application of coal tax credits

Maintenance expenses increased $12 million in 2008 primarily due to:

- Increased scheduled outage expense ($3 million)
- Increased maintenance of overhead conductors and devices ($3 million) due to storm restoration
- Increased gas distribution expense ($2 million) due to gas main maintenance
- Increased cost for other indirect maintenance ($2 million) due to increased software maintenance lease cost, maintenance fees and labor support
- Increased steam and boiler plant maintenance expense ($2 million) due to increased high energy piping inspections and repairs, scheduled outages, mill overhauls and barge unloading maintenance

Other expense – net increased $34 million in 2008 primarily due to increased expense related to ineffective interest rate swaps ($42 million), partially offset by the gain on the sale of the Company's Waterside property to the Louisville Arena Authority ($9 million). See Note 2 of Notes to Financial Statements.

Interest expense increased $3 million in 2008 primarily due to increased interest expense to affiliated companies ($8 million) due to additional debt, partially offset by decreased interest expense ($5 million) due to interest received on reacquired debt ($4 million) and a terminated cash flow hedge ($1 million).

CRITICAL ACCOUNTING POLICIES/ESTIMATES

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

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

Recent Accounting Pronouncements. Recent accounting pronouncements affecting LG&E are detailed in Note 1 of Notes to Financial Statements.

LIQUIDITY AND CAPITAL RESOURCES

LG&E uses net cash generated from its operations, external financing (including financing from affiliates) and/or infusions of capital from its parent mainly to fund construction of plant and equipment and the payment of dividends. As of December 31, 2008, LG&E had a working capital deficiency of $144 million, primarily due to short-term debt from affiliates associated with the repurchase of certain of its tax-exempt bonds totaling $163 million, and $120 million of tax-exempt bonds which allow the investors to put the bonds back to the Company causing them to be classified as current portion of long-term debt. The repurchased bonds are being held until they can be refinanced or restructured. See Note 7 of Notes to Financial Statements. LG&E believes that its sources of funds will be sufficient to meet the needs of its business in the foreseeable future.

E.ON U.S. and LG&E sponsor pension plans and E.ON U.S. sponsors a postretirement benefit plan for their employees. The performance of the capital markets affects the values of the assets that are held in trust to satisfy future obligations under the defined benefit pension plans. The market value of the combined investments within the plans declined by approximately 29% for the year ended December 31, 2008 due to the recent volatility in the capital markets. The benefit plan assets and obligations of E.ON U.S. and LG&E are remeasured annually using a December 31 measurement date. Investment losses resulted in an increase to the plans' unfunded status upon actuarial revaluation of the plans. Changes in the value of plan assets did not impact the income statement for 2008; however, reduced benefit plan assets will result in increased benefit costs in future years and may increase the amount, and accelerate the timing of, required future funding contributions. The Company anticipates its 2009 pension cost will be approximately $25 million higher than 2008. The amount of future funding will depend upon the actual return on plan assets and other factors, but the Company funds its pension obligations in a manner consistent with the Pension Protection Act of 2006. The amount of such contributions cannot be determined at this time.

Operating Activities

The 2008 net increase in cash provided by operations was $25 million and was primarily the result of increases in cash due to changes in:

- Pension and postretirement funding ($56 million) due to a contribution made in 2007
- Accrued income taxes ($34 million) primarily due to the timing of tax payments
- Gas supply clause receivable ($34 million) due to the timing of GSC collections
- Prepaid pension asset ($28 million) due to market conditions resulting in a liability
- Other current assets and liabilities ($4 million)
- Change in collateral deposit ($2 million)

These increases were partially offset by cash used by changes in:

- Earnings, net of non-cash items ($64 million)
- Materials and supplies ($29 million) due to higher gas cost per Mcf
- Wind storm regulatory asset ($24 million) due to new regulatory asset for Hurricane Ike restoration expenses
- Accounts receivable ($9 million) primarily due to increased heating degree days
- Accounts payable ($4 million)
- Change in hedging derivative liability ($3 million)

Investing Activities

The primary use of funds for investing activities continues to be for capital expenditures. Net cash used for investing activities increased $2 million in 2008 compared to 2007, primarily due to increased capital expenditures of $42 million and a change in restricted cash ($9 million), partially offset by increased non-hedging derivative liability ($30 million), an asset transferred to KU ($10 million) and proceeds from the sale of the Waterside property ($9 million). See Note 2 of Notes to Financial Statements.

Financing Activities

Net cash provided by financing activities decreased $20 million, due to the reacquisition of bonds of $259 million, an issuance of pollution control bonds in 2007 of $125 million and lower long-term borrowings from an affiliated company of $110 million, partially offset by net increased short-term borrowings from an affiliated company of $134 million, the retirement of first mortgage bonds in 2007 of $126 million, the reissuance of reacquired bonds of $95 million, the retirement of preferred stock of $90 million in 2007 and decreased dividend payments of $29 million.

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

Future Capital Requirements

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 and to comply with environmental regulations. These needs are continually being reassessed and appropriate revisions are made, when necessary, in construction schedules. LG&E expects its capital expenditures for the three-year period ending December 31, 2011 to total approximately $690 million, consisting primarily of on-going construction related to distribution assets totaling approximately $345 million, on-going construction related to generation assets totaling approximately $240 million, redevelopment of the Ohio Falls hydroelectric

facility totaling approximately $35 million, construction of TC2 totaling approximately $35 million (including $5 million for environmental controls), and information technology projects of approximately $35 million. See Note 9 of Notes to Financial Statements for additional information.

Future capital requirements may be affected in varying degrees by factors such as electric energy demand load growth, changes in construction expenditure levels, rate actions by regulatory agencies, new legislation, changes in commodity prices and labor rates, changes in environmental regulations and other regulatory requirements. See the Contractual Obligations table below and Note 9 of Notes to Financial Statements for current commitments. LG&E anticipates funding future capital requirements through operating cash flow, debt and/or infusions of capital from its parent.

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

Regulatory approvals are required for LG&E to incur additional debt. The FERC authorizes the issuance of short-term debt while the Kentucky Commission authorizes issuance of long-term debt. In November 2007, LG&E received a two-year authorization from the FERC to borrow up to $400 million in short-term funds. As of December 31, 2008, LG&E has borrowed $222 million of this authorized amount. See Note 8 of Notes to Financial Statements.

A significant portion of LG&E's short-term debt balance ($163 million) is for borrowings incurred to repurchase auction rate tax-exempt bonds. Following the repurchase, the auction rate tax-exempt bonds have been removed from the balance sheet. However, these bonds are being held until they can be refinanced or restructured. Given the uncertainty surrounding the timing of when the bonds could be remarketed to the public due to the current state of the capital markets and the $400 million limit on short-term debt, in October 2008, the Company sought and received authority from the Kentucky Commission to issue up to $100 million of new long-term debt to its affiliate, Fidelia. The Company currently believes this authorization provides the necessary flexibility to address any liquidity needs.

LG&E's debt ratings as of December 31, 2008, were:

	Moody's	S&P
Unenhanced pollution control revenue bonds	A2	BBB+
Issuer rating	A2	-
Corporate credit rating	-	BBB+

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

Contractual Obligations

The following is provided to summarize contractual cash obligations for periods after December 31, 2008. LG&E anticipates cash from operations and external financing will be sufficient to fund future obligations. See Statements of Capitalization.

(in millions)	Payments Due by Period						
Contractual Cash Obligations	2009	2010	2011	2012	2013	Thereafter	Total
Short-term debt (a)	$ 222	$ -	$ -	$ -	$ -	$ -	$ 222
Long-term debt	-	-	-	25	200	671 (b)	896
Interest on long-term debt to affiliated company (c)	27	27	26	26	21	204	331
Interest on fixed rate bonds (d)	8	8	8	7	5	54	90
Operating leases (e)	9	5	4	3	4	5	30
Unconditional power purchase obligations (f)	20	21	21	23	23	349	457
Coal and gas purchase obligations (g)	307	309	308	123	63	-	1,110
Postretirement benefit plan obligations (h)	7	7	8	8	8	37	75
Other obligations (i)	37	2	-	-	-	-	39
Total contractual cash obligations	$ 637	$ 379	$ 375	$ 215	$ 324	$ 1,320	$ 3,250

(a) Represents borrowings from affiliated company due within one year including $163 million used to acquire long-term debt issued by the Company.
(b) Includes long-term debt of $120 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 2026 to 2027. Reacquired bonds totaling $163 million are excluded.
(c) Represents future interest payments on long-term debt to affiliated company.
(d) Represents interest on fixed rate long-term bonds. Future interest obligations on variable rate long-term bonds cannot be quantified.
(e) Represents future operating lease payments.
(f) Represents future minimum payments under OVEC power purchase agreements through 2026.
(g) Represents contracts to purchase coal, natural gas and natural gas transportation. Obligations for 2014 and 2015 are indexed to future market prices and will not be included above until prices are set using the contracted methodology.
(h) Represents currently projected cash flows for the postretirement benefit plan as calculated by the actuary. For pension funding information see Note 5 of Notes to Financial Statements.
(i) Represents construction commitments, including commitments for TC2.

CONTROLS AND PROCEDURES

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

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the

risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

LG&E is not subject to the internal control and other requirements of the Sarbanes-Oxley Act of 2002 and associated rules (the "Act") and consequently is not required to evaluate the effectiveness of the Company's internal control over financial reporting pursuant to Section 404 of the Act. However, management has assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2008 using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control – Integrated Framework.* Management has concluded that, as of December 31, 2008, the Company's internal control over financial reporting was effective based on those criteria.

The effectiveness of the Company's internal control over financial reporting as of December 31, 2008, has been audited by PricewaterhouseCoopers LLP, an independent accounting firm, as stated in its report which is included in the 2008 LG&E financial statements and additional information.

Louisville Gas and Electric Company
Statements of Income
(Millions of $)

	Years Ended December 31	
	2008	2007
OPERATING REVENUES:		
Electric (Note 12)	$1,015	$ 933
Gas	452	353
Total operating revenues	1,467	1,286
OPERATING EXPENSES:		
Fuel for electric generation	345	318
Power purchased (Notes 9 and 12)	118	82
Gas supply expenses	347	254
Other operation and maintenance expenses	311	276
Depreciation and amortization (Note 1)	127	126
Total operating expenses	1,248	1,056
Net operating income	219	230
Other expense - net	35	1
Interest expense (Notes 7 and 8)	24	29
Interest expense to affiliated companies (Note 12)	29	21
Income before income taxes	131	179
Federal and state income taxes (Note 6)	41	59
Net income	$ 90	$ 120

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

Statements of Retained Earnings
(Millions of $)

	Years Ended December 31	
	2008	2007
Balance January 1	$ 690	$ 639
Add net income	90	120
Preferred stock buyback	-	(4)
	780	755
Deduct cash dividends declared on common stock	40	65
Balance December 31	$ 740	$ 690

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

Louisville Gas and Electric Company
Statements of Comprehensive Income
(Millions of $)

	Years Ended December 31	
	2008	2007
Net income	$ 90	$ 120
Gain (loss) on derivative instruments and hedging activities, net of tax benefit of $0 and $2 for 2008 and 2007, respectively (Notes 1 and 3)	(1)	(4)
Comprehensive income	$ 89	$ 116

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

Louisville Gas and Electric Company
Balance Sheets
(Millions of $)

	December 31 2008	December 31 2007
ASSETS:		
Current assets:		
Cash and cash equivalents (Note 1)	$ 4	$ 4
Restricted cash (Note 1)	2	7
Accounts receivable - less reserve of $2 million in 2008 and 2007 (Notes 1 and 12)	203	189
Materials and supplies (Note 1):		
Fuel (predominantly coal)	51	46
Gas stored underground	112	81
Other materials and supplies	32	31
Prepayments and other current assets	7	13
Total current assets	411	371
Utility plant, at original cost (Note 1):		
Electric	3,343	3,246
Gas	599	551
Common	190	178
Total utility plant, at original cost	4,132	3,975
Less: reserve for depreciation	1,690	1,619
Total utility plant, net	2,442	2,356
Construction work in progress	374	344
Total utility plant and construction work in progress	2,816	2,700
Deferred debits and other assets:		
Restricted cash (Note 1)	22	12
Prepaid pension assets	-	14
Regulatory assets (Note 2):		
Pension and postretirement benefits	250	110
Other	132	94
Other assets	6	12
Total deferred debits and other assets	410	242
Total Assets	$ 3,637	$ 3,313

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

Louisville Gas and Electric Company
Balance Sheets (continued)
(Millions of $)

	December 31 2008	December 31 2007
LIABILITIES AND EQUITY:		
Current liabilities:		
Current portion of long-term debt (Note 7)	$ 120	$ 120
Notes payable to affiliated companies (Notes 8 and 12)	222	78
Accounts payable	110	111
Accounts payable to affiliated companies (Note 12)	38	57
Customer deposits	22	19
Other current liabilities	43	34
Total current liabilities	555	419
Long-term debt:		
Long-term bonds (Note 7)	291	454
Long-term debt to affiliated company (Note 7)	485	410
Total long-term debt	776	864
Deferred credits and other liabilities:		
Accumulated deferred income taxes (Note 6)	342	342
Accumulated provision for pensions and related benefits (Note 5)	225	94
Investment tax credit (Note 6)	50	46
Asset retirement obligations	31	30
Regulatory liabilities (Note 2):		
Accumulated cost of removal of utility plant	251	241
Deferred income taxes	45	50
GSC and other	46	19
Derivative liability (Note 3)	55	22
Other liabilities	27	25
Total deferred credits and other liabilities	1,072	869
Commitments and contingencies (Note 9)		
COMMON EQUITY:		
Common stock, without par value -		
Authorized 75,000,000 shares, outstanding 21,294,223 shares	424	424
Additional paid-in capital (Note 12)	84	60
Accumulated other comprehensive income (Note 13)	(14)	(13)
Retained earnings	740	690
Total common equity	1,234	1,161
Total Liabilities and Equity	$ 3,637	$ 3,313

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

Louisville Gas and Electric Company
Statements of Cash Flows
(Millions of $)

	Years Ended December 31	
	2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 90	$ 120
Items not requiring cash currently:		
Depreciation and amortization	127	126
Deferred income taxes - net	(5)	12
Investment tax credit - net	4	5
Gain from disposal of asset	(9)	-
Provision for pension and postretirement plans	(1)	11
Other	2	(2)
Change in certain current assets and liabilities:		
Accounts receivable	(14)	(5)
Materials and supplies	(37)	(8)
Accounts payable	(1)	3
Accrued income taxes	13	(21)
Prepaid pension asset	14	(14)
Other current assets and liabilities	1	(3)
Pension and postretirement funding	(7)	(63)
Gas supply clause receivable, net	13	(21)
Change in hedging derivative liability	3	6
Change in collateral deposit – interest rate swap	(10)	(12)
Wind storm regulatory asset	(24)	-
Other	2	2
Net cash provided by operating activities	161	136
CASH FLOWS FROM INVESTING ACTIVITIES:		
Construction expenditures	(245)	(203)
Assets transferred to affiliate	10	-
Proceeds from sale of asset	9	-
Change in non-hedging derivative liability	30	-
Change in restricted cash	-	9
Net cash used for investing activities	(196)	(194)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Long-term borrowings from affiliated company (Note 7)	75	185
Short-term borrowings from affiliated company (Note 8)	320	134
Repayment of short-term borrowings from affiliated company	(176)	(124)
Retirement of first mortgage bonds	-	(126)
Issuance of pollution control bonds	-	125
Acquisition of outstanding bonds	(259)	-
Reissuance of reacquired bonds	95	-
Retirement of preferred stock	-	(90)
Payment of dividends	(40)	(69)
Additional paid-in capital	20	20
Net cash provided by financing activities	35	55
Change in cash and cash equivalents	-	(3)
Cash and cash equivalents at beginning of year	4	7
Cash and cash equivalents at end of year	$ 4	$ 4
Supplemental disclosures of cash flow information:		
Cash paid during the year for:		
Income taxes	$ 34	$ 62
Interest on borrowed money	20	24
Interest to affiliated companies on borrowed money	22	15

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

Louisville Gas and Electric Company
Statements of Capitalization
(Millions of $)

	December 31 2008	2007
LONG-TERM DEBT (Note 7):		
Pollution control series:		
Jefferson Co. 2000 Series A, due May 1, 2027, 5.375%	$ 25	$ 25
Trimble Co. 2000 Series A, due August 1, 2030, variable %	83	83
Jefferson Co. 2001 Series A, due September 1, 2027, variable %	10	10
Jefferson Co. 2001 Series A, due September 1, 2026, variable %	22	22
Trimble Co. 2001 Series A, due September 1, 2026, variable %	28	28
Jefferson Co. 2001 Series B, due November 1, 2027, variable %	35	35
Trimble Co. 2001 Series B, due November 1, 2027, variable %	35	35
Trimble Co. 2002 Series A, due October 1, 2032, variable %	42	42
Louisville Metro 2003 Series A, due October 1, 2033, variable %	128	128
Louisville Metro 2005 Series A, due February 1, 2035, 5.75%	40	40
Trimble Co. 2007 Series A, due June 1, 2033, 4.60%	60	60
Louisville Metro 2007 Series A, due June 1, 2033, 5.625%	31	31
Louisville Metro 2007 Series B, due June 1, 2033, variable %	35	35
Total pollution control series	574	574
Notes payable to Fidelia:		
Due January 16, 2012, 4.33%, unsecured	25	25
Due April 30, 2013, 4.55%, unsecured	100	100
Due August 15, 2013, 5.31%, unsecured	100	100
Due November 23, 2015, 6.48%, unsecured	50	-
Due July 25, 2018, 6.21%, unsecured	25	-
Due November 26, 2022, 5.72%, unsecured	47	47
Due April 13, 2031, 5.93%, unsecured	68	68
Due April 13, 2037, 5.98 %, unsecured	70	70
Total notes payable to Fidelia	485	410
Total long-term debt outstanding	1,059	984
Less reacquired debt	163	-
Less current portion of long-term debt	120	120
Long-term debt	776	864
COMMON EQUITY:		
Common stock, without par value -		
Authorized 75,000,000 shares, outstanding 21,294,223 shares	424	424
Additional paid-in capital (Note 12)	84	60
Accumulated other comprehensive income (Note 13)	(14)	(13)
Retained earnings	740	690
Total common equity	1,234	1,161
Total capitalization	$ 2,010	$ 2,025

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

Note 1 - Summary of Significant Accounting Policies

LG&E, incorporated in Kentucky in 1913, 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. LG&E provides electric service to approximately 389,000 customers in Louisville and adjacent areas in Kentucky covering approximately 700 square miles in 9 counties. Natural gas service is provided to approximately 314,000 customers in its electric service area and 8 additional counties in Kentucky. Approximately 97% of the electricity generated by LG&E is produced by its coal-fired generating stations, all equipped with systems to reduce SO_2 emissions. The remainder is generated by a hydroelectric power plant and natural gas and oil fueled CTs.

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

Certain reclassification entries have been made to the previous years' financial statements to conform to the 2008 presentation with no impact on net assets, liabilities and capitalization or previously reported net income and net cash flows.

Regulatory Accounting. LG&E is subject to SFAS No. 71, under which regulatory assets are created based on expected recovery from customers in future rates to defer costs that would otherwise be charged to expense. Likewise, regulatory liabilities are created based on expected return to customers in future rates to defer credits that would otherwise be reflected as income, or, in the case of costs of removal, are created to match long-term future obligations arising from the current use of assets. The accounting for regulatory assets and liabilities is based on specific ratemaking decisions or precedent for each item as prescribed by the FERC or the Kentucky Commission. See Note 2, Rates and Regulatory Matters, for additional detail regarding regulatory assets and liabilities.

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

Restricted Cash. A deposit in the amount of $22 million, used as collateral for an $83 million interest rate swap expiring in 2020, is classified as restricted cash on LG&E's balance sheet. Advanced deposits of $2 million relating to projects are also restricted for equipment purchases.

Allowance for Doubtful Accounts. The allowance for doubtful accounts is based on the ratio of the amounts charged-off during the last twelve months to the retail revenues billed over the same period multiplied by the retail revenues billed over the last four months. Accounts with no payment activity are charged-off after four months, although collection efforts continue thereafter.

Materials and Supplies. Fuel, natural gas stored underground and other materials and supplies inventories are accounted for using the average-cost method. Emission allowances are included in other materials and supplies and are not currently traded by LG&E. At December 31, 2008 and 2007, the emission allowances inventory was less than $1 million.

Other Property and Investments. Other property and investments, included in other assets on the balance

sheets, consists of LG&E's investment in OVEC and non-utility plant. LG&E and 11 other electric utilities are participating owners of OVEC, located in Piketon, Ohio. OVEC owns and operates two coal-fired power plants, Kyger Creek Station in Ohio and Clifty Creek Station in Indiana. Pursuant to current contractual agreements, LG&E's share of OVEC's output is 5.63%, approximately 124 Mw of generation capacity.

As of December 31, 2008 and 2007, LG&E's investment in OVEC totaled less than $1 million. LG&E is not the primary beneficiary of OVEC; therefore, it is not consolidated into the Company's financial statements and is accounted for under the cost method of accounting. The direct exposure to loss as a result of its involvement with OVEC is generally limited to the value of its investment. In the event of the inability of OVEC to fulfill its power provision requirements, LG&E anticipates substituting such power supply with either owned generation or market purchases and believes it would generally recover associated incremental costs through regulatory rate mechanisms. See Note 9, Commitments and Contingencies, for further discussion of developments regarding LG&E's ownership interest and power purchase rights.

Utility Plant. Utility plant is stated at original cost, which includes payroll-related costs such as taxes, fringe benefits and administrative and general costs. Construction work in progress has been included in the rate base for determining retail customer rates. LG&E has not recorded any allowance for funds used during construction, in accordance with Kentucky Commission regulations.

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

Depreciation and Amortization. Depreciation is provided on the straight-line method over the estimated service lives of depreciable plant. The amounts provided were approximately 3.1% in 2008 (2.9% electric, 2.7% gas and 7.3% common); and 3.2% in 2007 (3.0% electric, 2.8% gas and 7.7% common) of average depreciable plant. Of the amount provided for depreciation, at December 31, 2008, approximately 0.4% electric, 0.9% gas and 0.1% common were related to the retirement, removal and disposal costs of long lived assets. Of the amount provided for depreciation, at December 31, 2007, approximately 0.4% electric, 0.8% gas and 0.1% common were related to the retirement, removal and disposal costs of long lived assets.

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

Income Taxes. Income taxes are accounted for under SFAS No. 109, *Accounting for Income Taxes* and FIN 48, *Accounting for Uncertainty in Income Taxes, an Interpretation of SFAS No. 109*. In accordance with these statements, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, as measured by enacted tax rates that are expected to be in effect in the periods when the deferred tax assets and liabilities are expected to be settled or realized. Significant judgment is required in determining the provision for income taxes, and there are transactions for which the ultimate tax outcome is uncertain. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Uncertain tax positions are analyzed periodically

and adjustments are made when events occur to warrant a change. See Note 6, Income Taxes.

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

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

Revenue Recognition. Revenues are recorded based on service rendered to customers through month-end. LG&E accrues an estimate for unbilled revenues from each meter reading date to the end of the accounting period based on allocating the daily system net deliveries between billed volumes and unbilled volumes. The allocation is based on a daily ratio of the number of meter reading cycles remaining in the month to the total number of meter reading cycles in each month. Each day's ratio is then multiplied by each day's system net deliveries to determine an estimated billed and unbilled volume for each day of the accounting period. The unbilled revenue estimates included in accounts receivable were $73 million and $65 million at December 31, 2008 and 2007, respectively.

Fuel and Gas Costs. The cost of fuel for electric generation is charged to expense as used, and the cost of natural gas supply is charged to expense as delivered to the distribution system. LG&E operates under a Kentucky Commission-approved performance-based ratemaking mechanism related to natural gas procurement activity. See Note 2, 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. Accrued liabilities, including legal and environmental, are recorded when they are probable and estimable. Actual results could differ from those estimates.

Recent Accounting Pronouncements. The following are recent accounting pronouncements affecting LG&E:

SFAS No. 161

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133,* which is effective for fiscal years, and interim periods within those fiscal years, beginning on or after November 15, 2008. The objective of this statement is to enhance the current disclosure framework in SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities, as amended.* The adoption of SFAS No. 161 will have no impact on LG&E's statements of operations, financial position and cash flows, however, additional disclosures relating to derivatives will be required beginning in the first quarter of 2009.

SFAS No. 160

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements,* which is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. The objective of this statement is to improve the relevance, comparability and transparency of financial information in a reporting entity's consolidated financial statements. The Company expects the adoption of SFAS No. 160 to have no impact on its statements of operations, financial position and cash flows.

SFAS No. 159

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities – Including an Amendment of FASB Statement No. 115*. SFAS No. 159 permits entities to choose to measure many financial instruments and certain other assets and liabilities at fair value on an instrument-by-instrument basis (the fair value option). Unrealized gains and losses on items for which the fair value option has been elected are to be recognized in earnings at each subsequent reporting date. SFAS No. 159 was adopted effective January 1, 2008 and the Company elected not to fair value its eligible financial assets and liabilities.

SFAS No. 157

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, which, except as described below, is effective for fiscal years beginning after November 15, 2007. This statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 does not expand the application of fair value accounting to new circumstances. In February 2008, the FASB issued FASB Staff Position 157-2, *Effective Date of FASB Statement No. 157,* which delays the effective date of SFAS No. 157 for all nonfinancial assets and liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. All other amendments related to SFAS No. 157 have been evaluated and have no impact on the Company's financial statements. SFAS No. 157 was adopted effective January 1, 2008, except as it applies to those nonfinancial assets and liabilities, and had no impact on the statements of operations, financial position and cash flows, however, additional disclosures relating to its financial derivatives and cash collateral on derivatives, as required, are now provided. Per FASB Staff Position 157-2, fair value accounting for all nonrecurring fair value measurements of nonfinancial assets and liabilities will be adopted effective January 1, 2009.

Note 2 - Rates and Regulatory Matters

The Company is subject to the jurisdiction of the Kentucky Commission and the FERC in virtually all matters related to electric and gas utility regulation, and as such, its accounting is subject to SFAS No. 71. Given its position in the marketplace and the status of regulation in Kentucky, there are no plans or intentions to discontinue the application of SFAS No. 71.

Electric and Gas Rate Cases

In July 2008, LG&E filed an application with the Kentucky Commission requesting increases in base electric and gas rates. In conjunction with the filing of the application for changes in base rates, based on previous Orders by the Kentucky Commission approving settlement agreements among all interested

parties, the VDT surcredit terminated in August 2008. In January 2009, LG&E, the AG, KIUC and all other parties to the rate cases filed a settlement agreement with the Kentucky Commission, under which LG&E's base gas rates will increase by $22 million annually, and base electric rates will decrease by $13 million annually. An Order approving the settlement agreement was received in February 2009. The new rates were implemented effective February 6, 2009, at which time the merger surcredit terminated.

The VDT surcredit originated in December 2001, when the Kentucky Commission issued an Order approving a settlement agreement allowing LG&E to set up a regulatory asset of $141 million for workforce reduction costs and begin amortizing it over a five-year period starting in April 2001. The Order also provided for a surcredit to be included on customers' bills representing 40% of the annual savings derived from this initiative. For periods beginning January 1, 2006, the VDT surcredit had increased to $9 million per year.

In February 2006, LG&E and all parties to the proceeding reached a unanimous settlement agreement on the future ratemaking treatment of the VDT surcredit. Under the terms of the settlement agreement, the VDT surcredit continued at its current level until such time as LG&E filed for a change in electric or natural gas base rates. The Kentucky Commission issued an Order in March 2006, approving the settlement agreement. In accordance with the Order, the VDT surcredit terminated in August 2008, the first billing month after the July 2008 filing for a change in base rates.

The merger surcredit originated as part of the LG&E Energy merger with KU Energy Corporation in 1998. It was based on estimated non-fuel savings over a ten-year period following the merger. Costs to achieve these savings were deferred and amortized over a five-year period pursuant to regulatory orders. 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. These savings were provided in the form of a surcredit mechanism on customers' bills. In October 2003, the Kentucky Commission issued an Order approving a unanimous settlement agreement reached with all parties to the case in which the merger surcredit of $18 million per year would remain in place for another five-year term beginning July 1, 2003, and LG&E would file a plan for the merger surcredit six months before its expiration.

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

Regulatory Assets and Liabilities

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

(in millions)	2008	2007
ARO	$ 29	$ 24
GSC	28	16
MISO exit	12	13
Unamortized loss on bonds	24	19
FAC	7	9
ECR	4	4
Hurricane Ike	24	-
Other	4	9
Subtotal	132	94
Pension and postretirement benefits	250	110
Total regulatory assets	$ 382	$ 204
Accumulated cost of removal of utility plant	$ 251	$ 241
Deferred income taxes – net	45	50
GSC ($29 million and $10 million at December 31, 2008 and 2007, respectively) and other	46	19
Total regulatory liabilities	$ 342	$ 310

LG&E does not currently earn a rate of return on the GSC, FAC and gas performance-based ratemaking regulatory assets (included in "Other" above), all of which are separate recovery mechanisms with recovery within twelve months. No return is earned on the pension and postretirement benefits regulatory asset that represents the changes in funded status of the plans. LG&E will recover this asset through pension expense included in the calculation of base rates. No return is currently earned on the ARO asset. This regulatory asset will be offset against the associated regulatory liability, ARO asset and ARO liability at the time the underlying asset is retired. The MISO exit amount represents the costs relating to the withdrawal from MISO membership. Approval for the recovery of this asset was received from the Kentucky Commission as part of the 2008 base rate case. LG&E earns a rate of return on remaining regulatory assets, including other regulatory assets comprised of VDT costs (2007 only), merger surcredit, gas performance based ratemaking and Mill Creek Ash Pond costs. Other regulatory assets also include KCCS funding (see CMRG and KCCS Contributions below) and rate case expenses. LG&E will seek recovery of the KCCS funding in the next base rate case and received approval for the recovery of the rate case expenses as part of the 2008 base rate case. Other regulatory liabilities include DSM and MISO costs included in base rates that will be netted against costs of withdrawing from the MISO as part of the settlement agreement in the 2008 base rate case.

ARO. A summary of LG&E's net ARO assets, regulatory assets, ARO liabilities, regulatory liabilities and cost of removal established under FIN 47, *Accounting for Conditional Asset Retirement Obligations,*

an Interpretation of SFAS No. 143, and SFAS No. 143, *Accounting for Asset Retirement Obligations* follows:

(in millions)	ARO Net Assets	ARO Liabilities	Regulatory Assets	Regulatory Liabilities	Accumulated Cost of Removal
As of December 31, 2006	$ 4	$ (28)	$ 22	$ -	$ 3
ARO accretion	-	(2)	2	-	-
Removal cost incurred	-	1	-	-	-
As of December 31, 2007	4	(29)	24	-	3
ARO accretion	-	(2)	2	-	-
Removal cost reclass	-	-	3	(3)	-
As of December 31, 2008	$ 4	$ (31)	$ 29	$ (3)	$ 3

Pursuant to regulatory treatment prescribed under SFAS No. 71, an offsetting regulatory credit was recorded in depreciation and amortization in the income statement of $2 million in 2008 and 2007 for the ARO accretion and depreciation expense. LG&E AROs are primarily related to the final retirement of assets associated with generating units and natural gas wells. For assets associated with AROs, the removal cost accrued through depreciation under regulatory accounting is established as a regulatory liability pursuant to regulatory treatment prescribed under SFAS No. 71. There were no FIN 47 net asset additions during 2008 or 2007. For the year ended December 31, 2008, removal costs incurred were less than $1 million. For the years ended December 31, 2008 and 2007, LG&E recorded less than $1 million of depreciation expense related to the cost of removal of ARO related assets. An offsetting regulatory liability was established pursuant to regulatory treatment prescribed under SFAS No. 71.

