

In the Matter of:

THE APPLICATION OF KENTUCKY UTILITIES )  
COMPANY FOR CERTIFICATES OF PUBLIC )  
CONVENIENCE AND NECESSITY AND ) CASE NO.  
APPROVAL OF ITS 2011 COMPLIANCE PLAN ) 2011-00161  
FOR RECOVERY BY ENVIRONMENTAL )  
SURCHARGE )

**Response to the Attorney General's Supplemental Data  
Requests Question No. 5 dated August 18, 2011  
One Paper Copy - Volume 3 of 5  
Filed - October 25, 2011**

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Supplement, dated December 1, 2010 to Reoffering Circular dated December 10, 2008, as supplemented as of December 16, 2008 and October 29, 2010 (the "Reoffering Circular")

**\$50,000,000**

**County of Carroll, Kentucky**

**Environmental Facilities Revenue Bonds, 2004 Series A**

**(Kentucky Utilities Company Project)**

Effective as of December 1, 2010, through December 1, 2011 (the Letter of Credit (as defined below) expiration date, subject to extension or earlier termination), payment of the principal of and interest on the above-referenced bonds (the "Bonds") when due will be paid with funds drawn under an irrevocable transferable direct pay letter of credit (the "Letter of Credit") issued by

**WELLS FARGO BANK, NATIONAL ASSOCIATION**

The Letter of Credit will permit the Trustee to draw with respect to the Bonds up to an amount sufficient to pay (i) the principal thereof (or that portion of the purchase price corresponding to principal) plus (ii) interest thereon (or that portion of the purchase price corresponding to interest) at an assumed rate of 14% per annum for at least 45 days.

The Bonds will continue to bear interest at a Weekly Rate, determined by the Remarketing Agent in accordance with the Indenture, payable on the first Business Day of each calendar month, commencing on January 3, 2011. The interest rate period, interest rate and Interest Rate Mode will be subject to change under certain conditions, as described in the Reoffering Circular. The Bonds are subject to optional redemption, extraordinary optional redemption, in whole or in part, and mandatory redemption following a determination of taxability prior to maturity, as described in the Reoffering Circular. The Bonds are subject to mandatory purchase on any date on which the Bonds are converted to a different Interest Rate Mode and upon the expiration of the Letter of Credit or any Alternate Credit Facility.

This supplement contains a description of the Letter of Credit and Wells Fargo Bank, National Association, the issuer of the Letter of Credit. For purposes of the Reoffering Circular, the Letter of Credit is a "Credit Facility" and Wells Fargo Bank, National Association is a "Credit Facility Issuer." Except as otherwise specified herein, information in the Reoffering Circular referred to above has not been amended or modified and the information contained herein is qualified by reference to, and should be read in conjunction with, the Reoffering Circular, including information incorporated therein by reference. Terms not otherwise defined herein shall have the meanings ascribed to them in such Reoffering Circular.

*The eighth paragraph under the section of the Reoffering Circular captioned "Introductory Statement" is hereby amended to read in its entirety as follows:*

Effective December 1, 2010, the Company will cause to be delivered an irrevocable transferable direct pay letter of credit (the "Letter of Credit"), issued by Wells Fargo Bank, National Association (the "Bank"), to provide for the timely payment of principal of and accrued interest (calculated for at least 45 days at the maximum rate of 14% per annum) on, and purchase price of, the Bonds. The Company will be required to reimburse the Bank for all amounts drawn by the Trustee under the Letter of Credit pursuant to the terms of a certain letter agreement, to be dated as of December 1, 2010 (the "Reimbursement Agreement"), between the Company and the Bank. The Letter of Credit will expire on December 1, 2011, unless extended or earlier terminated.

\* \* \* \*

*The section of the Reoffering Circular captioned "The Letter of Credit" is hereby amended to read in its entirety as follows:*

#### **THE LETTER OF CREDIT**

*The following summarizes certain provisions of the Letter of Credit and the Reimbursement Agreement, to which reference is made for the detailed provisions thereof. Unless otherwise defined in this Reoffering Circular, capitalized terms in the following summary are used as defined in the Letter of Credit and the Reimbursement Agreement. The Company is permitted under the Indenture to deliver an Alternate Credit Facility to replace the Letter of Credit. Any such Alternate Credit Facility must meet certain requirements described in the Indenture.*

#### **The Letter of Credit**

The Letter of Credit will be an irrevocable transferable direct pay letter of credit issued by the Bank in order to provide additional security for the payment of principal of, purchase

price of, interest on and premium, if applicable, on any date when payments under the Bonds are due, including principal and interest payments and payments upon tender, redemption, acceleration or maturity of the Bonds. The Letter of Credit will provide for direct payments to or upon the order of the Trustee as set forth in the Letter of Credit in amounts sufficient to pay such amounts in accordance with the terms thereof.

The Letter of Credit will be issued in an amount equal to the aggregate principal amount of the outstanding Bonds, plus an amount that represents interest accrued thereon at an assumed rate of 14% per annum for 45 days (the "Credit Amount"). The Trustee, upon compliance with the terms of the Letter of Credit, is authorized to draw up to (a) an amount sufficient (i) to pay principal of the Bonds, when due, whether at maturity or upon redemption or acceleration, and (ii) to pay the portion of the purchase price of the Bonds delivered for purchase pursuant to a demand for purchase by the owner thereof or a mandatory tender for purchase and not remarketed (a "Liquidity Drawing") equal to the principal amount of the Bonds, plus (b) an amount not to exceed 45 days of accrued interest on such Bonds at an assumed rate of 14% per annum (i) to pay interest on the Bonds, when due, and (ii) to pay the portion of the interest accrued on the Bonds as of any Liquidity Drawing.

The amount available under the Letter of Credit will be automatically reduced by the amount of any drawing thereunder, subject to reinstatement as described below. With respect to a drawing by the Trustee solely to pay interest on the Bonds on an Interest Payment Date, the amount available under the Letter of Credit will be automatically reinstated in the amount of such drawing effective on the earlier of (i) receipt by the Bank from the Company of reimbursement of any drawing solely to pay interest in full or (ii) at the opening of business on the eleventh calendar day after the date the Bank honors such drawing, unless the Trustee has received written notice from the Bank by the tenth calendar day after the date the Bank honors such drawing the Bank is not so reinstating the available amount due to the Company's failure to reimburse the Bank for such drawing in full, or that an event of default has occurred and is continuing under the Reimbursement Agreement and, in either case, directing, an acceleration of the Bonds pursuant to the Indenture. With respect to a Liquidity Drawing under the Letter of Credit, the amount available under the Letter of Credit will be automatically reduced by the principal amount of the Bonds purchased with the proceeds of such drawing plus the amount of accrued interest on such Bonds. In the event of the remarketing of the Bonds purchased with the proceeds of a Liquidity Drawing, the amount available under the Letter of Credit will be automatically reinstated upon receipt by the Bank or the Trustee on the Bank's behalf of an amount equal to such principal amount plus accrued interest.

The Letter of Credit will terminate on the earliest to occur of:

(i) the Bank's close of business on December 1, 2011 (such date, as extended from time to time in accordance with the Letter of Credit is defined as the "Stated Expiration Date");

(ii) the Bank's close of business on the date which is five Business Days following the date of receipt by the Bank of a certificate from the Trustee certifying that (a) no Bonds remain Outstanding within the meaning of the Indenture, (b) all drawings required to be made under the Indenture and available under the Letter of Credit have



(iii) the Bank's close of business on the date of receipt by the Bank of a certificate from the Trustee confirming that the Trustee is required to terminate the Letter of Credit in accordance with the terms of the Indenture;

(iv) the date on which the Bank receives and honors an acceleration drawing certificate; or

(v) the Bank's close of business on the date which is 30 days after receipt by the Trustee of written notice from the Bank of an Event of Default under the \$400,000,000 Revolving Credit Agreement dated as of November 1, 2010 among the Company, the lending institutions party thereto from time to time and Wells Fargo Bank, National Association, as Administrative Agent (the "Credit Agreement") and instructing the Trustee to draw under the Letter of Credit.

### **The Reimbursement Agreement**

Pursuant to the Reimbursement Agreement, the Company is obligated to reimburse the Bank for all amounts drawn under the Letter of Credit, and to pay interest on all such amounts. The Company has also agreed to pay the Bank a periodic fee for issuing and maintaining the Letter of Credit.

The Reimbursement Agreement, through incorporation of the terms of the Credit Agreement, imposes various covenants and agreements, including various financial and operating covenants, on the Company. Such covenants include, but are not limited to, covenants relating to (i) inspection of the books and financial records of the Company; (ii) mergers or consolidations; and (iii) disposition of assets. Any such covenants may be amended, waived or modified at any time by the Bank and without the consent of the Trustee or the holders of the Bonds. Under certain circumstances, the failure of the Company to comply with such covenants may result in a mandatory tender or acceleration of the Bonds.

An Event of Default under the Credit Agreement will constitute an Event of Default under the Reimbursement Agreement. The following events will constitute an Event of Default under the Credit Agreement:

(i) the Borrower shall fail to pay when due any principal on any Loans under the Credit Agreement or Reimbursement Obligations; or

(ii) the Company shall fail to pay when due any interest on the Loans under the Credit Agreement and Reimbursement Obligations, any fee or any other amount payable hereunder or under any other Loan Document for five (5) days following the date such payment becomes due thereunder; or

(iii) the Company shall fail to observe or perform certain covenants or agreements contained in the Credit Agreement, including those related to mergers, disposition of assets and capitalization ratios; or

(iv) the Company shall fail to give notice of a Default or Event of Default under the Credit Agreement within a specified number of days following knowledge of such occurrence; or

(v) the Company shall fail to observe or perform any covenant or agreement contained in the Credit Agreement or any notes issued thereunder (other than those covered above) for thirty (30) days after written notice thereof has been given to the defaulting party by the administrative agent, or at the request of the required lenders; or

(vi) any representation, warranty or certification made by the Company in the Credit Agreement or any notes issued thereunder or in any certificate, financial statement or other document delivered pursuant hereto or thereto shall prove to have been incorrect in any material respect when made or deemed made; or

(vii) the Company shall (i) fail to pay any principal or interest, regardless of amount, due in respect of any Material Debt beyond any period of grace provided with respect thereto, or (ii) fail to observe or perform any other term, covenant, condition or agreement contained in any agreement or instrument evidencing or governing any such Material Debt beyond any period of grace provided with respect thereto if the effect of any failure referred to in this clause (ii) is to cause, or to permit the holder or holders of such Debt or a trustee on its or their behalf to cause, such Debt to become due prior to its stated maturity; or

(viii) the Company shall commence a voluntary case or other proceeding seeking liquidation, reorganization or other relief with respect to itself or its debts under any bankruptcy, insolvency or other similar law now or hereafter in effect or seeking the appointment of a trustee, receiver, liquidator, custodian or other similar official of it or any substantial part of its property, or shall consent to any such relief or to the appointment of or taking possession by any such official in an involuntary case or other proceeding commenced against it, or shall make a general assignment for the benefit of creditors, or shall fail generally to pay, or shall admit in writing its inability to pay, its debts as they become due, or shall take any corporate action to authorize any of the foregoing; or

(ix) an involuntary case or other proceeding shall be commenced against the Company seeking liquidation, reorganization or other relief with respect to it or its debts under any bankruptcy, insolvency or other similar law now or hereafter in effect or seeking the appointment of a trustee, receiver, liquidator, custodian or other similar official of it or any substantial part of its property, and such involuntary case or other proceeding shall remain undismissed and unstayed for a period of 60 days; or an order for relief shall be entered against the Company under the Bankruptcy Code; or

(x) any member of the ERISA Group shall fail to pay when due an amount or amounts aggregating in excess of \$50,000,000 which it shall have become liable to pay under Title IV of ERISA; or notice of intent to terminate a Material Plan shall be filed under Title IV of

ERISA by any member of the ERISA Group, any plan administrator or any combination of the foregoing; or the PBGC shall institute proceedings under Title IV of ERISA to terminate, to impose liability (other than for premiums under Section 4007 of ERISA) in respect of, or to cause a trustee to be appointed to administer any Material Plan; or a condition shall exist by reason of which the PBGC would be entitled to obtain a decree adjudicating that any Material Plan must be terminated; or there shall occur a complete or partial withdrawal from, or default, within the meaning of Section 4219(c)(5) of ERISA, with respect to, one or more Multiemployer Plans which could reasonably be expected to cause one or more members of the ERISA Group to incur a current payment obligation in excess of \$50,000,000; or

(xi) the Company shall fail within sixty (60) days to pay, bond or otherwise discharge any judgment or order for the payment of money in excess of \$20,000,000, entered against the Company that is not stayed on appeal or otherwise being appropriately contested in good faith; or

(xii) a Change of Control shall have occurred;

For purposes of the foregoing:

“Change of Control” means (i) the acquisition by any person, or two or more persons acting in concert, of beneficial ownership of 25% or more of the outstanding shares of voting stock of PPL Corporation or its successors or (ii) the failure at any time of PPL Corporation or its successors to own 80% or more of the outstanding shares of the voting stock in the Company.

“Credit Agreement” means the \$400,000,000 Revolving Credit Agreement dated as of November 1, 2010 among the Company, the lending institutions party thereto from time to time and Wells Fargo Bank, National Association, as Administrative Agent.

“Material Debt” means debt (other than the notes issued under the Credit Agreement) of the Company in a principal or face amount exceeding \$50,000,000



*Appendix C of the Reoffering Circular is hereby amended to read in its entirety as follows:*

### **Wells Fargo Bank, National Association**

*The information under this heading has been provided solely by Wells Fargo Bank, National Association and is believed to be reliable. This information has not been verified independently by the Company, the Issuer or the Remarketing Agent. The Company, the Issuer and the Remarketing Agent make no representation whatsoever as to the accuracy, adequacy or completeness of such information.*

### **Wells Fargo Bank, National Association**

Wells Fargo Bank, National Association (the “Bank”) is a national banking association organized under the laws of the United States of America with its main office at 101 North Phillips Avenue, Sioux Falls, South Dakota 57104, and engages in retail, commercial and corporate banking, real estate lending and trust and investment services. The Bank is an indirect, wholly owned subsidiary of Wells Fargo & Company, a diversified financial services company, a financial holding company and a bank holding company registered under the Bank Holding Company Act of 1956, as amended, with its principal executive offices located in San Francisco, California.

Each quarter, the Bank files with the FDIC financial reports entitled “Consolidated Reports of Condition and Income for Insured Commercial Banks with Domestic and Foreign Offices,” commonly referred to as the “Call Reports.” The Bank’s Call Reports are prepared in accordance with regulatory accounting principles, which may differ from generally accepted accounting principles. The publicly available portions of Call Reports filed by the Bank with the FDIC may be obtained from the FDIC, Disclosure Group, Room F518, 550 17<sup>th</sup> Street, N.W., Washington, D.C. 20429 at prescribed rates, or from the FDIC on its Internet site at <http://www.fdic.gov>, or by writing to Corporate Secretary’s Office, Wells Fargo Center, Sixth and Marquette, MAC N9305-173, Minneapolis, MN 55479.

**The Letter of Credit will be solely an obligation of the Bank and will not be an obligation of, or otherwise guaranteed by, Wells Fargo & Company, and no assets of Wells Fargo & Company or any affiliate of the Bank or Wells Fargo & Company will be pledged to the payment thereof. Payment of the Letter of Credit will not be insured by the FDIC.**

The information contained in this section, including financial information, relates to and has been obtained from the Bank, and is furnished solely to provide limited introductory information regarding the Bank and does not purport to be comprehensive. Any financial information provided in this section is qualified in its entirety by the detailed information appearing in the Call Reports referenced above. The delivery hereof shall not create any implication that there has been no change in the affairs of the Bank since the date hereof.

*Appendix A of the Reoffering Circular is hereby amended to read in its entirety as follows:*

**Kentucky Utilities Company –**

**Financial Statements and Additional Information**

*This Appendix A includes the Selected Financial Data presented below relating to Kentucky Utilities Company (“KU”), certain risk factors associated with KU, Pro Forma Condensed Financial Information (Unaudited), a description of the Business of KU, Management’s Discussion and Analysis of Financial Condition and Results of Operations (“Management’s Discussion and Analysis”), the Consolidated Financial Statements as of December 31, 2009 and 2008 and for the Years Ended December 31, 2009, 2008 and 2007 (Audited) (the “Consolidated Financial Statements”) and the Condensed Financial Statements as of September 30, 2010 and December 31, 2009 and for the Three and Nine Months Ended September 30, 2010 and 2009 (Unaudited) (the “Condensed Consolidated Financial Statements”).*

*The information contained in this Appendix A relates to and has been obtained from KU and from other sources as shown herein. The delivery of this Supplement shall not create any implication that there has been no change in the affairs of KU since the date hereof, or that the information contained or incorporated by reference in this Appendix A is correct at any time subsequent to its date. In this Appendix A, "KU", "the Company", "we", "us" or "our" refer to Kentucky Utilities Company.*

**Summary**

**Kentucky Utilities Company**

Kentucky Utilities Company, incorporated in Kentucky in 1912 and in Virginia in 1991, is a regulated public utility engaged in the generation, transmission, distribution and sale of electric energy in Kentucky, Virginia and Tennessee. We provide electric service to approximately 515,000 customers in 77 counties in central, southeastern and western Kentucky, to approximately 29,000 customers in 5 counties in southwestern Virginia and to 5 customers in Tennessee. Our service area covers approximately 6,600 square miles. During the first three quarters of 2010, approximately 99% of the electricity generated by us was produced by our coal-fired electric generating stations. The remainder is generated by a hydroelectric power plant and natural gas and oil fueled combustion turbines (“CTs”). In Virginia, we operate under the name Old Dominion Power Company. We also sell wholesale electric energy to 12 municipalities.

KU is a wholly-owned subsidiary of LG&E and KU Energy LLC. On November 1, 2010, PPL Corporation purchased all of the interests of LG&E and KU Energy LLC and, indirectly, all of the stock of the Company from E.ON AG, making KU an indirect wholly-owned subsidiary of PPL Corporation. KU’s affiliate, Louisville Gas and Electric Company (“LG&E”), is a regulated public utility engaged in the generation, transmission, distribution and sale of electric energy and natural gas in Kentucky.

## RISK FACTORS

*An investment in the Bonds involves a number of risks. Risks described below should be carefully considered together with the other information included in this Supplement, including this Appendix A. Any of the events or circumstances described as risks below could result in a significant or material adverse effect on our business, results of operations, cash flows or financial condition, and a corresponding decline in the price of, or our ability to repay, the Bonds. The risks and uncertainties described below may not be the only risks and uncertainties that we face. Additional risks and uncertainties not currently known or that we currently deem immaterial may also result in a significant or material adverse effect on our business, results of operations, cash flow or financial condition.*

### **Risks related to the Company**

***Our business is subject to significant and complex governmental regulation.***

Various federal and state entities, including but not limited to the Federal Energy Regulatory Commission (“FERC”), the Kentucky Public Service Commission (the “Kentucky Commission”), the Virginia State Corporation Commission (the “Virginia Commission”) and the Tennessee Regulatory Authority, regulate many aspects of our utility operations, including:

- the rates that we may charge and the terms and conditions of our service and operations;
- financial and capital structure matters;
- siting and construction of facilities;
- mandatory reliability and safety standards, and other standards of conduct;
- accounting, depreciation, and cost allocation methodologies;
- tax matters;
- affiliate restrictions;
- acquisition and disposal of utility assets and securities; and
- various other matters.

Such regulations or changes thereto may subject us 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 our rate requests and ultimately reduce, alter or limit the rates we seek.

Our profitability is highly dependent on our ability to recover the costs of providing energy and utility services to our customers and earn an adequate return on our capital investments. We currently provide services to our retail customers at rates approved by one or more federal or state regulatory commissions, including those commissions referred to above. While these rates are generally regulated based on an analysis of our costs incurred in a base year, the rates we are allowed to charge may or may not match our costs at any given time. While rate regulation is premised on providing a reasonable opportunity to earn a reasonable rate of return on invested capital, there can be no assurance that the applicable regulatory commissions will consider all of our costs to have been prudently incurred or that the regulatory process in which rates are determined will always result in rates that will produce full recovery of our costs or an adequate return on our capital investments. If our costs are not adequately recovered through rates, it could have an adverse affect on our business, results of operations, cash flows or financial condition.

We have agreed, subject to certain limited exceptions such as fuel and environmental cost recoveries, that no base rate increase would take effect for our Kentucky retail customers before January 1, 2013.



***Transmission and interstate market activities of the Company, as well as other aspects of the business, are subject to significant FERC regulation.***

Our business is subject to extensive regulation by the FERC covering matters including rates charged to transmission users, market-based or cost-based rates applicable to wholesale customers; interstate power market structure; construction and operation of transmission facilities; mandatory reliability standards; standards of conduct and affiliate restrictions and other matters. Existing FERC regulation, changes thereto or issuances of new rules or situations of non-compliance, including but not limited to the areas of market-based tariff authority, Revenue Sufficiency Guarantee (“RSG”) resettlements in the Midwest Independent Transmission System Operator, Inc. market, mandatory reliability standards and natural gas transportation regulation can affect the earnings, operations or other activities of the Company.

***Changes in transmission and wholesale power market structures could increase costs or reduce revenues.***

Wholesale revenues fluctuate with regional demand, fuel prices and contracted capacity. Changes to transmission and wholesale power market structures and prices may occur in the future, are not estimable and may result in unforeseen effects on energy purchases and sales, transmission and related costs or revenues. These can include commercial or regulatory changes affecting power pools, exchanges or markets in which we participate.

***We undertake significant capital projects and these activities are subject to unforeseen costs, delays or failures, as well as risk of inadequate recovery of resulting costs.***

Our business is capital intensive and requires significant investments in energy generation and distribution and other infrastructure projects, such as projects for environmental compliance. The completion of these projects without delays or cost overruns is subject to risks in many areas, including:

- approval, licensing and permitting;
- land acquisition and the availability of suitable land;
- skilled labor or equipment shortages;
- construction problems or delays, including disputes with third party intervenors;
- increases in commodity prices or labor rates;
- contractor performance;
- environmental considerations and regulations;
- weather and geological issues; and
- political, labor and regulatory developments.

Failure to complete our capital projects on schedule or on budget, or at all, could adversely affect our financial performance, operations and future growth.

***Our costs of compliance with, and liabilities under, environmental laws are significant and are subject to continuing changes.***

Extensive federal, state and local environmental laws and regulations are applicable to our 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 but could be material. In addition, our costs may increase significantly if the requirements or scope of environmental laws or regulations, or similar rules, are expanded or changed from prior versions by the relevant agencies. Costs may take the form of increased capital or operating and

maintenance expenses; monetary fines, penalties or forfeitures or other restrictions. Many of these environmental law considerations are also applicable to the operations of our key suppliers, or customers, such as coal producers, industrial power users, etc., and may impact the costs of their products or their demand for our services.

***Our 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 other factors can significantly affect our finances or operations by changing demand levels; causing outages; damaging infrastructure or requiring significant repair costs; affecting capital markets and general economic conditions or impacting future growth.

***We are subject to operational and financial risks regarding potential developments concerning global climate change.***

Various regulatory and industry initiatives have been implemented or are under development to regulate or otherwise reduce emissions of greenhouse gases (“GHGs”), which are emitted from the combustion of fossil fuels such as coal and natural gas, as occurs at our generating stations. Such developments could include potential federal or state legislation or industry initiatives allocating or limiting GHG emissions; establishing costs or charges on GHG emissions or on fuels relating to such emissions; requiring GHG capture and sequestration; establishing renewable portfolio standards or generation fleet-diversification requirements to address GHG emissions; promoting energy efficiency and conservation; changes in transmission grid construction, operation or pricing to accommodate GHG-related initiatives; or other measures. Our generation fleet is predominantly coal-fired and may be highly impacted by developments in this area. Compliance with any new laws or regulations regarding the reduction of GHG emissions could result in significant changes to the Company’s operations, significant capital expenditures by the Company and a significant increase in our cost of conducting business. We may face strong competition for, or difficulty in obtaining, required GHG-compliance related goods and services, including construction services, emissions allowances and financing, insurance and other inputs relating thereto. Increases in our costs or prices of producing or selling electric power due to GHG-related developments could materially reduce or otherwise affect the demand, revenue or margin levels applicable to our power, thus adversely affecting our financial condition or results of operations.

***We are subject to physical, market and economic risks relating to potential effects of climate change.***

Climate change may produce changes in weather or other environmental conditions, including temperature or precipitation changes, such as warming or drought. These changes may affect farm and agriculturally-dependent businesses and activities, which are an important part of Kentucky’s economy, and thus may impact consumer demand for electric power. Temperature increases could result in increased overall electricity volumes or peaks and precipitation changes could result in altered availability of water for plant cooling operations. These or other meteorological changes could lead to increased operating costs, capital expenses or power purchase costs by the Company. Conversely, climate change could have a number of potential impacts tending to reduce demand. Changes may entail more frequent or more intense storm activity, which, if severe, could temporarily disrupt regional economic conditions and adversely affect electricity demand levels. As discussed in other risk factors, storm outages and damage often directly decrease revenues or increase expenses, due to reduced usage and higher restoration charges, respectively. GHG regulation could increase the cost of electric power, particularly power generated by fossil-fuels, and such increases could have a depressive effect on the regional economy. Reduced economic and consumer activity in our service area both generally and specific to certain industries and consumers accustomed to previously low-cost power, could reduce demand for our electricity. Also, demand for our services could be similarly lowered should consumers’ preferences or market factors move toward favoring energy efficiency, low-carbon power sources or reduced electric usage generally.

***Our business is subject to risks associated with local, national and worldwide economic conditions.***

The consequences of prolonged recessionary conditions may include a lower level of economic activity and uncertainty or volatility regarding energy prices and the capital and commodity markets. A lower level of economic activity might result in a decline in energy consumption, unfavorable changes in energy and commodity prices and slower customer growth, which may adversely affect our future revenues and growth. Instability in the financial

markets, as a result of recession or otherwise, also may affect the cost of capital and our ability to raise capital. A deterioration of economic conditions may lead to decreased production by our industrial customers and, therefore, lower consumption of electricity. Decreased economic activity may also lead to fewer commercial and industrial customers and increased unemployment, which may in turn impact residential customers' ability to pay. Further, worldwide economic activity has an impact on the demand for basic commodities needed for utility infrastructure. Changes in global demand may impact the ability to acquire sufficient supplies and the cost of those commodities may be higher than expected.

***Our business is concentrated in the Midwest United States, specifically Kentucky.***

Although we also operate in Virginia and Tennessee, the majority of our operations are concentrated in Kentucky. Local and regional economic conditions, such as population growth, industrial growth, expansion and economic development or employment levels, as well as the operational or financial performance of major industries or customers, can affect the demand for energy and our results of operations. Significant industries and activities in our service territory include automotive; aluminum and steel smelting and fabrication; chemical processing; coal, mineral and ceramic-related activities; educational institutions; health care facilities; paper and pulp processing and water utilities. Any significant downturn in these industries or activities or in local and regional economic conditions in our service area may adversely affect the demand for electricity in our service territory.

***We are subject to operational risks relating to our generating plants, transmission facilities, distribution equipment, information technology systems and other assets and activities.***

Operation of power plants, transmission and distribution facilities, information technology systems and other assets and activities subjects the Company to many risks, including the breakdown or failure of equipment; accidents; security breaches, viruses or outages affecting information technology systems; labor disputes; obsolescence; delivery/transportation problems and disruptions of fuel supply and performance below expected levels. Occurrences of these events may impact our ability to conduct our business efficiently or lead to increased costs, expenses or losses.

Although we maintain customary insurance coverage for certain of these risks in common with some other utilities, we do not have insurance covering our transmission and distribution system, other than substations, because we have found the cost of such insurance to be prohibitive. If we are unable to recover the costs incurred in restoring our transmission and distribution properties following damage as a result of tornados or other natural disasters or to recover the costs of other liabilities arising from the risks of our business, through a change in our rates or otherwise, or if such recovery is not received on a timely basis, we may not be able to restore losses or damages to our properties without an adverse effect on our financial condition, results of operations or our reputation.

***We are subject to liability risks relating to our generating, transmission, distribution and retail businesses.***

Conduct of our physical and commercial operations subjects us to many risks, including risks of potential physical injury, property damage or other financial affects, caused to or caused by employees, customers, contractors, vendors, contractual or financial counterparties and other third-parties.

***We could be negatively affected by rising interest rates, downgrades to our bond credit ratings or other negative developments in our ability to access capital markets.***

In the ordinary course of business, we are reliant upon adequate long-term and short-term financing means to fund our significant capital expenditures, debt interest or maturities and operating needs. As a capital-intensive business, we are sensitive to developments in interest rate levels; credit rating considerations; insurance, security or collateral requirements; market liquidity and credit availability and refinancing steps necessary or advisable to respond to credit market changes. Changes in these conditions could result in increased costs and decreased liquidity to the Company.



*We are 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 the Company.

*We are subject to risks associated with defined benefit retirement plans, health care plans, wages and other employee-related matters.*

We sponsor pension and postretirement benefit plans for our employees. Risks with respect to these plans include adverse developments in legislation or regulation, future costs or funding levels, returns on investments, market fluctuations, interest rates and actuarial matters. Changes in health care rules, market practices or cost structures can affect our current or future funding requirements or liabilities. Without sustained growth in our investments over time to increase the value of our plan assets, we could be required to fund our plans with significant amounts of cash. We are also subject to risks related to changing wage levels, whether related to collective bargaining agreements or employment market conditions, ability to attract and retain key personnel and changing costs of providing health care benefits.

*We are subject to risks associated with federal and state tax regulations.*

Changes in taxation as well as the inherent difficulty in quantifying potential tax effects of business decisions could negatively impact our results of operations. We are required to make judgments in order to estimate our obligations to taxing authorities. These tax obligations include income, property, sales and use and employment-related taxes. We also estimate our ability to utilize tax benefits and tax credits. Due to the revenue needs of the states and jurisdictions in which we operate, various tax and fee increases may be proposed or considered. We cannot predict whether legislation or regulation will be introduced or the effect on the Company of any such changes. If enacted, any changes could increase tax expense and could have a negative impact on our results of operations and cash flows.

## PRO FORMA CONDENSED FINANCIAL INFORMATION (UNAUDITED)

On November 1, 2010, PPL Corporation completed the purchase of all of the outstanding limited liability company interests of LG&E and KU Energy LLC, our parent, for cash consideration of \$2,467 million. In addition, PPL Corporation assumed, through consolidation, \$764 million of outstanding debt, net of \$163 million repurchased and held for reissuance, and repaid all indebtedness owed by our parent and its subsidiaries to subsidiaries of E.ON AG.

The Unaudited Pro Forma Condensed Financial Statements (“pro forma financial statements”) have been derived from our historical financial statements.

The historical financial information has been adjusted in the pro forma financial statements to give effect to pro forma events that are: (1) directly attributable to the acquisition; (2) factually supportable; and (3) with respect to the statement of operations, expected to have a continuing impact on our results. Specifically, such pro forma adjustments include:

- Repayment of intercompany debt by us to E.ON AG and its affiliates, initially by intercompany loans from a subsidiary of PPL Corporation;
- Adjustments to push down the new basis of accounting recorded by PPL Corporation on the post-acquisition balance sheet of the Company; and
- The subsequent issuance of the \$1,500,000,000 of taxable first mortgage bonds by the Company assuming proceeds equal to the principal amounts thereof and the use of such proceeds thereafter to repay the intercompany debt.

The Unaudited Pro Forma Condensed Statements of Operations (“pro forma statements of operations”) for the nine months ended September 30, 2010 and for the year ended December 31, 2009 give effect to the adjustments as if they were completed on January 1, 2009. The Unaudited Pro Forma Condensed Balance Sheet (“pro forma balance sheet”) as of September 30, 2010 gives effect to the adjustments as if they were completed on September 30, 2010.

Assumptions and estimates underlying the pro forma adjustments are described in the accompanying notes, which should be read in conjunction with the pro forma financial statements. Generally accepted accounting principles in the United States permit up to one year from the date of acquisition to finalize all purchase accounting adjustments, therefore, the final amounts recorded as of the date of the acquisition may differ materially from the information presented in these pro forma financial statements. These estimates are subject to change pending further review of the assets acquired and liabilities assumed.

The pro forma financial statements have been presented for illustrative purposes only and are not necessarily indicative of results of operations and financial position that would have been achieved had the pro forma events taken place on the dates indicated, or the future results of operations or financial position of the company.

The following pro forma financial statements should be read in conjunction with:

- the accompanying notes to the pro forma financial statements;
- the 2009 Annual Financial Statements and the Third Quarter Financial Statements, contained elsewhere in this Appendix A.

**Pro Forma Condensed Statement of Operations**

	<b>Nine Months Ended September 30, 2010</b>		
	<b>Actual</b>	<b>Adjustments (Unaudited)</b>	<b>Pro Forma</b>
		(Millions of dollars)	
<b>Operating Revenues</b> .....	\$ 1,146		\$ 1,146
<b>Operating Expenses</b>			
Fuel for electric generation .....	391		391
Power purchased .....	135		135
Other operation and maintenance .....	251		251
Depreciation, accretion, and amortization .....	106	—	106
Total Operating Expenses .....	883	—	883
<b>Operating Income</b> .....	263		263
Other income, net .....	2		2
Interest Expense .....	5	\$ 44(a)	49
Interest Expense — Affiliates .....	55	(55)(a)	—
<b>Income from Continuing Operations Before Income Taxes</b> .....	205	11	216
Income Taxes .....	76	4(b)	80
<b>Income from Continuing Operations After Income Taxes</b> .....	129	7	136

The accompanying Notes to Pro Forma Condensed Financial Statements are an integral part of these pro forma financial statements. See Note 3 for information on pro forma adjustment references.

**Pro Forma Condensed Statement of Operations**

	Year Ended December 31, 2009		
	Actual	Adjustments (Unaudited)	Pro Forma
		(Millions of dollars)	
<b>Operating Revenues</b> .....	\$ 1,355		\$ 1,355
<b>Operating Expenses</b>			
Fuel for electric generation .....	434		434
Power purchased .....	199		199
Other operation and maintenance .....	320		320
Depreciation, accretion, and amortization .....	<u>133</u>	—	<u>133</u>
Total Operating Expenses .....	<u>1,086</u>	—	<u>1,086</u>
<b>Operating Income</b> .....	269		269
Other income, net .....	6		6
Interest Expense .....	6	59(a)	65
Interest Expense — Affiliates .....	<u>69</u>	<u>(69)(a)</u>	<u>—</u>
<b>Income from Continuing Operations Before Income Taxes</b> .....	200	10	210
Income Taxes .....	<u>67</u>	<u>4(b)</u>	<u>71</u>
<b>Income from Continuing Operations After Income Taxes</b> .....	133	6	139

The accompanying Notes to Pro Forma Condensed Financial Statements are an integral part of these pro forma financial statements. See Note 3 for information on pro forma adjustment references.

### Pro Forma Condensed Balance Sheet

	September 30, 2010		
	Actual	Adjustments	Pro Forma Entity
		(Unaudited) (Millions of dollars)	
<b>Current Assets</b>			
Cash and cash equivalents .....	\$ 2	\$ 140(c)	\$ 142
Accounts receivable .....	200		200
Fuel, materials and supplies .....	140		140
Regulatory assets .....	14		14
Prepayments and other current assets .....	11		11
Total Current Assets .....	367	140	507
Investment in unconsolidated venture .....	12	68(d)	80
Property, Plant and Equipment, net .....	4,470	30(l)	4,500
<b>Deferred debits and other assets</b>			
Regulatory assets .....	215	(16)(e)	199
Goodwill .....	—	573(f)	573
Other intangibles .....	—	201(g)	201
Other noncurrent assets .....	46	11(h)	57
Total deferred debits and other assets .....	261	769	1,030
<b>Total Assets</b> .....	5,110	1,007	6,117

The accompanying Notes to Pro Forma Condensed Financial Statements are an integral part of these pro forma financial statements. See Note 3 for information on pro forma adjustment references.

## Pro Forma Condensed Balance Sheet

	September 30, 2010		
	Actual	Adjustments (Unaudited)	Pro Forma Entity
	(Millions of dollars)		
<b>Liabilities and Equity</b>			
<b>Current Liabilities</b>			
Current portion long-term debt.....	\$ 228		228
Current portion long-term debt — affiliated company.....	33	\$ (33)(j)	—
Note payable — affiliate.....	61		61
Accounts payable.....	176	(18)(i)	158
Regulatory liabilities.....	12		12
Other current liabilities.....	62		62
Total Current Liabilities.....	572	(51)	521
<b>Long-term Debt</b> .....	123	1,501(j)	1,624
<b>Long-term Debt — Affiliates</b> .....	1,298	(1,298)(j)	—
<b>Deferred Credits and Other Liabilities</b>			
Deferred income taxes and investment tax credit.....	482	27(p)	509
Accumulated provision for pensions and related benefits.....	160	—(k)	160
Asset retirement obligations.....	59	(4)(l)	55
Regulatory liabilities.....	367	201(m)	568
Other liabilities.....	20	17(n)	37
Total Deferred Credits and Other Liabilities.....	1,088	241	1,329
<b>Commitments and Contingent Liabilities</b>			
Total Equity.....	2,029	614(o)	2,643
<b>Total Liabilities and Equity</b> .....	\$ 5,110	\$ 1,007	\$ 6,117

The accompanying Notes to Pro Forma Condensed Financial Statements are an integral part of these pro forma financial statements. See Note 3 for information on pro forma adjustment references.



**NOTES TO PRO FORMA CONDENSED FINANCIAL STATEMENTS**  
**(Unaudited)**

**Note 1 — Basis of Pro Forma Presentation**

The pro forma statements of operations for the nine months ended September 30, 2010 and for the year ended December 31, 2009 give effect to the adjustments as if they were completed on January 1, 2009. The pro forma balance sheet as of September 30, 2010 gives effect to the adjustments as if they were completed on September 30, 2010.

The pro forma financial statements have been derived from our historical financial statements. Assumptions and estimates underlying the pro forma adjustments are described in the accompanying notes, which should be read in conjunction with the pro forma financial statements. Since the pro forma financial statements have been prepared based upon preliminary estimates, the final amounts recorded at the date of the acquisition may differ materially from the information presented. These estimates are subject to change pending further review of the assets acquired and liabilities assumed.

The pro forma financial statements reflect the push down of the new basis of accounting for our assets and liabilities arising from the acquisition by PPL Corporation being accounted for based on the guidance provided by accounting standards for business combinations. In accordance with this accounting guidance, the assets acquired and the liabilities assumed have been measured at fair value by PPL Corporation and the difference between these assets and liabilities and the purchase price has been recorded as goodwill (this process is generally referred to as a *purchase price allocation*). In accordance with SEC guidance for wholly-owned subsidiaries, these fair value measurements and an allocated portion of goodwill have been pushed down and recorded on our pro forma financial statements as presented in Note 2. The fair value measurements utilize estimates based on key assumptions of the acquisition, and historical and current market data. These fair value measurements and the related pro forma adjustments included herein may be revised as additional information becomes available and as additional analyses are performed. The final purchase price allocation may differ materially from the information presented. As noted above, the pro forma financial statements also include adjustments to reflect the issuance of the Bonds, with proceeds assumed to equal the principal amount thereof and used to repay indebtedness owed by us to a subsidiary of PPL Corporation. The indebtedness was incurred to repay loans from a subsidiary of E.ON AG in connection with the PPL Corporation acquisition. The preliminary result of all these adjustments is presented in Note 2.

The amounts utilized in determining the pro forma adjustments presented on the Proforma Condensed Financial Statements are also set forth and described in Note 3.

For the purpose of measuring the estimated fair value of the assets acquired and liabilities assumed, PPL Corporation has applied the accounting guidance for fair value measurements. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

For purposes of measuring the fair value of the majority of property, plant and equipment and regulatory assets acquired and regulatory liabilities assumed, as reflected in the pro forma financial statements, PPL has determined that the fair value equaled their net book value, due to the regulatory environment in which they operate. The regulatory commissions allow for earning a rate of return on the book values of the regulated asset bases at rates determined to be fair and reasonable. Since there is no current prospect for deregulation, the expectation is that these operations will remain in a regulated environment for the foreseeable future and this presentation represents the highest and best use of these assets. In addition, certain fair value adjustments have been reflected on the balance sheet with an offsetting regulatory asset or liability based upon agreement with the regulatory commissions that purchase accounting adjustments will not impact customers and, therefore, will not be included in any cost recovery mechanisms or rates on a prospective basis.

## Note 2 — Preliminary Push Down of Purchase Price Allocation and Replacement of Debt

### Preliminary Purchase Price Allocation

The preliminary allocation of the purchase price to the fair value of assets acquired and liabilities assumed includes pro forma adjustments primarily related to the fair value of equity investments, contractual arrangements, goodwill, noncurrent liabilities and long-term debt and related deferred income taxes. The preliminary allocation of the purchase price, including the replacement of debt, is as follows (in millions):

Current assets.....	\$ 507
Property, plant and equipment.....	4,500
Investments.....	80
Goodwill.....	573
Other intangibles.....	201
Regulatory assets and other noncurrent assets.....	256
Current liabilities.....	(521)
Noncurrent liabilities.....	(1,329)
Long-term debt.....	<u>(1,624)</u>
<b>Total Equity.....</b>	<b><u>\$ 2,643</u></b>

### Note 3 — Pro Forma Adjustments

The adjustments included in the pro forma financial statements are as follows:

#### Adjustments to Pro Forma Condensed Statements of Operations

(a) *Interest expense* — Reflects the change in interest expense from the extinguishment of indebtedness owed by us to a subsidiary of E.ON AG, and replacement with the taxable first mortgage bonds and the application of proceeds thereof. The interest expense was adjusted assuming a weighted-average interest rate of 3.9%. No adjustment has been made for the actual rates.

(b) *Income taxes* — Reflects the income tax effect of the pro forma adjustments, which was calculated using an estimated statutory income tax rate of 40%. Income tax expense includes adjustments for state taxes and certain federal income tax items that are calculated on a combined or consolidated basis.

#### Adjustments to Pro Forma Condensed Balance Sheet

(c) *Cash* — Reflects \$1,500 million of estimated proceeds from the taxable first mortgage bonds. This amount was offset by a \$1,331 million of estimated repayment of the indebtedness and payables owed to subsidiaries of E.ON AG and its affiliates, the repayment of \$18 million of affiliate accounts payable, and approximately \$11 million related to the payment of debt issuance costs.

(d) *Investments* — Reflects the fair value adjustment of \$68 million related to our equity method investment in Electric Energy, Inc.

(e) *Regulatory assets* — Reflects the offsetting regulatory asset related to the fair value adjustments associated with the fair value of debt, coal contracts and asset retirement obligations. These fair value adjustments have been reflected on the balance sheet with an offsetting regulatory asset based upon agreement with the regulatory commissions that purchase accounting adjustments will not impact customers and, therefore, will not be included in any cost recovery mechanisms or rates on a prospective basis.

(f) *Goodwill* — Reflects the preliminary estimate of the excess of the purchase price paid over the net fair value of our assets acquired and liabilities assumed. This excess is calculated as follows (in millions):

Purchase price.....	\$ 2,643
Less: Fair value of net assets acquired.....	<u>2,070</u>
Estimated goodwill resulting from the acquisition .....	573
Less: pre-existing goodwill.....	<u>—</u>
Pro forma goodwill adjustment .....	<u>\$ 573</u>

PPL Corporation has not yet completed its goodwill allocation evaluation, but will allocate the final amount of goodwill to its reporting units that are expected to benefit from the business combination in accordance with applicable accounting guidance. The resulting goodwill that will ultimately be allocated and pushed down to us could differ materially from the amount presented.

(g) *Other intangibles* — Reflects the recognition of \$188 million related to the fair value of certain coal contracts and \$13 million related the fair value of emission allowances.

(h) *Other noncurrent assets* — Reflects the capitalization of \$11 million of estimated debt issuance costs incurred with the issuance of the Bonds.

(i) *Accounts payable* — Reflects the payment of affiliate accounts payable to E.ON AG and its affiliates.

(j) *Debt* — Reflects the adjustments to repay \$1,331 million of indebtedness owed by us to a subsidiary of E.ON AG and its affiliates. This decrease is offset by the issuance of \$1,500 million of the Bonds at an assumed weighted-average interest rate of 3.9%. No adjustment has been made for the actual rates. In addition, an increase of \$1 million was recorded to reflect the fair value of the assumed debt. The ultimate fair value determination of the debt will be based on prevailing market interest rates at the completion of the acquisition and the adjustment will be amortized as an adjustment to interest expense over the remaining life of the debt issues.

(k) *Accumulated provision for pensions and related benefits* — The accrued pension obligations have not been adjusted as the information required to make such adjustment was not yet available. The resulting adjustment could differ materially from the amount presented.

(l) *Asset retirement obligations* — Reflects a \$4 million adjustment to record the fair value of asset retirement obligations. As a result, the associated regulatory assets of \$34 million were written off, and \$30 million related to property, plant and equipment, net, were recorded.

(m) *Regulatory liabilities* — Reflects the offsetting regulatory liability related to the fair value adjustments associated with the fair value of emission allowances and coal contracts. These fair value adjustments have been reflected on the balance sheet with an offsetting regulatory liability based upon agreement with the regulatory commissions that purchase accounting adjustments will not impact customers and therefore, will not be included in any cost recovery mechanisms or rates on a prospective basis.

(n) *Other noncurrent liabilities* — Reflects the recognition of the fair value of certain coal contracts.

(o) *Equity* — Reflects the net purchase accounting adjustments to increase our historical equity balance of \$2,029 million to recognize the \$2,643 million of equity from the purchase price, including the push down of \$573 million of goodwill resulting from acquisition and other fair value adjustments previously discussed.

(p) *Deferred income taxes* — Represents estimated deferred taxes calculated at our estimated statutory tax rate of 40% applied to certain fair value adjustments recorded to the assets acquired and liabilities assumed, excluding goodwill.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

The following discussion and analysis by management focuses on those factors that had a material effect on our results of operations and financial condition during the periods presented and should be read in connection with the financial statements and notes included elsewhere in this Appendix A. The discussion contains certain forward-looking statements that involve risk and uncertainties. See "Risk Factors."

### Years Ended December 31, 2009, 2008 and 2007

#### Results of Operations

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

#### *Net Income*

Net income in 2009 decreased \$25 million compared to 2008. The decrease was primarily the result of decreased operating revenues (\$50 million), decreased equity in earnings (\$29 million), decreased other income — net (\$3 million) and increased interest expense (\$3 million), partially offset by decreased operating expenses (\$59 million) and decreased income taxes (\$1 million).

Net income in 2008 decreased \$9 million compared to 2007. The decrease was primarily the result of increased operating expenses (\$140 million) and increased interest expense (\$16 million), partially offset by increased operating revenues (\$133 million), decreased income taxes (\$9 million), increased equity in earnings (\$4 million) and increased other income — net (\$1 million).

#### *Revenues*

Revenues in 2009 decreased \$50 million compared to 2008 primarily due to:

- Decreased wholesale sales (\$75 million) due to lower sales volumes to LG&E (\$60 million) and third-parties (\$16 million). These lower volumes were primarily due to lower economic demand caused by low spot market pricing during most of 2009, and due to higher scheduled coal-fired generation unit outages during 2009. Via a mutual agreement, we sell our higher cost electricity to LG&E for its wholesale sales and we purchase LG&E's lower cost electricity to serve our native load. These decreases were partially offset by increased prices (\$1 million) for sales to LG&E due to the higher cost of fuel inventory.
- Decreased retail sales volumes delivered (\$55 million) due to reduced consumption by residential customers as a result of milder weather and significant 2009 storm outages as well as low energy usage by industrial and commercial customers as a result of weakened economic conditions.
- Decreased fuel costs billed to customers through a fuel adjustment clause (\$2 million) due to a refund of power purchased costs from Owensboro Municipal Utilities ("OMU") (\$6 million), partially offset by increased fuel prices (\$4 million).
- Decreased gains in unrealized energy marketing financial swaps (\$2 million).

Partially offset by:

- Increased environmental cost recovery surcharge (\$50 million) due to increased recoverable capital spending.
- Decreased merger surcredit (\$13 million) due to the surcredit termination in February 2009.
- Increased DSM cost recovery (\$9 million) due to increased recoverable program spending.

- Increased miscellaneous revenue (\$6 million) resulting from the assessment of late payment fees beginning in the second quarter of 2009.
- Increased retail sales revenue from base rates (\$5 million) due to the increase in Virginia rates in November 2009, and application of the Kentucky base rate settlement resulting in higher customer charge and demand revenue, partially offset by lower energy revenue.
- Decreased value delivery team (“VDT”) process surcredit (\$1 million) due to termination in August 2008.

Revenues in 2008 increased \$133 million compared to 2007 primarily due to:

- Increased fuel costs billed to customers through the fuel adjustment clause (\$52 million) due to increased fuel prices
- Increased wholesale sales (\$48 million) due to higher sales volumes and prices. Volumes increased to LG&E (\$34 million) and third-parties (\$10 million) as a result of excess generation made available by LG&E via a mutual agreement. We sell our higher cost electricity to LG&E for LG&E to make wholesale sales and we purchase LG&E’s lower cost electricity to serve our native load. Both the Company and LG&E experienced lower native load requirements due to milder weather and the weakening economy, and increased generation due to fewer scheduled coal-fired generation unit outages during 2008, resulting in higher volumes available for wholesale sales. Pricing to third-parties increased as a result of higher fuel costs (\$2 million). Wholesale sales also increased due to gains in energy marketing financial swaps (\$2 million).
- Increased environmental cost recovery surcharge (\$43 million) due to increased recoverable capital spending
- Increased DSM cost recovery (\$2 million) due to additional conservation programs
- Increased transmission sales (\$2 million) due to higher sales to LG&E
- Decreased merger surcredit (\$2 million) due to a lower rate approved by the Kentucky Commission in June 2008
- Decreased VDT surcredit (\$1 million) due to its termination in August 2008.

Partially offset by:

- Decreased retail sales volumes delivered (\$17 million) due to a 26% decrease in cooling degree days and weakening economic conditions

### *Expenses*

Fuel for electric generation comprises a large component of total operating expenses. Increases or decreases in the cost of fuel are reflected in retail rates through the fuel adjustment clause, subject to the approval of the Kentucky Commission, the Virginia Commission and the FERC.

#### Electric Generation Expense

Expenses related to fuel for electric generation decreased \$79 million in 2009 compared to 2008 primarily due to:

- Decreased volumes of fuel usage (\$97 million) due to decreased native load and wholesale sales

Partially offset by:

- Increased commodity and transportation costs for coal (\$18 million)

Expenses related to fuel for electric generation increased \$52 million in 2008 compared to 2007 primarily due to:

- Increased commodity and transportation costs for coal and natural gas (\$39 million)
- Increased generation (\$13 million) due to increased utilization of coal-fired generation units as a result of fewer scheduled outages in 2008

Power Purchased Expense

Power purchased expense decreased \$22 million in 2009 compared to 2008 primarily due to:

- Decreased prices for purchases used to serve retail customers (\$18 million) due to lower spot market pricing and increased availability of power from OMU
- Decreased purchases from LG&E due to lower prices (\$7 million) and lower volumes (\$2 million). Via a mutual agreement, we purchase LG&E's lower cost electricity to serve our native load. LG&E provided lower volumes due to its increased scheduled coal-fired outages during the fourth quarter of 2009.
- Decreased power purchased expense (\$6 million) due to a refund of power purchased costs related to the OMU settlement.

Partially offset by:

- Increased third-party purchased volumes for native load (\$8 million) primarily due to scheduled coal-fired generation unit outages.
- Increased demand payments for third-party purchases (\$3 million) on long-term contracts.

Power purchased expense increased \$53 million in 2008 compared to 2007 primarily due to:

- Increased prices for purchases used to serve retail customers (\$24 million) due to higher market prices, influenced by higher fuel costs
- Increased power purchased from LG&E via a mutual agreement due to higher volumes (\$8 million) and higher prices (\$8 million). We purchase LG&E's lower cost electricity to serve our native load. LG&E was able to provide higher volumes due to its reduced native load requirements as a result of milder weather and the weakening economy.
- Increased demand payments (\$7 million) for energy purchased on a long-term contract
- Increased third-party power purchase volume for native load (\$5 million) due to increased unscheduled coal-fired generation unit outages
- Increased expenses (\$1 million) due to activities in the PJM Interconnection LLC market for the entire year of 2008 compared to only one quarter in 2007

Other Operation and Maintenance Expenses

Other operation and maintenance expenses increased \$45 million in 2009 compared to 2008 primarily due to increased other operation expenses (\$30 million) and increased other maintenance expenses (\$15 million).

Other operation expenses increased \$30 million in 2009 compared to 2008 primarily due to:

- Increased pension expense (\$20 million) due to lower 2008 pension asset investment performance.
- Increased steam expense (\$7 million) due to utilization of selective catalytic reductions year-round.

- Increased administrative and general expense (\$5 million) due to increased DSM program spending as well as consulting fees for software training and increased labor and benefit costs, partially offset by decreased legal expenses mainly related to OMU in 2008, which case was settled in the second quarter of 2009.

Partially offset by:

- Decreased generation expense (\$2 million) due to scheduled unit outages and routine maintenance

Other maintenance expenses increased \$15 million in 2009 compared to 2008 primarily due to:

- Increased steam expense (\$7 million) due to increased scope of work for scheduled outages.
- Increased distribution expense (\$5 million) as a result of increased repairs and higher tree trimming expense in 2009 (\$3 million) and higher storm related expense in 2009 (\$2 million).
- Increased transmission expense (\$2 million) primarily due to increased overhead line maintenance for North American Electric Reliability Corporation (“NERC”) mandatory reliability compliance.
- Increased administrative and general expense (\$1 million) due to increased labor and system maintenance contracts resulting from completion of a significant in-house customer information system project.

Other operation and maintenance expenses increased \$20 million in 2008 compared to 2007 primarily due to increased other operation expenses (\$16 million) and increased maintenance expenses (\$4 million).

Other operation expenses increased \$16 million in 2008 compared to 2007 primarily due to:

- Increased outside services (\$4 million) due to increased legal expenses as a result of on-going litigation, mainly with OMU
- Increased cost of consumables (\$4 million) due to contract pricing and commissioning and start up costs of flue gas desulfurization systems (“FGDs”)
- Increased transmission expense (\$2 million) due to increased native load purchases from LG&E and the additional costs to comply with growing SERC Reliability Corporation and NERC Mandatory Reliability Standards
- Increased distribution expense (\$2 million) due to storm restoration
- Increased uncollectible accounts (\$2 million) due to the weakening economy
- Increased property taxes (\$2 million) due to net decrease in expense in 2007 as a result of the application of coal tax credits

Other maintenance expenses increased \$4 million in 2008 compared to 2007 primarily due to increased maintenance of overhead conductors and devices (\$4 million) resulting from storm restoration.

#### Income from Equity Investments

Equity income from Electric Energy, Inc. (“EEI”), in which we own 20% of the common stock, decreased \$29 million in 2009 compared to 2008 primarily due to lower earnings resulting from decreased market prices.

Equity income in EEI increased \$4 million in 2008 primarily due to an increased average price per mega-watt hour sold in 2008 over the price for 2007.

Other Income — Net

Other income — net decreased \$3 million in 2009 compared to 2008 primarily due to:

- Decreased \$2 million due to discontinuance of allowance for funds used during construction on environmental cost recovery projects as a result of the FERC rate case.
- Decreased \$1 million due mainly to depreciation expense on joint-use assets related to Trimble County Unit 2 (“TC2”) transferred from LG&E and currently held for future use.

Other income — net increased \$1 million in 2008 compared to 2007, primarily due to:

- Increased \$3 million due to allowance for funds used during construction related to several large multi-year projects
- Increased \$1 million due to net losses on the sale of property in 2007

Partially offset by:

- Decreased \$2 million due to lower income earned on bond deposits for special projects
- Decreased \$1 million due to settlement for Brown Station new source review litigation and related programs

Interest Expense

Interest expense increased \$3 million in 2009 compared to 2008 primarily due to increased interest expense to affiliated companies (\$13 million) resulting from additional debt, partially offset by decreased interest expense (\$8 million) due to lower interest rates on bonds and (\$2 million) due to lower interest rates on intercompany short term borrowings.

Interest expense increased \$16 million in 2008 compared to 2007 primarily due to increased interest expense to affiliated companies (\$17 million) due to additional debt, partially offset by decreased interest expense (\$1 million) due to interest received on reacquired debt.

Depreciation

Depreciation expense decreased \$3 million in 2009 compared to 2008, primarily due to the decrease in depreciation rates that became effective in February 2009, mainly related to an increase in the estimated useful lives on transmission and distribution assets.

Depreciation expense increased \$15 million in 2008 compared to 2007, primarily due to an increase in capital assets that were placed in service in 2008.

Income Tax Expense

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

	<u>2009</u>	<u>2008</u>	<u>2007</u>
		(In millions)	
Current — federal .....	\$ (5)	\$ 46	\$ 28
— state .....	1	10	13
Deferred — federal — net .....	43	(10)	(5)
— state — net .....	7	(3)	(1)
Investment tax credit — deferred .....	21	25	43
Amortization of investment tax credit .....	—	—	(1)
Total income tax expense .....	<u>\$ 67</u>	<u>\$ 68</u>	<u>\$ 77</u>



Deferred federal and state income tax expense increased in 2009 compared to 2008, primarily due to temporary differences related to storm costs and depreciation. The temporary differences also resulted in an offsetting decrease to current federal and state taxes in 2009. Current federal income tax expense increased and investment tax credit — deferred decreased primarily due to claiming \$18 million less in investment tax credits in 2008. Current state income tax decreased due to coal credits claimed in 2008. Deferred federal income tax expense decreased in 2008 compared to 2007, primarily due to adjusting prior year estimates to actual based on the filed tax return.

### **Cash Flows from Operating Activities**

Cash provided by operations in 2009 was \$39 million less than cash provided by operations in 2008 and was primarily the result of decreases in cash due to changes in:

- Storm restoration expenses (\$55 million) deferred for future recovery as regulatory assets
- Accounts receivable (\$16 million) due to timing of payments received from the Illinois Municipal Electric Agency (“IMEA”) and the Indiana Municipal Power Agency (“IMPA”) in 2008
- Pension and postretirement funding (\$15 million) due to increased contributions made in 2009
- Accounts payable (\$12 million) primarily due to fuel purchases and timing of payments
- Prepayment and other current assets (\$2 million)

These decreases were partially offset by increases in cash due to changes in:

- Earnings, net of non-cash items (\$49 million)<sup>(1)</sup>
- Materials and supplies (\$5 million) primarily due to a decrease in cash used for coal inventory
- Other (\$7 million)

(1) Management uses the term “earnings, net of non-cash items” in its discussion of cash flows from operating activities to describe net income adjusted by income or expenses not requiring cash currently, including depreciation, accretion, amortization, deferred income taxes, investment tax credits, provision for pension and postretirement benefits and other non-cash items. Although “earnings, net of non-cash items” may not be a measure determined in accordance with accounting principles generally accepted in the United States, the measure facilitates the analysis by management and investors of the Companies’ cash flows from operating activities.

Cash provided by operations in 2008 was \$19 million less than cash provided by operations in 2007 and was primarily the result of decreases in cash due to changes in:

- Materials and supplies (\$55 million) primarily due to increased fuel inventory volumes and higher fuel costs
- Earnings, net of non-cash items (\$15 million)<sup>(1)</sup>
- Other (\$12 million) primarily due to changes in utility plant and customer advances for construction
- Prepayment and other current assets (\$2 million)
- Wind storm regulatory asset (\$2 million) due to new regulatory asset for Hurricane Ike restoration expenses

These decreases were partially offset by increases in cash due to changes in:

- Accounts receivable (\$28 million) due to timing of payments received from IMEA and IMPA

- Accounts payable (\$24 million) primarily due to construction accruals related to FGD projects and TC2
- Pension and postretirement funding (\$14 million) due to contributions made in 2007
- Other current liabilities (\$1 million)

#### **Cash Flows from Investing Activities**

The primary use of funds for investing activities continues to be for capital expenditures. Net cash used for investing activities decreased \$188 million in 2009 compared to 2008 primarily due to decreased capital expenditures of \$170 million, assets purchased from LG&E of \$10 million in 2008 and changes in restricted cash from bonds issued in 2008 used to fund environmental equipment of \$8 million. Restricted cash represents the escrowed proceeds of the pollution control bonds, which are disbursed as qualifying costs are incurred.

Net cash used for investing activities decreased \$42 million in 2008 compared to 2007 primarily due to decreased capital expenditures of \$63 million, partially offset by decreased restricted cash of \$11 million and an asset purchased from LG&E of \$10 million. Restricted cash represents the escrowed proceeds of the pollution control bonds, which are disbursed as qualifying costs are incurred.

#### **Cash Flows from Financing Activities**

Net cash provided by financing activities decreased \$151 million due to decreased long-term borrowings from affiliated company of \$100 million, lower equity contributions in 2009 of \$70 million and reduced issuance of tax-exempt bonds in 2009 totaling \$17 million, all of which were partially offset by an increase of short-term borrowing from affiliate of \$36 million.

Net cash provided by financing activities decreased \$15 million in 2008 compared to 2007, primarily due to decreased long-term borrowings from affiliated company of \$198 million, reacquisition of bonds of \$80 million, retirement of pollution control bonds of \$60 million and issuance of pollution control bonds of \$1 million, partially offset by the retirement of first mortgage bonds of \$107 million in 2007, increased infusions from our Parent of \$70 million, decreased repayment of short-term borrowings from affiliate — net of \$67 million, reissuance of reacquired bonds of \$63 million and retirement of reacquired bonds of \$17 million.

See Note 7 to our 2009 Annual Financial Statements and Note 8 to our Third Quarter Financial Statements, each included elsewhere in this Appendix A, for information of redemptions, maturities and issuances of long-term debt.

### **Three Months Ended September 30, 2010, Compared to Three Months Ended September 30, 2009**

#### **Results of Operations**

##### *Net Income*

Net income was \$54 million for the three months ended September 30, 2010, compared to \$66 million for the same period in 2009. The decrease was primarily the result of the following (In millions of \$):

	Three Months Ended		Increase (Decrease)
	September 30,		
	2010	2009	
Total operating revenues .....	\$ 416	\$ 341	\$ 75
Total operating expenses .....	<u>311</u>	<u>216</u>	<u>95</u>
Operating income .....	105	125	(20)
Interest expense to affiliated companies .....	18	18	—
Other income (expense) — net .....	<u>(1)</u>	<u>(2)</u>	<u>1</u>
Income before income taxes .....	86	105	(19)
Income tax expense .....	<u>32</u>	<u>39</u>	<u>(7)</u>
Net income.....	<u>\$ 54</u>	<u>\$ 66</u>	<u>\$ (12)</u>

### *Revenues*

The \$75 million increase in operating revenues in the three months ended September 30, 2010, was primarily due to (In millions of \$):

	Increase (Decrease)
Retail sales volumes(a).....	\$ 40
Retail base rates(b) .....	14
ECR surcharge due to increased recoverable capital spending.....	10
Retail fuel adjustment clause (“FAC”) costs billed to customers due to higher fuel prices .....	6
Other .....	<u>5</u>
	<u>\$ 75</u>

- (a) Primarily due to increased consumption by residential customers as a result of increased cooling degree days and higher energy usage by industrial customers as a result of improved economic conditions and increased cooling degree days.
- (b) Primarily due to higher rates effective August 1, 2010. See Note 2 to our Third Quarter Financial Statements, included elsewhere in this Appendix A, for further discussion of the 2010 Kentucky rate case.

### *Expenses*

Fuel for electric generation comprises a large component of total operating expenses. Increases or decreases in the cost of fuel are reflected in retail rates through the FAC, subject to the approval of the Kentucky Commission, the Virginia Commission and the FERC. Operating expenses follow (in millions of \$):

	Three Months Ended		Increase (Decrease)
	September 30,		
	2010	2009	
Fuel for electric generation .....	\$ 146	\$ 114	\$ 32
Power purchased.....	41	47	(6)
Other operation and maintenance expenses .....	86	22	64
Depreciation, accretion and amortization .....	<u>38</u>	<u>33</u>	<u>5</u>
Total operating expenses .....	<u>\$ 311</u>	<u>\$ 216</u>	<u>\$ 95</u>

### *Electric Generation Expense*

The \$32 million increase in fuel for electric generation in the three months ended September 30, 2010, was primarily due to increased volumes of fuel usage due to increased retail sales volumes.

Power Purchased Expense

The \$6 million decrease in power purchased expense in the three months ended September 30, 2010, was primarily due to (in millions of \$):

	<u>Increase (Decrease)</u>
Third-party purchased volumes for native load .....	\$ (8)
Demand payments for third-party purchase.....	(4)
Prices for purchases used to serve retail customers .....	<u>6</u>
	<u>\$ (6)</u>

Other Operation and Maintenance Expenses

Other operation and maintenance expenses increased \$64 million in the three months ended September 30, 2010, due to \$55 million of increased maintenance expenses, and \$9 million of increased other operation expenses. These increases were primarily due to distribution expenses (\$53 million related to maintenance and \$4 million related to other operations) incurred in the first quarter of 2009 for wind and ice storm restoration that were reclassified to a regulatory asset in the third quarter of 2009.

Income Tax Expense

See Note 7 to our Third Quarter Financial Statements, included elsewhere in this Appendix A, for a reconciliation of differences between the U.S. federal income tax expense at statutory rates and our income tax expense.

**Nine Months Ended September 30, 2010, Compared to  
Nine Months Ended September 30, 2009**

**Results of Operations**

*Net Income*

Net income was \$129 million for the nine months ended September 30, 2010, compared to \$99 million for the same period in 2009. The increase was primarily the result of the following (in millions of \$):

	<u>Nine Months Ended September 30,</u>		<u>Increase (Decrease)</u>
	<u>2010</u>	<u>2009</u>	
Total operating revenues .....	\$ 1,146	\$ 1,009	\$ 137
Total operating expenses .....	<u>883</u>	<u>812</u>	<u>71</u>
Operating income .....	263	197	66
Interest expense to affiliated companies .....	55	51	4
Other income (expense) — net .....	<u>(3)</u>	<u>2</u>	<u>(5)</u>
Income before income taxes .....	205	148	57
Income tax expense .....	<u>76</u>	<u>49</u>	<u>27</u>
Net income .....	<u>\$ 129</u>	<u>\$ 99</u>	<u>\$ 30</u>

*Revenues*

The \$137 million increase in operating revenues in the nine months ended September 30, 2010, was primarily due to (in millions of \$):

	<u>Increase (Decrease)</u>
Retail sales volumes(a) .....	\$ 98
Retail base rates(b) .....	14
ECR surcharge due to increased recoverable capital spending .....	10
Miscellaneous operating revenue(c) .....	8
DSM revenue due to increased recoverable program spending .....	6
Other .....	<u>1</u>
	<u>\$ 137</u>

- 
- (a) Primarily due to increased consumption by residential customers as a result of increased cooling and heating degree days and higher energy usage by industrial customers as a result of improved economic conditions and increased cooling and heating degree days.
- (b) Primarily due to higher rates effective August 1, 2010. See Note 2 to our Third Quarter Financial Statements, included elsewhere in this Appendix A, for further discussion of the 2010 Kentucky rate case.
- (c) Primarily related to increased late payment charges and transmission service revenues.

*Expenses*

Fuel for electric generation comprises a large component of total operating expenses. Increases or decreases in the cost of fuel are reflected in retail rates through the FAC, subject to the approval of the Kentucky Commission, the Virginia Commission and the FERC. Operating expenses follow (In millions of \$):

	<u>Nine Months Ended</u> <u>September 30,</u>		<u>Increase</u> <u>(Decrease)</u>
	<u>2010</u>	<u>2009</u>	
Fuel for electric generation.....	\$ 391	\$ 329	\$ 62
Power purchased.....	135	154	(19)
Other operation and maintenance expenses.....	251	230	21
Depreciation, accretion and amortization.....	<u>106</u>	<u>99</u>	<u>7</u>
Total operating expenses.....	<u>\$ 883</u>	<u>\$ 812</u>	<u>\$ 71</u>

*Electric Generation Expense*

The \$62 million increase in fuel for electric generation in the nine months ended September 30, 2010, was primarily due to (In millions of \$):

	<u>Increase</u> <u>(Decrease)</u>
Fuel usage volumes due to increased native load and wholesale sales.....	\$ 73
Commodity and transportation costs for coal.....	<u>(11)</u>
	<u>\$ 62</u>

*Power Purchased Expense*

The \$19 million decrease in power purchased expense in the nine months ended September 30, 2010, was primarily due to (In millions of \$):

	<u>Increase</u> <u>(Decrease)</u>
Third-party purchased volumes for native load.....	\$ (16)
Purchases from LG&E due to volume(a).....	(13)
Demand payments for third-party purchases.....	(5)
Prices for purchases used to serve retail customers.....	7
OMU settlement received in 2009(b).....	6
Purchases from LG&E due to fuel costs.....	<u>2</u>
	<u>\$ (19)</u>

(a) Primarily due to increased consumption by residential customers at LG&E as a result of increased cooling and heating degree days and increased coal-fired generation outages in the first six months of 2010 and higher energy usage by industrial customers as a result of improved economic conditions and increased cooling and heating degree days. See Note 10 to our Third Quarter Financial Statements, included elsewhere in this Appendix A, for further discussion of the mutual agreement for wholesale sales and purchases between the Companies.

(b) See Note 9 to our Third Quarter Financial Statements, included elsewhere in this Appendix A, for further discussion of the OMU settlement.

*Other Operation and Maintenance Expenses*

Other operation and maintenance expenses increased \$21 million in the nine months ended September 30, 2010, due to \$19 million of increased other operation expenses and \$2 million of increased maintenance expenses.

Other Operation Expenses

The \$19 million increase in other operation expenses in the nine months ended September 30, 2010 was primarily due to (in millions of \$):

	<u>Increase (Decrease)</u>
Transmission expense(a) .....	\$ 7
Administrative and general(b) .....	6
Steam expense due to increased generation in 2010.....	5
Other .....	<u>1</u>
	<u>\$ 19</u>

- (a) Primarily due to transmission expense for a third party pursuant to a settlement agreement, the establishment of a regulatory asset approved by the Kentucky Commission for the EKPC settlement in 2009, net of nine months of amortization expense recorded in 2010, and increased transmission expense due to transmission charges for FERC jurisdictional municipal customers now unbundled from energy.
- (b) Primarily due to increased bad debt expense due to higher billed revenues, implementation of a late payment charge and a higher net charge-off percentage, increased labor costs, and increased insurance cost.

Interest Expense to Affiliated Companies

The \$4 million increase in interest expense to affiliated companies in the nine months ended September 30, 2010, was primarily due to increased intercompany notes outstanding.

Income Tax Expense

See Note 7 to our Third Quarter Financial Statements, included elsewhere in this Appendix A, for a reconciliation of differences between the U.S. federal income tax expense at statutory rates and our income tax expense.

**Liquidity and Capital Resources**

	<u>September 30, 2010</u>	<u>December 31, 2009</u>
	(in millions)	
Cash and cash equivalents .....	\$ 2	\$ 2
Current portion of long-term debt.....	228	228
Current portion of long-term debt to affiliated company.....	33	33
Notes payable to affiliated company .....	61	45

Activity in our cash and cash equivalents in the nine months ended September 30, 2010, included the following:

	<u>Increase (Decrease)</u>
	(In millions)
Cash provided by operating activities.....	\$ 300
Construction expenditures .....	(218)
A net increase in short-term borrowings from affiliated company .....	16
Expenditures to purchase assets from affiliate.....	(48)
Payment of dividends .....	<u>(50)</u>
	<u>\$ —</u>

We use net cash generated from our operations, external financing, financing from affiliates and/or infusions of capital from our Parent mainly to fund construction of plant and equipment. As of September 30, 2010, we had a working capital deficiency of \$205 million, primarily due to the terms of certain tax-exempt bonds totaling

\$228 million which allow the investors to put the bonds back to the Company causing them to be classified as current portion of long-term debt. We believe we have adequate liquidity facilities to repurchase any bonds put back to the Company. Working capital deficiencies can be funded through an intercompany money pool agreement or through a syndicated credit facility as described below. We believe that our sources of funds will be sufficient to meet the needs of our business in the foreseeable future.

On November 1, 2010, we entered into a new \$400 million unsecured Revolving Credit Agreement, expiring December 31, 2014. Under this credit facility, we have the ability to make cash borrowings and to request the lenders to issue letters of credit. Borrowings will generally bear interest at LIBOR-based rates plus a spread, depending upon our senior unsecured long-term debt rating. The new credit facility contains a financial covenant requiring our debt to total capitalization to not exceed 70% and other customary covenants. Under certain conditions, we may request that the facility's capacity be increased by up to \$100 million. This new credit facility replaced an existing bilateral line of credit totaling \$35 million that was terminated on the effective date of the new facility.

In addition, we maintain letter of credit facilities under which four letters of credit have been issued totaling \$198 million, which support existing pollution control bonds totaling approximately \$195 million. We plan to substitute letters of credit issued under our new Revolving Credit Agreement for these letters of credit currently supporting pollution control bonds. After the substitution, we plan to terminate these letter of credit facilities.

We also participate in an intercompany money pool agreement wherein our Parent and/or LG&E make funds available to us at market-based rates (based on highly rated commercial paper issues) up to \$400 million.

We, through our Parent, sponsor pension and postretirement benefit plans for our employees. The performance of the capital markets affects the values of the assets that are held in trust to satisfy future obligations under the defined benefit pension plans. The market value of the combined investments, including the impact of benefit payments, within the plans increased by approximately 15% for the year ended December 31, 2009. The benefit plan assets and obligations of our Parent and the Company are remeasured annually using a December 31 measurement date. Investment gains in 2009 resulted in a decrease to the plans' unfunded status upon actuarial revaluation of the plans, while investment losses in 2008 had the opposite effect. Our 2009 pension cost was approximately \$20 million higher than 2008. We anticipate our 2010 pension cost will be approximately \$5 million less than the 2009 expense. The amount of future funding will depend upon the actual return on plan assets, the discount rate and other factors, but we fund our pension obligations in a manner consistent with the Pension Protection Act of 2006. In January 2010, we made a voluntary contribution to our pension plan of \$13 million.

### **Future Capital Requirements**

Our construction program is designed to ensure that there will be adequate capacity and reliability to meet the electric needs of our service area and to comply with environmental regulations. These needs are continually being reassessed and appropriate revisions are made, when necessary, in construction schedules. At September 30, 2010, we estimated our capital expenditures for the three-year period ending December 31, 2012 to total approximately \$1,125 million, consisting primarily of on-going construction related to generation assets totaling approximately \$305 million, ash pond and landfill projects totaling approximately \$210 million, on-going construction related to distribution assets totaling approximately \$245 million, selective catalytic reduction projects totaling approximately \$155 million, installation of FGDs on Ghent and Brown units totaling approximately \$125 million, information technology projects totaling approximately \$35 million, other projects totaling approximately \$25 million and construction of TC2 totaling approximately \$25 million (including \$5 million for environmental controls).

In addition to the amounts above, evolving environmental regulations will likely increase the level of capital expenditures above the amounts currently expected over the next several years. With respect to NAAQS, CATR, CAMR (each as defined and described under "Business — Environmental Matters") replacement and coal combustion byproducts developments, based on a preliminary analysis of proposed regulations, we may be required to consider actions such as upgrading existing emissions controls, installing additional emissions controls, upgrading byproducts disposal and storage and possible early replacement of coal-fired units. Our capital expenditures associated with such actions are preliminarily estimated to be in the \$1.7 billion range over the next 10 years, although final costs may substantially vary. With respect to potential developments in water discharge, revised PCB



standards, or GHG initiatives, costs in such areas cannot be estimated due to the preliminary status or uncertain outcome of such developments, but would be in addition to the above amounts and could be substantial. See Note 9 to our Third Quarter Financial Statements, included elsewhere in this Appendix A, for further discussion of environmental matters.

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. Credit market conditions can affect aspects of the availability, terms or methods in which we fund our capital requirements. We anticipate funding future capital requirements through operating cash flow, issuance of debt (including issuance of first mortgage bonds) and/or infusions of capital from our Parent.

We have a variety of funding alternatives available to meet our capital requirements. We maintain a \$400 million unsecured revolving credit facility with a maturity date of December 31, 2014, and we participate in an intercompany money pool arrangement wherein our Parent and/or LG&E make funds of up to \$400 million available to the Company at market-based rates.

Regulatory approvals are required for the Company to incur additional debt. The Virginia Commission and the FERC authorize the issuance of short-term debt while the Kentucky Commission, the Virginia Commission and the Tennessee Regulatory Authority authorize the issuance of long-term debt. In November 2009, we received a two-year authorization from the FERC to borrow up to \$400 million in short-term funds. We also have authorization from the Virginia Commission that expires at the end of 2011 allowing short-term borrowing of up to \$400 million. We currently believe this authorization provides the necessary flexibility to address any liquidity needs. As of September 30, 2010, we have borrowed \$61 million of this authorized amount.

In September 2010 the Kentucky Commission, and in October 2010 the Virginia Commission and the Tennessee Regulatory Authority, issued orders in the Company's respective financing cases associated with the PPL acquisition. The orders each authorized the Company to:

- issue notes to a PPL affiliate to repay previously outstanding debt with an affiliate of E.ON AG;
- issue first mortgage bonds up to \$1.556 billion to
  - refund notes due to affiliates and
  - fund our cash needs;
- issue first mortgage bonds to secure and collateralize existing pollution control debt obligations;
- enter into and perform obligations under hedging agreements in connection with the issuance of the above first mortgage bonds; and
- enter into a multi-year revolving credit facility in an amount not to exceed \$400 million.

See Notes 7, 8 and 9 to our 2009 Annual Financial Statements and Notes 8 and 9 to our Third Quarter Financial Statements, each included elsewhere in this Appendix A, for additional information.

## Contractual Obligations

The following table is provided to summarize contractual cash obligations, as estimated by the Company at December 31, 2009. We anticipate cash from operations and external financing will be sufficient to fund future obligations.

<u>Contractual Cash Obligations</u>	<u>Payments Due by Period</u>						<u>Total</u>
	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>Thereafter</u>	
	<i>(In millions)</i>						
Short-term debt(a).....	\$ 45	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 45
Long-term debt(b)(j).....	33	—	50	175	100	1,324(b)	1,682
Interest on long-term debt to affiliated company(c)(k) .....	73	72	71	67	61	424	768
Interest on fixed rate bonds(d).....	2	2	2	2	2	21	31
Operating leases(e).....	7	6	5	4	4	3	29
Unconditional power purchase obligations(f).....	16	10	10	11	12	177	236
Coal and gas purchase obligations(g).....	391	307	145	88	92	—	1,023
Postretirement benefit plan obligations(h).....	5	6	6	6	6	34	63
Other obligations(i).....	57	5	—	—	—	—	62
Total contractual cash obligations .....	<u>\$ 629</u>	<u>\$ 408</u>	<u>\$ 289</u>	<u>\$ 353</u>	<u>\$ 277</u>	<u>\$ 1,983</u>	<u>\$ 3,939</u>

- (a) Represents borrowings from affiliated company due within one year.
- (b) Includes \$228 million of pollution control bonds classified as current liabilities, which bonds are subject to tender for purchase at the option of the holder and to mandatory tender for purchase upon the occurrence of certain events. Maturity dates for these bonds range from 2023 to 2034.
- (c) Represents future interest payments on long-term debt to affiliated company.
- (d) Represents interest on fixed rate long-term bonds. Future interest obligations on variable rate long-term bonds cannot be quantified.
- (e) Represents future operating lease payments.
- (f) Represents future minimum payments under OMU and Ohio Valley Electric Corporation power purchase agreements through May 2010 and 2026, respectively.
- (g) Represents contracts to purchase coal and natural gas transportation. Obligations for 2015 and 2016 are indexed to future market prices and are not included above, since prices will be set in the future using the contracted methodology.
- (h) Represents currently projected cash flows for the postretirement benefit plan as calculated by the actuary.
- (i) Represents construction commitments, including commitments for TC2 and the FGDs.
- (j) Includes long-term debt to affiliate of \$1,298 million in long-term debt and \$33 million in short-term debt, which was replaced with other affiliate borrowings at the time of the PPL acquisition of our Parent, which borrowings will be repaid with proceeds of the Bonds.
- (k) Debt to affiliate will be repaid with the proceeds of the Bonds, thereby modifying future interest obligations.

## Off-Balance Sheet Arrangements

We have very limited off-balance sheet activity. See Note 9 to our 2009 Annual Financial Statements, included elsewhere in this Appendix A, for more information.

## **Climate Change**

As a company with significant coal-fired generating assets, we could be substantially impacted by pending or future environmental rules or legislation requiring mandatory reductions in GHG emissions or other air emissions, imposing more stringent standards on discharges to waterways, establishing additional requirements for the handling or disposal of coal combustion byproducts, or addressing other environmental matters. However, the precise impact on our operations, including the reduction targets and deadlines that would be applicable, cannot be determined prior to the finalization of such requirements.

The cost to the Company and the effect on our business of complying with potential GHG restrictions will depend upon the details of the programs ultimately enacted. Some of the design elements which may have the greatest effect on the Company include (a) the required levels and timing of any carbon caps or limits, (b) the emission sources covered by such caps or limits, (c) transition and mitigation provisions, such as phase-in periods, free allowances or price caps, (d) the availability and pricing of relevant GHG-reduction technologies, goods or services and (e) economic, market and customer reaction to electricity price and demand changes due to GHG limits. While the costs to comply with future GHG developments are not currently determinable, such costs could be significant.

Ultimately, environmental matters or potential environmental matters represent an important element of current or future potential capital requirements, future unit retirement or replacement decisions, supply and demand for electricity, operating and maintenance expenses or compliance risks for the Company. While we currently anticipate that many of such direct costs or effects may be recoverable through rates or other regulatory mechanisms, particularly with respect to coal-related generation, the availability, timing or completeness of such rate recovery cannot be assured. Ultimately, climate change matters could result in material effects on our results of operations, liquidity and financial condition.

Growing global, national and local attention to climate change matters has led to the development of various international, federal, regional and state laws and regulations directly or indirectly relating to emissions of GHGs, including carbon dioxide, which is emitted from the combustion of fossil fuels such as coal and natural gas, as occurs at our generating stations. In particular, beginning in January 2011, GHG emissions from stationary sources, including our generating assets, will be subject to regulation by the EPA under the Prevention of Significant Deterioration and Title V provisions of the federal Clean Air Act through the GHG “tailoring” rule. Other developing laws and regulations include a variety of mechanisms and structures to regulate GHGs, including direct limits or caps, emission allowances or taxes, renewable generation requirements or standards and energy efficiency or conservation measures, and may require investments in transmission, alternative fuel or carbon sequestration or other emission reduction technologies. See “Business — Environmental Matters,” Note 9 to our 2009 Annual Financial Statements and Note 9 to our Third Quarter Financial Statements, each included elsewhere in this Appendix A, for additional information.

## **Quantitative and Qualitative Disclosures about Market Risk**

We conduct energy trading and risk management activities to maximize the value of power sales from physical assets we own. Energy trading activities are principally forward financial transactions to manage price risk and are accounted for as non-hedging derivatives on a mark-to-market basis in accordance with the derivatives and hedging topic of the Financial Accounting Standards Board’s (“FASB”) Accounting Standards Codification (“ASC”).

The Company manages its cost of borrowing by utilizing both fixed and floating rate debt. The exposure to floating rate debt can be mitigated through the use of interest rate swaps. We currently do not have any interest rate swaps in place.

For more information, see Note 3 to our 2009 Annual Financial Statements and Note 4 to our Third Quarter Financial Statements, each included elsewhere in this Appendix A.

## **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 our audited and unaudited financial statements included elsewhere in this Appendix A. 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.

Recent accounting pronouncements and 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 to our 2009 Annual Financial Statements and Notes 1, 2, 6, 7 and 9 to our Third Quarter Financial Statements, each included elsewhere in this Appendix A.

### **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.

As of December 31, 2009, we are not subject to the internal control and other requirements of the Sarbanes-Oxley Act of 2002 and associated rules ("Sarbanes-Oxley") and consequently are not required to evaluate the effectiveness of our internal control over financial reporting pursuant to Section 404 of Sarbanes-Oxley. However, management has assessed the effectiveness of our internal control over financial reporting as of December 31, 2009, using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control — Integrated Framework*. Management has concluded that, as of December 31, 2009, our internal control over financial reporting was effective based on those criteria. There have been no changes in our internal control over financial reporting that occurred during the twelve months ended December 31, 2009, or during the nine months ended September 30, 2010, that have materially affected, or are reasonably likely to materially affect our internal control over financial reporting.

The effectiveness of our internal control over financial reporting as of December 31, 2009, has been audited by PricewaterhouseCoopers LLP, an independent accounting firm, as stated in its report which is included within our 2009 Annual Financial Statements included elsewhere in this Appendix A.

## BUSINESS

### Overview

Kentucky Utilities Company, incorporated in Kentucky in 1912 and in Virginia in 1991, is a regulated public utility engaged in the generation, transmission, distribution and sale of electric energy in Kentucky, Virginia and Tennessee. We provide electric service to approximately 515,000 customers in 77 counties in central, southeastern and western Kentucky, to approximately 29,000 customers in 5 counties in southwestern Virginia and to 5 customers in Tennessee. Our service area covers approximately 6,600 square miles. During the first three quarters of 2010, approximately 99% of the electricity generated by us was produced by our coal-fired electric generating stations. The remainder is generated by a hydroelectric power plant and natural gas and oil fueled combustion turbines (“CTs”). In Virginia, we operate under the name Old Dominion Power Company. We also sell wholesale electric energy to 12 municipalities.

Our affiliate, Louisville Gas and Electric Company (“LG&E”), is a regulated public utility engaged in the generation, transmission, distribution and sale of electric energy and the distribution and sale of natural gas in Kentucky. We and LG&E became indirect wholly-owned subsidiaries of PPL Corporation on November 1, 2010.

### Operations

The sources of our operating revenues and volume of sales for the year ended December 31, 2009 were as follows:

	<u>Revenue</u>	<u>% Revenue</u>	<u>Volume</u>	<u>% Volume</u>
	(\$ in millions. Volume in GWH)			
Industrial & Commercial .....	\$ 637	47%	10,171	49%
Residential .....	480	35%	6,594	31%
Municipals .....	91	7%	1,848	9%
Other Retail .....	118	9%	1,647	8%
Wholesale(1).....	<u>29</u>	<u>2%</u>	<u>660</u>	<u>3%</u>
<b>Total.....</b>	<b><u>\$ 1,355</u></b>	<b><u>100%</u></b>	<b><u>20,920</u></b>	<b><u>100%</u></b>

(1) Includes transactions between the Company and LG&E

Our business is affected by seasonal temperatures. As a result, operating revenues (and associated operating expenses) are not generated evenly throughout the year. We frequently experience dual peaks in winter and summer; our peak load in 2009 of 4,640 megawatts (“Mw”) occurred on January 16, when the temperature reached a low of —3 degrees Fahrenheit in Lexington.

Our retail electric rates contain a FAC, whereby increases and decreases in the cost of fuel for electric generation are reflected in the rates charged to retail electric customers. The FAC allows us 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.

Kentucky law permits us 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 environmental cost recovery (“ECR”) mechanism. Pursuant to this mechanism, a regulatory asset or liability is established in the amount that has been under- or over-recovered due to timing or adjustments to the mechanism. This mechanism includes construction work in progress and a return on equity, currently set at 10.63%.

We have contracts with the Tennessee Valley Authority (“TVA”) to act as our transmission Reliability Coordinator and Southwest Power Pool, Inc. (“SPP”) to function as our independent transmission operator, pursuant to FERC requirements. With respect to certain of these matters, we have submitted filings with the FERC and the

Kentucky Commission proposing to approve agreed-upon continuations of these arrangements beyond their previous September 2010 expiration dates. The Kentucky Commission approved the continuation of this arrangement on October 27, 2010, and FERC approval is anticipated in 2010.

We and LG&E jointly dispatch our generation units with the lowest cost generation used to serve retail native load. When we have excess generation capacity after serving our own retail native load and our generation cost is lower than that of LG&E, LG&E purchases electricity from us. When LG&E has excess generation capacity after serving its own retail native load and its generation cost is lower than that of ours, we purchase electricity from LG&E. These transactions are recorded as intercompany wholesale sales and purchases and are recorded by each company at a price equal to the seller's fuel cost. Savings realized from purchasing electricity intercompany instead of generating from their own higher costs units or purchasing from the market are shared equally between the two companies. The volume of energy each company has to sell to the other is dependent upon its native load needs and its available generation. See Note 11 to our 2009 Annual Financial Statements and Note 10 to our Third Quarter Financial Statements, each included elsewhere in this Appendix A.

### *Properties*

Our power generating system includes coal-fired units operated at our four steam generating stations. Natural gas and oil fueled CTs supplement the system during peak or emergency periods. As of December 31, 2009, we owned all or a portion of, and operated the following generating stations\* while targeting a 13%-15% reserve margin:

<u>Plant</u>	<u>Location</u>	<u>2009 Heat Rate (Btu/KWh)</u>	<u>Plant Type</u>	<u>Fuel</u>	<u>Summer Capability Rating (Mw)</u>	<u>2009 Generation GWh</u>
<b>Steam Turbines</b>						
Ghent-Units 1-4 .....	Carroll County, KY	10,882	ST	Coal	1,918	11,346
E.W. Brown — Units 1-3 .....	Mercer County, KY	10,630	ST	Coal	697	2,505
Green River — Units 3-4.....	Muhlenberg County, KY	11,352	ST	Coal	163	625
Tyrone-Unit 3 .....	Woodford County, KY	13,156	ST	Coal	<u>71</u>	<u>24</u>
<b>Total Coal-fired Generation .....</b>					<b>2,849</b>	<b>14,500</b>
<b>Combustion Turbines</b>						
Trimble County — Units						
5-10.....	Trimble County, KY	11,603	CT	Gas	632	129
E.W. Brown — Units 5-11* .....	Mercer County, KY	15,424	CT	Gas	757	56
Secondary CTs* .....	Fayette/Jefferson County, KY	57,458	CT	Gas	<u>110</u>	<u>0</u>
<b>Total Gas-fired Generation.....</b>					<b>1,499</b>	<b>185</b>
<b>Hydroelectric Stations</b>						
Dix Dam .....	Mercer County, KY	NA	NA	Hydro	<u>24</u>	<u>69</u>
<b>Total Hydroelectric Generation ...</b>					<b>24</b>	<b>69</b>
<b>In Construction</b>						
Trimble County — Unit 2** .....	Trimble County, KY	NA	ST	Coal	<u>NA</u>	<u>NA</u>
<b>Grand Total.....</b>					<b><u>4,372</u></b>	<b><u>14,754</u></b>

\* Some of these units are jointly owned with LG&E and others (capability ratings reflect our ownership share). See Note 10 to our 2009 Annual Financial Statements, included elsewhere in this Appendix A, for information regarding jointly-owned units.

\*\* At November 1, 2010, TC2, a new 760-Mw capacity base-load, coal fired unit that will be jointly owned by the Company (60.75%) and LG&E (14.25%) and unrelated third parties, remains under construction with completion expected by year-end 2010.

At December 31, 2009, our transmission system included 130 substations (52 of which are shared with the distribution system) with a total capacity of approximately 13,016 Megavolt-ampere (“MVA”) and approximately 4,040 miles of lines. The distribution system included 479 substations (52 of which are shared with the transmission system) with a total capacity of approximately 6,973 MVA, 14,136 miles of overhead lines and 2,209 miles of underground conduit.

Substantially all of our real and tangible personal property located in Kentucky and used or to be used in connection with the generation, transmission and distribution of electricity, subject to certain exclusions and exceptions, is subject to the lien of the Mortgage, as described in “Description of the Bonds — Security; Lien of the Mortgage.”

We own 20% of the common stock of EEI, which owns and operates a 1,162-Mw generating station in southern Illinois. EEI generally sells its production into the wholesale market. Additional information regarding property and investments is provided in Notes 1, 9 and 10 to our 2009 Annual Financial Statements and Note 9 to our Third Quarter Financial Statements, each included elsewhere in this Appendix A.

### *Construction and Future Capital Requirements*

The Company and LG&E are currently constructing a new 760-Mw capacity base-load, coal fired unit, TC2, which will be jointly owned by the Company (60.75%) and LG&E (14.25%), together with the Illinois Municipal Electric Agency and the Indiana Municipal Power Agency. Each owner is responsible for its proportionate share of the capital cost during construction, and fuel, operation and maintenance cost when TC2 begins operation, which is scheduled to occur by year-end 2010. The contract price and its components attributable to us, currently approximating \$697 million (including \$192 million for environmental controls) 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.

Our construction program is designed to ensure that there will be adequate capacity and reliability to meet the electric needs of our service area and to comply with environmental regulations. These needs are continually being reassessed, and appropriate revisions are made, when necessary, in construction schedules. At September 30, 2010, we estimated our capital expenditures for the three-year period ending December 31, 2012, including those for TC2, to total approximately \$1.1 billion, consisting primarily of the following:

	(\$ in millions)
Construction of generation assets .....	\$ 305
Construction of distribution assets.....	245
Ash pond and landfill projects .....	210
Brown SCR.....	155
Installation of FGDs on Ghent and Brown units .....	125
Information technology projects.....	35
Other projects .....	25
Construction of TC2 (includes \$5 million for environmental controls).....	25
	<u>\$ 1,125</u>

In addition to the amounts above, evolving environmental regulations will likely increase the level of capital expenditures over the next several years. See “Business — Environmental Matters.” 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, further changes in environmental regulations and other regulatory requirements. Credit market conditions can affect aspects of the availability, terms or methods in which we fund our capital requirements. We anticipate funding future capital requirements through operating cash flow, debt and/or infusions of capital from our Parent.

For a discussion of liquidity, capital resources and financing activities, see “Management’s Discussion and Analysis.”

## Coal Supply

Coal-fired generating units provided approximately 99% of our net kilowatt-hour (“Kwh”) generation for 2009. The remaining net generation for 2009 was provided by natural gas and oil fueled CT peaking units and a hydroelectric plant. Coal is expected to be the predominant fuel used by us in the foreseeable future, with natural gas and oil being used for peaking capacity and flame stabilization in coal-fired boilers or in emergencies. We have no nuclear generating units and have no plans to build any in the foreseeable future.

Fuel inventory is maintained at levels estimated to be necessary to avoid operational disruptions at the coal-fired generating units. Reliability of coal deliveries can be affected from time to time by a number of factors including fluctuations in demand, coal mine production issues and other supplier or transporter operating difficulties.

We have entered into coal supply agreements with various suppliers for coal deliveries for 2010 and beyond, and normally augment our coal supply agreements with spot market purchases. We have a coal inventory policy which we believe provides adequate protection under most contingencies.

For our existing units, we expect to continue purchasing coal from western and eastern Kentucky, West Virginia, southern Indiana, southern Illinois and Ohio for the foreseeable future. With the installation of FGDs, we expect our use of higher sulfur coal to increase. Following commercial operation of the new TC2 unit, we may purchase small quantities of ultra low sulfur content coal from Wyoming for blending. Coal is delivered to our generating stations by a mix of transportation modes, including barge, truck and rail.

## Rates and Regulation

We are subject to the jurisdiction of the Kentucky Commission, the Virginia Commission, the Tennessee Regulatory Authority and the FERC in virtually all matters related to electric utility regulation, and as such, our accounting is subject to the regulated operations guidance of the FASB ASC. Given our competitive position in the marketplace and the status of regulation in Kentucky and Virginia, there are no plans or intentions to discontinue the application of the regulated operations guidance of the FASB ASC.

Our Kentucky base rates are calculated based on a return on capitalization (common equity, long-term debt and notes payable) including certain regulatory adjustments to exclude non-regulated investments and environmental compliance plans recovered separately through the ECR mechanism. Currently, none of the regulatory assets or regulatory liabilities are excluded from the return on capitalization utilized in the calculation of Kentucky base rates; therefore, a return is earned on all Kentucky regulatory assets. Our Virginia base rates are calculated based on a return on rate base (net utility plant less deferred taxes and miscellaneous deductions). All regulatory assets and liabilities are excluded from the return on rate base utilized in the calculation of Virginia base rates.

*PPL Acquisition.* In September 2010, the Kentucky Commission approved the September 2010 settlement agreement among PPL and all of the intervening parties to PPL’s joint application to the Kentucky Commission for approval of its acquisition of ownership and control of our Parent, the Company and LG&E. In the settlement, the parties agreed that we and LG&E would commit that no base rate increases would take effect before January 1, 2013. The Company’s rate increase that took effect on August 1, 2010 (as described below) will not be impacted by the settlement. Under the terms of the settlement, we retain the right to seek approval for the deferral of “extraordinary and uncontrollable costs.” Interim rate adjustments will continue to be permissible during that period for existing fuel, environmental and DSM recovery mechanisms. The agreement also substitutes an acquisition savings shared deferral mechanism for the requirement that the Company file a synergies plan with the Kentucky Commission. This mechanism, which will be in place until the earlier of five years or the first day of the year in which a base rate increase becomes effective, permits the Company to earn up to a 10.75% return on equity. Any earnings above a 10.75% return on equity will be shared with customers on a 50%/50% basis. The Kentucky Commission order and the settlement agreement contained a number of other commitments with regard to operations, workforce, community involvement and other matters.

In October 2010, both the Virginia Commission and the Tennessee Regulatory Authority approved the transfer of control of the Company from E.ON US Investments Corp. to PPL. Each of these orders contained certain commitments with regard to operations, workforce, community involvement and other matters.



In October 2010, the FERC approved the September 2010 settlement agreement among the Company, LG&E, other applicants and protesting parties. The settlement agreement includes various conditional commitments, such as a continuation of certain existing undertakings with protesters in prior cases, an agreement not to terminate certain of our municipal customer contracts prior to January 2017, an exclusion of any transaction-related costs from wholesale energy and tariff customer rates to the extent that we have agreed to not seek the same transaction-related cost from retail customers and agreements to coordinate with protesters in certain open or on-going matters.

*Kentucky Rate Case.* In January 2010, we filed an application with the Kentucky Commission requesting an increase in electric base rates of approximately 12%, or \$135 million annually, including an 11.5% return on equity. We requested the increase, based on the twelve month test year ended October 31, 2009, to become effective on and after March 1, 2010. The requested rates were suspended until August 1, 2010. A number of intervenors entered the rate case, including the office of the Attorney General of Kentucky (the "AG") Kentucky Attorney General's office, certain representatives of industrial and low-income groups and other third parties, and submitted filings challenging our requested rate increases, in whole or in part. A hearing was held on June 8, 2010. We and all of the intervenors except the AG agreed to a stipulation providing for an increase in electric base rates of \$98 million on an annual basis and filed a request with the Kentucky Commission to approve such stipulation. In July 2010, the Kentucky Commission issued an order in the proceeding approving all the provisions of the stipulation, with rates effective on and after August 1, 2010.

*Virginia Rate Case.* In June 2009, we filed an application with the Virginia Commission requesting an increase in electric base rates for our Virginia jurisdictional customers in an amount of \$12 million annually or approximately 21%. The proposed increase reflected a proposed rate of return on rate base of 8.586% based on a return on equity of 12%. During December 2009, we and the Virginia Commission Staff agreed to a stipulation and recommendation authorizing base rate revenue increases of \$11 million annually and a return on rate base of 7.846% based on a 10.5% return on common equity. A public hearing was held during January 2010. As permitted, pursuant to a Virginia Commission order, we elected to implement the proposed rates effective November 1, 2009, on an interim basis. In March 2010, the Virginia Commission issued an order approving the stipulation, with the increased rates to be put into effect as of April 1, 2010. As part of the stipulation, we refunded approximately \$1 million in interim rate amounts in excess of the ultimate approved rates. During August 2010, a report was filed with the Virginia Commission detailing the costs of the refunds, the accounts charged and confirming that applicable refunds had been applied.

*FERC Wholesale Rate Case.* In September 2008, we filed an application with the FERC for increases in electric base rates applicable to wholesale power sales contracts or interchange agreements involving, collectively, twelve Kentucky municipalities. The application requested a shift from an all-in stated unit charge rate to an unbundled formula rate, including an annual adjustment mechanism. In May 2009, the FERC issued an order approving a settlement among the parties in the case, incorporating increases of approximately 3% from prior rates and a return on equity of 11%. In May 2010, we submitted to the FERC the proposed current annual adjustment to the formula rate. This updated rate became effective on July 1, 2010, subject to certain review procedures by the wholesale requirements customers and the FERC, including potential refunds in the case of disallowed costs or charges.

By mutual agreement, the parties' settlement of the 2008 application left outstanding the issue of whether we must allocate to the municipal customers a portion of renewable resources we may be required to procure on behalf of our retail ratepayers. In August 2009, the FERC accepted the issue for briefing and the parties completed briefing submissions during 2009. An order was issued by the FERC in July 2010, indicating that we are not required to allocate a portion of any renewable resources to the twelve municipalities, thus resolving the remaining issue.

*Refund of Over-Collected Amounts.* On July 15, 2010, our Parent, on behalf of the Company and LG&E, submitted an informational filing indicating it had inadvertently over-collected certain costs related to the independent transmission organization and reliability coordinator in rates charged pursuant to the Attachment O formula rate included in the companies' open access transmission tariff. Total refunds being issued in connection with the inadvertent recovery are approximately \$1.2 million. No action has been taken by FERC with respect to this informational filing.

*Storm Restoration.* In January 2009, a significant ice storm passed through our service territory causing approximately 199,000 customer outages and was followed closely by a severe wind storm in February 2009 that caused approximately 44,000 customer outages. We incurred \$57 million in incremental operation and maintenance expenses and \$33 million in capital expenditures related to the restoration following the two storms. We filed an application with the Kentucky Commission in April 2009, requesting approval to establish a regulatory asset and defer for future recovery approximately \$62 million in incremental operation and maintenance expenses related to the storm restoration. In September 2009, the Kentucky Commission issued an order allowing us to establish a regulatory asset of up to \$62 million based on our actual costs for storm damages and service restoration due to the January and February 2009 storms. In September 2009, we established a regulatory asset of \$57 million for actual costs incurred. We received approval in our current base rate case to recover this asset over a ten year period beginning August 1, 2010.

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, we filed an application with the Kentucky Commission requesting approval to establish a regulatory asset, and defer for future recovery, approximately \$3 million of expenses related to the storm restoration. In December 2008, the Kentucky Commission issued an order allowing us to establish a regulatory asset of up to \$3 million based on our actual costs for storm damages and service restoration due to Hurricane Ike. In December 2008, we established a regulatory asset of \$2 million for actual costs incurred. We received approval in our current electric base rate cases to recover this asset over a ten year period beginning August 1, 2010.

*2008 Rate Case.* In July 2008, we filed an application with the Kentucky Commission requesting an increase in base electric rates. In conjunction with the filing of the application for a change in base rates, based on previous orders by the Kentucky Commission approving settlement agreements among all interested parties, the VDT surcredit terminated in August 2008. The VDT surcredit was a regulatory mechanism that reduced rates as the result of changes made to reduce operating costs following a previous acquisition transaction involving our Parent. In February 2009, the Kentucky Commission issued an order approving a settlement agreement among us, the AG, the Kentucky Industrial Utility Consumers, Inc. and all other parties to the rate case, under which our base electric rates decreased by \$9 million annually effective February 6, 2009, at which time the merger surcredit (which originated as part of our Parent's merger with KU Energy Corporation in 1998) terminated.

### ***Rate Mechanisms***

*FAC.* Our retail electric rates contain a FAC, whereby increases and decreases in the cost of fuel for electric generation are reflected in the rates charged to retail electric customers. The FAC allows us to adjust customers' accounts for the difference between the fuel cost component of base rates and the actual fuel cost, including transportation costs. Credits 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. A regulatory asset or liability is established in the amount that has been under- or over-recovered due to timing or adjustments to the mechanism.

*ECR.* Kentucky law permits us to recover the costs of complying with the Federal Clean Air Act and those federal, state and local environmental requirements that apply to coal combustion wastes and by-products from facilities utilized for production of energy from coal, including a return of operating expenses, and a return of and on capital invested, through the ECR mechanism. Pursuant to this mechanism, a regulatory asset or liability is established in the amount that has been under- or over-recovered due to timing or adjustments to the mechanism. This mechanism includes construction work in progress and a return on equity, currently set at 10.63%.

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

For a further discussion of current rates and regulatory matters, see Notes 2, 9 and 12 to our 2009 Annual Financial Statements and Notes 2 and 9 to our Third Quarter Financial Statements, included elsewhere in this Appendix A.

## Environmental Matters

*General.* Protection of the environment is a major priority for us and a significant element of our business activities. Our properties and operations are subject to extensive environmental-related oversight by federal, state and local regulatory agencies, including via air quality, water quality, waste management and similar laws and regulations. Therefore, we must conduct our operations in accordance with numerous permit and other requirements issued under or contained in such laws or regulations.

*Climate Change.* Growing global, national and local attention to climate change matters has led to the development of various international, federal, regional and state laws and regulations directly or indirectly relating to emissions of GHGs, including carbon dioxide, which is emitted from the combustion of fossil fuels such as coal and natural gas, as occurs at our generating stations. In particular, beginning in January 2011, GHG emissions from stationary sources, including our generating assets, will be subject to regulation by the EPA under the Prevention of Significant Deterioration and Title V provisions of the federal Clean Air Act through the GHG “tailoring” rule. Other developing laws and regulations include a variety of mechanisms and structures to regulate GHGs, including direct limits or caps, emission allowances or taxes, renewable generation requirements or standards and energy efficiency or conservation measures, and may require investments in transmission, alternative fuel or carbon sequestration or other emission reduction technologies.

While the final terms and impacts of such developments cannot be estimated, we, as a primarily coal-fired utility, could be adversely affected. Among other emissions, GHGs include carbon-dioxide, which is produced via the combustion of fossil-fuels such as coal and natural gas. Our generating fleet is approximately 63% coal-fired, 37% oil/gas-fired and less than 1% hydroelectric based on capacity. During 2009, we produced approximately 99% of our electricity from coal and 1% from natural gas combustion, on a megawatt-hours basis. During 2009, our emissions of GHGs were approximately 14.2 million metric tons of carbon-dioxide equivalents from our owned or controlled generation sources. While our generation activities account for the bulk of our GHG emissions, other GHG sources at the Company include operation of motor vehicles and powered equipment, evaporation associated with gas pipelines, refrigerating equipment and similar activities.

*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 state implementation plan (“SIP”) to bring such nonattainment areas into compliance. If a state fails to develop an adequate plan, the EPA must develop and implement a plan. As the EPA increases the stringency of the NAAQS through its periodic reviews, the attainment status of various areas may change, thereby triggering additional emission reduction obligations under revised SIPs aimed to achieve attainment.

In 1997, the EPA established new NAAQS for ozone and fine particulates that required additional reductions in SO<sub>2</sub> and NO<sub>x</sub> emissions from power plants. In 1998, the EPA issued its final “NO<sub>x</sub> SIP Call” rule requiring reductions in NO<sub>x</sub> emissions of approximately 85% from 1990 levels in order to mitigate ozone transport from the midwestern U.S. to the northeastern U.S. To implement the new federal requirements, Kentucky amended its SIP in 2002 to require electric generating units to reduce their NO<sub>x</sub> emissions to 0.15 pounds weight per MMBtu on a company-wide basis. In 2005, the EPA issued the Clean Air Interstate Rule (“CAIR”) which required additional SO<sub>2</sub> emission reductions of 70% and NO<sub>x</sub> emission reductions of 65% from 2003 levels. The CAIR provided for a two-phase cap and trade program, with initial reductions of NO<sub>x</sub> and SO<sub>2</sub> emissions due by 2009 and 2010, respectively, and final reductions due by 2015. In 2006, Kentucky proposed to amend its SIP to adopt state requirements similar to those under the federal CAIR.

In July 2008, a federal appeals court issued a ruling finding deficiencies in the CAIR and vacating it. In December 2008, the Court amended its previous order, directing the EPA to promulgate a new regulation, but leaving the CAIR in place in the interim. The remand of the CAIR results in some uncertainty with respect to certain other EPA or state programs and proceedings and our compliance plans relating thereto, due to the interconnection of the CAIR with such associated programs.

In January 2010, the EPA proposed a revised NAAQS for ozone which would increase the stringency of the standard. In addition, the EPA published final revised NAAQS for nitrogen dioxide (“NO<sub>2</sub>”) and SO<sub>2</sub> in February 2010 and June 2010, respectively, which are more stringent than previous standards. Depending on the level of action determined necessary to bring local nonattainment areas into compliance with the revised NAAQS, our power plants are potentially subject to requirements for additional reductions in SO<sub>2</sub> and NO<sub>x</sub> emissions.

In July 2010, the EPA issued the proposed the Clean Air Transport Rule (“CATR”), which serves to replace the CAIR. The CATR provides for a two-phase SO<sub>2</sub> reduction program with Phase I reductions due by 2012 and Phase II reductions due by 2014. The CATR provides for NO<sub>x</sub> reductions in 2012, but the EPA advised that it is studying whether additional NO<sub>x</sub> reductions should be required for 2014. The CATR is more stringent than the CAIR as it accelerates certain compliance dates and provides for only intrastate and limited interstate trading of emission allowances. In addition to its preferred approach, the EPA is seeking comment on alternative approaches, including one which would provide for individual emission limits at each power plant. The EPA has announced that it will propose additional “transport” rules to address compliance with revised NAAQS for ozone and particulate matter which will be issued by the EPA in the future, as discussed below.

*Hazardous Air Pollutants.* As provided in 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 Clean Air Mercury Rule (“CAMR”) establishing mercury standards for new power plants and requiring all states to issue new SIPs including mercury requirements for existing power plants. The EPA issued a model rule which provides for a two-phase cap and trade program with initial reductions due by 2010 and final reductions due by 2018. The CAMR provided for reductions of 70% from 2003 levels. The EPA closely integrated the CAMR and CAIR programs to ensure that the 2010 mercury reduction targets would be achieved as a “co-benefit” of the controls installed for purposes of compliance with the CAIR. In 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 entered into a consent decree requiring it to promulgate a utility Maximum Achievable Control Technology rule to replace the CAMR, with a proposed rule due by March 2011 and a final rule due by November 2011. Depending on the final outcome of the rulemaking, the CAMR could be replaced by new rules with different or more stringent requirements for reduction of mercury and other hazardous air pollutants. Kentucky has also repealed its corresponding state mercury regulations.

*Ash Ponds and Coal-Combustion Byproducts.* The EPA has undertaken various initiatives in response to a December 2008 impoundment failure at the TVA’s Kingston power plant, which resulted in a major release of coal combustion byproducts into the environment. The EPA issued information requests to utilities throughout the country, including the Company, to obtain information on their ash ponds and other impoundments. In addition, the EPA inspected a large number of impoundments located at power plants to determine their structural integrity. The inspections included several of our impoundments, which the EPA found to be in satisfactory condition except for certain impoundments at the Mill Creek and Cane Run stations, which were determined to be in fair condition. In June 2010, the EPA published proposed regulations for the management of coal combustion byproducts. The EPA has proposed two alternatives: (1) regulation of coal combustion byproducts in landfills and ash ponds as a hazardous waste or (2) regulation of coal combustion byproducts as a solid waste with minimum national standards. Under both alternatives, the EPA has proposed safety requirements to address the structural integrity of ash ponds. In addition, the EPA will consider potential refinements of the provisions for beneficial reuse of coal combustion byproducts.

*Water Discharges and PCB Regulations.* The EPA has also announced plans to develop revised effluent limitation guidelines governing discharges from power plants and standards for cooling water intake structures. The EPA has further announced plans to develop revised standards governing the use of polychlorinated biphenyls (“PCBs”) in electrical equipment. The Company is monitoring these ongoing regulatory developments but will be unable to determine the impact until such time as new rules are finalized.

*Impact of Pending and Future Environmental Developments.* As a company with significant coal-fired generating assets, we will likely be substantially impacted by pending or future environmental rules or legislation requiring mandatory reductions in GHG emissions or other air emissions, imposing more stringent standards on

discharges to waterways, or establishing additional requirements for handling or disposal of coal combustion byproducts. These evolving environmental regulations will likely require an increased level of capital expenditures and increased incremental operating and maintenance costs by us over the next several years. Due to the uncertain nature of the final regulations that will ultimately be adopted by the EPA, including the reduction targets and the deadlines that will be applicable, we cannot finalize estimates of the potential compliance costs, but should the final rules incorporate additional emission reduction requirements, require more stringent emissions controls or implement more stringent byproducts storage and disposal practices, such costs will likely be significant. With respect to NAAQS, CATR, CAMR replacement and coal combustion byproducts developments, based on a preliminary analysis of proposed regulations, we may be required to consider actions such as upgrading existing emissions controls, installing additional emissions controls, upgrading byproducts disposal and storage and possible early replacement of coal-fired units. Our capital expenditures associated with such actions are preliminarily estimated to be in the \$1.7 billion range over the next 10 years, although final costs may substantially vary. With respect to potential developments in water discharge, revised PCB standards or GHG initiatives, costs in such areas cannot be estimated due to the preliminary status or uncertain outcome of such developments, but would be in addition to the above amount and could be substantial. Ultimately, the precise impact on our operations of these various environmental developments cannot be determined prior to the finalization of such requirements. Based on prior regulatory precedent, we believe that many costs of complying with such pending or future requirements would likely be recoverable under the ECR or other potential cost-recovery mechanisms, but we can provide no assurance as to the ultimate outcome of such proceedings before the regulatory authorities.

Environmental laws and regulations applicable to our business and governing, among other things, air emissions, wastewater discharges, the use, handling and disposal of hazardous substances and wastes, soil and groundwater contaminants and employee health and safety are discussed in Notes 2 and 9 to our 2009 Annual Financial Statements and Notes 2 and 9 to our *Third Quarter Financial Statements*, each included elsewhere in this Appendix A.

#### **State Executive or Legislative Matters**

In November 2008, the Governor of Kentucky issued an action plan to create efficient, sustainable energy solutions and strategies and move toward state energy independence. The plan outlines the following seven strategies to work toward these goals:

- Improve the energy efficiency of Kentucky's homes, buildings, industries and transportation fleet
- Increase Kentucky's use of renewable energy
- Sustainably grow Kentucky's production of biofuels
- Develop a coal-to-liquids industry in Kentucky to replace petroleum-based liquids
- Implement a major and comprehensive effort to increase gas supplies, including coal-to-gas in Kentucky
- Initiate aggressive carbon capture/sequestration projects for coal-generated electricity in Kentucky
- Examine the use of nuclear power for electricity generation in Kentucky

In December 2009, the Governor of Kentucky's Executive Task Force on Biomass and Biofuels issued a final report to establish potential strategic actions to develop biomass and biofuels industries in Kentucky. The plan noted the potential importance of biomass as a renewable energy source available to Kentucky and discussed various goals or mechanisms, such as the use of approximately 25 million tons of biomass for generation fuel annually, allotment of electricity and gas taxes and state tax credits to support biomass development.

In January 2010, a state-established Kentucky Climate Action Plan Council commenced formal activities. The council, which includes governmental, industry, consumer and other representatives, seeks to identify possible Kentucky responses to potential climate change and federal legislation, including increasing statewide energy efficiency, energy independence and economic growth. The council has established various technical work groups,

including in the areas of energy supply and energy efficiency/conservation, to provide input, data and recommendations.

During prior legislative sessions, various bills have been introduced in the Kentucky General Assembly with respect to environmental or utility matters, including potential renewable energy portfolio requirements, energy conservation measures, coal mining or coal byproduct operations and other matters. It is expected that similar legislation will be introduced in upcoming sessions, but the prospects and final terms of any such legislation cannot be determined.

Legislative and regulatory actions as a result of these proposals and their impact on the Company, which may be significant, cannot currently be predicted.

### **Competition**

There are currently no other electric public utilities operating within our service area. 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 us, which may be significant, cannot currently be predicted. Virginia, formerly a deregulated jurisdiction, has enacted legislation which implements a hybrid model of cost-based regulation.

### **Employees and Labor Relations**

We had 964 full-time regular employees at December 31, 2009, 149 of which were operating, maintenance and construction employees represented by the IBEW (“International Brotherhood of Electrical Workers”) Local 2100 and the United Steelworkers of America (“USWA”) Local 9447-01. Effective August 4, 2009, we and our employees represented by the IBEW Local 2100 entered into a three-year collective bargaining agreement. The agreement provides for negotiated increases or changes to wages, benefits or other provisions and for annual wage re-openers. We and employees represented by the USWA Local 9447-01 entered into a three-year collective bargaining agreement in August 2008. This agreement provides for negotiated increases or changes to wages, benefits or other provisions and for annual wage re-openers.

### **Related Party Transactions**

We, our Parent and subsidiaries of our Parent engage in related party transactions. See Note 11 to our 2009 Annual Financial Statements and Note 10 to our Third Quarter Financial Statements, each included elsewhere in this Appendix A, for more information.

### **Legal Proceedings**

For a description of the significant legal proceedings, including, but not limited to, certain rates and regulatory, environmental, climate change and litigation matters, involving the Company, reference is made to the information in Note 9 to our 2009 Annual Financial Statements and Note 9 to our Third Quarter Financial Statements, each included elsewhere in this Appendix A.

In connection with an administrative proceeding alleging a violation by a former Argentine subsidiary of our Parent under that country’s 2002-2003 emergency currency exchange laws, claims are pending against the subsidiary’s then directors, including two individuals who are executive officers of the Company, in a specialized Argentine financial criminal court. Under applicable Argentine laws, directors of a local company may be liable for monetary penalties for a subject company’s violations of the currency laws. The subsidiary and the relevant executive officers believe their actions were in compliance with the relevant laws and have presented defenses in the administrative and criminal proceedings. Our Parent has standard indemnification arrangements with its executive officers. The former subsidiary is now owned by a third-party, which has agreed to indemnify our Parent and the relevant executive officers.

In the normal course of business from time to time, other lawsuits, claims, environmental actions and other governmental proceedings arise against the Company. To the extent that damages are assessed in any of these actions or proceedings, the Company believes that its insurance coverage is adequate. Although we cannot accurately predict the amount of any liability that may ultimately arise with respect to such matters, management, after consultation with legal counsel, does not currently anticipate that liabilities arising out of other currently pending or threatened lawsuits and claims will have a material adverse effect on the Company's financial condition or results of operations.

**KENTUCKY UTILITIES COMPANY**  
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**Kentucky Utilities Company**  
**Financial Statements**  
**As of December 31, 2009 and 2008**  
**and For the Years Ended**  
**December 31, 2009, 2008 and 2007**

## INDEX OF ABBREVIATIONS

AG . . . . .	Attorney General of Kentucky
ARO . . . . .	Asset Retirement Obligation
ASC . . . . .	Accounting Standards Codification
CAIR . . . . .	Clean Air Interstate Rule
CCN . . . . .	Certificate of Public Convenience and Necessity
Clean Air Act . . . . .	The Clean Air Act, as amended in 1990
CMRG . . . . .	Carbon Management Research Group
Company . . . . .	KU
CT . . . . .	Combustion Turbines
DSM . . . . .	Demand Side Management
ECR . . . . .	Environmental Cost Recovery
EEL . . . . .	Electric Energy, Inc.
E.ON . . . . .	E.ON AG
E.ON U.S. . . . .	E.ON U.S. LLC
E.ON U.S. Services . . . . .	E.ON U.S. Services Inc.
EPA . . . . .	U.S. Environmental Protection Agency
EPA 2005 . . . . .	Energy Policy Act of 2005
FAC . . . . .	Fuel Adjustment Clause
FASB . . . . .	Financial Accounting Standards Board
FERC . . . . .	Federal Energy Regulatory Commission
FGD . . . . .	Flue Gas Desulfurization
Fidelia . . . . .	Fidelia Corporation (an E.ON affiliate)
GHG . . . . .	Greenhouse Gas
Gwh . . . . .	Gigawatt hours or one thousand Mwh
IBEW . . . . .	International Brotherhood of Electrical Workers
IMEA . . . . .	Illinois Municipal Electric Agency
IMPA . . . . .	Indiana Municipal Power Agency
IRS . . . . .	Internal Revenue Service
KCCS . . . . .	Kentucky Consortium for Carbon Storage
Kentucky Commission . . . . .	Kentucky Public Service Commission
KIUC . . . . .	Kentucky Industrial Utility Consumers, Inc.
KU . . . . .	Kentucky Utilities Company
Kwh . . . . .	Kilowatt hours
LG&E . . . . .	Louisville Gas and Electric Company
LG&E Energy . . . . .	LG&E Energy LLC (now E.ON U.S. LLC)
MISO . . . . .	Midwest Independent Transmission System Operator, Inc.
MMBtu . . . . .	Million British thermal units
Moody's . . . . .	Moody's Investor Services, Inc.
MVA . . . . .	Megavolt-ampere
Mw . . . . .	Megawatts
Mwh . . . . .	Megawatt hours
NERC . . . . .	North American Electric Reliability Corporation
NOV . . . . .	Notice of Violation
NOx . . . . .	Nitrogen Oxide
OMU . . . . .	Owensboro Municipal Utilities
OVEC . . . . .	Ohio Valley Electric Corporation

PUHCA 2005 . . . . .	Public Utility Holding Company Act of 2005
RSG . . . . .	Revenue Sufficiency Guarantee
S&P . . . . .	Standard & Poor's Rating Services
SCR . . . . .	Selective Catalytic Reduction
SIP . . . . .	State Implementation Plan
SO <sub>2</sub> . . . . .	Sulfur Dioxide
TC1 . . . . .	Trimble County Unit 1
TC2 . . . . .	Trimble County Unit 2
VDT . . . . .	Value Delivery Team Process
Virginia Commission . . .	Virginia State Corporation Commission

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**Kentucky Utilities Company**  
**Statements of Income**

	<u>Years Ended December 31</u>		
	<u>2009</u>	<u>2008</u>	<u>2007</u>
	(Millions of \$)		
OPERATING REVENUES:			
Total operating revenues (Note 11) . . . . .	<u>\$1,355</u>	<u>\$1,405</u>	<u>\$1,272</u>
OPERATING EXPENSES:			
Fuel for electric generation . . . . .	434	513	461
Power purchased (Notes 9 and 11) . . . . .	199	221	168
Other operation and maintenance expenses . . . . .	320	275	255
Depreciation and amortization (Note 1) . . . . .	<u>133</u>	<u>136</u>	<u>121</u>
Total operating expenses . . . . .	<u>1,086</u>	<u>1,145</u>	<u>1,005</u>
Net operating income . . . . .	269	260	267
Equity in earnings of EEI (Note 1) . . . . .	(1)	(30)	(26)
Other income — net . . . . .	(5)	(8)	(7)
Interest expense (Notes 7 and 8) . . . . .	6	14	15
Interest expense to affiliated companies (Notes 8 and 11) . . . . .	<u>69</u>	<u>58</u>	<u>41</u>
Income before income taxes . . . . .	200	226	244
Federal and state income taxes (Note 6) . . . . .	<u>67</u>	<u>68</u>	<u>77</u>
Net income . . . . .	<u>\$ 133</u>	<u>\$ 158</u>	<u>\$ 167</u>

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

**Kentucky Utilities Company**  
**Statements of Retained Earnings**

	Years Ended December 31		
	2009	2008	2007
	(Millions of \$)		
Balance January 1 .....	\$1,195	\$1,037	\$ 870
Add net income .....	133	158	167
Balance December 31 .....	\$1,328	\$1,195	\$1,037

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

**Kentucky Utilities Company**

**Balance Sheets**

	<b>December 31</b>	
	<b>2009</b>	<b>2008</b>
	(Millions of \$)	
<b>ASSETS:</b>		
Current assets:		
Cash and cash equivalents (Note 1) . . . . .	\$ 2	\$ 2
Restricted cash (Note 1) . . . . .	—	9
Accounts receivable, net: (Notes 1 and 11)		
Customer — less reserves of \$1 million and \$3 million as of December 31, 2009 and 2008, respectively . . . . .	155	152
Other — less reserves of \$2 million and less than \$1 million as of December 31, 2009 and 2008 . . . . .	27	32
Materials and supplies (Note 1):		
Fuel (predominantly coal) . . . . .	98	73
Other materials and supplies . . . . .	39	36
Deferred income taxes — net (Note 6) . . . . .	3	2
Regulatory assets (Note 2) . . . . .	32	32
Prepayments and other current assets . . . . .	10	8
Total current assets . . . . .	366	346
Other property and investments (Note 1) . . . . .	12	23
Utility plant, at original cost (Note 1): . . . . .	4,892	4,446
Less: reserve for depreciation . . . . .	1,838	1,724
Total utility plant, net . . . . .	3,054	2,722
Construction work in progress . . . . .	1,257	1,176
Total utility plant and construction work in progress . . . . .	4,311	3,898
Deferred debits and other assets:		
Regulatory assets (Note 2):		
Pension benefits . . . . .	105	137
Other . . . . .	117	64
Cash surrender value of key man life insurance . . . . .	38	39
Other assets . . . . .	7	11
Total deferred debits and other assets . . . . .	267	251
Total Assets . . . . .	<b>\$4,956</b>	<b>\$4,518</b>

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

**Kentucky Utilities Company**  
**Balance Sheets (continued)**

	<b>December 31</b>	
	<b>2009</b>	<b>2008</b>
	(Millions of \$)	
<b>LIABILITIES AND EQUITY:</b>		
Current liabilities:		
Current portion of long-term debt (Note 7) . . . . .	\$ 261	\$ 228
Notes payable to affiliated companies (Notes 8 and 11) . . . . .	45	16
Accounts payable . . . . .	107	155
Accounts payable to affiliated companies (Note 11) . . . . .	88	38
Customer deposits . . . . .	22	21
Regulatory liabilities (Note 2) . . . . .	3	5
Other current liabilities . . . . .	42	34
Total current liabilities . . . . .	568	497
Long-term debt:		
Long-term bonds (Note 7) . . . . .	123	123
Long-term debt to affiliated company (Notes 7 and 11) . . . . .	1,298	1,181
Total long-term debt . . . . .	1,421	1,304
Deferred credits and other liabilities:		
Accumulated deferred income taxes (Note 6) . . . . .	336	279
Accumulated provision for pensions and related benefits (Note 5) . . . . .	160	186
Investment tax credit (Note 6) . . . . .	104	80
Asset retirement obligations . . . . .	34	32
Regulatory liabilities (Note 2):		
Accumulated cost of removal of utility plant . . . . .	331	329
Deferred income taxes . . . . .	9	16
Postretirement benefits . . . . .	9	10
Other . . . . .	11	15
Other liabilities . . . . .	21	26
Total deferred credits and other liabilities . . . . .	1,015	973
Commitments and contingencies (Note 9)		
<b>COMMON EQUITY:</b>		
Common stock, without par value —		
Authorized 80,000,000 shares, outstanding 37,817,878 shares . . . . .	308	308
Additional paid-in capital (Note 11) . . . . .	316	241
Retained earnings . . . . .	1,318	1,174
Undistributed subsidiary earnings . . . . .	10	21
Total retained earnings . . . . .	1,328	1,195
Total common equity . . . . .	1,952	1,744
Total Liabilities and Equity . . . . .	\$4,956	\$4,518

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



**Kentucky Utilities Company**  
**Statements of Cash Flows**

	<b>Years Ended December 31</b>		
	<b>2009</b>	<b>2008</b>	<b>2007</b>
	(Millions of \$)		
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net income . . . . .	\$ 133	\$ 158	\$ 167
Items not requiring cash currently:			
Depreciation and amortization . . . . .	133	136	121
Deferred income taxes — net . . . . .	50	(13)	(5)
Investment tax credit — net . . . . .	24	25	42
Provision for pension and postretirement plans . . . . .	26	10	11
Other . . . . .	—	1	(4)
Change in certain current assets and liabilities:			
Accounts receivable . . . . .	(4)	12	(16)
Materials and supplies . . . . .	(28)	(33)	22
Prepayments and other current assets . . . . .	(3)	(1)	1
Accounts payable . . . . .	(3)	9	(15)
Other current liabilities . . . . .	8	5	4
Pension and postretirement funding . . . . .	(20)	(5)	(19)
Storm restoration regulatory asset . . . . .	(57)	(2)	—
Other . . . . .	(6)	(10)	2
Net cash provided by operating activities . . . . .	<u>253</u>	<u>292</u>	<u>311</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Construction expenditures . . . . .	(516)	(686)	(749)
Assets purchased from affiliate . . . . .	—	(10)	—
Change in restricted cash . . . . .	9	1	12
Net cash used for investing activities . . . . .	<u>(507)</u>	<u>(695)</u>	<u>(737)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Long-term borrowings from affiliated company (Note 7) . . . . .	150	250	448
Short-term borrowings from affiliated company — net (Note 8) . . . . .	29	(7)	(74)
Retirement of first mortgage bonds . . . . .	—	—	(107)
Issuance of pollution control bonds . . . . .	—	77	78
Retirement of pollution control bonds . . . . .	—	(60)	—
Acquisition of outstanding bonds . . . . .	—	(80)	—
Reissuance of reacquired bonds . . . . .	—	63	—
Retirement of reacquired bonds . . . . .	—	17	—
Additional paid-in capital . . . . .	75	145	75
Net cash provided by financing activities . . . . .	<u>254</u>	<u>405</u>	<u>420</u>
Change in cash and cash equivalents . . . . .	—	2	(6)
Cash and cash equivalents at beginning of year . . . . .	2	—	6
Cash and cash equivalents at end of year . . . . .	<u>\$ 2</u>	<u>\$ 2</u>	<u>\$ —</u>
<b>Supplemental disclosures of cash flow information:</b>			
Cash paid during the year for:			
Income taxes . . . . .	\$ (9)	\$ 46	\$ 38
Interest on borrowed money . . . . .	3	13	16
Interest to affiliated companies on borrowed money . . . . .	67	53	29

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

**Kentucky Utilities Company**  
**Statements of Capitalization**

	December 31	
	2009	2008
	(Millions of \$)	
LONG-TERM DEBT (Note 7):		
Pollution control series:		
Mercer Co. 2000 Series A, due May 1, 2023, variable%	\$ 13	\$ 13
Carroll Co. 2002 Series A, due February 1, 2032, variable%	21	21
Carroll Co. 2002 Series B, due February 1, 2032, variable%	2	2
Muhlenberg Co. 2002 Series A, due February 1, 2032, variable%	2	2
Mercer Co. 2002 Series A, due February 1, 2032, variable%	8	8
Carroll Co. 2002 Series C, due October 1, 2032, variable%	96	96
Carroll Co. 2004 Series A, due October 1, 2034, variable%	50	50
Carroll Co. 2006 Series B, due October 1, 2034, variable%	54	54
Carroll Co. 2007 Series A, due February 1, 2026, 5.75%	18	18
Trimble Co. 2007 Series A, due March 1, 2037, 6.0%	9	9
Carroll Co. 2008 Series A, due February 1, 2032, variable%	78	78
Total pollution control series	351	351
Notes payable to Fidelity:		
Due November 24, 2010, 4.24%, unsecured	33	33
Due January 16, 2012, 4.39%, unsecured	50	50
Due April 30, 2013, 4.55%, unsecured	100	100
Due August 15, 2013, 5.31%, unsecured	75	75
Due December 19, 2014, 5.45%, unsecured	100	100
Due July 8, 2015, 4.735%, unsecured	50	50
Due December 21, 2015, 5.36%, unsecured	75	75
Due October 25, 2016, 5.675%, unsecured	50	50
Due April 24, 2017, 5.28%, unsecured	50	—
Due June 20, 2017, 5.98%, unsecured	50	50
Due July 25, 2018, 6.16%, unsecured	50	50
Due August 27, 2018, 5.645%, unsecured	50	50
Due December 17, 2018, 7.035%, unsecured	75	75
Due July 29, 2019, 4.81%, unsecured	50	—
Due October 25, 2019, 5.71%, unsecured	70	70
Due November 25, 2019, 4.445%, unsecured	50	—
Due February 7, 2022, 5.69%, unsecured	53	53
Due May 22, 2023, 5.85%, unsecured	75	75
Due September 14, 2028, 5.96%, unsecured	100	100
Due June 23, 2036, 6.33%, unsecured	50	50
Due March 30, 2037, 5.86%, unsecured	75	75
Total notes payable to Fidelity	1,331	1,181
Total long-term debt outstanding	1,682	1,532
Less current portion of long-term debt	261	228
Long-term debt	1,421	1,304
COMMON EQUITY:		
Common stock, without par value —		
Authorized 80,000,000 shares, outstanding 37,817,878 shares	308	308
Additional paid-in-capital (Note 11)	316	241
Retained earnings	1,318	1,174
Undistributed subsidiary earnings	10	21
Total retained earnings	1,328	1,195
Total common equity	1,952	1,744
Total capitalization	\$3,373	\$3,048

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

**Kentucky Utilities Company**  
**Notes to Financial Statements**

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

KU, incorporated in Kentucky in 1912 and in Virginia in 1991, is a regulated public utility engaged in the generation, transmission, distribution and sale of electric energy in Kentucky, Virginia and Tennessee. KU provides electric service to approximately 515,000 customers in 77 counties in central, southeastern and western Kentucky, to approximately 30,000 customers in 5 counties in southwestern Virginia and 5 customers in Tennessee. KU's service area covers approximately 6,600 square miles. Approximately 99% of the electricity generated by KU is produced by its coal-fired electric generating stations. The remainder is generated by a hydroelectric power plant and natural gas and oil fueled CTs. In Virginia, KU operates under the name Old Dominion Power Company. KU also sells wholesale electric energy to 12 municipalities.

