome of such legislative initiatives will not be known until mid-2003.

Page 34

Exhibit 99(d)

ITEM 8. Financial Statements and Supplementary Data.

INDEX OF ABBREVIATIONS

Capital Corp.	LG&E Capital Corp.
Clean Air Act	The Clean Air Act, as amended in 1990
CCN	Certificate of Public Convenience and Necessity
CT	Combustion Turbines
DSM	Demand Side Management
ECR	Environmental Cost Recovery
EEI	Electric Energy, Inc.
EITF	Emerging Issues Task Force Issue
E.ON	E.ON AG
EPA	U.S. Environmental Protection Agency
ESM	Earnings Sharing Mechanism
F	Fahrenheit
FAC	Fuel Adjustment Clause
FERC	Federal Energy Regulatory Commission
FPA	Federal Power Act
FT and FT-A	Firm Transportation
GSC	Gas Supply Clause
IBEW	International Brotherhood of Electrical Workers
IMEA	Illinois Municipal Electric Agency
IMPA	Indiana Municipal Power Agency
Kentucky Commission	Kentucky Public Service Commission
KIUC	Kentucky Industrial Utility Consumers, Inc.
KU	Kentucky Utilities Company
KU Energy	KU Energy Corporation
KU R	KU Receivables LLC
kV	Kilovolts

Kva	Kilovolt-ampere
KW	Kilowatts
Kwh	Kilowatt hours
LEM	LG&E Energy Marketing Inc.
LG&E	Louisville Gas and Electric Company
LG&E Energy	LG&E Energy Corp.
LG&E R	LG&E Receivables LLC
LG&E Services	LG&E Energy Services Inc.
Mcf	Thousand Cubic Feet
MGP	Manufactured Gas Plant
MISO	Midwest Independent System Operator
Mmbtu	Million British thermal units
Moody's	Moody's Investor Services, Inc.
Mw	Megawatts
Mwh	Megawatt hours
NNS	No-Notice Service
NOPR	Notice of Proposed Rulemaking
NOx	Nitrogen Oxide
OATT	Open Access Transmission Tariff
OMU	Owensboro Municipal Utilities
OVEC	Ohio Valley Electric Corporation
PBR	Performance-Based Ratemaking
PJM	Pennsylvania, New Jersey, Maryland Interconnection
Powergen	Powergen Limited (formerly Powergen plc)
PUHCA	Public Utility Holding Company Act of 1935
ROE	Return on Equity

Page 1

RTO	Regional Transmission Organization
S&P	Standard & Poor's Rating Services
SCR	Selective Catalytic Reduction
SEC	Securities and Exchange Commission
SERP	Supplemental Employee Retirement Plan
SFAS	Statement of Financial Accounting Standards
SIP	State Implementation Plan
SMD	Standard Market Design
SO2	Sulfur Dioxide
Tennessee Gas	Tennessee Gas Pipeline Company
Texas Gas	Texas Gas Transmission Corporation
TRA	Tennessee Regulatory Authority
Trimble County	LG&E's Trimble County Unit 1
USWA	United Steelworkers of America
Utility Operations	Operations of LG&E and KU
VDT	Value Delivery Team Process
Virginia Commission	Virginia State Corporation Commission
Virginia Staff	Virginia State Corporation Commission Staff

Page 2

Louisville Gas and Electric Company and Subsidiary  
Consolidated Statements of Income  
(Thousands of \$)

	Years Ended December 31	
	2002	2001
OPERATING REVENUES:		
Electric	\$ 723,775	\$ 674,492
Gas	267,693	290,775
Provision for rate		

collections (refunds) (Note 3)	12,267	(720)
Total operating revenues (Note 1)	1,003,735	964,547
OPERATING EXPENSES:		
Fuel for electric generation	194,900	159,231
Power purchased	61,881	49,322
Gas supply expenses	182,108	206,165
Other operation expenses	208,322	167,818
Maintenance	60,210	58,687
Depreciation and amortization (Note 1)	105,906	100,356
Federal and state income taxes (Note 7)	55,035	63,452
Property and other taxes	17,459	17,743
Total operating expenses	885,821	822,774
Net operating income	117,914	141,773
Other income - net (Note 8)	820	2,930
Interest charges	29,805	37,922
Net income	88,929	106,781
Preferred stock dividends	4,246	4,739
Net income available for common stock	\$ 84,683	\$ 102,042

Consolidated Statements of Retained Earnings  
(Thousands of \$)

	Years Ended 2002	December 31 2001
Balance January 1	\$393,636	\$314,594
Add net income	88,929	106,781
	482,565	421,375
Deduct: Cash dividends declared on stock:		
5% cumulative preferred	1,075	1,075
Auction rate cumulative preferred	1,702	2,195
\$5.875 cumulative preferred	1,469	1,469
Common	69,000	23,000
	73,246	27,739
Balance December 31	\$409,319	\$393,636

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

Page 3

Louisville Gas and Electric Company and Subsidiary  
Consolidated Statements of Comprehensive Income  
(Thousands of \$)

	Years Ended 2002	December 31 2001
Net income	\$88,929	\$106,781
Cumulative effect of change in accounting		

principle - Accounting for derivative instruments and hedging activities	-	(5,998)
Losses on derivative instruments and hedging activities (Note 1)	(8,511)	(2,606)
Additional minimum pension liability adjustment (Note 6)	(25,999)	(24,712)
Income tax benefit related to items of other comprehensive income	13,898	13,416
Other comprehensive loss, net of tax	(20,612)	(19,900)
Comprehensive income	\$68,317	\$86,881

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

Page 4

Louisville Gas and Electric Company and Subsidiary  
Consolidated Balance Sheets  
(Thousands of \$)

	December 31	
	2002	2001
<b>ASSETS:</b>		
Utility plant, at original cost (Note 1):		
Electric	\$2,717,187	\$2,598,152
Gas	435,235	409,994
Common	169,577	159,817
	3,321,999	3,167,963
Less: reserve for depreciation	1,463,674	1,381,874
	1,858,325	1,786,089
Construction work in progress	300,986	255,074
	2,159,311	2,041,163
Other property and investments - less reserve of \$63 in 2002 and 2001	764	1,176
Current assets:		
Cash	17,015	2,112
Accounts receivable - less reserve of \$2,125 in 2002 and \$1,575 in 2001	68,440	85,667
Materials and supplies - at average cost:		
Fuel (predominantly coal) (Note 1)	36,600	22,024
Gas stored underground (Note 1)	50,266	46,395
Other	25,651	29,050
Prepayments and other	5,298	4,688
	203,270	189,936
Deferred debits and other assets:		
Unamortized debt expense (Note 1)	6,532	5,921
Regulatory assets (Note 3)	153,446	197,142
Other	37,755	13,016
	197,733	216,079
	\$2,561,078	\$2,448,354

## CAPITAL AND LIABILITIES:

## Capitalization (see statements of capitalization):

Common equity	\$ 833,141	\$ 838,070
Cumulative preferred stock	95,140	95,140
Long-term debt (Note 9)	328,104	370,704
	1,256,385	1,303,914

## Current liabilities:

Current portion of long-term debt (Note 9)	288,800	246,200
Notes payable (Note 10)	193,053	94,197
Accounts payable	122,771	149,070
Accrued taxes	1,450	20,257
Other	19,536	18,658
	625,610	528,382

## Deferred credits and other liabilities:

Accumulated deferred income taxes (Notes 1 and 7)	313,225	298,143
Investment tax credit, in process of amortization	54,536	58,689
Accumulated provision for pensions and related benefits (Note 6)	224,703	167,526
Regulatory liabilities (Note 3)	52,424	65,349
Other	34,195	26,351
	679,083	616,058
Commitments and contingencies (Note 11)	\$2,561,078	\$2,448,354

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

Page 5

Louisville Gas and Electric Company and Subsidiary  
Consolidated Statements of Cash Flows  
(Thousands of \$)

	Years Ended December 31	
	2002	2001
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 88,929	\$ 106,781
Items not requiring cash currently:		
Depreciation and amortization	105,906	100,356
Deferred income taxes - net	11,915	3,021
Investment tax credit - net	(4,153)	(4,290)
Other	37,260	(528)
Change in certain net current assets:		
Accounts receivable	(3,973)	43,185
Materials and supplies	(15,048)	(2,018)
Accounts payable	(26,299)	14,678
Accrued taxes	(18,807)	12,184
Prepayments and other	321	(10,500)
Sale of accounts receivable (Note 1)	21,200	42,000
Other	15,130	(17,806)
Net cash flows from operating activities	212,381	287,063
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of securities	-	-
Proceeds from sales of securities	412	4,237
Construction expenditures	(220,416)	(252,958)
Net cash flows from investing activities	(220,004)	(248,721)

CASH FLOWS FROM FINANCING ACTIVITIES:		
Short-term borrowings and repayments	98,856	(20,392)
Issuance of pollution control bonds	158,635	9,662
Retirement of first mortgage bonds and pollution control bonds	(161,665)	-
Additional paid-in capital	-	-
Payment of dividends	(73,300)	(27,995)
Net cash flows from financing activities	22,526	(38,725)
Change in cash and temporary cash investments	14,903	(383)
Cash and temporary cash investments at beginning of year	2,112	2,495
Cash and temporary cash investments at end of year	\$ 17,015	\$ 2,112
Supplemental disclosures of cash flow information:		
Cash paid during the year for:		
Income taxes	\$51,540	\$ 35,546
Interest on borrowed money	25,673	30,989

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

Page 6

Louisville Gas and Electric Company and Subsidiary  
Consolidated Statements of Capitalization  
(Thousands of \$)

	December 31	
	2002	2001
COMMON EQUITY:		
Common stock, without par value -		
Authorized 75,000,000 shares,		
outstanding 21,294,223 shares	\$ 425,170	\$ 425,170
Common stock expense	(836)	(836)
Additional paid-in capital	40,000	40,000
Accumulated other comprehensive income	(40,512)	(19,900)
Retained earnings	409,319	393,636
	833,141	838,070
CUMULATIVE PREFERRED STOCK:		
	Shares	Current
	Outstanding	Redemption Price
\$25 par value,		
1,720,000 shares		
authorized - 5% series	860,287	\$28.00
Without par value,		
6,750,000 shares authorized -		
Auction rate	500,000	100.00
\$5.875 series	250,000	101.18
Preferred stock expense		(1,367)
		(1,367)
		95,140
		95,140
LONG-TERM DEBT (Note 9):		
First mortgage bonds -		
Series due August 15, 2003, 6%		42,600
		42,600

Pollution control series:		
R due November 1, 2020, 6.55 %	-	41,665
S due September 1, 2017, variable %	31,000	31,000
T due September 1, 2017, variable %	60,000	60,000
U due August 15, 2013, variable %	35,200	35,200
V due August 15, 2019, 5.625%	102,000	102,000
W due October 15, 2020, 5.45%	26,000	26,000
X due April 15, 2023, 5.90%	40,000	40,000
Y due May 1, 2027, variable %	25,000	25,000
Z due August 1, 2030, variable %	83,335	83,335
AA due September 1, 2027, variable %	10,104	10,104
BB due September 1, 2026, variable %	22,500	-
CC due September 1, 2026, variable %	27,500	-
DD due November 1, 2027, variable %	35,000	-
EE due November 1, 2027, variable %	35,000	-
FF due October 1, 2032, variable %	41,665	-
Total first mortgage bonds	616,904	496,904
Pollution control bonds (unsecured) -		
Series due September 1, 2026, variable %	-	22,500
Series due September 1, 2026, variable %	-	27,500
Series due November 1, 2027, variable %	-	35,000
Series due November 1, 2027, variable %	-	35,000
Total unsecured pollution control bonds	-	120,000
Total bonds outstanding	616,904	616,904
Less current portion of long-term debt	288,800	246,200
Long-term debt	328,104	370,704
Total capitalization	\$1,256,385	\$1,303,914

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

Page 7

Louisville Gas and Electric Company and Subsidiary  
Notes to Consolidated Financial Statements

Note 1 - Summary of Significant Accounting Policies

LG&E, a subsidiary of LG&E Energy and an indirect subsidiary of Powergen and E.ON, is a regulated public utility engaged in the generation, transmission, distribution, and sale of electric energy and the storage, distribution, and sale of natural gas in Louisville and adjacent areas in Kentucky. LG&E Energy is an exempt public utility holding company with wholly owned subsidiaries including LG&E, KU, Capital Corp., LEM, and LG&E Services. All of LG&E's Common Stock is held by LG&E Energy. LG&E has one wholly owned consolidated subsidiary, LG&E R.

On December 11, 2000, LG&E Energy was acquired by Powergen. On July 1, 2002, E.ON, a German company, completed its acquisition of Powergen plc (now Powergen Limited). E.ON had announced its pre-conditional cash offer of 5.1 billion pounds sterling (\$7.3 billion) for Powergen on April 9, 2001. E.ON and Powergen are registered public utility holding companies under PUHCA. No costs associated with these acquisitions nor any of the effects of purchase accounting have been reflected in the

financial statements of LG&E.

Certain reclassification entries have been made to the previous year's financial statements to conform to the 2002 presentation with no impact on the balance sheet totals or previously reported income.

Utility Plant. LG&E's 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. LG&E has not recorded any 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, plus removal expense less salvage value, 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. Pursuant to a final order of the Kentucky Commission dated December 3, 2001, LG&E implemented new depreciation rates effective January 1, 2001. The amounts provided were approximately 3.1% in 2002 (2.9% electric, 2.8% gas and 6.6% common) and 3.0% for 2001 (2.9% electric, 2.9% gas and 5.7% common), of average depreciable plant. Of the amount provided for depreciation, at December 31, 2002 and 2001, respectively, approximately 0.4 % electric, 0.9 % gas and 0.04% common were related to the retirement, removal and disposal costs of long lived assets.

Fuel Inventory. Fuel inventories of \$36.6 million and \$22.0 million at December 31, 2002, and 2001, respectively, are included in Fuel in the balance sheet. The inventory is accounted for using the average-cost method.

Gas Stored Underground. Gas inventories of \$50.3 million and \$46.4 million at December 31, 2002, and 2001, respectively, are included in gas stored underground in the balance sheet. The inventory is accounted for using the average-cost method.

Financial Instruments. LG&E uses over-the-counter interest-rate swap agreements to hedge its exposure to fluctuations in the interest rates it pays on variable-rate debt. Gains and losses on interest-rate swaps used to hedge interest rate risk are reflected in other comprehensive income. See Note 4- Financial Instruments.

Page 8

Unamortized Debt Expense. Debt expense is capitalized in deferred debits and amortized over the lives of the related bond issues, consistent with regulatory practices.

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 basis of assets and liabilities.

Investment Tax Credits. Investment tax credits resulted from provisions of the tax law that permitted a reduction of LG&E's tax liability based on credits for certain 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. LG&E accrues an estimate for unbilled revenues from each meter reading date to the end of the accounting period. The unbilled revenue estimates included in accounts receivable were approximately \$40.7 million and \$37.3 million, at December 31, 2002 and 2001, respectively. See Note 3, Rates and Regulatory Matters. LG&E recorded electric revenues that resulted from sales to a related party, KU, of \$46.5 million and \$28.5 million for years ended December 31, 2002 and 2001, respectively.

With the adoption of EITF 02-03, Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities, revenues on the income statement are shown net of cost associated with trading activities. As a result LG&E has netted the power purchased expense for trading activities against operating revenue for all years presented.

Fuel and Gas Costs. The cost of fuel for electric generation is charged to expense as used, and the cost of gas supply is charged to expense as delivered to the distribution system. LG&E implemented a Kentucky Commission-approved performance-based ratemaking mechanism related to gas procurement and off-system gas sales activity. See Note 3, Rates and Regulatory Matters.

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. Actual results could differ from those estimates. See Note 11, Commitments and Contingencies, for a further discussion.

Accounts Receivable Securitization. SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, revises the standards for accounting for securitizations and other transfers of financial assets and collateral and requires certain disclosures, and provides accounting and reporting standards for transfers and servicing of financial assets and extinguishments of liabilities. SFAS No. 140 was adopted in the first quarter of 2001, when LG&E entered into an accounts receivable securitization transaction.

On February 6, 2001, LG&E implemented an accounts receivable securitization program. The purpose of this program is to enable LG&E to accelerate the receipt of cash from the collection of retail accounts receivable, thereby reducing dependence upon more costly sources of working capital. The securitization program allows for a percentage of eligible receivables to be sold. Eligible receivables are generally all receivables associated with retail sales that have standard terms and are not past due. LG&E is able to terminate this program at any time without penalty. If there is a significant deterioration in the payment record of the receivables by the retail customers or if LG&E fails to meet certain covenants regarding the program, the program may terminate at the election of the financial institutions. In this case, payments from retail customers would first be used to repay the financial institutions participating in the program, and would then be available for use by LG&E.

As part of the program, LG&E sold retail accounts receivables to a wholly owned subsidiary, LG&E R. Simultaneously, LG&E R entered into two separate three-year accounts receivable securitization facilities with two financial institutions and their affiliates whereby LG&E R can sell, on a revolving basis, an undivided interest in certain of its receivables and receive up to \$75 million from an unrelated third party purchaser. The effective cost of the receivables programs is comparable to LG&E's lowest cost source of capital, and is based on prime rated commercial paper. LG&E retains servicing rights of the sold receivables through two separate servicing agreements with the third party purchaser. LG&E has obtained an opinion from independent legal counsel indicating these transactions qualify as true sale of receivables. As of December 31, 2002, the outstanding program balance was \$63.2 million. LG&E is considering unwinding its accounts receivable securitization arrangements involving LG&E R during 2003.

The allowance for doubtful accounts associated with the eligible securitized receivables was \$2.125 million at December 31, 2002. This allowance is based on historical experience of LG&E. Each securitization facility contains a fully funded reserve for uncollectible receivables.

#### New Accounting Pronouncements.

SFAS No. 143, Accounting for Asset Retirement Obligations was issued in 2001. SFAS No. 143 establishes accounting and reporting standards for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs.

The effective implementation date for SFAS No. 143 is January 1, 2003. Management has calculated the impact of SFAS No. 143 and the recently released FERC NOPR No. RM02-7, Accounting, Financial Reporting, and Rate Filing Requirements for Asset Retirement Obligations. As of January 1, 2003, LG&E recorded asset retirement obligation (ARO) assets in the amount of \$4.6 million and liabilities in the amount of \$9.3 million. LG&E also recorded a cumulative effect adjustment in the amount of \$5.3 million to reflect the accumulated depreciation and accretion of ARO assets at the transition date less amounts previously accrued under regulatory depreciation. LG&E recorded offsetting regulatory assets of \$5.3 million, pursuant to regulatory treatment prescribed under SFAS No. 71, Accounting for the Effects of Certain Types of Regulation. Also pursuant to SFAS No. 71, LG&E recorded regulatory liabilities in the amount of \$60,000 offsetting removal costs previously accrued under regulatory accounting in excess of amounts allowed under SFAS No. 143.

LG&E also expects to record ARO accretion expense of approximately \$617,000, ARO depreciation expense of approximately \$117,000 and an offsetting regulatory credit in the income statement of approximately \$734,000 in 2003, pursuant to regulatory treatment prescribed under SFAS No. 71, Accounting for the Effects of Certain Types of Regulation. The accretion, depreciation and regulatory credit will be annual adjustments. SFAS No. 143 will have no impact on the results of the operation of LG&E.

LG&E asset retirement obligations are primarily related to the final retirement of generating units. LG&E transmission and distribution lines largely operate under perpetual property easement agreements which do not generally require restoration upon removal of the property. Therefore, under SFAS No. 143, no material asset retirement obligations will be recorded for transmission and distribution assets.

LG&E adopted EITF No. 98-10, Accounting for Energy Trading and Risk Management Activities, effective January 1, 1999. This pronouncement

required that energy trading contracts be marked to market on the balance sheet, with the gains and losses shown net in the income statement.

The EITF clarified accounting standards related to energy trading activities under EITF Issue 02-03, Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in

Page 10

Energy Trading and Risk Management Activities. EITF No. 02-03 established the following:

- - Rescinded EITF No. 98-10,
- - Contracts that do not meet the definition of a derivative under SFAS No.133 should not be marked to fair market value, and
- - Revenues should be shown in the income statement net of costs associated with trading activities, whether or not the trades are physically settled.

With the rescission of EITF No. 98-10, energy trading contracts that do not also meet the definition of a derivative under SFAS No. 133 must be accounted for as executory contracts. Contracts previously recorded at fair value under EITF No. 98-10 that are not also derivatives under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, must be restated to historical cost through a cumulative effect adjustment. The rescission of this standard had no impact on financial position or results of operations of LG&E since all contracts marked to market under EITF No. 98-10 are also within the scope of SFAS No. 133.

As a result of EITF No. 02-03, LG&E has netted the power purchased expense for trading activities against electric operating revenue to reflect this accounting change. LG&E applied this guidance to all prior periods, which had no impact on previously reported net income or common equity.

	2002	2001
Gross electric operating revenues	\$746,224	\$706,645
Less costs reclassified from power purchased	22,449	32,153
Net electric operating revenues reported	\$723,775	\$674,492
Gross power purchased	\$ 84,330	\$ 81,475
Less costs reclassified to revenues	22,449	32,153
Net power purchased reported	\$ 61,881	\$ 49,332

In January 2003, the Financial Accounting Standards Board issued Financial Accounting Standards Board Interpretation No. 46, Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51 (FIN 46). FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 is effective immediately for all new variable interest entities created or acquired after January 31, 2003. For variable interest entities created or acquired prior to February 1, 2003, the provisions of FIN 46 must be applied for the first interim or annual period beginning after June 15, 2003. LG&E does not expect the adoption of this standard to have any impact on the financial position or results of operations.

Note 2 - Mergers and Acquisitions

On July 1, 2002, E.ON completed its acquisition of Powergen, including LG&E Energy, for approximately 5.1 billion pounds sterling (\$7.3 billion). As a result of the acquisition, LG&E Energy became a wholly owned subsidiary (through Powergen) of E.ON and, as a result, LG&E also became an indirect subsidiary of E.ON. LG&E has continued its separate identity and serves customers in Kentucky under its existing name. The preferred stock and debt securities of LG&E were not affected by this transaction and the utilities continue to file SEC reports. Following the acquisition, E.ON became, and Powergen remained, a registered holding company under PUHCA. LG&E, as a subsidiary of a registered holding company, is subject to additional regulations under PUHCA. As contemplated in their regulatory filings in connection with the E.ON acquisition, E.ON, Powergen and LG&E Energy completed an administrative reorganization to move the LG&E Energy group from an indirect Powergen subsidiary to an indirect E.ON subsidiary. This reorganization was effective in March 2003.

Page 11

LG&E Energy and KU Energy merged on May 4, 1998, with LG&E Energy as the surviving corporation. Management accounted for the merger as a pooling of interests and as a tax-free reorganization under the Internal Revenue Code. Following the acquisition, LG&E has continued to maintain its separate corporate identity and serve customers in Kentucky under its present name.

#### Note 3 - Rates and Regulatory Matters

Accounting for the regulated utility business conforms with generally accepted accounting principles as applied to regulated public utilities and as prescribed by FERC and the Kentucky Commission. LG&E is subject to SFAS No. 71, Accounting for the Effects of Certain Types of Regulation, under which certain costs that would otherwise be charged to expense are deferred as regulatory assets based on expected recovery from customers in future rates. Likewise, certain credits that would otherwise be reflected as income are deferred as regulatory liabilities based on expected return to customers in future rates. LG&E's current or expected recovery of deferred costs and expected return of deferred credits is generally based on specific ratemaking decisions or precedent for each item. The following regulatory assets and liabilities were included in LG&E's balance sheets as of December 31 (in thousands of \$):

	2002	2001
VDT Costs	\$ 98,044	\$127,529
Gas supply adjustments due from customers	13,714	30,135
Unamortized loss on bonds	18,843	17,902
ESM provision	12,500	-
LGE/KU merger costs	1,815	5,444
Manufactured gas sites	1,757	2,062
One utility costs	954	3,643
Other	5,819	10,427
Total regulatory assets	153,446	197,142
Deferred income taxes - net	(45,536)	(48,703)
Gas supply adjustments due to customers	(3,154)	(15,702)
Other	(3,734)	(944)
Total regulatory liabilities	(52,424)	(65,349)
Regulatory assets - net	\$101,022	\$131,793

Kentucky Commission Settlement - VDT Costs. During the first quarter 2001, LG&E recorded a \$144 million charge for a workforce reduction program. Primary components of the charge were separation benefits, enhanced early retirement benefits, and health care benefits. The result of this workforce reduction was the elimination of approximately 700 positions, accomplished primarily through a voluntary enhanced severance program.

On June 1, 2001, LG&E filed an application (VDT case) with the Kentucky Commission to create a regulatory asset relating to these first quarter 2001 charges. The application requested permission to amortize these costs over a four-year period. The Kentucky Commission also opened a case to review a new depreciation study and resulting depreciation rates implemented in 2001.

LG&E reached a settlement in the VDT case as well as the other cases involving depreciation rates and ESM with all intervening parties. The settlement agreement was approved by the Kentucky Commission on December 3, 2001. The order allowed LG&E to set up a regulatory asset of \$141 million for the workforce reduction costs and begin amortizing these costs over a five year period starting in April 2001. The first quarter 2001 charge of \$144 million represented all employees who had accepted a voluntary enhanced severance program. Some employees rescinded their participation in the voluntary enhanced severance program, thereby decreasing the

Page 12

original charge from \$144 million to \$141 million. The settlement will also reduce revenues approximately \$26 million through a surcredit on future bills to customers over the same five year period. The surcredit represents net savings stipulated by LG&E. The agreement also established LG&E's new depreciation rates in effect December 2001, retroactive to January 1, 2001. The new depreciation rates decreased depreciation expense by \$5.6 million in 2001.

PUHCA. LG&E Energy was purchased by Powergen on December 11, 2000. Effective July 1, 2002, Powergen was acquired by E.ON, which became a registered holding company under PUHCA. As a result, E.ON, its utility subsidiaries, including LG&E, and certain of its non-utility subsidiaries are subject to extensive regulation by the SEC under PUHCA with respect to issuances and sales of securities, acquisitions and sales of certain utility properties, and intra-system sales of certain goods and services. In addition, PUHCA generally limits the ability of registered holding companies to acquire additional public utility systems and to acquire and retain businesses unrelated to the utility operations of the holding company. LG&E believes that it has adequate authority (including financing authority) under existing SEC orders and regulations to conduct its business. LG&E will seek additional authorization when necessary.

Environmental Cost Recovery. In June 2000, the Kentucky Commission approved LG&E's application for a CCN to construct up to three SCR NOx reduction facilities. The construction and subsequent operation of the SCRs is intended to reduce NOx emission levels to meet the EPA's mandated NOx emission level of 0.15 lbs./ Mmbtu by May 2004. In its order, the Kentucky Commission ruled that LG&E's proposed plan for construction was "reasonable, cost-effective and will not result in the wasteful duplication of facilities." In October 2000, LG&E filed an application with the Kentucky Commission to amend its Environmental Compliance Plan to reflect the addition of the proposed NOx reduction technology projects and to amend its ECR Tariff to include an overall rate of return on capital investments. Approval of LG&E's application in April 2001 allowed LG&E to begin to

recover the costs associated with these new projects, subject to Kentucky Commission oversight during normal six-month and two-year reviews.

In August 2002, LG&E filed an application with the Kentucky Commission to amend its compliance plan to allow recovery of the cost of new and additional environmental compliance facilities. The estimated capital cost of the additional facilities is \$71.1 million. The Kentucky Commission conducted a public hearing on the case on December 20, 2002, final briefs were filed on January 15, 2003, and a final order was issued February 11, 2003. The final order approved recovery of four new environmental compliance facilities totaling \$43.1 million. A fifth project, expansion of the land fill facility at the Mill Creek Station, was denied without prejudice with an invitation to reapply for recovery when required construction permits are approved. Cost recovery through the environmental surcharge of the four approved projects will begin with the bills rendered in April 2003.

ESM. LG&E's electric rates are subject to an ESM. The ESM, initially in place for three years beginning in 2000, sets an upper and lower point for rate of return on equity, whereby if LG&E's rate of return for the calendar year falls within the range of 10.5% to 12.5%, no action is necessary. If earnings are above the upper limit, the excess earnings are shared 40% with ratepayers and 60% with shareholders; if earnings are below the lower limit, the earnings deficiency is recovered 40% from ratepayers and 60% from shareholders. By order of the Kentucky Commission, rate changes prompted by the ESM filing go into effect in April of each year subject to a balancing adjustment in successive periods. LG&E made its second ESM filing on March 1, 2002 for the calendar year 2001 reporting period. LG&E is in the process of refunding \$441,000 to customers for the 2001 reporting period. LG&E estimated that the rate of return will fall below the lower limit, subject to Kentucky Commission approval, for the year ended December 31, 2002. The 2002 financial statements include an accrual to reflect the earnings deficiency of \$12.5 million to be recovered from customers commencing in April 2003.

On November 27, 2002, LG&E filed a revised ESM tariff which proposed continuance of the existing ESM through December 2005. The Kentucky Commission issued an Order suspending the ESM tariff one day making the

Page 13

effective date January 2, 2003. In addition, the Kentucky Commission is conducting a management audit to review the ESM plan and reassess its reasonableness in 2003. LG&E and interested parties will have the opportunity to provide recommendations for modification and continuance of the ESM or other forms of alternative or incentive regulation.

DSM. LG&E's rates contain a DSM provision. The provision includes a rate mechanism that provides concurrent recovery of DSM costs and provides an incentive for implementing DSM programs. This program had allowed LG&E to recover revenues from lost sales associated with the DSM program. In May 2001, the Kentucky Commission approved LG&E's plan to continue DSM programs. This filing called for the expansion of the DSM programs into the service territory served by KU and proposed a mechanism to recover revenues from lost sales associated with DSM programs based on program planning engineering estimates and post-implementation evaluation.