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 are recorded for transmission and distribution assets.

GSC. LG&E's natural gas rates contain a GSC, whereby increases or decreases in the cost of natural 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 natural gas supply in that quarter. In addition, the GSC contains a mechanism whereby any over- or under-recoveries of natural gas supply cost from prior quarters is to be refunded to or recovered from customers through the adjustment factor determined for subsequent quarters.

LG&E's GSC was modified in 1997 to incorporate a natural gas procurement incentive mechanism. Since November 1, 1997, LG&E has operated under this PBR mechanism related to its natural gas procurement activities. LG&E's rates are adjusted annually to recover (or refund) its portion of the expense (or savings) incurred during each PBR year (12 months ending October 31). During the PBR year ending in 2008, LG&E achieved $11 million in savings. Of that total savings amount, LG&E's portion was approximately $3 million and the customers' portion was approximately $8 million. Pursuant to the extension of LG&E's natural gas supply cost PBR mechanism effective November 1, 2001, the sharing mechanism under the PBR requires savings (and expenses) to be shared 25% with shareholders and 75% with customers up to 4.5% of the benchmarked natural gas costs. Savings (and expenses) in excess of 4.5% of the benchmarked natural gas costs are shared 50% with shareholders and 50% with customers. The current natural gas supply cost PBR mechanism was extended through 2010 without further modification.

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

LG&E and the MISO have agreed upon overall calculation methods for the contractual exit fee to be paid by the Company following its withdrawal. In October 2006, the Company paid $13 million to the MISO pursuant to an invoice regarding the exit fee and made related FERC compliance filings. The Company's payment of this exit fee amount was with reservation of its rights to contest the amount, or components thereof, following a continuing review of its calculation and supporting documentation. LG&E and the MISO resolved their dispute regarding the calculation of the exit fee and, in November 2007, filed an application with the FERC for approval of a recalculation agreement. In March 2008, the FERC approved the parties' recalculation of the exit fee, and the approved agreement provided LG&E with an immediate recovery of less than $1 million and an estimated $2 million over the next seven years for credits realized from other payments the MISO will receive, plus interest. In accordance with Kentucky Commission Orders approving the MISO exit, LG&E has established a regulatory asset for the exit fee, subject to adjustment for possible future MISO credits, and a regulatory liability for certain revenues associated with former MISO administrative charges, which continue to be collected via base rates. The approved base rate case settlement provided for MISO Schedule 10 expenses collected through base rates from May 1, 2008 to February 6, 2009, and any future adjustments to the MISO exit fee, to be established as a regulatory liability until the amounts can be amortized in future base rate cases.

In November 2008, the FERC issued Orders in industry-wide proceedings relating to MISO RSG calculation and resettlement procedures. RSG charges are amounts assessed to various participants active in the MISO trading market which generally seek to compensate for uneconomic generation dispatch due to regional transmission or power market operational considerations, with some customer classes eligible for payments, while others may bear charges. The FERC Orders approved two requests for significantly altered formulas and principles, each of which the FERC applied differently to calculate RSG charges for various historical and future periods. LG&E and other parties have requested rehearing and a delay in any collection of RSG amounts. During January and February 2009, the FERC issued a deficiency letter in the proceeding relating to one prior Order, which delays collection of applicable RSG resettlements by the MISO pending further proceedings. Further developments in the RSG proceeding are expected to occur during 2009. Due to the numerous participants, complex principles at issue and changes from prior precedents, LG&E cannot predict the ultimate outcome of this matter. Based upon the recent FERC Orders, LG&E established a reserve during the fourth quarter of 2008, of $2 million relating to potential RSG resettlement costs for the period ended December 31, 2008.

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

FAC. LG&E's retail electric rates contain an FAC, whereby increases and decreases in the cost of fuel for electric generation are reflected in the rates charged to retail electric customers. The FAC allows the Company to adjust customers' accounts for the difference between the fuel cost component of base rates

and the actual fuel cost, including transportation costs. Refunds to customers occur if the actual costs are below the embedded cost component. Additional charges to customers occur if the actual costs exceed the embedded cost component. The amount of the regulatory asset or liability is the amount that has been under- or over-recovered due to timing or adjustments to the mechanism.

The Kentucky Commission requires public hearings at six-month intervals to examine past fuel adjustments, and at two-year intervals to review past operations of the fuel clause and transfer of the then current fuel adjustment charge or credit to the base charges.

In January 2009, the Kentucky Commission initiated a routine examination of LG&E's FAC for the two-year period November 1, 2006 through October 31, 2008. A public hearing is scheduled in March 2009. An order is anticipated in the second quarter of 2009.

In August 2008, the Kentucky Commission initiated a routine examination of LG&E's FAC for the six-month period November 1, 2007 through April 30, 2008. The Kentucky Commission issued an Order in January 2009, approving the charges and credits billed through the FAC during the review period.

In January 2008, the Kentucky Commission initiated a routine examination of LG&E's FAC for the six-month period May 1, 2007 through October 31, 2007. The Kentucky Commission issued an Order in May 2008, approving the charges and credits billed through the FAC during the review period.

In August 2007, the Kentucky Commission initiated a routine examination of LG&E's FAC for the six-month period of November 1, 2006 through April 30, 2007. The Kentucky Commission issued an Order in January 2008, approving the charges and credits billed through the FAC during the review period.

In December 2006, the Kentucky Commission initiated its periodic two-year review of LG&E's past operations of the fuel clause and transfer of fuel costs from the FAC to base rates for November 1, 2004 through October 31, 2006. In March 2007, the KIUC challenged LG&E's recovery of approximately $1 million in aggregate fuel costs LG&E incurred during a period prior to its exit from the MISO and requested the Kentucky Commission disallow this amount. A public hearing was held in May 2007. In October 2007, the Kentucky Commission issued its Order approving the calculation and application of LG&E's FAC charges and fuel procurement practices and indicated that LG&E was in compliance with the provisions of Administrative Regulation 807 KAR 5:5056. The Kentucky Commission further approved LG&E's recommendation for the transfer of fuel cost from the FAC to base rates. In November 2007, the KIUC filed a petition for rehearing, claiming the Kentucky Commission misinterpreted the KIUC's arguments in the proceeding. In the same month, the Kentucky Commission issued an Order denying the KIUC's request for rehearing. An appeal was not filed by the KIUC.

In January 2003, the Kentucky Commission reviewed KU's FAC and, as part of the Order in that case, required that an independent audit be conducted to examine operational and management aspects of both LG&E's and KU's fuel procurement functions. The final report's recommendations, issued in February 2004, related to documentation and process improvements. Management Audit Action Plans were agreed upon by LG&E and the Kentucky Commission Staff in the second quarter of 2004, and resulted in Audit Progress Reports being filed by LG&E with the Kentucky Commission. In February 2007, the Kentucky Commission staff indicated that LG&E fully complied with all audit recommendations and that no further reports are required.

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

recovered due to timing or adjustments to the mechanism.

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

In January 2009, the Kentucky Commission initiated a six-month review for the period ending October 31, 2008, of LG&E's environmental surcharge. An order is anticipated in the second quarter of 2009.

In June 2008, the Kentucky Commission initiated two six-month reviews for periods ending October 31, 2007 and April 30, 2008, of LG&E's environmental surcharge. The Kentucky Commission issued an Order in August 2008, approving the charges and credits billed through the ECR during the review period and the rate of return on capital.

In September 2007, the Kentucky Commission initiated six-month and two-year reviews for periods ending October 31, 2006 and April 30, 2007, respectively, of LG&E's environmental surcharge. The Kentucky Commission issued a final Order in March 2008, approving the charges and credits billed through the ECR during the review periods, as well as approving billing adjustments, roll-in adjustments to base rates, revisions to the monthly surcharge filing and the rates of return on capital.

Hurricane Ike. In September 2008, high winds from the remnants of Hurricane Ike passed through the service territory causing significant outages and system damage. In October 2008, LG&E filed an application with the Kentucky Commission requesting approval to establish a regulatory asset, and defer for future recovery, approximately $24 million of expenses related to the storm restoration. In December 2008, the Kentucky Commission issued an Order allowing the Company to establish a regulatory asset of up to $24 million based on its actual costs for storm damages and service restoration due to Hurricane Ike.

Mill Creek Ash Pond Costs. In June 2005, the Kentucky Commission issued an Order approving the establishment of a regulatory asset for $6 million in costs related to the removal of ash from the Mill Creek ash pond, and authorized amortization over four years beginning in May 2006.

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

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

Pension and Postretirement Benefits. LG&E adopted SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans,* in 2006. This statement requires employers to recognize the over-funded or under-funded status of a defined benefit pension and postretirement plan as an asset or liability in the balance sheet and to recognize through other comprehensive income the changes in the funded status in the year in which the changes occur. Under SFAS No. 71, LG&E can defer recoverable costs that would otherwise be charged to expense or equity by non-regulated entities. Current rate recovery in Kentucky is based on SFAS No. 87, *Employers' Accounting for Pensions,* and SFAS No. 106, *Employers' Accounting for Postretirement Benefits Other than Pensions,* both of which were amended by SFAS No. 158. Regulators have been clear and consistent with their historical treatment of such rate recovery, therefore, the Company has recorded a regulatory asset representing the change in funded status of the pension and postretirement plans that is expected to be recovered. The regulatory asset will be adjusted annually as prior service cost and actuarial gains and losses are recognized in net periodic benefit cost.

Accumulated Cost of Removal of Utility Plant. As of December 31, 2008 and 2007, LG&E has segregated the cost of removal, previously embedded in accumulated depreciation, of $251 million and $241 million, respectively, in accordance with FERC Order No. 631. This cost of removal component is for assets that do not have a legal ARO under SFAS No. 143. For reporting purposes in the balance sheets, LG&E has presented this cost of removal as a regulatory liability pursuant to SFAS No. 71.

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

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

In July 2007, LG&E and KU filed an application with the Kentucky Commission requesting an order approving enhanced versions of the existing DSM programs along with the addition of several new cost effective programs. The total annual budget for these programs is approximately $26 million, an increase over the previous annual costs of approximately $10 million. In March 2008, the Kentucky Commission issued an Order approving the application, with minor modifications. LG&E and KU filed revised tariffs in April 2008, under authority of this Order, which were effective in May 2008.

Other Regulatory Matters

Storm Restoration. In January 2009, a significant winter ice storm passed through LG&E's service territory causing approximately 205,000 customer outages, followed closely by a severe wind storm in February 2009, causing approximately 37,000 customer outages. LG&E currently estimates costs incurred of $34 million of expenses and $6 million of capital expenditures related to the restoration following the two storms. The Company expects to seek recovery of these costs from the Kentucky Commission.

Regional Reliability Council. LG&E has changed its regional reliability council membership from the Reliability First Corporation to the SERC, effective January 1, 2007. Regional reliability councils are industry consortiums that promote, coordinate and ensure the reliability of the bulk electric supply systems in North America.

Arena. In August 2006, LG&E filed an application with the Kentucky Commission requesting approval for the sale of its Waterside property to the Louisville Arena Authority. The Kentucky Commission issued an Order in September 2006, approving the proposed transaction. In November 2006, LG&E completed certain agreements pursuant to its August 2006 Memorandum of Understanding with the Louisville Arena Authority regarding the proposed construction of an arena in downtown Louisville. LG&E entered into a relocation agreement with the Louisville Arena Authority providing for the reimbursement to LG&E of the costs to be incurred in relocating certain LG&E facilities related to the arena transaction. These costs are currently estimated to be approximately $63 million. As of December 31, 2008, approximately $58 million of the estimated total costs have been received. The relocation work is expected to be completed during 2009. The parties further entered into a property sale contract providing for LG&E's sale of a downtown site to the Louisville Arena Authority which was completed for $9 million in September 2008. The contract amounts are subject to potential adjustments for certain cost or expense variances related to potential future demolition, construction or site environmental developments, although the Company does not currently anticipate such events.

TC2 CCN Application and Transmission Matters. A CCN application for construction of the new base-load, coal fired unit known as TC2, which will be jointly owned by LG&E and KU, together with the IMEA and the IMPA, was approved by the Kentucky Commission in November 2005.

CCN applications for two transmission lines associated with the TC2 unit were approved by the Kentucky Commission in September 2005 and May 2006. All regulatory approvals and rights of way for one transmission line have been obtained.

The CCN for the remaining line has been challenged by certain Hardin County, Kentucky property owners. In August 2006, LG&E and KU obtained a successful dismissal of the challenge at the Franklin County circuit court, which ruling was reversed by the Kentucky Court of Appeals in December 2007, and the proceeding reinstated. The matter is currently before the Kentucky Supreme Court on a motion for discretionary review filed by LG&E and KU in May 2008. The motion, which seeks reversal of the appellate court decision and reinstatement of the circuit court dismissal of the challenge has not yet been ruled upon.

Completion of the transmission lines are also subject to standard construction permit, environmental authorization and real property or easement acquisition procedures and certain Hardin County landowners have raised challenges to such transmission line in some of these forums as well. During 2008, LG&E and KU obtained various successful rulings at the Hardin County circuit court establishing their condemnation and easement rights. In August 2008, the landowners appealed such rulings to the Kentucky Court of Appeals and received a stay preventing LG&E and KU access to the properties during the appeal. LG&E and KU have petitioned the appellate court to lift the stay and otherwise sustain the lower court ruling, but such matter has not yet been ruled upon. In a separate proceeding, certain Hardin County landowners have also challenged the same transmission line in federal district court in Louisville, Kentucky, claiming that certain National Historic Preservation Act requirements were not fully complied with by the U.S. Army relating to easements for the line through Fort Knox. LG&E and KU are cooperating with the U.S. Army in its defense in this case.

LG&E and KU continue to actively engage in settlement negotiations with the Hardin County property owners involved in the appeals of the condemnation proceedings. During the fourth quarter of 2008, LG&E and KU entered into settlements with certain Meade County landowners and obtained dismissals of prior litigation they had brought challenging the same transmission line. LG&E and KU are not currently able to predict the ultimate outcome and possible effects, if any, on the construction schedule

relating to these transmission line approval and land acquisition proceedings.

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

Mandatory Reliability Standards. As a result of the EPAct 2005, certain formerly voluntary reliability standards became mandatory in June 2007, and authority was delegated to various RROs by the NERC, which was authorized by the FERC to enforce compliance with such standards, including promulgating new standards. Failure to comply with mandatory reliability standards can subject a registered entity to sanctions, including potential fines of up to $1 million per day, as well as non-monetary penalties, depending upon the circumstances of the violation. LG&E is a member of the SERC, which acts as LG&E's RRO. During May 2008, the SERC and LG&E agreed to a settlement involving penalties totaling less than $1 million related to LG&E's February 2008 self-report concerning possible violations of certain existing mitigation plans relating to reliability standards. The SERC and LG&E are currently involved in settlement negotiations concerning a June 2008 self-report by LG&E relating to three other standards and an October 2008 self-report of a possible violation relating to an additional standard. SERC proceedings for these June and October self-reports are in the early stages and therefore the outcome is unable to be determined. Mandatory reliability standard settlements commonly include other non-penalty elements, including compliance steps and mitigation plans. Settlements with the SERC proceed to NERC and FERC review before becoming final. In December 2008, the SERC commenced a routine, periodic audit of LG&E and KU relating to certain designated reliability standards. This audit was completed during the first quarter of 2009 with no violations identified. While LG&E believes itself to be in compliance with the mandatory reliability standards, the Company cannot predict the outcome of other analyses, including on-going SERC or other reviews described above.

IRP. Integrated resource planning regulations in Kentucky require major utilities to make triennial IRP filings with the Kentucky Commission. In April 2008, LG&E and KU filed their 2008 joint IRP with the Kentucky Commission. The IRP provides historical and projected demand, resource and financial data, and other operating performance and system information. The AG and the KIUC were granted intervention in the IRP proceeding. During September 2008, LG&E and KU responded to public comments and they are awaiting the Kentucky Commission staff report which will close this proceeding. LG&E and KU are not able to predict further proceedings at this time.

PUHCA 2005. E.ON, LG&E's ultimate parent, is a registered holding company under PUHCA 2005. E.ON, its utility subsidiaries, including LG&E, and certain of its non-utility subsidiaries, are subject to

extensive regulation by the FERC with respect to numerous matters, including: electric utility facilities and operations, wholesale sales of power and related transactions, accounting practices, issuances and sales of securities, acquisitions and sales of utility properties, payments of dividends out of capital and surplus, financial matters and inter-system sales of non-power goods and services. LG&E believes that it has adequate authority (including financing authority) under existing FERC orders and regulations to conduct its business and will seek additional authorization when necessary.

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

In February 2006, the Kentucky Commission initiated an administrative proceeding to consider the requirements of the EPAct 2005, Subtitle E Section 1252, Smart Metering, which concerns time-based metering and demand response, and Section 1254, Interconnections. EPAct 2005 requires each state regulatory authority to conduct a formal investigation and issue a decision on whether or not it is appropriate to implement certain Section 1252, Smart Metering standards within eighteen months after the enactment of EPAct 2005 and to commence consideration of Section 1254, Interconnection standards within one year after the enactment of EPAct 2005. Following a public hearing with all Kentucky jurisdictional electric utilities, in December 2006, the Kentucky Commission issued an Order in this proceeding indicating that the EPAct 2005 Section 1252, Smart Metering and Section 1254, Interconnection standards should not be adopted. However, all five Kentucky Commission jurisdictional utilities are required to file real-time pricing pilot programs for their large commercial and industrial customers. LG&E developed a real-time pricing pilot for large industrial and commercial customers and filed the details of the plan with the Kentucky Commission in April 2007. Data discovery concluded in July 2007, and no parties to the case requested a hearing. In February 2008, the Kentucky Commission issued an Order approving the real-time pricing pilot program proposed by LG&E for implementation within approximately eight months, for its large commercial and industrial customers. The tariff was filed in October 2008, with an effective date of December 1, 2008. LG&E will file annual reports on the program within 90 days of each plan year-end for the 3-year pilot period.

As part of the LG&E 2004 rate case settlement agreements, and as referred to in the Kentucky Commission EPAct 2005 Administrative Order, LG&E made its responsive pricing and smart metering pilot program filing, which addresses real-time pricing for residential and general service customers, in March 2007. The AG and KIUC were granted full intervention. In July 2007, the Kentucky Commission approved the application as filed, for 100 residential customers and a sampling of other customers, and authorized LG&E to establish the responsive pricing and smart metering pilot program, recovery of non-specific customer costs through the DSM billing mechanism and the filing of annual reports by April 1, 2009, 2010 and 2011. LG&E must also file an evaluation of the program by July 1, 2011.

Hydro Upgrade. In October 2005, LG&E received from the FERC a new license to upgrade, operate and maintain the Ohio Falls Hydroelectric Project. The license is for a period of 40 years, effective November 2005. LG&E began refurbishing the facility to add approximately 20 Mw of generating capacity in 2004, and plans to spend approximately $35 million from 2009 to 2011.

Gas Storage Field Matter. In March 2007, LG&E commenced a review of certain federal and state permitting, licensing and oversight matters relating to existing natural gas operations at its Doe Run, Kentucky storage field, which extends into Indiana. Following this review, LG&E submitted an application for Federal Power Act authorization in April 2007. The FERC accepted this application in July 2007, and granted appropriate permit status for retail gas activities and placed these activities in compliance for future periods. In August 2007, the FERC advised LG&E that it had concluded its investigation related to prior periods and had closed the matter with no further actions.

Green Energy Riders. In February 2007, LG&E and KU filed a Joint Application and Testimony for Proposed Green Energy Riders. The AG and KIUC were granted full intervention. In May 2007, a Kentucky Commission Order was issued authorizing LG&E to establish Small and Large Green Energy Riders, allowing customers to contribute funds to be used for the purchase of renewable energy credits.

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

Collection Cycle Revision. In September 2007, LG&E filed an application with the Kentucky Commission to revise the collection cycle for customer bill payments from 15 days to 10 days to more closely align with the KU billing cycle and to avoid confusion for delinquent customers. In April 2008, the Kentucky Commission issued an Order denying LG&E's request to revise its collection cycle without prejudice for refiling the request in a base rate proceeding. As part of the base rate case filed on July 29, 2008, LG&E again proposed to change the due date for customer bill payments from 15 days to 10 days to align its collection cycle with KU. In addition, KU proposed to include a late payment charge if payment is not received within 15 days from the bill issuance date to align with LG&E. The settlement agreement approved in the rate case in February 2009, changed the due date for customer bill payments to 12 days after bill issuance for both LG&E and KU.

Depreciation Study. In December 2007, LG&E filed a depreciation study with the Kentucky Commission as required by a previous Order. An adjustment to the depreciation rates is dependent on an order being received from the Kentucky Commission. In July 2008, LG&E filed a motion to consolidate the procedural schedule of the depreciation study with the application for a change in base rates. In August 2008, the Kentucky Commission issued an Order consolidating the depreciation study with the base rate case proceeding. The settlement agreement in the rate case established new depreciation rates effective February 2009.

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

Interconnection and Net Metering Guidelines. In May 2008, the Kentucky Commission on its own motion initiated a proceeding to establish interconnection and net metering guidelines in accordance

with amendments to existing statutory requirements for net metering of electricity. The jurisdictional electric utilities and intervenors in this case presented proposed interconnection guidelines to the Kentucky Commission in October 2008. In a January 2009 Order, the Kentucky Commission issued the Interconnection and Net Metering Guidelines – Kentucky that were developed by all parties to the proceeding. LG&E does not expect any impact as a result of this Order. LG&E shall file revised net metering tariffs and application forms within ninety days of the Order to comply with the new guidelines.

EISA 2007 Standards. In November 2008, the Kentucky Commission initiated an administrative proceeding to consider new standards as a result of the Energy Independence and Security Act of 2007 ("EISA 2007"), part of which amends the Public Utility Regulatory Policies Act of 1978 ("PURPA"). There are four new PURPA standards and one non-PURPA standard applicable to electric utilities. The proceeding also considers two new PURPA standards applicable to natural gas utilities. EISA 2007 requires state regulatory commissions and nonregulated utilities to begin consideration of the rate design and smart grid investments no later than December 19, 2008 and to complete the consideration by December 19, 2009.

Note 3 - Financial Instruments

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

	2008		2007	
(in millions)	Carrying Value	Fair Value	Carrying Value	Fair Value
Long-term debt (including current portion of $120 million)	$ 411	$ 392	$ 574	$ 571
Long-term debt from affiliate	$ 485	$ 458	$ 410	$ 438
Interest-rate swaps - liability	$ 55	$ 55	$ 21	$ 21

The long-term debt valuations reflect prices quoted by dealers. The fair value of the long-term debt from affiliate is determined using an internal valuation model that discounts the future cash flows of each loan at current market rates. The current market rates are determined based on quotes from investment banks that are actively involved in capital markets for utilities and factor in LG&E's credit ratings and default risk. The fair values of the swaps reflect price quotes from dealers, consistent with SFAS No. 157. The fair values of cash and cash equivalents, accounts receivable, accounts payable and notes payable are substantially the same as their carrying values.

LG&E is subject to the risk of fluctuating interest rates in the normal course of business. LG&E's policies allow for the interest rate risk to be managed through the use of fixed rate debt, floating rate debt and interest rate swaps. At December 31, 2008, a 100 basis point change in the benchmark rate on LG&E's variable rate debt, not effectively hedged by an interest rate swap, would impact pre-tax interest expense by $4 million annually.

Interest Rate Swaps. LG&E uses over-the-counter interest rate swaps to hedge exposure to market fluctuations in certain of its debt instruments. Pursuant to Company policy, use of these financial instruments is intended to mitigate risk, earnings and cash flow volatility and is not speculative in nature.

The fair value of the interest rate swaps is determined by a quote from the counterparty. This value is verified monthly by LG&E using a model that calculates the present value of future payments under the

swap utilizing current swap market rates obtained from another dealer active in the swap market and validated by market transactions. Market liquidity is considered, however the valuation does not require an adjustment for market liquidity as the market is very active for swaps such as the Company utilizes. LG&E considered the impact of counterparty credit risk by evaluating credit ratings and financial information. All counterparties had strong investment grade ratings at December 31, 2008. LG&E did not have any credit exposure to the swap counterparties, as LG&E was in a liability position at December 31, 2008, therefore, the market valuation required no adjustment for counterparty credit risk. In addition, LG&E and the counterparties have agreed to post margin if the credit exposure exceeds certain thresholds. Using these valuation methodologies, the swap contracts are considered level 2 based on SFAS No. 157 measurement criteria. Cash collateral for interest rate swaps is classified as restricted cash and is a level 1 measurement based on the funds being held in a demand deposit account.

LG&E was party to various interest rate swap agreements with aggregate notional amounts of $179 million and $211 million as of December 31, 2008 and 2007, respectively. Under these swap agreements, LG&E paid fixed rates averaging 4.52% and received variable rates based on LIBOR or the Securities Industry and Financial Markets Association's municipal swap index averaging 1.27% and 3.50% at December 31, 2008 and 2007, respectively. One swap hedging LG&E's $83 million Trimble County 2000 Series A bond has been designated as a cash flow hedge and continues to be highly effective. The remaining interest rate swaps designated to hedge LG&E's $128 million Jefferson County 2003 Series A bond became ineffective during 2008 as a result of the impact of downgrades of the underlying debt associated with issues involving the bond insurers. One swap with a notional value of $32 million was terminated in December 2008. See Note 7, Long-Term Debt.

The interest rate swaps are accounted for on a mark-to-market basis in accordance with SFAS No. 133, as amended. Financial instruments designated as effective cash flow hedges have resulting gains and losses recorded within other comprehensive income and stockholders' equity. See Note 13, Accumulated Other Comprehensive Income. The ineffective portion of financial instruments designated as cash flow hedges is recorded to earnings monthly as is the entire change in the market value of the ineffective swaps. LG&E recorded a pre-tax loss of $8 million in other expense (income) during 2008, to reflect the ineffective portion of the interest rate swaps deemed highly effective. LG&E recorded a $36 million mark-to-market loss in earnings on the interest rate swaps related to the Jefferson County 2003 Series A bond after the swaps were deemed ineffective. Amounts recorded in accumulated other comprehensive income will be reclassified into earnings in the same period during which the hedged forecasted transaction affects earnings. The amount expected to be reclassified from other comprehensive income to earnings in the next twelve months is less than $1 million. A deposit in the amount of $22 million, used as collateral for one of the interest rate swaps, is classified as restricted cash on the balance sheet. The amount of the deposit required is tied to the market value of the swap.

A decline of 100 basis points in the current market interest rates would reduce the fair value of LG&E's interest rate swaps by approximately $35 million. Such a change could affect other comprehensive income if the hedge is effective, or the income statement if the hedge is ineffective.

Energy Trading and Risk Management Activities. LG&E conducts energy trading and risk management activities to maximize the value of power sales from physical assets it owns. Energy trading activities are principally forward financial transactions to manage price risk and are accounted for as non-hedging derivatives on a mark-to-market basis in accordance with SFAS No. 133, as amended.

Energy trading and risk management contracts are valued using prices based on active trades on the

Intercontinental Exchange ("ICE"). In the absence of a traded price, midpoints of the best bids and offers will be the primary determinants of valuation. When sufficient trading activity is unavailable, other inputs can include prices quoted by brokers or observable inputs other than quoted prices such as one-sided bids or offers as of the balance sheet date. Using these valuation methodologies, these contracts are considered level 2 based on SFAS No. 157 measurement criteria. Quotes are verified quarterly using an independent pricing source of actual transactions. Quotes for combined off-peak and weekend timeframes are allocated between the two timeframes based on their historical proportional ratios to the integrated cost. No other adjustments are made to the forward prices.

No changes to valuation techniques for energy trading and risk management activities occurred during 2008 or 2007. Changes in market pricing, interest rate and volatility assumptions were made during both years. All contracts outstanding at December 31, 2008 and 2007, had a maturity of less than one year and were considered to be in a liquid market.

LG&E maintains policies intended to minimize credit risk and revalues credit exposures daily to monitor compliance with those policies. At December 31, 2008, 100% of the trading and risk management commitments were with counterparties rated BBB-/Baa3 equivalent or better. LG&E has reserved against counterparty credit risk based on the counterparty's credit rating and applying historical default rates within varying credit ratings over time provided by S&P or Moody's. At December 31, 2008 and 2007, counterparty credit reserves were less than $1 million.

LG&E manages the price volatility of its forecasted electric wholesale sales with the sales of market-traded electric forward contracts. Hedge accounting treatment has not been elected for these transactions, and therefore gains and losses are shown in the statements of income. Unrealized gains and losses are included in other expense – net, whereas realized gains and losses are included in electric revenues. Unrealized losses were $1 million and unrealized gains were less than $1 million in 2008 and 2007, respectively. Realized gains were $3 million and losses were $5 million in 2008 and 2007, respectively.

Effective January 1, 2008, LG&E adopted the required provisions of SFAS No. 157, excluding the exceptions related to nonfinancial assets and liabilities, which will be adopted effective January 1, 2009, consistent with FASB Staff Position 157-2. LG&E has classified the applicable financial assets and liabilities that are accounted for at fair value into the three levels of the fair value hierarchy, as defined by SFAS No. 157.

The following table sets forth by level within the fair value hierarchy LG&E's financial assets and liabilities that were accounted for at fair value on a recurring basis as of December 31, 2008. Cash collateral related to the energy trading and risk management contracts totals less than $1 million, is

categorized as restricted cash and is a level 1 measurement based on the funds being held in liquid accounts. There are no level 3 measurements for this period.

Recurring Fair Value Measurements (in millions)	Level 1	Level 2	Total
Financial Assets:			
Energy trading and risk management contracts	$ -	$ 1	$ 1
Interest rate swap cash collateral	22	-	22
Total Financial Assets	$ 22	$ 1	$ 23
Financial Liabilities:			
Interest rate swaps	$ -	$ 55	$ 55
Total Financial Liabilities	$ -	$ 55	$ 55

Note 4 - Concentrations of Credit and Other Risk

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

LG&E's customer receivables and natural gas and electric revenues arise from deliveries of natural gas to approximately 314,000 customers and electricity to approximately 389,000 customers in Louisville and adjacent areas in Kentucky. For the year ended December 31, 2008, 69% of total revenue was derived from electric operations and 31% from natural gas operations. For the year ended December 31, 2007, 73% of total revenue was derived from electric operations and 27% from natural gas operations. During 2008, LG&E's 10 largest electric and gas customers accounted for less than 10% and less than 15% of total volumes, respectively.