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

Certain reclassification entries have been made to the previous years' financial statements to conform to the 2009 presentation with no impact on net assets, liabilities and capitalization or previously reported net income. However, for 2008 cash from operations was decreased by \$5 million and cash flows from investing increased by \$5 million and for 2007 cash from operations increased by \$4 million and cash flows from investing decreased by \$4 million.

*Regulatory Accounting.* KU is subject to the regulated operations guidance of the FASB ASC, under which regulatory assets are created based on expected recovery from customers in future rates to defer costs that would otherwise be charged to expense. Likewise, regulatory liabilities are created based on expected return to customers in future rates to defer credits that would otherwise be reflected as income, or, in the case of costs of removal, are created to match long-term future obligations arising from the current use of assets. The accounting for regulatory assets and liabilities is based on specific ratemaking decisions or precedent for each item as prescribed by the FERC, the Kentucky Commission or the Virginia Commission. See Note 2, Rates and Regulatory Matters, for additional detail regarding regulatory assets and liabilities.

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

*Restricted Cash.* Proceeds from bond issuances for environmental equipment (primarily related to the installation of FGDs) are held in trust pending expenditure for qualifying assets.

*Allowance for Doubtful Accounts.* The allowance for doubtful accounts included in customer accounts receivable is based on the ratio of the amounts charged-off during the last twelve months to the retail revenues billed over the same period multiplied by the retail revenues billed over the last four months. Accounts with no payment activity are charged-off after four months, although collection efforts continue thereafter. The allowance for doubtful accounts included in other accounts receivable is composed of accounts aged more than four months. Accounts are written off as management determines them uncollectible.

*Materials and Supplies.* Fuel and other materials and supplies inventories are accounted for using the average-cost method. Emission allowances are included in other materials and supplies. At December 31, 2009 and 2008, the emission allowances inventory was \$1 million and less than \$1 million, respectively.

*Other Property and Investments.* Other property and investments on the balance sheets consists of KU's investment in EEI, KU's investment in OVEC, funds related to the long-term power purchase contract with OMU and non-utility plant.

Although KU holds investment interests in OVEC and EEI, it is not the primary beneficiary, therefore, neither are consolidated into the Company's financial statements. KU and 10 other electric utilities are owners of OVEC, located in Piketon, Ohio. OVEC owns and operates two coal-fired power plants, Kyger Creek Station in Ohio and

Clifty Creek Station in Indiana. OVEC's power is currently supplied to KU and 12 other companies affiliated with the various owners. Pursuant to current contractual agreements, KU owns 2.5% of OVEC's common stock and is contractually entitled to 2.5% of OVEC's output, approximately 55 Mw of generation capacity.

As of December 31, 2009 and 2008, KU's investment in OVEC totaled less than \$1 million and is accounted for under the cost method of accounting. The direct exposure to loss as a result of its involvement with OVEC is generally limited to the value of its investment. See Note 9, Commitments and Contingencies, for further discussion of developments regarding KU's ownership interests and power purchase rights.

KU owns 20% of the common stock of EEI, which owns and operates a 1,162-Mw generating station in southern Illinois. EEI, through a power marketer affiliated with its majority owner, sells its output to third parties. KU's investment in EEI is accounted for under the equity method of accounting and, as of December 31, 2009 and 2008, totaled \$12 million and \$22 million, respectively. KU's direct exposure to loss as a result of its involvement with EEI is generally limited to the value of its investment.

*Utility Plant.* Utility plant is stated at original cost, which includes payroll-related costs such as taxes, fringe benefits and administrative and general costs. Construction work in progress has been included in the rate base for determining retail customer rates in Kentucky. KU has not recorded a significant allowance for funds used during construction.

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

*Depreciation and Amortization.* Depreciation is provided on the straight-line method over the estimated service lives of depreciable plant. The amounts provided were approximately 2.6% in 2009, 3.0% in 2008 and 3.2% in 2007 of average depreciable plant. Of the amount provided for depreciation at December 31, 2009, approximately 0.4% was related to the retirement, removal and disposal costs of long lived assets. At December 31, 2008 and 2007, approximately 0.5% was related to the retirement, removal and disposal costs of long lived assets.

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

*Income Taxes.* In accordance with the guidance of the FASB ASC, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, as measured by enacted tax rates that are expected to be in effect in the periods when the deferred tax assets and liabilities are expected to be settled or realized. Significant judgment is required in determining the provision for income taxes, and there are transactions for which the ultimate tax outcome is uncertain. The income taxes guidance of the FASB ASC prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Uncertain tax positions are analyzed periodically and adjustments are made when events occur to warrant a change. See Note 6, Income Taxes.

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

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

*Revenue Recognition.* Revenues are recorded based on service rendered to customers through month-end. KU accrues an estimate for unbilled revenues from each meter reading date to the end of the accounting period based on allocating the daily system net deliveries between billed volumes and unbilled volumes. The allocation is based on a daily ratio of the number of meter reading cycles remaining in the month to the total number of meter

reading cycles in each month. Each day's ratio is then multiplied by each day's system net deliveries to determine an estimated billed and unbilled volume for each day of the accounting period. The unbilled revenue estimates included in accounts receivable were \$76 million, \$60 million and \$59 million at December 31, 2009, 2008 and 2007, respectively.

*Fuel Costs.* The cost of fuel for generation is charged to expense as used. See Note 2, Rates and Regulatory Matters, for a description of the FAC.

*Management's Use of Estimates.* The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported assets and liabilities and disclosure of contingent items at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Accrued liabilities, including legal and environmental, are recorded when they are probable and estimable. Actual results could differ from those estimates.

*Recent Accounting Pronouncements.* The following are recent accounting pronouncements affecting KU:

#### **Hierarchy of Generally Accepted Accounting Principles**

The guidance related to the hierarchy of generally accepted accounting principles was issued in June 2009, and is effective for interim and annual periods ending after September 15, 2009. The guidance establishes the FASB ASC as the single source of authoritative nongovernmental U.S. generally accepted accounting principles. It had no effect on the Company's results of operations, financial position or liquidity; however, references to authoritative accounting literature have changed with the adoption.

#### **Subsequent Events**

The guidance related to subsequent events was issued in May 2009, and is effective for interim and annual periods ending after June 15, 2009. This guidance requires disclosure of the date through which subsequent events have been evaluated, as well as whether that date is the date the financial statements were issued or the date they were available to be issued. The adoption of this guidance had no impact on the Company's results of operations, financial position or liquidity; however, additional disclosures were required with the adoption. See Note 12, Subsequent Events, for additional disclosures.

#### **Interim Disclosures about Fair Value of Financial Instruments**

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

#### **Employers' Disclosures about Postretirement Benefit Plan Assets**

The guidance related to employers' disclosures about postretirement benefit plan assets was issued in December 2008, and is effective as of December 31, 2009. This guidance requires additional disclosures related to pension and other postretirement benefit plan assets. Additional disclosures include the investment allocation decision-making process, the fair value of each major category of plan assets as well as the inputs and valuation techniques used to measure fair value and significant concentrations of risk within the plan assets. The adoption had no impact on the Company's results of operations, financial position or liquidity; however, additional disclosures were required with the adoption. See Note 5, Pension and Other Postretirement Benefit Plans, for additional disclosures.

#### **Disclosures about Derivative Instruments and Hedging Activities**

The guidance related to disclosures about derivative instruments and hedging activities was issued in March 2008, and is effective for fiscal years, and interim periods within those fiscal years, beginning on or after November 15, 2008. The objective of this guidance is to enhance the current disclosure framework. The adoption

had no impact on KU's results of operations, financial position or liquidity; however, additional disclosures relating to derivatives were required with the adoption effective January 1, 2009. See Note 3, Financial Instruments, for additional disclosures.

### **Noncontrolling Interests in Consolidated Financial Statements**

The guidance related to noncontrolling interests in consolidated financial statements was issued in December 2007, and is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. The objective of this guidance is to improve the relevance, comparability and transparency of financial information in a reporting entity's consolidated financial statements. The Company adopted this guidance effective January 1, 2009, and it had no impact on its results of operations, financial position or liquidity.

### **Fair Value Measurements**

In January 2010, the FASB issued guidance related to fair value measurement disclosures requiring separate disclosure of amounts of significant transfers in and out of level 1 and level 2 fair value measurements and separate information about purchases, sales, issuances, and settlements within level 3 measurements. This guidance is effective for the first reporting period beginning after issuance except for disclosures about the roll-forward of activity in level 3 fair value measurements. This guidance will have no impact on the Company's results of operations, financial position or liquidity; however, additional disclosures will be provided as required.

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

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

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

The Company adopted this guidance effective January 1, 2008, except as it applies to those nonfinancial assets and liabilities, and it had no impact on the results of operations, financial position or liquidity, however, additional disclosures relating to its financial derivatives and cash collateral on derivatives, as required, are now provided. Fair value accounting for all nonrecurring fair value measurements of nonfinancial assets and liabilities was adopted effective January 1, 2009, and it had no impact on the results of operations, financial position or liquidity. At December 31, 2009, no additional disclosures were required as KU did not have any nonfinancial assets or liabilities measured at fair value subsequent to initial measurement.

The guidance related to determining fair value was issued in April 2009, and is effective for interim and annual periods ending after June 15, 2009. This update provides additional guidance on determining fair values when there is no active market or where the price inputs being used represent distressed sales. The adoption had no impact on the Company's results of operations, financial position or liquidity.

### **Note 2 — Rates and Regulatory Matters**

The Company is subject to the jurisdiction of the Kentucky Commission, the Virginia Commission, the Tennessee Regulatory Authority and the FERC in virtually all matters related to electric utility regulation, and as such, its accounting is subject to the regulated operations guidance of the FASB ASC. Given its position in the

marketplace and the status of regulation in Kentucky and Virginia, there are no plans or intentions to discontinue the application of the regulated operations guidance of the FASB ASC.

### **2010 Kentucky Rate Case**

In January 2010, KU filed an application with the Kentucky Commission requesting an increase in base electric rates of approximately 12%, or \$135 million annually, including an 11.5% return on equity. KU has requested the increase, based on the twelve month test year ended October 31, 2009, to become effective on and after March 1, 2010. The requested rates have been suspended until August 1, 2010, at which time they may be put into effect, subject to refund, if the Kentucky Commission has not issued an order in the proceeding. The parties are currently exchanging data requests in the proceedings and a hearing date has been scheduled for June 2010. An order in the proceeding may occur during the third or fourth quarters of 2010.

### **2008 Kentucky Rate Case**

In July 2008, KU filed an application with the Kentucky Commission requesting an increase in base electric rates. In January 2009, KU, the AG, the KIUC and all other parties to the rate case filed a settlement agreement with the Kentucky Commission, under which KU's base electric rates decreased by \$9 million annually. An Order approving the settlement agreement was received in February 2009. The new rates were implemented effective February 6, 2009, at which time the merger surcredit terminated.

In conjunction with the filing of the application for changes in base rates the VDT surcredit terminated. The VDT surcredit resulted from a 2001 initiative to share savings of \$10 million from the VDT initiative with customers over five years. In February 2006, KU and all parties to the proceeding reached a unanimous settlement agreement on the future ratemaking treatment of the VDT surcredit which was approved by the Kentucky Commission in March 2006 at an annual rate of \$4 million. Under the terms of the settlement agreement, the VDT surcredit continued at its then current level until such time as KU filed for a change in base rates. In accordance with the Order, the VDT surcredit terminated in August 2008, the first billing month after the July 2008 filing for a change in base rates.

In December 2007, KU submitted its plan to allow the merger surcredit to terminate as scheduled on June 30, 2008. The merger surcredit originated as part of the LG&E Energy merger with KU Energy Corporation in 1998. In June 2008, the Kentucky Commission issued an Order approving a unanimous settlement agreement reached with all parties to the case which provided for a reduction in the merger surcredit to approximately \$6 million for a 7-month period beginning July 2008, termination of the merger surcredit when new base rates went into effect on or after January 31, 2009, and that the merger surcredit be continued at an annual rate of \$12 million thereafter should the Company not file for a change in base rates. In accordance with the Order, the merger surcredit was terminated effective February 6, 2009, with the implementation of new base rates.

### **Virginia Rate Case**

In June 2009, KU filed an application with the Virginia Commission requesting an increase in electric base rates for its Virginia jurisdictional customers in an amount of \$12 million annually or approximately 21%. The proposed increase reflected a proposed rate of return on rate base of 8.586% based upon a return on equity of 12%. During December 2009, KU and the Virginia Commission Staff agreed to a Stipulation and Recommendation authorizing base rate revenue increases of \$11 million annually and a return on rate base of 7.846% based on a 10.5% return on common equity. A public hearing was held during January 2010. As permitted, pursuant to a Virginia Commission order, KU elected to implement the proposed rates effective November 1, 2009, on an interim basis. In March 2010, the Virginia Commission issued an Order approving the stipulation, with the increased rates to be put into effect as of April 1, 2010. As part of the stipulation, KU will refund certain amounts collected since November 2009, consisting of interim increased rates in excess of the ultimate approved rates. These refunds aggregate approximately \$1 million and are anticipated to occur during the second quarter of 2010. See also Note 12 to Notes to Financial Statements.

### FERC Wholesale Rate Case

In September 2008, KU filed an application with the FERC for increases in base electric rates applicable to wholesale power sales contracts or interchange agreements involving, collectively, twelve Kentucky municipalities. The application requested a shift from current, all-in stated unit charge rates to an unbundled formula rate. In May 2009, as a result of settlement negotiations, KU submitted an unopposed motion informing the FERC of the filing of a settlement agreement and agreed-upon seven-year service agreements with the municipal customers. The unopposed motion requested interim rate structures containing terms corresponding to the overall settlement principles, to be effective from May 1, 2009, until FERC approval of the settlement agreement. The settlement and service agreements provide for unbundled formula rates which are subject to annual adjustment and approval processes. In May 2009, the FERC issued an Order approving the interim settlement with respect to rates effective May 1, 2009 representing increases of approximately 3% from prior charges and a return on equity of 11%. Additionally, during May 2009, KU filed the first annual adjustment to the formula rates to incorporate 2008 data, which adjusted formula rates became effective on July 1, 2009 and were approved by the FERC during September 2009.

Separately, the parties were not able to reach agreement on the issue of whether KU must allocate to the municipal customers a portion of renewable resources it may be required to procure on behalf of its retail ratepayers. In August 2009, the FERC accepted the issue for briefing and the parties completed briefing submissions during 2009. An order by the FERC on this matter may occur during 2010. KU is not currently able to predict the outcome of this proceeding, including whether its wholesale customers may or may not be entitled to certain rights or benefits relating to renewable energy, and the financial or operational effects, if any, of such outcomes.

### Regulatory Assets and Liabilities

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

	<u>2009</u>	<u>2008</u>
	(In millions)	
Current regulatory assets:		
ECR .....	\$ 28	\$ 20
FAC .....	1	8
Net MISO exit .....	2	—
Other .....	<u>1</u>	<u>4</u>
Total current regulatory assets .....	<u>\$ 32</u>	<u>\$ 32</u>
Non-current regulatory assets:		
Storm restoration .....	\$ 59	\$ 2
ARO .....	30	28
Unamortized loss on bonds .....	12	13
Net MISO exit .....	9	19
Other .....	<u>7</u>	<u>2</u>
Subtotal non-current regulatory assets .....	117	64
Pension benefits .....	<u>105</u>	<u>137</u>
Total non-current regulatory assets .....	<u>\$222</u>	<u>\$201</u>
Current regulatory liabilities:		
DSM .....	\$ 3	\$ 5
Total current regulatory liabilities .....	<u>\$ 3</u>	<u>\$ 5</u>
Non-current regulatory liabilities:		
Accumulated cost of removal of utility plant .....	\$331	\$329
Deferred income taxes — net .....	9	16
Postretirement benefits .....	9	10
Other .....	<u>11</u>	<u>15</u>
Total non-current regulatory liabilities .....	<u>\$360</u>	<u>\$370</u>



KU does not currently earn a rate of return on the ECR and FAC regulatory assets and the Virginia levelized fuel factor included in other regulatory assets, which are separate recovery mechanisms with recovery within twelve months. No return is earned on the pension regulatory asset that represents the changes in funded status of the plans. KU will recover this asset through pension expense included in the calculation of base rates with the Kentucky Commission and will seek recovery of this asset in future proceedings with the Virginia Commission. No return is currently earned on the ARO asset. When an asset with an ARO is retired, the related ARO regulatory asset will be offset against the associated ARO regulatory liability, ARO asset and ARO liability. A return is earned on the unamortized loss on bonds, and these costs are recovered through amortization over the life of the debt. The Company is seeking recovery of the Storm restoration regulatory asset and CMRG and KCCS contributions and FERC jurisdictional pension expense, included in other regulatory assets, in its current base rate cases. The Company recovers through the calculation of base rates, the amortization of the net MISO exit regulatory asset in Kentucky incurred through April 30, 2008. The Company recently received approval to recover the Virginia portion of this asset, as incurred through December 31, 2008, over a five year period and, due to the formula nature of its FERC rate structure, the FERC jurisdictional portion of the regulatory asset will be included in the annual updates to the rate formula. The Company recovers through the calculation of base rates, the amortization of the remaining regulatory assets, including other regulatory assets comprised of deferred storm costs, the East Kentucky Power Cooperative FERC transmission settlement agreement and Kentucky rate case expenses. Other regulatory liabilities include DSM, FERC jurisdictional supplies inventory and MISO administrative charges collected via base rates from May 2008 through February 5, 2009. The MISO regulatory liability will be netted against the remaining costs of withdrawing from the MISO, per a Kentucky Commission Order, in the current Kentucky base rate case.

*ARO.* A summary of KU's net ARO assets, regulatory assets, ARO liabilities, regulatory liabilities and cost of removal established under the asset retirement and environmental obligations guidance of the FASB ASC, follows:

(in millions of \$)	<u>ARO Net Assets</u>	<u>ARO Liabilities</u>	<u>Regulatory Assets</u>	<u>Regulatory Liabilities</u>	<u>Accumulated Cost of Removal</u>	<u>Cost of Removal Depreciation</u>
As of December 31, 2006 . . . . .	\$ 5	\$(28)	\$22	\$ (2)	\$ 2	\$ 1
ARO accretion . . . . .	—	(2)	2	—	—	—
As of December 31, 2007 . . . . .	\$ 5	\$(30)	\$24	\$ (2)	\$ 2	\$ 1
ARO accretion . . . . .	—	(2)	2	—	—	—
Removal cost reclass . . . . .	—	—	2	(2)	—	—
As of December 31, 2008 . . . . .	5	(32)	28	(4)	2	1
ARO accretion . . . . .	—	(2)	2	—	—	—
ARO depreciation . . . . .	(1)	—	—	—	—	—
Cost of removal depreciation . . . . .	—	—	—	—	—	1
As of December 31, 2009 . . . . .	<u>\$ 4</u>	<u>\$(34)</u>	<u>\$30</u>	<u>\$(4)</u>	<u>\$ 2</u>	<u>\$ 2</u>

Pursuant to regulatory treatment prescribed under the regulated operations guidance of the FASB ASC, an offsetting regulatory credit was recorded in depreciation and amortization in the income statement of \$2 million in 2009, 2008 and 2007 for the ARO accretion and depreciation expense. KU AROs are primarily related to the final retirement of assets associated with generating units. For assets associated with AROs, the removal cost accrued through depreciation under regulatory accounting is established as a regulatory liability pursuant to regulatory treatment prescribed under the regulated operations guidance of the FASB ASC. For the years ended December 31, 2008 and 2007, KU recorded less than \$1 million of depreciation expense related to the cost of removal of ARO related assets. An offsetting regulatory liability was established pursuant to regulatory treatment prescribed under the regulated operations guidance of the FASB ASC.

KU transmission and distribution lines largely operate under perpetual property easement agreements which do not generally require restoration upon removal of the property. Therefore, under the asset retirement and environmental obligations guidance of the FASB ASC, no material asset retirement obligations are recorded for transmission and distribution assets.

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

KU and the MISO have agreed upon overall calculation methods for the contractual exit fee to be paid by the Company following its withdrawal. In October 2006, the Company paid \$20 million to the MISO and made related FERC compliance filings. The Company's payment of this exit fee was with reservation of its rights to contest the amount, or components thereof, following a continuing review of its calculation and supporting documentation. KU and the MISO resolved their dispute regarding the calculation of the exit fee and, in November 2007, filed an application with the FERC for approval of a recalculation agreement. In March 2008, the FERC approved the parties' recalculation of the exit fee, and the approved agreement provided KU with an immediate recovery of \$1 million and an estimated \$3 million over the next seven years for credits realized from other payments the MISO will receive, plus interest.

In accordance with Kentucky Commission Orders approving the MISO exit, KU has established a regulatory asset for the MISO exit fee, net of former MISO administrative charges collected via Kentucky base rates through the base rate case test year ended April 30, 2008. The net MISO exit fee is subject to adjustment for possible future MISO credits, and a regulatory liability for certain revenues associated with former MISO administrative charges, which were collected via base rates until February 6, 2009. The approved 2008 base rate case settlement provided for MISO administrative charges collected through base rates from May 1, 2008 to February 6, 2009, and any future adjustments to the MISO exit fee, to be established as a regulatory liability until the amounts can be amortized in future base rate cases. This regulatory liability balance as of October 31, 2009 has been included in the base rate case application filed on January 29, 2010. MISO exit fee credit amounts subsequent to October 31, 2009, will continue to accumulate as a regulatory liability until they can be amortized in future base rate cases.

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

In August 2009, the FERC determined that the MISO had failed to demonstrate that its proposed exemptions to real-time RSG charges were just and reasonable. In November 2009, the MISO made a compliance filing incorporating the rulings of the FERC orders and a related task-force, with a primary open issue being whether certain of the tariff changes are applied prospectively only or retroactively to approximately January 6, 2009. The conclusion of the RSG matter, including the retroactivity decision, may result in refunds to the Company, but the Company cannot predict the ultimate outcome of this matter, nor the financial impact, at this time.

In November 2009, KU and LG&E filed an application with the FERC to approve certain independent transmission operator arrangements to be effective upon the expiration of their current contract with Southwest Power Pool, Inc. in September 2010. The application seeks authority for KU and LG&E to function after such date as the administrators of their own open access transmission tariffs for most purposes. The Tennessee Valley Authority, which currently acts as Reliability Coordinator, would also assume certain additional duties. A number of parties have intervened and filed comments in the matter and initial stages of data response proceedings have occurred. The application is subject to continuing FERC proceedings, including further submissions or filings by intervenors or FERC staff, prior to a ruling by the FERC. During January 2010, the Kentucky Commission issued an Order generally authorizing relevant state regulatory aspects of the proposed arrangements.

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

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

The Kentucky Commission requires public hearings at six-month intervals to examine past fuel adjustments, and at two-year intervals to review past operations of the fuel clause and transfer of the then current fuel adjustment charge or credit to the base charges. In November 2009, January 2009, June 2008 and January 2008, the Kentucky Commission issued Orders approving the charges and credits billed through the FAC for the six-month periods ending April 2009, April 2008, October 2007 and April 2007, respectively. In January 2009 and December 2006, the Kentucky Commission initiated routine examinations of the FAC for the two-year periods November 1, 2006 through October 31, 2008 and November 1, 2004 through October 31, 2006. The Kentucky Commission issued Orders in June 2009 and November 2007, approving the charges and credits billed through the FAC during the review periods.

KU also employs an FAC mechanism for Virginia customers using an average fuel cost factor based primarily on projected fuel costs. The Virginia levelized fuel factor allows fuel recovery based on projected fuel costs for the coming year plus an adjustment for any over- or under-recovery of fuel expenses from the prior year. At December 31, 2009 and 2008, KU had a regulatory liability of less than \$1 million and a regulatory asset of \$2 million, respectively.

In February 2009, KU filed an application with the Virginia Commission seeking approval of a 29% increase in its fuel cost factor beginning with service rendered in April 2009. In February 2009, the Virginia Commission issued an Order allowing the requested change to become effective on an interim basis. The Virginia Staff testimony filed in April 2009, recommended a slight decrease in the factor filed by KU. The Company indicated the Virginia Staff proposal was acceptable. A hearing was held in May 2009, with general resolution of remaining issues. In May 2009, the Virginia Commission issued an Order approving the revised fuel factor, representing an increase of 24%, effective May 2009.

In February 2008, KU filed an application with the Virginia Commission seeking approval of a decrease in its fuel cost factor applicable during the billing period, April 2008 through March 2009. The Virginia Commission allowed the new rates to be in effect for the April 2008 customer billings. In April 2008, the Virginia Commission Staff recommended a change to the fuel factor KU filed in its application, to which KU has agreed. Following a public hearing and an Order in May 2008, the recommended change became effective in June 2008, resulting in a decrease of 0.482 cents/kwh from the factor in effect for the April 2007 through March 2008 period.

*ECR.* Kentucky law permits KU to recover the costs of complying with the Federal Clean Air Act, including a return of operating expenses, and a return of and on capital invested, through the ECR mechanism. The amount of

the regulatory asset or liability is the amount that has been under- or over-recovered due to timing or adjustments to the mechanism.

The Kentucky Commission requires reviews of the past operations of the environmental surcharge for six-month and two-year billing periods to evaluate the related charges, credits and rates of return, as well as to provide for the roll-in of ECR amounts to base rates each two-year period. In December 2009, an Order was issued approving the charges and credits billed through the ECR during the two-year period ending April 2009, an increase in the jurisdictional revenue requirement, a base rate roll-in and a revised rate of return on capital. In July 2009, an Order was issued approving the charges and credits billed through the ECR during the six-month period ending October 2008, as well as approving billing adjustments for under-recovered costs and the rate of return on capital. In August 2008, an Order was issued approving the charges and credits billed through the ECR during the six-month periods ending April 2008 and October 2007, and the rate of return on capital. In March 2008, an Order was issued approving the charges and credits billed through the ECR during the six-month and two-year periods ending October 2006 and April 2007, respectively, as well as approving billing adjustments, roll-in adjustments to base rates, revisions to the monthly surcharge filing and the rates of return on capital.

In January 2010, the Kentucky Commission initiated a six-month review of KU's environmental surcharge for the billing period ending October 2009. The proceeding will progress throughout the first half of 2010.

In June 2009, the Company filed an application for a new ECR plan with the Kentucky Commission seeking approval to recover investments in environmental upgrades and operations and maintenance costs at the Company's generating facilities. During 2009, KU reached a unanimous settlement with all parties to the case and the Kentucky Commission issued an Order approving KU's application. Recovery on customer bills through the monthly ECR surcharge for these projects began with the February 2010 billing cycle.

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

In October 2007, KU met with the Kentucky Commission and other interested parties to discuss the status of the Ghent Unit 2 SCR construction. KU informed the Kentucky Commission that construction of the Ghent Unit 2 SCR was not going to commence before the CCN expired in December 2007, due to a change in the economics for the project. The CCN expired in December 2007, and KU has delayed construction of the Ghent Unit 2 SCR.

*Storm Restoration.* In January 2009, a significant ice storm passed through KU's service territory causing approximately 199,000 customer outages, followed closely by a severe wind storm in February 2009, causing approximately 44,000 customer outages. The Company filed an application with the Kentucky Commission in April 2009, requesting approval to establish a regulatory asset, and defer for future recovery, approximately \$62 million in incremental operation and maintenance expenses related to the storm restoration. In September 2009, the Kentucky Commission issued an Order allowing the Company to establish a regulatory asset of up to \$62 million based on its actual costs for storm damages and service restoration due to the January and February 2009 storms. In September 2009, the Company established a regulatory asset of \$57 million for actual costs incurred, and the Company is seeking recovery of this asset in its current base rate case.

In September 2008, high winds from the remnants of Hurricane Ike passed through the service territory causing significant outages and system damage. In October 2008, KU filed an application with the Kentucky Commission requesting approval to establish a regulatory asset, and defer for future recovery, approximately \$3 million of expenses related to the storm restoration. In December 2008, the Kentucky Commission issued an Order allowing the Company to establish a regulatory asset of up to \$3 million based on its actual costs for storm damages and service restoration due to Hurricane Ike. In December 2008, the Company established a regulatory asset of \$2 million for actual costs incurred, and the Company is seeking recovery of this asset in its current base rate case.

*FERC Jurisdictional Pension Costs.* Other regulatory assets include pension costs of \$3 million incurred by the Company and allocated to its FERC jurisdictional ratepayers. The Company will seek recovery of this asset in the next FERC rate proceeding.

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

*CMRG and KCCS Contributions.* In July 2008, KU and LG&E, along with Duke Energy Kentucky, Inc. and Kentucky Power Company, filed an application with the Kentucky Commission requesting approval to establish regulatory assets related to contributions to the CMRG for the development of technologies for reducing carbon dioxide emissions and the KCCS to study the feasibility of geologic storage of carbon dioxide. The filing companies proposed that these contributions be treated as regulatory assets to be deferred until recovery is provided in the next base rate case of each company, at which time the regulatory assets will be amortized over the life of each project: four years with respect to the KCCS and ten years with respect to the CMRG. KU and LG&E jointly agreed to provide less than \$2 million over two years to the KCCS and up to \$2 million over ten years to the CMRG. In October 2008, an Order approving the establishment of the requested regulatory assets was received and KU is seeking rate recovery in the Company's 2010 Kentucky base rate case.

*Deferred Storm Costs.* Based on an Order from the Kentucky Commission in June 2004, KU reclassified from maintenance expense to a regulatory asset, \$4 million related to costs not reimbursed from the 2003 ice storm. These costs were amortized through June 2009. KU earned a return of these amortized costs, which were included in jurisdictional operating expenses.

*Pension and Postretirement Benefits.* KU accounts for pension and postretirement benefits in accordance with the compensation — retirement benefits guidance of the FASB ASC. This guidance requires employers to recognize the over-funded or under-funded status of a defined benefit pension and postretirement plan as an asset or liability in the balance sheet and to recognize through other comprehensive income the changes in the funded status in the year in which the changes occur. Under the regulated operations guidance of the FASB ASC, KU can defer recoverable costs that would otherwise be charged to expense or equity by non-regulated entities. Current rate recovery in Kentucky and Virginia is based on the compensation — retirement benefits guidance of the FASB ASC. Regulators have been clear and consistent with their historical treatment of such rate recovery, therefore, the Company has recorded a regulatory asset representing the change in funded status of the pension plan that is expected to be recovered and a regulatory liability representing the change in funded status of the postretirement plan that is expected to be refunded. The regulatory asset and liability will be adjusted annually as prior service cost and actuarial gains and losses are recognized in net periodic benefit cost.

*Accumulated Cost of Removal of Utility Plant.* As of December 31, 2009 and 2008, KU has segregated the cost of removal, previously embedded in accumulated depreciation, of \$331 million and \$329 million, respectively, in accordance with FERC Order No. 631. This cost of removal component is for assets that do not have a legal ARO under the asset retirement and environmental obligations guidance of the FASB ASC. For reporting purposes in the balance sheets, KU has presented this cost of removal as a regulatory liability pursuant to the regulated operations guidance of the FASB ASC.

*Deferred Income Taxes — Net.* These regulatory assets and liabilities represent the future revenue impact from the reversal of deferred income taxes required for unamortized investment tax credits, the allowance for funds used during construction and deferred taxes provided at rates in excess of currently enacted rates.

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

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

## Other Regulatory Matters

*Kentucky Commission Report on Storms.* In November 2009, the Kentucky Commission issued a report following review and analysis of the effects and utility response to the September 2008 wind storm and the January 2009 ice storm, and possible utility industry preventative measures relating thereto. The report suggested a number of proposed or recommended preventative or responsive measures, including consideration of selective hardening of facilities, altered vegetation management programs, enhanced customer outage communications and similar measures. In March 2010, the Companies filed a joint response reporting on their actions with respect to such recommendations. The response indicated implementation or completion of substantially all of the recommendations, including, among other matters, on-going reviews of system hardening and vegetation management procedures, certain test or pilot programs in such areas, and fielding of enhanced operational and customer outage-related systems.

*Wind Power Agreements.* In August 2009, KU and LG&E filed a notice of intent with the Kentucky Commission indicating their intent to file an application for approval of wind power purchase contracts and cost recovery mechanisms. The contracts were executed in August 2009, and are contingent upon KU and LG&E receiving acceptable regulatory approvals. Pursuant to the proposed 20-year contracts, KU and LG&E would jointly purchase respective assigned portions of the output of two Illinois wind farms totaling an aggregate 109.5 Mw. In September 2009, the Companies filed an application and supporting testimony with the Kentucky Commission. In October 2009, the Kentucky Commission issued an Order denying the Companies' request to establish a surcharge for recovery of the costs of purchasing wind power. The Kentucky Commission stated that such recovery constitutes a general rate adjustment and is subject to the regulations of a base rate case. The Kentucky Commission Order currently provides for the request for approval of the wind power agreements to proceed independently from the request to recover the costs thereof via surcharges. In November 2009, KU and LG&E filed for rehearing of the Kentucky Commission's Order and requested that the matters of approval of the contract and recovery of the costs thereof remain the subject of the same proceeding. During December 2009, the Kentucky Commission issued data requests on this matter. In March 2010, the Companies filed a motion requesting a ruling on this matter during the second quarter of 2010. The Companies cannot currently predict the timing or outcome of this proceeding.

*Trimble County Asset Purchase and Depreciation.* KU and LG&E are currently constructing a new base-load, coal fired unit, TC2, which will be jointly owned by the Companies, together with the IMEA and the IMPA. In July 2009, the Companies notified the Kentucky Commission of the proposed sale from LG&E to KU of certain ownership interests in certain existing Trimble County generating station assets which are anticipated to provide joint or common use in support of the jointly-owned TC2 generating unit under construction at the station. The undivided ownership interests being sold are intended to provide KU an ownership interest in these common assets that is proportional to its interest in TC2 and the assets' role in supporting both TC1 and TC2. In December 2009, KU and LG&E completed the sale transaction at a price of \$48 million, representing the current net book value of the assets, multiplied by the proportional interest being sold.

In August 2009, in a separate proceeding, KU and LG&E jointly filed an application with the Kentucky Commission to approve new depreciation rates for applicable TC2-related generating, pollution control and other plant equipment and assets. The filing requests common depreciation rates for the applicable jointly-owned TC2-related assets, rather than applying differing depreciation rates in place with respect to KU's and LG&E's separately-owned base-load generating assets. During December 2009, the Kentucky Commission extended the data discovery process through January 2010 and authorized KU and LG&E on an interim basis to begin using the depreciation rates for TC2 as proposed in the application. In March 2010, the Kentucky Commission issued a final Order approving the use of the proposed depreciation rates on a permanent basis.

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

The CCN for the remaining line has been challenged by certain property owners in Hardin County, Kentucky. In August 2006, KU and LG&E obtained a successful dismissal of the challenge at the Franklin County Circuit Court, which ruling was reversed by the Kentucky Court of Appeals in December 2007, and the proceeding

reinstated. A motion for discretionary review of that reversal was filed by KU and LG&E with the Kentucky Supreme Court and was granted in April 2009. That proceeding, which seeks reinstatement of the Circuit Court dismissal of the CCN challenge, has been fully briefed and oral argument occurred during March 2010. A ruling on the matter could occur by mid 2010.

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

During 2008, KU obtained various successful rulings at the Hardin County Circuit Court confirming its condemnation rights. In August 2008, several landowners appealed such rulings to the Kentucky Court of Appeals and received a temporary stay preventing KU from accessing their properties. In April 2009, that appellate court denied KU's motion to lift the stay and issued an Order retaining the stay until a decision on the merits of the appeal. Efforts to seek reconsideration of that ruling, or to obtain intermediate review of the ruling by the Kentucky Supreme Court, were unsuccessful, and the stay remains in effect. The underlying appeal on KU's right to condemn remains pending before the Court of Appeals and oral argument on the matter is scheduled to occur during late March 2010.

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

As a result of the aforementioned unresolved litigation delays encountered in obtaining access to certain properties in Hardin County, KU has obtained easements to allow construction of temporary transmission facilities bypassing those properties while the litigated issues are resolved. In September 2009, the Kentucky Commission issued an Order stating that a CCN was necessary for two segments of the proposed temporary facilities. In December 2009, the Kentucky Commission granted the CCNs for the relevant segments and the property owners have filed various motions to intervene, stay and appeal certain elements of the Kentucky Commission's recent orders. In January 2010, in respect of two of such proceedings, the Franklin County circuit court issued Orders denying the property owners' request for a stay of construction and upholding the prior Kentucky Commission denial of their intervenor status. In parallel with, and consistent with the relevant proceedings and their status, the Company is conducting appropriate real estate acquisition and construction activities with respect to these temporary transmission facilities.

In a separate proceeding, certain Hardin County landowners have also challenged the same transmission line in federal district court in Louisville, Kentucky. In that action, the landowners claim that the U.S. Army failed to comply with certain National Historic Preservation Act requirements relating to easements for the line through Fort Knox. KU and LG&E are cooperating with the U.S. Army in its defense in this case and in October 2009, the federal court granted the defendants' motion for summary judgment and dismissed the plaintiffs' claims. During November 2009, the petitioners filed submissions for review of the decision with the 6th Circuit Court of Appeals.

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

*Utility Competition in Virginia.* The Commonwealth of Virginia passed the Virginia Electric Utility Restructuring Act in 1999. This act gave customers the ability to choose their electric supplier and capped electric rates through December 2010. KU subsequently received a legislative exemption from the customer choice requirements of this law. In April 2007, however, the Virginia General Assembly amended the Virginia Electric Utility Restructuring Act, thereby terminating this competitive market and commencing re-regulation of utility rates. The new act ended the cap on rates at the end of 2008. Pursuant to this legislation, the Virginia Commission adopted regulations revising the rules governing utility rate increase applications. As of January 2009, a hybrid model of regulation is being applied in Virginia. Under this model, utility rates are reviewed every two years. KU's exemption from the requirements of the Virginia Electric Utility Restructuring Act in 1999, however, discharges the Company from the requirements of the new hybrid model of regulation. In lieu of submitting an annual information filing, the Company has the option of requesting a change in base rates to recover prudently incurred costs by filing a

traditional base rate case. KU is also subject to other utility regulations in Virginia, including, but not limited to, the recovery of prudently incurred fuel costs through an annual fuel factor charge and the submission of integrated resource plans.

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

In June 2009, the FERC issued Order No. 697-C which generally clarified certain interpretations relating to power sales and purchases at control area interfaces or into control areas involving market power. In July 2009, the FERC issued an order approving the Company's September 2008 application for market-based rate authority. During July 2009, affiliates of KU completed a transaction terminating certain prior generation and power marketing activities in the Big Rivers Electric Corporation control area, which termination should ultimately allow a filing to request a determination that the Company no longer is deemed to have market power in such control area.

KU conducts certain of its wholesale power sales activities in accordance with existing market-based rate authority principles and interpretations. Future FERC proceedings relating to Orders 697 or market-based rate authority could alter the amount of sales made at market-based versus cost-based rates. The Company's sales under market-based rate authority totaled less than \$1 million for the year ended December 31, 2009.

*Mandatory Reliability Standards.* As a result of the EPAct 2005, certain formerly voluntary reliability standards became mandatory in June 2007, and authority was delegated to various Regional Reliability Organizations ("RROs") by the NERC, which was authorized by the FERC to enforce compliance with such standards, including promulgating new standards. Failure to comply with mandatory reliability standards can subject a registered entity to sanctions, including potential fines of up to \$1 million per day, as well as non-monetary penalties, depending upon the circumstances of the violation. KU is a member of the SERC Reliability Corporation ("SERC"), which acts as KU's RRO. During May 2008, the SERC and KU agreed to a settlement involving penalties totaling less than \$1 million related to KU's February 2008 self-report concerning possible violations of certain existing mitigation plans relating to reliability standards. During December 2009, the SERC and KU agreed to a settlement involving penalties totaling less than \$1 million concerning a June 2008 self-report by KU relating to three other standards and an October 2008 self-report relating to an additional standard. During December 2009, KU submitted a self-report relating to an additional standard. SERC proceedings for the December 2009 self-report are in the early stages and therefore the outcome is unable to be determined. Mandatory reliability standard settlements commonly include other non-penalty elements, including compliance steps and mitigation plans. Settlements with the SERC proceed to NERC and FERC review before becoming final. While KU believes itself to be in compliance with the mandatory reliability standards, the Company cannot predict the outcome of other analyses, including on-going SERC or other reviews described above.

*Integrated Resource Planning.* Integrated resource planning ("IRP") regulations in Kentucky require major utilities to make triennial IRP filings with the Kentucky Commission. In April 2008, KU and LG&E filed their 2008 joint IRP with the Kentucky Commission. The IRP provides historical and projected demand, resource and financial data, and other operating performance and system information. The Kentucky Commission issued a staff report and Order closing this proceeding in December 2009. Pursuant to the Virginia Commission's December 2008 Order, KU filed its IRP in July 2009. The filing consisted of the 2008 Joint IRP filed by KU and LG&E with the Kentucky Commission along with additional data. The Virginia Commission has not established a procedural schedule for this proceeding.



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

*EPAAct 2005.* The EPAAct 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 EPAAct 2005, Subtitle E Section 1252, Smart Metering, which concerns time-based metering and demand response, and Section 1254, Interconnections. EPAAct 2005 requires each state regulatory authority to conduct a formal investigation and issue a decision on whether or not it is appropriate to implement certain Section 1252 standards within eighteen months after the enactment of EPAAct 2005 and to commence consideration of Section 1254 standards within one year after the enactment of EPAAct 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 EPAAct 2005 Section 1252 and Section 1254 standards should not be adopted. However, all five Kentucky Commission jurisdictional utilities are required to file real-time pricing pilot programs for their large commercial and industrial customers. KU developed a real-time pricing pilot for large industrial and commercial customers and filed the details of the plan with the Kentucky Commission in April 2007. In February 2008, the Kentucky Commission issued an Order approving the real-time pricing pilot program proposed by KU for implementation within approximately eight months, for its large commercial and industrial customers. The tariff was filed in October 2008, with an effective date of December 1, 2008. KU files annual reports on the program within 90 days of each plan year-end for the 3-year pilot period.

*Green Energy Riders.* In February 2007, KU and LG&E filed a Joint Application and Testimony for Proposed Green Energy Riders. In May 2007, a Kentucky Commission Order was issued authorizing KU to establish Small and Large Green Energy Riders, allowing customers to contribute funds to be used for the purchase of renewable energy credits. During November 2009, KU and LG&E filed an application to both continue and modify the existing Green Energy Programs and requested a Kentucky Commission Order by March 2010.

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

*Collection Cycle Revision.* As part of its base rate case filed on July 29, 2008, LG&E proposed to change the due date for customer bill payments from 15 days to 10 days to align its collection cycle with KU. In addition, KU proposed to include a late payment charge if payment is not received within 15 days from the bill issuance date to align with LG&E. The settlement agreement approved in the rate case in February 2009, changed the due date for customer bill payments to 12 days after bill issuance for both KU and LG&E, and permitted KU's implementation of a late payment charge if payment is not received within 15 days from the bill issuance date.

*Depreciation Study.* In December 2007, KU filed a depreciation study with the Kentucky Commission as required by a previous Order. In August 2008, the Kentucky Commission issued an Order consolidating the depreciation study with the base rate case proceeding. The approved settlement agreement in the rate case established new depreciation rates effective February 2009. KU also filed the depreciation study with the Virginia Commission which approved the implementation of the new depreciation rates effective February 2009. Approval

by the Virginia Commission does not preclude the rates from being raised as an issue by any party in KU's current base rate case in Virginia.

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

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

*EISA 2007 Standards.* In November 2008, the Kentucky Commission initiated an administrative proceeding to consider new standards as a result of the Energy Independence and Security Act of 2007 ("EISA 2007"), part of which amends the Public Utility Regulatory Policies Act of 1978 ("PURPA"). There are four new PURPA standards and one non-PURPA standard applicable to electric utilities. The proceeding also considers two new PURPA standards applicable to natural gas utilities. EISA 2007 requires state regulatory commissions and nonregulated utilities to begin consideration of the rate design and smart grid investments no later than December 19, 2008, and to complete the consideration by December 19, 2009. The Kentucky Commission established a procedural schedule that allowed for data discovery and testimony through July 2009. A public hearing has not been scheduled in this matter. In October 2009, the Kentucky Commission held an informal conference for the purpose of discussing issues related to the standard regarding the consideration of Smart Grid investments.

### Note 3 — Financial Instruments

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

	2009		2008	
	Carrying Value	Fair Value	Carrying Value	Fair Value
	(In millions)			
Long-term debt (including current portion of \$228 million) . . . . .	\$ 351	\$ 351	\$ 351	\$ 349
Long-term debt from affiliate (including current portion of \$33 million) . . . . .	\$1,331	\$1,401	\$1,181	\$1,117

The long-term debt valuations reflect prices quoted by dealers. The fair value of the long-term debt from affiliate is determined using an internal valuation model that discounts the future cash flows of each loan at current market rates. The current market values are determined based on quotes from investment banks that are actively involved in capital markets for utilities and factor in KU's credit ratings and default risk. The fair values of cash and cash equivalents, accounts receivable, cash surrender value of key man life insurance, accounts payable and notes payable are substantially the same as their carrying values.

KU is subject to the risk of fluctuating interest rates in the normal course of business. The Company's policies allow the interest rate risk to be managed through the use of fixed rate debt, floating rate debt and interest rate swaps. At December 31, 2009, a 100 basis point change in the benchmark rate on KU's variable rate debt would impact pre-tax interest expense by \$4 million annually. Although the Company's policies allow for the use of interest rate swaps, as of December 31, 2008 and 2009, KU had no interest rate swaps outstanding.

The Company is subject to interest rate and commodity price risk related to on-going business operations. It currently manages these risks using derivative financial instruments including swaps and forward contracts.

KU has classified the applicable financial assets and liabilities that are accounted for at fair value into the three levels of the fair value hierarchy, as defined by the fair value measurements and disclosures guidance of the FASB ASC, as follows:

- Level 1 — Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 — Include other inputs that are directly or indirectly observable in the marketplace.
- Level 3 — Unobservable inputs which are supported by little or no market activity.

*Energy Trading and Risk Management Activities.* KU conducts energy trading and risk management activities to maximize the value of power sales from physical assets it owns. Energy trading activities are principally forward financial transactions to manage price risk and are accounted for as non-hedging derivatives on a mark-to-market basis in accordance with the derivatives and hedging guidance of the FASB ASC.

Energy trading and risk management contracts are valued using prices based on active trades from Intercontinental Exchange Inc. In the absence of a traded price, midpoints of the best bids and offers are the primary determinants of valuation. When sufficient trading activity is unavailable, other inputs include prices quoted by brokers or observable inputs other than quoted prices, such as one-sided bids or offers as of the balance sheet date. Using these valuation methodologies, these contracts are considered level 2 based on measurement criteria in the fair value measurements and disclosures guidance of the FASB ASC. Quotes are verified quarterly using an independent pricing source of actual transactions. Quotes for combined off-peak and weekend timeframes are allocated between the two timeframes based on their historically proportionate ratios to the integrated cost. No other adjustments are made to the forward prices. No changes to valuation techniques for energy trading and risk management activities occurred during 2009, 2008 or 2007. Changes in market pricing, interest rate and volatility assumptions were made during both years.

The Company maintains credit policies intended to minimize credit risk in wholesale marketing and trading activities by assessing the creditworthiness of potential counterparties prior to entering into transactions with them and continuing to evaluate their creditworthiness once transactions have been initiated. To further mitigate credit risk, KU seeks to enter into netting agreements or require cash deposits, letters of credit and parental company guarantees as security from counterparties. The Company uses S&P, Moody's and definitive qualitative and quantitative data to assess the financial strength of counterparties on an on-going basis. If no external rating exists, KU assigns an internally generated rating for which it sets appropriate risk parameters. As risk management contracts are valued based on changes in market prices of the related commodities, credit exposures are revalued and monitored on a daily basis. At December 31, 2009, 100% of the trading and risk management commitments were with counterparties rated BBB-/Baa3 equivalent or better. The Company has reserved against counterparty credit risk based on the counterparty's credit rating and applying historical default rates within varying credit ratings over time provided by S&P or Moody's. At December 31, 2009 and 2008, credit reserves related to the energy trading and risk management contracts were less than \$1 million.

The net volume of electricity based financial derivatives outstanding at December 31, 2009 and 2008, was 315,600 Mwhts and 146,000 Mwhts, respectively. All the volume outstanding at December 31, 2009 will settle in 2010.

The following table sets forth by level within the fair value hierarchy, KU's financial assets and liabilities that were accounted for at fair value on a recurring basis as of December 31, 2008. Cash collateral related to the energy trading and risk management contracts was less than \$1 million at December 31, 2009 and 2008. Cash collateral related to the energy

trading and risk management contracts is categorized as other accounts receivable and is a level 1 measurement based on the funds being held in liquid accounts. Energy trading and risk management contracts are considered level 2 based on measurement criteria in the fair value measurements and disclosures guidance of the FASB ASC. Financial assets as of December 31, 2009 and financial liabilities as of December 31, 2009 and 2008, arising from energy trading and risk management contracts accounted for at fair value total less than \$1 million and use level 2 measurements. There are no level 3 measurements for the periods ending December 31, 2009 and 2008.

<u>December 31, 2008</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Total</u>
Financial Assets:			
Energy trading and risk management contracts . . . . .	\$—	\$1	\$1
Total Financial Assets . . . . .	<u>\$—</u>	<u>\$1</u>	<u>\$1</u>

The Company does not net collateral against derivative instruments.

Certain of the Company's derivative instruments contain provisions that require the Company to provide immediate and on-going collateralization on derivative instruments in net liability positions based upon the Company's credit ratings from each of the major credit rating agencies. At December 31, 2009, there are no energy trading and risk management contracts with credit risk related contingent features that are in a liability position, and no collateral posted in the normal course of business. At December 31, 2009, a one notch downgrade of the Company's credit rating would have no effect on the energy trading and risk management contracts or collateral required as a result of these contracts.

The table below shows the fair value and balance sheet location of derivatives not designated as hedging instruments as of December 31, 2008:

<u>December 31, 2008</u>				
Energy trading and risk management contracts (current) . . . . .	Other current assets	\$1	Other current liabilities	\$—
Total . . . . .		<u>\$1</u>		<u>\$—</u>

Financial assets and liabilities as of December 31, 2009 arising from energy trading and risk management contracts accounted for at fair value total less than \$1 million.

KU manages the price risk of its estimated future excess economic generation capacity using market-traded forward financial contracts. Hedge accounting treatment has not been elected for these transactions, and therefore gains and losses are shown in the statements of income.

The following tables present the effect of derivatives not designated as hedging instruments on income for the years ended December 31, 2009 and 2008:

	<u>Location of Gain (Loss) Recognized in Income on Derivatives</u>	<u>Amount of Gain (Loss) Recognized in Income on Derivatives</u> (In millions)
<u>December 31, 2009</u>		
Energy trading and risk management contracts (unrealized) . . . . .	Electric revenues	\$(1)
Total . . . . .		<u>\$(1)</u>
<u>December 31, 2008</u>		
Energy trading and risk management contracts (unrealized) . . . . .	Electric revenues	\$ 1
Total . . . . .		<u>\$ 1</u>

Unrealized gains and losses were less than \$1 million for the year ended December 31, 2007. Net realized gains and losses were less than \$1 million for the years ended December 31, 2009, 2008, and 2007.

#### Note 4 — Concentrations of Credit and Other Risk

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

KU's customer receivables and revenues arise from deliveries of electricity to approximately 515,000 customers in over 600 communities and adjacent suburban and rural areas in 77 counties in central, southeastern and western Kentucky, to approximately 30,000 customers in 5 counties in southwestern Virginia and 5 customers in Tennessee. For the years ended December 31, 2009, 2008 and 2007, 100% of total revenue was derived from electric operations. During 2009, the Company's 10 largest customers accounted for less than 15% of electric volumes.

Effective August 4, 2009, the Company and its employees represented by the IBEW Local 2100 entered into a three-year collective bargaining agreement. The agreement provides for negotiated increases or changes to wages, benefits or other provisions and for annual wage re-openers. KU and employees represented by the USWA Local 9447-01 entered into a three-year collective bargaining agreement in August 2008. This agreement provides for negotiated increases or changes to wages, benefits or other provisions and for annual wage re-openers. The employees represented by these two bargaining units comprise approximately 15% of the Company's workforce at December 31, 2009.

#### Note 5 — Pension and Other Postretirement Benefit Plans

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

*Obligations and Funded Status.* The following tables provide a reconciliation of the changes in the defined benefit plans' obligations and the fair value of assets for the two-year period ending December 31, 2009, and the funded status for the plans as of December 31:

	<u>Pension Benefits</u>		<u>Other Postretirement Benefits</u>	
	<u>2009</u>	<u>2008</u>	<u>2009</u>	<u>2008</u>
	(In millions)			
<b>Change in benefit obligation</b>				
Benefit obligation at beginning of year . . . . .	\$306	\$ 284	\$ 75	\$ 76
Service cost . . . . .	6	5	2	1
Interest cost . . . . .	18	18	4	5
Benefits paid, net of retiree contributions . . . . .	(18)	(18)	(5)	(3)
Actuarial (gain)/loss and other . . . . .	4	17	4	(4)
Benefit obligation at end of year . . . . .	<u>\$316</u>	<u>\$ 306</u>	<u>\$ 80</u>	<u>\$ 75</u>
<b>Change in plan assets</b>				
Fair value of plan assets at beginning of year . . . . .	\$183	\$ 264	\$ 12	\$ 13
Actual return on plan assets . . . . .	41	(61)	3	(3)
Employer contributions . . . . .	13	—	7	5
Benefits paid, net of retiree contributions . . . . .	(18)	(18)	(5)	(3)
Administrative expenses and other . . . . .	—	(2)	—	—
Fair value of plan assets at end of year . . . . .	<u>\$219</u>	<u>\$ 183</u>	<u>\$ 17</u>	<u>\$ 12</u>
<b>Funded status at end of year . . . . .</b>	<u><b>\$(97)</b></u>	<u><b>\$(123)</b></u>	<u><b>\$(63)</b></u>	<u><b>\$(63)</b></u>

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

	<u>Pension Benefits</u>		<u>Other Postretirement Benefits</u>	
	<u>2009</u>	<u>2008</u>	<u>2009</u>	<u>2008</u>
	(In millions)			
Regulatory assets . . . . .	\$105	\$ 137	\$ —	\$ —
Regulatory liabilities . . . . .	—	—	(9)	(10)
Accrued benefit liability (non-current) . . . . .	(97)	(123)	(63)	(63)

Amounts recognized in regulatory assets and liabilities consist of:

	<u>Pension Benefits</u>		<u>Other Postretirement Benefits</u>	
	<u>2009</u>	<u>2008</u>	<u>2009</u>	<u>2008</u>
	(In millions)			
Transition obligation . . . . .	\$ —	\$ —	\$ 3	\$ 4
Prior service cost . . . . .	5	5	2	2
Accumulated (gain)/loss . . . . .	<u>100</u>	<u>132</u>	<u>(14)</u>	<u>(16)</u>
Total regulatory assets (liabilities) . . . . .	<u>\$105</u>	<u>\$137</u>	<u>\$ (9)</u>	<u>\$(10)</u>

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

	<u>Pension Benefits</u>		<u>Other Postretirement Benefits</u>	
	<u>2009</u>	<u>2008</u>	<u>2009</u>	<u>2008</u>
	(In millions)			
Benefit obligation . . . . .	\$316	\$306	\$80	\$75
Accumulated benefit obligation . . . . .	268	261	—	—
Fair value of plan assets . . . . .	219	183	17	12

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

The amounts recognized in regulatory assets and liabilities for the years ended December 31, are composed of the following:

	<u>Pension Benefits</u>		<u>Other Postretirement Benefits</u>	
	<u>2009</u>	<u>2008</u>	<u>2009</u>	<u>2008</u>
	(In millions)			
Prior service cost arising during the period . . . . .	\$ —	\$ —	\$ —	\$ 1
Net loss/(gain) arising during the period . . . . .	(22)	101	2	—
Amortization of prior service (cost)/credit . . . . .	(1)	(1)	—	(1)
Amortization of transitional (obligation)/asset . . . . .	—	—	(1)	(1)
Amortization of gain/(loss) . . . . .	<u>(9)</u>	<u>—</u>	<u>—</u>	<u>—</u>
Total amounts recognized in regulatory assets & liabilities . . . . .	<u>\$(32)</u>	<u>\$100</u>	<u>\$ 1</u>	<u>\$(1)</u>

*Components of Net Periodic Benefit Cost.* The following tables provide the components of net periodic benefit cost for pension and other postretirement benefit plans. The tables include the costs associated with both KU employees and E.ON U.S. Services' employees, who provide services to the utility. The E.ON U.S. Services' costs that are allocated to KU are approximately 49%, 46% and 45% of E.ON U.S. Services' total cost for 2009, 2008 and 2007, respectively.

	Pension Benefits								
	E.ON U.S. Services Allocation to KU			E.ON U.S. Services Allocation to KU			E.ON U.S. Services Allocation to KU		
	KU	Total KU	Total KU	KU	Total KU	Total KU	KU	Total KU	Total KU
	2009	2009	2009	2008	2008	2008	2007	2007	2007
	(In millions)								
Service cost . . . . .	\$ 6	\$ 5	\$ 11	\$ 6	\$ 4	\$ 10	\$ 6	\$ 4	\$ 10
Interest cost . . . . .	18	7	25	18	6	24	17	5	22
Expected return on plan assets . . . . .	(15)	(4)	(19)	(21)	(5)	(26)	(21)	(5)	(26)
Amortization of prior service costs . . . . .	1	1	2	1	1	2	1	1	2
Amortization of actuarial loss . . . . .	<u>9</u>	<u>2</u>	<u>11</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>2</u>	<u>1</u>	<u>3</u>
Benefit cost at end of year . . . . .	<u>\$ 19</u>	<u>\$ 11</u>	<u>\$ 30</u>	<u>\$ 4</u>	<u>\$ 6</u>	<u>\$ 10</u>	<u>\$ 5</u>	<u>\$ 6</u>	<u>\$ 11</u>

	Other Postretirement Benefits								
	E.ON U.S. Services Allocation to KU			E.ON U.S. Services Allocation to KU			E.ON U.S. Services Allocation to KU		
	KU	Total KU	Total KU	KU	Total KU	Total KU	KU	Total KU	Total KU
	2009	2009	2009	2008	2008	2008	2007	2007	2007
	(In millions)								
Service cost . . . . .	\$ 1	\$ 1	\$ 2	\$ 1	\$ 1	\$ 2	\$ 1	\$ 1	\$ 2
Interest cost . . . . .	5	—	5	5	—	5	5	—	5
Expected return on plan assets . . . . .	(1)	—	(1)	(1)	—	(1)	(1)	—	(1)
Amortization of transitional obligation . . . . .	<u>1</u>	<u>—</u>	<u>1</u>	<u>1</u>	<u>—</u>	<u>1</u>	<u>1</u>	<u>—</u>	<u>1</u>
Benefit cost at end of year . . . . .	<u>\$ 6</u>	<u>\$ 1</u>	<u>\$ 7</u>	<u>\$ 6</u>	<u>\$ 1</u>	<u>\$ 7</u>	<u>\$ 6</u>	<u>\$ 1</u>	<u>\$ 7</u>

The estimated amounts that will be amortized from regulatory assets and liabilities into net periodic benefit cost in 2010 are shown in the following table:

	Pension Benefits	Other Postretirement Benefits
	(In millions)	
Regulatory assets/liabilities:		
Net actuarial loss . . . . .	\$ 6	\$—
Prior service cost . . . . .	1	1
Transition obligation . . . . .	<u>—</u>	<u>1</u>
Total regulatory assets/liabilities amortized during 2010 . . . . .	<u>\$ 7</u>	<u>\$ 2</u>

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

	2009	2008
Weighted-average assumptions as of December 31:		
Discount rate . . . . .	6.13%	6.25%
Rate of compensation increase . . . . .	5.25%	5.25%

The discount rates were determined by the December 28, 2009, Mercer Pension Discount Yield Curve. These discount rates were then lowered by 8 basis points for the average change in 4 bond indices, Citigroup High Grade Credit Index AAA/AA 10+ years, Barclays Capital US Long Credit AA, Merrill Lynch US Corporate AA-AAA rated 10+ years and Merrill Lynch US Corporate AA rated 15+ years, for the period from December 28, 2009 to December 31, 2009.

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

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Discount rate . . . . .	6.25%	6.66%	5.96%
Expected long-term return on plan assets . . . . .	8.25%	8.25%	8.25%
Rate of compensation increase . . . . .	5.25%	5.25%	5.25%

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

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

- A 1% change in the assumed discount rate could have an approximate \$34 million positive or negative impact to the 2009 accumulated benefit obligation and an approximate \$45 million positive or negative impact to the 2009 projected benefit obligation.
- A 25 basis point change in the expected rate of return on assets would have resulted in less than a \$1 million positive or negative impact on 2009 pension expense.

*Assumed Health Care Cost Trend Rates.* For measurement purposes, an 8% annual increase in the per capita cost of covered health care benefits was assumed for 2009. The rate was assumed to decrease gradually to 4.5% by 2029 and remain at that level thereafter.

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A 1% change in assumed health care cost trend rates would have resulted in an increase or decrease of less than \$1 million on the 2009 total of service and interest costs components and an increase or decrease of \$4 million in year-end 2009 postretirement benefit obligations.

*Expected Future Benefit Payments and Medicare Subsidy Receipts.* The following list provides the amount of expected future benefit payments, which reflect expected future service and the estimated gross amount of Medicare subsidy receipts:

	<u>Pension Benefits</u>	<u>Other Postretirement Benefits</u>	<u>Medicare Subsidy Receipts</u>
	(In millions)		
2010 . . . . .	\$17	\$ 6	\$ 1
2011 . . . . .	17	6	—
2012 . . . . .	17	6	1
2013 . . . . .	17	6	—
2014 . . . . .	17	7	1
2015-19 . . . . .	97	37	3



*Plan Assets.* The following table shows the plans' weighted-average asset allocation by asset category at December 31:

<u>Pension Plans</u>	<u>Target Range</u>	<u>2009</u>	<u>2008</u>
Equity securities . . . . .	45% - 75%	59%	55%
Debt securities . . . . .	30% - 50%	40	43
Other . . . . .	0% - 10%	<u>1</u>	<u>2</u>
Totals . . . . .		<u>100%</u>	<u>100%</u>

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

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

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

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

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

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

KU has classified plan assets that are accounted for at fair value into the three levels of the fair value hierarchy, as defined by the fair value measurements and disclosures guidance of the FASB ASC. See Note 3 of the Notes to Financial Statements.

A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

A description of the valuation methodologies used to measure plan assets at fair value is provided below:

*Money Market Fund:* These investments are public investment vehicles valued using \$1 for the net asset value. The money market funds are classified within level 2 of the valuation hierarchy.

*Common/Collective Trusts:* Valued based on the beginning of year value of the plan's interests in the trust plus actual contributions and allocated investment income (loss) less actual distributions and allocated

administrative expenses. Quoted market prices are used to value investments in the trust, with the exception of the Group Annuity Contract (“GAC”). The fair value of certain other investments for which quoted market prices are not available are valued based on yields currently available on comparable securities of issuers with similar credit ratings. The common/collective trusts are classified within level 2 of the valuation hierarchy.

The preceding methods described may produce a fair value that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Company believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date. There were no changes in the plan’s valuation methodologies during 2009.

The following table sets forth, by level within the fair value hierarchy, the plan’s assets at fair value as of December 31, 2009:

	<u>Level 2</u> <u>(Millions)</u>
Money Market Fund . . . . .	\$ 2
Common/Collective Trusts . . . . .	<u>186</u>
Total investments at fair value . . . . .	<u>\$188</u>

There are no assets categorized as level 1 or level 3.

The GAC is an immediate participation guarantee contract. In accordance with the plan accounting guidance of the FASB ASC, the cost incurred to purchase the GAC prior to March 20, 1992, is permitted to be carried at contract value, since it is a contract with an insurance company and therefore is excluded from the table above. The cost incurred to fund the GAC after March 20, 1992, is carried at contract value in accordance with the plan accounting guidance of the FASB ASC, since it is a contract that incorporates mortality and morbidity risk. Contract value represents cost plus interest income less distributions for benefits and administrative expenses.

*Contributions.* KU made a discretionary contribution to the pension plan of \$13 million in April 2009 and \$13 million in January 2007. The Company also made contributions to other postretirement benefit plans of \$7 million, \$5 million and \$6 million in 2009, 2008 and 2007, respectively. The amount of future contributions to the pension plan will depend upon the actual return on plan assets and other factors, but the Company funds its pension obligations in a manner consistent with the Pension Protection Act of 2006. In January 2010, KU made a discretionary contribution to the pension plan of \$13 million and anticipates making voluntary contributions to fund Voluntary Employee Beneficiary Association trusts to match the annual postretirement expense and funding the 401(h) plan up to the maximum amount allowed by law.

*Pension Legislation.* The Pension Protection Act of 2006 was enacted in August 2006. New rules regarding funding of defined benefit plans are generally effective for plan years beginning in 2008. Among other matters, this comprehensive legislation contains provisions applicable to defined benefit plans which generally (i) mandate full funding of current liabilities within seven years; (ii) increase tax-deduction levels regarding contributions; (iii) revise certain actuarial assumptions, such as mortality tables and discount rates; and (iv) raise federal insurance premiums and other fees for under-funded and distressed plans. The legislation also contains a number of provisions relating to defined-contribution plans and qualified and non-qualified executive pension plans and other matters. The Company’s plan met the minimum funding requirements as defined by the Pension Protection Act of 2006 for years ended December 31, 2009 and 2008.

*Thrift Savings Plans.* KU has a thrift savings plan under section 401(k) of the Internal Revenue Code. Under the plan, eligible employees may defer and contribute to the plan a portion of current compensation in order to provide future retirement benefits. KU makes contributions to the plan by matching a portion of the employee contributions. The costs of this matching were \$3 million in 2009 and 2008, and \$2 million in 2007.

KU also makes contributions to retirement income accounts within the thrift savings plans for certain employees not covered by noncontributory defined benefit pension plans. These employees consist mainly of those hired after December 31, 2005. The Company makes these contributions based on years of service and the employees’ wage and

salary levels, and it makes them in addition to the matching contributions discussed above. The amounts contributed by the Company under this arrangement equaled less than \$1 million in 2009, 2008 and 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 KU, calculates its separate income tax for each period. The resulting separate-return tax cost or benefit is paid to or received from the parent company or its designee. The Company also files income tax returns in various state jurisdictions. While 2006 and later years are open under the federal statute of limitations, Revenue Agent Reports for 2006-2007 have been received from the IRS, effectively closing these years to additional audit adjustments. Adjustments to these tax years were previously recorded in the financial statements. Tax years 2007 and 2008 were examined under an IRS pilot program named “Compliance Assurance Process” (“CAP”). This program accelerates the IRS’s review to begin during the year applicable to the return and ends 90 days after the return is filed. KU had no adjustments for the 2007 federal return. Areas remaining under examination for 2008 include bonus depreciation and the Company’s application for a change in repair deductions. No net material adverse impact is expected from these remaining areas.

Additions and reductions of uncertain tax positions during 2009, 2008 and 2007 were less than \$1 million. Possible amounts of uncertain tax positions for KU that may decrease within the next 12 months total less than \$1 million and are based on the expiration of the audit periods as defined in the statutes. If recognized, the less than \$1 million of unrecognized tax benefits would reduce the effective income tax rate.

The amount KU recognized as interest expense and interest accrued related to unrecognized tax benefits was less than \$1 million as of December 31, 2009, 2008 and 2007. The interest expense and interest accrued is based on IRS and Kentucky Department of Revenue large corporate interest rates for underpayment of taxes. At the date of adoption, the Company accrued less than \$1 million in interest expense on uncertain tax positions. KU records the interest as interest expense and penalties as operating expenses in the income statement and accrued expenses in the balance sheets, on a pre-tax basis. No penalties were accrued by the Company through December 31, 2009.

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

	<u>2009</u>	<u>2008</u>	<u>2007</u>
	(In millions)		
Current — federal . . . . .	\$ (5)	\$ 46	\$ 28
— state . . . . .	1	10	13
Deferred — federal — net . . . . .	43	(10)	(5)
— state — net . . . . .	7	(3)	(1)
Investment tax credit — deferred . . . . .	21	25	43
Amortization of investment tax credit . . . . .	<u>—</u>	<u>—</u>	<u>(1)</u>
Total income tax expense . . . . .	<u>\$67</u>	<u>\$ 68</u>	<u>\$77</u>

Deferred federal and state income tax expense increased in 2009, compared to 2008, due primarily to temporary differences related to storm costs and depreciation. The temporary differences also resulted in an offsetting decrease to current federal and state taxes in 2009. Current federal income tax expense increased in 2008, compared to 2007, and investment tax credit — deferred decreased primarily due to claiming \$18 million less in investment tax credits in 2008. Current state income tax decreased due to coal credits claimed in 2008. Deferred federal income tax expense decreased in 2008 primarily due to adjusting prior year estimates to actual based on the filed tax return.

In June 2006, KU and LG&E filed a joint application with the U.S. Department of Energy (“DOE”) requesting certification to be eligible for investment tax credits applicable to the construction of TC2. In November 2006, the DOE and the IRS announced that KU and LG&E were selected to receive the tax credit. A final IRS certification required to obtain the investment tax credit was received in August 2007. In September 2007, KU received an Order from the Kentucky Commission approving the accounting of the investment tax credit. KU’s portion of the TC2 tax

credit will be approximately \$101 million over the construction period and will be amortized to income over the life of the related property beginning when the facility is placed in service. Based on eligible construction expenditures incurred, KU recorded investment tax credits of \$21 million, \$25 million and \$43 million in 2009, 2008 and 2007, respectively, decreasing current federal income taxes. The amount claimed through 2009 is all that KU is allowed to claim. KU has reached the maximum credit of \$101 million. In addition, a full depreciation basis adjustment is required for the amount of the credit. The income tax expense impact from amortizing these credits will begin when the facility is placed in service.

In March 2008, certain environmental and preservation groups filed suit in federal court in North Carolina against the DOE and IRS claiming the investment tax credit program was in violation of certain environmental laws and demanded relief, including suspension or termination of the program. During 2008 and 2009, the plaintiffs submitted amended complaints alleging additional claims for relief. In October 2009, the plaintiffs filed a motion for a preliminary injunction seeking temporary implementation of certain elements of the requested relief. The Company is not currently a party to this proceeding and is not able to predict the ultimate outcome of this matter.

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

	<u>2009</u>	<u>2008</u>
	(In millions)	
Deferred tax liabilities:		
Depreciation and other plant-related items . . . . .	\$303	\$284
Regulatory assets and other . . . . .	<u>69</u>	<u>40</u>
Total deferred tax liabilities . . . . .	<u>372</u>	<u>324</u>
Deferred tax assets:		
Income taxes due to customers . . . . .	4	6
Pensions and related benefits . . . . .	17	19
Liabilities and other . . . . .	<u>18</u>	<u>22</u>
Total deferred tax assets . . . . .	<u>39</u>	<u>47</u>
Net deferred income tax liability . . . . .	<u>\$333</u>	<u>\$277</u>
Balance sheet classification		
Current assets . . . . .	\$ (3)	\$ (2)
Non-current liabilities . . . . .	<u>336</u>	<u>279</u>
Net deferred income tax liability . . . . .	<u>\$333</u>	<u>\$277</u>

The Company expects to have adequate levels of taxable income to realize its recorded deferred tax assets.

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

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Statutory federal income tax rate . . . . .	35.0%	35.0%	35.0%
State income taxes, net of federal benefit . . . . .	2.7	2.6	3.4
Reduction of income tax reserve . . . . .	—	(0.2)	(0.4)
Qualified production activities deduction . . . . .	(0.3)	(1.1)	(1.2)
Dividends received deduction related to EEI investment . . . . .	(1.5)	(4.2)	(2.9)
Reversal of excess deferred taxes . . . . .	(0.9)	(0.6)	(0.8)
Other differences . . . . .	<u>(1.5)</u>	<u>(1.4)</u>	<u>(1.5)</u>
Effective income tax rate . . . . .	<u>33.5%</u>	<u>30.1%</u>	<u>31.6%</u>

The effective income tax rate increased from 2008 to 2009 primarily due to a \$15 million decrease in 2009 dividends received from Electric Energy Inc., reducing the dividends received deduction. The effective income tax rate decreased from 2007 to 2008 primarily due to increased dividends from its investment in EEI.

**Note 7 — Long-Term Debt**

As of December 31, 2009 and 2008, long-term debt and the current portion of long-term debt consist primarily of pollution control bonds and long-term loans from affiliated companies as summarized below.

	<u>Stated Interest Rates</u>	<u>Maturities</u>	<u>Principal Amounts</u> (In millions)
Outstanding at December 31, 2009:			
Noncurrent portion . . . . .	Variable — 7.035%	2011-2037	\$1,421
Current portion . . . . .	Variable — 4.240%	2010-2034	\$ 261
Outstanding at December 31, 2008:			
Noncurrent portion . . . . .	Variable — 7.035%	2010-2037	\$1,304
Current portion . . . . .	Variable	2023-2034	\$ 228

Long-term debt includes \$228 million of pollution control bonds that are classified as current portion because these bonds are subject to tender for purchase at the option of the holder and to mandatory tender for purchase upon the occurrence of certain events. These bonds include Carroll County 2002 Series A and B, 2004 Series A, 2006 Series B and 2008 Series A; Muhlenberg County 2002 Series A; and Mercer County 2000 Series A and 2002 Series A. Maturity dates for these bonds range from 2023 to 2034. The average annualized interest rate for these bonds during 2009, 2008 and 2007, was 0.61%, 1.75% and 3.72%, respectively.

Pollution control bonds are obligations issued in connection with tax-exempt pollution control revenue bonds issued by various governmental entities, principally counties in Kentucky. A loan agreement obligates the Company to make debt service payments to the county that equate to the debt service due from the county on the related pollution control revenue bonds. The loan agreement is an unsecured obligation of the Company. Proceeds from bond issuances for environmental equipment (primarily related to the installation of FGDs) were held in trust pending expenditure for qualifying assets. At December 31, 2009, KU had no bond proceeds in trust included in restricted cash on the balance sheet. At December 31, 2008, the Company had \$9 million of bond proceeds in trust included in restricted cash in the balance sheets.

Several of the pollution control bonds are insured by monoline bond insurers whose ratings have been reduced due to exposures relating to insurance of sub-prime mortgages. At December 31, 2009, the Company had an aggregate \$351 million of outstanding pollution control indebtedness, of which \$96 million is in the form of insured auction rate securities wherein interest rates are reset every 35 days via an auction process. Beginning in late 2007, the interest rates on these insured bonds began to increase due to investor concerns about the creditworthiness of the bond insurers. During 2008, interest rates increased, and the Company experienced “failed auctions” when there were insufficient bids for the bonds. When a failed auction occurs, the interest rate is set pursuant to a formula stipulated in the indenture. During 2009, 2008 and 2007, the average rate on the auction rate bonds was 0.44%, 4.50% and 3.96%, respectively. The instruments governing these auction rate bonds permit KU to convert the bonds to other interest rate modes, such as various short-term variable rates, long-term fixed rates or intermediate-term fixed rates that are reset infrequently. In June 2009, S&P downgraded the credit rating of Ambac from “A” to “BBB”. As a result, S&P downgraded the rating on certain bonds in June 2009. The S&P rating of these bonds is

now based on the rating of the Company rather than the rating of Ambac since the Company's rating is higher. The following table presents the bonds downgraded:

<u>Tax Exempt Bond Issues</u>	<u>Principal</u> (\$ in millions)	<u>Bond Rating</u>			
		<u>Moody's</u>		<u>S&amp;P</u>	
		<u>2009</u>	<u>2008</u>	<u>2009</u>	<u>2008</u>
Carroll County 2002 Series C . . . . .	\$96	A2	A2	BBB+	A
Carroll County 2007 Series A . . . . .	\$18	A2	A2	BBB+	A
Trimble County 2007 Series A . . . . .	\$ 9	A2	A2	BBB+	A

During 2008, KU converted several series of its pollution control bonds from the auction rate mode to a weekly interest rate mode, as permitted under the loan documents. In connection with these conversions, the Company purchased some of the bonds from the remarketing agent. The bonds that were repurchased from the remarketing agent in 2008 were either defeased or remarketed during 2008.

As of December 31, 2009, KU had no remaining repurchased bonds. During 2008, KU refinanced and remarketed \$63 million and refinanced \$17 million of pollution control bonds that had been previously repurchased by the Company.

All of KU's first mortgage bonds were released and terminated in February 2007. Under the provisions for certain of KU's variable-rate pollution control bonds, the bonds are subject to tender for purchase at the option of the holder and to mandatory tender for purchase upon the occurrence of certain events, causing the bonds to be classified as current portion of long-term debt in the balance sheets. The average annualized interest rate for these bonds during 2009, 2008 and 2007 was 0.61%, 1.75% and 3.72%, respectively.

There were no redemptions or maturities of long-term debt for 2009. Redemptions and maturities of long-term debt for 2008 and 2007 are summarized below:

<u>Year</u>	<u>Description</u>	<u>Principal Amount</u> (\$ in millions)	<u>Rate</u>	<u>Secured/Unsecured</u>	<u>Maturity</u>
2008	Pollution control bonds . . . . .	\$13	Variable	Secured	2035
2008	Pollution control bonds . . . . .	\$13	Variable	Secured	2035
2008	Pollution control bonds . . . . .	\$17	Variable	Secured	2036
2008	Pollution control bonds . . . . .	\$17	Variable	Secured	2036
2007	Pollution control bonds . . . . .	\$54	Variable	Secured	2024
2007	First mortgage bonds . . . . .	\$54	7.92%	Secured	2007

Issuances of long-term debt for 2009, 2008 and 2007 are summarized below:

<u>Year</u>	<u>Description</u>	<u>Principal Amount</u> (\$ in millions)	<u>Rate</u>	<u>Secured/ Unsecured</u>	<u>Maturity</u>
2009	Due to Fidelia	\$ 50	4.445%	Unsecured	2019
2009	Due to Fidelia .....	\$ 50	4.81%	Unsecured	2019
2009	Due to Fidelia .....	\$ 50	5.28%	Unsecured	2017
2008	Due to Fidelia .....	\$ 75	7.035%	Unsecured	2018
2008	Pollution control bonds .....	\$ 78	Variable	Unsecured	2032
2008	Due to Fidelia .....	\$ 50	6.16%	Unsecured	2018
2008	Due to Fidelia .....	\$ 50	5.645%	Unsecured	2018
2008	Due to Fidelia .....	\$ 75	5.85%	Unsecured	2023
2007	Pollution control bonds .....	\$ 54	Variable	Unsecured	2034
2007	Pollution control bonds .....	\$ 18	Variable	Unsecured	2026
2007	Pollution control bonds .....	\$ 9	Variable	Unsecured	2037
2007	Due to Fidelia .....	\$ 53	5.69%	Unsecured	2022
2007	Due to Fidelia .....	\$ 75	5.86%	Unsecured	2037
2007	Due to Fidelia .....	\$ 50	5.98%	Unsecured	2017
2007	Due to Fidelia .....	\$100	5.96%	Unsecured	2028
2007	Due to Fidelia .....	\$ 70	5.71%	Unsecured	2019
2007	Due to Fidelia .....	\$100	5.45%	Unsecured	2014

In February 2007, KU completed a series of financial transactions impacting its periodic reporting requirements. The \$54 million Pollution Control Series 10 bond was refinanced and replaced with a new unsecured tax-exempt bond of the same amount maturing in 2034. The \$53 million Series P bond was defeased and replaced with an intercompany loan totaling \$53 million from Fidelia. In conjunction with the defeasance, the Company terminated the related interest rate swap. Fidelia also agreed to eliminate the second lien on its two secured loans. Pursuant to the terms of the remaining tax-exempt bonds, the first mortgage bonds were cancelled and the underlying lien on substantially all of KU's assets was released following the completion of these steps. KU no longer has any secured debt and is no longer subject to periodic reporting under the Securities Exchange Act of 1934.

In October 2008, the Company issued Carroll County 2008 Series A tax exempt bonds in the amount of \$78 million. The new bonds mature on February 1, 2032, and bear interest at a variable rate. The new bonds refinance four existing bonds (Carroll County 2005 Series A and B — \$13 million each and the Carroll County 2006 Series A and C — \$17 million each), and include \$18 million of new funding. The proceeds were held in escrow pending incurrence of qualifying expenditures, but have now been used.

In December 2008, KU converted the interest rate mode of the Carroll County 2006 Series B to a weekly mode from an auction mode. The bonds along with the Carroll County 2004 Series A, the Mercer County 2000 Series A, and the Carroll County 2008 Series A, were issued with the enhancement of a letter of credit. The bonds have been reclassified as current portion of long-term debt because investors can put the bonds back to the Company on a weekly basis.

As of December 31, 2009, \$1,331 million of unsecured notes payable was outstanding to the Company's affiliate, Fidelia, with interest rates ranging from 4.24% to 7.04% and maturities ranging from 2010 to 2037.

Long-term debt maturities for KU are shown in the following table:

	(In millions)
2010 .....	\$ 33
2011 .....	—
2012 .....	50
2013 .....	175
2014 .....	100
Thereafter .....	<u>1,324(a)</u>
Total .....	<u>\$1,682</u>

(a) Includes long-term debt of \$228 million classified as current liabilities because these bonds are subject to tender for purchase at the option of the holder and to mandatory tender for purchase upon the occurrence of certain events. Maturity dates for these bonds range from 2023 to 2034.

#### Note 8 — Notes Payable and Other Short-Term Obligations

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

	<u>Total Money Pool Available</u>	<u>Amount Outstanding</u>	<u>Balance Available</u>	<u>Average Interest Rate</u>
	(\$ in millions)			
December 31, 2009 .....	\$400	\$45	\$355	0.20%
December 31, 2008 .....	\$400	\$16	\$384	1.49%

E.ON U.S. maintains revolving credit facilities totaling \$313 million at December 31, 2009 and 2008, to ensure funding availability for the money pool. At December 31, 2009 and 2008, one facility, totaling \$150 million, is with E.ON North America, Inc., while the remaining line, totaling \$163 million, is with Fidelity; both are affiliated companies. The balances are as follows:

	<u>Total Available</u>	<u>Amount Outstanding</u>	<u>Balance Available</u>	<u>Average Interest Rate</u>
	(\$ in millions)			
December 31, 2009 .....	\$313	\$276	\$37	1.25%
December 31, 2008 .....	\$313	\$299	\$14	2.05%

As of December 31, 2009, the Company maintained a bilateral line of credit, with an unaffiliated financial institution, totaling \$35 million which matures in June 2012. At December 31, 2009, there was no balance outstanding under this facility.

The covenants under this revolving line of credit include the following:

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

KU was in compliance with these covenants at December 31, 2009.

In October 2008, KU closed on a \$78 million bilateral line of credit which had a 364 day maturity. This facility was terminated in December 2008 and replaced by four new letter of credit facilities to allow issuance of letters of credit totaling \$198 million to support tax-exempt bonds totaling \$195 million of the \$228 million of bonds that can be put back to the Company. Should the holders elect to put the bonds back and they cannot be remarketed, the letter



of credit would fund the investor's payment. The expiration date for the letters of credit has been extended to December 2010. The reimbursement agreements are identical and contain the following covenants:

- E.ON must own 75% of voting stock of KU directly or indirectly
- A limitation on disposing of assets aggregating more than 20% of total assets as of most recent quarter-end.

At December 31, 2009, KU had no remaining capacity for letters of credit under these facilities and was in compliance with these covenants.

**Note 9 — Commitments and Contingencies**

*Operating Leases.* KU leases office space, office equipment, plant equipment, real estate, railcars, tele-communications and vehicles and accounts for these leases as operating leases. In addition, KU reimburses LG&E for a portion of the lease expense paid by LG&E for KU's usage of office space leased by LG&E. Total lease expense was \$10 million, \$9 million and \$6 million for 2009, 2008 and 2007, respectively. The future minimum annual lease payments for operating leases for years subsequent to December 31, 2009, are shown in the following table:

	(In millions)
2010 .....	\$ 7
2011 .....	6
2012 .....	5
2013 .....	4
2014 .....	4
Thereafter .....	<u>3</u>
Total .....	<u>\$29</u>

*Owensboro Contract Litigation.* In May 2004, the City of Owensboro, Kentucky and OMU commenced a suit which was removed to the U.S. District Court for the Western District of Kentucky, against KU concerning a long-term power supply contract (the "OMU Agreement") with KU. The dispute involved interpretational differences regarding issues under the OMU Agreement, including various payments or charges between KU and OMU and rights concerning excess power, termination and emissions allowances. In July 2005, the court issued a summary judgment ruling upholding OMU's contractual right to terminate the OMU agreement in May 2010.

In September and October 2008, the court granted rulings on a number of summary judgment petitions in the Company's favor. The summary judgment rulings resulted in the dismissal of all of OMU's remaining claims against the Company. The trial on KU's counterclaim occurred during October and November 2008. During February 2009, the court issued orders on the matters covered at trial, including (i) awarding the Company an aggregate \$9 million relating to the cost of NOx allowances charged by OMU to KU and the price of back-up power purchased by OMU from KU, plus pre- and post-judgment interest, and (ii) denying the Company's claim for damages based upon sub-par operations and availability of the OMU units. In April 2009, the court issued a ruling on various post-trial motions denying certain challenges to calculation elements of the \$9 million award or of interest amounts associated therewith. In May 2009, KU and OMU executed a settlement agreement resolving the matter on a basis consistent with the court's prior rulings and the Company has received the agreed settlement amounts.

*Sale and Leaseback Transaction.* The Company is a participant in a sale and leaseback transaction involving its 62% interest in two jointly owned CTs at KU's E.W. Brown generating station (Units 6 and 7). Commencing in December 1999, KU and LG&E entered into a tax-efficient, 18-year lease of the CTs. KU and LG&E have provided funds to fully defease the lease, and have executed an irrevocable notice to exercise an early purchase option contained in the lease after 15.5 years. The financial statement treatment of this transaction is no different than if KU had retained its ownership. The leasing transaction was entered into following receipt of required state and federal regulatory approvals.

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

At December 31, 2009, the maximum aggregate amount of default fees or amounts was \$8 million, of which KU would be responsible for 62% (approximately \$5 million). The Company has made arrangements with E.ON U.S., via guarantee and regulatory commitment, for E.ON U.S. to pay its full portion of any default fees or amounts.

*Letter of Credit.* KU has provided letters of credit totaling \$198 million supporting bonds of \$195 million and a letter of credit totaling less than \$1 million to support certain obligations related to workers' compensation.

*Power Purchases.* The Company has power purchase arrangements with OMU and OVEC. Under the OMU agreement, which will be terminated by OMU in May 2010, KU purchases all of the output of an approximately 400-Mw coal-fired generating station not required by OMU. The amount of power purchases available to the Company during 2010, which is expected to be approximately 5% of KU's total Kwh native load energy requirements, is dependent upon a number of factors including the OMU units' availability, maintenance schedules, fuel costs and OMU requirements. Payments are based on the total costs of the station allocated per terms of the OMU agreement. Included in the total costs is KU's proportionate share of debt service requirements on \$207 million of OMU bonds outstanding at December 31, 2009. The debt service is allocated to KU based on its annual allocated share of capacity, which averaged approximately 44% in 2009. KU does not guarantee the OMU bonds, or any requirements therein, in the event of default by OMU.

KU has a contract for power purchases with OVEC, terminating in 2026, for various Mw capacities. KU has an investment of 2.5% ownership in OVEC's common stock, which is accounted for on the cost method of accounting. The Company's share of OVEC's output is 2.5%, approximately 55 Mw of generation capacity. Future obligations for power purchases are shown in the following table:

	(In millions)
2010 .....	\$ 16
2011 .....	10
2012 .....	10
2013 .....	11
2014 .....	12
Thereafter .....	<u>177</u>
Total .....	<u>\$236</u>

*Coal and Gas Purchase Obligations.* KU has contracts to purchase coal and natural gas transportation. Future obligations are shown in the following table:

	(In millions)
2010 .....	\$ 391
2011 .....	307
2012 .....	145
2013 .....	88
2014 .....	92
Thereafter .....	<u>—(a)</u>
Total .....	<u>\$1,023</u>

(a) Obligations after 2014 are indexed to future market prices and are not included above since prices will be set in the future using the contracted methodology.

*Construction Program.* KU had \$62 million of commitments in connection with its construction program at December 31, 2009.

In June 2006, KU and LG&E entered into a construction contract regarding the TC2 project. The contract is generally in the form of a lump-sum, turnkey agreement for the design, engineering, procurement, construction, commissioning, testing and delivery of the project, according to designated specifications, terms and conditions. The contract price and its components are subject to a number of potential adjustments which may serve to increase or decrease the ultimate construction price paid or payable to the contractor. The contract also contains standard representations, covenants, indemnities, termination and other provisions for arrangements of this type, including termination for convenience or for cause rights. In March 2009, the parties completed an agreement resolving certain construction cost increases due to higher labor and per diem costs above an established baseline, and certain safety and compliance costs resulting from a change in law. The Company's share of additional costs from inception of the contract through the expected project completion in 2010 is estimated to be approximately \$30 million. During the past and to date in 2010, KU and LG&E have received a number of contractual notices from the TC2 construction contractor asserting force majeure/excusable event claims for adjustments to either or both of contract price or construction schedule with respect to certain events which, if granted, may affect such contractual terms in addition to a possible extension of the commercial operations date, liquidated damages or other relevant provisions. The parties are continuing to discuss such matters in good faith and to resolve them in a commercially reasonable manner. The Company cannot currently estimate the ultimate outcome of these matters, including the extent, if any, that it results in increased costs charged for construction of TC2 and/or relief relating to the construction completion or operations dates.

*TC2 Air Permit.* The Sierra Club and other environmental groups filed a petition challenging the air permit issued for the TC2 baseload generating unit which was issued by the Kentucky Division for Air Quality ("KDAQ") in November 2005. In September 2007, the Secretary of the Kentucky Environmental and Public Protection Cabinet issued a final Order upholding the permit. The environmental groups petitioned the EPA to object to the state permit and subsequent permit revisions. In determinations made in September 2008 and June 2009, the EPA rejected most of the environmental groups' claims, but identified three permit deficiencies which the KDAQ addressed by revising the permit. In August 2009, the EPA issued an order denying the remaining claims with the exception of two additional deficiencies which the KDAQ was directed to address. The EPA determined that the proposed permit subsequently issued by the KDAQ satisfied the conditions of the EPA Order, although the agency recommended certain enhancements to the administrative record. In January 2010, the KDAQ issued a final permit revision incorporating the proposed changes to address the two EPA objections. In March 2010, the Sierra Club submitted a petition to the EPA to object to the permit revision, which petition is now pending before the EPA. The Company believes that the final permit as revised should not have a material adverse effect on its financial condition or results of operations. However, until the right to challenge the final permit expires, the Company cannot predict the final outcome of this matter.

*Thermostat Replacement.* During January 2010, KU and LG&E announced a voluntary plan to replace certain thermostats which had been provided to customers as part of the Companies' demand reduction programs, due to concerns that the thermostats may present a safety hazard. Under the plan, the Companies anticipate replacing up to approximately 14,000 thermostats. Estimated costs associated with the replacement program may be \$2 million. However, the Companies cannot fully predict the ultimate outcome of the replacement program or other effects or developments which may be associated with the thermostat replacement matter at this time.

*Reserve Sharing Developments.* The membership of KU and LG&E in the Midwest Contingency Reserve Sharing Group terminated on December 31, 2009. In December 2009, the Companies entered into arrangements with Tennessee Valley Authority and East Kentucky Power Cooperative to form a new reserve sharing group, the TEE Contingency Reserve Sharing Group. Contingency reserves, including spinning reserves and supplemental reserves, relate to power or capacity requirements that the Companies must have available for certain reliability purposes. In general, the operational and financial impact of reserve sharing arrangements varies based upon factors such as the terms of the agreement, the relative generating and operations conduct of the parties and relevant market prices. While the Companies do not anticipate the revised reserve sharing developments will have a material adverse effect on their prospective operations or financial condition, such outcome cannot be guaranteed.

*Mine Safety Compliance Costs.* In March 2006, the Mine Safety and Health Administration enacted Emergency Temporary Standards regulations and has issued additional regulations as the result of the passage of the Mine Improvement and New Emergency Response Act of 2006, which was signed into law in June 2006. At the state level, Kentucky and other states that supply coal to KU, have passed new mine safety legislation. These pieces of legislation require all underground coal mines to implement new safety measures and install new safety equipment. Under the terms of the majority of the long-term coal contracts the Company has in place, provisions are made to allow for price adjustments for compliance costs resulting from new or amended laws or regulations. KU's coal suppliers regularly submit price adjustments related to these compliance costs. The Company employs an external consultant to review all relevant mine safety compliance cost claims for validity and reasonableness. Depending upon the terms of the contracts and commercial practice, the Company may delay payment of the adjustments or pay certain adjustments subject to refund. At appropriate times in the review, payment or refund processes, KU may make adjustments to the values or amounts or values of inventory, accounts receivable or accounts payable relating to coal matters. In general, the Company expects to recover these coal-related cost adjustments through the FAC.

*Environmental Matters.* The Company's operations are subject to a number of environmental laws and regulations in each of the jurisdictions in which it operates, governing, among other things, air emissions, wastewater discharges, the use, handling and disposal of hazardous substances and wastes, soil and groundwater contamination and employee health and safety.

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

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

In 1997, the EPA established new NAAQS for ozone and fine particulates that required additional reductions in SO<sub>2</sub> and NO<sub>x</sub> emissions from power plants. In 1998, the EPA issued its final "NO<sub>x</sub> SIP Call" rule requiring reductions in NO<sub>x</sub> emissions of approximately 85% from 1990 levels in order to mitigate ozone transport from the midwestern U.S. to the northeastern U.S. To implement the new federal requirements, Kentucky amended its SIP in 2002 to require electric generating units to reduce their NO<sub>x</sub> emissions to 0.15 pounds weight per MMBtu on a company-wide basis. In 2005, the EPA issued the CAIR which required additional SO<sub>2</sub> emission reductions of 70% and NO<sub>x</sub> emission reductions of 65% from 2003 levels. The CAIR provided for a two-phase cap and trade program, with initial reductions of NO<sub>x</sub> and SO<sub>2</sub> emissions due by 2009 and 2010, respectively, and final reductions due by 2015. In 2006, Kentucky proposed to amend its SIP to adopt state requirements similar to those under the federal CAIR. Depending on the level of action determined necessary to bring local nonattainment areas into compliance with the new ozone and fine particulate standards, KU's power plants are potentially subject to additional reductions in SO<sub>2</sub> and NO<sub>x</sub> emissions. In January 2010, EPA issued a proposed rule to reconsider the NAAQS for Ozone, previously revised in 2008. The proposal would institute more stringent standards. At present, the Company is unable to determine what, if any, additional requirements may be imposed to achieve compliance with the new ozone standard.

In July 2008, a federal appeals court issued a ruling finding deficiencies in the CAIR and vacating it. In December 2008, the Court amended its previous Order, directing the EPA to promulgate a new regulation, but leaving the CAIR in place in the interim. Depending upon the course of such matters, the CAIR could be superseded by new or revised NO<sub>x</sub> or SO<sub>2</sub> regulations with different or more stringent requirements and SIPs which incorporate

CAIR requirements could be subject to revision. KU is also reviewing aspects of its compliance plan relating to the CAIR, including scheduled or contracted pollution control construction programs. Finally, as discussed below, the remand of the CAIR results in some uncertainty with respect to certain other EPA or state programs and proceedings and the Companies' compliance plans relating thereto, due to the interconnection of the CAIR with such associated programs. At present, KU is not able to predict the outcomes of the legal and regulatory proceedings related to the CAIR and whether such outcomes could have a material effect on the Company's financial or operational conditions.

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

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

*Acid Rain Program.* The Clean Air Act, as amended, imposed a two-phased cap and trade program to reduce SO<sub>2</sub> emissions from power plants that were thought to contribute to "acid rain" conditions in the northeastern U.S. The Clean Air Act, as amended, also contains requirements for power plants to reduce NO<sub>x</sub> emissions through the use of available combustion controls.

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

*Installation of Pollution Controls.* Many of the programs under the Clean Air Act utilize cap and trade mechanisms that require a company to hold sufficient emissions allowances to cover its authorized emissions on a company-wide basis and do not require installation of pollution controls on every generating unit. Under cap and trade programs, companies are free to focus their pollution control efforts on plants where such controls are particularly efficient and utilize the resulting emission allowances for smaller plants where such controls are not cost effective. KU met its Phase I SO<sub>2</sub> requirements primarily through installation of FGD equipment on Ghent Unit 1. KU's strategy for its Phase II SO<sub>2</sub> requirements, which commenced in 2000, includes the installation of additional FGD equipment, as well as using accumulated emission allowances and fuel switching to defer certain additional capital expenditures. In order to achieve the NO<sub>x</sub> emission reductions and associated obligations, KU installed additional NO<sub>x</sub> controls, including SCR technology, during the 2000 through 2009 time period at a cost of \$221 million. In 2001, the Kentucky Commission granted approval to recover the costs incurred by KU for these projects through the environmental surcharge mechanism. Such monthly recovery is subject to periodic review by the Kentucky Commission.

In order to achieve mandated emissions reductions, KU expects to incur additional capital expenditures totaling approximately \$320 million during the 2010 through 2012 time period for pollution controls including FGD and SCR equipment, and additional operating and maintenance costs in operating such controls. In 2005, the Kentucky Commission granted approval to recover the costs incurred by the Company for these projects through the ECR mechanism. Such monthly recovery is subject to periodic review by the Kentucky Commission. KU believes its costs in reducing SO<sub>2</sub>, NO<sub>x</sub> and mercury emissions to be comparable to those of similarly situated utilities with like generation assets. KU's compliance plans are subject to many factors including developments in the emission allowance and fuels markets, future legislative and regulatory enactments, legal proceedings and advances in clean air technology. KU will continue to monitor these developments to ensure that its environmental obligations are met in the most efficient and cost-effective manner. See "Ambient Air Quality" above for a discussion of CAIR-related uncertainties.

*GHG Developments.* In 2005, the Kyoto Protocol for reducing GHG emissions took effect, obligating 37 industrialized countries to undertake substantial reductions in GHG emissions. The U.S. has not ratified the Kyoto Protocol and there are currently no mandatory GHG emission reduction requirements at the federal level. As discussed below, legislation mandating GHG reductions has been introduced in the Congress, but no federal legislation has been enacted to date. In the absence of a program at the federal level, various states have adopted their own GHG emission reduction programs. Such programs have been adopted in various states including 11 northeastern U.S. states and the District of Columbia under the Regional GHG Initiative program and California. Substantial efforts to pass federal GHG legislation are on-going. The current administration has announced its support for the adoption of mandatory GHG reduction requirements at the federal level. The United States and other countries met in Copenhagen, Denmark in December 2009, in an effort to negotiate a GHG reduction treaty to succeed the Kyoto Protocol, which is set to expire in 2013. At Copenhagen, the U.S. made a nonbinding commitment to, among other things, seek to reduce GHG emissions to 17% below 2005 levels by 2020 and provide financial support to developing countries. The United States and other nations are scheduled to meet in Cancun, Mexico in late 2010 to continue negotiations toward a binding agreement.

*GHG Legislation.* KU is monitoring on-going efforts to enact GHG reduction requirements and requirements governing carbon sequestration at the state and federal level and is assessing potential impacts of such programs and strategies to mitigate those impacts. In June 2009, the U.S. House of Representatives passed the American Clean Energy and Security Act of 2009, (H.R. 2454), which is a comprehensive energy bill containing the first-ever nation-wide GHG cap and trade program. If enacted into law, the bill would provide for reductions in GHG emissions of 3% below 2005 levels by 2012, 17% by 2020, and 83% by 2050. In order to cushion potential rate impacts for utility customers, approximately 43% of emissions allowances would initially be allocated at no cost to the electric utility sector, with this allocation gradually declining to 7% in 2029 and zero thereafter. The bill would also establish a renewable electricity standard requiring utilities to meet 20% of their electricity demand through renewable energy and energy efficiency by 2020. The bill contains additional provisions regarding carbon capture and sequestration, clean transportation, smart grid advancement, nuclear and advanced technologies and energy efficiency.

In September 2009, the Clean Energy Jobs and American Power Act (S. 1733), which is largely patterned on the House legislation, was introduced in the U.S. Senate. The Senate bill raises the emissions reduction target for 2020 to 20% below 2005 levels and does not include a renewable electricity standard. While the initial bill lacked detailed provisions for the allocation of emissions allowances, a subsequent revision has incorporated allowance allocation provisions similar to the House bill. The Company is closely monitoring the progress of the legislation, although the prospect for passage of comprehensive GHG legislation in 2010 is uncertain.

*GHG Regulations.* In April 2007, the U.S. Supreme Court ruled that the EPA has the authority to regulate GHG under the Clean Air Act. In April 2009, the EPA issued a proposed endangerment finding concluding that GHGs endanger public health and welfare, which is an initial rulemaking step under the Clean Air Act. A final endangerment finding was issued in December 2009. In September 2009, the EPA issued a final GHG reporting rule requiring reporting by facilities with annual GHG emissions equivalent to at least 25,000 tons of carbon dioxide. A number of the Company's facilities will be required to submit annual reports commencing with calendar year 2010. Also in September 2009, the EPA proposed to require new or modified sources with GHG emissions equivalent to at least 10,000 to 25,000 tons of carbon dioxide to obtain permits under the Prevention of Significant Deterioration

Program. Such new or modified facilities would be required to install Best Available Control Technology. While the Company is unaware of any currently available GHG control technology that might be required for installation on new or modified power plants, it is currently assessing the potential impact of the proposed rule. A final rule is expected in 2010.

The Company is unable to predict whether mandatory GHG reduction requirements will ultimately be enacted through legislation or regulations. As a company with significant coal-fired generating assets, KU could be substantially impacted by programs requiring mandatory reductions in GHG emissions, although the precise impact on its operations, including the reduction targets and deadlines that would be applicable, cannot be determined prior to the enactment of such programs. While the Company believes that many costs of complying with mandatory GHG reduction requirements or purchasing emission allowances to meet applicable requirements would likely be recoverable, in whole or in part under the ECR, where such costs are related to the Company's coal-fired generating assets, or other potential cost-recovery mechanisms, this cannot be assured.

*GHG Litigation.* A number of lawsuits have been filed asserting common law claims including nuisance, trespass and negligence against various companies with GHG emitting facilities. In October 2009, a three judge panel of the United States Court of Appeals for the 5th Circuit in the case of *Comer v. Murphy Oil* reversed a lower court, holding that private plaintiffs have standing to assert certain common law claims against more than 30 utility, oil, coal and chemical companies. However, in March 2010, the court vacated the opinion of the three-judge panel and granted a motion for rehearing. The *Comer* complaint alleges that GHG emissions from the defendants' facilities contributed to global warming which increased the intensity of Hurricane Katrina. E.ON, the parent of KU and LG&E was included as a defendant in the complaint, but has not been subject to the proceedings due to the failure of the plaintiffs to pursue service under the applicable international procedures. KU and LG&E are currently unable to predict further developments in the *Comer* case. KU and LG&E continue to monitor relevant GHG litigation to identify judicial developments that may be potentially relevant to their operations.

*Brown New Source Review Litigation.* In April 2006, the EPA issued an NOV alleging that KU had violated certain provisions of the Clean Air Act's new source review rules relating to work performed in 1997, on a boiler and turbine at KU's E.W. Brown generating station. In December 2006, the EPA issued a second NOV alleging the Company had exceeded heat input values in violation of the air permit for the unit. In March 2007, the Department of Justice filed a complaint in federal court in Kentucky alleging the same violations specified in the prior NOV's. The complaint sought civil penalties, including potential per-day fines, remedial measures and injunctive relief. In December 2008, the Company reached a tentative settlement with the government resolving all outstanding claims. The proposed consent decree, which was approved by the court in March 2009, provides for payment of a \$1 million civil penalty; funding of \$3 million in environmental mitigation projects; surrender of 53,000 excess SO<sub>2</sub> allowances; surrender of excess NO<sub>x</sub> allowances estimated at 650 allowances annually for eight years; installation of an FGD by December 31, 2010; installation of an SCR by December 31, 2012; and compliance with specified emission limits and operational restrictions.

*Section 114 Requests.* In August 2007, the EPA issued administrative information requests under Section 114 of the Clean Air Act requesting new source review-related data regarding certain projects undertaken at LG&E's Mill Creek 4 and TC1 generating units and KU's Ghent 2 generating unit. KU and LG&E have complied with the information requests and are not able to predict further proceedings in this matter at this time.

*Ghent Opacity NOV.* In September 2007, the EPA issued an NOV alleging that KU had violated certain provisions of the Clean Air Act's operating rules relating to opacity during June and July of 2007 at Units 1 and 3 of KU's Ghent generating station. The parties have met on this matter and KU has received no further communications from the EPA. The Company is not able to estimate the outcome or potential effects of these matters, including whether substantial fines, penalties or remedial measures may result.

*Ghent New Source Review NOV.* In March 2009, the EPA issued an NOV alleging that KU violated certain provisions of the Clean Air Act's rules governing new source review and prevention of significant deterioration by installing FGD and SCR controls at its Ghent generating station without assessing potential increased sulfuric acid mist emissions. KU contends that the work in question, as pollution control projects, was exempt from the requirements cited by the EPA. In December 2009, the EPA issued a Section 114 information request seeking additional information on this matter. The Company is currently unable to determine the final outcome of this

matter or the impact of an unfavorable determination upon the Company's financial position or results of operations.

*Ash Ponds, Coal-Combustion Byproducts and Water Discharges.* The EPA has undertaken various initiatives in response to the December 2008 impoundment failure at the Tennessee Valley Authority's Kingston power plant, which resulted in a major release of coal combustion byproducts into the environment. The EPA issued information requests to utilities throughout the country, including KU, to obtain information on their ash ponds and other impoundments. In addition, the EPA inspected a large number of impoundments located at power plants to determine their structural integrity. The inspections included several of the Company's impoundments, which the EPA found to be in satisfactory condition. The Company is awaiting final inspection reports for additional impoundments. The EPA and other agencies are currently considering the need to revise applicable standards governing the structural integrity of ash ponds and other impoundments. In addition, the EPA has announced that it is re-evaluating current regulatory requirements applicable to coal combustion byproducts and anticipates proposing new rules by early 2010. The EPA is considering a wide range of regulatory options including subjecting ash ponds and landfills handling coal combustion byproducts to regulation under the hazardous waste program. Finally, the EPA has announced plans to develop revised effluent limitations guidelines and standards governing discharges from power plants. The Company is monitoring these ongoing regulatory developments, but will be unable to determine the impact until such time as new rules are finalized.

*General Environmental Proceedings.* From time to time, KU appears before the EPA, various state or local regulatory agencies and state and federal courts regarding matters involving compliance with applicable environmental laws and regulations. Such matters include a completed settlement with state regulators regarding particulate limits in the air permit for KU's Tyrone generating station, remediation activities for, or other risks relating to elevated Polychlorinated Biphenyl ("PCB") levels at existing properties, and liability under the Comprehensive Environmental Response, Compensation and Liability Act for cleanup at various off-site waste sites. Based on analysis to date, the resolution of these matters is not expected to have a material impact on the Company's operations.

**Note 10 --- Jointly Owned Electric Utility Plant**

KU and LG&E are nearing completion of TC2, a jointly owned unit at the Trimble County site. KU and LG&E own undivided 60.75% and 14.25% interests, respectively, in TC2. Of the remaining 25% of TC2, IMEA owns a 12.12% undivided interest and IMPA owns a 12.88% undivided interest. Each company is responsible for its proportionate share of capital cost during construction, and fuel, operation and maintenance cost when TC2 begins operation, which is scheduled to occur in 2010. In December 2009 and June 2008, LG&E sold assets to KU related to the construction of TC2 with a net book value of \$48 million and \$10 million, respectively.

The following data represent shares of the jointly owned property (capacity based on nameplate rating):

	TC2				Total
	LG&E	KU	IMPA	IMEA	
Ownership interest . . . . .	14.25%	60.75%	12.88%	12.12%	100%
Mw capacity . . . . .	119	509	108	102	838



(In millions)

KU's 60.75% ownership:	
Plant held for future use . . . . .	\$121
Construction work in progress . . . . .	679
Accumulated depreciation . . . . .	<u>63</u>
Net book value . . . . .	<u>\$737</u>
LG&E's 14.25% ownership:	
Plant held for future use . . . . .	\$ 5
Construction work in progress . . . . .	169
Accumulated depreciation . . . . .	<u>2</u>
Net book value . . . . .	<u>\$172</u>

KU and LG&E jointly own the following CTs and related equipment (capacity based on net summer capability):

Ownership Percentage	KU				LG&E				Total			
	Mw Capacity	(\$) Cost	(\$) Depre- ciation	(\$) Net Book Value	Mw Capacity	(\$) Cost	(\$) Depre- ciation	(\$) Net Book Value	Mw Capacity	(\$) Cost	(\$) Depre- ciation	(\$) Net Book Value
	(\$ in millions)											
KU 47%, LG&E 53%(a) . . . . .	129	54	(13)	41	146	59	(15)	44	275	113	(28)	85
KU 62%, LG&E 38%(b) . . . . .	190	79	(15)	64	118	46	(7)	39	308	125	(22)	103
KU 71%, LG&E 29%(c) . . . . .	228	82	(21)	61	92	33	(8)	25	320	115	(29)	86
KU 63%, LG&E 37%(d) . . . . .	404	140	(25)	115	236	82	(16)	66	640	222	(41)	181
KU 71%, LG&E 29%(e) . . . . .	n/a	9	(2)	7	n/a	3	(1)	2	n/a	12	(3)	9

- (a) Comprised of Paddy's Run 13 and E.W. Brown 5. In addition to the above jointly owned utility plant, there is an inlet air cooling system attributable to unit 5 and units 8-11 at the E.W. Brown facility. This inlet air cooling system is not jointly owned, however, it is used to increase production on the units to which it relates, resulting in an additional 88 Mw of capacity for KU.
- (b) Comprised of units 6 and 7 at the E.W. Brown facility.
- (c) Comprised of units 5 and 6 at the Trimble County facility.
- (d) Comprised of CT Substation 7-10 and units 7, 8, 9 and 10 at the Trimble County facility.
- (e) Comprised of CT Substation 5 and 6 and CT Pipeline at the Trimble County facility.

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

#### Note 11 — Related Party Transactions

KU, subsidiaries of E.ON U.S. and subsidiaries of E.ON engage in related party transactions. These transactions are generally performed at cost and are in accordance with the FERC regulations under PUHCA 2005 and the applicable Kentucky Commission and Virginia Commission regulations. The significant related party transactions are disclosed below.

#### Electric Purchases

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

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

	<u>2009</u>	<u>2008</u>	<u>2007</u>
	(In millions)		
Electric operating revenues from LG&E . . . . .	\$ 21	\$ 80	\$46
Power purchased from LG&E . . . . .	101	109	93

### Interest Charges

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

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

	<u>2009</u>	<u>2008</u>	<u>2007</u>
	(In millions)		
Interest on money pool loans . . . . .	\$—	\$ 2	\$ 6
Interest on Fidelia loans . . . . .	69	56	35

### Other Intercompany Billings

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

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

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

	<u>2009</u>	<u>2008</u>	<u>2007</u>
	(In millions)		
E.ON U.S. Services billings to KU . . . . .	\$169	\$227	\$488
LG&E billings to KU . . . . .	44	5	12
KU billings to E.ON U.S. Services . . . . .	14	3	26
KU billings to LG&E . . . . .	78	75	6

In December 2009 and June 2008, LG&E sold assets to KU related to the construction of TC2, including \$3 million of unamortized investment tax credits, with net book values of \$48 million and \$10 million, respectively.

In March and June 2009, the Company received capital contributions of \$50 million and \$25 million, respectively, from its common shareholder, E.ON U.S.

In 2008 and 2007, KU received capital contributions from its common shareholder, E.ON U.S., totaling \$145 million and \$75 million, respectively.

**Note 12 — Subsequent Events**

Subsequent events have been evaluated through March 19, 2010, the date of issuance of these statements and these statements contain all necessary adjustments and disclosures resulting from that evaluation.

On March 4, 2010, the Virginia Commission approved the stipulation related to the rate increase filing with rates to become effective in April 2010.

On January 29, 2010, KU filed an application with the Kentucky Commission requesting an increase in base electric rates of approximately 12%, or \$135 million annually, including an 11.5% return on equity. KU has requested the increase, based on the twelve month test year ended October 31, 2009, to become effective on and after March 1, 2010. The requested rates have been suspended until August 1, 2010, at which time they may be put into effect, subject to refund, if the Kentucky Commission has not issued an order in the proceeding.

On January 13, 2010, the Company made a \$13 million contribution to its pension plan.

## Report of Independent Auditors

To the Shareholder of Kentucky Utilities Company:

In our opinion, the accompanying balance sheets and the related statements of capitalization, income, retained earnings, and cash flows present fairly, in all material respects, the financial position of Kentucky Utilities Company at December 31, 2009 and 2008, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2009 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2009, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assertion of the effectiveness of internal control over financial reporting, included in "Controls and Procedures" appearing on page 23 of the 2009 Kentucky Utilities Company financial statements and additional information. Our responsibility is to express opinions on these financial statements and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits of the financial statements in accordance with auditing standards generally accepted in the United States of America and our audit of internal control over financial reporting in accordance with attestation standards established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

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

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

*PricewaterhouseCoopers LLP*

Louisville, Kentucky  
March 19, 2010

**Kentucky Utilities Company**  
**Condensed Financial Statements**  
**(Unaudited)**

**As of September 30, 2010 and December 31, 2009**  
**and for the three and nine months ended**  
**September 30, 2010 and 2009**

## 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
CATR . . . . .	Clean Air Transport Rule
CCN . . . . .	Certificate of Public Convenience and Necessity
Clean Air Act . . . . .	The Clean Air Act, as amended in 1990
CMRG . . . . .	Carbon Management Research Group
Companies . . . . .	KU and LG&E
Company . . . . .	KU
DSM . . . . .	Demand Side Management
ECR . . . . .	Environmental Cost Recovery
EEI . . . . .	Edison Electric Institute
EKPC . . . . .	East Kentucky Power Cooperative, Inc.
E.ON . . . . .	E.ON AG
E.ON U.S. . . . .	E.ON U.S. LLC
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
FGD . . . . .	Flue Gas Desulfurization
Fidelia . . . . .	Fidelia Corporation (an E.ON affiliate)
GHG . . . . .	Greenhouse Gas
IRS . . . . .	Internal Revenue Service
KCCS . . . . .	Kentucky Consortium for Carbon Storage
KDAQ . . . . .	Kentucky Division for Air Quality
Kentucky Commission . . . . .	Kentucky Public Service Commission
KU . . . . .	Kentucky Utilities Company
LG&E . . . . .	Louisville Gas and Electric Company
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
NOV . . . . .	Notice of Violation
NOx . . . . .	Nitrogen Oxide
OMU . . . . .	Owensboro Municipal Utilities
OVEC . . . . .	Ohio Valley Electric Corporation
PPL . . . . .	PPL Corporation
S&P . . . . .	Standard & Poor's Ratings Services
SCR . . . . .	Selective Catalytic Reduction
SERC . . . . .	SERC Reliability Corporation
Servco . . . . .	LG&E and KU Services Company (formerly E.ON U.S. Services Inc.)
SIP . . . . .	State Implementation Plan
SO <sub>2</sub> . . . . .	Sulfur Dioxide
TC2 . . . . .	Trimble County Unit 2
Virginia Commission . . . . .	Virginia State Corporation Commission

**Kentucky Utilities Company**  
**Condensed Financial Statements**  
**(Unaudited)**

**As of September 30, 2010 and December 31, 2009**  
**and for the three and nine months ended**  
**September 30, 2010 and 2009**

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**Kentucky Utilities Company**  
**Condensed Statements of Income**

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
		(Unaudited)		
		(Millions of \$)		
Operating revenues (Note 10) . . . . .	\$416	\$341	\$1,146	\$1,009
Operating expenses:				
Fuel for electric generation . . . . .	146	114	391	329
Power purchased (Note 10) . . . . .	41	47	135	154
Other operation and maintenance expenses . . . . .	86	22	251	230
Depreciation, accretion and amortization . . . . .	38	33	106	99
Total operating expenses . . . . .	<u>311</u>	<u>216</u>	<u>883</u>	<u>812</u>
Operating income . . . . .	105	125	263	197
Interest expense (Note 8) . . . . .	2	2	5	5
Interest expense to affiliated companies (Notes 8 and 10) . . . . .	18	18	55	51
Other income (expense) — net . . . . .	<u>1</u>	<u>—</u>	<u>2</u>	<u>7</u>
Income before income taxes . . . . .	86	105	205	148
Income tax expense (Note 7) . . . . .	<u>32</u>	<u>39</u>	<u>76</u>	<u>49</u>
Net income . . . . .	<u>\$ 54</u>	<u>\$ 66</u>	<u>\$ 129</u>	<u>\$ 99</u>

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

**Kentucky Utilities Company**  
**Condensed Statements of Comprehensive Income**

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(Unaudited) (Millions of \$)			
Net income . . . . .	\$54	\$66	\$129	\$99
Comprehensive income (loss) attributable to unconsolidated venture — net of tax benefit of \$1, \$0, \$1 and \$0, respectively . . . . .	(2)	—	(2)	—
Comprehensive income . . . . .	<u>\$52</u>	<u>\$66</u>	<u>\$127</u>	<u>\$99</u>

**Condensed Statements of Retained Earnings**

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(Unaudited) (Millions of \$)			
Balance at beginning of period . . . . .	\$1,403	\$1,228	\$1,328	\$1,195
Net income . . . . .	54	66	129	99
	1,457	1,294	1,457	1,294
Cash dividends declared (Note 10) . . . . .	(50)	—	(50)	—
Balance at end of period . . . . .	<u>\$1,407</u>	<u>\$1,294</u>	<u>\$1,407</u>	<u>\$1,294</u>

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

**Kentucky Utilities Company**  
**Condensed Balance Sheets**

	September 30, 2010	December 31, 2009
	(Unaudited) (Millions of \$)	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents . . . . .	\$ 2	\$ 2
Accounts receivable — net:		
Customer — less reserves of \$2 in 2010 and \$1 in 2009 . . . . .	172	155
Affiliated companies . . . . .	—	9
Other — less reserves of \$2 in 2010 and 2009 . . . . .	28	18
Materials and supplies:		
Fuel (predominantly coal) . . . . .	98	98
Other materials and supplies . . . . .	42	39
Regulatory assets (Note 2) . . . . .	14	32
Prepayments and other current assets . . . . .	11	13
Total current assets . . . . .	367	366
Investment in unconsolidated venture . . . . .	12	12
Property, plant and equipment:		
Regulated utility plant — electric . . . . .	5,426	4,892
Accumulated depreciation . . . . .	(1,902)	(1,838)
Net regulated utility plant . . . . .	3,524	3,054
Construction work in progress . . . . .	946	1,257
Property, plant and equipment — net . . . . .	4,470	4,311
Deferred debits and other assets:		
Regulatory assets (Note 2):		
Pension benefits . . . . .	105	105
Other regulatory assets . . . . .	110	117
Cash surrender value of key man life insurance . . . . .	39	38
Other assets . . . . .	7	7
Total deferred debits and other assets . . . . .	261	267
Total assets . . . . .	\$ 5,110	\$ 4,956

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

**Kentucky Utilities Company**  
**Condensed Balance Sheets (continued)**

	September 30, 2010	December 31, 2009
	(Unaudited)	
	(Millions of \$)	
<b>LIABILITIES AND EQUITY</b>		
Current liabilities:		
Current portion of long-term debt (Notes 5 and 8) . . . . .	\$ 228	\$ 228
Current portion of long-term debt to affiliated company (Note 5) . . . . .	33	33
Notes payable to affiliated companies (Notes 8 and 10) . . . . .	61	45
Accounts payable . . . . .	105	107
Accounts payable to affiliated companies (Note 10) . . . . .	71	88
Customer deposits . . . . .	23	22
Regulatory liabilities (Note 2) . . . . .	12	4
Other current liabilities . . . . .	39	42
Total current liabilities . . . . .	<u>572</u>	<u>569</u>
Long-term debt:		
Long-term debt (Notes 5 and 8) . . . . .	123	123
Long-term debt to affiliated company (Notes 5, 8 and 10) . . . . .	1,298	1,298
Total long-term debt . . . . .	<u>1,421</u>	<u>1,421</u>
Deferred credits and other liabilities:		
Deferred income taxes . . . . .	378	336
Accumulated provision for pensions and related benefits (Note 6) . . . . .	160	160
Investment tax credits (Note 7) . . . . .	104	104
Asset retirement obligations (Note 3) . . . . .	59	34
Regulatory liabilities (Note 2):		
Accumulated cost of removal of utility plant . . . . .	343	331
Other regulatory liabilities . . . . .	24	29
Other liabilities . . . . .	20	20
Total deferred credits and other liabilities . . . . .	<u>1,088</u>	<u>1,014</u>
Common equity:		
Common stock, without par value —		
Authorized 80,000,000 shares, outstanding 37,817,878 shares . . . . .	308	308
Additional paid-in capital . . . . .	316	316
Accumulated other comprehensive loss . . . . .	(2)	—
Retained earnings:		
Retained earnings . . . . .	1,397	1,318
Undistributed earnings from unconsolidated venture . . . . .	10	10
Total common equity . . . . .	<u>2,029</u>	<u>1,952</u>
Total liabilities and equity . . . . .	<u>\$5,110</u>	<u>\$4,956</u>

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

**Kentucky Utilities Company**  
**Condensed Statements of Cash Flows**

	For the Nine Months Ended September 30,	
	2010	2009
	(Unaudited) (Millions of \$)	
Cash flows from operating activities:		
Net income . . . . .	\$ 129	\$ 99
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, accretion and amortization . . . . .	106	99
Deferred income taxes — net . . . . .	42	48
Investment tax credits (Note 7) . . . . .	—	17
Provision for pension and postretirement benefits . . . . .	11	13
Undistributed earnings of unconsolidated venture . . . . .	(4)	10
Other . . . . .	1	3
Changes in current assets and liabilities:		
Accounts receivable . . . . .	(6)	30
Materials and supplies . . . . .	(3)	(21)
Regulatory assets and liabilities . . . . .	26	(1)
Accounts payable . . . . .	(20)	(4)
Accounts payable to affiliated companies . . . . .	31	(8)
Other current assets and liabilities . . . . .	—	(10)
Pension and postretirement funding (Note 6) . . . . .	(17)	(17)
Other regulatory assets and liabilities . . . . .	(3)	(64)
Other — net . . . . .	<u>7</u>	<u>(4)</u>
Net cash provided by operating activities . . . . .	<u>300</u>	<u>190</u>
Cash flows from investing activities:		
Construction expenditures . . . . .	(218)	(378)
Purchases of assets from affiliate . . . . .	(48)	—
Change in restricted cash . . . . .	<u>—</u>	<u>9</u>
Net cash used in investing activities . . . . .	<u>(266)</u>	<u>(369)</u>
Cash flows from financing activities:		
Borrowings from affiliated company (Note 8) . . . . .	104	106
Repayments on borrowings from affiliated company (Note 8) . . . . .	(88)	—
Payment of dividends (Note 10) . . . . .	(50)	—
Capital contribution (Note 10) . . . . .	<u>—</u>	<u>75</u>
Net cash (used in) provided by financing activities . . . . .	<u>(34)</u>	<u>181</u>
Change in cash and cash equivalents . . . . .	—	2
Cash and cash equivalents at beginning of period . . . . .	<u>2</u>	<u>2</u>
Cash and cash equivalents at end of period . . . . .	<u>\$ 2</u>	<u>\$ 4</u>

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

**Kentucky Utilities Company**  
Notes to Condensed Financial Statements  
(Unaudited)

**Note 1 — General**

KU'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 condensed financial statements include all adjustments, consisting only of normal recurring adjustments, necessary for fair statements of income, comprehensive income, and retained earnings, balance sheets, and statements of 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 condensed 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, 2009, including the audited financial statements and notes therein.

The December 31, 2009, condensed balance sheet included herein is derived from the December 31, 2009, audited balance sheet. Amounts reported in the condensed statements of income are not necessarily indicative of amounts expected for the respective annual periods due to the effects of seasonal temperature variations on energy consumption, regulatory rulings, the timing of maintenance on electric generating units, changes in mark-to-market valuations, changing commodity prices and other factors.

Certain reclassification entries have been made to the previous year's financial statements to conform to the 2010 presentation with no impact on total assets, liabilities and capitalization or previously reported net income and net cash flows.

**PPL Acquisition**

On April 28, 2010, E.ON U.S. announced that a Purchase and Sale Agreement (the "Agreement") had been entered into among E.ON US Investments, PPL and E.ON.

The Agreement provides for the sale of E.ON U.S. to PPL. Pursuant to the Agreement, at closing, PPL will acquire all of the outstanding limited liability company interests of E.ON U.S. for cash consideration of \$2.6 billion. In addition, pursuant to the Agreement, PPL agreed to assume \$764 million of pollution control bonds and medium term notes and to repay indebtedness owed by E.ON U.S. and its subsidiaries to E.ON US Investments and its affiliates. Such affiliate indebtedness is currently estimated to be \$4.2 billion. The aggregate consideration payable by PPL on closing is currently estimated to be \$7.6 billion (including the assumed indebtedness), subject to contractually agreed adjustments.

The transaction is subject to customary closing conditions, including the expiration or termination of the applicable waiting period under the Hart-Scott-Rodino Act, receipt of required regulatory approvals (including state regulators in Kentucky, Virginia and Tennessee, and the FERC) and the absence of injunctions or restraints imposed by governmental entities. As of October 26, 2010, all of the required regulatory approvals were received, and the transaction is expected to close on November 1, 2010.

Change of control and financing-related applications were filed on May 28, 2010, with the Kentucky Commission and on June 15, 2010, with the Virginia Commission and the Tennessee Regulatory Authority. An application with the FERC was filed on June 28, 2010. During the second quarter of 2010, a number of parties were granted intervenor status in the Kentucky Commission proceedings, and data request filings and responses occurred. Early termination of the Hart-Scott-Rodino waiting period was received on August 2, 2010.

A hearing in the Kentucky Commission proceedings was held on September 8, 2010, at which time a unanimous settlement agreement was presented. In the settlement, KU and LG&E commit that no base rate increases would take effect before January 1, 2013. The KU and LG&E rate increases that took effect on August 1, 2010, were not impacted by the settlement. Under the terms of the settlement, the Companies retain the right to seek approval for the deferral of "extraordinary and uncontrollable costs." Interim rate adjustments will continue to be permissible during that period for existing fuel, environmental and demand-side management cost trackers. The

agreement also substitutes an acquisition savings shared deferral mechanism for the requirement that the Companies file a synergies plan with the Kentucky Commission. This mechanism, which will be in place until the earlier of five years or the first day of the year in which a base rate increase becomes effective, permits the Companies to earn up to a 10.75 percent return on equity. Any earnings above a 10.75 percent return on equity will be shared with customers on a 50%/50% basis. On September 30, 2010, the Kentucky Commission issued an Order approving the transfer of ownership of KU and LG&E via the acquisition of E.ON U.S. by PPL, incorporating the terms of the submitted settlement. On October 19, 2010 and October 21, 2010, respectively, Orders approving the acquisition of E.ON U.S. by PPL were received from the Virginia Commission and the Tennessee Regulatory Authority. The Commissions' Orders contained a number of other commitments with regard to operations, workforce, community involvement and other matters.