Gas PBR. Since November 1, 1997, LG&E has operated under an experimental PBR mechanism related to its gas procurement activities. For each of the last five years, LG&E's rates have been adjusted to recover its portion of

the savings (or expenses) incurred during each of the five 12-month periods beginning November 1 and ending October 31. Since its implementation on November 1, 1997, through October 31, 2001, LG&E has achieved \$38.1 million in savings. Of the total savings, LG&E has retained \$16.5 million, and the remaining portion of \$21.6 million has been distributed to customers. In December 2000, LG&E filed an application reporting on the operation of the experimental PBR and requested the Kentucky Commission to extend the PBR as a result of the benefits provided to both LG&E and its customers during the experimental period. Following the discovery and hearing process, the Kentucky Commission issued an order effective November 1, 2001, extending the experimental PBR program for an additional four years, and making other modifications, including changes to the sharing levels applicable to savings or expenses incurred under the PBR. Specifically, the Kentucky Commission modified the savings mechanism to a 25%/75% Company/Customer sharing for all savings (and expenses) up to 4.5% of the benchmarked gas costs. Savings (and expenses) in excess of 4.5% of the benchmarked gas costs are shared at a 50%/50% level.

FAC. Prior to implementation of the electric PBR in July 1999, and following its termination in March 2000, LG&E employed an FAC mechanism, which under Kentucky law allowed LG&E to recover from customers the actual fuel costs associated with retail electric sales. In February 1999, LG&E received orders from the Kentucky Commission requiring a refund to retail electric customers of approximately \$3.9 million resulting from reviews of the FAC from November 1994, through April 1998. While legal challenges to the Kentucky Commission order were pending, a comprehensive settlement was reached by all parties and approved by the Kentucky Commission on May 17, 2002. Thereunder, LG&E agreed to credit its fuel clause in the amount of \$720,000 (such credit provided over the course of June and July 2002), and the parties agreed on a prospective interpretation of the state's FAC regulation to ensure consistent and mutually acceptable application on a going-forward basis.

In December 2002, the Kentucky Commission initiated a two year review of the operation of LG&E's FAC for the period November 2000 through October 2002. Testimony in the review case was filed on January 20, 2003 and a public hearing was held February 18, 2003. Issues addressed at that time included the establishment of the current base fuel factor to be included in LG&E's base rates, verification of proper treatment of purchased power costs during unit outages, and compliance with fuel procurement policies and practices.

Gas Rate Case. In March 2000, LG&E filed an application with the Kentucky Commission requesting an adjustment in LG&E's gas rates. In September 2000, the Kentucky Commission granted LG&E an annual increase in its base gas revenues of \$20.2 million effective September 28, 2000. The Kentucky Commission authorized a return on equity of 11.25%. The Kentucky Commission approved LG&E's proposal for a weather normalization billing adjustment mechanism that will normalize the effect of weather on base gas revenues from gas sales.

Page 14

Wholesale Natural Gas Prices. On September 12, 2000, the Kentucky Commission issued an order establishing Administrative Case No. 384 - "An Investigation of Increasing Wholesale Natural Gas Prices and the Impacts of such Increase on the Retail Customers Served by Kentucky's Jurisdictional Natural Gas Distribution Companies". The impetus for this administrative proceeding was the escalation of wholesale natural gas prices during the summer of 2000.

The Kentucky Commission directed Kentucky's natural gas distribution companies, including LG&E, to file selected information regarding the individual companies' natural gas purchasing practices, expectations for the then-approaching winter heating season of 2000-2001, and potential actions which these companies might take to mitigate price volatility. On July 17, 2001, the Kentucky Commission issued an order encouraging the natural gas distribution companies in Kentucky to take various actions, among them to propose a natural gas hedge plan, consider performance-based ratemaking mechanisms, and to increase the use of storage.

In April 2002, in Case No. 2002-00136, LG&E proposed a hedging plan for the 2002/2003 winter heating season with three alternatives, the first two using a combination of storage and financial hedge instruments and the third relying upon storage alone. LG&E and the Attorney General, who represents Kentucky consumers, entered into a settlement which selected the third option. In August 2002, the Kentucky Commission approved the plan contemplated in the settlement. The Kentucky Commission validated the effectiveness of storage to mitigate potentially high winter gas prices by approving this natural gas hedging plan.

The Kentucky Commission also decided in Administrative Case No. 384 to engage a consultant to conduct a forward-looking audit of the gas procurement and supply procedures of Kentucky's largest natural gas distribution companies. The Kentucky Commission completed its audit in late 2002. The audit recognized LG&E as "efficient and effective [in the] procurement and management of significant quantities of natural gas supplies." The auditors also recognized that "the Company's residential gas prices have long been below averages for the U. S. and for the Commonwealth of Kentucky" which "demonstrates [LG&E's] effectiveness in [the] procurement and management of natural gas supplies." The audit also stated that the "Company's very impressive record in keeping its rates down provides sound evidence on the excellent job done in the area of gas supply procurement and management."

Kentucky Commission Administrative Case for Affiliate Transactions. In December 1997, the Kentucky Commission opened Administrative Case No. 369 to consider Kentucky Commission policy regarding cost allocations, affiliate transactions and codes of conduct governing the relationship between utilities and their non-utility operations and affiliates. The Kentucky Commission intended to address two major areas in the proceedings: the tools and conditions needed to prevent cost shifting and cross-subsidization between regulated and non-utility operations; and whether a code of conduct should be established to assure that non-utility segments of the holding company are not engaged in practices that could result in unfair competition caused by cost shifting from the non-utility affiliate to the utility. During the period September 1998 to February 2000, the Kentucky Commission issued draft codes of conduct and cost allocation guidelines. In early 2000, the Kentucky General Assembly enacted legislation, House Bill 897, which authorized the Kentucky Commission to require utilities that provide nonregulated activities to keep separate accounts and allocate costs in accordance with procedures established by the Kentucky Commission. In the same bill, the General Assembly set forth provisions to govern a utility's activities related to the sharing of information, databases, and resources between its employees or an affiliate involved in the marketing or the provision of nonregulated activities and its employees or an affiliate involved in the provision of regulated services. The legislation became law in July 2000 and LG&E has been operating pursuant thereto since that time. On February 14, 2001, the Kentucky Commission published notice of its intent to promulgate new

administrative regulations under the auspices of this new law. This effort is still on going.

Kentucky Commission Administrative Case for System Adequacy. On June 19, 2001, Kentucky Governor Paul E. Patton issued Executive Order 2001-771,

Page 15

which directed the Kentucky Commission to review and study issues relating to the need for and development of new electric generating capacity in Kentucky. The issues to be considered included the impact of new power plants on the electric supply grid, facility siting issues, and economic development matters, with the goal of ensuring a continued, reliable source of supply of electricity for the citizens of Kentucky and the continued environmental and economic vitality of Kentucky and its communities. In response to that Executive Order, in July 2001 the Kentucky Commission opened Administrative Case No. 387 to review the adequacy of Kentucky's generation capacity and transmission system. Specifically, the items reviewed were the appropriate level of reliance on purchased power, the appropriate reserve margins to meet existing and future electric demand, the impact of spikes in natural gas prices on electric utility planning strategies, and the adequacy of Kentucky's electric transmission facilities. LG&E, as a party to this proceeding, filed written testimony and responded to two requests for information. Public hearings were held and in October 2001, LG&E filed a final brief in the case. In December 2001, the Kentucky Commission issued an order in which it noted that LG&E is responsibly addressing the long-term supply needs of native load customers and that current reserve margins are appropriate. However, due to the rapid pace of change in the industry, the order also requires LG&E to provide an annual assessment of supply resources, future demand, reserve margin, and the need for new resources.

Regarding the transmission system, the Kentucky Commission concluded that the transmission system within Kentucky can reliably serve native load and a significant portion of the proposed new unregulated power plants. However, it will not be able to handle the volume of transactions envisioned by FERC without future upgrades, the costs of which should be borne by those for whom the upgrades are required.

The Kentucky Commission pledged to continue to monitor all relevant issues and advocate Kentucky's interests at all opportunities.

FERC SMD NOPR. On July 31, 2002, FERC issued a NOPR in Docket No. RM01-12-000 which would substantially alter the regulations governing the nation's wholesale electricity markets by establishing a common set of rules -- SMD. The SMD NOPR would require each public utility that owns, operates, or controls interstate transmission facilities to become an Independent Transmission Provider (ITP), belong to an RTO that is an ITP, or contract with an ITP for operation of its transmission assets. It would also establish a standardized congestion management system, real-time and day-ahead energy markets, and a single transmission service for network and point-to-point transmission customers. Review of the proposed rulemaking is underway and a final rule is expected during 2003. While it is expected that the SMD final rule will affect LG&E revenues and expenses, the specific impact of the rulemaking is not known at this time.

MISO. LG&E is a member of the MISO, which began commercial operations on February 1, 2002. MISO now has operational control over LG&E's high-voltage transmission facilities (100 kV and greater), while LG&E continues to control and operate the lower voltage transmission subject to the terms

and conditions of the MISO OATT. As a transmission-owning member of MISO, LG&E also incurs administrative costs of MISO pursuant to Schedule 10 of the MISO OATT.

MISO also proposed to implement a congestion management system. FERC directed the MISO to coordinate its efforts with FERC's Rulemaking on SMD. On September 24, 2002, the MISO filed new rate schedules designated as Schedules 16 and 17, which provide for the collection of costs incurred by the MISO to establish day-ahead and real-time energy markets. The MISO proposed to recover these costs under Schedules 16 and 17 once service commences. If approved by FERC, these schedules will cause LG&E to incur additional costs. LG&E opposes the establishment of Schedules 16 and 17. This effort is still on-going and the ultimate impact of the two schedules, if approved, is not known at this time.

ARO. In 2003, LG&E expects to record approximately \$6.0 million in regulatory assets and approximately \$60,000 in regulatory liabilities related to SFAS No. 143, Accounting for Asset Retirement Obligations.

Page 16

Merger Surcredit. As part of the LG&E Energy merger with KU Energy in 1998, LG&E Energy estimated non-fuel savings over a ten-year period following the merger. Costs to achieve these savings for LG&E of \$50.2 million were recorded in the second quarter of 1998, \$18.1 million of which was deferred and amortized over a five-year period pursuant to regulatory orders. Primary components of the merger costs were separation benefits, relocation costs, and transaction fees, the majority of which were paid by December 31, 1998. LG&E expensed the remaining costs associated with the merger (\$32.1 million) in the second quarter of 1998.

In approving the merger, the Kentucky Commission adopted LG&E's proposal to reduce its retail customers' bills based on one-half of the estimated merger-related savings, net of deferred and amortized amounts, over a five-year period. The surcredit mechanism provides that 50% of the net non-fuel cost savings estimated to be achieved from the merger be provided to ratepayers through a monthly bill credit, and 50% be retained by the Companies, over a five-year period. The surcredit was allocated 53% to KU and 47% to LG&E. In that same order, the Commission required LG&E and KU, after the end of the five-year period, to present a plan for sharing with customers the then-projected non-fuel savings associated with the merger. The Companies submitted this filing on January 13, 2003, proposing to continue to share with customers, on a 50%/50% basis, the estimated fifth-year gross level of non-fuel savings associated with the merger. The filing is currently under review.

Any fuel cost savings are passed to Kentucky customers through the fuel adjustment clause. See FAC above.

#### Note 4 - Financial Instruments

The cost and estimated fair values of LG&E's non-trading financial instruments as of December 31, 2002, and 2001 follow (in thousands of \$):

	2002		2001	
	Cost	Fair Value	Cost	Fair Value
Preferred stock subject to mandatory redemption	\$ 25,000	\$ 25,188	\$ 25,000	\$ 25,125
Long-term debt (including				

current portion)	616,904	623,325	616,904	620,504
Interest-rate swaps	-	(17,115)	-	(8,604)

All of the above valuations reflect prices quoted by exchanges except for the swaps. The fair values of the swaps reflect price quotes from dealers or amounts calculated using accepted pricing models.

Interest Rate Swaps. LG&E uses interest rate swaps to hedge exposure to market fluctuations in certain of its debt instruments. Pursuant to policy, use of these financial instruments is intended to mitigate risk and earnings volatility and is not speculative in nature. Management has designated all of the interest rate swaps as hedge instruments. Financial instruments designated as cash flow hedges have resulting gains and losses recorded within other comprehensive income and stockholders' equity. To the extent a financial instrument or the underlying item being hedged is prematurely terminated or the hedge becomes ineffective, the resulting gains or losses are reclassified from other comprehensive income to net income. Financial instruments designated as fair value hedges are periodically marked to market with the resulting gains and losses recorded directly into net income to correspond with income or expense recognized from changes in market value of the items being hedged.

As of December 31, 2002 and 2001, LG&E was party to various interest rate swap agreements with aggregate notional amounts of \$117.3 million. Under these swap agreements, LG&E paid fixed rates averaging 5.13% and received variable rates based on the Bond Market Association's municipal swap index

Page 17

averaging 1.52% and 1.61% at December 31, 2002 and 2001, respectively. The swap agreements in effect at December 31, 2002 have been designated as cash flow hedges and mature on dates ranging from 2003 to 2020. The hedges have been deemed to be fully effective resulting in a pretax loss of \$8.5 million for 2002, recorded in other comprehensive income. Upon expiration of these hedges, the amount recorded in other comprehensive income will be reclassified into earnings. The amounts expected to be reclassified from other comprehensive income to earnings in the next twelve months is immaterial.

Energy Trading & Risk Management Activities. LG&E conducts energy trading and risk management activities to maximize the value of power sales from physical assets it owns, in addition to the wholesale sale of excess asset capacity. Certain energy trading activities are accounted for on a mark-to-market basis in accordance with EITF 98-10, Accounting for Contracts Involved in Energy Trading and Risk Management Activities, SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, and SFAS No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities. Wholesale sales of excess asset capacity and wholesale purchases are treated as normal sales and purchases under SFAS No. 133 and SFAS No. 138 and are not marked-to-market.

The consensus reached by the EITF on EITF No. 02-03, Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities, to rescind EITF 98-10, effective for fiscal years after December 15, 2002, had no impact on LG&E's energy trading and risk management reporting as all contracts marked to market under EITF 98-10 are also within the scope of SFAS No. 133.

The table below summarizes LG&E's energy trading and risk management activities for 2002 and 2001 (in thousands of \$).

	2002	2001
Fair value of contracts at beginning of period, net liability	\$ (186)	\$ (17)
Fair value of contracts when entered into during the period	(65)	3,441
Contracts realized or otherwise settled during the period	448	(2,894)
Changes in fair values due to changes in assumptions	(353)	(716)
Fair value of contracts at end of period, net liability	\$ (156)	\$ (186)

No changes to valuation techniques for energy trading and risk management activities occurred during 2002. Changes in market pricing, interest rate and volatility assumptions were made during both years. All contracts outstanding at December 31, 2002, have a maturity of less than one year and are valued using prices actively quoted for proposed or executed transactions or quoted by brokers.

LG&E maintains policies intended to minimize credit risk and revalues credit exposures daily to monitor compliance with those policies. At December 31, 2002, 86% of the trading and risk management commitments were with counterparties rated BBB- equivalent or better.

#### Note 5 - 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.

LG&E's customer receivables and gas and electric revenues arise from deliveries of natural gas to approximately 310,000 customers and electricity to approximately 382,000 customers in Louisville and adjacent areas in Kentucky. For the year ended December 31, 2002, 73% of total revenue was derived from electric operations and 27% from gas operations.

#### Page 18

In November 2001, LG&E and IBEW Local 2100 employees, which represent approximately 70% of LG&E's workforce, entered into a four-year collective bargaining agreement.

#### Note 6 - Pension Plans and Retirement Benefits

LG&E sponsors several qualified and non-qualified pension plans and other postretirement benefit plans for its employees. The following tables provide a reconciliation of the changes in the plans' benefit obligations and fair value of assets over the two-year period ending December 31, 2002, and a statement of the funded status as of December 31 for each of the last two years (in thousands of \$):

	2002	2001
Pension Plans:		
Change in benefit obligation		
Benefit obligation at beginning of year	\$ 356,293	\$ 310,822
Service cost	1,484	1,311

Interest cost	24,512	25,361
Plan amendments	576	1,550
Curtailement loss	-	24,563
Special termination benefits	-	53,610
Benefits paid	(34,823)	(53,292)
Actuarial (gain) or loss and other	16,752	(7,632)
Benefit obligation at end of year	\$ 364,794	\$ 356,293

## Change in plan assets

Fair value of plan assets at beginning of year	\$ 233,944	\$ 333,378
Actual return on plan assets	(15,648)	(27,589)
Employer contributions and plan transfers	14,150	(17,134)
Benefits paid	(34,824)	(53,292)
Administrative expenses	(1,308)	(1,419)
Fair value of plan assets at end of year	\$ 196,314	\$ 233,944

## Reconciliation of funded status

Funded status	\$ (168,480)	\$ (122,349)
Unrecognized actuarial (gain) or loss	60,313	18,800
Unrecognized transition (asset) or obligation	(3,199)	(4,215)
Unrecognized prior service cost	32,265	35,435
Net amount recognized at end of year	\$ (79,101)	\$ (72,329)

## Other Benefits:

Change in benefit obligation	\$ 89,946	\$ 56,981
Benefit obligation at beginning of year	444	358
Service cost	5,956	5,865
Interest cost	-	1,487
Plan amendments	-	8,645
Curtailement loss	-	18,089
Special termination benefits	(4,988)	(4,877)
Benefits paid	1,875	3,398
Actuarial (gain) or loss	\$ 93,233	\$ 89,946

## Change in plan assets

Fair value of plan assets at beginning of year	\$ 2,802	\$ 7,166
Actual return on plan assets	(533)	(765)
Employer contributions and plan transfers	4,213	1,282
Benefits paid	(5,004)	(4,881)
Fair value of plan assets at end of year	\$ 1,478	\$ 2,802

Page 19

## Reconciliation of funded status

Funded status	\$ (91,755)	\$ (87,144)
Unrecognized actuarial (gain) or loss	16,971	15,947
Unrecognized transition (asset) or obligation	6,697	7,346
Unrecognized prior service cost	5,995	5,302
Net amount recognized at end of year	\$ (62,092)	\$ (58,549)

There are no plan assets in the nonqualified plans due to the nature of the plans.

LG&E made a contribution to the pension plan of \$83.1 million in January 2003.

The following tables provide the amounts recognized in the balance sheet and information for plans with benefit obligations in excess of plan assets

as of December 31, 2002 and 2001 (in thousands of \$):

	2002	2001
Pension Plans:		
Amounts recognized in the balance sheet consisted of:		
Prepaid benefits cost	\$ -	\$ -
Accrued benefit liability	(162,611)	(108,977)
Intangible asset	32,799	11,936
Accumulated other comprehensive income	50,711	24,712
Net amount recognized at year-end	\$ (79,101)	\$ (72,329)

Additional year-end information for plans with accumulated benefit obligations in excess of plan assets (1):

Projected benefit obligation	\$ 364,794	\$ 356,293
Accumulated benefit obligation	358,956	352,477
Fair value of plan assets	196,314	233,944

(1) 2002 and 2001 includes all plans.

Other Benefits:

Amounts recognized in the balance sheet consisted of:

Accrued benefit liability	\$ (62,092)	\$ (58,549)
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Additional year-end information for plans with benefit obligations in excess of plan assets:

Projected benefit obligation	\$ 93,233	\$ 89,946
Fair value of plan assets	1,478	2,802

The following table provides the components of net periodic benefit cost for the plans for 2002 and 2001 (in thousands of \$):

	2002	2001
Pension Plans:		
Components of net periodic benefit cost		
Service cost	\$ 1,484	\$ 1,311
Interest cost	24,512	25,361
Expected return on plan assets	(21,639)	(26,360)
Amortization of prior service cost	3,777	3,861
Amortization of transition (asset) or obligation	(1,016)	(1,000)
Recognized actuarial (gain) or loss	21	(777)
Net periodic benefit cost	\$ 7,139	\$ 2,396

Page 20

Special charges		
Prior service cost recognized	\$ -	\$ 10,237
Special termination benefits	-	53,610
Settlement loss	-	(2,244)
Total charges	\$ -	\$ 61,603

Other Benefits:

Components of net periodic benefit cost

Service cost	\$ 444	\$ 358
Interest cost	5,956	5,865
Expected return on plan assets	(204)	(420)
Amortization of prior service cost	920	951

Amortization of transition (asset) or obligation	650	719
Recognized actuarial (gain) or loss	116	(32)
Net periodic benefit cost	\$ 7,882	\$ 7,441
Special charges		
Curtailment loss	\$ -	\$ 6,671
Prior service cost recognized	-	2,391
Transition obligation recognized	-	4,743
Special termination benefits	-	18,089
Total charges	\$ -	\$ 31,894

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

	2002	2001
Weighted-average assumptions as of December 31:		
Discount rate	6.75%	7.25%
Expected long-term rate of return on plan assets	9.00%	9.50%
Rate of compensation increase	3.75%	4.25%

For measurement purposes, a 12.00% annual increase in the per capita cost of covered health care benefits was assumed for 2003. The rate was assumed to decrease gradually to 5.00% for 2014 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 the following effects (in thousands of \$):

	1% Decrease	1% Increase
Effect on total of service and interest cost components for 2002	(201)	227
Effect on year-end 2002 postretirement benefit obligations	(3,001)	3,347

Thrift Savings Plans. LG&E 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. LG&E makes contributions to the plan by matching a portion of the employee contributions. The costs of this matching were approximately \$1.7 million for 2002 and \$1.2 million for 2001.

Page 21

#### Note 7 - Income Taxes

Components of income tax expense are shown in the table below (in thousands of \$):

	2002	2001
Included in operating expenses:		
Current	\$26,231	\$42,997
- federal	8,083	8,668
- state	20,464	12,310
Deferred	4,410	3,767
- federal - net	(4,153)	(4,290)
- state - net	55,035	63,452
Amortization of investment tax credit		
Total		

Included in other income - net:		
Current - federal	(1,667)	(1,870)
- state	(430)	(483)
Deferred - federal - net	(206)	285
- state - net	(53)	73
Total	(2,356)	(1,995)
 Total income tax expense	 \$52,679	 \$61,457

Components of net deferred tax liabilities included in the balance sheet are shown below (in thousands of \$):

	2002	2001
Deferred tax liabilities:		
Depreciation and other plant-related items	\$346,737	\$334,914
Other liabilities	64,734	77,611
	411,471	412,525
Deferred tax assets:		
Investment tax credit	22,012	23,713
Income taxes due to customers	18,431	19,709
Pensions	21,056	6,621
Accrued liabilities not currently deductible and other	36,747	64,339
	98,246	114,382
 Net deferred income tax liability	 \$313,225	 \$298,143

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

	2002	2001
Statutory federal income tax rate	35.0%	35.0%
State income taxes, net of federal benefit	5.6	4.7
Amortization of investment tax credit	(2.9)	(2.6)
Other differences - net	(0.5)	(0.6)
Effective income tax rate	37.2%	36.5%

Page 22

Note 8 - Other Income - net

Other income - net consisted of the following at December 31 (in thousands of \$):

	2002	2001
Interest and dividend income	\$457	\$ 748
Gains on fixed asset disposals	421	1,217
Income taxes and other	(58)	965
Other income - net	\$820	\$2,930

Note 9 - First Mortgage Bonds and Pollution Control Bonds

Long-term debt and the current portion of long-term debt, summarized below (in thousands of \$), consists primarily of first mortgage bonds and pollution control bonds. Interest rates and maturities in the table below are for the amounts outstanding at December 31, 2002.

	Stated Interest Rates	Weighted Average Interest Rate	Maturities	Principal Amounts
Noncurrent portion	Variable - 5.90%	3.53%	2019-2032	\$ 328,104
Current portion	Variable - 6.00%	2.08%	2003-2027	288,800

Under the provisions for some of LG&E'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 consolidated balance sheets. The average annualized interest rate for these bonds during 2002 was 1.61%.

LG&E's First Mortgage Bond, 6% Series of \$42.6 million is scheduled to mature in 2003. There are no other scheduled maturities of pollution control bonds for the five years subsequent to December 31, 2002.

In October 2002, LG&E issued \$41.7 million variable rate pollution bonds due October 1, 2032, and exercised its call option on \$41.7 million, 6.55% pollution control bonds due November 1, 2020.

In March 2002, LG&E refinanced four unsecured pollution control bonds with an aggregate principal balance of \$120 million and replaced them with secured pollution control bonds. The new bonds and the previous bonds were all variable rate bonds, and the maturity dates remained unchanged.

In September 2001, LG&E issued \$10.1 million variable rate tax-exempt environmental facility revenue bonds due September 1, 2027.

Annual requirements for the sinking funds of LG&E's First Mortgage Bonds (other than the First Mortgage Bonds issued in connection with certain Pollution Control Bonds) are the amounts necessary to redeem 1% of the highest principal amount of each series of bonds at any time outstanding. Property additions (166 2/3% of principal amounts of bonds otherwise required to be so redeemed) have been applied in lieu of cash.

Substantially all of LG&E's utility plants are pledged as security for its first mortgage bonds. LG&E's indenture, as supplemented, provides that portions of retained earnings will not be available for the payment of dividends on common stock, under certain specified conditions. No portion of retained earnings is restricted by this provision as of December 31, 2002.

Page 23

#### Note 10 - Notes Payable

LG&E participates in an intercompany money pool agreement wherein LG&E Energy can make funds available to LG&E at market based rates up to \$400 million. The balance of the money pool loan from LG&E Energy was \$193.1 million at a rate of 1.61% and \$64.2 million at an average rate of 2.37%, at December 31, 2002 and 2001, respectively. LG&E also had outstanding commercial paper of \$30 million at an average rate of 2.54% at December 31, 2001. The remaining money pool availability at December 31, 2002, was \$206.9 million. LG&E Energy maintains facilities of \$450 million with affiliates to ensure funding availability for the money pool. The outstanding balance under these facilities as of December 31, 2002 was \$230 million, and availability of \$220 million remained.

## Note 11 - Commitments and Contingencies

Construction Program. LG&E had approximately \$15.1 million of commitments in connection with its construction program at December 31, 2002. Construction expenditures for the years 2003 and 2004 are estimated to total approximately \$340.0 million, although all of this amount is not currently committed, including the purchase of four jointly owned CTs, \$89.0 million, and construction of NOx equipment, \$34.0 million.

Operating Lease. LG&E leases office space and accounts for its office space lease as an operating lease. Total lease expense for 2002 and 2001 less amounts contributed by the parent company, was \$1.6 million and \$1.1 million, respectively. The future minimum annual lease payments under this lease agreement for years subsequent to December 31, 2002, are as follows (in thousands of \$):

2003	\$ 3,371
2004	3,399
2005	3,467
2006	3,536
2007	3,607
Thereafter	29,794
Total	\$47,174

Environmental. The Clean Air Act imposed stringent new SO<sub>2</sub> and NO<sub>x</sub> emission limits on electric generating units. LG&E previously had installed scrubbers on all of its generating units. LG&E's strategy for Phase II SO<sub>2</sub> reductions, which commenced January 1, 2000, is to increase scrubber removal efficiency to delay additional capital expenditures and may also include fuel switching or upgrading scrubbers. LG&E met the NO<sub>x</sub> emission requirements of the Act through installation of low-NO<sub>x</sub> burner systems. LG&E's compliance plans are subject to many factors including developments in the emission allowance and fuel markets, future regulatory and legislative initiatives, and advances in clean air control technology. LG&E will continue to monitor these developments to ensure that its environmental obligations are met in the most efficient and cost-effective manner.

In September 1998, the EPA announced its final "NO<sub>x</sub> SIP Call" rule requiring states to impose significant additional reductions in NO<sub>x</sub> emissions by May 2003, in order to mitigate alleged ozone transport impacts on the Northeast region. The Commonwealth of Kentucky is currently in the process of revising its SIP to require reductions in NO<sub>x</sub> emissions from coal-fired generating units to the 0.15 lb./Mmbtu level on a system-wide basis. In related proceedings in response to petitions filed by various Northeast states, in December 1999, EPA issued a final rule pursuant to Section 126 of the Clean Air Act directing similar NO<sub>x</sub> reductions from a number of specifically targeted generating units including all LG&E units. As a result of appeals to both rules, the compliance date was extended to May 2004. All LG&E generating units are subject to the May 2004 compliance date under these NO<sub>x</sub> emissions reduction rules.

Page 24

LG&E is currently implementing a plan for adding significant additional NO<sub>x</sub> controls to its generating units. Installation of additional NO<sub>x</sub> controls will proceed on a phased basis, with installation of controls commencing in late 2000 and continuing through the final compliance date. In addition, LG&E will incur additional operation and maintenance costs in operating new

NOx controls. LG&E believes its costs in this regard to be comparable to those of similarly situated utilities with like generation assets. LG&E had anticipated that such capital and operating costs are the type of costs that are eligible for recovery from customers under its environmental surcharge mechanism and believed that a significant portion of such costs could be recovered. In April 2001, the Kentucky Commission granted recovery of these costs for LG&E.

LG&E is also monitoring several other air quality issues which may potentially impact coal-fired power plants, including the appeal of the D.C. Circuit's remand of the EPA's revised air quality standards for ozone and particulate matter, measures to implement EPA's regional haze rule, and EPA's December 2000 determination to regulate mercury emissions from power plants. In addition, LG&E is currently working with local regulatory authorities to review the effectiveness of remedial measures aimed at controlling particulate matter emissions from its Mill Creek Station. LG&E previously settled a number of property damage claims from adjacent residents and completed significant remedial measures as part of its ongoing capital construction program. LG&E is in the process of converting the Mill Creek Station to wet stack operation in an effort to resolve all outstanding issues related to particulate matter emissions.

LG&E owns or formerly owned three properties which are the location of past MGP operations. Various contaminants are typically found at such former MGP sites and environmental remediation measures are frequently required. With respect to the sites, LG&E has completed cleanups, obtained regulatory approval of site management plans, or reached agreements for other parties to assume responsibility for cleanup. Based on currently available information, management estimates that it will incur additional costs of \$400,000. Accordingly, an accrual of \$400,000 has been recorded in the accompanying financial statements at December 31, 2002 and 2001.

Page 25

Purchased Power. LG&E has a contract for purchased power with OVEC for various Mw capacities. The estimated future minimum annual payments under purchased power agreements for the years subsequent to December 31, 2002, are as follows (in thousands of \$):

2003	\$ 10,773
2004	10,116
2005	10,152
2006	10,816
2007	10,816
Thereafter	184,544
Total	\$237,217

#### Note 12 - Jointly Owned Electric Utility Plant

LG&E owns a 75% undivided interest in Trimble County Unit 1 which the Kentucky Commission has allowed to be reflected in customer rates.

Of the remaining 25% of the Unit, IMEA owns a 12.12% undivided interest, and IMPA owns a 12.88% undivided interest. Each company is responsible for its proportionate ownership share of fuel cost, operation and maintenance expenses, and incremental assets.