Effective November 2008, LG&E and employees represented by the IBEW Local 2100 signed a three-year collective bargaining agreement. The new agreement provides for negotiated increases or changes to wages, benefits or other provisions. The employees represented by this bargaining agreement comprise approximately 68% of LG&E's workforce at December 31, 2008.

Note 5 - Pension and Other Postretirement Benefit Plans

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

Obligations and Funded Status. The following tables provide a reconciliation of the changes in the plans' benefit obligations and fair value of assets over the two-year period ending December 31, 2008, and a statement of the funded status as of December 31 for LG&E's sponsored defined benefit plans:

(in millions)	Pension Benefits		Other Postretirement Benefits	
	2008	2007	2008	2007
Change in benefit obligation				
Benefit obligation at beginning of year	$ 408	$ 408	$ 89	$ 105
Service cost	4	4	1	1
Interest cost	26	24	5	5
Plan amendments	-	19	2	2
Benefits paid, net of retiree contributions	(28)	(28)	(9)	(9)
Actuarial (gain)/loss and other	19	(19)	-	(15)
Benefit obligation at end of year	$ 429	$ 408	$ 88	$ 89
Change in plan assets				
Fair value of plan assets at beginning of year	$ 409	$ 356	$ 5	$ 6
Actual return on plan assets	(94)	26	-	1
Employer contributions	-	56	7	7
Benefits paid, net of retiree contributions	(28)	(28)	(9)	(9)
Administrative expenses and other	(1)	(1)	-	-
Fair value of plan assets at end of year	$ 286	$ 409	$ 3	$ 5
Funded status at end of year	$ (143)	$ 1	$ (85)	$ (84)

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

(in millions)	Pension Benefits		Other Postretirement Benefits	
	2008	2007	2008	2007
Regulatory assets	$ 233	$ 93	$ 17	$ 17
Non-current assets	-	14	-	-
Accrued benefit liability (current)	-	-	(3)	(3)
Accrued benefit liability (non-current)	(143)	(13)	(82)	(81)

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

(in millions)	Pension Benefits		Other Postretirement Benefits	
	2008	2007	2008	2007
Benefit obligation	$ 429	$ 408	$ 88	$ 89
Accumulated benefit obligation	396	378	-	-
Fair value of plan assets	286	409	3	5

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

Components of Net Periodic Benefit Cost. The following tables provide the components of net periodic benefit cost for pension and other postretirement benefit plans. The tables include the costs associated with both LG&E employees and E.ON U.S. Services' employees, who are providing services to the utility. The E.ON U.S. Services' costs that are allocated to LG&E are approximately 42% of E.ON U.S. Services' total cost for both 2008 and 2007.

(in millions)	Pension Benefits					
	LG&E 2008	Servco Allocation to LG&E 2008	Total LG&E 2008	LG&E 2007	Servco Allocation to LG&E 2007	Total LG&E 2007
Service cost	$ 4	$ 4	$ 8	$ 4	$ 4	$ 8
Interest cost	26	5	31	24	5	29
Expected return on plan assets	(32)	(5)	(37)	(32)	(5)	(37)
Amortization of prior service costs	6	1	7	5	1	6
Amortization of actuarial loss	1	-	1	2	1	3
Benefit cost at end of year	$ 5	$ 5	$ 10	$ 3	$ 6	$ 9

	Other Postretirement Benefits					
	LG&E 2008	Servco Allocation to LG&E 2008	Total LG&E 2008	LG&E 2007	Servco Allocation to LG&E 2007	Total LG&E 2007
Service cost	$ 1	$ 1	$ 2	$ 1	$ 1	$ 2
Interest cost	5	-	5	5	-	5
Amortization of prior service costs	2	-	2	2	-	2
Benefit cost at end of year	$ 8	$ 1	$ 9	$ 8	$ 1	$ 9

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

	2008	2007
Weighted-average assumptions as of December 31:		
Discount rate - Union plan	6.33%	6.56%
Discount rate - Non-union plan	6.25%	6.66%
Rate of compensation increase	5.25%	5.25%

The discount rates were determined by the December 29, 2008, Mercer Pension Discount Yield Curve. These discount rates were then lowered by 2 basis points for the average change in 4 bond indices, Citigroup High Grade Credit Index AAA/AA 10+ years, Lehman Brothers US AA Long Credit, Merrill Lynch US Corporate AA-AAA rated 10+ years and Merrill Lynch US Corporate AA rated 15+ years,

for the period from December 29, 2008 to December 31, 2008.

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

	2008	2007
Discount rate	6.66%	5.96%
Expected long-term return on plan assets	8.25%	8.25%
Rate of compensation increase	5.25%	5.25%

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

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

- A 1% change in the assumed discount rate could have an approximate $47 million positive or negative impact to the 2008 accumulated benefit obligation and an approximate $54 million positive or negative impact to the 2008 projected benefit obligation.
- A 25 basis point change in the expected rate of return on assets would have an approximate $1 million positive or negative impact on 2008 pension expense.

Assumed Health care Cost Trend Rates. For measurement purposes, an 8% annual increase in the per capita cost of covered health care benefits was assumed for 2008. The rate was assumed to decrease gradually to 5% by 2016 and remain at that level thereafter.

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A 1% change in assumed health care cost trend rates would have resulted in an increase or decrease of less than $1 million on the 2008 total of service and interest costs components and an increase or decrease of $2 million in year-end 2008 postretirement benefit obligations.

Expected Future Benefit Payments. The following list provides the amount of expected future benefit payments, which reflect expected future service:

(in millions)	Pension Benefits	Other Postretirement Benefits
2009	$ 27	$ 7
2010	26	7
2011	26	8
2012	26	8
2013	25	8
2014-18	133	37

Plan Assets. The following table shows LG&E's weighted-average asset allocation by asset category at December 31:

Pension Plans	Target Range	2008	2007
Equity securities	45% - 75%	55%	57%
Debt securities	30% - 50%	43	43
Other	0% - 10%	2	-
Totals		100%	100%

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

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

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

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

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

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

Contributions. LG&E made a discretionary contribution to the pension plan of $56 million in January 2007. In addition, contributions to other postretirement benefit plans of $7 million were made in 2008 and 2007. The amount of future contributions to the pension plan will depend upon the actual return on

plan assets and other factors, but the Company funds its pension obligations in a manner consistent with the Pension Protection Act of 2006. In 2009, LG&E anticipates making voluntary contributions to fund Voluntary Employee Beneficiary Association trusts to match the annual postretirement expense and funding the 401(h) plan up to the maximum amount allowed by law.

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

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 $3 million and $2 million for 2008 and 2007, respectively.

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

Note 6 - Income Taxes

A United States consolidated income tax return is filed by E.ON U.S.'s direct parent, E.ON US Investments Corp., for each tax period. Each subsidiary of the consolidated tax group, including LG&E, calculates its separate income tax for each period. The resulting separate-return tax cost or benefit is paid to or received from the parent company or its designee. LG&E also files income tax returns in various state jurisdictions. While the federal statute of limitations related to 2005 and later years are open, Revenue Agent Reports for 2005-2007 have been received from the IRS, effectively closing these years to additional audit adjustments. Adjustments made by the IRS for the 2005-2006 tax years were recorded in the 2008 financial statements. The tax year 2007 return was examined under an IRS pilot program named "Compliance Assurance Process" ("CAP"). This program accelerates the IRS's review to begin during the year applicable to the return and ends 90 days after the return is filed. Preliminary adjustments for 2007 were agreed to in January 2009, and were comprised of $5 million of depreciable temporary differences which will be recorded in 2009. The tax year 2008 return is also being examined under the CAP program.

LG&E adopted the provisions of FIN 48, *Accounting for Uncertainty in Income Taxes, an Interpretation of SFAS No. 109,* effective January 1, 2007. At the date of adoption, LG&E had $1 million of unrecognized tax benefits related to federal and state income taxes. If recognized, the amount of unrecognized tax benefits would reduce the effective income tax rate. Additions and reductions of uncertain tax positions during 2008 and 2007 were less than $1 million. Possible amounts of uncertain

tax positions for LG&E that may decrease within the next 12 months total less than $1 million and are based on the expiration of the audit periods as defined in the statutes.

Interest and penalties, if any, are recorded as operating expenses on the income statement and accrued expenses on the balance sheet. The amount LG&E recognized as interest expense and interest accrued related to unrecognized tax benefits was less than $1 million as of December 31, 2008 and 2007. The interest accrued is based on IRS and Kentucky Department of Revenue large corporate interest rates for underpayment of taxes. At the date of adoption, LG&E accrued less than $1 million in interest expense on uncertain tax positions. No penalties were accrued by LG&E upon adoption of FIN 48, or through December 31, 2008.

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

(in millions)		2008	2007
Current	- federal	$ 37	$ 34
	- state	4	8
Deferred	- federal – net	(2)	10
	- state – net	(2)	2
Investment tax credit – deferred		8	9
Amortization of investment tax credit		(4)	(4)
Total income tax expense		$ 41	$ 59

Current state tax expense decreased due to an increase in coal and recycle credits in 2008. Deferred federal income tax expense decreased at December 31, 2008 compared to December 31, 2007 due to temporary differences for mark-to-market interest rate swaps and GSC.

In June 2006, LG&E and KU filed a joint application with the U.S. Department of Energy ("DOE") requesting certification to be eligible for investment tax credits applicable to the construction of TC2. In November 2006, the DOE and the IRS announced that LG&E and KU were selected to receive the tax credit. A final IRS certification required to obtain the investment tax credit was received in August 2007. In September 2007, LG&E received an Order from the Kentucky Commission approving the accounting of the investment tax credit. LG&E's portion of the TC2 tax credit will be approximately $25 million over the construction period and will be amortized to income over the life of the related property beginning when the facility is placed in service. Based on eligible construction expenditures incurred, LG&E recorded investment tax credits of $8 million and $9 million in 2008 and 2007, respectively, decreasing current federal income taxes. In addition, a full depreciation basis adjustment is required for the amount of the credit. The income tax expense impact of this adjustment will begin when the facility is placed in service.

In March 2008, certain environmental and preservation groups filed suit in federal court in North Carolina against the DOE and IRS claiming the investment tax credit program was in violation of certain environmental laws and demanded relief, including suspension or termination of the program. In August 2008, the plaintiffs submitted an amended complaint alleging additional claims for relief. In November 2008, the Court dismissed the suit; however, the plaintiffs filed a motion for reconsideration. The Company is not currently a party to this proceeding and is not able to predict the ultimate outcome of this matter.

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

(in millions)	2008	2007
Deferred tax liabilities:		
Depreciation and other plant-related items	$ 372	$ 368
Regulatory assets and other	39	30
Pension and related benefits	4	5
Total deferred tax liabilities	415	403
Deferred tax assets:		
Investment tax credit	12	14
Income taxes due to customers	18	19
Liabilities and other	39	24
Total deferred tax assets	69	57
Net deferred income tax liability	$ 346	$ 346
Balance sheet classification		
Current liabilities	$ 4	$ 4
Non-current liabilities	342	342
Net deferred income tax liability	$ 346	$ 346

LG&E expects to have adequate levels of taxable income to realize its recorded deferred tax assets.

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

	2008	2007
Statutory federal income tax rate	35.0 %	35.0 %
State income taxes, net of federal benefit	0.6	3.4
Reduction of income tax reserve	(0.4)	(0.6)
Qualified production activities deduction	(1.0)	(1.1)
Amortization of investment tax credits	(3.0)	(2.2)
Other differences	0.1	(1.5)
Effective income tax rate	31.3 %	33.0 %

State income tax, net of federal benefit decreased due to coal and recycle credits claimed in 2008. Amortization of investment tax credits increased in 2008 due to the level of pre-tax income. Other differences primarily relate to various permanent differences and deferred adjustments.

Note 7 - Long-Term Debt

As of December 31, 2008 and 2007, long-term debt and the current portion of long-term debt consist primarily of pollution control bonds and long-term loans from affiliated companies as summarized below.

($ in millions)	Stated Interest Rates	Maturities	Principal Amounts
Outstanding at December 31, 2008:			
Noncurrent portion	Variable – 6.48%	2012-2037	$ 776
Current portion	Variable	2026-2027	$ 120
Outstanding at December 31, 2007:			
Noncurrent portion	Variable – 5.98%	2012-2037	$ 864
Current portion	Variable	2026-2027	$ 120

Long-term debt includes $120 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. These bonds include Jefferson County Series 2001 A and B and Trimble County Series 2001 A and B. Maturity dates for these bonds range from 2026 to 2027. The average annualized interest rate for these bonds during 2008 and 2007 was 2.34% and 3.66%, respectively.

Pollution control series bonds are obligations of LG&E issued in connection with tax-exempt pollution control revenue bonds issued by various governmental entities, principally counties in Kentucky. A loan agreement obligates LG&E to make debt service payments to the county that equate to the debt service due from the county on the related pollution control revenue bonds. Until a series of financing transactions was completed during April 2007, the county's debt was also secured by an equal amount of LG&E's first mortgage bonds that were pledged to the trustee for the pollution control revenue bonds that match the terms and conditions of the county's debt, but require no payment of principal and interest unless the Company defaults on the loan agreement. Subsequent to April 2007, the loan agreement is an unsecured obligation of LG&E.

Several of the pollution control bonds are or were insured by monoline bond insurers whose ratings have been under pressure due to exposures relating to insurance of sub-prime mortgages. At December 31, 2008, LG&E had an aggregate $574 million (including $163 million of reacquired bonds) of outstanding pollution control indebtedness, of which $135 million is in the form of insured auction rate securities wherein interest rates are reset either weekly or every 35 days via an auction process. Beginning in late 2007, the interest rates on these insured bonds began to increase due to investor concerns about the creditworthiness of the bond insurers. In 2008, interest rates have continued to increase, and the Company has experienced "failed auctions" where there are insufficient bids for the bonds. When there is a failed auction, the interest rate is set pursuant to a formula stipulated in the indenture which can be as high as 15%. During 2008 and 2007, the average rate on the auction rate bonds was 5.90% and 3.77%, respectively. The instruments governing these auction rate bonds permit LG&E to convert the bonds to other interest rate modes, such as various short-term variable rates, long-term fixed rates or intermediate-term fixed rates that are reset infrequently. In 2008, the ratings of the following bonds were downgraded due to downgrades of the bond insurers or the termination of the bond insurance.

($ in millions)		Bond Rating			
		Moody's		S&P	
Tax Exempt Bond Issues	Principal	2008	2007	2008	2007
Jefferson Co. 2000 Series A (1)	$ 25	A2	Aaa	BBB+	AAA
Trimble County 2000 Series A	$ 83	A2	Aaa	A	AAA
Jefferson Co. 2001 Series A	$ 10	A2	Aaa	A	AAA
Trimble County 2002 Series A	$ 42	A2	Aaa	A	AAA
Louisville Metro 2003 Series A	$ 128	A2	Aaa	BBB+	AAA
Louisville Metro 2005 Series A (1)	$ 40	A2	Aaa	BBB+	AAA
Trimble County 2007 Series A	$ 60	A2	Aaa	A	AAA
Louisville Metro 2007 Series A (1)	$ 31	A2	Aaa	BBB+	AAA
Louisville Metro 2007 Series B	$ 35	A2	Aaa	A	AAA

(1) Bond insurance terminated in November 2008 upon restructuring.

In February 2008, LG&E issued a notice to bondholders of its intention to convert the Louisville Metro 2005 Series A and, 2007 Series A and B bonds from the auction rate mode to a weekly interest rate mode, as permitted under the loan documents. These conversions were completed in March 2008, for the 2005 Series, and in April 2008, for the two 2007 Series. In connection with the conversions, LG&E purchased the bonds from the remarketing agent. The Louisville Metro 2005 and 2007 Series A bonds were remarketed in November 2008.

In March 2008, LG&E issued notices to bondholders of its intention to convert the Jefferson County 2000 Series A bonds from the auction mode to a weekly interest rate mode, as permitted under the loan documents. The conversion was completed in May 2008. In connection with the conversion, LG&E purchased the bonds from the remarketing agent. The bonds were remarketed in November 2008.

In June 2008, LG&E issued notices to bondholders of its intention to convert the Louisville Metro 2003 Series A bonds from the auction mode to a weekly interest rate mode, as permitted under the loan documents. The conversion was completed in July 2008. In connection with the conversion, LG&E purchased the bonds from the remarketing agent.

In November 2008, LG&E converted three pollution control bonds to a mode wherein the interest rate is fixed for an intermediate term, but not the full term of the bond. At the end of the intermediate term, the Company must remarket the bonds or buy them back. The terms of the November transactions are:

($ in millions) Series	Principal Amount	Interest Rate	End of Fixed Rate Term
Jefferson County 2000 Series A	$ 25	5.375%	November 30, 2011
Louisville Metro 2007 Series A	$ 31	5.625%	December 2, 2012
Louisville Metro 2005 Series A	$ 40	5.75%	December 1, 2013

At the time of the conversion, the bond insurance policy that had been in place was terminated.

As of December 31, 2008, LG&E continued to hold repurchased bonds in the amount of $163 million.

LG&E will hold some or all of such repurchased bonds until a later date, at which time LG&E may refinance, remarket or further convert such bonds. Uncertainty in markets relating to auction rate securities or steps LG&E has taken or may take to mitigate such uncertainty, such as additional conversion, subsequent restructuring or redemption and refinancing, could result in LG&E incurring increased interest expense, transaction expenses or other costs and fees or experiencing reduced liquidity relating to existing or future pollution control financing structures.

All of LG&E's first mortgage bonds were released and terminated in April 2007. Only the tax-exempt pollution control revenue bonds issued by the counties remain. Under the provisions for certain 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 balance sheets. The average annualized interest rate for these bonds during 2008 and 2007 was 2.34% and 3.66%, respectively.

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. 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. As of December 31, 2008 and 2007, LG&E had swaps with an aggregate notional value of $179 million and $211 million, respectively. See Note 3, Financial Instruments.

Redemptions and maturities of long-term debt for 2008 and 2007 are summarized below:

($ in millions)		Principal		Secured/	
Year	Description	Amount	Rate	Unsecured	Maturity
2007	Pollution control bonds	$ 31	Variable	Secured	2017
2007	Pollution control bonds	$ 60	Variable	Secured	2017
2007	Pollution control bonds	$ 35	Variable	Secured	2013
2007	Mandatorily Redeemable Preferred Stock	$ 20	5.875%	Unsecured	2008

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

($ in millions)		Principal		Secured/	
Year	Description	Amount	Rate	Unsecured	Maturity
2008	Due to Fidelia	$ 50	6.48%	Unsecured	2015
2008	Due to Fidelia	$ 25	6.21%	Unsecured	2018
2007	Pollution control bonds	$ 31	Variable	Unsecured	2033
2007	Pollution control bonds	$ 60	4.60%	Unsecured	2033
2007	Pollution control bonds	$ 35	Variable	Unsecured	2033
2007	Due to Fidelia	$ 70	5.98%	Unsecured	2037
2007	Due to Fidelia	$ 68	5.93%	Unsecured	2031
2007	Due to Fidelia	$ 47	5.72%	Unsecured	2022

In January 2007, the Kentucky Commission issued an Order approving LG&E's application for certain financial transactions, including arrangements which provided a source of funds for the redemption of LG&E's preferred stock. In April 2007, LG&E redeemed all of its outstanding shares of its series of preferred stock at the following redemption prices, respectively, plus an amount equal to accrued and unpaid dividends to the redemption date:

- 860,287 shares of 5% cumulative preferred stock (par value $25 per share) at $28 per share;

- 200,000 shares of $5.875 cumulative preferred stock (without par value) at $100 per share; and
- 500,000 shares of auction rate, series A, cumulative preferred stock (without par value) at $100 per share.

In April 2007, LG&E agreed with Fidelia to eliminate the lien on two secured intercompany loans totaling $125 million. LG&E entered into two long-term borrowing arrangements with Fidelia in an aggregate principal amount of $138 million. The loan proceeds were used to fund the preferred stock redemption and to repay certain short-term loans incurred to fund the pension contribution made by the Company during the first quarter. LG&E also completed a series of financial transactions impacting its periodic reporting requirements. The pollution control revenue bonds issued by certain governmental entities secured by the $31 million Pollution Control Series S, the $60 million Pollution Control Series T and the $35 million Pollution Control Series U bonds were refinanced and replaced with new unsecured tax-exempt bonds of like amounts. Pursuant to the terms of the bonds, an underlying lien on substantially all of LG&E's assets was released following the completion of these steps. LG&E no longer has any secured debt and is no longer subject to periodic reporting under the Securities Exchange Act of 1934.

Long-term debt maturities for LG&E are shown in the following table:

(in millions)	
2009 – 2011	$ -
2012	25
2013	200
Thereafter	671 (a)
Total	$ 896

(a) Includes long-term debt of $120 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 2026 to 2027.

Note 8 - Notes Payable and Other Short-Term Obligations

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

($ in millions)	Total Money Pool Available	Amount Outstanding	Balance Available	Average Interest Rate
December 31, 2008	$ 400	$ 222	$ 178	1.49%
December 31, 2007	$ 400	$ 78	$ 322	4.75%

E.ON U.S. maintains revolving credit facilities totaling $313 million and $150 million at December 31, 2008 and 2007, respectively, to ensure funding availability for the money pool. At December 31, 2008, one facility, totaling $150 million, is with E.ON North America, Inc., while the remaining line, totaling

$163 million, is with Fidelia; both are affiliated companies. The facility as of December 31, 2007, was with E.ON North America, Inc. The balances are as follows:

($ in millions)	Total Available	Amount Outstanding	Balance Available	Average Interest Rate
December 31, 2008	$ 313	$ 299	$ 14	2.05%
December 31, 2007	$ 150	$ 62	$ 88	4.97%

During June 2007, LG&E's five existing lines of credit totaling $185 million expired and were replaced with short-term bilateral lines of credit facilities totaling $125 million. During the third quarter of 2007, LG&E extended the maturity date of these facilities through June 2012. There was no outstanding balance under any of these facilities at December 31, 2008.

The covenants under these revolving lines of credit include the following:

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

LG&E was in compliance with these covenants at December 31, 2008.

Note 9 - Commitments and Contingencies

Operating Leases. LG&E leases office space, office equipment, plant equipment and vehicles and accounts for these leases as operating leases. Total lease expense less amounts contributed by affiliated companies occupying a portion of the office space leased by LG&E, was $6 million and $5 million for 2008 and 2007, respectively. The future minimum annual lease payments for operating leases for years subsequent to December 31, 2008, are shown in the following table:

(in millions)	
2009	$ 9
2010	5
2011	4
2012	3
2013	4
Thereafter	5
Total	$ 30

Sale and Leaseback Transaction. LG&E is a participant in a sale and leaseback transaction involving its 38% interest in two jointly owned CTs at KU's E.W. Brown generating station (Units 6 and 7). Commencing in December 1999, LG&E and KU entered into a tax-efficient, 18-year lease of the CTs. LG&E and KU have provided funds to fully defease the lease, and have executed an irrevocable notice to exercise an early purchase option contained in the lease after 15.5 years. The financial statement treatment of this transaction is no different than if LG&E had retained its ownership. The leasing transaction was entered into following receipt of required state and federal regulatory approvals.

In case of default under the lease, LG&E is obligated to pay to the lessor its share of certain fees or

amounts. Primary events of default include loss or destruction of the CTs, failure to insure or maintain the CTs and unwinding of the transaction due to governmental actions. No events of default currently exist with respect to the lease. Upon any termination of the lease, whether by default or expiration of its term, title to the CTs reverts jointly to LG&E and KU.

At December 31, 2008, the maximum aggregate amount of default fees or amounts was $9 million, of which LG&E would be responsible for 38% (approximately $3 million). LG&E has made arrangements with E.ON U.S., via guarantee and regulatory commitment, for E.ON U.S. to pay LG&E's full portion of any default fees or amounts.

Letters of Credit. LG&E has provided letters of credit totaling $3 million to support certain obligations related to landfill reclamation and a letter of credit totaling less than $1 million to support certain obligations related to workers' compensation.

Purchased Power. LG&E has a contract for purchased power with OVEC, terminating in 2026, for various Mw capacities. LG&E has an investment of 5.63% ownership in OVEC's common stock, which is accounted for on the cost method of accounting. LG&E's share of OVEC's output is 5.63%, approximately 124 Mw of generation capacity. Future obligations for power purchases are shown in the following table:

(in millions)	
2009	$ 20
2010	21
2011	21
2012	23
2013	23
Thereafter	349
Total	$ 457

Coal and Gas Purchase Obligations. LG&E has contracts to purchase coal, natural gas and natural gas transportation. Future obligations are shown in the following table:

(in millions)	
2009	$ 307
2010	309
2011	308
2012	123
2013	63
Thereafter	- (a)
Total	$ 1,110

(a) Obligations after 2013 are indexed to future market prices and will not be included above until prices are set using the contracted methodology.

Construction Program. LG&E had $39 million of commitments in connection with its construction program at December 31, 2008.

In June 2006, LG&E and KU entered into a construction contract regarding the TC2 project. The contract is generally in the form of a lump-sum, turnkey agreement for the design, engineering,

procurement, construction, commissioning, testing and delivery of the project, according to designated specifications, terms and conditions. The contract price and its components are subject to a number of potential adjustments which may serve to increase or decrease the ultimate construction price paid or payable to the contractor. The contract also contains standard representations, covenants, indemnities, termination and other provisions for arrangements of this type, including termination for convenience or for cause rights. The parties have commenced certain negotiations relating to potential construction cost increases due to higher labor and per diem costs above an established baseline, and certain safety and compliance costs resulting from a change in law. LG&E's share of additional costs from inception of the contract through the expected project completion in 2010 may be approximately $5 million.

TC2 Air Permit. The Sierra Club and other environmental groups filed a petition challenging the air permit issued for the TC2 baseload generating unit which was issued by the KDAQ in November 2005. The filing of the challenge did not stay the permit, so the Company was free to proceed with construction during the pendency of the action. In June 2007, the state hearing officer assigned to the matter recommended upholding the air permit with minor revisions. In September 2007, the Secretary of the Kentucky Environmental and Public Protection Cabinet issued a final Order approving the hearing officer's recommendation and upholding the permit. In September 2007, LG&E administratively applied for a permit revision to reflect minor design changes. In October 2007, the environmental groups submitted comments objecting to the draft permit revisions and, in part, attempting to reassert general objections to the generating unit. In January 2008, the KDAQ issued a final permit revision. The environmental groups did not appeal the final Order upholding the permit or file a petition challenging the permit revision by the applicable deadlines. However, in October 2007, the environmental groups filed a lawsuit in federal court seeking an order for the EPA to grant or deny their pending petition for the EPA to "veto" the state air permit and in April 2008, they filed a petition seeking veto of the permit revision. In September 2008, the EPA issued an Order denying nine of eleven claims alleged in one of the petitions, but finding deficiencies in two areas of the permit. The KDAQ revised the permit to address the issues identified in the EPA's Order, although the Sierra Club subsequently submitted comments objecting to the revisions. Although the Company does not expect material changes in the permit as a result of the various petitions, the EPA has yet to rule on several additional claims. The Company is currently unable to determine the final outcome of this matter or the impact of an unfavorable determination upon the Company's financial condition or results of operations.

Mine Safety Compliance Costs. In March 2006, the Mine Safety and Health Administration enacted Emergency Temporary Standards regulations and has issued additional regulations as the result of the passage of the Mine Improvement and New Emergency Response Act of 2006, which was signed into law in June 2006. At the state level, Kentucky and other states that supply coal to LG&E, have passed new mine safety legislation. These pieces of legislation require all underground coal mines to implement new safety measures and install new safety equipment. Under the terms of some of the coal contracts LG&E has in place, provisions are made to allow for price adjustments for compliance costs resulting from new or amended laws or regulations. LG&E has begun to receive information from the mines it contracts with regarding price adjustments related to these compliance costs and has hired a consultant to review all supplier claims for validity and reasonableness. At this time LG&E has not been notified of claims by all mines and is reviewing those claims it has received. An adjustment will be made to the value of the coal inventory once the amount is determinable, however, the amount cannot be estimated at this time. The Company expects to recover these costs through the FAC.

Environmental Matters. LG&E's operations are subject to a number of environmental laws and regulations, governing, among other things, air emissions, wastewater discharges, the use, handling and disposal of hazardous substances and wastes, soil and groundwater contamination and employee health

and safety.

Clean Air Act Requirements. The Clean Air Act establishes a comprehensive set of programs aimed at protecting and improving air quality in the United States by, among other things, controlling stationary sources of air emissions such as power plants. While the general regulatory framework for these programs is established at the federal level, most of the programs are implemented and administered by the states under the oversight of the EPA. The key Clean Air Act programs relevant to LG&E's business operations are described below.

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

In 1997, the EPA established new NAAQS for ozone and fine particulates that required additional reductions in SO_2 and NOx emissions from power plants. In 1998, the EPA issued its final "NOx SIP Call" rule requiring reductions in NOx emissions of approximately 85% from 1990 levels in order to mitigate ozone transport from the midwestern U.S. to the northeastern U.S. To implement the new federal requirements, Kentucky amended its SIP in 2002 to require electric generating units to reduce their NOx emissions to 0.15 pounds weight per MMBtu on a company-wide basis. In 2005, the EPA issued the CAIR which required additional SO_2 emission reductions of 70% and NOx emission reductions of 65% from 2003 levels. The CAIR provided for a two-phase cap and trade program, with initial reductions of NOx and SO_2 emissions due by 2009 and 2010, respectively, and final reductions due by 2015. In 2006, Kentucky proposed to amend its SIP to adopt state requirements similar to those under the federal CAIR. Depending on the level of action determined necessary to bring local nonattainment areas into compliance with the new ozone and fine particulate standards, LG&E's power plants are potentially subject to additional reductions in SO_2 and NOx emissions. In March 2008, the EPA issued a revised NAAQS for ozone, which contains a more stringent standard than that contained in the previous regulation. At present, LG&E is unable to determine what, if any, additional requirements may be imposed to achieve compliance with the new ozone standard.

In July 2008, a federal appeals court issued a ruling finding deficiencies in the CAIR and vacating it. In December 2008, the Court amended its previous Order, directing the EPA to promulgate a new regulation, but leaving the CAIR in the interim. Depending upon the course of such matters, the CAIR could be superseded by new or revised NOx or SO_2 regulations with different or more stringent requirements and SIPs which incorporate CAIR requirements could be subject to revision. LG&E is also reviewing aspects of its compliance plan relating to the CAIR, including scheduled or contracted pollution control construction programs. Finally, as discussed below, the remand of the CAIR results in some uncertainty with respect to certain other EPA or state programs and proceedings and LG&E's and KU's compliance plans relating thereto, due to the interconnection of the CAIR and CAIR-associated steps with such associated programs. At present, LG&E is not able to predict the outcomes of the legal and regulatory proceedings related to the CAIR and whether such outcomes could have a material effect on the Company's financial or operational conditions.