In mid-September 2010, KU and LG&E and other applicants in the FERC change of control proceeding reached an agreement with the protesters, whereby such protests have been withdrawn. The agreement, which has subsequently been filed for consideration with the FERC, includes various conditional commitments, such as a continuation of certain existing undertakings with protesters in prior cases, an agreement not to terminate certain KU municipal customer contracts prior to January 2017, an exclusion of any transaction-related costs from wholesale energy and tariff customer rates to the extent that the Company has agreed to not seek the same transaction-related cost from retail customers and agreements to coordinate with protesters in certain open or ongoing matters. A FERC Order approving the transaction was received on October 26, 2010.

On September 30, 2010, October 19, 2010 and October 21, 2010, respectively, KU received Kentucky Commission, Virginia Commission and Tennessee Regulatory Authority approvals to complete certain refinancing transactions in connection with the anticipated PPL acquisition and other business factors. Based on credit and financial market conditions, KU anticipates issuing up to \$1.5 billion in first mortgage bonds, the proceeds of which will substantially be used to refund existing long-term intercompany debt. On October 29, 2010, as required by existing covenants, in connection with the anticipated issuance of any such secured debt, KU completed collateralization of certain outstanding pollution control bond debt series which were formerly unsecured. Pursuant to such collateralization, approximately \$351 million in existing pollution control debt became collateralized debt, supported by a first mortgage lien. KU also anticipates replacing its \$35 million bilateral line of credit with an unaffiliated institution by entering into a multi-year revolving credit facility with several financial institutions in an aggregate amount not to exceed \$400 million. KU may complete these transactions, in whole or in part, during late 2010 and early 2011. See Note 8, Short-Term and Long-Term Debt, for further information regarding the refinancing, remarketing or conversion of existing pollution control debt.

## **Recent Accounting Pronouncements**

### ***Fair Value Measurements***

In January 2010, the FASB issued guidance related to fair value measurement disclosures requiring separate disclosure of amounts of significant transfers in and out of level 1 and level 2 fair value measurements and separate information about purchases, sales, issuances, and settlements within level 3 measurements. This guidance is effective for the interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about the roll-forward of activity in level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. This guidance has no impact on the Company's results of operations, financial position, liquidity or disclosures.

## **Note 2 — Rates and Regulatory Matters**

KU's Kentucky base rates are calculated based on a return on capitalization (common equity, long-term debt and notes payable) including certain regulatory adjustments to exclude non-regulated investments and environmental compliance plans recovered separately through the ECR mechanism. Currently, none of the regulatory assets or regulatory liabilities are excluded from the return on capitalization utilized in the calculation of Kentucky base rates; therefore, a return is earned on all Kentucky regulatory assets.

KU's Virginia base rates are calculated based on a return on rate base (net utility plant less deferred taxes and miscellaneous deductions). All regulatory assets and liabilities are excluded from the return on rate base utilized in the calculation of Virginia base rates.

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, Rates and Regulatory Matters, of KU's Annual Report for the year ended December 31, 2009.

### **2010 Kentucky Rate Case**

In January 2010, KU filed an application with the Kentucky Commission requesting an increase in electric base rates of approximately 12%, or \$135 million annually, including an 11.5% return on equity. KU requested the increase, based on the twelve month test year ended October 31, 2009, to become effective on and after March 1, 2010. The requested rates were suspended until August 1, 2010. A number of intervenors entered the rate case, including the AG, certain representatives of industrial and low-income groups and other third parties, and submitted filings challenging the Company's requested rate increases, in whole or in part. A hearing was held on June 8, 2010. KU and all of the intervenors, except the AG, agreed to a stipulation providing for an increase in electric base rates of \$98 million annually and filed a request with the Kentucky Commission to approve such settlement. An Order in the proceeding was issued in July 2010, approving all the provisions in the stipulation. The new rates became effective on August 1, 2010.

### **Virginia Rate Case**

In June 2009, KU filed an application with the Virginia Commission requesting an increase in electric base rates for its Virginia jurisdictional customers in an amount of \$12 million annually or approximately 21%. The proposed increase reflected a proposed rate of return on rate base of 8.586% based on a return on equity of 12%. During December 2009, KU and the Virginia Commission Staff agreed to a Stipulation and Recommendation authorizing base rate revenue increases of \$11 million annually and a return on rate base of 7.846% based on a 10.5% return on common equity. A public hearing was held during January 2010. As permitted, pursuant to a Virginia Commission Order, KU elected to implement the proposed rates effective November 1, 2009, on an interim basis. In March 2010, the Virginia Commission issued an Order approving the stipulation, with the increased rates to be put into effect as of April 1, 2010. As part of the stipulation, KU refunded approximately \$1 million in interim rate amounts in excess of the ultimate approved rates. During August 2010, a report was filed detailing the costs of the refunds, the accounts charged and details validating that all refunds have been applied.

### **FERC Wholesale Rate Case**

In September 2008, KU filed an application with the FERC for increases in electric base rates applicable to wholesale power sales contracts or interchange agreements involving, collectively, twelve Kentucky municipalities. The application requested a shift from an all-in stated unit charge rate to an unbundled formula rate, including an annual adjustment mechanism. In May 2009, the FERC issued an Order approving a settlement among the parties in the case, incorporating increases of approximately 3% from prior rates and a return on equity of 11%. In May 2010, KU submitted to the FERC the proposed current annual adjustment to the formula rate. This updated rate became effective on July 1, 2010, subject to certain review procedures by the wholesale requirements customers and the FERC, including potential refunds in the case of disallowed costs or charges.

By mutual agreement, the parties' settlement of the 2008 application left outstanding the issue of whether KU must allocate to the municipal customers a portion of renewable resources it may be required to procure on behalf of its retail ratepayers. In August 2009, the FERC accepted the issue for briefing and the parties completed briefing submissions during 2009. An Order was issued by the FERC in July 2010, indicating that KU is not required to allocate a portion of any renewable resources to the twelve municipalities, thus resolving the remaining issue.



## Regulatory Assets and Liabilities

The following regulatory assets and liabilities were included in KU's balance sheets as of:

	<u>September 30,</u> <u>2010</u>	<u>December 31,</u> <u>2009</u>
	(In millions)	
Current regulatory assets:		
Storm restoration(a) . . . . .	\$ 6	\$ —
FAC(b) . . . . .	4	1
ECR(b) . . . . .	—	28
MISO exit(a) . . . . .	1	2
Other(c) . . . . .	<u>3</u>	<u>1</u>
Total current regulatory assets . . . . .	<u>\$ 14</u>	<u>\$ 32</u>
Non-current regulatory assets:		
Pension benefits(d) . . . . .	\$105	\$105
Other non-current regulatory assets:		
Storm restoration(a) . . . . .	52	59
ARO(e) . . . . .	34	30
Unamortized loss on bonds(a) . . . . .	12	12
MISO exit(a) . . . . .	4	9
Other(c) . . . . .	<u>8</u>	<u>7</u>
Subtotal other non-current regulatory assets . . . . .	<u>110</u>	<u>117</u>
Total non-current regulatory assets . . . . .	<u>\$215</u>	<u>\$222</u>
Current regulatory liabilities:		
ECR . . . . .	\$ 6	\$ —
DSM . . . . .	4	3
Other(f) . . . . .	<u>2</u>	<u>1</u>
Total current regulatory liabilities . . . . .	<u>\$ 12</u>	<u>\$ 4</u>
Non-current regulatory liabilities:		
Accumulated cost of removal of utility plant . . . . .	\$343	\$331
Other non-current regulatory liabilities:		
Deferred income taxes — net . . . . .	8	9
Postretirement benefits . . . . .	9	9
MISO exit . . . . .	1	4
Other(f) . . . . .	<u>6</u>	<u>7</u>
Subtotal other non-current regulatory liabilities . . . . .	<u>24</u>	<u>29</u>
Total non-current regulatory liabilities . . . . .	<u>\$367</u>	<u>\$360</u>

(a) These regulatory assets are recovered through base rates.

(b) The FAC and ECR regulatory assets have separate recovery mechanisms with recovery within twelve months.

(c) Other regulatory assets:

- Other current and non-current regulatory assets, including the CMRG and KCCS contributions, an EKPC FERC transmission settlement agreement and rate case expenses, are recovered through base rates.
- The current portion of the unamortized loss on bonds is recovered through base rates.

- KU generally recovers the FERC jurisdictional portion of the EKPC FERC transmission settlement agreement included in current and non-current regulatory assets in the application of the annual Open Access Transmission Tariff formula rate updates.
  - Recovery of the FERC jurisdictional pension expense in non-current regulatory assets will be requested in a future FERC rate case.
- (d) KU generally recovers this asset through pension expense included in the calculation of base rates.
- (e) 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.
- (f) Other current and non-current regulatory liabilities includes the Virginia levelized fuel factor regulatory liability, ARO liabilities and a change in accounting method for FERC jurisdictional spare parts. ARO liabilities are established from the removal costs accrued through depreciation under regulatory accounting for assets associated with AROs.

### ***Storm Restoration***

In January 2009, a significant ice storm passed through KU's service territory causing approximately 199,000 customer outages and was followed closely by a severe wind storm in February 2009, which caused approximately 44,000 customer outages. KU incurred \$57 million in incremental operation and maintenance expenses and \$33 million in capital expenditures related to the restoration following the two storms. The Company filed an application with the Kentucky Commission in April 2009, requesting approval to establish a regulatory asset and defer for future recovery approximately \$62 million in incremental operation and maintenance expenses related to the storm restoration. In September 2009, the Kentucky Commission issued an Order allowing the Company to establish a regulatory asset of up to \$62 million based on its actual costs for storm damages and service restoration due to the January and February 2009 storms. In September 2009, the Company established a regulatory asset of \$57 million for actual costs incurred. The Company received approval in its 2010 base rate case to recover this asset over a ten year period beginning August 1, 2010.

In September 2008, high winds from the remnants of Hurricane Ike passed through the service territory causing significant outages and system damage. In October 2008, KU filed an application with the Kentucky Commission requesting approval to establish a regulatory asset and defer for future recovery approximately \$3 million of expenses related to the storm restoration. In December 2008, the Kentucky Commission issued an Order allowing the Company to establish a regulatory asset of up to \$3 million based on its actual costs for storm damages and service restoration due to Hurricane Ike. In December 2008, the Company established a regulatory asset of \$2 million for actual costs incurred. The Company received approval in its 2010 base rate case to recover this asset over a ten year period beginning August 1, 2010.

### ***FAC***

In August 2010, the Kentucky Commission initiated a six-month review of KU's FAC mechanism for the expense period ended April 2010. An order is expected by the end of the year.

In February 2010, KU filed an application with the Virginia Commission seeking approval of a decrease in its fuel cost factor beginning with service rendered in April 2010. An Order was issued in April 2010, resulting in an agreed upon decrease of 23% from the fuel factor in effect for April 2009 through March 2010.

In January 2010, the Kentucky Commission initiated a six-month review of KU's FAC mechanism for the expense period ended August 2009. In May 2010, an Order was issued approving the charges and credits billed through the FAC during the review period.

### ***ECR***

In July 2010, the Kentucky Commission initiated a six-month review of KU's environmental surcharge for the billing period ending April 2010. An order is expected in the fourth quarter of 2010.

In January 2010, the Kentucky Commission initiated a six-month review of KU's environmental surcharge for the billing period ending October 2009. In May 2010, an Order was issued approving the amounts billed through the ECR during the six-month period and the rate of return on capital and allowing recovery of the under-recovery position in subsequent monthly filings.

In June 2009, the Company filed an application for a new ECR plan with the Kentucky Commission seeking approval to recover investments in environmental upgrades and operations and maintenance costs at the Company's generating facilities. During 2009, KU reached a unanimous settlement with all parties to the case, and the Kentucky Commission issued an Order approving KU's application. Recovery on customer bills through the monthly ECR surcharge for these projects began with the February 2010 billing cycle. At December 31, 2009, the Company had a regulatory asset of \$28 million, which changed to a regulatory liability in the first quarter of 2010, as a result of these roll-in adjustments to base rates. At September 30, 2010, the regulatory liability balance was \$6 million.

### ***MISO***

In August 2010, the FERC issued three Orders accepting most facets of several MISO Revenue Sufficiency Guarantee ("RSG") compliance filings. The FERC ordered the MISO to issue refunds for RSG charges that were imposed by the MISO on the assumption that there were rate mismatches for the period beginning November 5, 2007 through the present. There is no financial statement impact to the Company from this Order, as the MISO had anticipated that the FERC would require these refunds and had preemptively included them in the resettlements paid in 2009. The FERC denied MISO's proposal to exempt certain resources from RSG charges, effective prospectively. The FERC accepted portions and rejected portions of the MISO's proposed RSG rate Redesign Proposal, which will be effective when the software is ready for implementation subject to further compliance filings. The impact of the Redesign Proposal on the Company cannot be estimated at this time.

### **Other Regulatory Matters**

#### ***TC2 Depreciation***

In August 2009, the Companies jointly filed an application with the Kentucky Commission to approve new common depreciation rates for applicable jointly-owned TC2-related generating, pollution control and other plant equipment and assets. During December 2009, the Kentucky Commission extended the data discovery process through January 2010, and authorized the Companies on an interim basis to begin using the depreciation rates for TC2 as proposed in the application. In March 2010, the Kentucky Commission issued a final Order approving the use of the proposed depreciation rates on a permanent basis.

#### ***TC2 Transmission Matters***

KU's and LG&E's CCN for a transmission line associated with the TC2 construction has been challenged by certain property owners in Hardin County, Kentucky. In August 2006, the Companies obtained a successful dismissal of the challenge at the Franklin County Circuit Court, which was reversed by the Kentucky Court of Appeals in December 2007. In April 2009, the Kentucky Supreme Court granted KU's and LG&E's motion for discretionary review of the Court of Appeals' decision. In August 2010, the Kentucky Supreme Court issued an Order reversing the decision of the Kentucky Court of Appeals and reinstating the Franklin County Circuit Court's dismissal of the property owners' challenge to KU's and LG&E's CCN.

During 2008, KU obtained various successful rulings at the Hardin County Circuit Court confirming its condemnation rights. In August 2008, several landowners appealed such rulings to the Kentucky Court of Appeals. In May 2010, the Kentucky Court of Appeals issued an Order affirming the Hardin Circuit Court's finding that KU had the right to condemn easements on the properties. In May 2010, the landowners filed a petition for reconsideration with the Court of Appeals. In July 2010, the Court of Appeals denied that petition. In August, 2010, the landowners filed for discretionary review of that denial by the Kentucky Supreme Court.

In a separate proceeding, certain Hardin County landowners filed an action in federal district court in Louisville, Kentucky against the U.S. Army challenging the same transmission line claiming that certain

Fort Knox-related sections of the line failed to comply with certain National Historic Preservation Act procedural requirements. In October 2009, the federal court granted the defendants' motion for summary judgment and dismissed the plaintiffs' claims. During November 2009, the petitioners filed submissions for review of the decision with the 6th Circuit Court of Appeals. In May 2010, the appellate court issued an order approving the plaintiffs' voluntary withdrawal of their appeals.

Consistent with the regulatory authorizations and relevant legal proceedings, the Companies have completed construction activities on temporary or permanent transmission line segments. During the second quarter of 2010, the Companies placed into operation an appropriate combination of permanent and temporary sections of the transmission line. While the Companies are not currently able to predict the ultimate outcome and possible financial effects of the remaining legal proceedings, the Companies do not believe the matter involves relevant or continuing risks to operations.

### ***Mandatory Reliability Standards***

As a result of the EPCRA 2005, certain formerly voluntary reliability standards became mandatory in June 2007, and authority was delegated to various Regional Reliability Organizations ("RROs") by the North American Electric Reliability Corporation ("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 on the circumstances of the violation. The Companies are members of SERC, which acts as KU's and LG&E's RRO. During December 2009, SERC and the Companies agreed to settlements involving penalties totaling less than \$1 million for each utility related to their self-reports during June and October 2008, concerning possible violations of standards. During December 2009 and April, July and August 2010, the Companies submitted ten self-reports relating to various standards, which self-reports remain in the early stages of RRO review, and therefore, the Companies are unable to estimate the outcome of these matters. Mandatory reliability standard settlements commonly also include non-penalty elements, including compliance steps and mitigation plans. Settlements with SERC proceed to NERC and FERC review before becoming final. While the Companies believe they are in compliance with the mandatory reliability standards, events of potential non-compliance may be identified from time-to-time. The Companies cannot predict such potential violations or the outcome of the self-reports described above.

### **Note 3 — Asset Retirement Obligation**

A summary of KU's net ARO assets, ARO liabilities and regulatory assets established under the asset retirement and environmental obligations guidance of the FASB ASC follows:

	<u>ARO Net Assets</u>	<u>ARO Liabilities</u> (In millions)	<u>Regulatory Assets</u>
As of December 31, 2009 . . . . .	\$ 4	\$(34)	\$30
ARO accretion . . . . .	—	(2)	2
ARO revaluation . . . . .	<u>21</u>	<u>(23)</u>	<u>2</u>
As of September 30, 2010 . . . . .	<u>\$25</u>	<u>\$(59)</u>	<u>\$34</u>

As of September 30, 2010, the Company performed a revaluation of its AROs as a result of recently proposed environmental legislation and improved ability to forecast asset retirement costs due to recent construction and retirement activity.

Pursuant to regulatory treatment prescribed under the regulated operations guidance of the FASB ASC, an offsetting regulatory credit was recorded in depreciation and amortization in the income statement of \$2 million for the nine months ended September 30, 2010 for the ARO accretion and depreciation expense. KU's AROs are primarily related to the final retirement of assets associated with generating units.

KU transmission and distribution lines largely operate under perpetual property easement agreements which do not generally require restoration on removal of the property. Therefore, under the asset retirement and

environmental obligations guidance of the FASB ASC, no material asset retirement obligations are recorded for transmission and distribution assets.

#### **Note 4 — Derivative Financial Instruments**

KU is subject to interest rate and commodity price risk related to on-going business operations. It currently manages these risks using derivative instruments, including swaps and forward contracts. The Company's policies allow the interest rate risk to be managed through the use of fixed rate debt, floating rate debt and interest rate swaps. At September 30, 2010, a 100 basis point change in the benchmark rate on KU's variable rate debt, not effectively hedged by an interest rate swap, would impact pre-tax interest expense by \$4 million annually. Although the Company's policies allow for the use of interest rate swaps, as of September 30, 2010 and December 31, 2009, KU had no interest rate swaps outstanding.

The Company does not net collateral against derivative instruments.

#### **Energy Trading and Risk Management Activities**

KU conducts energy trading and risk management activities to maximize the value of power sales from physical assets it owns. Energy trading activities are principally forward financial transactions to manage price risk and are accounted for as non-hedging derivatives on a mark-to-market basis in accordance with the derivatives and hedging topic of the FASB ASC.

Energy trading and risk management contracts are valued using prices based on active trades from Intercontinental Exchange Inc. In the absence of a traded price, midpoints of the best bids and offers are the primary determinants of valuation. When sufficient trading activity is unavailable, other inputs include prices quoted by brokers or observable inputs other than quoted prices, such as one-sided bids or offers as of the balance sheet date. 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 2010 or 2009. Changes in market pricing, interest rate and volatility assumptions were made during both years.

KU's financial assets and liabilities as of September 30, 2010 and December 31, 2009, arising from energy trading and risk management contracts not designated as hedging instruments accounted for at fair value total less than \$1 million and are recorded in prepayments and other current assets and other current liabilities, respectively.

The Company maintains credit policies intended to minimize credit risk in wholesale marketing and trading activities by assessing the creditworthiness of potential counterparties prior to entering into transactions with them and continuing to evaluate their creditworthiness once transactions have been initiated. To further mitigate credit risk, KU seeks to enter into netting agreements or require cash deposits, letters of credit and parental company guarantees as security from counterparties. The Company uses S&P, Moody's and definitive qualitative and quantitative data to assess the financial strength of counterparties on an on-going basis. If no external rating exists, KU assigns an internally generated rating for which it sets appropriate risk parameters. As risk management contracts are valued based on changes in market prices of the related commodities, credit exposures are revalued and monitored on a daily basis. At September 30, 2010, 100% of the trading and risk management commitments were with counterparties rated BBB-/Baa3 equivalent or better. The Company has reserves 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 September 30, 2010 and December 31, 2009, counterparty credit reserves related to energy trading and risk management contracts were less than \$1 million.

The net volume of electricity based financial derivatives outstanding at September 30, 2010 and December 31, 2009, was zero and 43,400 Mwhts, respectively. No cash collateral related to the energy trading and risk management contracts was required at September 30, 2010. Cash collateral related to the energy trading and risk management contracts was less than \$1 million at December 31, 2009. Cash collateral related to the energy trading and risk management contracts is categorized as other accounts receivable in the accompanying balance sheets.

KU manages the price risk of its estimated future excess economic generation capacity using market-traded forward contracts. Hedge accounting treatment has not been elected for these transactions, and therefore realized and unrealized gains and losses are included in the statements of income.

The following tables present the effect of derivatives not designated as hedging instruments on income:

<u>Loss Recognized in Income</u>	<u>Location</u>	<u>Three Months Ended September 30,</u>	
		<u>2010(a)</u>	<u>2009</u>
(In millions)			
Unrealized loss . . . . .	Electric revenues	<u>\$—</u>	<u>\$(3)</u>

<u>Loss Recognized in Income</u>	<u>Location</u>	<u>Nine Months Ended September 30,</u>	
		<u>2010(a)</u>	<u>2009</u>
(In millions)			
Unrealized loss . . . . .	Electric revenues	<u>\$—</u>	<u>\$(1)</u>

(a) Unrealized loss was less than \$1 million

Net realized gains were less than \$1 million in the three and nine months ended September 30, 2010 and 2009, respectively.

**Credit Risk Related Contingent Features**

Certain of the Company’s derivative instruments contain provisions that require the Company to provide immediate and on-going collateralization on derivative instruments in net liability positions based on the Company’s credit ratings from each of the major credit rating agencies. At September 30, 2010, there are no energy trading and risk management contracts with credit risk related contingent features that are in a liability position and no collateral posted in the normal course of business. At September 30, 2010, a one notch downgrade of the Company’s credit rating would have no effect on the energy trading and risk management contracts or collateral required.

**Note 5 — Fair Value Measurements**

KU adopted the fair value guidance in the FASB ASC in two phases. Effective January 1, 2008, the Company adopted it for all financial instruments and non-financial instruments accounted for at fair value on a recurring basis, and January 1, 2009, the Company adopted it for all non-financial instruments accounted for at fair value on a non-recurring basis. The FASB ASC guidance clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or a liability. As a basis for considering such assumptions, the FASB ASC guidance establishes a three-tier value hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value.

The carrying values and estimated fair values of KU’s non-trading instruments:

	<u>September 30, 2010</u>		<u>December 31, 2009</u>	
	<u>Carrying Value</u>	<u>Fair Value</u>	<u>Carrying Value</u>	<u>Fair Value</u>
(In millions)				
Long-term bonds (including current portion of \$228 million) . . . . .	\$ 351	\$ 352	\$ 351	\$ 351
Long-term debt to affiliated company (including current portion of \$33 million) . . . . .	1,331	1,527	1,331	1,401

The long-term bond valuations reflect prices quoted by investment banks, which are active in the market for these debt instruments. The fair value of the long-term debt due to affiliated company is determined using an internal valuation model that discounts the future cash flows of each loan at current market rates as determined based on quotes from investment banks that are actively involved in capital markets for utilities and factor in KU's credit ratings and default risk. The fair values of cash and cash equivalents, accounts receivable, cash surrender value of key man life insurance, accounts payable and notes payable are substantially the same as their carrying values.

KU has classified the applicable financial assets and liabilities that are accounted for at fair value into the three levels of the fair value hierarchy, as defined by the fair value measurements and disclosures topic of the FASB ASC, as follows:

- Level 1 — Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets
- Level 2 — Include other inputs that are directly or indirectly observable in the marketplace
- Level 3 — Unobservable inputs which are supported by little or no market activity

The fair value hierarchy also requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

The Company classifies its derivative cash collateral balances within level 1 based on the funds being held in a demand deposit account. The Company classifies its derivative energy trading and risk management contracts within level 2 because it values them using prices actively quoted for proposed or executed transactions, quoted by brokers or observable inputs other than quoted prices.

KU's financial assets and liabilities as of September 30, 2010 and December 31, 2009, arising from energy trading and risk management contracts accounted for at fair value on a recurring basis total less than \$1 million. No cash collateral related to the energy trading and risk management contracts was required at September 30, 2010. Cash collateral related to the energy trading and risk management contracts was less than \$1 million at December 31, 2009.

There were no level 3 measurements for the periods ending September 30, 2010 and December 31, 2009.

## Note 6 — Pension and Other Postretirement Benefit Plans

### Net Periodic Benefit Costs

The following tables provide the components of net periodic benefit cost for pension and other postretirement benefit plans. The tables include the costs associated with both KU employees and Servco employees who are providing services to KU. The Servco costs are allocated to KU based on employees' labor charges and are approximately 53% and 51% of Servco costs for September 30, 2010 and 2009, respectively.

	Pension Benefits					
	Three Months Ended September 30,					
	2010			2009		
KU	Servco Allocation to KU	Total KU	KU	Servco Allocation to KU	Total KU	
(In millions)						
Service cost . . . . .	\$ 2	\$ 1	\$ 3	\$ 2	\$ 1	\$ 3
Interest cost . . . . .	4	2	6	4	2	6
Expected return on plan assets . . . . .	(5)	(2)	(7)	(3)	(1)	(4)
Amortization of prior service cost . . . . .	—	1	1	—	—	—
Amortization of actuarial loss . . . . .	<u>2</u>	<u>1</u>	<u>3</u>	<u>2</u>	<u>1</u>	<u>3</u>
Net periodic benefit cost . . . . .	<u>\$ 3</u>	<u>\$ 3</u>	<u>\$ 6</u>	<u>\$ 5</u>	<u>\$ 3</u>	<u>\$ 8</u>

Other Postretirement Benefits Three Months Ended September 30,						
2010			2009			
(In millions)						
	KU	Servco Allocation to KU(a)	Total KU	KU	Servco Allocation to KU(a)	Total KU
Interest cost . . . . .	\$2	\$—	\$2	\$1	\$—	\$1
Net periodic benefit cost . . . . .	\$2	\$—	\$2	\$1	\$—	\$1

(a) amounts are less than \$1 million

Pension Benefits Nine Months Ended September 30,						
2010			2009			
(In millions)						
	KU	Servco Allocation to KU	Total KU	KU	Servco Allocation to KU	Total KU
Service cost . . . . .	\$ 5	\$ 4	\$ 9	\$ 4	\$ 4	\$ 8
Interest cost . . . . .	14	6	20	13	5	18
Expected return on plan assets . . . . .	(13)	(5)	(18)	(10)	(4)	(14)
Amortization of prior service cost . . . . .	—	1	1	1	1	2
Amortization of actuarial loss . . . . .	5	2	7	6	2	8
Net periodic benefit cost . . . . .	\$ 11	\$ 8	\$ 19	\$ 14	\$ 8	\$ 22

Other Postretirement Benefits Nine Months Ended September 30,						
2010			2009			
(In millions)						
	KU	Servco Allocation to KU	Total KU	KU	Servco Allocation to KU	Total KU
Service cost . . . . .	\$ 1	\$ 1	\$ 2	\$ 1	\$ 1	\$ 2
Interest cost . . . . .	4	—	4	3	—	3
Expected return on plan assets . . . . .	(1)	—	(1)	—	—	—
Amortization of transitional obligation . . . . .	1	—	1	1	—	1
Net periodic benefit cost . . . . .	\$ 5	\$ 1	\$ 6	\$ 5	\$ 1	\$ 6

### Contributions

In January 2010, KU and Servco made discretionary pension plan contributions of \$13 million and \$9 million, respectively. The amount of future contributions to the pension plan will depend on the actual return on plan assets and other factors, but the Company's intent is to fund the pension plan in a manner consistent with the requirements of the Pension Protection Act of 2006.

Through September 2010, KU made contributions to other postretirement benefit plans totaling \$4 million. An additional contribution totaling \$1 million was made in October. The Company anticipates further funding to match the annual postretirement expense and funding the 401(h) plan up to the maximum amount allowed by law.

### Health Care Reform

In March 2010, Health Care Reform (the Patient Protection and Affordable Care Act of 2010) was signed into law. Many provisions of Health Care Reform do not take effect for an extended period of time, and many aspects of the law which are currently unclear or undefined will likely be clarified in future regulations.



During each of the three and nine months ended September 30, 2010, KU recorded an income tax expense of less than \$1 million, to recognize the impact of the elimination of the tax deduction related to the Medicare Retiree Drug Subsidy that becomes effective in 2013.

Specific provisions within Health Care Reform that may impact KU include:

- Beginning in 2011, requirements extend dependent coverage up to age 26, remove the \$2 million lifetime maximum and eliminate cost sharing for certain preventative care procedures.
- Beginning in 2018, a potential excise tax is expected on high-cost plans providing health coverage that exceeds certain thresholds.

KU continues to evaluate all implications of Health Care Reform on its benefit programs but at this time cannot predict the significance of those implications.

#### **Note 7 — Income Taxes**

A United States consolidated income tax return is filed by E.ON U.S.'s direct parent, E.ON US Investments Corp., for each tax period. Each subsidiary of the consolidated tax group, including KU, calculates its separate income tax for each period. The resulting separate-return tax cost or benefit is paid to or received from the parent company or its designee. The Company also files income tax returns in various state jurisdictions. While 2007 and later years are open under the federal statute of limitations, Revenue Agent Reports for 2006-2008 have been received from the IRS, effectively closing these years to additional audit adjustments. Tax years beginning with 2007 were examined under an IRS pilot program named "Compliance Assurance Process" ("CAP"). This program accelerates the IRS' review to begin during the year applicable to the return and ends 90 days after the return is filed. For 2008, the IRS allowed additional deductions in connection with the Company's application for a change in repair deductions and disallowed some of the bonus depreciation claimed on the original return. The net temporary tax impact for the Company was \$12 million and was recorded in the second quarter of 2010. Tax years 2009 and 2010 are also being examined under CAP. The 2009 federal return was filed in the third quarter, and the IRS issued a Partial Acceptance Letter with the 2009 return. The IRS is continuing to review bonus depreciation, storms and other repairs. No material impact is expected from the IRS review. For the tax year 2010, no material items have been raised by the IRS at this time.

Additions and reductions of uncertain tax positions during 2010 and 2009 were less than \$1 million. Possible amounts of uncertain tax positions for KU that may decrease within the next 12 months total less than \$1 million and are based on the expiration of the audit periods as defined in the statutes. If recognized, the less than \$1 million of unrecognized tax benefits would reduce the effective income tax rate.

The amount KU recognized as interest expense and interest accrued related to unrecognized tax benefits was less than \$1 million as of September 30, 2010 and December 31, 2009. The interest expense and interest accrued is based on IRS and Kentucky Department of Revenue large corporate interest rates for underpayment of taxes. At the date of adoption, the Company accrued less than \$1 million in interest expense on uncertain tax positions. KU records the interest as interest expense and penalties as operating expenses in the income statement and accrued expenses in the balance sheet, on a pre-tax basis. No penalties were accrued by the Company through September 30, 2010.

In June 2006, the Companies filed a joint application with the U.S. Department of Energy ("DOE") requesting certification to be eligible for investment tax credits applicable to the construction of TC2. In November 2006, the DOE and the IRS announced that KU was selected to receive \$101 million in tax credits. A final IRS certification required to obtain the investment tax credits was received in August 2007. In September 2007, KU received an Order from the Kentucky Commission approving the accounting of the investment tax credits, which includes a full depreciation basis adjustment for the amount of the credits. Based on eligible construction expenditures incurred, KU recorded investment tax credits of \$6 and \$17 million during the three and nine months ended September 30, 2009, decreasing current federal income taxes. As of December 31, 2009 KU had recorded its maximum credit of \$101 million. The income tax expense impact from amortizing these credits over the life of the related property will begin when the facility is placed in service, which is expected to occur by year end.

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. The plaintiffs voluntarily dismissed their complaint in August 2010.

A reconciliation of differences between the income tax expense at the statutory U.S. federal income tax rate and the Company's actual income tax expense follows:

	<u>Three Months</u> <u>Ended</u> <u>September 30,</u>		<u>Nine Months</u> <u>Ended</u> <u>September 30,</u>	
	<u>2010</u>	<u>2009</u>	<u>2010</u>	<u>2009</u>
	(In millions)			
Statutory federal income tax expense . . . . .	\$ 30	\$ 37	\$ 72	\$ 52
State income taxes — net of federal benefit . . . . .	3	4	8	4
Dividends received deduction related to EEI investment . . . . .	—	—	—	(3)
Other differences — net . . . . .	<u>(1)</u>	<u>(2)</u>	<u>(4)</u>	<u>(4)</u>
Income tax expense . . . . .	<u>\$ 32</u>	<u>\$ 39</u>	<u>\$ 76</u>	<u>\$ 49</u>
Effective income tax rate . . . . .	37.2%	37.1%	37.1%	33.1%

The amounts shown in the table above are rounded to the nearest \$1 million; however, the effective income tax rates are based on actual underlying amounts. Other differences — net includes the qualified production activities deduction and excess deferred taxes on depreciation.

The effective tax rate for the nine months ended September 2010 was higher than the rate for the nine months ended 2009 due to state income taxes — net of federal benefit being lower due to a coal credit recorded in 2009 and a lower dividends received deduction primarily due to the lack of EEI dividends in 2010.

**Note 8 — Short-Term and Long-Term Debt**

KU's long-term debt includes \$228 million of pollution control bonds that are classified as current portion of long-term debt 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:

	(In millions)
Mercer Co. 2000 Series A, due May 1, 2023, variable% . . . . .	\$ 13
Carroll Co. 2002 Series A, due February 1, 2032, variable% . . . . .	21
Carroll Co. 2002 Series B, due February 1, 2032, variable% . . . . .	2
Carroll Co. 2008 Series A, due February 1, 2032, variable% . . . . .	78
Mercer Co. 2002 Series A, due February 1, 2032, variable% . . . . .	8
Muhlenberg Co. 2002 Series A, due February 1, 2032, variable% . . . . .	2
Carroll Co. 2004 Series A, due October 1, 2034, variable% . . . . .	50
Carroll Co. 2006 Series B, due October 1, 2034, variable% . . . . .	<u>54</u>
	<u>\$228</u>

The average annualized interest rates for these bonds follow:

	<u>September 30,</u>	
	<u>2010</u>	<u>2009</u>
Three months ended . . . . .	0.37%	0.51%
Nine months ended . . . . .	0.36%	0.65%

Pollution control bonds are obligations of KU issued in connection with tax-exempt pollution control bonds issued by counties in Kentucky. A loan agreement obligates the Company to make debt service payments to the counties that equate to the debt service due from the counties on the related pollution control bonds. The loan

agreement is an unsecured obligation of the Company. Debt issuance expense is capitalized in either regulatory assets or current or long-term other assets and amortized over the lives of the related bond issues, consistent with regulatory practices.

In October 2010, KU's pollution control bonds were converted from unsecured debt to debt which is collateralized by first mortgage bonds. Also in October 2010, one national rating agency revised downward the short-term credit rating of the pollution control bonds and the Company's issuer rating as a result of the pending acquisition by PPL.

Several of the KU pollution control bonds are insured by monoline bond insurers whose ratings have been reduced due to exposures relating to insurance of sub-prime mortgages. At September 30, 2010, KU had an aggregate \$351 million of outstanding pollution control indebtedness, of which \$96 million is in the form of insured auction rate securities wherein interest rates are reset every 35 days via an auction process. Beginning in late 2007, the interest rates on these insured bonds began to increase due to investor concerns about the creditworthiness of the bond insurers. Since 2008, the Company experienced "failed auctions" when there were insufficient bids for the bonds. When a failed auction occurs, the interest rate is set pursuant to a formula stipulated in the indenture.

The average annualized interest rates on the auction rate bonds follow:

	<u>September 30,</u>	
	<u>2010</u>	<u>2009</u>
Three months ended . . . . .	0.61%	0.34%
Nine months ended . . . . .	0.50%	0.51%

The instruments governing these auction rate bonds permit KU to convert the bonds to other interest rate modes, such as various short-term variable rates, long-term fixed rates or intermediate-term fixed rates that are reset infrequently. In June 2009, one national rating agency downgraded the credit rating of an insurer of the Company's bonds. As a result, the national rating agency downgraded the rating on the Carroll County 2002 Series C bond. The national agency's rating of this bond is now based on the rating of the Company rather than the rating of the insurer since the Company's rating is higher.

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

	<u>Total Money Pool Available</u>	<u>Amount Outstanding</u>	<u>Balance Available</u>	<u>Average Interest Rate</u>
	(In millions)			
September 30, 2010 . . . . .	\$400	\$61	\$339	0.28%
December 31, 2009 . . . . .	\$400	\$45	\$355	0.20%

E.ON U.S. maintained revolving credit facilities totaling \$313 million at September 30, 2010 and December 31, 2009, to ensure funding availability for the money pool. At September 30, 2010, one facility, totaling \$150 million, was with E.ON North America, Inc. while the remaining line, totaling \$163 million, was with Fidelia; both are affiliated companies. The balances are as follows:

	<u>Total Available</u>	<u>Amount Outstanding</u>	<u>Balance Available</u>	<u>Average Interest Rate</u>
	(In millions)			
September 30, 2010 . . . . .	\$313	\$181	\$132	1.44%
December 31, 2009 . . . . .	\$313	\$276	\$ 37	1.25%

As of September 30, 2010, the Company maintained a \$35 million bilateral line of credit, maturing in June 2012, with an unaffiliated financial institution. At September 30, 2010, there was no balance outstanding under this facility. The Company also maintains letter of credit facilities that support \$195 million of the \$228 million of bonds that can be put back to the Company. Should the holders elect to put the bonds back and they cannot be remarketed, the letter of credit would fund the investor's payment.

There were no redemptions or issuances of long-term debt year-to-date through September 30, 2010. KU was in compliance with all debt covenants at September 30, 2010 and December 31, 2009. See Note 1, General, for certain debt refinancing and associated transactions which are anticipated by KU in connection with the PPL acquisition and Note 10, Related Party Transactions, for long-term debt payable to affiliates.

#### **Note 9 — Commitments and Contingencies**

Except as may be discussed in this quarterly report (including Note 2, Rates and Regulatory Matters), material changes have not occurred in the current status of various commitments or contingent liabilities from that discussed in the Company's Annual Report for the year ended December 31, 2009 (including, but not limited to Note 2, Rates and Regulatory Matters; Note 9, Commitments and Contingencies; and Note 12, Subsequent Events, contained therein). See the Company's Annual Report regarding such commitments or contingencies.

#### **Letters of Credit**

KU has provided letters of credit as of September 30, 2010 and December 31, 2009, for on-balance sheet obligations totaling \$198 million to support bonds of \$195 million and a letter of credit for off-balance sheet obligations totaling less than \$1 million to support certain obligations related to workers' compensation.

#### **Owensboro Contract Litigation and Contract Termination**

In May 2004, the City of Owensboro, Kentucky and OMU commenced a suit against KU concerning a long-term power supply contract (the "OMU Agreement") with KU. In May 2009, KU and OMU executed a settlement agreement resolving the matter on a basis consistent with prior court rulings, and the Company has received the agreed settlement amounts. Pursuant to the settlement's operation, the OMU agreement terminated in May 2010. In connection with such termination, KU has recorded a net receivable totaling \$4 million reflecting its estimate of remaining adjustments concerning prior accruals. The parties are engaged in discussions to resolve those remaining adjustments.

#### **Construction Program**

KU had approximately \$167 million of commitments in connection with its construction program at September 30, 2010.

In June 2006, the Companies 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. During 2009 and 2010, the Companies received several contractual notices from the TC2 construction contractor asserting historical force majeure and excusable event claims for a number of adjustments to the contract price, construction schedule, commercial operations date, liquidated damages or other relevant provisions. In September 2010, the Companies and construction contractor agreed to a settlement to resolve certain force majeure and excusable event claims occurring through July 2010, under the TC2 construction contract, which settlement provided for a limited, negotiated extension of the contractual commercial operations date and/or relief from liquidated damages calculations. During commissioning activities in the second and third quarters, separate delays have occurred related to burner malfunctions and an excitation transformer failure. Certain temporary or permanent repairs for both matters have been completed, are underway or are planned for appropriate future outage periods. Commissioning steps resumed in October 2010, and a revised commercial operations date is currently expected by year end. The parties are analyzing the treatment of these additional delays under the liquidated damages provisions of the construction agreement. The Companies cannot currently estimate the ultimate outcome of these matters, including the extent, if any, that such outcome may result in materially increased costs for the construction of TC2, further changes in the TC2 construction completion or commercial operation dates or potential effects on levels of power purchases or wholesale sales due to such changed dates.

### **TC2 Air Permit**

The Sierra Club and other environmental groups filed a petition challenging the air permit issued for the TC2 baseload generating unit which was issued by the KDAQ in November 2005. In September 2007, the Secretary of the Kentucky Environmental and Public Protection Cabinet issued a final Order upholding the permit. The environmental groups petitioned the EPA to object to the state permit and subsequent permit revisions. In determinations made in September 2008 and June 2009, the EPA rejected most of the environmental groups' claims, but identified three permit deficiencies which the KDAQ addressed by revising the permit. In August 2009, the EPA issued an Order denying the remaining claims with the exception of two additional deficiencies which the KDAQ was directed to address. The EPA determined that the proposed permit subsequently issued by the KDAQ satisfied the conditions of the EPA Order although the agency recommended certain enhancements to the administrative record. In January 2010, the KDAQ issued a final permit revision incorporating the proposed changes to address the EPA objections. In March 2010, the environmental groups submitted a petition to the EPA to object to the permit revision, which is now pending before the EPA. The Company believes that the final permit as revised should not have a material adverse effect on its financial condition or results of operations. However, until the EPA issues a final ruling on the pending petition and all applicable appeals have been exhausted, the Company cannot predict the final outcome of this matter.

### **Thermostat Replacement**

During January 2010, the Companies announced a voluntary plan to replace certain thermostats, which had been provided to customers as part of the Companies' demand reduction programs, due to concerns that the thermostats may present a safety hazard. Under the plan, the Companies have replaced approximately 90% of the estimated 14,000 thermostats that need to be replaced. Total estimated costs associated with the replacement program are \$2 million. However, the Companies cannot fully predict the ultimate outcome of the replacement program or other effects or developments which may be associated with the thermostat replacement matter at this time.

### **OVEC**

KU holds a 2.5% investment interest in OVEC with 10 other electric utilities. KU is not the primary beneficiary; therefore the investment is not consolidated into the Company's financial statements, but is recorded on the cost basis. OVEC is located in Piketon, Ohio, and owns and operates two coal-fired power plants, Kyger Creek Station in Ohio, and Clifty Creek Station in Indiana. KU is contractually entitled to 2.5% of OVEC's output, approximately 55 Mw of generation capacity. Pursuant to the OVEC power purchase contract, the Company may be conditionally responsible for a 2.5% pro-rata share of certain obligations of OVEC under defined circumstances. These contingent liabilities may include unpaid OVEC indebtedness as well as shortfall amounts in certain excess decommissioning costs and post-retirement benefits other than pension. KU's potential proportionate share of OVEC's September 30, 2010 outstanding debt was \$35 million.

### **Environmental Matters**

The Company's operations are subject to a number of environmental laws and regulations in each of the jurisdictions in which it operates governing, among other things, air emissions, wastewater discharges, the use, handling and disposal of hazardous substances and wastes, soil and groundwater contamination and employee health and safety. As indicated below and summarized at the conclusion of this section, evolving environmental regulations will likely increase the level of capital and operating and maintenance expenditures incurred by the Company during the next several years. Based on prior regulatory precedent, the Company believes that many costs of complying with such pending or future requirements would likely be recoverable under the ECR or other potential cost-recovery mechanisms, but the Company can provide no assurance as to the ultimate outcome of such proceedings before the regulatory authorities.

*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<sub>2</sub> and NO<sub>x</sub> emissions from power plants. In 1998, the EPA issued its final “NO<sub>x</sub> SIP Call” rule requiring reductions in NO<sub>x</sub> emissions of approximately 85% from 1990 levels in order to mitigate ozone transport from the midwestern U.S. to the northeastern U.S. To implement the new federal requirements, Kentucky amended its SIP in 2002 to require electric generating units to reduce their NO<sub>x</sub> emissions to 0.15 pounds weight per MMBtu on a company-wide basis. In 2005, the EPA issued the CAIR which required additional SO<sub>2</sub> emission reductions of 70% and NO<sub>x</sub> emission reductions of 65% from 2003 levels. The CAIR provided for a two-phase cap and trade program, with initial reductions of NO<sub>x</sub> and SO<sub>2</sub> emissions due by 2009 and 2010, respectively, and final reductions due by 2015. In 2006, Kentucky proposed to amend its SIP to adopt state requirements similar to those under the federal CAIR.

In July 2008, a federal appeals court issued a ruling finding deficiencies in the CAIR and vacating it. In December 2008, the Court amended its previous Order, directing the EPA to promulgate a new regulation but leaving the CAIR in place in the interim. The remand of the CAIR results in some uncertainty with respect to certain other EPA or state programs and proceedings and the Companies’ compliance plans relating thereto due to the interconnection of the CAIR with such associated programs.

In January 2010, the EPA proposed a revised NAAQS for ozone which would increase the stringency of the standard. In addition, the EPA published final revised NAAQS standards for nitrogen dioxide (“NO<sub>2</sub>”) and SO<sub>2</sub> in February 2010 and June 2010, respectively, which are more stringent than previous standards. Depending on the level of action determined necessary to bring local nonattainment areas into compliance with the revised NAAQS standards, KU’s power plants are potentially subject to requirements for additional reductions in SO<sub>2</sub> and NO<sub>x</sub> emissions.

In July 2010, the EPA issued the proposed CATR, which serves to replace the CAIR. The CATR provides for a two-phase SO<sub>2</sub> reduction program with Phase I reductions due by 2012, and Phase II reductions due by 2014. The CATR provides for NO<sub>x</sub> reductions in 2012, but the EPA advised that it is studying whether additional NO<sub>x</sub> reductions should be required for 2014. The CATR is more stringent than the CAIR as it accelerates certain compliance dates and provides for only intrastate and limited interstate trading of emission allowances. In addition to its preferred approach, the EPA is seeking comment on an alternative approach which would provide for individual emission limits at each power plant. The EPA has announced that it will propose additional “transport” rules to address compliance with revised NAAQS standards for ozone and particulate matter which will be issued by the EPA in the future, as discussed below.

*Hazardous Air Pollutants.* As provided in 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 February 2008, a federal appellate court issued a decision vacating the CAMR. The EPA has entered into a consent decree requiring it to promulgate a utility Maximum Achievable Control Technology rule to replace the CAMR with a proposed rule due by March 2011, and a final rule due by November 2011. Depending on the final outcome of the rulemaking, the CAMR could be replaced by new rules with different or more stringent requirements for reduction of mercury and other hazardous air pollutants. Kentucky has also repealed its corresponding state mercury regulations.

*Acid Rain Program.* The Clean Air Act imposed a two-phased cap and trade program to reduce SO<sub>2</sub> emissions from power plants that were thought to contribute to “acid rain” conditions in the northeastern U.S. The

Clean Air Act also contains requirements for power plants to reduce NO<sub>x</sub> emissions through the use of available combustion controls.

*Regional Haze.* The Clean Air Act also includes visibility goals for certain federally designated areas, including national parks, and requires states to submit SIPs that will demonstrate reasonable progress toward preventing future impairment and remedying any existing impairment of visibility in those areas. In 2005, the EPA issued its Clean Air Visibility Rule 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 the CAIR could potentially impact regional haze SIPs. See "Ambient Air Quality" above for a discussion of CAIR-related uncertainties.

*Installation of Pollution Controls.* Many of the programs under the Clean Air Act utilize cap and trade mechanisms that require a company to hold sufficient emissions allowances to cover its authorized emissions on a company-wide basis and do not require installation of pollution controls on every generating unit. Under cap and trade programs, companies are free to focus their pollution control efforts on plants where such controls are particularly efficient and utilize the resulting emission allowances for smaller plants where such controls are not cost effective. KU met its Phase I SO<sub>2</sub> requirements primarily through installation of FGD equipment on Ghent Unit 1. KU's strategy for its Phase II SO<sub>2</sub> requirements, which commenced in 2000, includes the installation of additional FGD equipment, as well as, using accumulated emission allowances and fuel switching to defer certain additional capital expenditures. In order to achieve the NO<sub>x</sub> emission reductions mandated by the NO<sub>x</sub> SIP Call, KU installed additional NO<sub>x</sub> controls, including SCR technology, during the 2000 through 2009 time period at a cost of \$221 million. In 2001, the Kentucky Commission granted approval to recover the costs incurred by KU for these projects through the ECR mechanism. Such monthly recovery is subject to periodic review by the Kentucky Commission.

In order to achieve currently mandated emissions reductions, KU expects to incur additional capital expenditures totaling approximately \$285 million during the 2010 through 2012 time period for pollution controls including FGD and SCR equipment and additional operating and maintenance costs in operating such controls. In 2005, the Kentucky Commission granted approval to recover the costs incurred by the Company for these projects through the ECR mechanism. Such monthly recovery is subject to periodic review by the Kentucky Commission. KU believes its costs in reducing SO<sub>2</sub>, NO<sub>x</sub> and mercury emissions to be comparable to those of similarly situated utilities with like generation assets. KU's compliance plans are subject to many factors including developments in the emission allowance and fuels markets, future legislative and regulatory enactments, legal proceedings and advances in clean air technology. KU will continue to monitor these developments to ensure that its environmental obligations are met in the most efficient and cost-effective manner. See "Ambient Air Quality" above for a discussion of CAIR-related uncertainties.

*GHG Developments.* In 2005, the Kyoto Protocol for reducing GHG emissions took effect, obligating 37 industrialized countries to undertake substantial reductions in GHG emissions. The U.S. has not ratified the Kyoto Protocol and there are currently no mandatory GHG emission reduction requirements at the federal level. As discussed below, legislation mandating GHG reductions has been introduced in the Congress, but no federal legislation has been enacted to date. In the absence of a program at the federal level, various states have adopted their own GHG emission reduction programs, including 11 northeastern U.S. states and the District of Columbia under the Regional GHG Initiative program and California. Substantial efforts to pass federal GHG legislation are on-going. The current administration has announced its support for the adoption of mandatory GHG reduction requirements at the federal level. The United States and other countries met in Copenhagen, Denmark in December 2009, in an effort to negotiate a GHG reduction treaty to succeed the Kyoto Protocol, which is set to expire in 2013. In Copenhagen, the U.S. made a nonbinding commitment to, among other things, seek to reduce GHG emissions to 17% below 2005 levels by 2020 and provide financial support to developing countries. The United States and other nations are scheduled to meet in Cancun, Mexico in late 2010 to continue negotiations toward a binding agreement.

*GHG Legislation.* KU is monitoring on-going efforts to enact GHG reduction requirements and requirements governing carbon sequestration at the state and federal level and is assessing potential impacts of such

programs and strategies to mitigate those impacts. In June 2009, the U.S. House of Representatives passed the American Clean Energy and Security Act of 2009, which is a comprehensive energy bill containing the first-ever nation-wide GHG cap and trade program. The bill would provide for reductions in GHG emissions of 3% below 2005 levels by 2012, 17% by 2020 and 83% by 2050. In order to cushion potential rate impacts for utility customers, approximately 43% of emissions allowances would initially be allocated at no cost to the electric utility sector, with this allocation gradually declining to 7% in 2029 and zero thereafter. The bill would also establish a renewable electricity standard requiring utilities to meet 20% of their electricity demand through renewable energy and energy efficiency by 2020. The bill contains additional provisions regarding carbon capture and sequestration, clean transportation, smart grid advancement, nuclear and advanced technologies and energy efficiency.

In September 2009, the Clean Energy Jobs and American Power Act, which is largely patterned on the House legislation, was introduced in the U.S. Senate. The Senate bill raises the emissions reduction target for 2020 to 20% below 2005 levels and does not include a renewable electricity standard. While the initial bill lacked detailed provisions for the allocation of emissions allowances, a subsequent revision incorporated allowance allocation provisions similar to the House bill. In 2010, Senators Kerry and Lieberman and others have undertaken additional work to draft GHG legislation but have introduced no bill in the Senate to date. In July 2010, Senate Majority Leader Reid announced that he did not anticipate that GHG legislation would be brought to the Senate floor in the current session. The Company is closely monitoring the progress of pending energy legislation, but the prospect for passage of comprehensive GHG legislation in 2010 is uncertain.

*GHG Regulations.* In April 2007, the U.S. Supreme Court ruled that the EPA has the authority to regulate GHG under the Clean Air Act. In April 2009, the EPA issued a proposed endangerment finding concluding that GHGs endanger public health and welfare, which is an initial rulemaking step under the Clean Air Act. A final endangerment finding was issued in December 2009. In September 2009, the EPA issued a final GHG reporting rule requiring reporting by facilities with annual GHG emissions equivalent to at least 25,000 tons of carbon dioxide. A number of the Company's facilities will be required to submit annual reports commencing with calendar year 2010. In May 2010, the EPA issued a final GHG "tailoring" rule requiring new or modified sources with GHG emissions equivalent to at least 75,000 tons of carbon dioxide to obtain permits under the Prevention of Significant Deterioration Program. Such new or modified facilities would be required to install Best Available Control Technology. While the Company is unaware of any currently available GHG control technology that might be required for installation on new or modified power plants, it is currently assessing the potential impact of the rule. The final rule will apply to new and modified power plants beginning in January 2011. The Company is unable to predict whether mandatory GHG reduction requirements will ultimately be enacted through legislation or regulations.

*GHG Litigation.* A number of lawsuits have been filed asserting common law claims including nuisance, trespass and negligence against various companies with GHG emitting facilities. In October 2009, a three judge panel of the United States Court of Appeals for the 5th Circuit in the case of *Comer v. Murphy Oil* reversed a lower court, holding that private plaintiffs have standing to assert certain common law claims against more than 30 utility, oil, coal and chemical companies. In March 2010, the court vacated the opinion of the three-judge panel and granted a motion for rehearing but subsequently denied the appeal due to the lack of a quorum. The appellate ruling leaves in effect the lower court ruling dismissing the plaintiffs' claims. The petitioners filed a petition for a writ of mandamus with the Supreme Court in August 2010. The *Comer* complaint alleges that GHG emissions from the defendants' facilities contributed to global warming which increased the intensity of Hurricane Katrina. E.ON, the indirect parent of the Companies, was included as a defendant in the complaint but has not been subject to the proceedings due to the failure of the plaintiffs to pursue service under the applicable international procedures. The Companies are currently unable to predict further developments in the *Comer* case and continue to monitor relevant GHG litigation to identify judicial developments that may be potentially relevant to their operations.

*Ghent Opacity NOV.* In September 2007, the EPA issued an NOV alleging that KU had violated certain provisions of the Clean Air Act's operating rules relating to opacity during June and July of 2007 at Units 1 and 3 of KU's Ghent generating station. The parties have met on this matter and KU has received no further communications from the EPA. The Company is not able to estimate the outcome or potential effects of these matters, including whether substantial fines, penalties or remedial measures may result.



*Ghent New Source Review NOV.* In March 2009, the EPA issued an NOV alleging that KU violated certain provisions of the Clean Air Act's rules governing new source review and prevention of significant deterioration by installing FGD and SCR controls at its Ghent generating station without assessing potential increased sulfuric acid mist emissions. KU contends that the work in question, as pollution control projects, was exempt from the requirements cited by the EPA. In December 2009, the EPA issued a Section 114 information request seeking additional information on this matter. In March 2010, the Company received an EPA settlement proposal providing for imposition of additional permit limits and emission controls and anticipates continued settlement negotiations with the EPA. Depending on the provisions of a final settlement or the results of litigation, if any, resolution of this matter could involve significant increased operating and capital expenditures. The Company is currently unable to determine the final outcome of this matter or the impact of an unfavorable determination on the Company's financial position or results of operations.

*Ash Ponds and Coal-Combustion Byproducts.* The EPA has undertaken various initiatives in response to the December 2008 impoundment failure at the Tennessee Valley Authority's Kingston power plant, which resulted in a major release of coal combustion byproducts into the environment. The EPA issued information requests to utilities throughout the country, including KU, to obtain information on their ash ponds and other impoundments. In addition, the EPA inspected a large number of impoundments located at power plants to determine their structural integrity. The inspections included several of KU's impoundments, which the EPA found to be in satisfactory condition. In June 2010, the EPA published proposed regulations for coal combustion byproducts handled in landfills and ash ponds. The EPA has proposed two alternatives: (1) regulation of coal combustion byproducts in landfills and ash ponds as a hazardous waste or (2) regulation of coal combustion byproducts as a solid waste with minimum national standards. Under both alternatives, the EPA has proposed safety requirements to address the structural integrity of ash ponds. In addition, the EPA will consider potential refinements of the provisions for beneficial reuse of coal combustion byproducts.

*Water Discharges and PCB Regulations.* The EPA has also announced plans to develop revised effluent limitation guidelines governing discharges from power plants and standards for cooling water intake structures. The EPA has further announced plans to develop revised standards governing the use of polychlorinated biphenyls ("PCB") in electrical equipment. The Company is monitoring these ongoing regulatory developments but will be unable to determine the impact until such time as new rules are finalized.

*Impact of Pending and Future Environmental Developments.* As a company with significant coal-fired generating assets, KU will likely be substantially impacted by pending or future environmental rules or legislation requiring mandatory reductions in GHG emissions or other air emissions, imposing more stringent standards on discharges to waterways, or establishing additional requirements for handling or disposal of coal combustion byproducts. These evolving environmental regulations will likely require an increased level of capital expenditures and increased incremental operating and maintenance costs by the Company over the next several years. Due to the uncertain nature of the final regulations that will ultimately be adopted by the EPA, including the reduction targets and the deadlines that will be applicable, the Company cannot finalize estimates of the potential compliance costs, but should the final rules incorporate additional emission reduction requirements, require more stringent emissions controls or implement more stringent byproducts storage and disposal practices, such costs will likely be significant. With respect to NAAQS, CATR, CAMR replacement and coal combustion byproducts developments, based on a preliminary analysis of proposed regulations, the Company may be required to consider actions such as upgrading existing emissions controls, installing additional emissions controls, upgrading byproducts disposal and storage and possible early replacement of coal-fired units. Capital expenditures for KU associated with such actions are preliminarily estimated to be in the \$1.7 billion range over the next 10 years, although final costs may substantially vary. With respect to potential developments in water discharge, revised PCB standards or GHG initiatives, costs in such areas cannot be estimated due to the preliminary status or uncertain outcome of such developments, but would be in addition to the above amount and could be substantial. Ultimately, the precise impact on the Company's operations of these various environmental developments cannot be determined prior to the finalization of such requirements. Based on prior regulatory precedent, the Company believes that many costs of complying with such pending or future requirements would likely be recoverable under the ECR or other potential cost-recovery mechanisms, but the Company can provide no assurance as to the ultimate outcome of such proceedings before the regulatory authorities.

*TC2 Water Permit.* In May 2010, the Kentucky Waterways Alliance and other environmental groups filed a petition with the Kentucky Energy and Environment Cabinet challenging the Kentucky Pollutant Discharge Elimination System permit issued in April 2010, which covers water discharges from the Trimble County generating station. In October 2010, the hearing officer issued a report and recommended order providing for dismissal of the claims raised by the petitioners. Until such time as the Secretary issues a final order of the agency and all appeals are exhausted, the Company is unable to predict the outcome or precise impact of this matter.

*General Environmental Proceedings.* From time to time, KU appears before the EPA, various state or local regulatory agencies and state and federal courts regarding matters involving compliance with applicable environmental laws and regulations. Such matters include a prior Section 114 information request from the EPA relating to new-source issues at KU's Ghent unit 2; completed settlement with state regulators regarding compliance with particulate limits in the air permit for KU's Tyrone generating station; remediation activities for or other risks relating to elevated PCB levels at existing properties; liability under the Comprehensive Environmental Response, Compensation and Liability Act for cleanup at various off-site waste sites; and claims regarding the GHG emissions from the Company's generating stations. Based on analysis to date, the resolution of these matters is not expected to have a material impact on the Company's operations.

**Note 10 — Related Party Transactions**

KU, subsidiaries of E.ON U.S. and subsidiaries of E.ON engage in related party transactions. Transactions between KU and E.ON U.S. subsidiaries are eliminated on consolidation of E.ON U.S. Transactions between KU and E.ON subsidiaries are eliminated on consolidation of E.ON. These transactions are generally performed at cost and are in accordance with FERC regulations under the Public Utility Holding Company Act of 2005 and the applicable Kentucky Commission and Virginia Commission regulations. The significant related party transactions are disclosed below.

**Intercompany Wholesale Sales and Purchases**

KU and LG&E jointly dispatch their generation units with the lowest cost generation used to serve their retail native load. When LG&E has excess generation capacity after serving its own retail native load and its generation cost is lower than that of KU, KU purchases electricity from LG&E. When KU has excess generation capacity after serving its own retail native load and its generation cost is lower than that of LG&E, LG&E purchases electricity from KU. These transactions are recorded as intercompany wholesale sales and purchases are recorded by each company at a price equal to the seller's fuel cost. Savings realized from purchasing electricity intercompany instead of generating from their own higher costs units or purchasing from the market are shared equally between the two Companies. The volume of energy each company has to sell to the other is dependent on its native load needs and its available generation.

These sales and purchases are included in the statements of income as operating revenues, power purchased expenses and other operation and maintenance expenses. KU's intercompany electric revenues and power purchased expense were as follows:

	<u>Three Months Ended</u> <u>September 30,</u>		<u>Nine Months Ended</u> <u>September 30,</u>	
	<u>2010</u>	<u>2009</u>	<u>2010</u>	<u>2009</u>
	(In millions)			
Electric operating revenues from LG&E. . . . .	\$ 3	\$ 2	\$13	\$18
Power purchased and related operations and maintenance expenses from LG&E. . . . .	22	22	71	82

**Interest Charges**

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

KU's interest expense to affiliated companies was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(In millions)			
Interest on Fidelia loans .....	\$18	\$18	\$55	\$51

Interest expense paid to E.ON U.S. on the money pool arrangement was less than \$1 million for the three and nine months ended September 30, 2010 and 2009.

### Dividends

In September 2010, the Company paid dividends of \$50 million to its common shareholder, E.ON U.S.

### Capital Contributions

In March and June 2009, the Company received capital contributions of \$50 million and \$25 million, respectively, from its common shareholder, E.ON U.S.

### Other Intercompany Billings

Servco provides the Company with a variety of centralized administrative, management and support services. These services include payroll taxes paid by Servco on behalf of KU, labor and burdens of Servco employees performing services for KU, coal purchases and other vouchers paid by Servco on behalf of KU. The cost of these services is directly charged to the Company, 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, the Companies provide services to each other and to Servco. Billings between the Companies relate to labor and overheads associated with union and hourly employees performing work for the other utility, charges related to jointly-owned generating units and other miscellaneous charges. Billings from KU to Servco include cash received by Servco on behalf of KU, primarily tax settlements, and other payments made by the Company on behalf of other non-regulated businesses which are reimbursed through Servco.

Intercompany billings to and from KU were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(In millions)			
Servco billings to KU .....	\$64	\$43	\$181	\$121
KU billings to LG&E .....	—	16	1	63
LG&E billings to KU .....	28	—	47	—
KU billings to Servco .....	11	3	11	5

### Intercompany Balances

The Company had the following balances with its affiliates:

	September 30, 2010	December 31, 2009
	(In millions)	
Accounts receivable from E.ON U.S. . . . .	\$ —	\$ 9
Accounts payable to LG&E . . . . .	17	53
Accounts payable to Servco . . . . .	18	20
Accounts payable to E.ON U.S. . . . .	18	—
Accounts payable to Fidelity . . . . .	18	15
Notes payable to E.ON U.S. . . . .	61	45
Long-term debt to Fidelity (including current portion of \$33 million) . . .	1,331	1,331

### **Note 11 — Subsequent Events**

Subsequent events have been evaluated through October 29, 2010, the date of issuance of these statements, and these statements contain all necessary adjustments and disclosures resulting from that evaluation.

On October 29, 2010, KU's pollution control bonds were converted from unsecured debt to debt which is collateralized by first mortgage bonds. See Note 1, General, and Note 8, Short-Term and Long-Term Debt.

On October 26, 2010, the FERC issued an Order approving the acquisition of E.ON U.S. by PPL. See Note 1, General.

On October 19, 2010 and October 21, 2010, respectively, the Virginia Commission and Tennessee Regulatory Authority issued Orders approving the acquisition of E.ON U.S. by PPL. On the same dates, KU received Virginia Commission and Tennessee Regulatory Authority approvals to complete certain refinancing transactions in connection with the anticipated PPL acquisition and other business factors. See Note 1, General, and Note 8, Short-Term and Long-Term Debt.

Supplement, dated October 29, 2010 to Reoffering Circular dated December 10, 2008, as supplemented as of December 16, 2008 (the "Reoffering Circular")

**\$50,000,000**

**County of Carroll, Kentucky  
Environmental Facilities Revenue Bonds, 2004 Series A  
(Kentucky Utilities Company Project)**

Effective as of October 29, 2010, the above-referenced bonds (the "Bonds") will be further secured by the delivery to U.S. Bank National Association, as trustee for the Bonds (the "Trustee"), of a tranche of first mortgage bonds of Kentucky Utilities Company (the "Company"). The principal amount, maturity date and interest rate (or method of determining interest rates) of such tranche of first mortgage bonds will be identical to the principal amount, maturity date and interest rate (or method of determining interest rates) of the Bonds. The first mortgage bonds will only be payable, and interest thereon will only accrue, as described herein. See "Security," "Summary of the Loan Agreement — Issuance and Delivery of First Mortgage Bonds" and "Summary of the First Mortgage Bonds" for more information regarding the first mortgage bonds. The first mortgage bonds will not provide a direct source of liquidity to pay the purchase price of Bonds tendered for purchase in accordance with the Indenture (as hereinafter defined).

Please be advised that, as reflected in the Company's most recent financial statements that are filed on the Electronic Municipal Market Access (EMMA) system and are incorporated by reference herein, PPL Corporation has entered into an agreement with E.ON AG pursuant to which PPL Corporation would purchase all of the ownership interests of E.ON U.S. LLC, the Company's parent. Consummation of the transaction is subject to customary closing conditions, including receipt of all required regulatory approvals. Subject to receipt of such approvals, the transaction is expected to close by the end of 2010. If the transaction is completed, the Company will become an indirect wholly-owned subsidiary of PPL Corporation.

Except as otherwise specified herein, information in the Reoffering Circular referred to above has not been amended or modified and the information contained herein is qualified by reference to, and should be read in conjunction with, the Reoffering Circular, including information incorporated therein by reference. Terms not otherwise defined herein shall have the meanings ascribed to them in such Reoffering Circular.

*The section of the Reoffering Circular captioned "Security; Limitation on Liens" is hereby amended to read in its entirety as follows:*

### **Security**

Payment of the principal of and interest and any premium on the Bonds will be secured by an assignment by the Issuer to the Trustee of the Issuer's interest in and to the Loan Agreement and all payments to be made pursuant thereto (other than certain indemnification and expense payments). Pursuant to the Loan Agreement, the Company will agree to pay, among other things, amounts sufficient to pay the aggregate principal amount of and premium, if any, on the Bonds, together with interest thereon as and when the same become due. The Company further will agree to make payments of the purchase price of the Bonds tendered for purchase to the extent that funds are not otherwise available therefor under the provisions of the Indenture.

The payment of the principal of and interest and any premium on the Bonds will be further secured by a separate tranche of the Company's First Mortgage Bonds, Collateral Series 2010 (the "First Mortgage Bonds") to be issued under an Indenture, dated as of October 1, 2010, as supplemented (the "First Mortgage Indenture"), between the Company and The Bank of New York Mellon, as trustee (the "First Mortgage Trustee"). The principal amount of the First Mortgage Bonds will equal the principal amount of the Bonds. If the Bonds become immediately due and payable as a result of a default in payment of the principal of, premium, if any, or interest on the Bonds, or a default in payment of the purchase price of such Bonds, due to an event of default under the Loan Agreement and upon receipt by the First Mortgage Trustee of a written demand from the Trustee for redemption of the First Mortgage Bonds, or if all first mortgage bonds outstanding under the First Mortgage Indenture shall have been immediately due and payable, such First Mortgage Bonds will bear interest at the same interest rate or rates borne by the Bonds and the principal of such First Mortgage Bonds, together with interest accrued thereon from the last date or dates to which interest on the Bonds has been paid in full, will be payable in accordance with the Supplemental Indenture. See "Summary of the First Mortgage Bonds."

The First Mortgage Bonds are not intended to provide a direct source of liquidity to pay the purchase price of Bonds tendered for purchase in accordance with the Indenture. The First Mortgage Bonds are secured by a lien on certain property owned by the Company. In certain circumstances, the Company is permitted to reduce the aggregate principal amount of its First Mortgage Bonds held by the Trustee, but in no event to an amount lower than the aggregate outstanding principal amount of the Bonds.

\* \* \* \*

*The section of the Reoffering Circular captioned “Summary of the Loan Agreement — Limitation on Liens” is hereby deleted. The sections of the Reoffering Circular captioned “Summary of the Loan Agreement — Issuance and Delivery of First Mortgage Bonds”; “ — Insurance”; “ — Events of Default” and “ — Remedies” are hereby added or amended, as applicable, to read in their entirety as follows:*

### **Summary of the Loan Agreement**

\* \* \* \*

#### **Issuance and Delivery of First Mortgage Bonds**

For the purpose of providing security for the Bonds, the Company will execute and deliver to the Trustee the First Mortgage Bonds. The principal amount of the First Mortgage Bonds executed and delivered to the Trustee will be equal to the aggregate principal amount of the Bonds. If the Bonds become immediately due and payable as a result of a default in payment of the principal of, premium, if any, or interest on the Bonds, or a default in payment of the purchase price of such Bonds, due to an event of default under the Loan Agreement and upon receipt by the First Mortgage Trustee of a written demand from the Trustee for redemption of the First Mortgage Bonds, or if all first mortgage bonds outstanding under the First Mortgage Indenture shall have been immediately due and payable, such First Mortgage Bonds will bear interest at the same interest rate or rates borne by the Bonds and the principal of such First Mortgage Bonds, together with interest accrued thereon from the last date to which interest on the Bonds shall have been paid in full, will then be payable. See, however, "Summary of the Indenture — Waiver of Events of Default."

Upon payment of the principal of, premium, if any, and interest on any of the Bonds, and the surrender to and cancellation thereof by the Trustee, or upon provision for the payment thereof having been made in accordance with the Indenture, First Mortgage Bonds with corresponding principal amounts equal to the aggregate principal amount of the Bonds so surrendered and canceled or for the payment of which provision has been made, will be surrendered by the Trustee to the First Mortgage Trustee and will be canceled by the First Mortgage Trustee. The First Mortgage Bonds will be registered in the name of the Trustee and will be non transferable, except to effect transfers to any successor trustee under the Indenture.

#### **Insurance**

The Company has agreed to insure the Project in accordance with the provisions of the First Mortgage Indenture.

#### **Events of Default**

Each of the following events constitutes an “event of default” under the Loan Agreement:

- (1) failure by the Company to pay the amounts required for payment of the principal of, including purchase price for tendered Bonds and redemption and acceleration prices, and interest accrued, on the Bonds, at the times specified therein taking into account any periods of grace provided in the Indenture and the Bonds for the

(2) failure by the Company to observe and perform any covenant, condition or agreement, other than as referred to in paragraph (1) above, for a period of thirty days after written notice by the Issuer or Trustee, provided, however, that if such failure is capable of being corrected, but cannot be corrected in such 30-day period, it will not constitute an event of default under the Loan Agreement if corrective action with respect thereto is instituted within such period and is being diligently pursued;

(3) certain events of bankruptcy, dissolution, liquidation, reorganization or insolvency of the Company;

(4) the occurrence of an event of default under the Indenture; or

(5) all first mortgage bonds outstanding under the First Mortgage Indenture, if not already due, shall have become immediately due and payable, whether by declaration or otherwise, and such acceleration shall not have been rescinded or annulled by the First Mortgage Trustee.

Under the Loan Agreement, certain of the Company's obligations (other than the Company's obligations, among others, (i) not to permit any action which would result in interest paid on the Bonds being included in gross income for federal and Kentucky income taxes; (ii) to maintain its corporate existence and good standing, and to neither dispose of all or substantially all of its assets or consolidate with or merge into another corporation unless certain provisions of the Loan Agreement are satisfied; and (iii) to make loan payments and certain other payments under the provisions of the Loan Agreement) may be suspended if by reason of force majeure (as defined in the Loan Agreement) the Company is unable to carry out such obligations.

## **Remedies**

Upon the happening of an event of default under the Loan Agreement, the Trustee, on behalf of the Issuer, may, among other things, take whatever action at law or in equity may appear necessary or desirable to collect the amounts then due and thereafter to become due, or to enforce performance and observance of any obligation, agreement or covenant of the Company, under the Loan Agreement, including any remedies available in respect of the First Mortgage Bonds.

In the event of a default in payment of the principal of, premium, if any, or interest on the Bonds and the acceleration of the maturity date of the Bonds (to the extent not already due and payable) as a consequence of such event of default, the Trustee may demand redemption of the First Mortgage Bonds. See "Summary of the First Mortgage Bonds" and "Summary of the Indenture — Defaults and Remedies." Any amounts collected upon the happening of any such event of default will be applied in accordance with the Indenture or, if the Bonds have been fully paid (or provision for payment thereof has been made in accordance with the Indenture) and all other liabilities of the Company accrued under the Indenture and the Loan Agreement have been paid or satisfied, made available to the Company.



\* \* \* \*

*A new section is hereby added to the Reoffering Circular to read in its entirety as follows:*

### **Summary of the First Mortgage Bonds**

*The following, in addition to the provisions contained elsewhere in this Reoffering Circular, is a brief description of certain provisions of the First Mortgage Bonds and the First Mortgage Indenture. This description is only a summary and does not purport to be complete and definitive. Reference is made to the First Mortgage Indenture and to the form of the First Mortgage Bonds for the detailed provisions thereof.*

#### **General**

The First Mortgage Bonds, in a principal amount equal to the principal amount of the Bonds, were issued as a new tranche from a new series of first mortgage bonds under the First Mortgage Indenture (see "Summary of the Loan Agreement — Issuance and Delivery of First Mortgage Bonds"). The statements herein made (being for the most part summaries of certain provisions of the First Mortgage Indenture) are subject to the detailed provisions of the First Mortgage Indenture, which is incorporated herein by this reference. Words or phrases italicized are defined in the First Mortgage Indenture.

The First Mortgage Bonds will mature on the same date and bear interest at the same rate or rates as the Bonds; however, the principal of and interest on the First Mortgage Bonds will not be payable other than upon the occurrence of an event of default under the Loan Agreement. If the Bonds become immediately due and payable as a result of a default in payment of the principal of, premium, if any, or interest on the Bonds, or a default in payment of the purchase price of such Bonds, due to an event of default under the Loan Agreement, and if all first mortgage bonds outstanding under the First Mortgage Indenture shall not have become immediately due and payable following an event of default under the First Mortgage Indenture, the Company will be obligated to redeem the First Mortgage Bonds upon receipt by the First Mortgage Trustee of a Redemption Demand from the Trustee for redemption, at a redemption price equal to the principal amount thereof plus accrued interest at the rates borne by the Bonds from the last date to which interest on the Bonds has been paid.

The First Mortgage Bonds at all times will be in fully registered form registered in the name of the Trustee, will be non-negotiable, and will be non-transferable except to any successor trustee under the Indenture. Upon payment and cancellation of Bonds by the Trustee or the Paying Agent (other than any Bond or portion thereof that was canceled by the Trustee or the Paying Agent and for which one or more Bonds were delivered and authenticated pursuant to the Indenture), whether at maturity, by redemption or otherwise, or upon provision for the payment of the Bonds having been made in accordance with the Indenture, an equal principal amount of

First Mortgage Bonds will be deemed fully paid and the obligations of the Company thereunder will cease.

### **Security; Lien of the First Mortgage Indenture**

General. Except as described below under this heading and under “— Issuance of Additional First Mortgage Bonds,” and subject to the exceptions described under “— Satisfaction and Discharge,” all first mortgage bonds issued under the First Mortgage Indenture, including the Bonds, will be secured, equally and ratably, by the lien of the First Mortgage Indenture, which constitutes, subject to permitted liens as described below, a first mortgage lien on substantially all of the Company’s real and tangible personal property located in Kentucky and used or to be used in connection with the generation, transmission and distribution of electricity (other than property duly released from the lien of the First Mortgage Indenture in accordance with the provisions thereof and other than excepted property, as described below). Property that is subject to the lien of the First Mortgage Indenture is referred to herein as “Mortgaged Property.”

The Company may obtain the release of property from the lien of the First Mortgage Indenture from time to time, upon the bases provided for such release in the First Mortgage Indenture. See “— Release of Property.”

The Company may enter into supplemental indentures with the First Mortgage Trustee, without the consent of the holders of the first mortgage bonds, in order to subject additional property (including property that would otherwise be excepted from such lien) to the lien of the First Mortgage Indenture. This property would constitute *property additions* and would be available as a basis for the issuance of additional first mortgage bonds. See “— Issuance of Additional First Mortgage Bonds.”

The First Mortgage Indenture provides that after-acquired property (other than *excepted property*) will be subject to the lien of the First Mortgage Indenture. However, in the case of consolidation or merger (whether or not the Company is the surviving company) or transfer of the Mortgaged Property as or substantially as an entirety, the First Mortgage Indenture will not be required to be a lien upon any of the properties either owned or subsequently acquired by the successor company except properties acquired from the Company in or as a result of such transfer, as well as improvements, extensions and additions (as defined in the First Mortgage Indenture) to such properties and renewals, replacements and substitutions of or for any part or parts thereof. See “— Consolidation, Merger and Conveyance of Assets as an Entirety.”

Excepted Property. The lien of the First Mortgage Indenture does not cover, among other things, the following types of property: property located outside of Kentucky and not specifically subjected or required to be subjected to the lien of the First Mortgage Indenture; property not used by the Company in its electric generation, transmission and distribution business; cash and securities not paid, deposited or held under the First Mortgage Indenture; contracts, leases and other agreements of all kinds, contract rights, bills, notes and other instruments, revenues, accounts receivable, claims, demands and judgments; governmental and other licenses, permits, franchises, consents and allowances; intellectual property rights and other general intangibles; vehicles, movable equipment, aircraft and vessels; all goods, stock in trade, wares, merchandise

and inventory held for the purpose of sale or lease in the ordinary course of business; materials, supplies, inventory and other personal property consumable in the operation of the Company's business; fuel; tools and equipment; furniture and furnishings; computers and data processing, telecommunications and other facilities used primarily for administrative or clerical purposes or otherwise not used in connection with the operation or maintenance of electric generation, transmission and distribution facilities; coal, ore, gas, oil and other minerals and timber rights; electric energy and capacity, gas, steam, water and other products generated, produced, manufactured, purchased or otherwise acquired; real property and facilities used primarily for the production or gathering of natural gas; property which has been released from the lien of the First Mortgage Indenture; and leasehold interests. Property of the Company not covered by the lien of the First Mortgage Indenture is referred to herein as excepted property. Properties held by any of the Company's subsidiaries, as well as properties leased from others, would not be subject to the lien of the First Mortgage Indenture.

*Permitted Liens.* The lien of the First Mortgage Indenture is subject to permitted liens described in the First Mortgage Indenture. Such *permitted liens* include liens existing at the execution date of the First Mortgage Indenture, purchase money liens and other liens placed or otherwise existing on property acquired by the Company after the execution date of the First Mortgage Indenture at the time the Company acquires it, tax liens and other governmental charges which are not delinquent or which are being contested in good faith, mechanics', construction and materialmen's liens, certain judgment liens, easements, reservations and rights of others (including governmental entities) in, and defects of title to, the Company's property, certain leases and leasehold interests, liens to secure public obligations, rights of others to take minerals, timber, electric energy or capacity, gas, water, steam or other products produced by the Company or by others on the Company's property, rights and interests of persons other than the Company arising out of agreements relating to the common ownership or joint use of property, and liens on the interests of such persons in such property and liens which have been bonded or for which other security arrangements have been made.

The First Mortgage Indenture also provides that the First Mortgage Trustee will have a lien, prior to the lien on behalf of the holders of the first mortgage bonds, including the First Mortgage Bonds, upon the Mortgaged Property as security for the Company's payment of its reasonable compensation and expenses and for indemnity against certain liabilities. Any such lien would be a *permitted lien* under the First Mortgage Indenture.

### **Issuance of Additional First Mortgage Bonds**

The maximum principal amount of first mortgage bonds that may be authenticated and delivered under the First Mortgage Indenture is subject to the issuance restrictions described below; provided, however, that the maximum principal amount of first mortgage bonds outstanding at any one time shall not exceed One Quintillion Dollars (\$1,000,000,000,000,000,000), which amount may be changed by supplemental indenture. First mortgage bonds of any series may be issued from time to time on the basis of, and in an aggregate principal amount not exceeding:

- 66 2/3% of the *cost* or *fair value* to the Company (whichever is less) of *property additions* (as described below) which do not constitute *funded property* (generally, *property additions*)

which have been made the basis of the authentication and delivery of first mortgage bonds, the release of Mortgaged Property or the withdrawal of cash, which have been substituted for retired *funded property* or which have been used for other specified purposes) after certain deductions and additions, primarily including adjustments to offset property retirements;

- the aggregate principal amount of *retired securities* (as described below); or
- an amount of cash deposited with the First Mortgage Trustee.

*Property additions* generally include any property which is owned by the Company and is subject to the lien of the First Mortgage Indenture except (with certain exceptions) goodwill, going concern value rights or intangible property, or any property the acquisition or construction of which is properly chargeable to one of the Company's operating expense accounts.

*Retired securities* means, generally, first mortgage bonds which are no longer outstanding under the First Mortgage Indenture, which have not been retired by the application of *funded cash* and which have not been used as the basis for the authentication and delivery of first mortgage bonds, the release of property or the withdrawal of cash.

The First Mortgage Bonds will be issued on the basis of *property additions*. At August 31, 2010, approximately \$2.3 billion of *property additions* were available to be used as the basis for the authentication and delivery of first mortgage bonds.

### **Release of Property**

Unless an *event of default* has occurred and is continuing, the Company may obtain the release from the lien of the First Mortgage Indenture of any Mortgaged Property, except for cash held by the First Mortgage Trustee, upon delivery to the First Mortgage Trustee of an amount in cash equal to the amount, if any, by which sixty-six and two-thirds percent (66-2/3%) of the cost of the property to be released (or, if less, the *fair value* to the Company of such property at the time it became *funded property*) exceeds the aggregate of:

- an amount equal to 66 2/3% of the aggregate principal amount of obligations secured by *purchase money liens* upon the property to be released and delivered to the First Mortgage Trustee;
- an amount equal to 66 2/3% of the *cost* or *fair value* to the Company (whichever is less) of certified *property additions* not constituting *funded property* after certain deductions and additions, primarily including adjustments to offset property retirements (except that such adjustments need not be made if such *property additions* were acquired or made within the 90-day period preceding the release);
- the aggregate principal amount of first mortgage bonds the Company would be entitled to issue on the basis of *retired securities* (with such entitlement being waived by operation of such release);

- the aggregate principal amount of first mortgage bonds delivered to the First Mortgage Trustee (with such first mortgage bonds to be canceled by the First Mortgage Trustee);
- any amount of cash and/or an amount equal to 66 2/3% of the aggregate principal amount of obligations secured by *purchase money liens* upon the property released delivered to the trustee or other holder of a lien prior to the lien of the First Mortgage Indenture, subject to certain limitations described in the First Mortgage Indenture; and
- any taxes and expenses incidental to any sale, exchange, dedication or other disposition of the property to be released.

As used in the First Mortgage Indenture, the term *purchase money lien* means, generally, a lien on the property being released which is retained by the transferor of such property or granted to one or more other persons in connection with the transfer or release thereof, or granted to or held by a trustee or agent for any such persons, and may include liens which cover property in addition to the property being released and/or which secure indebtedness in addition to indebtedness to the transferor of such property.

Unless an *event of default* has occurred and is continuing, property which is not *funded property* may generally be released from the lien of the First Mortgage Indenture without depositing any cash or property with the First Mortgage Trustee as long as (a) the aggregate amount of *cost* or *fair value* to the Company (whichever is less) of all *property additions* which do not constitute *funded property* (excluding the property to be released) after certain deductions and additions, primarily including adjustments to offset property retirements, is not less than zero or (b) the cost or *fair value* (whichever is less) of property to be released does not exceed the aggregate amount of the cost or fair value to the Company (whichever is less) of *property additions* acquired or made within the 90-day period preceding the release.

The First Mortgage Indenture provides simplified procedures for the release of minor properties and property taken by eminent domain, and provides for dispositions of certain obsolete property and grants or surrender of certain rights without any release or consent by the First Mortgage Trustee.

If the Company retains any interest in any property released from the lien of the First Mortgage Indenture, the First Mortgage Indenture will not become a lien on such property or such interest therein or any improvements, extensions or additions to such property or renewals, replacements or substitutions of or for such property or any part or parts thereof.

### **Withdrawal of Cash**

Unless an *event of default* has occurred and is continuing, and subject to certain limitations, cash held by the First Mortgage Trustee may, generally, (1) be withdrawn by the Company (a) to the extent of sixty-six and two-thirds percent (66-2/3%) of the cost or *fair value* to the Company (whichever is less) of *property additions* not constituting *funded property*, after certain deductions and additions, primarily including adjustments to offset retirements (except that such adjustments need not be made if such *property additions* were acquired or made within the 90-day period preceding the withdrawal) or (b) in an amount equal to the aggregate principal

amount of first mortgage bonds that the Company would be entitled to issue on the basis of *retired securities* (with the entitlement to such issuance being waived by operation of such withdrawal) or (c) in an amount equal to the aggregate principal amount of any outstanding first mortgage bonds delivered to the First Mortgage Trustee; or (2) upon the Company's request, be applied to (a) the purchase of first mortgage bonds in a manner and at a price approved by the Company or (b) the payment (or provision for payment) at stated maturity of any first mortgage bonds or the redemption (or provision for payment) of any first mortgage bonds which are redeemable; provided, however, that cash deposited with the First Mortgage Trustee as the basis for the authentication and delivery of first mortgage bonds may, in addition, be withdrawn in an amount not exceeding the aggregate principal amount of cash delivered to the First Mortgage Trustee for such purpose.

### **Events of Default**

An "*event of default*" occurs under the First Mortgage Indenture if

- the Company does not pay any interest on any first mortgage bonds within 30 days of the due date;
- the Company does not pay principal or premium, if any, on any first mortgage bonds on the due date;
- the Company remains in breach of any other covenant (excluding covenants specifically dealt with elsewhere in this section) in respect of any first mortgage bonds for 90 days after the Company receives a written notice of default stating the Company is in breach and requiring remedy of the breach; the notice must be sent by either the First Mortgage Trustee or holders of 25% of the principal amount of outstanding first mortgage bonds; the First Mortgage Trustee or such holders can agree to extend the 90-day period and such an agreement to extend will be automatically deemed to occur if the Company initiates corrective action within such 90 day period and the Company is diligently pursuing such action to correct the default; or
- the Company files for bankruptcy or certain other events in bankruptcy, insolvency, receivership or reorganization occur.

### **Remedies**

*Acceleration of Maturity.* If an event of default occurs and is continuing, then either the First Mortgage Trustee or the holders of not less than 25% in principal amount of the outstanding first mortgage bonds may declare the principal amount of all of the first mortgage bonds to be due and payable immediately.

*Rescission of Acceleration.* After the declaration of acceleration has been made and before the First Mortgage Trustee has obtained a judgment or decree for payment of the money due, such declaration and its consequences will be rescinded and annulled, if

- the Company pays or deposits with the First Mortgage Trustee a sum sufficient to pay:

- all overdue interest;
- the principal of and premium, if any, which have become due otherwise than by such declaration of acceleration and interest thereon;
- interest on overdue interest to the extent lawful;
- all amounts due to the First Mortgage Trustee under the First Mortgage Indenture; and
- all *events of default*, other than the nonpayment of the principal which has become due solely by such declaration of acceleration, have been cured or waived as provided in the First Mortgage Indenture.

For more information as to waiver of defaults, see “— Waiver of Default and of Compliance” below.

*Appointment of Receiver and Other Remedies.* Subject to the First Mortgage Indenture, under certain circumstances and to the extent permitted by law, if an *event of default* occurs and is continuing, the First Mortgage Trustee has the power to appoint a receiver of the Mortgaged Property, and is entitled to all other remedies available to mortgagees and secured parties under the Uniform Commercial Code or any other applicable law.

*Control by Holders; Limitations.* Subject to the First Mortgage Indenture, if an *event of default* occurs and is continuing, the holders of a majority in principal amount of the outstanding first mortgage bonds will have the right to

- direct the time, method and place of conducting any proceeding for any remedy available to the First Mortgage Trustee, or
- exercise any trust or power conferred on the First Mortgage Trustee.

The rights of holders to make direction are subject to the following limitations:

- the holders’ directions may not conflict with any law or the First Mortgage Indenture; and
- the holders’ directions may not involve the First Mortgage Trustee in personal liability where the First Mortgage Trustee believes indemnity is not adequate.

The First Mortgage Trustee may also take any other action it deems proper which is not inconsistent with the holders’ direction.

In addition, the First Mortgage Indenture provides that no holder of any first mortgage bond will have any right to institute any proceeding, judicial or otherwise, with respect to the First Mortgage Indenture for the appointment of a receiver or for any other remedy thereunder unless

- that holder has previously given the First Mortgage Trustee written notice of a continuing *event of default*;
- the holders of 25% in aggregate principal amount of the outstanding first mortgage bonds have made written request to the First Mortgage Trustee to institute proceedings in respect of that *event of default* and have offered the First Mortgage Trustee reasonable indemnity against costs, expenses and liabilities incurred in complying with such request; and
- for 60 days after receipt of such notice, request and offer of indemnity, the First Mortgage Trustee has failed to institute any such proceeding and no direction inconsistent with such request has been given to the First Mortgage Trustee during such 60-day period by the holders of a majority in aggregate principal amount of outstanding first mortgage bonds.

Furthermore, no holder of any first mortgage bonds will be entitled to institute any such action if and to the extent that such action would disturb or prejudice the rights of other holders of first mortgage bonds.

However, each holder of any first mortgage bonds has an absolute and unconditional right to receive payment when due and to bring a suit to enforce that right.

*Notice of Default.* The First Mortgage Trustee is required to give the holders of the first mortgage bonds notice of any default under the First Mortgage Indenture to the extent required by the Trust Indenture Act, unless such default has been cured or waived; except that in the case of an *event of default* of the character specified in the third bullet point under “— Events of Default” (regarding a breach of certain covenants continuing for 90 days after the receipt of a written notice of default), no such notice shall be given to such holders until at least 60 days after the occurrence thereof. The Trust Indenture Act currently permits the First Mortgage Trustee to withhold notices of default (except for certain payment defaults) if the First Mortgage Trustee in good faith determines the withholding of such notice to be in the interests of the holders of the first mortgage bonds.

The Company will furnish the First Mortgage Trustee with an annual statement as to its compliance with the conditions and covenants in the First Mortgage Indenture.

*Waiver of Default and of Compliance.* The holders of a majority in aggregate principal amount of the outstanding first mortgage bonds may waive, on behalf of the holders of all outstanding first mortgage bonds, any past default under the First Mortgage Indenture, except a default in the payment of principal, premium or interest, or with respect to compliance with certain provisions of the First Mortgage Indenture that cannot be amended without the consent of the holder of each outstanding first mortgage bond affected.

Compliance with certain covenants in the First Mortgage Indenture or otherwise provided with respect to first mortgage bonds may be waived by the holders of a majority in aggregate principal amount of the affected first mortgage bonds, considered as one class.



## **Consolidation, Merger and Conveyance of Assets as an Entirety**

Subject to the provisions described below, the Company has agreed to preserve its corporate existence.

The Company has agreed not to consolidate with or merge with or into any other entity or convey, transfer or lease the Mortgaged Property as or substantially as an entirety to any entity unless

- the entity formed by such consolidation or into which the Company merges, or the entity which acquires or which leases the Mortgaged Property substantially as an entirety, is an entity organized and existing under the laws of the United States of America or any State or Territory thereof or the District of Columbia, and
- expressly assumes, by supplemental indenture, the due and punctual payment of the principal of, and premium and interest on, all the outstanding first mortgage bonds and the performance of all of the Company's covenants under the First Mortgage Indenture, and
- such entity confirms the lien of the First Mortgage Indenture on the Mortgaged Property, including property thereafter acquired by such entity which constitutes an improvement, extension or addition to the Mortgaged Property or a renewal, replacement or substitution thereof;
- in the case of a lease, such lease is made expressly subject to termination by (i) the Company or by the First Mortgage Trustee and (ii) the purchaser of the property so leased at any sale thereof, at any time during the continuance of an *event of default*; and
- immediately after giving effect to such transaction, no *event of default*, and no event which after notice or lapse of time or both would become an *event of default*, will have occurred and be continuing.

In the case of the conveyance or other transfer of the Mortgaged Property as or substantially as an entirety to any other person, upon the satisfaction of all the conditions described above the Company would be released and discharged from all obligations under the First Mortgage Indenture and on the first mortgage bonds then outstanding unless the Company elects to waive such release and discharge.

The First Mortgage Indenture does not prevent or restrict:

- any consolidation or merger after the consummation of which the Company would be the surviving or resulting entity; or
- any conveyance or other transfer, or lease, of any part of the Mortgaged Property which does not constitute the entirety or substantially the entirety thereof.

If following a conveyance or other transfer, or lease, of any part of the Mortgaged Property, the fair value of the Mortgaged Property retained by the Company exceeds an amount equal to three-halves (3/2) of the aggregate principal amount of all outstanding first mortgage bonds, then the part of the Mortgaged Property so conveyed, transferred or leased shall be deemed not to constitute the entirety or substantially the entirety of the Mortgaged Property. This fair value will be determined within 90 days of the conveyance or transfer by an independent expert that the Company selects and that is approved by the First Mortgage Trustee.

### **Modification of First Mortgage Indenture**

*Without Holder Consent.* Without the consent of any holders of first mortgage bonds, the Company and the First Mortgage Trustee may enter into one or more supplemental indentures for any of the following purposes:

- to evidence the succession of another entity to the Company;
- to add one or more covenants or other provisions for the benefit of the holders of all or any series or tranche of first mortgage bonds, or to surrender any right or power conferred upon the Company;
- to correct or amplify the description of any property at any time subject to the lien of the First Mortgage Indenture; or to better assure, convey and confirm unto the First Mortgage Trustee any property subject or required to be subjected to the lien of the First Mortgage Indenture; or to subject to the lien of the First Mortgage Indenture additional property (including property of others), to specify any additional Permitted Liens with respect to such additional property and to modify the provisions in the First Mortgage Indenture for dispositions of certain types of property without release in order to specify any additional items with respect to such additional property;
- to add any additional *events of default*, which may be stated to remain in effect only so long as the first mortgage bonds of any one more particular series remains outstanding;
- to change or eliminate any provision of the First Mortgage Indenture or to add any new provision to the First Mortgage Indenture that does not adversely affect the interests of the holders in any material respect;
- to establish the form or terms of any series or tranche of first mortgage bonds;
- to provide for the issuance of bearer securities;
- to evidence and provide for the acceptance of appointment of a successor First Mortgage Trustee or by a co-trustee or separate trustee;
- to provide for the procedures required to permit the utilization of a noncertificated system of registration for any series or tranche of first mortgage bonds;
- to change any place or places where

- the Company may pay principal, premium and interest,
- first mortgage bonds may be surrendered for transfer or exchange, and
- notices and demands to or upon the Company may be served;
- to amend and restate the First Mortgage Indenture as originally executed, and as amended from time to time, with such additions, deletions and other changes that do not adversely affect the interest of the holders in any material respect;
- to cure any ambiguity, defect or inconsistency or to make any other changes that do not adversely affect the interests of the holders in any material respect; or
- to increase or decrease the maximum principal amount of first mortgage bonds that may be outstanding at any time.

In addition, if the Trust Indenture Act is amended after the date of the First Mortgage Indenture so as to require changes to the First Mortgage Indenture or so as to permit changes to, or the elimination of, provisions which, at the date of the First Mortgage Indenture or at any time thereafter, were required by the Trust Indenture Act to be contained in the First Mortgage Indenture, the First Mortgage Indenture will be deemed to have been amended so as to conform to such amendment or to effect such changes or elimination, and the Company and the First Mortgage Trustee may, without the consent of any holders, enter into one or more supplemental indentures to effect or evidence such amendment.

*With Holder Consent.* Except as provided above, the consent of the holders of at least a majority in aggregate principal amount of the first mortgage bonds of all outstanding series, considered as one class, is generally required for the purpose of adding to, or changing or eliminating any of the provisions of, the First Mortgage Indenture pursuant to a supplemental indenture. However, if less than all of the series of outstanding first mortgage bonds are directly affected by a proposed supplemental indenture, then such proposal only requires the consent of the holders of a majority in aggregate principal amount of the outstanding first mortgage bonds of all directly affected series, considered as one class. Moreover, if the first mortgage bonds of any series have been issued in more than one tranche and if the proposed supplemental indenture directly affects the rights of the holders of first mortgage bonds of one or more, but less than all, of such tranches, then such proposal only requires the consent of the holders of a majority in aggregate principal amount of the outstanding first mortgage bonds of all directly affected tranches, considered as one class.

However, no amendment or modification may, without the consent of the holder of each outstanding first mortgage bond directly affected thereby,

- change the stated maturity of the principal or interest on any first mortgage bond (other than pursuant to the terms thereof), or reduce the principal amount, interest or premium payable (or method of calculating such rates) or change the currency in which any first mortgage bond is payable, or impair the right to bring suit to enforce any payment;

- create any lien (not otherwise permitted by the First Mortgage Indenture) ranking prior to the lien of the First Mortgage Indenture with respect to all or substantially all of the Mortgaged Property, or terminate the lien of the First Mortgage Indenture on all or substantially all of the Mortgaged Property (other than in accordance with the terms of the First Mortgage Indenture), or deprive any holder of the benefits of the security of the lien of the First Mortgage Indenture;
- reduce the percentages of holders whose consent is required for any supplemental indenture or waiver of compliance with any provision of the First Mortgage Indenture or of any default thereunder and its consequences, or reduce the requirements for quorum and voting under the First Mortgage Indenture; or
- modify certain of the provisions of the First Mortgage Indenture relating to supplemental indentures, waivers of certain covenants and waivers of past defaults with respect to first mortgage bonds.

A supplemental indenture which changes, modifies or eliminates any provision of the First Mortgage Indenture expressly included solely for the benefit of holders of first mortgage bonds of one or more particular series or tranches will be deemed not to affect the rights under the First Mortgage Indenture of the holders of first mortgage bonds of any other series or tranche.

### **Satisfaction and Discharge**

Any first mortgage bonds or any portion thereof will be deemed to have been paid and no longer outstanding for purposes of the First Mortgage Indenture and, at the Company's election, the Company's entire indebtedness with respect to those securities will be satisfied and discharged, if there shall have been irrevocably deposited with the First Mortgage Trustee or any Paying Agent (other than the Company), in trust:

- money sufficient, or
- in the case of a deposit made prior to the maturity of such first mortgage bonds, non-redeemable *eligible obligations* (as defined in the First Mortgage Indenture) sufficient, or
- a combination of the items listed in the preceding two bullet points, which in total are sufficient,

to pay when due the principal of, and any premium, and interest due and to become due on such first mortgage bonds or portions of such first mortgage bonds on and prior to their maturity.

The Company's right to cause its entire indebtedness in respect of the first mortgage bonds of any series to be deemed to be satisfied and discharged as described above will be subject to the satisfaction of any conditions specified in the instrument creating such series.

The First Mortgage Indenture will be deemed satisfied and discharged when no first mortgage bonds remain outstanding and when the Company has paid all other sums payable by it under the First Mortgage Indenture.

All moneys the Company pays to the First Mortgage Trustee or any Paying Agent on First Mortgage Bonds that remain unclaimed at the end of two years after payments have become due may be paid to or upon the Company's order. Thereafter, the holder of such First Mortgage Bond may look only to the Company for payment.

### **Duties of the First Mortgage Trustee; Resignation and Removal of the First Mortgage Trustee; Deemed Resignation**

The First Mortgage Trustee will have, and will be subject to, all the duties and responsibilities specified with respect to an indenture trustee under the Trust Indenture Act. Subject to these provisions, the First Mortgage Trustee will be under no obligation to exercise any of the powers vested in it by the First Mortgage Indenture at the request of any holder of first mortgage bonds, unless offered reasonable indemnity by such holder against the costs, expenses and liabilities which might be incurred thereby. The First Mortgage Trustee will not be required to expend or risk its own funds or otherwise incur financial liability in the performance of its duties if the First Mortgage Trustee reasonably believes that repayment or adequate indemnity is not reasonably assured to it.

The First Mortgage Trustee may resign at any time by giving written notice to the Company.

The First Mortgage Trustee may also be removed by act of the holders of a majority in principal amount of the then outstanding first mortgage bonds of any series.

No resignation or removal of the First Mortgage Trustee and no appointment of a successor trustee will become effective until the acceptance of appointment by a successor trustee in accordance with the requirements of the First Mortgage Indenture.

Under certain circumstances, the Company may appoint a successor trustee and if the successor accepts, the First Mortgage Trustee will be deemed to have resigned.

### **Evidence to be Furnished to the First Mortgage Trustee**

Compliance with First Mortgage Indenture provisions is evidenced by written statements of the Company's officers or persons selected or paid by the Company. In certain cases, opinions of counsel and certifications of an engineer, accountant, appraiser or other expert (who in some cases must be independent) must be furnished. In addition, the First Mortgage Indenture requires the Company to give to the First Mortgage Trustee, not less than annually, a brief statement as to the Company's compliance with the conditions and covenants under the First Mortgage Indenture.

## **Miscellaneous Provisions**

The First Mortgage Indenture provides that certain first mortgage bonds, including those for which payment or redemption money has been deposited or set aside in trust as described under “— Satisfaction and Discharge” above, will not be deemed to be “outstanding” in determining whether the holders of the requisite principal amount of the outstanding first mortgage bonds have given or taken any demand, direction, consent or other action under the First Mortgage Indenture as of any date, or are present at a meeting of holders for quorum purposes.

The Company will be entitled to set any day as a record date for the purpose of determining the holders of outstanding first mortgage bonds of any series entitled to give or take any demand, direction, consent or other action under the First Mortgage Indenture, in the manner and subject to the limitations provided in the First Mortgage Indenture. In certain circumstances, the First Mortgage Trustee also will be entitled to set a record date for action by holders. If such a record date is set for any action to be taken by holders of particular first mortgage bonds, such action may be taken only by persons who are holders of such first mortgage bonds on the record date.

## **Governing Law**

The First Mortgage Indenture and the first mortgage bonds provide that they are to be governed by and construed in accordance with the laws of the State of New York except where the Trust Indenture Act is applicable or where otherwise required by law. The effectiveness of the lien of the First Mortgage Indenture, and the perfection and priority thereof, will be governed by Kentucky law.

\* \* \* \*

*The sections of the Reoffering Circular captioned “Summary of the Indenture — Surrender of First Mortgage Bonds”; “— Defaults and Remedies”; “— Waiver of Events of Default”; and “— Voting of First Mortgage Bonds Held by Trustee” are hereby added or amended, as applicable, to read in their entirety as follows:*

### **Summary of the Indenture**

\* \* \* \*

#### **Surrender of First Mortgage Bonds**

Upon payment of any principal of, premium, if any, and interest on any of the Bonds which reduces the principal amount of Bonds outstanding, or upon provision for the payment thereof having been made in accordance with the Indenture, First Mortgage Bonds in a principal amount equal to the principal amount of the Bonds so paid, or for the payment of which such provision has been made, shall be surrendered by the Trustee to the First Mortgage Trustee. The First Mortgage Bonds so surrendered shall be deemed fully paid and the obligations of the Company thereunder terminated.

#### **Defaults and Remedies**

Each of the following events constitutes an “Event of Default” under the Indenture:

- (1) failure to make payment of any installment of interest on any Bond within a period of one Business Day from the due date;
- (2) failure to make punctual payment of the principal of, or premium, if any, on any Bond on the due date, whether at the stated maturity thereof, or upon proceedings for redemption, or upon the maturity thereof by declaration or if payment of the purchase price of any Bond required to be purchased pursuant to the Indenture is not made when such payment has become due and payable;
- (3) failure of the Issuer to perform or observe any other of the covenants, agreements or conditions in the Indenture or in the Bonds which failure continues for a period of 30 days after written notice by the Trustee, provided, however, that if such failure is capable of being cured, but cannot be cured in such 30-day period, it will not constitute an event of default under the Indenture if corrective action in respect of such failure is instituted within such 30-day period and is being diligently pursued;
- (4) the occurrence of an “event of default” under the Loan Agreement (see “Summary of the Loan Agreement — Events of Default”);
- (5) written notice from the Credit Facility Issuer to the Trustee of an event of default under the Reimbursement Agreement, by reason of which the Trustee has been directed to accelerate the Bonds;
- (6) if a Credit Facility is then held by the Trustee, on or before the close of business on the tenth calendar day following the honoring of a drawing under such Credit Facility

to pay interest on the Bonds on an Interest Payment Date, written notice from the Credit Facility Issuer to the Trustee that the interest component of the Credit Facility will not be reinstated; or

(7) all first mortgage bonds outstanding under the First Mortgage Indenture, if not already due, shall have become due and payable, whether by declaration or otherwise, and such acceleration shall not have been rescinded by the First Mortgage Trustee.

Upon the occurrence of an Event of Default under clauses (1), (2), (5), (6) or (7) above, the Trustee must: (i) enforce each and every right granted to the Trustee as a holder of the First Mortgage Bonds (see “Summary of the First Mortgage Bonds”), (ii) declare the principal of all Bonds and interest accrued thereon to be immediately due and payable, (iii) declare all payments under the Loan Agreement to be immediately due and payable and enforce each and every other right granted to the Issuer under the Loan Agreement for the benefit of the Bondholders and (iv) if a Credit Facility securing the Bonds is in effect, make an immediate drawing under the Credit Facility in accordance with its terms and deposit the proceeds of such drawing in the Bond Fund pending application to the payment of principal of the Bonds, subject to the provisions of the Indenture reserving to the Credit Facility Issuer the right to direct default proceedings and providing for termination of default proceedings upon certain occurrences.

Interest on the Bonds will cease to accrue on the date of issuance of the declaration of acceleration of payment of principal and interest on the Bonds.

In exercising such rights, the Trustee shall take any action that, in the judgment of the Trustee, would best serve the interests of the registered owners. Upon the occurrence of an Event of Default under the Indenture, the Trustee may also proceed to pursue any available remedy by suit at law or in equity to enforce the payment of the principal of, premium, if any, and interest on the Bonds then outstanding.

If an Event of Default under the Indenture shall occur and be continuing and the maturity date of the Bonds has been accelerated (to the extent the Bonds are not already due and payable) as a consequence of such event of default, the Trustee may, and upon the written request of the registered owners holding not less than 25% in principal amount of all Bonds then outstanding and upon receipt of indemnity satisfactory to it shall, exercise such rights as it shall possess under the First Mortgage Indenture as a holder of the First Mortgage Bonds and shall also issue a Redemption Demand for such First Mortgage Bonds to the First Mortgage Trustee.

If the Trustee recovers any moneys following an Event of Default, unless the principal of the Bonds shall have been declared due and payable, all such moneys shall be applied in the following order: (i) to the payment of the fees, expenses, liabilities and advances incurred or made by the Trustee and the Paying Agent, (ii) to the payment of all interest then due on the Bonds and (iii) to the payment of unpaid principal and premium, if any, of the Bonds. If the principal of the Bonds has become due or has been accelerated, such moneys shall be applied in the following order: (i) to the payment of the fees, expenses, liabilities and advances incurred or made by the Trustee and the Paying Agent and (ii) to the payment of principal of and interest then due and unpaid on the Bonds. In each case, however, Trustee and Paying Agent fees or



costs will not be payable from moneys derived from Credit Facility drawings, any remarketing proceeds or moneys constituting certain Available Moneys under the Indenture.

No Bondholder may institute any suit or proceeding in equity or at law for the enforcement of the Indenture unless an Event of Default has occurred of which the Trustee has been notified or is deemed to have notice, and registered owners holding not less than 25% in aggregate principal amount of Bonds then outstanding shall have made written request to the Trustee to proceed to exercise the powers granted under the Indenture or to institute such action in their own name and the Trustee shall fail or refuse to exercise its powers within a reasonable time after receipt of indemnity satisfactory to it.

Any judgment against the Issuer pursuant to the exercise of rights under the Indenture shall be enforceable only against specific assigned payments, funds and accounts under the Indenture in the hands of the Trustee. No deficiency judgment shall be authorized against the general credit of the Issuer.

No default under paragraph (3) above shall constitute an Event of Default until actual notice is given to the Issuer and the Company by the Trustee or to the Issuer, the Company and the Trustee by the registered owners holding not less than 25% in aggregate principal amount of all Bonds outstanding and the Issuer and the Company shall have had thirty days after such notice to correct the default and failed to do so. If the default is such that it cannot be corrected within the applicable period but is capable of being cured, it will not constitute an Event of Default if corrective action is instituted within the applicable period.

Notwithstanding the foregoing, in addition to the rights of the Trustee and the Bondholders to direct proceedings as described above, if a Credit Facility is in effect, for so long as such Credit Facility is outstanding and the Credit Facility Issuer is not in default in its duties under the Indenture or the Credit Facility, the Credit Facility Issuer will have the absolute right to direct all proceedings on behalf of the Bondholders of the Bonds. Additionally, if the Event of Default which has occurred is an Event of Default under paragraphs (5) or (6) above, the Credit Facility Issuer, if any, will have no right to direct the Trustee or the Bondholders with respect to any matters, including remedies, and the holders of a majority in aggregate principal amount of the Bonds then outstanding, will have the right, at any time, by an instrument or instruments in writing executed and delivered to the Trustee, to direct the time, method and place of conducting all proceedings to be taken in connection with the enforcement of the terms and conditions of the Indenture, or for the appointment of a receiver or any other proceedings hereunder; provided, that such direction shall not be otherwise than in accordance with the provisions of law and of the Indenture.

If an Event of Default has occurred under the Indenture due to failure by the Credit Facility Issuer, if any, to honor a properly presented and conforming drawing by the Trustee under the Credit Facility then in effect in accordance with the terms thereof, all obligations of the Trustee to the Credit Facility Issuer and all rights of such Credit Facility Issuer under the Indenture will be suspended until the earlier of the cure of such failure or all of the Bonds have been paid in full.

## **Waiver of Events of Default**

Except as provided below, the Trustee may in its discretion waive any Event of Default under the Indenture and shall do so upon the written request of the registered owners holding a majority in principal amount of all Bonds then outstanding. If, after the principal of all Bonds then outstanding shall have been declared to be due and payable and prior to any judgment or decree for the appointment of a receiver or for the payment of the moneys due shall have been entered, (i) the Company has caused to be deposited with the Trustee a sum sufficient to pay all matured installments of interest upon all Bonds and the principal of and premium, if any, on any and all Bonds which shall have become due otherwise than by reason of such declaration and the expenses of the Trustee in connection with such default (with interest thereon as provided in the Indenture) and (ii) all Events of Default under the Indenture (other than nonpayment of the principal of Bonds due by said declaration) shall have been remedied, then such Event of Default shall be deemed waived and such declaration and its consequences rescinded and annulled by the Trustee. Such waiver, rescission and annulment shall be binding upon all Bondholders. No such waiver, rescission and annulment shall extend to or affect any subsequent Event of Default or impair any right or remedy consequent thereon.

Upon any waiver or rescission as described above or any discontinuance or abandonment of proceedings under the Indenture, the Trustee shall immediately rescind in writing any Redemption Demand of First Mortgage Bonds previously given to the First Mortgage Trustee. The rescission under the First Mortgage Indenture of a declaration that all first mortgage bonds outstanding under the First Mortgage Indenture are immediately due and payable shall also constitute a waiver of an Event of Default described in paragraph (6) under the subcaption “— Defaults and Remedies” above and a waiver and rescission of its consequences, provided that no such waiver or rescission shall extend to or affect any subsequent or other default or impair any right consequent thereon.

The Trustee may not waive any default under clauses (5) or (6) above unless the Trustee has received in writing from the Credit Facility Issuer a written notice of full reinstatement of the full amount of the Credit Facility and a written rescission of the notice of the Event of Default.

Notwithstanding the foregoing, nothing in the Indenture shall affect the right of a registered owner to enforce the payment of principal of, premium, if any, and interest on the Bonds after the maturity thereof.

## **Voting of First Mortgage Bonds Held by Trustee**

The Trustee, as holder of the First Mortgage Bonds, shall attend any meeting of holders of first mortgage bonds outstanding under the First Mortgage Indenture as to which it receives due notice. The Trustee shall vote the First Mortgage Bonds held by it, or shall consent with respect thereto, proportionally in the way in which the Trustee reasonably believes will be the vote or consent of all other holders of first mortgage bonds outstanding under the First Mortgage Indenture then eligible to vote or consent.

Notwithstanding the foregoing, the Trustee may not vote the First Mortgage Bonds in favor of, or give consent to, any action which, in the Trustee’s opinion, would materially

adversely affect the First Mortgage Bonds in a manner not generally shared by all other series of first mortgage bonds, except upon notification by the Trustee to the registered owners of all Bonds then outstanding of such proposal and consent thereto of the registered owners of at least 66 2/3% in aggregate principal amount of all Bonds then outstanding.

**NOT A NEW ISSUE****BOOK-ENTRY-ONLY**

*On October 20, 2004, the date on which the Bonds were originally issued, Bond Counsel delivered its opinion that stated that, subject to the conditions and exceptions set forth under the caption "Tax Treatment," under then current law, interest on the Bonds would be excludable from the gross income of the recipients thereof for federal income tax purposes, except that no opinion was expressed regarding such exclusion from gross income with respect to any Bond during any period in which it is held by a "substantial user" or a "related person" of the Project as such terms are used in Section 147(a) of the Internal Revenue Code of 1986, as amended (the "Code"). Interest on the Bonds will be an item of tax preference in determining alternative minimum taxable income for individuals and corporations under the Code. Such interest may be subject to certain federal income taxes imposed on certain corporations, including imposition of the branch profits tax on a portion of such interest. Bond Counsel was further of the opinion that interest on the Bonds would be excludable from the gross income of the recipients thereof for Kentucky income tax purposes and that, under then current law, the principal of the Bonds would be exempt from ad valorem taxes in Kentucky. Such opinion has not been updated as of the date hereof and no continuing tax exemption opinions are expressed by Bond Counsel. However, in connection with the reoffering of the Bonds as described herein, Bond Counsel will deliver its opinion to the effect that the delivery of a letter of credit (a) is authorized or permitted by the Act and the Indenture and (b) will not adversely affect the validity of the Bonds or any exclusion of the interest thereon from the gross income of the owners of the Bonds for federal income tax purposes. See "Tax Treatment" herein.*

**\$50,000,000**  
**County of Carroll, Kentucky,**  
**Environmental Facilities Revenue Bonds,**  
**2004 Series A**  
**(Kentucky Utilities Company Project)**  
**Due: October 1, 2034**

**Reoffering Date: December 17, 2008**

The County of Carroll, Kentucky, Environmental Facilities Revenue Bonds, 2004 Series A (Kentucky Utilities Company Project) (the "Bonds") are special and limited obligations of the County of Carroll, Kentucky (the "Issuer"), payable by the Issuer solely from and secured by payments to be received by the Issuer pursuant to a Loan Agreement with

**KENTUCKY UTILITIES COMPANY**

(the "Company"), except as payable from proceeds of such Bonds or investment earnings thereon. The Bonds do not constitute general obligations of the Issuer or a charge against the general credit or taxing powers thereof or of the Commonwealth of Kentucky or any other political subdivision of Kentucky. The Bonds are not entitled to the benefits of any financial guaranty insurance policies.

The Bonds were originally issued on October 20, 2004 and currently bear interest at a Weekly Rate. Pursuant to the Indenture under which the Bonds were issued, the Company has elected to deliver a letter of credit to the Trustee and reoffer the Bonds. The Bonds are subject to mandatory purchase on the Reoffering Date and are being reoffered by this Reoffering Circular. Merrill Lynch, Pierce, Fenner & Smith Incorporated will serve as the Remarketing Agent for the Bonds.

From the Reoffering Date through December 16, 2009 (the Letter of Credit (as defined below) expiration date, subject to extension or earlier termination), payment of the principal of and interest on the Bonds when due will be paid with funds drawn under an irrevocable transferable direct pay letter of credit (the "Letter of Credit") issued by

**COMMERZBANK AG, NEW YORK BRANCH**

The Letter of Credit will permit the Trustee to draw with respect to the Bonds up to an amount sufficient to pay (i) the principal thereof (or that portion of the purchase price corresponding to principal) plus (ii) interest thereon (or that portion of the purchase price corresponding to interest) at an assumed rate of 14% per annum for at least 45 days.

From and after the Reoffering Date, the Bonds will continue to bear interest at a Weekly Rate, determined by the Remarketing Agent in accordance with the Indenture, payable on the first Business Day of each calendar month, commencing on January 2, 2009. The interest rate period, interest rate and Interest Rate Mode will be subject to change under certain conditions, as described in this Reoffering Circular. The Bonds are subject to optional redemption, extraordinary optional redemption, in whole or in part, and mandatory redemption following a determination of taxability prior to maturity, as described in this Reoffering Circular. The Bonds are subject to mandatory purchase on any date on which the Bonds are converted to a different Interest Rate Mode and upon the expiration of the Letter of Credit or any Alternate Credit Facility.

The Bonds are registered in the name of Cede & Co., as registered owner and nominee for The Depository Trust Company ("DTC"), New York, New York. DTC will act as securities depository. Except as described in this Reoffering Circular, purchases of beneficial ownership interests in the Bonds will be made in book-entry-only form in denominations of \$100,000 and multiples thereof. Purchasers will not receive certificates representing their beneficial interest in the Bonds. See the information contained under the caption "Summary of the Bonds—Book-Entry-Only System" in this Reoffering Circular. The principal of, premium, if any, and interest on the Bonds will be paid by U.S. Bank National Association, a national banking association, as successor Trustee, to Cede & Co., as long as Cede & Co. is the registered owner of the Bonds. Disbursement of such payments to the DTC Participants is the responsibility of DTC, and disbursement of such payments to the purchasers of beneficial ownership interests is the responsibility of DTC's Direct and Indirect Participants, as more fully described in this Reoffering Circular.

**Price: 100%**

The Bonds are reoffered subject to prior sale, withdrawal or modification of the offer without notice (provided, however, that any such notice of withdrawal must be given on the Business Day prior to the Reoffering Date) and to the approval of legality by Stoll Keenon Ogden PLLC, Louisville, Kentucky, as Bond Counsel, and upon satisfaction of certain conditions. Certain legal matters will be passed upon for the Company by its counsel, Jones Day, Chicago, Illinois, and John R. McCall, Esq., Executive Vice President, General Counsel, Corporate Secretary and Chief Compliance Officer of the Company, for the Issuer by its County Attorney, and for the Remarketing Agent by its counsel, Winston & Strawn LLP, Chicago, Illinois. It is expected that the Bonds will be available for redelivery to DTC in New York, New York on or about December 17, 2008.

**Merrill Lynch & Co.**

Dated: December 10, 2008

No dealer, broker, salesman or other person has been authorized by the Issuer, the Company or the Remarketing Agent to give any information or to make any representation with respect to the Bonds, other than those contained in this Reoffering Circular, and, if given or made, such other information or representation must not be relied upon as having been authorized by any of the foregoing. The Remarketing Agent has provided the following sentence for inclusion in this Reoffering Circular. The Remarketing Agent has reviewed the information in this Reoffering Circular in accordance with, and as part of, its responsibilities to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Remarketing Agent does not guarantee the accuracy or completeness of such information. The information and expressions of opinion herein are subject to change without notice, and neither the delivery of this Reoffering Circular nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the parties referred to above since the date hereof. The information set forth herein with respect to the Issuer has been obtained from the Issuer, and all other information has been obtained from the Company and from other sources that are believed to be reliable, but it is not guaranteed as to accuracy or completeness by, and is not to be construed as a representation by, the Remarketing Agent.

In connection with the reoffering of the Bonds, the Remarketing Agent may over-allot or effect transactions which stabilize or maintain the market prices of the Bonds at levels above those that might otherwise prevail in the open market. Such stabilizing, if commenced, may be discontinued at any time.

IN MAKING AN INVESTMENT DECISION, INVESTORS MUST RELY ON THEIR OWN EXAMINATION OF THE TERMS OF THE REOFFERING, INCLUDING THE MERITS AND RISKS INVOLVED. THESE SECURITIES HAVE NOT BEEN RECOMMENDED BY ANY FEDERAL OR STATE SECURITIES COMMISSION OR REGULATORY AUTHORITY. FURTHERMORE, THE FOREGOING AUTHORITIES HAVE NOT CONFIRMED THE ACCURACY OR DETERMINED THE ADEQUACY OF THIS DOCUMENT. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

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**\$50,000,000**  
**County of Carroll, Kentucky**  
**Environmental Facilities Revenue Bonds,**  
**2004 Series A**  
**(Kentucky Utilities Company Project)**  
**Due: October 1, 2034**

**Introductory Statement**

This Reoffering Circular, including the cover page and appendices, is provided to furnish information in connection with the reoffering by the County of Carroll, Kentucky (the “Issuer”) of its Environmental Facilities Revenue Bonds, 2004 Series A (Kentucky Utilities Company Project), in the aggregate principal amount of \$50,000,000 (the “Bonds”) issued on October 20, 2004 pursuant to an Indenture of Trust dated as of October 1, 2004 (the “Indenture”) between the Issuer and U.S. Bank National Association, a national banking association (the “Trustee”), as successor Trustee, Paying Agent and Bond Registrar, as the same will be amended and restated as of September 1, 2008.

Pursuant to a Loan Agreement by and between Kentucky Utilities Company (the “Company”) and the Issuer, dated as of October 1, 2004 (the “Loan Agreement”) (as the same has been amended and restated pursuant to an ordinance of the Issuer adopted October 28, 2008) as of September 1, 2008, proceeds from the sale of the Bonds, other than accrued interest, if any, paid by the initial purchasers thereof, were loaned by the Issuer to the Company. The Loan Agreement is a separate undertaking by and between the Company and the Issuer.

The Company will continue to repay the loan under the Loan Agreement by making payments to the Trustee in sufficient amounts to pay the principal of and interest and any premium on, and purchase price of, the Bonds. See “Summary of the Loan Agreement — General.” Pursuant to the Indenture, the Issuer’s rights under the Loan Agreement (other than with respect to certain indemnification and expense payments and notification rights) were assigned to the Trustee as security for the Bonds.

The proceeds of the Bonds were applied to pay and discharge \$50,000,000 in outstanding principal amount of “County of Carroll, Kentucky, Collateralized Solid Waste Disposal Facilities Revenue Bonds (Kentucky Utilities Company Project), 1993 Series A,” dated December 1, 1993 (the “1993 Bonds”), previously issued by the Issuer to finance certain solid waste disposal facilities (the “Project”) owned by the Company.

The Company is an operating subsidiary of E.ON U.S. LLC (formerly known as LG&E Energy LLC) and E.ON AG (the “Parents”). See “Appendix A — Kentucky Utilities Company — Financial Statements and Additional Information.” The Parents will have no obligation to make any payments due under the Loan Agreement or any other payments of principal, interest, premium or purchase price of the Bonds.

The Bonds are being reoffered at a Weekly Rate, but may be subsequently converted to bear interest at a Daily Rate, a Flexible Rate, a Semi-Annual Rate, an Annual Rate or a Dutch Auction Rate. **This Reoffering Circular pertains only to the Bonds during such period of time that they bear interest at the Weekly Rate.**

The Bonds are special and limited obligations of the Issuer, and the Issuer's obligation to pay the principal of and interest and any premium on, and purchase price of, the Bonds is limited solely to the revenues and other amounts received by the Trustee under the Indenture pursuant to the Loan Agreement and the Letter of Credit (as defined below). The Bonds will not constitute an indebtedness, general obligation or pledge of the faith and credit or taxing power of the Issuer, the Commonwealth of Kentucky or any political subdivision thereof. The Bonds are not entitled to the benefits of any financial guaranty insurance policies.

Concurrently with, and as a condition to, the reoffering of the Bonds, the Company will cause to be delivered an irrevocable transferable direct pay letter of credit (the "Letter of Credit"), issued by Commerzbank AG, New York Branch (the "Bank"), to provide for the timely payment of principal of and accrued interest (calculated for at least 45 days at the maximum rate of 14% per annum) on, and purchase price of, the Bonds. The Company will be required to reimburse the Bank for all amounts drawn by the Trustee under the Letter of Credit pursuant to the terms of a Reimbursement Agreement, to be dated as of December 17, 2008 (the "Reimbursement Agreement"), between the Company and the Bank. The Letter of Credit will expire on December 16, 2009, unless extended or earlier terminated.

Upon expiration of the Letter of Credit or any Alternate Credit Facility, the related Bonds will be subject to mandatory tender for purchase. See "Summary of the Bonds — Mandatory Purchases of Bonds — Mandatory Purchase upon Delivery, Cancellation, Substitution, Extension, Termination or Expiration of Any Credit Facility or Replacement with an Alternate Credit Facility." As used in this Reoffering Circular, "Bank" or "Credit Facility Issuer" refers to the Bank as the issuer of the Letter of Credit and any other issuer of any Alternate Credit Facility delivered in accordance with the Indenture; "Letter of Credit" or "Credit Facility" means the Letter of Credit delivered under the Indenture and, as applicable, any Alternate Credit Facility which may be subsequently delivered in accordance with the Indenture; and "Reimbursement Agreement" refers to the initial Reimbursement Agreement under which the Letter of Credit is provided and any subsequent agreement entered into between the Company and any other party in connection with the delivery of any Alternate Credit Facility.

Merrill Lynch, Pierce, Fenner & Smith Incorporated will be appointed under the Indenture to serve as Remarketing Agent for the Bonds. Any Remarketing Agent may resign or be removed and a successor Remarketing Agent may be appointed in accordance with the terms of the Indenture and the Remarketing Agreement for the Bonds between the Remarketing Agent and the Company.

Brief descriptions of the Company, the Issuer, the Bonds, the Loan Agreement, the Indenture, the Letter of Credit and the Reimbursement Agreement are included in this Reoffering Circular. Appendix A to this Reoffering Circular has been furnished by the Company. The Issuer and Bond Counsel assume no responsibility for the accuracy or completeness of such Appendix A or such information. Appendix B to this Reoffering Circular contains the opinion of



Bond Counsel delivered on the date on which the Bonds were initially issued, and the proposed form of opinion of Bond Counsel to be delivered in connection with the reoffering of the Bonds and the delivery of the Letter of Credit. Appendix C to this Reoffering Circular contains information about the Bank. The Issuer and Bond Counsel assume no responsibility for the accuracy or completeness of such Appendix C or such information. Such descriptions and information do not purport to be complete, comprehensive or definitive and are not to be construed as a representation or a guaranty of accuracy or completeness. All references herein to the documents are qualified in their entirety by reference to such documents, and references herein to the Bonds are qualified in their entirety by reference to the definitive form thereof included in the Indenture. Copies of the Loan Agreement, the Indenture, the Letter of Credit and the Reimbursement Agreement will be available for inspection at the principal corporate trust office of the Trustee. Certain information relating to The Depository Trust Company (“DTC”) and the book-entry-only system has been furnished by DTC. All statements herein are qualified in their entirety by reference to each such document and, with respect to the enforceability of certain rights and remedies, to laws and principles of equity relating to or affecting generally the enforcement of creditors’ rights.

### **The Project**

The Project has been completed, placed in operation, and is the property of the Company. The Project consists of certain solid waste disposal facilities at the Company’s Ghent Generating Station located in Carroll County.

### **The Issuer**

The Issuer is a public body corporate and politic duly created and existing as a county and political subdivision under the Constitution and laws of the Commonwealth of Kentucky. The Issuer is authorized by Sections 103.200 to 103.285, inclusive, of the Kentucky Revised Statutes (collectively, the “Act”) to (a) reoffer the Bonds and (b) amend and restate and continue to perform its obligations under the Loan Agreement and the Indenture. The Issuer, through its legislative body, the Fiscal Court, has adopted one or more ordinances authorizing the issuance of the Bonds and the execution and delivery of the related documents.

THE BONDS ARE SPECIAL AND LIMITED OBLIGATIONS PAYABLE SOLELY AND ONLY FROM CERTAIN SOURCES, INCLUDING AMOUNTS TO BE RECEIVED BY THE TRUSTEE FROM THE LETTER OF CREDIT AND BY OR ON BEHALF OF THE ISSUER UNDER THE LOAN AGREEMENT. THE BONDS DO NOT CONSTITUTE AN INDEBTEDNESS, GENERAL OBLIGATION OR PLEDGE OF THE FAITH AND CREDIT OR TAXING POWER OF THE ISSUER, THE COMMONWEALTH OF KENTUCKY OR ANY POLITICAL SUBDIVISION THEREOF, AND DO NOT GIVE RISE TO A PECUNIARY LIABILITY OF THE ISSUER OR A CHARGE AGAINST ITS GENERAL CREDIT OR TAXING POWERS.