The following data represent shares of the jointly owned property:

Trimble County

	LG&E	IMPA	IMEA	Total
Ownership interest	75%	12.88%	12.12%	100%
Mw capacity	386.2	66.4	62.4	515.0

LG&E's 75% ownership (in thousands of \$):

Cost	\$595,747
Accumulated depreciation	182,711
Net book value	\$413,036

Construction work in progress  
(included above) \$12,867

Page 26

LG&E and KU jointly own the following combustion turbines (in thousands of \$):

		LG&E	KU	Total
Paddy's Run 13	Ownership %	53%	47%	100%
	Mw capacity	84	74	158
	Cost	\$33,919	\$29,973	\$63,892
	Depreciation	1,711	1,499	3,210
	Net book value	\$32,208	\$28,474	\$60,682
E.W. Brown 5	Ownership %	53%	47%	100%
	Mw capacity	71	63	134
	Cost	\$23,973	\$21,106	\$45,079
	Depreciation	1,206	1,052	2,258
	Net book value	\$22,767	\$20,054	\$42,821
E.W. Brown 6	Ownership %	38%	62%	100%
	Mw capacity	59	95	154
	Cost	\$23,696	\$36,957	\$60,653
	Depreciation	1,770	4,201	5,971
	Net book value	\$21,926	\$32,756	\$54,682
E.W. Brown 7	Ownership %	38%	62%	100%
	Mw capacity	59	95	154
	Cost	\$23,607	\$44,792	\$68,399
	Depreciation	4,054	4,502	8,556
	Net book value	\$19,553	\$40,290	\$59,843
Trimble 5	Ownership %	29%	71%	100%
	Mw capacity	45	110	155
	Cost	\$15,970	\$39,045	\$55,015
	Depreciation	251	614	865
	Net book value	\$15,719	\$38,431	\$54,150
Trimble 6	Ownership %	29%	71%	100%
	Mw capacity	45	110	155
	Cost	\$15,961	\$39,025	\$54,986
	Depreciation	251	614	865
	Net book value	\$15,710	\$38,411	\$54,121
Trimble CT Pipeline	Ownership %	29%	71%	100%
	Cost	\$1,835	\$4,475	\$6,310
	Depreciation	39	96	135
	Net book value	\$1,796	\$4,379	\$6,175

See also Note 11, Construction Program, for LG&E's planned purchase of four jointly owned CTs in 2004.

Page 27

#### Note 13 - Segments of Business and Related Information

Effective December 31, 1998, LG&E adopted SFAS No. 131, Disclosure About Segments of an Enterprise and Related Information. LG&E is a regulated public utility engaged in the generation, transmission, distribution, and sale of electricity and the storage, distribution, and sale of natural gas. Financial data for business segments, follow (in thousands of \$):

	Electric	Gas	Total
2002			
Operating revenues	\$736,042 (a)	\$267,693	\$1,003,735
Depreciation and amortization	90,248	15,658	105,906
Interest income	381	76	457
Interest expense	24,837	4,968	29,805
Operating income taxes	49,010	6,025	55,035
Net income	79,246	9,683	88,929
Total assets	2,105,956	455,122	2,561,078
Construction expenditures	195,662	24,754	220,416
2001			
Operating revenues	\$673,772 (b)	\$290,775	\$964,547
Depreciation and amortization	85,572	14,784	100,356
Interest income	616	132	748
Interest expense	31,295	6,627	37,922
Operating income taxes	55,527	7,925	63,452
Net income	95,103	11,768	106,781
Total assets	1,985,252	463,102	2,448,354
Construction expenditures	227,107	25,851	252,958

(a) Net of provision for rate collections of \$12.3 million.

(b) Net of provision for rate refunds of \$.7 million.

#### Note 14 - Selected Quarterly Data (Unaudited)

Selected financial data for the four quarters of 2002 and 2001 are shown below. Because of seasonal fluctuations in temperature and other factors, results for quarters may fluctuate throughout the year.

	Quarters Ended			
	March	June	September	December
	(Thousands of \$)			
2002				
Operating revenues	\$278,005	\$216,163	\$243,074	\$266,493
Net operating income	28,748	22,410	41,652	25,104
Net income	20,943	15,256	34,204	18,526
Net income available for common stock	19,878	14,207	33,129	17,469
2001				
Operating revenues	\$308,929	\$212,918	\$229,848	\$212,852
Net operating income (loss) (a)	(43,732)	37,624	49,092	98,789
Net income (loss) (a)	(54,115)	28,467	40,270	92,159

Net income (loss) available for common stock (a)	(55,413)	27,247	39,160	91,048
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(a) Loss resulted from the VDT pre-tax charge of \$144.0 million in March 2001, which was reversed in December 2001. See Note 3.

Page 28

Note 15 - Subsequent Events

LG&E made a contribution to the pension plan of \$83.1 million in January 2003.

On March 18, 2003, the Kentucky Commission approved LG&E and KU's joint application for the acquisition of four CTs from an unregulated affiliate, LG&E Capital Corp. The total projected construction cost for the turbines, expected to be available for June 2004 in-service, is \$227.4 million. The requested ownership share of the turbines is 63% for KU and 37% for LG&E.

Page 29

Louisville Gas and Electric Company  
REPORT OF MANAGEMENT

The management of Louisville Gas and Electric Company is responsible for the preparation and integrity of the financial statements and related information. These statements have been prepared in accordance with accounting principles generally accepted in the United States applied on a consistent basis and, necessarily, include amounts that reflect the best estimates and judgment of management.

LG&E's 2002 and 2001 financial statements have been audited by PricewaterhouseCoopers LLP, independent accountants. Management made available to PricewaterhouseCoopers LLP all LG&E's financial records and related data as well as the minutes of shareholders' and directors' meetings.

Management has established and maintains a system of internal controls that provides reasonable assurance that transactions are completed in accordance with management's authorization, that assets are safeguarded and that financial statements are prepared in conformity with generally accepted accounting principles. Management believes that an adequate system of internal controls is maintained through the selection and training of personnel, appropriate division of responsibility, establishment and communication of policies and procedures and by regular reviews of internal accounting controls by LG&E's internal auditors. Management reviews and modifies its system of internal controls in light of changes in conditions and operations, as well as in response to recommendations from the internal and external auditors. These recommendations for the year ended December 31, 2002, did not identify any material weaknesses in the design and operation of LG&E's internal control structure.

In carrying out its oversight role for the financial reporting and internal controls of LG&E, the Board of Directors meets regularly with LG&E's independent public accountants, internal auditors and management. The Board of Directors reviews the results of the independent accountants' audit of the financial statements and their audit procedures, and discusses the adequacy of internal accounting controls. The Board of Directors also approves the annual internal auditing program and reviews the activities

and results of the internal auditing function. Both the independent public accountants and the internal auditors have access to the Board of Directors at any time.

Louisville Gas and Electric Company maintains and internally communicates a written code of business conduct that addresses, among other items, potential conflicts of interest, compliance with laws, including those relating to financial disclosure, and the confidentiality of proprietary information.

S. Bradford Rives  
Chief Financial Officer

Louisville Gas and Electric Company  
Louisville, Kentucky  
November 12, 2003

Page 30

Louisville Gas and Electric Company and Subsidiary  
REPORT OF INDEPENDENT ACCOUNTANTS

To the Shareholders of Louisville Gas and Electric Company and Subsidiary:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of capitalization, income, retained earnings, cash flows and comprehensive income present fairly, in all material respects, the financial position of Louisville Gas and Electric Company and Subsidiary (the "Company"), a wholly-owned subsidiary of LG&E Energy Corp., at December 31, 2002 and 2001, and the results of their operations and their cash flows for each of the two years in the period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1 to the financial statements, effective January 1, 2003, the Company adopted EITF No. 02-03, Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities.

/s/ PricewaterhouseCoopers LLP  
Louisville, Kentucky  
January 21, 2003, except for Note 1 as to which the date is November 12, 2003

Page 31

INDEX OF ABBREVIATIONS

Capital Corp.            LG&E Capital Corp.

Clean Air Act	The Clean Air Act, as amended in 1990
CCN	Certificate of Public Convenience and Necessity
CT	Combustion Turbines
DSM	Demand Side Management
ECR	Environmental Cost Recovery
EEI	Electric Energy, Inc.
EITF	Emerging Issues Task Force Issue
E.ON	E.ON AG
EPA	U.S. Environmental Protection Agency
ESM	Earnings Sharing Mechanism
F	Fahrenheit
FAC	Fuel Adjustment Clause
FERC	Federal Energy Regulatory Commission
FPA	Federal Power Act
FT and FT-A	Firm Transportation
GSC	Gas Supply Clause
IBEW	International Brotherhood of Electrical Workers
IMEA	Illinois Municipal Electric Agency
IMPA	Indiana Municipal Power Agency
Kentucky Commission	Kentucky Public Service Commission
KIUC	Kentucky Industrial Utility Consumers, Inc.
KU	Kentucky Utilities Company
KU Energy	KU Energy Corporation
KU R	KU Receivables LLC
kV	Kilovolts
Kva	Kilovolt-ampere
KW	Kilowatts
Kwh	Kilowatt hours
LEM	LG&E Energy Marketing Inc.
LG&E	Louisville Gas and Electric Company
LG&E Energy	LG&E Energy Corp.
LG&E R	LG&E Receivables LLC
LG&E Services	LG&E Energy Services Inc.
Mcf	Thousand Cubic Feet
MGP	Manufactured Gas Plant
MISO	Midwest Independent System Operator
Mmbtu	Million British thermal units
Moody's	Moody's Investor Services, Inc.
Mw	Megawatts
Mwh	Megawatt hours
NNS	No-Notice Service
NOPR	Notice of Proposed Rulemaking
NOx	Nitrogen Oxide
OATT	Open Access Transmission Tariff
OMU	Owensboro Municipal Utilities
OVEC	Ohio Valley Electric Corporation
PBR	Performance-Based Ratemaking
PJM	Pennsylvania, New Jersey, Maryland Interconnection
Powergen	Powergen Limited (formerly Powergen plc)
PUHCA	Public Utility Holding Company Act of 1935
ROE	Return on Equity
RTO	Regional Transmission Organization
S&P	Standard & Poor's Rating Services
SCR	Selective Catalytic Reduction
SEC	Securities and Exchange Commission

Page 32

SERP	Supplemental Employee Retirement Plan
SFAS	Statement of Financial Accounting Standards

SIP	State Implementation Plan
SMD	Standard Market Design
SO2	Sulfur Dioxide
Tennessee Gas	Tennessee Gas Pipeline Company
Texas Gas	Texas Gas Transmission Corporation
TRA	Tennessee Regulatory Authority
Trimble County	LG&E's Trimble County Unit 1
USWA	United Steelworkers of America
Utility Operations	Operations of LG&E and KU
VDT	Value Delivery Team Process
Virginia Commission	Virginia State Corporation Commission
Virginia Staff	Virginia State Corporation Commission Staff

Page 33

Kentucky Utilities Company and Subsidiary  
Consolidated Statements of Income  
(Thousands of \$)

	Years Ended December 31	
	2002	2001
OPERATING REVENUES:		
Electric (Note 1)	\$848,637	\$821,675
Provision for rate collections (refunds) (Note 3)	13,027	(954)
Total operating revenues	861,664	820,721
OPERATING EXPENSES:		
Fuel for electric generation	250,117	236,985
Power purchased	131,400	118,410
Other operation expenses	144,118	118,359
Non-recurring charge (Note 3)	-	6,867
Maintenance	62,909	57,021
Depreciation and amortization (Note 1)	95,462	90,299
Federal and state income taxes (Note 7)	54,032	57,482
Property and other taxes	14,983	13,928
Total operating expenses	753,021	699,351
Net operating income	108,643	121,370
Other income - net (Note 3)	10,429	8,932
Interest charges	25,688	34,024
Net income before cumulative effect of a change in accounting principle	93,384	96,278
Cumulative effect of a change in accounting principle-accounting for Derivative instruments and hedging activities, net of tax	-	136
Net income	93,384	96,414
Preferred stock dividends	2,256	2,256
Net income available for common stock	\$ 91,128	\$ 94,158

Consolidated Statements of Retained Earnings  
(Thousands of \$)

	Years Ended December 31	
	2002	2001
Balance January 1	\$410,896	\$347,238
Add net income	93,384	96,414
	504,280	443,652
Deduct: Cash dividends declared on stock:		
4.75% cumulative preferred	950	950
6.53% cumulative preferred	1,306	1,306
Common	-	30,500
	2,256	32,756
Balance December 31	\$502,024	\$410,896

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

Page 34

Kentucky Utilities Company and Subsidiary  
Consolidated Statements of Comprehensive Income  
(Thousands of \$)

	Years Ended December 31	
	2002	2001
Net income	\$ 93,384	\$ 96,414
Cumulative effect of change in accounting principle - Accounting for derivative instruments and hedging activities	-	2,647
Losses on derivative instruments and hedging activities	(2,647)	-
Additional minimum pension liability adjustment (Note 6)	(17,543)	-
Income tax benefit (expense) related to items of other comprehensive income	8,140	(1,059)
Other comprehensive (loss) income, net of tax	(12,050)	1,588
Comprehensive income	\$ 81,334	\$ 98,002

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

Page 35

Kentucky Utilities Company and Subsidiary  
Consolidated Balance Sheets  
(Thousands of \$)

December 31	
2002	2001

<b>ASSETS:</b>		
Utility plant, at original cost (Note 1)	\$3,089,529	\$2,960,818
Less: reserve for depreciation	1,536,658	1,457,754
	1,552,871	1,503,064
Construction work in progress	191,233	103,402
	1,744,104	1,606,466
Other property and investments - less reserve of \$130 in 2002 and 2001	14,358	9,629
<b>Current assets:</b>		
Cash and temporary cash investments (Note 1)	5,391	3,295
Accounts receivable -less reserve of \$800 in 2002 and 2001	49,588	45,291
Materials and supplies - at average cost:		
Fuel (predominantly coal) (Note 1)	46,090	43,382
Other	26,408	26,188
Prepayments and other	6,584	4,942
	134,061	123,098
<b>Deferred debits and other assets:</b>		
Unamortized debt expense (Note 1)	4,991	4,316
Regulatory assets (Note 3)	65,404	66,467
Other	35,465	16,926
	105,860	87,709
	\$1,998,383	\$ 1,826,902
<b>CAPITAL AND LIABILITIES:</b>		
<b>Capitalization (see statements of capitalization):</b>		
Common equity	\$ 814,107	\$ 735,029
Cumulative preferred stock	40,000	40,000
Long-term debt (Note 9)	346,562	434,506
	1,200,669	1,209,535
<b>Current liabilities:</b>		
Current portion of long-term debt (Note 9)	153,930	54,000
Notes payable to parent (Note 10)	119,490	47,790
Accounts payable	95,374	85,149
Accrued taxes	4,955	20,520
Other	21,442	22,150
	395,191	229,609
<b>Deferred credits and other liabilities:</b>		
Accumulated deferred income taxes (Notes 1 and 7)	241,184	239,204
Investment tax credit, in process of amortization	8,500	11,455
Accumulated provision for pensions and related benefits (Note 6)	110,927	91,235
Regulatory liabilities (Note 3)	29,876	33,889
Other	12,036	11,975
	402,523	387,758
Commitments and contingencies (Note 11)	\$1,998,383	\$1,826,902

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

Page 36

Kentucky Utilities Company and Subsidiary  
Consolidated Statements of Cash Flows  
(Thousands of \$)

	Years Ended December 31	
	2002	2001
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 93,384	\$ 96,414
Items not requiring cash currently:		
Depreciation and amortization	95,462	90,299
Deferred income taxes - net	(2,038)	(12,088)
Investment tax credit - net	(2,955)	(3,446)
Other	(1,267)	11,776
Change in certain net current assets:		
Accounts receivable	(8,497)	28
Materials and supplies	(2,928)	(31,263)
Accounts payable	10,225	8,810
Accrued taxes	(15,565)	898
Prepayments and other	(2,350)	(6,033)
Sale of accounts receivable (Note 1)	4,200	45,100
Other	8,086	(12,364)
Net cash flows from operating activities	175,757	188,131
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Proceeds from sales of securities	-	3,480
Construction expenditures	(237,909)	(142,425)
Net cash flows from investing activities	(237,909)	(138,945)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Short-term borrowings and repayments	71,700	(13,449)
Retirement of long-term debt	(133,930)	-
Issuance of long-term debt	128,734	-
Additional paid-in capital	-	-
Payment of dividends	(2,256)	(32,756)
Net cash flows used for financing activities	64,248	(46,205)
Change in cash and temporary cash investments	2,096	2,981
Cash and temporary cash investments at beginning of year	3,295	314
Cash and temporary cash investments at end of year	\$ 5,391	\$ 3,295
<b>Supplemental disclosures of cash flow information:</b>		
Cash paid during the year for:		
Income taxes	\$59,580	\$72,432
Interest on borrowed money	37,866	39,829

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

Page 37

Kentucky Utilities Company and Subsidiary  
Consolidated Statements of Capitalization  
(Thousands of \$)

	December 31	
	2002	2001
COMMON EQUITY:		
Common stock, without par value -		
authorized 80,000,000 shares, outstanding		
37,817,878 shares	\$ 308,140	\$ 308,140
Additional paid-in-capital	15,000	15,000
Accumulated other comprehensive income	(10,462)	1,588
Other	(595)	(595)
Retained earnings	502,024	410,896
	814,107	735,029

## CUMULATIVE PREFERRED STOCK:

	Shares Outstanding	Current Redemption Price		
Without par value,				
5,300,000 shares authorized -				
4.75% series, \$100 stated value				
Redeemable on 30 days				
notice by KU	200,000	\$101.00	20,000	20,000
6.53% series,				
\$100 stated value	200,000	Not redeemable	20,000	20,000
			40,000	40,000

## LONG-TERM DEBT (Note 9);

First mortgage bonds -				
Q due June 15, 2003, 6.32%		62,000	62,000	62,000
S due January 15, 2006, 5.99%		36,000	36,000	36,000
P due May 15, 2007, 7.92%		53,000	53,000	53,000
R due June 1, 2025, 7.55%		50,000	50,000	50,000
P due May 15, 2027, 8.55%		33,000	33,000	33,000
Pollution control series:				
1B due February 1, 2018, 6.25%		-	20,930	20,930
2B due February 1, 2018, 6.25%		-	2,400	2,400
3B due February 1, 2018, 6.25%		-	7,200	7,200
4B due February 1, 2018, 6.25%		-	7,400	7,400
8, due September 15, 2016, 7.45%		-	96,000	96,000
9, due December 1, 2023, 5.75%		50,000	50,000	50,000
10, due November 1, 2024, variable %		54,000	54,000	54,000
11, due May 1, 2023, variable %		12,900	12,900	12,900
12, due February 1, 2032, variable %		20,930	-	-
13, due February 1, 2032, variable %		2,400	-	-
14, due February 1, 2032, variable %		7,400	-	-
15, due February 1, 2032, variable %		7,200	-	-
16, due October 1, 2032, variable %		96,000	-	-
Long-term debt marked to market (Note 4)		15,662	3,676	3,676
Total bonds outstanding		500,492	488,506	488,506
Less current portion of long-term debt		153,930	54,000	54,000
Long-term debt		346,562	434,506	434,506
Total capitalization		\$1,200,669	\$1,209,535	\$1,209,535

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

Page 38

Kentucky Utilities Company and Subsidiary  
Notes to Consolidated Financial Statements

Note 1 - Summary of Significant Accounting Policies

KU, a subsidiary of LG&E Energy and an indirect subsidiary of Powergen and E.ON, is a regulated public utility engaged in the generation, transmission, distribution, and sale of electric energy. LG&E Energy is an exempt public utility holding company with wholly owned subsidiaries including LG&E, KU, Capital Corp., LEM, and LG&E Services. All of KU's Common Stock is held by LG&E Energy. KU has one wholly owned consolidated subsidiary, KU R.

On December 11, 2000, LG&E Energy was acquired by Powergen. On July 1, 2002, E.ON, a German company, completed its acquisition of Powergen plc (now Powergen Limited). E.ON had announced its pre-conditional cash offer of 5.1 billion pounds sterling (\$7.3 billion) for Powergen on April 9, 2001. Powergen and E.ON are registered public utility holding companies under PUHCA. No costs associated with these acquisitions nor any of the effects of purchase accounting have been reflected in the financial statements of KU.

Certain reclassification entries have been made to the previous year's financial statements to conform to the 2002 presentation with no impact on the balance sheet totals or previously reported income.

Utility Plant. KU's 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. KU has not recorded any 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, plus removal expense less salvage value, 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. Pursuant to a final order of the Kentucky Commission dated December 3, 2001, KU implemented new depreciation rates effective January 1, 2001. The amounts provided were approximately 3.1% in 2002 and 3.1% in 2001, of average depreciable plant. Of the amount provided for depreciation at December 31, 2002 and 2001, respectively, approximately 0.7% was related to the retirement, removal and disposal costs of long lived assets.

Cash and Temporary Cash Investments. KU considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents. Temporary cash investments are carried at cost, which approximates fair value.

Fuel Inventories. Fuel inventories of \$46.1 million and \$43.4 million at December 31, 2002 and 2001, respectively, are included in Fuel in the balance sheet. The inventory is accounted for using the average-cost

method.

**Financial Instruments.** KU uses over-the-counter interest-rate swap agreements to hedge its exposure to interest rates. Gains and losses on interest-rate swaps used to hedge interest rate risk are reflected in interest charges monthly. See Note 4 - Financial Instruments.

Page 39

**Unamortized Debt Expense.** Debt expense is capitalized in deferred debits and amortized over the lives of the related bond issues, consistent with regulatory practices.

**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 basis of assets and liabilities.

**Investment Tax Credits.** Investment tax credits resulted from provisions of the tax law that permitted a reduction of KU's tax liability based on credits for certain 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. The unbilled revenue estimates included in accounts receivable were approximately \$36.4 million and \$33.4 million at December 31, 2002, and 2001, respectively. KU recorded electric revenues that resulted from sales to a related party, LG&E, of \$34.6 million and \$31.1 million for years ended December 31, 2002 and 2001, respectively. See Note 3, Rates and Regulatory Matters.

With the adoption of EITF 02-03, Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities, revenues on the income statement are shown net of cost associated with trading activities. As a result KU has netted the power purchased expense for trading activities against operating revenue for all years presented.

**Fuel Costs.** The cost of fuel for electric generation is charged to expense as used.

**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. Actual results could differ from those estimates. See Note 11, Commitments and Contingencies, for a further discussion.

**Accounts Receivable Securitization.** SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, revises the standards for accounting for securitizations and other transfers of financial assets and collateral and requires certain disclosures, and provides accounting and reporting standards for transfers and servicing of financial assets and extinguishments of liabilities. SFAS No. 140 was adopted in the first quarter of 2001, when KU entered into an accounts receivable securitization transaction.

On February 6, 2001, KU implemented an accounts receivable securitization program. The purpose of this program is to enable KU to accelerate the receipt of cash from the collection of retail accounts receivable, thereby reducing dependence upon more costly sources of working capital. The securitization program allows for a percentage of eligible receivables to be sold. Eligible receivables are generally all receivables associated with retail sales that have standard terms and are not past due. KU is able to terminate this program at any time without penalty. If there is a significant deterioration in the payment record of the receivables by the retail customers or if KU fails to meet certain covenants regarding the program, the program may terminate at the election of the financial institutions. In this case, payments from retail customers would first be used to repay the financial institutions participating in the program, and would then be available for use by KU.

As part of the program, KU sold retail accounts receivables to a wholly owned subsidiary, KU R. Simultaneously, KU R entered into two separate

Page 40

three-year accounts receivable securitization facilities with two financial institutions and their affiliates whereby KU R can sell, on a revolving basis, an undivided interest in certain of its receivables and receive up to \$50 million from an unrelated third party purchaser. The effective cost of the receivables programs is comparable to KU's lowest cost source of capital, and is based on prime rated commercial paper. KU retains servicing rights of the sold receivables through two separate servicing agreements with the third party purchaser. KU has obtained an opinion from independent legal counsel indicating these transactions qualify as a true sale of receivables. As of December 31, 2002, the outstanding program balance was \$49.3 million. KU is considering unwinding its accounts receivable securitization arrangements involving KU R during 2003.

The allowance for doubtful accounts associated with the eligible securitized receivables was \$520,000 at December 31, 2002. This allowance is based on historical experience of KU. Each securitization facility contains a fully funded reserve for uncollectible receivables.

#### New Accounting Pronouncements.

SFAS No. 143, Accounting for Asset Retirement Obligations was issued in 2001. SFAS No. 143 establishes accounting and reporting standards for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs.

The effective implementation date for SFAS No. 143 is January 1, 2003. Management has calculated the impact of SFAS No. 143 and the recently released FERC NOPR No. RM02-7, Accounting, Financial Reporting, and Rate Filing Requirements for Asset Retirement Obligations. As of January 1, 2003, KU recorded asset retirement obligation (ARO) assets in the amount of \$8.6 million and liabilities in the amount of \$18.5 million. KU also recorded a cumulative effect adjustment in the amount of \$9.9 million to reflect the accumulated depreciation and accretion of ARO assets at the transition date less amounts previously accrued under regulatory depreciation. KU recorded offsetting regulatory assets of \$9.9 million, pursuant to regulatory treatment prescribed under SFAS No. 71, Accounting for the Effects of Certain Types of Regulation. Also pursuant to SFAS No. 71, KU recorded regulatory liabilities in the amount of \$888,000 offsetting removal costs previously accrued under regulatory accounting in excess of

amounts allowed under SFAS No. 143.

KU also expects to record ARO accretion expense of approximately \$1.2 million, ARO depreciation expense of approximately \$176,000 and an offsetting regulatory credit in the income statement of approximately \$1.4 million in 2003, pursuant to regulatory treatment prescribed under SFAS No. 71, Accounting for the Effects of Certain Types of Regulation. The accretion, depreciation and regulatory credit will be annual adjustments. SFAS No. 143 will have no impact on the results of the operation of KU.

KU asset retirement obligations are primarily related to the final retirement of generating units. KU transmission and distribution lines largely operate under perpetual property easement agreements which do not generally require restoration upon removal of the property. Therefore, under SFAS No. 143, no material asset retirement obligations will be recorded for transmission and distribution assets.

KU adopted EITF No. 98-10, Accounting for Energy Trading and Risk Management Activities, effective January 1, 1999. This pronouncement required that energy trading contracts be marked to market on the balance sheet, with the gains and losses shown net in the income statement.

The EITF clarified accounting standards related to energy trading activities under EITF Issue 02-03, Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in

Page 41

Energy Trading and Risk Management Activities. EITF No. 02-03 established the following:

- - Rescinded EITF No. 98-10,
- - Contracts that do not meet the definition of a derivative under SFAS No. 133 should not be marked to fair market value, and
- - Revenues should be shown in the income statement net of costs associated with trading activities, whether or not the trades are physically settled.

With the rescission of EITF No. 98-10, energy trading contracts that do not also meet the definition of a derivative under SFAS No. 133 must be accounted for as executory contracts. Contracts previously recorded at fair value under EITF No. 98-10 that are not also derivatives under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, must be restated to historical cost through a cumulative effect adjustment. The rescission of this standard had no impact on financial position or results of operations of KU since all contracts marked to market under EITF No. 98-10 are also within the scope of SFAS No. 133.

As a result of EITF No. 02-03, KU has netted the power purchased expense for trading activities against electric operating revenue to reflect this accounting change. KU applied this guidance to all prior periods, which had no impact on previously reported net income or common equity.

	2002	2001
Gross electric operating revenues	\$875,192	\$860,426
Less costs reclassified from power purchased	26,555	38,751
Net electric operating revenues reported	\$848,637	\$821,675
Gross power purchased	\$157,955	\$157,161

Less costs reclassified to revenues	26,555	38,751
Net power purchased reported	\$131,400	\$118,410

In January 2003, the Financial Accounting Standards Board issued Financial Accounting Standards Board Interpretation No. 46, Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51 (FIN 46). FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 is effective immediately for all new variable interest entities created or acquired after January 31, 2003. For variable interest entities created or acquired prior to February 1, 2003, the provisions of FIN 46 must be applied for the first interim or annual period beginning after June 15, 2003. KU does not expect the adoption of this standard to have any impact on the financial position or results of operations.

#### Note 2 - Mergers and Acquisitions

On July 1, 2002, E.ON completed its acquisition of Powergen, including LG&E Energy, for approximately 5.1 billion pounds sterling (\$7.3 billion).

As a result of the acquisition, LG&E Energy became a wholly owned subsidiary (through Powergen) of E.ON and, as a result, KU also became an indirect subsidiary of E.ON. KU has continued its separate identity and serves customers in Kentucky, Virginia and Tennessee under its existing names. The preferred stock and debt securities of KU were not affected by this transaction and the utilities continue to file SEC reports. Following the acquisition, E.ON became, and Powergen remained, a registered holding company under PUHCA. KU, as a subsidiary of a registered holding company, is subject to additional regulations under PUHCA. As contemplated in their regulatory filings in connection with the E.ON acquisition, E.ON, Powergen and LG&E Energy completed an administrative reorganization to move the LG&E Energy group from an indirect Powergen subsidiary to an indirect E.ON subsidiary. This reorganization was effective in March 2003.

Page 42

LG&E Energy and KU Energy merged on May 4, 1998, with LG&E Energy as the surviving corporation. Management accounted for the merger as a pooling of interests and as a tax-free reorganization under the Internal Revenue Code. Following these acquisitions, KU has continued to maintain its separate identity and serve customers under its present name.

#### Note 3 - Rates and Regulatory Matters

Accounting for the regulated utility business conforms with generally accepted accounting principles as applied to regulated public utilities and as prescribed by FERC, the Kentucky Commission and the Virginia Commission. KU is subject to SFAS No. 71, Accounting for the Effects of Certain Types of Regulation, under which certain costs that would otherwise be charged to expense are deferred as regulatory assets based on expected recovery from customers in future rates. Likewise, certain credits that would otherwise be reflected as income are deferred as regulatory liabilities based on expected return to customers in future rates. KU's current or expected recovery of deferred costs and expected return of deferred credits is generally based on specific ratemaking decisions or precedent for each item. The following regulatory assets and liabilities were included in KU's balance sheets as of December 31 (in thousands of \$):

	2002	2001
VDT costs	\$ 38,375	\$ 48,811
Unamortized loss on bonds	9,456	6,142
LG&E/KU merger costs	2,046	6,139
One utility costs	873	4,365
ESM provision	13,500	-
Other	1,154	1,010
Total regulatory assets	65,404	66,467
Deferred income taxes - net	(28,854)	(32,872)
Other	(1,022)	(1,017)
Total regulatory liabilities	(29,876)	(33,889)
Regulatory assets - net	\$ 35,528	\$ 32,578

Kentucky Commission Settlement Order - VDT Costs. During the first quarter 2001, KU recorded a \$64 million charge for a workforce reduction program. Primary components of the charge were separation benefits, enhanced early retirement benefits, and health care benefits. The result of this workforce reduction was the elimination of approximately 300 positions, accomplished primarily through a voluntary enhanced severance program.