Hazardous Air Pollutants. As provided in the 1990 amendments to the Clean Air Act, the EPA investigated hazardous air pollutant emissions from electric utilities and submitted a report to Congress identifying mercury emissions from coal-fired power plants as warranting further study. In 2005, the EPA issued the CAMR establishing mercury standards for new power plants and requiring all states to issue new SIPs including mercury requirements for existing power plants. The EPA issued a model rule which provides for a two-phase cap and trade program with initial reductions due by 2010 and final reductions due by 2018. The CAMR provided for reductions of 70% from 2003 levels. The EPA closely integrated the CAMR and CAIR programs to ensure that the 2010 mercury reduction targets would be achieved as a "co-benefit" of the controls installed for purposes of compliance with the CAIR. In addition, in 2006, the Metro Louisville Air Pollution Control District adopted rules aimed at regulating additional hazardous air pollutants from sources including power plants.

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

Acid Rain Program. The 1990 amendments to the Clean Air Act imposed a two-phased cap and trade program to reduce SO_2 emissions from power plants that were thought to contribute to "acid rain" conditions in the northeastern U.S. The 1990 amendments also contained requirements for power plants to reduce NOx emissions through the use of available combustion controls.

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

Installation of Pollution Controls. Many of the programs under the Clean Air Act utilize cap and trade mechanisms that require a company to hold sufficient emissions allowances to cover its authorized emissions on a company-wide basis and do not require installation of pollution controls on every generating unit. Under cap and trade programs, companies are free to focus their pollution control efforts on plants where such controls are particularly efficient and utilize the resulting emission allowances for smaller plants where such controls are not cost effective. LG&E had previously installed flue gas desulfurization equipment on all of its generating units prior to the effective date of the acid rain program. LG&E's strategy for its Phase II SO_2 requirements, which commenced in 2000, is to use accumulated emission allowances to defer additional capital expenditures and LG&E will continue to evaluate improvements to further reduce SO_2 emissions. In order to achieve the NOx emission reductions mandated by the NOx SIP Call, LG&E installed additional NOx controls, including selective catalytic reduction technology, during the 2000 through 2008 time period at a cost of $197 million. In

2001, the Kentucky Commission granted recovery in principal of these costs incurred by LG&E for these projects under its periodic environmental surcharge mechanisms. Such monthly recovery is subject to periodic review by the Kentucky Commission.

In order to achieve mandated emissions reductions, LG&E expects to incur additional capital expenditures totaling $100 million during the 2009 through 2011 time period for pollution control equipment, and additional operating and maintenance costs in operating such controls. In 2005, the Kentucky Commission granted approval to recover the costs incurred by the Company for these projects through the ECR mechanism. Such monthly recovery is subject to periodic review by the Kentucky Commission. LG&E believes its costs in reducing SO_2, NOx and mercury emissions to be comparable to those of similarly situated utilities with like generation assets. LG&E's compliance plans are subject to many factors including developments in the emission allowance and fuels markets, future legislative and regulatory enactments, legal proceedings and advances in clean air technology. LG&E will continue to monitor these developments to ensure that its environmental obligations are met in the most efficient and cost-effective manner. See "Ambient Air Quality" above for a discussion of CAIR-related uncertainties.

Potential GHG Controls. In 2005, the Kyoto Protocol for reducing GHG emissions took effect, obligating 37 industrialized countries to undertake substantial reductions in GHG emissions. The U.S. has not ratified the Kyoto Protocol and there are currently no mandatory GHG emission reduction requirements at the federal level. Legislation mandating GHG reductions has been introduced in the Congress, but no federal legislation has been enacted to date. In the absence of a program at the federal level, various states have adopted their own GHG emission reduction programs. Such programs have been adopted in various states including 11 northeastern U.S. states and the District of Columbia under the Regional GHG Initiative program and California. Substantial efforts to pass federal GHG legislation are on-going. In April 2007, the U.S. Supreme Court ruled that the EPA has the authority to regulate GHG under the Clean Air Act. LG&E is monitoring on-going efforts to enact GHG reduction requirements at the state and federal level and is assessing potential impacts of such programs and strategies to mitigate those impacts. LG&E is also monitoring on-going regulatory proceedings including the EPA's advanced notice of proposed rulemaking for regulation of GHGs under the existing authority of the Clean Air Act and proposed rules governing carbon sequestration. The new administration has announced its intention to exercise its existing authority under the Clean Air Act to achieve reductions in GHG emissions. LG&E is unable to predict whether mandatory GHG reduction requirements will ultimately be enacted. As a Company with significant coal-fired generating assets, LG&E could be substantially impacted by programs requiring mandatory reductions in GHG emissions, although the precise impact on the operations of LG&E, including the reduction targets and deadlines that would be applicable, cannot be determined prior to the enactment of such programs.

Section 114 Requests. In August 2007, the EPA issued administrative information requests under Section 114 of the Clean Air Act requesting new source review-related data regarding certain projects undertaken at LG&E's Mill Creek 4 and Trimble County 1 generating units and KU's Ghent 2 generating unit. LG&E and KU have complied with the information requests and are not able to predict further proceedings in this matter at this time.

General Environmental Proceedings. From time to time, LG&E appears before the EPA, various state or local regulatory agencies and state and federal courts regarding matters involving compliance with applicable environmental laws and regulations. Such matters include remediation obligations or activities for former manufactured gas plant sites or elevated PCB levels at existing properties; liability under the Comprehensive Environmental Response, Compensation and Liability Act for cleanup at

various off-site waste sites; on-going claims regarding alleged particulate emissions from LG&E's Cane Run station and claims regarding GHG emissions from LG&E's generating stations. With respect to the former manufactured gas plant sites, LG&E has estimated that it could incur additional costs of less than $1 million for remaining clean-up activities under existing approved plans or agreements. Based on analysis to date, the resolution of these matters is not expected to have a material impact on the operations of LG&E.

Note 10 - 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 Unit 1			
	LG&E	IMPA	IMEA	Total
Ownership interest	75%	12.88%	12.12%	100%
Mw capacity	383	66	62	511

(in millions)	
LG&E's 75% ownership:	
Cost	$ 606
Accumulated depreciation	251
Net book value	$ 355
Construction work in progress (included in above)	$ 12

LG&E and KU have begun construction of TC2, a jointly owned unit at the Trimble County site. LG&E and KU own undivided 14.25% and 60.75% interests, respectively, in TC2. Of the remaining 25% of TC2, IMEA owns a 12.12% undivided interest and IMPA owns a 12.88% undivided interest. Each company is responsible for its proportionate share of capital cost during construction, and fuel, operation and maintenance cost when TC2 begins operation, which is

expected to occur in 2010. In June 2008, LG&E transferred assets related to TC2 with a net book value of $10 million to KU.

	TC2				
	LG&E	KU	IMPA	IMEA	Total
Ownership interest	14.25%	60.75%	12.88%	12.12%	100%
Mw capacity	107	455	97	91	750

(in millions)			
LG&E's 14.25% ownership:		KU's 60.75% ownership:	
Cost	$ 136	Cost	$ 560
Accumulated depreciation	2	Accumulated depreciation	-
Net book value	$ 134	Net book value	$ 560

	LG&E	KU
Construction work in progress (included in above)	$132	$550

LG&E and KU jointly own the following CTs and related equipment:

($ in millions)	LG&E				KU				Total			
Ownership Percentage	Mw Capacity	($) Cost	($) Depre-ciation	($) Net Book Value	Mw Capacity	($) Cost	($) Depre-ciation	($) Net Book Value	Mw Capacity	($) Cost	($) Depre-ciation	($) Net Book Value
LG&E 53%, KU 47% (a)	146	62	(15)	47	129	53	(12)	41	275	115	(27)	88
LG&E 38%, KU 62% (b)	118	51	(8)	43	190	82	(14)	68	308	133	(22)	111
LG&E 29%, KU 71% (c)	92	32	(6)	26	228	80	(18)	62	320	112	(24)	88
LG&E 37%, KU 63% (d)	236	79	(12)	67	404	137	(21)	116	640	216	(33)	183
LG&E 29%, KU 71% (e)	n/a	3	(1)	2	n/a	9	(2)	7	n/a	12	(3)	9

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

Both LG&E's and KU's participating share of direct expenses of the jointly owned plants is included in the corresponding operating expenses on its respective income statement (e.g., fuel, maintenance of plant, other operating expense).

Note 11 - Segments of Business 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. LG&E is regulated by the Kentucky Commission and files electric and natural gas financial information separately with the Kentucky

Commission. The Kentucky Commission establishes rates specifically for the electric and natural gas businesses. Therefore, management reports analyze financial performance based on the electric and natural gas segments of the business. Financial data for business segments follow:

(in millions)	Electric	Gas	Total
2008			
Operating revenues	$ 1,015	$ 452	$ 1,467
Depreciation and amortization	107	20	127
Income taxes	36	5	41
Interest income	1	-	1
Interest expense	43	10	53
Net income	82	8	90
Total assets	2,827	810	3,637
Construction expenditures	195	50	245
2007			
Operating revenues	$ 933	$ 353	$ 1,286
Depreciation and amortization	107	19	126
Income taxes	54	5	59
Interest income	1	-	1
Interest expense	41	9	50
Net income	112	8	120
Total assets	2,669	644	3,313
Construction expenditures	164	39	203

Note 12 - Related Party Transactions

LG&E, subsidiaries of E.ON U.S. and subsidiaries of E.ON engage in related party transactions. Transactions between LG&E and E.ON U.S. subsidiaries are eliminated upon consolidation of E.ON U.S. Transactions between LG&E and E.ON subsidiaries are eliminated upon consolidation of E.ON. These transactions are generally performed at cost and are in accordance with FERC regulations under PUHCA 2005 and the applicable Kentucky Commission regulations. The significant related party transactions are disclosed below.

Electric Purchases

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

(in millions)	2008	2007
Electric operating revenues from KU	$ 109	$ 93
Purchased power from KU	80	46

Interest Charges

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

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

(in millions)	2008	2007
Interest on money pool loans	$ 6	$ 4
Interest on Fidelia loans	23	17

Other Intercompany Billings

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

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

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

(in millions)	2008	2007
E.ON U.S. Services billings to LG&E	$ 206	$ 385
LG&E billings to KU	5	12
KU billings to LG&E	75	6
LG&E billings to E.ON U.S. Services	5	12

In June 2008, LG&E transferred assets related to TC2 with a net book value of $10 million to KU.

In March 2008, LG&E paid a dividend of $40 million to its common shareholder, E.ON U.S.

LG&E received capital contributions of $20 million from its common shareholder, E.ON U.S., in both December 2008 and December 2007.

Note 13 – Accumulated Other Comprehensive Income

Accumulated other comprehensive income (loss) consisted of the following:

(in millions)	Accumulated Derivative Gain or Loss	Pre-Tax	Income Taxes	Net
Balance at December 31, 2006	$ (15)	$ (15)	$ 6	$ (9)
Gains (losses) on derivative instruments designated and qualifying as cash flow hedging instruments	(6)	(6)	2	(4)
Balance at December 31, 2007	$ (21)	$ (21)	$ 8	$ (13)
Gains (losses) on derivative instruments designated and qualifying as cash flow hedging instruments	(1)	(1)	-	(1)
Balance at December 31, 2008	$ (22)	$ (22)	$ 8	$ (14)

Note 14 - Subsequent Events

On January 13, 2009, LG&E, the AG, KIUC and all other parties to the rate cases filed a settlement agreement with the Kentucky Commission. Under the terms of the settlement agreement, LG&E's base gas rates will increase $22 million annually, and base electric rates will decrease $13 million annually. An Order approving the settlement was received on February 5, 2009. The new rates were implemented effective February 6, 2009. However, in connection with the application and effective date of the new rates, the VDT surcredit and merger surcredit, respectively, terminated, which will amount in increased revenues of approximately $21 million annually.

On January 27 and 28, 2009, a significant winter ice storm passed through LG&E's service territory causing approximately 205,000 customer outages, followed closely by a severe wind storm on February 11, 2009, causing approximately 37,000 customer outages. LG&E currently estimates costs incurred of $34 million of expenses and $6 million of capital expenditures related to the restoration following the two storms. The Company expects to seek recovery of these costs from the Kentucky Commission.

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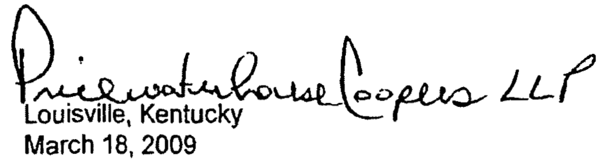
Report of Independent Auditors

To the Shareholder of Louisville Gas and Electric Company:

In our opinion, the accompanying balance sheets and the related 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 at December 31, 2008 and 2007, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assertion of the effectiveness of internal control over financial reporting, included in "Controls and Procedures" appearing on page 19 of the 2008 Louisville Gas and Electric Company financial statements and additional information. Our responsibility is to express opinions on these financial statements and on the Company's internal control over financial reporting based on our audits (which was an integrated audit in 2008). We conducted our audits of the financial statements in accordance with auditing standards generally accepted in the United States of America and our audit of internal control over financial reporting in accordance with attestation standards established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

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

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



Louisville, Kentucky
March 18, 2009

2007 - Annual Financial Statements and Additional Information

Louisville Gas and Electric Company

Financial Statements and Additional Information

As of December 31, 2007 and 2006

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INDEX OF ABBREVIATIONS

AG	Attorney General of Kentucky
ARO	Asset Retirement Obligation
BART	Best Available Retrofit Technology
CAIR	Clean Air Interstate Rule
CAMR	Clean Air Mercury Rule
CCN	Certificate of Public Convenience and Necessity
Clean Air Act	The Clean Air Act, as amended in 1990
Company	LG&E
CT	Combustion Turbines
DSM	Demand Side Management
ECR	Environmental Cost Recovery
E.ON	E.ON AG
E.ON U.S.	E.ON U.S. LLC (formerly LG&E Energy LLC and LG&E Energy Corp.)
E.ON U.S. Services	E.ON U.S. Services Inc. (formerly LG&E Energy Services Inc.)
EPA	U.S. Environmental Protection Agency
EPAct 2005	Energy Policy Act of 2005
FAC	Fuel Adjustment Clause
FASB	Financial Accounting Standards Board
FERC	Federal Energy Regulatory Commission
Fidelia	Fidelia Corporation (an E.ON affiliate)
FIN	FASB Interpretation No.
FT and FT-A	Firm Transportation
GHG	Greenhouse Gas
GSC	Gas Supply Clause
IBEW	International Brotherhood of Electrical Workers
IMEA	Illinois Municipal Electric Agency
IMPA	Indiana Municipal Power Agency
IRP	Integrated Resource Plan
IRS	Internal Revenue Service
Kentucky Commission	Kentucky Public Service Commission
KIUC	Kentucky Industrial Utility Consumers, Inc.
KU	Kentucky Utilities Company
Kwh	Kilowatt hours
LG&E	Louisville Gas and Electric Company
LG&E Energy	LG&E Energy LLC (now E.ON U.S. LLC)
Mcf	Thousand Cubic Feet
MISO	Midwest Independent Transmission System Operator, Inc.
MMBtu	Million British thermal units
Moody's	Moody's Investor Services, Inc.
MVA	Megavolt - ampere
Mw	Megawatts
Mwh	Megawatt hours
NNS	No-Notice Service
NOx	Nitrogen Oxide
OVEC	Ohio Valley Electric Corporation
PBR	Performance-Based Ratemaking
PUHCA 2005	Public Utility Holding Company Act of 2005
S&P	Standard and Poor's Rating Service
SFAS	Statement of Financial Accounting Standards
SIP	State Implementation Plan
SO_2	Sulfur Dioxide
TC2	Trimble County Unit 2
Tennessee Gas	Tennessee Gas Pipeline Company
Texas Gas	Texas Gas Transmission LLC
VDT	Value Delivery Team Process

Business

GENERAL

LG&E, incorporated in Kentucky in 1913, 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. LG&E supplies natural gas to approximately 326,000 customers and electricity to approximately 401,000 customers in Louisville and adjacent areas in Kentucky. LG&E's service area covers approximately 700 square miles in 17 counties. LG&E also provides natural gas service in limited additional areas. LG&E's coal-fired electric generating stations, all equipped with systems to reduce SO_2 emissions, produce most of LG&E's electricity. The remainder is generated by a hydroelectric power plant and natural gas and oil fueled CTs. Underground natural gas storage fields help LG&E provide economical and reliable natural gas service to customers.

LG&E is a wholly-owned subsidiary of E.ON U.S., formerly known as LG&E Energy LLC. E.ON U.S. is an indirect wholly-owned subsidiary of E.ON, a German corporation, making LG&E an indirect wholly-owned subsidiary of E.ON. LG&E's affiliate, KU, is a regulated public utility engaged in the generation, transmission, distribution and sale of electric energy in Kentucky, Virginia and Tennessee.

OPERATING REVENUES

For the year ended December 31, 2007, 73% of total operating revenues were derived from electric operations and 27% from natural gas operations. Electric and gas operating revenues and the percentages by class of service on a combined basis for this period were as follows:

(in millions)	Electric	Gas	Combined	% Combined
Residential	$309	$218	$ 527	41%
Industrial & Commercial	382	101	483	38%
Other Retail	75	15	90	7%
Wholesale	167	19	186	14%
Total	$933	$353	$1,286	100%

See Note 11 of Notes to Financial Statements for financial information concerning segments of business for the two years ended December 31, 2007 and 2006.

ELECTRIC OPERATIONS

The sources of electric operating revenues and volumes of sales for the two years ended December 31, 2007 and 2006, were as follows:

	2007		2006	
	Revenues (millions)	Volumes (000 Mwh)	Revenues (millions)	Volumes (000 Mwh)
Residential	$309	4,486	$272	4,018
Industrial & Commercial	382	6,830	361	6,682
Other Retail	75	1,342	69	1,265
Wholesale	167	6,186	241	7,621
Total	$933	18,844	$943	19,586

LG&E set a new record peak load of 2,834 Mw on August 16, 2007, when the temperature reached 105 degrees Fahrenheit in Louisville.

LG&E's power generating system includes coal-fired units operated at its three steam generating stations. Natural gas and oil fueled CTs supplement the system during peak or emergency periods. As of December 31, 2007, LG&E owned and operated the following electric generating stations while maintaining a 12%-14% reserve margin.

	Summer Capability Rating (Mw)
Steam Stations:	
Mill Creek – Jefferson County, KY	1,472
Cane Run – Jefferson County, KY	563
Trimble County – Trimble County, KY (a)	383
Total Steam Stations	2,418
Ohio Falls Hydroelectric Station – Jefferson County, KY	50
CT Generators (Peaking capability):	
Zorn – Jefferson County, KY	14
Paddy's Run – Jefferson County, KY (c)	119
Cane Run – Jefferson County, KY	14
Waterside – Jefferson County, KY (b)	-
E.W. Brown – Mercer County, KY (c)	190
Trimble County – Trimble County, KY (c)	328
Total CT Generators	665
Total Capability Rating	3,133

(a) Amount shown represents LG&E's 75% interest. See Note 10 of Notes to Financial Statements for information regarding jointly owned units.
(b) Pursuant to the Definitive Property Sale Agreement entered into with the Louisville Arena Authority in 2006, the Waterside property will be sold to the Louisville Arena Authority when the relocation of the LG&E assets has been completed, which is expected to occur by the end of 2008. The Waterside units were retired in December 2006.
(c) Some of these units are jointly owned with KU. See Note 10 of Notes to Financial Statements for information regarding jointly owned units.

At December 31, 2007, LG&E's electric transmission system included 41 substations (27 of which are shared with the distribution system) with a total capacity of approximately 11,900 MVA and approximately 894 miles o: lines. The electric distribution system included 93 substations (27 of which are shared with the transmission system) with a total capacity of approximately 4,940 MVA, 3,927 miles of overhead lines and 2,261 miles of underground conduit.

LG&E was formerly a member of the MISO, a non-profit independent transmission system operator that serves the electrical transmission needs of much of the Midwest. LG&E withdrew from the MISO effective September 1, 2006 LG&E now contracts with the Tennessee Valley Authority to act as its transmission reliability coordinator and Southwest Power Pool, Inc. to function as its independent transmission operator, pursuant to FERC requirements. See Note 2 of Notes to Financial Statements.

GAS OPERATIONS

The sources of LG&E's natural gas operating revenues and the sales volumes for the two years ended December 31, 2007 and 2006, were as follows:

	2007		2006	
	Revenues (millions)	Volumes (000 Mcf)	Revenues (millions)	Volumes (000 Mcf)
Residential	$218	19,811	$248	17,816
Industrial & Commercial	101	10,182	119	9,621
Other Retail	15	1,553	19	1,499
Wholesale	19	13,575	9	12,149
Total	$353	45,121	$395	41,085

LG&E's natural gas transmission system includes 256 miles of transmission mains and the natural gas distribution system includes 4,203 miles of distribution mains.

The natural gas utility business is affected by seasonal temperatures. As a result, operating revenues (and associated operating expenses) are not generated evenly throughout the year. LG&E gas billings include a Weather Normalization Adjustment ("WNA") mechanism which adjusts the distribution cost component of the natural gas billings of residential and commercial customers to normal temperatures during the heating season months of November through April, somewhat mitigating the effect of above- or below-normal weather on residential and commercial revenues. In October 2006, the Kentucky Commission approved LG&E's request to extend the current WNA mechanism through April 30, 2009.

LG&E has five underground natural gas storage fields, with a current working gas capacity of approximately 15 million Mcf, that help provide economical and reliable natural gas service to ultimate consumers. By using natural 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 natural 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 natural gas and pipeline transportation services during the winter months when customer demand increases and when the prices for natural gas supply and transportation services are typically at their highest. Currently, LG&E buys competitively priced natural gas from several suppliers under contracts of varying duration. LG&E's underground storage facilities, in combination with its purchasing practices, enable it to offer natural gas sales service at competitive rates. At December 31, 2007, LG&E had an inventory balance of natural gas stored underground of 11 million Mcf of working natural gas valued at $81 million.

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

The estimated maximum deliverability from storage during the early part of the heating season is expected to be in excess of 350,000 Mcf/day. Under mid-winter design conditions, LG&E expects to be able to withdraw about 300,000 Mcf/day from its storage facilities. The deliverability of natural gas from LG&E's storage facilities decreases as storage inventory levels are reduced by seasonal withdrawals.

During 2007, the maximum daily gas sendout was approximately 442,000 Mcf, occurring on February 5, 2007, when the average temperature for the day in Louisville was 14 degrees Fahrenheit. Supply on that day consisted of approximately 174,000 Mcf from pipeline deliveries, approximately 192,000 Mcf delivered from underground storage and approximately 76,000 Mcf transported for large commercial and industrial customers.

RATES AND REGULATIONS

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

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

LG&E is subject to the jurisdiction of the Kentucky Commission and the FERC 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 its competitive position in the marketplace and the status of regulation in Kentucky, LG&E has no plans or intentions to discontinue its application of SFAS No. 71.

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

COAL SUPPLY

Coal-fired generating units provided approximately 97% of LG&E's net Kwh generation for 2007. The remaining net generation for 2007 was provided by natural gas and oil fueled CT peaking units and a hydroelectric plant. Coal is expected to be the predominant fuel used by 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 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 production issues and other supplier or transporter operating difficulties.

LG&E has entered into coal supply agreements with various suppliers for coal deliveries for 2008 and beyond and 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 expects to continue purchasing most of its coal, which has sulfur content in the 2.0% - 3.5% range, from western Kentucky, southern Indiana, southern Illinois, Ohio and West Virginia for the foreseeable future. This supply, in combination with the Company's SO_2 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 generating stations by a mix of transportation modes including rail and barge.

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.

LG&E currently transports natural gas on the Texas Gas system under Rate Schedules NNS and FT service. LG&E's total winter season NNS capacity is 184,900 MMBtu/day and its total summer season NNS capacity is 60,000 MMBtu/day. There are three separate NNS agreements with Texas Gas which are subject to termination by LG&E in equal amounts during 2010, 2011 and 2013. LG&E's total winter and summer season FT capacity is 28,000 MMBtu/day. One of the FT agreements with Texas Gas is for 10,000 MMBtu/day (winter and summer seasons) and is subject to termination by LG&E during 2011. The other FT agreement with Texas Gas is for 18,000 MMBtu/day (winter and summer seasons) and has been terminated effective November 1, 2008. Commencing November 1, 2008, LG&E has contracted for transportation service with Texas Gas under Rate Schedule Short-Term Firm with a winter season capacity of 100 MMBtu/day and a summer season capacity of 18,000 MMBtu/day. This new Short-Term Firm agreement is subject to termination by LG&E during 2013. LG&E also transports on the Tennessee Gas system under Tennessee Gas' Rate Schedule FT-A. LG&E's contract capacity with Tennessee Gas is 51,000 MMBtu/day throughout the year (winter and summer seasons). The FT-A agreement with Tennessee Gas expires during 2012.

LG&E participates in rate and other proceedings affecting the regulated interstate natural gas pipelines that provide it service. Both Texas Gas and Tennessee Gas have active proceedings at the FERC in which LG&E is participating. However, neither pipeline is billing charges subject to refund, and neither currently has rate case proceedings before the FERC that would change the pipeline's base transportation rates under which LG&E receives service.

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

For further discussion of wholesale natural gas prices, see Note 2 of Notes to Financial Statements.

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. See Note 9 of Notes to Financial Statements for additional information.

COMPETITION

At this time, neither the Kentucky General Assembly nor the Kentucky Commission has adopted or approved a plan or timetable for retail electric industry competition in Kentucky. The nature or timing of the ultimate legislative or regulatory actions regarding industry restructuring and their impact on LG&E, which may be significant, cannot currently be predicted. Some states that have already deregulated have begun discussions that could lead to re-regulation. See Note 2 of Notes to Financial Statements for additional information.

EMPLOYEES AND LABOR RELATIONS

LG&E had 944 full-time regular employees at December 31, 2007, 655 of which were operating, maintenance an construction employees represented by the IBEW Local 2100. LG&E and employees represented by the IBEW Local 2100 signed a three-year collective bargaining agreement in November 2005. The new agreement provides fo negotiated increases or changes to wages and annual benefits re-openers. Benefits re-openers were negotiated in November 2006 and November 2007.

OFFICERS OF THE COMPANY

At December 31, 2007: **

Name	Age	Position	Effective Date of Election to Present Position
Victor A. Staffieri	52	Chairman of the Board, President and Chief Executive Officer	May 2001
John R. McCall	64	Executive Vice President, General Counsel, Corporate Secretary and Chief Compliance Officer	July 1994
S. Bradford Rives	49	Chief Financial Officer	September 2003
Martyn Gallus *	43	Senior Vice President – Energy Marketing	December 2000
Chris Hermann	60	Senior Vice President – Energy Delivery	February 2003
Paula H. Pottinger	50	Senior Vice President – Human Resources	January 2006
Paul W. Thompson	50	Senior Vice President – Energy Services	June 2000
Wendy C. Welsh	53	Senior Vice President – Information Technology	December 2000
Michael S. Beer	49	Vice President – Federal Regulation and Policy	September 2004
Lonnie E. Bellar	43	Vice President – State Regulation and Rates	August 2007
Kent W. Blake	41	Vice President – Corporate Planning and Development	August 2007
D. Ralph Bowling	50	Vice President – Power Operations – WKE	August 2002
Laura G. Douglas	58	Vice President – Corporate Responsibility and Community Affairs	November 2007
R. W. Chip Keeling	51	Vice President – Communications	March 2002
John P. Malloy	46	Vice President – Energy Delivery – Retail Business	April 2007
Dorothy E. O'Brien	54	Vice President and Deputy General Counsel – Legal and Environmental Affairs	October 2007
George R. Siemens	58	Vice President – External Affairs	January 2001
P. Greg Thomas	51	Vice President – Energy Delivery – Distribution Operations	April 2007
John N. Voyles, Jr.	53	Vice President – Regulated Generation	June 2003
Daniel K. Arbough	46	Treasurer	December 2000
Valerie L. Scott	51	Controller	January 2005

Officers generally serve in the same capacities at LG&E and its affiliates, E.ON U.S. and KU.
*Mr. Gallus is serving in a position with an international E.ON affiliate, effective January 2008.
**David Sinclair, age 46, was promoted to Vice President – Energy Marketing in January 2008.

Risk Factors

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

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

Changes in transmission and wholesale power market structures, as well as LG&E's exit from the MISO, could increase costs or reduce revenues. The resulting changes to transmission and wholesale power market structures and prices are not estimable and may result in unforeseen effects on energy purchases and sales, transmission and related costs or revenues.

Transmission and interstate market activities of LG&E, as well as other aspects of the business, are subject to significant FERC regulation. LG&E's business is subject to extensive regulation under the FERC covering matters including rates charged to transmission users and wholesale customers; interstate power market structure; construction and operation of transmission facilities; mandatory reliability standards; standards of conduct and affiliate restrictions; certain natural gas operations and other matters. Existing FERC regulation, changes thereto or issuances of new rules or situations of non-compliance, can affect the earnings, operations or other activities of LG&E.

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

LG&E's costs of compliance with environmental laws are significant and are subject to continuing changes. Extensive federal, state and local environmental regulations are applicable to LG&E's air emissions, water discharges and the management of hazardous and solid waste, among other areas; and the costs of compliance or alleged non-compliance cannot be predicted with certainty. Costs may take the form of increased capital or operating and maintenance expenses; monetary fines, penalties or forfeitures or other restrictions.

LG&E's operating results are affected by weather conditions, including storms and seasonal temperature variations, as well as by significant man-made or accidental disturbances, including terrorism or natural disasters. These weather or man-made factors can significantly affect LG&E's finances or operations by changing demand levels; causing outages; damaging infrastructure or requiring significant repair costs; affecting capital markets or impacting future growth.

LG&E is subject to risks regarding potential developments concerning global climate change matters. Such developments could include potential federal or state legislation or industry initiatives limiting GHG

emissions; establishing costs or charges on GHG emissions or on fuels relating to such emissions; requiring GHG remediation or sequestration; establishing renewable portfolio standards or generation fleet-diversification requirements to address GHG emissions; promoting energy efficiency and conservation or other measures. LG&E's generation fleet is predominantly coal-fired and may be highly impacted by developments in this area.

LG&E's business is concentrated in the Midwest United States, specifically Kentucky. Local and regional economic conditions, such as population growth, industrial growth or expansion and economic development, as well as the operational or financial performance of major industries or customers, can affect the demand for energy.

LG&E is subject to operational risks relating to its generating plants, transmission facilities and distribution equipment. Operation of power plants, transmission and distribution facilities subjects LG&E to many risks, including the breakdown or failure of equipment; accidents; labor disputes; delivery/transportation problems; disruptions of fuel supply and performance below expected levels.

LG&E could be negatively affected by rising interest rates, downgrades to company or bond insurer credit ratings that could impact the Company's bond credit ratings or other negative developments in its ability to access capital markets. In the ordinary course of business, LG&E is reliant upon adequate long-term and short-term financing means to fund its significant capital expenditures, debt interest or maturities and operating needs. Increases in interest rates could result in increased costs to LG&E.

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

LG&E is subject to risks associated with defined benefit retirement plans, health care plans, wages and other employee-related matters. Risks include adverse developments in legislation or regulation, future costs or funding levels, returns on investments, interest rates and actuarial matters, as well as, changing wage levels whether related to collective bargaining agreements or employment market conditions, ability to attract and retain key personnel and changing costs of providing health care benefits.