## Summary of the Bonds

### General

The Bonds will be issued in the aggregate principal amount set forth on the cover page of this Reoffering Circular and will mature on October 1, 2034. The Bonds are also subject to optional redemption, extraordinary optional redemption, in whole or in part, and mandatory redemption prior to maturity as described herein.

The Bonds currently bear interest at a Weekly Rate. From and after the Reoffering Date, the Bonds will bear interest at a Weekly Rate and will be payable on the first Business Day of each calendar month, commencing on January 2, 2009. The Bonds will continue to bear interest at the Weekly Rate until a Conversion to another Interest Rate Mode is specified by the Company or until the redemption or maturity of the Bonds. The permitted Interest Rate Modes for the Bonds are (i) the "Flexible Rate," (ii) the "Daily Rate," (iii) the "Weekly Rate," (iv) the "Semi-Annual Rate," (v) the "Annual Rate," (vi) the "Long Term Rate" and (vii) the "Dutch Auction Rate." Changes in the Interest Rate Mode will be effected, and notice of such changes will be given, as described below in "— Conversion of Interest Rate Modes and Changes of Long Term Rate Periods."

During each Rate Period for an Interest Rate Mode (other than a Dutch Auction Rate), the interest rate or rates for the Bonds in that Interest Rate Mode, and Flexible Rate Periods for Bonds accruing interest at a Flexible Rate, will be determined by the Remarketing Agent in accordance with the Indenture; provided that the interest rate or rates borne by any Bonds may not exceed the lesser of (i) the maximum interest rate permitted by applicable law or (ii) 14% per annum.

Interest on the Bonds which bear interest at a Flexible Rate, Daily Rate or Weekly Rate will be computed on the basis of a year of 365 or 366 days, as appropriate, and paid for the actual number of days elapsed. Interest on the Bonds which bear interest at a Semi-Annual Rate, Annual Rate or Long Term Rate will be computed on the basis of a 360-day year of twelve 30-day months. Interest on the Bonds which bear interest at a Dutch Auction Rate will be computed on the basis of a 360-day year for the actual number of days elapsed. Interest payable on any Interest Payment Date will be payable to the registered owner of the Bond as of the Record Date for such payment; provided that in the case of Bonds bearing interest at the Flexible Rate, interest will be payable to the registered owner of such Bond on the Interest Payment Date therefor. The Record Date, in the case of interest accrued at a Daily Rate or Weekly Rate, will be the close of business on the Business Day immediately preceding each Interest Payment Date, in the case of interest accrued at a Dutch Auction Rate, will be the close of business on the second Business Day immediately preceding each Interest Payment Date, and in the case of interest accrued at a Semi-Annual Rate, Annual Rate or Long Term Rate, will be the close of business on the fifteenth day (whether or not a Business Day) of the month preceding each Interest Payment Date.

The Bonds initially will be issued solely in book-entry-only form through DTC (or its nominee, Cede & Co.). So long as the Bonds are held in the book-entry-only system, DTC or its nominee will be the registered owner or holder of the Bonds for all purposes of the Indenture, the

Bonds and this Reoffering Circular. See “— Book-Entry-Only System” below. Individual purchases of book-entry interests in the Bonds will be made in book-entry-only form in (i) denominations of \$25,000 and integral multiples thereof, if bearing interest at the Dutch Auction Rate, (ii) denominations of \$100,000 or any integral multiple thereof, if bearing interest at the Daily Rate or the Weekly Rate, (iii) denominations of \$100,000 or any integral multiple of \$5,000 in excess of \$100,000, if bearing interest at Flexible Rates, or (iv) denominations of \$5,000 and integral multiples thereof, if bearing interest at the Semi-Annual Rate, the Annual Rate or the Long Term Rate.

Except as otherwise described below for Bonds held in DTC’s book-entry-only system, the principal or redemption price of the Bonds is payable at the designated corporate trust office in Nashville, Tennessee, of the Trustee, as paying agent (the “Paying Agent”). Except as otherwise described below for Bonds held in DTC’s book-entry-only system, interest on the Bonds is payable by check mailed to the owner of record; provided that interest payable on each Bond will be payable in immediately available funds by wire transfer within the continental United States or by deposit into a bank account maintained with the Paying Agent (i) if the Interest Rate Mode is the Daily Rate, the Weekly Rate, the Dutch Auction Rate or the Flexible Rate, or (ii) at the written request of any owner of record holding at least \$1,000,000 aggregate principal amount of the Bonds, if the Interest Rate Mode is the Semi-Annual Rate, Annual Rate or Long Term Rate, received by the Trustee, as bond registrar (the “Bond Registrar”), at least one Business Day prior to any Record Date. Except as otherwise described below for Bonds held in DTC’s book-entry-only system, if the Interest Rate Mode is the Flexible Rate, interest payable on each Bond will be paid only upon presentation and surrender of such Bond.

Bonds may be transferred or exchanged for an equal total amount of Bonds of other authorized denominations upon surrender of such Bonds at the principal office of the Bond Registrar, accompanied by a written instrument of transfer or authorization for exchange in form and with guaranty of signature satisfactory to the Bond Registrar, duly executed by the registered owner or the owner’s duly authorized attorney. Except as provided in the Indenture, the Bond Registrar will not be required to register the transfer or exchange of any Bond (i) during the fifteen days before any mailing of a notice of redemption of Bonds, (ii) after such Bond has been called for redemption or (iii) for which a registered owner has submitted a demand for purchase (see “— Purchases of Bonds on Demand of Owner” below), or which has been purchased (see “— Payment of Purchase Price” below). Registration of transfers and exchanges will be made without charge to the registered owners of Bonds, except that the Bond Registrar may require any registered owner requesting registration of transfer or exchange to pay any required tax or governmental charge.

### **The Bonds Are Not Insured**

Upon the issuance of the Letter of Credit on the Reoffering Date, the Municipal Bond New Issue Insurance Policy (the “Bond Insurance Policy”) issued by Financial Guaranty Insurance Company (“Financial Guaranty”) on October 20, 2004 will have been irrevocably surrendered and cancelled. The Bonds described in this Reoffering Circular are not insured, and holders thereof will have no recourse to, under or against any bond insurance policy or bond insurer, including the aforementioned Bond Insurance Policy issued by Financial Guaranty.

## **Tender Agent**

Owners may tender their Bonds, and in certain circumstances will be required to tender their Bonds, to the Tender Agent for purchase at the times and in the manner described below under “—Summary of Certain Provisions of the Bonds,” “— Purchases of Bonds on Demand of Owner” and “— Mandatory Purchases of Bonds.” So long as the Bonds are held in DTC’s book-entry-only system, the Trustee will act as Tender Agent under the Indenture. Any successor Tender Agent appointed pursuant to the Indenture will also be a Paying Agent.

## **Remarketing Agent**

Merrill Lynch, Pierce, Fenner & Smith Incorporated will act as the Remarketing Agent with respect to the Bonds (the “Remarketing Agent”). The Remarketing Agent may resign or be removed and a successor Remarketing Agent may be appointed in accordance with the terms of the Indenture and the Remarketing Agreement for the Bonds between the Remarketing Agent and the Company.

## **Special Considerations Relating to the Remarketing Agent**

### *The Remarketing Agent is paid by the Company.*

The Remarketing Agent’s responsibilities include determining the interest rate from time to time and remarketing Bonds that are optionally or mandatorily tendered by the owners thereof (subject, in each case, to the terms of the Remarketing Agreement), all as further described herein. The Remarketing Agent is appointed by the Issuer at the request of the Company and paid by the Company for its services. As a result, the interests of the Remarketing Agent may differ from those of existing holders and potential purchasers of Bonds.

### *The Remarketing Agent routinely purchases bonds for its own account.*

The Remarketing Agent acts as remarketing agent for a variety of variable rate demand obligations and, in its sole discretion, routinely purchases such obligations for its own account in order to achieve a successful remarketing of the obligations (i.e., because there are otherwise not enough buyers to purchase the obligations) or for other reasons. The Remarketing Agent is permitted, but not obligated, to purchase tendered Bonds for its own account and, if it does so, it may cease doing so at any time without notice. The Remarketing Agent may also make a market in the Bonds by routinely purchasing and selling Bonds other than in connection with an optional or mandatory tender and remarketing. Such purchases and sales may be at or below par. However, the Remarketing Agent is not required to make a market in the Bonds. The Remarketing Agent may also sell any Bonds it has purchased to one or more affiliated investment vehicles for collective ownership or enter into derivative arrangements with affiliates or others in order to reduce its exposure to the Bonds. The purchase of Bonds by the Remarketing Agent may create the appearance that there is greater third party demand for the Bonds in the market than is actually the case. The practices described above also may result in fewer Bonds being tendered in a remarketing.

Bonds may be offered at different prices on any date.

As more fully described under the caption “— Determination of Interest Rates for Interest Rate Modes,” the Remarketing Agent shall determine the minimum rate of interest per annum which in the opinion of the Remarketing Agent, would be necessary on and as of such day to remarket the Bonds in a secondary market transaction at a price equal to the principal amount thereof plus accrued interest thereon, if any, provided that such rate of interest shall not exceed 14% per annum. The interest rate will reflect, among other factors, the level of market demand for the Bonds (including whether the Remarketing Agent is willing to purchase Bonds for its own account). There may or may not be Bonds tendered and remarketed on a day that the rate on the Bonds are set, the Remarketing Agent may or may not be able to remarket any Bonds tendered for purchase on such date at par and the Remarketing Agent may sell Bonds at varying prices to different investors on such date or any other date. The Remarketing Agent is not obligated to advise purchasers in a remarketing if it does not have third party buyers for all of the Bonds at the remarketing price. In the event the Remarketing Agent owns any Bonds for its own account, it may, in its sole discretion in a secondary market transaction outside the tender process, offer such Bonds on any date, including the day that the rate on the Bonds are set, at a discount to par to some investors.

The ability to sell the Bonds other than through the tender process may be limited.

**The Remarketing Agent may buy and sell Bonds other than through the tender process. However, it is not obligated to do so and may cease doing so at any time without notice and may require holders that wish to tender their Bonds to do so through the Trustee with appropriate notice. Thus, investors who purchase the Bonds, whether in a remarketing or otherwise, should not assume that they will be able to sell their Bonds other than by tendering the Bonds in accordance with the tender process.**

### **Certain Definitions**

As used herein, each of the following terms will have the meaning indicated. Certain capitalized terms used herein and not otherwise defined will have the meanings set forth in the Indenture.

“*Alternate Credit Facility*” means an irrevocable letter of credit, a municipal bond insurance policy, a surety bond, a line or lines of credit, a guarantee or other similar agreement or agreements or any other agreement or agreements used to provide liquidity or credit support for the Bonds, satisfactory to the Company and the Remarketing Agent and containing administrative provisions reasonably satisfactory to the Trustee, issued and delivered to the Trustee in accordance with the Indenture.

“*Annual Rate Period*” means the period beginning on, and including, the Conversion Date to the Annual Rate and ending on, and including, the day next preceding the second Interest Payment Date thereafter, and each successive twelve-month period (or portion thereof) thereafter until the day preceding the earlier of the Conversion to a different Interest Rate Mode or the maturity of the Bonds.

“*Beneficial Owner*” means the person in whose name a Bond is recorded as such upon the systems of DTC and each DTC Participant (as defined herein) or the registered holder of such Bond if such Bond is not then registered in the name of Cede & Co.

“*Business Day*” means any day other than a Saturday or Sunday or legal holiday or a day on which banking institutions located in the City of New York, New York, or the New York Stock Exchange or banking institutions in the city in which the principal office of the Trustee, the Bond Registrar, the Tender Agent, the Paying Agent, the Auction Agent, the Company, the Credit Facility Issuer or the Remarketing Agent is located are authorized by law or executive order to close.

“*Conversion*” means any conversion from time to time in accordance with the terms of the Indenture of the Bonds from one Interest Rate Mode to another Interest Rate Mode.

“*Conversion Date*” means the date on which any Conversion becomes effective.

“*Credit Facility*” means an irrevocable direct pay letter of credit or other credit enhancement or liquidity support facility, or any combination thereof, delivered to and in favor of the Trustee for the benefit of the owners of the Bonds pursuant to the Indenture and designated as a “Credit Facility” under the Indenture, and includes the Initial Credit Facility or any Alternate Credit Facility delivered to the Trustee pursuant to the Indenture.

“*Credit Facility Issuer*” means the Initial Credit Facility Issuer and the issuer of any Credit Facility or Alternate Credit Facility subsequently in effect.

“*Daily Rate Period*” means the period beginning on, and including, the Conversion Date to the Daily Rate and ending on and including the day preceding the next Business Day and each period thereafter beginning on and including a Business Day and ending on and including the day preceding the next succeeding Business Day until the day preceding the earlier of the Conversion to a different Interest Rate Mode or the maturity of the Bonds.

“*Dutch Auction Rate*” means the rate of interest to be borne by the Bonds during each Dutch Auction Rate Period determined in accordance with the Indenture.

“*Dutch Auction Rate Period*” means the period during which the Bonds bear interest at the Dutch Auction Rate.

“*Flexible Rate*” means the Interest Rate Mode for the Bonds in which the interest rate for each Bond is determined with respect to that Bond during each Flexible Rate Period applicable to that Bond, as provided in the Indenture.

“*Flexible Rate Period*” means with respect to any Bond, each period (which may be from one day to 364 days, or such lower maximum number of days as is then permitted under the Indenture) determined for such Bond, as provided in the Indenture.

“*Initial Credit Facility*” means the irrevocable direct pay letter of credit issued by the Initial Credit Facility Issuer to the Trustee with respect to the Bonds on the Reoffering Date.

*“Initial Credit Facility Issuer”* means Commerzbank AG, New York Branch.

*“Interest Payment Date”* means (i) if the Interest Rate Mode is the Daily Rate or the Weekly Rate, the first Business Day of each calendar month, (ii) if the Interest Rate Mode is the Flexible Rate, for each Bond the last day of each Flexible Rate Period for such Bond (or if such day is not a Business Day, the next succeeding Business Day), (iii) if the Interest Rate Mode is the Semi-Annual Rate, the Annual Rate or the Long Term Rate, April 1 and October 1, and, in the case of the Long Term Rate, the effective date of a change to a new Long Term Rate Period; (iv) if the Interest Rate Mode is the Dutch Auction Rate Mode, the dates determined in accordance with the terms of the Indenture; and (v) any Conversion Date (including the date of a failed Conversion) or a change to a new Long Term Rate Period for such Bonds. In any case, the final Interest Payment Date will be the maturity date of the Bonds.

*“Interest Period”* means for all Bonds (or for any Bond if the Interest Rate Mode is the Flexible Rate) the period from and including each Interest Payment Date to and including the day immediately preceding the next Interest Payment Date, provided, however that the first Interest Period for the Bonds will begin on (and include) the date of issuance of the Bonds and the final Interest Period will end on September 30, 2034.

*“Interest Rate Mode”* means the Dutch Auction Rate, the Flexible Rate, the Daily Rate, the Weekly Rate, the Semi-Annual Rate, the Annual Rate and the Long Term Rate.

*“Long Term Rate Period”* means any period established by the Company as hereinafter set forth under “— Determination of Interest Rates for Interest Rate Modes — Long Term Rates and Long Term Rate Periods” and beginning on, and including, the Conversion Date to the Long Term Rate and ending on, and including, the day preceding the last Interest Payment Date for such period and, thereafter, each successive period of the same duration as the Long Term Rate Period previously established until the day preceding the earliest of the change to a different Long Term Rate Period, the Conversion to a different Interest Rate Mode or the maturity of the Bonds.

*“Prevailing Market Conditions”* means, without limitation, the following factors: existing short-term or long-term market rates for securities, the interest on which is excluded from gross income for federal income tax purposes; indexes of such short-term or long-term rates and the existing market supply and demand for securities bearing such short-term or long-term rates; existing yield curves for short-term or long-term securities for obligations of credit quality comparable to the Bonds, the interest on which is excluded from gross income for federal income tax purposes; general economic conditions; industry economic and financial conditions that may affect or be relevant to the Bonds; and such other facts, circumstances and conditions as the Remarketing Agent, in its sole discretion, determines to be relevant.

*“Purchase Date”* means any date on which Bonds are to be purchased on the demand of the registered owners thereof or are subject to mandatory purchase as described in the Indenture.

*“Reimbursement Agreement”* means the Reimbursement Agreement, to be dated as of December 17, 2008, between the Company and the Initial Credit Facility Issuer, as the same may be amended from time to time, and any other agreement between the Company and a Credit

Facility Issuer, setting forth the obligations of the Company to such Credit Facility Issuer arising out of any payments under such Credit Facility and which provides that it will be deemed to be a Reimbursement Agreement for the purpose of the Indenture.

“*Semi-Annual Rate Period*” means the period beginning on, and including, the Conversion Date to the Semi-Annual Rate, and ending on, and including, the day preceding the first Interest Payment Date thereafter and each successive six-month period thereafter beginning on and including an Interest Payment Date and ending on and including the day next preceding the next Interest Payment Date until the day preceding the earlier of the Conversion to a different Interest Rate Mode or the maturity of the Bonds.

“*Weekly Rate Period*” means the period beginning on, and including, the Conversion Date to the Weekly Rate, and ending on, and including, the next Tuesday, and thereafter the period beginning on, and including, each Wednesday and ending on, and including, the earliest of the next Tuesday, the day preceding the Conversion to a different Interest Rate Mode or the maturity of the Bonds.

### **Summary of Certain Provisions of the Bonds**

The following table summarizes, for each of the permitted Interest Rate Modes (except the Dutch Auction Rate): the dates on which interest will be paid (*Interest Payment Dates*); the dates on which each interest rate will be determined (*Interest Rate Determination Dates*); the period of time (*Interest Rate Periods*) each interest rate will be in effect (provided that the initial Interest Rate Period for each Interest Rate Mode may begin on a different date from that specified, which date will be the Conversion Date or the date of a change in the Long Term Rate, as applicable); the dates on which registered owners may tender their Bonds for purchase to the Tender Agent and the notice requirements therefor (provided that while the Bonds are held in book-entry-only form, all notices of tender for purchase will be given by Beneficial Owners in the manner described under “— Purchases of Bonds on Demand of Owner — Notice Required for Purchases”) (*Purchase on Demand of Owner; Required Notice*); the dates on which the Bonds are subject to mandatory tender for purchase (*Mandatory Purchase Dates*); the redemption provisions applicable to the Bonds (*Redemption*); the notice requirements for redemption and mandatory tender for purchase (*Notices of Redemption and Mandatory Purchases*); and the manner by which registered owners will receive payments of principal, interest, redemption price and purchase price (*Manner of Payment*). All times stated are New York City time.



	<b><u>FLEXIBLE RATE</u></b>	<b><u>DAILY RATE</u></b>	<b><u>WEEKLY RATE</u></b>
<b>Interest Payment Dates</b>	With respect to any Bond, the last day of each Flexible Rate Period (or if such day is not a Business Day, the next succeeding Business Day).	The first Business Day of each calendar month.	The first Business Day of each calendar month.
<b>Interest Rate Determination Dates</b>	For each Bond, not later than 12:00 noon on the first day of each Flexible Rate Period for such Bond.	Not later than 9:30 a.m. on each Business Day.	Not later than 4:00 p.m. on the day preceding each Weekly Rate Period or, if not a Business Day, on the next preceding Business Day.
<b>Interest Rate Periods</b>	For each Bond, each Flexible Rate Period will be of a duration designated by the Remarketing Agent of one day to 364 days (or lower maximum number as specified in the Indenture); must end on a day immediately prior to a Business Day.	From and including each Business Day to but not including the next Business Day.	From and including each Wednesday to and including the following Tuesday.
<b>Purchase on Demand of Owner; Required Notice*</b>	No purchase on demand of the owner.	Any Business Day; by written or telephonic notice, promptly confirmed in writing, to the Tender Agent by 10:00 a.m. on such Business Day.	Any Business Day; by written notice to the Tender Agent not later than 5:00 p.m. on a Business Day at least seven days prior to the Purchase Date.
<b>Mandatory Purchase Dates</b>	Any Conversion Date; with respect to each Bond, on each Interest Payment Date for such Bond; and upon delivery, cancellation, substitution, extension, termination or expiration of any Credit Facility or replacement with Alternate Credit Facility.	Any Conversion Date; and upon delivery, cancellation, substitution, extension, termination or expiration of any Credit Facility or replacement with Alternate Credit Facility.	Any Conversion Date; and upon delivery, cancellation, substitution, extension, termination or expiration of any Credit Facility or replacement with Alternate Credit Facility.
<b>Redemption</b>	Optional at par on any Interest Payment Date; Extraordinary Optional and Mandatory at par, on any Business Day (other than extraordinary optional redemption as a result of damage, destruction or condemnation which will be on an Interest Payment Date).	Optional, Extraordinary Optional and Mandatory at par on any Business Day.	Optional, Extraordinary Optional and Mandatory at par on any Business Day.
<b>Notices of Conversion, Redemption and Mandatory Purchases*</b>	Not fewer than 15 days (30 days notice of Conversion to the Semi-Annual, Annual or Long Term Rate) or greater than 45 days. No notice of mandatory purchase following end of each Flexible Rate Period.	Not fewer than 15 days (30 days notice of Conversion to the Semi-Annual, Annual or Long Term Rate) or greater than 45 days.	Not fewer than 15 days (30 days notice of Conversion to the Semi-Annual, Annual or Long Term Rate) or greater than 45 days.
<b>Manner of Payment*</b>	Principal or redemption price upon surrender of the Bond to the Paying Agent; purchase price upon surrender of the Bond to the Tender Agent.	Principal or redemption price upon surrender of the Bond to the Paying Agent; purchase price upon surrender of the Bond to the Tender Agent.	Principal or redemption price upon surrender of the Bond to the Paying Agent; purchase price upon surrender of the Bond to the Tender Agent.

\* So long as DTC or its nominee is the registered owner of the Bonds, notices of redemption and mandatory purchases shall be sent to Cede & Co., payments of principal, redemption and purchase price of and interest on the Bonds will be paid through the facilities of DTC and notices of mandatory purchases may be given not less than five days prior to the Purchase Date. See “— Book-Entry-Only System” below.

	<u>SEMI-ANNUAL</u>	<u>ANNUAL</u>	<u>LONG TERM</u>
<b>Interest Payment Date</b>	Each April 1 and October 1.	Each April 1 and October 1.	Each April 1 and October 1; any Conversion Date; and the effective date of any change to a new Long Term Rate Period.
<b>Interest Rate Determination Dates</b>	Not later than 2:00 p.m. on the Business Day preceding the first day of the Semi-Annual Rate Period.	Not later than 12:00 noon on the Business Day preceding the first day of the Annual Rate Period.	Not later than 12:00 noon on the Business Day preceding the first day of the Long Term Rate Period.
<b>Interest Rate Periods</b>	Each six-month period from and including each April 1 and October 1 to and including the day preceding the next Interest Payment Date.	Each period from and including the Conversion Date to the Annual Rate to and including the day immediately preceding the second Interest Payment Date thereafter and each successive twelve month period thereafter.	Each period designated by the Company of more than one year in duration and which is an integral multiple of six months, from and including the first day of such period (April 1 and October 1) to and including the day immediately preceding the last Interest Payment Date for that period.
<b>Purchase on Demand of Owner; Required Notice*</b>	On any Interest Payment Date; by written notice to the Tender Agent on any Business Day not later than the fifteenth day prior to the Purchase Date.	On the final Interest Payment Date for the Annual Rate Period; by written notice to the Tender Agent on any Business Day not later than the fifteenth day prior to the Purchase Date.	On the final Interest Payment Date for the Long Term Rate Period; by written notice to the Tender Agent on a Business Day not later than the fifteenth day prior to the Purchase Date.
<b>Mandatory Purchase Dates</b>	Any Conversion Date; the first Business Day after the end of each Semi-Annual Rate Period; and upon delivery, cancellation, substitution, extension, termination or expiration of any Credit Facility or replacement with Alternate Credit Facility.	Any Conversion Date; the first Business Day after the end of each Annual Rate Period; and upon delivery, cancellation, substitution, extension, termination or expiration of any Credit Facility or replacement with Alternate Credit Facility.	Any Conversion Date; the first Business Day after the end of each Long Term Rate Period; the effective date of a change of Long Term Rate Period; and upon delivery, cancellation, substitution, extension, termination or expiration of any Credit Facility or replacement with Alternate Credit Facility.
<b>Redemption</b>	Optional at par on any Interest Payment Date; Extraordinary Optional and Mandatory at par, on any Business Day (other than extraordinary optional redemption as a result of damage, destruction or condemnation which will be on an Interest Payment Date).	Optional at par on the final Interest Payment Date; Extraordinary Optional and Mandatory at par, on any Business Day.	Optional at times and prices dependent on the length of the Long Term Rate Period; Extraordinary Optional and Mandatory at par, on any Business Day.
<b>Notices of Conversion, Redemption and Mandatory Purchases*</b>	Not fewer than 15 days (30 days for notice of Conversion or redemption) or greater than 45 days.	Not fewer than 15 days (30 days for notice of Conversion or redemption) or greater than 45 days.	Not fewer than 15 days (30 days for notice of Conversion or redemption) or greater than 45 days.
<b>Manner of Payment*</b>	Principal or redemption price upon surrender of the Bond to the Paying Agent; interest by check mailed to the registered owners or, upon request of registered owner, of \$1,000,000 or more of an individual issue of Bonds, in immediately available funds; purchase price upon surrender of the Bond to the Tender Agent.	Principal or redemption price upon surrender of the Bond to the Paying Agent; interest by check mailed to the registered owners or, upon request of registered owner, of \$1,000,000 or more of an individual issue of Bonds, in immediately available funds; purchase price upon surrender of the Bond to the Tender Agent.	Principal or redemption price upon surrender of the Bond to the Paying Agent; interest by check mailed to the registered owners or, upon request of registered owner, of \$1,000,000 or more of an individual issue of Bonds, in immediately available funds; purchase price upon surrender of the Bond to the Tender Agent.

\* So long as DTC or its nominee is the registered owner of the Bonds, notices of redemption and mandatory purchases shall be sent to Cede & Co., payments of principal, redemption and purchase price of and interest on the Bonds will be paid through the facilities of DTC and notices of mandatory purchase may be given not less than five days prior to the Purchase Date. See “— Book-Entry-Only System” below.

## **Determination of Interest Rates for Interest Rate Modes**

*Daily Rate.* If the Interest Rate Mode for the Bonds is the Daily Rate, the interest rate on the Bonds for any Business Day will be the rate established by the Remarketing Agent no later than 9:30 a.m. (New York City time) on such Business Day as the minimum rate of interest necessary, in the judgment of the Remarketing Agent taking into account then Prevailing Market Conditions, to enable the Remarketing Agent to sell the Bonds on such Business Day at a price equal to the principal amount thereof, plus accrued interest, if any, thereon. For any day which is not a Business Day or if the Remarketing Agent does not give notice of a change in the interest rate, the interest rate on the Bonds will be the interest rate in effect for the immediately preceding Business Day.

*Weekly Rate.* If the Interest Rate Mode for the Bonds is the Weekly Rate, the interest rate on the Bonds for a particular Weekly Rate Period will be the rate established by the Remarketing Agent no later than 4:00 p.m. (New York City time) on the day preceding such Weekly Rate Period or, if such day is not a Business Day, on the next preceding Business Day, as the minimum rate of interest necessary, in the judgment of the Remarketing Agent taking into account then Prevailing Market Conditions, to enable the Remarketing Agent to sell the Bonds on such first day at a price equal to the principal amount thereof, plus accrued interest, if any, thereon.

*Flexible Rates and Flexible Rate Periods.* If the Interest Rate Mode for the Bonds is the Flexible Rate, the interest rate on a Bond for a specific Flexible Rate Period will be the rate established by the Remarketing Agent no later than 12:00 noon (New York City time) on the first day of that Flexible Rate Period as the minimum rate of interest necessary, in the judgment of the Remarketing Agent taking into account then Prevailing Market Conditions, to enable the Remarketing Agent to sell such Bond on that day at a price equal to the principal amount thereof. Each Flexible Rate Period applicable for a Bond will be determined separately by the Remarketing Agent on or prior to the first day of such Flexible Rate Period as being the Flexible Rate Period permitted under the Indenture which, in the judgment of the Remarketing Agent, taking into account then Prevailing Market Conditions, will, with respect to such Bond, ultimately produce the lowest overall interest cost on the Bonds while the Interest Rate Mode for the Bonds is the Flexible Rate. Each Flexible Rate Period will be from one day to 364 days in length and will end on a day preceding a Business Day. If the Remarketing Agent fails to set the length of a Flexible Rate Period for any Bond, a new Flexible Rate Period lasting to, but not including, the next Business Day (or until the earlier Conversion or maturity of the Bonds) will be established automatically in accordance with the Indenture.

*Semi-Annual Rate.* If the Interest Rate Mode for the Bonds is the Semi-Annual Rate, the interest rate on the Bonds for a particular Semi-Annual Rate Period will be the rate established by the Remarketing Agent no later than 2:00 p.m. (New York City time) on the Business Day immediately preceding the first day of such Semi-Annual Rate Period as the minimum rate of interest necessary, in the judgment of the Remarketing Agent taking into account then Prevailing Market Conditions, to enable the Remarketing Agent to sell the Bonds on such first day at a price equal to the principal amount thereof.

Annual Rate. If the Interest Rate Mode for the Bonds is the Annual Rate, the interest rate on the Bonds for a particular Annual Rate Period will be the rate of interest established by the Remarketing Agent no later than 12:00 noon (New York City time) on the Business Day preceding the first day of such Annual Rate Period as the minimum rate of interest necessary, in the judgment of the Remarketing Agent taking into account then Prevailing Market Conditions, to enable the Remarketing Agent to sell the Bonds on such first day at a price equal to the principal amount thereof.

Dutch Auction Rate. If the Interest Rate Mode for the Bonds is the Dutch Auction Rate, the interest rate on the Bonds for a particular Dutch Auction Rate Period will be the rate established in accordance with the procedures set forth in the Indenture.

Long Term Rates and Long Term Rate Periods. If the Interest Rate Mode for the Bonds is the Long Term Rate, the interest rate on the Bonds for a particular Long Term Rate Period will be the rate established by the Remarketing Agent no later than 12:00 noon (New York City time) on the Business Day preceding the first day of such Long Term Rate Period as the minimum rate of interest necessary, in the judgment of the Remarketing Agent taking into account then Prevailing Market Conditions, to enable the Remarketing Agent to sell the Bonds on such first day at a price equal to the principal amount thereof. The Company will establish the duration of the Long Term Rate Period at the time that it directs the Conversion of the Interest Rate Mode to the Long Term Rate, and thereafter each successive Long Term Rate Period will be the same as the Long Term Rate Period so established by the Company until a different Long Term Rate Period is specified by the Company in accordance with the Indenture (in which case the duration of that Long Term Rate Period will control succeeding Long Term Rate Periods), subject in all cases to the occurrence of a Conversion Date or the maturity of the Bonds. Each Long Term Rate Period will be more than one year in duration, will be for a period which is an integral multiple of six months and will end on the day next preceding an Interest Payment Date; provided that if a Long Term Rate Period commences on a date other than an April 1 or October 1, such Long Term Rate Period may be for a period which is not an integral multiple of six months but will be of a duration as close as possible to (but not in excess of) such Long Term Rate Period established by the Company and will terminate on a day preceding an Interest Payment Date, and each successive Long Term Rate Period thereafter will be for the full period established by the Company until a different Long Term Rate Period is specified by the Company in accordance with the Indenture or until the occurrence of a Conversion Date or the maturity of the Bonds; provided further that no Long Term Rate Period will extend beyond the final maturity date of the Bonds.

Failure to Determine Rate. If for any reason the interest rate for a Bond is not determined by the Remarketing Agent, except as described below under “— Conversion of Interest Rate Modes and Changes of Long Term Rate Periods — Change of Long Term Rate Period” and “— Cancellation of Conversion of Interest Rate Mode,” the interest rate for such Bond for the next succeeding interest rate period will be the interest rate in effect for such Bond for the preceding interest rate period and, pursuant to the terms of the Indenture, there will be no change in the then applicable Long Term Rate Period or any Conversion from the then applicable Interest Rate Mode. Notwithstanding the foregoing, if for any reason the interest rate for a Bond bearing interest at a Flexible Rate is not determined by the Remarketing Agent, the interest rate for such Bond for the next succeeding Interest Period will be equal to The Bond

Market Association Municipal Swap Index™ (the “Municipal Index”) as defined in the Indenture and the Interest Period for such Bond will extend through the day preceding the next Business Day, until the Trustee is notified of a new Flexible Rate and Flexible Rate Period determined for such Bond by the Remarketing Agent.

### **Conversion of Interest Rate Modes and Changes of Long Term Rate Periods**

*Method of Conversion.* The Interest Rate Mode for the Bonds is subject to Conversion from time to time, in whole but not in part, on the dates specified below under “— Limitations on Conversion,” at the option of the Company, upon notice from the Bond Registrar to the registered owners of the Bonds, as described below. With any notice of Conversion, the Company must also deliver to the Bond Registrar and the Credit Facility Issuer an opinion of Bond Counsel stating that such Conversion is authorized or permitted by the Act and is authorized by the Indenture and will not adversely affect the exclusion from gross income of interest on the Bonds for federal income tax purposes, other than a Conversion from the Daily Rate Period to the Weekly Rate Period or from the Weekly Rate Period to the Daily Rate Period.

*Conditions Precedent to Conversions.* The following conditions are applicable to Conversions of the Bonds:

(a) any Credit Facility to be held by the Trustee after the Conversion Date must be sufficient to cover the principal of and accrued interest on the outstanding Bonds for the maximum Interest Period permitted for that particular Interest Rate Mode plus 10 days at the maximum interest rate, and if a Credit Facility is to be held by the Trustee after the Conversion of the Bonds to a Long Term Rate Period, that Credit Facility must also extend for the entire Long Term Rate Period plus 10 days at the maximum interest rate; and

(b) if a Credit Facility is then in effect and the purchase price of the Bonds under the Indenture includes any premium, the Trustee will be entitled to draw on that Credit Facility in an aggregate amount sufficient to pay the applicable purchase price (including such premium) or, in the alternative, available moneys will be available in the necessary amount and are applied to the payment of such premium.

*Limitations on Conversion.* Any Conversion of the Interest Rate Mode for the Bonds must be in compliance with the following conditions: (i) the Conversion Date must be a date on which the Bonds are subject to optional redemption (see “— Redemptions — Optional Redemption” below); provided that any Conversion from the Daily Rate Period to a Weekly Rate Period or from the Weekly Rate Period to the Daily Rate Period must be on a Wednesday and, if the Conversion is to or from a Dutch Auction Rate Period, the Conversion Date must be the last Interest Payment Date in respect of that Dutch Auction Rate Period; (ii) if the proposed Conversion Date would not be an Interest Payment Date but for the Conversion, the Conversion Date must be a Business Day; (iii) if the Conversion is from the Flexible Rate, (a) the Conversion Date may be no earlier than the latest Interest Payment Date established prior to the giving of notice to the Remarketing Agent of such proposed Conversion and (b) no further Interest Payment Date may be established while the Interest Rate Mode is then the Flexible Rate if such Interest Payment Date would occur after the effective date of that Conversion; and

(iv) after a determination is made requiring mandatory redemption of all Bonds pursuant to the Indenture (see “— Redemptions” below), no change in the Interest Rate Mode may be made prior to such mandatory redemption.

*Change of Long Term Rate Period.* The Company may change from one Long Term Rate Period to another Long Term Rate Period on any Business Day on which the Bonds are subject to optional redemption as described under “— Redemptions — Optional Redemption” below upon notice from the Bond Registrar to the owners of Bonds as described below. With any notice of such change, the Company must also deliver an opinion of Bond Counsel stating that such change is authorized or permitted by the Act and is authorized by the Indenture and will not adversely affect the exclusion from gross income of interest on the Bonds for federal income tax purposes. Notwithstanding the foregoing, the Long Term Rate Period will not be changed to a new Long Term Rate Period if (A) the Remarketing Agent has not determined the interest rate for the new Long Term Rate Period in accordance with the terms of the Indenture or (B) the Bond Registrar receives written notice from Bond Counsel prior to the effective date of the change to the effect that the opinion of such Bond Counsel required under the Indenture has been rescinded. Upon the occurrence of any of the events described in the preceding sentence, the Bonds will bear interest at the Weekly Rate commencing on the date which would have been the effective date of the proposed change of Long Term Rate Period, subject to the provisions described below under “— Cancellation of Conversion of Interest Rate Mode.”

*Notice to Owners of Conversion of Interest Rate Mode or of Change of Long Term Rate Period.* The Bond Registrar will notify each registered owner of the Conversion or change of Long Term Rate Period, as applicable, by first class mail at least 15 days (30 days in the case of Conversion from or to the Semi-Annual Rate, the Annual Rate or a Long Term Rate or in the case of a change in the Long Term Rate Period) but not more than 45 days before each Conversion Date or each effective date of a change in the Long Term Rate Period. The notice will state those matters required to be set forth therein under the Indenture.

*Cancellation of Conversion of Interest Rate Mode.* Notwithstanding the foregoing, no Conversion will occur if (A) the Remarketing Agent has not determined the initial interest rate for the new Interest Rate Mode in accordance with the terms of the Indenture, (B) the Bonds that are to be purchased are not remarketed or sold by the Remarketing Agent or (C) the Bond Registrar receives written notice from Bond Counsel prior to the opening of business on the effective date of Conversion to the effect that the opinion of such Bond Counsel required under the Indenture has been rescinded. If such Conversion fails to occur, such Bonds in the Dutch Auction Rate will remain in such Interest Rate Mode and Bonds in any other Interest Rate Mode will automatically be converted to the Weekly Rate (with the first period adjusted in length so that the last day of such period will be a Tuesday) at the rate determined by the Remarketing Agent on the failed Conversion Date; provided, that there must be delivered to the Issuer, the Trustee, the Tender Agent, the Company, the Credit Facility Issuer and the Remarketing Agent an opinion of Bond Counsel to the effect that determining the interest rate to be borne by the Bonds at a Weekly Rate is authorized or permitted by the Act and is authorized under the Indenture and will not adversely affect the exclusion from gross income of interest on the Bonds for federal income tax purposes. If such opinion is not delivered on the failed Conversion Date, the Bonds will bear interest for a Rate Period of the same type and of substantially the same length as the Rate Period in effect prior to the failed Conversion Date at a rate of interest

determined by the Remarketing Agent on the failed Conversion Date (or if shorter, the Rate Period ending on the date before the maturity date); provided that if the Bonds then bear interest at the Long Term Rate, and if such opinion is not delivered on the date which would have been the effective date of a new Long Term Rate Period, the Bonds will bear interest at the Annual Rate, commencing on such date, at an Annual Rate determined by the Remarketing Agent on such date. If the proposed Conversion of Bonds fails as described herein, any mandatory purchase of such Bonds will remain effective.

#### **Purchases of Bonds on Demand of Owner**

If the Bonds are in the book-entry-only system, demands for purchase may be made by Beneficial Owners only through such Beneficial Owner's Direct Participant (as defined under the caption "—Book-Entry-Only System"). If the Bonds are in certificated form, demands for purchase may be made only by registered owners. When the Interest Rate Mode is the Dutch Auction Rate, the Bonds are not subject to purchase on demand of the owners thereof.

*Daily Rate.* If the Interest Rate Mode for the Bonds is the Daily Rate, any Bond will be purchased on the demand of the registered owner thereof on any Business Day during a Daily Rate Period at a purchase price equal to the principal amount thereof plus accrued interest, if any, to the Purchase Date upon written notice or telephonic notice (to be immediately confirmed in writing) to the Tender Agent at its principal office not later than 10:00 a.m. (New York City time) on such Business Day.

*Weekly Rate.* If the Interest Rate Mode for the Bonds is the Weekly Rate, any Bond will be purchased on the demand of the registered owner thereof on any Business Day during a Weekly Rate Period at a purchase price equal to the principal amount thereof plus accrued interest, if any, to the Purchase Date upon written notice to the Tender Agent at its principal office at or before 5:00 p.m. (New York City time) on a Business Day not later than the seventh day prior to the Purchase Date.

*Semi-Annual Rate.* If the Interest Rate Mode for the Bonds is the Semi-Annual Rate, any Bond will be purchased on the demand of the registered owner thereof on any Interest Payment Date for a Semi-Annual Rate Period at a purchase price equal to the principal amount thereof upon written notice to the Tender Agent at its principal office on a Business Day not later than the fifteenth day prior to such Purchase Date.

*Annual Rate.* If the Interest Rate Mode for the Bonds is the Annual Rate, any Bond will be purchased on the demand of the registered owner thereof on the final Interest Payment Date for such Annual Rate Period at a purchase price equal to the principal amount thereof upon written notice to the Tender Agent at its principal office on a Business Day not later than the fifteenth day prior to such Purchase Date.

*Long Term Rate.* If the Interest Rate Mode for the Bonds is the Long Term Rate, any Bond will be purchased on the demand of the registered owner thereof on the final Interest Payment Date for such Long Term Rate Period (unless such date is the final maturity date) at a purchase price equal to the principal amount thereof upon written notice to the Tender Agent at its principal office on a Business Day not later than the fifteenth day prior to such Purchase Date.

Limitations on Purchases on Demand of Owner. Notwithstanding the foregoing, there will be no purchase of (a) a portion of any Bond unless the portion to be purchased and the portion to be retained each will be in an authorized denomination or (b) any Bond upon the demand of the registered owner if an Event of Default under the Indenture with respect to the payment of principal of, interest on, or purchase price of, the Bonds has occurred and is continuing. Also, if the Interest Rate Mode for the Bonds is the Flexible Rate, the Bonds will not be subject to purchase on the demand of the registered owners thereof, but each Bond will be subject to mandatory purchase on each Conversion Date and on the Interest Payment Date with respect to such Bond, as described below under the caption “— Mandatory Purchases of Bonds.”

Notice Required for Purchases. Any written notice delivered to the Tender Agent by an owner demanding the purchase of Bonds must (A) be delivered by the time and dates specified above, (B) state the number and principal amount (or portion thereof) of such Bond to be purchased, (C) state the Purchase Date on which such Bond is to be purchased, (D) irrevocably request such purchase and state that the owner agrees to deliver such Bond, duly endorsed in blank for transfer, with all signatures guaranteed, to the Tender Agent at or prior to 11:00 a.m. (1:00 p.m. if a tender during a Daily Rate Period and 12:00 noon if a tender during a Weekly Rate Period) (New York City time) on such Purchase Date.

#### **Mandatory Purchases of Bonds**

Mandatory Purchase on Conversion Dates or Change by the Company in Long Term Rate Period. The Bonds will be subject to mandatory purchase at a purchase price equal to the principal amount thereof, plus accrued interest, if any, to the Purchase Date, plus, if the Interest Rate Mode is the Long Term Rate, the redemption premium, if any, which would be payable as described under “— Redemptions — Optional Redemption” below, if the Bonds were redeemed on the Purchase Date (A) on each Conversion Date and (B) on the effective date of any change by the Company of the Long Term Rate Period. Such tender and purchase will be required even if the change in Long Term Rate Period or the Conversion is canceled pursuant to the Indenture.

Mandatory Purchase on Each Interest Payment Date for Flexible Rate Period. Whenever the Interest Rate Mode for the Bonds is the Flexible Rate, each Bond will be subject to mandatory purchase at a purchase price equal to the principal amount thereof, without premium, plus accrued interest, if any, to the Purchase Date, on each Interest Payment Date that interest on such Bond is payable at an interest rate determined for the Flexible Rate. Owners of Bonds will receive no notice of such mandatory purchase.

Mandatory Purchase on Day after End of the Semi-Annual Rate Period, the Annual Rate Period or the Long Term Rate Period. Whenever the Interest Rate Mode for the Bonds is the Semi-Annual Rate, the Annual Rate or the Long Term Rate, such Bonds will be subject to mandatory purchase on the Business Day following the end of each Semi-Annual Rate Period, Annual Rate Period or Long Term Rate Period, as the case may be, for such Bond at a purchase price equal to the principal amount thereof plus accrued interest, if any, to such date.



*Mandatory Purchase upon Delivery, Cancellation, Substitution, Extension, Termination or Expiration of Any Credit Facility or Replacement with an Alternate Credit Facility.* If, at the option of the Company, a Credit Facility (other than the initial Letter of Credit) is delivered with respect to the Bonds subsequent to the Reoffering Date, the Bonds will be subject to mandatory tender for purchase at a purchase price equal to 100% of the principal amount thereof, plus accrued interest, if any, to the Purchase Date on the date of the delivery of the Credit Facility. In addition, if the Bonds are secured by a Credit Facility, the Bonds will be subject to mandatory tender for purchase at a purchase price equal to 100% of the principal amount thereof, plus accrued interest, if any, (A) on the Interest Payment Date at least five days prior to the date of the cancellation of or the expiration of the term of the then current Credit Facility and (B) on the Interest Payment Date on which a Credit Facility is replaced with an Alternate Credit Facility.

*Notice to Owners of Mandatory Purchases.* Notice to owners of a mandatory purchase of Bonds (except for mandatory purchase on each Interest Payment Date for Flexible Rate Periods) will be given by the Bond Registrar, by first class mail at least 15 days but not more than 45 days before the Purchase Date; provided, however, as an alternative to the foregoing, if DTC or its nominee is the registered owner of the Bonds, notice may be given to DTC not less than five days before the Purchase Date. The notice of mandatory purchase will state those matters required to be set forth therein under the Indenture. No notice of mandatory purchase will be given in connection with a mandatory purchase on an Interest Payment Date for a Flexible Rate Period.

#### **Remarketing and Purchase of Bonds**

The Indenture provides that, subject to the terms of a Remarketing Agreement with the Company, the Remarketing Agent will use its reasonable best efforts to offer for sale Bonds purchased upon demand of the owners thereof and, unless otherwise instructed by the Company and with the consent of any Credit Facility Issuer, upon mandatory purchase, provided that Bonds will not be remarketed upon the occurrence and continuance of certain Events of Default under the Indenture, except in the sole discretion of the Remarketing Agent. Each such sale will be at a price equal to the principal amount thereof, plus interest accrued to the date of sale. The Remarketing Agent, the Trustee, the Paying Agent, the Bond Registrar or the Tender Agent each may purchase any Bonds offered for sale for its own account.

On each date Bonds are to be purchased pursuant to optional or mandatory purchase under the Indenture, such Bonds will be purchased from the following sources in the order of priority indicated, provided that funds derived from clause (c) may not be combined with the funds derived from clauses (a) or (b) to purchase any Bonds:

(a) proceeds of the remarketing of such Bonds to persons other than the Company, its affiliates or the Issuer and furnished to the Tender Agent by the Remarketing Agent and deposited directly into, and held in, the Remarketing Proceeds Subaccount of the Purchase Fund established with the Tender Agent under the Indenture;

(b) proceeds of the Credit Facility, if any, furnished by the Trustee, as Tender Agent, and deposited by the Tender Agent directly into, and held in, the Credit Facility Subaccount of the Purchase Fund; and

(c) moneys paid by the Company (including the proceeds of the remarketing of the Bonds to the Company, its affiliates or the Issuer) to pay the purchase price to the Tender Agent.

If there is no Credit Facility in operation to secure the Bonds, any Bonds will be purchased with any moneys made available by the Company, including proceeds from the remarketing of the Bonds.

### **Payment of Purchase Price**

When a book-entry-only system is not in effect, payment of the purchase price of any Bond will be payable (and delivery of a replacement Bond in exchange for the portion of any Bond not purchased if such Bond is purchased in part will be made) on the Purchase Date upon delivery of such Bond to the Tender Agent on such Purchase Date; provided that such Bond must be delivered to the Tender Agent: (i) at or prior to 12:00 noon (New York City time), in the case of Bonds delivered for purchase during a Weekly Rate Period or Flexible Rate Period, (ii) at or prior to 1:00 p.m. (New York City time), in the case of Bonds delivered for purchase during a Daily Rate Period or (iii) at or prior to 11:00 a.m. (New York City time), in the case of Bonds delivered for purchase during a Semi-Annual Rate Period, Annual Rate Period or Long Term Rate Period. If the date of such purchase is not a Business Day, the purchase price will be payable on the next succeeding Business Day.

Any Bond delivered for payment of the purchase price must be accompanied by an instrument of transfer thereof in form satisfactory to the Tender Agent executed in blank by the registered owner thereof and with all signatures guaranteed. The Tender Agent may refuse to accept delivery of any Bond for which an instrument of transfer satisfactory to it has not been provided and has no obligation to pay the purchase price of such Bond until a satisfactory instrument is delivered.

If the registered owner of any Bond (or portion thereof) that is subject to purchase pursuant to the Indenture fails to deliver such Bond with an appropriate instrument of transfer to the Tender Agent for purchase on the Purchase Date, and if the Tender Agent is in receipt of the purchase price therefor, such Bond (or portion thereof) nevertheless will be deemed purchased on the Purchase Date thereof. Any owner who so fails to deliver such Bond for purchase on (or before) the Purchase Date will have no further rights thereunder, except the right to receive the purchase price thereof from those moneys deposited with the Tender Agent in the Purchase Fund pursuant to the Indenture upon presentation and surrender of such Bond to the Tender Agent properly endorsed for transfer in blank with all signatures guaranteed.

When a book-entry-only system is in effect, the requirement for physical delivery of the Bonds will be deemed satisfied when the ownership rights in the Bonds are transferred by Direct Participants on the records of DTC to the participant account of the Tender Agent.

## Redemptions

### Optional Redemption.

(a) Whenever the Interest Rate Mode for the Bonds is the Daily Rate or the Weekly Rate, the Bonds will be subject to redemption at the option of the Issuer, upon the written direction of the Company, in whole or in part, at a redemption price of 100% of the principal amount thereof, plus interest accrued, if any, to the redemption date, on any Business Day.

(b) Whenever the Interest Rate Mode for a Bond is the Flexible Rate, such Bond will be subject to redemption at the option of the Issuer, upon the written direction of the Company, in whole or in part, at a redemption price of 100% of the principal amount thereof on any Interest Payment Date for that Bond.

(c) Whenever the Interest Rate Mode for the Bonds is the Dutch Auction Rate, the Bonds will be subject to redemption at the option of the Issuer, upon the written direction of the Company, in whole or in part, on the Business Day immediately succeeding any auction date, at a redemption price of 100% of the principal amount thereof, together with accrued interest to the redemption date.

(d) Whenever the Interest Rate Mode for the Bonds is the Semi-Annual Rate, the Bonds will be subject to redemption at the option of the Issuer, upon the written direction of the Company, in whole or in part, at a redemption price of 100% of the principal amount thereof on any Interest Payment Date.

(e) Whenever the Interest Rate Mode for the Bonds is the Annual Rate, the Bonds will be subject to redemption at the option of the Issuer, upon the written direction of the Company, in whole or in part, at a redemption price of 100% of the principal amount thereof on the final Interest Payment Date for each Annual Rate Period.

(f) Whenever the Interest Rate Mode for the Bonds is the Long Term Rate, the Bonds will be subject to redemption at the option of the Issuer, upon the written direction of the Company, in whole or in part, (1) on the final Interest Payment Date for the then-current Long Term Rate Period at a redemption price of 100% of the principal amount thereof and (2) prior to the end of the then-current Long Term Rate Period at any time during the redemption periods and at the redemption prices set forth below, plus in each case interest accrued, if any, to the redemption date:

<b>Original Length of Current Long Term Rate Period (Years)</b>	<b>Commencement of Redemption Period</b>	<b>Redemption Price as Percentage of Principal</b>
More than or equal to 11 years	First Interest Payment Date on or after the tenth anniversary of commencement of Long Term Rate Period	100%
Less than 11 years	Non-callable	Non-callable

Subject to certain conditions, including provision of an opinion of Bond Counsel that a change in the redemption provisions of the Bonds will not adversely affect the exclusion from gross income of interest on the Bonds for federal income tax purposes, the redemption periods and redemption prices may be revised, effective as of the Conversion Date, the date of a change in the Long Term Rate Period or a Purchase Date on the final Interest Payment Date during a Long Term Rate Period, to reflect Prevailing Market Conditions on such date as determined by the Remarketing Agent in its judgment.

*Extraordinary Optional Redemption in Whole.* The Bonds may be redeemed by the Issuer in whole at any time at 100% of the principal amount thereof plus accrued interest to the redemption date upon the exercise by the Company of an option under the Loan Agreement to prepay the loan if any of the following events shall have occurred within 180 days preceding the giving of written notice by the Company to the Trustee of such election:

(i) if in the judgment of the Company, unreasonable burdens or excessive liabilities have been imposed upon the Company after the issuance of the Bonds with respect to the Project or the operation thereof, including without limitation federal, state or other ad valorem property, income or other taxes not imposed on the date of the Loan Agreement, other than ad valorem taxes levied upon privately owned property used for the same general purpose as the Project;

(ii) if the Project or a portion thereof or other property of the Company in connection with which the Project is used has been damaged or destroyed to such an extent so as, in the judgment of the Company, to render the Project or such other property of the Company in connection with which the Project is used unsatisfactory to the Company for its intended use, and such condition continues for a period of six months;

(iii) there has occurred condemnation of all or substantially all of the Project or the taking by eminent domain of such use or control of the Project or other property of the Company in connection with which the Project is used so as, in the judgment of the Company, to render the Project or such other property of the Company unsatisfactory to the Company for its intended use;

(iv) in the event changes, which the Company cannot reasonably control, in the economic availability of materials, supplies, labor, equipment or other properties or things necessary for the efficient operation of the generating station where the Project is located have occurred, which, in the judgment of the Company, render the continued operation of such generating station or any generating unit at such station uneconomical; or changes in circumstances after the issuance of the Bonds, including but not limited to changes in solid waste abatement, control and disposal requirements, have occurred such that the Company determines that use of the Project is no longer required or desirable;

(v) the Loan Agreement has become void or unenforceable or impossible of performance by reason of any changes in the Constitution of the Commonwealth of Kentucky or the Constitution of the United States of America or by reason of legislative or administrative action (whether state or federal) or any final decree, judgment or order of any court or administrative body, whether state or federal; or

(vi) a final order or decree of any court or administrative body after the issuance of the Bonds requires the Company to cease a substantial part of its operation at the generating station where the Project is located to such extent that the Company will be prevented from carrying on its normal operations at such generating station for a period of six months.

Extraordinary Optional Redemption in Whole or in Part. The Bonds are also subject to redemption in whole or in part at 100% of the principal amount thereof plus accrued interest to the redemption date at the option of the Company in an amount not to exceed the net proceeds received from insurance or any condemnation award received by the Issuer or the Company in the event of damage, destruction or condemnation of all or a portion of the Project, subject to receipt of an opinion of Bond Counsel that such redemption will not adversely affect the exclusion of interest on any of the Bonds from gross income for federal income tax purposes, and such net proceeds must be applied to reimburse the Credit Facility Issuer for drawings under the Credit Facility to redeem the Bonds. See “Summary of the Loan Agreement — Maintenance; Damage, Destruction and Condemnation.” Such redemption may occur at any time, provided that if such event occurs while the Interest Rate Mode for the Bonds is the Daily Rate, Weekly Rate, Flexible Rate or Semi-Annual Rate, such redemption must occur on a date on which the Bonds are otherwise subject to optional redemption as described above.

Mandatory Redemption; Determination of Taxability. The Bonds are required to be redeemed by the Issuer, in whole, or in such part as described below, at a redemption price equal to 100% of the principal amount thereof, without redemption premium, plus accrued interest, if any, to the redemption date, within 180 days following a “Determination of Taxability.” As used herein, a “Determination of Taxability” means the receipt by the Trustee of written notice from a current or former registered owner of a Bond or from the Company or the Issuer of (A) the issuance of a published or private ruling or a technical advice memorandum by the Internal Revenue Service in which the Company participated or has been given the opportunity to participate, and which ruling or memorandum the Company, in its discretion, does not contest or from which no further right of administrative or judicial review or appeal exists, or (B) a final determination from which no further right of appeal exists of any court of competent jurisdiction in the United States in a proceeding in which the Company has participated or has been a party,

or has been given the opportunity to participate or be a party, in each case, to the effect that as a result of a failure by the Company to perform or observe any covenant or agreement or the inaccuracy of any representation contained in the Loan Agreement or any other agreement or certificate delivered in connection with the Bonds, the interest on the Bonds is included in the gross income of the owners thereof for federal income tax purposes, other than with respect to a person who is a “substantial user” or a “related person” of a substantial user within the meaning of the Section 147 of Internal Revenue Code of 1986, as amended (the “Code”); provided, however, that no such Determination of Taxability shall be considered to exist as a result of the Trustee receiving notice from a current or former registered owner of a Bond or from the Issuer unless (A) the Issuer or the registered owner or former registered owner of the Bond involved in such proceeding or action (1) gives the Company and the Trustee prompt notice of the commencement thereof, and (2) (if the Company agrees to pay all expenses in connection therewith) offers the Company the opportunity to control unconditionally the defense thereof, and (B) either (1) the Company does not agree within 30 days of receipt of such offer to pay such expenses and liabilities and to control such defense, or (2) the Company shall exhaust or choose not to exhaust all available proceedings for the contest, review, appeal or rehearing of such decree, judgment or action which the Company determines to be appropriate. No Determination of Taxability described above will result from the inclusion of interest on any Bond in the computation of minimum or indirect taxes. All of the Bonds are required to be redeemed upon a Determination of Taxability as described above unless, in the opinion of Bond Counsel, redemption of a portion of such Bonds would have the result that interest payable on the remaining Bonds outstanding after the redemption would not be so included in any such gross income.

In the event any of the Issuer, the Company or the Trustee has been put on notice or becomes aware of the existence or pendency of any inquiry, audit or other proceedings relating to the Bonds being conducted by the Internal Revenue Service, the party so put on notice is required to give immediate written notice to the other parties of such matters. Promptly upon learning of the occurrence of a Determination of Taxability (whether or not the same is being contested), or any of the events described above, the Company is required to give notice thereof to the Trustee and the Issuer.

If the Internal Revenue Service or a court of competent jurisdiction determines that the interest paid or to be paid on any Bond (except to a “substantial user” of the Project or a “related person” within the meaning of Section 147(a) of the Code) is or was includable in the gross income of the recipient for federal income tax purposes for reasons other than as a result of a failure by the Company to perform or observe any of its covenants, agreements or representations in the Loan Agreement or any other agreement or certificate delivered in connection therewith, the Bonds are not subject to redemption. In such circumstances, Bondholders would continue to hold their Bonds, receiving principal and interest at the applicable rate as and when due, but would be required to include such interest payments in gross income for federal income tax purposes. Also, if the lien of the Indenture is discharged or defeased prior to the occurrence of a final Determination of Taxability, Bonds will not be redeemed as described herein.

General Redemption Terms. So long as a Credit Facility is in effect in respect of the Bonds, the redemption price (including accrued interest) will be paid from drawings under such Credit Facility or from moneys which otherwise constitute Available Moneys under the Indenture. Notice of redemption will be given by mailing a redemption notice by first class mail to the registered owners of the Bonds to be redeemed not less than 30 days (15 days if the Interest Rate Mode for the Bonds is the Dutch Auction Rate, Flexible Rate, Daily Rate or Weekly Rate) but not more than 45 days prior to the redemption date. Any notice mailed as provided in the Indenture will be conclusively presumed to have been given, irrespective of whether the owner receives the notice. Failure to give any such notice by mailing or any defect therein in respect of any Bond will not affect the validity of any proceedings for the redemption of any other Bond. No further interest will accrue on the principal of any Bond called for redemption after the redemption date if funds sufficient for such redemption have been deposited with the Paying Agent as of the redemption date. If the provisions for discharging the Indenture set forth below under the caption, “Summary of the Indenture — Discharge of the Indenture” have not been complied with, any redemption notice will state that it is conditional on there being sufficient moneys to pay the full redemption price for the Bonds to be redeemed. So long as the Bonds are held in book-entry-only form, all redemption notices will be sent only to Cede & Co.

### **Book-Entry-Only System**

*Portions of the following information concerning DTC and DTC’s book-entry-only system have been obtained from DTC. The Issuer, the Company and the Remarketing Agent make no representation as to the accuracy of such information.*

Initially, DTC will act as securities depository for the Bonds and the Bonds initially will be issued solely in book-entry-only form to be held under DTC’s book-entry-only system, registered in the name of Cede & Co. (DTC’s partnership nominee). One fully registered bond in the aggregate principal amount of the Bonds will be deposited with DTC.

DTC, the world’s largest depository, is a limited-purpose trust company organized under the New York Banking Law, a “banking organization” within the meaning of the New York Banking Law, a member of the Federal Reserve System, a “clearing corporation” within the meaning of the New York Uniform Commercial Code, and a “clearing agency” registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934 (the “Exchange Act”). DTC holds and provides asset servicing for over 2.2 million issues of U.S. and non-U.S. equity, corporate and municipal debt issues, and money market instruments from over 100 countries that DTC’s participants (“Direct Participants”) deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants’ accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation (“DTCC”). DTCC, in turn, is owned by a number of Direct Participants of DTC and Members of the National Securities Clearing Corporation, Fixed Income Clearing Corporation, and Emerging Markets Clearing Corporation (NSCC, FICC and EMCC, also subsidiaries of DTCC), as well as

by the New York Stock Exchange, Inc., the American Stock Exchange LLC and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly (“Indirect Participants” and, together with “Direct Participants,” “Participants”). DTC has Standard & Poor’s highest rating: AAA. The DTC Rules applicable to its Participants are on file with the SEC. More information about DTC can be found at [www.dtcc.com](http://www.dtcc.com) and [www.dtc.org](http://www.dtc.org).

Purchases of the Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Bonds on DTC’s records. The ownership interest of each actual purchaser of each Bond (“Beneficial Owner”) is in turn to be recorded on the Direct and Indirect Participants’ records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Bonds are to be accomplished by entries made on the books of Direct or Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in the Bonds, except in the event that use of the book-entry system for the Bonds is discontinued.

To facilitate subsequent transfers, all Bonds deposited by Direct Participants with DTC are registered in the name of DTC’s partnership nominee, Cede & Co. or such other name as may be requested by an authorized representative of DTC. The deposit of Bonds with DTC and their registration in the name of Cede & Co. or such other nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Bonds; DTC’s records reflect only the identity of the Direct Participants to whose accounts such Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time.

Redemption notices shall be sent to DTC. If less than all of the Bonds are being redeemed, DTC’s practice is to determine by lot the amount of the interest of each Direct Participant to be redeemed.

Neither DTC nor Cede & Co. (nor such other DTC nominee) will consent or vote with respect to the Bonds unless authorized by a Direct Participant in accordance with DTC’s Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the Issuer as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.’s consenting or voting rights to those Direct Participants to whose accounts the Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).



Principal and interest payments on the Bonds will be made to Cede & Co. or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts, upon DTC's receipt of funds and corresponding detail information from the Issuer or the Trustee on the payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC nor its nominee, the Trustee, the Company or the Issuer, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal and interest to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the Issuer or the Trustee, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

A Beneficial Owner shall give notice to elect to have its Bonds purchased or tendered, through its Participant, to the Tender Agent, and shall effect delivery of such Bonds by causing the Direct Participant to transfer the Participant's interest in the Bonds, on DTC's records, to the Tender Agent. The requirement for physical delivery of Bonds in connection with a demand for purchase or a mandatory purchase will be deemed satisfied when the ownership rights in the Bonds are transferred by Direct Participants on DTC's records and followed by a book-entry credit of tendered Bonds to the Tender Agent's DTC account.

DTC may discontinue providing its services as securities depository with respect to the Bonds at any time by giving reasonable notice to the Issuer, the Company, the Tender Agent and the Trustee, or the Issuer, at the request of the Company, may remove DTC as the securities depository for the Bonds. Under such circumstances, in the event that a successor securities depository is not obtained, bond certificates are required to be delivered as described in the Indenture (see "— Revision of Book-Entry-Only System; Replacement Bonds" below). The Beneficial Owner, upon registration of certificates held in the Beneficial Owner's name, will become the registered owner of the Bonds.

So long as Cede & Co. is the registered owner of the Bonds, as nominee of DTC, references herein to the registered owners of the Bonds will mean Cede & Co. and will not mean the Beneficial Owners. Under the Indenture, payments made by the Trustee to DTC or its nominee will satisfy the Issuer's obligations under the Indenture, the Company's obligations under the Loan Agreement, to the extent of the payments so made. Beneficial Owners will not be, and will not be considered by the Issuer or the Trustee to be, and will not have any rights as, owners of Bonds under the Indenture.

The Trustee and the Issuer, so long as a book-entry-only system is used for the Bonds, will send any notice of redemption or of proposed document amendments requiring consent of registered owners and any other notices required by the document (including notices of Conversion and mandatory purchase) to be sent to registered owners only to DTC (or any successor securities depository) or its nominee. Any failure of DTC to advise any Direct Participant, or of any Direct Participant or Indirect Participant to notify the Beneficial Owner, of any such notice and its content or effect will not affect the validity of the redemption of the

Bonds called for redemption, the document amendment, the Conversion, the mandatory purchase or any other action premised on that notice.

The Issuer, the Company, the Trustee and the Remarketing Agent cannot and do not give any assurances that DTC will distribute payments on the Bonds made to DTC or its nominee as the registered owner or any redemption or other notices, to the Participants, or that the Participants or others will distribute such payments or notices to the Beneficial Owners, or that they will do so on a timely basis, or that DTC will serve and act in the manner described in this Reoffering Circular.

THE ISSUER, THE COMPANY, THE REMARKETING AGENT AND THE TRUSTEE WILL HAVE NO RESPONSIBILITY OR OBLIGATION TO ANY DIRECT PARTICIPANT, INDIRECT PARTICIPANT OR ANY BENEFICIAL OWNER OR ANY OTHER PERSON NOT SHOWN ON THE REGISTRATION BOOKS OF THE TRUSTEE AS BEING A REGISTERED OWNER WITH RESPECT TO: (1) THE ACCURACY OF ANY RECORDS MAINTAINED BY DTC OR ANY DIRECT PARTICIPANT OR INDIRECT PARTICIPANT; (2) THE PAYMENT OF ANY AMOUNT DUE BY DTC TO ANY DIRECT PARTICIPANT OR BY ANY DIRECT PARTICIPANT OR INDIRECT PARTICIPANT TO ANY BENEFICIAL OWNER IN RESPECT OF THE PRINCIPAL AMOUNT OR REDEMPTION OR PURCHASE PRICE OF OR INTEREST ON THE BONDS; (3) THE DELIVERY OF ANY NOTICE BY DTC TO ANY DIRECT PARTICIPANT OR BY ANY DIRECT PARTICIPANT OR INDIRECT PARTICIPANT TO ANY BENEFICIAL OWNER WHICH IS REQUIRED OR PERMITTED TO BE GIVEN TO REGISTERED OWNERS UNDER THE TERMS OF THE INDENTURE; (4) THE SELECTION OF THE BENEFICIAL OWNERS TO RECEIVE PAYMENT IN THE EVENT OF ANY PARTIAL REDEMPTION OF THE BONDS; OR (5) ANY CONSENT GIVEN OR OTHER ACTION TAKEN BY DTC AS REGISTERED OWNER.

Revision of Book-Entry-Only System; Replacement Bonds. In the event that DTC determines not to continue as securities depository or is removed by the Issuer, at the direction of the Company, as securities depository, the Issuer, at the direction of the Company, may appoint a successor securities depository reasonably acceptable to the Trustee. If the Issuer does not or is unable to appoint a successor securities depository, the Issuer will issue and the Trustee will authenticate and deliver fully registered Bonds, in authorized denominations, to the assignees of DTC or their nominees.

In the event that the book-entry-only system is discontinued, the following provisions will apply. The Bonds may be issued in denominations of \$25,000 and integral multiples thereof, if the Interest Rate Mode is the Dutch Auction Rate; in denominations of \$5,000 and integral multiples thereof, if the Interest Rate Mode is the Semi-Annual Rate, the Annual Rate or the Long Term Rate; in denominations of \$100,000 and integral multiples of \$5,000 in excess thereof, if the Interest Rate Mode is the Flexible Rate; and in denominations of \$100,000 and integral multiples thereof, if the Interest Rate Mode is the Daily Rate or the Weekly Rate. Bonds may be transferred or exchanged for an equal total amount of Bonds of other authorized denominations upon surrender of such Bonds at the principal office of the Bond Registrar, accompanied by a written instrument of transfer or authorization for exchange in form and with guaranty of signature satisfactory to the Bond Registrar, duly executed by the registered owner

or the owner's duly authorized attorney. Except as provided in the Indenture, the Bond Registrar will not be required to register the transfer or exchange of any Bond during the fifteen days before any mailing of a notice of redemption, after such Bond has been called for redemption in whole or in part, or after such Bond has been tendered or deemed tendered for optional or mandatory purchase as described under "— Purchases of Bonds on Demand of Owner" and "— Mandatory Purchases of Bonds." Registration of transfers and exchanges will be made without charge to the owners of Bonds, except that the Bond Registrar may require any owner requesting registration of transfer or exchange to pay any required tax or governmental charge.

### **Security; Limitation on Liens**

Payment of the principal of and interest and any premium on the Bonds are secured by an assignment by the Issuer to the Trustee of the Issuer's interest in and to the Loan Agreement and all payments to be made pursuant thereto (other than certain indemnification and expense payments and notification rights). Pursuant to the Loan Agreement, the Company will agree to pay, among other things, amounts sufficient to pay the aggregate principal amount of and premium, if any, on the Bonds, together with interest thereon as and when the same become due. The Company further will agree to make payments of the purchase price of the Bonds tendered for purchase to the extent that funds are not otherwise available therefor under the provisions of the Indenture.

The Bonds are unsecured general obligations of the Company, ranking on a parity with the Company's obligations under the Loan Agreement to make payments on the Bonds.

In the Loan Agreement, the Company covenants that it will not, so long as any of the Bonds are outstanding, issue, assume or guarantee any debt for borrowed money secured by any mortgage, security interest, pledge or lien ("mortgage") on any of the Company's operating property (as defined below), whether the Company owns it at the date hereof or acquires it later, unless the Company similarly secures its obligations under the Loan Agreement to make payments to the Trustee in sufficient amounts to pay the principal of, premium, if any, and interest required to be paid on the Bonds. This restriction will not apply to:

- mortgages on any property existing at the time the Company acquires the property or at the time the Company acquires the corporation owning the property;
- purchase money mortgages;
- specified governmental mortgages; or
- any extension, renewal or replacement (or successive extensions, renewals or replacements) of any mortgage referred to in the three clauses listed above, so long as the principal amount of indebtedness secured under this clause and not otherwise authorized by the clauses listed above, does not exceed the principal amount of indebtedness secured at the time of the extension, renewal or replacement.

In addition, the Company can also issue secured debt so long as the amount of the secured debt does not exceed the greater of 10% of net tangible assets or 10% of capitalization.

For purposes of this limitation on liens, “operating property” means (1) any interest in real property owned by the Company, and (2) any asset owned by the Company that is depreciable in accordance with generally accepted accounting principles.

### **The Letter of Credit**

*The following summarizes certain provisions of the Letter of Credit and the Reimbursement Agreement, to which reference is made for the detailed provisions thereof. Unless otherwise defined in this Reoffering Circular, capitalized terms in the following summary are used as defined in the Letter of Credit and the Reimbursement Agreement. The Company is permitted under the Indenture to deliver an Alternate Credit Facility to replace the Letter of Credit. Any such Alternate Credit Facility must meet certain requirements described in the Indenture.*

### **The Letter of Credit**

The Letter of Credit will be an irrevocable transferable direct pay letter of credit issued by the Bank in order to provide additional security for the payment of principal of, purchase price of, interest on and premium, if applicable, on any date when payments under the Bonds are due, including principal and interest payments and payments upon tender, redemption, acceleration or maturity of the Bonds. The Letter of Credit will provide for direct payments to or upon the order of the Trustee as set forth in the Letter of Credit in amounts sufficient to pay to or upon the order of the Trustee, upon request and in accordance with the terms thereof.

The Letter of Credit will be issued in an amount equal to the aggregate principal amount of the outstanding Bonds, plus an amount that represents interest accrued thereon at an assumed rate of 14% per annum for 45 days (the “Credit Amount”). The Trustee, upon compliance with the terms of the Letter of Credit, is authorized to draw up to (a) an amount sufficient (i) to pay principal of the Bonds, when due, whether at maturity or upon redemption or acceleration, and (ii) to pay the portion of the purchase price of the Bonds delivered for purchase pursuant to a demand for purchase by the owner thereof or a mandatory tender for purchase and not remarketed (a “Liquidity Drawing”) equal to the principal amount of the Bonds, plus (b) an amount not to exceed 45 days of accrued interest on such Bonds at an assumed rate of 14% per annum (i) to pay interest on the Bonds, when due, and (ii) to pay the portion of the purchase price of the Bonds, delivered for purchase pursuant to a demand for purchase by the owner thereof or a mandatory tender for purchase and not remarketed, equal to the interest accrued, if any, on the Bonds.

The amount available under the Letter of Credit will be automatically reduced by the amount of any drawing thereunder, subject to reinstatement as described below. With respect to a drawing by the Trustee solely to pay interest on the Bonds on an Interest Payment Date, the amount available under the Letter of Credit will be automatically reinstated in the amount of such drawing effective on the earlier of (i) receipt by the Bank from the Company of reimbursement of any drawing solely to pay interest in full or (ii) at the opening of business on

the eleventh calendar day after the date the Bank honors such drawing, unless the Trustee has received written notice from the Bank by the tenth calendar day after the date the Bank honors such drawing the Bank is not so reinstating the available amount due to the Company's failure to reimburse the Bank for such drawing in full, or that an event of default has occurred and is continuing under the Reimbursement Agreement and, in either case, directing, an acceleration of the Bonds pursuant to the Indenture. With respect to a Liquidity Drawing under the Letter of Credit, the amount available under the Letter of Credit will be automatically reduced by the principal amount of the Bonds purchased with the proceeds of such drawing plus the amount of accrued interest on such Bonds. In the event of the remarketing of the Bonds purchased with the proceeds of a Liquidity Drawing, the amount available under the Letter of Credit will be automatically reinstated upon receipt by the Bank or the Trustee on the Bank's behalf of an amount equal to such principal amount plus accrued interest.

The Letter of Credit will terminate on the earliest to occur of:

(a) the Bank's close of business on December 16, 2009 (such date, as extended from time to time in accordance with the Letter of Credit is defined as the "Stated Expiration Date");

(b) the Bank's close of business on the date which is five Business Days following the date of receipt by the Bank of a certificate from the Trustee certifying that (a) no Bonds remain Outstanding within the meaning of the Indenture, (b) all drawings required to be made under the Indenture and available under the Letter of Credit have been made and honored, (c) an Alternate Credit Facility has been delivered to the Trustee in accordance with the Indenture to replace the Letter of Credit or (d) all of the outstanding Bonds were converted to Bonds bearing interest at a rate other than the Daily Rate or the Weekly Rate;

(c) the Bank's close of business on the date of receipt by the Bank of a certificate from the Trustee confirming that the Trustee is required to terminate the Letter of Credit in accordance with the terms of the Indenture; or

(d) the date on which the Bank receives and honors an acceleration drawing certificate.

### **The Reimbursement Agreement**

Pursuant to the Reimbursement Agreement, the Company is obligated to reimburse the Bank for all amounts drawn under the Letter of Credit, and to pay interest on all such amounts. The Company has also agreed to pay the Bank a periodic fee for issuing and maintaining the Letter of Credit.

The Reimbursement Agreement imposes various covenants and agreements, including various financial and operating covenants, on the Company. Such covenants include, but are not limited to, covenants relating to (i) inspection of the books and financial records of the Company; (ii) creation of liens; (iii) liquidations, mergers, consolidations or sales of all or substantially all of the Company's assets; and (iv) disposition of assets. Any such covenants may be amended, waived or modified at any time by the Bank and without the consent of the

Trustee or the holders of the Bonds. Under certain circumstances, the failure of the Company to comply with such covenants may result in a mandatory tender or acceleration of the Bonds.

The following events will constitute an “event of default” under the Reimbursement Agreement:

(a) nonpayment of certain fees and other amounts required to be paid or reimbursed by the Company under the Reimbursement Agreement to the Bank within five days after the same was required to be paid;

(b) any representation or warranty made or deemed made by or on behalf of the Company or any of its Significant Subsidiaries to the Bank under or in connection with the Reimbursement Agreement or any other Transaction Document, any advance or any certificate or information delivered pursuant to or in connection with the Reimbursement Agreement or any other Transaction Document, was false or misleading in any material respect as of the time it was made or furnished;

(c) an “event of default” (not due to the Bank’s failure to properly honor a drawing on the Letter of Credit) occurred under the Indenture or any of the other Transaction Documents and any applicable grace period has expired;

(d) the breach by the Company or any of its Significant Subsidiaries of any of the terms or provisions of certain covenants contained in the Reimbursement Agreement including, but not limited to, covenants relating to the provision of notice to the Bank regarding an “event of default” or “default” under the Reimbursement Agreement, the corporate existence and license or qualification and good standing of the Company in jurisdictions in which it owns or leases property, the creation of liens, the liquidation, merger, consolidation or sale of all or substantially all of the assets of the Company and the disposition of assets;

(e) the breach by the Company or any of its Significant Subsidiaries (other than a breach which constitutes a “default” described above) of any of the terms or provisions of the Reimbursement Agreement or any Security Document that is not remedied within thirty (30) days after an executive officer of the Company has actual knowledge of such default or written notice of such default has been given to the Company by the Bank;

(f) the Bonds cease to be valid for any reason;

(g) a default or event of default has occurred at any time under the terms of any other agreement involving borrowed money or the extension of credit or any other Indebtedness under which the Company or any of its Significant Subsidiaries may be obligated for the payment of \$50,000,000 or more in the aggregate, and such breach, default or event of default continues beyond any period of grace permitted with respect thereto and as a result thereof such Indebtedness is accelerated, becomes due or is otherwise required to be repurchased or redeemed prior to the scheduled date of maturity thereof;

(h) a proceeding has been instituted in a court having jurisdiction in the premises seeking a decree or order for relief in respect of the Company or any Significant Subsidiary in an involuntary case under any applicable bankruptcy, insolvency, reorganization or other similar law now or hereafter in effect, or for the appointment of a receiver, liquidator, assignee, custodian, trustee, sequestrator, conservator (or similar official) of the Company or any Significant Subsidiary for any substantial part of its property, or for the winding-up or liquidation of its affairs, and such proceeding shall remain undismissed or unstayed and in effect for a period of sixty (60) consecutive days; such court shall enter a decree or order granting any of the relief sought in such proceeding; or the Company or any Significant Subsidiary shall consent, approve or otherwise acquiesce in any of the actions sought in such proceeding;

(i) the Company or any Significant Subsidiary shall commence a voluntary case under any applicable bankruptcy, insolvency, reorganization or other similar law now or hereafter in effect, shall consent to the entry of an order for relief in an involuntary case under any such law, or shall consent to the appointment or taking possession by a receiver, liquidator, assignee, custodian, trustee, sequestrator, conservator (or other similar official) of itself or for any substantial part of its property or shall make a general assignment for the benefit of creditors, or shall fail generally to pay its debts as they become due, or shall take any action in furtherance of any of the foregoing;

(j) without the application, approval or consent of the Company or any of its Significant Subsidiaries, a receiver, trustee, examiner, liquidator or similar official shall be appointed for the Company or any of its Significant Subsidiaries, or for any substantial portion of its Property, or a proceeding described in paragraph (h) above has been instituted against the Company or any of its Significant Subsidiaries, and such appointment continues undischarged or such proceeding continues undismissed or unstayed for a period of 60 consecutive days;

(k) any of the following occurs: (i) any Reportable Event which constitutes grounds under Section 4042 of ERISA for the termination of any Plan by the PBGC or the appointment of a trustee to administer or liquidate any Plan, shall have occurred and be continuing; (ii) a notice of intent to terminate any Plan shall have been filed with the PBGC under Section 4041 of ERISA; (iii) the PBGC shall give notice under Section 4042 of ERISA of its intent to institute proceedings to terminate any Plan or Plans or to appoint a trustee to administer or liquidate any Plan; (iv) the Company or any member of the ERISA Group shall fail to make any contributions when due to a Plan or a Multiemployer Plan; (v) the Company or any member of the ERISA Group shall make any amendment to a Plan with respect to which security is required under Section 307 of ERISA; (vi) the Company or any member of the ERISA Group shall withdraw completely or partially from a Multiemployer Plan pursuant to Subtitle E of Title IV of ERISA; or (vii) the Company or any member of the ERISA Group shall withdraw within the meaning of Section 4063 of ERISA (or shall be deemed under Section 4062(e) of ERISA to withdraw) from a Multiple Employer Plan; and, with respect to any of such events specified in clause (i), (ii), (iii), (iv), (v), (vi) or (vii), such occurrence would be reasonably likely to result in a Material Adverse Effect;

(l) any final judgment(s) or order(s) for the payment of money shall be entered against the Company or any of its Significant Subsidiaries by a court having jurisdiction in the premises which judgment is not discharged, vacated, bonded or stayed pending appeal within a period of thirty (30) days from the date of entry if the aggregate uninsured amount of all such judgments and orders exceeds \$50,000,000;

(m) the Company or any of its Significant Subsidiaries ceases to conduct business (other than as permitted hereunder) or the Company is enjoined, restrained or in any way prevented by court order from conducting all or any material part of its business and such injunction, restraint or other preventive order is not dismissed within thirty (30) days after the entry thereof; or

(n) E.ON AG fails to own, directly or indirectly, at least seventy-five percent (75%) of the outstanding Voting Capital of the Company.

For purposes of the foregoing:

“Bond Documents” means the Indenture, the Custody Agreement, the Loan Agreement, the Bonds and the Remarketing Agreement.

“Material Adverse Effect” means (i) a material adverse change in the business, property, condition (financial or otherwise), operations or results of operations of the Company and its subsidiaries taken as a whole, (ii) a material adverse change in the ability of the Company to perform its obligation under the Transaction Documents or (iii) a material adverse change in the validity or enforceability of any of the Transaction Documents or the rights or remedies of the Bank thereunder.

“Security Documents” means the Custody, Pledge and Security Agreement dated as of December 17, 2008 among the Trustee, the Company and the Bank with respect to any Bond purchased during the period from and including the date of its purchase with proceeds of a Liquidity Drawing to but excluding the date on which such Bond is purchased by any person as a result of a remarketing of such Bond pursuant to the Remarketing Agreement and the Indenture.

“Transaction Documents” means, collectively, the Reimbursement Agreement, Bond Documents, the Security Documents and all other operative documents relating to the issuance, sale and securing of the Bonds (including without limitation any document(s) or instrument(s) through which the Bonds are now or hereafter collateralized, such as mortgages, security agreements, etc.).



## **Summary of the Loan Agreement**

*The following, in addition to the provisions contained elsewhere in this Reoffering Circular, is a brief description of certain provisions of the Loan Agreement. This description is only a summary and does not purport to be complete and definitive. Reference is made to the Loan Agreement for the detailed provisions thereof.*

### **General**

The Loan Agreement initially commenced as of its initial date and is amended and restated as of September 1, 2008 and will end on the earliest to occur of October 1, 2034, or the date on which all of the Bonds shall have been fully paid or provision has been made for such payment pursuant to the Indenture. See “Summary of the Indenture — Discharge of Indenture.”

The Company has agreed to repay the loan pursuant to the Loan Agreement by making timely payments to the Trustee in sufficient amounts to pay the principal of, premium, if any, and interest required to be paid on the Bonds on each date upon which any such payments are due. The Company has also agreed to pay (a) the agreed upon fees and expenses of the Trustee, the Bond Registrar, any Tender Agent and any Paying Agent appointed under the Indenture, (b) the expenses in connection with any redemption of the Bonds and (c) the reasonable expenses of the Issuer.

The Company covenants and agrees with the Issuer that it will cause the purchase of tendered Bonds that are not remarketed in accordance with the Indenture and, to that end, the Company shall cause funds to be made available to the Tender Agent at the times and in the manner required to effect such purchases in accordance with the Indenture; provided, however, that the obligation of the Company to make any such payment will be reduced by the amount of (A) moneys paid by the Remarketing Agent as proceeds of the remarketing of such Bonds by the Remarketing Agent, (B) moneys drawn under a Credit Facility, if any, for the purpose of paying such purchase price and (C) other moneys made available by the Company (see “Summary of the Bonds — Remarketing and Purchase of Bonds”).

All payments to be made by the Company to the Issuer pursuant to the Loan Agreement (except the reasonable out-of-pocket expenses of the Issuer, the Trustee, the Paying Agent, the Bond Registrar, the Tender Agent and amounts related to indemnification) have been assigned by the Issuer to the Trustee, and the Company will pay such amounts directly to the Trustee. The obligations of the Company to make the payments pursuant to the Loan Agreement are absolute and unconditional.

### **Maintenance of Tax Exemption**

The Company and the Issuer have agreed not to take any action that would result in the interest paid on the Bonds being included in gross income of any Bondholder (other than a holder who is a “substantial user” of the Project or a “related person” within the meaning of Section 147(a) of the Code) for federal income tax purposes or that adversely affects the validity of the Bonds.

### **Limitation on Liens**

The Company has agreed that, so long as any of the Bonds are outstanding, it will not create, assume or guarantee debt for borrowed money secured by any mortgage, except as described above under “Security; Limitation on Liens.”

### **Payment of Taxes**

The Company has agreed to pay certain taxes and other governmental charges that may be lawfully assessed, levied or charged against or with respect to the Project (see, however, subparagraph (i) under “Summary of the Bonds — Redemptions — Extraordinary Optional Redemption in Whole”). The Company may contest such taxes or other governmental charges unless the security provided by the Indenture would be materially endangered.

### **Maintenance; Damage, Destruction and Condemnation**

So long as any Bonds are outstanding, the Company will maintain the Project or cause the Project to be maintained in good working condition and will make or cause to be made all proper repairs, replacements and renewals necessary to continue to constitute the Project as solid waste disposal facilities under Section 142(a)(6) of the Code and the Act. However, the Company will have no obligation to maintain, repair, replace or renew any portion of the Project, the maintenance, repair, replacement or renewal of which becomes uneconomical to the Company because of certain events, including damage or destruction by a cause not within the Company’s control, condemnation of the Project, change in government standards and regulations, economic or other obsolescence or termination of operation of generating facilities to the Project.

The Company, at its own expense, may remodel the Project or make substitutions, modifications and improvements to the Project as it deems desirable, which remodeling, substitutions, modifications and improvements will be deemed, under the terms of the Loan Agreement to be a part of the Project. The Company may not, however, change or alter the basic nature of the Project or cause it to lose its status under Section 142(a)(6) of the Code and the Act.

If, prior to the payment of all Bonds outstanding, the Project or any portion thereof is destroyed, damaged or taken by the exercise of the power of eminent domain and the Issuer or the Company receives net proceeds from insurance or a condemnation award in connection therewith, the Company must (i) cause such net proceeds to be used to repair or restore the Project or (ii) reimburse the Credit Facility Issuer for drawings under the Credit Facility for the redemption of the Bonds in whole or in part at their principal amount, which, by the opinion of Bond Counsel, will not adversely affect the exclusion of the interest on the Bonds from gross income for federal income tax purposes. See “Summary of the Bonds — Redemptions — Extraordinary Optional Redemption in Whole or in Part.”

### **Project Insurance**

The Company will insure the Project in a manner consistent with general industry practice.

## **Assignment, Merger and Release of Obligations of the Company**

The Company may assign the Loan Agreement, pursuant to an opinion of Bond Counsel that such assignment will not adversely affect the exclusion of the interest on the Bonds from gross income for federal income tax purposes, without obtaining the consent of either the Issuer or the Trustee. Such assignment, however, shall not relieve the Company from primary liability for any of its obligations under the Loan Agreement and performance and observance of the other covenants and agreements to be performed by the Company. The Company may dispose of all or substantially all of its assets or consolidate with or merge into another corporation, provided the acquirer of the Company's assets or the corporation with which it shall consolidate with or merge into shall be a corporation or other business organization organized and existing under the laws of the United States of America or one of the states of the United States of America or the District of Columbia, shall be qualified and admitted to do business in the Commonwealth of Kentucky and shall assume in writing all of the obligations and covenants of the Company under the Loan Agreement.

## **Release and Indemnification Covenant**

The Company will indemnify and hold the Issuer harmless against any expense or liability incurred, including attorneys' fees, resulting from any loss or damage to property or any injury to or death of any person occurring on or about or resulting from any defect in the Project or from any action commenced in connection with the financing thereof.

## **Events of Default**

Each of the following events constitutes an "event of default" under the Loan Agreement:

(1) failure by the Company to pay the amounts required for payment of the principal of, including purchase price for tendered Bonds and redemption and acceleration prices, and interest accrued, on the Bonds, at the times specified therein taking into account any periods of grace provided in the Indenture and the Bonds for the applicable payment of interest on the Bonds (see "Summary of the Indenture — Defaults and Remedies");

(2) failure by the Company to observe and perform any covenant, condition or agreement, other than as referred to in paragraph (1) above, for a period of thirty days after written notice by the Issuer or Trustee, provided, however, that if such failure is capable of being corrected, but cannot be corrected in such 30-day period, it will not constitute an event of default under the Loan Agreement if corrective action with respect thereto is instituted within such period and is being diligently pursued; or

(3) certain events of bankruptcy, dissolution, liquidation, reorganization or insolvency of the Company.

Under the Loan Agreement, certain of the Company's obligations (other than the Company's obligation (i) not to permit any action which would result in interest paid on the Bonds being included in gross income for federal and Kentucky income taxes and (ii) to make loan payments and certain other payments under the provisions of the Loan Agreement) may be

suspended if by reason of force majeure (as defined in the Loan Agreement) the Company is unable to carry out such obligations.

### **Remedies**

Upon the happening of an event of default under the Loan Agreement, the Issuer may, among other things, take whatever action at law or in equity may appear necessary or desirable to collect the amounts then due and thereafter to become due, or to enforce performance and observance of any obligation, agreement or covenant of the Company, under the Loan Agreement.

Any amounts collected upon the happening of any such event of default shall be applied in accordance with the Indenture or, if the Bonds have been fully paid (or provision for payment thereof has been made in accordance with the Indenture), made available to the Company.

### **Options to Prepay, Obligation to Prepay**

The Company may prepay the loan pursuant to the Loan Agreement, in whole or in part, on certain dates, at the prepayment prices as shown under the captions “Summary of the Bonds — Redemptions — Optional Redemption,” “— Extraordinary Optional Redemption in Whole” and “— Extraordinary Optional Redemption in Whole or in Part.” Upon the occurrence of the event described under the caption “Summary of the Bonds — Redemptions — Mandatory Redemption; Determination of Taxability,” the Company shall be obligated to prepay the loan in an aggregate amount sufficient to redeem the required principal amount of the Bonds.

In each instance, the loan prepayment price shall be a sum sufficient, together with other funds deposited with the Trustee and available for such purpose, to redeem the requisite amount of the Bonds at a price equal to the applicable redemption price plus accrued interest to the redemption date, and to pay all reasonable and necessary fees and expenses of the Trustee, the Paying Agent and all other liabilities of the Company under the Loan Agreement accrued to the redemption date.

### **Amendments and Modifications**

No amendment or modification of the Loan Agreement is permissible without the written consent of the Trustee. The Issuer and the Trustee may, however, without the consent of or notice to any Bondholders, enter into any amendment or modification of the Loan Agreement (i) which may be required by the provisions of the Loan Agreement or the Indenture, (ii) for the purpose of curing any ambiguity or formal defect or omission, (iii) in connection with any modification or change necessary to conform the Loan Agreement with changes and modifications in the Indenture or (iv) in connection with any other change which, in the judgment of the Trustee, does not adversely affect the Trustee or the Bondholders. Except for such amendments, the Loan Agreement may be amended or modified only with the consent of the Bondholders holding a majority in principal amount of the Bonds then outstanding (see “Summary of the Indenture — Supplemental Indentures” for an explanation of the procedures necessary for Bondholder consent); provided, however, that the approval of the Bondholders holding 100% in principal amount of the Bonds then outstanding is necessary to effectuate an amendment or modification with respect to the Loan Agreement of the type described in clauses

(i) through (iv) of the first sentence of the second paragraph of “Summary of the Indenture — Supplemental Indentures.” Any amendments, changes or modification of the Loan Agreement that require the consent of the Bondholders must additionally be approved by the Credit Facility Issuer, if the Bonds are at the time secured by a Credit Facility. Additionally, so long as a Credit Facility is in place or while any amounts are outstanding under a Reimbursement Agreement, the Credit Facility Issuer must consent in writing to any amendment, change, or modification to the Agreement.

### **Summary of the Indenture**

*The following, in addition to the provisions contained elsewhere in this Reoffering Circular, is a brief description of certain provisions of the Indenture. This description is only a summary and does not purport to be complete and definitive. Reference is made to the Indenture for the detailed provisions thereof.*

#### **Security**

Pursuant to the Indenture, the Issuer has assigned and pledged to the Trustee its interest in and to the Loan Agreement, including payments and other amounts due the Issuer thereunder, together with all moneys, property and securities from time to time held by the Trustee under the Indenture (with certain exceptions, including moneys held in or earnings on the Rebate Fund and the Purchase Fund). The Bonds are not directly secured by the Project.

#### **No Pecuniary Liability of the Issuer**

No provision, covenant or agreement contained in the Indenture or in the Loan Agreement, nor any breach thereof, shall give rise to any pecuniary liability of the Issuer or any charge upon its general credit or taxing powers. The Issuer has not obligated itself by making the covenants, agreements or provisions contained in the Indenture or in the Loan Agreement, except with respect to the Project and the application of the amounts assigned to payment of the principal of, premium, if any, and interest on the Bonds.

#### **The Bond Fund**

The payments to be made by the Company pursuant to the Loan Agreement to the Issuer and certain other amounts specified in the Indenture will be deposited into a Bond Fund established pursuant to the Indenture (the “Bond Fund”) and will be maintained in trust by the Trustee. Moneys in the Bond Fund will be used for the payment of the principal of, premium, if any, and interest on the Bonds, and for the redemption of Bonds prior to maturity in the following order of priority: (i) proceeds of the Credit Facility, if any, deposited into the Bond Fund in accordance with the Indenture and (ii) any other moneys provided by or on behalf of the Company. Any moneys held in the Bond Fund will be invested by the Trustee at the specific written direction of the Company in certain Governmental Obligations, investment-grade corporate obligations and other investments permitted under the Indenture.

So long as a Credit Facility is then held by the Trustee and there is no default in the payment of principal or redemption price of or interest on the Bonds, any amounts in the Bond Fund provided by or on behalf of the Company will be paid to the Credit Facility Issuer to the

extent of any amounts that the Company owes the Credit Facility Issuer pursuant to the Reimbursement Agreement. Any amounts remaining in the Bond Fund (first, from the proceeds of the Credit Facility, and second, from the moneys provided by or on behalf of the Company) after payment in full of the principal or redemption price of and interest on the Bonds (or provision for payment thereof) and payment of any outstanding fees and expenses of the Trustee (including its reasonable attorney fees and expenses) will be paid, first, to the Credit Facility Issuer, to the extent of any amounts that the Company owes the Credit Facility Issuer pursuant to the Reimbursement Agreement and, second, to the Company. Any amounts remaining in the Bond Fund (i) after all of the outstanding Bonds have been paid and discharged, (ii) after payment of all fees, charges and expenses to the Issuer, the Trustee, the Registrar and the Paying Agent and of all other amounts required to be paid under the Indenture and the Loan Agreement and (iii) after the receipt by the Trustee of the written request of the Company for such payment, will be paid to the Credit Facility Issuer, if any, to the extent of any amounts that the Company owes to such Credit Facility Issuer pursuant to the Reimbursement Agreement, and then to the Company to the extent that those moneys are in excess of the amounts necessary to effect the payment and discharge of the outstanding Bonds.

### **The Rebate Fund**

A Rebate Fund has been created by the Indenture (the “Rebate Fund”) and is maintained as a separate fund free and clear of the lien of the Indenture. The Issuer, the Trustee and the Company have agreed to comply with all rebate requirements of the Code and, in particular, the Company has agreed that if necessary, it will deposit in the Rebate Fund any such amount as is required under the Code. However, the Issuer, the Trustee and the Company may disregard the Rebate Fund provisions to the extent that they receive an opinion of Bond Counsel that such failure to comply will not adversely affect the exclusion of the interest on the Bonds from gross income for federal income tax purposes.

### **Discharge of Indenture**

When all the Bonds and all fees and charges accrued and to accrue of the Trustee and the Paying Agent have been paid or provided for, and when proper notice has been given to the Bondholders or the Trustee that the proper amounts have been so paid or provided for, and if the Issuer is not in default in any other respect under the Indenture, the Indenture shall become null and void. The Bonds will be deemed to have been paid and discharged when there have been irrevocably deposited with the Trustee moneys sufficient to pay the principal, premium, if any, and accrued interest on such Bonds to the due date (whether such date be by reason of maturity or upon redemption) or, in lieu thereof, Governmental Obligations have been deposited which mature in such amounts and at such times as will provide the funds necessary to so pay such Bonds, and when all reasonable and necessary fees and expenses of the Trustee, the Authenticating Agent, the Bond Registrar and the Paying Agent have been paid or provided for.

Notwithstanding anything to the contrary, if any Bonds are rated by a rating service, no such Bonds will be deemed to have been paid and discharged by reason of any deposit pursuant to the Indenture, unless each such rating service has confirmed in writing to the Trustee that its rating will not be withdrawn or lowered as a result of any such deposit.

So long as the Company owes any amounts to the Credit Facility Issuer, if any, pursuant to the Reimbursement Agreement: (A) the lien of the Indenture may not be discharged; (B) such Credit Facility Issuer shall be subrogated to the extent of such amounts owed by the Company to such Credit Facility Issuer to all rights of the Bondholders to enforce the payment of the Bonds from the revenues and all other rights of the Bondholders under the Bonds, the Indenture and the Loan Agreement; (C) the Bondholders will be deemed paid to the extent of money drawn by the Trustee under the Credit Facility; and (D) subject to the Indenture, the Trustee will sign, execute and deliver all documents or instruments and do all things that may be reasonably required by the Credit Facility Issuer to effect the Credit Facility Issuer's subrogation of rights of enforcement and remedies set forth in the Indenture.

### **Defaults and Remedies**

Each of the following events constitutes an "Event of Default" under the Indenture:

(a) failure to make payment of any installment of interest on any Bond within a period of one Business Day from the due date;

(b) failure to make punctual payment of the principal of, or premium, if any, on any Bond on the due date, whether at the stated maturity thereof, or upon proceedings for redemption, or upon the maturity thereof by declaration or if payment of the purchase price of any Bond required to be purchased pursuant to the Indenture is not made when such payment has become due and payable;

(c) failure of the Issuer to perform or observe any other of the covenants, agreements or conditions in the Indenture or in the Bonds which failure continues for a period of 30 days after written notice by the Trustee, provided, however, that if such failure is capable of being cured, but cannot be cured in such 30-day period, it will not constitute an event of default under the Indenture if corrective action in respect of such failure is instituted within such 30-day period and is being diligently pursued;

(d) the occurrence of an "event of default" under the Loan Agreement (see "Summary of the Loan Agreement — Events of Default");

(e) written notice from the Credit Facility Issuer to the Trustee of an event of default under the Reimbursement Agreement, by reason of which the Trustee has been directed to accelerate the Bonds; or

(f) if a Credit Facility is then held by the Trustee, on or before the close of business on the tenth calendar day following the honoring of a drawing under such Credit Facility to pay interest on the Bonds on an Interest Payment Date, written notice from the Credit Facility Issuer to the Trustee that the interest component of the Credit Facility will not be reinstated.

Upon the occurrence of an Event of Default under clauses (a), (b), (e) or (f) above, the Trustee must: (i) declare the principal of all Bonds and interest accrued thereon to be immediately due and payable; (ii) declare all payments under the Loan Agreement to be immediately due and payable and enforce each and every other right granted to the Issuer under

the Loan Agreement for the benefit of the Bondholders; and (iii) if a Credit Facility securing the Bonds is in effect, make an immediate drawing under the Credit Facility in accordance with its terms and deposit the proceeds of such drawing in the Bond Fund pending application to the payment of principal of the Bonds, subject to the provisions of the Indenture reserving to the Credit Facility Issuer the right to direct default proceedings and providing for termination of default proceedings upon certain occurrences.

Interest on the Bonds will cease to accrue on the date of issuance of the declaration of acceleration of payment of principal and interest on the Bonds.

In exercising such rights, the Trustee will take any action that, in the judgment of the Trustee, would best serve the interests of the registered owners. Upon the occurrence of an Event of Default under the Indenture, the Trustee may also proceed to pursue any available remedy by suit at law or in equity to enforce the payment of the principal of, premium, if any, and interest on the Bonds then outstanding.

If the Trustee recovers any moneys following an Event of Default, unless the principal of the Bonds shall have been declared due and payable, all such moneys shall be applied in the following order: (i) to the payment of the fees, expenses, liabilities and advances incurred or made by the Trustee and the Paying Agent, (ii) to the payment of all interest then due on the Bonds and (iii) to the payment of unpaid principal and premium, if any, of the Bonds. If the principal of the Bonds has become due or has been accelerated, such moneys shall be applied in the following order: (i) to the payment of the fees, expenses, liabilities and advances incurred or made by the Trustee and the Paying Agent and (ii) to the payment of principal of and interest then due and unpaid on the Bonds. In each case, however, Trustee and Paying Agent fees or costs will not be payable from moneys derived from Credit Facility drawings, any remarketing proceeds or moneys constituting certain Available Moneys under the Indenture.

No Bondholder may institute any suit or proceeding in equity or at law for the enforcement of the Indenture unless an Event of Default has occurred of which the Trustee has been notified or is deemed to have notice, and registered owners holding not less than 25% in aggregate principal amount of Bonds then outstanding shall have made written request to the Trustee to proceed to exercise the powers granted under the Indenture or to institute such action in their own name and the Trustee shall fail or refuse to exercise its powers within a reasonable time after receipt of indemnity satisfactory to it.

Any judgment against the Issuer pursuant to the exercise of rights under the Indenture shall be enforceable only against specific assigned payments, funds and accounts under the Indenture in the hands of the Trustee. No deficiency judgment shall be authorized against the general credit of the Issuer.

No default under paragraph (c) above shall constitute an Event of Default until actual notice is given to the Issuer and the Company by the Trustee, or to the Issuer, the Company and the Trustee by the registered owners holding not less than 25% in aggregate principal amount of all Bonds outstanding or the Issuer and the Company shall have had thirty days after such notice to correct the default and failed to do so. If the default is such that it cannot be corrected within



the applicable period but is capable of being cured, it will not constitute an Event of Default if corrective action is instituted within the applicable period.

Notwithstanding the foregoing, in addition to the rights of the Trustee and the Bondholders to direct proceedings as described above, if a Credit Facility is in effect, for so long as such Credit Facility is outstanding and the Credit Facility Issuer is not in default in its duties under the Indenture or the Credit Facility, the Credit Facility Issuer issuing will have the absolute right to direct all proceedings on behalf of the Bondholders of the Bonds. Additionally, if the Event of Default which has occurred is an Event of Default under paragraphs (e) or (f) above, the Credit Facility Issuer, if any, will have no right to direct the Trustee or the Bondholders with respect to any matters, including remedies, and the holders of a majority in aggregate principal amount of the Bonds then outstanding, will have the right, at any time, by an instrument or instruments in writing executed and delivered to the Trustee, to direct the time, method and place of conducting all proceedings to be taken in connection with the enforcement of the terms and conditions of the Indenture, or for the appointment of a receiver or any other proceedings hereunder; provided, that such direction shall not be otherwise than in accordance with the provisions of law and of the Indenture.

If an Event of Default has occurred under the Indenture due to failure by the Credit Facility Issuer, if any, to honor a properly presented and conforming drawing by the Trustee under the Credit Facility then in effect in accordance with the terms thereof, all obligations of the Trustee to the Credit Facility Issuer and all rights of such Credit Facility Issuer under the Indenture will be suspended until the earlier of the cure of such failure or all of the Bonds have been paid in full.

#### **Waiver of Events of Default**

Except as provided below, the Trustee may in its discretion waive any Event of Default under the Indenture and shall do so upon the written request of the registered owners holding a majority in principal amount of all Bonds then outstanding. If, after the principal of all Bonds then outstanding shall have been declared to be due and payable and prior to any judgment or decree for the appointment of a receiver or for the payment of the moneys due shall have been entered, (i) the Company has caused to be deposited with the Trustee a sum sufficient to pay all matured installments of interest upon all Bonds and the principal of and premium, if any, on any and all Bonds which shall have become due otherwise than by reason of such declaration and the expenses of the Trustee in connection with such default (with interest thereon as provided in the Indenture) and (ii) all Events of Default under the Indenture (other than nonpayment of the principal of Bonds due by said declaration) shall have been remedied, then such Event of Default shall be deemed waived and such declaration and its consequences rescinded and annulled by the Trustee. Such waiver, rescission and annulment shall be binding upon all Bondholders. No such waiver, rescission and annulment shall extend to or affect any subsequent Event of Default or impair any right or remedy consequent thereon.

The Trustee may not waive any default under clauses (e) or (f) above unless the Trustee has received in writing from the Credit Facility Issuer a written notice of full reinstatement of the full amount of the Credit Facility and a written rescission of the notice of the Event of Default.

Notwithstanding the foregoing, nothing in the Indenture shall affect the right of a registered owner to enforce the payment of principal of, premium, if any, and interest on the Bonds after the maturity thereof.

### **Supplemental Indentures**

The Issuer and the Trustee may enter into indentures supplemental to the Indenture without the consent of or notice to, the Bondholders in order (i) to cure any ambiguity or formal defect or omission in the Indenture, (ii) to grant to the Trustee, as may lawfully be granted, additional rights for the benefit of the Bondholders, (iii) to subject to the Indenture additional revenues, properties or collateral, (iv) to permit qualification of the Indenture under any federal statute or state blue sky law, (v) to add additional covenants and agreements of the Issuer for the protection of the Bondholders or to surrender or limit any rights reserved to the Issuer, (vi) to make any modification or change to the Indenture which, in the sole judgment of the Trustee, does not adversely affect the Trustee or any Bondholder, (vii) to make amendments to provisions relating to federal income tax matters under the Code or other relevant provisions if, in the opinion of Bond Counsel, those amendments would not adversely affect the exclusion of the interest on the Bonds from gross income for federal income tax purposes, (viii) to make any modifications or changes to the Indenture necessary to provide the securing of a Credit Facility or Alternate Credit Facility or any liquidity or credit support of any kind for the security of the Bonds (including without limitation any line of credit, letter of credit, guaranty agreement or insurance coverage), including any modifications of the Indenture or the Agreement necessary to upgrade or maintain the then applicable ratings on the Bonds; or (ix) to permit the issuance of the Bonds in other than book-entry-only form or to provide changes to or for the book-entry system.

Subject to the consent of the Credit Facility Issuer, if any, exclusive of supplemental indentures for the purposes set forth in the preceding paragraph, the consent of registered owners holding a majority in principal amount of all Bonds then outstanding is required to approve any supplemental indenture, except no such supplemental indenture shall permit, without the consent of all of the registered owners of the Bonds then outstanding, (i) an extension of the maturity of the principal of or the interest on any Bond issued under the Indenture or a reduction in the principal amount of any Bond or the rate of interest or time of redemption or redemption premium thereon, (ii) a privilege or priority of any Bond or Bonds over any other Bond or Bonds, (iii) a reduction in the principal amount of the Bonds required for consent to such supplemental indenture or (iv) the deprivation of any registered owners of the lien of the Indenture.

If at any time the Issuer shall request the Trustee to enter into any supplemental indenture requiring the consent of the registered owners of the Bonds, the Trustee, upon being satisfactorily indemnified with respect to expenses, must notify all such registered owners. Such notice shall set forth the nature of the proposed supplemental indenture and shall state that copies thereof are on file at the principal office of the Trustee for inspection. If, within sixty days (or such longer period as shall be prescribed by the Issuer or the Company) following the mailing of such notice, the registered owners holding the requisite amount of the Bonds outstanding shall have consented to the execution thereof, no Bondholder shall have any right to object or question the execution thereof.

No supplemental indenture shall become effective unless the Company consents to the execution and delivery of such supplemental indenture. The Company shall be deemed to have consented to the execution and delivery of any supplemental indenture if the Trustee does not receive a notice of protest or objection signed by the Company on or before 4:30 p.m., local time in the city in which the principal office of the Trustee is located, on the fifteenth day after the mailing to the Company of a notice of the proposed changes and a copy of the proposed supplemental indenture.

Notwithstanding the foregoing, any Supplemental Indenture that requires the consent of the Bondholders that (i) is to become effective while a Credit Facility is in place or while any amounts are outstanding under any Reimbursement Agreement and (ii) adversely affects the Credit Facility Issuer will not become effective unless and until the Credit Facility Issuer consents in writing to the execution and delivery of such Supplemental Indenture.

### **Cancellation of Credit Facility; Delivery of Alternate Credit Facility**

The Trustee will, at the written direction of the Company but subject to the conditions described in this paragraph and the receipt of an Opinion of Bond Counsel stating that the cancellation of such Credit Facility is authorized under the Indenture and under the Act and will not adversely affect the exclusion from gross income of interest on the Bonds for federal income tax purposes, cancel any Credit Facility in accordance with the terms thereof which cancellation may be without substitution therefor or replacement thereof; provided, that any such cancellation will not become effective, surrender of such Credit Facility will not take place and that Credit Facility will not terminate, in any event, until (i) payment by the Credit Facility Issuer has been made for any and all drawings by the Trustee effected on or before such cancellation date (including, if applicable, any drawings for payment of the purchase price of Bonds to be purchased pursuant to the Indenture in connection with such cancellation) and (ii) if the Bonds are in an Long Term Rate Period, only if the then current Long Term Rate Period for the Bonds is ending on, or the Bonds are subject to optional redemption on, the Interest Payment Date immediately preceding the date of such cancellation. Upon written notice given by the Company to the Trustee at least 20 days (35 days if the Bonds are bearing interest at the Long Term Rate) prior to the date of cancellation of any Credit Facility of such cancellation and the effective date of such cancellation, the Trustee will surrender such Credit Facility to the Credit Facility Issuer by which it was issued on or promptly after the effective date of such cancellation in accordance with its terms; provided, that such notice will not be given in any event, if the purchase price of any Bonds to be purchased pursuant to the Indenture in connection with such cancellation includes any premium unless the Company has certified in such notice that the Trustee can draw under a Credit Facility (other than any Alternate Credit Facility being delivered in connection with such cancellation) on the purchase date related to such purchase of Bonds in an aggregate amount sufficient to pay the premium due upon such purchase of Bonds on such purchase date.

The Company may, at its option, provide for the delivery to the Trustee of an Alternate Credit Facility in replacement of any Credit Facility then in effect. At least 20 days (35 days if the Interest Rate on the Bonds is a Long Term Rate) prior to the date of delivery of an Alternate Credit Facility to the Trustee, the Company must give notice, which notice will also be given to the Remarketing Agent, of such replacement to the Trustee, together with an Opinion of Bond Counsel to the effect that the delivery of such Alternate Credit Facility to the Trustee is

authorized under the Indenture and the Act and complies with the terms thereof and that the delivery of such Alternate Credit Facility will not adversely affect the exclusion from gross income of interest on the Bonds for federal income tax purposes. The Trustee will then accept such Alternate Credit Facility and surrender the previously held Credit Facility, if any, to the previous Credit Facility Issuer for cancellation promptly on or after the 5th day after the Alternate Credit Facility becomes effective; provided, however, that such Alternate Credit Facility must become effective on an Interest Payment Date and, if the Bonds are in a Long Term Rate Period, such Alternate Credit Facility may only become effective on either the last Interest Payment Date for such Long Term Rate Period or an Interest Payment Date on which the Bonds are subject to optional redemption. The notice given to the Trustee shall also be given to the Issuer, the then current Credit Facility Issuer, Moody's, if the Bonds are then rated by Moody's, and S&P, if the Bonds are then rated by S&P; provided that the notice will not be given if the purchase price of any Bonds to be purchased pursuant to the Indenture in connection with such cancellation includes any premium unless the Company has certified in such notice that the Trustee can draw under a Credit Facility then in effect on the purchase date related to such purchase of Bonds in an aggregate amount sufficient to pay the premium due upon such purchase of Bonds on such purchase date and until payment under the Credit Facility to be surrendered shall have been made for any and all drawings by the Trustee effected on or before the date of such surrender for cancellation (including, if applicable, any drawings for payment of the purchase price of Bonds to be purchased pursuant to the Indenture in connection with such cancellation).

Any Alternate Credit Facility delivered to the Trustee must be accompanied by an opinion of counsel to the issuer or provider of such Credit Facility stating that such Credit Facility is a legal, valid, binding and enforceable obligation of such issuer or obligor in accordance with its terms.

The Bonds will be subject to mandatory tender for purchase on the date of cancellation of a Credit Facility and on the date of the delivery of an Alternate Credit Facility. See "Summary of the Bonds — Mandatory Purchases of Bonds."

### **Enforceability of Remedies**

The remedies available to the Trustee, the Issuer and the owners upon an event of default under the Loan Agreement or the Indenture are in many respects dependent upon judicial actions which are often subject to discretion and delay. Under existing constitutional and statutory law and judicial decisions, the remedies specified by the Loan Agreement or the Indenture may not be readily available or may be limited. The various legal opinions to be delivered concurrently with the delivery of the Bonds will be qualified as to the enforceability of the various legal instruments by limitations imposed by principles of equity, bankruptcy, reorganization, insolvency, moratorium or other similar laws affecting the rights of creditors generally.

## **Reoffering**

Subject to the terms and conditions of the Remarketing and Bond Purchase Agreement (the "Remarketing Agreement"), between the Company and Merrill Lynch, Pierce, Fenner & Smith Incorporated, as Remarketing Agent, the Remarketing Agent has agreed to purchase and reoffer the Bonds delivered to the Paying Agent for purchase, at a price equal to 100% of the principal amount of the Bonds, plus accrued interest (if any), and in connection therewith will receive compensation in the amount of \$125,000, plus reimbursement of certain expenses. Under the terms of the Remarketing Agreement, the Company has agreed to indemnify the Remarketing Agent against certain civil liabilities, including liabilities under federal securities laws.

In the ordinary course of their business, the Remarketing Agent and certain of its affiliates, have engaged, and may in the future engage, in investment banking or commercial banking transactions with the Company.

## **Tax Treatment**

On October 20, 2004, the date of original issuance and delivery of the Bonds, Bond Counsel delivered its opinion stating that under existing law, including current statutes, regulations, administrative rulings and official interpretations, subject to the qualifications and exceptions set forth below, interest on the Bonds will be excluded from the gross income of the recipients thereof for federal income tax purposes, except that no opinion will be expressed regarding such exclusion from gross income with respect to any Bond during any period in which it is held by a "substantial user" of the Project or a "related person" as such terms are used in Section 147(a) of the Code. Interest on the Bonds will be an item of tax preference in determining alternative minimum taxable income for individuals and corporations under the Code. Bond Counsel further opined that, subject to the assumptions stated in the preceding sentence, (i) interest on the Bonds would be excluded from gross income of the owners thereof for Kentucky income tax purposes and (ii) the Bonds would be exempt from all ad valorem taxes in Kentucky. Such opinion has not been updated as of the date hereof and no continuing tax exemption opinion is expressed by Bond Counsel.

Bond Counsel also will deliver an opinion in connection with this reoffering to the effect that the delivery of the Letter of Credit (i) is authorized or permitted by Sections 103.200 to 103.285, inclusive, of the Kentucky Revised Statutes (the "Act") and the Indenture and (ii) will not adversely affect the validity of the Bonds or any exclusion from gross income of interest on the Bonds for federal income tax purposes to which interest on the Bonds would otherwise be entitled.

The opinions of Bond Counsel as to the excludability of interest from gross income for federal income tax purposes were based upon and assumed the accuracy of certain representations of facts and circumstances, including with respect to the Project, which were within the knowledge of the Company and compliance by the Company with certain covenants and undertakings set forth in the proceedings authorizing the Bonds which are intended to assure that the Bonds are and will remain obligations the interest on which is not includable in gross income of the recipients thereof under the law in effect on the date of such opinion. Bond

Counsel did not independently verify the accuracy of the certifications and representations made by the Company and the Issuer. On the date of the opinion and subsequent to the original delivery of the Bonds on October 20, 2004, such representations of facts and circumstances must be accurate and such covenants and undertakings must continue to be complied with in order that interest on the Bonds be and remain excludable from gross income of the recipients thereof for federal income tax purposes under existing law. Bond Counsel expressed no opinion (i) regarding the exclusion of interest on any Bond from gross income for federal income tax purposes on or after the date on which any change, including any interest rate conversion, permitted by the documents other than with the approval of Bond Counsel is taken which adversely affects the tax treatment of the Bonds or (ii) as to the treatment for purposes of federal income taxation of interest on the Bonds upon a Determination of Taxability.

Bond Counsel further opined that the Code prescribed a number of qualifications and conditions for the interest on state and local government obligations to be and to remain excluded from gross income for federal income tax purposes, some of which, including provisions for potential payments by the Issuers to the federal government, require future or continued compliance after issuance of the Bonds in order for the interest to be and to continue to be so excluded from the date of issuance. Noncompliance with certain of these requirements by the Company or the Issuer with respect to the Bonds could cause the interest on the Bonds to be included in gross income for federal income tax purposes and to be subject to federal income taxation retroactively to the date of their issuance. The Company and the Issuer each covenanted to take all actions required of each to assure that the interest on the Bonds shall be and remain excluded from gross income for federal income tax purposes, and not to take any actions that would adversely affect that exclusion.

The opinion of Bond Counsel as to the exclusion of interest on the Bonds from gross income for federal income tax purposes and federal tax treatment of interest on the Bonds was subject to the following exceptions and qualifications:

(a) The Code provides for a “branch profits tax” which subjects to tax, at a rate of 30%, the effectively connected earnings and profits of a foreign corporation which engages in a United States trade or business. Interest on the Bonds would be includable in the amount of effectively connected earnings and profits and thus would increase the branch profits tax liability.

(b) The Code also provides that passive investment income, including interest on the Bonds, may be subject to taxation for any S corporation with Subchapter C earnings and profits at the close of its taxable year if greater than 25% of its gross receipts is passive investment income.

Except as stated above, Bond Counsel expressed no opinion as to any federal or Kentucky tax consequences resulting from the receipt of interest on the Bonds.

Owners of the Bonds should be aware that the ownership of the Bonds may result in collateral federal income tax consequences. For instance, the Code provides that property and casualty insurance companies will be required to reduce their loss reserve deductions by 15% of the tax-exempt interest received on certain obligations, such as the Bonds, acquired after August

7, 1986. (For purposes of the immediately preceding sentence, a portion of dividends paid to an affiliated insurance company may be treated as tax-exempt interest.) The Code further provides for the disallowance of any deduction for interest expenses incurred by banks and certain other financial institutions allocable to carrying certain tax-exempt obligations, such as the Bonds, acquired after August 7, 1986. The Code also provides that, with respect to taxpayers other than such financial institutions, such taxpayers will be unable to deduct any portion of the interest expenses incurred or continued to purchase or carry the Bonds. The Code also provides, with respect to individuals, that interest on tax-exempt obligations, including the Bonds, is included in modified adjusted gross income for purposes of determining the taxability of social security and railroad retirement benefits. Furthermore, the earned income tax credit is not allowed for individuals with an aggregate amount of disqualified income within the meaning of Section 32 of the Code, which exceeds \$2,200. Interest on the Bonds will be taken into account in the calculation of disqualified income. Prospective purchasers of the Bonds should consult their own tax advisors regarding such matters and any other tax consequences of holding the Bonds.

From time to time, there are legislative proposals in Congress which, if enacted, could alter or amend one or more of the federal tax matters referred to above or could adversely affect the market value of the Bonds. It cannot be predicted whether or in what form any such proposal might be enacted or whether, if enacted, it would apply to obligations (such as the Bonds) issued prior to enactment.

The opinion of Bond Counsel relating to the reoffering of the Bonds in substantially the form in which it is expected to be delivered on the Reoffering Date, redated to the Reoffering Date, is attached as Appendix B-2.

### **Legal Matters**

Certain legal matters in connection with the reoffering of the Bonds will be passed upon by Stoll Keenon Ogden PLLC, Louisville, Kentucky, Bond Counsel. Certain legal matters pertaining to the Company will be passed upon by Jones Day, Chicago, Illinois, and John R. McCall, Esq., Executive Vice President, General Counsel, Corporate Secretary and Chief Compliance Officer of the Company. Winston & Strawn LLP, Chicago, Illinois, will pass upon certain legal matters for the Remarketing Agent.

### **Continuing Disclosure**

Because the Bonds are special and limited obligations of the Issuer, the Issuer is not an “obligated person” for purposes of Rule 15c2-12 (the “Rule”) promulgated by the SEC under the Exchange Act, and does not have any continuing obligations thereunder. Accordingly, the Issuer will not provide any continuing disclosure information with respect to the Bonds or the Issuer.

In order to enable the Remarketing Agent to comply with the requirements of the Rule, the Company has covenanted in a continuing disclosure undertaking agreement delivered to the Trustee for the benefit of the holders of the Bonds (the “Continuing Disclosure Agreement”) to provide certain continuing disclosure for the benefit of the holders of the Bonds. Under its Continuing Disclosure Agreement, the Company has covenanted to take the following actions:

(a) The Company will provide to each nationally recognized municipal securities information repository (“NRMSIR”), recognized by the SEC pursuant to the Rule, and the state information depository, if any, of the Commonwealth of Kentucky (a “SID” and, together with the NRMSIR, a “Repository”) recognized by the SEC (1) annual financial information of the type set forth in Appendix A to this Reoffering Circular (including any information incorporated by reference therein) and (2) audited financial statements prepared in accordance with generally accepted accounting principles, in each case not later than 120 days after the end of the Company’s fiscal year.

(b) The Company will file in a timely manner with each NRMSIR or the Municipal Securities Rulemaking Board, and with the SID, if any, notice of the occurrence of any of the following events (if applicable) with respect to the Bonds, if material: (i) principal and interest payment delinquencies; (ii) non-payment related defaults; (iii) any unscheduled draws on debt service reserves reflecting financial difficulties; (iv) unscheduled draws on credit enhancement facilities reflecting financial difficulties; (v) substitution of credit or liquidity providers, or their failure to perform; (vi) adverse tax opinions or events affecting the tax-exempt status of the Bonds; (vii) modifications to rights of the holders of the Bonds; (viii) the giving of notice of optional or unscheduled redemption of any Bonds; (ix) defeasance of the Bonds or any portion thereof; (x) release, substitution, or sale of property securing repayment of the Bonds; and (xi) rating changes with respect to the Bonds or the Company or any obligated person, within the meaning of the Rule.

(c) The Company will file in a timely manner with each Repository notice of a failure by the Company to file any of the notices or reports referred to in paragraphs (a) and (b) above by the due date.

The Company may amend its Continuing Disclosure Agreement (and the Trustee shall agree to any amendment so requested by the Company that does not change the duties of the Trustee thereunder) or waive any provision thereof, but only with a change in circumstances that arises from a change in legal requirements, change in law, or change in the nature or status of the Company with respect to the Bonds or the type of business conducted by the Company; provided that the undertaking, as amended or following such waiver, would have complied with the requirements of the Rule on the date of issuance of the Bonds, after taking into account any amendments to the Rule as well as any change in circumstances, and the amendment or waiver does not materially impair the interests of the holders of the Bonds to which such undertaking relates, in the opinion of the Trustee or counsel expert in federal securities laws acceptable to both the Company and the Trustee, or is approved by the Beneficial Owners of a majority in aggregate principal amount of the outstanding Bonds. The Company acknowledges that its undertakings pursuant to the Rule described under this heading are intended to be for the benefit for the holders of the Bonds and shall be enforceable by the holders of those Bonds or by the Trustee on behalf of such holders. Any breach by the Company of these undertakings pursuant to the Rule will not constitute an event of default under the Indenture, the Loan Agreement or the Bonds.



This Reoffering Circular has been duly approved, executed and delivered by the Company.

KENTUCKY UTILITIES COMPANY

By: /s/ Daniel K. Arbough  
Daniel K. Arbough  
Treasurer

**Appendix A**

[DELETED AND REPLACED- SEE APPENDIX A TO SUPPLEMENT DATED DECEMBER  
1, 2010]

**APPENDIX B**

**Opinion of Bond Counsel and  
Form of Reoffering Opinion of Bond Counsel**

**APPENDIX B-1**

**Opinion of Bond Counsel dated October 20, 2004 relating to the Bonds**

**HARPER, FERGUSON & DAVIS**  
*Division of Ogden Newell & Welch PLLC*

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**SPENCER E. HARPER, JR.**

DIRECT DIAL 502-560-4249  
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sharper@ogdenlaw.com

October 20, 2004

Re: \$50,000,000 County of Carroll, Kentucky, Environmental Facilities Revenue Bonds,  
2004 Series A (Kentucky Utilities Company Project)

We hereby certify that we have examined certified copies of the proceedings of record of the County of Carroll, Kentucky (the "County"), acting by and through its Fiscal Court as its duly authorized governing body, preliminary to and in connection with the issuance by the County of its Environmental Facilities Revenue Bonds, 2004 Series A (Kentucky Utilities Company Project), dated their date of issuance, in the aggregate principal amount of \$50,000,000 (the "Bonds"). The Bonds are issued under the provisions of Sections 103.200 to 103.285, inclusive, of the Kentucky Revised Statutes (the "Act"), for the purpose of providing funds which will be used, with other funds provided by Kentucky Utilities Company (the "Company") for the current refunding of \$50,000,000 aggregate principal amount of the County's Collateralized Solid Waste Disposal Facilities Revenue Bonds (Kentucky Utilities Company Project) 1993 Series A, dated December 1, 1993 (the "Prior Bonds"), which were issued for the purpose of financing the costs of construction, acquisition, installation and equipping of certain solid waste disposal facilities to serve the Ghent Generating Station of the Company in Carroll County, Kentucky (the "Project") in order to provide for the collection, storage, treatment, processing and final disposal of solid wastes, as provided by the Act.

The Bonds mature on October 1, 2034 and bear interest initially at the Dutch Auction Rate, as defined in the Indenture, hereinafter described, subject to change as provided in such Indenture. The Bonds will be subject to optional and mandatory redemption prior to maturity at the times, in the manner and upon the terms set forth in each of the Bonds. From such examination of the proceedings of the Fiscal Court of the County referred to above and from an examination of the Act, we are of the opinion that the County is duly authorized and empowered to issue the Bonds under the laws of the Commonwealth of Kentucky now in force.

October 20, 2004

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We have examined an executed counterpart of a certain Loan Agreement, dated as of October 1, 2004 (the "Loan Agreement"), between the County and the Company and a certified copy of the proceedings of record of the Fiscal Court of the County preliminary to and in connection with the execution and delivery of the Loan Agreement, pursuant to which the County has agreed to issue the Bonds and to lend the proceeds thereof to the Company to provide funds to pay and discharge, with other funds provided by the Company, the Prior Bonds. The Company has agreed to make Loan payments to the Trustee at times and in amounts fully adequate to pay maturing principal of, interest on and redemption premium, if any, on the Bonds as same become due and payable. From such examination, we are of the opinion that such proceedings of the Fiscal Court of the County show lawful authority for the execution and delivery of the Loan Agreement; that the Loan Agreement has been duly authorized, executed and delivered by the County; and that the Loan Agreement is a legal, valid and binding obligation of the County, enforceable in accordance with its terms, subject to the qualification that the enforcement thereof may be limited by laws relating to bankruptcy, insolvency or other similar laws affecting creditors' rights generally, including equitable provisions where equitable remedies are sought.

We have also examined an executed counterpart of a certain Indenture of Trust, dated as of October 1, 2004 (the "Indenture"), by and between the County and Wachovia Bank of Delaware, National Association, as trustee (the "Trustee"), securing the Bonds and setting forth the covenants and undertakings of the County in connection with the Bonds and a certified copy of the proceedings of record of the Fiscal Court of the County preliminary to and in connection with the execution and delivery of the Indenture. Pursuant to the Indenture, certain of the County's rights under the Loan Agreement, including the right to receive payments thereunder, and all moneys and securities held by the Trustee in accordance with the Indenture (except moneys and securities in the Rebate Fund created thereby) have been assigned to the Trustee, as security for the holders of the Bonds. From such examination, we are of the opinion that such proceedings of the Fiscal Court of the County show lawful authority for the execution and delivery of the Indenture; that the Indenture has been duly authorized, executed and delivered by the County; and that the Indenture is a legal, valid and binding obligation upon the parties thereto according to its terms, subject to the qualification that the enforcement thereof may be limited by laws relating to bankruptcy, insolvency or other similar laws affecting creditors' rights generally, including equitable provisions where equitable remedies are sought.

In our opinion the Bonds have been validly authorized, executed and issued in accordance with the laws of the Commonwealths of Kentucky and Virginia now in full force and effect, and constitute legal, valid and binding special obligations of the County entitled to the benefit of the security provided by the Indenture and enforceable in accordance with their terms, subject to the qualification that the enforcement thereof may be limited by laws relating to bankruptcy, insolvency or other similar laws affecting creditors' rights generally, including equitable provisions where equitable remedies are sought. The Bonds are payable by the County solely and only from payments and other amounts derived from the Loan Agreement and as provided in the Indenture.