On June 1, 2001, KU filed an application (VDT case) with the Kentucky Commission to create a regulatory asset relating to these first quarter 2001 charges. The application requested permission to amortize these costs over a four-year period. The Kentucky Commission also opened a case to review a new depreciation study and resulting depreciation rates implemented in 2001.

KU reached a settlement in the VDT case as well as the other cases involving depreciation rates and ESM with all intervening parties. The settlement agreement was approved by the Kentucky Commission on December 3, 2001. The order allowed KU to set up a regulatory asset of \$54 million for the workforce reduction costs and begin amortizing these costs over a five year period starting in April 2001. The first quarter 2001 charge of \$64 million represented all employees who had accepted a voluntary enhanced

Page 43

severance program. Some employees rescinded their participation in the voluntary enhanced severance program and, along with the non-recurring charge of \$6.9 million for FERC and Virginia jurisdictions, thereby decreasing the original charge of the regulatory asset from \$64 million to \$54 million. The settlement will also reduce revenues approximately \$11 million through a surcredit on future bills to customers over the same five year period. The surcredit represents net savings stipulated by KU. The agreement also established KU's new depreciation rates in effect December 2001, retroactive to January 1, 2001. The new depreciation rates decreased depreciation expense by \$6.0 million in 2001.

PUHCA. LG&E Energy was purchased by Powergen on December 11, 2000. Effective July 1, 2002, Powergen was acquired by E.ON, which became a registered holding company under PUHCA. As a result, E.ON, its utility subsidiaries, including KU, and certain of its non-utility subsidiaries are subject to extensive regulation by the SEC under PUHCA with respect to issuances and sales of securities, acquisitions and sales of certain utility properties, and intra-system sales of certain goods and services. In addition, PUHCA generally limits the ability of registered holding companies to acquire additional public utility systems and to acquire and retain businesses unrelated to the utility operations of the holding

company. KU believes that it has adequate authority (including financing authority) under existing SEC orders and regulations to conduct its business. KU will seek additional authorization when necessary.

**Environmental Cost Recovery.** In June 2000, the Kentucky Commission approved KU's application for a CCN to construct up to four SCR NOx reduction facilities. The construction and subsequent operation of the SCRs is intended to reduce NOx emission levels to meet the EPA's mandated NOx emission level of 0.15 lbs./ Mmbtu by May 2004. In its order, the Kentucky Commission ruled that KU's proposed plan for construction was "reasonable, cost-effective and will not result in the wasteful duplication of facilities." In October 2000, KU filed an application with the Kentucky Commission to amend its Environmental Compliance Plan to reflect the addition of the proposed NOx reduction technology projects and to amend its ECR Tariff to include an overall rate of return on capital investments. Approval of KU's application in April 2001 allowed KU to begin to recover the costs associated with these new projects, subject to Kentucky Commission oversight during normal six-month and two-year reviews.

In August 2002, KU filed an application with the Kentucky Commission to amend its compliance plan to allow recovery of the cost of a new and additional environmental compliance facility. The estimated capital cost of the additional facilities is \$17.3 million. The Kentucky Commission conducted a public hearing on the case on December 20, 2002, final briefs were filed on January 15, 2003, and a final order was issued February 11, 2003. The final order approved recovery of the new environmental compliance facility totaling \$17.3 million. Cost recovery through the environmental surcharge of the approved project will begin with bills rendered in April 2003.

**ESM.** KU's electric rates are subject to an ESM. The ESM, initially in place for three years beginning in 2000, sets an upper and lower point for rate of return on equity, whereby if KU's rate of return for the calendar year falls within the range of 10.5% to 12.5%, no action is necessary. If earnings are above the upper limit, the excess earnings are shared 40% with ratepayers and 60% with shareholders; if earnings are below the lower limit, the earnings deficiency is recovered 40% from ratepayers and 60% from shareholders. By order of the Kentucky Commission, rate changes prompted by the ESM filing go into effect in April of each year subject to a balancing adjustment in successive periods. KU made its second ESM filing on March 1, 2002 for the calendar year 2001 reporting period. KU is in the process of refunding \$1 million to customers for the 2001 reporting period. KU estimated that the rate of return will fall below the lower limit, subject to Kentucky Commission approval, for the year ended December 31, 2002. The 2002 financial statements include an accrual to reflect the earnings deficiency of \$13.5 million to be recovered from customers commencing in April 2003.

On November 27, 2002, KU filed a revised ESM tariff which proposed continuance of the existing ESM through December 2005. The Kentucky Commission issued an order suspending the ESM tariff one day making the

Page 44

effective date January 2, 2003. In addition, the Kentucky Commission is conducting a management audit to review the ESM plan and reassess its reasonableness in 2003. KU and interested parties will have the opportunity to provide recommendations for modification and continuance of the ESM or other forms of alternative or incentive regulation.

DSM. In May 2001, the Kentucky Commission approved a plan that would expand LG&E's current DSM programs into the service territory served by KU. The filing included a rate mechanism that provided for concurrent recovery of DSM costs, provided an incentive for implementing DSM programs, and recovered revenues from lost sales associated with the DSM program based on program planning engineering estimates and post-implementation evaluation.

FAC. KU employs a FAC mechanism which allows KU to recover from customers' fuel costs associated with retail electric sales. In July 1999, the Kentucky Commission issued a series of orders requiring KU to refund approximately \$10.1 million resulting from reviews of the FAC from November 1994 to October 1998. In August 1999, after a rehearing request by KU, the Kentucky Commission issued a final order that reduced the refund obligation to \$6.7 million (\$5.8 million on a Kentucky jurisdictional basis) from the original order amount of \$10.1 million. KU implemented the refund from October 1999 through September 2000. Both KU and the KIUC appealed the order. Pending a decision on this appeal, a comprehensive settlement was reached by all parties and approved by the Kentucky Commission on May 17, 2002. Thereunder, KU agreed to credit its fuel clause in the amount of \$954,000 (refund made in June and July 2002), and the parties agreed on a prospective interpretation of the state's FAC regulation to ensure consistent and mutually acceptable application on a going-forward basis.

In December 2002, the Kentucky Commission initiated a two year review of the operation of KU's FAC for the period November 2000 through October 2002. Testimony in the review case was filed on January 20, 2003 and a public hearing was held February 18, 2003. Issues addressed at that time included the establishment of the current base fuel factor to be included in KU's base rates, verification of proper treatment of purchased power costs during unit outages, and compliance with fuel procurement policies and practices.

Kentucky Commission Administrative Case for Affiliate Transactions. In December 1997, the Kentucky Commission opened Administrative Case No. 369 to consider Kentucky Commission policy regarding cost allocations, affiliate transactions and codes of conduct governing the relationship between utilities and their non-utility operations and affiliates. The Kentucky Commission intended to address two major areas in the proceedings: the tools and conditions needed to prevent cost shifting and cross-subsidization between regulated and non-utility operations; and whether a code of conduct should be established to assure that non-utility segments of the holding company are not engaged in practices that could result in unfair competition caused by cost shifting from the non-utility affiliate to the utility. During the period September 1998 to February 2000, the Kentucky Commission issued draft codes of conduct and cost allocation guidelines. In early 2000, the Kentucky General Assembly enacted legislation, House Bill 897, which authorized the Kentucky Commission to require utilities that provide nonregulated activities to keep separate accounts and allocate costs in accordance with procedures established by the Kentucky Commission. In the same Bill, the General Assembly set forth provisions to govern a utility's activities related to the sharing of information, databases, and resources between its employees or an affiliate involved in the marketing or the provision of nonregulated activities and its employees or an affiliate involved in the provision of regulated services. The legislation became law in July 2000 and KU has been operating pursuant thereto since that time. On February 14, 2001, the Kentucky Commission published notice of their intent to promulgate new administrative regulations under the auspices of this new law. This effort is still on-going.

Page 45

Kentucky Commission Administrative Case for System Adequacy. On June 19, 2001, Kentucky Governor Paul E. Patton issued Executive Order 2001-771, which directed the Kentucky Commission to review and study issues relating to the need for and development of new electric generating capacity in Kentucky. The issues to be considered included the impact of new power plants on the electric supply grid, facility siting issues, and economic development matters, with the goal of ensuring a continued, reliable source of supply of electricity for the citizens of Kentucky and the continued environmental and economic vitality of Kentucky and its communities. In response to that Executive Order, in July 2001 the Kentucky Commission opened Administrative Case No. 387 to review the adequacy of Kentucky's generation capacity and transmission system. Specifically, the items reviewed were the appropriate level of reliance on purchased power, the appropriate reserve margins to meet existing and future electric demand, the impact of spikes in natural gas prices on electric utility planning strategies, and the adequacy of Kentucky's electric transmission facilities. KU, as a party to this proceeding, filed written testimony and responded to two requests for information. Public hearings were held October 2001 and KU filed a final brief in the case. In December 2001, the Kentucky Commission issued an order in which it noted that KU is responsibly addressing the long-term supply needs of native load customers and that current reserve margins are appropriate. However, due to the rapid pace of change in the industry, the order also requires KU to provide an annual assessment of supply resources, future demand, reserve margin, and the need for new resources.

Regarding the transmission system, the Kentucky Commission concluded that the transmission system within Kentucky can reliably serve native load and a significant portion of the proposed new unregulated power plants. However, it will not be able to handle the volume of transactions envisioned by FERC without future upgrades, the costs of which should be borne by those for whom the upgrades are required.

The Kentucky Commission pledged to continue to monitor all relevant issues and advocate Kentucky's interests at all opportunities.

FERC SMD NOPR. On July 31, 2002, the FERC issued a NOPR in Docket No. RM01-12-000 which would substantially alter the regulations governing the nation's wholesale electricity markets by establishing a common set of rules -- SMD. The SMD NOPR would require each public utility that owns, operates, or controls interstate transmission facilities to become an Independent Transmission Provider (ITP), belong to an RTO that is an ITP, or contract with an ITP for operation of its transmission assets. It would also establish a standardized congestion management system, real-time and day-ahead energy markets, and a single transmission service for network and point-to-point transmission customers. Review of the proposed rulemaking is underway and a final rule is expected during 2003. While it is expected that the SMD final rule will affect KU revenues and expenses, the specific impact of the rulemaking is not known at this time.

MISO. KU is a member of the MISO, which began commercial operations on February 1, 2002. MISO now has operational control over KU's high-voltage transmission facilities (100 kV and greater), while KU continues to control and operate the lower voltage transmission subject to the terms and conditions of the MISO OATT. As a transmission-owning member of MISO, KU also incurs administrative costs of MISO pursuant to Schedule 10 of the MISO OATT.

MISO also proposed to implement a congestion management system. FERC directed the MISO to coordinate its efforts with FERC's Rulemaking on SMD. On September 24, 2002, the MISO filed new rate schedules designated as Schedules 16 and 17, which provide for the collection of costs incurred by the MISO to establish day-ahead and real-time energy markets. The MISO proposed to recover these costs under Schedules 16 and 17 once service commences. If approved by FERC, these schedules will cause KU to incur additional costs. KU opposes the establishment of Schedules 16 and 17. This effort is still on-going and the ultimate impact of the two schedules, if approved, is not known at this time.

Page 46

ARO. In 2003, KU expects to record approximately \$11.3 million in regulatory assets and approximately \$888,000 in regulatory liabilities related to SFAS No. 143, Accounting for Asset Retirement Obligations.

Merger Surcredit. As part of the LG&E Energy merger with KU Energy, KU estimated non-fuel savings over a ten-year period following the merger. Costs to achieve these savings for KU of \$42.3 million were recorded in the second quarter of 1998, \$20.5 million of which was deferred and amortized over a five-year period pursuant to regulatory orders. Primary components of the merger costs were separation benefits, relocation costs, and transaction fees, the majority of which were paid by December 31, 1998. KU expensed the remaining costs associated with the merger (\$21.8 million) in the second quarter of 1998.

In approving the merger, the Kentucky Commission adopted KU's proposal to reduce its retail customers' bills based on one-half of the estimated merger-related savings, net of deferred and amortized amounts, over a five year period. The surcredit mechanism provides that 50% of the net non-fuel cost savings estimated to be achieved from the merger would be provided to ratepayers through a monthly bill credit, and 50% retained by the Companies, over a five-year period. The surcredit was allocated 53% to KU and 47% to LG&E. In that same order, the Commission required LG&E and KU, after the end of the five-year period, to present a plan for sharing with customers the then-projected non-fuel savings associated with the merger. The Companies submitted this filing on January 13, 2003, proposing to continue to share with customers, on a 50%/50% basis, the estimated fifth-year gross level of non-fuel savings associated with the merger. The filing is currently under review.

Any fuel cost savings are passed to Kentucky customers through the fuel adjustment clauses. See FAC above.

#### Note 4 - Financial Instruments

The cost and estimated fair values of KU's non-trading financial instruments as of December 31, 2002, and 2001 follow (in thousands of \$):

	2002		2001	
	Cost	Fair Value	Cost	Fair Value
Long-term debt				
(including current portion)	\$484,830	\$503,194	\$484,830	\$499,618
Interest-rate swaps	-	16,928	-	6,906

All of the above valuations reflect prices quoted by exchanges except for

the swaps. The fair values of the swaps reflect price quotes from dealers or amounts calculated using accepted pricing models.

Interest Rate Swaps. KU uses interest rate swaps to hedge exposure to market fluctuations in certain of its debt instruments. Pursuant to policy, use of these financial instruments is intended to mitigate risk and earnings volatility and is not speculative in nature. Management has designated all of the interest rate swaps as hedge instruments. Financial instruments designated as fair value hedges are periodically marked to market with the resulting gains and losses recorded directly into net income to correspond with income or expense recognized from changes in market value of the items being hedged.

As of December 31, 2002 and 2001, KU was party to various interest rate swap agreements with aggregate notional amounts of \$153 million in 2002 and 2001. Under these swap agreements, KU paid variable rates based on either

Page 47

LIBOR or the Bond Market Association's municipal swap index averaging 2.36% and 2.54%, and received fixed rates averaging 7.13% and 7.13% at December 31, 2002 and 2001, respectively. The swap agreements in effect at December 31, 2002 have been designated as fair value hedges and mature on dates ranging from 2007 to 2025. For 2002, the effect of marking these financial instruments and the underlying debt to market resulted in immaterial pretax gains recorded in interest expense.

Interest rate swaps hedge interest rate risk on the underlying debt under SFAS 133, in addition to swaps being marked to market, the item being hedged must also be marked to market, consequently at December 31, 2002, KU's debt reflects a \$15.7 million mark to market adjustment.

Energy Trading & Risk Management Activities. KU conducts energy trading and risk management activities to maximize the value of power sales from physical assets it owns, in addition to the wholesale sale of excess asset capacity. Certain energy trading activities are accounted for on a mark-to-market basis in accordance with EITF 98-10, Accounting for Contracts Involved in Energy Trading and Risk Management Activities, SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, and SFAS No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities. Wholesale sales of excess asset capacity and wholesale purchases are treated as normal sales and purchases under SFAS No. 133 and SFAS No. 138 and are not marked-to-market.

The consensus reached by the EITF on EITF No. 02-03, Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities, to rescind EITF 98-10, effective for fiscal years after December 15, 2002, had no impact on KU's energy trading and risk management reporting as all contracts marked to market under EITF 98-10 are also within the scope of SFAS No. 133.

The table below summarizes KU's energy trading and risk management activities for 2002 and 2001 (in thousands of \$).

	2002	2001
Fair value of contracts at beginning of period, net liability	\$ (186)	\$ (17)
Fair value of contracts when entered into during the period	(65)	3,441
Contracts realized or otherwise		

settled during the period	448	(2,894)
Changes in fair values due to changes in assumptions	(353)	(716)
Fair value of contracts at end of period, net liability	\$ (156)	\$ (186)

No changes to valuation techniques for energy trading and risk management activities occurred during 2002. Changes in market pricing, interest rate and volatility assumptions were made during both years. All contracts outstanding at December 31, 2002, have a maturity of less than one year and are valued using prices actively quoted for proposed or executed transactions or quoted by brokers.

KU maintains policies intended to minimize credit risk and revalues credit exposures daily to monitor compliance with those policies. At December 31, 2002, 86% of the trading and risk management commitments were with counterparties rated BBB- equivalent or better.

#### Note 5 - 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.

Page 48

KU's customer receivables and revenues arise from deliveries of electricity to approximately 477,000 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 five counties in southwestern Virginia and less than ten customers in Tennessee. For the year ended December 31, 2002, 100% of total utility revenue was derived from electric operations.

In August 2001, KU and its employees represented by IBEW Local 2100 entered into a two-year collective bargaining agreement. KU and its employees represented by USWA Local 9447-01 entered into a three-year collective bargaining agreement effective August 2002 and expiring August 2005. The employees represented by these two bargaining units comprise approximately 17% of KU's workforce.

#### Note 6 - Pension Plans and Retirement Benefits

KU sponsors qualified and non-qualified pension plans and other postretirement benefit plans for its employees. The following tables provide a reconciliation of the changes in the plans' benefit obligations and fair value of assets over the two-year period ending December 31, 2002, and a statement of the funded status as of December 31 for each of the last two years (in thousands of \$):

	2002	2001
Pension Plans:		
Change in benefit obligation		
Benefit obligation at beginning of year	\$244,472	\$233,034
Service cost	2,637	2,761
Interest cost	16,598	17,534

Plan amendment	28	4
Change due to transfers	-	(16,827)
Curtailement loss	-	1,400
Special termination benefits	-	24,274
Benefits paid	(23,291)	(29,166)
Actuarial (gain) or loss and other	7,283	11,458
Benefit obligation at end of year	\$247,727	\$244,472
Change in plan assets		
Fair value of plan assets at beginning of year	\$216,947	\$244,677
Actual return on plan assets	(13,767)	18,155
Employer contributions and plan transfers	(99)	(15,300)
Benefits paid	(23,291)	(29,166)
Administrative expenses	(1,256)	(1,419)
Fair value of plan assets at end of year	\$178,534	\$216,947
Reconciliation of funded status		
Funded status	\$ (69,193)	\$ (27,525)
Unrecognized actuarial (gain) or loss	36,233	(20,581)
Unrecognized transition (asset) or obligation	(532)	(664)
Unrecognized prior service cost	10,106	11,027
Net amount recognized at end of year	\$ (23,386)	\$ (37,743)

Page 49

## Other Benefits:

Change in benefit obligation		
Benefit obligation at beginning of year	\$ 83,223	\$ 64,213
Service cost	610	495
Interest cost	6,379	5,433
Plan amendments	-	-
Curtailement loss	-	6,381
Special termination benefits	-	3,824
Benefits paid net of retiree contributions	(4,640)	(5,446)
Actuarial (gain) or loss	19,030	8,323
Benefit obligation at end of year	\$104,602	\$ 83,223
Change in plan assets		
Fair value of plan assets at beginning of year	\$ 14,330	\$ 23,762
Actual return on plan assets	(2,698)	(4,404)
Employer contributions and plan transfers	1,648	473
Benefits paid net of retiree contributions	(5,337)	(5,501)
Fair value of plan assets at end of year	\$ 7,943	\$ 14,330
Reconciliation of funded status		
Funded status	\$ (96,659)	\$ (68,893)
Unrecognized actuarial (gain) or loss	22,667	(437)
Unrecognized transition (asset) or obligation	11,209	12,290
Unrecognized prior service cost	2,891	3,548
Net amount recognized at end of year	\$ (59,892)	\$ (53,492)

There are no plan assets in the non-qualified plan due to the nature of the plan.

KU made a contribution to the pension plan of \$3.5 million in January 2003.

The following tables provide the amounts recognized in the balance sheet and information for plans with benefit obligations in excess of plan assets as of December 31, 2002 and 2001 (in thousands of \$):

	2002	2001
Pension Plans:		
Amounts recognized in the balance sheet consisted of:		
Accrued benefit liability	\$ (51,035)	\$ (37,743)
Intangible asset	10,106	-
Accumulated other comprehensive income	17,543	-
Net amount recognized at year-end	\$ (23,386)	\$ (37,743)
Additional year-end information for plans with accumulated benefit obligations in excess of plan assets (1):		
Projected benefit obligation	\$247,727	\$244,472
Accumulated benefit obligation	229,569	224,261
Fair value of plan assets	178,534	216,947

(1) 2002 and 2001 includes all plans.

Other Benefits:		
Amounts recognized in the balance sheet consisted of:		
Accrued benefit liability	\$ (59,892)	\$ (53,492)
Additional year-end information for plans with benefit obligations in excess of plan assets:		
Projected benefit obligation	\$104,602	\$ 83,223
Fair value of plan assets	7,943	14,330

Page 51

The following table provides the components of net periodic benefit cost for the plans for 2002 and 2001 (in thousands of \$):

	2002	2001
Pension Plans:		
Components of net periodic benefit cost		
Service cost	\$ 2,637	\$ 2,761
Interest cost	16,598	17,534
Expected return on plan assets	(18,406)	(19,829)
Amortization of transition (asset) or obligation	(133)	(136)
Amortization of prior service cost	956	962
Recognized actuarial (gain) or loss	1	(120)
Net periodic benefit cost	\$ 1,653	\$ 1,172
Special charges	\$ -	\$ 1,238
Prior service cost recognized	-	24,274
Special termination benefits	\$ -	\$ 25,512
Total charges		

Other Benefits:  
Components of net periodic benefit cost

Service cost	\$ 610	\$ 495
Interest cost	6,379	5,433
Expected return on plan assets	(1,022)	(1,313)
Amortization of prior service cost	691	740
Amortization of transition (asset) or obligation	1,081	1,193
Recognized actuarial (gain) or loss	343	(40)
Net periodic benefit cost	\$ 8,082	\$ 6,508
Special charges	\$ -	\$ 7,638
Transition obligation recognized	-	1,613
Prior service cost recognized	-	3,824
Special termination benefits	\$ -	\$ 13,075
Total charges		

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

	2002	2001
Weighted-average assumptions as of December 31:		
Discount rate	6.75%	7.25%
Expected long-term rate of return on plan assets	9.00%	9.50%
Rate of compensation increase	3.75%	4.25%

For measurement purposes, a 12.00% annual increase in the per capita cost of covered health care benefits was assumed for 2003. The rate was assumed to decrease gradually to 5.00% for 2014 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 the following effects (in thousands of \$):

Page 52

	1% Decrease	1% Increase
Effect on total of service and interest cost components for 2002	(422)	479
Effect on year-end 2002 postretirement benefit obligations	(7,010)	7,972

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 approximately \$1.5 million for 2002 and \$1.4 million for 2001.

#### Note 7 - Income Taxes

Components of income tax expense are shown in the table below (in thousands of \$):

	2002	2001
Included in operating expenses:		
Current - federal	\$38,524	\$58,337

- state	10,494	13,465
Deferred - federal - net	3,467	(12,980)
- state - net	1,547	(1,340)
Total	54,032	57,482
Included in other income - net:		
Current - federal	(685)	(948)
- state	15	(268)
Deferred - federal - net	(195)	863
- state - net	(88)	222
Amortization of investment tax credit	(2,955)	(3,446)
Total	(3,908)	(3,577)
Total income tax expense	\$50,124	\$53,905

Components of net deferred tax liabilities included in the balance sheet are shown below (in thousands of \$):

	2002	2001
Deferred tax liabilities:		
Depreciation and other plant-related items	\$271,792	\$269,752
Other liabilities	30,378	33,376
	302,170	303,128
Deferred tax assets:		
Investment tax credit	3,431	4,623
Income taxes due to customers	11,609	13,263
Pensions	15,861	4,595
Accrued liabilities not currently deductible and other	30,085	41,443
	60,986	63,924
Net deferred income tax liability	\$241,184	\$239,204

Page 53

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

	2002	2001
Statutory federal income tax rate	35.0%	35.0%
State income taxes, net of federal benefit	5.5	5.4
Amortization of investment tax credit	(2.4)	(2.3)
Other differences - net	(3.2)	(2.2)
Effective income tax rate	34.9%	35.9%

The change in other differences is due to increased non-taxable earnings from an unconsolidated KU investment.

Note 8 - Other Income - net

Other income - net consisted of the following at December 31 (in thousands of \$):

	2002	2001
Equity in earnings - subsidiary company	\$ 6,697	\$ 1,803
Interest and dividend income	641	1,368
Gains on fixed asset disposals	157	1,844
Income taxes and other	2,934	3,917

Other income - net \$10,429 \$ 8,932

Note 9 - First Mortgage Bonds and Pollution Control Bonds

Long-term debt and the current portion of long-term debt, summarized below (in thousands of \$), consists primarily of first mortgage bonds and pollution control bonds. Interest rates and maturities in the table below are for the amounts outstanding at December 31, 2002.

	Stated Interest Rates	Weighted Average Interest Rate	Maturities	Principal Amounts
Noncurrent portion	Variable - 8.55%	5.21%	2006-2032	\$346,562
Current portion	Variable - 6.32%	3.58%	2003-2032	\$153,930

Under the provisions for KU's variable-rate pollution control bonds Series PCS 10, 12, 13, 14, and 15, 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 consolidated balance sheets. The average annualized interest rate for these bonds during 2002 was 1.58%.

In September 2002, KU issued \$96 million variable rate pollution control Series 16 due October 1, 2032, and exercised its call option on \$96 million, 7.45% pollution control Series 8 due September 15, 2016.

In May 2002, KU issued \$37.9 million variable rate pollution control Series 12, 13, 14 and 15 due February 1, 2032, and exercised its call option on \$37.9 million, 6.25% pollution control Series 1B, 2B, 3B, and 4B due February 1, 2018.

Page 54

KU's First Mortgage Bond, 6.32% Series Q of \$62 million is scheduled to mature in June 2003, KU's First Mortgage Bond, 5.99% Series S of \$36 million matures in 2006, and KU's First Mortgage Bond, 7.92% Series P of \$53 million matures in 2007. There are no scheduled maturities of Pollution Control Bonds for the five years subsequent to December 31, 2002.

Substantially all of KU's utility plant is pledged as security for its First Mortgage Bonds.

Note 10 - Notes Payable to Parent

KU participates in an intercompany money pool agreement wherein LG&E Energy can make funds available to KU at market based rates up to \$400 million. The balance of the money pool loan from LG&E Energy was \$119.5 million at a rate of 1.61% and \$47.8 million at an average rate of 2.37% at December 31, 2002 and 2001, respectively. The remaining money pool availability at December 31, 2002, was \$280.5 million. LG&E Energy maintains facilities of \$450 million with affiliates to ensure funding availability for the money pool. The outstanding balance under these facilities as of December 31, 2002 was \$230 million, and availability of \$220 million remained.

Note 11 - Commitments and Contingencies

Construction Program. KU had approximately \$6.2 million of commitments in connection with its construction program at December 31, 2002.

Construction expenditures for the years 2003 and 2004 are estimated to total approximately \$550.0 million; although all of this is not currently committed, including the purchase of four jointly owned CTs, \$152.0 million, and construction of NOx equipment, \$177.0 million.

Operating Leases. KU leases office space, office equipment, and vehicles. KU accounts for these leases as operating leases. Total lease expense for 2002 and 2001 was \$2.6 million and \$2.8 million, respectively.

Environmental. The Clean Air Act imposed stringent new SO<sub>2</sub> and NO<sub>x</sub> emission limits on electric generating units. KU met its Phase I SO<sub>2</sub> requirements primarily through installation of a scrubber on Ghent Unit 1. KU's strategy for Phase II SO<sub>2</sub> reductions, which commenced January 1, 2000, is to use accumulated emissions allowances to delay additional capital expenditures and may also include fuel switching or the installation of additional scrubbers. KU met the NO<sub>x</sub> emission requirements of the Act through installation of low-NO<sub>x</sub> burner systems. KU's compliance plans are subject to many factors including developments in the emission allowance and fuel markets, future regulatory and legislative initiatives, and advances in clean air control technology. KU will continue to monitor these developments to ensure that its environmental obligations are met in the most efficient and cost-effective manner.

In September 1998, the EPA announced its final "NO<sub>x</sub> SIP Call" rule requiring states to impose significant additional reductions in NO<sub>x</sub> emissions by May 2003, in order to mitigate alleged ozone transport impacts on the Northeast region. The Commonwealth of Kentucky is currently in the process of revising its SIP to require reductions in NO<sub>x</sub> emissions from coal-fired generating units to the 0.15 lb./Mmbtu level on a system-wide basis. In related proceedings in response to petitions filed by various Northeast states, in December 1999, EPA issued a final rule pursuant to Section 126 of the Clean Air Act directing similar NO<sub>x</sub> reductions from a number of specifically targeted generating units including all KU units in the eastern half of Kentucky. Additional petitions currently pending before EPA may potentially result in rules encompassing KU's remaining generating units. As a result of appeals to both rules, the compliance date was extended to May 2004. All KU generating units are subject to the May 2004 compliance date under these NO<sub>x</sub> emissions reduction rules.

Page 54

KU is currently implementing a plan for adding significant additional NO<sub>x</sub> controls to its generating units. Installation of additional NO<sub>x</sub> controls will proceed on a phased basis, with installation of controls commencing in late 2000 and continuing through the final compliance date. In addition, KU will incur additional operation and maintenance costs in operating new NO<sub>x</sub> controls. KU believes its costs in this regard to be comparable to those of similarly situated utilities with like generation assets. KU had anticipated that such capital and operating costs are the type of costs that are eligible for recovery from customers under its environmental surcharge mechanism and believed that a significant portion of such costs could be recovered. In April 2001, the Kentucky Commission granted recovery of these costs for KU.

KU is also monitoring several other air quality issues which may potentially impact coal-fired power plants, including the appeal of the D.C. Circuit's remand of the EPA's revised air quality standards for ozone and particulate matter, measures to implement EPA's regional haze rule, and EPA's December 2000 determination to regulate mercury emissions from power plants.