Legal Proceedings

Rates and Regulatory Matters

For a discussion of current rates and regulatory matters, including electric and natural gas base rate increase proceedings, merger surcredit proceedings, VDT proceedings, TC2 proceedings, Kentucky Commission, FERC and MISO proceedings and other rates or regulatory matters affecting LG&E, see Notes 2 and 9 of Notes to Financial Statements.

Environmental

For a discussion of environmental matters including additional reductions in SO_2, NOx and other emissions mandated by recent or potential regulations; items regarding other emissions proceedings and the manufactured gas plant sites; global warming or climate change matters and other environmental items affecting LG&E, see Note 9 of Notes to Financial Statements.

Litigation

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

Other

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

Selected Financial Data

(in millions)	Years Ended December 31				
	2007	2006	2005	2004	2003
Operating revenues	$1,286	$1,338	$1,424	$1,173	$1,094
Net operating income	$ 230	$ 223	$ 230	$ 185	$ 179
Net income	$ 120	$ 117	$ 129	$ 96	$ 91
Total assets	$3,313	$3,184	$3,146	$2,967	$2,882
Long-term obligations (including amounts due within one year)	$ 984	$ 820	$ 821	$ 872	$ 798

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

Management's Discussion and Analysis

The following discussion and analysis by management focuses on those factors that had a material effect on LG&E's financial results of operations and financial condition during 2007 and 2006 and should be read in connection with the financial statements and notes thereto.

Forward Looking Statements

Some of the following discussion may contain forward-looking statements that are subject to risks, uncertainties and assumptions. Such forward-looking statements are intended to be identified in this document by the words "anticipate," "expect," "estimate," "objective," "possible," "potential" and similar expressions. Actual results may materially vary. Factors that could cause actual results to materially differ include: 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, including as noted in the Risk Factors section of this report.

RESULTS OF OPERATIONS

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

Net Income

Net income related to the electric business increased $5 million and net income related to the natural gas business decreased $2 million in 2007 compared to 2006, resulting in an overall $3 million net income increase. Increased retail sales volumes associated with warmer summer weather and cooler winter weather and increased natural gas wholesale sales resulted in an increase in net income. Lower electric wholesale sales and lower MISO related revenues partially offset this increase.

Revenues

Electric revenues in 2007 decreased $10 million primarily due to:

- Decreased wholesale sales ($66 million) due to decreased volumes and lower wholesale market pricing
- Decreased MISO related revenues ($8 million) resulting from the exit from the MISO

These decreases were partially offset by:

- Increased fuel costs ($35 million) billed to customers through the FAC due to increased fuel prices and sales volumes delivered
- Increased sales volumes delivered ($19 million) resulting from a 3% increase in heating degree days and a 51% increase in cooling degree days
- Increased ECR surcharge ($9 million) due to increased recoverable capital spending

Natural gas revenues in 2007 decreased $42 million primarily due to a decrease in the average cost of gas billed to customers throughout the year ($71 million), partially offset by increased volumes ($19 million) and increased wholesale sales ($10 million).

Expenses

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

Fuel for electric generation increased $24 million in 2007 primarily due to:

- Increased cost of fuel burned ($17 million) due to higher coal prices
- Increased generation ($7 million) due to higher demand

Power purchased expense decreased $32 million in 2007 primarily due to:

- Decreased volumes purchased ($33 million) due to increased internal generation
- Increased cost per Mwh of purchases ($2 million) due to higher fuel prices

Gas supply expenses decreased $41 million in 2007 primarily due to:

- Decreased cost of net gas supply ($77 million) due to lower inventory unit cost and adjustments to the GSC for recoveries
- Increased volumes of natural gas delivered to the distribution system ($36 million) due to higher demand

Other operation and maintenance expenses decreased $12 million in 2007 primarily due to decreased other operation expenses ($17 million), partially offset by increased maintenance expenses ($4 million).

Other operation expenses decreased $17 million in 2007 primarily due to:

- Decreased VDT workforce reduction expense ($8 million) due to completion of VDT amortization in March 2006
- Decreased MISO Day 1 and Day 2 expense ($8 million) due to the exit from the MISO effective September 1, 2006, and refunds from the MISO for certain charges
- Decreased steam expense ($5 million) due to lower lease expense
- Decreased pension expense ($3 million) due to a pension contribution early in 2007
- Decreased write-offs of uncollectible accounts ($3 million) primarily due to lower gas prices in 2007 as compared with prices in the first quarter of 2006
- Increased wholesale expense ($6 million) due to a recorded credit in April 2006 for a FERC ordered refund from the MISO for charges assessed in excess of the rates in the MISO transmission tariff
- Increased scrubber reactant expense ($2 million) due to a higher priced lime contract in 2007

Maintenance expenses increased $4 million in 2007 primarily due to:

- Increased boiler maintenance expense ($3 million)
- Increased gas main distribution maintenance and other maintenance services ($2 million)
- Decreased overhead conductor and devices maintenance ($1 million)

Other expense – net decreased $2 million in 2007 primarily due to increased other income ($1 million) and decreased other expense ($1 million).

Interest expense increased $9 million in 2007 primarily due to increased interest to affiliated companies ($8 million) due to increased affiliate borrowings to fund the pension plan and redeem the Company's preferred stock and increased interest rates on variable rate debt ($1 million).

CRITICAL ACCOUNTING POLICIES/ESTIMATES

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

Critical accounting policies and estimates including unbilled revenue, allowance for doubtful accounts, regulatory mechanisms, pension and postretirement benefits and income taxes are detailed in Notes 1, 2, 3, 5, 6 and 9 of Notes to Financial Statements.

Recent Accounting Pronouncements. Recent accounting pronouncements affecting LG&E are detailed in Note 1 of Notes to Financial Statements.

LIQUIDITY AND CAPITAL RESOURCES

LG&E uses net cash generated from its operations and external financing (including financing from affiliates) 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.

As of December 31, 2007, LG&E is in a negative working capital position in part because of the classification of certain variable-rate pollution control bonds totaling $120 million that are subject to tender for purchase at the option of the holder as current portion of long-term debt. Credit facilities totaling $125 million are in place to fund such tenders, if necessary. LG&E has never needed to access these facilities. LG&E expects to cover any working capital deficiencies with cash flow from operations, money pool borrowings and borrowings from Fidelia.

Operating Activities

Cash provided by operations was $138 million and $320 million in 2007 and 2006, respectively.

The 2007 decrease of $182 million was primarily the result of decreases in cash due to changes in:

- Accounts receivable ($88 million) due to higher GSC and FAC billings in December 2007, related to higher year end coal and gas prices
- Materials and supplies ($48 million) due to higher coal inventory at December 31, 2007 resulting from higher coal prices as well as greater volumes on hand
- GSC recovery ($40 million) due to refunds of over recoveries
- Pension and postretirement funding ($26 million)
- Accrued income taxes ($22 million) due to estimated payments during 2007 being greater than income ta
accrued
- Property and other taxes payable ($17 million)
- Prepaid pension asset ($14 million)

These decreases were partially offset by cash provided by changes in:

- Accounts payable ($33 million)
- Earnings, net of non-cash items ($13 million)
- MISO exit fee ($13 million) due to the MISO exit being completed effective September 1, 2006
- ECR recovery ($13 million)

Investing Activities

The primary use of funds for investing activities continues to be for capital expenditures. Net cash used for investing activities in 2007 increased $50 million in 2007 compared to 2006, primarily due to increased capital expenditures of $48 million and $2 million in restricted cash. Restricted cash primarily relates to cash received as a prepayment for equipment on order for the Louisville Arena project.

Financing Activities

Net cash inflows (outflows) for financing activities were $56 million and ($173) million in 2007 and 2006, respectively. See Note 7 of Notes to Financial Statements for information of redemptions, maturities and issuances of long-term debt.

Future Capital Requirements

LG&E expects its capital expenditures for the three-year period ending December 31, 2010, to total approximately $735 million, consisting primarily of construction of TC2 totaling approximately $85 million (including $25 million for environmental controls), gas main replacement initiatives of approximately $50 million, redevelopment of the Ohio Falls hydroelectric facility totaling approximately $45 million, a customer care system totaling approximately $30 million and on-going construction related to generation and distribution assets. See Note 9 of Notes to Financial Statements for additional information.

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 and to comply with environmental regulations. These needs are continually being reassessed and appropriate revisions are made, when necessary, in construction schedules. Future capital requirements may be affected in varying degrees by factors such as electric energy demand load growth, changes in construction expenditure levels, rate actions by regulatory agencies, new legislation, market entry of competing electric power generators, changes in commodity prices and labor rates, changes in environmental regulations and other regulatory requirements. See Contractual Obligations further below and Note 9 of Notes to Financial Statements for current commitments. LG&E anticipates funding future capital requirements through operating cash flow, debt and/or infusions of capital from its parent.

Regulatory approvals are required for LG&E to incur additional debt. The FERC authorizes the issuance of short-term debt while the Kentucky Commission authorizes issuance of long-term debt. In November 2007, LG&E received a two-year authorization from the FERC to borrow up to $400 million in short-term funds.

LG&E's debt ratings as of December 31, 2007, were:

	Moody's	S&P
Pollution control revenue bonds	A2	BBB+
Issuer rating	A2	-
Corporate credit rating	-	BBB+

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

Contractual Obligations

The following is provided to summarize contractual cash obligations for periods after December 31, 2007. LG&E anticipates cash from operations and external financing will be sufficient to fund future obligations. Future interest obligations cannot be quantified because most of LG&E's debt is variable rate. See Statements of Capitalization.

(in millions)	Payments Due by Period						
Contractual Cash Obligations	2008	2009	2010	2011	2012	Thereafter	Total
Short-term debt (a)	$ 78	$ -	$ -	$ -	$ -	$ -	$ 78
Long-term debt	-	-	-	-	25	959 (b)	984
Operating leases (c)	5	4	4	3	3	5	24
Unconditional power purchase obligations (d)	16	18	19	19	19	322	413
Coal and gas purchase obligations (e)	245	197	200	212	67	5	926
Retirement obligations (f)	35	35	34	34	33	167	338
Other obligations (g)	75	26	3	-	-	-	104
Total contractual cash obligations	$ 454	$ 280	$ 260	$ 268	$ 147	$ 1,458	$ 2,867

(a) Represents borrowings from affiliated company due within one year.
(b) Includes long-term debt of $120 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 2026 to 2027. LG&E does not expect to pay these amounts in 2008.
(c) Represents future operating lease payments.
(d) Represents future minimum payments under OVEC power purchase agreements through 2026.
(e) Represents contracts to purchase coal and natural gas.
(f) Represents currently projected cash flows for pension, postretirement and other post-employment benefits as calculated by the actuary.
(g) Represents construction commitments, including commitments for TC2.

CONTROLS AND PROCEDURES

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

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls

may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

The Company has assessed the effectiveness of its internal control over financial reporting as of December 31, 2007. In making this assessment, the Company used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control - Integrated Framework ("COSO"). The Company has concluded that, as of December 31, 2007, the Company's internal control over financial reporting was effective based on those criteria.

LG&E is no longer subject to the internal control and other requirements of the Sarbanes-Oxley Act of 2002 and associated rules (the "Act") and consequently has not issued Management's Report on Internal Controls over Financial Reporting pursuant to Section 404 of the Act.

Louisville Gas and Electric Company
Statements of Income
(Millions of $)

	Years Ended December 31 2007	2006
OPERATING REVENUES:		
Electric (Note 12)	$ 933	$ 943
Gas	353	395
Total operating revenues	1,286	1,338
OPERATING EXPENSES:		
Fuel for electric generation	318	294
Power purchased (Notes 9 and 12)	82	114
Gas supply expenses	254	295
Other operation and maintenance expenses	276	288
Depreciation and amortization (Note 1)	126	124
Total operating expenses	1,056	1,115
Net operating income	230	223
Other expense - net	1	3
Interest expense (Notes 7 and 8)	29	28
Interest expense to affiliated companies (Note 12)	21	13
Income before income taxes	179	179
Federal and state income taxes (Note 6)	59	62
Net income	$ 120	$ 117

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

Statements of Retained Earnings
(Millions of $)

	Years Ended December 31 2007	2006
Balance January 1	$639	$621
Add net income	120	117
Preferred stock buyback	(4)	-
	755	738
Deduct: Cash dividends declared on stock:		
5% cumulative preferred	-	1
Auction rate cumulative preferred	-	3
Common	65	95
	65	99
Balance December 31	$690	$639

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

Louisville Gas and Electric Company
Statements of Comprehensive Income
(Millions of $)

	Years Ended December 31	
	2007	2006
Net income	$120	$117
Gain (loss) on derivative instruments and hedging activities, net of tax benefit (expense) of $2 and $(1) for 2007 and 2006, respectively (Notes 1 and 3)	(4)	2
Additional minimum pension liability adjustment, net of tax expense of $0 and $30 for 2007 and 2006, respectively (Note 5)	-	47
Other comprehensive income (loss), net of tax (Note 13)	(4)	49
Comprehensive income	$116	$166

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

Louisville Gas and Electric Company
Balance Sheets
(Millions of $)

	December 31 2007	December 31 2006
ASSETS:		
Current assets:		
Cash and cash equivalents (Note 1)	$ 4	$ 7
Restricted cash (Note 1)	7	-
Accounts receivable - less reserve of $2 in 2007 and 2006 (Note 1)	189	165
Accounts receivable from affiliated companies (Note 12)	-	19
Materials and supplies (Note 1):		
Fuel (predominantly coal)	46	38
Gas stored underground	81	83
Other materials and supplies	31	30
Prepayments and other current assets	13	9
Total current assets	371	351
Utility plant, at original cost (Note 1):		
Electric	3,246	3,200
Gas	551	526
Common	178	180
Total utility plant, at original cost	3,975	3,906
Less: reserve for depreciation	1,619	1,534
Total utility plant, net	2,356	2,372
Construction work in progress	344	217
Total utility plant and construction work in progress	2,700	2,589
Deferred debits and other assets:		
Restricted cash (Note 1)	12	16
Prepaid pension assets	14	-
Regulatory assets (Notes 1 and 2):		
Pension and postretirement benefits	110	126
Other	94	93
Other assets	12	9
Total deferred debits and other assets	242	244
Total Assets	$3,313	$3,184

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

Louisville Gas and Electric Company
Balance Sheets (continued)
(Millions of $)

	December 31 2007	December 31 2006
LIABILITIES AND EQUITY:		
Current liabilities:		
Current portion of long term debt (Note 7)	$ 120	$ 248
Notes payable to affiliated companies (Notes 8 and 12)	78	68
Accounts payable	111	103
Accounts payable to affiliated companies (Note 12)	57	55
Customer deposits	19	18
Other current liabilities	34	40
Total current liabilities	419	532
Long-term debt:		
Long-term bonds (Note 7)	454	328
Long-term notes to affiliated company (Note 7)	410	225
Mandatorily redeemable preferred stock (Note 7)	-	19
Total long-term debt	864	572
Deferred credits and other liabilities:		
Accumulated deferred income taxes (Note 6)	342	333
Accumulated provision for pensions and related benefits (Note 5)	94	149
Investment tax credit, in process of amortization	46	41
Asset retirement obligations	30	28
Regulatory liabilities (Note 2):		
Accumulated cost of removal of utility plant	241	232
Deferred income taxes	50	54
Other regulatory liabilities	19	35
Other liabilities	47	44
Total deferred credits and other liabilities	869	916
Commitments and contingencies (Note 9)		
Cumulative preferred stock	-	70
COMMON EQUITY:		
Common stock, without par value -		
Authorized 75,000,000 shares, outstanding 21,294,223 shares	424	424
Additional paid-in capital (Note 12)	60	40
Accumulated other comprehensive income (Note 13)	(13)	(9)
Retained earnings	690	639
Total common equity	1,161	1,094
Total Liabilities and Equity	$3,313	$3,184

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

Louisville Gas and Electric Company
Statements of Cash Flows
(Millions of $)

	Years Ended December 31	
	2007	2006
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 120	$ 117
Items not requiring cash currently:		
Depreciation and amortization	126	124
Deferred income taxes - net	9	22
Investment tax credit - net	5	(1)
VDT amortization	-	8
Provision for pension and postretirement plans	16	(13)
Other	(3)	3
Change in certain current assets and liabilities:		
Accounts receivable	(5)	83
Materials and supplies	(7)	41
Accounts payable	(14)	(47)
Accrued income taxes	(14)	8
Property and other taxes payable	(3)	14
Prepayments and other current assets	(4)	-
Prepaid pension asset	(14)	-
Other current liabilities	7	2
Pension and postretirement funding	(55)	(29)
Gas supply clause receivable, net	(23)	17
Fuel adjustment clause receivable, net	(5)	(4)
MISO exit fee	-	(13)
Environmental cost recovery mechanism receivable	6	(7)
Other	(4)	(5)
Net cash provided by operating activities	138	320
CASH FLOWS FROM INVESTING ACTIVITIES:		
Construction expenditures	(194)	(146)
Change in restricted cash	(3)	(1)
Net cash used for investing activities	(197)	(147)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Long-term borrowings from affiliated company (Note 7)	185	-
Short-term borrowings from affiliated company (Note 8)	134	700
Repayment of short-term borrowings from affiliated company	(124)	(773)
Retirement of first mortgage bonds	(126)	-
Issuance of pollution control bonds	126	-
Retirement of cumulative preferred stock	(70)	-
Retirement of mandatorily redeemable preferred stock	(20)	(1)
Preferred stock buyback adjustment	(4)	-
Payment of dividends	(65)	(99)
Additional paid-in capital	20	-
Net cash provided by (used for) financing activities	56	(173)
Change in cash and cash equivalents	(3)	-
Cash and cash equivalents at beginning of year	7	7
Cash and cash equivalents at end of year	$ 4	$ 7
Supplemental disclosures of cash flow information:		
Cash paid during the year for:		
Income taxes	$62	$64
Interest on borrowed money	24	24
Interest to affiliated companies on borrowed money	15	11

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

Louisville Gas and Electric Company
Statements of Capitalization
(Millions of $)

	December 31 2007	December 31 2006
LONG-TERM DEBT (Note 7):		
Pollution control series:		
S due September 1, 2017, variable %	$ -	$ 31
T due September 1, 2017, variable %	-	60
U due August 15, 2013, variable %	-	35
Jefferson Co. 2000 Series A, due May 1, 2027, variable %	25	25
Trimble Co. 2000 Series A, due August 1, 2030, variable %	83	83
Jefferson Co. 2001 Series A environmental facilities bonds, due September 1, 2027, variable %	10	10
Jefferson Co. 2001 Series A pollution control bonds, due September 1, 2026, variable %	23	23
Trimble Co. 2001 Series A, due September 1, 2026, variable %	28	28
Jefferson Co. 2001 Series B, due November 1, 2027, variable %	35	35
Trimble Co. 2001 Series B, due November 1, 2027, variable %	35	35
Trimble Co. 2002 Series A, due October 1, 2032, variable %	42	42
Louisville Metro 2003 Series A, due October 1, 2033, variable %	128	128
Louisville Metro 2005 Series A, due February 1, 2035, variable %	40	40
Trimble Co. 2007 Series A, due June 1, 2033, 4.60%	60	-
Louisville Metro 2007 Series B, due June 1, 2033, variable %	35	-
Louisville Metro 2007 Series A, due June 1, 2033, variable %	31	-
Notes payable to Fidelia:		
Due January 16, 2012, 4.33%, unsecured	25	25
Due April 30, 2013, 4.55%, unsecured	100	100
Due August 15, 2013, 5.31%, unsecured	100	100
Due November 26, 2022, 5.72%, unsecured	47	-
Due April 13, 2031, 5.93%, unsecured	67	-
Due April 13, 2037, 5.98 %, unsecured	70	-
Mandatorily redeemable preferred stock:		
$5.875 series, outstanding shares of 0 in 2007 and 200,000 in 2006	-	20
Total long-term debt outstanding	984	820
Less current portion of long-term debt	120	248
Long-term debt	864	572
CUMULATIVE PREFERRED STOCK:		
$25 par value, 1,720,000 shares authorized – 5% series, outstanding shares of 0 in 2007 and 860,287 in 2006	-	21
Without par value, 6,750,000 shares authorized –auction rate, outstanding shares of 0 in 2007 and 500,000 in 2006	-	49
	-	70
COMMON EQUITY:		
Common stock, without par value -		
Authorized 75,000,000 shares, outstanding 21,294,223 shares	424	424
Additional paid-in capital (Note 12)	60	40
Accumulated other comprehensive income (Note 13)	(13)	(9)
Retained earnings	690	639
Total common equity	1,161	1,094
Total capitalization	$2,025	$1,736

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

Note 1 - Summary of Significant Accounting Policies

LG&E, incorporated in Kentucky in 1913, 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. LG&E supplies natural gas to approximately 326,000 customers and electricity to approximately 401,000 customers in Louisville and adjacent areas in Kentucky. LG&E's coal-fired electric generating stations, all equipped with systems to reduce SO_2 emissions, produce most of LG&E's electricity. The remainder is generated by a hydroelectric power plant and natural gas and oil fueled CTs.

LG&E is a wholly-owned subsidiary of E.ON U.S., formerly known as LG&E Energy LLC. E.ON U.S. is an indirect wholly-owned subsidiary of E.ON, a German corporation, making LG&E an indirect wholly-owned subsidiary of E.ON. LG&E's affiliate, KU, is a regulated public utility engaged in the generation, transmission, distribution and sale of electric energy in Kentucky, Virginia and Tennessee.

Certain reclassification entries have been made to the previous years' financial statements to conform to the 2007 presentation with no impact on net assets, liabilities and capitalization or previously reported net income and cash flows.

Regulatory Accounting. LG&E is subject to SFAS No. 71, under which regulatory assets are created based on expected recovery from customers in future rates to defer costs that would otherwise be charged to expense. Likewise, regulatory liabilities are created based on expected return to customers in future rates to defer credits that would otherwise be reflected as income, or, in the case of costs of removal, are created to match long-term future obligations arising from the current use of assets. The accounting for regulatory assets and liabilities is based on specific ratemaking decisions or precedent for each item as prescribed by the FERC or the Kentucky Commission. See Note 2, Rates and Regulatory Matters, for additional detail regarding regulatory assets and liabilities.

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

Restricted Cash. A deposit in the amount of $12 million, used as collateral for an $83 million interest rate swap expiring in 2020, is classified as restricted cash on LG&E's balance sheet. An advance deposit of $7 million from the Louisville Arena Authority is also restricted for equipment purchases related to relocating transmission facilities.

Allowance for Doubtful Accounts. The allowance for doubtful accounts is based on the ratio of the amounts charged-off during the last twelve months to the retail revenues billed over the same period multiplied by the retail revenues billed over the last four months. Accounts with no payment activity are charged-off after four months, although collection efforts continue thereafter.

Materials and Supplies. Fuel, natural gas stored underground and other materials and supplies inventories are accounted for using the average-cost method. Emission allowances are included in other materials and supplies and are not currently traded by LG&E. At December 31, 2007 and 2006, the emission allowances inventory was less than $1 million.

Other Property and Investments. Other property and investments on the balance sheets consists of LG&E's investment in OVEC and non-utility plant. 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. Pursuant to current contractual agreements, LG&E's share of OVEC's output is 5.63%, approximately 124 Mw of generation capacity.

As of December 31, 2007 and 2006, LG&E's investment in OVEC totaled less than $1 million. LG&E is not the primary beneficiary of OVEC; therefore, it is not consolidated into the financial statements of LG&E and is accounted for under the cost method of accounting. LG&E's maximum exposure to loss as a result of its involvement with OVEC is limited to the value of its investment. In the event of the inability of OVEC to fulfill its power provision requirements, LG&E anticipates substituting such power supply with either owned generation or market purchases and believes it would generally recover associated incremental costs through regulatory rate mechanisms. See Note 9, Commitments and Contingencies, for further discussion of developments regarding LG&E's ownership interest and power purchase rights.

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, in accordance with Kentucky Commission regulations.

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

Depreciation and Amortization. Depreciation is provided on the straight-line method over the estimated service lives of depreciable plant. The amounts provided were approximately 3.2% in 2007 (3.0% electric, 2.8% gas and 7.7% common); and 3.2% in 2006 (3.0% electric, 2.9% gas and 7.8% common) of average depreciable plant. Of the amount provided for depreciation, at December 31, 2007, approximately 0.4% electric, 0.8% gas and 0.1% common were related to the retirement, removal and disposal costs of long lived assets. Of the amount provided for depreciation, at December 31, 2006, approximately 0.4% electric, 0.9% gas and 0.4% common were related to the retirement, removal and disposal costs of long lived assets.

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

Income Taxes. Income taxes are accounted for under SFAS No. 109, *Accounting for Income Taxes* and FIN 48, *Accounting for Uncertainty in Income Taxes, an Interpretation of SFAS No. 109.* In accordance with these statements, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, as measured by enacted tax rates that are expected to be in effect in the periods when the deferred tax assets and liabilities are expected to be settled or realized. Significant judgment is required in determining the provision for income taxes, and there are transactions for which the ultimate tax outcome is uncertain. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Uncertain tax positions are analyzed periodically and adjustments are made when events occur to warrant a change. See Note 6, Income Taxes.

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

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

Revenue Recognition. Revenues are recorded based on service rendered to customers through month-end. LG&E accrues an estimate for unbilled revenues from each meter reading date to the end of the accounting period based on allocating the daily system net deliveries between billed volumes and unbilled volumes. The allocation is based on a daily ratio of the number of meter reading cycles remaining in the month to the total number of meter reading cycles in each month. Each day's ratio is then multiplied by each day's system net deliveries to determine an estimated billed and unbilled volume for each day of the accounting period. The unbilled revenue estimates included in accounts receivable were $65 million and $53 million at December 31, 2007 and 2006, respectively.

Fuel and Gas Costs. The cost of fuel for electric generation is charged to expense as used, and the cost of natural gas supply is charged to expense as delivered to the distribution system. LG&E operates under a Kentucky Commission-approved performance-based ratemaking mechanism related to natural gas procurement activity. See Note 2, 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. Accrued liabilities, including legal and environmental, are recorded when they are probable and estimable. Actual results could differ from those estimates.

Recent Accounting Pronouncements. The following are recent accounting pronouncements affecting LG&E:

SFAS No. 160

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements,* which is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. The objective of this statement is to improve the relevance, comparability and transparency of financial information in a reporting entity's consolidated financial statements. The Company expects the adoption of SFAS No. 160 to have no impact on its statements of operations, financial position and cash flows.

SFAS No. 159

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities – Including an Amendment of FASB Statement No. 115*. SFAS No. 159 permits entities to choose to measure many financial instruments and certain other assets and liabilities at fair value on an instrument-by-instrument basis (the fair value option). Unrealized gains and losses on items for which the fair value option has been elected are to be recognized in earnings at each subsequent reporting date. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. SFAS No. 159 was adopted effective January 1, 2008 and had no impact on the statements of operations, financial position and cash flows.

SFAS No. 157

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, which, except as described below, is effective for fiscal years beginning after November 15, 2007. This statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 does not expand the application of fair value accounting to new circumstances. In February 2008, the FASB issued FASB Staff Position 157-2, *Effective Date of FASB Statement No. 157,* which delays the effective date of SFAS No. 157 for all nonfinancial assets and liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), to fiscal years beginning after November 15, 2008 and interim periods within those fiscal years. SFAS No. 157 was adopted effective January 1, 2008, except as it applies to those nonfinancial assets and liabilities, and had no impact on the statements of operations, financial position and cash flows, however, the Company will provide additional disclosures relating to its financial derivatives, AROs and pension assets as required in 2008.

FIN 48

In July 2006, the FASB issued FIN 48 which clarifies the accounting for the uncertainty of income tax positions recognized in an enterprise's financial statements in accordance with SFAS No. 109. This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return.

The evaluation of a tax position in accordance with FIN 48 is a two-step process. The first step is recognition based on the determination of whether it is "more likely than not" that a tax position will be sustained upon examination. The second step is to measure a tax position that meets the "more likely than not" threshold. The tax position is measured as the amount of potential benefit that exceeds 50% likelihood of being realized.

FIN 48 is effective for fiscal years beginning after December 15, 2006, and was adopted effective January 1, 2007. The impact of FIN 48 on the statements of operations, financial position and cash flows was not material.

Note 2 - Rates and Regulatory Matters

LG&E is subject to the jurisdiction of the Kentucky Commission and the FERC in virtually all matters related to electric and gas utility regulation, and as such, its accounting is subject to SFAS No. 71. Given its competitive position in the marketplace and the status of regulation in Kentucky, LG&E has no plans or intentions to discontinue its application of SFAS No. 71.

Electric and Gas Rate Cases

In December 2003, LG&E filed an application with the Kentucky Commission requesting adjustments in LG&E's electric and natural gas rates. The revenue increases requested were $64 million for electric and $19 million for natural gas. In June 2004, the Kentucky Commission issued an Order approving increases in LG&E's electric base rates of approximately $43 million (8%) and natural gas base rates of approximately $12 million (3%). The rate increases took effect on July 1, 2004.

Final proceedings took place during the first quarter of 2006 concerning the sole remaining open issue relating to state income tax rates used in calculating the granted rate increase. On March 31, 2006, the Kentucky Commission issued an Order resolving this issue in LG&E's favor consistent with the original rate increase order

Regulatory Assets and Liabilities

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

(in millions)	2007	2006
ARO	$ 24	$ 22
GSC adjustments	16	21
MISO exit	13	13
FAC	9	4
Unamortized loss on bonds	19	20
ECR	4	9
Other	9	4
Subtotal	94	93
Pension and postretirement benefits	110	126
Total regulatory assets	$ 204	$ 219
Accumulated cost of removal of utility plant	$ 241	$ 232
Deferred income taxes - net	50	54
GSC adjustments	10	31
Other	9	4
Total regulatory liabilities	$ 310	$ 321

LG&E does not currently earn a rate of return on the GSC adjustments, FAC and gas performance-based ratemaking regulatory assets, all of which are separate recovery mechanisms with recovery within twelve months No return is earned on the pension and postretirement benefits regulatory asset which represents the changes in funded status of the plans. The Company will seek recovery of this asset in future proceedings with the Kentucky Commission. No return is currently earned on the ARO asset. This regulatory asset will be offset against the associated regulatory liability, ARO asset and ARO liability at the time the underlying asset is retired. The MISO exit amount represents the costs relating to the withdrawal from MISO membership. LG&E will seek recovery of this asset in future proceedings with the Kentucky Commission. LG&E currently earns a rate of return on the remaining regulatory assets. Other regulatory assets include VDT costs, the merger surcredit, gas performance based ratemaking and Mill Creek Ash Pond costs. Other regulatory liabilities include DSM and MISO costs included in base rates that will be netted against costs of withdrawing from the MISO in the next rate case.