In our opinion, under existing laws, including current statutes, regulations, administrative rulings and official interpretations by the Internal Revenue Service, subject to the exceptions and qualifications contained in the succeeding paragraphs, interest on the Bonds is excluded from the gross income of the recipients thereof for federal income tax purposes, except that no opinion is expressed regarding such exclusion from gross income with respect to any Bond during any period in which it is held by a "substantial user" of the Project or a "related person," as such terms are used in Section 147(a) of the Internal Revenue Code of 1986, as amended (the "Code"). Interest on the Bonds is a separate item of tax preference in determining alternative minimum taxable income for individuals and corporations under the Code. In arriving at this opinion, we have relied upon representations, factual statements and certifications of the Company with respect to certain material facts which are solely within the Company's knowledge in reaching our conclusion, inter alia, that not less than 95% of the net proceeds of the Prior Bonds were used to finance solid waste disposal facilities qualified for financing under Section 142(a)(6) of the Code and the Act. Further, in arriving at the opinion set forth in this paragraph as to the exclusion from gross income of interest on the Bonds, we have assumed and this opinion is conditioned on, the accuracy of and continuing compliance by the Company and the County with representations and covenants set forth in the Loan Agreement and the Indenture which are intended to assure compliance with certain tax-exempt interest provisions of the Code. Such representations and covenants must be accurate and must be complied with subsequent to the issuance of the Bonds in order that interest on the Bonds be excluded from gross income for federal income tax purposes. Failure to comply with certain of such representations and covenants in respect of the Bonds subsequent to the issuance of the Bonds could cause the interest thereon to be included in gross income for federal income tax purposes retroactively to the date of issuance of the Bonds. We express no opinion (i) regarding the exclusion of interest on any Bond from gross income for federal income tax purposes on or after the date on which any change, including any interest rate conversion, permitted by the documents (other than with approval of this firm) is taken which adversely affects the tax treatment of the Bonds or (ii) as to the treatment for purposes of federal income taxation of interest on the Bonds upon a Determination of Taxability. We are further of the opinion that interest on the Bonds is excluded from gross income of the recipients thereof for Kentucky income tax purposes and that the Bonds are exempt from ad valorem taxation by the Commonwealth of Kentucky and all political subdivisions thereof.

Our opinion as to the exclusion of interest on the Bonds from gross income for federal income tax purposes and federal tax treatment of interest on the Bonds is further subject to the following exceptions and qualifications:

(a) The Code provides for a "branch profits tax" which subjects to tax, at a rate of 30%, the effectively connected earnings and profits of a foreign corporation which engages in a United States trade or business. Interest on the Bonds would be includable in the amount of effectively connected earnings and profits and thus would increase the branch profits tax liability.

(b) The Code also provides that passive investment income, including interest on the Bonds, may be subject to taxation for any S corporation with Subchapter C earnings and profits at the close of its taxable year if greater than 25% of its gross receipts is passive investment income.

Except as stated above, we express no opinion as to any federal or Kentucky tax consequences resulting from the receipt of interest on the Bonds.

Holders of the Bonds should be aware that the ownership of the Bonds may result in collateral federal income tax consequences. For instance, the Code provides that, for taxable years beginning after December 31, 1986, property and casualty insurance companies will be required to reduce their loss reserve deductions by 15% of the tax-exempt interest received on certain obligations, such as the Bonds, acquired after August 7, 1986. (For purposes of the immediately preceding sentence, a portion of dividends paid to an affiliated insurance company may be treated as tax-exempt interest.) The Code further provides for the disallowance of any deduction for interest expenses incurred by banks and certain other financial institutions allocable to carrying certain tax-exempt obligations, such as the Bonds, acquired after August 7, 1986. The Code also provides that, with respect to taxpayers other than such financial institutions, such taxpayers will be unable to deduct any portion of the interest expenses incurred or continued to purchase or carry the Bonds. The Code also provides, with respect to individuals, that interest on tax-exempt obligations, including the Bonds, is included in modified adjusted gross income for purposes of determining the taxability of social security and railroad retirement benefits. Furthermore, the earned income credit is not allowed for individuals with an aggregate amount of disqualified income within the meaning of section 32 of the Code, which exceeds \$2,200. Interest on the Bonds will be taken into account in the calculation of disqualified income.

We have received opinions of John R. McCall, Esq., General Counsel of the Company and Jones Day, Chicago, Illinois, counsel to the Company, of even date herewith. In rendering this opinion, we have relied upon said opinions with respect to the matters therein. We have also received an opinion of even date herewith of Hon. James C. Monk, County Attorney of the County, and relied upon said opinion with respect to the matters therein. Said opinions are in forms satisfactory to us as to both scope and content.

We express no opinion as to the title to, the description of, or the existence or priority of any liens, charges or encumbrances on, the Project.

In rendering the foregoing opinions, we are passing upon only those matters specifically set forth in such opinions and are not passing upon the investment quality of the Bonds or the accuracy or completeness of any statements made in connection with any sale thereof. The opinions herein are expressed as of the date hereof and we assume no obligation to supplement or update such opinions to reflect any facts or circumstances that may hereafter come to our attention or any changes in law that may hereafter occur.



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We are members of the Bar of the Commonwealth of Kentucky and do not purport to be experts on the laws of any jurisdiction other than the Commonwealth of Kentucky and the United States of America, and we express no opinion as to the laws of any jurisdiction other than those specified.

HARPER, FERGUSON & DAVIS  
(Division of Ogden Newell & Welch PLLC)

By   
SPENCER E. HARPER, JR.

**(Form of Reoffering Opinion of Bond Counsel)**

December 17, 2008

County of Carroll, Kentucky  
Carrollton, Kentucky 41008

U.S. Bank National Association,  
as successor Trustee  
Nashville, Tennessee 37219

Re: Reoffering of \$50,000,000 “County of Carroll, Kentucky, Environmental Facilities Revenue Bonds, 2004 Series A (Kentucky Utilities Company Project)”

Ladies and Gentlemen:

This opinion is being furnished in accordance with the requirements of the Indenture of Trust, dated as of October 1, 2004 (the “Indenture”), between the County of Carroll, Kentucky (the “Issuer”) and U.S. Bank National Association, a national banking association, as successor Trustee (the “Trustee”), pertaining to \$50,000,000 principal amount of County of Carroll, Kentucky, Environmental Facilities Revenue Bonds, 2004 Series A (Kentucky Utilities Company Project), dated October 20, 2004 (the “Bonds”), in order to satisfy certain requirements of the Indenture. Pursuant to the authority of the Indenture and an ordinance adopted by the Issuer, the Company is terminating a municipal bond new issue insurance policy insuring the Bonds and simultaneously delivering a letter of credit to the Trustee for the benefit of the Bondholders. The terms used herein denoted by initial capitals and not otherwise defined shall have the meanings specified in the Indenture.

We have examined the law and such documents and matters as we have deemed necessary to provide this opinion. As to questions of fact material to the opinions expressed herein, we have relied upon the provisions of the Indenture and related documents, and upon representations made to us without undertaking to verify the same by independent investigation.

Based upon the foregoing, as of the date hereof, we are of the opinion that the delivery of a letter of credit and the reoffering of the Bonds as described herein (a) is authorized or permitted by the Act and the Indenture and (b) will not adversely affect the validity of the Bonds or any exclusion from gross income for federal income tax purposes to which interest on the Bonds would otherwise be entitled. Interest on the Bonds is not and will not be excluded from gross income during any period when the Bonds are held by the Company or a “related person” of the Company as defined in Section 147(a) of the Internal Revenue Code of 1986, as amended.

In rendering this opinion, we assume, without verifying, that the Issuer and the Company have complied and will comply with all covenants contained in the Indenture, the Loan Agreement between the Issuer and the Company, dated October 1, 2004, and other documents relating to the Bonds. We rendered our approving opinion at the time of the issuance of the Bonds relating to, among other things, the validity of the Bonds and the exclusion from federal income taxation of interest on the Bonds. We have not been requested to update or continue

such opinion and have not undertaken to do so. Accordingly, we do not express any opinion with respect to the Bonds except as set forth above.

Our opinion represents our legal judgment based upon our review of the law and the facts that we deem relevant to render such opinion and is not a guarantee of a result. This opinion is given as of the date hereof and we assume no obligation to review or supplement this opinion to reflect any facts or circumstances that may hereafter come to our attention or any changes in law that may hereafter occur.

We express no opinion herein as to the investment quality of the Bonds or the adequacy, accuracy or completeness of any information furnished to any person in connection with any offer or sale of the Bonds.

Respectfully submitted,

STOLL KEENON OGDEN PLLC

**Commerzbank AG, New York Branch**

Commerzbank Aktiengesellschaft (“Commerzbank” or the “Bank”) is a major German private-sector bank. Its products and services for retail and corporate customers extend to all aspects of banking. The Bank is also active in specialized fields - partially covered by its subsidiaries - such as mortgage banking and real-estate business, leasing and asset management. Its services are concentrated on managing customers’ accounts and handling payment transactions, loan, savings and investment plans, and also on securities transactions. Additional financial services are offered within the framework of the Bank’s “bancassurance” strategy of cooperating with leading companies in finance-related sectors, including home loan savings schemes and insurance products. The Commerzbank Group’s operating business has been categorized into six segments: Private and Business Customers, Mittelstandsbank, Central & Eastern Europe, Corporates & Markets, Commercial Real Estate as well as Public Finance and Treasury. On August 31, 2008, Commerzbank announced that Commerzbank and Allianz SE have agreed upon the sale of 100% of Dresdner Bank AG to Commerzbank. The transaction will occur in two steps and is expected to be completed by the end of 2009, subject to regulatory and antitrust approvals.

As of September 30, 2008, the Commerzbank Group had total assets of approximately 595.6 billion euros and total shareholders’ equity of approximately \$15.257 billion euros. The shares of Commerzbank are fully paid-up and are in bearer form. They are listed on all seven German stock exchanges as well as on the London Stock Exchange and the Swiss Exchange based in Zurich. There is also a sponsored-ADR program in the USA.

In the Federal Republic of Germany (“Germany”), Commerzbank manages a nationwide branch network covering all customer segments from its headquarters in Frankfurt am Main. Abroad, Commerzbank has branches, representative offices and key subsidiaries in approximately 50 countries.

Commerzbank conducts extensive banking business in the United States, concentrating primarily in corporate lending, letter of credit and bankers’ acceptance facilities, syndicated loan transactions and treasury operations including foreign exchange transactions. Commerzbank has branches in New York, Chicago and Los Angeles and has an agency office in Atlanta.

For further information on the Commerzbank Group, a copy of Commerzbank’s annual report can be obtained by contacting Ms. Karin Rapaglia at 2 World Financial Center, New York, New York 10281.

Commerzbank is authorized to conduct general banking business and to provide financial services under and, subject to the requirements set forth in, the German Banking Act (Kreditwesengesetz). The Bank is subject to comprehensive regulation and supervision by the German Financial Services Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht) and by the German central bank (Deutsche Bundesbank). The European Central Bank regulates Commerzbank in relation to minimum reserves on deposits. In addition, Commerzbank is subject to regulation by the countries in which it operates.

The New York Branch of Commerzbank is licensed by the Superintendent of Banks of the State of New York. It is subject to the banking laws of the State of New York and is examined annually by the New York State Banking Department. Commerzbank's branches in Chicago and Los Angeles are subject to similar regulation by the states in which they operate. In addition to being subject to state laws and regulations, Commerzbank is also subject to federal regulation under the International Banking Act, as amended, (the "IBA") and, through the IBA, the Bank Holding Company Act, as amended, (the "BHCA"). In this regard, the Commerzbank U.S. branches and the Atlanta Agency are also examined annually by the Federal Reserve Banks in the states in which they are located.



Supplement, dated December 1, 2010 to Reoffering Circular dated December 11, 2008, as supplemented as of December 16, 2008 and October 29, 2010 (the “Reoffering Circular”)

**\$54,000,000**  
**County of Carroll, Kentucky**  
**Environmental Facilities Revenue**  
**Refunding Bonds, 2006 Series B**  
**(Kentucky Utilities Company Project)**

**\$77,947,405**  
**County of Carroll, Kentucky**  
**Environmental Facilities Revenue**  
**Bonds,**  
**2008 Series A**  
**(Kentucky Utilities Company Project)**

Effective as of December 1, 2010, through December 1, 2011 (the Letter of Credit (as defined below) expiration date, subject to extension or earlier termination), payment of the principal of and interest on each series of the above-referenced bonds (individually, the “2006 Series B Bonds” and the “2008 Series A Bonds” and, collectively, the “Bonds”) when due will be paid with funds drawn under an irrevocable transferable direct pay letter of credit (the “Letter of Credit”) issued by

**WELLS FARGO BANK, NATIONAL ASSOCIATION**

The Letter of Credit will permit the Trustee to draw with respect to each series of Bonds up to an amount sufficient to pay (i) the principal of such series of Bonds (or that portion of the purchase price corresponding to principal) plus (ii) interest thereon (or that portion of the purchase price corresponding to interest) at an assumed rate of 15% per annum for at least 45 days.

Each series of Bonds will continue to bear interest at a Weekly Rate, determined by the Remarketing Agent in accordance with the Indenture, payable on the first Business Day of each calendar month, commencing on January 3, 2011. The interest rate period, interest rate and Interest Rate Mode for each series of Bonds will be subject to change under certain conditions, as described in the Reoffering Circular. The Bonds of each series are subject to optional redemption, extraordinary optional redemption, in whole or in part, and mandatory redemption following a determination of taxability prior to maturity, as described in the Reoffering Circular. The Bonds of each series are subject to mandatory purchase on any date on which the Bonds are converted to a different Interest Rate Mode and upon the expiration of the Letter of Credit or any Alternate Credit Facility.

This supplement contains a description of the Letter of Credit and Wells Fargo Bank, National Association, the issuer of the Letter of Credit. For purposes of the Reoffering Circular, the Letter of Credit is a “Credit Facility” and Wells Fargo Bank, National Association is a “Credit Facility Issuer.” Except as otherwise specified herein, information in the Reoffering Circular referred to above has not been amended or modified and the information contained herein is qualified by reference to, and should be read in conjunction with, the Reoffering Circular, including information incorporated therein by reference. Terms not otherwise defined herein shall have the meanings ascribed to them in such Reoffering Circular.

*The eighth paragraph under the section of the Reoffering Circular captioned "Introductory Statement" is hereby amended to read in its entirety as follows:*

Effective December 1, 2010, the Company will cause to be delivered separate irrevocable transferable direct pay letters of credit (the "Letters of Credit") with respect to each of the 2006 Series B Bonds and the 2008 Series A Bonds, issued by Wells Fargo Bank, National Association (the "Bank"), to provide for the timely payment of principal of and accrued interest (calculated for at least 45 days at the maximum rate of 15% per annum) on, and purchase price of, the Bonds. The Company will be required to reimburse the Bank for all amounts drawn by the Trustee under the Letters of Credit pursuant to the terms of separate letter agreements, to be dated as of December 1, 2010 (collectively, the "Reimbursement Agreement"), with respect to each of the 2006 Series B Bonds and the 2008 Series A Bonds, between the Company and the Bank. Each Letter of Credit will expire on December 1, 2011 unless extended or earlier terminated.

\* \* \* \*

*The section of the Reoffering Circular captioned "The Letter of Credit" is hereby amended to read in its entirety as follows:*

#### **THE LETTER OF CREDIT**

*The following summarizes certain provisions of the Letter of Credit and the Reimbursement Agreement, to which reference is made for the detailed provisions thereof. Unless otherwise defined in this Reoffering Circular, capitalized terms in the following summary are used as defined in the Letter of Credit and the Reimbursement Agreement. The Company is permitted under the Indenture to deliver an Alternate Credit Facility to replace the Letter of Credit. Any such Alternate Credit Facility must meet certain requirements described in the Indenture.*



## **The Letter of Credit**

The Letter of Credit will be an irrevocable transferable direct pay letter of credit issued by the Bank in order to provide additional security for the payment of principal of, purchase price of, interest on and premium, if applicable, on any date when payments under the Bonds are due, including principal and interest payments and payments upon tender, redemption, acceleration or maturity of the Bonds. The Letter of Credit will provide for direct payments to or upon the order of the Trustee as set forth in the Letter of Credit in amounts sufficient to pay such amounts in accordance with the terms thereof.

The Letter of Credit will be issued in an amount equal to the aggregate principal amount of the outstanding Bonds, plus an amount that represents interest accrued thereon at an assumed rate of 15% per annum for 45 days (the "Credit Amount"). The Trustee, upon compliance with the terms of the Letter of Credit, is authorized to draw up to (a) an amount sufficient (i) to pay principal of the Bonds, when due, whether at maturity or upon redemption or acceleration, and (ii) to pay the portion of the purchase price of the Bonds delivered for purchase pursuant to a demand for purchase by the owner thereof or a mandatory tender for purchase and not remarketed (a "Liquidity Drawing") equal to the principal amount of the Bonds, plus (b) an amount not to exceed 45 days of accrued interest on such Bonds at an assumed rate of 15% per annum (i) to pay interest on the Bonds, when due, and (ii) to pay the portion of the interest accrued on the Bonds as of any Liquidity Drawing.

The amount available under the Letter of Credit will be automatically reduced by the amount of any drawing thereunder, subject to reinstatement as described below. With respect to a drawing by the Trustee solely to pay interest on the Bonds on an Interest Payment Date, the amount available under the Letter of Credit will be automatically reinstated in the amount of such drawing effective on the earlier of (i) receipt by the Bank from the Company of reimbursement of any drawing solely to pay interest in full or (ii) at the opening of business on the eleventh calendar day after the date the Bank honors such drawing, unless the Trustee has received written notice from the Bank by the tenth calendar day after the date the Bank honors such drawing the Bank is not so reinstating the available amount due to the Company's failure to reimburse the Bank for such drawing in full, or that an event of default has occurred and is continuing under the Reimbursement Agreement and, in either case, directing, an acceleration of the Bonds pursuant to the Indenture. With respect to a Liquidity Drawing under the Letter of Credit, the amount available under the Letter of Credit will be automatically reduced by the principal amount of the Bonds purchased with the proceeds of such drawing plus the amount of accrued interest on such Bonds. In the event of the remarketing of the Bonds purchased with the proceeds of a Liquidity Drawing, the amount available under the Letter of Credit will be automatically reinstated upon receipt by the Bank or the Trustee on the Bank's behalf of an amount equal to such principal amount plus accrued interest.

The Letter of Credit will terminate on the earliest to occur of:

- (i) the Bank's close of business on December 1, 2011 (such date, as extended from time to time in accordance with the Letter of Credit is defined as the "Stated Expiration Date");

(ii) the Bank's close of business on the date which is five Business Days following the date of receipt by the Bank of a certificate from the Trustee certifying that (a) no Bonds remain Outstanding within the meaning of the Indenture, (b) all drawings required to be made under the Indenture and available under the Letter of Credit have been made and honored, (c) an Alternate Credit Facility has been delivered to the Trustee in accordance with the Indenture to replace the Letter of Credit or (d) all of the outstanding Bonds were converted to Bonds bearing interest at a rate other than the Daily Rate or the Weekly Rate;

(iii) the Bank's close of business on the date of receipt by the Bank of a certificate from the Trustee confirming that the Trustee is required to terminate the Letter of Credit in accordance with the terms of the Indenture;

(iv) the date on which the Bank receives and honors an acceleration drawing certificate; or

(v) the Bank's close of business on the date which is 30 days after receipt by the Trustee of written notice from the Bank of an Event of Default under the \$400,000,000 Revolving Credit Agreement dated as of November 1, 2010 among the Company, the lending institutions party thereto from time to time and Wells Fargo Bank, National Association, as Administrative Agent (the "Credit Agreement") and instructing the Trustee to draw under the Letter of Credit.

### **The Reimbursement Agreement**

Pursuant to the Reimbursement Agreement, the Company is obligated to reimburse the Bank for all amounts drawn under the Letter of Credit, and to pay interest on all such amounts. The Company has also agreed to pay the Bank a periodic fee for issuing and maintaining the Letter of Credit.

The Reimbursement Agreement, through incorporation of the terms of the Credit Agreement, imposes various covenants and agreements, including various financial and operating covenants, on the Company. Such covenants include, but are not limited to, covenants relating to (i) inspection of the books and financial records of the Company; (ii) mergers or consolidations; and (iii) disposition of assets. Any such covenants may be amended, waived or modified at any time by the Bank and without the consent of the Trustee or the holders of the Bonds. Under certain circumstances, the failure of the Company to comply with such covenants may result in a mandatory tender or acceleration of the Bonds.

An Event of Default under the Credit Agreement will constitute an Event of Default under the Reimbursement Agreement. The following events will constitute an Event of Default under the Credit Agreement:

(i) the Borrower shall fail to pay when due any principal on any Loans under the Credit Agreement or Reimbursement Obligations; or

(ii) the Company shall fail to pay when due any interest on the Loans under the Credit Agreement and Reimbursement Obligations, any fee or any other amount payable

hereunder or under any other Loan Document for five (5) days following the date such payment becomes due thereunder; or

(iii) the Company shall fail to observe or perform certain covenants or agreements contained in the Credit Agreement, including those related to mergers, disposition of assets and capitalization ratios; or

(iv) the Company shall fail to give notice of a Default or Event of Default under the Credit Agreement within a specified number of days following knowledge of such occurrence; or

(v) the Company shall fail to observe or perform any covenant or agreement contained in the Credit Agreement or any notes issued thereunder (other than those covered above) for thirty (30) days after written notice thereof has been given to the defaulting party by the administrative agent, or at the request of the required lenders; or

(vi) any representation, warranty or certification made by the Company in the Credit Agreement or any notes issued thereunder or in any certificate, financial statement or other document delivered pursuant hereto or thereto shall prove to have been incorrect in any material respect when made or deemed made; or

(vii) the Company shall (i) fail to pay any principal or interest, regardless of amount, due in respect of any Material Debt beyond any period of grace provided with respect thereto, or (ii) fail to observe or perform any other term, covenant, condition or agreement contained in any agreement or instrument evidencing or governing any such Material Debt beyond any period of grace provided with respect thereto if the effect of any failure referred to in this clause (ii) is to cause, or to permit the holder or holders of such Debt or a trustee on its or their behalf to cause, such Debt to become due prior to its stated maturity; or

(viii) the Company shall commence a voluntary case or other proceeding seeking liquidation, reorganization or other relief with respect to itself or its debts under any bankruptcy, insolvency or other similar law now or hereafter in effect or seeking the appointment of a trustee, receiver, liquidator, custodian or other similar official of it or any substantial part of its property, or shall consent to any such relief or to the appointment of or taking possession by any such official in an involuntary case or other proceeding commenced against it, or shall make a general assignment for the benefit of creditors, or shall fail generally to pay, or shall admit in writing its inability to pay, its debts as they become due, or shall take any corporate action to authorize any of the foregoing; or

(ix) an involuntary case or other proceeding shall be commenced against the Company seeking liquidation, reorganization or other relief with respect to it or its debts under any bankruptcy, insolvency or other similar law now or hereafter in effect or seeking the appointment of a trustee, receiver, liquidator, custodian or other similar official of it or any substantial part of its property, and such involuntary case or other proceeding shall remain undismissed and unstayed for a period of 60 days; or an order for relief shall be entered against the Company under the Bankruptcy Code; or

(x) any member of the ERISA Group shall fail to pay when due an amount or amounts aggregating in excess of \$50,000,000 which it shall have become liable to pay under Title IV of ERISA; or notice of intent to terminate a Material Plan shall be filed under Title IV of ERISA by any member of the ERISA Group, any plan administrator or any combination of the foregoing; or the PBGC shall institute proceedings under Title IV of ERISA to terminate, to impose liability (other than for premiums under Section 4007 of ERISA) in respect of, or to cause a trustee to be appointed to administer any Material Plan; or a condition shall exist by reason of which the PBGC would be entitled to obtain a decree adjudicating that any Material Plan must be terminated; or there shall occur a complete or partial withdrawal from, or default, within the meaning of Section 4219(c)(5) of ERISA, with respect to, one or more Multiemployer Plans which could reasonably be expected to cause one or more members of the ERISA Group to incur a current payment obligation in excess of \$50,000,000; or

(xi) the Company shall fail within sixty (60) days to pay, bond or otherwise discharge any judgment or order for the payment of money in excess of \$20,000,000, entered against the Company that is not stayed on appeal or otherwise being appropriately contested in good faith; or

(xii) a Change of Control shall have occurred;

For purposes of the foregoing:

“Change of Control” means (i) the acquisition by any person, or two or more persons acting in concert, of beneficial ownership of 25% or more of the outstanding shares of voting stock of PPL Corporation or its successors or (ii) the failure at any time of PPL Corporation or its successors to own 80% or more of the outstanding shares of the voting stock in the Company.

“Credit Agreement” means the \$400,000,000 Revolving Credit Agreement dated as of November 1, 2010 among the Company, the lending institutions party thereto from time to time and Wells Fargo Bank, National Association, as Administrative Agent.

“Material Debt” means debt (other than the notes issued under the Credit Agreement) of the Company in a principal or face amount exceeding \$50,000,000

*Appendix C of the Reoffering Circular is hereby amended to read in its entirety as follows:*

### **Wells Fargo Bank, National Association**

*The information under this heading has been provided solely by Wells Fargo Bank, National Association and is believed to be reliable. This information has not been verified independently by the Company, the Issuer or the Remarketing Agent. The Company, the Issuer and the Remarketing Agent make no representation whatsoever as to the accuracy, adequacy or completeness of such information.*

### **Wells Fargo Bank, National Association**

Wells Fargo Bank, National Association (the “Bank”) is a national banking association organized under the laws of the United States of America with its main office at 101 North Phillips Avenue, Sioux Falls, South Dakota 57104, and engages in retail, commercial and corporate banking, real estate lending and trust and investment services. The Bank is an indirect, wholly owned subsidiary of Wells Fargo & Company, a diversified financial services company, a financial holding company and a bank holding company registered under the Bank Holding Company Act of 1956, as amended, with its principal executive offices located in San Francisco, California.

Each quarter, the Bank files with the FDIC financial reports entitled “Consolidated Reports of Condition and Income for Insured Commercial Banks with Domestic and Foreign Offices,” commonly referred to as the “Call Reports.” The Bank’s Call Reports are prepared in accordance with regulatory accounting principles, which may differ from generally accepted accounting principles. The publicly available portions of Call Reports filed by the Bank with the FDIC may be obtained from the FDIC, Disclosure Group, Room F518, 550 17<sup>th</sup> Street, N.W., Washington, D.C. 20429 at prescribed rates, or from the FDIC on its Internet site at <http://www.fdic.gov>, or by writing to Corporate Secretary’s Office, Wells Fargo Center, Sixth and Marquette, MAC N9305-173, Minneapolis, MN 55479.

**The Letter of Credit will be solely an obligation of the Bank and will not be an obligation of, or otherwise guaranteed by, Wells Fargo & Company, and no assets of Wells Fargo & Company or any affiliate of the Bank or Wells Fargo & Company will be pledged to the payment thereof. Payment of the Letter of Credit will not be insured by the FDIC.**

The information contained in this section, including financial information, relates to and has been obtained from the Bank, and is furnished solely to provide limited introductory information regarding the Bank and does not purport to be comprehensive. Any financial information provided in this section is qualified in its entirety by the detailed information appearing in the Call Reports referenced above. The delivery hereof shall not create any implication that there has been no change in the affairs of the Bank since the date hereof.

*Appendix A of the Reoffering Circular is hereby amended to read in its entirety as follows:*

**Kentucky Utilities Company –**

**Financial Statements and Additional Information**

*This Appendix A includes the Selected Financial Data presented below relating to Kentucky Utilities Company (“KU”), certain risk factors associated with KU, Pro Forma Condensed Financial Information (Unaudited), a description of the Business of KU, Management’s Discussion and Analysis of Financial Condition and Results of Operations (“Management’s Discussion and Analysis”), the Consolidated Financial Statements as of December 31, 2009 and 2008 and for the Years Ended December 31, 2009, 2008 and 2007 (Audited) (the “Consolidated Financial Statements”) and the Condensed Financial Statements as of September 30, 2010 and December 31, 2009 and for the Three and Nine Months Ended September 30, 2010 and 2009 (Unaudited) (the “Condensed Consolidated Financial Statements”).*

*The information contained in this Appendix A relates to and has been obtained from KU and from other sources as shown herein. The delivery of this Supplement shall not create any implication that there has been no change in the affairs of KU since the date hereof, or that the information contained or incorporated by reference in this Appendix A is correct at any time subsequent to its date. In this Appendix A, “KU”, “the Company”, “we”, “us” or “our” refer to Kentucky Utilities Company.*

**Summary**

**Kentucky Utilities Company**

Kentucky Utilities Company, incorporated in Kentucky in 1912 and in Virginia in 1991, is a regulated public utility engaged in the generation, transmission, distribution and sale of electric energy in Kentucky, Virginia and Tennessee. We provide electric service to approximately 515,000 customers in 77 counties in central, southeastern and western Kentucky, to approximately 29,000 customers in 5 counties in southwestern Virginia and to 5 customers in Tennessee. Our service area covers approximately 6,600 square miles. During the first three quarters of 2010, approximately 99% of the electricity generated by us was produced by our coal-fired electric generating stations. The remainder is generated by a hydroelectric power plant and natural gas and oil fueled combustion turbines (“CTs”). In Virginia, we operate under the name Old Dominion Power Company. We also sell wholesale electric energy to 12 municipalities.

KU is a wholly-owned subsidiary of LG&E and KU Energy LLC. On November 1, 2010, PPL Corporation purchased all of the interests of LG&E and KU Energy LLC and, indirectly, all of the stock of the Company from E.ON AG, making KU an indirect wholly-owned subsidiary of PPL Corporation. KU’s affiliate, Louisville Gas and Electric Company (“LG&E”), is a regulated public utility engaged in the generation, transmission, distribution and sale of electric energy and natural gas in Kentucky.

## RISK FACTORS

*An investment in the Bonds involves a number of risks. Risks described below should be carefully considered together with the other information included in this Supplement, including this Appendix A. Any of the events or circumstances described as risks below could result in a significant or material adverse effect on our business, results of operations, cash flows or financial condition, and a corresponding decline in the price of, or our ability to repay, the Bonds. The risks and uncertainties described below may not be the only risks and uncertainties that we face. Additional risks and uncertainties not currently known or that we currently deem immaterial may also result in a significant or material adverse effect on our business, results of operations, cash flow or financial condition.*

### **Risks related to the Company**

*Our business is subject to significant and complex governmental regulation.*

Various federal and state entities, including but not limited to the Federal Energy Regulatory Commission (“FERC”), the Kentucky Public Service Commission (the “Kentucky Commission”), the Virginia State Corporation Commission (the “Virginia Commission”) and the Tennessee Regulatory Authority, regulate many aspects of our utility operations, including:

- the rates that we may charge and the terms and conditions of our service and operations;
- financial and capital structure matters;
- siting and construction of facilities;
- mandatory reliability and safety standards, and other standards of conduct;
- accounting, depreciation, and cost allocation methodologies;
- tax matters;
- affiliate restrictions;
- acquisition and disposal of utility assets and securities; and
- various other matters.

Such regulations or changes thereto may subject us 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 our rate requests and ultimately reduce, alter or limit the rates we seek.

Our profitability is highly dependent on our ability to recover the costs of providing energy and utility services to our customers and earn an adequate return on our capital investments. We currently provide services to our retail customers at rates approved by one or more federal or state regulatory commissions, including those commissions referred to above. While these rates are generally regulated based on an analysis of our costs incurred in a base year, the rates we are allowed to charge may or may not match our costs at any given time. While rate regulation is premised on providing a reasonable opportunity to earn a reasonable rate of return on invested capital, there can be no assurance that the applicable regulatory commissions will consider all of our costs to have been prudently incurred or that the regulatory process in which rates are determined will always result in rates that will produce full recovery of our costs or an adequate return on our capital investments. If our costs are not adequately recovered through rates, it could have an adverse affect on our business, results of operations, cash flows or financial condition.

We have agreed, subject to certain limited exceptions such as fuel and environmental cost recoveries, that no base rate increase would take effect for our Kentucky retail customers before January 1, 2013.

*Transmission and interstate market activities of the Company, as well as other aspects of the business, are subject to significant FERC regulation.*

Our business is subject to extensive regulation by the FERC covering matters including rates charged to transmission users, market-based or cost-based rates applicable to wholesale customers; interstate power market structure; construction and operation of transmission facilities; mandatory reliability standards; standards of conduct and affiliate restrictions and other matters. Existing FERC regulation, changes thereto or issuances of new rules or situations of non-compliance, including but not limited to the areas of market-based tariff authority, Revenue Sufficiency Guarantee (“RSG”) resettlements in the Midwest Independent Transmission System Operator, Inc. market, mandatory reliability standards and natural gas transportation regulation can affect the earnings, operations or other activities of the Company.

*Changes in transmission and wholesale power market structures could increase costs or reduce revenues.*

Wholesale revenues fluctuate with regional demand, fuel prices and contracted capacity. Changes to transmission and wholesale power market structures and prices may occur in the future, are not estimable and may result in unforeseen effects on energy purchases and sales, transmission and related costs or revenues. These can include commercial or regulatory changes affecting power pools, exchanges or markets in which we participate.

*We undertake significant capital projects and these activities are subject to unforeseen costs, delays or failures, as well as risk of inadequate recovery of resulting costs.*

Our business is capital intensive and requires significant investments in energy generation and distribution and other infrastructure projects, such as projects for environmental compliance. The completion of these projects without delays or cost overruns is subject to risks in many areas, including:

- approval, licensing and permitting;
- land acquisition and the availability of suitable land;
- skilled labor or equipment shortages;
- construction problems or delays, including disputes with third party intervenors;
- increases in commodity prices or labor rates;
- contractor performance;
- environmental considerations and regulations;
- weather and geological issues; and
- political, labor and regulatory developments.

Failure to complete our capital projects on schedule or on budget, or at all, could adversely affect our financial performance, operations and future growth.

*Our costs of compliance with, and liabilities under, environmental laws are significant and are subject to continuing changes.*

Extensive federal, state and local environmental laws and regulations are applicable to our 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 but could be material. In addition, our costs may increase significantly if the requirements or scope of environmental laws or regulations, or similar rules, are expanded or changed from prior versions by the relevant agencies. Costs may take the form of increased capital or operating and



maintenance expenses; monetary fines, penalties or forfeitures or other restrictions. Many of these environmental law considerations are also applicable to the operations of our key suppliers, or customers, such as coal producers, industrial power users, etc., and may impact the costs of their products or their demand for our services.

***Our 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 other factors can significantly affect our finances or operations by changing demand levels; causing outages; damaging infrastructure or requiring significant repair costs; affecting capital markets and general economic conditions or impacting future growth.

***We are subject to operational and financial risks regarding potential developments concerning global climate change.***

Various regulatory and industry initiatives have been implemented or are under development to regulate or otherwise reduce emissions of greenhouse gases (“GHGs”), which are emitted from the combustion of fossil fuels such as coal and natural gas, as occurs at our generating stations. Such developments could include potential federal or state legislation or industry initiatives allocating or limiting GHG emissions; establishing costs or charges on GHG emissions or on fuels relating to such emissions; requiring GHG capture and sequestration; establishing renewable portfolio standards or generation fleet-diversification requirements to address GHG emissions; promoting energy efficiency and conservation; changes in transmission grid construction, operation or pricing to accommodate GHG-related initiatives; or other measures. Our generation fleet is predominantly coal-fired and may be highly impacted by developments in this area. Compliance with any new laws or regulations regarding the reduction of GHG emissions could result in significant changes to the Company’s operations, significant capital expenditures by the Company and a significant increase in our cost of conducting business. We may face strong competition for, or difficulty in obtaining, required GHG-compliance related goods and services, including construction services, emissions allowances and financing, insurance and other inputs relating thereto. Increases in our costs or prices of producing or selling electric power due to GHG-related developments could materially reduce or otherwise affect the demand, revenue or margin levels applicable to our power, thus adversely affecting our financial condition or results of operations.

***We are subject to physical, market and economic risks relating to potential effects of climate change.***

Climate change may produce changes in weather or other environmental conditions, including temperature or precipitation changes, such as warming or drought. These changes may affect farm and agriculturally-dependent businesses and activities, which are an important part of Kentucky’s economy, and thus may impact consumer demand for electric power. Temperature increases could result in increased overall electricity volumes or peaks and precipitation changes could result in altered availability of water for plant cooling operations. These or other meteorological changes could lead to increased operating costs, capital expenses or power purchase costs by the Company. Conversely, climate change could have a number of potential impacts tending to reduce demand. Changes may entail more frequent or more intense storm activity, which, if severe, could temporarily disrupt regional economic conditions and adversely affect electricity demand levels. As discussed in other risk factors, storm outages and damage often directly decrease revenues or increase expenses, due to reduced usage and higher restoration charges, respectively. GHG regulation could increase the cost of electric power, particularly power generated by fossil-fuels, and such increases could have a depressive effect on the regional economy. Reduced economic and consumer activity in our service area both generally and specific to certain industries and consumers accustomed to previously low-cost power, could reduce demand for our electricity. Also, demand for our services could be similarly lowered should consumers’ preferences or market factors move toward favoring energy efficiency, low-carbon power sources or reduced electric usage generally.

***Our business is subject to risks associated with local, national and worldwide economic conditions.***

The consequences of prolonged recessionary conditions may include a lower level of economic activity and uncertainty or volatility regarding energy prices and the capital and commodity markets. A lower level of economic activity might result in a decline in energy consumption, unfavorable changes in energy and commodity prices and slower customer growth, which may adversely affect our future revenues and growth. Instability in the financial

markets, as a result of recession or otherwise, also may affect the cost of capital and our ability to raise capital. A deterioration of economic conditions may lead to decreased production by our industrial customers and, therefore, lower consumption of electricity. Decreased economic activity may also lead to fewer commercial and industrial customers and increased unemployment, which may in turn impact residential customers' ability to pay. Further, worldwide economic activity has an impact on the demand for basic commodities needed for utility infrastructure. Changes in global demand may impact the ability to acquire sufficient supplies and the cost of those commodities may be higher than expected.

***Our business is concentrated in the Midwest United States, specifically Kentucky.***

Although we also operate in Virginia and Tennessee, the majority of our operations are concentrated in Kentucky. Local and regional economic conditions, such as population growth, industrial growth, expansion and economic development or employment levels, as well as the operational or financial performance of major industries or customers, can affect the demand for energy and our results of operations. Significant industries and activities in our service territory include automotive; aluminum and steel smelting and fabrication; chemical processing; coal, mineral and ceramic-related activities; educational institutions; health care facilities; paper and pulp processing and water utilities. Any significant downturn in these industries or activities or in local and regional economic conditions in our service area may adversely affect the demand for electricity in our service territory.

***We are subject to operational risks relating to our generating plants, transmission facilities, distribution equipment, information technology systems and other assets and activities.***

Operation of power plants, transmission and distribution facilities, information technology systems and other assets and activities subjects the Company to many risks, including the breakdown or failure of equipment; accidents; security breaches, viruses or outages affecting information technology systems; labor disputes; obsolescence; delivery/transportation problems and disruptions of fuel supply and performance below expected levels. Occurrences of these events may impact our ability to conduct our business efficiently or lead to increased costs, expenses or losses.

Although we maintain customary insurance coverage for certain of these risks in common with some other utilities, we do not have insurance covering our transmission and distribution system, other than substations, because we have found the cost of such insurance to be prohibitive. If we are unable to recover the costs incurred in restoring our transmission and distribution properties following damage as a result of tornados or other natural disasters or to recover the costs of other liabilities arising from the risks of our business, through a change in our rates or otherwise, or if such recovery is not received on a timely basis, we may not be able to restore losses or damages to our properties without an adverse effect on our financial condition, results of operations or our reputation.

***We are subject to liability risks relating to our generating, transmission, distribution and retail businesses.***

Conduct of our physical and commercial operations subjects us to many risks, including risks of potential physical injury, property damage or other financial affects, caused to or caused by employees, customers, contractors, vendors, contractual or financial counterparties and other third-parties.

***We could be negatively affected by rising interest rates, downgrades to our bond credit ratings or other negative developments in our ability to access capital markets.***

In the ordinary course of business, we are reliant upon adequate long-term and short-term financing means to fund our significant capital expenditures, debt interest or maturities and operating needs. As a capital-intensive business, we are sensitive to developments in interest rate levels; credit rating considerations; insurance, security or collateral requirements; market liquidity and credit availability and refinancing steps necessary or advisable to respond to credit market changes. Changes in these conditions could result in increased costs and decreased liquidity to the Company.

*We are 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 the Company.

*We are subject to risks associated with defined benefit retirement plans, health care plans, wages and other employee-related matters.*

We sponsor pension and postretirement benefit plans for our employees. Risks with respect to these plans include adverse developments in legislation or regulation, future costs or funding levels, returns on investments, market fluctuations, interest rates and actuarial matters. Changes in health care rules, market practices or cost structures can affect our current or future funding requirements or liabilities. Without sustained growth in our investments over time to increase the value of our plan assets, we could be required to fund our plans with significant amounts of cash. We are also subject to risks related to changing wage levels, whether related to collective bargaining agreements or employment market conditions, ability to attract and retain key personnel and changing costs of providing health care benefits.

*We are subject to risks associated with federal and state tax regulations.*

Changes in taxation as well as the inherent difficulty in quantifying potential tax effects of business decisions could negatively impact our results of operations. We are required to make judgments in order to estimate our obligations to taxing authorities. These tax obligations include income, property, sales and use and employment-related taxes. We also estimate our ability to utilize tax benefits and tax credits. Due to the revenue needs of the states and jurisdictions in which we operate, various tax and fee increases may be proposed or considered. We cannot predict whether legislation or regulation will be introduced or the effect on the Company of any such changes. If enacted, any changes could increase tax expense and could have a negative impact on our results of operations and cash flows.

## PRO FORMA CONDENSED FINANCIAL INFORMATION (UNAUDITED)

On November 1, 2010, PPL Corporation completed the purchase of all of the outstanding limited liability company interests of LG&E and KU Energy LLC, our parent, for cash consideration of \$2,467 million. In addition, PPL Corporation assumed, through consolidation, \$764 million of outstanding debt, net of \$163 million repurchased and held for reissuance, and repaid all indebtedness owed by our parent and its subsidiaries to subsidiaries of E.ON AG.

The Unaudited Pro Forma Condensed Financial Statements (“pro forma financial statements”) have been derived from our historical financial statements.

The historical financial information has been adjusted in the pro forma financial statements to give effect to pro forma events that are: (1) directly attributable to the acquisition; (2) factually supportable; and (3) with respect to the statement of operations, expected to have a continuing impact on our results. Specifically, such pro forma adjustments include:

- Repayment of intercompany debt by us to E.ON AG and its affiliates, initially by intercompany loans from a subsidiary of PPL Corporation;
- Adjustments to push down the new basis of accounting recorded by PPL Corporation on the post-acquisition balance sheet of the Company; and
- The subsequent issuance of the \$1,500,000,000 of taxable first mortgage bonds by the Company assuming proceeds equal to the principal amounts thereof and the use of such proceeds thereafter to repay the intercompany debt.

The Unaudited Pro Forma Condensed Statements of Operations (“pro forma statements of operations”) for the nine months ended September 30, 2010 and for the year ended December 31, 2009 give effect to the adjustments as if they were completed on January 1, 2009. The Unaudited Pro Forma Condensed Balance Sheet (“pro forma balance sheet”) as of September 30, 2010 gives effect to the adjustments as if they were completed on September 30, 2010.

Assumptions and estimates underlying the pro forma adjustments are described in the accompanying notes, which should be read in conjunction with the pro forma financial statements. Generally accepted accounting principles in the United States permit up to one year from the date of acquisition to finalize all purchase accounting adjustments, therefore, the final amounts recorded as of the date of the acquisition may differ materially from the information presented in these pro forma financial statements. These estimates are subject to change pending further review of the assets acquired and liabilities assumed.

The pro forma financial statements have been presented for illustrative purposes only and are not necessarily indicative of results of operations and financial position that would have been achieved had the pro forma events taken place on the dates indicated, or the future results of operations or financial position of the company.

The following pro forma financial statements should be read in conjunction with:

- the accompanying notes to the pro forma financial statements;
- the 2009 Annual Financial Statements and the Third Quarter Financial Statements, contained elsewhere in this Appendix A.

### Pro Forma Condensed Statement of Operations

	Nine Months Ended September 30, 2010		
	Actual	Adjustments (Unaudited)	Pro Forma
	(Millions of dollars)		
<b>Operating Revenues</b> .....	\$ 1,146		\$ 1,146
<b>Operating Expenses</b>			
Fuel for electric generation .....	391		391
Power purchased .....	135		135
Other operation and maintenance .....	251		251
Depreciation, accretion, and amortization .....	106	—	106
Total Operating Expenses .....	883	—	883
<b>Operating Income</b> .....	263		263
Other income, net .....	2		2
Interest Expense .....	5	\$ 44(a)	49
Interest Expense — Affiliates .....	55	(55)(a)	—
<b>Income from Continuing Operations Before Income Taxes</b> .....	205	11	216
Income Taxes .....	76	4(b)	80
<b>Income from Continuing Operations After Income Taxes</b> .....	129	7	136

The accompanying Notes to Pro Forma Condensed Financial Statements are an integral part of these pro forma financial statements. See Note 3 for information on pro forma adjustment references.

### Pro Forma Condensed Statement of Operations

	Year Ended December 31, 2009		
	Actual	Adjustments (Unaudited)	Pro Forma
		(Millions of dollars)	
<b>Operating Revenues</b> .....	\$ 1,355		\$ 1,355
<b>Operating Expenses</b>			
Fuel for electric generation .....	434		434
Power purchased .....	199		199
Other operation and maintenance .....	320		320
Depreciation, accretion, and amortization .....	133	—	133
Total Operating Expenses .....	1,086	—	1,086
<b>Operating Income</b> .....	269		269
Other income, net .....	6		6
Interest Expense .....	6	59(a)	65
Interest Expense — Affiliates .....	69	(69)(a)	—
<b>Income from Continuing Operations Before Income Taxes</b> .....	200	10	210
Income Taxes .....	67	4(b)	71
<b>Income from Continuing Operations After Income Taxes</b> .....	133	6	139

The accompanying Notes to Pro Forma Condensed Financial Statements are an integral part of these pro forma financial statements. See Note 3 for information on pro forma adjustment references.

### Pro Forma Condensed Balance Sheet

	September 30, 2010		
	Actual	Adjustments	Pro Forma Entity
	(Unaudited) (Millions of dollars)		
<b>Current Assets</b>			
Cash and cash equivalents .....	\$ 2	\$ 140(c)	\$ 142
Accounts receivable .....	200		200
Fuel, materials and supplies .....	140		140
Regulatory assets .....	14		14
Prepayments and other current assets .....	11		11
Total Current Assets .....	367	140	507
Investment in unconsolidated venture .....	12	68(d)	80
<b>Property, Plant and Equipment, net</b> .....	4,470	30(l)	4,500
<b>Deferred debits and other assets</b>			
Regulatory assets .....	215	(16)(e)	199
Goodwill .....	—	573(f)	573
Other intangibles .....	—	201(g)	201
Other noncurrent assets .....	46	11(h)	57
Total deferred debits and other assets .....	261	769	1,030
<b>Total Assets</b> .....	5,110	1,007	6,117

The accompanying Notes to Pro Forma Condensed Financial Statements are an integral part of these pro forma financial statements. See Note 3 for information on pro forma adjustment references.

**Pro Forma Condensed Balance Sheet**

	<b>September 30, 2010</b>		
	<u>Actual</u>	<u>Adjustments</u>	<u>Pro Forma Entity</u>
		(Unaudited)	
		(Millions of dollars)	
<b>Liabilities and Equity</b>			
<b>Current Liabilities</b>			
Current portion long-term debt .....	\$ 228		228
Current portion long-term debt — affiliated company .....	33	\$ (33)(j)	—
Note payable — affiliate .....	61		61
Accounts payable .....	176	(18)(i)	158
Regulatory liabilities .....	12		12
Other current liabilities .....	62		62
Total Current Liabilities .....	572	(51)	521
<b>Long-term Debt</b> .....	123	1,501(j)	1,624
<b>Long-term Debt — Affiliates</b> .....	1,298	(1,298)(j)	—
<b>Deferred Credits and Other Liabilities</b>			
Deferred income taxes and investment tax credit .....	482	27(p)	509
Accumulated provision for pensions and related benefits .....	160	—(k)	160
Asset retirement obligations .....	59	(4)(l)	55
Regulatory liabilities .....	367	201(m)	568
Other liabilities .....	20	17(n)	37
Total Deferred Credits and Other Liabilities .....	1,088	241	1,329
<b>Commitments and Contingent Liabilities</b>			
Total Equity .....	2,029	614(o)	2,643
<b>Total Liabilities and Equity</b> .....	\$ 5,110	\$ 1,007	\$ 6,117

The accompanying Notes to Pro Forma Condensed Financial Statements are an integral part of these pro forma financial statements. See Note 3 for information on pro forma adjustment references.



**NOTES TO PRO FORMA CONDENSED FINANCIAL STATEMENTS**  
**(Unaudited)**

**Note 1 — Basis of Pro Forma Presentation**

The pro forma statements of operations for the nine months ended September 30, 2010 and for the year ended December 31, 2009 give effect to the adjustments as if they were completed on January 1, 2009. The pro forma balance sheet as of September 30, 2010 gives effect to the adjustments as if they were completed on September 30, 2010.

The pro forma financial statements have been derived from our historical financial statements. Assumptions and estimates underlying the pro forma adjustments are described in the accompanying notes, which should be read in conjunction with the pro forma financial statements. Since the pro forma financial statements have been prepared based upon preliminary estimates, the final amounts recorded at the date of the acquisition may differ materially from the information presented. These estimates are subject to change pending further review of the assets acquired and liabilities assumed.

The pro forma financial statements reflect the push down of the new basis of accounting for our assets and liabilities arising from the acquisition by PPL Corporation being accounted for based on the guidance provided by accounting standards for business combinations. In accordance with this accounting guidance, the assets acquired and the liabilities assumed have been measured at fair value by PPL Corporation and the difference between these assets and liabilities and the purchase price has been recorded as goodwill (this process is generally referred to as a *purchase price allocation*). In accordance with SEC guidance for wholly-owned subsidiaries, these fair value measurements and an allocated portion of goodwill have been pushed down and recorded on our pro forma financial statements as presented in Note 2. The fair value measurements utilize estimates based on key assumptions of the acquisition, and historical and current market data. These fair value measurements and the related pro forma adjustments included herein may be revised as additional information becomes available and as additional analyses are performed. The final purchase price allocation may differ materially from the information presented. As noted above, the pro forma financial statements also include adjustments to reflect the issuance of the Bonds, with proceeds assumed to equal the principal amount thereof and used to repay indebtedness owed by us to a subsidiary of PPL Corporation. The indebtedness was incurred to repay loans from a subsidiary of E.ON AG in connection with the PPL Corporation acquisition. The preliminary result of all these adjustments is presented in Note 2.

The amounts utilized in determining the pro forma adjustments presented on the Proforma Condensed Financial Statements are also set forth and described in Note 3.

For the purpose of measuring the estimated fair value of the assets acquired and liabilities assumed, PPL Corporation has applied the accounting guidance for fair value measurements. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

For purposes of measuring the fair value of the majority of property, plant and equipment and regulatory assets acquired and regulatory liabilities assumed, as reflected in the pro forma financial statements, PPL has determined that the fair value equaled their net book value, due to the regulatory environment in which they operate. The regulatory commissions allow for earning a rate of return on the book values of the regulated asset bases at rates determined to be fair and reasonable. Since there is no current prospect for deregulation, the expectation is that these operations will remain in a regulated environment for the foreseeable future and this presentation represents the highest and best use of these assets. In addition, certain fair value adjustments have been reflected on the balance sheet with an offsetting regulatory asset or liability based upon agreement with the regulatory commissions that purchase accounting adjustments will not impact customers and, therefore, will not be included in any cost recovery mechanisms or rates on a prospective basis.

## Note 2 — Preliminary Push Down of Purchase Price Allocation and Replacement of Debt

### Preliminary Purchase Price Allocation

The preliminary allocation of the purchase price to the fair value of assets acquired and liabilities assumed includes pro forma adjustments primarily related to the fair value of equity investments, contractual arrangements, goodwill, noncurrent liabilities and long-term debt and related deferred income taxes. The preliminary allocation of the purchase price, including the replacement of debt, is as follows (in millions):

Current assets.....	\$ 507
Property, plant and equipment.....	4,500
Investments.....	80
Goodwill.....	573
Other intangibles.....	201
Regulatory assets and other noncurrent assets.....	256
Current liabilities.....	(521)
Noncurrent liabilities.....	(1,329)
Long-term debt.....	(1,624)
<b>Total Equity.....</b>	<b><u>\$ 2,643</u></b>

### Note 3 — Pro Forma Adjustments

The adjustments included in the pro forma financial statements are as follows:

#### Adjustments to Pro Forma Condensed Statements of Operations

(a) *Interest expense* — Reflects the change in interest expense from the extinguishment of indebtedness owed by us to a subsidiary of E.ON AG, and replacement with the taxable first mortgage bonds and the application of proceeds thereof. The interest expense was adjusted assuming a weighted-average interest rate of 3.9%. No adjustment has been made for the actual rates.

(b) *Income taxes* — Reflects the income tax effect of the pro forma adjustments, which was calculated using an estimated statutory income tax rate of 40%. Income tax expense includes adjustments for state taxes and certain federal income tax items that are calculated on a combined or consolidated basis.

#### Adjustments to Pro Forma Condensed Balance Sheet

(c) *Cash* — Reflects \$1,500 million of estimated proceeds from the taxable first mortgage bonds. This amount was offset by a \$1,331 million of estimated repayment of the indebtedness and payables owed to subsidiaries of E.ON AG and its affiliates, the repayment of \$18 million of affiliate accounts payable, and approximately \$11 million related to the payment of debt issuance costs.

(d) *Investments* — Reflects the fair value adjustment of \$68 million related to our equity method investment in Electric Energy, Inc.

(e) *Regulatory assets* — Reflects the offsetting regulatory asset related to the fair value adjustments associated with the fair value of debt, coal contracts and asset retirement obligations. These fair value adjustments have been reflected on the balance sheet with an offsetting regulatory asset based upon agreement with the regulatory commissions that purchase accounting adjustments will not impact customers and, therefore, will not be included in any cost recovery mechanisms or rates on a prospective basis.

(f) *Goodwill* — Reflects the preliminary estimate of the excess of the purchase price paid over the net fair value of our assets acquired and liabilities assumed. This excess is calculated as follows (in millions):

Purchase price.....	\$ 2,643
Less: Fair value of net assets acquired.....	<u>2,070</u>
Estimated goodwill resulting from the acquisition .....	573
Less: pre-existing goodwill.....	<u>—</u>
Pro forma goodwill adjustment .....	<u>\$ 573</u>

PPL Corporation has not yet completed its goodwill allocation evaluation, but will allocate the final amount of goodwill to its reporting units that are expected to benefit from the business combination in accordance with applicable accounting guidance. The resulting goodwill that will ultimately be allocated and pushed down to us could differ materially from the amount presented.

(g) *Other intangibles* — Reflects the recognition of \$188 million related to the fair value of certain coal contracts and \$13 million related the fair value of emission allowances.

(h) *Other noncurrent assets* — Reflects the capitalization of \$11 million of estimated debt issuance costs incurred with the issuance of the Bonds.

(i) *Accounts payable* — Reflects the payment of affiliate accounts payable to E.ON AG and its affiliates.

(j) *Debt* — Reflects the adjustments to repay \$1,331 million of indebtedness owed by us to a subsidiary of E.ON AG and its affiliates. This decrease is offset by the issuance of \$1,500 million of the Bonds at an assumed weighted-average interest rate of 3.9%. No adjustment has been made for the actual rates. In addition, an increase of \$1 million was recorded to reflect the fair value of the assumed debt. The ultimate fair value determination of the debt will be based on prevailing market interest rates at the completion of the acquisition and the adjustment will be amortized as an adjustment to interest expense over the remaining life of the debt issues.

(k) *Accumulated provision for pensions and related benefits* — The accrued pension obligations have not been adjusted as the information required to make such adjustment was not yet available. The resulting adjustment could differ materially from the amount presented.

(l) *Asset retirement obligations* — Reflects a \$4 million adjustment to record the fair value of asset retirement obligations. As a result, the associated regulatory assets of \$34 million were written off, and \$30 million related to property, plant and equipment, net, were recorded.

(m) *Regulatory liabilities* — Reflects the offsetting regulatory liability related to the fair value adjustments associated with the fair value of emission allowances and coal contracts. These fair value adjustments have been reflected on the balance sheet with an offsetting regulatory liability based upon agreement with the regulatory commissions that purchase accounting adjustments will not impact customers and therefore, will not be included in any cost recovery mechanisms or rates on a prospective basis.

(n) *Other noncurrent liabilities* — Reflects the recognition of the fair value of certain coal contracts.

(o) *Equity* — Reflects the net purchase accounting adjustments to increase our historical equity balance of \$2,029 million to recognize the \$2,643 million of equity from the purchase price, including the push down of \$573 million of goodwill resulting from acquisition and other fair value adjustments previously discussed.

(p) *Deferred income taxes* — Represents estimated deferred taxes calculated at our estimated statutory tax rate of 40% applied to certain fair value adjustments recorded to the assets acquired and liabilities assumed, excluding goodwill.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

The following discussion and analysis by management focuses on those factors that had a material effect on our results of operations and financial condition during the periods presented and should be read in connection with the financial statements and notes included elsewhere in this Appendix A. The discussion contains certain forward-looking statements that involve risk and uncertainties. See "Risk Factors."

### Years Ended December 31, 2009, 2008 and 2007

#### Results of Operations

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

#### *Net Income*

Net income in 2009 decreased \$25 million compared to 2008. The decrease was primarily the result of decreased operating revenues (\$50 million), decreased equity in earnings (\$29 million), decreased other income — net (\$3 million) and increased interest expense (\$3 million), partially offset by decreased operating expenses (\$59 million) and decreased income taxes (\$1 million).

Net income in 2008 decreased \$9 million compared to 2007. The decrease was primarily the result of increased operating expenses (\$140 million) and increased interest expense (\$16 million), partially offset by increased operating revenues (\$133 million), decreased income taxes (\$9 million), increased equity in earnings (\$4 million) and increased other income — net (\$1 million).

#### *Revenues*

Revenues in 2009 decreased \$50 million compared to 2008 primarily due to:

- Decreased wholesale sales (\$75 million) due to lower sales volumes to LG&E (\$60 million) and third-parties (\$16 million). These lower volumes were primarily due to lower economic demand caused by low spot market pricing during most of 2009, and due to higher scheduled coal-fired generation unit outages during 2009. Via a mutual agreement, we sell our higher cost electricity to LG&E for its wholesale sales and we purchase LG&E's lower cost electricity to serve our native load. These decreases were partially offset by increased prices (\$1 million) for sales to LG&E due to the higher cost of fuel inventory.
- Decreased retail sales volumes delivered (\$55 million) due to reduced consumption by residential customers as a result of milder weather and significant 2009 storm outages as well as low energy usage by industrial and commercial customers as a result of weakened economic conditions.
- Decreased fuel costs billed to customers through a fuel adjustment clause (\$2 million) due to a refund of power purchased costs from Owensboro Municipal Utilities ("OMU") (\$6 million), partially offset by increased fuel prices (\$4 million).
- Decreased gains in unrealized energy marketing financial swaps (\$2 million).

Partially offset by:

- Increased environmental cost recovery surcharge (\$50 million) due to increased recoverable capital spending.
- Decreased merger surcredit (\$13 million) due to the surcredit termination in February 2009.
- Increased DSM cost recovery (\$9 million) due to increased recoverable program spending.

- Increased miscellaneous revenue (\$6 million) resulting from the assessment of late payment fees beginning in the second quarter of 2009.
- Increased retail sales revenue from base rates (\$5 million) due to the increase in Virginia rates in November 2009, and application of the Kentucky base rate settlement resulting in higher customer charge and demand revenue, partially offset by lower energy revenue.
- Decreased value delivery team (“VDT”) process surcredit (\$1 million) due to termination in August 2008.

Revenues in 2008 increased \$133 million compared to 2007 primarily due to:

- Increased fuel costs billed to customers through the fuel adjustment clause (\$52 million) due to increased fuel prices
- Increased wholesale sales (\$48 million) due to higher sales volumes and prices. Volumes increased to LG&E (\$34 million) and third-parties (\$10 million) as a result of excess generation made available by LG&E via a mutual agreement. We sell our higher cost electricity to LG&E for LG&E to make wholesale sales and we purchase LG&E’s lower cost electricity to serve our native load. Both the Company and LG&E experienced lower native load requirements due to milder weather and the weakening economy, and increased generation due to fewer scheduled coal-fired generation unit outages during 2008, resulting in higher volumes available for wholesale sales. Pricing to third-parties increased as a result of higher fuel costs (\$2 million). Wholesale sales also increased due to gains in energy marketing financial swaps (\$2 million).
- Increased environmental cost recovery surcharge (\$43 million) due to increased recoverable capital spending
- Increased DSM cost recovery (\$2 million) due to additional conservation programs
- Increased transmission sales (\$2 million) due to higher sales to LG&E
- Decreased merger surcredit (\$2 million) due to a lower rate approved by the Kentucky Commission in June 2008
- Decreased VDT surcredit (\$1 million) due to its termination in August 2008.

Partially offset by:

- Decreased retail sales volumes delivered (\$17 million) due to a 26% decrease in cooling degree days and weakening economic conditions

### ***Expenses***

Fuel for electric generation comprises a large component of total operating expenses. Increases or decreases in the cost of fuel are reflected in retail rates through the fuel adjustment clause, subject to the approval of the Kentucky Commission, the Virginia Commission and the FERC.

#### *Electric Generation Expense*

Expenses related to fuel for electric generation decreased \$79 million in 2009 compared to 2008 primarily due to:

- Decreased volumes of fuel usage (\$97 million) due to decreased native load and wholesale sales

Partially offset by:

- Increased commodity and transportation costs for coal (\$18 million)

Expenses related to fuel for electric generation increased \$52 million in 2008 compared to 2007 primarily due to:

- Increased commodity and transportation costs for coal and natural gas (\$39 million)
- Increased generation (\$13 million) due to increased utilization of coal-fired generation units as a result of fewer scheduled outages in 2008

Power Purchased Expense

Power purchased expense decreased \$22 million in 2009 compared to 2008 primarily due to:

- Decreased prices for purchases used to serve retail customers (\$18 million) due to lower spot market pricing and increased availability of power from OMU
- Decreased purchases from LG&E due to lower prices (\$7 million) and lower volumes (\$2 million). Via a mutual agreement, we purchase LG&E's lower cost electricity to serve our native load. LG&E provided lower volumes due to its increased scheduled coal-fired outages during the fourth quarter of 2009.
- Decreased power purchased expense (\$6 million) due to a refund of power purchased costs related to the OMU settlement.

Partially offset by:

- Increased third-party purchased volumes for native load (\$8 million) primarily due to scheduled coal-fired generation unit outages.
- Increased demand payments for third-party purchases (\$3 million) on long-term contracts.

Power purchased expense increased \$53 million in 2008 compared to 2007 primarily due to:

- Increased prices for purchases used to serve retail customers (\$24 million) due to higher market prices, influenced by higher fuel costs
- Increased power purchased from LG&E via a mutual agreement due to higher volumes (\$8 million) and higher prices (\$8 million). We purchase LG&E's lower cost electricity to serve our native load. LG&E was able to provide higher volumes due to its reduced native load requirements as a result of milder weather and the weakening economy.
- Increased demand payments (\$7 million) for energy purchased on a long-term contract
- Increased third-party power purchase volume for native load (\$5 million) due to increased unscheduled coal-fired generation unit outages
- Increased expenses (\$1 million) due to activities in the PJM Interconnection LLC market for the entire year of 2008 compared to only one quarter in 2007

Other Operation and Maintenance Expenses

Other operation and maintenance expenses increased \$45 million in 2009 compared to 2008 primarily due to increased other operation expenses (\$30 million) and increased other maintenance expenses (\$15 million).

Other operation expenses increased \$30 million in 2009 compared to 2008 primarily due to:

- Increased pension expense (\$20 million) due to lower 2008 pension asset investment performance.
- Increased steam expense (\$7 million) due to utilization of selective catalytic reductions year-round.

- Increased administrative and general expense (\$5 million) due to increased DSM program spending as well as consulting fees for software training and increased labor and benefit costs, partially offset by decreased legal expenses mainly related to OMU in 2008, which case was settled in the second quarter of 2009.

Partially offset by:

- Decreased generation expense (\$2 million) due to scheduled unit outages and routine maintenance

Other maintenance expenses increased \$15 million in 2009 compared to 2008 primarily due to:

- Increased steam expense (\$7 million) due to increased scope of work for scheduled outages.
- Increased distribution expense (\$5 million) as a result of increased repairs and higher tree trimming expense in 2009 (\$3 million) and higher storm related expense in 2009 (\$2 million).
- Increased transmission expense (\$2 million) primarily due to increased overhead line maintenance for North American Electric Reliability Corporation (“NERC”) mandatory reliability compliance.
- Increased administrative and general expense (\$1 million) due to increased labor and system maintenance contracts resulting from completion of a significant in-house customer information system project.

Other operation and maintenance expenses increased \$20 million in 2008 compared to 2007 primarily due to increased other operation expenses (\$16 million) and increased maintenance expenses (\$4 million).

Other operation expenses increased \$16 million in 2008 compared to 2007 primarily due to:

- Increased outside services (\$4 million) due to increased legal expenses as a result of on-going litigation, mainly with OMU
- Increased cost of consumables (\$4 million) due to contract pricing and commissioning and start up costs of flue gas desulfurization systems (“FGDs”)
- Increased transmission expense (\$2 million) due to increased native load purchases from LG&E and the additional costs to comply with growing SERC Reliability Corporation and NERC Mandatory Reliability Standards
- Increased distribution expense (\$2 million) due to storm restoration
- Increased uncollectible accounts (\$2 million) due to the weakening economy
- Increased property taxes (\$2 million) due to net decrease in expense in 2007 as a result of the application of coal tax credits

Other maintenance expenses increased \$4 million in 2008 compared to 2007 primarily due to increased maintenance of overhead conductors and devices (\$4 million) resulting from storm restoration.

#### Income from Equity Investments

Equity income from Electric Energy, Inc. (“EEI”), in which we own 20% of the common stock, decreased \$29 million in 2009 compared to 2008 primarily due to lower earnings resulting from decreased market prices.

Equity income in EEI increased \$4 million in 2008 primarily due to an increased average price per mega-watt hour sold in 2008 over the price for 2007.

Other Income — Net

Other income — net decreased \$3 million in 2009 compared to 2008 primarily due to:

- Decreased \$2 million due to discontinuance of allowance for funds used during construction on environmental cost recovery projects as a result of the FERC rate case.
- Decreased \$1 million due mainly to depreciation expense on joint-use assets related to Trimble County Unit 2 (“TC2”) transferred from LG&E and currently held for future use.

Other income — net increased \$1 million in 2008 compared to 2007, primarily due to:

- Increased \$3 million due to allowance for funds used during construction related to several large multi-year projects
- Increased \$1 million due to net losses on the sale of property in 2007

Partially offset by:

- Decreased \$2 million due to lower income earned on bond deposits for special projects
- Decreased \$1 million due to settlement for Brown Station new source review litigation and related programs

Interest Expense

Interest expense increased \$3 million in 2009 compared to 2008 primarily due to increased interest expense to affiliated companies (\$13 million) resulting from additional debt, partially offset by decreased interest expense (\$8 million) due to lower interest rates on bonds and (\$2 million) due to lower interest rates on intercompany short term borrowings.

Interest expense increased \$16 million in 2008 compared to 2007 primarily due to increased interest expense to affiliated companies (\$17 million) due to additional debt, partially offset by decreased interest expense (\$1 million) due to interest received on reacquired debt.

Depreciation

Depreciation expense decreased \$3 million in 2009 compared to 2008, primarily due to the decrease in depreciation rates that became effective in February 2009, mainly related to an increase in the estimated useful lives on transmission and distribution assets.

Depreciation expense increased \$15 million in 2008 compared to 2007, primarily due to an increase in capital assets that were placed in service in 2008.

Income Tax Expense

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

	<u>2009</u>	<u>2008</u>	<u>2007</u>
		(In millions)	
Current — federal .....	\$ (5)	\$ 46	\$ 28
— state .....	1	10	13
Deferred — federal — net .....	43	(10)	(5)
— state — net .....	7	(3)	(1)
Investment tax credit — deferred .....	21	25	43
Amortization of investment tax credit .....	—	—	(1)
Total income tax expense .....	<u>\$ 67</u>	<u>\$ 68</u>	<u>\$ 77</u>



Deferred federal and state income tax expense increased in 2009 compared to 2008, primarily due to temporary differences related to storm costs and depreciation. The temporary differences also resulted in an offsetting decrease to current federal and state taxes in 2009. Current federal income tax expense increased and investment tax credit — deferred decreased primarily due to claiming \$18 million less in investment tax credits in 2008. Current state income tax decreased due to coal credits claimed in 2008. Deferred federal income tax expense decreased in 2008 compared to 2007, primarily due to adjusting prior year estimates to actual based on the filed tax return.

### **Cash Flows from Operating Activities**

Cash provided by operations in 2009 was \$39 million less than cash provided by operations in 2008 and was primarily the result of decreases in cash due to changes in:

- Storm restoration expenses (\$55 million) deferred for future recovery as regulatory assets
- Accounts receivable (\$16 million) due to timing of payments received from the Illinois Municipal Electric Agency (“IMEA”) and the Indiana Municipal Power Agency (“IMPA”) in 2008
- Pension and postretirement funding (\$15 million) due to increased contributions made in 2009
- Accounts payable (\$12 million) primarily due to fuel purchases and timing of payments
- Prepayment and other current assets (\$2 million)

These decreases were partially offset by increases in cash due to changes in:

- Earnings, net of non-cash items (\$49 million)<sup>(1)</sup>
- Materials and supplies (\$5 million) primarily due to a decrease in cash used for coal inventory
- Other (\$7 million)

(1) Management uses the term “earnings, net of non-cash items” in its discussion of cash flows from operating activities to describe net income adjusted by income or expenses not requiring cash currently, including depreciation, accretion, amortization, deferred income taxes, investment tax credits, provision for pension and postretirement benefits and other non-cash items. Although “earnings, net of non-cash items” may not be a measure determined in accordance with accounting principles generally accepted in the United States, the measure facilitates the analysis by management and investors of the Companies’ cash flows from operating activities.

Cash provided by operations in 2008 was \$19 million less than cash provided by operations in 2007 and was primarily the result of decreases in cash due to changes in:

- Materials and supplies (\$55 million) primarily due to increased fuel inventory volumes and higher fuel costs
- Earnings, net of non-cash items (\$15 million)<sup>(1)</sup>
- Other (\$12 million) primarily due to changes in utility plant and customer advances for construction
- Prepayment and other current assets (\$2 million)
- Wind storm regulatory asset (\$2 million) due to new regulatory asset for Hurricane Ike restoration expenses

These decreases were partially offset by increases in cash due to changes in:

- Accounts receivable (\$28 million) due to timing of payments received from IMEA and IMPA

- Accounts payable (\$24 million) primarily due to construction accruals related to FGD projects and TC2
- Pension and postretirement funding (\$14 million) due to contributions made in 2007
- Other current liabilities (\$1 million)

#### **Cash Flows from Investing Activities**

The primary use of funds for investing activities continues to be for capital expenditures. Net cash used for investing activities decreased \$188 million in 2009 compared to 2008 primarily due to decreased capital expenditures of \$170 million, assets purchased from LG&E of \$10 million in 2008 and changes in restricted cash from bonds issued in 2008 used to fund environmental equipment of \$8 million. Restricted cash represents the escrowed proceeds of the pollution control bonds, which are disbursed as qualifying costs are incurred.

Net cash used for investing activities decreased \$42 million in 2008 compared to 2007 primarily due to decreased capital expenditures of \$63 million, partially offset by decreased restricted cash of \$11 million and an asset purchased from LG&E of \$10 million. Restricted cash represents the escrowed proceeds of the pollution control bonds, which are disbursed as qualifying costs are incurred.

#### **Cash Flows from Financing Activities**

Net cash provided by financing activities decreased \$151 million due to decreased long-term borrowings from affiliated company of \$100 million, lower equity contributions in 2009 of \$70 million and reduced issuance of tax-exempt bonds in 2009 totaling \$17 million, all of which were partially offset by an increase of short-term borrowing from affiliate of \$36 million.

Net cash provided by financing activities decreased \$15 million in 2008 compared to 2007, primarily due to decreased long-term borrowings from affiliated company of \$198 million, reacquisition of bonds of \$80 million, retirement of pollution control bonds of \$60 million and issuance of pollution control bonds of \$1 million, partially offset by the retirement of first mortgage bonds of \$107 million in 2007, increased infusions from our Parent of \$70 million, decreased repayment of short-term borrowings from affiliate — net of \$67 million, reissuance of reacquired bonds of \$63 million and retirement of reacquired bonds of \$17 million.

See Note 7 to our 2009 Annual Financial Statements and Note 8 to our Third Quarter Financial Statements, each included elsewhere in this Appendix A, for information of redemptions, maturities and issuances of long-term debt.

### **Three Months Ended September 30, 2010, Compared to Three Months Ended September 30, 2009**

#### **Results of Operations**

##### *Net Income*

Net income was \$54 million for the three months ended September 30, 2010, compared to \$66 million for the same period in 2009. The decrease was primarily the result of the following (In millions of \$):

	Three Months Ended September 30,		Increase (Decrease)
	2010	2009	
Total operating revenues .....	\$ 416	\$ 341	\$ 75
Total operating expenses .....	311	216	95
Operating income .....	105	125	(20)
Interest expense to affiliated companies .....	18	18	—
Other income (expense) — net .....	(1)	(2)	1
Income before income taxes .....	86	105	(19)
Income tax expense .....	32	39	(7)
Net income .....	<u>\$ 54</u>	<u>\$ 66</u>	<u>\$ (12)</u>

### *Revenues*

The \$75 million increase in operating revenues in the three months ended September 30, 2010, was primarily due to (In millions of \$):

	Increase (Decrease)
Retail sales volumes(a) .....	\$ 40
Retail base rates(b) .....	14
ECR surcharge due to increased recoverable capital spending.....	10
Retail fuel adjustment clause (“FAC”) costs billed to customers due to higher fuel prices .....	6
Other .....	<u>5</u>
	<u>\$ 75</u>

- (a) Primarily due to increased consumption by residential customers as a result of increased cooling degree days and higher energy usage by industrial customers as a result of improved economic conditions and increased cooling degree days.
- (b) Primarily due to higher rates effective August 1, 2010. See Note 2 to our Third Quarter Financial Statements, included elsewhere in this Appendix A, for further discussion of the 2010 Kentucky rate case.

### *Expenses*

Fuel for electric generation comprises a large component of total operating expenses. Increases or decreases in the cost of fuel are reflected in retail rates through the FAC, subject to the approval of the Kentucky Commission, the Virginia Commission and the FERC. Operating expenses follow (in millions of \$):

	Three Months Ended September 30,		Increase (Decrease)
	2010	2009	
Fuel for electric generation .....	\$ 146	\$ 114	\$ 32
Power purchased.....	41	47	(6)
Other operation and maintenance expenses.....	86	22	64
Depreciation, accretion and amortization .....	38	33	5
Total operating expenses .....	<u>\$ 311</u>	<u>\$ 216</u>	<u>\$ 95</u>

### Electric Generation Expense

The \$32 million increase in fuel for electric generation in the three months ended September 30, 2010, was primarily due to increased volumes of fuel usage due to increased retail sales volumes.

Power Purchased Expense

The \$6 million decrease in power purchased expense in the three months ended September 30, 2010, was primarily due to (in millions of \$):

	<u>Increase (Decrease)</u>
Third-party purchased volumes for native load .....	\$ (8)
Demand payments for third-party purchase.....	(4)
Prices for purchases used to serve retail customers .....	<u>6</u>
	<u>\$ (6)</u>

Other Operation and Maintenance Expenses

Other operation and maintenance expenses increased \$64 million in the three months ended September 30, 2010, due to \$55 million of increased maintenance expenses, and \$9 million of increased other operation expenses. These increases were primarily due to distribution expenses (\$53 million related to maintenance and \$4 million related to other operations) incurred in the first quarter of 2009 for wind and ice storm restoration that were reclassified to a regulatory asset in the third quarter of 2009.

Income Tax Expense

See Note 7 to our Third Quarter Financial Statements, included elsewhere in this Appendix A, for a reconciliation of differences between the U.S. federal income tax expense at statutory rates and our income tax expense.

**Nine Months Ended September 30, 2010, Compared to  
Nine Months Ended September 30, 2009**

**Results of Operations**

*Net Income*

Net income was \$129 million for the nine months ended September 30, 2010, compared to \$99 million for the same period in 2009. The increase was primarily the result of the following (in millions of \$):

	<u>Nine Months Ended</u> <u>September 30,</u>		<u>Increase</u> <u>(Decrease)</u>
	<u>2010</u>	<u>2009</u>	
Total operating revenues .....	\$ 1,146	\$ 1,009	\$ 137
Total operating expenses .....	883	812	71
Operating income .....	263	197	66
Interest expense to affiliated companies .....	55	51	4
Other income (expense) — net .....	(3)	2	(5)
Income before income taxes .....	205	148	57
Income tax expense .....	76	49	27
Net income.....	<u>\$ 129</u>	<u>\$ 99</u>	<u>\$ 30</u>

*Revenues*

The \$137 million increase in operating revenues in the nine months ended September 30, 2010, was primarily due to (in millions of \$):

	<u>Increase</u> <u>(Decrease)</u>
Retail sales volumes(a).....	\$ 98
Retail base rates(b) .....	14
ECR surcharge due to increased recoverable capital spending.....	10
Miscellaneous operating revenue(c) .....	8
DSM revenue due to increased recoverable program spending.....	6
Other .....	<u>1</u>
	<u>\$ 137</u>

- 
- (a) Primarily due to increased consumption by residential customers as a result of increased cooling and heating degree days and higher energy usage by industrial customers as a result of improved economic conditions and increased cooling and heating degree days.
  - (b) Primarily due to higher rates effective August 1, 2010. See Note 2 to our Third Quarter Financial Statements, included elsewhere in this Appendix A, for further discussion of the 2010 Kentucky rate case.
  - (c) Primarily related to increased late payment charges and transmission service revenues.

### *Expenses*

Fuel for electric generation comprises a large component of total operating expenses. Increases or decreases in the cost of fuel are reflected in retail rates through the FAC, subject to the approval of the Kentucky Commission, the Virginia Commission and the FERC. Operating expenses follow (In millions of \$):

	<u>Nine Months Ended</u> <u>September 30,</u>		<u>Increase</u> <u>(Decrease)</u>
	<u>2010</u>	<u>2009</u>	
Fuel for electric generation .....	\$ 391	\$ 329	\$ 62
Power purchased.....	135	154	(19)
Other operation and maintenance expenses.....	251	230	21
Depreciation, accretion and amortization .....	<u>106</u>	<u>99</u>	<u>7</u>
Total operating expenses .....	<u>\$ 883</u>	<u>\$ 812</u>	<u>\$ 71</u>

#### *Electric Generation Expense*

The \$62 million increase in fuel for electric generation in the nine months ended September 30, 2010, was primarily due to (In millions of \$):

	<u>Increase</u> <u>(Decrease)</u>
Fuel usage volumes due to increased native load and wholesale sales .....	\$ 73
Commodity and transportation costs for coal .....	<u>(11)</u>
	<u>\$ 62</u>

#### *Power Purchased Expense*

The \$19 million decrease in power purchased expense in the nine months ended September 30, 2010, was primarily due to (In millions of \$):

	<u>Increase</u> <u>(Decrease)</u>
Third-party purchased volumes for native load .....	\$ (16)
Purchases from LG&E due to volume(a) .....	(13)
Demand payments for third-party purchases .....	(5)
Prices for purchases used to serve retail customers .....	7
OMU settlement received in 2009(b) .....	6
Purchases from LG&E due to fuel costs.....	<u>2</u>
	<u>\$ (19)</u>

- 
- (a) Primarily due to increased consumption by residential customers at LG&E as a result of increased cooling and heating degree days and increased coal-fired generation outages in the first six months of 2010 and higher energy usage by industrial customers as a result of improved economic conditions and increased cooling and heating degree days. See Note 10 to our Third Quarter Financial Statements, included elsewhere in this Appendix A, for further discussion of the mutual agreement for wholesale sales and purchases between the Companies.
- (b) See Note 9 to our Third Quarter Financial Statements, included elsewhere in this Appendix A, for further discussion of the OMU settlement.

#### *Other Operation and Maintenance Expenses*

Other operation and maintenance expenses increased \$21 million in the nine months ended September 30, 2010, due to \$19 million of increased other operation expenses and \$2 million of increased maintenance expenses.

Other Operation Expenses

The \$19 million increase in other operation expenses in the nine months ended September 30, 2010 was primarily due to (in millions of \$):

	<u>Increase (Decrease)</u>
Transmission expense(a) .....	\$ 7
Administrative and general(b) .....	6
Steam expense due to increased generation in 2010 .....	5
Other .....	<u>1</u>
	<u>\$ 19</u>

- (a) Primarily due to transmission expense for a third party pursuant to a settlement agreement, the establishment of a regulatory asset approved by the Kentucky Commission for the EKPC settlement in 2009, net of nine months of amortization expense recorded in 2010, and increased transmission expense due to transmission charges for FERC jurisdictional municipal customers now unbundled from energy.
- (b) Primarily due to increased bad debt expense due to higher billed revenues, implementation of a late payment charge and a higher net charge-off percentage, increased labor costs, and increased insurance cost.

Interest Expense to Affiliated Companies

The \$4 million increase in interest expense to affiliated companies in the nine months ended September 30, 2010, was primarily due to increased intercompany notes outstanding.

Income Tax Expense

See Note 7 to our Third Quarter Financial Statements, included elsewhere in this Appendix A, for a reconciliation of differences between the U.S. federal income tax expense at statutory rates and our income tax expense.

**Liquidity and Capital Resources**

	<u>September 30, 2010</u>	<u>December 31, 2009</u>
	(in millions)	
Cash and cash equivalents .....	\$ 2	\$ 2
Current portion of long-term debt.....	228	228
Current portion of long-term debt to affiliated company.....	33	33
Notes payable to affiliated company .....	61	45

Activity in our cash and cash equivalents in the nine months ended September 30, 2010, included the following:

	<u>Increase (Decrease)</u>
	(In millions)
Cash provided by operating activities.....	\$ 300
Construction expenditures .....	(218)
A net increase in short-term borrowings from affiliated company .....	16
Expenditures to purchase assets from affiliate.....	(48)
Payment of dividends .....	<u>(50)</u>
	<u>\$ —</u>

We use net cash generated from our operations, external financing, financing from affiliates and/or infusions of capital from our Parent mainly to fund construction of plant and equipment. As of September 30, 2010, we had a working capital deficiency of \$205 million, primarily due to the terms of certain tax-exempt bonds totaling

\$228 million which allow the investors to put the bonds back to the Company causing them to be classified as current portion of long-term debt. We believe we have adequate liquidity facilities to repurchase any bonds put back to the Company. Working capital deficiencies can be funded through an intercompany money pool agreement or through a syndicated credit facility as described below. We believe that our sources of funds will be sufficient to meet the needs of our business in the foreseeable future.

On November 1, 2010, we entered into a new \$400 million unsecured Revolving Credit Agreement, expiring December 31, 2014. Under this credit facility, we have the ability to make cash borrowings and to request the lenders to issue letters of credit. Borrowings will generally bear interest at LIBOR-based rates plus a spread, depending upon our senior unsecured long-term debt rating. The new credit facility contains a financial covenant requiring our debt to total capitalization to not exceed 70% and other customary covenants. Under certain conditions, we may request that the facility's capacity be increased by up to \$100 million. This new credit facility replaced an existing bilateral line of credit totaling \$35 million that was terminated on the effective date of the new facility.

In addition, we maintain letter of credit facilities under which four letters of credit have been issued totaling \$198 million, which support existing pollution control bonds totaling approximately \$195 million. We plan to substitute letters of credit issued under our new Revolving Credit Agreement for these letters of credit currently supporting pollution control bonds. After the substitution, we plan to terminate these letter of credit facilities.

We also participate in an intercompany money pool agreement wherein our Parent and/or LG&E make funds available to us at market-based rates (based on highly rated commercial paper issues) up to \$400 million.

We, through our Parent, sponsor pension and postretirement benefit plans for our employees. The performance of the capital markets affects the values of the assets that are held in trust to satisfy future obligations under the defined benefit pension plans. The market value of the combined investments, including the impact of benefit payments, within the plans increased by approximately 15% for the year ended December 31, 2009. The benefit plan assets and obligations of our Parent and the Company are remeasured annually using a December 31 measurement date. Investment gains in 2009 resulted in a decrease to the plans' unfunded status upon actuarial revaluation of the plans, while investment losses in 2008 had the opposite effect. Our 2009 pension cost was approximately \$20 million higher than 2008. We anticipate our 2010 pension cost will be approximately \$5 million less than the 2009 expense. The amount of future funding will depend upon the actual return on plan assets, the discount rate and other factors, but we fund our pension obligations in a manner consistent with the Pension Protection Act of 2006. In January 2010, we made a voluntary contribution to our pension plan of \$13 million.

### **Future Capital Requirements**

Our construction program is designed to ensure that there will be adequate capacity and reliability to meet the electric needs of our service area and to comply with environmental regulations. These needs are continually being reassessed and appropriate revisions are made, when necessary, in construction schedules. At September 30, 2010, we estimated our capital expenditures for the three-year period ending December 31, 2012 to total approximately \$1,125 million, consisting primarily of on-going construction related to generation assets totaling approximately \$305 million, ash pond and landfill projects totaling approximately \$210 million, on-going construction related to distribution assets totaling approximately \$245 million, selective catalytic reduction projects totaling approximately \$155 million, installation of FGDs on Ghent and Brown units totaling approximately \$125 million, information technology projects totaling approximately \$35 million, other projects totaling approximately \$25 million and construction of TC2 totaling approximately \$25 million (including \$5 million for environmental controls).

In addition to the amounts above, evolving environmental regulations will likely increase the level of capital expenditures above the amounts currently expected over the next several years. With respect to NAAQS, CATR, CAMR (each as defined and described under "Business — Environmental Matters") replacement and coal combustion byproducts developments, based on a preliminary analysis of proposed regulations, we may be required to consider actions such as upgrading existing emissions controls, installing additional emissions controls, upgrading byproducts disposal and storage and possible early replacement of coal-fired units. Our capital expenditures associated with such actions are preliminarily estimated to be in the \$1.7 billion range over the next 10 years, although final costs may substantially vary. With respect to potential developments in water discharge, revised PCB



standards, or GHG initiatives, costs in such areas cannot be estimated due to the preliminary status or uncertain outcome of such developments, but would be in addition to the above amounts and could be substantial. See Note 9 to our Third Quarter Financial Statements, included elsewhere in this Appendix A, for further discussion of environmental matters.

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. Credit market conditions can affect aspects of the availability, terms or methods in which we fund our capital requirements. We anticipate funding future capital requirements through operating cash flow, issuance of debt (including issuance of first mortgage bonds) and/or infusions of capital from our Parent.

We have a variety of funding alternatives available to meet our capital requirements. We maintain a \$400 million unsecured revolving credit facility with a maturity date of December 31, 2014, and we participate in an intercompany money pool arrangement wherein our Parent and/or LG&E make funds of up to \$400 million available to the Company at market-based rates.

Regulatory approvals are required for the Company to incur additional debt. The Virginia Commission and the FERC authorize the issuance of short-term debt while the Kentucky Commission, the Virginia Commission and the Tennessee Regulatory Authority authorize the issuance of long-term debt. In November 2009, we received a two-year authorization from the FERC to borrow up to \$400 million in short-term funds. We also have authorization from the Virginia Commission that expires at the end of 2011 allowing short-term borrowing of up to \$400 million. We currently believe this authorization provides the necessary flexibility to address any liquidity needs. As of September 30, 2010, we have borrowed \$61 million of this authorized amount.

In September 2010 the Kentucky Commission, and in October 2010 the Virginia Commission and the Tennessee Regulatory Authority, issued orders in the Company's respective financing cases associated with the PPL acquisition. The orders each authorized the Company to:

- issue notes to a PPL affiliate to repay previously outstanding debt with an affiliate of E.ON AG;
- issue first mortgage bonds up to \$1.556 billion to
  - refund notes due to affiliates and
  - fund our cash needs;
- issue first mortgage bonds to secure and collateralize existing pollution control debt obligations;
- enter into and perform obligations under hedging agreements in connection with the issuance of the above first mortgage bonds; and
- enter into a multi-year revolving credit facility in an amount not to exceed \$400 million.

See Notes 7, 8 and 9 to our 2009 Annual Financial Statements and Notes 8 and 9 to our Third Quarter Financial Statements, each included elsewhere in this Appendix A, for additional information.

## Contractual Obligations

The following table is provided to summarize contractual cash obligations, as estimated by the Company at December 31, 2009. We anticipate cash from operations and external financing will be sufficient to fund future obligations.

Contractual Cash Obligations	Payments Due by Period						Total
	2010	2011	2012	2013	2014	Thereafter	
	(In millions)						
Short-term debt(a).....	\$ 45	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 45
Long-term debt(b)(j).....	33	—	50	175	100	1,324(b)	1,682
Interest on long-term debt to affiliated company(c)(k) .....	73	72	71	67	61	424	768
Interest on fixed rate bonds(d).....	2	2	2	2	2	21	31
Operating leases(e) .....	7	6	5	4	4	3	29
Unconditional power purchase obligations(f).....	16	10	10	11	12	177	236
Coal and gas purchase obligations(g).....	391	307	145	88	92	—	1,023
Postretirement benefit plan obligations(h).....	5	6	6	6	6	34	63
Other obligations(i).....	57	5	—	—	—	—	62
Total contractual cash obligations .....	<u>\$ 629</u>	<u>\$ 408</u>	<u>\$ 289</u>	<u>\$ 353</u>	<u>\$ 277</u>	<u>\$ 1,983</u>	<u>\$ 3,939</u>

- (a) Represents borrowings from affiliated company due within one year.
- (b) Includes \$228 million of pollution control bonds classified as current liabilities, which bonds are subject to tender for purchase at the option of the holder and to mandatory tender for purchase upon the occurrence of certain events. Maturity dates for these bonds range from 2023 to 2034.
- (c) Represents future interest payments on long-term debt to affiliated company.
- (d) Represents interest on fixed rate long-term bonds. Future interest obligations on variable rate long-term bonds cannot be quantified.
- (e) Represents future operating lease payments.
- (f) Represents future minimum payments under OMU and Ohio Valley Electric Corporation power purchase agreements through May 2010 and 2026, respectively.
- (g) Represents contracts to purchase coal and natural gas transportation. Obligations for 2015 and 2016 are indexed to future market prices and are not included above, since prices will be set in the future using the contracted methodology.
- (h) Represents currently projected cash flows for the postretirement benefit plan as calculated by the actuary.
- (i) Represents construction commitments, including commitments for TC2 and the FGDs.
- (j) Includes long-term debt to affiliate of \$1,298 million in long-term debt and \$33 million in short-term debt, which was replaced with other affiliate borrowings at the time of the PPL acquisition of our Parent, which borrowings will be repaid with proceeds of the Bonds.
- (k) Debt to affiliate will be repaid with the proceeds of the Bonds, thereby modifying future interest obligations.

## Off-Balance Sheet Arrangements

We have very limited off-balance sheet activity. See Note 9 to our 2009 Annual Financial Statements, included elsewhere in this Appendix A, for more information.

## **Climate Change**

As a company with significant coal-fired generating assets, we could be substantially impacted by pending or future environmental rules or legislation requiring mandatory reductions in GHG emissions or other air emissions, imposing more stringent standards on discharges to waterways, establishing additional requirements for the handling or disposal of coal combustion byproducts, or addressing other environmental matters. However, the precise impact on our operations, including the reduction targets and deadlines that would be applicable, cannot be determined prior to the finalization of such requirements.

The cost to the Company and the effect on our business of complying with potential GHG restrictions will depend upon the details of the programs ultimately enacted. Some of the design elements which may have the greatest effect on the Company include (a) the required levels and timing of any carbon caps or limits, (b) the emission sources covered by such caps or limits, (c) transition and mitigation provisions, such as phase-in periods, free allowances or price caps, (d) the availability and pricing of relevant GHG-reduction technologies, goods or services and (e) economic, market and customer reaction to electricity price and demand changes due to GHG limits. While the costs to comply with future GHG developments are not currently determinable, such costs could be significant.

Ultimately, environmental matters or potential environmental matters represent an important element of current or future potential capital requirements, future unit retirement or replacement decisions, supply and demand for electricity, operating and maintenance expenses or compliance risks for the Company. While we currently anticipate that many of such direct costs or effects may be recoverable through rates or other regulatory mechanisms, particularly with respect to coal-related generation, the availability, timing or completeness of such rate recovery cannot be assured. Ultimately, climate change matters could result in material effects on our results of operations, liquidity and financial condition.

Growing global, national and local attention to climate change matters has led to the development of various international, federal, regional and state laws and regulations directly or indirectly relating to emissions of GHGs, including carbon dioxide, which is emitted from the combustion of fossil fuels such as coal and natural gas, as occurs at our generating stations. In particular, beginning in January 2011, GHG emissions from stationary sources, including our generating assets, will be subject to regulation by the EPA under the Prevention of Significant Deterioration and Title V provisions of the federal Clean Air Act through the GHG “tailoring” rule. Other developing laws and regulations include a variety of mechanisms and structures to regulate GHGs, including direct limits or caps, emission allowances or taxes, renewable generation requirements or standards and energy efficiency or conservation measures, and may require investments in transmission, alternative fuel or carbon sequestration or other emission reduction technologies. See “Business — Environmental Matters,” Note 9 to our 2009 Annual Financial Statements and Note 9 to our Third Quarter Financial Statements, each included elsewhere in this Appendix A, for additional information.

## **Quantitative and Qualitative Disclosures about Market Risk**

We conduct energy trading and risk management activities to maximize the value of power sales from physical assets we own. Energy trading activities are principally forward financial transactions to manage price risk and are accounted for as non-hedging derivatives on a mark-to-market basis in accordance with the derivatives and hedging topic of the Financial Accounting Standards Board’s (“FASB”) Accounting Standards Codification (“ASC”).

The Company manages its cost of borrowing by utilizing both fixed and floating rate debt. The exposure to floating rate debt can be mitigated through the use of interest rate swaps. We currently do not have any interest rate swaps in place.

For more information, see Note 3 to our 2009 Annual Financial Statements and Note 4 to our Third Quarter Financial Statements, each included elsewhere in this Appendix A.

## **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 our audited and unaudited financial statements included elsewhere in this Appendix A. 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.

Recent accounting pronouncements and 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 to our 2009 Annual Financial Statements and Notes 1, 2, 6, 7 and 9 to our Third Quarter Financial Statements, each included elsewhere in this Appendix A.

### **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.

As of December 31, 2009, we are not subject to the internal control and other requirements of the Sarbanes-Oxley Act of 2002 and associated rules ("Sarbanes-Oxley") and consequently are not required to evaluate the effectiveness of our internal control over financial reporting pursuant to Section 404 of Sarbanes-Oxley. However, management has assessed the effectiveness of our internal control over financial reporting as of December 31, 2009, using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control — Integrated Framework*. Management has concluded that, as of December 31, 2009, our internal control over financial reporting was effective based on those criteria. There have been no changes in our internal control over financial reporting that occurred during the twelve months ended December 31, 2009, or during the nine months ended September 30, 2010, that have materially affected, or are reasonably likely to materially affect our internal control over financial reporting.

The effectiveness of our internal control over financial reporting as of December 31, 2009, has been audited by PricewaterhouseCoopers LLP, an independent accounting firm, as stated in its report which is included within our 2009 Annual Financial Statements included elsewhere in this Appendix A.

## BUSINESS

### Overview

Kentucky Utilities Company, incorporated in Kentucky in 1912 and in Virginia in 1991, is a regulated public utility engaged in the generation, transmission, distribution and sale of electric energy in Kentucky, Virginia and Tennessee. We provide electric service to approximately 515,000 customers in 77 counties in central, southeastern and western Kentucky, to approximately 29,000 customers in 5 counties in southwestern Virginia and to 5 customers in Tennessee. Our service area covers approximately 6,600 square miles. During the first three quarters of 2010, approximately 99% of the electricity generated by us was produced by our coal-fired electric generating stations. The remainder is generated by a hydroelectric power plant and natural gas and oil fueled combustion turbines (“CTs”). In Virginia, we operate under the name Old Dominion Power Company. We also sell wholesale electric energy to 12 municipalities.

Our affiliate, Louisville Gas and Electric Company (“LG&E”), is a regulated public utility engaged in the generation, transmission, distribution and sale of electric energy and the distribution and sale of natural gas in Kentucky. We and LG&E became indirect wholly-owned subsidiaries of PPL Corporation on November 1, 2010.

### Operations

The sources of our operating revenues and volume of sales for the year ended December 31, 2009 were as follows:

	<u>Revenue</u>	<u>% Revenue</u>	<u>Volume</u>	<u>% Volume</u>
	(\$ in millions. Volume in GWH)			
Industrial & Commercial .....	\$ 637	47%	10,171	49%
Residential .....	480	35%	6,594	31%
Municipals .....	91	7%	1,848	9%
Other Retail .....	118	9%	1,647	8%
Wholesale(1).....	29	2%	660	3%
<b>Total</b> .....	<b>\$ 1,355</b>	<b>100%</b>	<b>20,920</b>	<b>100%</b>

(1) Includes transactions between the Company and LG&E

Our business is affected by seasonal temperatures. As a result, operating revenues (and associated operating expenses) are not generated evenly throughout the year. We frequently experience dual peaks in winter and summer; our peak load in 2009 of 4,640 megawatts (“Mw”) occurred on January 16, when the temperature reached a low of —3 degrees Fahrenheit in Lexington.

Our retail electric rates contain a FAC, whereby increases and decreases in the cost of fuel for electric generation are reflected in the rates charged to retail electric customers. The FAC allows us 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.

Kentucky law permits us 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 environmental cost recovery (“ECR”) mechanism. Pursuant to this mechanism, a regulatory asset or liability is established in the amount that has been under- or over-recovered due to timing or adjustments to the mechanism. This mechanism includes construction work in progress and a return on equity, currently set at 10.63%.

We have contracts with the Tennessee Valley Authority (“TVA”) to act as our transmission Reliability Coordinator and Southwest Power Pool, Inc. (“SPP”) to function as our independent transmission operator, pursuant to FERC requirements. With respect to certain of these matters, we have submitted filings with the FERC and the

Kentucky Commission proposing to approve agreed-upon continuations of these arrangements beyond their previous September 2010 expiration dates. The Kentucky Commission approved the continuation of this arrangement on October 27, 2010, and FERC approval is anticipated in 2010.

We and LG&E jointly dispatch our generation units with the lowest cost generation used to serve retail native load. When we have excess generation capacity after serving our own retail native load and our generation cost is lower than that of LG&E, LG&E purchases electricity from us. When LG&E has excess generation capacity after serving its own retail native load and its generation cost is lower than that of ours, we purchase electricity from LG&E. These transactions are recorded as intercompany wholesale sales and purchases and are recorded by each company at a price equal to the seller's fuel cost. Savings realized from purchasing electricity intercompany instead of generating from their own higher costs units or purchasing from the market are shared equally between the two companies. The volume of energy each company has to sell to the other is dependent upon its native load needs and its available generation. See Note 11 to our 2009 Annual Financial Statements and Note 10 to our Third Quarter Financial Statements, each included elsewhere in this Appendix A.

### Properties

Our power generating system includes coal-fired units operated at our four steam generating stations. Natural gas and oil fueled CTs supplement the system during peak or emergency periods. As of December 31, 2009, we owned all or a portion of, and operated the following generating stations\* while targeting a 13%-15% reserve margin:

<u>Plant</u>	<u>Location</u>	<u>2009 Heat Rate (Btu/KWh)</u>	<u>Plant Type</u>	<u>Fuel</u>	<u>Summer Capability Rating (Mw)</u>	<u>2009 Generation GWh</u>
<b>Steam Turbines</b>						
Ghent-Units 1-4.....	Carroll County, KY	10,882	ST	Coal	1,918	11,346
E.W. Brown — Units 1-3 .....	Mercer County, KY	10,630	ST	Coal	697	2,505
Green River — Units 3-4.....	Muhlenberg County, KY	11,352	ST	Coal	163	625
Tyrone-Unit 3 .....	Woodford County, KY	13,156	ST	Coal	<u>71</u>	<u>24</u>
<b>Total Coal-fired Generation .....</b>					<b>2,849</b>	<b>14,500</b>
<b>Combustion Turbines</b>						
Trimble County — Units						
5-10.....	Trimble County, KY	11,603	CT	Gas	632	129
E.W. Brown — Units 5-11* .....	Mercer County, KY	15,424	CT	Gas	757	56
Secondary CTs* .....	Fayette/Jefferson County, KY	57,458	CT	Gas	<u>110</u>	<u>0</u>
<b>Total Gas-fired Generation.....</b>					<b>1,499</b>	<b>185</b>
<b>Hydroelectric Stations</b>						
Dix Dam .....	Mercer County, KY	NA	NA	Hydro	<u>24</u>	<u>69</u>
<b>Total Hydroelectric Generation ...</b>					<b>24</b>	<b>69</b>
<b>In Construction</b>						
Trimble County — Unit 2** .....	Trimble County, KY	NA	ST	Coal	<u>NA</u>	<u>NA</u>
<b>Grand Total.....</b>					<b><u>4,372</u></b>	<b><u>14,754</u></b>

\* Some of these units are jointly owned with LG&E and others (capability ratings reflect our ownership share). See Note 10 to our 2009 Annual Financial Statements, included elsewhere in this Appendix A, for information regarding jointly-owned units.

\*\* At November 1, 2010, TC2, a new 760-Mw capacity base-load, coal fired unit that will be jointly owned by the Company (60.75%) and LG&E (14.25%) and unrelated third parties, remains under construction with completion expected by year-end 2010.

At December 31, 2009, our transmission system included 130 substations (52 of which are shared with the distribution system) with a total capacity of approximately 13,016 Megavolt-ampere (“MVA”) and approximately 4,040 miles of lines. The distribution system included 479 substations (52 of which are shared with the transmission system) with a total capacity of approximately 6,973 MVA, 14,136 miles of overhead lines and 2,209 miles of underground conduit.

Substantially all of our real and tangible personal property located in Kentucky and used or to be used in connection with the generation, transmission and distribution of electricity, subject to certain exclusions and exceptions, is subject to the lien of the Mortgage, as described in “Description of the Bonds — Security; Lien of the Mortgage.”

We own 20% of the common stock of EEI, which owns and operates a 1,162-Mw generating station in southern Illinois. EEI generally sells its production into the wholesale market. Additional information regarding property and investments is provided in Notes 1, 9 and 10 to our 2009 Annual Financial Statements and Note 9 to our Third Quarter Financial Statements, each included elsewhere in this Appendix A.

### *Construction and Future Capital Requirements*

The Company and LG&E are currently constructing a new 760-Mw capacity base-load, coal fired unit, TC2, which will be jointly owned by the Company (60.75%) and LG&E (14.25%), together with the Illinois Municipal Electric Agency and the Indiana Municipal Power Agency. Each owner is responsible for its proportionate share of the capital cost during construction, and fuel, operation and maintenance cost when TC2 begins operation, which is scheduled to occur by year-end 2010. The contract price and its components attributable to us, currently approximating \$697 million (including \$192 million for environmental controls) 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.

Our construction program is designed to ensure that there will be adequate capacity and reliability to meet the electric needs of our service area and to comply with environmental regulations. These needs are continually being reassessed, and appropriate revisions are made, when necessary, in construction schedules. At September 30, 2010, we estimated our capital expenditures for the three-year period ending December 31, 2012, including those for TC2, to total approximately \$1.1 billion, consisting primarily of the following:

	(\$ in millions)
Construction of generation assets .....	\$ 305
Construction of distribution assets.....	245
Ash pond and landfill projects .....	210
Brown SCR.....	155
Installation of FGDs on Ghent and Brown units .....	125
Information technology projects.....	35
Other projects .....	25
Construction of TC2 (includes \$5 million for environmental controls).....	<u>25</u>
	<u>\$ 1,125</u>

In addition to the amounts above, evolving environmental regulations will likely increase the level of capital expenditures over the next several years. See “Business — Environmental Matters.” 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, further changes in environmental regulations and other regulatory requirements. Credit market conditions can affect aspects of the availability, terms or methods in which we fund our capital requirements. We anticipate funding future capital requirements through operating cash flow, debt and/or infusions of capital from our Parent.

For a discussion of liquidity, capital resources and financing activities, see “Management’s Discussion and Analysis.”

## Coal Supply

Coal-fired generating units provided approximately 99% of our net kilowatt-hour (“Kwh”) generation for 2009. The remaining net generation for 2009 was provided by natural gas and oil fueled CT peaking units and a hydroelectric plant. Coal is expected to be the predominant fuel used by us in the foreseeable future, with natural gas and oil being used for peaking capacity and flame stabilization in coal-fired boilers or in emergencies. We have no nuclear generating units and have no plans to build any in the foreseeable future.

Fuel inventory is maintained at levels estimated to be necessary to avoid operational disruptions at the coal-fired generating units. Reliability of coal deliveries can be affected from time to time by a number of factors including fluctuations in demand, coal mine production issues and other supplier or transporter operating difficulties.

We have entered into coal supply agreements with various suppliers for coal deliveries for 2010 and beyond, and normally augment our coal supply agreements with spot market purchases. We have a coal inventory policy which we believe provides adequate protection under most contingencies.

For our existing units, we expect to continue purchasing coal from western and eastern Kentucky, West Virginia, southern Indiana, southern Illinois and Ohio for the foreseeable future. With the installation of FGDs, we expect our use of higher sulfur coal to increase. Following commercial operation of the new TC2 unit, we may purchase small quantities of ultra low sulfur content coal from Wyoming for blending. Coal is delivered to our generating stations by a mix of transportation modes, including barge, truck and rail.

## Rates and Regulation

We are subject to the jurisdiction of the Kentucky Commission, the Virginia Commission, the Tennessee Regulatory Authority and the FERC in virtually all matters related to electric utility regulation, and as such, our accounting is subject to the regulated operations guidance of the FASB ASC. Given our competitive position in the marketplace and the status of regulation in Kentucky and Virginia, there are no plans or intentions to discontinue the application of the regulated operations guidance of the FASB ASC.

Our Kentucky base rates are calculated based on a return on capitalization (common equity, long-term debt and notes payable) including certain regulatory adjustments to exclude non-regulated investments and environmental compliance plans recovered separately through the ECR mechanism. Currently, none of the regulatory assets or regulatory liabilities are excluded from the return on capitalization utilized in the calculation of Kentucky base rates; therefore, a return is earned on all Kentucky regulatory assets. Our Virginia base rates are calculated based on a return on rate base (net utility plant less deferred taxes and miscellaneous deductions). All regulatory assets and liabilities are excluded from the return on rate base utilized in the calculation of Virginia base rates.

*PPL Acquisition.* In September 2010, the Kentucky Commission approved the September 2010 settlement agreement among PPL and all of the intervening parties to PPL’s joint application to the Kentucky Commission for approval of its acquisition of ownership and control of our Parent, the Company and LG&E. In the settlement, the parties agreed that we and LG&E would commit that no base rate increases would take effect before January 1, 2013. The Company’s rate increase that took effect on August 1, 2010 (as described below) will not be impacted by the settlement. Under the terms of the settlement, we retain the right to seek approval for the deferral of “extraordinary and uncontrollable costs.” Interim rate adjustments will continue to be permissible during that period for existing fuel, environmental and DSM recovery mechanisms. The agreement also substitutes an acquisition savings shared deferral mechanism for the requirement that the Company file a synergies plan with the Kentucky Commission. This mechanism, which will be in place until the earlier of five years or the first day of the year in which a base rate increase becomes effective, permits the Company to earn up to a 10.75% return on equity. Any earnings above a 10.75% return on equity will be shared with customers on a 50%/50% basis. The Kentucky Commission order and the settlement agreement contained a number of other commitments with regard to operations, workforce, community involvement and other matters.

In October 2010, both the Virginia Commission and the Tennessee Regulatory Authority approved the transfer of control of the Company from E.ON US Investments Corp. to PPL. Each of these orders contained certain commitments with regard to operations, workforce, community involvement and other matters.



In October 2010, the FERC approved the September 2010 settlement agreement among the Company, LG&E, other applicants and protesting parties. The settlement agreement includes various conditional commitments, such as a continuation of certain existing undertakings with protesters in prior cases, an agreement not to terminate certain of our municipal customer contracts prior to January 2017, an exclusion of any transaction-related costs from wholesale energy and tariff customer rates to the extent that we have agreed to not seek the same transaction-related cost from retail customers and agreements to coordinate with protesters in certain open or on-going matters.

*Kentucky Rate Case.* In January 2010, we filed an application with the Kentucky Commission requesting an increase in electric base rates of approximately 12%, or \$135 million annually, including an 11.5% return on equity. We requested the increase, based on the twelve month test year ended October 31, 2009, to become effective on and after March 1, 2010. The requested rates were suspended until August 1, 2010. A number of intervenors entered the rate case, including the office of the Attorney General of Kentucky (the "AG") Kentucky Attorney General's office, certain representatives of industrial and low-income groups and other third parties, and submitted filings challenging our requested rate increases, in whole or in part. A hearing was held on June 8, 2010. We and all of the intervenors except the AG agreed to a stipulation providing for an increase in electric base rates of \$98 million on an annual basis and filed a request with the Kentucky Commission to approve such stipulation. In July 2010, the Kentucky Commission issued an order in the proceeding approving all the provisions of the stipulation, with rates effective on and after August 1, 2010.

*Virginia Rate Case.* In June 2009, we filed an application with the Virginia Commission requesting an increase in electric base rates for our Virginia jurisdictional customers in an amount of \$12 million annually or approximately 21%. The proposed increase reflected a proposed rate of return on rate base of 8.586% based on a return on equity of 12%. During December 2009, we and the Virginia Commission Staff agreed to a stipulation and recommendation authorizing base rate revenue increases of \$11 million annually and a return on rate base of 7.846% based on a 10.5% return on common equity. A public hearing was held during January 2010. As permitted, pursuant to a Virginia Commission order, we elected to implement the proposed rates effective November 1, 2009, on an interim basis. In March 2010, the Virginia Commission issued an order approving the stipulation, with the increased rates to be put into effect as of April 1, 2010. As part of the stipulation, we refunded approximately \$1 million in interim rate amounts in excess of the ultimate approved rates. During August 2010, a report was filed with the Virginia Commission detailing the costs of the refunds, the accounts charged and confirming that applicable refunds had been applied.

*FERC Wholesale Rate Case.* In September 2008, we filed an application with the FERC for increases in electric base rates applicable to wholesale power sales contracts or interchange agreements involving, collectively, twelve Kentucky municipalities. The application requested a shift from an all-in stated unit charge rate to an unbundled formula rate, including an annual adjustment mechanism. In May 2009, the FERC issued an order approving a settlement among the parties in the case, incorporating increases of approximately 3% from prior rates and a return on equity of 11%. In May 2010, we submitted to the FERC the proposed current annual adjustment to the formula rate. This updated rate became effective on July 1, 2010, subject to certain review procedures by the wholesale requirements customers and the FERC, including potential refunds in the case of disallowed costs or charges.

By mutual agreement, the parties' settlement of the 2008 application left outstanding the issue of whether we must allocate to the municipal customers a portion of renewable resources we may be required to procure on behalf of our retail ratepayers. In August 2009, the FERC accepted the issue for briefing and the parties completed briefing submissions during 2009. An order was issued by the FERC in July 2010, indicating that we are not required to allocate a portion of any renewable resources to the twelve municipalities, thus resolving the remaining issue.

*Refund of Over-Collected Amounts.* On July 15, 2010, our Parent, on behalf of the Company and LG&E, submitted an informational filing indicating it had inadvertently over-collected certain costs related to the independent transmission organization and reliability coordinator in rates charged pursuant to the Attachment O formula rate included in the companies' open access transmission tariff. Total refunds being issued in connection with the inadvertent recovery are approximately \$1.2 million. No action has been taken by FERC with respect to this informational filing.

*Storm Restoration.* In January 2009, a significant ice storm passed through our service territory causing approximately 199,000 customer outages and was followed closely by a severe wind storm in February 2009 that caused approximately 44,000 customer outages. We incurred \$57 million in incremental operation and maintenance expenses and \$33 million in capital expenditures related to the restoration following the two storms. We filed an application with the Kentucky Commission in April 2009, requesting approval to establish a regulatory asset and defer for future recovery approximately \$62 million in incremental operation and maintenance expenses related to the storm restoration. In September 2009, the Kentucky Commission issued an order allowing us to establish a regulatory asset of up to \$62 million based on our actual costs for storm damages and service restoration due to the January and February 2009 storms. In September 2009, we established a regulatory asset of \$57 million for actual costs incurred. We received approval in our current base rate case to recover this asset over a ten year period beginning August 1, 2010.

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, we filed an application with the Kentucky Commission requesting approval to establish a regulatory asset, and defer for future recovery, approximately \$3 million of expenses related to the storm restoration. In December 2008, the Kentucky Commission issued an order allowing us to establish a regulatory asset of up to \$3 million based on our actual costs for storm damages and service restoration due to Hurricane Ike. In December 2008, we established a regulatory asset of \$2 million for actual costs incurred. We received approval in our current electric base rate cases to recover this asset over a ten year period beginning August 1, 2010.

*2008 Rate Case.* In July 2008, we filed an application with the Kentucky Commission requesting an increase in base electric rates. In conjunction with the filing of the application for a change in base rates, based on previous orders by the Kentucky Commission approving settlement agreements among all interested parties, the VDT surcredit terminated in August 2008. The VDT surcredit was a regulatory mechanism that reduced rates as the result of changes made to reduce operating costs following a previous acquisition transaction involving our Parent. In February 2009, the Kentucky Commission issued an order approving a settlement agreement among us, the AG, the Kentucky Industrial Utility Consumers, Inc. and all other parties to the rate case, under which our base electric rates decreased by \$9 million annually effective February 6, 2009, at which time the merger surcredit (which originated as part of our Parent's merger with KU Energy Corporation in 1998) terminated.

#### ***Rate Mechanisms***

*FAC.* Our retail electric rates contain a FAC, whereby increases and decreases in the cost of fuel for electric generation are reflected in the rates charged to retail electric customers. The FAC allows us to adjust customers' accounts for the difference between the fuel cost component of base rates and the actual fuel cost, including transportation costs. Credits 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. A regulatory asset or liability is established in the amount that has been under- or over-recovered due to timing or adjustments to the mechanism.

*ECR.* Kentucky law permits us to recover the costs of complying with the Federal Clean Air Act and those federal, state and local environmental requirements that apply to coal combustion wastes and by-products from facilities utilized for production of energy from coal, including a return of operating expenses, and a return of and on capital invested, through the ECR mechanism. Pursuant to this mechanism, a regulatory asset or liability is established in the amount that has been under- or over-recovered due to timing or adjustments to the mechanism. This mechanism includes construction work in progress and a return on equity, currently set at 10.63%.

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

For a further discussion of current rates and regulatory matters, see Notes 2, 9 and 12 to our 2009 Annual Financial Statements and Notes 2 and 9 to our Third Quarter Financial Statements, included elsewhere in this Appendix A.

## Environmental Matters

*General.* Protection of the environment is a major priority for us and a significant element of our business activities. Our properties and operations are subject to extensive environmental-related oversight by federal, state and local regulatory agencies, including via air quality, water quality, waste management and similar laws and regulations. Therefore, we must conduct our operations in accordance with numerous permit and other requirements issued under or contained in such laws or regulations.

*Climate Change.* Growing global, national and local attention to climate change matters has led to the development of various international, federal, regional and state laws and regulations directly or indirectly relating to emissions of GHGs, including carbon dioxide, which is emitted from the combustion of fossil fuels such as coal and natural gas, as occurs at our generating stations. In particular, beginning in January 2011, GHG emissions from stationary sources, including our generating assets, will be subject to regulation by the EPA under the Prevention of Significant Deterioration and Title V provisions of the federal Clean Air Act through the GHG “tailoring” rule. Other developing laws and regulations include a variety of mechanisms and structures to regulate GHGs, including direct limits or caps, emission allowances or taxes, renewable generation requirements or standards and energy efficiency or conservation measures, and may require investments in transmission, alternative fuel or carbon sequestration or other emission reduction technologies.

While the final terms and impacts of such developments cannot be estimated, we, as a primarily coal-fired utility, could be adversely affected. Among other emissions, GHGs include carbon-dioxide, which is produced via the combustion of fossil-fuels such as coal and natural gas. Our generating fleet is approximately 63% coal-fired, 37% oil/gas-fired and less than 1% hydroelectric based on capacity. During 2009, we produced approximately 99% of our electricity from coal and 1% from natural gas combustion, on a megawatt-hours basis. During 2009, our emissions of GHGs were approximately 14.2 million metric tons of carbon-dioxide equivalents from our owned or controlled generation sources. While our generation activities account for the bulk of our GHG emissions, other GHG sources at the Company include operation of motor vehicles and powered equipment, evaporation associated with gas pipelines, refrigerating equipment and similar activities.

*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 state implementation plan (“SIP”) to bring such nonattainment areas into compliance. If a state fails to develop an adequate plan, the EPA must develop and implement a plan. As the EPA increases the stringency of the NAAQS through its periodic reviews, the attainment status of various areas may change, thereby triggering additional emission reduction obligations under revised SIPs aimed to achieve attainment.

In 1997, the EPA established new NAAQS for ozone and fine particulates that required additional reductions in SO<sub>2</sub> and NO<sub>x</sub> emissions from power plants. In 1998, the EPA issued its final “NO<sub>x</sub> SIP Call” rule requiring reductions in NO<sub>x</sub> emissions of approximately 85% from 1990 levels in order to mitigate ozone transport from the midwestern U.S. to the northeastern U.S. To implement the new federal requirements, Kentucky amended its SIP in 2002 to require electric generating units to reduce their NO<sub>x</sub> emissions to 0.15 pounds weight per MMBtu on a company-wide basis. In 2005, the EPA issued the Clean Air Interstate Rule (“CAIR”) which required additional SO<sub>2</sub> emission reductions of 70% and NO<sub>x</sub> emission reductions of 65% from 2003 levels. The CAIR provided for a two-phase cap and trade program, with initial reductions of NO<sub>x</sub> and SO<sub>2</sub> emissions due by 2009 and 2010, respectively, and final reductions due by 2015. In 2006, Kentucky proposed to amend its SIP to adopt state requirements similar to those under the federal CAIR.

In July 2008, a federal appeals court issued a ruling finding deficiencies in the CAIR and vacating it. In December 2008, the Court amended its previous order, directing the EPA to promulgate a new regulation, but leaving the CAIR in place in the interim. The remand of the CAIR results in some uncertainty with respect to certain other EPA or state programs and proceedings and our compliance plans relating thereto, due to the interconnection of the CAIR with such associated programs.

In January 2010, the EPA proposed a revised NAAQS for ozone which would increase the stringency of the standard. In addition, the EPA published final revised NAAQS for nitrogen dioxide (“NO<sub>2</sub>”) and SO<sub>2</sub> in February 2010 and June 2010, respectively, which are more stringent than previous standards. Depending on the level of action determined necessary to bring local nonattainment areas into compliance with the revised NAAQS, our power plants are potentially subject to requirements for additional reductions in SO<sub>2</sub> and NO<sub>x</sub> emissions.

In July 2010, the EPA issued the proposed the Clean Air Transport Rule (“CATR”), which serves to replace the CAIR. The CATR provides for a two-phase SO<sub>2</sub> reduction program with Phase I reductions due by 2012 and Phase II reductions due by 2014. The CATR provides for NO<sub>x</sub> reductions in 2012, but the EPA advised that it is studying whether additional NO<sub>x</sub> reductions should be required for 2014. The CATR is more stringent than the CAIR as it accelerates certain compliance dates and provides for only intrastate and limited interstate trading of emission allowances. In addition to its preferred approach, the EPA is seeking comment on alternative approaches, including one which would provide for individual emission limits at each power plant. The EPA has announced that it will propose additional “transport” rules to address compliance with revised NAAQS for ozone and particulate matter which will be issued by the EPA in the future, as discussed below.

*Hazardous Air Pollutants.* As provided in 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 Clean Air Mercury Rule (“CAMR”) establishing mercury standards for new power plants and requiring all states to issue new SIPs including mercury requirements for existing power plants. The EPA issued a model rule which provides for a two-phase cap and trade program with initial reductions due by 2010 and final reductions due by 2018. The CAMR provided for reductions of 70% from 2003 levels. The EPA closely integrated the CAMR and CAIR programs to ensure that the 2010 mercury reduction targets would be achieved as a “co-benefit” of the controls installed for purposes of compliance with the CAIR. In 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 entered into a consent decree requiring it to promulgate a utility Maximum Achievable Control Technology rule to replace the CAMR, with a proposed rule due by March 2011 and a final rule due by November 2011. Depending on the final outcome of the rulemaking, the CAMR could be replaced by new rules with different or more stringent requirements for reduction of mercury and other hazardous air pollutants. Kentucky has also repealed its corresponding state mercury regulations.

*Ash Ponds and Coal-Combustion Byproducts.* The EPA has undertaken various initiatives in response to a December 2008 impoundment failure at the TVA’s Kingston power plant, which resulted in a major release of coal combustion byproducts into the environment. The EPA issued information requests to utilities throughout the country, including the Company, to obtain information on their ash ponds and other impoundments. In addition, the EPA inspected a large number of impoundments located at power plants to determine their structural integrity. The inspections included several of our impoundments, which the EPA found to be in satisfactory condition except for certain impoundments at the Mill Creek and Cane Run stations, which were determined to be in fair condition. In June 2010, the EPA published proposed regulations for the management of coal combustion byproducts. The EPA has proposed two alternatives: (1) regulation of coal combustion byproducts in landfills and ash ponds as a hazardous waste or (2) regulation of coal combustion byproducts as a solid waste with minimum national standards. Under both alternatives, the EPA has proposed safety requirements to address the structural integrity of ash ponds. In addition, the EPA will consider potential refinements of the provisions for beneficial reuse of coal combustion byproducts.

*Water Discharges and PCB Regulations.* The EPA has also announced plans to develop revised effluent limitation guidelines governing discharges from power plants and standards for cooling water intake structures. The EPA has further announced plans to develop revised standards governing the use of polychlorinated biphenyls (“PCBs”) in electrical equipment. The Company is monitoring these ongoing regulatory developments but will be unable to determine the impact until such time as new rules are finalized.

*Impact of Pending and Future Environmental Developments.* As a company with significant coal-fired generating assets, we will likely be substantially impacted by pending or future environmental rules or legislation requiring mandatory reductions in GHG emissions or other air emissions, imposing more stringent standards on

discharges to waterways, or establishing additional requirements for handling or disposal of coal combustion byproducts. These evolving environmental regulations will likely require an increased level of capital expenditures and increased incremental operating and maintenance costs by us over the next several years. Due to the uncertain nature of the final regulations that will ultimately be adopted by the EPA, including the reduction targets and the deadlines that will be applicable, we cannot finalize estimates of the potential compliance costs, but should the final rules incorporate additional emission reduction requirements, require more stringent emissions controls or implement more stringent byproducts storage and disposal practices, such costs will likely be significant. With respect to NAAQS, CATR, CAMR replacement and coal combustion byproducts developments, based on a preliminary analysis of proposed regulations, we may be required to consider actions such as upgrading existing emissions controls, installing additional emissions controls, upgrading byproducts disposal and storage and possible early replacement of coal-fired units. Our capital expenditures associated with such actions are preliminarily estimated to be in the \$1.7 billion range over the next 10 years, although final costs may substantially vary. With respect to potential developments in water discharge, revised PCB standards or GHG initiatives, costs in such areas cannot be estimated due to the preliminary status or uncertain outcome of such developments, but would be in addition to the above amount and could be substantial. Ultimately, the precise impact on our operations of these various environmental developments cannot be determined prior to the finalization of such requirements. Based on prior regulatory precedent, we believe that many costs of complying with such pending or future requirements would likely be recoverable under the ECR or other potential cost-recovery mechanisms, but we can provide no assurance as to the ultimate outcome of such proceedings before the regulatory authorities.

Environmental laws and regulations applicable to our business and governing, among other things, air emissions, wastewater discharges, the use, handling and disposal of hazardous substances and wastes, soil and groundwater contaminants and employee health and safety are discussed in Notes 2 and 9 to our 2009 Annual Financial Statements and Notes 2 and 9 to our Third Quarter Financial Statements, each included elsewhere in this Appendix A.

#### **State Executive or Legislative Matters**

In November 2008, the Governor of Kentucky issued an action plan to create efficient, sustainable energy solutions and strategies and move toward state energy independence. The plan outlines the following seven strategies to work toward these goals:

- Improve the energy efficiency of Kentucky's homes, buildings, industries and transportation fleet
- Increase Kentucky's use of renewable energy
- Sustainably grow Kentucky's production of biofuels
- Develop a coal-to-liquids industry in Kentucky to replace petroleum-based liquids
- Implement a major and comprehensive effort to increase gas supplies, including coal-to-gas in Kentucky
- Initiate aggressive carbon capture/sequestration projects for coal-generated electricity in Kentucky
- Examine the use of nuclear power for electricity generation in Kentucky

In December 2009, the Governor of Kentucky's Executive Task Force on Biomass and Biofuels issued a final report to establish potential strategic actions to develop biomass and biofuels industries in Kentucky. The plan noted the potential importance of biomass as a renewable energy source available to Kentucky and discussed various goals or mechanisms, such as the use of approximately 25 million tons of biomass for generation fuel annually, allotment of electricity and gas taxes and state tax credits to support biomass development.

In January 2010, a state-established Kentucky Climate Action Plan Council commenced formal activities. The council, which includes governmental, industry, consumer and other representatives, seeks to identify possible Kentucky responses to potential climate change and federal legislation, including increasing statewide energy efficiency, energy independence and economic growth. The council has established various technical work groups,

including in the areas of energy supply and energy efficiency/conservation, to provide input, data and recommendations.

During prior legislative sessions, various bills have been introduced in the Kentucky General Assembly with respect to environmental or utility matters, including potential renewable energy portfolio requirements, energy conservation measures, coal mining or coal byproduct operations and other matters. It is expected that similar legislation will be introduced in upcoming sessions, but the prospects and final terms of any such legislation cannot be determined.

Legislative and regulatory actions as a result of these proposals and their impact on the Company, which may be significant, cannot currently be predicted.

### **Competition**

There are currently no other electric public utilities operating within our service area. 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 us, which may be significant, cannot currently be predicted. Virginia, formerly a deregulated jurisdiction, has enacted legislation which implements a hybrid model of cost-based regulation.

### **Employees and Labor Relations**

We had 964 full-time regular employees at December 31, 2009, 149 of which were operating, maintenance and construction employees represented by the IBEW (“International Brotherhood of Electrical Workers”) Local 2100 and the United Steelworkers of America (“USWA”) Local 9447-01. Effective August 4, 2009, we and our employees represented by the IBEW Local 2100 entered into a three-year collective bargaining agreement. The agreement provides for negotiated increases or changes to wages, benefits or other provisions and for annual wage re-openers. We and employees represented by the USWA Local 9447-01 entered into a three-year collective bargaining agreement in August 2008. This agreement provides for negotiated increases or changes to wages, benefits or other provisions and for annual wage re-openers.

### **Related Party Transactions**

We, our Parent and subsidiaries of our Parent engage in related party transactions. See Note 11 to our 2009 Annual Financial Statements and Note 10 to our Third Quarter Financial Statements, each included elsewhere in this Appendix A, for more information.

### **Legal Proceedings**

For a description of the significant legal proceedings, including, but not limited to, certain rates and regulatory, environmental, climate change and litigation matters, involving the Company, reference is made to the information in Note 9 to our 2009 Annual Financial Statements and Note 9 to our Third Quarter Financial Statements, each included elsewhere in this Appendix A.

In connection with an administrative proceeding alleging a violation by a former Argentine subsidiary of our Parent under that country’s 2002-2003 emergency currency exchange laws, claims are pending against the subsidiary’s then directors, including two individuals who are executive officers of the Company, in a specialized Argentine financial criminal court. Under applicable Argentine laws, directors of a local company may be liable for monetary penalties for a subject company’s violations of the currency laws. The subsidiary and the relevant executive officers believe their actions were in compliance with the relevant laws and have presented defenses in the administrative and criminal proceedings. Our Parent has standard indemnification arrangements with its executive officers. The former subsidiary is now owned by a third-party, which has agreed to indemnify our Parent and the relevant executive officers.

In the normal course of business from time to time, other lawsuits, claims, environmental actions and other governmental proceedings arise against the Company. To the extent that damages are assessed in any of these actions or proceedings, the Company believes that its insurance coverage is adequate. Although we cannot accurately predict the amount of any liability that may ultimately arise with respect to such matters, management, after consultation with legal counsel, does not currently anticipate that liabilities arising out of other currently pending or threatened lawsuits and claims will have a material adverse effect on the Company's financial condition or results of operations.