KU owns or formerly owned several properties that contained past MGP operations. Various contaminants are typically found at such former MGP sites and environmental remediation measures are frequently required. KU has completed the cleanup of a site owned by KU. With respect to other former MGP sites no longer owned by KU, KU is unaware of what, if any, additional exposure or liability it may have.

In October 1999, approximately 38,000 gallons of diesel fuel leaked from a cracked valve in an underground pipeline at KU's E.W. Brown Station. Under the oversight of EPA and state officials, KU commenced immediate spill containment and recovery measures which prevented the spill from reaching the Kentucky River. KU ultimately recovered approximately 34,000 gallons of diesel fuel. In November 1999, the Kentucky Division of Water issued a notice of violation for the incident. KU is currently negotiating with the state in an effort to reach a complete resolution of this matter. KU incurred costs of approximately \$1.8 million and received insurance reimbursement of \$1.2 million. In December 2002, the Department of Justice (DOJ) sent correspondence to KU regarding a potential per-day fine for failure to timely submit a spill control plan and a per-gallon fine for the amount of oil discharged. KU and the DOJ have commenced settlement discussions using existing DOJ settlement guidelines on this matter.

In April 2002, the EPA sent correspondence to KU regarding potential exposure in connection with \$1.5 million in completed remediation costs associated with a transformer scrap-yard. KU believes it is one of the more remote among a number of potentially responsible parties and has entered into settlement discussions with the EPA on this matter.

**Purchased Power.** KU has purchase power arrangements with OMU, EEI and other parties. Under the OMU agreement, which expires on January 1, 2020, KU purchases all of the output of a 400-Mw generating station not required by OMU. The amount of purchased power available to KU during 2003-2007, which is expected to be approximately 8% of KU's total kWh native load energy requirements, is dependent upon a number of factors including the 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, which generally follow delivered kWh. Included in the total costs is KU's proportionate share of debt service requirements on \$149.6 million of OMU bonds outstanding at December 31, 2002. The debt service is allocated to KU based on its annual allocated share of capacity, which averaged approximately 50% in 2002.

KU has a 20% equity ownership in EEI, which is accounted for on the equity method of accounting. KU's entitlement is 20% of the available capacity of a 1,000 Mw station. Payments are based on the total costs of the station allocated per terms of an agreement among the owners, which generally follow delivered kWh.

Page 56

KU has several other contracts for purchased power of various Mw capacities.

The estimated future minimum annual payments under purchased power agreements for the years subsequent to December 31, 2002, are as follows (in thousands of \$):

2003	\$ 34,317
2004	39,653

2005	39,653
2006	39,884
2007	39,994
Thereafter	643,946
Total	\$837,447

Page 57

## Note 12 - Jointly Owned Electric Utility Plant

LG&E and KU jointly own the following combustion turbines (in thousands of \$):

		LG&E	KU	Total
Paddy's Run 13	Ownership %	53%	47%	100%
	Mw capacity	84	74	158
	Cost	\$33,919	\$29,973	\$63,892
	Depreciation	1,711	1,499	3,210
	Net book value	\$32,208	\$28,474	\$60,682
E.W. Brown 5	Ownership %	53%	47%	100%
	Mw capacity	71	63	134
	Cost	\$23,973	\$21,106	\$45,079
	Depreciation	1,206	1,052	2,258
	Net book value	\$22,767	\$20,054	\$42,821
E.W. Brown 6	Ownership %	38%	62%	100%
	Mw capacity	59	95	154
	Cost	\$23,696	\$36,957	\$60,653
	Depreciation	1,770	4,201	5,971
	Net book value	\$21,926	\$32,756	\$54,682
E.W. Brown 7	Ownership %	38%	62%	100%
	Mw capacity	59	95	154
	Cost	\$23,607	\$44,792	\$68,399
	Depreciation	4,054	4,502	8,556
	Net book value	\$19,553	\$40,290	\$59,843
Trimble 5	Ownership %	29%	71%	100%
	Mw capacity	45	110	155
	Cost	\$15,970	\$39,045	\$55,015
	Depreciation	251	614	865
	Net book value	\$15,719	\$38,431	\$54,150
Trimble 6	Ownership %	29%	71%	100%
	Mw capacity	45	110	155
	Cost	\$15,961	\$39,025	\$54,986
	Depreciation	251	614	865
	Net book value	\$15,710	\$38,411	\$54,121
Trimble CT Pipeline	Ownership %	29%	71%	100%
	Cost	\$1,835	\$4,475	\$6,310
	Depreciation	39	96	135
	Net book value	\$1,796	\$4,379	\$6,175

See also Note 11, Construction Program, for KU's planned purchase of four jointly owned CTs in 2004.

Page 58

## Note 13 - Selected Quarterly Data (Unaudited)

Selected financial data for the four quarters of 2002 and 2001 are shown below. Because of seasonal fluctuations in temperature and other factors, results for quarters may fluctuate throughout the year.

	March	Quarters Ended		
		June	September	December
		(Thousands of \$)		
2002				
Revenues	\$209,023	\$196,020	\$235,059	\$221,562
Net operating income	28,200	20,047	31,028	29,368
Net income	24,357	12,752	31,085	25,190
Net income available for common stock	23,793	12,188	30,521	24,626
2001				
Revenues	\$206,162	\$201,745	\$212,438	\$200,376
Net operating income (loss) (a)	(344)	28,422	30,253	63,039
Net income (loss) (a)	(7,995)	22,080	26,340	55,989
Net income (loss) available for common stock (a)	(8,559)	21,516	25,776	55,425

(a) Loss resulted from the VDT pre-tax charge of \$64.0 million in March 2001, which \$57.1 million was reversed in December 2001. See Note 3.

## Note 14 - Subsequent Events

In January 2003, the Kentucky Commission reviewed the FAC of KU for the six month period ended October 31, 2001. The Kentucky Commission ordered KU to reduce its fuel costs for purposes of calculating its FAC by \$673,000. At issue was the purchase of approximately 102,000 tons of coal from Western Kentucky Energy Corporation, a non-regulated affiliate, for use at KU's Ghent Facility. The Kentucky Commission further ordered that an independent audit be conducted to examine operational and management aspects of KU's fuel procurement functions.

On February 15, 2003, KU experienced a severe ice storm in Lexington, Kentucky, and surrounding service area causing over 140,000 customers to lose power. KU is still in the process of accumulating the costs of the storm. Costs relate to repair of transmission and distribution system, property damage, and significant labor costs, including contractor costs. A portion of the costs may be offset by insurance proceeds.

On March 18, 2003, the Kentucky Commission approved LG&E and KU's joint application for the acquisition of four CTs from an unregulated affiliate, LG&E Capital Corp. The total projected construction cost for the turbines, expected to be available for June 2004 in-service, is \$227.4 million. The requested ownership share of the turbines is 63% for KU and 37% for LG&E.

The management of Kentucky Utilities Company is responsible for the preparation and integrity of the financial statements and related information. These statements have been prepared in accordance with accounting principles generally accepted in the United States applied on a consistent basis and, necessarily, include amounts that reflect the best estimates and judgment of management.

KU's 2002 and 2001 financial statements have been audited by PricewaterhouseCoopers LLP, independent accountants. Management made available to PricewaterhouseCoopers LLP all KU's financial records and related data as well as the minutes of shareholders' and directors' meetings.

Management has established and maintains a system of internal controls that provide reasonable assurance that transactions are completed in accordance with management's authorization, that assets are safeguarded and that financial statements are prepared in conformity with generally accepted accounting principles. Management believes that an adequate system of internal controls is maintained through the selection and training of personnel, appropriate division of responsibility, establishment and communication of policies and procedures and by regular reviews of internal accounting controls by KU's internal auditors. Management reviews and modifies its system of internal controls in light of changes in conditions and operations, as well as in response to recommendations from the internal and external auditors. These recommendations for the year ended December 31, 2002, did not identify any material weaknesses in the design and operation of KU's internal control structure.

In carrying out its oversight role for the financial reporting and internal controls of KU, the Board of Directors meets regularly with KU's independent public accountants, internal auditors and management. The Board of Directors reviews the results of the independent accountants' audit of the financial statements and their audit procedures, and discusses the adequacy of internal accounting controls. The Board of Directors also approves the annual internal auditing program, and reviews the activities and results of the internal auditing function. Both the independent public accountants and the internal auditors have access to the Board of Directors at any time.

Kentucky Utilities Company maintains and internally communicates a written code of business conduct that addresses, among other items, potential conflicts of interest, compliance with laws, including those relating to financial disclosure, and the confidentiality of proprietary information.

S. Bradford Rives  
Chief Financial Officer

Kentucky Utilities Company  
Louisville, Kentucky  
November 12, 2003

Page 60

Kentucky Utilities Company and Subsidiary  
REPORT OF INDEPENDENT ACCOUNTANTS

To the Shareholders of Kentucky Utilities Company and Subsidiary:

In our opinion, the accompanying consolidated balance sheets and the

related consolidated statements of capitalization, income, retained earnings, cash flows and comprehensive income present fairly, in all material respects, the financial position of Kentucky Utilities Company and Subsidiary (the "Company"), a wholly-owned subsidiary of LG&E Energy Corp., at December 31, 2002 and 2001, and the results of their operations and their cash flows for each of the two years in the period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1 to the financial statements, effective January 1, 2003, the Company adopted EITF No. 02-03, Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities.

/s/ PricewaterhouseCoopers LLP  
Louisville, Kentucky

January 21, 2003, except for note 1 as to which the date is November 12, 2003

Page 61

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**SEC Form 8-K – May 14, 2003**

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CONFORMED SUBMISSION TYPE: 8-K  
PUBLIC DOCUMENT COUNT: 1  
CONFORMED PERIOD OF REPORT: 20030331  
ITEM INFORMATION: Regulation FD Disclosure  
FILED AS OF DATE: 20030514

FILER:

COMPANY DATA:

COMPANY CONFORMED NAME: KENTUCKY UTILITIES CO  
CENTRAL INDEX KEY: 0000055387  
STANDARD INDUSTRIAL CLASSIFICATION: ELECTRIC SERVICES [4911]  
IRS NUMBER: 610247570  
STATE OF INCORPORATION: KY  
FISCAL YEAR END: 1229

FILING VALUES:

FORM TYPE: 8-K  
SEC ACT: 1934 Act  
SEC FILE NUMBER: 001-03464  
FILM NUMBER: 03697321

BUSINESS ADDRESS:

STREET 1: ONE QUALITY ST  
CITY: LEXINGTON  
STATE: KY  
ZIP: 40507  
BUSINESS PHONE: 6062552100

FILER:

COMPANY DATA:

COMPANY CONFORMED NAME: LOUISVILLE GAS & ELECTRIC CO  
CENTRAL INDEX KEY: 0000060549  
STANDARD INDUSTRIAL CLASSIFICATION: ELECTRIC & OTHER SERVICES CO  
IRS NUMBER: 610264150  
STATE OF INCORPORATION: KY  
FISCAL YEAR END: 1231

FILING VALUES:

FORM TYPE: 8-K  
SEC ACT: 1934 Act  
SEC FILE NUMBER: 001-02893  
FILM NUMBER: 03697322

BUSINESS ADDRESS:

STREET 1: 220 W MAIN ST  
 STREET 2: P O BOX 32030  
 CITY: LOUISVILLE  
 STATE: KY  
 ZIP: 40232  
 BUSINESS PHONE: 5026272000

## MAIL ADDRESS:

STREET 1: 220 WEST MAIN ST  
 CITY: LUUISVILLE  
 STATE: KY  
 ZIP: 40232

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SECURITIES AND EXCHANGE COMMISSION  
 Washington, D.C. 20549

## FORM 8-K

## CURRENT REPORT

Pursuant to Section 13 or 15(d) of  
 the Securities Exchange Act of 1934

Date of Report (Date of earliest event reported): May  
 14, 2003

Commission Registrant, State of Incorporation, IRS Employer  
 File Number Address, and Telephone Number Identification No.

2-26720 Louisville Gas and Electric Company 61-0264150  
 (A Kentucky Corporation)  
 220 West Main Street  
 P.O. Box 32010  
 Louisville, Ky. 40232  
 (502) 627-2000

1-3464 Kentucky Utilities Company 61-0247570  
 (A Kentucky and Virginia Corporation)  
 One Quality Street  
 Lexington, Kentucky 40507-1428  
 (859) 255-2100

This combined Form 8-K is separately filed by Louisville Gas and Electric Company and Kentucky Utilities Company. Information contained herein relating to any individual registrant is filed by such registrant on its own behalf and each registrant makes no representation as to information relating to the other registrant.

Item 4. Regulation FD Disclosure

On May 14, 2003, in connection with the filing of the

respective Quarterly Reports on Form 10-Q of Louisville Gas and Electric Company and Kentucky Utilities Company (each, the "Company") for the period ended March 31, 2003 (the "Report"), the Chairman, President and Chief Executive Officer and the Chief Financial Officer of each Company respectively certified, pursuant to and solely for the purposes of 18 U.S.C. 1350, as adopted pursuant to 906 of the Sarbanes-Oxley Act of 2002, that, to such officer's knowledge:

- "(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company as of the dates and for the periods expressed in the Report."

Additionally, the Report itself included the separate certifications required by 15 U.S.C. 78m(a), as adopted pursuant to 302 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

Company Louisville Gas and Electric

Dated: May 14, 2003

By: /s/ John R. McCall  
Executive Vice President,  
General Counsel and  
Corporate Secretary

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

Kentucky Utilities Company

Dated: May 14, 2003

By: /s/ John R. McCall  
Executive Vice President,  
General Counsel and  
Corporate Secretary

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-----END PRIVACY-ENHANCED MESSAGE-----

**SEC Form 8-K – March 25, 2003**

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549

**FORM 8-K**

**CURRENT REPORT**  
Pursuant to Section 13 or 15(d) of  
the Securities Exchange Act of 1934

Date of Report (Date of earliest event reported):      March 25, 2003

Commission File Number	Registrant, State of Incorporation, Address, and Telephone Number	IRS Employer Identification No.
2-26720	<p><b>Louisville Gas and Electric Company</b> (A Kentucky Corporation) 220 West Main Street P.O. Box 32010 Louisville, Ky. 40232 (502) 627-2000</p>	61-0264150
1-3464	<p><b>Kentucky Utilities Company</b> (A Kentucky and Virginia Corporation) One Quality Street Lexington, Kentucky 40507-1428 (859) 255-2100</p>	61-0247570

This combined Form 8-K is separately filed by Louisville Gas and Electric Company and Kentucky Utilities Company. Information contained herein relating to any individual registrant is filed by such registrant on its own behalf and each registrant makes no representation as to information relating to the other registrant.

**Item 9. Regulation FD Disclosure**

On March 25, 2003, in connection with the filing of the respective Annual Reports on Form 10-K of Louisville Gas and Electric Company and Kentucky Utilities Company (each, the "Company") for the year ended December 31, 2002 (the "Report"), the Chairman, President and Chief Executive Officer and the Chief Financial Officer of each Company respectively certified, pursuant to and solely for the purposes of 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that, to such officer's knowledge:

- "(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company as of the dates and for the periods expressed in the Report."

Additionally, the Report itself included the separate certifications required by 15 U.S.C. § 78m(a), as adopted pursuant to § 302 of the Sarbanes-Oxley Act of 2002.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

**LOUISVILLE GAS AND ELECTRIC COMPANY**

Dated: March 25, 2003

BY: /s/ John R. McCall  
Executive Vice President,  
General Counsel and  
Corporate Secretary

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

**KENTUCKY UTILITIES COMPANY**

Dated: March 25, 2003

BY: /s/ John R. McCall  
Executive Vice President,  
General Counsel and  
Corporate Secretary

**SEC Form 8-K – November 14, 2002**

-----BEGIN PRIVACY-ENHANCED MESSAGE-----

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ACCESSION NUMBER: 0000861388-02-000020  
CONFORMED SUBMISSION TYPE: 8-K  
PUBLIC DOCUMENT COUNT: 1  
CONFORMED PERIOD OF REPORT: 20020930  
ITEM INFORMATION: Other events  
FILED AS OF DATE: 20021114

FILER:

COMPANY DATA:

COMPANY CONFORMED NAME: KENTUCKY UTILITIES CO  
CENTRAL INDEX KEY: 0000055387  
STANDARD INDUSTRIAL CLASSIFICATION: ELECTRIC SERVICES [4911]  
IRS NUMBER: 610247570  
STATE OF INCORPORATION: KY  
FISCAL YEAR END: 1229

FILING VALUES:

FORM TYPE: 8-K  
SEC ACT: 1934 Act  
SEC FILE NUMBER: 001-03464  
FILM NUMBER: 02826217

BUSINESS ADDRESS:

STREET 1: ONE QUALITY ST  
CITY: LEXINGTON  
STATE: KY  
ZIP: 40507  
BUSINESS PHONE: 6062552100

FILER:

COMPANY DATA:

COMPANY CONFORMED NAME: LOUISVILLE GAS & ELECTRIC CO  
CENTRAL INDEX KEY: 0000060549  
STANDARD INDUSTRIAL CLASSIFICATION: ELECTRIC & OTHER SERVICES CO  
IRS NUMBER: 610264150  
STATE OF INCORPORATION: KY  
FISCAL YEAR END: 1231

FILING VALUES:

FORM TYPE: 8-K  
SEC ACT: 1934 Act  
SEC FILE NUMBER: 001-02893  
FILM NUMBER: 02826215

BUSINESS ADDRESS:

STREET 1: 220 W MAIN ST  
 STREET 2: P O BOX 32030  
 CITY: LOUISVILLE  
 STATE: KY  
 ZIP: 40232  
 BUSINESS PHONE: 5026272000

## MAIL ADDRESS:

STREET 1: 220 WEST MAIN ST  
 CITY: LUUISVILLE  
 STATE: KY  
 ZIP: 40232

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SECURITIES AND EXCHANGE COMMISSION  
 Washington, D.C. 20549

## FORM 8-K

## CURRENT REPORT

Pursuant to Section 13 or 15(d) of  
 the Securities Exchange Act of 1934

Date of Report (Date of earliest event reported): November 14,  
 2002

Commission Registrant, State of Incorporation, IRS Employer  
 File Number Address, and Telephone Number Identification No.

2-26720 Louisville Gas and Electric Company 61-0264150  
 (A Kentucky Corporation)  
 220 West Main Street  
 P.O. Box 32010  
 Louisville, Ky. 40232  
 (502) 627-2000

1-3464 Kentucky Utilities Company 61-0247570  
 (A Kentucky and Virginia Corporation)  
 One Quality Street  
 Lexington, Kentucky 40507-1428  
 (859) 255-2100

This combined Form 8-K is separately filed by Louisville Gas and Electric Company and Kentucky Utilities Company. Information contained herein relating to any individual registrant is filed by such registrant on its own behalf and each registrant makes no representation as to information relating to the other registrant.

Item 4. Regulation FD Disclosure

On September 14, 2002, in connection with the filing of the



**SEC Form 8-K -- August 14, 2002**

-----BEGIN PRIVACY-ENHANCED MESSAGE-----

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Originator-Key-Asymmetric:

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ACCESSION NUMBER: 0000861388-02-000014  
CONFORMED SUBMISSION TYPE: 8-K  
PUBLIC DOCUMENT COUNT: 1  
CONFORMED PERIOD OF REPORT: 20020630  
ITEM INFORMATION: Other events  
FILED AS OF DATE: 20020814

FILER:

COMPANY DATA:

COMPANY CONFORMED NAME: LOUISVILLE GAS & ELECTRIC CO  
CENTRAL INDEX KEY: 0000060549  
STANDARD INDUSTRIAL CLASSIFICATION: ELECTRIC & OTHER SERVICES CO  
IRS NUMBER: 610264150  
STATE OF INCORPORATION: KY  
FISCAL YEAR END: 1231

FILING VALUES:

FORM TYPE: 8-K  
SEC ACT: 1934 Act  
SEC FILE NUMBER: 001-02893  
FILM NUMBER: 02735755

BUSINESS ADDRESS:

STREET 1: 220 W MAIN ST  
STREET 2: P O BOX 32030  
CITY: LOUISVILLE  
STATE: KY  
ZIP: 40232  
BUSINESS PHONE: 5026272000

MAIL ADDRESS:

STREET 1: 220 WEST MAIN ST  
CITY: LUUISVILLE  
STATE: KY  
ZIP: 40232

FILER:

COMPANY DATA:

COMPANY CONFORMED NAME: KENTUCKY UTILITIES CO  
CENTRAL INDEX KEY: 0000055387  
STANDARD INDUSTRIAL CLASSIFICATION: ELECTRIC SERVICES [4911]  
IRS NUMBER: 610247570  
STATE OF INCORPORATION: KY  
FISCAL YEAR END: 1229

## FILING VALUES:

FORM TYPE: 8-K  
 SEC ACT: 1934 Act  
 SEC FILE NUMBER: 001-03464  
 FILM NUMBER: 02735756

## BUSINESS ADDRESS:

STREET 1: ONE QUALITY ST  
 CITY: LEXINGTON  
 STATE: KY  
 ZIP: 40507  
 BUSINESS PHONE: 6062552100

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SECURITIES AND EXCHANGE COMMISSION  
 Washington, D.C. 20549

FORM 8-K

## CURRENT REPORT

Pursuant to Section 13 or 15(d) of  
 the Securities Exchange Act of 1934

Date of Report (Date of earliest event reported): August 14, 2002

Commission File Number	Registrant, State of Incorporation, Address, and Telephone Number	IRS Employer Identification No.
2-26720	Louisville Gas and Electric Company (A Kentucky Corporation) 220 West Main Street P.O. Box 32010 Louisville, Ky. 40232 (502) 627-2000	61-0264150
1-3464	Kentucky Utilities Company (A Kentucky and Virginia Corporation) One Quality Street Lexington, Kentucky 40507-1428 (859) 255-2100	61-0247570

This combined Form 8-K is separately filed by Louisville Gas and Electric Company and Kentucky Utilities Company. Information contained herein relating to any individual registrant is filed by such registrant on its own behalf and each registrant makes no representation as to information relating to the other registrant.

Item 9. Regulation FD Disclosure

On August 14, 2002, in connection with the filing of the

respective Quarterly Reports on Form 10-Q of Louisville Gas and Electric Company and Kentucky Utilities Company (each, the "Company") for the period ended June 30, 2002 (the "Report"), the Chairman, President and Chief Executive Officer and the Chief Financial Officer of each Company respectively certified, pursuant to and solely for the purposes of 18 U.S.C. 1350, as adopted pursuant to 906 of the Sarbanes-Oxley Act of 2002, that, to such officer's knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company as of the dates and for the periods expressed in the Report."

#### SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

Louisville Gas and Electric Company

Dated: August 14, 2002 By: /s/ John R. McCall  
Executive Vice President,  
General Counsel and  
Corporate Secretary

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

Kentucky Utilities Company

Dated: August 14, 2002 By: /s/ John R. McCall  
Executive Vice President,  
General Counsel and  
Corporate Secretary

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**SEC Form 8-K – February 21, 2002**

8-K 1 a2071549z8-k.htm 8-K

[QuickLinks](#) -- Click here to rapidly navigate through this document**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 8-K****CURRENT REPORT**Pursuant to Section 13 or 15(d) of  
the Securities Exchange Act of 1934

Date of Report (Date of earliest event reported): February 21, 2002

Commission File Number	Registrant, State of Incorporation, Address, and Telephone Number	IRS Employer Identification No.
2-26720	<b>Louisville Gas and Electric Company</b> (A Kentucky Corporation) 220 West Main Street P.O. Box 32010 Louisville, Ky. 40232 (502) 627-2000	61-0264150
1-3464	<b>Kentucky Utilities Company</b> (A Kentucky and Virginia Corporation) One Quality Street Lexington, Kentucky 40507-1428 (606) 255-2100	61-0247570

This combined Form 8-K is separately filed by Louisville Gas and Electric Company and Kentucky Utilities Company. Information contained herein relating to any individual registrant is filed by such registrant on its own behalf and each registrant makes no representation as to information relating to the other registrant.

**Item 5. Other Events**

Louisville Gas and Electric Company and Kentucky Utilities Company, both subsidiaries of LG&E Energy Corp. and members of the Powergen plc group, announced respective financial results for the year ended December 31, 2001.

A news release of LG&E Energy Corp. describing the above matters is filed with this report as Exhibit 99.01 and is incorporated herein by reference.

Item 7(c). Exhibits Filed

99.01 News Release of LG&amp;E Energy Corp.



EX-99.01 3 a2071549zex-99\_01.htm EX-99.01

[QuickLinks](#) -- Click here to rapidly navigate through this document

## Press Release

220 West Main Street  
Louisville, KY 40232**Media Contact: Chip Keeling**  
**24-Hour Media Hotline: 502.627.4999****Toll-free: 888.627.4999**

### LG&E Energy Corp. Reports 2001 Utility Earnings

(LOUISVILLE, KY—February 21, 2002)—LG&E Energy Corp. today reported earnings of its two utility subsidiaries, Louisville Gas and Electric Company and Kentucky Utilities Company, for the year ended December 2001.

#### Full-Year 2001 Results

*Louisville Gas & Electric Company*—2001 net income available for common stock was \$102 million, down \$3 million from the \$105 million earned in 2000. Primary factors driving LG&E's 2001 earnings included \$20 million higher net revenues from electric and gas sales and \$5 million lower interest expense offset by higher other operating and maintenance expenses of approximately \$27 million.

Electric sales margins were higher than in 2000 primarily resulting from the lower cost of power purchased. Gas sales margins increased as a result of a gas rate increase ordered by the Kentucky Public Service Commission in September 2000, partially offset by a decrease in volumes sold.

Items contributing to the increase in other operating and maintenance expenses included an increase in pension and related benefits expense (\$12 million), amortization of deferred costs from the Company's work force transition separation program (\$13 million) and increases in bad debt expenses, property insurance, one-utility program cost amortization and maintenance costs (\$6 million). These higher costs were offset in part by lower salary and related benefit expenses due to the work force reductions during 2001. The lower interest expense is primarily attributable to reductions in short-term interest rates throughout 2001.

*Kentucky Utilities Company*—2001 net income available for common stock was \$94 million, up \$1 million from the \$93 million earned in 2000. 2001 net electric revenues were relatively flat when compared to 2000.

Primary factors driving KU's 2001 earnings included an increase in other operating and maintenance costs of approximately \$6 million, non-recurring charges of approximately \$7 million as a result of the Company's work force transition separation program, lower depreciation and amortization expense of approximately \$8 million mainly resulting from a settlement order in December 2001 from the Kentucky Public Service Commission (KPSC), lower property and other taxes of \$3 million and approximately \$5 million of lower interest expense resulting from reductions in short-term interest rates throughout the year.

Items contributing to the increase in other operating and maintenance expenses included an increase in pension and related benefits expense (\$7 million), amortization of deferred costs from the Company's work force transition separation program (\$5 million), offset in part by lower salary and related benefit expenses resulting from workforce reductions during 2001 and decreased power generation maintenance expenses.

#### Fourth Quarter 2001 Results

*Louisville Gas & Electric Company*—LG&E earned \$91 million in net income available for common stock in the fourth quarter 2001 representing a \$65 million increase over the amount earned during the same period in 2000. Pursuant to the settlement order received from the KPSC in December 2001, LG&E reversed the \$144 million non-recurring charge taken earlier in the year by recording a regulatory asset and booked additional operating expense of \$13 million representing amortization of the regulatory asset for 2001. Operating revenues were \$72 million lower in the fourth quarter 2001

compared to the same period in 2000 primarily due to unseasonably mild weather and lower fuel costs billed.

*Kentucky Utilities Company*—KU earned \$55 million in net income available for common stock in the fourth quarter 2001, an increase of \$31 million as compared to the same period in 2000. This increase was primarily due to the effects of the settlement order received from the KPSC in December 2001. Pursuant to the order, KU reversed \$57 million of the non-recurring charge taken earlier in the year by recording a regulatory asset, booked additional operating expenses of \$5 million representing amortization of the regulatory asset for 2001 and reduced depreciation expense by \$6 million.

LG&E Energy Corp., headquartered in Louisville, Ky., is a diversified energy services company that is a member of the Powergen plc (LSE: NYSE: PWG) family of companies. LG&E Energy owns and operates Louisville Gas and Electric Company, a regulated electric and gas utility serving Louisville, Ky., and 16 surrounding counties and Kentucky Utilities Company, a regulated electric utility, based in Lexington, Ky., which serves customers in 77 Kentucky counties and five counties in Virginia.