ARO. A summary of LG&E's net ARO assets, regulatory assets, liabilities and cost of removal established under FIN 47, *Accounting for Conditional Asset Retirement Obligations, an Interpretation of SFAS No. 143,* and SFAS No. 143, *Accounting for Asset Retirement Obligations* follows:

(in millions)	ARO Net Assets	ARO Liabilities	Regulatory Assets	Accumulated Cost of Removal
As of December 31, 2005	$ 4	$ (27)	$ 20	$ 3
ARO accretion	-	(1)	2	-
As of December 31, 2006	4	(28)	22	3
ARO accretion	-	(2)	2	-
Removal cost incurred	-	1	-	-
As of December 31, 2007	$ 4	$ (29)	$ 24	$ 3

Pursuant to regulatory treatment prescribed under SFAS No. 71, an offsetting regulatory credit was recorded in depreciation and amortization in the income statement of $2 million in 2007 and 2006 for the ARO accretion and depreciation expense. LG&E AROs are primarily related to the final retirement of assets associated with generating units and natural gas wells. For assets associated with AROs, the removal cost accrued through depreciation under regulatory accounting is established as a regulatory liability pursuant to regulatory treatment prescribed under SFAS No. 71. There were no FIN 47 net asset additions during 2007. FIN 47 net asset additions during 2006 were less than $1 million. For the years ended December 31, 2007 and 2006, LG&E recorded less than $1 million of depreciation expense related to the cost of removal of ARO related assets. An offsetting regulatory liability was established pursuant to regulatory treatment prescribed under SFAS No. 71.

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 are recorded for transmission and distribution assets.

GSC Adjustments. LG&E's natural gas rates contain a GSC, whereby increases or decreases in the cost of natural 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 natural gas supply in that quarter. In addition, the GSC contains a mechanism whereby any over- or under-recoveries of natural gas supply cost from prior quarters is to be refunded to or recovered from customers through the adjustment factor determined for subsequent quarters.

LG&E's GSC was modified in 1997 to incorporate a natural gas procurement incentive mechanism. Since November 1, 1997, LG&E has operated under this PBR mechanism related to its natural gas procurement activities. LG&E's rates are adjusted annually to recover (or refund) its portion of the expense (or savings) incurred during each PBR year (12 months ending October 31). During the PBR year ending in 2007, LG&E achieved $10 million in savings. Of that total savings amount, LG&E's portion was approximately $2 million and the ratepayers' portion was approximately $8 million. Pursuant to the extension of LG&E's natural gas supply cost PBR mechanism effective November 1, 2001, the sharing mechanism under the PBR requires savings (and expenses) to be shared 25% with shareholders and 75% with ratepayers up to 4.5% of the benchmarked natural gas costs. Savings (and expenses) in excess of 4.5% of the benchmarked natural gas costs are shared 50% with shareholders and 50% with ratepayers. The current natural gas supply cost PBR mechanism was extended through 2010 without further modification.

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

LG&E and the MISO have agreed upon overall calculation methods for the contractual exit fee to be paid by the Company following its withdrawal. In October 2006, LG&E paid approximately $13 million to the MISO pursuant to an invoice regarding the exit fee and made related FERC compliance filings. The Company's payment of this exit fee amount was with reservation of its rights to contest the amount, or components thereof, following a continuing review of its calculation and supporting documentation. In December 2006, LG&E provided notice to the MISO of its disagreement with the calculation of the exit fee. LG&E and the MISO have resolved their dispute regarding the calculation of the exit fee and, in November 2007, filed an application with the FERC for approval of a recalculation agreement. In March 2008, the FERC approved the parties' recalculation of the exit fee, and the approved agreement provides LG&E with an immediate recovery of less

than $1 million and will provide an estimated $2 million over the next eight years for credits realized from other payments the MISO will receive, plus interest. Orders of the Kentucky Commission approving the Company's exit from the MISO have authorized the establishment of a regulatory asset for the exit fee, subject to adjustment for possible future MISO credits, and a regulatory liability for certain revenues associated with former MISO administrative charges, which may continue to be collected via base rates. The treatment of the regulatory asset and liability will be determined in LG&E's next rate case, however, the Company historically has received approval to recover and refund regulatory assets and liabilities.

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

The Kentucky Commission requires public hearings at six-month intervals to examine past fuel adjustments, and at two-year intervals to review past operations of the fuel clause and transfer of the then current fuel adjustment charge or credit to the base charges.

In January 2008, the Kentucky Commission initiated a routine examination of LG&E's FAC for the six-month period May 1, 2007 through October 31, 2007. Data discovery is ongoing and a public hearing is scheduled in March 2008.

In August 2007, the Kentucky Commission initiated a routine examination of LG&E's FAC for the six-month period of November 1, 2006 through April 30, 2007. Data discovery has concluded and a public hearing was held in October 2007. The Kentucky Commission issued an Order in January 2008, approving the charges and credits billed through the FAC during the review period.

In December 2006, the Kentucky Commission initiated its periodic two-year review of LG&E's past operations of the fuel clause and transfer of fuel costs from the FAC to base rates for November 1, 2004 through October 31, 2006. In March 2007, the KIUC challenged LG&E's recovery of approximately $1 million in aggregate fuel costs LG&E incurred during a period prior to its exit from the MISO and requested the Kentucky Commission disallow this amount. A public hearing was held in May 2007. In October 2007, the Kentucky Commission issued its Order approving the calculation and application of LG&E's FAC charges and fuel procurement practices and indicated that LG&E was in compliance with the provisions of Administrative Regulation 807 KAR 5:5056. The Kentucky Commission further approved LG&E's recommendation for the transfer of fuel cost from the FAC to base rates. In November 2007, the KIUC filed a petition for rehearing, claiming the Kentucky Commission misinterpreted the KIUC's arguments in the proceeding. In the same month, the Kentucky Commission issued an Order denying the KIUC's request for rehearing. An appeal was not filed by the KIUC.

In July 2006, the Kentucky Commission initiated a six-month review of the FAC for LG&E for the period of November 1, 2005 through April 30, 2006. The Kentucky Commission issued an Order in November 2006, approving the charges and credits billed through the FAC during the review period.

In January 2003, the Kentucky Commission reviewed KU's FAC and, as part of the Order in that case, required that an independent audit be conducted to examine operational and management aspects of both LG&E's and KU's fuel procurement functions. The final report's recommendations, issued in February 2004, related to documentation and process improvements. Management Audit Action Plans were agreed upon by LG&E and the Kentucky Commission Staff in the second quarter of 2004, and resulted in Audit Progress Reports being filed by

LG&E with the Kentucky Commission. In February 2007, the Kentucky Commission staff indicated that LG&E fully complied with all audit recommendations and that no further reports are required.

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

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

In September 2007, the Kentucky Commission initiated six-month and two-year reviews for periods ending October 31, 2006 and April 30, 2007, respectively, of LG&E's environmental surcharge. Data discovery concluded in December 2007, and all parties to the case submitted requests with the Kentucky Commission to waive rights to a hearing on this matter. The case is submitted for decision and an order is anticipated in the second quarter of 2008.

In June 2006, LG&E filed an application to amend its ECR plan with the Kentucky Commission seeking approval to recover investments in environmental upgrades at the Company's generating facilities. The estimated capital cost of the upgrades for the years 2008 through 2010 is approximately $40 million, of which approximately $30 million is for the Air Quality Control System at TC2. A final Order was issued by the Kentucky Commission in December 2006, approving all expenditures and investments as submitted.

In April 2006, the Kentucky Commission initiated six-month and two-year reviews of LG&E's environmental surcharge for six-month periods ending October 2003, April 2004, October 2004, October 2005 and April 2006, and for the two-year period ending April 2005. A final Order was received in January 2007, approving the charges and credits billed through the ECR during the review period as well as approving billing adjustments, a roll-in to base rates, revisions to the monthly surcharge filing and the rate of return on capital.

VDT. In December 2001, the Kentucky Commission issued an Order approving a settlement agreement allowing LG&E to set up a regulatory asset of $141 million for workforce reduction costs and begin amortizing it over a five-year period starting in April 2001. Some employees rescinded their participation in the voluntary enhanced severance program, which thereby decreased the charge to the regulatory asset from $144 million to $141 million. The Order reduced revenues by approximately $26 million through a surcredit on bills to ratepayers over the same five-year period, reflecting a sharing (40% to the ratepayers and 60% to LG&E) of savings as stipulated by LG&E, net of amortization costs of the workforce reduction. The five-year VDT amortization period expired in March 2006.

As part of the settlement agreements in the electric and natural gas rate cases, in September 2005, LG&E filed with the Kentucky Commission a plan for the future ratemaking treatment of the VDT surcredit and costs. In February 2006, the AG, KIUC and LG&E reached a settlement agreement on the future ratemaking treatment of the VDT surcredits and costs and subsequently submitted a joint motion to the Kentucky Commission to approve the unanimous settlement agreement. Under the terms of the settlement agreement, the VDT surcredit will continue at the current level until such time as LG&E files for a change in electric or natural gas base rates. The Kentucky Commission issued an Order in March 2006, approving the settlement agreement.

Merger Surcredit. As part of the LG&E Energy merger with KU Energy Corporation in 1998, LG&E estimated non-fuel savings over a ten-year period following the merger. Costs to achieve these savings were deferred and

amortized over a five-year period pursuant to regulatory orders. 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 LG&E over a five-year period. In that same order, the Kentucky Commission required LG&E, after the end of the five-year period, to present a plan for sharing with ratepayers the then-projected non-fuel savings associated with the merger. LG&E submitted this filing in January 2003, proposing to continue to share with ratepayers, on a 50%/50% basis, the estimated fifth-year gross level of non-fuel savings associated with the merger. In October 2003, the Kentucky Commission issued an Order approving a settlement agreement reached with the parties in the case. According to the Order, LG&E's merger surcredit would remain in place for another five-year term beginning July 1, 2003, the merger savings would continue to be shared 50% with ratepayers and 50% with shareholders and LG&E would file a plan for the merger surcredit six months before its expiration.

In December 2007, LG&E submitted to the Kentucky Commission its plan to allow the merger surcredit to terminate as scheduled on June 30, 2008. The Kentucky Commission has not issued a procedural schedule for this proceeding.

Pension and Postretirement Benefits. LG&E adopted SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans,* in 2006. This statement requires employers to recognize the over-funded or under-funded status of a defined benefit pension and postretirement plan as an asset or liability in the balance sheet and to recognize through comprehensive income the changes in the funded status in the year in which the changes occur. Under SFAS No. 71, LG&E can defer recoverable costs that would otherwise be charged to expense or equity by non-regulated entities. Current rate recovery in Kentucky is based on SFAS No. 87, *Employers' Accounting for Pensions,* and SFAS No. 106, *Employers' Accounting for Postretirement Benefits Other than Pensions,* both of which were amended by SFAS No. 158. Regulators have been clear and consistent with their historical treatment of such rate recovery, therefore, LG&E has recorded a regulatory asset representing the probable recovery of the portion of the change in funded status of the pension and postretirement plans that is expected to be recovered. The regulatory asset will be adjusted annually as prior service cost and actuarial gains and losses are recognized in net periodic benefit cost.

Accumulated Cost of Removal of Utility Plant. As of December 31, 2007 and 2006, LG&E has segregated the cost of removal, previously embedded in accumulated depreciation, of $241 million and $232 million, respectively, in accordance with FERC Order No. 631. This cost of removal component is for assets that do not have a legal ARO under SFAS No. 143. For reporting purposes in the balance sheets, LG&E has presented this cost of removal as a regulatory liability pursuant to SFAS No. 71.

Deferred Income Taxes – Net. Deferred income taxes represent the future income tax effects of recognizing the regulatory assets and liabilities in the income statement. Deferred income taxes are recognized at currently enacted tax rates for all material temporary differences between the financial reporting and income tax bases of assets and liabilities.

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

In July 2007, LG&E and KU filed an application with the Kentucky Commission requesting an order approving enhanced versions of the existing DSM programs along with the addition of several new cost effective programs.

The total annual budget for these programs is approximately $26 million, an increase over the existing annual budget of approximately $10 million. Data discovery concluded in November 2007, and the Community Action Council ("CAC") for Lexington-Fayette, Bourbon, Harrison and Nicholas counties and the Kentucky Association for Community Action ("KACA"), filed a motion for hearing. In January 2008, the CAC and KACA filed a motion with the Kentucky Commission to withdraw the request because the parties reached a settlement. The Kentucky Commission is allowing the current tariffs to remain in effect until a final order is issued.

Other Regulatory Matters

Regional Reliability Council. LG&E has changed its regional reliability council membership from the Reliability First Corporation to the SERC Reliability Corporation ("SERC"), effective January 1, 2007. Regional reliability councils are industry consortiums that promote, coordinate and ensure the reliability of the bulk electric supply systems in North America.

Arena. In August 2006, LG&E filed an application with the Kentucky Commission requesting approval for sale of the Waterside property to the Louisville Arena Authority. The Kentucky Commission issued an Order in September 2006, approving the proposed transaction. In November 2006, LG&E completed certain agreements pursuant to its August 2006 Memorandum of Understanding with the Louisville Arena Authority regarding the proposed construction of an arena in downtown Louisville. LG&E entered into a relocation agreement with the Louisville Arena Authority providing for the reimbursement to LG&E of the costs to be incurred in moving certain LG&E facilities related to the arena transaction. Those costs are currently estimated to be approximately $63 million. The parties further entered into a property sale contract providing for LG&E's sale of a downtown site to the Louisville Arena Authority for approximately $10 million, which represents the appraised value of the parcel, less certain agreed upon demolition costs. The amounts specified in the contracts are subject to certain adjustments. Depending upon continuing progress of the proposed arena, the transactions contemplated by the contracts will occur through 2008.

TC2 CCN Application. A CCN application for construction of the new, base-load, coal fired unit TC2, which will be jointly owned by LG&E and KU, was approved by the Kentucky Commission in November 2005, and initial CCN applications for three transmission lines were approved in September 2005 and May 2006. In August 2006, LG&E obtained dismissal of a judicial review of such CCN approvals by certain property owners. In December 2007, the Kentucky Court of Appeals reversed and remanded the lower Court's dismissal. Both parties have filed for reconsideration of elements of the appellate court's ruling. The transmission lines are also subject to routine regulatory filings and the right-of-way acquisition process. See Note 9, Commitments and Contingencies, for further discussion regarding the TC2 air permit.

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

FERC Audit Results. In July 2006, the FERC issued a final report under a routine audit that its Office of Enforcement (formerly its Office of Market Oversight and Investigations) had conducted regarding the compliance of E.ON U.S. and its subsidiaries, including LG&E, under the FERC's standards of conduct and codes of conduct requirements, as well as other areas. The final report contained certain findings calling for improvements in E.ON U.S. and its subsidiaries' structures, policies and procedures relating to transmission, generation dispatch, energy marketing and other practices. E.ON U.S. and its subsidiaries have agreed to certain corrective actions and have submitted procedures related to such corrective actions to the FERC. The corrective actions are in the nature of organizational and operational improvements as described above and are not expected to have a material adverse impact on the Company's results of operations or financial condition.

Mandatory Reliability Standards. As a result of EPAct 2005, certain formerly voluntary reliability standards became mandatory in June 2007, and authority was delegated to various regional reliability organizations ("RRO") by the Electric Reliability Organization, which was authorized by the FERC to enforce compliance with such standards, including promulgating new standards. Failure to comply with mandatory reliability standards can subject a registered entity to sanctions, including potential fines of up to $1 million per day as well as non-monetary penalties, depending upon the circumstances of the violation. LG&E is a member of the SERC, which acts as LG&E's RRO. The SERC is currently assessing LG&E's compliance with certain existing mitigation plans resulting from a prior RRO's audit of various reliability standards. While LG&E believes itself to be in substantial compliance with the mandatory reliability standards generally, LG&E cannot predict the outcome of the current SERC proceeding or of other analysis which may be conducted regarding compliance with particular reliability standards.

IRP. Integrated resource planning regulations in Kentucky require major utilities to make triennial IRP filings with the Kentucky Commission. In April 2005, LG&E and KU filed their 2005 joint IRP with the Kentucky Commission. The IRP provides historical and projected demand, resource and financial data, and other operating performance and system information. The AG and the KIUC were granted intervention in the IRP proceeding. The Kentucky Commission issued its staff report with no substantive issues noted and closed the case by Order in February 2006. LG&E and KU will submit the next joint triennial filing in April 2008.

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

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

In February 2006, the Kentucky Commission initiated an administrative proceeding to consider the requirements of the EPAct 2005, Subtitle E Section 1252, Smart Metering, which concerns time-based metering and demand response, and Section 1254, Interconnections. EPAct 2005 requires each state regulatory authority to conduct a formal investigation and issue a decision on whether or not it is appropriate to implement certain Section 1252,

Smart Metering standards within eighteen months after the enactment of EPAct 2005 and to commence consideration of Section 1254, Interconnection standards within one year after the enactment of EPAct 2005. Following a public hearing with all Kentucky jurisdictional electric utilities, in December 2006, the Kentucky Commission issued an Order in this proceeding indicating that the EPAct 2005 Section 1252, Smart Metering and Section 1254, Interconnection standards should not be adopted. However, all five Kentucky Commission jurisdictional utilities are required to file real-time pricing pilot programs for their large commercial and industrial customers. LG&E developed a real-time pricing pilot for large industrial and commercial customers and filed the details of the plan with the Kentucky Commission in April 2007. Data discovery concluded in July 2007, and no parties to the case requested a hearing. In February 2008, the Kentucky Commission issued an Order approving the real-time pricing pilot program proposed by LG&E for implementation within approximately eight months. LG&E will notify the Kentucky Commission 10 days prior to the actual implementation date and will file annual reports on the program within 90 days of each plan year-end for the 3-year pilot period.

As part of the LG&E 2004 rate case settlement agreements, and as referred to in the Kentucky Commission EPAct 2005 Administrative Order, LG&E made its responsive pricing and smart metering pilot program filing, which addresses real-time pricing for residential and general service customers, in March 2007. The AG and KIUC were granted full intervention. In July 2007, the Kentucky Commission approved the application as filed, for 100 residential customers and a sampling of other customers, and authorized LG&E to establish the responsive pricing and smart metering pilot program, recovery of non-specific customer costs through the DSM billing mechanism and the filing of annual reports by April 1, 2009, 2010 and 2011. LG&E must also file an evaluation of the program by July 1, 2011.

Hydro Upgrade. In October 2005, LG&E received from the FERC a new license to upgrade, operate and maintain the Ohio Falls Hydroelectric Project. The license is for a period of 40 years, effective November 2005. LG&E began refurbishing the facility to add approximately 20 Mw of generating capacity in 2004, and plans to spend approximately $45 million from 2008 to 2010.

Gas Storage Field Matter. In March 2007, LG&E commenced a review of certain federal and state permitting, licensing and oversight matters relating to existing natural gas operations at its Doe Run, Kentucky storage field, which extends into Indiana. The review related, in part, to the applicable jurisdictional status of such operations under the Natural Gas Act and whether additional applications, filings or exemptions were required or advisable. During March 2007, LG&E reported to the FERC the existence of possible permitting failures and in April 2007, filed an application for corrective Federal Power Act authorizations. In July 2007, the FERC accepted LG&E's Federal Power Act filing granting appropriate permit status for retail gas activities. This corrective event places these activities in compliance for future periods. In August 2007, the FERC advised LG&E that it had concluded its investigation related to prior periods and had closed the matter with no further actions.

Green Energy Riders. In February 2007, LG&E and KU filed a Joint Application and Testimony for Proposed Green Energy Riders. The AG and KIUC were granted full intervention. In May 2007, a Kentucky Commission Order was issued authorizing LG&E to establish Small and Large Green Energy Riders, allowing customers to contribute funds to be used for the purchase of renewable energy credits.

Home Energy Assistance Program. In July 2007, LG&E filed an application with the Kentucky Commission for the establishment of a new Home Energy Assistance program. During September 2007, the Kentucky Commission approved LG&E's new five-year program as filed, effective in October 2007. The program terminates in September 2012, and is funded through a $0.10 per month meter charge.

Collection Cycle Revision. In September 2007, LG&E filed an application with the Kentucky Commission to revise the collection cycle for customer bill payments from 15 days to 10 days to more closely align with the KU billing cycle and to avoid confusion for delinquent customers. In December 2007, the Kentucky Commission denied LG&E's request to shorten the collection cycle. LG&E filed a motion with the Kentucky Commission for reconsideration and received an Order granting approval. The Kentucky Commission issued additional data requests to LG&E in February 2008. No procedural schedule has been established.

Depreciation Study. In December 2007, LG&E filed a depreciation study with the Kentucky Commission requesting a change in the depreciation rates as required by a previous Order. An adjustment to the depreciation rates is dependent on an order being received by the Kentucky Commission, the timing of which cannot currently be determined.

Note 3 - Financial Instruments

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

	2007		2006	
(in millions)	Carrying Value	Fair Value	Carrying Value	Fair Value
Preferred stock subject to mandatory redemption (including current portion of $1 million)	$ -	$ -	$ 20	$ 20
Long-term debt (including current portion of $120 million)	$574	$571	$574	$574
Long-term debt from affiliate	$410	$438	$225	$222
Interest-rate swaps - liability	$ 21	$ 21	$ 15	$ 15

All of the above valuations reflect prices quoted by exchanges except for the swaps and loans from affiliate. The fair values of the swaps reflect price quotes from dealers. The loans from affiliate are fair valued using accepted valuation models. The fair values of cash and cash equivalents, accounts receivable, accounts payable and notes payable are substantially the same as their carrying values.

Interest Rate Swaps (hedging derivatives). LG&E uses over-the-counter interest rate swaps to hedge exposure to market fluctuations in certain of its debt instruments. Pursuant to Company policy, 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 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. See Note 13, Accumulated Other Comprehensive Income.

LG&E was party to various interest rate swap agreements with aggregate notional amounts of $211 million as of December 31, 2007 and 2006. Under these swap agreements, LG&E paid fixed rates averaging 4.38% and received variable rates based on the London Interbank Offer Rate or the Securities Industry and Financial Markets Association's municipal swap index averaging 3.5% and 3.75% at December 31, 2007 and 2006, respectively. The swap agreements in effect at December 31, 2007 have been designated as cash flow hedges and mature on dates ranging from 2020 to 2033. The cash flow designation was assigned because the underlying variable rate debt has variable future cash flows. The hedges have been deemed to be highly effective resulting ir a pre-tax loss of $6 million for 2007 and a pre-tax gain of $3 million for 2006, recorded in other comprehensive income. Amounts in accumulated other comprehensive income will be reclassified into earnings in the same period during which the hedged forecasted transaction affects earnings. The amount expected to be reclassified from other comprehensive income to earnings in the next twelve months is less than $1 million. A deposit in the

amount of $12 million, used as collateral for one of the interest rate swaps, is classified as restricted cash on the balance sheets. The amount of the deposit required is tied to the market value of the swap.

Energy Risk Management Activities (non-hedging derivatives). LG&E conducts energy trading and risk management activities to maximize the value of power sales from physical assets it owns. Energy trading activities are principally forward financial transactions to hedge price risk and are accounted for on a mark-to-market basis in accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities,* as amended.

The table below summarizes LG&E's energy trading and risk management activities:

(in millions)	2007	2006
Fair value of contracts at beginning of period, net asset	$ 1	$ 1
Unrealized gains and losses recognized at contract inception during the period	-	-
Realized gains and losses recognized during the period	(5)	16
Changes in fair values attributable to changes in valuation techniques and assumptions	4	(17)
Other unrealized gains and losses and changes in fair values	-	1
Fair value of contracts at end of period, net asset	$ -	$ 1

No changes to valuation techniques for energy trading and risk management activities occurred during 2007 or 2006. Changes in market pricing, interest rate and volatility assumptions were made during both years. All contracts outstanding at December 31, 2007 and 2006, 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, 2007, 100% of the trading and risk management commitments were with counterparties rated BBB-/Baa3 equivalent or better.

LG&E hedges the price volatility of its forecasted electric wholesale sales with the sales of market-traded electric forward contracts for periods of less than one year. Hedge accounting treatment has not been elected for these transactions, and therefore gains and losses are shown in the statements of income in other expense - net. Pre-tax losses of $5 million resulted in 2007. Pre-tax gains of $16 million resulted in 2006.

Note 4 - Concentrations of Credit and Other Risk

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

LG&E's customer receivables and natural gas and electric revenues arise from deliveries of natural gas to approximately 326,000 customers and electricity to approximately 401,000 customers in Louisville and adjacent areas in Kentucky. For the year ended December 31, 2007, 73% of total revenue was derived from electric operation and 27% from natural gas operations. For the year ended December 31, 2006, 70% of total revenue was derived fron electric operations and 30% from natural gas operations.

Effective November 2005, LG&E and its employees represented by the IBEW Local 2100 entered into a three-year collective bargaining agreement. The new agreement provides for negotiated increases or changes to wages and annual benefits re-openers. Benefits re-openers were negotiated in November 2006, and November 2007. The employees represented by this bargaining agreement comprise approximately 69% of LG&E's workforce at December 31, 2007.

Note 5 - Pension and Other Postretirement Benefit Plans

LG&E has both funded and unfunded non-contributory defined benefit pension plans and other postretirement benefit plans that together cover substantially all of its employees. The healthcare plans are contributory with participants' contributions adjusted annually. LG&E uses December 31 as the measurement date for its plans.

Obligations and Funded Status. The following tables provide a reconciliation of the changes in the plans' benefit obligations and fair value of assets over the two-year period ending December 31, 2007, and a statement of the funded status as of December 31 for LG&E's sponsored defined benefit plans:

(in millions)	Pension Benefits		Other Postretirement Benefits	
	2007	2006	2007	2006
Change in benefit obligation				
Benefit obligation at beginning of year	$ 408	$ 427	$ 105	$ 106
Service cost	4	4	1	1
Interest cost	24	23	5	6
Plan amendments	19	4	2	-
Benefits paid, net of retiree contributions	(28)	(29)	(9)	(8)
Actuarial gain and other	(19)	(21)	(15)	-
Benefit obligation at end of year	$ 408	$ 408	$ 89	$ 105
Change in plan assets				
Fair value of plan assets at beginning of year	$ 356	$ 333	$ 6	$ 3
Actual return on plan assets	26	36	1	-
Employer contributions	56	18	7	11
Benefits paid, net of retiree contributions	(28)	(29)	(9)	(8)
Administrative expenses and other	(1)	(2)	-	-
Fair value of plan assets at end of year	$ 409	$ 356	$ 5	$ 6
Funded status at end of year	$ 1	$ (52)	$ (84)	$ (99)

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

(in millions)	Pension Benefits		Other Postretirement Benefits	
	2007	2006	2007	2006
Regulatory assets	$ 93	$ 93	$ 17	$ 33
Non-current assets	14	-	-	-
Accrued benefit liability (current)	-	-	(3)	(2)
Accrued benefit liability (non-current)	(13)	(52)	(81)	(97)

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

(in millions)	Pension Benefits		Other Postretirement Benefits	
	2007	2006	2007	2006
Benefit obligation	$ 408	$ 408	$ 89	$ 105
Accumulated benefit obligation	378	391	-	-
Fair value of plan assets	409	356	5	6

Components of Net Periodic Benefit Cost. The following table provides the components of net periodic benefit cost for the plans:

(in millions)	Pension Benefits		Other Postretirement Benefits	
	2007	2006	2007	2006
Service cost	$ 4	$ 4	$ 1	$ 1
Interest cost	24	23	5	6
Expected return on plan assets	(32)	(27)	-	-
Amortization of prior service costs	5	4	2	2
Amortization of transitional asset	-	(1)	-	-
Amortization of actuarial loss	2	4	-	-
Amortization of transitional obligation	-	-	-	1
Benefit cost at end of year	$ 3	$ 7	$ 8	$ 10

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

	2007	2006
Weighted-average assumptions as of December 31:		
Discount rate - Union plan	6.56%	5.91%
Discount rate - Non-union plan	6.66%	5.96%
Rate of compensation increase	5.25%	5.25%

The discount rate is based on the November Mercer Pension Discount Yield Curve, adjusted by the basis point change in the Moody's Corporate Aa Bond Rate in December.

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

	2007	2006
Discount rate	5.90%	5.50%
Expected long-term return on plan assets	8.25%	8.25%
Rate of compensation increase	5.25%	5.25%

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

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

- A 1% change in the assumed discount rate could have an approximate $45 million positive or negative impact to the 2007 accumulated benefit obligation and an approximate $52 million positive or negative impact to the 2007 projected benefit obligation.
- A 25 basis point change in the expected rate of return on assets would have an approximate $1 million positive or negative impact on 2007 pension expense.

Assumed Healthcare Cost Trend Rates. For measurement purposes, a 9% annual increase in the per capita cost of covered healthcare benefits was assumed for 2007. The rate was assumed to decrease gradually to 5% by 2015 and remain at that level thereafter.

Assumed healthcare cost trend rates have a significant effect on the amounts reported for the healthcare plans. A 1% change in assumed healthcare cost trend rates would have resulted in an increase or decrease of less than $1 million on the 2007 total of service and interest costs components and an increase or decrease of $2 million in year-end 2007 postretirement benefit obligations.

Expected Future Benefit Payments. The following list provides the amount of expected future benefit payments, which reflect expected future service:

(in millions)	Pension Plans	Other Postretirement Benefits
2008	$ 28	$ 7
2009	27	8
2010	26	8
2011	26	8
2012	25	8
2013-17	129	38

Plan Assets. The following table shows LG&E's weighted-average asset allocation by asset category at December 31:

Pension Plans	Target Range	2007	2006
Equity securities	45% - 75%	57%	61%
Debt securities	30% - 50%	43%	39%
Other	0% - 10%	0%	0%
Totals		100%	100%

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

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

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

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

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

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

Contributions. LG&E made discretionary contributions to the pension plan of $56 million in January 2007, and $18 million in January 2006. The discretionary contribution made in January 2007, was slightly more than the $52 million accumulated benefit obligation and its projected benefit obligation as of December 31, 2006.

In addition, LG&E made contributions to other postretirement benefit plans of $7 million and $11 million in 2007 and 2006, respectively. In 2008, LG&E anticipates making voluntary contributions to fund the Voluntary Employee Beneficiary Association trusts to match the annual postretirement expense and funding the 401(h) plan up to the maximum amount allowed by law.

Pension Legislation. The Pension Protection Act of 2006 was enacted in August 2006. The new rules are generally effective for plan years beginning after 2008. Among other matters, this comprehensive legislation contains provisions applicable to defined benefit plans which generally (i) mandate 100% funding of current liabilities within seven years; (ii) increase tax-deduction levels regarding contributions; (iii) revise certain actuarial assumptions, such as mortality tables and discount rates; and (iv) raise federal insurance premiums and other fees for under-funded and distressed plans. The legislation also contains similar provisions relating to defined-contribution plans and qualified and non-qualified executive pension plans and other matters.

Thrift Savings Plans. LG&E has a thrift savings plan under section 401(k) of the Internal Revenue Code. Under th 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 $2 million for 2007 and 2006.