**KENTUCKY UTILITIES COMPANY**  
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**Kentucky Utilities Company**  
**Financial Statements**  
**As of December 31, 2009 and 2008**  
**and For the Years Ended**  
**December 31, 2009, 2008 and 2007**

## INDEX OF ABBREVIATIONS

AG	Attorney General of Kentucky
ARO	Asset Retirement Obligation
ASC	Accounting Standards Codification
CAIR	Clean Air Interstate Rule
CCN	Certificate of Public Convenience and Necessity
Clean Air Act	The Clean Air Act, as amended in 1990
CMRG	Carbon Management Research Group
Company	KU
CT	Combustion Turbines
DSM	Demand Side Management
ECR	Environmental Cost Recovery
EEI	Electric Energy, Inc.
E.ON	E.ON AG
E.ON U.S.	E.ON U.S. LLC
E.ON U.S. Services	E.ON U.S. Services Inc.
EPA	U.S. Environmental Protection Agency
EPAct 2005	Energy Policy Act of 2005
FAC	Fuel Adjustment Clause
FASB	Financial Accounting Standards Board
FERC	Federal Energy Regulatory Commission
FGD	Flue Gas Desulfurization
Fidelia	Fidelia Corporation (an E.ON affiliate)
GHG	Greenhouse Gas
Gwh	Gigawatt hours or one thousand Mwh
IBEW	International Brotherhood of Electrical Workers
IMEA	Illinois Municipal Electric Agency
IMPA	Indiana Municipal Power Agency
IRS	Internal Revenue Service
KCCS	Kentucky Consortium for Carbon Storage
Kentucky Commission	Kentucky Public Service Commission
KIUC	Kentucky Industrial Utility Consumers, Inc.
KU	Kentucky Utilities Company
Kwh	Kilowatt hours
LG&E	Louisville Gas and Electric Company
LG&E Energy	LG&E Energy LLC (now E.ON U.S. LLC)
MISO	Midwest Independent Transmission System Operator, Inc.
MMBtu	Million British thermal units
Moody's	Moody's Investor Services, Inc.
MVA	Megavolt-ampere
Mw	Megawatts
Mwh	Megawatt hours
NERC	North American Electric Reliability Corporation
NOV	Notice of Violation
NOx	Nitrogen Oxide
OMU	Owensboro Municipal Utilities
OVEC	Ohio Valley Electric Corporation

PUHCA 2005 . . . . .	Public Utility Holding Company Act of 2005
RSG . . . . .	Revenue Sufficiency Guarantee
S&P . . . . .	Standard & Poor's Rating Services
SCR . . . . .	Selective Catalytic Reduction
SIP . . . . .	State Implementation Plan
SO <sub>2</sub> . . . . .	Sulfur Dioxide
TC1 . . . . .	Trimble County Unit 1
TC2 . . . . .	Trimble County Unit 2
VDT . . . . .	Value Delivery Team Process
Virginia Commission . . .	Virginia State Corporation Commission

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**Kentucky Utilities Company**  
**Statements of Income**

	Years Ended December 31		
	2009	2008	2007
	(Millions of \$)		
<b>OPERATING REVENUES:</b>			
Total operating revenues (Note 11) . . . . .	<u>\$1,355</u>	<u>\$1,405</u>	<u>\$1,272</u>
<b>OPERATING EXPENSES:</b>			
Fuel for electric generation . . . . .	434	513	461
Power purchased (Notes 9 and 11) . . . . .	199	221	168
Other operation and maintenance expenses . . . . .	320	275	255
Depreciation and amortization (Note 1) . . . . .	<u>133</u>	<u>136</u>	<u>121</u>
Total operating expenses . . . . .	<u>1,086</u>	<u>1,145</u>	<u>1,005</u>
Net operating income . . . . .	269	260	267
Equity in earnings of EEI (Note 1) . . . . .	(1)	(30)	(26)
Other income — net . . . . .	(5)	(8)	(7)
Interest expense (Notes 7 and 8) . . . . .	6	14	15
Interest expense to affiliated companies (Notes 8 and 11) . . . . .	<u>69</u>	<u>58</u>	<u>41</u>
Income before income taxes . . . . .	200	226	244
Federal and state income taxes (Note 6) . . . . .	<u>67</u>	<u>68</u>	<u>77</u>
Net income . . . . .	<u>\$ 133</u>	<u>\$ 158</u>	<u>\$ 167</u>

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

**Kentucky Utilities Company**  
**Statements of Retained Earnings**

	Years Ended December 31		
	2009	2008	2007
	(Millions of \$)		
Balance January 1 .....	\$1,195	\$1,037	\$ 870
Add net income .....	133	158	167
Balance December 31 .....	\$1,328	\$1,195	\$1,037

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

**Kentucky Utilities Company**

**Balance Sheets**

	<b>December 31</b>	
	<b>2009</b>	<b>2008</b>
	(Millions of \$)	
<b>ASSETS:</b>		
Current assets:		
Cash and cash equivalents (Note 1) . . . . .	\$ 2	\$ 2
Restricted cash (Note 1) . . . . .	—	9
Accounts receivable, net: (Notes 1 and 11)		
Customer — less reserves of \$1 million and \$3 million as of December 31, 2009 and 2008, respectively . . . . .	155	152
Other — less reserves of \$2 million and less than \$1 million as of December 31, 2009 and 2008 . . . . .	27	32
Materials and supplies (Note 1):		
Fuel (predominantly coal) . . . . .	98	73
Other materials and supplies . . . . .	39	36
Deferred income taxes — net (Note 6) . . . . .	3	2
Regulatory assets (Note 2) . . . . .	32	32
Prepayments and other current assets . . . . .	10	8
Total current assets . . . . .	366	346
Other property and investments (Note 1) . . . . .	12	23
Utility plant, at original cost (Note 1): . . . . .	4,892	4,446
Less: reserve for depreciation . . . . .	1,838	1,724
Total utility plant, net . . . . .	3,054	2,722
Construction work in progress . . . . .	1,257	1,176
Total utility plant and construction work in progress . . . . .	4,311	3,898
Deferred debits and other assets:		
Regulatory assets (Note 2):		
Pension benefits . . . . .	105	137
Other . . . . .	117	64
Cash surrender value of key man life insurance . . . . .	38	39
Other assets . . . . .	7	11
Total deferred debits and other assets . . . . .	267	251
Total Assets . . . . .	<b>\$4,956</b>	<b>\$4,518</b>

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

**Kentucky Utilities Company**  
**Balance Sheets (continued)**

December 31  
2009      2008  
(Millions of \$)

**LIABILITIES AND EQUITY:**

Current liabilities:		
Current portion of long-term debt (Note 7) . . . . .	\$ 261	\$ 228
Notes payable to affiliated companies (Notes 8 and 11) . . . . .	45	16
Accounts payable . . . . .	107	155
Accounts payable to affiliated companies (Note 11) . . . . .	88	38
Customer deposits . . . . .	22	21
Regulatory liabilities (Note 2) . . . . .	3	5
Other current liabilities . . . . .	<u>42</u>	<u>34</u>
Total current liabilities . . . . .	<u>568</u>	<u>497</u>
Long-term debt:		
Long-term bonds (Note 7) . . . . .	123	123
Long-term debt to affiliated company (Notes 7 and 11) . . . . .	<u>1,298</u>	<u>1,181</u>
Total long-term debt . . . . .	<u>1,421</u>	<u>1,304</u>
Deferred credits and other liabilities:		
Accumulated deferred income taxes (Note 6) . . . . .	336	279
Accumulated provision for pensions and related benefits (Note 5) . . . . .	160	186
Investment tax credit (Note 6) . . . . .	104	80
Asset retirement obligations . . . . .	34	32
Regulatory liabilities (Note 2):		
Accumulated cost of removal of utility plant . . . . .	331	329
Deferred income taxes . . . . .	9	16
Postretirement benefits . . . . .	9	10
Other . . . . .	11	15
Other liabilities . . . . .	<u>21</u>	<u>26</u>
Total deferred credits and other liabilities . . . . .	<u>1,015</u>	<u>973</u>
Commitments and contingencies (Note 9)		
<b>COMMON EQUITY:</b>		
Common stock, without par value —		
Authorized 80,000,000 shares, outstanding 37,817,878 shares . . . . .	308	308
Additional paid-in capital (Note 11) . . . . .	316	241
Retained earnings . . . . .	1,318	1,174
Undistributed subsidiary earnings . . . . .	<u>10</u>	<u>21</u>
Total retained earnings . . . . .	<u>1,328</u>	<u>1,195</u>
Total common equity . . . . .	<u>1,952</u>	<u>1,744</u>
Total Liabilities and Equity . . . . .	<u>\$4,956</u>	<u>\$4,518</u>

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



**Kentucky Utilities Company**  
**Statements of Cash Flows**

	<b>Years Ended December 31</b>		
	<b>2009</b>	<b>2008</b>	<b>2007</b>
	(Millions of \$)		
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net income . . . . .	\$ 133	\$ 158	\$ 167
Items not requiring cash currently:			
Depreciation and amortization . . . . .	133	136	121
Deferred income taxes — net . . . . .	50	(13)	(5)
Investment tax credit — net . . . . .	24	25	42
Provision for pension and postretirement plans . . . . .	26	10	11
Other . . . . .	—	1	(4)
Change in certain current assets and liabilities:			
Accounts receivable . . . . .	(4)	12	(16)
Materials and supplies . . . . .	(28)	(33)	22
Prepayments and other current assets . . . . .	(3)	(1)	1
Accounts payable . . . . .	(3)	9	(15)
Other current liabilities . . . . .	8	5	4
Pension and postretirement funding . . . . .	(20)	(5)	(19)
Storm restoration regulatory asset . . . . .	(57)	(2)	—
Other . . . . .	(6)	(10)	2
Net cash provided by operating activities . . . . .	<u>253</u>	<u>292</u>	<u>311</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Construction expenditures . . . . .	(516)	(686)	(749)
Assets purchased from affiliate . . . . .	—	(10)	—
Change in restricted cash . . . . .	9	1	12
Net cash used for investing activities . . . . .	<u>(507)</u>	<u>(695)</u>	<u>(737)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Long-term borrowings from affiliated company (Note 7) . . . . .	150	250	448
Short-term borrowings from affiliated company — net (Note 8) . . . . .	29	(7)	(74)
Retirement of first mortgage bonds . . . . .	—	—	(107)
Issuance of pollution control bonds . . . . .	—	77	78
Retirement of pollution control bonds . . . . .	—	(60)	—
Acquisition of outstanding bonds . . . . .	—	(80)	—
Reissuance of reacquired bonds . . . . .	—	63	—
Retirement of reacquired bonds . . . . .	—	17	—
Additional paid-in capital . . . . .	75	145	75
Net cash provided by financing activities . . . . .	<u>254</u>	<u>405</u>	<u>420</u>
Change in cash and cash equivalents . . . . .	—	2	(6)
Cash and cash equivalents at beginning of year . . . . .	2	—	6
Cash and cash equivalents at end of year . . . . .	<u>\$ 2</u>	<u>\$ 2</u>	<u>\$ —</u>
<b>Supplemental disclosures of cash flow information:</b>			
Cash paid during the year for:			
Income taxes . . . . .	\$ (9)	\$ 46	\$ 38
Interest on borrowed money . . . . .	3	13	16
Interest to affiliated companies on borrowed money . . . . .	67	53	29

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

**Kentucky Utilities Company**  
**Statements of Capitalization**

	December 31	
	2009	2008
	(Millions of \$)	
<b>LONG-TERM DEBT (Note 7):</b>		
Pollution control series:		
Mercer Co. 2000 Series A, due May 1, 2023, variable%	\$ 13	\$ 13
Carroll Co. 2002 Series A, due February 1, 2032, variable%	21	21
Carroll Co. 2002 Series B, due February 1, 2032, variable%	2	2
Muhlenberg Co. 2002 Series A, due February 1, 2032, variable%	2	2
Mercer Co. 2002 Series A, due February 1, 2032, variable%	8	8
Carroll Co. 2002 Series C, due October 1, 2032, variable%	96	96
Carroll Co. 2004 Series A, due October 1, 2034, variable%	50	50
Carroll Co. 2006 Series B, due October 1, 2034, variable%	54	54
Carroll Co. 2007 Series A, due February 1, 2026, 5.75%	18	18
Trimble Co. 2007 Series A, due March 1, 2037, 6.0%	9	9
Carroll Co. 2008 Series A, due February 1, 2032, variable%	78	78
Total pollution control series	351	351
Notes payable to Fidelity:		
Due November 24, 2010, 4.24%, unsecured	33	33
Due January 16, 2012, 4.39%, unsecured	50	50
Due April 30, 2013, 4.55%, unsecured	100	100
Due August 15, 2013, 5.31%, unsecured	75	75
Due December 19, 2014, 5.45%, unsecured	100	100
Due July 8, 2015, 4.735%, unsecured	50	50
Due December 21, 2015, 5.36%, unsecured	75	75
Due October 25, 2016, 5.675%, unsecured	50	50
Due April 24, 2017, 5.28%, unsecured	50	—
Due June 20, 2017, 5.98%, unsecured	50	50
Due July 25, 2018, 6.16%, unsecured	50	50
Due August 27, 2018, 5.645%, unsecured	50	50
Due December 17, 2018, 7.035%, unsecured	75	75
Due July 29, 2019, 4.81%, unsecured	50	—
Due October 25, 2019, 5.71%, unsecured	70	70
Due November 25, 2019, 4.445%, unsecured	50	—
Due February 7, 2022, 5.69%, unsecured	53	53
Due May 22, 2023, 5.85%, unsecured	75	75
Due September 14, 2028, 5.96%, unsecured	100	100
Due June 23, 2036, 6.33%, unsecured	50	50
Due March 30, 2037, 5.86%, unsecured	75	75
Total notes payable to Fidelity	1,331	1,181
Total long-term debt outstanding	1,682	1,532
Less current portion of long-term debt	261	228
Long-term debt	1,421	1,304
<b>COMMON EQUITY:</b>		
Common stock, without par value —		
Authorized 80,000,000 shares, outstanding 37,817,878 shares	308	308
Additional paid-in-capital (Note 11)	316	241
Retained earnings	1,318	1,174
Undistributed subsidiary earnings	10	21
Total retained earnings	1,328	1,195
Total common equity	1,952	1,744
Total capitalization	\$3,373	\$3,048

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

**Kentucky Utilities Company**  
**Notes to Financial Statements**

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

KU, incorporated in Kentucky in 1912 and in Virginia in 1991, is a regulated public utility engaged in the generation, transmission, distribution and sale of electric energy in Kentucky, Virginia and Tennessee. KU provides electric service to approximately 515,000 customers in 77 counties in central, southeastern and western Kentucky, to approximately 30,000 customers in 5 counties in southwestern Virginia and 5 customers in Tennessee. KU's service area covers approximately 6,600 square miles. Approximately 99% of the electricity generated by KU is produced by its coal-fired electric generating stations. The remainder is generated by a hydroelectric power plant and natural gas and oil fueled CTs. In Virginia, KU operates under the name Old Dominion Power Company. KU also sells wholesale electric energy to 12 municipalities.

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

Certain reclassification entries have been made to the previous years' financial statements to conform to the 2009 presentation with no impact on net assets, liabilities and capitalization or previously reported net income. However, for 2008 cash from operations was decreased by \$5 million and cash flows from investing increased by \$5 million and for 2007 cash from operations increased by \$4 million and cash flows from investing decreased by \$4 million.

*Regulatory Accounting.* KU is subject to the regulated operations guidance of the FASB ASC, under which regulatory assets are created based on expected recovery from customers in future rates to defer costs that would otherwise be charged to expense. Likewise, regulatory liabilities are created based on expected return to customers in future rates to defer credits that would otherwise be reflected as income, or, in the case of costs of removal, are created to match long-term future obligations arising from the current use of assets. The accounting for regulatory assets and liabilities is based on specific ratemaking decisions or precedent for each item as prescribed by the FERC, the Kentucky Commission or the Virginia Commission. See Note 2, Rates and Regulatory Matters, for additional detail regarding regulatory assets and liabilities.

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

*Restricted Cash.* Proceeds from bond issuances for environmental equipment (primarily related to the installation of FGDs) are held in trust pending expenditure for qualifying assets.

*Allowance for Doubtful Accounts.* The allowance for doubtful accounts included in customer accounts receivable is based on the ratio of the amounts charged-off during the last twelve months to the retail revenues billed over the same period multiplied by the retail revenues billed over the last four months. Accounts with no payment activity are charged-off after four months, although collection efforts continue thereafter. The allowance for doubtful accounts included in other accounts receivable is composed of accounts aged more than four months. Accounts are written off as management determines them uncollectible.

*Materials and Supplies.* Fuel and other materials and supplies inventories are accounted for using the average-cost method. Emission allowances are included in other materials and supplies. At December 31, 2009 and 2008, the emission allowances inventory was \$1 million and less than \$1 million, respectively.

*Other Property and Investments.* Other property and investments on the balance sheets consists of KU's investment in EEI, KU's investment in OVEC, funds related to the long-term power purchase contract with OMU and non-utility plant.

Although KU holds investment interests in OVEC and EEI, it is not the primary beneficiary, therefore, neither are consolidated into the Company's financial statements. KU and 10 other electric utilities are owners of OVEC, located in Piketon, Ohio. OVEC owns and operates two coal-fired power plants, Kyger Creek Station in Ohio and

Clifty Creek Station in Indiana. OVEC's power is currently supplied to KU and 12 other companies affiliated with the various owners. Pursuant to current contractual agreements, KU owns 2.5% of OVEC's common stock and is contractually entitled to 2.5% of OVEC's output, approximately 55 Mw of generation capacity.

As of December 31, 2009 and 2008, KU's investment in OVEC totaled less than \$1 million and is accounted for under the cost method of accounting. The direct exposure to loss as a result of its involvement with OVEC is generally limited to the value of its investment. See Note 9, *Commitments and Contingencies*, for further discussion of developments regarding KU's ownership interests and power purchase rights.

KU owns 20% of the common stock of EEI, which owns and operates a 1,162-Mw generating station in southern Illinois. EEI, through a power marketer affiliated with its majority owner, sells its output to third parties. KU's investment in EEI is accounted for under the equity method of accounting and, as of December 31, 2009 and 2008, totaled \$12 million and \$22 million, respectively. KU's direct exposure to loss as a result of its involvement with EEI is generally limited to the value of its investment.

*Utility Plant.* Utility plant is stated at original cost, which includes payroll-related costs such as taxes, fringe benefits and administrative and general costs. Construction work in progress has been included in the rate base for determining retail customer rates in Kentucky. KU has not recorded a significant allowance for funds used during construction.

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

*Depreciation and Amortization.* Depreciation is provided on the straight-line method over the estimated service lives of depreciable plant. The amounts provided were approximately 2.6% in 2009, 3.0% in 2008 and 3.2% in 2007 of average depreciable plant. Of the amount provided for depreciation at December 31, 2009, approximately 0.4% was related to the retirement, removal and disposal costs of long lived assets. At December 31, 2008 and 2007, approximately 0.5% was related to the retirement, removal and disposal costs of long lived assets.

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

*Income Taxes.* In accordance with the guidance of the FASB ASC, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, as measured by enacted tax rates that are expected to be in effect in the periods when the deferred tax assets and liabilities are expected to be settled or realized. Significant judgment is required in determining the provision for income taxes, and there are transactions for which the ultimate tax outcome is uncertain. The income taxes guidance of the FASB ASC prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Uncertain tax positions are analyzed periodically and adjustments are made when events occur to warrant a change. See Note 6, *Income Taxes*.

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

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

*Revenue Recognition.* Revenues are recorded based on service rendered to customers through month-end. KU accrues an estimate for unbilled revenues from each meter reading date to the end of the accounting period based on allocating the daily system net deliveries between billed volumes and unbilled volumes. The allocation is based on a daily ratio of the number of meter reading cycles remaining in the month to the total number of meter

reading cycles in each month. Each day's ratio is then multiplied by each day's system net deliveries to determine an estimated billed and unbilled volume for each day of the accounting period. The unbilled revenue estimates included in accounts receivable were \$76 million, \$60 million and \$59 million at December 31, 2009, 2008 and 2007, respectively.

*Fuel Costs.* The cost of fuel for generation is charged to expense as used. See Note 2, Rates and Regulatory Matters, for a description of the FAC.

*Management's Use of Estimates.* The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported assets and liabilities and disclosure of contingent items at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Accrued liabilities, including legal and environmental, are recorded when they are probable and estimable. Actual results could differ from those estimates.

*Recent Accounting Pronouncements.* The following are recent accounting pronouncements affecting KU:

### **Hierarchy of Generally Accepted Accounting Principles**

The guidance related to the hierarchy of generally accepted accounting principles was issued in June 2009, and is effective for interim and annual periods ending after September 15, 2009. The guidance establishes the FASB ASC as the single source of authoritative nongovernmental U.S. generally accepted accounting principles. It had no effect on the Company's results of operations, financial position or liquidity; however, references to authoritative accounting literature have changed with the adoption.

### **Subsequent Events**

The guidance related to subsequent events was issued in May 2009, and is effective for interim and annual periods ending after June 15, 2009. This guidance requires disclosure of the date through which subsequent events have been evaluated, as well as whether that date is the date the financial statements were issued or the date they were available to be issued. The adoption of this guidance had no impact on the Company's results of operations, financial position or liquidity; however, additional disclosures were required with the adoption. See Note 12, Subsequent Events, for additional disclosures.

### **Interim Disclosures about Fair Value of Financial Instruments**

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

### **Employers' Disclosures about Postretirement Benefit Plan Assets**

The guidance related to employers' disclosures about postretirement benefit plan assets was issued in December 2008, and is effective as of December 31, 2009. This guidance requires additional disclosures related to pension and other postretirement benefit plan assets. Additional disclosures include the investment allocation decision-making process, the fair value of each major category of plan assets as well as the inputs and valuation techniques used to measure fair value and significant concentrations of risk within the plan assets. The adoption had no impact on the Company's results of operations, financial position or liquidity; however, additional disclosures were required with the adoption. See Note 5, Pension and Other Postretirement Benefit Plans, for additional disclosures.

### **Disclosures about Derivative Instruments and Hedging Activities**

The guidance related to disclosures about derivative instruments and hedging activities was issued in March 2008, and is effective for fiscal years, and interim periods within those fiscal years, beginning on or after November 15, 2008. The objective of this guidance is to enhance the current disclosure framework. The adoption

had no impact on KU's results of operations, financial position or liquidity; however, additional disclosures relating to derivatives were required with the adoption effective January 1, 2009. See Note 3, Financial Instruments, for additional disclosures.

### **Noncontrolling Interests in Consolidated Financial Statements**

The guidance related to noncontrolling interests in consolidated financial statements was issued in December 2007, and is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. The objective of this guidance is to improve the relevance, comparability and transparency of financial information in a reporting entity's consolidated financial statements. The Company adopted this guidance effective January 1, 2009, and it had no impact on its results of operations, financial position or liquidity.

### **Fair Value Measurements**

In January 2010, the FASB issued guidance related to fair value measurement disclosures requiring separate disclosure of amounts of significant transfers in and out of level 1 and level 2 fair value measurements and separate information about purchases, sales, issuances, and settlements within level 3 measurements. This guidance is effective for the first reporting period beginning after issuance except for disclosures about the roll-forward of activity in level 3 fair value measurements. This guidance will have no impact on the Company's results of operations, financial position or liquidity; however, additional disclosures will be provided as required.

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

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

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

The Company adopted this guidance effective January 1, 2008, except as it applies to those nonfinancial assets and liabilities, and it had no impact on the results of operations, financial position or liquidity, however, additional disclosures relating to its financial derivatives and cash collateral on derivatives, as required, are now provided. Fair value accounting for all nonrecurring fair value measurements of nonfinancial assets and liabilities was adopted effective January 1, 2009, and it had no impact on the results of operations, financial position or liquidity. At December 31, 2009, no additional disclosures were required as KU did not have any nonfinancial assets or liabilities measured at fair value subsequent to initial measurement.

The guidance related to determining fair value was issued in April 2009, and is effective for interim and annual periods ending after June 15, 2009. This update provides additional guidance on determining fair values when there is no active market or where the price inputs being used represent distressed sales. The adoption had no impact on the Company's results of operations, financial position or liquidity.

### **Note 2 — Rates and Regulatory Matters**

The Company is subject to the jurisdiction of the Kentucky Commission, the Virginia Commission, the Tennessee Regulatory Authority and the FERC in virtually all matters related to electric utility regulation, and as such, its accounting is subject to the regulated operations guidance of the FASB ASC. Given its position in the

marketplace and the status of regulation in Kentucky and Virginia, there are no plans or intentions to discontinue the application of the regulated operations guidance of the FASB ASC.

### **2010 Kentucky Rate Case**

In January 2010, KU filed an application with the Kentucky Commission requesting an increase in base electric rates of approximately 12%, or \$135 million annually, including an 11.5% return on equity. KU has requested the increase, based on the twelve month test year ended October 31, 2009, to become effective on and after March 1, 2010. The requested rates have been suspended until August 1, 2010, at which time they may be put into effect, subject to refund, if the Kentucky Commission has not issued an order in the proceeding. The parties are currently exchanging data requests in the proceedings and a hearing date has been scheduled for June 2010. An order in the proceeding may occur during the third or fourth quarters of 2010.

### **2008 Kentucky Rate Case**

In July 2008, KU filed an application with the Kentucky Commission requesting an increase in base electric rates. In January 2009, KU, the AG, the KIUC and all other parties to the rate case filed a settlement agreement with the Kentucky Commission, under which KU's base electric rates decreased by \$9 million annually. An Order approving the settlement agreement was received in February 2009. The new rates were implemented effective February 6, 2009, at which time the merger surcredit terminated.

In conjunction with the filing of the application for changes in base rates the VDT surcredit terminated. The VDT surcredit resulted from a 2001 initiative to share savings of \$10 million from the VDT initiative with customers over five years. In February 2006, KU and all parties to the proceeding reached a unanimous settlement agreement on the future ratemaking treatment of the VDT surcredit which was approved by the Kentucky Commission in March 2006 at an annual rate of \$4 million. Under the terms of the settlement agreement, the VDT surcredit continued at its then current level until such time as KU filed for a change in base rates. In accordance with the Order, the VDT surcredit terminated in August 2008, the first billing month after the July 2008 filing for a change in base rates.

In December 2007, KU submitted its plan to allow the merger surcredit to terminate as scheduled on June 30, 2008. The merger surcredit originated as part of the LG&E Energy merger with KU Energy Corporation in 1998. In June 2008, the Kentucky Commission issued an Order approving a unanimous settlement agreement reached with all parties to the case which provided for a reduction in the merger surcredit to approximately \$6 million for a 7-month period beginning July 2008, termination of the merger surcredit when new base rates went into effect on or after January 31, 2009, and that the merger surcredit be continued at an annual rate of \$12 million thereafter should the Company not file for a change in base rates. In accordance with the Order, the merger surcredit was terminated effective February 6, 2009, with the implementation of new base rates.

### **Virginia Rate Case**

In June 2009, KU filed an application with the Virginia Commission requesting an increase in electric base rates for its Virginia jurisdictional customers in an amount of \$12 million annually or approximately 21%. The proposed increase reflected a proposed rate of return on rate base of 8.586% based upon a return on equity of 12%. During December 2009, KU and the Virginia Commission Staff agreed to a Stipulation and Recommendation authorizing base rate revenue increases of \$11 million annually and a return on rate base of 7.846% based on a 10.5% return on common equity. A public hearing was held during January 2010. As permitted, pursuant to a Virginia Commission order, KU elected to implement the proposed rates effective November 1, 2009, on an interim basis. In March 2010, the Virginia Commission issued an Order approving the stipulation, with the increased rates to be put into effect as of April 1, 2010. As part of the stipulation, KU will refund certain amounts collected since November 2009, consisting of interim increased rates in excess of the ultimate approved rates. These refunds aggregate approximately \$1 million and are anticipated to occur during the second quarter of 2010. See also Note 12 to Notes to Financial Statements.

### FERC Wholesale Rate Case

In September 2008, KU filed an application with the FERC for increases in base electric rates applicable to wholesale power sales contracts or interchange agreements involving, collectively, twelve Kentucky municipalities. The application requested a shift from current, all-in stated unit charge rates to an unbundled formula rate. In May 2009, as a result of settlement negotiations, KU submitted an unopposed motion informing the FERC of the filing of a settlement agreement and agreed-upon seven-year service agreements with the municipal customers. The unopposed motion requested interim rate structures containing terms corresponding to the overall settlement principles, to be effective from May 1, 2009, until FERC approval of the settlement agreement. The settlement and service agreements provide for unbundled formula rates which are subject to annual adjustment and approval processes. In May 2009, the FERC issued an Order approving the interim settlement with respect to rates effective May 1, 2009 representing increases of approximately 3% from prior charges and a return on equity of 11%. Additionally, during May 2009, KU filed the first annual adjustment to the formula rates to incorporate 2008 data, which adjusted formula rates became effective on July 1, 2009 and were approved by the FERC during September 2009.

Separately, the parties were not able to reach agreement on the issue of whether KU must allocate to the municipal customers a portion of renewable resources it may be required to procure on behalf of its retail ratepayers. In August 2009, the FERC accepted the issue for briefing and the parties completed briefing submissions during 2009. An order by the FERC on this matter may occur during 2010. KU is not currently able to predict the outcome of this proceeding, including whether its wholesale customers may or may not be entitled to certain rights or benefits relating to renewable energy, and the financial or operational effects, if any, of such outcomes.

### Regulatory Assets and Liabilities

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

	<u>2009</u>	<u>2008</u>
	(In millions)	
Current regulatory assets:		
ECR . . . . .	\$ 28	\$ 20
FAC . . . . .	1	8
Net MISO exit . . . . .	2	—
Other . . . . .	<u>1</u>	<u>4</u>
Total current regulatory assets . . . . .	<u>\$ 32</u>	<u>\$ 32</u>
Non-current regulatory assets:		
Storm restoration . . . . .	\$ 59	\$ 2
ARO . . . . .	30	28
Unamortized loss on bonds . . . . .	12	13
Net MISO exit . . . . .	9	19
Other . . . . .	<u>7</u>	<u>2</u>
Subtotal non-current regulatory assets . . . . .	117	64
Pension benefits . . . . .	<u>105</u>	<u>137</u>
Total non-current regulatory assets . . . . .	<u>\$222</u>	<u>\$201</u>
Current regulatory liabilities:		
DSM . . . . .	\$ 3	\$ 5
Total current regulatory liabilities . . . . .	<u>\$ 3</u>	<u>\$ 5</u>
Non-current regulatory liabilities:		
Accumulated cost of removal of utility plant . . . . .	\$331	\$329
Deferred income taxes — net . . . . .	9	16
Postretirement benefits . . . . .	9	10
Other . . . . .	<u>11</u>	<u>15</u>
Total non-current regulatory liabilities . . . . .	<u>\$360</u>	<u>\$370</u>



KU does not currently earn a rate of return on the ECR and FAC regulatory assets and the Virginia levelized fuel factor included in other regulatory assets, which are separate recovery mechanisms with recovery within twelve months. No return is earned on the pension regulatory asset that represents the changes in funded status of the plans. KU will recover this asset through pension expense included in the calculation of base rates with the Kentucky Commission and will seek recovery of this asset in future proceedings with the Virginia Commission. No return is currently earned on the ARO asset. When an asset with an ARO is retired, the related ARO regulatory asset will be offset against the associated ARO regulatory liability, ARO asset and ARO liability. A return is earned on the unamortized loss on bonds, and these costs are recovered through amortization over the life of the debt. The Company is seeking recovery of the Storm restoration regulatory asset and CMRG and KCCS contributions and FERC jurisdictional pension expense, included in other regulatory assets, in its current base rate cases. The Company recovers through the calculation of base rates, the amortization of the net MISO exit regulatory asset in Kentucky incurred through April 30, 2008. The Company recently received approval to recover the Virginia portion of this asset, as incurred through December 31, 2008, over a five year period and, due to the formula nature of its FERC rate structure, the FERC jurisdictional portion of the regulatory asset will be included in the annual updates to the rate formula. The Company recovers through the calculation of base rates, the amortization of the remaining regulatory assets, including other regulatory assets comprised of deferred storm costs, the East Kentucky Power Cooperative FERC transmission settlement agreement and Kentucky rate case expenses. Other regulatory liabilities include DSM, FERC jurisdictional supplies inventory and MISO administrative charges collected via base rates from May 2008 through February 5, 2009. The MISO regulatory liability will be netted against the remaining costs of withdrawing from the MISO, per a Kentucky Commission Order, in the current Kentucky base rate case.

*ARO.* A summary of KU's net ARO assets, regulatory assets, ARO liabilities, regulatory liabilities and cost of removal established under the asset retirement and environmental obligations guidance of the FASB ASC, follows:

(in millions of \$)	<u>ARO Net Assets</u>	<u>ARO Liabilities</u>	<u>Regulatory Assets</u>	<u>Regulatory Liabilities</u>	<u>Accumulated Cost of Removal</u>	<u>Cost of Removal Depreciation</u>
As of December 31, 2006 . . . . .	\$ 5	\$(28)	\$22	\$(2)	\$ 2	\$ 1
ARO accretion . . . . .	—	(2)	2	—	—	—
As of December 31, 2007 . . . . .	\$ 5	\$(30)	\$24	\$(2)	\$ 2	\$ 1
ARO accretion . . . . .	—	(2)	2	—	—	—
Removal cost reclass . . . . .	—	—	2	(2)	—	—
As of December 31, 2008 . . . . .	5	(32)	28	(4)	2	1
ARO accretion . . . . .	—	(2)	2	—	—	—
ARO depreciation . . . . .	(1)	—	—	—	—	—
Cost of removal depreciation . . . . .	—	—	—	—	—	1
As of December 31, 2009 . . . . .	<u>\$ 4</u>	<u>\$(34)</u>	<u>\$30</u>	<u>\$(4)</u>	<u>\$ 2</u>	<u>\$ 2</u>

Pursuant to regulatory treatment prescribed under the regulated operations guidance of the FASB ASC, an offsetting regulatory credit was recorded in depreciation and amortization in the income statement of \$2 million in 2009, 2008 and 2007 for the ARO accretion and depreciation expense. KU AROs are primarily related to the final retirement of assets associated with generating units. For assets associated with AROs, the removal cost accrued through depreciation under regulatory accounting is established as a regulatory liability pursuant to regulatory treatment prescribed under the regulated operations guidance of the FASB ASC. For the years ended December 31, 2008 and 2007, KU recorded less than \$1 million of depreciation expense related to the cost of removal of ARO related assets. An offsetting regulatory liability was established pursuant to regulatory treatment prescribed under the regulated operations guidance of the FASB ASC.

KU transmission and distribution lines largely operate under perpetual property easement agreements which do not generally require restoration upon removal of the property. Therefore, under the asset retirement and environmental obligations guidance of the FASB ASC, no material asset retirement obligations are recorded for transmission and distribution assets.

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

KU and the MISO have agreed upon overall calculation methods for the contractual exit fee to be paid by the Company following its withdrawal. In October 2006, the Company paid \$20 million to the MISO and made related FERC compliance filings. The Company's payment of this exit fee was with reservation of its rights to contest the amount, or components thereof, following a continuing review of its calculation and supporting documentation. KU and the MISO resolved their dispute regarding the calculation of the exit fee and, in November 2007, filed an application with the FERC for approval of a recalculation agreement. In March 2008, the FERC approved the parties' recalculation of the exit fee, and the approved agreement provided KU with an immediate recovery of \$1 million and an estimated \$3 million over the next seven years for credits realized from other payments the MISO will receive, plus interest.

In accordance with Kentucky Commission Orders approving the MISO exit, KU has established a regulatory asset for the MISO exit fee, net of former MISO administrative charges collected via Kentucky base rates through the base rate case test year ended April 30, 2008. The net MISO exit fee is subject to adjustment for possible future MISO credits, and a regulatory liability for certain revenues associated with former MISO administrative charges, which were collected via base rates until February 6, 2009. The approved 2008 base rate case settlement provided for MISO administrative charges collected through base rates from May 1, 2008 to February 6, 2009, and any future adjustments to the MISO exit fee, to be established as a regulatory liability until the amounts can be amortized in future base rate cases. This regulatory liability balance as of October 31, 2009 has been included in the base rate case application filed on January 29, 2010. MISO exit fee credit amounts subsequent to October 31, 2009, will continue to accumulate as a regulatory liability until they can be amortized in future base rate cases.

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

In August 2009, the FERC determined that the MISO had failed to demonstrate that its proposed exemptions to real-time RSG charges were just and reasonable. In November 2009, the MISO made a compliance filing incorporating the rulings of the FERC orders and a related task-force, with a primary open issue being whether certain of the tariff changes are applied prospectively only or retroactively to approximately January 6, 2009. The conclusion of the RSG matter, including the retroactivity decision, may result in refunds to the Company, but the Company cannot predict the ultimate outcome of this matter, nor the financial impact, at this time.

In November 2009, KU and LG&E filed an application with the FERC to approve certain independent transmission operator arrangements to be effective upon the expiration of their current contract with Southwest Power Pool, Inc. in September 2010. The application seeks authority for KU and LG&E to function after such date as the administrators of their own open access transmission tariffs for most purposes. The Tennessee Valley Authority, which currently acts as Reliability Coordinator, would also assume certain additional duties. A number of parties have intervened and filed comments in the matter and initial stages of data response proceedings have occurred. The application is subject to continuing FERC proceedings, including further submissions or filings by intervenors or FERC staff, prior to a ruling by the FERC. During January 2010, the Kentucky Commission issued an Order generally authorizing relevant state regulatory aspects of the proposed arrangements.

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

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

The Kentucky Commission requires public hearings at six-month intervals to examine past fuel adjustments, and at two-year intervals to review past operations of the fuel clause and transfer of the then current fuel adjustment charge or credit to the base charges. In November 2009, January 2009, June 2008 and January 2008, the Kentucky Commission issued Orders approving the charges and credits billed through the FAC for the six-month periods ending April 2009, April 2008, October 2007 and April 2007, respectively. In January 2009 and December 2006, the Kentucky Commission initiated routine examinations of the FAC for the two-year periods November 1, 2006 through October 31, 2008 and November 1, 2004 through October 31, 2006. The Kentucky Commission issued Orders in June 2009 and November 2007, approving the charges and credits billed through the FAC during the review periods.

KU also employs an FAC mechanism for Virginia customers using an average fuel cost factor based primarily on projected fuel costs. The Virginia levelized fuel factor allows fuel recovery based on projected fuel costs for the coming year plus an adjustment for any over- or under-recovery of fuel expenses from the prior year. At December 31, 2009 and 2008, KU had a regulatory liability of less than \$1 million and a regulatory asset of \$2 million, respectively.

In February 2009, KU filed an application with the Virginia Commission seeking approval of a 29% increase in its fuel cost factor beginning with service rendered in April 2009. In February 2009, the Virginia Commission issued an Order allowing the requested change to become effective on an interim basis. The Virginia Staff testimony filed in April 2009, recommended a slight decrease in the factor filed by KU. The Company indicated the Virginia Staff proposal was acceptable. A hearing was held in May 2009, with general resolution of remaining issues. In May 2009, the Virginia Commission issued an Order approving the revised fuel factor, representing an increase of 24%, effective May 2009.

In February 2008, KU filed an application with the Virginia Commission seeking approval of a decrease in its fuel cost factor applicable during the billing period, April 2008 through March 2009. The Virginia Commission allowed the new rates to be in effect for the April 2008 customer billings. In April 2008, the Virginia Commission Staff recommended a change to the fuel factor KU filed in its application, to which KU has agreed. Following a public hearing and an Order in May 2008, the recommended change became effective in June 2008, resulting in a decrease of 0.482 cents/kwh from the factor in effect for the April 2007 through March 2008 period.

*ECR.* Kentucky law permits KU to recover the costs of complying with the Federal Clean Air Act, including a return of operating expenses, and a return of and on capital invested, through the ECR mechanism. The amount of

the regulatory asset or liability is the amount that has been under- or over-recovered due to timing or adjustments to the mechanism.

The Kentucky Commission requires reviews of the past operations of the environmental surcharge for six-month and two-year billing periods to evaluate the related charges, credits and rates of return, as well as to provide for the roll-in of ECR amounts to base rates each two-year period. In December 2009, an Order was issued approving the charges and credits billed through the ECR during the two-year period ending April 2009, an increase in the jurisdictional revenue requirement, a base rate roll-in and a revised rate of return on capital. In July 2009, an Order was issued approving the charges and credits billed through the ECR during the six-month period ending October 2008, as well as approving billing adjustments for under-recovered costs and the rate of return on capital. In August 2008, an Order was issued approving the charges and credits billed through the ECR during the six-month periods ending April 2008 and October 2007, and the rate of return on capital. In March 2008, an Order was issued approving the charges and credits billed through the ECR during the six-month and two-year periods ending October 2006 and April 2007, respectively, as well as approving billing adjustments, roll-in adjustments to base rates, revisions to the monthly surcharge filing and the rates of return on capital.

In January 2010, the Kentucky Commission initiated a six-month review of KU's environmental surcharge for the billing period ending October 2009. The proceeding will progress throughout the first half of 2010.

In June 2009, the Company filed an application for a new ECR plan with the Kentucky Commission seeking approval to recover investments in environmental upgrades and operations and maintenance costs at the Company's generating facilities. During 2009, KU reached a unanimous settlement with all parties to the case and the Kentucky Commission issued an Order approving KU's application. Recovery on customer bills through the monthly ECR surcharge for these projects began with the February 2010 billing cycle.

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

In October 2007, KU met with the Kentucky Commission and other interested parties to discuss the status of the Ghent Unit 2 SCR construction. KU informed the Kentucky Commission that construction of the Ghent Unit 2 SCR was not going to commence before the CCN expired in December 2007, due to a change in the economics for the project. The CCN expired in December 2007, and KU has delayed construction of the Ghent Unit 2 SCR.

*Storm Restoration.* In January 2009, a significant ice storm passed through KU's service territory causing approximately 199,000 customer outages, followed closely by a severe wind storm in February 2009, causing approximately 44,000 customer outages. The Company filed an application with the Kentucky Commission in April 2009, requesting approval to establish a regulatory asset, and defer for future recovery, approximately \$62 million in incremental operation and maintenance expenses related to the storm restoration. In September 2009, the Kentucky Commission issued an Order allowing the Company to establish a regulatory asset of up to \$62 million based on its actual costs for storm damages and service restoration due to the January and February 2009 storms. In September 2009, the Company established a regulatory asset of \$57 million for actual costs incurred, and the Company is seeking recovery of this asset in its current base rate case.

In September 2008, high winds from the remnants of Hurricane Ike passed through the service territory causing significant outages and system damage. In October 2008, KU filed an application with the Kentucky Commission requesting approval to establish a regulatory asset, and defer for future recovery, approximately \$3 million of expenses related to the storm restoration. In December 2008, the Kentucky Commission issued an Order allowing the Company to establish a regulatory asset of up to \$3 million based on its actual costs for storm damages and service restoration due to Hurricane Ike. In December 2008, the Company established a regulatory asset of \$2 million for actual costs incurred, and the Company is seeking recovery of this asset in its current base rate case.

*FERC Jurisdictional Pension Costs.* Other regulatory assets include pension costs of \$3 million incurred by the Company and allocated to its FERC jurisdictional ratepayers. The Company will seek recovery of this asset in the next FERC rate proceeding.

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

*CMRG and KCCS Contributions.* In July 2008, KU and LG&E, along with Duke Energy Kentucky, Inc. and Kentucky Power Company, filed an application with the Kentucky Commission requesting approval to establish regulatory assets related to contributions to the CMRG for the development of technologies for reducing carbon dioxide emissions and the KCCS to study the feasibility of geologic storage of carbon dioxide. The filing companies proposed that these contributions be treated as regulatory assets to be deferred until recovery is provided in the next base rate case of each company, at which time the regulatory assets will be amortized over the life of each project: four years with respect to the KCCS and ten years with respect to the CMRG. KU and LG&E jointly agreed to provide less than \$2 million over two years to the KCCS and up to \$2 million over ten years to the CMRG. In October 2008, an Order approving the establishment of the requested regulatory assets was received and KU is seeking rate recovery in the Company's 2010 Kentucky base rate case.

*Deferred Storm Costs.* Based on an Order from the Kentucky Commission in June 2004, KU reclassified from maintenance expense to a regulatory asset, \$4 million related to costs not reimbursed from the 2003 ice storm. These costs were amortized through June 2009. KU earned a return of these amortized costs, which were included in jurisdictional operating expenses.

*Pension and Postretirement Benefits.* KU accounts for pension and postretirement benefits in accordance with the compensation — retirement benefits guidance of the FASB ASC. This guidance requires employers to recognize the over-funded or under-funded status of a defined benefit pension and postretirement plan as an asset or liability in the balance sheet and to recognize through other comprehensive income the changes in the funded status in the year in which the changes occur. Under the regulated operations guidance of the FASB ASC, KU can defer recoverable costs that would otherwise be charged to expense or equity by non-regulated entities. Current rate recovery in Kentucky and Virginia is based on the compensation — retirement benefits guidance of the FASB ASC. Regulators have been clear and consistent with their historical treatment of such rate recovery, therefore, the Company has recorded a regulatory asset representing the change in funded status of the pension plan that is expected to be recovered and a regulatory liability representing the change in funded status of the postretirement plan that is expected to be refunded. The regulatory asset and liability will be adjusted annually as prior service cost and actuarial gains and losses are recognized in net periodic benefit cost.

*Accumulated Cost of Removal of Utility Plant.* As of December 31, 2009 and 2008, KU has segregated the cost of removal, previously embedded in accumulated depreciation, of \$331 million and \$329 million, respectively, in accordance with FERC Order No. 631. This cost of removal component is for assets that do not have a legal ARO under the asset retirement and environmental obligations guidance of the FASB ASC. For reporting purposes in the balance sheets, KU has presented this cost of removal as a regulatory liability pursuant to the regulated operations guidance of the FASB ASC.

*Deferred Income Taxes — Net.* These regulatory assets and liabilities represent the future revenue impact from the reversal of deferred income taxes required for unamortized investment tax credits, the allowance for funds used during construction and deferred taxes provided at rates in excess of currently enacted rates.

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

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

## Other Regulatory Matters

*Kentucky Commission Report on Storms.* In November 2009, the Kentucky Commission issued a report following review and analysis of the effects and utility response to the September 2008 wind storm and the January 2009 ice storm, and possible utility industry preventative measures relating thereto. The report suggested a number of proposed or recommended preventative or responsive measures, including consideration of selective hardening of facilities, altered vegetation management programs, enhanced customer outage communications and similar measures. In March 2010, the Companies filed a joint response reporting on their actions with respect to such recommendations. The response indicated implementation or completion of substantially all of the recommendations, including, among other matters, on-going reviews of system hardening and vegetation management procedures, certain test or pilot programs in such areas, and fielding of enhanced operational and customer outage-related systems.

*Wind Power Agreements.* In August 2009, KU and LG&E filed a notice of intent with the Kentucky Commission indicating their intent to file an application for approval of wind power purchase contracts and cost recovery mechanisms. The contracts were executed in August 2009, and are contingent upon KU and LG&E receiving acceptable regulatory approvals. Pursuant to the proposed 20-year contracts, KU and LG&E would jointly purchase respective assigned portions of the output of two Illinois wind farms totaling an aggregate 109.5 Mw. In September 2009, the Companies filed an application and supporting testimony with the Kentucky Commission. In October 2009, the Kentucky Commission issued an Order denying the Companies' request to establish a surcharge for recovery of the costs of purchasing wind power. The Kentucky Commission stated that such recovery constitutes a general rate adjustment and is subject to the regulations of a base rate case. The Kentucky Commission Order currently provides for the request for approval of the wind power agreements to proceed independently from the request to recover the costs thereof via surcharges. In November 2009, KU and LG&E filed for rehearing of the Kentucky Commission's Order and requested that the matters of approval of the contract and recovery of the costs thereof remain the subject of the same proceeding. During December 2009, the Kentucky Commission issued data requests on this matter. In March 2010, the Companies filed a motion requesting a ruling on this matter during the second quarter of 2010. The Companies cannot currently predict the timing or outcome of this proceeding.

*Trimble County Asset Purchase and Depreciation.* KU and LG&E are currently constructing a new base-load, coal fired unit, TC2, which will be jointly owned by the Companies, together with the IMEA and the IMPA. In July 2009, the Companies notified the Kentucky Commission of the proposed sale from LG&E to KU of certain ownership interests in certain existing Trimble County generating station assets which are anticipated to provide joint or common use in support of the jointly-owned TC2 generating unit under construction at the station. The undivided ownership interests being sold are intended to provide KU an ownership interest in these common assets that is proportional to its interest in TC2 and the assets' role in supporting both TC1 and TC2. In December 2009, KU and LG&E completed the sale transaction at a price of \$48 million, representing the current net book value of the assets, multiplied by the proportional interest being sold.

In August 2009, in a separate proceeding, KU and LG&E jointly filed an application with the Kentucky Commission to approve new depreciation rates for applicable TC2-related generating, pollution control and other plant equipment and assets. The filing requests common depreciation rates for the applicable jointly-owned TC2-related assets, rather than applying differing depreciation rates in place with respect to KU's and LG&E's separately-owned base-load generating assets. During December 2009, the Kentucky Commission extended the data discovery process through January 2010 and authorized KU and LG&E on an interim basis to begin using the depreciation rates for TC2 as proposed in the application. In March 2010, the Kentucky Commission issued a final Order approving the use of the proposed depreciation rates on a permanent basis.

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

The CCN for the remaining line has been challenged by certain property owners in Hardin County, Kentucky. In August 2006, KU and LG&E obtained a successful dismissal of the challenge at the Franklin County Circuit Court, which ruling was reversed by the Kentucky Court of Appeals in December 2007, and the proceeding

reinstated. A motion for discretionary review of that reversal was filed by KU and LG&E with the Kentucky Supreme Court and was granted in April 2009. That proceeding, which seeks reinstatement of the Circuit Court dismissal of the CCN challenge, has been fully briefed and oral argument occurred during March 2010. A ruling on the matter could occur by mid 2010.

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

During 2008, KU obtained various successful rulings at the Hardin County Circuit Court confirming its condemnation rights. In August 2008, several landowners appealed such rulings to the Kentucky Court of Appeals and received a temporary stay preventing KU from accessing their properties. In April 2009, that appellate court denied KU's motion to lift the stay and issued an Order retaining the stay until a decision on the merits of the appeal. Efforts to seek reconsideration of that ruling, or to obtain intermediate review of the ruling by the Kentucky Supreme Court, were unsuccessful, and the stay remains in effect. The underlying appeal on KU's right to condemn remains pending before the Court of Appeals and oral argument on the matter is scheduled to occur during late March 2010.

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

As a result of the aforementioned unresolved litigation delays encountered in obtaining access to certain properties in Hardin County, KU has obtained easements to allow construction of temporary transmission facilities bypassing those properties while the litigated issues are resolved. In September 2009, the Kentucky Commission issued an Order stating that a CCN was necessary for two segments of the proposed temporary facilities. In December 2009, the Kentucky Commission granted the CCNs for the relevant segments and the property owners have filed various motions to intervene, stay and appeal certain elements of the Kentucky Commission's recent orders. In January 2010, in respect of two of such proceedings, the Franklin County circuit court issued Orders denying the property owners' request for a stay of construction and upholding the prior Kentucky Commission denial of their intervenor status. In parallel with, and consistent with the relevant proceedings and their status, the Company is conducting appropriate real estate acquisition and construction activities with respect to these temporary transmission facilities.

In a separate proceeding, certain Hardin County landowners have also challenged the same transmission line in federal district court in Louisville, Kentucky. In that action, the landowners claim that the U.S. Army failed to comply with certain National Historic Preservation Act requirements relating to easements for the line through Fort Knox. KU and LG&E are cooperating with the U.S. Army in its defense in this case and in October 2009, the federal court granted the defendants' motion for summary judgment and dismissed the plaintiffs' claims. During November 2009, the petitioners filed submissions for review of the decision with the 6th Circuit Court of Appeals.

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

*Utility Competition in Virginia.* The Commonwealth of Virginia passed the Virginia Electric Utility Restructuring Act in 1999. This act gave customers the ability to choose their electric supplier and capped electric rates through December 2010. KU subsequently received a legislative exemption from the customer choice requirements of this law. In April 2007, however, the Virginia General Assembly amended the Virginia Electric Utility Restructuring Act, thereby terminating this competitive market and commencing re-regulation of utility rates. The new act ended the cap on rates at the end of 2008. Pursuant to this legislation, the Virginia Commission adopted regulations revising the rules governing utility rate increase applications. As of January 2009, a hybrid model of regulation is being applied in Virginia. Under this model, utility rates are reviewed every two years. KU's exemption from the requirements of the Virginia Electric Utility Restructuring Act in 1999, however, discharges the Company from the requirements of the new hybrid model of regulation. In lieu of submitting an annual information filing, the Company has the option of requesting a change in base rates to recover prudently incurred costs by filing a

traditional base rate case. KU is also subject to other utility regulations in Virginia, including, but not limited to, the recovery of prudently incurred fuel costs through an annual fuel factor charge and the submission of integrated resource plans.

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

In June 2009, the FERC issued Order No. 697-C which generally clarified certain interpretations relating to power sales and purchases at control area interfaces or into control areas involving market power. In July 2009, the FERC issued an order approving the Company's September 2008 application for market-based rate authority. During July 2009, affiliates of KU completed a transaction terminating certain prior generation and power marketing activities in the Big Rivers Electric Corporation control area, which termination should ultimately allow a filing to request a determination that the Company no longer is deemed to have market power in such control area.

KU conducts certain of its wholesale power sales activities in accordance with existing market-based rate authority principles and interpretations. Future FERC proceedings relating to Orders 697 or market-based rate authority could alter the amount of sales made at market-based versus cost-based rates. The Company's sales under market-based rate authority totaled less than \$1 million for the year ended December 31, 2009.

*Mandatory Reliability Standards.* As a result of the EPAct 2005, certain formerly voluntary reliability standards became mandatory in June 2007, and authority was delegated to various Regional Reliability Organizations ("RROs") by the NERC, which was authorized by the FERC to enforce compliance with such standards, including promulgating new standards. Failure to comply with mandatory reliability standards can subject a registered entity to sanctions, including potential fines of up to \$1 million per day, as well as non-monetary penalties, depending upon the circumstances of the violation. KU is a member of the SERC Reliability Corporation ("SERC"), which acts as KU's RRO. During May 2008, the SERC and KU agreed to a settlement involving penalties totaling less than \$1 million related to KU's February 2008 self-report concerning possible violations of certain existing mitigation plans relating to reliability standards. During December 2009, the SERC and KU agreed to a settlement involving penalties totaling less than \$1 million concerning a June 2008 self-report by KU relating to three other standards and an October 2008 self-report relating to an additional standard. During December 2009, KU submitted a self-report relating to an additional standard. SERC proceedings for the December 2009 self-report are in the early stages and therefore the outcome is unable to be determined. Mandatory reliability standard settlements commonly include other non-penalty elements, including compliance steps and mitigation plans. Settlements with the SERC proceed to NERC and FERC review before becoming final. While KU believes itself to be in compliance with the mandatory reliability standards, the Company cannot predict the outcome of other analyses, including on-going SERC or other reviews described above.

*Integrated Resource Planning.* Integrated resource planning ("IRP") regulations in Kentucky require major utilities to make triennial IRP filings with the Kentucky Commission. In April 2008, KU and LG&E filed their 2008 joint IRP with the Kentucky Commission. The IRP provides historical and projected demand, resource and financial data, and other operating performance and system information. The Kentucky Commission issued a staff report and Order closing this proceeding in December 2009. Pursuant to the Virginia Commission's December 2008 Order, KU filed its IRP in July 2009. The filing consisted of the 2008 Joint IRP filed by KU and LG&E with the Kentucky Commission along with additional data. The Virginia Commission has not established a procedural schedule for this proceeding.



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

*EPAAct 2005.* The EPAAct 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 EPAAct 2005, Subtitle E Section 1252, Smart Metering, which concerns time-based metering and demand response, and Section 1254, Interconnections. EPAAct 2005 requires each state regulatory authority to conduct a formal investigation and issue a decision on whether or not it is appropriate to implement certain Section 1252 standards within eighteen months after the enactment of EPAAct 2005 and to commence consideration of Section 1254 standards within one year after the enactment of EPAAct 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 EPAAct 2005 Section 1252 and Section 1254 standards should not be adopted. However, all five Kentucky Commission jurisdictional utilities are required to file real-time pricing pilot programs for their large commercial and industrial customers. KU developed a real-time pricing pilot for large industrial and commercial customers and filed the details of the plan with the Kentucky Commission in April 2007. In February 2008, the Kentucky Commission issued an Order approving the real-time pricing pilot program proposed by KU for implementation within approximately eight months, for its large commercial and industrial customers. The tariff was filed in October 2008, with an effective date of December 1, 2008. KU files annual reports on the program within 90 days of each plan year-end for the 3-year pilot period.

*Green Energy Riders.* In February 2007, KU and LG&E filed a Joint Application and Testimony for Proposed Green Energy Riders. In May 2007, a Kentucky Commission Order was issued authorizing KU to establish Small and Large Green Energy Riders, allowing customers to contribute funds to be used for the purchase of renewable energy credits. During November 2009, KU and LG&E filed an application to both continue and modify the existing Green Energy Programs and requested a Kentucky Commission Order by March 2010.

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

*Collection Cycle Revision.* As part of its base rate case filed on July 29, 2008, LG&E proposed to change the due date for customer bill payments from 15 days to 10 days to align its collection cycle with KU. In addition, KU proposed to include a late payment charge if payment is not received within 15 days from the bill issuance date to align with LG&E. The settlement agreement approved in the rate case in February 2009, changed the due date for customer bill payments to 12 days after bill issuance for both KU and LG&E, and permitted KU's implementation of a late payment charge if payment is not received within 15 days from the bill issuance date.

*Depreciation Study.* In December 2007, KU filed a depreciation study with the Kentucky Commission as required by a previous Order. In August 2008, the Kentucky Commission issued an Order consolidating the depreciation study with the base rate case proceeding. The approved settlement agreement in the rate case established new depreciation rates effective February 2009. KU also filed the depreciation study with the Virginia Commission which approved the implementation of the new depreciation rates effective February 2009. Approval

by the Virginia Commission does not preclude the rates from being raised as an issue by any party in KU's current base rate case in Virginia.

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

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

*EISA 2007 Standards.* In November 2008, the Kentucky Commission initiated an administrative proceeding to consider new standards as a result of the Energy Independence and Security Act of 2007 ("EISA 2007"), part of which amends the Public Utility Regulatory Policies Act of 1978 ("PURPA"). There are four new PURPA standards and one non-PURPA standard applicable to electric utilities. The proceeding also considers two new PURPA standards applicable to natural gas utilities. EISA 2007 requires state regulatory commissions and nonregulated utilities to begin consideration of the rate design and smart grid investments no later than December 19, 2008, and to complete the consideration by December 19, 2009. The Kentucky Commission established a procedural schedule that allowed for data discovery and testimony through July 2009. A public hearing has not been scheduled in this matter. In October 2009, the Kentucky Commission held an informal conference for the purpose of discussing issues related to the standard regarding the consideration of Smart Grid investments.

**Note 3 — Financial Instruments**

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

	2009		2008	
	Carrying Value	Fair Value	Carrying Value	Fair Value
	(In millions)			
Long-term debt (including current portion of \$228 million) . . . . .	\$ 351	\$ 351	\$ 351	\$ 349
Long-term debt from affiliate (including current portion of \$33 million) . . . . .	\$1,331	\$1,401	\$1,181	\$1,117

The long-term debt valuations reflect prices quoted by dealers. The fair value of the long-term debt from affiliate is determined using an internal valuation model that discounts the future cash flows of each loan at current market rates. The current market values are determined based on quotes from investment banks that are actively involved in capital markets for utilities and factor in KU's credit ratings and default risk. The fair values of cash and cash equivalents, accounts receivable, cash surrender value of key man life insurance, accounts payable and notes payable are substantially the same as their carrying values.

KU is subject to the risk of fluctuating interest rates in the normal course of business. The Company's policies allow the interest rate risk to be managed through the use of fixed rate debt, floating rate debt and interest rate swaps. At December 31, 2009, a 100 basis point change in the benchmark rate on KU's variable rate debt would impact pre-tax interest expense by \$4 million annually. Although the Company's policies allow for the use of interest rate swaps, as of December 31, 2008 and 2009, KU had no interest rate swaps outstanding.

The Company is subject to interest rate and commodity price risk related to on-going business operations. It currently manages these risks using derivative financial instruments including swaps and forward contracts.

KU has classified the applicable financial assets and liabilities that are accounted for at fair value into the three levels of the fair value hierarchy, as defined by the fair value measurements and disclosures guidance of the FASB ASC, as follows:

- Level 1 — Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 — Include other inputs that are directly or indirectly observable in the marketplace.
- Level 3 — Unobservable inputs which are supported by little or no market activity.

*Energy Trading and Risk Management Activities.* KU conducts energy trading and risk management activities to maximize the value of power sales from physical assets it owns. Energy trading activities are principally forward financial transactions to manage price risk and are accounted for as non-hedging derivatives on a mark-to-market basis in accordance with the derivatives and hedging guidance of the FASB ASC.

Energy trading and risk management contracts are valued using prices based on active trades from Intercontinental Exchange Inc. In the absence of a traded price, midpoints of the best bids and offers are the primary determinants of valuation. When sufficient trading activity is unavailable, other inputs include prices quoted by brokers or observable inputs other than quoted prices, such as one-sided bids or offers as of the balance sheet date. Using these valuation methodologies, these contracts are considered level 2 based on measurement criteria in the fair value measurements and disclosures guidance of the FASB ASC. Quotes are verified quarterly using an independent pricing source of actual transactions. Quotes for combined off-peak and weekend timeframes are allocated between the two timeframes based on their historically proportionate ratios to the integrated cost. No other adjustments are made to the forward prices. No changes to valuation techniques for energy trading and risk management activities occurred during 2009, 2008 or 2007. Changes in market pricing, interest rate and volatility assumptions were made during both years.

The Company maintains credit policies intended to minimize credit risk in wholesale marketing and trading activities by assessing the creditworthiness of potential counterparties prior to entering into transactions with them and continuing to evaluate their creditworthiness once transactions have been initiated. To further mitigate credit risk, KU seeks to enter into netting agreements or require cash deposits, letters of credit and parental company guarantees as security from counterparties. The Company uses S&P, Moody's and definitive qualitative and quantitative data to assess the financial strength of counterparties on an on-going basis. If no external rating exists, KU assigns an internally generated rating for which it sets appropriate risk parameters. As risk management contracts are valued based on changes in market prices of the related commodities, credit exposures are revalued and monitored on a daily basis. At December 31, 2009, 100% of the trading and risk management commitments were with counterparties rated BBB-/Baa3 equivalent or better. The Company has reserved against counterparty credit risk based on the counterparty's credit rating and applying historical default rates within varying credit ratings over time provided by S&P or Moody's. At December 31, 2009 and 2008, credit reserves related to the energy trading and risk management contracts were less than \$1 million.

The net volume of electricity based financial derivatives outstanding at December 31, 2009 and 2008, was 315,600 Mwhts and 146,000 Mwhts, respectively. All the volume outstanding at December 31, 2009 will settle in 2010.

The following table sets forth by level within the fair value hierarchy, KU's financial assets and liabilities that were accounted for at fair value on a recurring basis as of December 31, 2008. Cash collateral related to the energy trading and risk management contracts was less than \$1 million at December 31, 2009 and 2008. Cash collateral related to the energy

trading and risk management contracts is categorized as other accounts receivable and is a level 1 measurement based on the funds being held in liquid accounts. Energy trading and risk management contracts are considered level 2 based on measurement criteria in the fair value measurements and disclosures guidance of the FASB ASC. Financial assets as of December 31, 2009 and financial liabilities as of December 31, 2009 and 2008, arising from energy trading and risk management contracts accounted for at fair value total less than \$1 million and use level 2 measurements. There are no level 3 measurements for the periods ending December 31, 2009 and 2008.

<u>December 31, 2008</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Total</u>
Financial Assets:			
Energy trading and risk management contracts . . . . .	\$—	\$1	\$1
Total Financial Assets . . . . .	<u>\$—</u>	<u>\$1</u>	<u>\$1</u>

The Company does not net collateral against derivative instruments.

Certain of the Company's derivative instruments contain provisions that require the Company to provide immediate and on-going collateralization on derivative instruments in net liability positions based upon the Company's credit ratings from each of the major credit rating agencies. At December 31, 2009, there are no energy trading and risk management contracts with credit risk related contingent features that are in a liability position, and no collateral posted in the normal course of business. At December 31, 2009, a one notch downgrade of the Company's credit rating would have no effect on the energy trading and risk management contracts or collateral required as a result of these contracts.

The table below shows the fair value and balance sheet location of derivatives not designated as hedging instruments as of December 31, 2008:

<u>December 31, 2008</u>				
Energy trading and risk management contracts (current) . . . . .	Other current assets	\$1	Other current liabilities	\$—
Total . . . . .		<u>\$1</u>		<u>\$—</u>

Financial assets and liabilities as of December 31, 2009 arising from energy trading and risk management contracts accounted for at fair value total less than \$1 million.

KU manages the price risk of its estimated future excess economic generation capacity using market-traded forward financial contracts. Hedge accounting treatment has not been elected for these transactions, and therefore gains and losses are shown in the statements of income.

The following tables present the effect of derivatives not designated as hedging instruments on income for the years ended December 31, 2009 and 2008:

	<u>Location of Gain (Loss) Recognized in Income on Derivatives</u>	<u>Amount of Gain (Loss) Recognized in Income on Derivatives</u> (In millions)
<u>December 31, 2009</u>		
Energy trading and risk management contracts (unrealized) . . . . .	Electric revenues	\$(1)
Total . . . . .		<u>\$(1)</u>
<u>December 31, 2008</u>		
Energy trading and risk management contracts (unrealized) . . . . .	Electric revenues	\$ 1
Total . . . . .		<u>\$ 1</u>

Unrealized gains and losses were less than \$1 million for the year ended December 31, 2007. Net realized gains and losses were less than \$1 million for the years ended December 31, 2009, 2008, and 2007.

#### Note 4 — Concentrations of Credit and Other Risk

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

KU's customer receivables and revenues arise from deliveries of electricity to approximately 515,000 customers in over 600 communities and adjacent suburban and rural areas in 77 counties in central, southeastern and western Kentucky, to approximately 30,000 customers in 5 counties in southwestern Virginia and 5 customers in Tennessee. For the years ended December 31, 2009, 2008 and 2007, 100% of total revenue was derived from electric operations. During 2009, the Company's 10 largest customers accounted for less than 15% of electric volumes.

Effective August 4, 2009, the Company and its employees represented by the IBEW Local 2100 entered into a three-year collective bargaining agreement. The agreement provides for negotiated increases or changes to wages, benefits or other provisions and for annual wage re-openers. KU and employees represented by the USWA Local 9447-01 entered into a three-year collective bargaining agreement in August 2008. This agreement provides for negotiated increases or changes to wages, benefits or other provisions and for annual wage re-openers. The employees represented by these two bargaining units comprise approximately 15% of the Company's workforce at December 31, 2009.

#### Note 5 — Pension and Other Postretirement Benefit Plans

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

*Obligations and Funded Status.* The following tables provide a reconciliation of the changes in the defined benefit plans' obligations and the fair value of assets for the two-year period ending December 31, 2009, and the funded status for the plans as of December 31:

	Pension Benefits		Other Postretirement Benefits	
	2009	2008	2009	2008
	(In millions)			
<b>Change in benefit obligation</b>				
Benefit obligation at beginning of year . . . . .	\$306	\$ 284	\$ 75	\$ 76
Service cost . . . . .	6	5	2	1
Interest cost . . . . .	18	18	4	5
Benefits paid, net of retiree contributions . . . . .	(18)	(18)	(5)	(3)
Actuarial (gain)/loss and other . . . . .	4	17	4	(4)
Benefit obligation at end of year . . . . .	<u>\$316</u>	<u>\$ 306</u>	<u>\$ 80</u>	<u>\$ 75</u>
<b>Change in plan assets</b>				
Fair value of plan assets at beginning of year . . . . .	\$183	\$ 264	\$ 12	\$ 13
Actual return on plan assets . . . . .	41	(61)	3	(3)
Employer contributions . . . . .	13	—	7	5
Benefits paid, net of retiree contributions . . . . .	(18)	(18)	(5)	(3)
Administrative expenses and other . . . . .	—	(2)	—	—
Fair value of plan assets at end of year . . . . .	<u>\$219</u>	<u>\$ 183</u>	<u>\$ 17</u>	<u>\$ 12</u>
<b>Funded status at end of year . . . . .</b>	<u><b>\$(97)</b></u>	<u><b>\$(123)</b></u>	<u><b>\$(63)</b></u>	<u><b>\$(63)</b></u>

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

	Pension Benefits		Other Postretirement Benefits	
	2009	2008	2009	2008
	(In millions)			
Regulatory assets . . . . .	\$105	\$ 137	\$ —	\$ —
Regulatory liabilities . . . . .	—	—	(9)	(10)
Accrued benefit liability (non-current) . . . . .	(97)	(123)	(63)	(63)

Amounts recognized in regulatory assets and liabilities consist of:

	Pension Benefits		Other Postretirement Benefits	
	2009	2008	2009	2008
	(In millions)			
Transition obligation . . . . .	\$ —	\$ —	\$ 3	\$ 4
Prior service cost . . . . .	5	5	2	2
Accumulated (gain)/loss . . . . .	<u>100</u>	<u>132</u>	<u>(14)</u>	<u>(16)</u>
Total regulatory assets (liabilities) . . . . .	<u>\$105</u>	<u>\$137</u>	<u>\$ (9)</u>	<u>\$(10)</u>

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

	Pension Benefits		Other Postretirement Benefits	
	2009	2008	2009	2008
	(In millions)			
Benefit obligation . . . . .	\$316	\$306	\$80	\$75
Accumulated benefit obligation . . . . .	268	261	—	—
Fair value of plan assets . . . . .	219	183	17	12

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

The amounts recognized in regulatory assets and liabilities for the years ended December 31, are composed of the following:

	Pension Benefits		Other Postretirement Benefits	
	2009	2008	2009	2008
	(In millions)			
Prior service cost arising during the period . . . . .	\$ —	\$ —	\$—	\$ 1
Net loss/(gain) arising during the period . . . . .	(22)	101	2	—
Amortization of prior service (cost)/credit . . . . .	(1)	(1)	—	(1)
Amortization of transitional (obligation)/asset . . . . .	—	—	(1)	(1)
Amortization of gain/(loss) . . . . .	<u>(9)</u>	<u>—</u>	<u>—</u>	<u>—</u>
Total amounts recognized in regulatory assets & liabilities . . . . .	<u>\$(32)</u>	<u>\$100</u>	<u>\$ 1</u>	<u>\$(1)</u>

*Components of Net Periodic Benefit Cost.* The following tables provide the components of net periodic benefit cost for pension and other postretirement benefit plans. The tables include the costs associated with both KU employees and E.ON U.S. Services' employees, who provide services to the utility. The E.ON U.S. Services' costs that are allocated to KU are approximately 49%, 46% and 45% of E.ON U.S. Services' total cost for 2009, 2008 and 2007, respectively.

	Pension Benefits								
	E.ON U.S. Services Allocation to KU			E.ON U.S. Services Allocation to KU			E.ON U.S. Services Allocation to KU		
	KU	Total KU	Total KU	KU	Total KU	Total KU	KU	Total KU	Total KU
	2009	2009	2009	2008	2008	2008	2007	2007	2007
	(In millions)								
Service cost	\$ 6	\$ 5	\$ 11	\$ 6	\$ 4	\$ 10	\$ 6	\$ 4	\$ 10
Interest cost	18	7	25	18	6	24	17	5	22
Expected return on plan assets	(15)	(4)	(19)	(21)	(5)	(26)	(21)	(5)	(26)
Amortization of prior service costs	1	1	2	1	1	2	1	1	2
Amortization of actuarial loss	9	2	11	—	—	—	2	1	3
Benefit cost at end of year	<u>\$ 19</u>	<u>\$ 11</u>	<u>\$ 30</u>	<u>\$ 4</u>	<u>\$ 6</u>	<u>\$ 10</u>	<u>\$ 5</u>	<u>\$ 6</u>	<u>\$ 11</u>

	Other Postretirement Benefits								
	E.ON U.S. Services Allocation to KU			E.ON U.S. Services Allocation to KU			E.ON U.S. Services Allocation to KU		
	KU	Total KU	Total KU	KU	Total KU	Total KU	KU	Total KU	Total KU
	2009	2009	2009	2008	2008	2008	2007	2007	2007
	(In millions)								
Service cost	\$ 1	\$ 1	\$ 2	\$ 1	\$ 1	\$ 2	\$ 1	\$ 1	\$ 2
Interest cost	5	—	5	5	—	5	5	—	5
Expected return on plan assets	(1)	—	(1)	(1)	—	(1)	(1)	—	(1)
Amortization of transitional obligation	1	—	1	1	—	1	1	—	1
Benefit cost at end of year	<u>\$ 6</u>	<u>\$ 1</u>	<u>\$ 7</u>	<u>\$ 6</u>	<u>\$ 1</u>	<u>\$ 7</u>	<u>\$ 6</u>	<u>\$ 1</u>	<u>\$ 7</u>

The estimated amounts that will be amortized from regulatory assets and liabilities into net periodic benefit cost in 2010 are shown in the following table:

	Pension Benefits	Other Postretirement Benefits
	(In millions)	
Regulatory assets/liabilities:		
Net actuarial loss	\$ 6	\$—
Prior service cost	1	1
Transition obligation	—	1
Total regulatory assets/liabilities amortized during 2010	<u>\$ 7</u>	<u>\$ 2</u>

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

	2009	2008
Weighted-average assumptions as of December 31:		
Discount rate	6.13%	6.25%
Rate of compensation increase	5.25%	5.25%

The discount rates were determined by the December 28, 2009, Mercer Pension Discount Yield Curve. These discount rates were then lowered by 8 basis points for the average change in 4 bond indices, Citigroup High Grade Credit Index AAA/AA 10+ years, Barclays Capital US Long Credit AA, Merrill Lynch US Corporate AA-AAA rated 10+ years and Merrill Lynch US Corporate AA rated 15+ years, for the period from December 28, 2009 to December 31, 2009.

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

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Discount rate . . . . .	6.25%	6.66%	5.96%
Expected long-term return on plan assets . . . . .	8.25%	8.25%	8.25%
Rate of compensation increase . . . . .	5.25%	5.25%	5.25%

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

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

- A 1% change in the assumed discount rate could have an approximate \$34 million positive or negative impact to the 2009 accumulated benefit obligation and an approximate \$45 million positive or negative impact to the 2009 projected benefit obligation.
- A 25 basis point change in the expected rate of return on assets would have resulted in less than a \$1 million positive or negative impact on 2009 pension expense.

*Assumed Health Care Cost Trend Rates.* For measurement purposes, an 8% annual increase in the per capita cost of covered health care benefits was assumed for 2009. The rate was assumed to decrease gradually to 4.5% by 2029 and remain at that level thereafter.

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A 1% change in assumed health care cost trend rates would have resulted in an increase or decrease of less than \$1 million on the 2009 total of service and interest costs components and an increase or decrease of \$4 million in year-end 2009 postretirement benefit obligations.

*Expected Future Benefit Payments and Medicare Subsidy Receipts.* The following list provides the amount of expected future benefit payments, which reflect expected future service and the estimated gross amount of Medicare subsidy receipts:

	<u>Pension Benefits</u>	<u>Other Postretirement Benefits</u>	<u>Medicare Subsidy Receipts</u>
		(In millions)	
2010 . . . . .	\$17	\$ 6	\$ 1
2011 . . . . .	17	6	—
2012 . . . . .	17	6	1
2013 . . . . .	17	6	—
2014 . . . . .	17	7	1
2015-19 . . . . .	97	37	3



*Plan Assets.* The following table shows the plans' weighted-average asset allocation by asset category at December 31:

<u>Pension Plans</u>	<u>Target Range</u>	<u>2009</u>	<u>2008</u>
Equity securities . . . . .	45% - 75%	59%	55%
Debt securities . . . . .	30% - 50%	40	43
Other . . . . .	0% - 10%	<u>1</u>	<u>2</u>
Totals . . . . .		<u>100%</u>	<u>100%</u>

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

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

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

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

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

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

KU has classified plan assets that are accounted for at fair value into the three levels of the fair value hierarchy, as defined by the fair value measurements and disclosures guidance of the FASB ASC. See Note 3 of the Notes to Financial Statements.

A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

A description of the valuation methodologies used to measure plan assets at fair value is provided below:

*Money Market Fund:* These investments are public investment vehicles valued using \$1 for the net asset value. The money market funds are classified within level 2 of the valuation hierarchy.

*Common/Collective Trusts:* Valued based on the beginning of year value of the plan's interests in the trust plus actual contributions and allocated investment income (loss) less actual distributions and allocated

administrative expenses. Quoted market prices are used to value investments in the trust, with the exception of the Group Annuity Contract (“GAC”). The fair value of certain other investments for which quoted market prices are not available are valued based on yields currently available on comparable securities of issuers with similar credit ratings. The common/collective trusts are classified within level 2 of the valuation hierarchy.

The preceding methods described may produce a fair value that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Company believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date. There were no changes in the plan’s valuation methodologies during 2009.

The following table sets forth, by level within the fair value hierarchy, the plan’s assets at fair value as of December 31, 2009:

	<u>Level 2</u> (Millions)
Money Market Fund . . . . .	\$ 2
Common/Collective Trusts . . . . .	<u>186</u>
Total investments at fair value . . . . .	<u>\$188</u>

There are no assets categorized as level 1 or level 3.

The GAC is an immediate participation guarantee contract. In accordance with the plan accounting guidance of the FASB ASC, the cost incurred to purchase the GAC prior to March 20, 1992, is permitted to be carried at contract value, since it is a contract with an insurance company and therefore is excluded from the table above. The cost incurred to fund the GAC after March 20, 1992, is carried at contract value in accordance with the plan accounting guidance of the FASB ASC, since it is a contract that incorporates mortality and morbidity risk. Contract value represents cost plus interest income less distributions for benefits and administrative expenses.

*Contributions.* KU made a discretionary contribution to the pension plan of \$13 million in April 2009 and \$13 million in January 2007. The Company also made contributions to other postretirement benefit plans of \$7 million, \$5 million and \$6 million in 2009, 2008 and 2007, respectively. The amount of future contributions to the pension plan will depend upon the actual return on plan assets and other factors, but the Company funds its pension obligations in a manner consistent with the Pension Protection Act of 2006. In January 2010, KU made a discretionary contribution to the pension plan of \$13 million and anticipates making voluntary contributions to fund Voluntary Employee Beneficiary Association trusts to match the annual postretirement expense and funding the 401(h) plan up to the maximum amount allowed by law.

*Pension Legislation.* The Pension Protection Act of 2006 was enacted in August 2006. New rules regarding funding of defined benefit plans are generally effective for plan years beginning in 2008. Among other matters, this comprehensive legislation contains provisions applicable to defined benefit plans which generally (i) mandate full funding of current liabilities within seven years; (ii) increase tax-deduction levels regarding contributions; (iii) revise certain actuarial assumptions, such as mortality tables and discount rates; and (iv) raise federal insurance premiums and other fees for under-funded and distressed plans. The legislation also contains a number of provisions relating to defined-contribution plans and qualified and non-qualified executive pension plans and other matters. The Company’s plan met the minimum funding requirements as defined by the Pension Protection Act of 2006 for years ended December 31, 2009 and 2008.

*Thrift Savings Plans.* KU has a thrift savings plan under section 401(k) of the Internal Revenue Code. Under the plan, eligible employees may defer and contribute to the plan a portion of current compensation in order to provide future retirement benefits. KU makes contributions to the plan by matching a portion of the employee contributions. The costs of this matching were \$3 million in 2009 and 2008, and \$2 million in 2007.

KU also makes contributions to retirement income accounts within the thrift savings plans for certain employees not covered by noncontributory defined benefit pension plans. These employees consist mainly of those hired after December 31, 2005. The Company makes these contributions based on years of service and the employees’ wage and

salary levels, and it makes them in addition to the matching contributions discussed above. The amounts contributed by the Company under this arrangement equaled less than \$1 million in 2009, 2008 and 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 KU, calculates its separate income tax for each period. The resulting separate-return tax cost or benefit is paid to or received from the parent company or its designee. The Company also files income tax returns in various state jurisdictions. While 2006 and later years are open under the federal statute of limitations, Revenue Agent Reports for 2006-2007 have been received from the IRS, effectively closing these years to additional audit adjustments. Adjustments to these tax years were previously recorded in the financial statements. Tax years 2007 and 2008 were examined under an IRS pilot program named “Compliance Assurance Process” (“CAP”). This program accelerates the IRS’s review to begin during the year applicable to the return and ends 90 days after the return is filed. KU had no adjustments for the 2007 federal return. Areas remaining under examination for 2008 include bonus depreciation and the Company’s application for a change in repair deductions. No net material adverse impact is expected from these remaining areas.

Additions and reductions of uncertain tax positions during 2009, 2008 and 2007 were less than \$1 million. Possible amounts of uncertain tax positions for KU that may decrease within the next 12 months total less than \$1 million and are based on the expiration of the audit periods as defined in the statutes. If recognized, the less than \$1 million of unrecognized tax benefits would reduce the effective income tax rate.

The amount KU recognized as interest expense and interest accrued related to unrecognized tax benefits was less than \$1 million as of December 31, 2009, 2008 and 2007. The interest expense and interest accrued is based on IRS and Kentucky Department of Revenue large corporate interest rates for underpayment of taxes. At the date of adoption, the Company accrued less than \$1 million in interest expense on uncertain tax positions. KU records the interest as interest expense and penalties as operating expenses in the income statement and accrued expenses in the balance sheets, on a pre-tax basis. No penalties were accrued by the Company through December 31, 2009.

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

	<u>2009</u>	<u>2008</u>	<u>2007</u>
	(In millions)		
Current — federal . . . . .	\$ (5)	\$ 46	\$ 28
— state . . . . .	1	10	13
Deferred — federal — net . . . . .	43	(10)	(5)
— state — net . . . . .	7	(3)	(1)
Investment tax credit — deferred . . . . .	21	25	43
Amortization of investment tax credit . . . . .	<u>—</u>	<u>—</u>	<u>(1)</u>
Total income tax expense . . . . .	<u>\$67</u>	<u>\$ 68</u>	<u>\$77</u>

Deferred federal and state income tax expense increased in 2009, compared to 2008, due primarily to temporary differences related to storm costs and depreciation. The temporary differences also resulted in an offsetting decrease to current federal and state taxes in 2009. Current federal income tax expense increased in 2008, compared to 2007, and investment tax credit — deferred decreased primarily due to claiming \$18 million less in investment tax credits in 2008. Current state income tax decreased due to coal credits claimed in 2008. Deferred federal income tax expense decreased in 2008 primarily due to adjusting prior year estimates to actual based on the filed tax return.

In June 2006, KU and LG&E filed a joint application with the U.S. Department of Energy (“DOE”) requesting certification to be eligible for investment tax credits applicable to the construction of TC2. In November 2006, the DOE and the IRS announced that KU and LG&E were selected to receive the tax credit. A final IRS certification required to obtain the investment tax credit was received in August 2007. In September 2007, KU received an Order from the Kentucky Commission approving the accounting of the investment tax credit. KU’s portion of the TC2 tax

credit will be approximately \$101 million over the construction period and will be amortized to income over the life of the related property beginning when the facility is placed in service. Based on eligible construction expenditures incurred, KU recorded investment tax credits of \$21 million, \$25 million and \$43 million in 2009, 2008 and 2007, respectively, decreasing current federal income taxes. The amount claimed through 2009 is all that KU is allowed to claim. KU has reached the maximum credit of \$101 million. In addition, a full depreciation basis adjustment is required for the amount of the credit. The income tax expense impact from amortizing these credits will begin when the facility is placed in service.

In March 2008, certain environmental and preservation groups filed suit in federal court in North Carolina against the DOE and IRS claiming the investment tax credit program was in violation of certain environmental laws and demanded relief, including suspension or termination of the program. During 2008 and 2009, the plaintiffs submitted amended complaints alleging additional claims for relief. In October 2009, the plaintiffs filed a motion for a preliminary injunction seeking temporary implementation of certain elements of the requested relief. The Company is not currently a party to this proceeding and is not able to predict the ultimate outcome of this matter.

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

	<u>2009</u>	<u>2008</u>
	(In millions)	
Deferred tax liabilities:		
Depreciation and other plant-related items . . . . .	\$303	\$284
Regulatory assets and other . . . . .	<u>69</u>	<u>40</u>
Total deferred tax liabilities . . . . .	<u>372</u>	<u>324</u>
Deferred tax assets:		
Income taxes due to customers . . . . .	4	6
Pensions and related benefits . . . . .	17	19
Liabilities and other . . . . .	<u>18</u>	<u>22</u>
Total deferred tax assets . . . . .	<u>39</u>	<u>47</u>
Net deferred income tax liability . . . . .	<u>\$333</u>	<u>\$277</u>
Balance sheet classification		
Current assets . . . . .	\$ (3)	\$ (2)
Non-current liabilities . . . . .	<u>336</u>	<u>279</u>
Net deferred income tax liability . . . . .	<u>\$333</u>	<u>\$277</u>

The Company expects to have adequate levels of taxable income to realize its recorded deferred tax assets.

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

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Statutory federal income tax rate . . . . .	35.0%	35.0%	35.0%
State income taxes, net of federal benefit . . . . .	2.7	2.6	3.4
Reduction of income tax reserve . . . . .	—	(0.2)	(0.4)
Qualified production activities deduction . . . . .	(0.3)	(1.1)	(1.2)
Dividends received deduction related to EEI investment . . . . .	(1.5)	(4.2)	(2.9)
Reversal of excess deferred taxes . . . . .	(0.9)	(0.6)	(0.8)
Other differences . . . . .	<u>(1.5)</u>	<u>(1.4)</u>	<u>(1.5)</u>
Effective income tax rate . . . . .	<u>33.5%</u>	<u>30.1%</u>	<u>31.6%</u>

The effective income tax rate increased from 2008 to 2009 primarily due to a \$15 million decrease in 2009 dividends received from Electric Energy Inc., reducing the dividends received deduction. The effective income tax rate decreased from 2007 to 2008 primarily due to increased dividends from its investment in EEI.

#### Note 7 — Long-Term Debt

As of December 31, 2009 and 2008, long-term debt and the current portion of long-term debt consist primarily of pollution control bonds and long-term loans from affiliated companies as summarized below.

	<u>Stated Interest Rates</u>	<u>Maturities</u>	<u>Principal Amounts</u> (In millions)
Outstanding at December 31, 2009:			
Noncurrent portion . . . . .	Variable — 7.035%	2011-2037	\$1,421
Current portion . . . . .	Variable — 4.240%	2010-2034	\$ 261
Outstanding at December 31, 2008:			
Noncurrent portion . . . . .	Variable — 7.035%	2010-2037	\$1,304
Current portion . . . . .	Variable	2023-2034	\$ 228

Long-term debt includes \$228 million of pollution control bonds that are classified as current portion because these bonds are subject to tender for purchase at the option of the holder and to mandatory tender for purchase upon the occurrence of certain events. These bonds include Carroll County 2002 Series A and B, 2004 Series A, 2006 Series B and 2008 Series A; Muhlenberg County 2002 Series A; and Mercer County 2000 Series A and 2002 Series A. Maturity dates for these bonds range from 2023 to 2034. The average annualized interest rate for these bonds during 2009, 2008 and 2007, was 0.61%, 1.75% and 3.72%, respectively.

Pollution control bonds are obligations issued in connection with tax-exempt pollution control revenue bonds issued by various governmental entities, principally counties in Kentucky. A loan agreement obligates the Company to make debt service payments to the county that equate to the debt service due from the county on the related pollution control revenue bonds. The loan agreement is an unsecured obligation of the Company. Proceeds from bond issuances for environmental equipment (primarily related to the installation of FGDs) were held in trust pending expenditure for qualifying assets. At December 31, 2009, KU had no bond proceeds in trust included in restricted cash on the balance sheet. At December 31, 2008, the Company had \$9 million of bond proceeds in trust included in restricted cash in the balance sheets.

Several of the pollution control bonds are insured by monoline bond insurers whose ratings have been reduced due to exposures relating to insurance of sub-prime mortgages. At December 31, 2009, the Company had an aggregate \$351 million of outstanding pollution control indebtedness, of which \$96 million is in the form of insured auction rate securities wherein interest rates are reset every 35 days via an auction process. Beginning in late 2007, the interest rates on these insured bonds began to increase due to investor concerns about the creditworthiness of the bond insurers. During 2008, interest rates increased, and the Company experienced “failed auctions” when there were insufficient bids for the bonds. When a failed auction occurs, the interest rate is set pursuant to a formula stipulated in the indenture. During 2009, 2008 and 2007, the average rate on the auction rate bonds was 0.44%, 4.50% and 3.96%, respectively. The instruments governing these auction rate bonds permit KU to convert the bonds to other interest rate modes, such as various short-term variable rates, long-term fixed rates or intermediate-term fixed rates that are reset infrequently. In June 2009, S&P downgraded the credit rating of Ambac from “A” to “BBB”. As a result, S&P downgraded the rating on certain bonds in June 2009. The S&P rating of these bonds is

now based on the rating of the Company rather than the rating of Ambac since the Company's rating is higher. The following table presents the bonds downgraded:

<u>Tax Exempt Bond Issues</u>	<u>Principal</u> (\$ in millions)	<u>Bond Rating</u>			
		<u>Moody's</u>		<u>S&amp;P</u>	
		<u>2009</u>	<u>2008</u>	<u>2009</u>	<u>2008</u>
Carroll County 2002 Series C . . . . .	\$96	A2	A2	BBB+	A
Carroll County 2007 Series A . . . . .	\$18	A2	A2	BBB+	A
Trimble County 2007 Series A . . . . .	\$ 9	A2	A2	BBB+	A

During 2008, KU converted several series of its pollution control bonds from the auction rate mode to a weekly interest rate mode, as permitted under the loan documents. In connection with these conversions, the Company purchased some of the bonds from the remarketing agent. The bonds that were repurchased from the remarketing agent in 2008 were either defeased or remarketed during 2008.

As of December 31, 2009, KU had no remaining repurchased bonds. During 2008, KU refinanced and remarketed \$63 million and refinanced \$17 million of pollution control bonds that had been previously repurchased by the Company.

All of KU's first mortgage bonds were released and terminated in February 2007. Under the provisions for certain of KU's variable-rate pollution control bonds, the bonds are subject to tender for purchase at the option of the holder and to mandatory tender for purchase upon the occurrence of certain events, causing the bonds to be classified as current portion of long-term debt in the balance sheets. The average annualized interest rate for these bonds during 2009, 2008 and 2007 was 0.61%, 1.75% and 3.72%, respectively.

There were no redemptions or maturities of long-term debt for 2009. Redemptions and maturities of long-term debt for 2008 and 2007 are summarized below:

<u>Year</u>	<u>Description</u>	<u>Principal Amount</u> (\$ in millions)	<u>Rate</u>	<u>Secured/Unsecured</u>	<u>Maturity</u>
2008	Pollution control bonds . . . . .	\$13	Variable	Secured	2035
2008	Pollution control bonds . . . . .	\$13	Variable	Secured	2035
2008	Pollution control bonds . . . . .	\$17	Variable	Secured	2036
2008	Pollution control bonds . . . . .	\$17	Variable	Secured	2036
2007	Pollution control bonds . . . . .	\$54	Variable	Secured	2024
2007	First mortgage bonds . . . . .	\$54	7.92%	Secured	2007

Issuances of long-term debt for 2009, 2008 and 2007 are summarized below:

<u>Year</u>	<u>Description</u>	<u>Principal Amount</u> (\$ in millions)	<u>Rate</u>	<u>Secured/ Unsecured</u>	<u>Maturity</u>
2009	Due to Fidelity	\$ 50	4.445%	Unsecured	2019
2009	Due to Fidelity .....	\$ 50	4.81%	Unsecured	2019
2009	Due to Fidelity .....	\$ 50	5.28%	Unsecured	2017
2008	Due to Fidelity .....	\$ 75	7.035%	Unsecured	2018
2008	Pollution control bonds .....	\$ 78	Variable	Unsecured	2032
2008	Due to Fidelity .....	\$ 50	6.16%	Unsecured	2018
2008	Due to Fidelity .....	\$ 50	5.645%	Unsecured	2018
2008	Due to Fidelity .....	\$ 75	5.85%	Unsecured	2023
2007	Pollution control bonds .....	\$ 54	Variable	Unsecured	2034
2007	Pollution control bonds .....	\$ 18	Variable	Unsecured	2026
2007	Pollution control bonds .....	\$ 9	Variable	Unsecured	2037
2007	Due to Fidelity .....	\$ 53	5.69%	Unsecured	2022
2007	Due to Fidelity .....	\$ 75	5.86%	Unsecured	2037
2007	Due to Fidelity .....	\$ 50	5.98%	Unsecured	2017
2007	Due to Fidelity .....	\$100	5.96%	Unsecured	2028
2007	Due to Fidelity .....	\$ 70	5.71%	Unsecured	2019
2007	Due to Fidelity .....	\$100	5.45%	Unsecured	2014

In February 2007, KU completed a series of financial transactions impacting its periodic reporting requirements. The \$54 million Pollution Control Series 10 bond was refinanced and replaced with a new unsecured tax-exempt bond of the same amount maturing in 2034. The \$53 million Series P bond was defeased and replaced with an intercompany loan totaling \$53 million from Fidelity. In conjunction with the defeasance, the Company terminated the related interest rate swap. Fidelity also agreed to eliminate the second lien on its two secured loans. Pursuant to the terms of the remaining tax-exempt bonds, the first mortgage bonds were cancelled and the underlying lien on substantially all of KU's assets was released following the completion of these steps. KU no longer has any secured debt and is no longer subject to periodic reporting under the Securities Exchange Act of 1934.

In October 2008, the Company issued Carroll County 2008 Series A tax exempt bonds in the amount of \$78 million. The new bonds mature on February 1, 2032, and bear interest at a variable rate. The new bonds refinance four existing bonds (Carroll County 2005 Series A and B — \$13 million each and the Carroll County 2006 Series A and C — \$17 million each), and include \$18 million of new funding. The proceeds were held in escrow pending incurrence of qualifying expenditures, but have now been used.

In December 2008, KU converted the interest rate mode of the Carroll County 2006 Series B to a weekly mode from an auction mode. The bonds along with the Carroll County 2004 Series A, the Mercer County 2000 Series A, and the Carroll County 2008 Series A, were issued with the enhancement of a letter of credit. The bonds have been reclassified as current portion of long-term debt because investors can put the bonds back to the Company on a weekly basis.

As of December 31, 2009, \$1,331 million of unsecured notes payable was outstanding to the Company's affiliate, Fidelity, with interest rates ranging from 4.24% to 7.04% and maturities ranging from 2010 to 2037.

Long-term debt maturities for KU are shown in the following table:

	(In millions)
2010 .....	\$ 33
2011 .....	—
2012 .....	50
2013 .....	175
2014 .....	100
Thereafter .....	<u>1,324(a)</u>
Total .....	<u>\$1,682</u>

(a) Includes long-term debt of \$228 million classified as current liabilities because these bonds are subject to tender for purchase at the option of the holder and to mandatory tender for purchase upon the occurrence of certain events. Maturity dates for these bonds range from 2023 to 2034.

#### Note 8 — Notes Payable and Other Short-Term Obligations

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

	<u>Total Money Pool Available</u>	<u>Amount Outstanding</u>	<u>Balance Available</u>	<u>Average Interest Rate</u>
	(\$ in millions)			
December 31, 2009 .....	\$400	\$45	\$355	0.20%
December 31, 2008 .....	\$400	\$16	\$384	1.49%

E.ON U.S. maintains revolving credit facilities totaling \$313 million at December 31, 2009 and 2008, to ensure funding availability for the money pool. At December 31, 2009 and 2008, one facility, totaling \$150 million, is with E.ON North America, Inc., while the remaining line, totaling \$163 million, is with Fidelia; both are affiliated companies. The balances are as follows:

	<u>Total Available</u>	<u>Amount Outstanding</u>	<u>Balance Available</u>	<u>Average Interest Rate</u>
	(\$ in millions)			
December 31, 2009 .....	\$313	\$276	\$37	1.25%
December 31, 2008 .....	\$313	\$299	\$14	2.05%

As of December 31, 2009, the Company maintained a bilateral line of credit, with an unaffiliated financial institution, totaling \$35 million which matures in June 2012. At December 31, 2009, there was no balance outstanding under this facility.

The covenants under this revolving line of credit include the following:

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

KU was in compliance with these covenants at December 31, 2009.

In October 2008, KU closed on a \$78 million bilateral line of credit which had a 364 day maturity. This facility was terminated in December 2008 and replaced by four new letter of credit facilities to allow issuance of letters of credit totaling \$198 million to support tax-exempt bonds totaling \$195 million of the \$228 million of bonds that can be put back to the Company. Should the holders elect to put the bonds back and they cannot be remarketed, the letter



of credit would fund the investor's payment. The expiration date for the letters of credit has been extended to December 2010. The reimbursement agreements are identical and contain the following covenants:

- E.ON must own 75% of voting stock of KU directly or indirectly
- A limitation on disposing of assets aggregating more than 20% of total assets as of most recent quarter-end.

At December 31, 2009, KU had no remaining capacity for letters of credit under these facilities and was in compliance with these covenants.

**Note 9 — Commitments and Contingencies**

*Operating Leases.* KU leases office space, office equipment, plant equipment, real estate, railcars, telecommunications and vehicles and accounts for these leases as operating leases. In addition, KU reimburses LG&E for a portion of the lease expense paid by LG&E for KU's usage of office space leased by LG&E. Total lease expense was \$10 million, \$9 million and \$6 million for 2009, 2008 and 2007, respectively. The future minimum annual lease payments for operating leases for years subsequent to December 31, 2009, are shown in the following table:

	(In millions)
2010 .....	\$ 7
2011 .....	6
2012 .....	5
2013 .....	4
2014 .....	4
Thereafter .....	<u>3</u>
Total .....	<u>\$29</u>

*Owensboro Contract Litigation.* In May 2004, the City of Owensboro, Kentucky and OMU commenced a suit which was removed to the U.S. District Court for the Western District of Kentucky, against KU concerning a long-term power supply contract (the "OMU Agreement") with KU. The dispute involved interpretational differences regarding issues under the OMU Agreement, including various payments or charges between KU and OMU and rights concerning excess power, termination and emissions allowances. In July 2005, the court issued a summary judgment ruling upholding OMU's contractual right to terminate the OMU agreement in May 2010.

In September and October 2008, the court granted rulings on a number of summary judgment petitions in the Company's favor. The summary judgment rulings resulted in the dismissal of all of OMU's remaining claims against the Company. The trial on KU's counterclaim occurred during October and November 2008. During February 2009, the court issued orders on the matters covered at trial, including (i) awarding the Company an aggregate \$9 million relating to the cost of NOx allowances charged by OMU to KU and the price of back-up power purchased by OMU from KU, plus pre- and post-judgment interest, and (ii) denying the Company's claim for damages based upon sub-par operations and availability of the OMU units. In April 2009, the court issued a ruling on various post-trial motions denying certain challenges to calculation elements of the \$9 million award or of interest amounts associated therewith. In May 2009, KU and OMU executed a settlement agreement resolving the matter on a basis consistent with the court's prior rulings and the Company has received the agreed settlement amounts.

*Sale and Leaseback Transaction.* The Company is a participant in a sale and leaseback transaction involving its 62% interest in two jointly owned CTs at KU's E.W. Brown generating station (Units 6 and 7). Commencing in December 1999, KU and LG&E entered into a tax-efficient, 18-year lease of the CTs. KU and LG&E have provided funds to fully defease the lease, and have executed an irrevocable notice to exercise an early purchase option contained in the lease after 15.5 years. The financial statement treatment of this transaction is no different than if KU had retained its ownership. The leasing transaction was entered into following receipt of required state and federal regulatory approvals.

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

At December 31, 2009, the maximum aggregate amount of default fees or amounts was \$8 million, of which KU would be responsible for 62% (approximately \$5 million). The Company has made arrangements with E.ON U.S., via guarantee and regulatory commitment, for E.ON U.S. to pay its full portion of any default fees or amounts.

*Letter of Credit.* KU has provided letters of credit totaling \$198 million supporting bonds of \$195 million and a letter of credit totaling less than \$1 million to support certain obligations related to workers' compensation.

*Power Purchases.* The Company has power purchase arrangements with OMU and OVEC. Under the OMU agreement, which will be terminated by OMU in May 2010, KU purchases all of the output of an approximately 400-Mw coal-fired generating station not required by OMU. The amount of power purchases available to the Company during 2010, which is expected to be approximately 5% of KU's total Kwh native load energy requirements, is dependent upon a number of factors including the OMU units' availability, maintenance schedules, fuel costs and OMU requirements. Payments are based on the total costs of the station allocated per terms of the OMU agreement. Included in the total costs is KU's proportionate share of debt service requirements on \$207 million of OMU bonds outstanding at December 31, 2009. The debt service is allocated to KU based on its annual allocated share of capacity, which averaged approximately 44% in 2009. KU does not guarantee the OMU bonds, or any requirements therein, in the event of default by OMU.

KU has a contract for power purchases with OVEC, terminating in 2026, for various Mw capacities. KU has an investment of 2.5% ownership in OVEC's common stock, which is accounted for on the cost method of accounting. The Company's share of OVEC's output is 2.5%, approximately 55 Mw of generation capacity. Future obligations for power purchases are shown in the following table:

	(In millions)
2010 .....	\$ 16
2011 .....	10
2012 .....	10
2013 .....	11
2014 .....	12
Thereafter .....	<u>177</u>
Total .....	<u>\$236</u>

*Coal and Gas Purchase Obligations.* KU has contracts to purchase coal and natural gas transportation. Future obligations are shown in the following table:

	(In millions)
2010 .....	\$ 391
2011 .....	307
2012 .....	145
2013 .....	88
2014 .....	92
Thereafter .....	<u>—(a)</u>
Total .....	<u>\$1,023</u>

(a) Obligations after 2014 are indexed to future market prices and are not included above since prices will be set in the future using the contracted methodology.

*Construction Program.* KU had \$62 million of commitments in connection with its construction program at December 31, 2009.

In June 2006, KU and LG&E entered into a construction contract regarding the TC2 project. The contract is generally in the form of a lump-sum, turnkey agreement for the design, engineering, procurement, construction, commissioning, testing and delivery of the project, according to designated specifications, terms and conditions. The contract price and its components are subject to a number of potential adjustments which may serve to increase or decrease the ultimate construction price paid or payable to the contractor. The contract also contains standard representations, covenants, indemnities, termination and other provisions for arrangements of this type, including termination for convenience or for cause rights. In March 2009, the parties completed an agreement resolving certain construction cost increases due to higher labor and per diem costs above an established baseline, and certain safety and compliance costs resulting from a change in law. The Company's share of additional costs from inception of the contract through the expected project completion in 2010 is estimated to be approximately \$30 million. During the past and to date in 2010, KU and LG&E have received a number of contractual notices from the TC2 construction contractor asserting force majeure/excusable event claims for adjustments to either or both of contract price or construction schedule with respect to certain events which, if granted, may affect such contractual terms in addition to a possible extension of the commercial operations date, liquidated damages or other relevant provisions. The parties are continuing to discuss such matters in good faith and to resolve them in a commercially reasonable manner. The Company cannot currently estimate the ultimate outcome of these matters, including the extent, if any, that it results in increased costs charged for construction of TC2 and/or relief relating to the construction completion or operations dates.

*TC2 Air Permit.* The Sierra Club and other environmental groups filed a petition challenging the air permit issued for the TC2 baseload generating unit which was issued by the Kentucky Division for Air Quality ("KDAQ") in November 2005. In September 2007, the Secretary of the Kentucky Environmental and Public Protection Cabinet issued a final Order upholding the permit. The environmental groups petitioned the EPA to object to the state permit and subsequent permit revisions. In determinations made in September 2008 and June 2009, the EPA rejected most of the environmental groups' claims, but identified three permit deficiencies which the KDAQ addressed by revising the permit. In August 2009, the EPA issued an order denying the remaining claims with the exception of two additional deficiencies which the KDAQ was directed to address. The EPA determined that the proposed permit subsequently issued by the KDAQ satisfied the conditions of the EPA Order, although the agency recommended certain enhancements to the administrative record. In January 2010, the KDAQ issued a final permit revision incorporating the proposed changes to address the two EPA objections. In March 2010, the Sierra Club submitted a petition to the EPA to object to the permit revision, which petition is now pending before the EPA. The Company believes that the final permit as revised should not have a material adverse effect on its financial condition or results of operations. However, until the right to challenge the final permit expires, the Company cannot predict the final outcome of this matter.

*Thermostat Replacement.* During January 2010, KU and LG&E announced a voluntary plan to replace certain thermostats which had been provided to customers as part of the Companies' demand reduction programs, due to concerns that the thermostats may present a safety hazard. Under the plan, the Companies anticipate replacing up to approximately 14,000 thermostats. Estimated costs associated with the replacement program may be \$2 million. However, the Companies cannot fully predict the ultimate outcome of the replacement program or other effects or developments which may be associated with the thermostat replacement matter at this time.

*Reserve Sharing Developments.* The membership of KU and LG&E in the Midwest Contingency Reserve Sharing Group terminated on December 31, 2009. In December 2009, the Companies entered into arrangements with Tennessee Valley Authority and East Kentucky Power Cooperative to form a new reserve sharing group, the TEE Contingency Reserve Sharing Group. Contingency reserves, including spinning reserves and supplemental reserves, relate to power or capacity requirements that the Companies must have available for certain reliability purposes. In general, the operational and financial impact of reserve sharing arrangements varies based upon factors such as the terms of the agreement, the relative generating and operations conduct of the parties and relevant market prices. While the Companies do not anticipate the revised reserve sharing developments will have a material adverse effect on their prospective operations or financial condition, such outcome cannot be guaranteed.

*Mine Safety Compliance Costs.* In March 2006, the Mine Safety and Health Administration enacted Emergency Temporary Standards regulations and has issued additional regulations as the result of the passage of the Mine Improvement and New Emergency Response Act of 2006, which was signed into law in June 2006. At the state level, Kentucky and other states that supply coal to KU, have passed new mine safety legislation. These pieces of legislation require all underground coal mines to implement new safety measures and install new safety equipment. Under the terms of the majority of the long-term coal contracts the Company has in place, provisions are made to allow for price adjustments for compliance costs resulting from new or amended laws or regulations. KU's coal suppliers regularly submit price adjustments related to these compliance costs. The Company employs an external consultant to review all relevant mine safety compliance cost claims for validity and reasonableness. Depending upon the terms of the contracts and commercial practice, the Company may delay payment of the adjustments or pay certain adjustments subject to refund. At appropriate times in the review, payment or refund processes, KU may make adjustments to the values or amounts or values of inventory, accounts receivable or accounts payable relating to coal matters. In general, the Company expects to recover these coal-related cost adjustments through the FAC.

*Environmental Matters.* The Company's operations are subject to a number of environmental laws and regulations in each of the jurisdictions in which it operates, governing, among other things, air emissions, wastewater discharges, the use, handling and disposal of hazardous substances and wastes, soil and groundwater contamination and employee health and safety.

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

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

In 1997, the EPA established new NAAQS for ozone and fine particulates that required additional reductions in SO<sub>2</sub> and NO<sub>x</sub> emissions from power plants. In 1998, the EPA issued its final "NO<sub>x</sub> SIP Call" rule requiring reductions in NO<sub>x</sub> emissions of approximately 85% from 1990 levels in order to mitigate ozone transport from the midwestern U.S. to the northeastern U.S. To implement the new federal requirements, Kentucky amended its SIP in 2002 to require electric generating units to reduce their NO<sub>x</sub> emissions to 0.15 pounds weight per MMBtu on a company-wide basis. In 2005, the EPA issued the CAIR which required additional SO<sub>2</sub> emission reductions of 70% and NO<sub>x</sub> emission reductions of 65% from 2003 levels. The CAIR provided for a two-phase cap and trade program, with initial reductions of NO<sub>x</sub> and SO<sub>2</sub> emissions due by 2009 and 2010, respectively, and final reductions due by 2015. In 2006, Kentucky proposed to amend its SIP to adopt state requirements similar to those under the federal CAIR. Depending on the level of action determined necessary to bring local nonattainment areas into compliance with the new ozone and fine particulate standards, KU's power plants are potentially subject to additional reductions in SO<sub>2</sub> and NO<sub>x</sub> emissions. In January 2010, EPA issued a proposed rule to reconsider the NAAQS for Ozone, previously revised in 2008. The proposal would institute more stringent standards. At present, the Company is unable to determine what, if any, additional requirements may be imposed to achieve compliance with the new ozone standard.

In July 2008, a federal appeals court issued a ruling finding deficiencies in the CAIR and vacating it. In December 2008, the Court amended its previous Order, directing the EPA to promulgate a new regulation, but leaving the CAIR in place in the interim. Depending upon the course of such matters, the CAIR could be superseded by new or revised NO<sub>x</sub> or SO<sub>2</sub> regulations with different or more stringent requirements and SIPs which incorporate

CAIR requirements could be subject to revision. KU is also reviewing aspects of its compliance plan relating to the CAIR, including scheduled or contracted pollution control construction programs. Finally, as discussed below, the remand of the CAIR results in some uncertainty with respect to certain other EPA or state programs and proceedings and the Companies' compliance plans relating thereto, due to the interconnection of the CAIR with such associated programs. At present, KU is not able to predict the outcomes of the legal and regulatory proceedings related to the CAIR and whether such outcomes could have a material effect on the Company's financial or operational conditions.

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

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

*Acid Rain Program.* The Clean Air Act, as amended, imposed a two-phased cap and trade program to reduce SO<sub>2</sub> emissions from power plants that were thought to contribute to "acid rain" conditions in the northeastern U.S. The Clean Air Act, as amended, also contains requirements for power plants to reduce NO<sub>x</sub> emissions through the use of available combustion controls.

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

*Installation of Pollution Controls.* Many of the programs under the Clean Air Act utilize cap and trade mechanisms that require a company to hold sufficient emissions allowances to cover its authorized emissions on a company-wide basis and do not require installation of pollution controls on every generating unit. Under cap and trade programs, companies are free to focus their pollution control efforts on plants where such controls are particularly efficient and utilize the resulting emission allowances for smaller plants where such controls are not cost effective. KU met its Phase I SO<sub>2</sub> requirements primarily through installation of FGD equipment on Ghent Unit 1. KU's strategy for its Phase II SO<sub>2</sub> requirements, which commenced in 2000, includes the installation of additional FGD equipment, as well as using accumulated emission allowances and fuel switching to defer certain additional capital expenditures. In order to achieve the NO<sub>x</sub> emission reductions and associated obligations, KU installed additional NO<sub>x</sub> controls, including SCR technology, during the 2000 through 2009 time period at a cost of \$221 million. In 2001, the Kentucky Commission granted approval to recover the costs incurred by KU for these projects through the environmental surcharge mechanism. Such monthly recovery is subject to periodic review by the Kentucky Commission.

In order to achieve mandated emissions reductions, KU expects to incur additional capital expenditures totaling approximately \$320 million during the 2010 through 2012 time period for pollution controls including FGD and SCR equipment, and additional operating and maintenance costs in operating such controls. In 2005, the Kentucky Commission granted approval to recover the costs incurred by the Company for these projects through the ECR mechanism. Such monthly recovery is subject to periodic review by the Kentucky Commission. KU believes its costs in reducing SO<sub>2</sub>, NO<sub>x</sub> and mercury emissions to be comparable to those of similarly situated utilities with like generation assets. KU's compliance plans are subject to many factors including developments in the emission allowance and fuels markets, future legislative and regulatory enactments, legal proceedings and advances in clean air technology. KU will continue to monitor these developments to ensure that its environmental obligations are met in the most efficient and cost-effective manner. See "Ambient Air Quality" above for a discussion of CAIR-related uncertainties.

*GHG Developments.* In 2005, the Kyoto Protocol for reducing GHG emissions took effect, obligating 37 industrialized countries to undertake substantial reductions in GHG emissions. The U.S. has not ratified the Kyoto Protocol and there are currently no mandatory GHG emission reduction requirements at the federal level. As discussed below, legislation mandating GHG reductions has been introduced in the Congress, but no federal legislation has been enacted to date. In the absence of a program at the federal level, various states have adopted their own GHG emission reduction programs. Such programs have been adopted in various states including 11 northeastern U.S. states and the District of Columbia under the Regional GHG Initiative program and California. Substantial efforts to pass federal GHG legislation are on-going. The current administration has announced its support for the adoption of mandatory GHG reduction requirements at the federal level. The United States and other countries met in Copenhagen, Denmark in December 2009, in an effort to negotiate a GHG reduction treaty to succeed the Kyoto Protocol, which is set to expire in 2013. At Copenhagen, the U.S. made a nonbinding commitment to, among other things, seek to reduce GHG emissions to 17% below 2005 levels by 2020 and provide financial support to developing countries. The United States and other nations are scheduled to meet in Cancun, Mexico in late 2010 to continue negotiations toward a binding agreement.

*GHG Legislation.* KU is monitoring on-going efforts to enact GHG reduction requirements and requirements governing carbon sequestration at the state and federal level and is assessing potential impacts of such programs and strategies to mitigate those impacts. In June 2009, the U.S. House of Representatives passed the American Clean Energy and Security Act of 2009, (H.R. 2454), which is a comprehensive energy bill containing the first-ever nation-wide GHG cap and trade program. If enacted into law, the bill would provide for reductions in GHG emissions of 3% below 2005 levels by 2012, 17% by 2020, and 83% by 2050. In order to cushion potential rate impacts for utility customers, approximately 43% of emissions allowances would initially be allocated at no cost to the electric utility sector, with this allocation gradually declining to 7% in 2029 and zero thereafter. The bill would also establish a renewable electricity standard requiring utilities to meet 20% of their electricity demand through renewable energy and energy efficiency by 2020. The bill contains additional provisions regarding carbon capture and sequestration, clean transportation, smart grid advancement, nuclear and advanced technologies and energy efficiency.

In September 2009, the Clean Energy Jobs and American Power Act (S. 1733), which is largely patterned on the House legislation, was introduced in the U.S. Senate. The Senate bill raises the emissions reduction target for 2020 to 20% below 2005 levels and does not include a renewable electricity standard. While the initial bill lacked detailed provisions for the allocation of emissions allowances, a subsequent revision has incorporated allowance allocation provisions similar to the House bill. The Company is closely monitoring the progress of the legislation, although the prospect for passage of comprehensive GHG legislation in 2010 is uncertain.

*GHG Regulations.* In April 2007, the U.S. Supreme Court ruled that the EPA has the authority to regulate GHG under the Clean Air Act. In April 2009, the EPA issued a proposed endangerment finding concluding that GHGs endanger public health and welfare, which is an initial rulemaking step under the Clean Air Act. A final endangerment finding was issued in December 2009. In September 2009, the EPA issued a final GHG reporting rule requiring reporting by facilities with annual GHG emissions equivalent to at least 25,000 tons of carbon dioxide. A number of the Company's facilities will be required to submit annual reports commencing with calendar year 2010. Also in September 2009, the EPA proposed to require new or modified sources with GHG emissions equivalent to at least 10,000 to 25,000 tons of carbon dioxide to obtain permits under the Prevention of Significant Deterioration

Program. Such new or modified facilities would be required to install Best Available Control Technology. While the Company is unaware of any currently available GHG control technology that might be required for installation on new or modified power plants, it is currently assessing the potential impact of the proposed rule. A final rule is expected in 2010.

The Company is unable to predict whether mandatory GHG reduction requirements will ultimately be enacted through legislation or regulations. As a company with significant coal-fired generating assets, KU could be substantially impacted by programs requiring mandatory reductions in GHG emissions, although the precise impact on its operations, including the reduction targets and deadlines that would be applicable, cannot be determined prior to the enactment of such programs. While the Company believes that many costs of complying with mandatory GHG reduction requirements or purchasing emission allowances to meet applicable requirements would likely be recoverable, in whole or in part under the ECR, where such costs are related to the Company's coal-fired generating assets, or other potential cost-recovery mechanisms, this cannot be assured.

*GHG Litigation.* A number of lawsuits have been filed asserting common law claims including nuisance, trespass and negligence against various companies with GHG emitting facilities. In October 2009, a three judge panel of the United States Court of Appeals for the 5th Circuit in the case of *Comer v. Murphy Oil* reversed a lower court, holding that private plaintiffs have standing to assert certain common law claims against more than 30 utility, oil, coal and chemical companies. However, in March 2010, the court vacated the opinion of the three-judge panel and granted a motion for rehearing. The *Comer* complaint alleges that GHG emissions from the defendants' facilities contributed to global warming which increased the intensity of Hurricane Katrina. E.ON, the parent of KU and LG&E was included as a defendant in the complaint, but has not been subject to the proceedings due to the failure of the plaintiffs to pursue service under the applicable international procedures. KU and LG&E are currently unable to predict further developments in the *Comer* case. KU and LG&E continue to monitor relevant GHG litigation to identify judicial developments that may be potentially relevant to their operations.

*Brown New Source Review Litigation.* In April 2006, the EPA issued an NOV alleging that KU had violated certain provisions of the Clean Air Act's new source review rules relating to work performed in 1997, on a boiler and turbine at KU's E.W. Brown generating station. In December 2006, the EPA issued a second NOV alleging the Company had exceeded heat input values in violation of the air permit for the unit. In March 2007, the Department of Justice filed a complaint in federal court in Kentucky alleging the same violations specified in the prior NOVs. The complaint sought civil penalties, including potential per-day fines, remedial measures and injunctive relief. In December 2008, the Company reached a tentative settlement with the government resolving all outstanding claims. The proposed consent decree, which was approved by the court in March 2009, provides for payment of a \$1 million civil penalty; funding of \$3 million in environmental mitigation projects; surrender of 53,000 excess SO<sub>2</sub> allowances; surrender of excess NO<sub>x</sub> allowances estimated at 650 allowances annually for eight years; installation of an FGD by December 31, 2010; installation of an SCR by December 31, 2012; and compliance with specified emission limits and operational restrictions.

*Section 114 Requests.* In August 2007, the EPA issued administrative information requests under Section 114 of the Clean Air Act requesting new source review-related data regarding certain projects undertaken at LG&E's Mill Creek 4 and TC1 generating units and KU's Ghent 2 generating unit. KU and LG&E have complied with the information requests and are not able to predict further proceedings in this matter at this time.

*Ghent Opacity NOV.* In September 2007, the EPA issued an NOV alleging that KU had violated certain provisions of the Clean Air Act's operating rules relating to opacity during June and July of 2007 at Units 1 and 3 of KU's Ghent generating station. The parties have met on this matter and KU has received no further communications from the EPA. The Company is not able to estimate the outcome or potential effects of these matters, including whether substantial fines, penalties or remedial measures may result.

*Ghent New Source Review NOV.* In March 2009, the EPA issued an NOV alleging that KU violated certain provisions of the Clean Air Act's rules governing new source review and prevention of significant deterioration by installing FGD and SCR controls at its Ghent generating station without assessing potential increased sulfuric acid mist emissions. KU contends that the work in question, as pollution control projects, was exempt from the requirements cited by the EPA. In December 2009, the EPA issued a Section 114 information request seeking additional information on this matter. The Company is currently unable to determine the final outcome of this

matter or the impact of an unfavorable determination upon the Company's financial position or results of operations.

*Ash Ponds, Coal-Combustion Byproducts and Water Discharges.* The EPA has undertaken various initiatives in response to the December 2008 impoundment failure at the Tennessee Valley Authority's Kingston power plant, which resulted in a major release of coal combustion byproducts into the environment. The EPA issued information requests to utilities throughout the country, including KU, to obtain information on their ash ponds and other impoundments. In addition, the EPA inspected a large number of impoundments located at power plants to determine their structural integrity. The inspections included several of the Company's impoundments, which the EPA found to be in satisfactory condition. The Company is awaiting final inspection reports for additional impoundments. The EPA and other agencies are currently considering the need to revise applicable standards governing the structural integrity of ash ponds and other impoundments. In addition, the EPA has announced that it is re-evaluating current regulatory requirements applicable to coal combustion byproducts and anticipates proposing new rules by early 2010. The EPA is considering a wide range of regulatory options including subjecting ash ponds and landfills handling coal combustion byproducts to regulation under the hazardous waste program. Finally, the EPA has announced plans to develop revised effluent limitations guidelines and standards governing discharges from power plants. The Company is monitoring these ongoing regulatory developments, but will be unable to determine the impact until such time as new rules are finalized.

*General Environmental Proceedings.* From time to time, KU appears before the EPA, various state or local regulatory agencies and state and federal courts regarding matters involving compliance with applicable environmental laws and regulations. Such matters include a completed settlement with state regulators regarding particulate limits in the air permit for KU's Tyrone generating station, remediation activities for, or other risks relating to elevated Polychlorinated Biphenyl ("PCB") levels at existing properties, and liability under the Comprehensive Environmental Response, Compensation and Liability Act for cleanup at various off-site waste sites. Based on analysis to date, the resolution of these matters is not expected to have a material impact on the Company's operations.

**Note 10 — Jointly Owned Electric Utility Plant**

KU and LG&E are nearing completion of TC2, a jointly owned unit at the Trimble County site. KU and LG&E own undivided 60.75% and 14.25% interests, respectively, in TC2. Of the remaining 25% of TC2, IMEA owns a 12.12% undivided interest and IMPA owns a 12.88% undivided interest. Each company is responsible for its proportionate share of capital cost during construction, and fuel, operation and maintenance cost when TC2 begins operation, which is scheduled to occur in 2010. In December 2009 and June 2008, LG&E sold assets to KU related to the construction of TC2 with a net book value of \$48 million and \$10 million, respectively.

The following data represent shares of the jointly owned property (capacity based on nameplate rating):

	TC2				Total
	LG&E	KU	IMPA	IMEA	
Ownership interest . . . . .	14.25%	60.75%	12.88%	12.12%	100%
Mw capacity . . . . .	119	509	108	102	838



(In millions)

KU's 60.75% ownership:	
Plant held for future use . . . . .	\$121
Construction work in progress . . . . .	679
Accumulated depreciation . . . . .	<u>63</u>
Net book value . . . . .	<u>\$737</u>
LG&E's 14.25% ownership:	
Plant held for future use . . . . .	\$ 5
Construction work in progress . . . . .	169
Accumulated depreciation . . . . .	<u>2</u>
Net book value . . . . .	<u>\$172</u>

KU and LG&E jointly own the following CTs and related equipment (capacity based on net summer capability):

Ownership Percentage	KU				LG&E				Total			
	Mw Capacity	(\$) Cost	(\$) Depre- ciation	(\$) Net Book Value	Mw Capacity	(\$) Cost	(\$) Depre- ciation	(\$) Net Book Value	Mw Capacity	(\$) Cost	(\$) Depre- ciation	(\$) Net Book Value
	(\$ in millions)											
KU 47%, LG&E 53%(a) . . . . .	129	54	(13)	41	146	59	(15)	44	275	113	(28)	85
KU 62%, LG&E 38%(b) . . . . .	190	79	(15)	64	118	46	(7)	39	308	125	(22)	103
KU 71%, LG&E 29%(c) . . . . .	228	82	(21)	61	92	33	(8)	25	320	115	(29)	86
KU 63%, LG&E 37%(d) . . . . .	404	140	(25)	115	236	82	(16)	66	640	222	(41)	181
KU 71%, LG&E 29%(e) . . . . .	n/a	9	(2)	7	n/a	3	(1)	2	n/a	12	(3)	9

- (a) Comprised of Paddy's Run 13 and E.W. Brown 5. In addition to the above jointly owned utility plant, there is an inlet air cooling system attributable to unit 5 and units 8-11 at the E.W. Brown facility. This inlet air cooling system is not jointly owned, however, it is used to increase production on the units to which it relates, resulting in an additional 88 Mw of capacity for KU.
- (b) Comprised of units 6 and 7 at the E.W. Brown facility.
- (c) Comprised of units 5 and 6 at the Trimble County facility.
- (d) Comprised of CT Substation 7-10 and units 7, 8, 9 and 10 at the Trimble County facility.
- (e) Comprised of CT Substation 5 and 6 and CT Pipeline at the Trimble County facility.

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

#### Note 11 — Related Party Transactions

KU, subsidiaries of E.ON U.S. and subsidiaries of E.ON engage in related party transactions. These transactions are generally performed at cost and are in accordance with the FERC regulations under PUHCA 2005 and the applicable Kentucky Commission and Virginia Commission regulations. The significant related party transactions are disclosed below.

#### Electric Purchases

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

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

	<u>2009</u>	<u>2008</u>	<u>2007</u>
	(In millions)		
Electric operating revenues from LG&E . . . . .	\$ 21	\$ 80	\$46
Power purchased from LG&E . . . . .	101	109	93

### Interest Charges

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

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

	<u>2009</u>	<u>2008</u>	<u>2007</u>
	(In millions)		
Interest on money pool loans . . . . .	\$—	\$ 2	\$ 6
Interest on Fidelia loans . . . . .	69	56	35

### Other Intercompany Billings

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

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

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

	<u>2009</u>	<u>2008</u>	<u>2007</u>
	(In millions)		
E.ON U.S. Services billings to KU . . . . .	\$169	\$227	\$488
LG&E billings to KU . . . . .	44	5	12
KU billings to E.ON U.S. Services . . . . .	14	3	26
KU billings to LG&E . . . . .	78	75	6

In December 2009 and June 2008, LG&E sold assets to KU related to the construction of TC2, including \$3 million of unamortized investment tax credits, with net book values of \$48 million and \$10 million, respectively.

In March and June 2009, the Company received capital contributions of \$50 million and \$25 million, respectively, from its common shareholder, E.ON U.S.

In 2008 and 2007, KU received capital contributions from its common shareholder, E.ON U.S., totaling \$145 million and \$75 million, respectively.

**Note 12 — Subsequent Events**

Subsequent events have been evaluated through March 19, 2010, the date of issuance of these statements and these statements contain all necessary adjustments and disclosures resulting from that evaluation.

On March 4, 2010, the Virginia Commission approved the stipulation related to the rate increase filing with rates to become effective in April 2010.

On January 29, 2010, KU filed an application with the Kentucky Commission requesting an increase in base electric rates of approximately 12%, or \$135 million annually, including an 11.5% return on equity. KU has requested the increase, based on the twelve month test year ended October 31, 2009, to become effective on and after March 1, 2010. The requested rates have been suspended until August 1, 2010, at which time they may be put into effect, subject to refund, if the Kentucky Commission has not issued an order in the proceeding.

On January 13, 2010, the Company made a \$13 million contribution to its pension plan.