### Louisville Gas & Electric Company and Subsidiary

#### Consolidated Income Statements

(In thousands of dollars)

(Unaudited)

	Three Months Ended December 31,		Twelve Months Ended December 31,	
	2001	2000	2001	2000
<b>Operating Revenues</b>				
Electric	\$ 148,034	\$ 164,620	\$ 705,925	\$ 710,958
Gas	74,669	129,813	290,775	272,489
<b>Total operating revenues</b>	<b>\$ 222,703</b>	<b>\$ 294,433</b>	<b>\$ 996,700</b>	<b>\$ 983,447</b>
<b>Operating Expenses</b>				
Fuel for electric generation	\$ 34,660	\$ 38,988	\$ 159,231	\$ 159,418
Power purchased	21,824	26,888	81,475	96,894
Gas supply expenses	48,574	98,732	206,165	196,912
Non-recurring charges	(144,385)	(8,141)	—	—
Other operating & maintenance expenses	77,465	54,383	226,505	199,652
Depreciation and amortization	23,173	25,122	100,356	98,291
Federal and state income taxes	57,813	16,808	63,452	64,425
Property and other taxes	4,790	4,821	17,743	18,985
<b>Total operating expenses</b>	<b>\$ 123,914</b>	<b>\$ 257,601</b>	<b>\$ 854,927</b>	<b>\$ 834,577</b>
<b>Net Operating Income</b>	<b>\$ 98,789</b>	<b>\$ 36,832</b>	<b>\$ 141,773</b>	<b>\$ 148,870</b>
<b>Other Income—Net</b>	<b>1,212</b>	<b>431</b>	<b>2,930</b>	<b>4,921</b>

	\$ 100,001	\$ 37,263	\$ 144,703	\$ 153,791
<b>Income before Interest Charges</b>				
<b>Interest Charges</b>	7,842	10,237	37,922	43,218
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
<b>Net Income</b>	\$ 92,159	\$ 27,026	\$ 106,781	\$ 110,573
<b>Dividends on Preferred Stock</b>	1,111	1,367	4,739	5,210
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
<b>Net Income Available for Common Stock</b>	\$ 91,048	\$ 25,659	\$ 102,042	\$ 105,363
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>

**Kentucky Utilities Company and Subsidiary**

**Consolidated Income Statements**

(In thousands of dollars)

(Unaudited)

	Three Months Ended		Twelve Months Ended	
	December 31,		December 31,	
	2001	2000	2001	2000
<b>Operating Revenues</b>	\$ 211,950	\$ 212,854	\$ 859,472	\$ 851,941
<b>Operating Expenses</b>				
Fuel for electric generation	\$ 59,889	\$ 56,830	\$ 236,985	\$ 219,923
Power purchased	41,115	44,730	157,161	166,918
Non-recurring charges	(56,921)	(11,030)	6,867	—
Other operating & maintenance expenses	48,820	45,006	175,380	169,715
Depreciation and amortization	18,494	24,900	90,299	98,256
Federal and state income taxes	35,875	15,109	57,482	51,963
Property and other taxes	1,639	3,999	13,928	17,030
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Total operating expenses	\$ 148,911	\$ 179,544	\$ 738,102	\$ 723,805
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
<b>Net Operating Income</b>	\$ 63,039	\$ 33,310	\$ 121,370	\$ 128,136
<b>Other Income—Net</b>	3,234	1,542	8,932	6,843
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
<b>Income before Interest Charges</b>	\$ 66,273	\$ 34,852	\$ 130,302	\$ 134,979
<b>Interest Charges</b>	10,284	9,517	34,024	39,455
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
<b>Net Income Before Cumulative Effect of Change in Accounting</b>	\$ 55,989	\$ 25,335	\$ 96,278	\$ 95,524
<b>Cumulative Effect of Change in Accounting for</b>				

<b>Derivatives, Net of Income Taxes</b>	—	—	136	—
	—————	—————	—————	—————
<b>Net Income</b>	\$ 55,989	\$ 25,335	\$ 96,414	\$ 95,524
<b>Dividends on Preferred Stock</b>	564	564	2,256	2,256
	—————	—————	—————	—————
<b>Net Income Available for Common Stock</b>	\$ 55,425	\$ 24,771	\$ 94,158	\$ 93,268
	—————	—————	—————	—————

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### QuickLinks

[LG&E Energy Corp. Reports 2001 Utility Earnings](#)

[Full-Year 2001 Results](#)

[Fourth Quarter 2001 Results](#)

[Louisville Gas & Electric Company and Subsidiary Consolidated Income Statements \(In thousands of dollars\) \(Unaudited\)](#)

[Kentucky Utilities Company and Subsidiary Consolidated Income Statements \(In thousands of dollars\) \(Unaudited\)](#)



**Louisville Gas and Electric Company**  
**Case No. 2003-00433**  
**Historical Test Period Filing Requirements**

**Filing Requirement**  
**807 KAR 5:001 Section 10(6)(t)**  
**Sponsoring Witness: Valerie L. Scott**  
**Page 1 of 2**

**Description of Filing Requirement:**

*If the utility had any amounts charged or allocated to it by an affiliate or general or home office or paid any monies to an affiliate or general or home office during the test period or during the previous three (3) calendar years, the utility shall file:*

- 1. A detailed description of the method and amounts allocated or charged to the utility by the affiliate or general or home office for each charge allocation or payment;*
- 2. An explanation of how the allocator for the test period was determined; and*
- 3. All facts relied upon, including other regulatory approval, to demonstrate that each amount charged, allocated or paid during the test period was reasonable;*

**Response:**

Please see the attached schedule for a description of the amounts charged or allocated to LG&E. The method of allocation is set forth in the attached Cost Allocation Manual. The allocator for the test period was determined using the methodology set forth in the Cost Allocation Manual. The amounts charged, allocated or paid during the test period were reasonable for the following reasons: (i) the Cost Allocation Manual has been approved by the Securities and Exchange Commission, the Public Service Commission and the Virginia State Corporation Commission; (ii) the allocations are made utilizing the methodology set forth in the Cost Allocation Manual; (iii) after the allocations are made LG&E reviews

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**Page 2 of 2**

the allocations to assure that they have been made in accordance with the Cost Allocation Manual.

**Louisville Gas & Electric Co.  
Inter Company Charges Billed From:**

	<u>Test Year</u>	<u>Year</u>	<u>Year</u>	<u>Year</u>
	<u>10/02 - 9/03</u>	<u>Jan 02 - Dec 02</u>	<u>Jan 01 - Dec 01</u>	<u>Jan 00 - Dec 00</u>
Kentucky Utilities Co.	\$ 66,700,097.87	\$ 69,738,630.31	\$ 119,421,447.55	\$ 119,275,785.29
LG&E Energy Services Inc.	\$ 197,253,287.99	\$ 185,214,322.17	\$ 187,506,340.79	\$ -
LG&E Energy Corp.	\$ -	\$ -	\$ -	\$ 97,869,480.67

# **Cost Allocation Manual**

# **LG&E ENERGY SERVICES INC.**

## **Cost Allocation Manual**

# LG&E Energy Services, Inc. Cost Allocation Manual

## Table of Contents

	<u>Section</u>
Introduction	I
Description of Services	II
Overview	
Regulated Services	
Incidental Nonregulated Services	
Nonregulated Business Activities	
Corporate Organization	III
Overview	
Utility Operations	
Service Company	
Other Business Operations	
Corporate Organization Chart	
Transactions with Affiliates	IV
Overview	
Transactions Provided by LG&E Energy Services to Affiliates	
Transactions Provided by Affiliates to LG&E Energy Services	
Cost Apportionment Methodology	V
Overview	
Allocation Methods	
Time Distribution	VI
Overview	
Positive Time Reporting	
Exception Time Reporting	

# LG&E Energy Services, Inc. Cost Allocation Manual

## I. INTRODUCTION

Rule 93 of the Public Utility Company Holding Company Act of 1935 (“PUHCA” or the “Act”) states that mutual service companies must keep all accounts, cost accounting procedures, or other records necessary in a manner prescribed in 17 CFR Part 257 (Uniform System of Accounts, or “USOA”). The purpose of this Cost Allocation Manual (“CAM”) is to document the methods, policies and procedures that LG&E Energy Services Inc. (“SERVCO”) will follow in performing certain services for affiliate companies. SERVCO was formed upon approval of the merger between PowerGen and LG&E Energy, and became operational January 1, 2001.

Periodic changes to the CAM may be necessary due to future management decisions, interpretations by state or Federal regulatory bodies, by changes in structure or activities of affiliates or other internal procedures. The CAM has been designed to track and date changes in order to provide the most updated version for internal use and for annual regulatory compliance filings. Revisions to the CAM should be submitted to the PUCHA Compliance Manager for subsequent approval by the PUCHA Compliance Committee.

Development of the CAM was accomplished during a twelve week, four-stage process involving a project team representing various departments within the organization. Deliverables for each stage were submitted to a Steering Committee (consisting of both service providers and service users) for review and approval before proceeding to the next stage. *The overriding goal of the project team was to ensure the methods, policies and procedures contained in this CAM were PUHCA compliant so that SERVCO costs are fully segregated, and fairly and equitably allocated among the affiliate companies to protect investors and consumers.*

In addition to this Introduction section, the CAM contains five more sections as noted below:

- Section II - Description of Services  
The purpose of this section is to provide the reader with a clear definition of services provided by SERVCO. Service descriptions are organized by SERVCO responsibility areas, or provider departments. Service levels were developed using a combination of current intercompany service provisions, interviews and validations with provider department employees, and reviews of non-affiliated company CAMS and activity dictionaries.
- Section III - Corporate Organization  
The purpose of this section is to provide the reader with an overall summary of the entire organizational structure; ownership between affiliated entities, and a description of the related business activities.

## LG&E Energy Services, Inc. Cost Allocation Manual

- Section III - Corporate Organization (continued)

Development of the SERVCO organization chart and roster was predicated on the simple fact that if the employee performed activities benefiting more than one affiliate, that employee would become a part of the SERVCO organization. In many respects, employees residing in typical finance, administrative and general, management and other support departments were fully subject to SERVCO organizational placement.

Many operational employees dedicated to providing a service to just one affiliate, by definition, were not subject to SERVCO placement. However most management and support staff overseeing the business activities of one or more of these operational groups were subject to SERVCO placement.

- Section IV- Transactions with Affiliates

The purpose of this section is to identify the nature, frequency and pricing terms of costs associated with each service and the typical affiliated company receiving the service.

Service Agreements (“SA”) establish the general terms and conditions for providing those services specifically mentioned in Section II of the CAM, as well as any special services as may be requested by an affiliated company that SERVCO concludes it is able to provide.

Each service listed requires an associated service level agreement (“SLA”) representing a more detailed narrative of the services being provided, other considerations such as service timeliness or quality aspects, and billing / payment procedures between the parties. SLAs represent an arm’s-length negotiation between the parties and are typically formed during the budget process for the subsequent year. SLAs incorporate by reference the most recent SA made and entered into by SERVCO and the affiliate company receiving the service.

Copies of SAs and SLAs are maintained by the PUCHA Compliance Manager.

- Section V- Cost Apportionment Methodology

The purpose of this section is to describe the apportionment methods for services provided to affiliates. In general, the CAM defines costs into four categories:

***Directly Assignable*** – Expenses incurred for activities and services exclusively for the benefit of one affiliate. In many respects, these types of expenses relate to non-SERVCO employees that perform dedicated services to one affiliate, although SERVCO employees also directly report where feasible.

***Directly Attributable*** – Expenses incurred for activities and services that benefit more than one affiliate and which can be apportioned using direct measures of costs causation.

## LG&E Energy Services, Inc. Cost Allocation Manual

- Section V- Cost Apportionment Methodology (continued)

***Indirectly Attributable*** – Expenses incurred for activities and services that benefit more than one affiliate and which can be apportioned using general measures of cost causation.

***Unattributable*** - Expenses incurred for activities and services that have been determined as not appropriate for apportionment. These costs relate primarily to activities such as corporate diversification, political or philanthropic endeavors and, as such, are charged directly to LG&E Energy.

- Section VI - Time Distribution, Billing And Asset Policies

The purpose of this section is to provide the reader a clear understanding as to SERVCO time reporting procedures and how labor charges are captured and flow through the various feeder, accounting and reporting systems in order to maintain an accurate audit trail. Included in this section is a description of how intercompany billings are prepared, monitored and reported.

## II. DESCRIPTION OF SERVICES

### Operations Organization

**Retail Business Services** – Provides the following services: customer service, sales and marketing, economic development & major accounts, data retrieval, meter operations, meter asset management, cash remittance and customer accounting services. Also provides support services to Home Services and Enertech.

Customer Services – All costs related to providing billing, mailing, call center and customer communication services for both electric and gas customers, including residential, business service and business office customers.

Sales and Marketing Services – All costs associated with providing programs related to establishing strategies, providing oversight for marketing, sales and branding of utility and related services, and conducting marketing and sales programs for economic development, demand side management and home service products.

Support Services to Home Services - All costs associated with providing energy-related products and services.

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Support Services to Enertech - All costs associated with providing energy efficient improvement programs.

Economic Development & Major Accounts Services - All costs associated with community development, partnerships with state, regional, and local economic development allies, and customized products and services.

Data Retrieval Services – All costs associated with providing meter reading and meter data services.

Meter Operations Services – All cost associated with the testing of meters, completion of all customer requested service/field credit orders and the installation of commercial/industrial meters.

Meter Asset Management Services – All cost associated with inventory, quality and environmental issues, policy and standards, technical support, as well as, logistics.

Cash Remittance Services – All costs associated with providing remittance processing, customer payments, theft protection and collection services.

Customer Accounting Services – All costs associated with administering and providing customer billings and credit reviews.

**Power Supply Services** – Provides generation construction, planning and engineering services, along with fuel procurement, transmission, system laboratory and combustion turbines operations & maintenance services.

Generation Construction Services – All costs associated with coordinating and managing all major generation construction for the regulated utilities.

System Laboratory Services – All costs associated with providing system laboratory services to the generating stations.

Generation Engineering Services – All costs associated with providing engineering management for new and existing generation assets.

Generation Planning Services – All costs associated with short and long term generation planning services.

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Combustion Turbines Operations & Maintenance Services – All costs associated with providing operations and maintenance of jointly owned and operated combustion turbines.

Fuel Procurement Services – All costs associated with procuring coal, natural gas, oil and other bulk materials for generation facilities and ensuring compliance with price and quality provisions of fuel contracts.

Transmission Planning and Substation Services - All costs associated with providing transmission planning and substation services.

Transmission Line Services – All costs associated with providing transmission line services.

Systems Control Center Services - All costs associated with providing system control center services.

**Regulatory Affairs Services** – Provides regulatory and environmental affairs services.

Regulatory Affairs Services – All costs associated with providing management services for compliance with all laws, regulations and other policy requirements, including regulatory filings; expert testimony; tariff administration and compliance; pricing support; and development and monitoring of positions regarding ongoing regulatory matters.

Environmental Affairs Services – All costs associated with providing management services related to performing analyses, monitoring and advocacy of regulatory and legislative environmental matters including securing of permits and approvals; providing environmental technical expertise; and representing the company in industry groups and before regulatory agencies dealing with environmental issues.

**Energy Services** – Provide shareholder and customer protection of utility assets by compliance with all Kentucky Public Service Commission laws and providing market services to take advantage of the highest excess generation prices in the open market.

Regulatory Power Marketing Services - All costs associated with the provision of regulatory power marketing services.

**Distribution Operations Services** – The types of services provided are related to network trouble and dispatch, mapping and records management, electric engineering, substation construction and maintenance and distribution management services.

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Network Trouble and Dispatch Services – All costs associated with providing dispatch services, reporting outage situations and coordinating restoration.

Mapping and Records Management Services – All costs associated with providing and maintaining the mapping of the electric infrastructure.

Electric Engineering Services – All costs associated with providing development engineering and construction standards, distribution system planning and analysis, substation construction project management and telecommunications systems design and analyses.

Distribution Asset Management Services - All costs associated with the management and investment decisions regarding Distribution Assets, including resource allocation, development of uniform standards and procedures, determining performance targets and managing assets information and data.

Substation Construction and Maintenance Services – All costs associated with providing engineering and design services for substation construction, maintenance and operations areas.

Distribution Management Services – All costs associated with providing senior management leadership (Directors) to the Distribution organization.

### **Finance Organization**

**Finance and Business Development Services** – Provides financial planning services including managing, coordinating and reporting the budgeting process, utility market financial forecasting, and investment planning and analysis.

Budgeting Services - All costs associated with providing management services for the budgeting process and providing budget reporting.

Market Forecasting Services – All costs associated with providing management services for financial forecasts of the utility market.

Financial Planning Services – All costs associated with providing financial planning services, investment analysis and investment planning reports.

## **LG&E Energy Services, Inc.**

### **Cost Allocation Manual**

**Corporate Controller Organization Services** – Provides accounting, reporting, payroll, tax and various financial, analytical and analysis services.

Internal Financial and Management Reporting Services – All costs associated with providing internal financial reports including standard and ad hoc management reporting packages, preliminary earnings reports and other requested reports.

External Financial Reporting Services – All costs associated with providing financial reports required or used by various external constituencies such as the SEC, FERC, PSC, DOL, IRS and financial institutions.

Accounting and Reporting Services – All costs associated with providing management and direction services including GAAP analyses and interpretation and promulgation of accounting and internal control procedures.

Accounts and Projects Services – All costs associated with performing general ledger account and project analyses, reconciliations and balancing, consolidation and UK/US GAAP adjustments.

Sundry Billing Services – All costs associated with processing miscellaneous and non-standard billings and maintaining and monitoring associated accounts receivable.

Property Accounting Services – All costs associated with maintaining, analyzing and reporting related to continuing property records.

Accounts Payable Services – All costs associated with processing payments for purchase orders, check requests, employees expense reimbursements, etc., and providing ad-hoc research and analysis services.

Energy Marketing Accounting Services – All costs associated with performing month end validation of all power transactions and resolving any discrepancies; preparing invoices and wires; validating bills from other counterparties; preparing accounting, allocation and analysis of off system (OSS) sales, off system purchases, intercompany sales and purchases; and preparing various FERC, Fuel Clause, WSPP, and DOE reports.

Energy Marketing Trading Controls Services - All costs associated with performing weekly and daily reporting on the trading portfolios related to total exposure, trading limits, and mark-to-market calculations. Other activities include performing an independent valuation and validation of significant transactions, verifying price curves marked by traders and valuation algorithms, ensuring trading system security and performing trading system enhancements.

## **LG&E Energy Services, Inc. Cost Allocation Manual**

Energy Marketing Contract Administration Services – All costs associated with negotiating contracts with counterparties; administrating contracts; and maintaining contracts with in the trading systems. Additional activities include assisting various departments with contract disputes and preparing and validating confirmations.

Revenue Accounting Services – All costs associated with managing and analyzing internal and external revenue reporting.

Payroll Services – All costs associated with payroll services including the managing of payroll systems.

Tax Accounting, Compliance and Reporting Services - All costs associated with the preparation of consolidated and subsidiary Federal, state and local income tax returns; current and deferred tax accounting; utility gross receipts; sales/use tax; and supporting roles for business development, special requests and tax legislation.

Tax Planning Services - All costs associated with providing detailed one year forecasts and/or multiyear forecasting of foreign, federal and state taxes as well as, capital based and property tax planning.

Tax – Special Projects Services - All costs associated with providing Business or Project Development, asset dispositions, tax credit studies, review/analysis of proposed tax legislation, etc.

Oracle Business Systems – All costs associated with providing business support and electronic data processing services for all financial systems including treasury, accounting, tax, financial planning, regulatory and auditing.

**Internal Auditing Services** – Provides independent and objective assurance and consulting services.

Auditing Services – All costs associated with providing independent and objective assurance and consulting services.

**Information Technology Services** – Provides IT strategy, planning and security, operations and development services as well as specialized internal customer relations management services in various functional organizations.

Information Technology - Corporate Functions Services – All costs associated with corporate functions, not specific companies or work groups, and include groups such as IT

## **LG&E Energy Services, Inc. Cost Allocation Manual**

Security, Program Management, and IT Research & Migration Planning. This is where corporate standards, security policies and procedures and the programs are developed and administered for the corporation.

Information Technology - Administrative Services – All costs associated with management, administrative support, non project-specific supplies, tuition reimbursement, general training, travel, etc. Total Administrative services are proportionally recovered based on the level of charges assigned from the other products and services.

Information Technology - Project Services – All costs associate with discretionary, project-based work done in IT. These projects create new client value or add business value to existing products/services. An example would be to add a new report to CIS or to make a billing modification.

Information Technology - Application Services – All costs associated with each of the existing applications that IT provides to the business, like CIS, PeopleSoft HR, etc. The cost represents the real, bottom-line cost to provide basic ongoing service per the service level agreement. Costs included in this category are application license fees and application support costs.

Information Technology - Client Services – All costs associated with existing end user tools and related productivity software that the users can identify and interact with, like a PC or phone. Included in this category are products like PC's, desktop phone service as well as Email and file and print services.

Information Technology - Platform Services- All costs associated with shared platforms like computing platforms (IBM mainframe, HP UNIX servers, etc.), databases (DB2, Oracle, etc.), network and TSS (help desk). All costs are recovered through IT Client Services or IT Application Subscriptions using an algorithm that is based on the level of utilization of the platforms by each application. TSS is allocated as a platform based on an analysis of their call profiles.

**Corporate Finance and Treasury Services** – Provides cash management, investment and finance services as well as shareholder relations, risk management and strategic planning.

Cash Management and Investment Services – All costs associated with providing management and monitoring of cash flows including review and acquisition of business entity cash requirements and procurement of short-term financing and credit lines.

## **LG&E Energy Services, Inc. Cost Allocation Manual**

Corporate Finance Services – All costs associated with providing overall finance options including evaluation of new financing vehicles and instruments, analysis of existing financing positions and raising long-term funds for all entities.

Shareholder Services – All costs associated with managing and maintaining relations with security analysts, ratings agencies and institutional investors as well as providing transfer agent and related services to shareholders.

Risk Management Services – All costs associated with managing outside providers of risk services comprised of providing insurance and assisting affiliated entities in managing property and liability risks including claims, security, environmental, safety and consulting services.

Strategic Planning Services – All costs associated with providing assistance to affiliated entities in the development and analysis of strategies, strategic forecasts and economics of strategic plans.

### **General Counsel / Secretary Organization**

**Legal Services** – Provides legal, public affairs and government affairs services.

Legal Services – All costs associated with providing various legal services for all affiliated entities including in-house counsel and staff assistance in the areas of corporate and securities law, employment law, regulatory law, contract law, and patent law, as well as, evaluating legal claims and managing legal fees for outside counsel.

Public Affairs Management Services – All costs associated with providing community relations functions, communicating public information to local organizations and providing oversight and communications to employees.

Government Affairs Management Services – All costs associated with maintaining relationships with government policy makers and conducting lobbying activities.

**Corporate Communications Services** – Provides all administrative and management support for corporate communications including internal/external communications services, brand image management, corporate events, and LG&E Foundation's charitable donations.

Internal Communications Services – All costs associated with providing internal communication services.

# LG&E Energy Services, Inc.

## Cost Allocation Manual

External and Brand Communications Services – All costs associated with providing external communication services, brand image management, corporate events, and LG&E Foundation's charitable donations.

### Administration Organization

**Operating Services** – Provides the following types of services relating to the facilities, building, security, mail, document, right of way and transportation services.

Facilities and Building Services – All costs associated with providing building and grounds maintenance including coordination of office furniture and equipment purchases/leases, space utilization and layout, and building code and fire protection services.

Office Furniture and Equipment – All costs associated with providing office furniture and equipment for the Operating Companies and affiliates.

Security Services – All costs associated with providing security personnel, security and monitoring devices for all affiliated entities requiring limited access.

Production Mail Services – All costs associated with providing production mail services.

Document Services – All costs associated with providing document printing, reproduction services including mail delivery, scanning, off-site storage and service desk support.

Right-of-Way Services – All costs associated with obtaining and retaining easements or fee simple property for placement and operation of company and affiliate equipment as well as managing real estate assets and maintaining real estate records.

Transportation Services – All costs associated with providing and operating transportation fleet for all affiliated companies including developing fleet policy, administering regulatory compliance programs, managing repair and maintenance of vehicles and procuring vehicles.

**Supply Chain and Logistics Services** – Provides procurement and major contract, strategic sourcing, material logistics and field support services.

Procurement and Major Contracts Services – All costs associated with providing for and administering major contract negotiations, requests for quotes, supplier relations and order placement services.

## **LG&E Energy Services, Inc. Cost Allocation Manual**

Strategic Sourcing Services – All costs associated with providing strategic sourcing services such as maintaining and analyzing the supplier base and performing supplier selection activities including contract negotiations and ongoing compliance.

Materials Logistics Services – All costs associated with providing order management, materials handling and logistics, and inventory management services.

Sourcing Support Services – All costs associated with providing order management and general field support services for system policy and maintenance management, developing and monitoring of key performance metrics, and supplying day to day variance and reconciliation reporting services.

**Human Resource Services** – Provides human resource services in the areas of employee relations, compensation, benefits, health & safety, organization development & training, distribution & retail, power generation, as well as, corporate and headquarters services.

Human Resources – Compensation Services – All costs associated with providing services relating to the establishment and oversight of compensation policies for executives and employees.

Human Resources – Benefits Services – All costs associated with providing services relating to the establishment and oversight of benefits policies for employees, including administrative billings to vendors and retiree and survivor services, and maintenance of all personnel records.

Human Resources – Health & Safety Services – All costs associated with providing services relating to the establishment and oversight of health and safety policies for employees.

Human Resources – Organization Development and Training Services – All costs associated with providing training services to improve organizational effectiveness with an emphasis on employee and leadership development, leadership succession planning, and the change management process.

Human Resources – Headquarters Services – All costs associated with providing services relating to operational and strategic human resources management for corporate staff.

Human Resources – Power Generation Services – All costs associated with providing services relating to operational and strategic human resources management for Power Generation employees.

## **LG&E Energy Services, Inc. Cost Allocation Manual**

Human Resources – Distribution and Retail Services – All costs associated with providing services relating to operational and strategic human resources management for Distribution and Retail employees.

Human Resources - Corporate Services – All costs associated with providing centralized corporate human resources services in support of the lines of business.

Technical and Safety Training Services – All costs associated with providing training services on technical and safety matters primarily for the Distribution, Retail and Power Generation businesses.

Industrial Relations Management Services – All costs associated with providing communication and oversight for union matters, negotiation of union contracts, and union dispute resolution services.

Executive Management Services – All costs associated with providing executive leadership to the corporation which are comprised of the compensation and benefits of the corporate officers and executive assistants.

### **III. CORPORATE ORGANIZATION**

#### **OVERVIEW**

LG&E Energy Services, Inc. is a wholly owned subsidiary of LG&E Energy Corporation, a wholly owned subsidiary of PowerGen. PowerGen is a UK-based holding company whose primary businesses are in the generation and distribution of electricity, the transportation, marketing and delivery of natural gas, and the development and operation of combined heat and power plants and renewable energy facilities. PowerGen is a registered holding company under Section 5 of the Public Utility Holding Company Act of 1935.

Goods and services provided by PowerGen are billed directly to LG&E Energy Services, Inc. consistent with the policies and procedures noted in this CAM. Reference is made to Item 3.F., pages 100 –108, of the Form U-1 Application-Declaration filing with the Securities and Exchange Commission regarding “Intra-System Provision of Services”.

LG&E Energy Corporation and its utility subsidiaries are engaged principally in the generation, purchase, transmission, distribution and sale of electricity and in the purchase, transmission, distribution, sale and transportation of natural gas. LG&E Energy Corp. and its subsidiaries are subject to the regulatory provisions of PUHCA. The utility subsidiaries are subject to regulation by the FERC and state utility commissions in Kentucky, Virginia and Tennessee. Over 69% of LG&E Energy Corp.’s revenues are derived from its regulated utility operations.

## **LG&E Energy Services, Inc. Cost Allocation Manual**

LG&E Energy Corp. was incorporated under the laws of the Commonwealth of Kentucky in 1989. It is a holding company exempt from regulation by the Commission under the Act pursuant to Section 3(a)(1) of the Act and by order of the Commission in LG&E Energy Corp., Holding Co. Act Release No. 26866, 67 S.E.C. 107. LG&E Energy has five direct subsidiaries: Louisville Gas & Electric(LG&E), Kentucky Utilities(KU), LG&E Energy Foundation, Inc.(LG&E Energy Foundation), LG&E Energy Marketing, Inc.(LEM) and LG&E Capital Corp.(LG&E Capital Corp), which includes WKE Corp, a holding company, which wholly-own the following non-utility subsidiaries: WKE Station Two, Inc. and Western Kentucky Energy Corp. LG&E and KU are public utility companies under the Act.

LG&E Energy Corp.'s non-utility subsidiary is principally involved in numerous non-utility, energy-related businesses, including consumer lending programs and services, interests in overseas projects, development and operation of domestic power generation facilities.

### **UTILITY OPERATIONS**

Louisville Gas & Electric is engaged primarily in the generation transmission and distribution of electricity to approximately 366,000 customers in Louisville and adjacent areas in Kentucky. LG&E's service area covers approximately 700 square miles in 17 counties in Kentucky and has an estimated population of one million. LG&E also purchases, distributes and sells natural gas to approximately 295,000 customers within this service area and in limited additional areas. Included within LG&E's service area is the Fort Knox Military Reservation, to which LG&E transports gas and provides electric service, but which maintains its own distribution systems. Retail sales rates, services and other aspects of LG&E's electric and gas retail operations are subject to the jurisdiction of the Kentucky Commission. The Kentucky Commission also possesses regulatory authority over aspects of LG&E's financial activities including security issuances, property transfers when the asset value is in excess of \$100,000, and mergers with other utilities. The FERC has jurisdiction under the FPA over certain of the electric utility facilities and operations, transmission in interstate commerce, wholesale sale of power and related transactions and accounting practices of LG&E, and in certain other aspects.

LG&E owns 4.9% of the common stock of OVEC, which has one wholly-owned subsidiary, Indiana-Kentucky Electric Corp.(IKEC). OVEC and IKEC were organized in 1952 by LG&E and other public utilities to supply the entire power requirements of the U.S. Department of Energy's gaseous diffusion plant in Pike County, Ohio. OVEC owns a 1,075 MW generating station near Cheshire, Ohio, and IKEC owns a 1,290 MW generating station at Madison, Indiana. All of the electricity sold by OVEC and IKEC is sold either to the U.S. Department of Energy or to the owners of the stock of OVEC (or their subsidiaries, all of which are utility companies). OVEC and IKEC do not sell electricity to private consumers and do not have any securities outstanding in the hands of the public. For each of the three years in the period ended December 31, 1999, LG&E derived less than 0.2% of its net income from its share of the earnings of OVEC.

## **LG&E Energy Services, Inc. Cost Allocation Manual**

KU is engaged in producing, transmitting, and selling electric energy to approximately 458,000 customers in over 600 communities and adjacent suburban and rural areas in 77 counties in central, southeastern and western Kentucky, and to about 29,000 customers in 5 counties in southwestern Virginia. In Virginia, KU operates under the name Old Dominion Power Company. KU also sells electric energy at wholesale for resale to 12 municipalities in Kentucky and one municipality in Pennsylvania. The territory served by KU has an aggregate population estimated at approximately one million. The largest city served is Lexington, Kentucky. The population of the metropolitan Lexington area is estimated at about 225,000. The populations of the next 10 largest cities served at retail range from about 9,000 to 21,000. The territory served includes most of the Bluegrass Region of central Kentucky and parts of the coal mining areas in southeastern and western Kentucky and southwestern Virginia. KU is subject to the jurisdiction of the Kentucky Commission and the Virginia Commission as to retail rates and service, accounts, issuance of securities, and in other respects. The FERC has jurisdiction under the FPA over certain of the electric utility facilities and operations, wholesale sale of power and related transactions and accounting practices of

KU, and in certain other respects. By reason of owning and operating a small amount of electric utility property in one county in Tennessee (having a book value of about \$251,000) which serves five customers, KU may also be subject to the jurisdiction of the Tennessee Commission as to retail rates, accounts, and issuance of securities and in other respects.