Note 6 - Income Taxes

A United States consolidated income tax return is filed by E.ON U.S.'s direct parent, E.ON US Investments Corp., for each tax period. Each subsidiary of the consolidated tax group, including LG&E, will calculate its separate income tax for the tax period. The resulting separate-return tax cost or benefit will be paid to or received from the parent company or its designee. LG&E also files income tax returns in various state jurisdictions. With few exceptions, LG&E is no longer subject to U.S. federal income tax examinations for years before 2004. Statutes of limitations related to 2004 and later returns are still open. Tax years 2005, 2006 and 2007 are under audit by the IRS with the 2007 return being examined under an IRS pilot program named "Compliance Assurance Process". This program accelerates the IRS's review to the actual calendar year applicable to the return and ends 90 days after the return is filed.

LG&E adopted the provisions of FIN 48 effective January 1, 2007. At the date of adoption, LG&E had $1 million of unrecognized tax benefits related to federal and state income taxes. If recognized, the entire $1 million of unrecognized tax benefits would reduce the effective income tax rate. Additions and reductions of uncertain tax positions during 2007 were less than $1 million.

Possible amounts of uncertain tax positions for LG&E that may decrease within the next 12 months total less than $1 million and are based on the expiration of statutes during 2008.

LG&E, upon adoption of FIN 48, adopted a new financial statement classification for interest and penalties. Prior to the adoption of FIN 48, LG&E recorded interest and penalties for income taxes on the income statements in income tax expense and in the taxes accrued balance sheet account, net of tax. Upon adoption of FIN 48, interest is recorded as interest expense and penalties are recorded as operating expenses on the income statement and accrued expenses in the balance sheets, on a pre-tax basis. Interest of less than $1 million was accrued for 2007 and 2006 based on IRS and Kentucky Department of Revenue large corporate interest rates for underpayment of taxes. No penalties were accrued by LG&E upon adoption of FIN 48 or through December 31, 2007.

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

(in millions)		2007	2006
Current	- federal	$ 34	$ 60
	- state	8	11
Deferred	- federal – net	10	(7)
	- state – net	2	(1)
Investment tax credit – deferred		9	3
Amortization of investment tax credit		(4)	(4)
Total income tax expense		$ 59	$ 62

Current federal income tax expense decreased and investment tax credit – deferred increased primarily due to the recording of investment tax credits of $9 million and $3 million at December 31, 2007 and 2006, respectively, as discussed below.

In June 2006, LG&E and KU filed a joint application with the U.S. Department of Energy ("DOE") requesting certification to be eligible for investment tax credits applicable to the construction of TC2. The EPAct 2005 added Section 48A to the Internal Revenue Code, which provides for an investment tax credit to promote the commercialization of advanced coal technologies that will generate electricity in an environmentally responsible manner. LG&E's and KU's application requested up to the maximum amount of "advanced coal project" credit allowed per taxpayer, or $125 million, based on an estimate of 15% of projected qualifying TC2 expenditures. In November 2006, the DOE and IRS announced that

LG&E and KU were selected to receive the tax credit. A final IRS certification required to obtain the investment tax credit was received in August 2007. LG&E's portion of the TC2 tax credit will be approximately $25 million over the construction period and will be amortized to income over the life of the related property beginning when the facility is placed in service. Based on eligible construction expenditures incurred, LG&E recorded investment tax credits of $9 million and $3 million in 2007 and 2006, respectively, decreasing current federal income taxes.

In September 2007, LG&E received Order 2007-00179 from the Kentucky Commission approving the accounting of the investment tax credit. In March 2008, certain groups filed suit in federal court in North Carolina against the DOE and IRS claiming the investment tax credit program was violative of certain environmental laws and demanded relief, including suspension or termination of the program. LG&E is not able to predict the ultimate outcome of this proceeding.

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

(in millions)	2007	2006
Deferred tax liabilities:		
Depreciation and other plant-related items	$368	$367
Regulatory assets and other	30	22
Pension and related benefits	5	6
Total deferred tax liabilities	403	395
Deferred tax assets:		
Investment tax credit	14	15
Income taxes due to customers	19	21
Liabilities and other	24	26
Total deferred tax assets	57	62
Net deferred income tax liability	$346	$333
Balance sheet classification		
Current liabilities	$ 4	$ -
Non-current liabilities	342	333
Net deferred income tax liability	$346	$333

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

	2007	2006
Statutory federal income tax rate	35.0%	35.0%
State income taxes, net of federal benefit	3.4	3.8
Reduction of income tax accruals	(0.6)	(0.4)
Qualified production deduction	(1.1)	(0.6)
Amortization of investment tax credits	(2.2)	(2.2)
Other differences	(1.5)	(1.0)
Effective income tax rate	33.0%	34.6%

Other differences primarily relate to excess deferred taxes which reflect the benefits of deferred taxes reversing a tax rates that differ from statutory rates and various other permanent differences.

H. R. 4520, known as the "American Jobs Creation Act of 2004", allows electric utilities to take a deduction for qualified production activities income starting in 2005.

Kentucky House Bill 272, also known as "Kentucky's Tax Modernization Plan", was signed into law in March 2005. This bill contains a number of changes in Kentucky's tax system, including the reduction of the Corporate income tax rate from 8.25% to 7% effective January 1, 2005, and a further reduction to 6% effective January 1, 2007. As a result of the income tax rate changes, LG&E's deferred tax reserve amount will exceed its actual deferred tax liability attributable to existing temporary differences, since the new statutory rates are lower than rates when the deferred tax liability originated. In December 2006, LG&E received approval from the Kentucky Commission to establish and amortize a regulatory liability of $16 million for these net excess deferred income tax balances. LG&E will amortize these depreciation-related excess deferred income tax balances under the average rate assumption method which matches the amortization of the excess deferred income taxes with the life of the timing differences to which they relate. Excess deferred income tax balances related to non-depreciation timing differences were expensed in 2006 due to their immaterial amount. There were no additional adjustments in 2007.

LG&E expects to have adequate levels of taxable income to realize its recorded deferred tax assets.

Note 7 - Long-Term Debt

As of December 31, 2007 and 2006, long-term debt and the current portion of long-term debt consist primarily of pollution control bonds and long-term loans from affiliated companies as summarized below.

(in millions)	Stated Interest Rates	Maturities	Principal Amounts
Outstanding at December 31, 2007:			
Noncurrent portion	Variable	2012-2037	$ 864
Current portion	Variable	2026-2027	$ 120
Outstanding at December 31, 2006:			
Noncurrent portion	Variable - 5.875%	2008-2035	$ 572
Current portion	Variable	2007-2027	$ 248

Pollution control series bonds are obligations of LG&E issued in connection with tax-exempt pollution control revenue bonds issued by various governmental entities, principally counties in Kentucky. A loan agreement obligates LG&E to make debt service payments to the county that equate to the debt service due from the county on the related pollution control revenue bonds. Until a series of financing transactions was completed during April 2007, the county's debt was also secured by an equal amount of LG&E's first mortgage bonds that were pledged to the trustee for the pollution control revenue bonds that match the terms and conditions of the county's debt, but require no payment of principal and interest unless LG&E defaults on the loan agreement.

Several of the LG&E pollution control bonds are insured by monoline bond insurers whose ratings have been under pressure due to exposures relating to insurance of sub-prime mortgages. At December 31, 2007, LG&E had an aggregate $575 million of outstanding pollution control indebtedness, of which $394 million is in the form of insured auction rate securities wherein interest rates are reset either weekly or every 35 days via an auction process. Beginning in late 2007, the interest rates on these insured bonds began to increase due to investor concerns about the creditworthiness of the bond insurers. In 2008, interest rates have continued to increase, and the Company has experienced "failed auctions" when there are insufficient bids for the bonds. When there is a failed auction, the interest rate is set pursuant to a formula stipulated in the indenture which can be as high as 15%. During 2007, the average rate on the auction rate bonds was 3.77%, whereas the average rate

in January and February of 2008 was 4.58%. The instruments governing these auction rate bonds permit LG&E to convert the bonds to other interest rate modes, such as various short-term variable rates, long-term fixed rates or intermediate-term fixed rates that are reset infrequently. In the first quarter of 2008, the ratings of the Louisville Metro 2003 Series A bonds were downgraded from Aaa to A2 by Moody's and from AAA to A- by S&P due to downgrades of the bond insurer. In February 2008, LG&E issued a notice to bondholders of its intention to convert the Louisville Metro 2005 Series A, 2007 Series A and 2007 Series B bonds from the auction rate mode to a weekly interest rate mode, as permitted under the loan documents. In March 2008, LG&E will issue notices to bondholders of its intention to convert the Jefferson County 2000 Series A bonds from the auction mode to a weekly interest rate mode, as permitted under the loan documents. LG&E expects to purchase such bonds and hold some or all such bonds until a later date, including potential further conversion, remarketings or refinancings. Uncertainty in markets relating to auction rate securities or steps LG&E has taken or may take to mitigate such uncertainty, such as additional conversions, subsequent restructurings or redemptions and refinancings, could result in LG&E incurring increased interest expense, transaction expenses or other costs and fees or experiencing reduced liquidity relating to existing or future pollution control financing structures. See Note 14, Subsequent Events.

All of LG&E's first mortgage bonds were released and terminated in April 2007. Only the tax-exempt pollution control revenue bonds issued by the counties remain. Under the provisions for certain 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 balance sheets. The average annualized interest rate for these bonds during 2007 and 2006 was 3.66% and 3.50%, respectively.

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. 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. As of December 31, 2007 and 2006, LG&E had swaps with an aggregate notional value of $211 million. See Note 3, Financial Instruments.

Redemptions and maturities of long-term debt for 2007 and 2006 are summarized below:

($ in millions) Year	Description	Principal Amount	Rate	Secured/ Unsecured	Maturity
2007	Pollution control bonds	$31	Variable	Secured	2017
2007	Pollution control bonds	$60	Variable	Secured	2017
2007	Pollution control bonds	$35	Variable	Secured	2013
2007	Mandatorily Redeemable Preferred Stock	$20	5.875%	Unsecured	2008
2006	Mandatorily Redeemable Preferred Stock	$ 1	5.875%	Unsecured	2006

LG&E did not issue any new long-term debt in 2006. Issuances of long-term debt for 2007 are summarized below:

($ in millions) Year	Description	Principal Amount	Rate	Secured/ Unsecured	Maturity
2007	Pollution control bonds	$31	Variable	Unsecured	2033
2007	Pollution control bonds	$60	4.60%	Unsecured	2033
2007	Pollution control bonds	$35	Variable	Unsecured	2033
2007	Due to Fidelia	$70	5.98%	Unsecured	2037
2007	Due to Fidelia	$67	5.93%	Unsecured	2031
2007	Due to Fidelia	$47	5.72%	Unsecured	2022

In January 2007, the Kentucky Commission issued an Order approving LG&E's application for certain financial transactions, including arrangements which provided a source of funds for the redemption of LG&E's preferred stock. In April 2007, LG&E redeemed all of its outstanding shares of its series of preferred stock at the following redemption prices, respectively, plus an amount equal to accrued and unpaid dividends to the redemption date:

- 860,287 shares of 5% cumulative preferred stock (par value $25 per share) at $28 per share;
- 200,000 shares of $5.875 cumulative preferred stock (without par value) at $100 per share; and
- 500,000 shares of auction rate, series A, cumulative preferred stock (without par value) at $100 per share.

In April 2007, LG&E agreed with Fidelia to eliminate the lien on two secured intercompany loans totaling $125 million. LG&E entered into two long-term borrowing arrangements with Fidelia in an aggregate principal amoun of $138 million. The loan proceeds were used to fund the preferred stock redemption and to repay certain short-term loans incurred to fund the pension contribution made by the Company during the first quarter. LG&E also completed a series of financial transactions impacting its periodic reporting requirements. The pollution control revenue bonds issued by certain governmental entities secured by the $31 million Pollution Control Series S, the $60 million Pollution Control Series T and the $35 million Pollution Control Series U bonds were refinanced and replaced with new unsecured tax-exempt bonds of like amounts. Pursuant to the terms of the bonds, an underlying lien on substantially all of LG&E's assets was released following the completion of these steps. LG&E no longer has any secured debt and is no longer subject to periodic reporting under the Securities Exchange Act of 1934.

Long-term debt maturities for LG&E are shown in the following table:

(in millions)	
2008 - 2011	$ -
2012	25
Thereafter	959 (a)
Total	$984

(a) Includes long-term debt of $120 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 2026 to 2027. LG&E does not expect to pay these amounts in 2008.

Note 8 - Notes Payable and Other Short-Term Obligations

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

($ in millions)	Total Money Pool Available	Amount Outstanding	Balance Available	Average Interest Rate
December 31, 2007	$400	$ 78	$322	4.75%
December 31, 2006	$400	$ 68	$332	5.25%

As of December 31, 2007 and 2006, E.ON U.S. maintained a revolving credit facility totaling $150 million and $200 million, respectively, with an affiliated company, E.ON North America, Inc., to ensure funding availability for the money pool. The balance is as follows:

($ in millions)	Total Available	Amount Outstanding	Balance Available	Average Interest Rate
December 31, 2007	$150	$ 62	$88	4.97%
December 31, 2006	$200	$102	$98	5.49%

During June 2007, LG&E's five existing lines of credit totaling $185 million expired and were replaced with short-term bilateral lines of credit facilities totaling $125 million. During the third quarter of 2007, LG&E extended the maturity date of these facilities through June 2012. There was no outstanding balance under any of these facilities at December 31, 2007.

The covenants under these revolving lines of credit include the following:

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

Note 9 - Commitments and Contingencies

Operating Leases. LG&E leases office space, office equipment and vehicles and accounts for these leases as operating leases. Total lease expense less amounts contributed by affiliated companies occupying a portion of the office space leased by LG&E, was $5 million for 2007 and 2006. The future minimum annual lease payments for operating leases for years subsequent to December 31, 2007, are shown in the following table:

(in millions)	
2008	$ 5
2009	4
2010	4
2011	3
2012	3
Thereafter	5
Total	$24

Sale and Leaseback Transaction. LG&E is a participant in a sale and leaseback transaction involving its 38% interest in two jointly owned CTs at KU's E.W. Brown generating station (Units 6 and 7). Commencing in December 1999, LG&E and KU entered into a tax-efficient, 18-year lease of the CTs. LG&E and KU have provided funds to fully defease the lease, and have executed an irrevocable notice to exercise an early purchase option contained in the lease after 15.5 years. The financial statement treatment of this transaction is no different than if LG&E had retained its ownership. The leasing transaction was entered into following receipt of required state and federal regulatory approvals.

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

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

At December 31, 2007, the maximum aggregate amount of default fees or amounts was $10 million, of which LG&E would be responsible for 38% (approximately $4 million). LG&E has made arrangements with E.ON U.S., via guarantee and regulatory commitment, for E.ON U.S. to pay LG&E's full portion of any default fees or amounts.

Letters of Credit. LG&E has provided letters of credit totaling $3 million to support certain obligations related to landfill reclamation and a letter of credit totaling less than $1 million to support certain obligations related to workers' compensation.

Purchased Power. LG&E has a contract for purchased power with OVEC, terminating in 2026, for various Mw capacities. LG&E has an investment of 5.63% ownership in OVEC's common stock, which is accounted for on the cost method of accounting. LG&E's share of OVEC's output is 5.63%, approximately 124 Mw of generation capacity. Future obligations for power purchases are shown in the following table:

(in millions)	
2008	$ 16
2009	18
2010	19
2011	19
2012	19
Thereafter	322
Total	$ 413

Construction Program. LG&E had $104 million of commitments in connection with its construction program at December 31, 2007.

In June 2006, LG&E and KU entered into a construction contract regarding the TC2 project. The contract is generally in the form of a lump-sum, turnkey agreement for the design, engineering, procurement, construction, commissioning, testing and delivery of the project, according to designated specifications, terms and conditions. The contract price and its components are subject to a number of potential adjustments which may serve to increase or decrease the ultimate construction price paid or payable to the contractor. The contract also contains standard representations, covenants, indemnities, termination and other provisions for arrangements of this type, including termination for convenience or for cause rights.

TC2 Air Permit. The Sierra Club and other environmental groups filed a petition challenging the air permit issued for the TC2 baseload generating unit which was issued by the Kentucky Division of Air Quality in November 2005. The filing of the challenge did not stay the permit, so the Company was free to proceed with construction during the pendancy of the action. In June 2007, the state hearing officer assigned to the matter recommended upholding the air permit with minor revisions. In September 2007, the Secretary of the Kentucky Environmental and Public Protection Cabinet issued a final Order approving the hearing officer's recommendation and upholding the permit. In September 2007, LG&E administratively applied for a permit revision to reflec minor design changes. In October 2007, the environmental groups submitted comments objecting to the draft permit revisions and, in part, attempting to reassert general objections to the generating unit. An agency decision on the final permit revisions may occur during 2008. The Company is currently unable to determine the final outcome of this matter.

Mine Safety Compliance Costs. In March 2006, the Mine Safety and Health Administration enacted Emergency Temporary Standards regulations and has issued additional regulations as the result of the passage of the Mine Improvement and New Emergency Response Act of 2006, which was signed into law in June 2006. At the state level, Kentucky and other states that supply coal to LG&E, have passed new mine safety legislation. These pieces of legislation require all underground coal mines to implement new safety measures and install new safety equipment. Under the terms of some of the coal contracts LG&E has in place, provisions are made to allow for price adjustments for compliance costs resulting from new or amended laws or regulations. LG&E has begun to receive information from the mines it contracts with regarding price adjustments related to these compliance costs and has hired a consultant to review all supplier claims for validity and reasonableness. At this time LG&E has not been notified of claims by all mines and is reviewing those claims it has received. An adjustment will be made to the value of the coal inventory once the amount is determinable, however, the amount cannot be estimated at this time. The Company expects to recover these costs through the FAC.

Environmental Matters. LG&E's operations are subject to a number of environmental laws and regulations, governing, among other things, air emissions, wastewater discharges, the use, handling and disposal of hazardous substances and wastes, soil and groundwater contamination and employee health and safety.

Clean Air Act Requirements. The Clean Air Act establishes a comprehensive set of programs aimed at protecting and improving air quality in the United States by, among other things, controlling stationary sources of air emissions such as power plants. While the general regulatory framework for these programs is established at the federal level, most of the programs are implemented and administered by the states under the oversight of the EPA. The key Clean Air Act programs relevant to LG&E's business operations are described below.

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

In 1997, the EPA established new NAAQS for ozone and fine particulates that required additional reductions in SO_2 and NOx emissions from power plants. In 1998, the EPA issued its final "NOx SIP Call" rule requiring reductions in NOx emissions of approximately 85% from 1990 levels in order to mitigate ozone transport from the midwestern U.S. to the northeastern U.S. To implement the new federal requirements, Kentucky amended its SIP in 2002 to require electric generating units to reduce their NOx emissions to 0.15 pounds weight per MMBtu on a company-wide basis. In 2005, the EPA issued the CAIR which requires additional SO_2 emission reductions of 70% and NOx emission reductions of 65% from 2003 levels. The CAIR provides for a two-phase cap and trade program, with initial reductions of NOx and SO_2 emissions due by 2009 and 2010, respectively, and final reductions due by 2015. The final rule is currently under challenge in a number of federal court proceedings. In 2006, Kentucky proposed to amend its SIP to adopt state requirements similar to those under the federal CAIR. Depending on the level of action determined necessary to bring local nonattainment areas into compliance with the new ozone and fine particulate standards, LG&E's power plants are potentially subject to additional reductions in SO_2 and NOx emissions. LG&E's weighted-average company-wide emission rate for SO_2 in 2007 was approximately 0.50 lbs./MMBtu of heat input, with every generating unit below its emission limit established by the Kentucky Division for Air Quality and the Louisville Metro Air Pollution Control District.

Hazardous Air Pollutants. As provided in the 1990 amendments to the Clean Air Act, the EPA investigated hazardous air pollutant emissions from electric utilities and submitted a report to Congress identifying mercury emissions from coal-fired power plants as warranting further study. In 2005, the EPA issued the CAMR establishing mercury standards for new power plants and requiring all states to issue new SIPs including mercury requirements for existing power plants. The EPA issued a model rule which provides for a two-phase cap and trade program with initial reductions due by 2010 and final reductions due by 2018. The CAMR provides for reductions of 70% from 2003 levels. The EPA closely integrated the CAMR and CAIR programs to ensure that the 2010 mercury reduction targets will be achieved as a "co-benefit" of the controls installed for purposes of compliance with the CAIR. The final rule is also currently under challenge in the federal courts. In February 2008, a federal appellate court issued a decision in one of the proceedings vacating the current CAMR, an outcome that may have the effect of resulting in more stringent mercury reduction rules. However, the ruling could be subject to further appeal. In 2006, Kentucky proposed to amend its SIP to adopt state requirements similar to those under the federal CAMR. In 2005, the local air agency in Jefferson County, Kentucky adopted a regulation aimed at regulating additional hazardous air pollutants from sources including power plants. A similar regulation was proposed by the Kentucky air agency in 2006, but it was withdrawn in 2007. To the extent those rules are final, they are not expected to have a material impact on LG&E's power plant operations.

Acid Rain Program. The 1990 amendments to the Clean Air Act imposed a two-phased cap and trade program to reduce SO_2 emissions from power plants that were thought to contribute to "acid rain" conditions in the northeastern U.S. The 1990 amendments also contained requirements for power plants to reduce NOx emissions through the use of available combustion controls.

Regional Haze. The Clean Air Act also includes visibility goals for certain federally designated areas, including national parks, and requires states to submit SIPs that will demonstrate reasonable progress toward preventing future impairment and remedying any existing impairment of visibility in those areas. In 2005, the EPA issued its Clean Air Visibility Rule detailing how the Clean Air Act's BART requirements will be applied to facilities, including power plants, built between 1962 and 1974 that emit certain levels of visibility impairing pollutants. Under the final rule, as the CAIR will result in more visibility improvement than BART, states are allowed to substitute CAIR requirements in their regional haze SIPs in lieu of controls that would otherwise be required by BART. The final rule has been challenged in the courts.

Installation of Pollution Controls. Many of the programs under the Clean Air Act utilize cap and trade mechanisms that require a company to hold sufficient emissions allowances to cover its authorized emissions on a company-wide basis and do not require installation of pollution controls on every generating unit. Under cap and trade programs, companies are free to focus their pollution control efforts on plants where such controls are particularly efficient and utilize the resulting emission allowances for smaller plants where such controls are not cost effective. LG&E had previously installed flue gas desulfurization equipment on all of its generating units prior to the effective date of the acid rain program. LG&E's strategy for its Phase II SO_2 requirements, which commenced in 2000, is to use accumulated emissions allowances to defer additional capital expenditures and LG&E will continue to evaluate improvements to further reduce SO_2 emissions. In order to achieve the NOx emission reductions and associated obligations, LG&E installed additional NOx controls, including selective catalytic reduction technology, during the 2000 to 2007 time period at a cost of $197 million. In 2001, the Kentucky Commission granted approval to recover the costs incurred by LG&E for these projects through the environmental surcharge mechanism. Such monthly recovery is subject to periodic review by the Kentucky Commission.

In order to achieve the emissions reductions mandated by the CAIR and CAMR, LG&E expects to incur additional capital expenditures totaling $130 million during the 2008 through 2010 time period for pollution control equipment, and additional operating and maintenance costs in operating such controls. In 2005, the

Kentucky Commission granted approval to recover the costs incurred by LG&E for these projects through the ECR mechanism. Such monthly recovery is subject to periodic review by the Kentucky Commission. LG&E believes its costs in reducing SO_2, NOx and mercury emissions to be comparable to those of similarly situated utilities with like generation assets. LG&E's compliance plans are subject to many factors including developments in the emission allowance and fuels markets, future legislative and regulatory enactments, legal proceedings and advances in clean air technology. LG&E will continue to monitor these developments to ensure that its environmental obligations are met in the most efficient and cost-effective manner.

Potential GHG Controls. In 2005, the Kyoto Protocol for reducing GHG emissions took effect, obligating 37 industrialized countries to undertake substantial reductions in GHG emissions. The U.S. has not ratified the Kyoto Protocol and there are currently no mandatory GHG emission reduction requirements at the federal level. Legislation mandating GHG reductions has been introduced in the Congress, but no federal legislation has been enacted to date. In the absence of a program at the federal level, various states have adopted their own GHG emission reduction programs. Such programs have been adopted in various states including 11 northeastern U.S. states and the District of Columbia under the Regional GHG Initiative program and California. Substantial efforts to pass federal GHG legislation are ongoing. In addition, litigation is currently pending before various courts to determine whether the EPA and the states have the authority to regulate GHG emissions under existing law. In April 2007, the U.S. Supreme Court ruled that the EPA has the authority to regulate GHG under the Clean Air Act. LG&E is monitoring ongoing efforts to enact GHG reduction requirements at the state and federal level and is assessing potential impacts of such programs and strategies to mitigate those impacts. LG&E is unable to predict whether mandatory GHG reduction requirements will ultimately be enacted. As a Company with significant coal-fired generating assets, LG&E could be substantially impacted by programs requiring mandatory reductions in GHG emissions, although the precise impact on the operations of LG&E, including the reduction targets and deadlines that would be applicable, cannot be determined prior to the enactment of such programs.

Section 114 Requests. In August 2007, the EPA issued administrative information requests under Section 114 of the Clean Air Act requesting new source review-related data regarding certain construction and maintenance activities at LG&E's Mill Creek 4 and Trimble County 1 generating units and KU's Ghent 2 generating unit. The Companies are complying with the information requests and are not able to predict further proceedings in this matter at this time.

General Environmental Proceedings. From time to time, LG&E appears before the EPA, various state or local regulatory agencies and state and federal courts regarding matters involving compliance with applicable environmental laws and regulations. Such matters include remediation obligations for former manufactured gas plant sites; liability under the Comprehensive Environmental Response, Compensation and Liability Act for cleanup at various off-site waste sites; ongoing claims regarding alleged particulate emissions from LG&E's Cane Run station and ongoing claims regarding GHG emissions from LG&E's generating stations. With respect to the former manufactured gas plant sites, LG&E has estimated that it could incur additional costs of less than $ million for remaining clean-up activities under existing approved plans or agreements. Based on analysis to date, the resolution of the other matters is also not expected to have a material impact on the operations of LG&E.

Note 10 - 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 Unit 1			
	LG&E	IMPA	IMEA	Total
Ownership interest	75%	12.88%	12.12%	100%
Mw capacity	383	66	62	511

(in millions)	
LG&E's 75% ownership:	
Cost	$ 633
Accumulated depreciation	246
Net book value	$ 387
Construction work in progress (included in above)	$ 27

LG&E and KU have begun construction of TC2, a jointly owned unit at the Trimble County site. LG&E and KU own undivided 14.25% and 60.75% interests, respectively, in TC2. Of the remaining 25% of TC2, IMEA owns a 12.12% undivided interest and IMPA owns a 12.88% undivided interest. Each company is responsible for its proportionate share of capital cost during construction, and fuel, operation and maintenance cost when TC2 begins operation, which is expected to occur in 2010.

	TC2				
	LG&E	KU	IMPA	IMEA	Total
Ownership interest	14.25%	60.75%	12.88%	12.12%	100%
Mw capacity	107	455	97	91	750

(in millions)	LG&E	KU
Construction work in progress	$74	$332

LG&E and KU jointly own the following CTs and related equipment:

($ in millions)	LG&E				KU				Total			
Ownership Percentage	Mw Capacity	($) Cost	($) Depre-ciation	($) Net Book Value	Mw Capacity	($) Cost	($) Depre-ciation	($) Net Book Value	Mw Capacity	($) Cost	($) Depre-ciation	($) Net Book Value
LG&E 53%, KU 47% (1)	146	58	(12)	46	129	51	(11)	40	275	109	(23)	86
LG&E 38%, KU 62% (2)	118	50	(10)	40	190	78	(14)	64	308	128	(24)	104
LG&E 29%, KU 71% (3)	92	32	(6)	26	228	80	(14)	66	320	112	(20)	92
LG&E 37%, KU 63% (4)	236	79	(8)	71	404	137	(17)	120	640	216	(25)	191
LG&E 29%, KU 71% (5)	n/a	3	-	3	n/a	9	(2)	7	n/a	12	(2)	10

1) Comprised of Paddy's Run 13 and E.W. Brown 5. In addition to the above jointly owned utility plant, there is an inlet air cooling system attributable to Unit 5 and units 8-11 at the E.W. Brown facility. This inlet air cooling system is not jointly owned, however, it is used to increase production on the units to which it relates, resulting in an additional 10 Mw of capacity for LG&E.
2) Comprised of units 6 and 7 at the E.W. Brown facility.
3) Comprised of units 5 and 6 at the Trimble County facility.
4) Comprised of CT Substation 7-10 and units 7, 8, 9 and 10 at the Trimble County facility
5) Comprised of CT Substation 5 and 6 and CT Pipeline at the Trimble County facility.

Both LG&E's and KU's participating share of direct expenses of the jointly owned plants is included in the corresponding operating expenses on its respective income statement (e.g., fuel, maintenance of plant, other operating expense).

Note 11 - Segments of Business 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. LG&E is regulated by the Kentucky Commission and files electric and natural gas financial information separately with the Kentucky Commission. The Kentucky Commission establishes rates specifically for the electric and natural gas businesses. Therefore, management reports analyze financial performance based on the electric and natural gas segments of the business. Financial data for business segments follow:

(in millions)	Electric	Gas	Total
2007			
Operating revenues	$ 933	$ 353	$1,286
Depreciation and amortization	107	19	126
Income taxes	54	5	59
Interest income	1	-	1
Interest expense	41	9	50
Net income	112	8	120
Total assets	2,669	644	3,313
Construction expenditures	157	37	194
2006			
Operating revenues	$ 943	$ 395	$1,338
Depreciation and amortization	105	19	124
Income taxes	57	5	62
Interest income	1	-	1
Interest expense	33	8	41
Net income	107	10	117
Total assets	2,519	665	3,184
Construction expenditures	111	35	146

Note 12 - Related Party Transactions

LG&E, subsidiaries of E.ON U.S. and subsidiaries of E.ON engage in related party transactions. Transactions between LG&E and E.ON U.S. subsidiaries are eliminated upon consolidation of E.ON U.S. Transactions between LG&E and E.ON subsidiaries are eliminated upon consolidation of E.ON. These transactions are generally performed at cost and are in accordance with FERC regulations under PUHCA 2005 and the applicable Kentucky Commission regulations. The significant related party transactions are disclosed below.

Electric Purchases

LG&E and KU purchase energy from each other in order to effectively manage the load of their retail and wholesale customers. These sales and purchases are included in the statements of income as electric operating

revenues and purchased power operating expense. LG&E intercompany electric revenues and purchased power expense for the years ended December 31, were as follows:

(in millions)	2007	2006
Electric operating revenues from KU	$93	$99
Purchased power from KU	46	77

Interest Charges

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

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

(in millions)	2007	2006
Interest on money pool loans	$ 4	$ 2
Interest on Fidelia loans	17	11

Other Intercompany Billings

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

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

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

(in millions)	2007	2006
E.ON U.S. Services billings to LG&E	$385	$230
LG&E billings to KU	12	53
KU billings to LG&E	6	56
LG&E billings to E.ON U.S. Services	12	7

In December 2007, LG&E received a capital contribution from its shareholder, E.ON U.S. in the amount of $20 million.