## Report of Independent Auditors

To the Shareholder of Kentucky Utilities Company:

In our opinion, the accompanying balance sheets and the related statements of capitalization, income, retained earnings, and cash flows present fairly, in all material respects, the financial position of Kentucky Utilities Company at December 31, 2009 and 2008, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2009 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2009, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assertion of the effectiveness of internal control over financial reporting, included in "Controls and Procedures" appearing on page 23 of the 2009 Kentucky Utilities Company financial statements and additional information. Our responsibility is to express opinions on these financial statements and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits of the financial statements in accordance with auditing standards generally accepted in the United States of America and our audit of internal control over financial reporting in accordance with attestation standards established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

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

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

*PricewaterhouseCoopers LLP*

Louisville, Kentucky  
March 19, 2010

**Kentucky Utilities Company**  
**Condensed Financial Statements**  
**(Unaudited)**

**As of September 30, 2010 and December 31, 2009**  
**and for the three and nine months ended**  
**September 30, 2010 and 2009**

## 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
CATR . . . . .	Clean Air Transport Rule
CCN . . . . .	Certificate of Public Convenience and Necessity
Clean Air Act . . . . .	The Clean Air Act, as amended in 1990
CMRG . . . . .	Carbon Management Research Group
Companies . . . . .	KU and LG&E
Company . . . . .	KU
DSM . . . . .	Demand Side Management
ECR . . . . .	Environmental Cost Recovery
EEl . . . . .	Edison Electric Institute
EKPC . . . . .	East Kentucky Power Cooperative, Inc.
E.ON . . . . .	E.ON AG
E.ON U.S. . . . .	E.ON U.S. LLC
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
FGD . . . . .	Flue Gas Desulfurization
Fidelia . . . . .	Fidelia Corporation (an E.ON affiliate)
GHG . . . . .	Greenhouse Gas
IRS . . . . .	Internal Revenue Service
KCCS . . . . .	Kentucky Consortium for Carbon Storage
KDAQ . . . . .	Kentucky Division for Air Quality
Kentucky Commission . . . . .	Kentucky Public Service Commission
KU . . . . .	Kentucky Utilities Company
LG&E . . . . .	Louisville Gas and Electric Company
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
NOV . . . . .	Notice of Violation
NOx . . . . .	Nitrogen Oxide
OMU . . . . .	Owensboro Municipal Utilities
OVEC . . . . .	Ohio Valley Electric Corporation
PPL . . . . .	PPL Corporation
S&P . . . . .	Standard & Poor's Ratings Services
SCR . . . . .	Selective Catalytic Reduction
SERC . . . . .	SERC Reliability Corporation
Servco . . . . .	LG&E and KU Services Company (formerly E.ON U.S. Services Inc.)
SIP . . . . .	State Implementation Plan
SO <sub>2</sub> . . . . .	Sulfur Dioxide
TC2 . . . . .	Trimble County Unit 2
Virginia Commission . . . . .	Virginia State Corporation Commission

**Kentucky Utilities Company**  
**Condensed Financial Statements**  
**(Unaudited)**

**As of September 30, 2010 and December 31, 2009**  
**and for the three and nine months ended**  
**September 30, 2010 and 2009**

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**Kentucky Utilities Company**  
**Condensed Statements of Income**

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(Unaudited) (Millions of \$)			
Operating revenues (Note 10) . . . . .	\$416	\$341	\$1,146	\$1,009
Operating expenses:				
Fuel for electric generation . . . . .	146	114	391	329
Power purchased (Note 10) . . . . .	41	47	135	154
Other operation and maintenance expenses . . . . .	86	22	251	230
Depreciation, accretion and amortization . . . . .	38	33	106	99
Total operating expenses . . . . .	<u>311</u>	<u>216</u>	<u>883</u>	<u>812</u>
Operating income . . . . .	105	125	263	197
Interest expense (Note 8) . . . . .	2	2	5	5
Interest expense to affiliated companies (Notes 8 and 10) . . . . .	18	18	55	51
Other income (expense) — net . . . . .	<u>1</u>	<u>—</u>	<u>2</u>	<u>7</u>
Income before income taxes . . . . .	86	105	205	148
Income tax expense (Note 7) . . . . .	<u>32</u>	<u>39</u>	<u>76</u>	<u>49</u>
Net income . . . . .	<u>\$ 54</u>	<u>\$ 66</u>	<u>\$ 129</u>	<u>\$ 99</u>

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

**Kentucky Utilities Company**  
**Condensed Statements of Comprehensive Income**

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(Unaudited) (Millions of \$)			
Net income . . . . .	\$54	\$66	\$129	\$99
Comprehensive income (loss) attributable to unconsolidated venture — net of tax benefit of \$1, \$0, \$1 and \$0, respectively . . . . .	(2)	—	(2)	—
Comprehensive income . . . . .	<u>\$52</u>	<u>\$66</u>	<u>\$127</u>	<u>\$99</u>

**Condensed Statements of Retained Earnings**

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(Unaudited) (Millions of \$)			
Balance at beginning of period . . . . .	\$1,403	\$1,228	\$1,328	\$1,195
Net income . . . . .	54	66	129	99
	1,457	1,294	1,457	1,294
Cash dividends declared (Note 10) . . . . .	(50)	—	(50)	—
Balance at end of period . . . . .	<u>\$1,407</u>	<u>\$1,294</u>	<u>\$1,407</u>	<u>\$1,294</u>

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

**Kentucky Utilities Company**  
**Condensed Balance Sheets**

	September 30, 2010	December 31, 2009
	(Unaudited) (Millions of \$)	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents . . . . .	\$ 2	\$ 2
Accounts receivable — net:		
Customer — less reserves of \$2 in 2010 and \$1 in 2009 . . . . .	172	155
Affiliated companies . . . . .	—	9
Other — less reserves of \$2 in 2010 and 2009 . . . . .	28	18
Materials and supplies:		
Fuel (predominantly coal) . . . . .	98	98
Other materials and supplies . . . . .	42	39
Regulatory assets (Note 2) . . . . .	14	32
Prepayments and other current assets . . . . .	11	13
Total current assets . . . . .	367	366
Investment in unconsolidated venture . . . . .	12	12
Property, plant and equipment:		
Regulated utility plant — electric . . . . .	5,426	4,892
Accumulated depreciation . . . . .	(1,902)	(1,838)
Net regulated utility plant . . . . .	3,524	3,054
Construction work in progress . . . . .	946	1,257
Property, plant and equipment — net . . . . .	4,470	4,311
Deferred debits and other assets:		
Regulatory assets (Note 2):		
Pension benefits . . . . .	105	105
Other regulatory assets . . . . .	110	117
Cash surrender value of key man life insurance . . . . .	39	38
Other assets . . . . .	7	7
Total deferred debits and other assets . . . . .	261	267
Total assets . . . . .	\$ 5,110	\$ 4,956

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

**Kentucky Utilities Company**  
**Condensed Balance Sheets (continued)**

	<u>September 30,</u> <u>2010</u>	<u>December 31,</u> <u>2009</u>
<u>(Unaudited)</u> <u>(Millions of \$)</u>		
<b>LIABILITIES AND EQUITY</b>		
Current liabilities:		
Current portion of long-term debt (Notes 5 and 8) . . . . .	\$ 228	\$ 228
Current portion of long-term debt to affiliated company (Note 5) . . . . .	33	33
Notes payable to affiliated companies (Notes 8 and 10) . . . . .	61	45
Accounts payable . . . . .	105	107
Accounts payable to affiliated companies (Note 10) . . . . .	71	88
Customer deposits . . . . .	23	22
Regulatory liabilities (Note 2) . . . . .	12	4
Other current liabilities . . . . .	<u>39</u>	<u>42</u>
Total current liabilities . . . . .	<u>572</u>	<u>569</u>
Long-term debt:		
Long-term debt (Notes 5 and 8) . . . . .	123	123
Long-term debt to affiliated company (Notes 5, 8 and 10) . . . . .	<u>1,298</u>	<u>1,298</u>
Total long-term debt . . . . .	<u>1,421</u>	<u>1,421</u>
Deferred credits and other liabilities:		
Deferred income taxes . . . . .	378	336
Accumulated provision for pensions and related benefits (Note 6) . . . . .	160	160
Investment tax credits (Note 7) . . . . .	104	104
Asset retirement obligations (Note 3) . . . . .	59	34
Regulatory liabilities (Note 2):		
Accumulated cost of removal of utility plant . . . . .	343	331
Other regulatory liabilities . . . . .	24	29
Other liabilities . . . . .	<u>20</u>	<u>20</u>
Total deferred credits and other liabilities . . . . .	<u>1,088</u>	<u>1,014</u>
Common equity:		
Common stock, without par value —		
Authorized 80,000,000 shares, outstanding 37,817,878 shares . . . . .	308	308
Additional paid-in capital . . . . .	316	316
Accumulated other comprehensive loss . . . . .	(2)	—
Retained earnings:		
Retained earnings . . . . .	1,397	1,318
Undistributed earnings from unconsolidated venture . . . . .	<u>10</u>	<u>10</u>
Total common equity . . . . .	<u>2,029</u>	<u>1,952</u>
Total liabilities and equity . . . . .	<u>\$5,110</u>	<u>\$4,956</u>

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

**Kentucky Utilities Company**  
**Condensed Statements of Cash Flows**

	For the Nine Months Ended September 30,	
	2010	2009
	(Unaudited) (Millions of \$)	
Cash flows from operating activities:		
Net income . . . . .	\$ 129	\$ 99
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, accretion and amortization . . . . .	106	99
Deferred income taxes — net . . . . .	42	48
Investment tax credits (Note 7) . . . . .	—	17
Provision for pension and postretirement benefits . . . . .	11	13
Undistributed earnings of unconsolidated venture . . . . .	(4)	10
Other . . . . .	1	3
Changes in current assets and liabilities:		
Accounts receivable . . . . .	(6)	30
Materials and supplies . . . . .	(3)	(21)
Regulatory assets and liabilities . . . . .	26	(1)
Accounts payable . . . . .	(20)	(4)
Accounts payable to affiliated companies . . . . .	31	(8)
Other current assets and liabilities . . . . .	—	(10)
Pension and postretirement funding (Note 6) . . . . .	(17)	(17)
Other regulatory assets and liabilities . . . . .	(3)	(64)
Other — net . . . . .	7	(4)
Net cash provided by operating activities . . . . .	<u>300</u>	<u>190</u>
Cash flows from investing activities:		
Construction expenditures . . . . .	(218)	(378)
Purchases of assets from affiliate . . . . .	(48)	—
Change in restricted cash . . . . .	—	9
Net cash used in investing activities . . . . .	<u>(266)</u>	<u>(369)</u>
Cash flows from financing activities:		
Borrowings from affiliated company (Note 8) . . . . .	104	106
Repayments on borrowings from affiliated company (Note 8) . . . . .	(88)	—
Payment of dividends (Note 10) . . . . .	(50)	—
Capital contribution (Note 10) . . . . .	—	75
Net cash (used in) provided by financing activities . . . . .	<u>(34)</u>	<u>181</u>
Change in cash and cash equivalents . . . . .	—	2
Cash and cash equivalents at beginning of period . . . . .	<u>2</u>	<u>2</u>
Cash and cash equivalents at end of period . . . . .	<u>\$ 2</u>	<u>\$ 4</u>

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

## Kentucky Utilities Company

### Notes to Condensed Financial Statements (Unaudited)

#### Note 1 — General

KU'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 condensed financial statements include all adjustments, consisting only of normal recurring adjustments, necessary for fair statements of income, comprehensive income, and retained earnings, balance sheets, and statements of 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 condensed 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, 2009, including the audited financial statements and notes therein.

The December 31, 2009, condensed balance sheet included herein is derived from the December 31, 2009, audited balance sheet. Amounts reported in the condensed statements of income are not necessarily indicative of amounts expected for the respective annual periods due to the effects of seasonal temperature variations on energy consumption, regulatory rulings, the timing of maintenance on electric generating units, changes in mark-to-market valuations, changing commodity prices and other factors.

Certain reclassification entries have been made to the previous year's financial statements to conform to the 2010 presentation with no impact on total assets, liabilities and capitalization or previously reported net income and net cash flows.

#### PPL Acquisition

On April 28, 2010, E.ON U.S. announced that a Purchase and Sale Agreement (the "Agreement") had been entered into among E.ON US Investments, PPL and E.ON.

The Agreement provides for the sale of E.ON U.S. to PPL. Pursuant to the Agreement, at closing, PPL will acquire all of the outstanding limited liability company interests of E.ON U.S. for cash consideration of \$2.6 billion. In addition, pursuant to the Agreement, PPL agreed to assume \$764 million of pollution control bonds and medium term notes and to repay indebtedness owed by E.ON U.S. and its subsidiaries to E.ON US Investments and its affiliates. Such affiliate indebtedness is currently estimated to be \$4.2 billion. The aggregate consideration payable by PPL on closing is currently estimated to be \$7.6 billion (including the assumed indebtedness), subject to contractually agreed adjustments.

The transaction is subject to customary closing conditions, including the expiration or termination of the applicable waiting period under the Hart-Scott-Rodino Act, receipt of required regulatory approvals (including state regulators in Kentucky, Virginia and Tennessee, and the FERC) and the absence of injunctions or restraints imposed by governmental entities. As of October 26, 2010, all of the required regulatory approvals were received, and the transaction is expected to close on November 1, 2010.

Change of control and financing-related applications were filed on May 28, 2010, with the Kentucky Commission and on June 15, 2010, with the Virginia Commission and the Tennessee Regulatory Authority. An application with the FERC was filed on June 28, 2010. During the second quarter of 2010, a number of parties were granted intervenor status in the Kentucky Commission proceedings, and data request filings and responses occurred. Early termination of the Hart-Scott-Rodino waiting period was received on August 2, 2010.

A hearing in the Kentucky Commission proceedings was held on September 8, 2010, at which time a unanimous settlement agreement was presented. In the settlement, KU and LG&E commit that no base rate increases would take effect before January 1, 2013. The KU and LG&E rate increases that took effect on August 1, 2010, were not impacted by the settlement. Under the terms of the settlement, the Companies retain the right to seek approval for the deferral of "extraordinary and uncontrollable costs." Interim rate adjustments will continue to be permissible during that period for existing fuel, environmental and demand-side management cost trackers. The

agreement also substitutes an acquisition savings shared deferral mechanism for the requirement that the Companies file a synergies plan with the Kentucky Commission. This mechanism, which will be in place until the earlier of five years or the first day of the year in which a base rate increase becomes effective, permits the Companies to earn up to a 10.75 percent return on equity. Any earnings above a 10.75 percent return on equity will be shared with customers on a 50%/50% basis. On September 30, 2010, the Kentucky Commission issued an Order approving the transfer of ownership of KU and LG&E via the acquisition of E.ON U.S. by PPL, incorporating the terms of the submitted settlement. On October 19, 2010 and October 21, 2010, respectively, Orders approving the acquisition of E.ON U.S. by PPL were received from the Virginia Commission and the Tennessee Regulatory Authority. The Commissions' Orders contained a number of other commitments with regard to operations, workforce, community involvement and other matters.

In mid-September 2010, KU and LG&E and other applicants in the FERC change of control proceeding reached an agreement with the protesters, whereby such protests have been withdrawn. The agreement, which has subsequently been filed for consideration with the FERC, includes various conditional commitments, such as a continuation of certain existing undertakings with protesters in prior cases, an agreement not to terminate certain KU municipal customer contracts prior to January 2017, an exclusion of any transaction-related costs from wholesale energy and tariff customer rates to the extent that the Company has agreed to not seek the same transaction-related cost from retail customers and agreements to coordinate with protesters in certain open or ongoing matters. A FERC Order approving the transaction was received on October 26, 2010.

On September 30, 2010, October 19, 2010 and October 21, 2010, respectively, KU received Kentucky Commission, Virginia Commission and Tennessee Regulatory Authority approvals to complete certain refinancing transactions in connection with the anticipated PPL acquisition and other business factors. Based on credit and financial market conditions, KU anticipates issuing up to \$1.5 billion in first mortgage bonds, the proceeds of which will substantially be used to refund existing long-term intercompany debt. On October 29, 2010, as required by existing covenants, in connection with the anticipated issuance of any such secured debt, KU completed collateralization of certain outstanding pollution control bond debt series which were formerly unsecured. Pursuant to such collateralization, approximately \$351 million in existing pollution control debt became collateralized debt, supported by a first mortgage lien. KU also anticipates replacing its \$35 million bilateral line of credit with an unaffiliated institution by entering into a multi-year revolving credit facility with several financial institutions in an aggregate amount not to exceed \$400 million. KU may complete these transactions, in whole or in part, during late 2010 and early 2011. See Note 8, Short-Term and Long-Term Debt, for further information regarding the refinancing, remarketing or conversion of existing pollution control debt.

## **Recent Accounting Pronouncements**

### ***Fair Value Measurements***

In January 2010, the FASB issued guidance related to fair value measurement disclosures requiring separate disclosure of amounts of significant transfers in and out of level 1 and level 2 fair value measurements and separate information about purchases, sales, issuances, and settlements within level 3 measurements. This guidance is effective for the interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about the roll-forward of activity in level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. This guidance has no impact on the Company's results of operations, financial position, liquidity or disclosures.

## **Note 2 — Rates and Regulatory Matters**

KU's Kentucky base rates are calculated based on a return on capitalization (common equity, long-term debt and notes payable) including certain regulatory adjustments to exclude non-regulated investments and environmental compliance plans recovered separately through the ECR mechanism. Currently, none of the regulatory assets or regulatory liabilities are excluded from the return on capitalization utilized in the calculation of Kentucky base rates; therefore, a return is earned on all Kentucky regulatory assets.

KU's Virginia base rates are calculated based on a return on rate base (net utility plant less deferred taxes and miscellaneous deductions). All regulatory assets and liabilities are excluded from the return on rate base utilized in the calculation of Virginia base rates.

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, Rates and Regulatory Matters, of KU's Annual Report for the year ended December 31, 2009.

### **2010 Kentucky Rate Case**

In January 2010, KU filed an application with the Kentucky Commission requesting an increase in electric base rates of approximately 12%, or \$135 million annually, including an 11.5% return on equity. KU requested the increase, based on the twelve month test year ended October 31, 2009, to become effective on and after March 1, 2010. The requested rates were suspended until August 1, 2010. A number of intervenors entered the rate case, including the AG, certain representatives of industrial and low-income groups and other third parties, and submitted filings challenging the Company's requested rate increases, in whole or in part. A hearing was held on June 8, 2010. KU and all of the intervenors, except the AG, agreed to a stipulation providing for an increase in electric base rates of \$98 million annually and filed a request with the Kentucky Commission to approve such settlement. An Order in the proceeding was issued in July 2010, approving all the provisions in the stipulation. The new rates became effective on August 1, 2010.

### **Virginia Rate Case**

In June 2009, KU filed an application with the Virginia Commission requesting an increase in electric base rates for its Virginia jurisdictional customers in an amount of \$12 million annually or approximately 21%. The proposed increase reflected a proposed rate of return on rate base of 8.586% based on a return on equity of 12%. During December 2009, KU and the Virginia Commission Staff agreed to a Stipulation and Recommendation authorizing base rate revenue increases of \$11 million annually and a return on rate base of 7.846% based on a 10.5% return on common equity. A public hearing was held during January 2010. As permitted, pursuant to a Virginia Commission Order, KU elected to implement the proposed rates effective November 1, 2009, on an interim basis. In March 2010, the Virginia Commission issued an Order approving the stipulation, with the increased rates to be put into effect as of April 1, 2010. As part of the stipulation, KU refunded approximately \$1 million in interim rate amounts in excess of the ultimate approved rates. During August 2010, a report was filed detailing the costs of the refunds, the accounts charged and details validating that all refunds have been applied.

### **FERC Wholesale Rate Case**

In September 2008, KU filed an application with the FERC for increases in electric base rates applicable to wholesale power sales contracts or interchange agreements involving, collectively, twelve Kentucky municipalities. The application requested a shift from an all-in stated unit charge rate to an unbundled formula rate, including an annual adjustment mechanism. In May 2009, the FERC issued an Order approving a settlement among the parties in the case, incorporating increases of approximately 3% from prior rates and a return on equity of 11%. In May 2010, KU submitted to the FERC the proposed current annual adjustment to the formula rate. This updated rate became effective on July 1, 2010, subject to certain review procedures by the wholesale requirements customers and the FERC, including potential refunds in the case of disallowed costs or charges.

By mutual agreement, the parties' settlement of the 2008 application left outstanding the issue of whether KU must allocate to the municipal customers a portion of renewable resources it may be required to procure on behalf of its retail ratepayers. In August 2009, the FERC accepted the issue for briefing and the parties completed briefing submissions during 2009. An Order was issued by the FERC in July 2010, indicating that KU is not required to allocate a portion of any renewable resources to the twelve municipalities, thus resolving the remaining issue.



## Regulatory Assets and Liabilities

The following regulatory assets and liabilities were included in KU's balance sheets as of:

	<u>September 30,</u> <u>2010</u>	<u>December 31,</u> <u>2009</u>
	(In millions)	
Current regulatory assets:		
Storm restoration(a) . . . . .	\$ 6	\$ —
FAC(b) . . . . .	4	1
ECR(b) . . . . .	—	28
MISO exit(a) . . . . .	1	2
Other(c) . . . . .	<u>3</u>	<u>1</u>
Total current regulatory assets . . . . .	<u>\$ 14</u>	<u>\$ 32</u>
Non-current regulatory assets:		
Pension benefits(d) . . . . .	\$105	\$105
Other non-current regulatory assets:		
Storm restoration(a) . . . . .	52	59
ARO(e) . . . . .	34	30
Unamortized loss on bonds(a) . . . . .	12	12
MISO exit(a) . . . . .	4	9
Other(c) . . . . .	<u>8</u>	<u>7</u>
Subtotal other non-current regulatory assets . . . . .	<u>110</u>	<u>117</u>
Total non-current regulatory assets . . . . .	<u>\$215</u>	<u>\$222</u>
Current regulatory liabilities:		
ECR . . . . .	\$ 6	\$ —
DSM . . . . .	4	3
Other(f) . . . . .	<u>2</u>	<u>1</u>
Total current regulatory liabilities . . . . .	<u>\$ 12</u>	<u>\$ 4</u>
Non-current regulatory liabilities:		
Accumulated cost of removal of utility plant . . . . .	\$343	\$331
Other non-current regulatory liabilities:		
Deferred income taxes — net . . . . .	8	9
Postretirement benefits . . . . .	9	9
MISO exit . . . . .	1	4
Other(f) . . . . .	<u>6</u>	<u>7</u>
Subtotal other non-current regulatory liabilities . . . . .	<u>24</u>	<u>29</u>
Total non-current regulatory liabilities . . . . .	<u>\$367</u>	<u>\$360</u>

(a) These regulatory assets are recovered through base rates.

(b) The FAC and ECR regulatory assets have separate recovery mechanisms with recovery within twelve months.

(c) Other regulatory assets:

- Other current and non-current regulatory assets, including the CMRG and KCCS contributions, an EKPC FERC transmission settlement agreement and rate case expenses, are recovered through base rates.
- The current portion of the unamortized loss on bonds is recovered through base rates.

- KU generally recovers the FERC jurisdictional portion of the EKPC FERC transmission settlement agreement included in current and non-current regulatory assets in the application of the annual Open Access Transmission Tariff formula rate updates.
  - Recovery of the FERC jurisdictional pension expense in non-current regulatory assets will be requested in a future FERC rate case.
- (d) KU generally recovers this asset through pension expense included in the calculation of base rates.
- (e) 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.
- (f) Other current and non-current regulatory liabilities includes the Virginia levelized fuel factor regulatory liability, ARO liabilities and a change in accounting method for FERC jurisdictional spare parts. ARO liabilities are established from the removal costs accrued through depreciation under regulatory accounting for assets associated with AROs.

### ***Storm Restoration***

In January 2009, a significant ice storm passed through KU's service territory causing approximately 199,000 customer outages and was followed closely by a severe wind storm in February 2009, which caused approximately 44,000 customer outages. KU incurred \$57 million in incremental operation and maintenance expenses and \$33 million in capital expenditures related to the restoration following the two storms. The Company filed an application with the Kentucky Commission in April 2009, requesting approval to establish a regulatory asset and defer for future recovery approximately \$62 million in incremental operation and maintenance expenses related to the storm restoration. In September 2009, the Kentucky Commission issued an Order allowing the Company to establish a regulatory asset of up to \$62 million based on its actual costs for storm damages and service restoration due to the January and February 2009 storms. In September 2009, the Company established a regulatory asset of \$57 million for actual costs incurred. The Company received approval in its 2010 base rate case to recover this asset over a ten year period beginning August 1, 2010.

In September 2008, high winds from the remnants of Hurricane Ike passed through the service territory causing significant outages and system damage. In October 2008, KU filed an application with the Kentucky Commission requesting approval to establish a regulatory asset and defer for future recovery approximately \$3 million of expenses related to the storm restoration. In December 2008, the Kentucky Commission issued an Order allowing the Company to establish a regulatory asset of up to \$3 million based on its actual costs for storm damages and service restoration due to Hurricane Ike. In December 2008, the Company established a regulatory asset of \$2 million for actual costs incurred. The Company received approval in its 2010 base rate case to recover this asset over a ten year period beginning August 1, 2010.

### ***FAC***

In August 2010, the Kentucky Commission initiated a six-month review of KU's FAC mechanism for the expense period ended April 2010. An order is expected by the end of the year.

In February 2010, KU filed an application with the Virginia Commission seeking approval of a decrease in its fuel cost factor beginning with service rendered in April 2010. An Order was issued in April 2010, resulting in an agreed upon decrease of 23% from the fuel factor in effect for April 2009 through March 2010.

In January 2010, the Kentucky Commission initiated a six-month review of KU's FAC mechanism for the expense period ended August 2009. In May 2010, an Order was issued approving the charges and credits billed through the FAC during the review period.

### ***ECR***

In July 2010, the Kentucky Commission initiated a six-month review of KU's environmental surcharge for the billing period ending April 2010. An order is expected in the fourth quarter of 2010.

In January 2010, the Kentucky Commission initiated a six-month review of KU's environmental surcharge for the billing period ending October 2009. In May 2010, an Order was issued approving the amounts billed through the ECR during the six-month period and the rate of return on capital and allowing recovery of the under-recovery position in subsequent monthly filings.

In June 2009, the Company filed an application for a new ECR plan with the Kentucky Commission seeking approval to recover investments in environmental upgrades and operations and maintenance costs at the Company's generating facilities. During 2009, KU reached a unanimous settlement with all parties to the case, and the Kentucky Commission issued an Order approving KU's application. Recovery on customer bills through the monthly ECR surcharge for these projects began with the February 2010 billing cycle. At December 31, 2009, the Company had a regulatory asset of \$28 million, which changed to a regulatory liability in the first quarter of 2010, as a result of these roll-in adjustments to base rates. At September 30, 2010, the regulatory liability balance was \$6 million.

### ***MISO***

In August 2010, the FERC issued three Orders accepting most facets of several MISO Revenue Sufficiency Guarantee ("RSG") compliance filings. The FERC ordered the MISO to issue refunds for RSG charges that were imposed by the MISO on the assumption that there were rate mismatches for the period beginning November 5, 2007 through the present. There is no financial statement impact to the Company from this Order, as the MISO had anticipated that the FERC would require these refunds and had preemptively included them in the resettlements paid in 2009. The FERC denied MISO's proposal to exempt certain resources from RSG charges, effective prospectively. The FERC accepted portions and rejected portions of the MISO's proposed RSG rate Redesign Proposal, which will be effective when the software is ready for implementation subject to further compliance filings. The impact of the Redesign Proposal on the Company cannot be estimated at this time.

### **Other Regulatory Matters**

#### ***TC2 Depreciation***

In August 2009, the Companies jointly filed an application with the Kentucky Commission to approve new common depreciation rates for applicable jointly-owned TC2-related generating, pollution control and other plant equipment and assets. During December 2009, the Kentucky Commission extended the data discovery process through January 2010, and authorized the Companies on an interim basis to begin using the depreciation rates for TC2 as proposed in the application. In March 2010, the Kentucky Commission issued a final Order approving the use of the proposed depreciation rates on a permanent basis.

#### ***TC2 Transmission Matters***

KU's and LG&E's CCN for a transmission line associated with the TC2 construction has been challenged by certain property owners in Hardin County, Kentucky. In August 2006, the Companies obtained a successful dismissal of the challenge at the Franklin County Circuit Court, which was reversed by the Kentucky Court of Appeals in December 2007. In April 2009, the Kentucky Supreme Court granted KU's and LG&E's motion for discretionary review of the Court of Appeals' decision. In August 2010, the Kentucky Supreme Court issued an Order reversing the decision of the Kentucky Court of Appeals and reinstating the Franklin County Circuit Court's dismissal of the property owners' challenge to KU's and LG&E's CCN.

During 2008, KU obtained various successful rulings at the Hardin County Circuit Court confirming its condemnation rights. In August 2008, several landowners appealed such rulings to the Kentucky Court of Appeals. In May 2010, the Kentucky Court of Appeals issued an Order affirming the Hardin Circuit Court's finding that KU had the right to condemn easements on the properties. In May 2010, the landowners filed a petition for reconsideration with the Court of Appeals. In July 2010, the Court of Appeals denied that petition. In August, 2010, the landowners filed for discretionary review of that denial by the Kentucky Supreme Court.

In a separate proceeding, certain Hardin County landowners filed an action in federal district court in Louisville, Kentucky against the U.S. Army challenging the same transmission line claiming that certain

Fort Knox-related sections of the line failed to comply with certain National Historic Preservation Act procedural requirements. In October 2009, the federal court granted the defendants' motion for summary judgment and dismissed the plaintiffs' claims. During November 2009, the petitioners filed submissions for review of the decision with the 6th Circuit Court of Appeals. In May 2010, the appellate court issued an order approving the plaintiffs' voluntary withdrawal of their appeals.

Consistent with the regulatory authorizations and relevant legal proceedings, the Companies have completed construction activities on temporary or permanent transmission line segments. During the second quarter of 2010, the Companies placed into operation an appropriate combination of permanent and temporary sections of the transmission line. While the Companies are not currently able to predict the ultimate outcome and possible financial effects of the remaining legal proceedings, the Companies do not believe the matter involves relevant or continuing risks to operations.

***Mandatory Reliability Standards***

As a result of the EPAct 2005, certain formerly voluntary reliability standards became mandatory in June 2007, and authority was delegated to various Regional Reliability Organizations ("RROs") by the North American Electric Reliability Corporation ("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 on the circumstances of the violation. The Companies are members of SERC, which acts as KU's and LG&E's RRO. During December 2009, SERC and the Companies agreed to settlements involving penalties totaling less than \$1 million for each utility related to their self-reports during June and October 2008, concerning possible violations of standards. During December 2009 and April, July and August 2010, the Companies submitted ten self-reports relating to various standards, which self-reports remain in the early stages of RRO review, and therefore, the Companies are unable to estimate the outcome of these matters. Mandatory reliability standard settlements commonly also include non-penalty elements, including compliance steps and mitigation plans. Settlements with SERC proceed to NERC and FERC review before becoming final. While the Companies believe they are in compliance with the mandatory reliability standards, events of potential non-compliance may be identified from time-to-time. The Companies cannot predict such potential violations or the outcome of the self-reports described above.

**Note 3 — Asset Retirement Obligation**

A summary of KU's net ARO assets, ARO liabilities and regulatory assets established under the asset retirement and environmental obligations guidance of the FASB ASC follows:

	<u>ARO Net Assets</u>	<u>ARO Liabilities</u> (In millions)	<u>Regulatory Assets</u>
As of December 31, 2009 . . . . .	\$ 4	\$(34)	\$30
ARO accretion . . . . .	—	(2)	2
ARO revaluation . . . . .	<u>21</u>	<u>(23)</u>	<u>2</u>
As of September 30, 2010 . . . . .	<u>\$25</u>	<u>\$(59)</u>	<u>\$34</u>

As of September 30, 2010, the Company performed a revaluation of its AROs as a result of recently proposed environmental legislation and improved ability to forecast asset retirement costs due to recent construction and retirement activity.

Pursuant to regulatory treatment prescribed under the regulated operations guidance of the FASB ASC, an offsetting regulatory credit was recorded in depreciation and amortization in the income statement of \$2 million for the nine months ended September 30, 2010 for the ARO accretion and depreciation expense. KU's AROs are primarily related to the final retirement of assets associated with generating units.

KU transmission and distribution lines largely operate under perpetual property easement agreements which do not generally require restoration on removal of the property. Therefore, under the asset retirement and

environmental obligations guidance of the FASB ASC, no material asset retirement obligations are recorded for transmission and distribution assets.

#### **Note 4 — Derivative Financial Instruments**

KU is subject to interest rate and commodity price risk related to on-going business operations. It currently manages these risks using derivative instruments, including swaps and forward contracts. The Company's policies allow the interest rate risk to be managed through the use of fixed rate debt, floating rate debt and interest rate swaps. At September 30, 2010, a 100 basis point change in the benchmark rate on KU's variable rate debt, not effectively hedged by an interest rate swap, would impact pre-tax interest expense by \$4 million annually. Although the Company's policies allow for the use of interest rate swaps, as of September 30, 2010 and December 31, 2009, KU had no interest rate swaps outstanding.

The Company does not net collateral against derivative instruments.

#### **Energy Trading and Risk Management Activities**

KU conducts energy trading and risk management activities to maximize the value of power sales from physical assets it owns. Energy trading activities are principally forward financial transactions to manage price risk and are accounted for as non-hedging derivatives on a mark-to-market basis in accordance with the derivatives and hedging topic of the FASB ASC.

Energy trading and risk management contracts are valued using prices based on active trades from Intercontinental Exchange Inc. In the absence of a traded price, midpoints of the best bids and offers are the primary determinants of valuation. When sufficient trading activity is unavailable, other inputs include prices quoted by brokers or observable inputs other than quoted prices, such as one-sided bids or offers as of the balance sheet date. 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 2010 or 2009. Changes in market pricing, interest rate and volatility assumptions were made during both years.

KU's financial assets and liabilities as of September 30, 2010 and December 31, 2009, arising from energy trading and risk management contracts not designated as hedging instruments accounted for at fair value total less than \$1 million and are recorded in prepayments and other current assets and other current liabilities, respectively.

The Company maintains credit policies intended to minimize credit risk in wholesale marketing and trading activities by assessing the creditworthiness of potential counterparties prior to entering into transactions with them and continuing to evaluate their creditworthiness once transactions have been initiated. To further mitigate credit risk, KU seeks to enter into netting agreements or require cash deposits, letters of credit and parental company guarantees as security from counterparties. The Company uses S&P, Moody's and definitive qualitative and quantitative data to assess the financial strength of counterparties on an on-going basis. If no external rating exists, KU assigns an internally generated rating for which it sets appropriate risk parameters. As risk management contracts are valued based on changes in market prices of the related commodities, credit exposures are revalued and monitored on a daily basis. At September 30, 2010, 100% of the trading and risk management commitments were with counterparties rated BBB-/Baa3 equivalent or better. The Company has reserves 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 September 30, 2010 and December 31, 2009, counterparty credit reserves related to energy trading and risk management contracts were less than \$1 million.

The net volume of electricity based financial derivatives outstanding at September 30, 2010 and December 31, 2009, was zero and 43,400 Mwhts, respectively. No cash collateral related to the energy trading and risk management contracts was required at September 30, 2010. Cash collateral related to the energy trading and risk management contracts was less than \$1 million at December 31, 2009. Cash collateral related to the energy trading and risk management contracts is categorized as other accounts receivable in the accompanying balance sheets.

KU manages the price risk of its estimated future excess economic generation capacity using market-traded forward contracts. Hedge accounting treatment has not been elected for these transactions, and therefore realized and unrealized gains and losses are included in the statements of income.

The following tables present the effect of derivatives not designated as hedging instruments on income:

<u>Loss Recognized in Income</u>	<u>Location</u>	<u>Three Months Ended September 30,</u>	
		<u>2010(a)</u>	<u>2009</u>
		(In millions)	
Unrealized loss . . . . .	Electric revenues	<u>\$—</u>	<u>\$(3)</u>

<u>Loss Recognized in Income</u>	<u>Location</u>	<u>Nine Months Ended September 30,</u>	
		<u>2010(a)</u>	<u>2009</u>
		(In millions)	
Unrealized loss . . . . .	Electric revenues	<u>\$—</u>	<u>\$(1)</u>

(a) Unrealized loss was less than \$1 million

Net realized gains were less than \$1 million in the three and nine months ended September 30, 2010 and 2009, respectively.

**Credit Risk Related Contingent Features**

Certain of the Company’s derivative instruments contain provisions that require the Company to provide immediate and on-going collateralization on derivative instruments in net liability positions based on the Company’s credit ratings from each of the major credit rating agencies. At September 30, 2010, there are no energy trading and risk management contracts with credit risk related contingent features that are in a liability position and no collateral posted in the normal course of business. At September 30, 2010, a one notch downgrade of the Company’s credit rating would have no effect on the energy trading and risk management contracts or collateral required.

**Note 5 — Fair Value Measurements**

KU adopted the fair value guidance in the FASB ASC in two phases. Effective January 1, 2008, the Company adopted it for all financial instruments and non-financial instruments accounted for at fair value on a recurring basis, and January 1, 2009, the Company adopted it for all non-financial instruments accounted for at fair value on a non-recurring basis. The FASB ASC guidance clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or a liability. As a basis for considering such assumptions, the FASB ASC guidance establishes a three-tier value hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value.

The carrying values and estimated fair values of KU’s non-trading instruments:

	<u>September 30, 2010</u>		<u>December 31, 2009</u>	
	<u>Carrying Value</u>	<u>Fair Value</u>	<u>Carrying Value</u>	<u>Fair Value</u>
	(In millions)			
Long-term bonds (including current portion of \$228 million) . . . . .	\$ 351	\$ 352	\$ 351	\$ 351
Long-term debt to affiliated company (including current portion of \$33 million) . . . . .	1,331	1,527	1,331	1,401

The long-term bond valuations reflect prices quoted by investment banks, which are active in the market for these debt instruments. The fair value of the long-term debt due to affiliated company is determined using an internal valuation model that discounts the future cash flows of each loan at current market rates as determined based on quotes from investment banks that are actively involved in capital markets for utilities and factor in KU's credit ratings and default risk. The fair values of cash and cash equivalents, accounts receivable, cash surrender value of key man life insurance, accounts payable and notes payable are substantially the same as their carrying values.

KU has classified the applicable financial assets and liabilities that are accounted for at fair value into the three levels of the fair value hierarchy, as defined by the fair value measurements and disclosures topic of the FASB ASC, as follows:

- Level 1 — Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets
- Level 2 — Include other inputs that are directly or indirectly observable in the marketplace
- Level 3 — Unobservable inputs which are supported by little or no market activity

The fair value hierarchy also requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

The Company classifies its derivative cash collateral balances within level 1 based on the funds being held in a demand deposit account. The Company classifies its derivative energy trading and risk management contracts within level 2 because it values them using prices actively quoted for proposed or executed transactions, quoted by brokers or observable inputs other than quoted prices.

KU's financial assets and liabilities as of September 30, 2010 and December 31, 2009, arising from energy trading and risk management contracts accounted for at fair value on a recurring basis total less than \$1 million. No cash collateral related to the energy trading and risk management contracts was required at September 30, 2010. Cash collateral related to the energy trading and risk management contracts was less than \$1 million at December 31, 2009.

There were no level 3 measurements for the periods ending September 30, 2010 and December 31, 2009.

## Note 6 — Pension and Other Postretirement Benefit Plans

### Net Periodic Benefit Costs

The following tables provide the components of net periodic benefit cost for pension and other postretirement benefit plans. The tables include the costs associated with both KU employees and Servco employees who are providing services to KU. The Servco costs are allocated to KU based on employees' labor charges and are approximately 53% and 51% of Servco costs for September 30, 2010 and 2009, respectively.

	Pension Benefits Three Months Ended September 30,					
	2010			2009		
	KU	Servco Allocation to KU	Total KU	KU	Servco Allocation to KU	Total KU
	(In millions)					
Service cost . . . . .	\$ 2	\$ 1	\$ 3	\$ 2	\$ 1	\$ 3
Interest cost . . . . .	4	2	6	4	2	6
Expected return on plan assets . . . . .	(5)	(2)	(7)	(3)	(1)	(4)
Amortization of prior service cost . . . . .	—	1	1	—	—	—
Amortization of actuarial loss . . . . .	<u>2</u>	<u>1</u>	<u>3</u>	<u>2</u>	<u>1</u>	<u>3</u>
Net periodic benefit cost . . . . .	<u>\$ 3</u>	<u>\$ 3</u>	<u>\$ 6</u>	<u>\$ 5</u>	<u>\$ 3</u>	<u>\$ 8</u>

Other Postretirement Benefits Three Months Ended September 30,						
2010			2009			
(In millions)						
	KU	Servco Allocation to KU(a)	Total KU	KU	Servco Allocation to KU(a)	Total KU
Interest cost . . . . .	\$2	\$—	\$2	\$1	\$—	\$1
Net periodic benefit cost . . . . .	<u>\$2</u>	<u>\$—</u>	<u>\$2</u>	<u>\$1</u>	<u>\$—</u>	<u>\$1</u>

(a) amounts are less than \$1 million

Pension Benefits Nine Months Ended September 30,						
2010			2009			
(In millions)						
	KU	Servco Allocation to KU	Total KU	KU	Servco Allocation to KU	Total KU
Service cost . . . . .	\$ 5	\$ 4	\$ 9	\$ 4	\$ 4	\$ 8
Interest cost . . . . .	14	6	20	13	5	18
Expected return on plan assets . . . . .	(13)	(5)	(18)	(10)	(4)	(14)
Amortization of prior service cost . . . . .	—	1	1	1	1	2
Amortization of actuarial loss . . . . .	<u>5</u>	<u>2</u>	<u>7</u>	<u>6</u>	<u>2</u>	<u>8</u>
Net periodic benefit cost . . . . .	<u>\$ 11</u>	<u>\$ 8</u>	<u>\$ 19</u>	<u>\$ 14</u>	<u>\$ 8</u>	<u>\$ 22</u>

Other Postretirement Benefits Nine Months Ended September 30,						
2010			2009			
(In millions)						
	KU	Servco Allocation to KU	Total KU	KU	Servco Allocation to KU	Total KU
Service cost . . . . .	\$ 1	\$ 1	\$ 2	\$ 1	\$ 1	\$ 2
Interest cost . . . . .	4	—	4	3	—	3
Expected return on plan assets . . . . .	(1)	—	(1)	—	—	—
Amortization of transitional obligation . . . . .	<u>1</u>	<u>—</u>	<u>1</u>	<u>1</u>	<u>—</u>	<u>1</u>
Net periodic benefit cost . . . . .	<u>\$ 5</u>	<u>\$ 1</u>	<u>\$ 6</u>	<u>\$ 5</u>	<u>\$ 1</u>	<u>\$ 6</u>

### Contributions

In January 2010, KU and Servco made discretionary pension plan contributions of \$13 million and \$9 million, respectively. The amount of future contributions to the pension plan will depend on the actual return on plan assets and other factors, but the Company's intent is to fund the pension plan in a manner consistent with the requirements of the Pension Protection Act of 2006.

Through September 2010, KU made contributions to other postretirement benefit plans totaling \$4 million. An additional contribution totaling \$1 million was made in October. The Company anticipates further funding to match the annual postretirement expense and funding the 401(h) plan up to the maximum amount allowed by law.

### Health Care Reform

In March 2010, Health Care Reform (the Patient Protection and Affordable Care Act of 2010) was signed into law. Many provisions of Health Care Reform do not take effect for an extended period of time, and many aspects of the law which are currently unclear or undefined will likely be clarified in future regulations.



During each of the three and nine months ended September 30, 2010, KU recorded an income tax expense of less than \$1 million, to recognize the impact of the elimination of the tax deduction related to the Medicare Retiree Drug Subsidy that becomes effective in 2013.

Specific provisions within Health Care Reform that may impact KU include:

- Beginning in 2011, requirements extend dependent coverage up to age 26, remove the \$2 million lifetime maximum and eliminate cost sharing for certain preventative care procedures.
- Beginning in 2018, a potential excise tax is expected on high-cost plans providing health coverage that exceeds certain thresholds.

KU continues to evaluate all implications of Health Care Reform on its benefit programs but at this time cannot predict the significance of those implications.

#### **Note 7 — Income Taxes**

A United States consolidated income tax return is filed by E.ON U.S.'s direct parent, E.ON US Investments Corp., for each tax period. Each subsidiary of the consolidated tax group, including KU, calculates its separate income tax for each period. The resulting separate-return tax cost or benefit is paid to or received from the parent company or its designee. The Company also files income tax returns in various state jurisdictions. While 2007 and later years are open under the federal statute of limitations, Revenue Agent Reports for 2006-2008 have been received from the IRS, effectively closing these years to additional audit adjustments. Tax years beginning with 2007 were examined under an IRS pilot program named "Compliance Assurance Process" ("CAP"). This program accelerates the IRS' review to begin during the year applicable to the return and ends 90 days after the return is filed. For 2008, the IRS allowed additional deductions in connection with the Company's application for a change in repair deductions and disallowed some of the bonus depreciation claimed on the original return. The net temporary tax impact for the Company was \$12 million and was recorded in the second quarter of 2010. Tax years 2009 and 2010 are also being examined under CAP. The 2009 federal return was filed in the third quarter, and the IRS issued a Partial Acceptance Letter with the 2009 return. The IRS is continuing to review bonus depreciation, storms and other repairs. No material impact is expected from the IRS review. For the tax year 2010, no material items have been raised by the IRS at this time.

Additions and reductions of uncertain tax positions during 2010 and 2009 were less than \$1 million. Possible amounts of uncertain tax positions for KU that may decrease within the next 12 months total less than \$1 million and are based on the expiration of the audit periods as defined in the statutes. If recognized, the less than \$1 million of unrecognized tax benefits would reduce the effective income tax rate.

The amount KU recognized as interest expense and interest accrued related to unrecognized tax benefits was less than \$1 million as of September 30, 2010 and December 31, 2009. The interest expense and interest accrued is based on IRS and Kentucky Department of Revenue large corporate interest rates for underpayment of taxes. At the date of adoption, the Company accrued less than \$1 million in interest expense on uncertain tax positions. KU records the interest as interest expense and penalties as operating expenses in the income statement and accrued expenses in the balance sheet, on a pre-tax basis. No penalties were accrued by the Company through September 30, 2010.

In June 2006, the Companies filed a joint application with the U.S. Department of Energy ("DOE") requesting certification to be eligible for investment tax credits applicable to the construction of TC2. In November 2006, the DOE and the IRS announced that KU was selected to receive \$101 million in tax credits. A final IRS certification required to obtain the investment tax credits was received in August 2007. In September 2007, KU received an Order from the Kentucky Commission approving the accounting of the investment tax credits, which includes a full depreciation basis adjustment for the amount of the credits. Based on eligible construction expenditures incurred, KU recorded investment tax credits of \$6 and \$17 million during the three and nine months ended September 30, 2009, decreasing current federal income taxes. As of December 31, 2009 KU had recorded its maximum credit of \$101 million. The income tax expense impact from amortizing these credits over the life of the related property will begin when the facility is placed in service, which is expected to occur by year end.

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. The plaintiffs voluntarily dismissed their complaint in August 2010.

A reconciliation of differences between the income tax expense at the statutory U.S. federal income tax rate and the Company's actual income tax expense follows:

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2010</u>	<u>2009</u>	<u>2010</u>	<u>2009</u>
	(In millions)			
Statutory federal income tax expense . . . . .	\$ 30	\$ 37	\$ 72	\$ 52
State income taxes — net of federal benefit . . . . .	3	4	8	4
Dividends received deduction related to EEI investment . . . . .	—	—	—	(3)
Other differences — net . . . . .	<u>(1)</u>	<u>(2)</u>	<u>(4)</u>	<u>(4)</u>
Income tax expense . . . . .	<u>\$ 32</u>	<u>\$ 39</u>	<u>\$ 76</u>	<u>\$ 49</u>
Effective income tax rate . . . . .	37.2%	37.1%	37.1%	33.1%

The amounts shown in the table above are rounded to the nearest \$1 million; however, the effective income tax rates are based on actual underlying amounts. Other differences — net includes the qualified production activities deduction and excess deferred taxes on depreciation.

The effective tax rate for the nine months ended September 2010 was higher than the rate for the nine months ended 2009 due to state income taxes — net of federal benefit being lower due to a coal credit recorded in 2009 and a lower dividends received deduction primarily due to the lack of EEI dividends in 2010.

**Note 8 — Short-Term and Long-Term Debt**

KU's long-term debt includes \$228 million of pollution control bonds that are classified as current portion of long-term debt 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:

	(In millions)
Mercer Co. 2000 Series A, due May 1, 2023, variable% . . . . .	\$ 13
Carroll Co. 2002 Series A, due February 1, 2032, variable% . . . . .	21
Carroll Co. 2002 Series B, due February 1, 2032, variable% . . . . .	2
Carroll Co. 2008 Series A, due February 1, 2032, variable% . . . . .	78
Mercer Co. 2002 Series A, due February 1, 2032, variable% . . . . .	8
Muhlenberg Co. 2002 Series A, due February 1, 2032, variable% . . . . .	2
Carroll Co. 2004 Series A, due October 1, 2034, variable% . . . . .	50
Carroll Co. 2006 Series B, due October 1, 2034, variable% . . . . .	<u>54</u>
	<u>\$228</u>

The average annualized interest rates for these bonds follow:

	<u>September 30,</u>	
	<u>2010</u>	<u>2009</u>
Three months ended . . . . .	0.37%	0.51%
Nine months ended . . . . .	0.36%	0.65%

Pollution control bonds are obligations of KU issued in connection with tax-exempt pollution control bonds issued by counties in Kentucky. A loan agreement obligates the Company to make debt service payments to the counties that equate to the debt service due from the counties on the related pollution control bonds. The loan

agreement is an unsecured obligation of the Company. Debt issuance expense is capitalized in either regulatory assets or current or long-term other assets and amortized over the lives of the related bond issues, consistent with regulatory practices.

In October 2010, KU's pollution control bonds were converted from unsecured debt to debt which is collateralized by first mortgage bonds. Also in October 2010, one national rating agency revised downward the short-term credit rating of the pollution control bonds and the Company's issuer rating as a result of the pending acquisition by PPL.

Several of the KU pollution control bonds are insured by monoline bond insurers whose ratings have been reduced due to exposures relating to insurance of sub-prime mortgages. At September 30, 2010, KU had an aggregate \$351 million of outstanding pollution control indebtedness, of which \$96 million is in the form of insured auction rate securities wherein interest rates are reset every 35 days via an auction process. Beginning in late 2007, the interest rates on these insured bonds began to increase due to investor concerns about the creditworthiness of the bond insurers. Since 2008, the Company experienced "failed auctions" when there were insufficient bids for the bonds. When a failed auction occurs, the interest rate is set pursuant to a formula stipulated in the indenture.

The average annualized interest rates on the auction rate bonds follow:

	<u>September 30,</u>	
	<u>2010</u>	<u>2009</u>
Three months ended . . . . .	0.61%	0.34%
Nine months ended . . . . .	0.50%	0.51%

The instruments governing these auction rate bonds permit KU to convert the bonds to other interest rate modes, such as various short-term variable rates, long-term fixed rates or intermediate-term fixed rates that are reset infrequently. In June 2009, one national rating agency downgraded the credit rating of an insurer of the Company's bonds. As a result, the national rating agency downgraded the rating on the Carroll County 2002 Series C bond. The national agency's rating of this bond is now based on the rating of the Company rather than the rating of the insurer since the Company's rating is higher.

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

	<u>Total Money Pool Available</u>	<u>Amount Outstanding</u>	<u>Balance Available</u>	<u>Average Interest Rate</u>
	(In millions)			
September 30, 2010 . . . . .	\$400	\$61	\$339	0.28%
December 31, 2009 . . . . .	\$400	\$45	\$355	0.20%

E.ON U.S. maintained revolving credit facilities totaling \$313 million at September 30, 2010 and December 31, 2009, to ensure funding availability for the money pool. At September 30, 2010, one facility, totaling \$150 million, was with E.ON North America, Inc. while the remaining line, totaling \$163 million, was with Fidelia; both are affiliated companies. The balances are as follows:

	<u>Total Available</u>	<u>Amount Outstanding</u>	<u>Balance Available</u>	<u>Average Interest Rate</u>
	(In millions)			
September 30, 2010 . . . . .	\$313	\$181	\$132	1.44%
December 31, 2009 . . . . .	\$313	\$276	\$ 37	1.25%

As of September 30, 2010, the Company maintained a \$35 million bilateral line of credit, maturing in June 2012, with an unaffiliated financial institution. At September 30, 2010, there was no balance outstanding under this facility. The Company also maintains letter of credit facilities that support \$195 million of the \$228 million of bonds that can be put back to the Company. Should the holders elect to put the bonds back and they cannot be remarketed, the letter of credit would fund the investor's payment.

There were no redemptions or issuances of long-term debt year-to-date through September 30, 2010. KU was in compliance with all debt covenants at September 30, 2010 and December 31, 2009. See Note 1, General, for certain debt refinancing and associated transactions which are anticipated by KU in connection with the PPL acquisition and Note 10, Related Party Transactions, for long-term debt payable to affiliates.

#### **Note 9 --- Commitments and Contingencies**

Except as may be discussed in this quarterly report (including Note 2, Rates and Regulatory Matters), material changes have not occurred in the current status of various commitments or contingent liabilities from that discussed in the Company's Annual Report for the year ended December 31, 2009 (including, but not limited to Note 2, Rates and Regulatory Matters; Note 9, Commitments and Contingencies; and Note 12, Subsequent Events, contained therein). See the Company's Annual Report regarding such commitments or contingencies.

#### **Letters of Credit**

KU has provided letters of credit as of September 30, 2010 and December 31, 2009, for on-balance sheet obligations totaling \$198 million to support bonds of \$195 million and a letter of credit for off-balance sheet obligations totaling less than \$1 million to support certain obligations related to workers' compensation.

#### **Owensboro Contract Litigation and Contract Termination**

In May 2004, the City of Owensboro, Kentucky and OMU commenced a suit against KU concerning a long-term power supply contract (the "OMU Agreement") with KU. In May 2009, KU and OMU executed a settlement agreement resolving the matter on a basis consistent with prior court rulings, and the Company has received the agreed settlement amounts. Pursuant to the settlement's operation, the OMU agreement terminated in May 2010. In connection with such termination, KU has recorded a net receivable totaling \$4 million reflecting its estimate of remaining adjustments concerning prior accruals. The parties are engaged in discussions to resolve those remaining adjustments.

#### **Construction Program**

KU had approximately \$167 million of commitments in connection with its construction program at September 30, 2010.

In June 2006, the Companies 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. During 2009 and 2010, the Companies received several contractual notices from the TC2 construction contractor asserting historical force majeure and excusable event claims for a number of adjustments to the contract price, construction schedule, commercial operations date, liquidated damages or other relevant provisions. In September 2010, the Companies and construction contractor agreed to a settlement to resolve certain force majeure and excusable event claims occurring through July 2010, under the TC2 construction contract, which settlement provided for a limited, negotiated extension of the contractual commercial operations date and/or relief from liquidated damages calculations. During commissioning activities in the second and third quarters, separate delays have occurred related to burner malfunctions and an excitation transformer failure. Certain temporary or permanent repairs for both matters have been completed, are underway or are planned for appropriate future outage periods. Commissioning steps resumed in October 2010, and a revised commercial operations date is currently expected by year end. The parties are analyzing the treatment of these additional delays under the liquidated damages provisions of the construction agreement. The Companies cannot currently estimate the ultimate outcome of these matters, including the extent, if any, that such outcome may result in materially increased costs for the construction of TC2, further changes in the TC2 construction completion or commercial operation dates or potential effects on levels of power purchases or wholesale sales due to such changed dates.

## **TC2 Air Permit**

The Sierra Club and other environmental groups filed a petition challenging the air permit issued for the TC2 baseload generating unit which was issued by the KDAQ in November 2005. In September 2007, the Secretary of the Kentucky Environmental and Public Protection Cabinet issued a final Order upholding the permit. The environmental groups petitioned the EPA to object to the state permit and subsequent permit revisions. In determinations made in September 2008 and June 2009, the EPA rejected most of the environmental groups' claims, but identified three permit deficiencies which the KDAQ addressed by revising the permit. In August 2009, the EPA issued an Order denying the remaining claims with the exception of two additional deficiencies which the KDAQ was directed to address. The EPA determined that the proposed permit subsequently issued by the KDAQ satisfied the conditions of the EPA Order although the agency recommended certain enhancements to the administrative record. In January 2010, the KDAQ issued a final permit revision incorporating the proposed changes to address the EPA objections. In March 2010, the environmental groups submitted a petition to the EPA to object to the permit revision, which is now pending before the EPA. The Company believes that the final permit as revised should not have a material adverse effect on its financial condition or results of operations. However, until the EPA issues a final ruling on the pending petition and all applicable appeals have been exhausted, the Company cannot predict the final outcome of this matter.

## **Thermostat Replacement**

During January 2010, the Companies announced a voluntary plan to replace certain thermostats, which had been provided to customers as part of the Companies' demand reduction programs, due to concerns that the thermostats may present a safety hazard. Under the plan, the Companies have replaced approximately 90% of the estimated 14,000 thermostats that need to be replaced. Total estimated costs associated with the replacement program are \$2 million. However, the Companies cannot fully predict the ultimate outcome of the replacement program or other effects or developments which may be associated with the thermostat replacement matter at this time.

## **OVEC**

KU holds a 2.5% investment interest in OVEC with 10 other electric utilities. KU is not the primary beneficiary; therefore the investment is not consolidated into the Company's financial statements, but is recorded on the cost basis. OVEC is located in Piketon, Ohio, and owns and operates two coal-fired power plants, Kyger Creek Station in Ohio, and Clifty Creek Station in Indiana. KU is contractually entitled to 2.5% of OVEC's output, approximately 55 Mw of generation capacity. Pursuant to the OVEC power purchase contract, the Company may be conditionally responsible for a 2.5% pro-rata share of certain obligations of OVEC under defined circumstances. These contingent liabilities may include unpaid OVEC indebtedness as well as shortfall amounts in certain excess decommissioning costs and post-retirement benefits other than pension. KU's potential proportionate share of OVEC's September 30, 2010 outstanding debt was \$35 million.

## **Environmental Matters**

The Company's operations are subject to a number of environmental laws and regulations in each of the jurisdictions in which it operates governing, among other things, air emissions, wastewater discharges, the use, handling and disposal of hazardous substances and wastes, soil and groundwater contamination and employee health and safety. As indicated below and summarized at the conclusion of this section, evolving environmental regulations will likely increase the level of capital and operating and maintenance expenditures incurred by the Company during the next several years. Based on prior regulatory precedent, the Company believes that many costs of complying with such pending or future requirements would likely be recoverable under the ECR or other potential cost-recovery mechanisms, but the Company can provide no assurance as to the ultimate outcome of such proceedings before the regulatory authorities.

*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<sub>2</sub> and NO<sub>x</sub> emissions from power plants. In 1998, the EPA issued its final “NO<sub>x</sub> SIP Call” rule requiring reductions in NO<sub>x</sub> emissions of approximately 85% from 1990 levels in order to mitigate ozone transport from the midwestern U.S. to the northeastern U.S. To implement the new federal requirements, Kentucky amended its SIP in 2002 to require electric generating units to reduce their NO<sub>x</sub> emissions to 0.15 pounds weight per MMBtu on a company-wide basis. In 2005, the EPA issued the CAIR which required additional SO<sub>2</sub> emission reductions of 70% and NO<sub>x</sub> emission reductions of 65% from 2003 levels. The CAIR provided for a two-phase cap and trade program, with initial reductions of NO<sub>x</sub> and SO<sub>2</sub> emissions due by 2009 and 2010, respectively, and final reductions due by 2015. In 2006, Kentucky proposed to amend its SIP to adopt state requirements similar to those under the federal CAIR.

In July 2008, a federal appeals court issued a ruling finding deficiencies in the CAIR and vacating it. In December 2008, the Court amended its previous Order, directing the EPA to promulgate a new regulation but leaving the CAIR in place in the interim. The remand of the CAIR results in some uncertainty with respect to certain other EPA or state programs and proceedings and the Companies’ compliance plans relating thereto due to the interconnection of the CAIR with such associated programs.

In January 2010, the EPA proposed a revised NAAQS for ozone which would increase the stringency of the standard. In addition, the EPA published final revised NAAQS standards for nitrogen dioxide (“NO<sub>2</sub>”) and SO<sub>2</sub> in February 2010 and June 2010, respectively, which are more stringent than previous standards. Depending on the level of action determined necessary to bring local nonattainment areas into compliance with the revised NAAQS standards, KU’s power plants are potentially subject to requirements for additional reductions in SO<sub>2</sub> and NO<sub>x</sub> emissions.

In July 2010, the EPA issued the proposed CATR, which serves to replace the CAIR. The CATR provides for a two-phase SO<sub>2</sub> reduction program with Phase I reductions due by 2012, and Phase II reductions due by 2014. The CATR provides for NO<sub>x</sub> reductions in 2012, but the EPA advised that it is studying whether additional NO<sub>x</sub> reductions should be required for 2014. The CATR is more stringent than the CAIR as it accelerates certain compliance dates and provides for only intrastate and limited interstate trading of emission allowances. In addition to its preferred approach, the EPA is seeking comment on an alternative approach which would provide for individual emission limits at each power plant. The EPA has announced that it will propose additional “transport” rules to address compliance with revised NAAQS standards for ozone and particulate matter which will be issued by the EPA in the future, as discussed below.

*Hazardous Air Pollutants.* As provided in 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 February 2008, a federal appellate court issued a decision vacating the CAMR. The EPA has entered into a consent decree requiring it to promulgate a utility Maximum Achievable Control Technology rule to replace the CAMR with a proposed rule due by March 2011, and a final rule due by November 2011. Depending on the final outcome of the rulemaking, the CAMR could be replaced by new rules with different or more stringent requirements for reduction of mercury and other hazardous air pollutants. Kentucky has also repealed its corresponding state mercury regulations.

*Acid Rain Program.* The Clean Air Act imposed a two-phased cap and trade program to reduce SO<sub>2</sub> emissions from power plants that were thought to contribute to “acid rain” conditions in the northeastern U.S. The

Clean Air Act also contains requirements for power plants to reduce NO<sub>x</sub> emissions through the use of available combustion controls.

*Regional Haze.* The Clean Air Act also includes visibility goals for certain federally designated areas, including national parks, and requires states to submit SIPs that will demonstrate reasonable progress toward preventing future impairment and remedying any existing impairment of visibility in those areas. In 2005, the EPA issued its Clean Air Visibility Rule 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 the CAIR could potentially impact regional haze SIPs. See "Ambient Air Quality" above for a discussion of CAIR-related uncertainties.

*Installation of Pollution Controls.* Many of the programs under the Clean Air Act utilize cap and trade mechanisms that require a company to hold sufficient emissions allowances to cover its authorized emissions on a company-wide basis and do not require installation of pollution controls on every generating unit. Under cap and trade programs, companies are free to focus their pollution control efforts on plants where such controls are particularly efficient and utilize the resulting emission allowances for smaller plants where such controls are not cost effective. KU met its Phase I SO<sub>2</sub> requirements primarily through installation of FGD equipment on Ghent Unit 1. KU's strategy for its Phase II SO<sub>2</sub> requirements, which commenced in 2000, includes the installation of additional FGD equipment, as well as, using accumulated emission allowances and fuel switching to defer certain additional capital expenditures. In order to achieve the NO<sub>x</sub> emission reductions mandated by the NO<sub>x</sub> SIP Call, KU installed additional NO<sub>x</sub> controls, including SCR technology, during the 2000 through 2009 time period at a cost of \$221 million. In 2001, the Kentucky Commission granted approval to recover the costs incurred by KU for these projects through the ECR mechanism. Such monthly recovery is subject to periodic review by the Kentucky Commission.

In order to achieve currently mandated emissions reductions, KU expects to incur additional capital expenditures totaling approximately \$285 million during the 2010 through 2012 time period for pollution controls including FGD and SCR equipment and additional operating and maintenance costs in operating such controls. In 2005, the Kentucky Commission granted approval to recover the costs incurred by the Company for these projects through the ECR mechanism. Such monthly recovery is subject to periodic review by the Kentucky Commission. KU believes its costs in reducing SO<sub>2</sub>, NO<sub>x</sub> and mercury emissions to be comparable to those of similarly situated utilities with like generation assets. KU's compliance plans are subject to many factors including developments in the emission allowance and fuels markets, future legislative and regulatory enactments, legal proceedings and advances in clean air technology. KU will continue to monitor these developments to ensure that its environmental obligations are met in the most efficient and cost-effective manner. See "Ambient Air Quality" above for a discussion of CAIR-related uncertainties.

*GHG Developments.* In 2005, the Kyoto Protocol for reducing GHG emissions took effect, obligating 37 industrialized countries to undertake substantial reductions in GHG emissions. The U.S. has not ratified the Kyoto Protocol and there are currently no mandatory GHG emission reduction requirements at the federal level. As discussed below, legislation mandating GHG reductions has been introduced in the Congress, but no federal legislation has been enacted to date. In the absence of a program at the federal level, various states have adopted their own GHG emission reduction programs, including 11 northeastern U.S. states and the District of Columbia under the Regional GHG Initiative program and California. Substantial efforts to pass federal GHG legislation are on-going. The current administration has announced its support for the adoption of mandatory GHG reduction requirements at the federal level. The United States and other countries met in Copenhagen, Denmark in December 2009, in an effort to negotiate a GHG reduction treaty to succeed the Kyoto Protocol, which is set to expire in 2013. In Copenhagen, the U.S. made a nonbinding commitment to, among other things, seek to reduce GHG emissions to 17% below 2005 levels by 2020 and provide financial support to developing countries. The United States and other nations are scheduled to meet in Cancun, Mexico in late 2010 to continue negotiations toward a binding agreement.

*GHG Legislation.* KU is monitoring on-going efforts to enact GHG reduction requirements and requirements governing carbon sequestration at the state and federal level and is assessing potential impacts of such

programs and strategies to mitigate those impacts. In June 2009, the U.S. House of Representatives passed the American Clean Energy and Security Act of 2009, which is a comprehensive energy bill containing the first-ever nation-wide GHG cap and trade program. The bill would provide for reductions in GHG emissions of 3% below 2005 levels by 2012, 17% by 2020 and 83% by 2050. In order to cushion potential rate impacts for utility customers, approximately 43% of emissions allowances would initially be allocated at no cost to the electric utility sector, with this allocation gradually declining to 7% in 2029 and zero thereafter. The bill would also establish a renewable electricity standard requiring utilities to meet 20% of their electricity demand through renewable energy and energy efficiency by 2020. The bill contains additional provisions regarding carbon capture and sequestration, clean transportation, smart grid advancement, nuclear and advanced technologies and energy efficiency.

In September 2009, the Clean Energy Jobs and American Power Act, which is largely patterned on the House legislation, was introduced in the U.S. Senate. The Senate bill raises the emissions reduction target for 2020 to 20% below 2005 levels and does not include a renewable electricity standard. While the initial bill lacked detailed provisions for the allocation of emissions allowances, a subsequent revision incorporated allowance allocation provisions similar to the House bill. In 2010, Senators Kerry and Lieberman and others have undertaken additional work to draft GHG legislation but have introduced no bill in the Senate to date. In July 2010, Senate Majority Leader Reid announced that he did not anticipate that GHG legislation would be brought to the Senate floor in the current session. The Company is closely monitoring the progress of pending energy legislation, but the prospect for passage of comprehensive GHG legislation in 2010 is uncertain.

*GHG Regulations.* In April 2007, the U.S. Supreme Court ruled that the EPA has the authority to regulate GHG under the Clean Air Act. In April 2009, the EPA issued a proposed endangerment finding concluding that GHGs endanger public health and welfare, which is an initial rulemaking step under the Clean Air Act. A final endangerment finding was issued in December 2009. In September 2009, the EPA issued a final GHG reporting rule requiring reporting by facilities with annual GHG emissions equivalent to at least 25,000 tons of carbon dioxide. A number of the Company's facilities will be required to submit annual reports commencing with calendar year 2010. In May 2010, the EPA issued a final GHG "tailoring" rule requiring new or modified sources with GHG emissions equivalent to at least 75,000 tons of carbon dioxide to obtain permits under the Prevention of Significant Deterioration Program. Such new or modified facilities would be required to install Best Available Control Technology. While the Company is unaware of any currently available GHG control technology that might be required for installation on new or modified power plants, it is currently assessing the potential impact of the rule. The final rule will apply to new and modified power plants beginning in January 2011. The Company is unable to predict whether mandatory GHG reduction requirements will ultimately be enacted through legislation or regulations.

*GHG Litigation.* A number of lawsuits have been filed asserting common law claims including nuisance, trespass and negligence against various companies with GHG emitting facilities. In October 2009, a three judge panel of the United States Court of Appeals for the 5th Circuit in the case of *Comer v. Murphy Oil* reversed a lower court, holding that private plaintiffs have standing to assert certain common law claims against more than 30 utility, oil, coal and chemical companies. In March 2010, the court vacated the opinion of the three-judge panel and granted a motion for rehearing but subsequently denied the appeal due to the lack of a quorum. The appellate ruling leaves in effect the lower court ruling dismissing the plaintiffs' claims. The petitioners filed a petition for a writ of mandamus with the Supreme Court in August 2010. The *Comer* complaint alleges that GHG emissions from the defendants' facilities contributed to global warming which increased the intensity of Hurricane Katrina. E.ON, the indirect parent of the Companies, was included as a defendant in the complaint but has not been subject to the proceedings due to the failure of the plaintiffs to pursue service under the applicable international procedures. The Companies are currently unable to predict further developments in the *Comer* case and continue to monitor relevant GHG litigation to identify judicial developments that may be potentially relevant to their operations.

*Ghent Opacity NOV.* In September 2007, the EPA issued an NOV alleging that KU had violated certain provisions of the Clean Air Act's operating rules relating to opacity during June and July of 2007 at Units 1 and 3 of KU's Ghent generating station. The parties have met on this matter and KU has received no further communications from the EPA. The Company is not able to estimate the outcome or potential effects of these matters, including whether substantial fines, penalties or remedial measures may result.



*Ghent New Source Review NOV.* In March 2009, the EPA issued an NOV alleging that KU violated certain provisions of the Clean Air Act's rules governing new source review and prevention of significant deterioration by installing FGD and SCR controls at its Ghent generating station without assessing potential increased sulfuric acid mist emissions. KU contends that the work in question, as pollution control projects, was exempt from the requirements cited by the EPA. In December 2009, the EPA issued a Section 114 information request seeking additional information on this matter. In March 2010, the Company received an EPA settlement proposal providing for imposition of additional permit limits and emission controls and anticipates continued settlement negotiations with the EPA. Depending on the provisions of a final settlement or the results of litigation, if any, resolution of this matter could involve significant increased operating and capital expenditures. The Company is currently unable to determine the final outcome of this matter or the impact of an unfavorable determination on the Company's financial position or results of operations.

*Ash Ponds and Coal-Combustion Byproducts.* The EPA has undertaken various initiatives in response to the December 2008 impoundment failure at the Tennessee Valley Authority's Kingston power plant, which resulted in a major release of coal combustion byproducts into the environment. The EPA issued information requests to utilities throughout the country, including KU, to obtain information on their ash ponds and other impoundments. In addition, the EPA inspected a large number of impoundments located at power plants to determine their structural integrity. The inspections included several of KU's impoundments, which the EPA found to be in satisfactory condition. In June 2010, the EPA published proposed regulations for coal combustion byproducts handled in landfills and ash ponds. The EPA has proposed two alternatives: (1) regulation of coal combustion byproducts in landfills and ash ponds as a hazardous waste or (2) regulation of coal combustion byproducts as a solid waste with minimum national standards. Under both alternatives, the EPA has proposed safety requirements to address the structural integrity of ash ponds. In addition, the EPA will consider potential refinements of the provisions for beneficial reuse of coal combustion byproducts.

*Water Discharges and PCB Regulations.* The EPA has also announced plans to develop revised effluent limitation guidelines governing discharges from power plants and standards for cooling water intake structures. The EPA has further announced plans to develop revised standards governing the use of polychlorinated biphenyls ("PCB") in electrical equipment. The Company is monitoring these ongoing regulatory developments but will be unable to determine the impact until such time as new rules are finalized.

*Impact of Pending and Future Environmental Developments.* As a company with significant coal-fired generating assets, KU will likely be substantially impacted by pending or future environmental rules or legislation requiring mandatory reductions in GHG emissions or other air emissions, imposing more stringent standards on discharges to waterways, or establishing additional requirements for handling or disposal of coal combustion byproducts. These evolving environmental regulations will likely require an increased level of capital expenditures and increased incremental operating and maintenance costs by the Company over the next several years. Due to the uncertain nature of the final regulations that will ultimately be adopted by the EPA, including the reduction targets and the deadlines that will be applicable, the Company cannot finalize estimates of the potential compliance costs, but should the final rules incorporate additional emission reduction requirements, require more stringent emissions controls or implement more stringent byproducts storage and disposal practices, such costs will likely be significant. With respect to NAAQS, CATR, CAMR replacement and coal combustion byproducts developments, based on a preliminary analysis of proposed regulations, the Company may be required to consider actions such as upgrading existing emissions controls, installing additional emissions controls, upgrading byproducts disposal and storage and possible early replacement of coal-fired units. Capital expenditures for KU associated with such actions are preliminarily estimated to be in the \$1.7 billion range over the next 10 years, although final costs may substantially vary. With respect to potential developments in water discharge, revised PCB standards or GHG initiatives, costs in such areas cannot be estimated due to the preliminary status or uncertain outcome of such developments, but would be in addition to the above amount and could be substantial. Ultimately, the precise impact on the Company's operations of these various environmental developments cannot be determined prior to the finalization of such requirements. Based on prior regulatory precedent, the Company believes that many costs of complying with such pending or future requirements would likely be recoverable under the ECR or other potential cost-recovery mechanisms, but the Company can provide no assurance as to the ultimate outcome of such proceedings before the regulatory authorities.

*TC2 Water Permit.* In May 2010, the Kentucky Waterways Alliance and other environmental groups filed a petition with the Kentucky Energy and Environment Cabinet challenging the Kentucky Pollutant Discharge Elimination System permit issued in April 2010, which covers water discharges from the Trimble County generating station. In October 2010, the hearing officer issued a report and recommended order providing for dismissal of the claims raised by the petitioners. Until such time as the Secretary issues a final order of the agency and all appeals are exhausted, the Company is unable to predict the outcome or precise impact of this matter.

*General Environmental Proceedings.* From time to time, KU appears before the EPA, various state or local regulatory agencies and state and federal courts regarding matters involving compliance with applicable environmental laws and regulations. Such matters include a prior Section 114 information request from the EPA relating to new-source issues at KU's Ghent unit 2; completed settlement with state regulators regarding compliance with particulate limits in the air permit for KU's Tyrone generating station; remediation activities for or other risks relating to elevated PCB levels at existing properties; liability under the Comprehensive Environmental Response, Compensation and Liability Act for cleanup at various off-site waste sites; and claims regarding the GHG emissions from the Company's generating stations. Based on analysis to date, the resolution of these matters is not expected to have a material impact on the Company's operations.

**Note 10 — Related Party Transactions**

KU, subsidiaries of E.ON U.S. and subsidiaries of E.ON engage in related party transactions. Transactions between KU and E.ON U.S. subsidiaries are eliminated on consolidation of E.ON U.S. Transactions between KU and E.ON subsidiaries are eliminated on consolidation of E.ON. These transactions are generally performed at cost and are in accordance with FERC regulations under the Public Utility Holding Company Act of 2005 and the applicable Kentucky Commission and Virginia Commission regulations. The significant related party transactions are disclosed below.

**Intercompany Wholesale Sales and Purchases**

KU and LG&E jointly dispatch their generation units with the lowest cost generation used to serve their retail native load. When LG&E has excess generation capacity after serving its own retail native load and its generation cost is lower than that of KU, KU purchases electricity from LG&E. When KU has excess generation capacity after serving its own retail native load and its generation cost is lower than that of LG&E, LG&E purchases electricity from KU. These transactions are recorded as intercompany wholesale sales and purchases are recorded by each company at a price equal to the seller's fuel cost. Savings realized from purchasing electricity intercompany instead of generating from their own higher costs units or purchasing from the market are shared equally between the two Companies. The volume of energy each company has to sell to the other is dependent on its native load needs and its available generation.

These sales and purchases are included in the statements of income as operating revenues, power purchased expenses and other operation and maintenance expenses. KU's intercompany electric revenues and power purchased expense were as follows:

	<u>Three Months Ended</u> <u>September 30,</u>		<u>Nine Months Ended</u> <u>September 30,</u>	
	<u>2010</u>	<u>2009</u>	<u>2010</u>	<u>2009</u>
	(In millions)			
Electric operating revenues from LG&E. . . . .	\$ 3	\$ 2	\$13	\$18
Power purchased and related operations and maintenance expenses from LG&E. . . . .	22	22	71	82

**Interest Charges**

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

KU's interest expense to affiliated companies was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(In millions)			
Interest on Fidelia loans .....	\$18	\$18	\$55	\$51

Interest expense paid to E.ON U.S. on the money pool arrangement was less than \$1 million for the three and nine months ended September 30, 2010 and 2009.

### Dividends

In September 2010, the Company paid dividends of \$50 million to its common shareholder, E.ON U.S.

### Capital Contributions

In March and June 2009, the Company received capital contributions of \$50 million and \$25 million, respectively, from its common shareholder, E.ON U.S.

### Other Intercompany Billings

Servco provides the Company with a variety of centralized administrative, management and support services. These services include payroll taxes paid by Servco on behalf of KU, labor and burdens of Servco employees performing services for KU, coal purchases and other vouchers paid by Servco on behalf of KU. The cost of these services is directly charged to the Company, 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, the Companies provide services to each other and to Servco. Billings between the Companies relate to labor and overheads associated with union and hourly employees performing work for the other utility, charges related to jointly-owned generating units and other miscellaneous charges. Billings from KU to Servco include cash received by Servco on behalf of KU, primarily tax settlements, and other payments made by the Company on behalf of other non-regulated businesses which are reimbursed through Servco.

Intercompany billings to and from KU were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(In millions)			
Servco billings to KU .....	\$64	\$43	\$181	\$121
KU billings to LG&E .....	—	16	1	63
LG&E billings to KU .....	28	—	47	—
KU billings to Servco .....	11	3	11	5

### Intercompany Balances

The Company had the following balances with its affiliates:

	<u>September 30,</u> <u>2010</u>	<u>December 31,</u> <u>2009</u>
	(In millions)	
Accounts receivable from E.ON U.S. . . . .	\$ —	\$ 9
Accounts payable to LG&E . . . . .	17	53
Accounts payable to Servco . . . . .	18	20
Accounts payable to E.ON U.S. . . . .	18	—
Accounts payable to Fidelia . . . . .	18	15
Notes payable to E.ON U.S. . . . .	61	45
Long-term debt to Fidelia (including current portion of \$33 million) . . .	1,331	1,331

### **Note 11 — Subsequent Events**

Subsequent events have been evaluated through October 29, 2010, the date of issuance of these statements, and these statements contain all necessary adjustments and disclosures resulting from that evaluation.

On October 29, 2010, KU's pollution control bonds were converted from unsecured debt to debt which is collateralized by first mortgage bonds. See Note 1, General, and Note 8, Short-Term and Long-Term Debt.

On October 26, 2010, the FERC issued an Order approving the acquisition of E.ON U.S. by PPL. See Note 1, General.

On October 19, 2010 and October 21, 2010, respectively, the Virginia Commission and Tennessee Regulatory Authority issued Orders approving the acquisition of E.ON U.S. by PPL. On the same dates, KU received Virginia Commission and Tennessee Regulatory Authority approvals to complete certain refinancing transactions in connection with the anticipated PPL acquisition and other business factors. See Note 1, General, and Note 8, Short-Term and Long-Term Debt.

Supplement, dated October 29, 2010 to Reoffering Circular dated December 11, 2008, as supplemented as of December 16, 2008 (the “Reoffering Circular”)

**\$54,000,000**  
**County of Carroll, Kentucky**  
**Environmental Facilities Revenue**  
**Refunding Bonds, 2006 Series B**  
**(Kentucky Utilities Company Project)**

**\$77,947,405**  
**County of Carroll, Kentucky**  
**Environmental Facilities Revenue**  
**Bonds,**  
**2008 Series A**  
**(Kentucky Utilities Company Project)**

Effective as of October 29, 2010, each series of the above-referenced bonds (collectively, the “Bonds”) will be further secured by the delivery to Deutsche Bank Trust Company Americas, as trustee for each series of Bonds (the “Trustee”), of a separate tranche of first mortgage bonds of Kentucky Utilities Company (the “Company”). The principal amount, maturity date and interest rate (or method of determining interest rates) of each such tranche of first mortgage bonds will be identical to the principal amount, maturity date and interest rate (or method of determining interest rates) of the applicable series of Bonds. The first mortgage bonds will only be payable, and interest thereon will only accrue, as described herein. See “Security,” “Summary of the Loan Agreement — Issuance and Delivery of First Mortgage Bonds” and “Summary of the First Mortgage Bonds” for more information regarding the first mortgage bonds. The first mortgage bonds will not provide a direct source of liquidity to pay the purchase price of Bonds tendered for purchase in accordance with the applicable Indenture (as hereinafter defined).

Please be advised that, as reflected in the Company’s most recent financial statements that are filed on the Electronic Municipal Market Access (EMMA) system and are incorporated by reference herein, PPL Corporation has entered into an agreement with E.ON AG pursuant to which PPL Corporation would purchase all of the ownership interests of E.ON U.S. LLC, the Company’s parent. Consummation of the transaction is subject to customary closing conditions, including receipt of all required regulatory approvals. Subject to receipt of such approvals, the transaction is expected to close by the end of 2010. If the transaction is completed, the Company will become an indirect wholly-owned subsidiary of PPL Corporation.

Except as otherwise specified herein, information in the Reoffering Circular referred to above has not been amended or modified and the information contained herein is qualified by reference to, and should be read in conjunction with, the Reoffering Circular, including information incorporated therein by reference. Terms not otherwise defined herein shall have the meanings ascribed to them in such Reoffering Circular.

*The section of the Reoffering Circular captioned "Separate Series" is hereby amended to read in its entirety as follows:*

### **Separate Series**

The 2006 Series B Bonds and the 2008 Series A Bonds are separate series and optional or mandatory redemption of any series may be made in the manner described below without the redemption of the other series. Similarly, a default under one of the series of Bonds or one of the Loan Agreements will not necessarily constitute a default under the other series of Bonds or Loan Agreements. Each series of Bonds can bear interest at an Interest Rate Mode different from the Interest Rate Mode borne by the other series of Bonds. Unless specifically otherwise noted, any discussion herein and under the captions "Summary of the Bonds," "The Letter of Credit," "Security" "Summary of the Loan Agreement," "Summary of the First Mortgage Bonds," "Summary of the Indenture," "Enforceability of Remedies" and "Tax Treatment" applies equally, but separately, to the 2006 Series B Bonds and the 2008 Series A Bonds.

As used herein under such captions with respect to the 2006 Series B Bonds, the term "Project" shall mean the 2006 Series B Project, the term "Bonds" shall mean the 2006 Series B Bonds, the term "First Mortgage Bonds" shall mean the Carroll County Tranche 5 of the First Mortgage Bonds delivered to the 2006 Series B Trustee, the term "Loan Agreement" shall mean the 2006 Series B Loan Agreement pursuant to which the Issuer loaned the proceeds from the sale of the 2006 Series B Bonds to the Company, the term "Indenture" shall mean the 2006 Series B Indenture, the term "Remarketing Agent" shall mean Banc of America Securities LLC, the terms "Trustee" and "Tender Agent" shall mean the 2006 Series B Trustee and the term "Letter of Credit" shall mean the Letter of Credit delivered to the 2006 Series B Trustee.

As used herein under such captions with respect to the 2008 Series A Bonds, the term "Project" shall mean the 2008 Series A Project, the term "Bonds" shall mean the 2008 Series A Bonds, the term "First Mortgage Bonds" shall mean the Carroll County Tranche 7 of the First Mortgage Bonds delivered to the 2008 Series A Trustee the term "Loan Agreement" shall mean the 2008 Series A Loan Agreement pursuant to which the Issuer loaned the proceeds from the sale of the 2008 Series A Bonds to the Company, the term "Indenture" shall mean the 2008 Series A Indenture, the term "Remarketing Agent" shall mean Banc of America Securities LLC, the terms "Trustee" and "Tender Agent" shall mean the 2008 Series A Trustee and the term "Letter of Credit" shall mean the Letter of Credit delivered to the 2008 Series A Trustee.

*The section of the Reoffering Circular captioned "Security; Limitation on Liens" is hereby amended to read in its entirety as follows:*

### **Security**

Payment of the principal of and interest and any premium on the Bonds will be secured by an assignment by the Issuer to the Trustee of the Issuer's interest in and to the Loan Agreement and all payments to be made pursuant thereto (other than certain indemnification and expense payments). Pursuant to the Loan Agreement, the Company will agree to pay, among other things, amounts sufficient to pay the aggregate principal amount of and premium, if any, on the Bonds, together with interest thereon as and when the same become due. The Company further will agree to make payments of the purchase price of the Bonds tendered for purchase to the extent that funds are not otherwise available therefor under the provisions of the Indenture.

The payment of the principal of and interest and any premium on the Bonds will be further secured by a separate tranche of the Company's First Mortgage Bonds, Collateral Series 2010 (the "First Mortgage Bonds") to be issued under an Indenture, dated as of October 1, 2010, as supplemented (the "First Mortgage Indenture"), between the Company and The Bank of New York Mellon, as trustee (the "First Mortgage Trustee"). The principal amount of the First Mortgage Bonds will equal the principal amount of the Bonds. If the Bonds become immediately due and payable as a result of a default in payment of the principal of, premium, if any, or interest on the Bonds, or a default in payment of the purchase price of such Bonds, due to an event of default under the Loan Agreement and upon receipt by the First Mortgage Trustee of a written demand from the Trustee for redemption of the First Mortgage Bonds, or if all first mortgage bonds outstanding under the First Mortgage Indenture shall have been immediately due and payable, such First Mortgage Bonds will bear interest at the same interest rate or rates borne by the Bonds and the principal of such First Mortgage Bonds, together with interest accrued thereon from the last date or dates to which interest on the Bonds has been paid in full, will be payable in accordance with the Supplemental Indenture. See "Summary of the First Mortgage Bonds."

The First Mortgage Bonds are not intended to provide a direct source of liquidity to pay the purchase price of Bonds tendered for purchase in accordance with the Indenture. The First Mortgage Bonds are secured by a lien on certain property owned by the Company. In certain circumstances, the Company is permitted to reduce the aggregate principal amount of its First Mortgage Bonds held by the Trustee, but in no event to an amount lower than the aggregate outstanding principal amount of the Bonds.

\* \* \* \*

*The section of the Reoffering Circular captioned "Summary of the Loan Agreement — Limitation on Liens" is hereby deleted. The sections of the Reoffering Circular captioned "Summary of the Loan Agreement — Issuance and Delivery of First Mortgage Bonds"; " — Insurance"; " — Events of Default" and " — Remedies" are hereby added or amended, as applicable, to read in their entirety as follows:*

### **Summary of the Loan Agreement**

\* \* \* \*

#### **Issuance and Delivery of First Mortgage Bonds**

For the purpose of providing security for the Bonds, the Company will execute and deliver to the Trustee the First Mortgage Bonds. The principal amount of the First Mortgage Bonds executed and delivered to the Trustee will be equal to the aggregate principal amount of the Bonds. If the Bonds become immediately due and payable as a result of a default in payment of the principal of, premium, if any, or interest on the Bonds, or a default in payment of the purchase price of such Bonds, due to an event of default under the Loan Agreement and upon receipt by the First Mortgage Trustee of a written demand from the Trustee for redemption of the First Mortgage Bonds, or if all first mortgage bonds outstanding under the First Mortgage Indenture shall have been immediately due and payable, such First Mortgage Bonds will bear interest at the same interest rate or rates borne by the Bonds and the principal of such First Mortgage Bonds, together with interest accrued thereon from the last date to which interest on the Bonds shall have been paid in full, will then be payable. See, however, "Summary of the Indenture — Waiver of Events of Default."

Upon payment of the principal of, premium, if any, and interest on any of the Bonds, and the surrender to and cancellation thereof by the Trustee, or upon provision for the payment thereof having been made in accordance with the Indenture, First Mortgage Bonds with corresponding principal amounts equal to the aggregate principal amount of the Bonds so surrendered and canceled or for the payment of which provision has been made, will be surrendered by the Trustee to the First Mortgage Trustee and will be canceled by the First Mortgage Trustee. The First Mortgage Bonds will be registered in the name of the Trustee and will be non transferable, except to effect transfers to any successor trustee under the Indenture.

#### **Insurance**

The Company has agreed to insure the Project in accordance with the provisions of the First Mortgage Indenture.

#### **Events of Default**

Each of the following events constitutes an "event of default" under the Loan Agreement:

- (1) failure by the Company to pay the amounts required for payment of the principal of, including purchase price for tendered Bonds and redemption and acceleration prices, and interest accrued, on the Bonds, at the times specified therein taking into account any periods of grace provided in the Indenture and the Bonds for the



applicable payment of interest on the Bonds (see “Summary of the Indenture — Defaults and Remedies”);

(2) failure by the Company to observe and perform any covenant, condition or agreement, other than as referred to in paragraph (1) above, for a period of thirty days after written notice by the Issuer or Trustee, provided, however, that if such failure is capable of being corrected, but cannot be corrected in such 30-day period, it will not constitute an event of default under the Loan Agreement if corrective action with respect thereto is instituted within such period and is being diligently pursued;

(3) certain events of bankruptcy, dissolution, liquidation, reorganization or insolvency of the Company;

(4) the occurrence of an event of default under the Indenture; or

(5) all first mortgage bonds outstanding under the First Mortgage Indenture, if not already due, shall have become immediately due and payable, whether by declaration or otherwise, and such acceleration shall not have been rescinded or annulled by the First Mortgage Trustee.

Under the Loan Agreement, certain of the Company’s obligations (other than the Company’s obligations, among others, (i) not to permit any action which would result in interest paid on the Bonds being included in gross income for federal and Kentucky income taxes; (ii) to maintain its corporate existence and good standing, and to neither dispose of all or substantially all of its assets or consolidate with or merge into another corporation unless certain provisions of the Loan Agreement are satisfied; and (iii) to make loan payments and certain other payments under the provisions of the Loan Agreement) may be suspended if by reason of force majeure (as defined in the Loan Agreement) the Company is unable to carry out such obligations.

## **Remedies**

Upon the happening of an event of default under the Loan Agreement, the Trustee, on behalf of the Issuer, may, among other things, take whatever action at law or in equity may appear necessary or desirable to collect the amounts then due and thereafter to become due, or to enforce performance and observance of any obligation, agreement or covenant of the Company, under the Loan Agreement, including any remedies available in respect of the First Mortgage Bonds.

In the event of a default in payment of the principal of, premium, if any, or interest on the Bonds and the acceleration of the maturity date of the Bonds (to the extent not already due and payable) as a consequence of such event of default, the Trustee may demand redemption of the First Mortgage Bonds. See "Summary of the First Mortgage Bonds" and "Summary of the Indenture — Defaults and Remedies." Any amounts collected upon the happening of any such event of default will be applied in accordance with the Indenture or, if the Bonds have been fully paid (or provision for payment thereof has been made in accordance with the Indenture) and all other liabilities of the Company accrued under the Indenture and the Loan Agreement have been paid or satisfied, made available to the Company.

\* \* \* \*

*A new section is hereby added to the Reoffering Circular to read in its entirety as follows:*

### **Summary of the First Mortgage Bonds**

*The following, in addition to the provisions contained elsewhere in this Reoffering Circular, is a brief description of certain provisions of the First Mortgage Bonds and the First Mortgage Indenture. This description is only a summary and does not purport to be complete and definitive. Reference is made to the First Mortgage Indenture and to the form of the First Mortgage Bonds for the detailed provisions thereof.*

#### **General**

The First Mortgage Bonds, in a principal amount equal to the principal amount of the Bonds, were issued as a new tranche from a new series of first mortgage bonds under the First Mortgage Indenture (see "Summary of the Loan Agreement — Issuance and Delivery of First Mortgage Bonds"). The statements herein made (being for the most part summaries of certain provisions of the First Mortgage Indenture) are subject to the detailed provisions of the First Mortgage Indenture, which is incorporated herein by this reference. Words or phrases italicized are defined in the First Mortgage Indenture.

The First Mortgage Bonds will mature on the same date and bear interest at the same rate or rates as the Bonds; however, the principal of and interest on the First Mortgage Bonds will not be payable other than upon the occurrence of an event of default under the Loan Agreement. If the Bonds become immediately due and payable as a result of a default in payment of the principal of, premium, if any, or interest on the Bonds, or a default in payment of the purchase price of such Bonds, due to an event of default under the Loan Agreement, and if all first mortgage bonds outstanding under the First Mortgage Indenture shall not have become immediately due and payable following an event of default under the First Mortgage Indenture, the Company will be obligated to redeem the First Mortgage Bonds upon receipt by the First Mortgage Trustee of a Redemption Demand from the Trustee for redemption, at a redemption price equal to the principal amount thereof plus accrued interest at the rates borne by the Bonds from the last date to which interest on the Bonds has been paid.

The First Mortgage Bonds at all times will be in fully registered form registered in the name of the Trustee, will be non-negotiable, and will be non-transferable except to any successor trustee under the Indenture. Upon payment and cancellation of Bonds by the Trustee or the Paying Agent (other than any Bond or portion thereof that was canceled by the Trustee or the Paying Agent and for which one or more Bonds were delivered and authenticated pursuant to the Indenture), whether at maturity, by redemption or otherwise, or upon provision for the payment of the Bonds having been made in accordance with the Indenture, an equal principal amount of

First Mortgage Bonds will be deemed fully paid and the obligations of the Company thereunder will cease.

### **Security; Lien of the First Mortgage Indenture**

General. Except as described below under this heading and under “— Issuance of Additional First Mortgage Bonds,” and subject to the exceptions described under “— Satisfaction and Discharge,” all first mortgage bonds issued under the First Mortgage Indenture, including the Bonds, will be secured, equally and ratably, by the lien of the First Mortgage Indenture, which constitutes, subject to permitted liens as described below, a first mortgage lien on substantially all of the Company’s real and tangible personal property located in Kentucky and used or to be used in connection with the generation, transmission and distribution of electricity (other than property duly released from the lien of the First Mortgage Indenture in accordance with the provisions thereof and other than excepted property, as described below). Property that is subject to the lien of the First Mortgage Indenture is referred to herein as “Mortgaged Property.”

The Company may obtain the release of property from the lien of the First Mortgage Indenture from time to time, upon the bases provided for such release in the First Mortgage Indenture. See “— Release of Property.”

The Company may enter into supplemental indentures with the First Mortgage Trustee, without the consent of the holders of the first mortgage bonds, in order to subject additional property (including property that would otherwise be excepted from such lien) to the lien of the First Mortgage Indenture. This property would constitute *property additions* and would be available as a basis for the issuance of additional first mortgage bonds. See “— Issuance of Additional First Mortgage Bonds.”

The First Mortgage Indenture provides that after-acquired property (other than *excepted property*) will be subject to the lien of the First Mortgage Indenture. However, in the case of consolidation or merger (whether or not the Company is the surviving company) or transfer of the Mortgaged Property as or substantially as an entirety, the First Mortgage Indenture will not be required to be a lien upon any of the properties either owned or subsequently acquired by the successor company except properties acquired from the Company in or as a result of such transfer, as well as improvements, extensions and additions (as defined in the First Mortgage Indenture) to such properties and renewals, replacements and substitutions of or for any part or parts thereof. See “— Consolidation, Merger and Conveyance of Assets as an Entirety.”

Excepted Property. The lien of the First Mortgage Indenture does not cover, among other things, the following types of property: property located outside of Kentucky and not specifically subjected or required to be subjected to the lien of the First Mortgage Indenture; property not used by the Company in its electric generation, transmission and distribution business; cash and securities not paid, deposited or held under the First Mortgage Indenture; contracts, leases and other agreements of all kinds, contract rights, bills, notes and other instruments, revenues, accounts receivable, claims, demands and judgments; governmental and other licenses, permits, franchises, consents and allowances; intellectual property rights and other general intangibles; vehicles, movable equipment, aircraft and vessels; all goods, stock in trade, wares, merchandise

and inventory held for the purpose of sale or lease in the ordinary course of business; materials, supplies, inventory and other personal property consumable in the operation of the Company's business; fuel; tools and equipment; furniture and furnishings; computers and data processing, telecommunications and other facilities used primarily for administrative or clerical purposes or otherwise not used in connection with the operation or maintenance of electric generation, transmission and distribution facilities; coal, ore, gas, oil and other minerals and timber rights; electric energy and capacity, gas, steam, water and other products generated, produced, manufactured, purchased or otherwise acquired; real property and facilities used primarily for the production or gathering of natural gas; property which has been released from the lien of the First Mortgage Indenture; and leasehold interests. Property of the Company not covered by the lien of the First Mortgage Indenture is referred to herein as excepted property. Properties held by any of the Company's subsidiaries, as well as properties leased from others, would not be subject to the lien of the First Mortgage Indenture.

*Permitted Liens.* The lien of the First Mortgage Indenture is subject to permitted liens described in the First Mortgage Indenture. Such *permitted liens* include liens existing at the execution date of the First Mortgage Indenture, purchase money liens and other liens placed or otherwise existing on property acquired by the Company after the execution date of the First Mortgage Indenture at the time the Company acquires it, tax liens and other governmental charges which are not delinquent or which are being contested in good faith, mechanics', construction and materialmen's liens, certain judgment liens, easements, reservations and rights of others (including governmental entities) in, and defects of title to, the Company's property, certain leases and leasehold interests, liens to secure public obligations, rights of others to take minerals, timber, electric energy or capacity, gas, water, steam or other products produced by the Company or by others on the Company's property, rights and interests of persons other than the Company arising out of agreements relating to the common ownership or joint use of property, and liens on the interests of such persons in such property and liens which have been bonded or for which other security arrangements have been made.

The First Mortgage Indenture also provides that the First Mortgage Trustee will have a lien, prior to the lien on behalf of the holders of the first mortgage bonds, including the First Mortgage Bonds, upon the Mortgaged Property as security for the Company's payment of its reasonable compensation and expenses and for indemnity against certain liabilities. Any such lien would be a *permitted lien* under the First Mortgage Indenture.

### **Issuance of Additional First Mortgage Bonds**

The maximum principal amount of first mortgage bonds that may be authenticated and delivered under the First Mortgage Indenture is subject to the issuance restrictions described below; provided, however, that the maximum principal amount of first mortgage bonds outstanding at any one time shall not exceed One Quintillion Dollars (\$1,000,000,000,000,000,000), which amount may be changed by supplemental indenture. First mortgage bonds of any series may be issued from time to time on the basis of, and in an aggregate principal amount not exceeding:

- 66 2/3% of the *cost* or *fair value* to the Company (whichever is less) of *property additions* (as described below) which do not constitute *funded property* (generally, *property additions*)

which have been made the basis of the authentication and delivery of first mortgage bonds, the release of Mortgaged Property or the withdrawal of cash, which have been substituted for retired *funded property* or which have been used for other specified purposes) after certain deductions and additions, primarily including adjustments to offset property retirements;

- the aggregate principal amount of *retired securities* (as described below); or
- an amount of cash deposited with the First Mortgage Trustee.

*Property additions* generally include any property which is owned by the Company and is subject to the lien of the First Mortgage Indenture except (with certain exceptions) goodwill, going concern value rights or intangible property, or any property the acquisition or construction of which is properly chargeable to one of the Company's operating expense accounts.

*Retired securities* means, generally, first mortgage bonds which are no longer outstanding under the First Mortgage Indenture, which have not been retired by the application of *funded cash* and which have not been used as the basis for the authentication and delivery of first mortgage bonds, the release of property or the withdrawal of cash.

The First Mortgage Bonds will be issued on the basis of *property additions*. At August 31, 2010, approximately \$2.3 billion of *property additions* were available to be used as the basis for the authentication and delivery of first mortgage bonds.

### **Release of Property**

Unless an *event of default* has occurred and is continuing, the Company may obtain the release from the lien of the First Mortgage Indenture of any Mortgaged Property, except for cash held by the First Mortgage Trustee, upon delivery to the First Mortgage Trustee of an amount in cash equal to the amount, if any, by which sixty-six and two-thirds percent (66-2/3%) of the cost of the property to be released (or, if less, the *fair value* to the Company of such property at the time it became *funded property*) exceeds the aggregate of:

- an amount equal to 66 2/3% of the aggregate principal amount of obligations secured by *purchase money liens* upon the property to be released and delivered to the First Mortgage Trustee;
- an amount equal to 66 2/3% of the *cost* or *fair value* to the Company (whichever is less) of certified *property additions* not constituting *funded property* after certain deductions and additions, primarily including adjustments to offset property retirements (except that such adjustments need not be made if such *property additions* were acquired or made within the 90-day period preceding the release);
- the aggregate principal amount of first mortgage bonds the Company would be entitled to issue on the basis of *retired securities* (with such entitlement being waived by operation of such release);

- the aggregate principal amount of first mortgage bonds delivered to the First Mortgage Trustee (with such first mortgage bonds to be canceled by the First Mortgage Trustee);
- any amount of cash and/or an amount equal to 66 2/3% of the aggregate principal amount of obligations secured by *purchase money liens* upon the property released delivered to the trustee or other holder of a lien prior to the lien of the First Mortgage Indenture, subject to certain limitations described in the First Mortgage Indenture; and
- any taxes and expenses incidental to any sale, exchange, dedication or other disposition of the property to be released.

As used in the First Mortgage Indenture, the term *purchase money* lien means, generally, a lien on the property being released which is retained by the transferor of such property or granted to one or more other persons in connection with the transfer or release thereof, or granted to or held by a trustee or agent for any such persons, and may include liens which cover property in addition to the property being released and/or which secure indebtedness in addition to indebtedness to the transferor of such property.

Unless an *event of default* has occurred and is continuing, property which is not *funded property* may generally be released from the lien of the First Mortgage Indenture without depositing any cash or property with the First Mortgage Trustee as long as (a) the aggregate amount of *cost* or *fair value* to the Company (whichever is less) of all *property additions* which do not constitute *funded property* (excluding the property to be released) after certain deductions and additions, primarily including adjustments to offset property retirements, is not less than zero or (b) the *cost* or *fair value* (whichever is less) of property to be released does not exceed the aggregate amount of the *cost* or *fair value* to the Company (whichever is less) of *property additions* acquired or made within the 90-day period preceding the release.

The First Mortgage Indenture provides simplified procedures for the release of minor properties and property taken by eminent domain, and provides for dispositions of certain obsolete property and grants or surrender of certain rights without any release or consent by the First Mortgage Trustee.

If the Company retains any interest in any property released from the lien of the First Mortgage Indenture, the First Mortgage Indenture will not become a lien on such property or such interest therein or any improvements, extensions or additions to such property or renewals, replacements or substitutions of or for such property or any part or parts thereof.

### **Withdrawal of Cash**

Unless an *event of default* has occurred and is continuing, and subject to certain limitations, cash held by the First Mortgage Trustee may, generally, (1) be withdrawn by the Company (a) to the extent of sixty-six and two-thirds percent (66-2/3%) of the *cost* or *fair value* to the Company (whichever is less) of *property additions* not constituting *funded property*, after certain deductions and additions, primarily including adjustments to offset retirements (except that such adjustments need not be made if such *property additions* were acquired or made within the 90-day period preceding the withdrawal) or (b) in an amount equal to the aggregate principal

amount of first mortgage bonds that the Company would be entitled to issue on the basis of *retired securities* (with the entitlement to such issuance being waived by operation of such withdrawal) or (c) in an amount equal to the aggregate principal amount of any outstanding first mortgage bonds delivered to the First Mortgage Trustee; or (2) upon the Company's request, be applied to (a) the purchase of first mortgage bonds in a manner and at a price approved by the Company or (b) the payment (or provision for payment) at stated maturity of any first mortgage bonds or the redemption (or provision for payment) of any first mortgage bonds which are redeemable; provided, however, that cash deposited with the First Mortgage Trustee as the basis for the authentication and delivery of first mortgage bonds may, in addition, be withdrawn in an amount not exceeding the aggregate principal amount of cash delivered to the First Mortgage Trustee for such purpose.

### **Events of Default**

An "*event of default*" occurs under the First Mortgage Indenture if

- the Company does not pay any interest on any first mortgage bonds within 30 days of the due date;
- the Company does not pay principal or premium, if any, on any first mortgage bonds on the due date;
- the Company remains in breach of any other covenant (excluding covenants specifically dealt with elsewhere in this section) in respect of any first mortgage bonds for 90 days after the Company receives a written notice of default stating the Company is in breach and requiring remedy of the breach; the notice must be sent by either the First Mortgage Trustee or holders of 25% of the principal amount of outstanding first mortgage bonds; the First Mortgage Trustee or such holders can agree to extend the 90-day period and such an agreement to extend will be automatically deemed to occur if the Company initiates corrective action within such 90 day period and the Company is diligently pursuing such action to correct the default; or
- the Company files for bankruptcy or certain other events in bankruptcy, insolvency, receivership or reorganization occur.

### **Remedies**

*Acceleration of Maturity.* If an event of default occurs and is continuing, then either the First Mortgage Trustee or the holders of not less than 25% in principal amount of the outstanding first mortgage bonds may declare the principal amount of all of the first mortgage bonds to be due and payable immediately.

*Rescission of Acceleration.* After the declaration of acceleration has been made and before the First Mortgage Trustee has obtained a judgment or decree for payment of the money due, such declaration and its consequences will be rescinded and annulled, if

- the Company pays or deposits with the First Mortgage Trustee a sum sufficient to pay:

- all overdue interest;
- the principal of and premium, if any, which have become due otherwise than by such declaration of acceleration and interest thereon;
- interest on overdue interest to the extent lawful;
- all amounts due to the First Mortgage Trustee under the First Mortgage Indenture; and
- all *events of default*, other than the nonpayment of the principal which has become due solely by such declaration of acceleration, have been cured or waived as provided in the First Mortgage Indenture.

For more information as to waiver of defaults, see “— Waiver of Default and of Compliance” below.

*Appointment of Receiver and Other Remedies.* Subject to the First Mortgage Indenture, under certain circumstances and to the extent permitted by law, if an *event of default* occurs and is continuing, the First Mortgage Trustee has the power to appoint a receiver of the Mortgaged Property, and is entitled to all other remedies available to mortgagees and secured parties under the Uniform Commercial Code or any other applicable law.

*Control by Holders; Limitations.* Subject to the First Mortgage Indenture, if an *event of default* occurs and is continuing, the holders of a majority in principal amount of the outstanding first mortgage bonds will have the right to

- direct the time, method and place of conducting any proceeding for any remedy available to the First Mortgage Trustee, or
- exercise any trust or power conferred on the First Mortgage Trustee.

The rights of holders to make direction are subject to the following limitations:

- the holders’ directions may not conflict with any law or the First Mortgage Indenture; and
- the holders’ directions may not involve the First Mortgage Trustee in personal liability where the First Mortgage Trustee believes indemnity is not adequate.

The First Mortgage Trustee may also take any other action it deems proper which is not inconsistent with the holders’ direction.

In addition, the First Mortgage Indenture provides that no holder of any first mortgage bond will have any right to institute any proceeding, judicial or otherwise, with respect to the First Mortgage Indenture for the appointment of a receiver or for any other remedy thereunder unless



- that holder has previously given the First Mortgage Trustee written notice of a continuing *event of default*;
- the holders of 25% in aggregate principal amount of the outstanding first mortgage bonds have made written request to the First Mortgage Trustee to institute proceedings in respect of that *event of default* and have offered the First Mortgage Trustee reasonable indemnity against costs, expenses and liabilities incurred in complying with such request; and
- for 60 days after receipt of such notice, request and offer of indemnity, the First Mortgage Trustee has failed to institute any such proceeding and no direction inconsistent with such request has been given to the First Mortgage Trustee during such 60-day period by the holders of a majority in aggregate principal amount of outstanding first mortgage bonds.

Furthermore, no holder of any first mortgage bonds will be entitled to institute any such action if and to the extent that such action would disturb or prejudice the rights of other holders of first mortgage bonds.

However, each holder of any first mortgage bonds has an absolute and unconditional right to receive payment when due and to bring a suit to enforce that right.

*Notice of Default.* The First Mortgage Trustee is required to give the holders of the first mortgage bonds notice of any default under the First Mortgage Indenture to the extent required by the Trust Indenture Act, unless such default has been cured or waived; except that in the case of an *event of default* of the character specified in the third bullet point under “— Events of Default” (regarding a breach of certain covenants continuing for 90 days after the receipt of a written notice of default), no such notice shall be given to such holders until at least 60 days after the occurrence thereof. The Trust Indenture Act currently permits the First Mortgage Trustee to withhold notices of default (except for certain payment defaults) if the First Mortgage Trustee in good faith determines the withholding of such notice to be in the interests of the holders of the first mortgage bonds.

The Company will furnish the First Mortgage Trustee with an annual statement as to its compliance with the conditions and covenants in the First Mortgage Indenture.

*Waiver of Default and of Compliance.* The holders of a majority in aggregate principal amount of the outstanding first mortgage bonds may waive, on behalf of the holders of all outstanding first mortgage bonds, any past default under the First Mortgage Indenture, except a default in the payment of principal, premium or interest, or with respect to compliance with certain provisions of the First Mortgage Indenture that cannot be amended without the consent of the holder of each outstanding first mortgage bond affected.

Compliance with certain covenants in the First Mortgage Indenture or otherwise provided with respect to first mortgage bonds may be waived by the holders of a majority in aggregate principal amount of the affected first mortgage bonds, considered as one class.

## Consolidation, Merger and Conveyance of Assets as an Entirety

Subject to the provisions described below, the Company has agreed to preserve its corporate existence.

The Company has agreed not to consolidate with or merge with or into any other entity or convey, transfer or lease the Mortgaged Property as or substantially as an entirety to any entity unless

- the entity formed by such consolidation or into which the Company merges, or the entity which acquires or which leases the Mortgaged Property substantially as an entirety, is an entity organized and existing under the laws of the United States of America or any State or Territory thereof or the District of Columbia, and
- expressly assumes, by supplemental indenture, the due and punctual payment of the principal of, and premium and interest on, all the outstanding first mortgage bonds and the performance of all of the Company's covenants under the First Mortgage Indenture, and
- such entity confirms the lien of the First Mortgage Indenture on the Mortgaged Property, including property thereafter acquired by such entity which constitutes an improvement, extension or addition to the Mortgaged Property or a renewal, replacement or substitution thereof;
- in the case of a lease, such lease is made expressly subject to termination by (i) the Company or by the First Mortgage Trustee and (ii) the purchaser of the property so leased at any sale thereof, at any time during the continuance of an *event of default*; and
- immediately after giving effect to such transaction, no *event of default*, and no event which after notice or lapse of time or both would become an *event of default*, will have occurred and be continuing.

In the case of the conveyance or other transfer of the Mortgaged Property as or substantially as an entirety to any other person, upon the satisfaction of all the conditions described above the Company would be released and discharged from all obligations under the First Mortgage Indenture and on the first mortgage bonds then outstanding unless the Company elects to waive such release and discharge.

The First Mortgage Indenture does not prevent or restrict:

- any consolidation or merger after the consummation of which the Company would be the surviving or resulting entity; or
- any conveyance or other transfer, or lease, of any part of the Mortgaged Property which does not constitute the entirety or substantially the entirety thereof.

If following a conveyance or other transfer, or lease, of any part of the Mortgaged Property, the fair value of the Mortgaged Property retained by the Company exceeds an amount equal to three-halves (3/2) of the aggregate principal amount of all outstanding first mortgage bonds, then the part of the Mortgaged Property so conveyed, transferred or leased shall be deemed not to constitute the entirety or substantially the entirety of the Mortgaged Property. This fair value will be determined within 90 days of the conveyance or transfer by an independent expert that the Company selects and that is approved by the First Mortgage Trustee.

### **Modification of First Mortgage Indenture**

*Without Holder Consent.* Without the consent of any holders of first mortgage bonds, the Company and the First Mortgage Trustee may enter into one or more supplemental indentures for any of the following purposes:

- to evidence the succession of another entity to the Company;
- to add one or more covenants or other provisions for the benefit of the holders of all or any series or tranche of first mortgage bonds, or to surrender any right or power conferred upon the Company;
- to correct or amplify the description of any property at any time subject to the lien of the First Mortgage Indenture; or to better assure, convey and confirm unto the First Mortgage Trustee any property subject or required to be subjected to the lien of the First Mortgage Indenture; or to subject to the lien of the First Mortgage Indenture additional property (including property of others), to specify any additional Permitted Liens with respect to such additional property and to modify the provisions in the First Mortgage Indenture for dispositions of certain types of property without release in order to specify any additional items with respect to such additional property;
- to add any additional *events of default*, which may be stated to remain in effect only so long as the first mortgage bonds of any one more particular series remains outstanding;
- to change or eliminate any provision of the First Mortgage Indenture or to add any new provision to the First Mortgage Indenture that does not adversely affect the interests of the holders in any material respect;
- to establish the form or terms of any series or tranche of first mortgage bonds;
- to provide for the issuance of bearer securities;
- to evidence and provide for the acceptance of appointment of a successor First Mortgage Trustee or by a co-trustee or separate trustee;
- to provide for the procedures required to permit the utilization of a noncertificated system of registration for any series or tranche of first mortgage bonds;
- to change any place or places where

- the Company may pay principal, premium and interest,
- first mortgage bonds may be surrendered for transfer or exchange, and
- notices and demands to or upon the Company may be served;
- to amend and restate the First Mortgage Indenture as originally executed, and as amended from time to time, with such additions, deletions and other changes that do not adversely affect the interest of the holders in any material respect;
- to cure any ambiguity, defect or inconsistency or to make any other changes that do not adversely affect the interests of the holders in any material respect; or
- to increase or decrease the maximum principal amount of first mortgage bonds that may be outstanding at any time.

In addition, if the Trust Indenture Act is amended after the date of the First Mortgage Indenture so as to require changes to the First Mortgage Indenture or so as to permit changes to, or the elimination of, provisions which, at the date of the First Mortgage Indenture or at any time thereafter, were required by the Trust Indenture Act to be contained in the First Mortgage Indenture, the First Mortgage Indenture will be deemed to have been amended so as to conform to such amendment or to effect such changes or elimination, and the Company and the First Mortgage Trustee may, without the consent of any holders, enter into one or more supplemental indentures to effect or evidence such amendment.

*With Holder Consent.* Except as provided above, the consent of the holders of at least a majority in aggregate principal amount of the first mortgage bonds of all outstanding series, considered as one class, is generally required for the purpose of adding to, or changing or eliminating any of the provisions of, the First Mortgage Indenture pursuant to a supplemental indenture. However, if less than all of the series of outstanding first mortgage bonds are directly affected by a proposed supplemental indenture, then such proposal only requires the consent of the holders of a majority in aggregate principal amount of the outstanding first mortgage bonds of all directly affected series, considered as one class. Moreover, if the first mortgage bonds of any series have been issued in more than one tranche and if the proposed supplemental indenture directly affects the rights of the holders of first mortgage bonds of one or more, but less than all, of such tranches, then such proposal only requires the consent of the holders of a majority in aggregate principal amount of the outstanding first mortgage bonds of all directly affected tranches, considered as one class.

However, no amendment or modification may, without the consent of the holder of each outstanding first mortgage bond directly affected thereby,

- change the stated maturity of the principal or interest on any first mortgage bond (other than pursuant to the terms thereof), or reduce the principal amount, interest or premium payable (or method of calculating such rates) or change the currency in which any first mortgage bond is payable, or impair the right to bring suit to enforce any payment;

- create any lien (not otherwise permitted by the First Mortgage Indenture) ranking prior to the lien of the First Mortgage Indenture with respect to all or substantially all of the Mortgaged Property, or terminate the lien of the First Mortgage Indenture on all or substantially all of the Mortgaged Property (other than in accordance with the terms of the First Mortgage Indenture), or deprive any holder of the benefits of the security of the lien of the First Mortgage Indenture;
- reduce the percentages of holders whose consent is required for any supplemental indenture or waiver of compliance with any provision of the First Mortgage Indenture or of any default thereunder and its consequences, or reduce the requirements for quorum and voting under the First Mortgage Indenture; or
- modify certain of the provisions of the First Mortgage Indenture relating to supplemental indentures, waivers of certain covenants and waivers of past defaults with respect to first mortgage bonds.

A supplemental indenture which changes, modifies or eliminates any provision of the First Mortgage Indenture expressly included solely for the benefit of holders of first mortgage bonds of one or more particular series or tranches will be deemed not to affect the rights under the First Mortgage Indenture of the holders of first mortgage bonds of any other series or tranche.

#### **Satisfaction and Discharge**

Any first mortgage bonds or any portion thereof will be deemed to have been paid and no longer outstanding for purposes of the First Mortgage Indenture and, at the Company's election, the Company's entire indebtedness with respect to those securities will be satisfied and discharged, if there shall have been irrevocably deposited with the First Mortgage Trustee or any Paying Agent (other than the Company), in trust:

- money sufficient, or
- in the case of a deposit made prior to the maturity of such first mortgage bonds, non-redeemable *eligible obligations* (as defined in the First Mortgage Indenture) sufficient, or
- a combination of the items listed in the preceding two bullet points, which in total are sufficient,

to pay when due the principal of, and any premium, and interest due and to become due on such first mortgage bonds or portions of such first mortgage bonds on and prior to their maturity.

The Company's right to cause its entire indebtedness in respect of the first mortgage bonds of any series to be deemed to be satisfied and discharged as described above will be subject to the satisfaction of any conditions specified in the instrument creating such series.

The First Mortgage Indenture will be deemed satisfied and discharged when no first mortgage bonds remain outstanding and when the Company has paid all other sums payable by it under the First Mortgage Indenture.

All moneys the Company pays to the First Mortgage Trustee or any Paying Agent on First Mortgage Bonds that remain unclaimed at the end of two years after payments have become due may be paid to or upon the Company's order. Thereafter, the holder of such First Mortgage Bond may look only to the Company for payment.

### **Duties of the First Mortgage Trustee; Resignation and Removal of the First Mortgage Trustee; Deemed Resignation**

The First Mortgage Trustee will have, and will be subject to, all the duties and responsibilities specified with respect to an indenture trustee under the Trust Indenture Act. Subject to these provisions, the First Mortgage Trustee will be under no obligation to exercise any of the powers vested in it by the First Mortgage Indenture at the request of any holder of first mortgage bonds, unless offered reasonable indemnity by such holder against the costs, expenses and liabilities which might be incurred thereby. The First Mortgage Trustee will not be required to expend or risk its own funds or otherwise incur financial liability in the performance of its duties if the First Mortgage Trustee reasonably believes that repayment or adequate indemnity is not reasonably assured to it.

The First Mortgage Trustee may resign at any time by giving written notice to the Company.

The First Mortgage Trustee may also be removed by act of the holders of a majority in principal amount of the then outstanding first mortgage bonds of any series.

No resignation or removal of the First Mortgage Trustee and no appointment of a successor trustee will become effective until the acceptance of appointment by a successor trustee in accordance with the requirements of the First Mortgage Indenture.

Under certain circumstances, the Company may appoint a successor trustee and if the successor accepts, the First Mortgage Trustee will be deemed to have resigned.

### **Evidence to be Furnished to the First Mortgage Trustee**

Compliance with First Mortgage Indenture provisions is evidenced by written statements of the Company's officers or persons selected or paid by the Company. In certain cases, opinions of counsel and certifications of an engineer, accountant, appraiser or other expert (who in some cases must be independent) must be furnished. In addition, the First Mortgage Indenture requires the Company to give to the First Mortgage Trustee, not less than annually, a brief statement as to the Company's compliance with the conditions and covenants under the First Mortgage Indenture.

## **Miscellaneous Provisions**

The First Mortgage Indenture provides that certain first mortgage bonds, including those for which payment or redemption money has been deposited or set aside in trust as described under “— Satisfaction and Discharge” above, will not be deemed to be “outstanding” in determining whether the holders of the requisite principal amount of the outstanding first mortgage bonds have given or taken any demand, direction, consent or other action under the First Mortgage Indenture as of any date, or are present at a meeting of holders for quorum purposes.

The Company will be entitled to set any day as a record date for the purpose of determining the holders of outstanding first mortgage bonds of any series entitled to give or take any demand, direction, consent or other action under the First Mortgage Indenture, in the manner and subject to the limitations provided in the First Mortgage Indenture. In certain circumstances, the First Mortgage Trustee also will be entitled to set a record date for action by holders. If such a record date is set for any action to be taken by holders of particular first mortgage bonds, such action may be taken only by persons who are holders of such first mortgage bonds on the record date.

## **Governing Law**

The First Mortgage Indenture and the first mortgage bonds provide that they are to be governed by and construed in accordance with the laws of the State of New York except where the Trust Indenture Act is applicable or where otherwise required by law. The effectiveness of the lien of the First Mortgage Indenture, and the perfection and priority thereof, will be governed by Kentucky law.

\* \* \* \*

*The sections of the Reoffering Circular captioned “Summary of the Indenture — Surrender of First Mortgage Bonds”; “— Defaults and Remedies”; “— Waiver of Events of Default”; and “— Voting of First Mortgage Bonds Held by Trustee” are hereby added or amended, as applicable, to read in their entirety as follows:*

### **Summary of the Indenture**

\* \* \* \*

#### **Surrender of First Mortgage Bonds**

Upon payment of any principal of, premium, if any, and interest on any of the Bonds which reduces the principal amount of Bonds outstanding, or upon provision for the payment thereof having been made in accordance with the Indenture, First Mortgage Bonds in a principal amount equal to the principal amount of the Bonds so paid, or for the payment of which such provision has been made, shall be surrendered by the Trustee to the First Mortgage Trustee. The First Mortgage Bonds so surrendered shall be deemed fully paid and the obligations of the Company thereunder terminated.

#### **Defaults and Remedies**

Each of the following events constitutes an “Event of Default” under the Indenture:

- (1) Failure to make payment of any installment of interest on any Bond, (a) if such Bond bears interest at other than the Long Term Rate, within a period of one Business Day from the due date and (b) if such Bond bears interest at the Long Term Rate, within a period of five Business Days from the date due;
- (2) Failure to make punctual payment of the principal of, or premium, if any, on any Bond on the due date, whether at the stated maturity thereof, or upon proceedings for redemption, or upon the maturity thereof by declaration or if payment of the purchase price of any Bond required to be purchased pursuant to the Indenture is not made when such payment has become due and payable;
- (3) Failure of the Issuer to perform or observe any other of the covenants, agreements or conditions in the Indenture or in the Bonds which failure continues for a period of 30 days after written notice by the Trustee, provided, however, that if such failure is capable of being cured, but cannot be cured in such 30-day period, it will not constitute an event of default under the Indenture if corrective action in respect of such failure is instituted within such 30-day period and is being diligently pursued;
- (4) The occurrence of an “event of default” under the Loan Agreement (see “Summary of the Loan Agreement — Events of Default”);



(5) Written notice from the Credit Facility Issuer to the Trustee of an event of default under the Reimbursement Agreement, by reason of which the Trustee has been directed to accelerate the Bonds;

(6) If a Credit Facility is then held by the Trustee, on or before the close of business on the tenth calendar day following the honoring of a drawing under such Credit Facility to pay interest on the bonds on an Interest Payment Date, written notice from the Credit Facility Issuer to the Trustee that the interest component of the Credit Facility will not be reinstated; or

(7) All first mortgage bonds outstanding under the First Mortgage Indenture, if not already due, shall have become due and payable, whether by declaration or otherwise, and such acceleration shall not have been rescinded by the First Mortgage Trustee.

Upon the occurrence of an Event of Default under clauses (1), (2), (5), (6) or (7) above, the Trustee must: (i) enforce each and every right granted to the Trustee as a holder of the First Mortgage Bonds (see "Summary of the First Mortgage Bonds"), (ii) declare the principal of all Bonds and interest accrued thereon to be immediately due and payable, (iii) declare all payments under the Loan Agreement to be immediately due and payable and enforce each and every other right granted to the Issuer under the Loan Agreement for the benefit of the Bondholders and (iv) if a Credit Facility securing the Bonds is in effect, make an immediate drawing under the Credit Facility in accordance with its terms and deposit the proceeds of such drawing in the Bond Fund pending application to the payment of principal of the Bonds, subject to the provisions of the Indenture reserving to the Credit Facility Issuer the right to direct default proceedings and providing for termination of default proceedings upon certain occurrences.

Interest on the Bonds will cease to accrue on the date of issuance of the declaration of acceleration of payment of principal and interest on the Bonds.

In exercising such rights, the Trustee shall take any action that, in the judgment of the Trustee, would best serve the interests of the registered owners. Upon the occurrence of an Event of Default under the Indenture, the Trustee may also proceed to pursue any available remedy by suit at law or in equity to enforce the payment of the principal of, premium, if any, and interest on the Bonds then outstanding.

If an Event of Default under the Indenture shall occur and be continuing and the maturity date of the Bonds has been accelerated (to the extent the Bonds are not already due and payable) as a consequence of such event of default, the Trustee may, and upon the written request of the registered owners holding not less than 25% in principal amount of all Bonds then outstanding and upon receipt of indemnity satisfactory to it shall, exercise such rights as it shall possess under the First Mortgage Indenture as a holder of the First Mortgage Bonds and shall also issue a Redemption Demand for such First Mortgage Bonds to the First Mortgage Trustee.

If the Trustee recovers any moneys following an Event of Default, unless the principal of the Bonds shall have been declared due and payable, all such moneys shall be applied in the following order: (i) to the payment of the fees, expenses, liabilities and advances incurred or made by the Trustee and the Paying Agent and the payment of any sums due and payable to the

United States pursuant to Section 148(f) of the Code, (ii) to the payment of all interest then due on the Bonds and (iii) to the payment of unpaid principal and premium, if any, of the Bonds. If the principal of the Bonds has become due or has been accelerated, such moneys shall be applied in the following order: (i) to the payment of the fees, expenses, liabilities and advances incurred or made by the Trustee and the Paying Agent and (ii) to the payment of principal of and interest then due and unpaid on the Bonds. In each case, however, Trustee and Paying Agent fees or costs will not be payable from moneys derived from Credit Facility drawings, any remarketing proceeds or moneys constituting certain Available Moneys under the Indenture.

No Bondholder may institute any suit or proceeding in equity or at law for the enforcement of the Indenture unless an Event of Default has occurred of which the Trustee has been notified or is deemed to have notice, and registered owners holding not less than 25% in aggregate principal amount of Bonds then outstanding shall have made written request to the Trustee to proceed to exercise the powers granted under the Indenture or to institute such action in their own name and the Trustee shall fail or refuse to exercise its powers within a reasonable time after receipt of indemnity satisfactory to it.

Any judgment against the Issuer pursuant to the exercise of rights under the Indenture shall be enforceable only against specific assigned payments, funds and accounts under the Indenture in the hands of the Trustee. No deficiency judgment shall be authorized against the general credit of the Issuer.

No default under paragraph (3) above shall constitute an Event of Default until actual notice is given to the Issuer and the Company by the Trustee or to the Issuer, the Company and the Trustee by the registered owners holding not less than 25% in aggregate principal amount of all Bonds outstanding and the Issuer and the Company shall have had thirty days after such notice to correct the default and failed to do so. If the default is such that it cannot be corrected within the applicable period but is capable of being cured, it will not constitute an Event of Default if corrective action is instituted by the Issuer or the Company within the applicable period and diligently pursued until the default is corrected.

Notwithstanding the foregoing, in addition to the rights of the Trustee and the Bondholders to direct proceedings as described above, if a Credit Facility is in effect, for so long as such Credit Facility is outstanding and the Credit Facility Issuer is not in default in its duties under the Indenture or the Credit Facility, the Credit Facility Issuer will have the absolute right to direct all proceedings on behalf of the Bondholders of the Bonds. Additionally, if the Event of Default which has occurred is an Event of Default under paragraphs (5) or (6) above, the Credit Facility Issuer, if any, will have no right to direct the Trustee or the Bondholders with respect to any matters, including remedies, and the holders of a majority in aggregate principal amount of the Bonds then outstanding, will have the right, at any time, by an instrument or instruments in writing executed and delivered to the Trustee, to direct the time, method and place of conducting all proceedings to be taken in connection with the enforcement of the terms and conditions of the Indenture, or for the appointment of a receiver or any other proceedings hereunder; provided, that such direction shall not be otherwise than in accordance with the provisions of law and of the Indenture.

If an Event of Default has occurred under the Indenture due to failure by the Credit Facility Issuer, if any, to honor a properly presented and conforming drawing by the Trustee under the Credit Facility then in effect in accordance with the terms thereof, all obligations of the Trustee to the Credit Facility Issuer and all rights of such Credit Facility Issuer under the Indenture will be suspended until the earlier of the cure of such failure or all of the Bonds have been paid in full.

### **Waiver of Events of Default**

Except as provided below, the Trustee may in its discretion waive any Event of Default under the Indenture and shall do so upon the written request of the registered owners holding a majority in principal amount of all Bonds then outstanding. If, after the principal of all Bonds then outstanding shall have been declared to be due and payable as a result of a default under the Indenture and prior to any judgment or decree for the appointment of a receiver or for the payment of the moneys due shall have been entered, (i) the Company has caused to be deposited with the Trustee a sum sufficient to pay all matured installments of interest upon all Bonds and the principal of and premium, if any, on any and all Bonds which shall have become due otherwise than by reason of such declaration and the expenses of the Trustee in connection with such default (with interest thereon as provided in the Indenture) and (ii) all Events of Default under the Indenture (other than nonpayment of the principal of Bonds due by said declaration) shall have been remedied, then such Event of Default shall be deemed waived and such declaration and its consequences rescinded and annulled by the Trustee. Such waiver, rescission and annulment shall be binding upon all Bondholders. No such waiver, rescission and annulment shall extend to or affect any subsequent Event of Default or impair any right or remedy consequent thereon.

Upon any waiver or rescission as described above or any discontinuance or abandonment of proceedings under the Indenture, the Trustee shall immediately rescind in writing any Redemption Demand of First Mortgage Bonds previously given to the First Mortgage Trustee. The rescission under the First Mortgage Indenture of a declaration that all first mortgage bonds outstanding under the First Mortgage Indenture are immediately due and payable shall also constitute a waiver of an Event of Default described in paragraph (6) under the subcaption “— Defaults and Remedies” above and a waiver and rescission of its consequences, provided that no such waiver or rescission shall extend to or affect any subsequent or other default or impair any right consequent thereon.

The Trustee may not waive any default under clauses (5) or (6) above unless the Trustee has received in writing from the Credit Facility Issuer a written notice of full reinstatement of the full amount of the Credit Facility and a written rescission of the notice of the Event of Default.

Notwithstanding the foregoing, nothing in the Indenture shall affect the right of a registered owner to enforce the payment of principal of, premium, if any, and interest on the Bonds after the maturity thereof.

### **Voting of First Mortgage Bonds Held by Trustee**

The Trustee, as holder of the First Mortgage Bonds, shall attend any meeting of holders of first mortgage bonds outstanding under the First Mortgage Indenture as to which it receives due notice. The Trustee shall vote the First Mortgage Bonds held by it, or shall consent with respect thereto, proportionally in the way in which the Trustee reasonably believes will be the vote or consent of all other holders of first mortgage bonds outstanding under the First Mortgage Indenture then eligible to vote or consent.

Notwithstanding the foregoing, the Trustee may not vote the First Mortgage Bonds in favor of, or give consent to, any action which, in the Trustee's opinion, would materially adversely affect the First Mortgage Bonds in a manner not generally shared by all other series of first mortgage bonds, except upon notification by the Trustee to the registered owners of all Bonds then outstanding of such proposal and consent thereto of the registered owners of at least 66 2/3% in aggregate principal amount of all Bonds then outstanding.

On February 23, 2007 and October 17, 2008, the dates on which the Bonds were originally issued, Bond Counsel delivered its opinions that stated that, subject to the conditions and exceptions set forth under the caption "Tax Treatment," under then current law, interest on each series of Bonds would be excludable from the gross income of the recipients thereof for federal income tax purposes, except that no opinion was expressed regarding such exclusion from gross income with respect to any Bond during any period in which it is held by a "substantial user" or a "related person" of the related Project as such terms are used in Section 147(a) of the Internal Revenue Code of 1986, as amended (the "Code"). Interest on each series of Bonds will be an item of tax preference in determining alternative minimum taxable income for individuals and corporations under the Code. Such interest may be subject to certain federal income taxes imposed on certain corporations, including imposition of the branch profits tax on a portion of such interest. Bond Counsel was further of the opinion that interest on each series of Bonds would be excludable from the gross income of the recipients thereof for Kentucky income tax purposes and that, under then current law, the principal of each series of Bonds would be exempt from ad valorem taxes in Kentucky. Such opinions have not been updated as of the date hereof and no continuing tax exemption opinions are expressed by Bond Counsel. However, in connection with the conversion of the interest rate mode on each series of Bonds to the Weekly Rate, as described in this Reoffering Circular, Bond Counsel will deliver its opinions to the effect that the conversion of the interest rate on each series of Bonds and the delivery of a letter of credit (a) is authorized or permitted by the Act and the related Indenture and (b) will not adversely affect the validity of the Bonds or any exclusion of the interest thereon from the gross income of the owners of the Bonds for federal income tax purposes. See "Tax Treatment" in this Reoffering Circular.

**\$54,000,000**  
**County of Carroll, Kentucky**  
**Environmental Facilities Revenue**  
**Refunding Bonds, 2006 Series B**  
**(Kentucky Utilities Company Project)**  
**Due: October 1, 2034**

**\$77,947,405**  
**County of Carroll, Kentucky**  
**Environmental Facilities Revenue Bonds**  
**2008 Series A**  
**(Kentucky Utilities Company Project)**  
**Due: February 1, 2032**

**Conversion Date: December 19, 2008**

The Bonds of each series (individually, the "2006 Series B Bonds" and the "2008 Series A Bonds" and, collectively, the "Bonds") are special and limited obligations of the County of Carroll, Kentucky (the "Issuer"), payable by the Issuer solely from and secured by payments to be received by the Issuer pursuant to separate Loan Agreements with

**Kentucky Utilities Company**

(the "Company"), except as payable from proceeds of such Bonds or investment earnings thereon. The Bonds do not constitute general obligations of the Issuer or a charge against the general credit or taxing powers thereof or of the Commonwealth of Kentucky or any other political subdivision of Kentucky. The Bonds will not be entitled to the benefits of any financial guaranty insurance policies.