KU owns 2.5% of the common stock of OVEC. KU also owns 20% of EEI. EEI provides electric energy to a uranium enrichment plant located near Paducah, Kentucky by the United State Enrichment Corporation. EEI owns the Joppa Plant, a 1,015 MW coal-fired electric generation plant located near Joppa, Illinois, and six 161 kilovolt (KV) transmission lines which transmit power from the Joppa Plant to the Paducah enrichment plant. EEI's common stock is held by KU and three other utility companies. EEI sells its excess electricity to its sponsoring utilities for resale. The uranium enrichment facility is EEI's only end-user customer. For each year in the three-year period ending December 31, 1999, KU derived less than 3% of its net income from its share of the earnings of EEI and OVEC.

### **SERVICE COMPANY**

LG&E Energy Services, Inc., a wholly-owned subsidiary of LG&E Energy Corp., was incorporated in 2000 under the laws of the State of Kentucky. LG&E Energy Services, Inc. is the service company for the LG&E Energy system and provides a variety of administrative, management, engineering, construction, environmental and support services. LG&E Energy Services, Inc. provides its services to the LG&E Energy Group of companies generally at cost, pursuant to service agreements approved by the SEC under PUHCA.

### **OTHER BUSINESS OPERATIONS**

LG&E Energy Foundation (LG&E Energy Foundation), a charitable foundation exempt from Federal Income tax under Section 501©(3) of the Internal Revenue Code, makes charitable contributions to

## **LG&E Energy Services, Inc. Cost Allocation Manual**

qualified entities. It is wholly-owned by LG&E Energy. As of December 31, 1999, the market value of the assets of LG&E Energy Foundation were \$19.9 million.

LG&E Energy Marketing, Inc. (LEM) is wholly-owned by LG&E Energy and engages in energy marketing and trading on behalf of LG&E Energy's utility and non-utility operations. Effective June 30, 1998, LEM discontinued its merchant trading and sales business. LEM, however, maintains the technical systems and personnel necessary to engage in power marketing sales from assets it owns or controls, including LG&E, KU, and Western Kentucky Energy Corp.

LG&E Capital Corp. (LG&E Capital), through various subsidiaries and joint ventures, is involved in numerous non-utility, energy-related businesses. The activities of these subsidiaries are more fully described below:

LG&E Credit Corp. is wholly-owned by LG&E Capital and offers consumer lending programs and services in the Louisville metropolitan area.

LG&E International, Inc. (LG&E International) is wholly owned by LG&E Capital, and is a management and holding company for international energy projects investments and operations. LG&E International's wholly-owned subsidiaries hold interests in overseas projects and conduct other related businesses. Through its subsidiaries, LG&E International holds interests in three Argentine natural gas distribution companies, all of which have obtained FUCO status under Section 33 of the Act. LG&E International has a controlling interest in Distribuidora de Gas del Centro (Centro), and minority interest in Distribuidora de Gas Cuyana (Cuyana), and Gas Natural BAN, S.A. (Gas BAN). Together, Centro, Cuyana, and Gas BAN serve approximately 1.8 million customers in seven provinces in Argentina. LG&E International also owns an interest in a windpower generating facility in Tarifa, Spain, which has obtained FUCO status under Section 33 of the Act.

LG&E Power, Inc. (LG&E Power) is wholly owned by LG&E Capital and is a management and holding company for non-regulated subsidiaries. LG&E Power develops, operates, maintains, and owns domestic power generation facilities. LG&E Power currently has interests in 8 projects capable of generating approximately 500 MW of power in North Carolina, Virginia, California, Texas, and Minnesota, and small interests in three additional facilities in Texas and Washington. Each of these domestic facilities is either a qualifying cogeneration facility (QF) under the Public Utility Regulatory Policies Act of 1978, or an exempt wholesale generator (EWG) under Section 32 of the Act. In 1998, LG&E Power, through a subsidiary, entered into a partnership with Columbia Energy Corporation for the development of a natural gas-fired cogeneration project in Gregory, Texas, which will be capable of generating 550 MW equivalent of power and steam. The project was completed in the summer of 2000. In 1999, a subsidiary of LG&E Power entered into a lease wherein it agreed to lease a facility under construction in Georgia, which will be capable of generating 450 MW of power. The facility is scheduled to be completed in June 2001. LG&E Power's wholly-owned subsidiaries also engage in natural gas storage, transmission, and processing. Also in 1999, another subsidiary of LG&E Power entered into a contract to purchase eight turbines, capable of generating 1,600 MW of power. The facility is scheduled to be completed in June 2003.

## **LG&E Energy Services, Inc. Cost Allocation Manual**

WKE Corp., a holding company, and its subsidiaries are wholly owned by LG&E Capital. WKE Corp.'s wholly-owned subsidiary, WKE Station Two, Inc. (Station Two), operates and maintains the Station Two generating facility of the City of Henderson, KY. WKE Corp.'s wholly-owned subsidiary, Western Kentucky Energy Corp. (WKEC), currently enjoys EWG status under Section 32 of the Act, and leases and operates the generating facilities owned by Big Rivers Electric Corporation (three coal-fired plants and one combustion turbine), and sells the output of those facilities to LG&E Energy Marketing and, potentially, other affiliates and third-parties. LG&E Energy is considering reorganization of WKEC, which could change WKEC's current status as an EWG. The FERC has authorized the consolidation of WKEC with its subsidiaries and related companies.

CRC-Evans International, Inc. (CRC-Evans) is wholly owned by LG&E Capital. CRC-Evans and its related companies provide specialized equipment and services used in the construction and rehabilitation of gas and oil transmission pipelines.

### **IV. TRANSACTIONS WITH AFFILIATES**

#### **OVERVIEW**

LG&E Energy Corp. formed SERVCO, as a service company (under the definition of the Act) to provide goods and services for affiliated companies within the LG&E Energy system. At formation certain LG&E, KU and LEC employees became employees of SERVCO and such employees continued to provide goods and services to the regulated and non-regulated entities. SERVCO provides a variety of administrative, management, engineering, construction, environmental and support services.

Regulated affiliates receive services at cost, pursuant to service agreements approved by the SEC under PUHCA. Non-regulated affiliates generally receive services at cost; however, certain services may permit pricing at fair-market value to the extent authorized by the Securities and Exchange Commission. The provisions included in contracts or service agreements govern transactions between SERVCO and the regulated and non-regulated affiliates.

This section separately details the nature, frequency and terms of transactions for services provided by SERVCO to affiliated companies, as described below:

#### **Frequency of Transactions**

*Ongoing* – Provided on a prearranged, continuous basis (i.e., daily)

*Frequent* – Provided as requested on a regular basis (i.e., several times per month)

*Infrequent* – Provided as requested on an irregular basis (i.e., several times per year)

## LG&E Energy Services, Inc. Cost Allocation Manual

### Terms of Transactions

**Tariff Rate** – The price charged to customers under applicable tariffs on file with Federal or state regulatory commissions.

**Prevailing Price** – The price held out by the providing entity to the general public in the normal course of business (i.e., market price).

**Cost** – The charge used for transactions with affiliates for which no tariff rate or prevailing price exists. SERVCO follows the definition of cost as described in Rule 91 of the Act stating: “Direct charges shall be made so far as costs can be identified and related to the particular transactions involved without excessive effort or expense. Other elements of cost include taxes, interest, other overhead, and compensation for the use of capital...”

**All charges by SERVCO to affiliated entities follow this principle of fully distributed cost, or “FDC”.** Primary affiliates receiving the service are designated below as:

- R – Regulated
- NR – Non-regulated
- C – Corporate
- A - All

### TRANSACTIONS PROVIDED BY SERVCO TO AFFILIATES

Product or Service	Description	Frequency	Primary Affiliate
Customer Services	All costs related to providing billing, mailing, call center and customer communication services for both electric and gas customers, including residential, business service and business office customers.	Ongoing	R
Sales and Marketing Services	All costs associated with providing programs related to establishing strategies, providing oversight for marketing, sales and branding of utility and related services, and conducting marketing and sales programs for economic development, demand side management and home service products.	Frequent	R, NR

**LG&E Energy Services, Inc.  
Cost Allocation Manual**

Support Services to Homes Services	All costs associated with providing energy-related products and services.	Frequent	R, NR
Support Services to Enertech	All costs associated with providing energy efficient improvement programs.	Frequent	R, NR
Economic Development & Major Accounts Services	All costs associated with community development, partnerships with state, regional, and local economic development allies, and customized products and services.	Frequent	R
Data Retrieval Services	All costs associated with providing meter reading and meter data services.	Frequent	R
Meter Operations Services	All cost associated with the testing of meters, completion of all customer requested service/field credit orders and the installation of commercial/industrial meters.	Ongoing	R
Meter Asset Management Services	All cost associated with inventory, quality and environmental issues, policy and standards, technical support, as well as, logistics.	Ongoing	R
Cash Remittance Services	All costs associated with providing remittance processing, customer payments, theft protection and collection services.	Ongoing	R
Customer Accounting Services	All costs associated with administering and providing customer billings and credit reviews.	Ongoing	R
Generation Construction Services	All costs associated with coordinating and managing all major generation construction for the regulated utilities.	Infrequent	R

**LG&E Energy Services, Inc.  
Cost Allocation Manual**

System Laboratory Services	All costs associated with providing system laboratory services to the generating stations.	Ongoing	R
Generation Engineering Services	All costs associated with providing engineering management for new and existing generation assets.	Ongoing	R
Generation Planning Services	All costs associated with short and long term generation planning services.	Ongoing	R
Combustion Turbine Operations & Maintenance Services	All costs associated with providing operations and maintenance of jointly owned and operated combustion turbines.	Ongoing	R
Fuel Procurement Services	All costs associated with procuring coal, natural gas, oil and other bulk materials for generation facilities and ensuring compliance with price and quality provisions of fuel contracts.	Ongoing	R
Transmission Planning and Substation Services	All costs associated with providing transmission planning and substation services.	Ongoing	R
Transmission Line Services	All costs associated with providing transmission line services.	Ongoing	R
Systems Control Center Services	All costs associated with providing system control center services.	Ongoing	R
Regulatory Affairs Services	All costs associated with providing management services for compliance with all laws, regulations and other policy requirements, including regulatory filings; expert testimony; tariff administration and compliance; pricing support; and development and monitoring of positions regarding ongoing regulatory matters.	Frequent	R

**LG&E Energy Services, Inc.**  
**Cost Allocation Manual**

Environmental Affairs Services	All costs associated with providing management services related to performing analyses, monitoring and advocacy of regulatory and legislative environmental matters including securing of permits and approvals; providing environmental technical expertise; and representing the company in industry groups and before regulatory agencies dealing with environmental issues.	Frequent	R
Regulatory Power Marketing Services	All costs associated with the provision of regulatory power marketing services.	Frequent	R
Network Trouble and Dispatch Services	All costs associated with providing dispatch services, reporting outage situations and coordinating restoration.	Ongoing	R
Mapping and Records Management Services	All costs associated with providing and maintaining the mapping of the electric infrastructure.	Ongoing	R
Electric Engineering Services	All costs associated with providing development engineering and construction standards, distribution system planning and analysis, substation construction project management and telecommunications systems design and analyses.	Ongoing	R
Distribution Asset Management Services	All costs associated with the management and investment decisions regarding Distribution Assets, including resource allocation, development of uniform standards and procedures, determining performance targets and managing assets information and data.	Ongoing	R

**LG&E Energy Services, Inc.  
Cost Allocation Manual**

Substation Construction and Maintenance Services	All costs associated with providing engineering and design services for substation construction, maintenance and operations areas.	Frequent	R
Distribution Management Services	All costs associated with providing senior management leadership (Directors) to the Distribution organization.	Ongoing	R
Budgeting Services	All costs associated with providing management services for the budgeting process and providing budget reporting.	Frequent	A
Market Forecasting Services	All costs associated with providing management services for financial forecasts of the utility market.	Infrequent	R
Financial Planning Services	All costs associated with providing financial planning services, investment analysis and investment planning reports.	Frequent	A
Internal Financial and Management Reporting Services	All costs associated with providing internal financial reports including standard and ad hoc management reporting packages, preliminary earnings reports, parent reports and other requested reports.	Frequent	A
External Financial Reporting Services	All costs associated with providing financial reports required or used by various external constituencies such as SEC, FERC, PSC, DOL, IRS, and financial institutions.	Frequent	A

**LG&E Energy Services, Inc.  
Cost Allocation Manual**

Accounting and Reporting Services	All costs associated with providing management and direction services including GAAP analyses and interpretation and promulgation of accounting and internal control procedures.	Frequent	C
Accounts and Projects Services	All costs associated with performing general ledger account and project analyses, reconciliations and balancing, consolidation, and UK/US GAAP adjustments.	Frequent	C
Sundry Billings Services	All costs associated with processing miscellaneous and non-standard billings and maintaining and monitoring associated accounts receivable.	Frequent	A
Property Accounting Services	All costs associated with maintaining, analyzing and reporting related to continuing property records.	Ongoing	R
Accounts Payable Services	All costs associated with processing payments for purchase orders, check requests, employees expense reimbursements, etc., and providing ad-hoc research and analysis services.	Ongoing	A
Energy Marketing Accounting Services	All costs associated with performing month end validation of all power transactions and resolving any discrepancies; preparing invoices and wires; validating bills from other counterparties; preparing accounting, allocation and analysis of off system (OSS) sales, off system purchases, intercompany sales and purchases; and preparing various FERC, Fuel Clause, WSPP, and DOE reports.	Ongoing	A

**LG&E Energy Services, Inc.  
Cost Allocation Manual**

Energy Marketing Trading Controls Services	All costs associated with performing weekly and daily reporting on the trading portfolios related to total exposure, trading limits, and mark-to-market calculations. Other activities include performing an independent valuation and validation of significant transactions, verifying price curves marked by traders and valuation algorithms, ensuring trading system security and performing trading system enhancements.	Ongoing	A
Energy Marketing Contract Administration Services	All costs associated with negotiating contracts with counterparties; administrating contracts; and maintaining contracts with in the trading systems. Additional activities include assisting various departments with contract disputes and preparing and validating confirmations.	Ongoing	A
Revenue Accounting Services	All costs associated with managing and analyzing internal and external revenue reporting.	Ongoing	R
Payroll Services	All costs associated with payroll services including the managing of payroll systems.	Ongoing	A
Tax Accounting, Compliance and Reporting Services	All costs associated with the preparation of consolidated and subsidiary Federal, state and local income tax returns; current and deferred tax accounting; utility gross receipts; sales/use tax; and supporting roles for business development, special requests and tax legislation.	Frequent	A
Tax Planning Services	All costs associated with providing detailed one year forecasts and/or multiyear forecasting of foreign, federal and state taxes, as well as, capital based and property tax planning.	Infrequent	A

**LG&E Energy Services, Inc.**  
**Cost Allocation Manual**

Tax -- Special Projects Services	All costs associated with providing business or project development, asset dispositions, tax credit studies, review/analysis of proposed tax legislation, etc., for major initiatives within the Company.	Infrequent	A
Oracle Business Systems	All costs associated with providing business support and electronic data processing services for all financial systems including treasury, accounting, tax, financial planning, regulatory and auditing.	Ongoing	A
Audit Services	All costs associated with providing independent and objective assurance and consulting services.	Frequent	A
IT Corporate Functions Services	All costs associated with corporate functions, not specific companies or work groups, and include groups such as IT Security, Program Management, and IT Research & Migration Planning. This is where corporate standards, security policies and procedures, and the programs are developed and administered for the corporation.	Ongoing	A
IT Administrative Services	All costs associated with management, administrative support, non project-specific supplies, tuition reimbursement, general training, travel, etc. Total Administrative services are proportionally recovered based on the level of charges assigned from the other products and services.	Ongoing	A

**LG&E Energy Services, Inc.  
Cost Allocation Manual**

IT Project Services	All costs associate with discretionary, project-based work done in IT. These projects create new client value or add business value to existing products/services. An example would be to add a new report to CIS or to make a billing modification.	Frequent	A
IT Application Services	All costs associated with each of the existing applications that IT provides to the business, like CIS, PeopleSoft HR, etc. The cost represents the real, bottom-line cost to provide basic ongoing service per the service level agreement. Costs included in this category are application license fees and application support costs.	Ongoing	A
IT Client Services	All costs associated with existing end user tools and related productivity software that the users can identify and interact with, like a PC or phone. Included in this category are products like PC's, desktop phone service as well as Email, file and print services.	Ongoing	A
IT Platform Services	All costs associated with shared platforms like computing platforms (IBM mainframe, HP UNIX servers, etc.), databases (DB2, Oracle, etc.), network and TSS (help desk). All costs are recovered through IT Client Services or IT Application Subscriptions using an algorithm that is based on the level of utilization of the platforms by each application. TSS is allocated as a platform based on an analysis of their call profiles.	Ongoing	A
Cash Management and Investment Services	All costs associated with providing management and monitoring of cash flows including review and acquisition of business entity cash requirements and procurement of short-term financing and credit lines.	Ongoing	A

**LG&E Energy Services, Inc.  
Cost Allocation Manual**

Corporate Finance Services	All costs associated with providing overall finance options including evaluation of new financing vehicles and instruments, analysis of existing financing positions and raising long-term funds for all entities.	Ongoing	A
Shareholder Services	All costs associated with managing and maintaining relations with security analysts, ratings agencies and institutional investors as well as providing transfer agent and related services to shareholders.	Ongoing	C
Risk Management Services	All costs associated with managing outside providers of risk services comprised of providing insurance and assisting affiliated entities in managing property and liability risks including claims, security, environmental, safety and consulting services.	Ongoing	A
Strategic Planning Services	All costs associated with providing assistance to affiliated entities in the development and analysis of strategies, strategic forecasts and economics of strategic plans.	Frequent	A
Legal Services	All costs associated with providing various legal services for all affiliated entities including in-house counsel and staff assistance in the areas of corporate and securities law, employment law, regulatory law, contract law, and patent law, as well as, evaluating legal claims and managing legal fees for outside counsel.	Frequent	A

**LG&E Energy Services, Inc.  
Cost Allocation Manual**

Public Affairs Management Services	All costs associated with providing community relations functions, communicating public information to local organizations and providing oversight and communications to employees.	Frequent	C
Government Affairs Management Services	All costs associated with maintaining relationships with government policy makers and conducting lobbying activities.	Frequent	C
Internal Communications Services	All costs associated with providing internal communication services.	Frequent	C
External and Brand Communications	All costs associated with providing external communication services, brand image management, corporate events, and LG&E Foundation's charitable donations.	Frequent	C
Facilities and Building Services	All costs associated with providing building and grounds maintenance including coordination of office furniture and equipment purchases/leases, space utilization and layout, and building code and fire protection services.	Ongoing	A
Office Furniture and Equipment	All costs associated with providing office furniture and equipment for the Operating Companies and affiliates.	Ongoing	A
Security Services	All costs associated with providing security personnel, security and monitoring devices for all affiliated entities requiring limited access.	Ongoing	A
Production Mail Services	All costs associated with providing production mail services.	Frequent	R

**LG&E Energy Services, Inc.  
Cost Allocation Manual**

Document Services	All costs associated with providing document printing, reproduction services including mail delivery, scanning, off-site storage and service desk support.	Ongoing	A
Right of Way Services	All costs associated with obtaining and retaining easements or fee simple property for placement and operation of company and affiliate equipment as well as managing real estate assets and maintaining real estate records.	Frequent	A
Transportation Services	All costs associated with providing and operating transportation fleet for all affiliated companies including developing fleet policy, administering regulatory compliance programs, managing repair and maintenance of vehicles and procuring vehicles.	Ongoing	A
Procurement and Major Contracts Services	All costs associated with providing for and administering major contract negotiations, requests for quotes, supplier relations and order placement services.	Ongoing	A
Strategic Sourcing Services	All costs associated with providing strategic sourcing services such as maintaining and analyzing the supplier base and performing supplier selection activities including contract negotiations and ongoing compliance.	Frequent	A
Materials Logistics Services	All costs associated with providing order management, materials handling and logistics, and inventory management services.	Ongoing	R

**LG&E Energy Services, Inc.  
Cost Allocation Manual**

Sourcing Support Services	All costs associated with providing order management and general field support services for system policy and maintenance management, developing and monitoring of key performance metrics, and supplying day to day variance and reconciliation reporting services.	Frequent	R
HR Compensation Services	All costs associated with providing services relating to the establishment and oversight of compensation policies for executives and employees.	Frequent	A
HR Benefits Services	All costs associated with providing services relating to the establishment and oversight of benefits policies for employees, including administrative billings to vendors and retiree and survivor services, and maintenance of all personnel records.	Frequent	A
HR Health and Safety Services	All costs associated with providing services relating to the establishment and oversight of health and safety policies for employees.	Frequent	A
HR Organizational Development and Training Services	All costs associated with providing training services to improve organizational effectiveness with an emphasis on employee and leadership development, leadership succession planning, and the change management process.	Frequent	A
HR Headquarters Services	All costs associated with providing services relating to operational and strategic human resources management for corporate staff.	Frequent	A
HR Power Generation Services	All costs associated with providing services relating to operational and strategic human resources management for Power Generation employees.	Frequent	R

**LG&E Energy Services, Inc.  
Cost Allocation Manual**

HR Distribution and Retail Services	All costs associated with providing services relating to operational and strategic human resources management for Distribution and Retail employees.	Frequent	R
HR Corporate Services	All costs associated with providing centralized corporate human resources services in support of the lines of business.	Frequent	A
Technical and Safety Training Services	All costs associated with providing training services on technical and safety matters primarily for the Distribution, Retail and Power Generation businesses.	Frequent	R
Industrial Relations Management Services	All costs associated with providing communication and oversight for union matters, negotiation of union contracts, and union dispute resolution services.	Frequent	R
Executive Management Services	All costs associated with providing executive leadership to the corporation which are comprised of the compensation and benefits of the corporate officers and executive assistants.	Ongoing	A

## V. COST APPORTIONMENT METHODOLOGY

### OVERVIEW

The costs of services provided by SERVCO will be directly assigned, distributed or allocated by activity, project, program, work order or other appropriate basis. The primary basis for charges to affiliates is the direct charge method (see section VI for time reporting procedures). The methodologies listed below pertain to all other costs which are not directly assigned but which make up the fully distributed cost of providing the product or service.

SERVCO will allocate the costs of service among the affiliated companies using one of several methods that most accurately distributes the costs. The method of cost allocation varies based on the department rendering the service. The allocation methods used by SERVCO are as follows:

## LG&E Energy Services, Inc. Cost Allocation Manual

### CURRENTLY BEING UTILIZED:

**Information Systems Chargeback Rates** – Rates for services, including but not limited to software, consulting, mainframe and personal computer services, are based on the costs of labor, materials and information services overheads related to the provision of each service. Such rates are applied based on the specific equipment employed and the measured usage of services by Client entities. These rates will be determined annually based on actual experience and may be adjusted for any known and reasonably quantifiable events, or at such time as may be required due to significant changes.

**Number of Customers Ratio** – A ratio based on the number of retail electric and/or gas customers. This ratio will be determined annually based on the actual number of customers at the end of the previous calendar year and may be adjusted for any known and reasonably quantifiable events, or at such time as may be required due to significant changes. In some cases, the ratio may be calculated based on the type of customer class being served (i.e. Residential, Commercial or Industrial).

**Number of Employees Ratio** – A ratio based on the number of employees benefiting from the performance of a service. This ratio will be determined annually based on actual counts of applicable employees at the end of the previous calendar year and may be adjusted for any known and reasonably quantifiable events, or at such time as may be required due to significant changes. In some cases, a two-step assignment methodology is utilized to properly allocate SERVCO employee costs to the proper legal entity.

**Departmental Charge Ratio** – A specific SERVCO department ratio based upon various factors such as labor hours, labor dollars, departmental or Client entity headcount, etc. The departmental charge ratio typically applies to indirectly attributable costs (defined in Section V, Cost Apportionment Methodology) such as departmental administrative, support, and/or material and supply costs that benefit more than one affiliate and that require allocation using general measures of cost causation. Methods for assignment are department-specific depending on the type of product or service being performed and are documented and monitored by the PUHCA Compliance Manager on a monthly basis to ensure consistent and proper application and periodic true-up, where necessary, for SERVCO billing purposes.

**Electric Peak Load Ratio** – Based on the sum of the monthly electric maximum system demands for the immediately preceding twelve consecutive calendar months, the numerator of which is for an operating company and the denominator of which is for all operating companies. This ratio will be determined annually, or at such time as may be required due to a significant change.

**Revenue Ratio** – Based on the sum of the revenue at the end of each month for the immediately preceding twelve consecutive calendar months, the numerator of which is for an operating company or an affected affiliate company and the denominator of which is for all operating companies and affected affiliate companies. This ratio will be determined annually, or at such time as may be required due to significant changes.

## **LG&E Energy Services, Inc.**

### **Cost Allocation Manual**

**Payroll Ratio** – Based on the sum of the payroll at the end of each month for the immediately preceding twelve consecutive calendar months, the numerator of which is for an operating company or an affected affiliate company and the denominator of which is for all operating companies and affected affiliate companies. This ratio will be determined annually, or at such time as may be required due to significant changes.

**Total Assets Ratio** – Based on the total assets at year end for the preceding year, the numerator of which is for an operating company or affected affiliate company and the denominator of which is for all operating companies and affected affiliate companies. This ratio will be determined annually, or at such time as may be required due to significant changes. In the event of joint ownership of a specific asset, asset ownership percentages will be utilized to assign costs.

**Contract Ratio** – Based on the sum of the physical amount (i.e. tons of coal, cubic feet of natural gas) of the contract for both coal and natural gas at the end of each month for the immediately preceding twelve consecutive calendar months, the numerator of which is for an operating company or an affected affiliate company and the denominator of which is for all operating companies and affected affiliate companies. This ratio will be determined annually, or at such time as may be required due to significant changes.

**Shareholder Ratio** – Based on the average number of preferred shareholders at the end of each month for the immediately preceding twelve consecutive calendar months, the numerator of which is for an operating company or an affected affiliate company and the denominator of which is for all operating companies and affected affiliate companies. This ratio will be determined on an annual basis, or at such time as may be required due to significant changes.

**Number of Meters Ratio** – Ratio based on the number or types of meters being utilized by all levels of customer classes within the system for the immediately preceding twelve consecutive calendar months. The numerator is equal to the number of meters for a specific Client entity and the denominator is equal to such expenditures for all applicable client entities. This ratio will be determined annually, or at such time as may be required due to significant change.

**Number of Transactions Ratio** – Based on the sum of transactions occurring in the immediately preceding twelve consecutive calendar months, the numerator of which is for an operating company or an affected affiliate company and the denominator of which is for all operating companies and affected affiliate companies. This ratio will be determined on a monthly basis, or at such time as may be required due to significant changes. For example, services with regard to Procurement and Major Contracts would define a transaction as the number of contracts negotiated. Services pertaining to Materials Logistics would define the transaction as the number of items ordered, picked and disbursed out of the warehouse. Services pertaining to Accounts Payable would define the transaction as the number of invoices processed. Similar to the Departmental Charge Ratio, defined previously, the PUHCA Compliance Manager is responsible for maintaining and monitoring specific product/service methodology documentation and periodic true-up requirements for actual transactions related to SERVCO billings.

## **LG&E Energy Services, Inc. Cost Allocation Manual**

**Retail Revenue Ratio** – Based on utility revenues, excluding energy marketing revenues, for the immediate preceding twelve consecutive calendar months, the numerator of which is for an operating company or an affiliate and the denominator of which is for all operating companies and affected affiliate companies. This ratio will be determined annually, or at such time as may be required due to a significant change.

**Energy Marketing Ratio** – Based on the absolute value of equivalent megawatt hours purchased or sold for the immediate preceding twelve consecutive calendar months, the numerator of which is for an operating company or an affiliate and the denominator of which is for all operating companies and affected affiliate companies. This ratio will be determined annually, or at such time as may be required due to a significant change.

**Regulatory Mandate Ratios** – Based on Federal or state mandated percentage allocations based on regulatory proceedings and requirements. These ratios are typically developed in concert with regulatory authorities representing the results of merger or joint asset ownership negotiations and are supported by specific contracts regarding legal entity allocation requirements. Contract terms and periodic updates, if necessary, are maintained and monitored by the PUHCA Compliance Manager and SERVCO departmental management.

**Project Ratio** – Based on the total costs for any departmental or affiliate project at the end of each month for the immediately preceding twelve consecutive calendar months, the numerator of which is for an operating company or an affected affiliate company and the denominator of which is for all operating companies and affected affiliate companies. This ratio will be determined on a monthly basis, or at such time as may be required due to significant changes.

**Transportation Resource Management System Chargeback Rate** – Rates for use of transportation equipment are based on the costs associated with providing and operating transportation fleet for all affiliated companies including developing fleet policy, administering regulatory compliance programs, managing repair and maintenance of vehicles and procuring vehicles. Such rates are applied based on the specific equipment employment and the measured usage of services by Client entities. These rates will be determined annually based on actual experience and may be adjusted for any known and reasonably quantifiable events, or at such time as may be required due to significant changes.

**Non-Fuel Material and Services Expenditures** – A ratio based on non-fuel material and services expenditures, net of reimbursements, for the immediately preceding twelve consecutive calendar months. The numerator is equal to such expenditures for a specific Client entity and/or line-of-business as appropriate and the denominator is equal to such expenditures for all applicable Client entities. This ratio will be determined annually, or at such time as may be required due to a significant change.

## LG&E Energy Services, Inc. Cost Allocation Manual

**MAY BE UTILIZED IN THE FUTURE:** *The following ratios may be applicable in future SERVCO operations as enterprise strategic, tactical and organizational changes dictate. These are listed for informational purposes only. As circumstances require, any change in allocation methodology will be promptly communicated to the requisite SEC authority for discussion and approval prior to any application for SERVCO billing purposes.*

**Supplier Spend Ratio** – Based on the sum of dollars spent with suppliers for the immediately preceding twelve consecutive calendar months, the numerator of which is for an operating company or an affected affiliate company and the denominator of which is for all operating companies and affected affiliate companies. This ratio will be determined on a monthly basis, or at such time as may be required due to significant changes.

**Telecommunications Chargeback Rates** – Rates for use of telecommunications services other than those encompassed by Information Systems Chargeback Rates are based on the costs of labor, materials, outside services and telecommunications overheads. Such rates are applied based on the specific equipment employment and the measured usage of services by Client entities. These rates will be determined annually based on actual experience and may be adjusted for any known and reasonably quantifiable events, or at such time as may be required due to significant changes.

**Transmission Construction Expenditures Ratio** – A ratio based on transmission construction or capital expenditures, net of reimbursements, for the immediately preceding twelve consecutive calendar months. The numerator is equal to such expenditures for a specific Client entity and the denominator is equal to such expenditures for all applicable client entities. This ratio will be determined annually, or at such time as may be required due to significant change.