Note 13 – Accumulated Other Comprehensive Income

Accumulated other comprehensive income (loss) consisted of the following:

(in millions)	Minimum Pension Liability Adjustment	Accumulated Derivative Gain or Loss	Pre-Tax	Income Taxes	Net
Balance at December 31, 2005	$(77)	$(18)	$(95)	$37	$(58)
Minimum pension liability adjustment	77	-	77	(30)	47
Gains (losses) on derivative instruments designated and qualifying as cash flow hedging instruments	-	3	3	(1)	2
Balance at December 31, 2006	-	(15)	(15)	6	(9)
Gains (losses) on derivative instruments designated and qualifying as cash flow hedging instruments	-	(6)	(6)	2	(4)
Balance at December 31, 2007	$ -	$(21)	$(21)	$ 8	$(13)

Subsequent to the application of SFAS No. 158, adjustments to the minimum pension liability are recorded as regulatory assets and liabilities. As a result, there are no adjustments to the minimum pension liability recorded in accumulated other comprehensive income at December 31, 2007 or 2006.

Note 14 - Subsequent Events

On January 18, 2008, the Kentucky Commission issued an Order approving the charges and credits billed through the FAC during the review period of November 1, 2006 through April 30, 2007.

On February 1, 2008, the Kentucky Commission issued an Order approving the real-time pricing pilot program proposed by LG&E, for implementation within approximately eight months, for its large commercial and industrial customers.

On February 7, 2008 and February 25, 2008, the ratings of the Louisville Metro 2003 Series A bonds were downgraded from Aaa to A2 by Moody's and from AAA to A- by S&P, due to downgrades of the bond insurer.

On February 26, 2008, LG&E commenced steps, including notice to relevant parties, to convert the Louisville Metro 2005 Series A bonds from the auction rate mode of interest to a weekly interest rate mode. Such conversion is scheduled to occur on March 24, 2008.

On February 27, 2008, LG&E commenced steps, including notice to relevant parties, to convert the Louisville Metro 2007 Series A and 2007 Series B bonds from the auction rate mode of interest to a weekly interest rate mode. Such conversions are scheduled to occur on April 4, 2008.

Beginning in late 2007, the interest rates on the insured bonds, wherein interest rates are reset either weekly or every 35 days via an auction process, began to increase due to investor concerns about the creditworthiness of the bond insurers. In 2008, interest rates have continued to increase, and the Company has experienced "failed auctions" when there are insufficient bids for the bonds. When there is a failed auction, the interest rate is set pursuant to a formula stipulated in the indenture which can be as high as 15%. During 2007, the average rate on the auction rate bonds was 3.77%, whereas the average rate in January and February of 2008 was 4.58%.

On March 4, 2008, the FERC issued an Order approving the MISO exit fee recalculation agreement which provides LG&E with an immediate recovery of less than $1 million and an estimated $2 million over the next eight years for credits realized from other payments the MISO will receive, plus interest.

Report of Independent Auditors

To the Shareholder of Louisville Gas and Electric Company:

In our opinion, the accompanying balance sheets and the related 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 at December 31, 2007 and 2006, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 2 to the financial statements, Louisville Gas and Electric Company changed the manner in which it accounts for defined benefit pension and other postretirement benefit plans as of December 31, 2006.

/s/ PricewaterhouseCoopers LLP
Louisville, Kentucky
March 18, 2008

2009 - 3rd Quarter Financial Statements and Additional Information

Louisville Gas and Electric Company

Financial Statements and Additional Information

(Unaudited)

As of September 30, 2009 and December 31, 2008
and for the three-month and nine-month periods ended
September 30, 2009 and 2008

INDEX OF ABBREVIATIONS

AG	Attorney General of Kentucky
ARO	Asset Retirement Obligation
ASC	Accounting Standards Codification
BART	Best Available Retrofit Technology
CAIR	Clean Air Interstate Rule
CAMR	Clean Air Mercury Rule
CCN	Certificate of Public Convenience and Necessity
Clean Air Act	The Clean Air Act, as amended in 1990
CMRG	Carbon Management Research Group
Company	LG&E
DSM	Demand Side Management
ECR	Environmental Cost Recovery
EKPC	East Kentucky Power Cooperative, Inc.
E.ON	E.ON AG
E.ON U.S.	E.ON U.S. LLC
E.ON U.S. Services	E.ON U.S. Services Inc.
EPA	U.S. Environmental Protection Agency
FAC	Fuel Adjustment Clause
FASB	Financial Accounting Standards Board
FERC	Federal Energy Regulatory Commission
Fidelia	Fidelia Corporation (an E.ON affiliate)
GHG	Greenhouse Gas
GSC	Gas Supply Clause
IRS	Internal Revenue Service
KCCS	Kentucky Consortium for Carbon Storage
KDAQ	Kentucky Division for Air Quality
Kentucky Commission	Kentucky Public Service Commission
KIUC	Kentucky Industrial Utility Consumers, Inc.
KU	Kentucky Utilities Company
LG&E	Louisville Gas and Electric Company
Mcf	Thousand Cubic Feet
MISO	Midwest Independent Transmission System Operator, Inc.
MMBtu	Million British thermal units
Moody's	Moody's Investors Service, Inc.
Mw	Megawatts
Mwh	Megawatt hours
NAAQS	National Ambient Air Quality Standards
NOx	Nitrogen Oxide
OCI	Other Comprehensive Income
RSG	Revenue Sufficiency Guarantee
S&P	Standard & Poor's Ratings Services
SIP	State Implementation Plan
SO_2	Sulfur Dioxide
TC2	Trimble County Unit 2
VDT	Value Delivery Team Process

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Louisville Gas and Electric Company
Statements of Income
(Unaudited)
(Millions of $)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
OPERATING REVENUES				
Electric (Note 9)	$ 248	$ 284	$ 711	$ 748
Gas	28	47	270	295
Total operating revenues	276	331	981	1,043
OPERATING EXPENSES				
Fuel for electric generation	83	96	256	257
Power purchased (Note 9)	10	27	43	75
Gas supply expenses	10	32	189	224
Other operation and maintenance expenses (Note 2)	44	90	252	247
Depreciation and amortization	35	32	102	95
Total operating expenses	182	277	842	898
Operating income	94	54	139	145
Other expense (income) – net (Note 3)	4	(3)	(11)	(1)
Interest expense (Notes 3 and 6)	4	3	13	20
Interest expense to affiliated companies (Notes 6 and 9)	7	8	20	20
Income before income taxes	79	46	117	106
Federal and state income tax expense (Note 5)	29	13	41	33
Net income	$ 50	$ 33	$ 76	$ 73

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

Statements of Retained Earnings
(Unaudited)
(Millions of $)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Balance at beginning of period	$ 686	$ 690	$ 740	$ 690
Net income	50	33	76	73
Cash dividends declared on common stock (Note 9)	-	-	80	40
Balance at end of period	$ 736	$ 723	$ 736	$ 723

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

Louisville Gas and Electric Company
Balance Sheets
(Unaudited)
(Millions of $)

ASSETS	September 30, 2009	December 31, 2008
Current assets:		
Cash and cash equivalents	$ 6	$ 4
Restricted cash	1	2
Accounts receivable, net:		
Customer – less reserves of $1 million as of September 30, 2009 and December 31, 2008	105	180
Other – less reserves of $1 million as of September 30, 2009 and December 31, 2008	12	23
Materials and supplies:		
Fuel (predominantly coal)	57	51
Gas stored underground	60	112
Other materials and supplies	33	32
Deferred income taxes – net (Note 5)	4	14
Regulatory assets (Note 2)	13	43
Prepayments and other current assets	6	9
Total current assets	297	470
Utility plant:		
At original cost	4,262	4,132
Less: reserve for depreciation	1,740	1,690
Total utility plant, net	2,522	2,442
Construction work in progress	333	374
Total utility plant and construction work in progress	2,855	2,816
Deferred debits and other assets:		
Collateral deposit (Note 3)	16	22
Regulatory assets (Note 2):		
Pension and postretirement benefits	250	250
Other	126	89
Other assets	4	6
Total deferred debits and other assets	396	367
Total assets	$ 3,548	$ 3,653

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

Louisville Gas and Electric Company
Balance Sheets (cont.)
(Unaudited)
(Millions of $)

LIABILITIES AND EQUITY	September 30, 2009	December 31, 2008
Current liabilities:		
Current portion of long-term debt (Note 6)	$ 120	$ 120
Notes payable to affiliated companies (Notes 6 and 9)	149	222
Accounts payable	60	105
Accounts payable to affiliated companies (Note 9)	27	38
Customer deposits	23	22
Regulatory liabilities (Note 2)	47	35
Other current liabilities	41	46
Total current liabilities	467	588
Long-term debt:		
Long-term bonds (Note 6)	291	291
Long-term debt to affiliated company (Notes 6 and 9)	485	485
Total long-term debt	776	776
Deferred credits and other liabilities:		
Accumulated deferred income taxes (Note 5)	383	360
Accumulated provision for pensions and related benefits (Note 4)	238	225
Investment tax credit (Note 5)	51	50
Asset retirement obligations	31	31
Regulatory liabilities (Note 2):		
Accumulated cost of removal of utility plant	258	251
Deferred income taxes – net	42	45
Other	6	11
Derivative liability (Note 3)	38	55
Other liabilities	26	27
Total deferred credits and other liabilities	1,073	1,055
Common equity:		
Common stock, without par value -		
Authorized 75,000,000 shares, outstanding 21,294,223 shares	424	424
Additional paid-in capital	84	84
Accumulated other comprehensive loss	(12)	(14)
Retained earnings (Note 9)	736	740
Total common equity	1,232	1,234
Total liabilities and equity	$ 3,548	$ 3,653

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

Louisville Gas and Electric Company
Statements of Cash Flows
(Unaudited)
(Millions of $)

	For the Nine Months Ended September 30,	
	2009	2008
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 76	$ 73
Items not requiring cash currently:		
Depreciation and amortization	102	95
Deferred income taxes – net	29	11
Provision for pension and postretirement plans	25	10
Gain from disposal of asset	-	(9)
Derivative liability	(14)	5
Changes in current assets and liabilities:		
Accounts receivable	86	21
Materials and supplies	45	(36)
Accounts payable	(55)	(3)
Accrued income taxes	(7)	7
Other current assets and liabilities	10	6
Long-term derivative liability	(4)	(3)
Collateral deposit – interest rate swap (Note 3)	6	(1)
Pension and postretirement funding (Note 4)	(13)	(4)
Storm restoration regulatory asset (Note 2)	(44)	-
Gas supply clause, net	32	(13)
Fuel adjustment clause	9	2
Other	(1)	7
Net cash provided by operating activities	282	168
CASH FLOWS FROM INVESTING ACTIVITIES:		
Construction expenditures	(127)	(179)
Assets transferred to affiliate	-	10
Proceeds from sale of asset	-	9
Net cash used for investing activities	(127)	(160)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Long-term borrowings from affiliated company (Note 6)	-	25
Short-term borrowings from affiliated company – net (Note 6)	(73)	266
Reacquired bonds (Note 6)	-	(259)
Payment of dividends (Note 9)	(80)	(40)
Net cash used for financing activities	(153)	(8)
CHANGE IN CASH AND CASH EQUIVALENTS	2	-
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	4	4
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 6	$ 4

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

Louisville Gas and Electric Company
Statements of Comprehensive Income
(Unaudited)
(Millions of $)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Net income	$ 50	$ 33	$ 76	$ 73
Gain (loss) on derivative instruments and hedging activities - net of tax (expense) benefit of $1 million, less than $(1) million, $(1) million and $(1) million, respectively (Note 3)	(2)	-	2	2
Comprehensive income	$ 48	$ 33	$ 78	$ 75

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

Note 1 - General

LG&E's common stock is wholly-owned by E.ON U.S., an indirect wholly-owned subsidiary of E.ON. In the opinion of management, the unaudited interim financial statements include all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of financial position, results of operations, retained earnings, 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. These unaudited financial statements and notes should be read in conjunction with the Company's Financial Statements and Additional Information ("Annual Report") for the year ended December 31, 2008, including the audited financial statements and notes therein.

Certain reclassification entries have been made to the previous years' financial statements to conform to the 2009 presentation with no impact on net assets, liabilities and capitalization or previously reported net income and net cash flows.

RECENT ACCOUNTING PRONOUNCEMENTS

Fair Value

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

ASC 105-10

The guidance in ASC 105-10, *Hierarchy of Generally Accepted Accounting Principles,* was issued in June 2009, and is effective for interim and annual periods ending after September 15, 2009. ASC 105-10 establishes the FASB Accounting Standards Codification ("Codification") as the single source of authoritative nongovernmental U.S. generally accepted accounting principles. ASC 105-10 will have no effect on the Company's results of operations, financial position or liquidity; however, references to authoritative accounting literature have changed with the adoption.

ASC 855-10

The guidance in ASC 855-10, *Subsequent Events,* was issued in May 2009, and is effective for interim and annual periods ending after June 15, 2009. ASC 855-10 requires disclosure of the date through which subsequent events have been evaluated, as well as whether that date is the date the financial statements were issued or the date they were available to be issued. The adoption of ASC 855-10 had no impact on the Company's results of operations, financial position or liquidity; however, additional disclosures were required with the adoption. See Note 10, Subsequent Events, for additional disclosures.

ASC 825-10

The guidance in ASC 825-10, *Interim Disclosures about Fair Value of Financial Instruments,* was issued in April 2009, and is effective for interim and annual periods ending after June 15, 2009. This guidance requires qualitative and quantitative disclosures about fair values of assets and liabilities on a quarterly basis. The adoption of ASC 825-10 had no impact on the Company's results of operations, financial position or liquidity; however, additional disclosures were required with the adoption. See Note 3, Financial Instruments, for additional disclosures.

ASC 715-20

The guidance in ASC 715-20, *Employers' Disclosures about Postretirement Benefit Plan Assets,* was issued in December 2008, and will be effective as of December 31, 2009. This guidance requires additional disclosures related to pension and other postretirement benefit plan assets. Additional disclosures include the investment allocation decision-making process, the fair value of each major category of plan assets as well as the inputs and valuation techniques used to measure fair value and significant concentrations of risk within the plan assets. The adoption of ASC 715-20 will have no impact on the Company's results of operations, financial position or liquidity; however, additional disclosures will be required with the adoption.

ASC 815-10

The guidance in ASC 815-10, *Disclosures about Derivative Instruments and Hedging Activities,* was issued in March 2008, and is effective for fiscal years, and interim periods within those fiscal years, beginning on or after November 15, 2008. The objective of this statement is to enhance the current disclosure framework in ASC 815-10. The adoption of ASC 815-10 had no impact on LG&E's statements of operations, financial position and cash flows; however, additional disclosures relating to derivatives were required with the adoption effective January 1, 2009. See Note 3, Financial Instruments, for additional disclosures.

ASC 810-10

The guidance in ASC 810-10, *Noncontrolling Interests in Consolidated Financial Statements,* was issued in December 2007, and is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. The objective of this statement is to improve the relevance, comparability and transparency of financial information in a reporting entity's consolidated financial statements. The Company adopted ASC 810-10 effective January 1, 2009, and it had no impact on its statements of operations, financial position and cash flows.

ASC 820-10

The guidance in ASC 820-10, *Fair Value Measurements*, was issued in September 2006 and, except as described below, was effective for fiscal years beginning after November 15, 2007. This statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. ASC 820-10 does not expand the application of fair value accounting to new circumstances.

In February 2008, guidance on fair value measurements and disclosures delayed the effective date of ASC 820-10 for all nonfinancial assets and liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. All other amendments related to ASC 820-10 have been evaluated and have no impact on the Company's financial statements.

The Company adopted ASC 820-10 effective January 1, 2008, except as it applies to those nonfinancial assets and liabilities, and it had no impact on the statements of operations, financial position and cash flows, however, additional disclosures relating to its financial derivatives and cash collateral on derivatives, as required, are now provided. Per ASC 820-10, fair value accounting for all nonrecurring fair value measurements of nonfinancial assets and liabilities was adopted effective January 1, 2009, and it had no impact on the statements of operations, financial position and cash flows. At September 30, 2009, no additional disclosures were required per ASC 820-10 as LG&E did not have any nonfinancial assets or liabilities measured at fair value subsequent to initial measurement. The guidance in ASC 820-10, *Determining Fair Value when the Volume and Level of Activity for the Asset or Liability have Significantly Decreased and Identifying Transactions that are not Orderly,* was issued in April 2009, and is effective for interim and annual periods ending after June 15, 2009. ASC 820-10 provides additional guidance on determining fair values when there is no active market or where the price inputs being used represent distressed sales. The adoption of ASC 820-10 had no impact on the Company's financial position, statements of operations and cash flows.

Note 2 - Rates and Regulatory Matters

For a description of each line item of regulatory assets and liabilities and for descriptions of certain matters which may not have undergone material changes relating to the period covered by this quarterly report, reference is made to Note 2 of LG&E's Annual Report for the year ended December 31, 2008.

Electric and Gas Rate Cases

In January 2009, LG&E, the AG, KIUC and all other parties to electric and gas base rate cases filed a settlement agreement with the Kentucky Commission. Under the terms of the settlement agreement, LG&E's base gas rates will increase $22 million annually, and base electric rates will decrease $13 million annually. An Order approving the settlement was received in February 2009, and the new rates were implemented effective February 6, 2009. In connection with the application and effective date of the new rates, the VDT surcredit and merger surcredit terminated, which will result in increased revenues of approximately $21 million annually.

Regulatory Assets and Liabilities

The following regulatory assets and liabilities were included in LG&E's Balance Sheets:

(in millions)	September 30, 2009	December 31, 2008
Current regulatory assets:		
GSC	$ 3	$ 28
ECR	6	4
FAC	-	7
Net MISO exit	1	-
Other	3	4
Total current regulatory assets	$ 13	$ 43
Non-current other regulatory assets:		
Storm restoration	$ 68	$ 24
ARO	29	29
Unamortized loss on bonds	22	23
Net MISO exit	5	12
Other	2	1
Subtotal non-current other regulatory assets	126	89
Pension and postretirement benefits	250	250
Total non-current regulatory assets	$ 376	$ 339
Current regulatory liabilities:		
GSC	$ 37	$ 30
DSM	8	5
Other	2	-
Total current regulatory liabilities	$ 47	$ 35
Non-current regulatory liabilities:		
Accumulated cost of removal of utility plant	$ 258	$ 251
Deferred income taxes – net	42	45
Other	6	11
Total non-current regulatory liabilities	$ 306	$ 307

LG&E does not currently earn a rate of return on the ECR, FAC, GSC and gas performance-based ratemaking (included in "GSC" above) regulatory assets which are separate recovery mechanisms with recovery within twelve months. No return is earned on the pension and postretirement benefits regulatory asset that represents the changes in funded status of the plans. LG&E will recover this asset through pension expense included in the calculation of base rates. No return is currently earned on the ARO asset. When an asset with an ARO is retired, the related ARO regulatory asset will be offset against the associated ARO regulatory liability, ARO asset and ARO liability. A return is earned on the unamortized loss on bonds, and these costs are recovered through amortization over the life of the debt. LG&E currently earns a rate of return on the balance of Mill Creek Ash Pond costs included in other regulatory assets, as well as recovery of these costs. The Company will seek recovery of the Storm restoration regulatory asset and CMRG and KCCS contributions, included in other regulatory assets, in the next base rate case. The Company recovers through the calculation of base rates, the amortization of the

net MISO exit regulatory asset incurred through April 30, 2008, and other regulatory assets including EKPC FERC transmission settlement agreement and rate case expenses. Other regulatory liabilities include DSM and MISO administrative charges collected via base rates from May 2008 through February 5, 2009. The MISO regulatory liability will be netted against the remaining costs of withdrawing from the MISO, per a Kentucky Commission Order, in the next base rate case.

ECR. In August 2009, the Kentucky Commission initiated a two year review of LG&E's environmental surcharge for the period ending April 2009. An order is anticipated in the fourth quarter of 2009.

In June 2009, the Company filed an application for a new ECR plan with the Kentucky Commission seeking approval to recover investments in environmental upgrades and operations and maintenance costs at the Company's generating facilities. The Company anticipates an order by the end of 2009, and recovery on customer bills through the monthly ECR surcredit beginning February 2010.

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

In January 2009, the Kentucky Commission initiated a six-month review of LG&E's environmental surcharge for the period ending October 31, 2008. The Kentucky Commission issued an Order in July 2009, approving the charges and credits billed through the ECR during the review periods, as well as approving billing adjustments for under-recovered costs and the rate of return on capital.

FAC. In August 2009, the Kentucky Commission initiated a routine examination of the FAC for the 6-month period November 1, 2008 through April 30, 2009. A formal hearing was held in October 2009. An Order is anticipated in the fourth quarter of 2009.

In January 2009, the Kentucky Commission initiated a routine examination of the FAC for the two-year period November 1, 2006 through October 31, 2008. The Kentucky Commission issued an Order in June 2009, approving the charges and credits billed through the FAC during the review period.

In August 2008, the Kentucky Commission initiated a routine examination of the FAC for the six-month period November 1, 2007 through April 30, 2008. The Kentucky Commission issued an Order in January 2009, approving the charges and credits billed through the FAC during the review period.

MISO. In accordance with Kentucky Commission Orders approving the MISO exit, LG&E has established a regulatory asset for the MISO exit fee, net of former MISO administrative charges collected via base rates through the base rate case test year ended April 30, 2008. The net MISO exit fee is subject to adjustment for possible future MISO credits, and a regulatory liability for certain revenues associated with former MISO administrative charges, which were collected via base rates until February 6, 2009. The approved 2008 base rate case settlement provided for MISO administrative charges collected through base rates from May 1, 2008 to February 6,

2009, and any future adjustments to the MISO exit fee, to be established as a regulatory liability until the amounts can be amortized in future base rate cases.

In November 2008, the FERC issued Orders in industry-wide proceedings relating to MISO RSG calculation and resettlement procedures. RSG charges are amounts assessed to various participants active in the MISO trading market which generally seek to compensate for uneconomic generation dispatch due to regional transmission or power market operational considerations, with some customer classes eligible for payments, while others may bear charges. The FERC Orders approved two requests for significantly altered formulas and principles, each of which the FERC applied differently to calculate RSG charges for various historical and future periods. Based upon the 2008 FERC Orders, the Company established a reserve during the fourth quarter of 2008 of $2 million relating to potential RSG resettlement costs for the period ended December 31, 2008. However, in May 2009, after a portion of the resettlement payments had been made, the FERC issued an Order on the requests for rehearing on one November 2008 Order which changed the effective date and reduced almost all of the previously accrued RSG resettlement costs. Therefore, these costs were reversed and a receivable was established for amounts already paid of $1 million, which the MISO began refunding back to the Company in June 2009, and which were fully collected by September 2009. In June 2009, the FERC issued an Order in the rate mismatch RSG proceeding, stating it will not require resettlements of the rate mismatch calculation from April 1, 2005 to November 4, 2007. An accrual had previously been recorded in 2008 for the rate mismatch issue for the time period April 25, 2006 to August 9, 2007, but no accrual had been recorded for the time period November 5, 2007 to November 9, 2008 based on the prior Order. Accordingly, the accrual for the former time period was reversed and an accrual for the latter time period was recorded in June 2009, with a net effect of less than $1 million of expense, substantially all of which was paid by September 2009.

On August 7, 2009, the FERC determined that the MISO had failed to demonstrate that its proposed exemptions to real-time RSG charges were just and reasonable and it ordered the MISO to make a compliance filing within 90 days to allow time for further study of the issue. The conclusion of this issue may result in refunds to the Company, but the Company cannot predict the ultimate outcome of this matter, nor the financial impact, at this time.

In November 2009, LG&E and KU filed an application with the FERC to approve certain independent transmission operator arrangements to be effective upon the expiration of their current contract with Southwest Power Pool, Inc. in September 2010. The application seeks authority for LG&E and KU to function after such date as the administrator of their own open access transmission tariffs for most purposes. The Tennessee Valley Authority, which currently acts as reliability coordinator, would also assume certain additional duties. The application is subject to continuing FERC proceedings, including potential comments by the public, intervenors or FERC staff, prior to a ruling by the FERC.

Storm Restoration. In January 2009, a significant winter ice storm passed through LG&E's service territory causing approximately 205,000 customer outages, followed closely by a severe wind storm in February 2009, causing approximately 37,000 customer outages. The Company filed an application with the Kentucky Commission in April 2009, requesting approval to establish a regulatory asset, and defer for future recovery, approximately $45 million in incremental operation and maintenance expenses related to the storm restoration. In September 2009, the Kentucky Commission issued an Order allowing the Company to establish a regulatory

asset of up to $45 million based on its actual costs for storm damages and service restoration due to the January and February 2009 winter storms. In September 2009, the Company established a regulatory asset of $44 million for actual costs incurred.

Hurricane Ike Wind Storm. In September 2008, high winds from the remnants of Hurricane Ike passed through the service territory causing significant outages and system damage. In October 2008, LG&E filed an application with the Kentucky Commission requesting approval to establish a regulatory asset, and defer for future recovery, approximately $24 million of expenses related to the storm restoration. In December 2008, the Kentucky Commission issued an Order allowing the Company to establish a regulatory asset of up to $24 million based on its actual costs for storm damages and service restoration due to Hurricane Ike. In December 2008, the Company established a regulatory asset of $24 million for actual costs incurred.

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

Other Regulatory Matters

Wind Power Agreements. In August 2009, LG&E and KU filed a notice of intent with the Kentucky Commission indicating their intent to file an application for approval of wind purchase power contracts and cost recovery mechanisms. The contracts were executed in August 2009, and are contingent upon LG&E and KU receiving acceptable regulatory approvals. Pursuant to the proposed 20-year contracts, LG&E and KU would jointly purchase respective assigned portions of the output of two Illinois wind farms totaling an aggregate 109.5 Mw. In September 2009, the Companies filed an application and supporting testimony with the Kentucky Commission. In October 2009, the Kentucky Commission issued an order denying the Companies' request to establish a surcharge for recovery of the costs of purchasing wind power. The Kentucky Commission stated that such recovery constitutes a general rate adjustment and is subject to the regulations of a base rate case. The Kentucky Commission Order currently allows the application's request for approval of the wind power agreements to continue to proceed independently from the application's request to recover the costs thereof via surcharges. In November 2009, LG&E and KU filed for rehearing of the Kentucky Commission's Order and requested that the issues of approval of the contract and recovery of the costs thereof remain the subject of the same proceeding.

Trimble County Asset Transfer and Depreciation. LG&E and KU are currently constructing a new base-load, coal fired unit, TC2, which will be jointly owned by the Companies, together with the Illinois Municipal Electric Agency and the Indiana Municipal Power Agency. In July 2009, the Companies notified the Kentucky Commission of the proposed transfer from LG&E to KU of certain ownership interests in certain existing Trimble County generating station assets

which are anticipated to provide joint or common use in support of the jointly-owned TC2 generating unit under construction at the station. The undivided ownership interests being transferred are intended to provide KU an ownership interest in these common assets that is proportional to its interest in TC2. It is anticipated that the assets will be transferred at a price equal to the net book value associated with the proportional interests at the time of the transfer. The assets have a net book value of approximately $50 million as of June 2009. This transfer is expected to be made upon the beginning of TC2 unit testing which is estimated to be December 2009.

In August 2009, in a separate proceeding, LG&E and KU jointly filed an application with the Kentucky Commission to approve new depreciation rates for applicable TC2-related generating, pollution control and other plant equipment and assets. The filing requests common depreciation rates for the applicable jointly-owned TC2-related assets, rather than applying differing depreciation rates in place with respect to LG&E's and KU's separately-owned base-load generating assets. In September 2009, data discovery was initiated by the Kentucky Commission and continues through November 2009. The ruling was requested prior to December 2009.

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

The CCN for the remaining line has been challenged by certain property owners in Hardin County, Kentucky. In August 2006, LG&E and KU obtained a successful dismissal of the challenge at the Franklin County Circuit Court, which ruling was reversed by the Kentucky Court of Appeals in December 2007, and the proceeding reinstated. A motion for discretionary review of that reversal was filed by LG&E and KU with the Kentucky Supreme Court and was granted in April 2009. That proceeding, which seeks reinstatement of the Circuit Court dismissal of the CCN challenge, has been fully briefed and could be ruled upon by mid 2010.

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

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

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

As a result of the aforementioned unresolved litigation delays encountered in obtaining access to certain properties in Hardin County, KU has obtained temporary easements and options to purchase temporary easements to allow construction of temporary transmission facilities bypassing those properties while the litigated issues are resolved. In September 2009, the Kentucky Commission issued an Order stating that a CCN was necessary for two segments of the proposed temporary facilities. KU is presently seeking that CCN, with a decision by the Kentucky Commission expected in December 2009.

In a separate proceeding, certain Hardin County landowners have also challenged the same transmission line in federal district court in Louisville, Kentucky. In that action, the landowners claim that the U.S. Army failed to comply with certain National Historic Preservation Act requirements relating to easements for the line through Fort Knox. LG&E and KU are cooperating with the U.S. Army in its defense in this case and in October 2009, the federal court granted the defendants' motion for summary judgment and dismissed the plaintiffs' claims.

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

Depreciation Study. In December 2007, LG&E filed a depreciation study with the Kentucky Commission as required by a previous Order. In August 2008, the Kentucky Commission issued an Order consolidating the depreciation study with the base rate case proceeding. The approved settlement agreement in the rate case established new depreciation rates effective February 2009.

Interconnection and Net Metering Guidelines. In May 2008, the Kentucky Commission on its own motion initiated a proceeding to establish interconnection and net metering guidelines in accordance with amendments to existing statutory requirements for net metering of electricity. The jurisdictional electric utilities and intervenors in this case presented proposed interconnection guidelines to the Kentucky Commission in October 2008. In a January 2009 Order, the Kentucky Commission issued the Interconnection and Net Metering Guidelines – Kentucky that were developed by all parties to the proceeding. LG&E does not expect any financial or other impact as a result of this Order. In April 2009, LG&E filed revised net metering tariffs and application forms pursuant to the Kentucky Commission's Order. The Kentucky Commission issued an Order in April 2009, that suspends for five months all net metering tariffs filed by the jurisdictional electric utilities. This suspension is intended to allow sufficient time for review of the filed tariffs by the Kentucky Commission Staff and intervening parties. In June 2009, the Kentucky Commission Staff held a telephonic informal conference with the parties to discuss issues related to the net metering tariffs filed by LG&E. Following this conference, the intervenors and LG&E have resolved all issues and LG&E has filed revised net metering tariffs with the Kentucky Commission. In August 2009, the Kentucky Commission issued an Order approving the revised tariffs.

EISA 2007 Standards. In November 2008, the Kentucky Commission initiated an administrative proceeding to consider new standards as a result of the Energy Independence and Security Act of 2007 ("EISA 2007"), part of which amends the Public Utility Regulatory Policies Act of 1978 ("PURPA"). There are four new PURPA standards and one non-PURPA standard applicable to electric utilities. The proceeding also considers two new PURPA standards applicable to natural gas utilities. EISA 2007 requires state regulatory commissions and nonregulated utilities to begin consideration of the rate design and smart grid investments no later than December 19, 2008, and to complete the consideration by December 19, 2009. The