**Distribution Construction Expenditures Ratio** – A ratio based on distribution construction or capital expenditures, net of reimbursements, for the immediately preceding twelve consecutive calendar months. The numerator is equal to such expenditures for a specific Client entity and the denominator is equal to such expenditures for all applicable Client entities. This ratio will be determined annually, or at such time as may be required due to a significant change.

**Substation Construction Expenditures Ratio** – A ratio based on substation construction or capital expenditures, net of reimbursements, for the immediately preceding twelve consecutive calendar months. The numerator is equal to such expenditures for a specific Client entity and the denominator is equal to such expenditures for all applicable Client entities. This ratio will be determined annually, or at such time as may be required due to a significant change.

**Electric MWh Generation Ratio** – A ratio based on the sum of electric MWh generated during each month for the immediately preceding twelve consecutive calendar months. The numerator is equal to the electric MWh generated by a specific Client entity and the denominator is equal to all electric MWh generated by all applicable Client entities. This ratio will be determined annually, or at such time as may be required due to significant changes.

## **LG&E Energy Services, Inc.**

### **Cost Allocation Manual**

**Electric Sales Ratio** – Based on firm kilowatt-hour electric sales, excluding inter-system sales, for the immediate preceding twelve consecutive calendar months, the numerator of which is for an operating company or and affiliate and the denominator of which is for all operating companies and affected affiliate companies. This ratio will be determined annually, or at such time as may be required due to a significant change.

**Residential Sales Ratio** – Based on firm kilowatt-hour electric sales to residential customers for the immediate preceding twelve consecutive calendar months, the numerator of which is for an operating company or an affiliate and the denominator or which is for all operating companies and affected affiliate companies. This ratio will be determined annually, or at such time as may be required due to a significant change.

**Business Sales Ratio** – Based on firm kilowatt-hour electric sales to business customers that purchase less than 250 kilowatts for the immediate preceding twelve consecutive calendar months, the numerator of which is for an operating company or an affiliate and the denominator of which is for all operating companies and affected affiliate companies. This ratio will be determined annually, or at such as may be required due to a significant change.

**Large Commercial & Industrial Sales Ratio** – Based on firm kilowatt-hour electric sales to large commercial and industrial customers that purchase greater than 250 kilowatts for the immediate preceding twelve consecutive calendar months, the numerator of which is for an operating company or an affiliate and the denominator of which is for all operating companies and affected affiliate companies. This ratio will be determined annually, or at such time as may be required due to a significant change.

**Construction Expenditures Ratio** – Based on construction or capital expenditures, net of reimbursements, for the immediately preceding twelve consecutive calendar months, the numerator of which is for an operating company or an affected affiliate company and the denominator of which is for all operating companies and affected affiliate companies. This ratio will be determined annually, or at such time as may be required due to a significant change.

**Total Common Equity Ratio** – Based on the sum of the common equity at the end of each month for the immediately preceding twelve calendar months, the numerator of which is for an operating company or an affected affiliate company and the denominator of which is for all operating companies and affected affiliate companies. This ratio will be determined annually, or at such time as may be required due to significant changes.

**Wholesale Revenue Ratio** – Based on the sum of the electric wholesale revenue at the end of each month for the immediately preceding twelve consecutive calendar months, the numerator of which is for an operating company or an affected affiliate company and the denominator of which is for all operating companies and affected affiliate companies. This ratio will be determined annually, or at such time as may be required due to significant changes.

## LG&E Energy Services, Inc. Cost Allocation Manual

**Industrial Revenue Ratio** – Based on the sum of the electric industrial revenue at the end of each month for the immediately preceding twelve consecutive calendar months, the numerator of which is for an operating company or an affected affiliate company and the denominator of which is for all operating companies and affected affiliate companies. This ratio will be determined annually, or at such time as may be required due to significant changes.

**Electric kWh Purchased Power Ratio** – Based on the sum of electric kWh purchased power during each month for the immediately preceding twelve consecutive calendar months, the numerator of which is for an operating company and the denominator of which is for all operating companies. This ratio will be determined annually, or at such time as may be required due to significant changes.

The following product and service listing details the type of assignments being employed.

<b>Product or Service</b>	<b>Assignment Method</b>
Customer Services	Number of Customers Ratio
Sales and Marketing Services	Departmental Charge Ratio
Support Services to Home Services	Departmental Charge Ratio
Support Services to Enertech	Departmental Charge Ratio
Economic Development & Major Account Services	Departmental Charge Ratio
Data Retrieval Services	Departmental Charge Ratio
Meter Operations Services	Number of Meters Ratio
Meter Asset Management Services	Number of Meters Ratio
Cash Remittance Services	Revenue Ratio
Customer Accounting Services	Number of Customers Ratio
Generation Construction Services	Total Assets Ratio
System Laboratory Services	Departmental Charge Ratio
Generation Engineering Services	Departmental Charge Ratio
Generation Planning Services	Electric Peak Load Ratio
Combustion Turbine Operations & Maintenance Services	Total Assets Ratio
Fuel Procurement Services	Contract Ratio
Transmission Planning and Substation Services	Departmental Charge Ratio
Transmission Line Services	Departmental Charge Ratio
Systems Control Center Services	Regulatory Mandate Ratios
Regulatory Affairs Services	Revenue Ratio
Environmental Affairs Services	Departmental Charge Ratio
Regulatory Power Marketing Services	Regulatory Mandate Ratios
Network Trouble and Dispatch Services	Departmental Charge Ratio
Mapping and Records Management Services	Departmental Charge Ratio
Electric Engineering Services	Departmental Charge Ratio
Distribution Asset Management Services	Total Assets Ratio

**LG&E Energy Services, Inc.**  
**Cost Allocation Manual**

Substation Construction and Maintenance Services	Departmental Charge Ratio
Distribution Management Services	Departmental Charge Ratio
Budgeting Services	Revenue, Total Assets & Payroll Ratios
Market Forecasting Services	Departmental Charge Ratio
Financial Planning Services	Revenue, Total Assets & Payroll Ratios
Internal Financial and Management Reporting Services	Revenue, Total Assets & Payroll Ratios
External Financial Reporting Services	Revenue, Total Assets & Payroll Ratios
Accounting and Reporting Services	Revenue, Total Assets & Payroll Ratios
Accounts and Projects Services	Revenue, Total Assets & Payroll Ratios
Sundry Billings Services	Revenue, Total Assets & Payroll Ratios
Property Accounting Services	Departmental Charge Ratio
Accounts Payable Services	Number of Transactions Ratio
Energy Marketing Accounting Services	Energy Marketing Ratio
Energy Marketing Trading Controls Services	Energy Marketing Ratio
Energy Marketing Contract Administration Services	Energy Marketing Ratio
Revenue Accounting Services	Retail Revenue Ratio
Payroll Services	Number of Employees Ratio
Tax Accounting, Compliance and Reporting Services	Revenue, Total Assets & Payroll Ratios
Tax Planning Services	Revenue, Total Assets & Payroll Ratios
Tax – Special Projects Services	Direct Charges Only
Oracle Business Systems	Number of Employees Ratio
Audit Services	Project Ratio
IT Corporate Functions Services	Information Systems Chargeback Rates
IT Administrative Services	Information Systems Chargeback Rates
IT Project Services	Information Systems Chargeback Rates
IT Application Services	Information Systems Chargeback Rates
IT Client Services	Information Systems Chargeback Rates
IT Platform Services	Information Systems Chargeback Rates
Cash Management and Investment Services	Revenue, Total Assets & Payroll Ratios
Corporate Finance Services	Revenue, Total Assets & Payroll Ratios
Shareholder Services	Shareholder Ratios
Risk Management Services	OUTSOURCED – Direct Charges Only
Strategic Planning Services	Direct Charges Only
Legal Services	Departmental Charge Ratio
Public Affairs Management Services	Departmental Charge Ratio
Government Affairs Management Services	Departmental Charge Ratio
Internal Communication Services	Departmental Charge Ratio
External and Brand Communication Services	Departmental Charge Ratio
Facilities and Building Services	Departmental Charge Ratio
Office Furniture and Equipment	Departmental Charge Ratio
Security Services	Departmental Charge Ratio
Production Mail Services	Number of Customers Ratio

**LG&E Energy Services, Inc.  
Cost Allocation Manual**

Document Services	Number of Employees Ratio
Right-of-Way Services	Departmental Charge Ratio
Transportation Services	Transportation Resource Management System Chargeback Rates
Procurement and Major Contracts Services	Non-Fuel Material & Services Expenditures Ratio
Strategic Sourcing Services	Non-Fuel Material & Services Expenditures Ratio
Materials Logistics Services	Number of Transactions Ratio
Sourcing Support Services	Non-Fuel Material & Services Expenditures Ratio
HR Compensation Services	Number of Employees Ratio
HR Benefits Services	Number of Employees Ratio
HR Health and Safety Services	Number of Employees Ratio
HR Organization Development and Training Services	Number of Employees Ratio
HR Headquarters Services	Number of Employees Ratio
HR Power Generation Services	Number of Employees Ratio
HR Distribution & Retail Services	Number of Employees Ratio
HR Corporate Services	Number of Employees Ratio
Technical and Safety Training Services	Number of Employees Ratio
Industrial Relations Management Services	Departmental Charge Ratio
Executive Management Services	Departmental Charge Ratio

## **VI. TIME DISTRIBUTION, BILLING AND ASSET TRANSFER POLICIES**

### **OVERVIEW**

SERVCO utilizes ORACLE financial systems in which project/task combinations are set up to equate to products and services. In some cases, departments have set up many project/tasks that map to products and services. In many cases, there is a one to one relationship between the project/task and the product. The ORACLE system also automatically captures the home company (providing the service) and the charge company (receiving the service). Regardless of the method of reporting, charges related to specific products reside on the company receiving the service and therefore can be identified for billing purposes as well as for preparation of SERVCO financial statements. This ensures that:

1. Separation of costs between regulated and non-regulated affiliates will be maintained
2. Intercompany transactions and related billings are structured so that non-regulated activities are not subsidized by regulated affiliates
3. Adequate audit trails exist on the books and records

# **LG&E Energy Services, Inc.**

## **Cost Allocation Manual**

### **BILLING POLICIES**

Billings for transactions between SERVCO and affiliates are issued on a timely basis with documentation sufficient to provide the receiving party with enough detail to understand the nature of the billing, the relevant components, and other information as required by the SLAs. Financial settlements for transactions are made within 30 days. Late charges at a reasonable rate will apply.

### **ASSET TRANSFERS**

Any transfers or sales of assets from regulated affiliates to non-regulated affiliates will be priced at the greater of cost or fair market value. Conversely, any transfers or sales of assets from non-regulated affiliates to regulated affiliates will be priced at the lower of cost or fair market value. Settlement of liabilities will be treated in the same manner.

### **TIME DISTRIBUTION**

SERVCO has three methods of distribution to record employee salaries and wages while providing services for the affiliated entities: Positive time reporting, allocation time reporting and exception time reporting. Each department's job activities will dictate the type of time reporting method used.

#### **POSITIVE TIME REPORTING**

Positive time reporting or direct time reporting requires all employees of a department to track all chargeable hours every day. This is usually done in half-hour to one-hour increments.

Departments that have positive time reporting have labor-based activities that are easily trackable given the project task code combinations noted above. All employees are given appropriate project numbers that are associated with the service that is being provided. The proper coding for direct assignment of costs is on various source documents, including the payroll time system and disbursement requests. Each department or project manager is responsible for ensuring employees charge the appropriate charge codes for the services performed. This form of time reporting is documented by using a time sheet, which upon completion, is verified by the employees immediate supervisor.

#### **ALLOCATION TIME REPORTING**

Allocation time reporting allows for certain departments to set up a predefined allocation percentage to affiliated company project/tasks. This is typically the case when the department is transaction-based, therefore, performing routine, similar tasks benefiting multiple affiliates. Each department will use their

## **LG&E Energy Services, Inc. Cost Allocation Manual**

annual or monthly budget, current projects at hand and historical costs to allocate the appropriate time to individual charge numbers that are associated to that department's services. These allocation percentages are reviewed on a monthly to annual basis to update to actual allocation percentages when needed.

### **EXCEPTION TIME REPORTING**

Exception time reporting is the same as allocation time reporting, except for one small difference. This time reporting method is used to show exceptions in the predetermined allocation for a specific pay period. If an employee was working on a completely new project that had not been defined within the monthly or annual allocation process, then the employee would fill out an exception time report to replace the allocation of time that is now incorrect.



**Louisville Gas and Electric Company  
Case No. 2003-00433  
Historical Test Period Filing Requirements**

**Filing Requirement  
807 KAR 5:001 Section 10(6)(u)  
Sponsoring Witness: W. Steven Seelye**

**Description of Filing Requirement:**

*If the utility provides gas, electric or water utility service and has annual gross revenues greater than \$5,000,000, a cost of service study based on a methodology generally accepted within the industry and based on current and reliable data from a single time period.*

**Response:**

Please refer to Volume 4, the testimony of W. Steven Seelye. Also, please refer to Volume 5 for Mr. Seelye's Exhibits.



**Louisville Gas and Electric Company  
Case No. 2003-00433  
Historical Test Period Filing Requirements**

**Filing Requirement  
807 KAR 5:001 Section 10(6)(v)  
Sponsoring Witness: Michael S. Beer**

**Description of Filing Requirement:**

*Local exchange carriers with fewer than 50,000 access lines shall not be required to file cost of service studies, except as specifically directed by the commission. Local exchange carriers with more than 50,000 access lines shall file:*

*1. A jurisdictional separations study consistent with Part 36 of the Federal Communications Commission's rules and regulations; and*

*2. Service specific cost studies to support the pricing of all services that generate annual revenue greater than \$1,000,000, except local exchange access:*

*a. Based on current and reliable data from a single time period; and*

*b. Using generally recognized fully allocated, embedded, or incremental cost principles.*

**Response:**

Not applicable to LG&E's Application.



**Louisville Gas and Electric Company  
Case No. 2003-00433  
Historical Test Period Filing Requirements**

**Filing Requirement  
807 KAR 5:001 Section 10(7)(a)  
Sponsoring Witness: Valerie L. Scott**

**Description of Filing Requirement:**

*Upon good cause shown, a utility may request pro forma adjustments for known and measurable changes to ensure fair, just and reasonable rates based on the historical test period. The following information shall be filed with applications requesting pro forma adjustments or a statement explaining why the required information does not exist and is not applicable to the utility's application:*

*(a) A detailed income statement and balance sheet reflecting the impact of all proposed adjustments;*

**Response:**

See attached.

**Louisville Gas and Electric Company**  
**Electric Income Statement**  
**12 Months Ending September 30, 2003**

	Test Year Electric		Adjustments Inc (Dec)	Adjusted Electric
<b>1 OPERATING REVENUES</b>				
2 Sales to Ultimate Consumers	587,929,052			587,929,052
3 Sales for Resale	157,302,063			157,302,063
4 Brokered	5,389,000			5,389,000
5 Miscellaneous	17,905,669			17,905,669
6 Total Operating Revenues	768,525,784	(1)	(41,046,023)	727,479,761
7				
<b>8 OPERATING EXPENSES</b>				
9 Fuel	198,798,005	(2)	(2,005,300)	196,792,705
10 Power Purchased	83,608,926	(3)	(7,811,321)	75,797,605
11 Operation and Maintenance	223,386,066	(4)	24,240,260	247,626,326
12 Depreciation and Amortization	90,459,063	(5)	12,922,706	103,381,769
13 Taxes Other Than Income Taxes	12,603,252	(6)	(159,776)	12,443,476
14 Income Taxes	50,987,079	(7)	(27,559,417)	23,427,662
15 Total Utility Operating Expenses	659,842,391		(372,848)	659,469,543
16 Net Utility Operating Income	108,683,393		(40,673,175)	68,010,218
17				
18 Net Other Income and Deductions	1,083,805			1,083,805
19				
20 Net Interest Charges	24,725,165			24,725,165
21				
22 Net Income Before Extraordinary Items	85,042,033		(40,673,175)	44,368,858
23				
24 Extraordinary Items	3,149,402	(8)	(3,149,402)	-
25				
26 Net Income	81,892,631		(37,523,773)	44,368,858
27				
28 Preferred Dividends	2,796,485			2,796,485
29				
30 Net Income Available for Common	79,096,146		(37,523,773)	41,572,373

(1) See Seelye Exhibit 1 for the following:

Schedule 1.00	(1,867,000)
Schedule 1.01	(4,406,145)
Schedule 1.02	547,244
Schedule 1.03	(11,228,429)
Schedule 1.04	723,260
Schedule 1.05	(1,929,923)
Schedule 1.09	(3,277,501)
Schedule 1.10	2,614,347
Schedule 1.28	6,445
See Scott Exhibit 1 for the following:	
Schedule 1.06	(5,389,000)
Schedule 1.07	(6,974,780)
Schedule 1.08	(7,150,231)
Schedule 1.21	44,485
Schedule 1.22	(2,758,795)
	(41,046,023)

(2) See Seelye Exhibit 1 for the following:

Schedule 1.01	(2,005,300)
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(3) See Scott Exhibit 1 for the following:

Schedule 1.06	(7,811,321)
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(4) See Seelye Exhibit 1 for the following:

Schedule 1.03	(224,576)
Schedule 1.09	(3,280,013)
Schedule 1.10	1,458,544
See Scott Exhibit 1 for the following:	
Schedule 1.12	854,540
Schedule 1.13	2,755,476
Schedule 1.14	70,492
Schedule 1.15	(62,499)
Schedule 1.16	333,580
Schedule 1.17	58,333
Schedule 1.18	(1,061,924)
Schedule 1.19	501,449
Schedule 1.20	5,640,000
Schedule 1.21	(224,718)
Schedule 1.22	19,427,401
Schedule 1.23	(2,722,005)
Schedule 1.24	709,577
Schedule 1.26	(431,834)
Schedule 1.27	(2,157,640)
Schedule 1.29	1,798,420
Schedule 1.30	3,588,000
Schedule 1.31	(1,373,632)
Schedule 1.32	(1,416,711)
	24,240,260

(5) See Robinson/Scott Exhibit 1 for the following:

Schedule 1.11	8,959,749
See Seelye Exhibit 1 for the following:	
Schedule 1.03	(1,317,952)
See Scott Exhibit 1 for the following:	
Schedule 1.25	5,280,909
	12,922,706

(6) See Seelye Exhibit 1 for the following:

Schedule 1.03	(223,816)
See Scott Exhibit 1 for the following:	
Schedule 1.12	64,040
	(159,776)

(7) See Rives Exhibit 1 for the following:

Schedule 1.36	(27,540,380)
Schedule 1.37	39,556
Schedule 1.38	(58,593)
	(27,559,417)

(8) Reclassification

Schedule 1.25	(5,280,909)
Tax 40.3625%	2,131,507
	(3,149,402)

**Louisville Gas and Electric Company**  
**Gas Income Statement**  
**12 Months Ending September 30, 2003**

	Test Year Gas		Adjustments Inc (Dec)	Adjusted Gas
<b>1 OPERATING REVENUES</b>				
2 Sales to Ultimate Consumers	292,475,221			292,475,221
3 Sales for Resale	10,242,834			10,242,834
4 Transportation Revenue	6,149,239			6,149,239
5 Miscellaneous	1,908,051			1,908,051
6 Total Operating Revenues	310,775,345	(1)	(225,808,231)	84,967,114
7				
<b>8 OPERATING EXPENSES</b>				
9 Purchased Gas	220,775,974	(2)	(220,151,701)	624,273
10 Operation and Maintenance	45,125,535	(3)	1,494,751	46,620,286
11 Depreciation and Amortization	16,669,595	(4)	1,605,685	18,275,280
12 Taxes Other Than Income Taxes	3,888,055	(5)	16,844	3,904,899
13 Income Taxes	7,592,206	(6)	(3,299,855)	4,292,351
14 Total Utility Operating Expenses	294,051,365		(220,334,276)	73,717,089
15 Net Utility Operating Income	16,723,980		(5,473,955)	11,250,025
16				
17 Net Other Income and (Deductions)	(396,847)			(396,847)
18				
19 Net Interest Charges	4,794,481			4,794,481
20				
21 Net Income	11,532,652		(5,473,955)	6,058,697
22				
23 Preferred Dividends	544,193			544,193
24				
25 Net Income Available for Common	10,988,459		(5,473,955)	5,514,504

(1) See Seelye Exhibit 1 for the following:

Schedule 1.00	(2,780,000)
Schedule 1.09	(1,526,197)
Schedule 1.10	(56,581)
Schedule 1.28	(41,331)
Schedule 1.33	(221,622,896)
Schedule 1.35	(13,022)

See Scott Exhibit 1 for the following:

Schedule 1.21	231,796
	<u>(225,808,231)</u>

(2) See Seelye Exhibit 1 for the following:

Schedule 1.33	<u>(220,151,701)</u>
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(3) See Scott Exhibit 1 for the following:

Schedule 1.12	224,768
Schedule 1.13	724,767
Schedule 1.15	(21,625)
Schedule 1.16	217,131
Schedule 1.18	(564,537)
Schedule 1.19	293,513
Schedule 1.20	1,515,000
Schedule 1.21	(141,372)
Schedule 1.26	(113,585)
Schedule 1.29	478,061

See Seelye Exhibit 1 for the following:

Schedule 1.09	(1,527,223)
Schedule 1.10	(16,901)
Schedule 1.34	426,754
	<u>1,494,751</u>

(4) See Robinson/Scott Exhibit 1 for the following:

Schedule 1.11	<u>1,605,685</u>
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(5) See Scott Exhibit 1 for the following:

Schedule 1.12	<u>16,844</u>
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(6) See Rives Exhibit 1 for the following:

Schedule 1.36	(3,541,329)
Schedule 1.37	(151,228)
Schedule 1.38	392,702
	<u>(3,299,855)</u>

**Louisville Gas and Electric Company**  
**Pro-forma Balance Sheet**  
**Total Company (Electric and Gas)**

	Per Books 9/30/2003	Pro-forma Adjustments	Adjusted Balance
<b>1 ASSETS</b>			
<b>2 UTILITY PLANT</b>			
3 Utility Plant	3,752,179,495		3,752,179,495
4 Less Accumulated Depreciation	(1,522,825,599)	(11,378,989) (1)	(1,534,204,588)
5 Net Utility Plant	<u>2,229,353,896</u>	<u>(11,378,989)</u>	<u>2,217,974,907</u>
6			
7 OTHER PROPERTY AND INVESTMENTS	<u>5,610,748</u>		<u>5,610,748</u>
8			
9 CURRENT ASSETS			
10 Cash	3,400,209		3,400,209
11 Accounts Receivable-Less Reserve	14,415,542		14,415,542
12 Notes Receivable from LG&E-R	18,791,941		18,791,941
13 Accounts Receivable from Assoc Companies	17,017,143		17,017,143
14 Gas Stored Underground	69,634,028		69,634,028
15 Materials & Operating Supplies	49,441,475		49,441,475
16 Allowance Inventory	61,888		61,888
17 Prepayments	2,138,694		2,138,694
18 Miscellaneous Current & Accrued Assets	461,046		461,046
19 Total Current Assets	<u>175,361,966</u>	-	<u>175,361,966</u>
20			
21 OTHER ASSETS			
22 Unamortized Debt Expense	6,333,944		6,333,944
23 Unamortized Loss on Bonds	18,003,964		18,003,964
24 Accumulated Deferred Income Taxes	111,978,883		111,978,883
25 Deferred Regulatory Assets	86,705,101		86,705,101
26 Other Deferred Debits	73,873,090		73,873,090
27 Total Other Assets	<u>296,894,982</u>	-	<u>296,894,982</u>
28 <b>TOTAL ASSETS</b>	<u>2,707,221,592</u>	<u>(11,378,989)</u>	<u>2,695,842,603</u>
29			
30 <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
31 CAPITALIZATION			
32 Common Shareholders' Equity	(906,432,535)	42,997,728 (2)	(863,434,807)
33 Preferred Stock	(70,424,594)		(70,424,594)
34 Long-Term Debt	(797,769,753)		(797,769,753)
35			
36 CURRENT LIABILITIES			
37 Notes Payable to Associated Companies	(75,132,051)		(75,132,051)
38 <b>TOTAL CAPITAL STRUCTURE</b>	<u>(1,849,758,933)</u>	<u>42,997,728</u>	<u>(1,806,761,205)</u>
39			
40 Accounts Payable	(60,894,610)	(62,478,011) (3)	(123,372,621)
41 Accounts Payable to Associated Companies	(23,357,066)		(23,357,066)
42 Taxes Accrued	(12,933,270)	30,859,272 (4)	17,926,002
43 Customer Deposits	(9,950,348)		(9,950,348)
44 Interest Accrued	(6,087,809)		(6,087,809)
45 Dividends Declared	(442,592)		(442,592)
46 Misc. Current & Accrued Liabilities	(3,764,361)		(3,764,361)
47 Total Current Liabilities	<u>(117,430,056)</u>	<u>(31,618,739)</u>	<u>(149,048,795)</u>
48			
49 DEFERRED CREDITS AND OTHER			
50 Accumulated Deferred Income Taxes	(456,138,439)		(456,138,439)
51 Investment Tax Credit	(51,380,228)		(51,380,228)
52 Regulatory Liabilities	(44,779,585)		(44,779,585)
53 Customer Advances for Construction	(9,700,499)		(9,700,499)
54 Asset Retirement Obligations	(9,792,529)		(9,792,529)
55 Other Deferred Credits	(34,398,681)		(34,398,681)
56 Misc. Long-Term Liabilities	(76,551,429)		(76,551,429)
57 Accum. Provision for Post-Retirement Benefits	(57,291,213)		(57,291,213)
58 Total Deferred Credits	<u>(740,032,603)</u>	-	<u>(740,032,603)</u>
59 <b>TOTAL LIABILITIES</b>	<u>(2,707,221,592)</u>	<u>11,378,989</u>	<u>(2,695,842,603)</u>

(1) See line 12 and 24, adjustments, Electric Income Statement and line 11, adjustments, Gas Income Statement.

(2) See line 30, adjustments, Electric Income Statement and line 25, adjustments, Gas Income Statement.

(3) See lines 6, 9, 10, 11, 13 adjustments, Electric Income Statement and line 6, 9, 10, 12, adjustments, Gas Income Statement.

(4) See line 14, adjustments, Electric Income Statement and line 13, adjustments, Gas Income Statement.

(5) Consistent with Filing Requirement used in LG&E Case No. 2000-080, only income statement pro-forma adjustments are shown and balance sheet is shown on a total company basis.



**Louisville Gas and Electric Company**  
**Case No. 2003-00433**  
**Historical Test Period Filing Requirements**

**Filing Requirement**  
**807 KAR 5:001 Section 10(7)(b)**  
**Sponsoring Witness: Valerie L. Scott**

**Description of Filing Requirement:**

*Upon good cause shown, a utility may request pro forma adjustments for known and measurable changes to ensure fair, just and reasonable rates based on the historical test period. The following information shall be filed with applications requesting pro forma adjustments or a statement explaining why the required information does not exist and is not applicable to the utility's application:*

*(b) The most recent capital construction budget containing at least the period of time as proposed for any pro forma adjustment for plant additions.*

**Response:**

Not applicable since no pro forma adjustments for plant additions are proposed.



**Louisville Gas and Electric Company**  
**Case No. 2003-00433**  
**Historical Test Period Filing Requirements**

**Filing Requirement**  
**807 KAR 5:001 Section 10(7)(c)**  
**Sponsoring Witness: Valerie L. Scott**

**Description of Filing Requirement:**

*Upon good cause shown, a utility may request pro forma adjustments for known and measurable changes to ensure fair, just and reasonable rates based on the historical test period. The following information shall be filed with applications requesting pro forma adjustments or a statement explaining why the required information does not exist and is not applicable to the utility's application:*

*(c) For each proposed pro forma adjustment reflecting plant additions provide the following information:*

- 1. The starting date of the construction of each major component of plant;*
- 2. The proposed in-service date;*
- 3. The total estimated cost of construction at completion;*
- 4. The amount contained in construction work in progress at the end of the test period;*
- 5. A schedule containing a complete description of actual plant retirements and anticipated plant retirements related to the pro forma plant additions including the actual or anticipated date of retirement;*
- 6. The original cost, cost of removal and salvage for each component of plant to be retired during the period of the proposed pro forma adjustment for plant additions;*

**Louisville Gas and Electric Company  
Case No. 2003-00433  
Historical Test Period Filing Requirements**

**Filing Requirement  
807 KAR 5:001 Section 10(7)(c)  
Sponsoring Witness: Valerie L. Scott**

**Description of Filing Requirement (continued):**

*7. An explanation of any differences in the amounts contained in the capital construction budget and the amounts of capital construction cost contained in the pro forma adjustment period; and*

*8. The impact on depreciation expense of all proposed pro forma adjustments for plant additions and retirements;*

**Response:**

Not applicable since no pro forma adjustments for plant additions are proposed.



**Louisville Gas and Electric Company  
Case No. 2003-00433  
Historical Test Period Filing Requirements**

**Filing Requirement  
807 KAR 5:001 Section 10(7)(d)  
Sponsoring Witness: Valerie L. Scott**

**Description of Filing Requirement:**

*Upon good cause shown, a utility may request pro forma adjustments for known and measurable changes to ensure fair, just and reasonable rates based on the historical test period. The following information shall be filed with applications requesting pro forma adjustments or a statement explaining why the required information does not exist and is not applicable to the utility's application:*

*(d) The operating budget for each period encompassing the pro forma adjustments.*

**Response:**

See attached.





**Louisville Gas and Electric Company  
Case No. 2003-00433  
Historical Test Period Filing Requirements**

**Filing Requirement  
807 KAR 5:001 Section 10(7)(e)  
Sponsoring Witness: W. Steven Seelye**

**Description of Filing Requirement:**

*Upon good cause shown, a utility may request pro forma adjustments for known and measurable changes to ensure fair, just and reasonable rates based on the historical test period. The following information shall be filed with applications requesting pro forma adjustments or a statement explaining why the required information does not exist and is not applicable to the utility's application:*

*(e) The number of customers to be added to the test period-end level of customers and the related revenue requirements impact for all pro forma adjustments with complete details and supporting work papers.*

**Response:**

Please refer to Volume 4, the testimony of W. Steven Seelye. Also, please refer to Volume 5 for Mr. Seelye's Exhibits.