The 2006 Series B Bonds were originally issued on February 23, 2007 and the 2008 Series A Bonds were originally issued on October 17, 2008, each as a separate series. The 2006 Series B Bonds currently bear interest at a Dutch Auction Rate, and the 2008 Series A Bonds currently bear interest at a Flexible Rate. Pursuant to the Indentures under which the Bonds were issued, the Company has elected to convert the interest rate mode on each of the 2006 Series B Bonds and the 2008 Series A Bonds to a Weekly Rate, effective as of December 19, 2008 (the "Conversion Date"). The Bonds are subject to mandatory purchase on the Conversion Date and are being reoffered hereby. Banc of America Securities LLC will serve as the Remarketing Agent for the Bonds.

From and after the Conversion Date through December 18, 2009 (the Letter of Credit (as defined below) expiration date, subject to extension or earlier termination), payment of the principal of and interest on the Bonds when due will be paid with funds drawn under an irrevocable transferable direct pay letter of credit (the "Letter of Credit") issued by

**COMMERZBANK AG, NEW YORK BRANCH**

The Letter of Credit will permit the Trustee to draw with respect to the Bonds up to an amount sufficient to pay (i) the principal thereof (or that portion of the purchase price corresponding to principal) plus (ii) interest thereon (or that portion of the purchase price corresponding to interest) at an assumed rate of 15% per annum for at least 45 days.

From the Conversion Date, each series of Bonds will bear interest at a Weekly Rate, determined by the Remarketing Agent in accordance with the applicable Indenture, payable on the first Business Day of each calendar month, commencing on January 2, 2009. The interest rate period, interest rate and Interest Rate Mode for each series of Bonds will be subject to change under certain conditions, as described in this Reoffering Circular. The Bonds of each series are subject to optional redemption, extraordinary optional redemption, in whole or in part, and mandatory redemption following a determination of taxability prior to maturity, as described in this Reoffering Circular. The Bonds of each series are subject to mandatory purchase on any date on which the Bonds are converted to a different Interest Rate Mode and upon the expiration of the Letter of Credit or any Alternate Credit Facility.

The Bonds of each series are separate series, and the sale and delivery of one series is not dependent on the sale and delivery of any other series.

The Bonds are registered in the name of Cede & Co., as registered owner and nominee for The Depository Trust Company ("DTC"), New York, New York. DTC will act as securities depository. Except as described herein, purchases of beneficial ownership interests in the Bonds will be made in book-entry-only form in denominations of \$100,000 and multiples thereof; provided that one 2008 Series A Bond may be in the denomination of, or include an additional, \$47,405. Purchasers will not receive certificates representing their beneficial interests in the Bonds. See the information contained under the caption "Summary of the Bonds—Book-Entry-Only System" below. The principal of, premium, if any, and interest on the Bonds will be paid by Deutsche Bank Trust Company Americas, as Trustee, to Cede & Co., as long as Cede & Co. is the registered owner of the Bonds. Disbursement of such payments to the DTC Participants is the responsibility of DTC, and disbursement of such payments to the purchasers of beneficial ownership interests is the responsibility of DTC's Direct and Indirect Participants, as described below.

**PRICE: 100%**

*The Bonds are reoffered subject to prior sale, withdrawal or modification of the offer without notice (provided, however, that any such notice of withdrawal must be given on the Business Day prior to the Conversion Date) and to the approval of legality by Stoll Keenon Ogden PLLC, Louisville, Kentucky, as Bond Counsel and upon satisfaction of certain conditions. Certain legal matters will be passed upon for the Company by its counsel, Jones Day, Chicago, Illinois, and John R. McCall, Esq., Executive Vice President, General Counsel, Corporate Secretary and Chief Compliance Officer of the Company, for the Issuer by its County Attorney, and for the Remarketing Agent by its counsel, Winston & Strawn LLP, Chicago, Illinois. It is expected that the Bonds will be available for redelivery to DTC in New York, New York on or about December 19, 2008.*

**Banc of America Securities LLC**

Dated: December 11, 2008

No dealer, broker, salesman or other person has been authorized by the Issuer, the Company or the Remarketing Agent to give any information or to make any representation with respect to the Bonds, other than those contained in this Reoffering Circular, and, if given or made, such other information or representation must not be relied upon as having been authorized by any of the foregoing. The Remarketing Agent has provided the following sentence for inclusion in this Reoffering Circular. The Remarketing Agent has reviewed the information in this Reoffering Circular in accordance with, and as part of, its responsibilities to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Remarketing Agent does not guarantee the accuracy or completeness of such information. The information and expressions of opinion herein are subject to change without notice and neither the delivery of this Reoffering Circular nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the parties referred to above since the date hereof. The information set forth herein with respect to the Issuer has been obtained from the Issuer, and all other information has been obtained from the Company and from other sources that are believed to be reliable, but it is not guaranteed as to accuracy or completeness by, and is not to be construed as a representation by, the Remarketing Agent.

In connection with the reoffering of the Bonds, the Remarketing Agent may over-allot or effect transactions which stabilize or maintain the market prices of the Bonds at levels above those that might otherwise prevail in the open market. Such stabilizing, if commenced, may be discontinued at any time.

IN MAKING AN INVESTMENT DECISION, INVESTORS MUST RELY ON THEIR OWN EXAMINATION OF THE TERMS OF THE REOFFERING, INCLUDING THE MERITS AND RISKS INVOLVED. THESE SECURITIES HAVE NOT BEEN RECOMMENDED BY ANY FEDERAL OR STATE SECURITIES COMMISSION OR REGULATORY AUTHORITY. FURTHERMORE, THE FOREGOING AUTHORITIES HAVE NOT CONFIRMED THE ACCURACY OR DETERMINED THE ADEQUACY OF THIS DOCUMENT. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

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**\$54,000,000**  
**County of Carroll, Kentucky**  
**Environmental Facilities Revenue**  
**Refunding Bonds, 2006 Series B**  
**(Kentucky Utilities Company Project)**  
**Due: October 1, 2034**

**\$77,947,405**  
**County of Carroll, Kentucky**  
**Environmental Facilities Revenue Bonds**  
**2008 Series A**  
**(Kentucky Utilities Company Project)**  
**Due: February 1, 2032**

### **Introductory Statement**

This Reoffering Circular, including the cover page and appendices, is provided to furnish information in connection with the reoffering by the County of Carroll, Kentucky (the “Issuer”) of its (i) Environmental Facilities Revenue Refunding Bonds, 2006 Series B (Kentucky Utilities Company Project, in the aggregate principal amount of \$54,000,000 (the “2006 Series B Bonds”), issued pursuant to an Indenture of Trust dated as of October 1, 2006 (the “2006 Series B Indenture”) between the Issuer and Deutsche Bank Trust Company Americas (the “2006 Series B Trustee”), as Trustee, Paying Agent and Bond Registrar, as the same has been amended and restated as of September 1, 2008, and (ii) Environmental Facilities Revenue Bonds, 2008 Series A (Kentucky Utilities Company Project), in the aggregate principal amount of \$77,947,405 (the “Bonds”) issued pursuant to an Indenture of Trust dated as of August 1, 2008 (the “2008 Series A Indenture” and, collectively with the 2006 Series B Indenture, the “Indentures”) between the Issuer and Deutsche Bank Trust Company Americas (the “2008 Series A Trustee” and, collectively with the 2006 Series B Trustee, the “Trustee”), as Trustee, Paying Agent and Bond Registrar.

Pursuant to separate Loan Agreements by and between Kentucky Utilities Company (the “Company”) and the Issuer, dated as of October 1, 2006 (as the same have been amended and restated as of September 1, 2008 pursuant to an ordinance of the Issuer adopted October 28, 2008), with respect to the 2006 Series B Bonds (the “2006 Series B Loan Agreement”), and August 1, 2008 (pursuant to an ordinance of the Issuer adopted September 23, 2008) with respect to the 2008 Series A Bonds (the “2008 Series A Loan Agreement” and, collectively with the 2006 Series B Loan Agreement, the “Loan Agreements”), proceeds from the sale of the Bonds, other than accrued interest, if any, paid by the initial purchasers thereof, were loaned by the Issuer to the Company. The Loan Agreements are separate undertakings by and between the Company and the Issuer.

The Company will continue to repay the loans under the 2006 Series B Loan Agreement and the 2008 Series A Loan Agreement by making payments to the applicable Trustee in sufficient amounts to pay the principal of and interest and any premium on, and purchase price of, the applicable series of Bonds. See “Summary of the Loan Agreement — General.” Pursuant to the applicable Indenture, the Issuer’s rights under the applicable Loan Agreement (other than with respect to certain indemnification and expense payments and notification rights) were assigned to the applicable Trustee as security for the applicable series of Bonds.

The proceeds of the 2006 Series B Bonds were applied to pay and discharge all of the \$54,000,000 outstanding principal amount of County of Carroll, Kentucky, Collateralized Solid



Waste Disposal Facilities Revenue Bonds (Kentucky Utilities Company Project) 1994 Series A,” dated November 23, 1994, previously issued by the Issuer to finance certain solid waste disposal facilities owned by the Company (the “2006 Series B Project”). The proceeds of the 2008 Series A Bonds were applied to (i) finance the acquisition, construction, installation and equipping of certain solid waste disposal facilities owned by the Company in the amount of \$18,026,265 and (ii) pay and discharge all of the \$13,266,950 outstanding principal amount of County of Carroll, Kentucky, Environmental Facilities Revenue Bonds, 2005 Series A (Kentucky Utilities Company Project), \$13,266,950 outstanding principal amount of County of Carroll, Kentucky, Environmental Facilities Revenue Bonds, 2005 Series B (Kentucky Utilities Company Project), \$16,693,620 outstanding principal amount of County of Carroll, Kentucky, Environmental Facilities Revenue Bonds, 2006 Series A (Kentucky Utilities Company Project) and \$16,693,620 outstanding principal amount of County of Carroll, Kentucky, Environmental Facilities Revenue Bonds, 2006 Series C (Kentucky Utilities Company Project), all previously issued by the Issuer to finance certain solid waste disposal facilities (collectively, the “2008 Series A Project”) owned by the Company. For information regarding the Project, see “The Project.”

The Company is an operating subsidiary of E.ON U.S. LLC (formerly known as LG&E Energy LLC) and E.ON AG (the “Parents”). See “Appendix A — Kentucky Utilities Company — Financial Statements and Additional Information.” The Parents have no obligation to make any payments due under the Loan Agreements or any other payments of principal, interest, premium or purchase price of the Bonds.

The Bonds are being converted to bear interest at a Weekly Rate, but may be subsequently converted again to bear interest at a Daily Rate, a Weekly Rate, a Flexible Rate, a Semi-Annual Rate, an Annual Rate, a Long Term Rate or with respect to the 2006 Series B Bonds, a Dutch Auction Rate. **This Reoffering Circular pertains only to the Bonds during such period of time that they bear interest at the Weekly Rate.**

The Bonds are special and limited obligations of the Issuer, and the Issuer’s obligation to pay the principal of and interest and any premium on, and purchase price of, each series of the Bonds is limited solely to the revenues and other amounts received by the applicable Trustee under the applicable Indenture pursuant to the applicable Loan Agreement (and the applicable Letter of Credit (as defined below). The Bonds do not constitute an indebtedness, general obligation or pledge of the faith and credit or taxing power of the Issuer, the Commonwealth of Kentucky or any political subdivision thereof. The Bonds are not entitled to the benefits of any financial guaranty insurance policies.

Concurrently with, and as a condition to, the conversion and reoffering of the Bonds, the Company will cause to be delivered separate irrevocable transferable direct pay letters of credit (the “Letters of Credit”) with respect to each of the 2006 Series B Bonds and the 2008 Series A Bonds, issued by Commerzbank AG, New York Branch (the “Bank”), to provide for the timely payment of principal of and accrued interest (calculated for at least 45 days at the maximum rate of 15% per annum) on, and purchase price of, the Bonds. The Company will be required to reimburse the Bank for all amounts drawn by the Trustee under the Letters of Credit pursuant to the terms of separate Reimbursement Agreements, to be dated as of December 19, 2008 (collectively, the “Reimbursement Agreement”), with respect to each of the 2006 Series B Bonds

and the 2008 Series A Bonds, between the Company and the Bank. Each Letter of Credit will expire on December 18, 2009, unless extended or earlier terminated.

Upon expiration of a Letter of Credit or any Alternate Credit Facility, the related series of Bonds will be subject to mandatory tender for purchase. See “Summary of the Bonds — Mandatory Purchases of Bonds — Mandatory Purchase upon Delivery, Cancellation, Substitution, Extension, Termination or Expiration of Any Credit Facility or Replacement with an Alternate Credit Facility.” As used in this Reoffering Circular, “Bank” or “Credit Facility Issuer” refers to the Bank as the issuer of the applicable Letter of Credit and any other issuer of any Alternate Credit Facility delivered in accordance with the applicable Indenture; “Letter of Credit” or “Credit Facility” means the applicable Letter of Credit delivered under the applicable Indenture and, as applicable, any Alternate Credit Facility which may be subsequently delivered in accordance with such Indenture; and “Reimbursement Agreement” refers to the applicable initial Reimbursement Agreement under which the related Letter of Credit is provided and any subsequent agreement entered into between the Company and any other party in connection with the delivery of any Alternate Credit Facility.

Banc of America Securities LLC will be appointed under the Indentures to serve as Remarketing Agent for the Bonds. Any Remarketing Agent may resign or be removed and a successor Remarketing Agent may be appointed in accordance with the terms of the applicable Indenture and the applicable Remarketing Agreement for the Bonds between such Remarketing Agent and the Company.

Brief descriptions of the Company, the Issuer, the Bonds, the Loan Agreements, the Indentures, the Letters of Credit and the Reimbursement Agreements are included in this Reoffering Circular. Appendix A to this Reoffering Circular has been furnished by the Company. The Issuer and Bond Counsel assume no responsibility for the accuracy or completeness of such Appendix A or such information. Appendix B to this Reoffering Circular contains the opinions of Bond Counsel delivered on the dates on which each series of the Bonds were initially issued, and the proposed forms of opinions of Bond Counsel to be delivered in connection with the conversion of each series of the Bonds to the Weekly Rate. Appendix C to this Reoffering Circular contains information about the Bank. The Issuer and Bond Counsel assume no responsibility for the accuracy or completeness of such Appendix C or such information. Such descriptions and information do not purport to be complete, comprehensive or definitive and are not to be construed as a representation or a guaranty of accuracy or completeness. All references herein to the documents are qualified in their entirety by reference to such documents, and references herein to a series of Bonds are qualified in their entirety by reference to the definitive form thereof included in the applicable Indenture. Copies of the Loan Agreements, the Indentures, the Letters of Credit and the Reimbursement Agreements will be available for inspection at the principal corporate trust office of the Trustee party thereto. Certain information relating to The Depository Trust Company (“DTC”) and the book-entry-only system has been furnished by DTC. All statements herein are qualified in their entirety by reference to each such document and, with respect to the enforceability of certain rights and remedies, to laws and principles of equity relating to or affecting generally the enforcement of creditors’ rights.

## The Projects

### 2006 Series B Project

The 2006 Series B Project has been completed, placed in operation and is the property of the Company and consists of certain solid waste disposal facilities at the Company's Ghent Generating Station located in Carroll County, Kentucky for the collection, storage, treatment processing and final disposal of solid wastes.

### 2008 Series A Project

The 2008 Series A Project consists of the Construction Project and the Refunding Project.

*Construction Project.* The "Construction Project" consists of certain solid waste disposal facilities at the Company's Ghent Generating Station, Unit 1, located in Carroll County, Kentucky for the collection, storage, treatment and final disposal of solid wastes ("Ghent Generating Station"). The Company has begun construction and fabrication of the Construction Project. The Kentucky Public Service Commission has issued a Certificate of Convenience and Necessity ("CCN") that authorizes construction of the Construction Project. When constructed, the Construction Project will be the property of the Company.

*Refunding Project.* The "Refunding Project" consists of certain solid waste disposal facilities at the Ghent Generating Station for the collection, storage, treatment and final disposal of solid wastes. The Refunding Project has been completed, placed in operation and Completion Certificates in respect thereof have been issued. The Refunding Project has and will contribute to the collection, storage, treatment, processing and final disposal of solid wastes.

## Separate Series

The 2006 Series B Bonds and the 2008 Series A Bonds are separate series and optional or mandatory redemption of any series may be made in the manner described below without the redemption of the other series. Similarly, a default under one of the series of Bonds or one of the Loan Agreements will not necessarily constitute a default under the other series of Bonds or Loan Agreements. Each series of Bonds can bear interest at an Interest Rate Mode different from the Interest Rate Mode borne by the other series of Bonds. Unless specifically otherwise noted, any discussion herein and under the captions "Summary of the Bonds," "The Letter of Credit," "Security; Limitation of Liens," "Summary of the Loan Agreement," "Summary of the Indenture," "Enforceability of Remedies" and "Tax Treatment" applies equally, but separately, to the 2006 Series B Bonds and the 2008 Series A Bonds.

As used herein under such captions with respect to the 2006 Series B Bonds, the term "Project" shall mean the 2006 Series B Project, the term "Bonds" shall mean the 2006 Series B Bonds, the term "Loan Agreement" shall mean the 2006 Series B Loan Agreement pursuant to which the Issuer loaned the proceeds from the sale of the 2006 Series B Bonds to the Company, the term "Indenture" shall mean the 2006 Series B Indenture, the term "Remarketing Agent" shall mean Banc of America Securities LLC, the terms "Trustee" and "Tender Agent" shall mean the 2006 Series B Trustee and the term "Letter of Credit" shall mean the Letter of Credit delivered to the 2006 Series B Trustee.

As used herein under such captions with respect to the 2008 Series A Bonds, the term “Project” shall mean the 2008 Series A Project, the term “Bonds” shall mean the 2008 Series A Bonds, the term “Loan Agreement” shall mean the 2008 Series A Loan Agreement pursuant to which the Issuer loaned the proceeds from the sale of the 2008 Series A Bonds to the Company, the term “Indenture” shall mean the 2008 Series A Indenture, the term “Remarketing Agent” shall mean Banc of America Securities LLC, the terms “Trustee” and “Tender Agent” shall mean the 2008 Series A Trustee and the term “Letter of Credit” shall mean the Letter of Credit delivered to the 2008 Series A Trustee.

### **The Issuer**

The Issuer is a public body corporate and politic duly created and existing as a county and political subdivision under the Constitution and laws of the Commonwealth of Kentucky. The Issuer is authorized by Sections 103.200 to 103.285, inclusive, of the Kentucky Revised Statutes (collectively, the “Act”) to (a) convert and reoffer the Bonds and (b) amend and restate and continue to perform its obligations under the Loan Agreement and the Indenture. The Issuer, through its legislative body, the Fiscal Court, has adopted one or more ordinances authorizing the issuance of the Bonds and the execution and delivery of the related documents.

THE BONDS ARE SPECIAL AND LIMITED OBLIGATIONS PAYABLE SOLELY AND ONLY FROM CERTAIN SOURCES, INCLUDING AMOUNTS TO BE RECEIVED BY THE TRUSTEE FROM THE APPLICABLE LETTER OF CREDIT AND BY OR ON BEHALF OF THE ISSUER UNDER THE APPLICABLE LOAN AGREEMENT. THE BONDS DO NOT CONSTITUTE AN INDEBTEDNESS, GENERAL OBLIGATION OR PLEDGE OF THE FAITH AND CREDIT OR TAXING POWER OF THE ISSUER, THE COMMONWEALTH OF KENTUCKY OR ANY POLITICAL SUBDIVISION THEREOF, AND DO NOT GIVE RISE TO A PECUNIARY LIABILITY OF THE ISSUER OR A CHARGE AGAINST ITS GENERAL CREDIT OR TAXING POWERS.

### **Summary of the Bonds**

*Although each series of Bonds is an entirely separate issue and has been issued under a separate Indenture, each Indenture contains substantially the same terms and provisions except as otherwise noted below.*

### **General**

The Bonds will be issued in the aggregate principal amounts set forth on the cover page of this Reoffering Circular. The 2006 Series B Bonds will mature on October 1, 2034. The 2008 Series A Bonds will mature on February 1, 2032. The Bonds are also subject to optional redemption, extraordinary optional redemption, in whole or in part, and mandatory redemption prior to maturity as described in this Reoffering Circular.

The 2006 Series B Bonds currently bear interest at a Dutch Auction Rate, and the 2008 Series A Bonds currently bear interest at a Flexible Rate. Pursuant to the terms and provisions of the Indentures summarized below, the Company has exercised its option, effective December 19, 2008 (the “Conversion Date”), to convert the interest rate on the Bonds to a Weekly Rate. From and after the Conversion Date and reoffering of the Bonds, the Bonds will bear interest at a

Weekly Rate and will be payable on the first Business Day of each calendar month, commencing on January 2, 2009. The Bonds will continue to bear interest at the Weekly Rate until a Conversion to another Interest Rate Mode or until the maturity or redemption of the Bonds. The permitted Interest Rate Modes for the Bonds are (i) the “Flexible Rate,” (ii) the “Daily Rate,” (iii) the “Weekly Rate,” (iv) the “Semi-Annual Rate,” (v) the “Annual Rate,” (vi) the “Long Term Rate” and (vii) with respect to the 2006 Series B Bonds, the “Dutch Auction Rate.” Changes in the Interest Rate Mode will be effected, and notice of such changes will be given, as described below in “—Conversion of Interest Rate Modes and Changes of Long Term Rate Periods.”

During each Rate Period for an Interest Rate Mode (other than the Dutch Auction Rate Mode with respect to the 2006 Series B Bonds), the interest rate or rates for the Bonds in that Interest Rate Mode, and Flexible Rate Periods for Bonds accruing interest at a Flexible Rate, will be determined by the Remarketing Agent in accordance with the Indenture; provided that the interest rate or rates borne by any Bonds may not exceed the lesser of (i) the maximum interest rate permitted by applicable law or (ii) 15% per annum. With respect to the 2006 Series B Bonds, the interest rate for the Bonds that bear interest at a Dutch Auction Rate will be determined in accordance with the procedures established pursuant to the Indenture.

Interest on the Bonds which bear interest at a Flexible Rate, Daily Rate or Weekly Rate will be computed on the basis of a year of 365 or 366 days, as appropriate, and paid for the actual number of days elapsed. Interest on the Bonds which bear interest at a Semi-Annual Rate, Annual Rate or Long Term Rate will be computed on the basis of a 360-day year, consisting of twelve 30-day months. With respect to the 2006 Series B Bonds, interest on the Bonds which bear interest at a Dutch Auction Rate will be computed on the basis of a 360-day year for the actual number of days elapsed. Interest payable on any Interest Payment Date will be payable to the registered owner of the Bond as of the Record Date for such payment; provided that in the case of Bonds bearing interest at the Flexible Rate, interest will be payable to the registered owner of such Bond on the Interest Payment Date therefor. The Record Date, in the case of interest accrued at a Daily Rate or Weekly Rate, will be the close of business on the Business Day immediately preceding each Interest Payment Date, in the case of interest accrued at a Semi-Annual Rate, Annual Rate or Long Term Rate, will be the close of business on the fifteenth day (whether or not a Business Day) of the month preceding each Interest Payment Date, and with respect to the 2006 Series B Bonds, in the case of interest accrued at a Dutch Auction Rate, will be the close of business on the second Business Day preceding each Interest Payment Date.

The Bonds initially will be issued solely in book-entry-only form through DTC (or its nominee, Cede & Co.). So long as the Bonds are held in the book-entry-only system, DTC or its nominee will be the registered owner or holder of the Bonds for all purposes of the Indenture, the Bonds and this Reoffering Circular. See “— Book-Entry-Only System” below. Individual purchases of book-entry interests in the Bonds will be made in book-entry-only form in (i) denominations of \$100,000 or any integral multiple thereof, if bearing interest at the Daily Rate or the Weekly Rate, (ii) denominations of \$100,000 or any integral multiple of \$5,000 in excess of \$100,000, if bearing interest at Flexible Rates, (iii) denominations of \$5,000 and integral multiples thereof, if bearing interest at the Semi-Annual Rate, the Annual Rate or the Long Term Rate, or (iv) with respect to the 2006 Series B Bonds, denominations of \$25,000 and integral multiples thereof, if bearing interest at a Dutch Auction Rate; provided, that with respect to the

2008 Series A Bonds, (i) if such 2008 Series A Bonds bear interest at the Daily Rate or the Weekly Rate, one 2008 Series A Bond may be in the denomination of, or include an additional \$47,405 and (ii) if such 2008 Series A Bonds bear interest at the Semi-Annual Rate, the Annual Rate, the Long Term Rate or the Flexible Rate, one 2008 Series A Bond may be in the denomination of, or include an additional \$2,405.

Except as otherwise described below for Bonds held in DTC's book-entry-only system, the principal or redemption price of the Bonds is payable at the designated corporate trust office in New York, New York, of the Trustee, as paying agent (the "Paying Agent"). Except as otherwise described below for Bonds held in DTC's book-entry-only system, interest on the Bonds is payable by check mailed to the owner of record; provided that interest payable on each Bond will be payable in immediately available funds by wire transfer within the continental United States or by deposit into a bank account maintained with the Trustee or a Paying Agent (i) if the Interest Rate Mode is the Daily Rate, the Weekly Rate or the Flexible Rate or, with respect to the 2006 Series B Bonds, the Dutch Auction Rate or (ii) at the written request of any owner of record holding at least \$1,000,000 aggregate principal amount of the Bonds, if the Interest Rate Mode is the Semi-Annual Rate, Annual Rate or Long Term Rate, received by the Trustee, as bond registrar (the "Bond Registrar"), at least one Business Day prior to any Record Date. Except as otherwise described below for Bonds held in DTC's book-entry-only system, if the Interest Rate Mode is the Flexible Rate, interest payable on each Bond will be paid only upon presentation and surrender of such Bond.

Bonds may be transferred or exchanged for an equal total amount of Bonds of other authorized denominations upon surrender of such Bonds at the principal office of the Bond Registrar, accompanied by a written instrument of transfer or authorization for exchange in form and with guaranty of signature satisfactory to the Bond Registrar, duly executed by the registered owner or the owner's duly authorized attorney. Except as provided in the Indenture, the Bond Registrar will not be required to register the transfer or exchange of any Bond (i) during the fifteen days before any mailing of a notice of redemption of Bonds, (ii) after such Bond has been called for redemption or (iii) for which a registered owner has submitted a demand for purchase (see "— Purchases of Bonds on Demand of Owner" below), or which has been purchased (see "— Payment of Purchase Price" below). Registration of transfers and exchanges will be made without charge to the registered owners of Bonds, except that the Bond Registrar may require any registered owner requesting registration of transfer or exchange to pay any required tax or governmental charge.

### **The Bonds Are Not Insured**

Upon the conversion of the Bonds to a Weekly Rate on the Conversion Date and the delivery of the Letter of Credit, the Financial Guaranty Insurance Policy (the "Bond Insurance Policy") issued by Ambac Assurance Corporation ("Ambac") with respect to the 2006 Series B Bonds on February 23, 2007 will have been irrevocably surrendered and cancelled. The 2008 Series A Bonds are currently not entitled to the benefits of any financial guaranty insurance policy. The Bonds described in this Reoffering Circular are not insured, and holders thereof will have no recourse to, under or against any bond insurance policy or bond insurer, including the aforementioned Bond Insurance Policy issued by Ambac.

## **Tender Agent**

Owners may tender their Bonds, and in certain circumstances will be required to tender their Bonds, to the Tender Agent for purchase at the times and in the manner described herein under “— Summary of Certain Provisions of the Bonds,” “— Purchases of Bonds on Demand of Owner” and “— Mandatory Purchases of Bonds.” So long as the Bonds are held in DTC’s book-entry-only system, the Trustee will act as Tender Agent under the Indenture. Any successor Tender Agent appointed pursuant to the Indenture will also be a Paying Agent.

## **Remarketing Agent**

Banc of America Securities LLC will act as the Remarketing Agent with respect to the Bonds (the “Remarketing Agent”). The Remarketing Agent may resign or be removed and a successor Remarketing Agent may be appointed in accordance with the terms of the applicable Indenture and the applicable Remarketing Agreement for the Bonds between the Remarketing Agent and the Company.

## **Special Considerations Relating to the Remarketing Agent**

### *The Remarketing Agent is paid by the Company.*

The Remarketing Agent’s responsibilities include determining the interest rate from time to time and remarketing Bonds that are optionally or mandatorily tendered by the owners thereof (subject, in each case, to the terms of the Remarketing Agreement), all as further described herein. The Remarketing Agent is appointed by the Issuer at the request of the Company and paid by the Company for its services. As a result, the interests of the Remarketing Agent may differ from those of existing holders and potential purchasers of Bonds.

### *The Remarketing Agent routinely purchases bonds for its own account.*

The Remarketing Agent acts as remarketing agent for a variety of variable rate demand obligations and, in its sole discretion, routinely purchases such obligations for its own account in order to achieve a successful remarketing of the obligations (i.e., because there are otherwise not enough buyers to purchase the obligations) or for other reasons. The Remarketing Agent is permitted, but not obligated, to purchase tendered Bonds for its own account and, if it does so, it may cease doing so at any time without notice. The Remarketing Agent may also make a market in the Bonds by routinely purchasing and selling Bonds other than in connection with an optional or mandatory tender and remarketing. Such purchases and sales may be at or below par. However, the Remarketing Agent is not required to make a market in the Bonds. The Remarketing Agent may also sell any Bonds it has purchased to one or more affiliated investment vehicles for collective ownership or enter into derivative arrangements with affiliates or others in order to reduce its exposure to the Bonds. The purchase of Bonds by the Remarketing Agent may create the appearance that there is greater third party demand for the Bonds in the market than is actually the case. The practices described above also may result in fewer Bonds being tendered in a remarketing.

*Bonds may be offered at different prices on any date.*

As more fully described under the caption “— Determination of Interest Rates for Interest Rate Modes,” the Remarketing Agent shall determine the minimum rate of interest per annum which in the opinion of the Remarketing Agent, would be necessary on and as of such day to remarket the Bonds in a secondary market transaction at a price equal to the principal amount thereof plus accrued interest thereon, if any, provided that such rate of interest shall not exceed 15% per annum. The interest rate will reflect, among other factors, the level of market demand for the Bonds (including whether the Remarketing Agent is willing to purchase Bonds for its own account). There may or may not be Bonds tendered and remarketed on a day that the rate on the Bonds are set, the Remarketing Agent may or may not be able to remarket any Bonds tendered for purchase on such date at par and the Remarketing Agent may sell Bonds at varying prices to different investors on such date or any other date. The Remarketing Agent is not obligated to advise purchasers in a remarketing if it does not have third party buyers for all of the Bonds at the remarketing price. In the event the Remarketing Agent owns any Bonds for its own account, it may, in its sole discretion in a secondary market transaction outside the tender process, offer such Bonds on any date, including the day that the rate on the Bonds are set, at a discount to par to some investors.

*The ability to sell the Bonds other than through the tender process may be limited.*

**The Remarketing Agent may buy and sell Bonds other than through the tender process. However, it is not obligated to do so and may cease doing so at any time without notice and may require holders that wish to tender their Bonds to do so through the Trustee with appropriate notice. Thus, investors who purchase the Bonds, whether in a remarketing or otherwise, should not assume that they will be able to sell their Bonds other than by tendering the Bonds in accordance with the tender process.**

#### **Certain Definitions**

As used herein, each of the following terms will have the meaning indicated.

“*Alternate Credit Facility*” means an irrevocable letter of credit, a municipal bond insurance policy, a surety bond, a line or lines of credit, a guarantee or other similar agreement or agreements or any other agreement or agreements used to provide liquidity or credit support for the Bonds, satisfactory to the Company and the Remarketing Agent and containing administrative provisions reasonably satisfactory to the Trustee, issued and delivered to the Trustee in accordance with the Indenture.

“*Annual Rate Period*” means the period beginning on, and including, the Conversion Date to the Annual Rate and ending on, and including, the day next preceding the second Interest Payment Date thereafter, and each successive twelve-month period (or portion thereof) thereafter until the day preceding the earlier of the Conversion to a different Interest Rate Mode or the maturity of the Bonds.

“*Beneficial Owner*” means the person in whose name a Bond is recorded as such by the respective systems of DTC and each DTC Participant (as defined herein) or the registered holder of such Bond if such Bond is not then registered in the name of Cede & Co.



“*Business Day*” means any day other than a Saturday or Sunday or legal holiday or a day on which banking institutions located in the City of New York, New York, or the New York Stock Exchange or banking institutions in the city in which the principal office of the Trustee, the Bond Registrar, the Tender Agent, the Paying Agent, the Auction Agent with respect to the 2006 Series B Bonds, the Company, the Credit Facility Issuer or the Remarketing Agent is located are authorized by law or executive order to close.

“*Conversion*” means any conversion from time to time in accordance with the terms of the Indenture of the Bonds from one Interest Rate Mode to another Interest Rate Mode.

“*Conversion Date*” means initially the date of original issuance of the Bonds, and thereafter means the date on which any Conversion becomes effective.

“*Credit Facility*” means an irrevocable direct pay letter of credit or other credit enhancement or liquidity support facility, or any combination thereof, delivered to and in favor of the Trustee for the benefit of the owners of the Bonds pursuant to the Indenture and designated as a “Credit Facility” under the Indenture, and includes the Initial Credit Facility or any Alternate Credit Facility delivered to the Trustee pursuant to the Indenture.

“*Credit Facility Issuer*” means the Initial Credit Facility Issuer and the issuer of any Credit Facility or Alternate Credit Facility subsequently in effect.

“*Daily Rate Period*” means the period beginning on, and including, the Conversion Date to the Daily Rate and ending on and including the day preceding the next Business Day and each period thereafter beginning on and including a Business Day and ending on and including the day preceding the next succeeding Business Day until the day preceding the earlier of the Conversion to a different Interest Rate Mode or the maturity of the Bonds.

“*Dutch Auction Rate*” means, with respect to the 2006 Series B Bonds, the rate of interest to be borne by the Bonds during each Dutch Auction Rate Period determined in accordance with the 2006 Series B Indenture.

“*Dutch Auction Rate Period*” means, with respect to the 2006 Series B Bonds, each period during which the 2006 Series B Bonds bear interest at a Dutch Auction Rate.

“*Flexible Rate*” means the Interest Rate Mode for the Bonds in which the interest rate for each Bond is determined with respect to such Bond during each Flexible Rate Period applicable to that Bond, as provided in the Indenture.

“*Flexible Rate Period*” means with respect to any Bond, each period (which may be from one day to 270 days, or such lower maximum number of days as is then permitted under the Indenture) determined for such Bond, as provided in the Indenture.

“*Initial Credit Facility*” means the irrevocable direct pay letter of credit issued by the Initial Credit Facility Issuer to the Trustee with respect to the Bonds on the Conversion Date.

“*Initial Credit Facility Issuer*” means Commerzbank AG, New York.

*“Interest Payment Date”* means (i) if the Interest Rate Mode is the Daily Rate or the Weekly Rate, the first Business Day of each calendar month, (ii) if the Interest Rate Mode is the Flexible Rate, for each Bond the last day of each Flexible Rate Period for such Bond (or if such day is not a Business Day, the next succeeding Business Day), (iii) if the Interest Rate Mode is the Semi-Annual Rate, the Annual Rate or the Long Term Rate, June 1 and December 1, and, in the case of the Long Term Rate, also the Conversion Date or the effective date of a change to a new Long Term Rate Period, (iv) with respect to the 2006 Series B Bonds, if the Interest Rate Mode is the Dutch Auction Rate Period, the dates determined in accordance with the terms of the Indenture or (v) with respect to any Bond, the Conversion Date (including the date of a failed Conversion) or the effective date of a change to a new Long Term Rate Period for such Bond. In any case, the final Interest Payment Date will be the maturity date of the Bonds.

*“Interest Period”* means for all Bonds (or for any Bond if the Interest Rate Mode is the Flexible Rate) the period from and including each Interest Payment Date to and including the day immediately preceding the next Interest Payment Date, provided, however that the first Interest Period for the Bonds will begin on (and include) the date of issuance of the Bonds and the final Interest Period will end on September 30, 2034, with respect to the 2006 Series B Bonds, or January 31, 2032, with respect to the 2008 Series A Bonds.

*“Interest Rate Mode”* means the Flexible Rate, the Daily Rate, the Weekly Rate, the Semi-Annual Rate, the Annual Rate, the Long Term Rate for each series of the Bonds and, with respect to the 2006 Series B Bonds, the Dutch Auction Rate.

*“Long Term Rate Period”* means any period established by the Company as hereinafter set forth under “— Determination of Interest Rates for Interest Rate Modes — Long Term Rates and Long Term Rate Periods” and beginning on, and including, the Conversion Date to the Long Term Rate and ending on, and including, the day preceding the last Interest Payment Date for such period and, thereafter, each successive period of the same duration as the Long Term Rate Period previously established until the day preceding the earliest of the change to a different Long Term Rate Period, the Conversion to a different Interest Rate Mode or the maturity of the Bonds.

*“Maximum Rate”* means the lesser of (i) the maximum interest rate permitted by applicable law or (ii) 15%.

*“Prevailing Market Conditions”* means, without limitation, the following factors: existing short-term or long-term market rates for securities, the interest on which is excluded from gross income for federal income tax purposes; indexes of such short-term or long-term rates and the existing market supply and demand for securities bearing such short-term or long-term rates; existing yield curves for short-term or long-term securities for obligations of credit quality comparable to the Bonds, the interest on which is excluded from gross income for federal income tax purposes; general economic conditions; industry economic and financial conditions that may affect or be relevant to the Bonds; and such other facts, circumstances and conditions as the Remarketing Agent, in its sole discretion, determines to be relevant.

*“Purchase Date”* means any date on which Bonds are to be purchased on the demand of the registered owners thereof or are subject to mandatory purchase as described in the Indenture.

“*Reimbursement Agreement*” means the Reimbursement Agreement, to be dated as of December 19, 2008, between the Company and the Initial Credit Facility Issuer, as the same may be amended from time to time, and any other agreement between the Company and a Credit Facility Issuer, setting forth the obligations of the Company to such Credit Facility Issuer arising out of any payments under such Credit Facility and which provides that it will be deemed to be a Reimbursement Agreement for the purpose of the Indenture.

“*Semi-Annual Rate Period*” means any period beginning on, and including, the Conversion Date to the Semi-Annual Rate, and ending on, and including, the day preceding the first Interest Payment Date thereafter and each successive six-month period thereafter beginning on and including an Interest Payment Date and ending on and including the day next preceding the next Interest Payment Date until the day preceding the earlier of the Conversion to a different Interest Rate Mode or the maturity of the Bonds.

“*Weekly Rate Period*” means, (i) with respect to the 2006 Series B Bonds, the period beginning on, and including the Conversion Date to the Weekly Rate, and ending on, and including, the next Thursday, and thereafter the period beginning on, and including any Friday and ending on, and including, the earliest of the next Thursday, the day preceding the Conversion to a different Interest Rate Mode or the maturity of the Bonds, and (ii) with respect to the 2008 Series A Bonds, the period beginning on, and including, the Conversion Date to the Weekly Rate, and ending on, and including, the next Wednesday, and thereafter the period beginning on, and including, any Thursday and ending on, and including, the earliest of the next Wednesday, the day preceding the Conversion to a different Interest Rate Mode or the maturity of the Bonds.

### **Summary of Certain Provisions of the Bonds**

The following table summarizes, for each of the permitted Interest Rate Modes (except the Dutch Auction Rate with respect to the 2006 Series B Bonds): the dates on which interest will be paid (*Interest Payment Dates*); the dates on which each interest rate will be determined (*Interest Rate Determination Dates*); the period of time (*Interest Rate Periods*) each interest rate will be in effect (provided that the initial Interest Rate Period for each Interest Rate Mode may begin on a different date from that specified, which date will be the Conversion Date or the date of a change in the Long Term Rate, as applicable); the dates on which registered owners may tender their Bonds for purchase to the Tender Agent and the notice requirements therefor (provided that while the Bonds are held in book-entry-only form, all notices of tender for purchase will be given by Beneficial Owners in the manner described below under “Purchases of Bonds on Demand of Owner — Notice Required for Purchases”) (*Purchase on Demand of Owner; Required Notice*); the dates on which Bonds are subject to mandatory tender for purchase (*Mandatory Purchase Dates*); the redemption provisions applicable to the Bonds (*Redemption*); the notice requirements for redemption and mandatory tender for purchase (*Notices of Redemption and Mandatory Purchases*); and the manner by which registered owners will receive payments of principal, interest, redemption price and purchase price (*Manner of Payment*). All times stated are New York City time. Provisions relating to the Bonds while they bear interest at a Dutch Auction Rate, with respect to the 2006 Series B Bonds, will be determined in accordance with auction procedures established at the time of conversion to the Dutch Auction Rate.

	<u>FLEXIBLE RATE</u>	<u>DAILY RATE</u>	<u>WEEKLY RATE</u>
<b>Interest Payment Dates</b>	With respect to any Bond, the last day of each Flexible Rate Period (or if such day is not a Business Day, the next succeeding Business Day).	The first Business Day of each calendar month.	The first Business Day of each calendar month.
<b>Interest Rate Determination Dates</b>	For each Bond, not later than 12:00 noon on the first day of each Flexible Rate Period for such Bond.	Not later than 9:30 a.m. on each Business Day.	Not later than 4:00 p.m. on the day preceding the first day of each Weekly Rate Period or, if not a Business Day, on the next preceding Business Day.
<b>Interest Rate Periods</b>	For each Bond, each Flexible Rate Period will be of a duration designated by the Remarketing Agent of one day to 270 days (or lower maximum number as specified in the Indenture), must end on a day immediately preceding a Business Day.	From and including each Business Day to but not including the next Business Day.	From and including each Friday to and including the following Thursday for the 2006 Series B Bonds.  From and including each Thursday to and including the following Wednesday for the 2008 Series A Bonds.
<b>Purchase on Demand of Owner; Required Notice*</b>	No purchase on demand of the owner.	Any Business Day; by written or telephonic notice, promptly, with respect to the 2006 Series B Bonds, or immediately, with respect to the 2008 Series A Bonds, confirmed in writing, to the Tender Agent by 10:00 a.m. on such Business Day.	Any Business Day; by written notice to the Tender Agent not later than 5:00 p.m. on a Business Day at least seven days prior to the Purchase Date.
<b>Mandatory Purchase Dates</b>	Any Conversion Date; and with respect to each Bond, on each Interest Payment Date for such Bond; and upon delivery, cancellation, substitution, extension, termination or expiration of any Credit Facility or replacement with Alternate Credit Facility.	Any Conversion Date; and upon delivery, cancellation, substitution, extension, termination or expiration of any Credit Facility or replacement with Alternate Credit Facility.	Any Conversion Date; and upon delivery, cancellation, substitution, extension, termination or expiration of any Credit Facility or replacement with Alternate Credit Facility.
<b>Redemption</b>	Optional at par on any Interest Payment Date; Extraordinary Optional and Mandatory at par, on any Business Day (other than extraordinary optional redemption as a result of damage, destruction or condemnation which will be on an Interest Payment Date).	Optional, Extraordinary Optional and Mandatory at par on any Business Day.	Optional, Extraordinary Optional and Mandatory at par on any Business Day.
<b>Notices of Conversion, Redemption and Mandatory Purchases</b>	Not fewer than 15 days (30 days notice of Conversion to the Semi-Annual, Annual or Long Term Rate) or greater than 45 days. No notice of mandatory purchase following end of each Flexible Rate Period.	Not fewer than 15 days (30 days notice of Conversion to the Semi-Annual, Annual or Long Term Rate) or greater than 45 days.	Not fewer than 15 days (30 days notice of Conversion to the Semi-Annual, Annual or Long Term Rate) or greater than 45 days.
<b>Manner of Payment*</b>	Principal or redemption price upon surrender of the Bond to the Paying Agent; purchase price upon surrender of the Bond to the Tender Agent.	Principal or redemption price upon surrender of the Bond to the Paying Agent; purchase price upon surrender of the Bond to the Tender Agent.	Principal or redemption price upon surrender of the Bond to the Paying Agent; purchase price upon surrender of the Bond to the Tender Agent.

\* So long as DTC or its nominee is the registered owner of the Bonds, notices of redemption and mandatory purchases shall be sent to Cede & Co., payments of principal, redemption and purchase price of and interest on the Bonds will be paid through the facilities of DTC and notices of mandatory purchase may be given not less than five days prior to the Purchase Date. See “— Book-Entry-Only System” below.

	<b>SEMI-ANNUAL</b>	<b>ANNUAL</b>	<b>LONG TERM</b>
<b>Interest Payment Date</b>	Each June 1 and December 1.	Each June 1 and December 1.	Each June 1 and December 1; any Conversion Date; and the effective date of any change to a new Long Term Rate Period.
<b>Interest Rate Determination Dates</b>	Not later than 2:00 p.m. on the Business Day preceding the first day of the Semi-Annual Rate Period.	Not later than 12:00 noon on the Business Day preceding the first day of the Annual Rate Period.	Not later than 12:00 noon on the Business Day preceding the first day of the Long Term Rate Period.
<b>Interest Rate Periods</b>	Each six-month period from and including each June 1 and December 1 to and including the day preceding the next Interest Payment Date.	Each period from and including the Conversion Date to the Annual Rate to and including the day immediately preceding the second Interest Payment Date thereafter and each successive twelve month period thereafter.	Each period designated by the Company of more than one year in duration and which is an integral multiple of six months, from and including the first day of such period (June 1 and December 1) to and including the day immediately preceding the last Interest Payment Date for that period.
<b>Purchase on Demand of Owner; Required Notice</b>	On any Interest Payment Date; by written notice to the Tender Agent on any Business Day not later than the fifteenth day prior to the Purchase Date.	On the final Interest Payment Date for the Annual Rate Period; by written notice to the Tender Agent on any Business Day not later than the fifteenth day prior to the Purchase Date.	On the final Interest Payment Date for the Long Term Rate Period; by written notice to the Tender Agent on a Business Day not later than the fifteenth day prior to the Purchase Date.
<b>Mandatory Purchase Dates</b>	Any Conversion Date; the first Business Day after the end of each Semi-Annual Rate Period; and upon delivery, cancellation, substitution, extension, termination or expiration of any Credit Facility or replacement with Alternate Credit Facility.	Any Conversion Date; the first Business Day after the end of each Annual Rate Period; and upon delivery, cancellation, substitution, extension, termination or expiration of any Credit Facility or replacement with Alternate Credit Facility.	Any Conversion Date; the first Business Day after the end of each Long Term Rate Period; the effective date of a change of Long Term Rate Period; and upon delivery, cancellation, substitution, extension, termination or expiration of any Credit Facility or replacement with Alternate Credit Facility.
<b>Redemption</b>	Optional at par on any Interest Payment Date; Extraordinary Optional and Mandatory at par, on any Business Day (other than extraordinary optional redemption as a result of damage, destruction or condemnation which will be on an Interest Payment Date).	Optional at par on the final Interest Payment Date; Extraordinary Optional and Mandatory at par, on any Business Day.	Optional at times and prices dependent on the length of the Long Term Rate Period; Extraordinary Optional and Mandatory at par, on any Business Day.
<b>Notices of Conversion, Redemption and Mandatory Purchases</b>	Not fewer than 15 days (30 days for notice of Conversion or redemption) or greater than 45 days.	Not fewer than 15 days (30 days for notice of Conversion or redemption) or greater than 45 days.	Not fewer than 15 days (30 days for notice of Conversion or redemption) or greater than 45 days.
<b>Manner of Payment</b>	Principal or redemption price upon surrender of the Bond to the Paying Agent; interest by check mailed to the registered owners or, upon request of registered owner, of \$1,000,000 or more of an individual issue of Bonds, in immediately available funds; purchase price upon surrender of the Bond to the Tender Agent.	Principal or redemption price upon surrender of the Bond to the Paying Agent; interest by check mailed to the registered owners or, upon request of registered owner, of \$1,000,000 or more of an individual issue of Bonds, in immediately available funds; purchase price upon surrender of the Bond to the Tender Agent.	Principal or redemption price upon surrender of the Bond to the Paying Agent; interest by check mailed to the registered owners or, upon request of registered owner, of \$1,000,000 or more of an individual issue of Bonds, in immediately available funds; purchase price upon surrender of the Bond to the Tender Agent.

\* So long as DTC or its nominee is the registered owner of the Bonds, notices of redemption and mandatory purchases shall be sent to Cede & Co., payments of principal, redemption and purchase price of and interest on the Bonds will be paid through the facilities of DTC and notices of mandatory purchase may be given not less than five days prior to the Purchase Date. See “— Book-Entry-Only System” below.

## **Determination of Interest Rates for Interest Rate Modes**

Daily Rate. If the Interest Rate Mode for the Bonds is the Daily Rate, the interest rate on the Bonds for any Business Day will be the rate established by the Remarketing Agent no later than 9:30 a.m. (New York City time) on each Business Day as the minimum rate of interest necessary, in the judgment of the Remarketing Agent taking into account then Prevailing Market Conditions, to enable the Remarketing Agent to sell the Bonds on such Business Day at a price equal to the principal amount thereof, plus accrued interest, if any, thereon. For any day which is not a Business Day or if the Remarketing Agent does not give notice of a change in the interest rate, the interest rate on the Bonds will be the interest rate in effect for the immediately preceding Business Day.

Weekly Rate. If the Interest Rate Mode for the Bonds is the Weekly Rate, the interest rate on the Bonds for a particular Weekly Rate Period will be the rate established by the Remarketing Agent no later than 4:00 p.m. (New York City time) on the day preceding such Weekly Rate Period or, if such day is not a Business Day, on the next preceding Business Day, as the minimum rate of interest necessary, in the judgment of the Remarketing Agent taking into account then Prevailing Market Conditions, to enable the Remarketing Agent to sell the Bonds on such first day at a price equal to the principal amount thereof, plus accrued interest, if any, thereon.

Flexible Rates and Flexible Rate Periods. If the Interest Rate Mode for the Bonds is the Flexible Rate, the interest rate on a Bond for a specific Flexible Rate Period will be the rate established by the Remarketing Agent no later than 12:00 noon (New York City time) on the first day of that Flexible Rate Period as the minimum rate of interest necessary, in the judgment of the Remarketing Agent taking into account then Prevailing Market Conditions, to enable the Remarketing Agent to sell such Bond on that day at a price equal to the principal amount thereof. Each Flexible Rate Period applicable for a Bond will be determined separately by the Remarketing Agent on or prior to the first day of such Flexible Rate Period as being the Flexible Rate Period permitted under the Indenture which, in the judgment of the Remarketing Agent, taking into account then Prevailing Market Conditions, will, with respect to such Bond, ultimately produce the lowest overall interest cost on the Bonds while the Interest Rate Mode for the Bonds is the Flexible Rate. Each Flexible Rate Period will be from one day to 270 days in length and will end on a day preceding a Business Day. If the Remarketing Agent fails to set the length of a Flexible Rate Period for any Bond, a new Flexible Rate Period lasting to, but not including, the next Business Day (or until the earlier Conversion or maturity of the Bonds) will be established automatically in accordance with the Indenture.

Semi-Annual Rate. If the Interest Rate Mode for the Bonds is the Semi-Annual Rate, the interest rate on the Bonds for a particular Semi-Annual Rate Period will be the rate established by the Remarketing Agent no later than 2:00 p.m. (New York City time) on the Business Day immediately preceding the first day of such Semi-Annual Rate Period as the minimum rate of interest necessary, in the judgment of the Remarketing Agent taking into account then Prevailing Market Conditions, to enable the Remarketing Agent to sell the Bonds on such first day at a price equal to the principal amount thereof.

Annual Rate. If the Interest Rate Mode for the Bonds is the Annual Rate, the interest rate on the Bonds for a particular Annual Rate Period will be the rate of interest established by the Remarketing Agent no later than 12:00 noon (New York City time) on the Business Day preceding the first day of such Annual Rate Period as the minimum rate of interest necessary, in the judgment of the Remarketing Agent taking into account then Prevailing Market Conditions, to enable the Remarketing Agent to sell the Bonds on such first day at a price equal to the principal amount thereof.

Dutch Auction Rate. With respect to the 2006 Series B Bonds, if the Interest Rate Mode for the Bonds is the Auction Rate, the interest rate on the Bonds for a particular Auction Rate Period will be the rate established in accordance with the procedures set forth in the Indenture.

Long Term Rates and Long Term Rate Periods. If the Interest Rate Mode for the Bonds is the Long Term Rate, the interest rate on the Bonds for a particular Long Term Rate Period will be the rate established by the Remarketing Agent no later than 12:00 noon (New York City time) on the Business Day preceding the first day of such Long Term Rate Period as the minimum rate of interest necessary, in the judgment of the Remarketing Agent taking into account then Prevailing Market Conditions, to enable the Remarketing Agent to sell the Bonds on such first day at a price equal to the principal amount thereof. The Company will establish the duration of the Long Term Rate Period at the time that it directs the Conversion of the Interest Rate Mode to the Long Term Rate, and thereafter each successive Long Term Rate Period will be the same as the Long Term Rate Period so established by the Company until a different Long Term Rate Period is specified by the Company in accordance with the Indenture (in which case the duration of that Long Term Rate Period will control succeeding Long Term Rate Periods), subject in all cases to the occurrence of a Conversion Date or the maturity of the Bonds. Each Long Term Rate Period will be more than one year in duration, will be for a period which is an integral multiple of six months and will end on the day next preceding an Interest Payment Date; provided that if a Long Term Rate Period commences on a date other than a June 1 or December 1, such Long Term Rate Period may be for a period which is not an integral multiple of six months but will be of a duration as close as possible to (but not in excess of) such Long Term Rate Period established by the Company and will terminate on a day preceding an Interest Payment Date, and each successive Long Term Rate Period thereafter will be for the full period established by the Company until a different Long Term Rate Period is specified by the Company in accordance with the Indenture or until the occurrence of a Conversion Date or the maturity of the Bonds; provided further that no Long Term Rate Period will extend beyond the final maturity date of the Bonds.

Change of Long Term Rate Period. The Company may change from one Long Term Rate Period to another Long Term Rate Period on any Business Day on which the Bonds are subject to optional redemption as described under “— Redemptions — Optional Redemption” below upon notice from the Bond Registrar to the owners of Bonds as described below. With any notice of such change, the Company must also deliver an opinion of Bond Counsel stating that such change is authorized or permitted by the Act and is authorized by the Indenture and will not adversely affect the exclusion from gross income of interest on the Bonds for federal income tax purposes. Notwithstanding the foregoing, the Long Term Rate Period will not be changed to a new Long Term Rate Period if (A) the Remarketing Agent has not determined the interest rate for the new Long Term Rate Period in accordance with the terms of the Indenture or

(B) the Bond Registrar receives written notice from Bond Counsel prior to the effective date of the change to the effect that the opinion of such Bond Counsel required under the Indenture has been rescinded. Upon the occurrence of any of the events described in the preceding sentence, the Bonds will bear interest at the Weekly Rate commencing on the date which would have been the effective date of the proposed change of Long Term Rate Period, subject to the provisions described under “— Conversion of Interest Rate Modes — Cancellation of Conversion of Interest Rate Mode” below.

*Notice to Owners of Change of Long Term Rate Period.* The Bond Registrar will notify each registered owner of the change of Long Term Rate Period by first class mail at least 30 days in the case of a change in the Long Term Rate Period but not more than 45 days before each effective date of a change in the Long Term Rate Period. The notice will state those matters required to be set forth therein under the Indenture.

*Failure to Determine Rate.* If for any reason the interest rate for a Bond is not determined by the Remarketing Agent, except as described above under “— Change of Long Term Rate Period” and below under “— Conversion of Interest Rate Modes — Cancellation of Conversion of Interest Rate Mode,” the interest rate for such Bond for the next succeeding interest rate period will be the interest rate in effect for such Bond for the preceding interest rate period and, pursuant to the terms of the Indenture, there will be no change in the then applicable Long Term Rate Period or any Conversion from the then applicable Interest Rate Mode. Notwithstanding the foregoing, if for any reason the interest rate for a Bond bearing interest at a Flexible Rate is not determined by the Remarketing Agent, the interest rate for such Bond for the next succeeding Interest Period will be equal to The Bond Market Association Municipal Swap Index™ (the “Municipal Index”) as defined in the Indenture, and the Interest Period for such Bond will extend through the day preceding the next Business Day, until the Trustee is notified of a new Flexible Rate and Flexible Rate Period determined for such Bond by the Remarketing Agent.

### **Conversion of Interest Rate Modes**

*Method of Conversion.* The Interest Rate Mode for the Bonds is subject to Conversion from time to time, in whole but not in part, on the dates specified below under “— Limitations on Conversion,” at the option of the Company, upon notice from the Bond Registrar to the registered owners of the Bonds, as described below. With any notice of Conversion, the Company must also deliver to the Bond Registrar and the Credit Facility Issuer an opinion of Bond Counsel stating that such Conversion is authorized or permitted by the Act and is authorized by the Indenture and will not adversely affect the exclusion from gross income of interest on the Bonds for federal income tax purposes, other than a Conversion from the Daily Rate Period to the Weekly Rate Period or from the Weekly Rate Period to the Daily Rate Period.



Conditions Precedent to Conversions. The following conditions are applicable to Conversions of the Bonds:

(a) any Credit Facility to be held by the Trustee after the Conversion Date must be sufficient to cover the principal of and accrued interest on the outstanding Bonds for the maximum Interest Period permitted for that particular Interest Rate Mode plus 10 days at the maximum interest rate, and if a Credit Facility is to be held by the Trustee after the Conversion of the Bonds to a Long Term Rate Period, that Credit Facility must also extend for the entire Long Term Rate Period plus 10 days at the maximum interest rate; and

(b) if a Credit Facility is then in effect and the purchase price of the Bonds under the Indenture includes any premium, the Trustee will be entitled to draw on that Credit Facility in an aggregate amount sufficient to pay the applicable purchase price (including such premium) or, in the alternative, available moneys will be available in the necessary amount and are applied to the payment of such premium.

Limitations on Conversion. Any Conversion of the Interest Rate Mode for the Bonds must be in compliance with the following conditions: (i) the Conversion Date must be a date on which the Bonds are subject to optional redemption (see “— Redemptions — Optional Redemption” below); provided that any Conversion from the Daily Rate Period to a Weekly Rate Period or from the Weekly Rate Period to the Daily Rate Period must be on a Friday, with respect to the 2006 Series B Bonds, or Thursday, with respect to the 2008 Series A Bonds, and, with respect to the 2006 Series B Bonds, if the Conversion is to or from a Dutch Auction Rate Period, the Conversion Date must be the last Interest Payment Date in respect of that Dutch Auction Rate Period; (ii) if the proposed Conversion Date would not be an Interest Payment Date but for the Conversion, the Conversion Date must be a Business Day; (iii) if the Conversion is from the Flexible Rate, (a) the Conversion Date may be no earlier than the latest Interest Payment Date established prior to the giving of notice to the Remarketing Agent of such proposed Conversion and (b) no further Interest Payment Date may be established while the Interest Rate Mode is then the Flexible Rate if such Interest Payment Date would occur after the effective date of that Conversion; and (iv) after a determination is made requiring mandatory redemption of all Bonds pursuant to the Indenture (see “— Redemptions” below), no change in the Interest Rate Mode may be made prior to such mandatory redemption.

Notice to Owners of Conversion of Interest Rate Mode. The Bond Registrar will notify each registered owner of the Conversion by first class mail at least 15 days (30 days in the case of Conversion from or to the Semi-Annual Rate, the Annual Rate, a Long Term Rate or, with respect to the 2006 Series B Bonds, a Dutch Auction Rate) but not more than 45 days before the Conversion Date. The notice will state those matters required to be set forth therein under the Indenture.

Cancellation of Conversion of Interest Rate Mode. Notwithstanding the foregoing, no Conversion will occur if (i) the Remarketing Agent has not determined the initial interest rate for the new Interest Rate Mode in accordance with the terms of the Indenture, (ii) the Bonds that are to be purchased are not remarketed or sold by the Remarketing Agent or (iii) the Bond Registrar receives written notice from Bond Counsel prior to the opening of business on the effective date

of Conversion to the effect that the opinion of such Bond Counsel required under the Indenture has been rescinded. If such Conversion fails to occur, such Bonds will automatically be converted to the Weekly Rate (with the first period adjusted in length so that the last day of such period will be a Wednesday) at the rate determined by the Remarketing Agent on the failed Conversion Date or, with respect to the 2006 Series B Bonds that bear interest at a Dutch Auction Rate, such Bonds will remain in such Interest Rate Mode; provided, that there must be delivered to the Issuer, the Trustee, the Bond Registrar, the Tender Agent, the Company, the Credit Facility Issuer and the Remarketing Agent an opinion of Bond Counsel to the effect that determining the interest rate to be borne by the Bonds at a Weekly Rate is authorized or permitted by the Act and is authorized under the Indenture and will not adversely affect the exclusion from gross income of interest on the Bonds for federal income tax purposes. If such opinion is not delivered on the failed Conversion Date, the Bonds will bear interest for a Rate Period of the same type and of substantially the same length as the Rate Period in effect prior to the failed Conversion Date at a rate of interest determined by the Remarketing Agent on the failed Conversion Date (or if shorter, the Rate Period ending on the day before the maturity date, with respect to the 2006 Series B Bonds); provided that if the Bonds then bear interest at the Long Term Rate, and if such opinion is not delivered on the date which would have been the effective date of a new Long Term Rate Period, the Bonds will bear interest at the Annual Rate, commencing on such date, at an Annual Rate determined by the Remarketing Agent on such date. If the proposed Conversion of Bonds fails as described herein, any mandatory purchase of such Bonds will remain effective.

#### **Purchases of Bonds on Demand of Owner**

If the Bonds are in the book-entry-only system, demands for purchase may be made by Beneficial Owners only through such Beneficial Owner's Direct Participant (as defined under the caption "— Book-Entry-Only System" below). If the Bonds are in certificated form, demands for purchase may be made only by registered owners. When the Interest Rate Mode is the Dutch Auction Rate, the Bonds are not subject to purchase on demand of the owners thereof.

*Daily Rate.* If the Interest Rate Mode for the Bonds is the Daily Rate, any Bond will be purchased on the demand of the registered owner thereof on any Business Day during a Daily Rate Period at a purchase price equal to the principal amount thereof plus accrued interest, if any, to the Purchase Date upon written notice or telephonic notice (to be immediately confirmed in writing) to the Tender Agent at its principal office not later than 10:00 a.m. (New York City time) on such Business Day.

*Weekly Rate.* If the Interest Rate Mode for the Bonds is the Weekly Rate, any Bond will be purchased on the demand of the registered owner thereof on any Business Day during a Weekly Rate Period at a purchase price equal to the principal amount thereof plus accrued interest, if any, to the Purchase Date upon written notice to the Tender Agent at its principal office at or before 5:00 p.m. (New York City time) on a Business Day not later than the seventh day prior to the Purchase Date.

*Semi-Annual Rate.* If the Interest Rate Mode for the Bonds is the Semi-Annual Rate, any Bond will be purchased on the demand of the registered owner thereof on any Interest Payment Date for a Semi-Annual Rate Period at a purchase price equal to the principal amount thereof upon written notice to the Tender Agent at its principal office on a Business Day not later than the fifteenth day prior to such Purchase Date.

*Annual Rate.* If the Interest Rate Mode for the Bonds is the Annual Rate, any Bond will be purchased on the demand of the registered owner thereof on the final Interest Payment Date for such Annual Rate Period at a purchase price equal to the principal amount thereof upon written notice to the Tender Agent at its principal office on a Business Day not later than the fifteenth day prior to such Purchase Date.

*Long Term Rate.* If the Interest Rate Mode for the Bonds is the Long Term Rate, any Bond will be purchased on the demand of the registered owner thereof on the final Interest Payment Date for such Long Term Rate Period (unless such date is the final maturity date) at a purchase price equal to the principal amount thereof upon written notice to the Tender Agent at its principal office on a Business Day not later than the fifteenth day prior to such Purchase Date.

*Limitations on Purchases on Demand of Owner.* Notwithstanding the foregoing, there will be no purchase of (a) a portion of any Bond unless the portion to be purchased and the portion to be retained each will be in an authorized denomination or (b) any Bond upon the demand of the registered owner if an Event of Default under the Indenture with respect to the payment of principal of, interest on, or purchase price of, the Bonds has occurred and is continuing. Also, if the Interest Rate Mode for the Bonds is the Flexible Rate, the Bonds will not be subject to purchase on the demand of the registered owners thereof, but each Bond will be subject to mandatory purchase on each Conversion Date and on the Interest Payment Date with respect to such Bond, as described below under the caption “— Mandatory Purchases of Bonds.”

*Notice Required for Purchases.* Any written notice delivered to the Tender Agent by an owner demanding the purchase of Bonds must (A) be delivered by the time and dates specified above, (B) state the number and principal amount (or portion thereof) of such Bond to be purchased, (C) state the Purchase Date on which such Bond is to be purchased, (D) irrevocably request such purchase and state that the owner agrees to deliver such Bond, duly endorsed in blank for transfer, with all signatures guaranteed, to the Tender Agent at or prior to 11:00 a.m. (1:00 p.m. if a tender during a Daily Rate Period and 12:00 noon if a tender during a Weekly Rate Period) (New York City time) on such Purchase Date.

## **Mandatory Purchases of Bonds**

*Mandatory Purchase on Conversion Dates or Change by the Company in Long Term Rate Period.* The Bonds will be subject to mandatory purchase at a purchase price equal to the principal amount thereof, plus accrued interest, if any, to the Purchase Date, plus, if the Interest Rate Mode is the Long Term Rate, the redemption premium, if any, which would be payable as described under “— Redemptions — Optional Redemption” below, if the Bonds were redeemed (A) on the Purchase Date, (B) on each Conversion Date and (C) on the effective date of any change by the Company of the Long Term Rate Period. Such tender and purchase will be

required even if the change in Long Term Rate Period or the Conversion is canceled pursuant to the Indenture.

*Mandatory Purchase on Each Interest Payment Date for Flexible Rate Period.* Whenever the Interest Rate Mode for the Bonds is the Flexible Rate, each Bond will be subject to mandatory purchase at a purchase price equal to the principal amount thereof, without premium, plus accrued interest, if any, to the Purchase Date, on each Interest Payment Date that interest on such Bond is payable at an interest rate determined for the Flexible Rate. Owners of Bonds will receive no notice of such mandatory purchase.

*Mandatory Purchase on Day after End of the Semi-Annual Rate Period, the Annual Rate Period or the Long Term Rate Period.* Whenever the Interest Rate Mode for the Bonds is the Semi-Annual Rate, the Annual Rate or the Long Term Rate, such Bonds will be subject to mandatory purchase on the Business Day following the end of each Semi-Annual Rate Period, Annual Rate Period or Long Term Rate Period, as the case may be, for such Bond at a purchase price equal to the principal amount thereof plus accrued interest, if any, to such date.

*Mandatory Purchase upon Delivery, Cancellation, Substitution, Extension, Termination or Expiration of Any Credit Facility or Replacement with an Alternate Credit Facility.* If, at the option of the Company, a Credit Facility (other than the initial Letter of Credit) is delivered with respect to the Bonds subsequent to the Reoffering Date, the Bonds will be subject to mandatory tender for purchase at a purchase price equal to 100% of the principal amount thereof, plus accrued interest, if any, to the Purchase Date on the date of the delivery of the Credit Facility. In addition, if the Bonds are secured by a Credit Facility, the Bonds will be subject to mandatory tender for purchase at a purchase price equal to 100% of the principal amount thereof, plus accrued interest, if any, (A) on the Interest Payment Date at least five days prior to the date of the cancellation of or the expiration of the term of the then current Credit Facility and (B) on the Interest Payment Date on which a Credit Facility is replaced with an Alternate Credit Facility.

*Notice to Owners of Mandatory Purchases.* Notice to owners of a mandatory purchase of Bonds (except for mandatory purchase on each Interest Payment Date for Flexible Rate Periods) will be given by the Bond Registrar, by first class mail at least 15 days but not more than 45 days before the Purchase Date; provided, however, as an alternative to the foregoing, if DTC or its nominee is the registered owner of the Bonds, notice may be given to DTC not less than five days before the Purchase Date. The notice of mandatory purchase will state those matters required to be set forth therein under the Indenture. No notice of mandatory purchase will be given in connection with a mandatory purchase on an Interest Payment Date for a Flexible Rate Period.

### **Remarketing and Purchase of Bonds**

The Indenture provides that, subject to the terms of a Remarketing Agreement with the Company, the Remarketing Agent will use its reasonable best efforts to offer for sale Bonds purchased upon demand of the owners thereof and, unless otherwise instructed by the Company and with the consent of any Credit Facility Issuer, upon mandatory purchase, provided that Bonds will not be remarketed upon the occurrence and continuance of certain Events of Default under the Indenture, except in the sole discretion of the Remarketing Agent. Each such sale will

be at a price equal to the principal amount thereof, plus interest accrued to the date of sale. The Remarketing Agent, the Trustee, the Paying Agent, the Bond Registrar or the Tender Agent each may purchase any Bonds offered for sale for its own account.

On each date Bonds are to be purchased pursuant to optional or mandatory purchase under the Indenture, such Bonds will be purchased from the following sources in the order of priority indicated, provided that funds derived from clause (c) may not be combined with the funds derived from clauses (a) or (b) to purchase any Bonds:

(a) proceeds of the remarketing of such Bonds to persons other than the Company, its affiliates or the Issuer and furnished to the Tender Agent by the Remarketing Agent and deposited directly into, and held in, the Remarketing Proceeds Subaccount of the Purchase Fund established with the Tender Agent under the Indenture;

(b) proceeds of the Credit Facility, if any, furnished by the Trustee, as Tender Agent, and deposited by the Tender Agent directly into, and held in, the Credit Facility Subaccount of the Purchase Fund; and

(c) moneys paid by the Company (including the proceeds of the remarketing of the Bonds to the Company, its affiliates or the Issuer) to pay the purchase price to the Tender Agent.

If there is no Credit Facility in operation to secure the Bonds, any Bonds will be purchased with any moneys made available by the Company, including proceeds from the remarketing of the Bonds.

### **Payment of Purchase Price**

When a book-entry-only system is not in effect, payment of the purchase price of any Bond will be payable (and delivery of a replacement Bond in exchange for the portion of any Bond not purchased if such Bond is purchased in part will be made) on the Purchase Date upon delivery of such Bond to the Tender Agent on such Purchase Date; provided that such Bond must be delivered to the Tender Agent: (i) at or prior to 12:00 noon (New York City time), in the case of Bonds delivered for purchase during a Weekly Rate Period or Flexible Rate Period, (ii) at or prior to 1:00 p.m. (New York City time), in the case of Bonds delivered for purchase during a Daily Rate Period or (iii) at or prior to 11:00 a.m. (New York City time), in the case of Bonds delivered for purchase during a Semi-Annual Rate Period, Annual Rate Period or Long Term Rate Period. If the date of such purchase is not a Business Day, the purchase price will be payable on the next succeeding Business Day.

Any Bond delivered for payment of the purchase price must be accompanied by an instrument of transfer thereof in form satisfactory to the Tender Agent executed in blank by the registered owner thereof and with all signatures guaranteed. The Tender Agent may refuse to accept delivery of any Bond for which an instrument of transfer satisfactory to it has not been provided and has no obligation to pay the purchase price of such Bond until a satisfactory instrument is delivered.

If the registered owner of any Bond (or portion thereof) that is subject to purchase pursuant to the Indenture fails to deliver such Bond with an appropriate instrument of transfer to the Tender Agent for purchase on the Purchase Date, and if the Tender Agent is in receipt of the purchase price therefor, such Bond (or portion thereof) nevertheless will be deemed purchased on the Purchase Date thereof. Any owner who so fails to deliver such Bond for purchase on (or before) the Purchase Date will have no further rights thereunder, except the right to receive the purchase price thereof from those moneys deposited with the Tender Agent in the Purchase Fund pursuant to the Indenture upon presentation and surrender of such Bond to the Tender Agent properly endorsed for transfer in blank with all signatures guaranteed.

When a book-entry-only system is in effect, the requirement for physical delivery of the Bonds will be deemed satisfied when the ownership rights in the Bonds are transferred by Direct Participants on the records of DTC to the participant account of the Tender Agent.

## **Redemptions**

### *Optional Redemption.*

(i) Whenever the Interest Rate Mode for the Bonds is the Daily Rate or the Weekly Rate, the Bonds will be subject to redemption at the option of the Issuer, upon the written direction of the Company, in whole or in part, at a redemption price of 100% of the principal amount thereof, plus interest accrued, if any, to the redemption date, on any Business Day.

(ii) Whenever the Interest Rate Mode for a Bond is the Flexible Rate, such Bond will be subject to redemption at the option of the Issuer, upon the written direction of the Company, in whole or in part, at a redemption price of 100% of the principal amount thereof, plus accrued interest, if any, to the redemption date with respect to the 2008 Series A Bonds, on any Interest Payment Date for that Bond.

(iii) Whenever the Interest Rate Mode for the Bonds is the Semi-Annual Rate, the Bonds will be subject to redemption at the option of the Issuer, upon the written direction of the Company, in whole or in part, at a redemption price of 100% of the principal amount thereof on any Interest Payment Date for each Semi-Annual Rate Period.

(iv) Whenever the Interest Rate Mode for the Bonds is the Annual Rate, the Bonds will be subject to redemption at the option of the Issuer, upon the written direction of the Company, in whole or in part, at a redemption price of 100% of the principal amount thereof on the final Interest Payment Date for each Annual Rate Period.

(v) With respect to the 2006 Series B Bonds, whenever the Interest Rate Mode for the Bonds is the Dutch Auction Rate, the Bonds will be subject to redemption at the option of the Issuer, upon the written direction of the Company, in whole or in part, on the Business Day immediately succeeding any auction date at a redemption price of 100% of the principal amount thereof, together with accrued interest to the redemption date.

(vi) Whenever the Interest Rate Mode for the Bonds is the Long Term Rate, the Bonds will be subject to redemption at the option of the Issuer, upon the written direction of the Company, in whole or in part, (A) on the final Interest Payment Date for the then current Long Term Rate Period at a redemption price of 100% of the principal amount thereof and (B) prior to the end of the then current Long Term Rate Period at any time during the redemption periods and at the redemption prices set forth below, plus in each case interest accrued, if any, to the redemption date:

<b>Original Length of Current Long Term Rate Period (Years)</b>	<b>Commencement of Redemption Period</b>	<b>Redemption Price as Percentage of Principal</b>
<i>2006 Series B Bonds:</i>		
More than or equal to 11 years	First Interest Payment Date on or after the tenth anniversary of commencement of Long Term Rate Period	100%
Less than 11 years	Non-callable	Non-callable
<i>2008 Series A Bonds:</i>		
More than or equal to 10 years	First Interest Payment Date on or after the tenth anniversary of commencement of Long Term Rate Period	100%
Less than 10 years	Non-callable	Non-callable

Subject to certain conditions, including provision of an opinion of Bond Counsel that a change in the redemption provisions of the Bonds will not adversely affect the exclusion from gross income of interest on the Bonds for federal income tax purposes, the redemption periods and redemption prices may be revised, effective as of the Conversion Date, the date of a change in the Long Term Rate Period or a Purchase Date on the final Interest Payment Date during a Long Term Rate Period, to reflect Prevailing Market Conditions on such date as determined by the Remarketing Agent in its judgment. Any such revision of the redemption periods and redemption prices will not be considered an amendment or a supplement to the Indenture and will not require the consent of any Bondholder or any other person or entity.

Extraordinary Optional Redemption in Whole. The Bonds may be redeemed by the Issuer in whole at any time at 100% of the principal amount thereof plus accrued interest to the redemption date upon the exercise by the Company of an option under the Loan Agreement to prepay the loan if any of the following events occurs within 180 days preceding the giving of written notice by the Company to the Trustee of such election:

(i) if in the judgment of the Company, unreasonable burdens or excessive liabilities have been imposed upon the Company after the issuance of the Bonds with respect to the Project or the operation thereof, including without limitation federal, state or other ad valorem property, income or other taxes not imposed on the date of the Loan Agreement, other than ad valorem taxes levied upon privately owned property used for the same general purpose as the Project;

(ii) if the Project or a portion thereof or other property of the Company in connection with which the Project is used has been damaged or destroyed to such an extent so as, in the judgment of the Company, to render the Project or such other property of the Company in connection with which the Project is used unsatisfactory to the Company for its intended use, and such condition continues for a period of six months;

(iii) there has occurred condemnation of all or substantially all of the Project or the taking by eminent domain of such use or control of the Project or other property of the Company in connection with which the Project is used so as, in the judgment of the Company, to render the Project or such other property of the Company unsatisfactory to the Company for its intended use;

(iv) in the event changes, which the Company cannot reasonably control, in the economic availability of materials, supplies, labor, equipment or other properties or things necessary for the efficient operation of the generating station where the Project is located have occurred, which, in the judgment of the Company, render the continued operation of such generating station or any generating unit at such station uneconomical; or changes in circumstances after the issuance of the Bonds, including but not limited to changes in solid waste abatement, control and disposal requirements, have occurred such that the Company determines that use of the Project is no longer required or desirable;

(v) the Loan Agreement has become void or unenforceable or impossible of performance by reason of any changes in the Constitution of the Commonwealth of Kentucky or the Constitution of the United States of America or by reason of legislative or administrative action (whether state or federal) or any final decree, judgment or order of any court or administrative body, whether state or federal; or

(vi) a final order or decree of any court or administrative body after the issuance of the Bonds requires the Company to cease a substantial part of its operation at the generating station where the Project is located to such extent that the Company will be prevented from carrying on its normal operations at such generating station for a period of six months.



Extraordinary Optional Redemption in Whole or in Part. The Bonds are also subject to redemption in whole or in part at 100% of the principal amount thereof plus accrued interest to the redemption date at the option of the Company in an amount not to exceed the net proceeds received from insurance or any condemnation award received by the Issuer or the Company in the event of damage, destruction or condemnation of all or a portion of the Project, subject to receipt of an opinion of Bond Counsel that such redemption will not adversely affect the exclusion of interest on any of the Bonds from gross income for federal income tax purposes, and such net proceeds must be applied to reimburse the Credit Facility Issuer for drawings under the Credit Facility to redeem the Bonds. See “Summary of the Loan Agreement — Maintenance; Damage, Destruction and Condemnation.” Such redemption may occur at any time, provided that if such event occurs while the Interest Rate Mode for the Bonds is the Flexible Rate or Semi-Annual Rate, such redemption must occur on a date on which the Bonds are otherwise subject to optional redemption as described above.

Mandatory Redemption: Determination of Taxability. The Bonds are required to be redeemed by the Issuer, in whole, or in such part as described below, at a redemption price equal to 100% of the principal amount thereof, without redemption premium, plus accrued interest, if any, to the redemption date, within 180 days following a “Determination of Taxability.” As used herein, a “Determination of Taxability” means the receipt by the Trustee of written notice from a current or former registered owner of a Bond or from the Company or the Issuer of (i) the issuance of a published or private ruling or a technical advice memorandum by the Internal Revenue Service in which the Company participated or has been given the opportunity to participate, and which ruling or memorandum the Company, in its discretion, does not contest or from which no further right of administrative or judicial review or appeal exists, or (ii) a final determination from which no further right of appeal exists of any court of competent jurisdiction in the United States in a proceeding in which the Company has participated or has been a party, or has been given the opportunity to participate or be a party, in each case, to the effect that as a result of a failure by the Company to perform or observe any covenant or agreement or the inaccuracy of any representation contained in the Loan Agreement or any other agreement or certificate delivered in connection with the Bonds, the interest on the Bonds is included in the gross income of the owners thereof for federal income tax purposes, other than with respect to a person who is a “substantial user” or a “related person” of a substantial user of the Project within the meaning of the Section 147 of Internal Revenue Code of 1986, as amended (the “Code”); provided, however, that no such Determination of Taxability shall be considered to exist as a result of the Trustee receiving notice from a current or former registered owner of a Bond or from the Issuer unless (i) the Issuer or the registered owner or former registered owner of the Bond involved in such proceeding or action (A) gives the Company and the Trustee prompt notice of the commencement thereof, and (B) (if the Company agrees to pay all expenses in connection therewith) offers the Company the opportunity to control unconditionally the defense thereof, and (ii) either (A) the Company does not agree within 30 days of receipt of such offer to pay such expenses and liabilities and to control such defense, or (B) the Company shall exhaust or choose not to exhaust all available proceedings for the contest, review, appeal or rehearing of such decree, judgment or action which the Company determines to be appropriate. No Determination of Taxability described above will result from the inclusion of interest on any Bond in the computation of minimum or indirect taxes. All of the Bonds are required to be redeemed upon a Determination of Taxability as described above unless, in the opinion of Bond Counsel, redemption of a portion of such Bonds would have the result that interest payable on

the remaining Bonds outstanding after the redemption would not be so included in any such gross income.

In the event any of the Issuer, the Company or the Trustee has been put on notice or becomes aware of the existence or pendency of any inquiry, audit or other proceedings relating to the Bonds being conducted by the Internal Revenue Service, the party so put on notice is required to give immediate written notice to the other parties of such matters. Promptly upon learning of the occurrence of a Determination of Taxability (whether or not the same is being contested), or any of the events described above, the Company is required to give notice thereof to the Trustee and the Issuer.

If the Internal Revenue Service or a court of competent jurisdiction determines that the interest paid or to be paid on any Bond (except to a “substantial user” of the Project or a “related person” within the meaning of Section 147(a) of the Code) is or was includable in the gross income of the recipient for federal income tax purposes for reasons other than as a result of a failure by the Company to perform or observe any of its covenants, agreements or representations in the Loan Agreement or any other agreement or certificate delivered in connection therewith, the Bonds are not subject to redemption. In such circumstances, Bondholders would continue to hold their Bonds, receiving principal and interest at the applicable rate as and when due, but would be required to include such interest payments in gross income for federal income tax purposes. Also, if the lien of the Indenture is discharged or defeased prior to the occurrence of a final Determination of Taxability, Bonds will not be redeemed as described herein.

*General Redemption Terms.* So long as a Credit Facility is in effect in respect of the Bonds, the redemption price (including accrued interest) will be paid from drawings under such Credit Facility or from moneys which otherwise constitute Available Moneys under the Indenture. Notice of redemption will be given by mailing a redemption notice conforming to the provisions and requirements of the Indenture by first class mail to the registered owners of the Bonds to be redeemed not less than 30 days (15 days if the Interest Rate Mode for the Bonds is the Flexible Rate, Daily Rate, Weekly Rate or, with respect to the 2006 Series B Bonds, the Dutch Auction Rate) but not more than 45 days prior to the redemption date.

Any notice mailed as provided in the Indenture will be conclusively presumed to have been given, irrespective of whether the owner receives the notice. Failure to give any such notice by mailing or any defect therein in respect of any Bond will not affect the validity of any proceedings for the redemption of any other Bond. No further interest will accrue on the principal of any Bond called for redemption after the redemption date if funds sufficient for such redemption have been deposited with the Paying Agent as of the redemption date. If the provisions for discharging the Indenture set forth below under the caption, “Summary of the Indenture — Discharge of Indenture” have not been complied with, any redemption notice will state that it is conditional on there being sufficient moneys to pay the full redemption price for the Bonds to be redeemed. So long as the Bonds are held in book-entry-only form, all redemption notices will be sent only to Cede & Co.

## **Book-Entry-Only System**

*Portions of the following information concerning DTC and DTC's book entry only system have been obtained from DTC. The Issuer, the Company and the Remarketing Agent make no representation as to the accuracy of such information.*

Initially, DTC will act as securities depository for the Bonds and the Bonds initially will be issued solely in book-entry-only form to be held under DTC's book-entry-only system, registered in the name of Cede & Co. (DTC's partnership nominee). One fully registered bond in the aggregate principal amount of the Bonds will be deposited with DTC.

DTC, the world's largest depository, is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934 (the "Exchange Act"). DTC holds and provides asset servicing for over 2.2 million issues of U.S. and non-U.S. equity, corporate and municipal debt issues, and money market instruments from over 100 countries that DTC's participants ("Direct Participants") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC, in turn, is owned by a number of Direct Participants of DTC and Members of the National Securities Clearing Corporation, Fixed Income Clearing Corporation, and Emerging Markets Clearing Corporation (NSCC, FICC and EMCC, also subsidiaries of DTCC), as well as by the New York Stock Exchange, Inc., the American Stock Exchange LLC and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants" and, together with "Direct Participants," "Participants"). DTC has Standard & Poor's highest rating: AAA. The DTC Rules applicable to its Participants are on file with the SEC. More information about DTC can be found at [www.dtcc.com](http://www.dtcc.com) and [www.dtc.org](http://www.dtc.org).

Purchases of the Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Bonds on DTC's records. The ownership interest of each actual purchaser of each Bond ("Beneficial Owner") is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Bonds are to be accomplished by entries made on the books of Direct or Indirect Participants acting on behalf of Beneficial Owners.

Beneficial Owners will not receive certificates representing their ownership interests in the Bonds, except in the event that use of the book-entry system for the Bonds is discontinued.

To facilitate subsequent transfers, all Bonds deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co. or such other name as may be requested by an authorized representative of DTC. The deposit of Bonds with DTC and their registration in the name of Cede & Co. or such other nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time.

Redemption notices shall be sent to DTC. If less than all of the Bonds are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant to be redeemed.

Neither DTC nor Cede & Co. (nor such other DTC nominee) will consent or vote with respect to the Bonds unless authorized by a Direct Participant in accordance with DTC's Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the Issuer as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Principal and interest payments on the Bonds will be made to Cede & Co. or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts, upon DTC's receipt of funds and corresponding detail information from the Issuer or the Trustee on the payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC nor its nominee, the Trustee, the Company or the Issuer, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal and interest to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the Issuer or the Trustee, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

A Beneficial Owner shall give notice to elect to have its Bonds purchased or tendered, through its Participant, to the Tender Agent, and shall effect delivery of such Bonds by causing the Direct Participant to transfer the Participant's interest in the Bonds, on DTC's records, to the Tender Agent. The requirement for physical delivery of Bonds in connection with a demand for purchase or a mandatory purchase will be deemed satisfied when the ownership rights in the Bonds are transferred by Direct Participants on DTC's records and followed by a book-entry credit of tendered Bonds to the Tender Agent's DTC account.

DTC may discontinue providing its services as securities depository with respect to the Bonds at any time by giving reasonable notice to the Issuer, the Company, the Tender Agent and the Trustee, or the Issuer, at the request of the Company, may remove DTC as the securities depository for the Bonds. Under such circumstances, in the event that a successor securities depository is not obtained, bond certificates are required to be delivered as described in the Indenture (see “— Revision of Book Entry Only System; Replacement Bonds” below). The Beneficial Owner, upon registration of certificates held in the Beneficial Owner's name, will become the registered owner of the Bonds.

So long as Cede & Co. is the registered owner of the Bonds, as nominee of DTC, references herein to the registered owners of the Bonds will mean Cede & Co. and will not mean the Beneficial Owners. Under the Indenture, payments made by the Trustee to DTC or its nominee will satisfy the Issuer's obligations under the Indenture, the Company's obligations under the Loan Agreement, to the extent of the payments so made. Beneficial Owners will not be, and will not be considered by the Issuer or the Trustee to be, and will not have any rights as, owners of Bonds under the Indenture.

The Trustee and the Issuer, so long as a book entry only system is used for the Bonds, will send any notice of redemption or of proposed document amendments requiring consent of registered owners and any other notices required by the document (including notices of Conversion and mandatory purchase) to be sent to registered owners only to DTC (or any successor securities depository) or its nominee. Any failure of DTC to advise any Direct Participant, or of any Direct Participant or Indirect Participant to notify the Beneficial Owner, of any such notice and its content or effect will not affect the validity of the redemption of the Bonds called for redemption, the document amendment, the Conversion, the mandatory purchase or any other action premised on that notice.

The Issuer, the Company, the Trustee and the Remarketing Agent cannot and do not give any assurances that DTC will distribute payments on the Bonds made to DTC or its nominee as the registered owner or any redemption or other notices, to the Participants, or that the Participants or others will distribute such payments or notices to the Beneficial Owners, or that they will do so on a timely basis, or that DTC will serve and act in the manner described in this Reoffering Circular.

THE ISSUER, THE COMPANY, THE REMARKETING AGENT AND THE TRUSTEE WILL HAVE NO RESPONSIBILITY OR OBLIGATION TO ANY DIRECT PARTICIPANT, INDIRECT PARTICIPANT OR ANY BENEFICIAL OWNER OR ANY OTHER PERSON NOT SHOWN ON THE REGISTRATION BOOKS OF THE TRUSTEE AS BEING A REGISTERED OWNER WITH RESPECT TO: (1) THE ACCURACY OF ANY RECORDS MAINTAINED BY DTC OR ANY DIRECT PARTICIPANT OR INDIRECT PARTICIPANT; (2) THE PAYMENT OF ANY AMOUNT DUE BY DTC TO ANY DIRECT PARTICIPANT OR BY ANY DIRECT PARTICIPANT OR INDIRECT PARTICIPANT TO ANY BENEFICIAL OWNER IN RESPECT OF THE PRINCIPAL AMOUNT OR REDEMPTION OR PURCHASE PRICE OF OR INTEREST ON THE BONDS; (3) THE DELIVERY OF ANY NOTICE BY DTC TO ANY DIRECT PARTICIPANT OR BY ANY DIRECT PARTICIPANT OR INDIRECT PARTICIPANT TO ANY BENEFICIAL OWNER WHICH IS REQUIRED OR PERMITTED TO BE GIVEN TO REGISTERED OWNERS UNDER THE TERMS OF THE INDENTURE; (4) THE SELECTION OF THE BENEFICIAL OWNERS TO RECEIVE PAYMENT IN THE EVENT OF ANY PARTIAL REDEMPTION OF THE BONDS; OR (5) ANY CONSENT GIVEN OR OTHER ACTION TAKEN BY DTC AS REGISTERED OWNER.

Revision of Book-Entry-Only System; Replacement Bonds. In the event that DTC determines not to continue as securities depository or is removed by the Issuer, at the direction of the Company, as securities depository, the Issuer, at the direction of the Company, may appoint a successor securities depository reasonably acceptable to the Trustee. If the Issuer does not or is unable to appoint a successor securities depository, the Issuer will issue and the Trustee will authenticate and deliver fully registered Bonds, in authorized denominations, to the assignees of DTC or their nominees.

In the event that the book-entry-only system is discontinued, the following provisions will apply. The Bonds may be issued in denominations of \$5,000 and multiples thereof, if the Interest Rate Mode is the Semi-Annual Rate, the Annual Rate or the Long Term Rate; in denominations of \$100,000 and multiples of \$5,000 in excess thereof, if the Interest Rate Mode is the Flexible Rate; in denominations of \$100,000 and multiples thereof, if the Interest Rate Mode is the Daily Rate or the Weekly Rate; and with respect to 2006 Series B Bonds, in denominations of \$25,000 and multiples thereof; provided, that, (i) if the Bonds bear interest at the Daily Rate or the Weekly Rate, one Bond may be in the denomination of, or include an additional, \$47,405 and (ii) if the Bonds bear interest at the Semi-Annual Rate, the Annual Rate, the Long Term Rate or the Flexible Rate, one Bond may be in the denomination of, or include an additional \$2,405. Bonds may be transferred or exchanged for an equal total amount of Bonds of other authorized denominations upon surrender of such Bonds at the principal office of the Bond Registrar, accompanied by a written instrument of transfer or authorization for exchange in form and with guaranty of signature satisfactory to the Bond Registrar, duly executed by the registered owner or the owner's duly authorized attorney. Except as provided in the Indenture, the Bond Registrar will not be required to register the transfer or exchange of any Bond during the fifteen days before any mailing of a notice of redemption, after such Bond has been called for redemption in whole or in part, or after such Bond has been tendered or deemed tendered for optional or mandatory purchase as described under "Purchases of Bonds on Demand of Owner" and "Mandatory Purchases of Bonds." Registration of transfers and exchanges will be made

without charge to the owners of Bonds, except that the Bond Registrar may require any owner requesting registration of transfer or exchange to pay any required tax or governmental charge.

### **Security; Limitation on Liens**

Payment of the principal of and interest and any premium on the Bonds are secured by an assignment by the Issuer to the Trustee of the Issuer's interest in and to the Loan Agreement and all payments to be made pursuant thereto (other than certain indemnification and expense payments and notification rights). Pursuant to the Loan Agreement, the Company has agreed to pay, among other things, amounts sufficient to pay the aggregate principal amount of and premium, if any, on the Bonds, together with interest thereon as and when the same become due. The Company further will agree to make payments of the purchase price of the Bonds tendered for purchase to the extent that funds are not otherwise available therefor under the provisions of the Indenture.

The Bonds are unsecured general obligations of the Company, ranking on a parity with the Company's obligations under the Loan Agreement to make payments on the Bonds..

In the Loan Agreement, the Company has covenanted that it will not issue, assume or guarantee any debt for borrowed money secured by any mortgage, security interest, pledge, or lien ("mortgage") on any of the Company's operating property (as defined below), whether the Company owns it at the date hereof or acquires it later, and will not permit to exist any debt for borrowed money secured by a mortgage on any such property unless the Company similarly secures its obligations under the Loan Agreement to make payments to the Trustee in sufficient amounts to pay the principal of, premium, if any, and interest required to be paid on the Bonds. This restriction will not apply to:

- mortgages on any property existing at the time the Company acquires the property or at the time the Company acquires the corporation owning the property;
- purchase money mortgages;
- specified governmental mortgages; or
- any extension, renewal or replacement (or successive extensions, renewals or replacements) of any mortgage referred to in the three clauses listed above, so long as the principal amount of indebtedness secured under this clause and not otherwise authorized by the clauses listed above does not exceed the principal amount of indebtedness secured at the time of the extension, renewal or replacement.

In addition, the Company can also issue secured debt so long as the amount of the secured debt does not exceed the greater of 10% of net tangible assets or 10% of capitalization.

The Company will not, so long as any of the Bonds are outstanding, issue, assume, guarantee or permit to exist any debt of the Company secured by a mortgage, the creditor of which controls, is controlled by or is under common control with, the Company.

For purposes of this limitation on liens, “operating property” means (i) any interest in real property owned by the Company and (ii) any asset owned by the Company that is depreciable in accordance with generally accepted accounting principles.

### **The Letter of Credit**

*The following summarizes certain provisions of the Letter of Credit and the Reimbursement Agreement, to which reference is made for the detailed provisions thereof. Unless otherwise defined in this Reoffering Circular, capitalized terms in the following summary are used as defined in the Letter of Credit and the Reimbursement Agreement. The Company is permitted under the Indenture to deliver an Alternate Credit Facility to replace the related Letter of Credit. Any such Alternate Credit Facility must meet certain requirements described in the Indenture.*

### **The Letter of Credit**

The Letter of Credit will be an irrevocable transferable direct pay letter of credit issued by the Bank in order to provide additional security for the payment of principal of, purchase price of, interest on and premium, if applicable, on any date when payments under the Bonds are due, including principal and interest payments and payments upon tender, redemption, acceleration or maturity of the Bonds. The Letter of Credit will provide for direct payments to or upon the order of the Trustee as set forth in the Letter of Credit in amounts sufficient to pay to or upon the order of the Trustee, upon request and in accordance with the terms thereof.

The Letter of Credit will be issued in an amount equal to the aggregate principal amount of the outstanding Bonds, plus an amount that represents interest accrued thereon at an assumed rate of 15% per annum for 45 days (the “Credit Amount”). The Trustee, upon compliance with the terms of the Letter of Credit, is authorized to draw up to (a) an amount sufficient (i) to pay principal of the Bonds, when due, whether at maturity or upon redemption or acceleration, and (ii) to pay the portion of the purchase price of the Bonds delivered for purchase pursuant to a demand for purchase by the owner thereof or a mandatory tender for purchase and not remarketed (a “Liquidity Drawing”) equal to the principal amount of the Bonds, plus (b) an amount not to exceed 45 days of accrued interest on such Bonds at an assumed rate of 15% per annum (i) to pay interest on the Bonds, when due, and (ii) to pay the portion of the purchase price of the Bonds, delivered for purchase pursuant to a demand for purchase by the owner thereof or a mandatory tender for purchase and not remarketed, equal to the interest accrued, if any, on the Bonds.

The amount available under the Letter of Credit will be automatically reduced by the amount of any drawing thereunder, subject to reinstatement as described below. With respect to a drawing by the Trustee solely to pay interest on the Bonds on an Interest Payment Date, the amount available under the Letter of Credit will be automatically reinstated in the amount of such drawing effective on the earlier of (i) receipt by the Bank from the Company of reimbursement of any drawing solely to pay interest in full or (ii) at the opening of business on the eleventh calendar day after the date the Bank honors such drawing, unless the Trustee has received written notice from the Bank by the tenth calendar day after the date the Bank honors such drawing the Bank is not so reinstating the available amount due to the Company’s failure to



reimburse the Bank for such drawing in full, or that an event of default has occurred and is continuing under the Reimbursement Agreement and, in either case, directing, an acceleration of the Bonds pursuant to the Indenture. With respect to a Liquidity Drawing under the Letter of Credit, the amount available under the Letter of Credit will be automatically reduced by the principal amount of the Bonds purchased with the proceeds of such drawing plus the amount of accrued interest on such Bonds. In the event of the remarketing of the Bonds purchased with the proceeds of a Liquidity Drawing, the amount available under the Letter of Credit will be automatically reinstated upon receipt by the Bank or the Trustee on the Bank's behalf of an amount equal to such principal amount plus accrued interest.

The Letter of Credit will terminate on the earliest to occur of:

(a) the Bank's close of business on December 18, 2009 (such date, as extended from time to time in accordance with the Letter of Credit is defined as the "Stated Expiration Date");

(b) the Bank's close of business on the date which is five Business Days following the date of receipt by the Bank of a certificate from the Trustee certifying that (a) no Bonds remain Outstanding within the meaning of the Indenture, (b) all drawings required to be made under the Indenture and available under the Letter of Credit have been made and honored, (c) an Alternate Credit Facility has been delivered to the Trustee in accordance with the Indenture to replace the Letter of Credit or (d) all of the outstanding Bonds were converted to Bonds bearing interest at a rate other than the Daily Rate or the Weekly Rate;

(c) the Bank's close of business on the date of receipt by the Bank of a certificate from the Trustee confirming that the Trustee is required to terminate the Letter of Credit in accordance with the terms of the Indenture; or

(d) the date on which the Bank receives and honors an acceleration drawing certificate.

### **The Reimbursement Agreement**

Pursuant to the Reimbursement Agreement, the Company is obligated to reimburse the Bank for all amounts drawn under the Letter of Credit, and to pay interest on all such amounts. The Company has also agreed to pay the Bank a periodic fee for issuing and maintaining the Letter of Credit.

The Reimbursement Agreement imposes various covenants and agreements, including various financial and operating covenants, on the Company. Such covenants include, but are not limited to, covenants relating to (i) inspection of the books and financial records of the Company; (ii) creation of liens; (iii) liquidations, mergers, consolidations or sales of all or substantially all of the Company's assets; and (iv) disposition of assets. Any such covenants may be amended, waived or modified at any time by the Bank and without the consent of the Trustee or the holders of the Bonds. Under certain circumstances, the failure of the Company to comply with such covenants may result in a mandatory tender or acceleration of the Bonds.

The following events will constitute an “event of default” under the Reimbursement Agreement:

(a) nonpayment of certain fees and other amounts required to be paid or reimbursed by the Company under the Reimbursement Agreement to the Bank within five days after the same was required to be paid;

(b) any representation or warranty made or deemed made by or on behalf of the Company or any of its Significant Subsidiaries to the Bank under or in connection with the Reimbursement Agreement or any other Transaction Document, any advance or any certificate or information delivered pursuant to or in connection with the Reimbursement Agreement or any other Transaction Document, was false or misleading in any material respect as of the time it was made or furnished;

(c) an “event of default” (not due to the Bank’s failure to properly honor a drawing on the Letter of Credit) occurred under the Indenture or any of the other Transaction Documents and any applicable grace period has expired;

(d) the breach by the Company or any of its Significant Subsidiaries of any of the terms or provisions of certain covenants contained in the Reimbursement Agreement including, but not limited to, covenants relating to the provision of notice to the Bank regarding an “event of default” or “default” under the Reimbursement Agreement, the corporate existence and license or qualification and good standing of the Company in jurisdictions in which it owns or leases property, the creation of liens, the liquidation, merger, consolidation or sale of all or substantially all of the assets of the Company and the disposition of assets;

(e) the breach by the Company or any of its Significant Subsidiaries (other than a breach which constitutes a “default” described above) of any of the terms or provisions of the Reimbursement Agreement or any Security Document that is not remedied within thirty (30) days after an executive officer of the Company has actual knowledge of such default or written notice of such default has been given to the Company by the Bank;

(f) the Bonds cease to be valid for any reason;

(g) a default or event of default has occurred at any time under the terms of any other agreement involving borrowed money or the extension of credit or any other Indebtedness under which the Company or any of its Significant Subsidiaries may be obligated for the payment of \$50,000,000 or more in the aggregate, and such breach, default or event of default continues beyond any period of grace permitted with respect thereto and as a result thereof such Indebtedness is accelerated, becomes due or is otherwise required to be repurchased or redeemed prior to the scheduled date of maturity thereof;

(h) a proceeding has been instituted in a court having jurisdiction in the premises seeking a decree or order for relief in respect of the Company or any Significant Subsidiary in an involuntary case under any applicable bankruptcy, insolvency,

reorganization or other similar law now or hereafter in effect, or for the appointment of a receiver, liquidator, assignee, custodian, trustee, sequestrator, conservator (or similar official) of the Company or any Significant Subsidiary for any substantial part of its property, or for the winding-up or liquidation of its affairs, and such proceeding shall remain undismissed or unstayed and in effect for a period of sixty (60) consecutive days; such court shall enter a decree or order granting any of the relief sought in such proceeding; or the Company or any Significant Subsidiary shall consent, approve or otherwise acquiesce in any of the actions sought in such proceeding;

(i) the Company or any Significant Subsidiary shall commence a voluntary case under any applicable bankruptcy, insolvency, reorganization or other similar law now or hereafter in effect, shall consent to the entry of an order for relief in an involuntary case under any such law, or shall consent to the appointment or taking possession by a receiver, liquidator, assignee, custodian, trustee, sequestrator, conservator (or other similar official) of itself or for any substantial part of its property or shall make a general assignment for the benefit of creditors, or shall fail generally to pay its debts as they become due, or shall take any action in furtherance of any of the foregoing;

(j) without the application, approval or consent of the Company or any of its Significant Subsidiaries, a receiver, trustee, examiner, liquidator or similar official shall be appointed for the Company or any of its Significant Subsidiaries, or for any substantial portion of its Property, or a proceeding described in paragraph (h) above has been instituted against the Company or any of its Significant Subsidiaries, and such appointment continues undischarged or such proceeding continues undismissed or unstayed for a period of 60 consecutive days;

(k) any of the following occurs: (i) any Reportable Event which constitutes grounds under Section 4042 of ERISA for the termination of any Plan by the PBGC or the appointment of a trustee to administer or liquidate any Plan, shall have occurred and be continuing; (ii) a notice of intent to terminate any Plan shall have been filed with the PBGC under Section 4041 of ERISA; (iii) the PBGC shall give notice under Section 4042 of ERISA of its intent to institute proceedings to terminate any Plan or Plans or to appoint a trustee to administer or liquidate any Plan; (iv) the Company or any member of the ERISA Group shall fail to make any contributions when due to a Plan or a Multiemployer Plan; (v) the Company or any member of the ERISA Group shall make any amendment to a Plan with respect to which security is required under Section 307 of ERISA; (vi) the Company or any member of the ERISA Group shall withdraw completely or partially from a Multiemployer Plan pursuant to Subtitle E of Title IV of ERISA; or (vii) the Company or any member of the ERISA Group shall withdraw within the meaning of Section 4063 of ERISA (or shall be deemed under Section 4062(e) of ERISA to withdraw) from a Multiple Employer Plan; and, with respect to any of such events specified in clause (i), (ii), (iii), (iv), (v), (vi) or (vii), such occurrence would be reasonably likely to result in a Material Adverse Effect;

(l) any final judgment(s) or order(s) for the payment of money shall be entered against the Company or any of its Significant Subsidiaries by a court having jurisdiction in the premises which judgment is not discharged, vacated, bonded or stayed

pending appeal within a period of thirty (30) days from the date of entry if the aggregate uninsured amount of all such judgments and orders exceeds \$50,000,000;

(m) the Company or any of its Significant Subsidiaries ceases to conduct business (other than as permitted hereunder) or the Company is enjoined, restrained or in any way prevented by court order from conducting all or any material part of its business and such injunction, restraint or other preventive order is not dismissed within thirty (30) days after the entry thereof; or

(n) E.ON AG fails to own, directly or indirectly, at least seventy-five percent (75%) of the outstanding Voting Capital of the Company.

For purposes of the foregoing:

“Bond Documents” means the Indenture, the Custody Agreement, the Loan Agreement, the Bonds and the Remarketing Agreement.

“Material Adverse Effect” means (i) a material adverse change in the business, property, condition (financial or otherwise), operations or results of operations of the Company and its subsidiaries taken as a whole, (ii) a material adverse change in the ability of the Company to perform its obligation under the Transaction Documents or (iii) a material adverse change in the validity or enforceability of any of the Transaction Documents or the rights or remedies of the Bank thereunder.

“Security Documents” means the Custody, Pledge and Security Agreement dated as of December 19, 2008 among the Trustee, the Company and the Bank with respect to any Bond purchased during the period from and including the date of its purchase with proceeds of a Liquidity Drawing to but excluding the date on which such Bond is purchased by any person as a result of a remarketing of such Bond pursuant to the Remarketing Agreement and the Indenture.

“Transaction Documents” means, collectively, the Reimbursement Agreement, Bond Documents, the Security Documents and all other operative documents relating to the issuance, sale and securing of the Bonds (including without limitation any document(s) or instrument(s) through which the Bonds are now or hereafter collateralized, such as mortgages, security agreements, etc.).

## Summary of the Loan Agreement

*The following, in addition to the provisions contained elsewhere in this Reoffering Circular, is a brief description of certain provisions of the Loan Agreement. This description is only a summary and does not purport to be complete and definitive. Reference is made to the Loan Agreement for the detailed provisions thereof.*

### General

The Loan Agreement initially commenced as of its initial date, and, with respect to the 2006 Series A Bonds, is amended and restated as of September 1, 2008, and will end on the earliest to occur of October 1, 2034, with respect to the 2006 Series B Bonds, or February 1, 2032, with respect to the 2008 Series A Bonds, or the date on which all of the Bonds have been fully paid or provision has been made for such payment pursuant to the Indenture. See “Summary of the Indenture — Discharge of Indenture.”

The Company has agreed to repay the loan pursuant to the Loan Agreement by making timely payments to the Trustee in sufficient amounts to pay the principal of, premium, if any, and interest required to be paid on the Bonds on each date upon which any such payments are due. The Company has also agreed to pay (a) the agreed upon fees and expenses of the Trustee, the Bond Registrar, the Tender Agent and the Paying Agent and all other amounts which may be payable to the Trustee, the Bond Registrar, the Paying Agent, the Auction Agent with respect to the 2006 Series B Bonds, and the Tender Agent, as may be applicable, under the Indenture, (b) the expenses in connection with any redemption of the Bonds and (c) the reasonable expenses of the Issuer.

The Company covenants and agrees with the Issuer that it will cause the purchase of tendered Bonds that are not remarketed in accordance with the Indenture and, to that end, the Company will cause funds to be made available to the Tender Agent at the times and in the manner required to effect such purchases in accordance with the Indenture; provided, however, that the obligation of the Company to make any such payment will be reduced by the amount of (A) moneys paid by the Remarketing Agent as proceeds of the remarketing of such Bonds; (B) moneys drawn under a Credit Facility, if any, for the purpose of paying such purchase price and (C) other moneys made available by the Company (see “Summary of the Bonds — Remarketing and Purchase of Bonds”).

All payments to be made by the Company to the Issuer pursuant to the Loan Agreement (except the fees and reasonable out-of-pocket expenses of the Issuer, the Trustee, the Paying Agent, the Bond Registrar, the Auction Agent with respect to the 2006 Series B Bonds and the Tender Agent, and amounts related to indemnification) have been assigned by the Issuer to the Trustee, and the Company will pay such amounts directly to the Trustee. The obligations of the Company to make the payments pursuant to the Loan Agreement are absolute and unconditional.

## **Maintenance of Tax Exemption**

The Company and the Issuer have agreed not to take any action that would result in the interest paid on the Bonds being included in gross income of any Bondholder (other than a holder who is a “substantial user” of the Project or a “related person” within the meaning of Section 147(a) of the Code) for federal income tax purposes or that adversely affects the validity of the Bonds.

## **Limitation on Liens**

The Company has agreed that, so long as any of the Bonds are outstanding, it will not create, assume or guarantee debt for borrowed money secured by any mortgage, except as described above under “Security; Limitation on Liens.”

## **Payment of Taxes**

The Company has agreed to pay certain taxes and other governmental charges that may be lawfully assessed, levied or charged against or with respect to the Project (see, however, subparagraph (i) under “Summary of the Bonds — Redemptions — Extraordinary Optional Redemption in Whole”). The Company may contest such taxes or other governmental charges unless the security provided by the Indenture would be materially endangered.

## **Maintenance; Damage, Destruction and Condemnation**

So long as any Bonds are outstanding, the Company will maintain the Project or cause the Project to be maintained in good working condition and will make or cause to be made all proper repairs, replacements and renewals necessary to continue to constitute the Project as solid waste disposal facilities under Section 142(a)(6) of the Code and the Act. However, the Company will have no obligation to maintain, repair, replace or renew any portion of the Project, the maintenance, repair, replacement or renewal of which becomes uneconomical to the Company because of certain events, including damage or destruction by a cause not within the Company’s control, condemnation of the Project, change in government standards and regulations, economic or other obsolescence or termination of operation of generating facilities to the Project.

The Company, at its own expense, may remodel the Project or make substitutions, modifications and improvements to the Project as it deems desirable, which remodeling, substitutions, modifications and improvements will be deemed, under the terms of the Loan Agreement to be a part of the Project. The Company may not, however, change or alter the basic nature of the Project or cause it to lose its status under Section 142(a)(6) of the Code and the Act.

If, prior to the payment of all Bonds outstanding, the Project or any portion thereof is destroyed, damaged or taken by the exercise of the power of eminent domain and the Issuer or the Company receives net proceeds from insurance or a condemnation award in connection therewith, the Company must (i) cause such net proceeds to be used to repair or restore the Project or (ii) reimburse the Credit Facility Issuer for drawings under the Credit Facility for the redemption of the Bonds in whole or in part at their principal amount, which, by the opinion of Bond Counsel, will not adversely affect the exclusion of the interest on the Bonds from gross

income for federal income tax purposes. See “Summary of the Bonds — Redemptions — Extraordinary Optional Redemption in Whole or in Part.”

### **Project Insurance**

The Company will insure the Project in a manner consistent with general industry practice.

### **Assignment, Merger and Release of Obligations of the Company**

The Company may assign the Loan Agreement, pursuant to an opinion of Bond Counsel that such assignment will not adversely affect the exclusion of the interest on the Bonds from gross income for federal income tax purposes, without obtaining the consent of either the Issuer or the Trustee. Such assignment, however, will not relieve the Company from primary liability for any of its obligations under the Loan Agreement and performance and observance of the other covenants and agreements to be performed by the Company. The Company may dispose of all or substantially all of its assets or consolidate with or merge into another corporation, provided the acquirer of the Company’s assets or the corporation with which it will consolidate with or merge into is a corporation or other business organization organized and existing under the laws of the United States of America or one of the states of the United States of America or the District of Columbia, is qualified and admitted to do business in the Commonwealth of Kentucky, assumes in writing all of the obligations and covenants of the Company under the Loan Agreement and delivers a copy of such assumption to the Issuer and Trustee.

### **Release and Indemnification Covenant**

The Company will indemnify and hold the Issuer harmless against any expense or liability incurred, including attorneys’ fees, resulting from any loss or damage to property or any injury to or death of any person occurring on or about or resulting from any defect in the Project or from any action commenced in connection with the financing thereof.

### **Events of Default**

Each of the following events constitutes an “Event of Default” under the Loan Agreement:

(1) failure by the Company to pay the amounts required for payment of the principal of, including purchase price for tendered Bonds and redemption and acceleration prices, and interest accrued, on the Bonds, at the times specified therein taking into account any periods of grace provided in the Indenture and the Bonds for the applicable payment of interest on the Bonds (see “Summary of the Indenture — Defaults and Remedies”);

(2) failure by the Company to observe and perform any covenant, condition or agreement, other than as referred to in paragraph (1) above, for a period of thirty days after written notice by the Issuer or Trustee, provided, however, that if such failure is capable of being corrected, but cannot be corrected in such 30-day period, it will not

constitute an Event of Default under the Loan Agreement if corrective action with respect thereto is instituted within such period and is being diligently pursued;

(3) certain events of bankruptcy, dissolution, liquidation, reorganization or insolvency of the Company; or

(4) the occurrence of an Event of Default under the Indenture.

Under the Loan Agreement, certain of the Company's obligations (other than the Company's obligations, among others, (i) not to permit any action which would result in interest paid on the Bonds being included in gross income for federal and Kentucky income taxes; (ii) to maintain its corporate existence and good standing, and to neither dispose of all or substantially all of its assets or consolidate with or merge into another corporation unless certain provisions of the Loan Agreement are satisfied; and (iii) to make loan payments and certain other payments under the provisions of the Loan Agreement) may be suspended if by reason of force majeure (as defined in the Loan Agreement) the Company is unable to carry out such obligations.

### **Remedies**

Upon the happening of an Event of Default under the Loan Agreement, the Trustee, on behalf of the Issuer, may, among other things, take whatever action at law or in equity may appear necessary or desirable to collect the amounts then due and thereafter to become due, or to enforce performance and observance of any obligation, agreement or covenant of the Company, under the Loan Agreement.

Any amounts collected upon the happening of any such Event of Default must be applied in accordance with the Indenture or, if the Bonds have been fully paid (or provision for payment thereof has been made in accordance with the Indenture) and all other liabilities of the Company accrued under the Indenture and the Loan Agreement have been paid or satisfied, made available to the Company.

### **Options to Prepay, Obligation to Prepay**

The Company may prepay the loan pursuant to the Loan Agreement, in whole or in part, on certain dates, at the prepayment prices as shown under the captions "Summary of the Bonds — Redemptions — Optional Redemption," "— Extraordinary Optional Redemption in Whole" and "— Extraordinary Optional Redemption in Whole or in Part." Upon the occurrence of the event described under the caption "Summary of the Bonds — Redemptions — Mandatory Redemption; Determination of Taxability," the Company will be obligated to prepay the loan in an aggregate amount sufficient to redeem the required principal amount of the Bonds.

In each instance, the loan prepayment price must be a sum sufficient, together with other funds deposited with the Trustee and available for such purpose, to redeem the requisite amount of the Bonds at a price equal to the applicable redemption price plus accrued interest to the redemption date, and to pay all reasonable and necessary fees and expenses of the Trustee, the Paying Agent and, with respect to the 2008 Series A Bonds, the Bond Registrar and the Tender Agent and all other liabilities of the Company under the Loan Agreement accrued to the redemption date.



## **Amendments and Modifications**

No amendment or modification of the Loan Agreement is permissible without the written consent of the Trustee. The Issuer and the Trustee may, however, without the consent of or notice to any Bondholders, enter into any amendment or modification of the Loan Agreement (i) which may be required by the provisions of the Loan Agreement or the Indenture, (ii) for the purpose of curing any ambiguity or formal defect or omission, (iii) in connection with any modification or change necessary to conform the Loan Agreement with changes and modifications in the Indenture or (iv) in connection with any other change which, in the judgment of the Trustee, does not adversely affect the Trustee or the Bondholders. Except for such amendments, the Loan Agreement may be amended or modified only with the consent of the Bondholders holding a majority in principal amount of the Bonds then outstanding (see “Summary of the Indenture — Supplemental Indentures” for an explanation of the procedures necessary for Bondholder consent); provided, however, that the approval of the Bondholders holding 100% in principal amount of the Bonds then outstanding is necessary to effectuate an amendment or modification with respect to the Loan Agreement of the type described in clauses (i) through (iv) of the first sentence of the second paragraph of “Summary of the Indenture — Supplemental Indentures.” Any amendments, changes or modification of the Loan Agreement that require the consent of the Bondholders must additionally be approved by the Credit Facility Issuer, if the Bonds are at the time secured by a Credit Facility. Additionally, so long as a Credit Facility is in place or while any amounts are outstanding under a Reimbursement Agreement, the Credit Facility Issuer must consent in writing to any amendment, change, or modification to the Agreement.

## **Summary of the Indenture**

*The following, in addition to the provisions contained elsewhere in this Reoffering Circular, is a brief description of certain provisions of the Indenture. This description is only a summary and does not purport to be complete and definitive. Reference is made to the Indenture for the detailed provisions thereof.*

### **Security**

Pursuant to the Indenture, the Issuer has assigned and pledged to the Trustee its interest in and to the Loan Agreement, including payments and other amounts due the Issuer thereunder, together with all moneys, property and securities from time to time held by the Trustee under the Indenture (with certain exceptions, including moneys held in or earnings on the Rebate Fund and the Purchase Fund). The Bonds are not directly secured by the Project.

### **No Pecuniary Liability of the Issuer**

No provision, covenant or agreement contained in the Indenture or in the Loan Agreement, nor any breach thereof, will constitute or give rise to any pecuniary liability of the Issuer or any charge upon any of its assets or its general credit or taxing powers. The Issuer has not obligated itself by making the covenants, agreements or provisions contained in the Indenture or in the Loan Agreement, except with respect to the Project and the application of the amounts assigned to payment of the principal of, premium, if any, and interest on the Bonds.

## **The Bond Fund**

The payments to be made by the Company pursuant to the Loan Agreement to the Issuer and certain other amounts specified in the Indenture will be deposited into a Bond Fund established pursuant to the Indenture (the “Bond Fund”) and will be maintained in trust by the Trustee. Moneys in the Bond Fund will be used for the payment of the principal of, premium, if any, and interest on the Bonds, and for the redemption of Bonds prior to maturity in the following order of priority: (i) proceeds of the Credit Facility, if any, deposited into the Bond Fund in accordance with the Indenture and (ii) any other moneys provided by or on behalf of the Company. Any moneys held in the Bond Fund will be invested by the Trustee at the specific written direction of the Company in certain Governmental Obligations, investment-grade corporate obligations and other investments permitted under the Indenture.

So long as a Credit Facility is in held by the Trustee and there is no default in the payment of principal or redemption price of or interest on the Bonds, any amounts in the Bond Fund provided by or on behalf of the Company will be paid to the Credit Facility Issuer to the extent of any amounts that the Company owes the Credit Facility Issuer pursuant to the Reimbursement Agreement. Any amounts remaining in the Bond Fund (first, from the proceeds of the Credit Facility, and second, from the moneys provided by or on behalf of the Company) after payment in full of the principal or redemption price of and interest on the Bonds (or provision for payment thereof) and payment of any outstanding fees and expenses of the Trustee (including its reasonable attorney fees and expenses) will be paid, first, to the Credit Facility Issuer, to the extent of any amounts that the Company owes the Credit Facility Issuer pursuant to the Reimbursement Agreement and, second, to the Company. Any amounts remaining in the Bond Fund (i) after all of the outstanding Bonds have been paid and discharged, (ii) after payment of all fees, charges and expenses to the Issuer, the Trustee, the Registrar and the Paying Agent and of all other amounts required to be paid under the Indenture and the Loan Agreement and (iii) after the receipt by the Trustee of the written request of the Company for such payment, will be paid to the Credit Facility Issuer, if any, to the extent of any amounts that the Company owes to such Credit Facility Issuer pursuant to the Reimbursement Agreement, and then to the Company to the extent that those moneys are in excess of the amounts necessary to effect the payment and discharge of the outstanding Bonds.

## **The Rebate Fund**

A Rebate Fund has been created by the Indenture (the “Rebate Fund”) and will be maintained as a separate fund free and clear of the lien of the Indenture. The Issuer, the Trustee and the Company have agreed to comply with all rebate requirements of the Code and, in particular, the Company has agreed that if necessary, it will deposit in the Rebate Fund any such amount as is required under the Code. However, the Issuer, the Trustee and the Company may disregard the Rebate Fund provisions to the extent that they receive an opinion of Bond Counsel that such failure to comply will not adversely affect the exclusion of the interest on the Bonds from gross income for federal income tax purposes.

## **Discharge of Indenture**

When all the Bonds and all fees and charges accrued and to accrue of the Trustee and the Paying Agent have been paid or provided for, and when proper notice has been given to the Bondholders or the Trustee that the proper amounts have been so paid or provided for, and if the Issuer is not in default in any other respect under the Indenture, the Indenture will become null and void. The Bonds will be deemed to have been paid and discharged when there have been irrevocably deposited with the Trustee moneys sufficient to pay the principal, premium, if any, and accrued interest on such Bonds to the due date (whether such date be by reason of maturity or upon redemption) or, in lieu thereof, Governmental Obligations have been deposited which mature in such amounts and at such times as will provide the funds necessary to so pay such Bonds, and when all reasonable and necessary fees and expenses of the Trustee, the Tender Agent, the Authenticating Agent, the Bond Registrar and the Paying Agent have been paid or provided for.

Notwithstanding anything to the contrary, if any Bonds are rated by a rating service, no such Bonds will be deemed to have been paid and discharged by reason of any deposit pursuant to the Indenture, unless each such rating service has confirmed in writing to the Trustee that its rating will not be withdrawn or lowered as a result of any such deposit.

So long as the Company owes any amounts to the Credit Facility Issuer, if any, pursuant to the Reimbursement Agreement: (A) the lien of the Indenture may not be discharged; (B) such Credit Facility Issuer shall be subrogated to the extent of such amounts owed by the Company to such Credit Facility Issuer to all rights of the Bondholders to enforce the payment of the Bonds from the revenues and all other rights of the Bondholders under the Bonds, the Indenture and the Loan Agreement; (C) the Bondholders will be deemed paid to the extent of money drawn by the Trustee under the Credit Facility; and (D) subject to the Indenture, the Trustee will sign, execute and deliver all documents or instruments and do all things that may be reasonably required by the Credit Facility Issuer to effect the Credit Facility Issuer's subrogation of rights of enforcement and remedies set forth in the Indenture.

## **Defaults and Remedies**

Each of the following events constitutes an "Event of Default" under the Indenture:

(a) Failure to make payment of any installment of interest on any Bond, (i) if such Bond bears interest at other than the Long Term Rate, within a period of one Business Day from the due date and (ii) if such Bond bears interest at the Long Term Rate, within a period of five Business Days from the date due;

(b) Failure to make punctual payment of the principal of, or premium, if any, on any Bond on the due date, whether at the stated maturity thereof, or upon proceedings for redemption, or upon the maturity thereof by declaration or if payment of the purchase price of any Bond required to be purchased pursuant to the Indenture is not made when such payment has become due and payable;

(c) Failure of the Issuer to perform or observe any other of the covenants, agreements or conditions in the Indenture or in the Bonds which failure continues for a

period of 30 days after written notice by the Trustee, provided, however, that if such failure is capable of being cured, but cannot be cured in such 30-day period, it will not constitute an Event of Default under the Indenture if corrective action in respect of such failure is instituted within such 30-day period and is being diligently pursued;

(d) The occurrence of an “Event of Default” under the Loan Agreement (see “Summary of the Loan Agreement — Events of Default”);

(e) written notice from the Credit Facility Issuer to the Trustee of an event of default under the Reimbursement Agreement, by reason of which the Trustee has been directed to accelerate the Bonds; or

(f) if a Credit Facility is then held by the Trustee, on or before the close of business on the tenth calendar day following the honoring of a drawing under such Credit Facility to pay interest on the Bonds on an Interest Payment Date, written notice from the Credit Facility Issuer to the Trustee that the interest component of the Credit Facility will not be reinstated.

Upon the occurrence of an Event of Default under clauses (a), (b), (e) or (f) above, the Trustee must: (i) declare the principal of all Bonds and interest accrued thereon to be immediately due and payable; (ii) declare all payments under the Loan Agreement to be immediately due and payable and enforce each and every other right granted to the Issuer under the Loan Agreement for the benefit of the Bondholders; and (iii) if a Credit Facility securing the Bonds is in effect, make an immediate drawing under the Credit Facility in accordance with its terms and deposit the proceeds of such drawing in the Bond Fund pending application to the payment of principal of the Bonds, subject to the provisions of the Indenture reserving to the Credit Facility Issuer the right to direct default proceedings and providing for termination of default proceedings upon certain occurrences.

Interest on the Bonds will cease to accrue on the date of issuance of the declaration of acceleration of payment of principal and interest on the Bonds.

In exercising such rights, the Trustee will take any action that, in the judgment of the Trustee, would best serve the interests of the registered owners. Upon the occurrence of an Event of Default under the Indenture, the Trustee may also proceed to pursue any available remedy by suit at law or in equity to enforce the payment of the principal of, premium, if any, and interest on the Bonds then outstanding.

If the Trustee recovers any moneys following an Event of Default, unless the principal of the Bonds has been declared due and payable, all such moneys will be applied in the following order: (i) to the payment of the fees, expenses, liabilities and advances incurred or made by the Trustee and the Paying Agent and the payment of any sums due and payable to the United States pursuant to Section 148(f) of the Code, (ii) to the payment of all interest then due on the Bonds and (iii) to the payment of unpaid principal and premium, if any, of the Bonds. If the principal of the Bonds has become due or has been accelerated, such moneys will be applied in the following order: (i) to the payment of the fees, expenses, liabilities and advances incurred or made by the Trustee and the Paying Agent and (ii) to the payment of principal of and interest then due and

unpaid on the Bonds. In each case, however, Trustee and Paying Agent fees or costs will not be payable from moneys derived from Credit Facility drawings, any remarketing proceeds or moneys constituting certain Available Moneys under the Indenture.

No Bondholder may institute any suit or proceeding in equity or at law for the enforcement of the Indenture unless an Event of Default has occurred of which the Trustee has been notified or is deemed to have notice, and registered owners holding not less than 25% in aggregate principal amount of Bonds then outstanding have made written request to the Trustee to proceed to exercise the powers granted under the Indenture or to institute such action in their own name and the Trustee fails or refuses to exercise its powers within a reasonable time after receipt of indemnity satisfactory to it.

Any judgment against the Issuer pursuant to the exercise of rights under the Indenture will be enforceable only against specific assigned payments, funds and accounts under the Indenture in the hands of the Trustee. No deficiency judgment will be authorized against the general credit of the Issuer.

No default under paragraph (c) above will constitute an Event of Default until actual notice is given to the Issuer and the Company by the Trustee or to the Issuer, the Company and the Trustee by the registered owners holding not less than 25% in aggregate principal amount of all Bonds outstanding and the Issuer and the Company have had thirty days after such notice to correct the default and failed to do so. If the default is such that it cannot be corrected within the applicable period but is capable of being cured, it will not constitute an Event of Default if corrective action is instituted by the Issuer or the Company within the applicable period and diligently pursued until the default is corrected.

Notwithstanding the foregoing, in addition to the rights of the Trustee and the Bondholders to direct proceedings as described above, if a Credit Facility is in effect, for so long as such Credit Facility is outstanding and the Credit Facility Issuer is not in default in its duties under the Indenture or the Credit Facility, the Credit Facility Issuer issuing will have the absolute right to direct all proceedings on behalf of the Bondholders of the Bonds. Additionally, if the Event of Default which has occurred is an Event of Default under paragraphs (e) or (f) above, the Credit Facility Issuer, if any, will have no right to direct the Trustee or the Bondholders with respect to any matters, including remedies, and the holders of a majority in aggregate principal amount of the Bonds then outstanding, will have the right, at any time, by an instrument or instruments in writing executed and delivered to the Trustee, to direct the time, method and place of conducting all proceedings to be taken in connection with the enforcement of the terms and conditions of the Indenture, or for the appointment of a receiver or any other proceedings hereunder; provided, that such direction shall not be otherwise than in accordance with the provisions of law and of the Indenture.

If an Event of Default has occurred under the Indenture due to failure by the Credit Facility Issuer, if any, to honor a properly presented and conforming drawing by the Trustee under the Credit Facility then in effect in accordance with the terms thereof, all obligations of the Trustee to the Credit Facility Issuer and all rights of such Credit Facility Issuer under the Indenture will be suspended until the earlier of the cure of such failure or all of the Bonds have been paid in full.

## **Waiver of Events of Default**

Except as provided below, the Trustee may in its discretion waive any Event of Default under the Indenture and will do so upon the written request of the registered owners holding a majority in principal amount of all Bonds then outstanding. If, after the principal of all Bonds then outstanding have been declared to be due and payable as a result of a default under the Indenture and prior to any judgment or decree for the appointment of a receiver or for the payment of the moneys due has been obtained or entered, (i) the Company causes to be deposited with the Trustee a sum sufficient to pay all matured installments of interest upon all Bonds and the principal of and premium, if any, on any and all Bonds which would become due otherwise than by reason of such declaration (with interest thereon as provided in the Indenture) and the expenses of the Trustee in connection with such default and (ii) all Events of Default under the Indenture (other than nonpayment of the principal of Bonds due by such declaration) have been remedied, then such Event of Default will be deemed waived and such declaration and its consequences rescinded and annulled by the Trustee. Such waiver, rescission and annulment will be binding upon all Bondholders. No such waiver, rescission and annulment will extend to or affect any subsequent Event of Default or impair any right or remedy consequent thereon.

The Trustee may not waive any default under clauses (e) or (f) unless the Trustee has received in writing from the Credit Facility Issuer a written notice of full reinstatement of the full amount of the Credit Facility and a written rescission of the notice of the Event of Default.

Notwithstanding the foregoing, nothing in the Indenture will affect the right of a registered owner to enforce the payment of principal of, premium, if any, and interest on the Bonds after the maturity thereof.

## **Supplemental Indentures**

The Issuer and the Trustee may enter into indentures supplemental to the Indenture without the consent of or notice to the Bondholders in order (i) to cure any ambiguity or formal defect or omission in the Indenture, (ii) to grant to or confer upon the Trustee, as may lawfully be granted, additional rights, remedies, powers or authorities for the benefit of the Bondholders, (iii) to subject to the Indenture additional revenues, properties or collateral, (iv) to permit qualification of the Indenture under any federal statute or state blue sky law, (v) to add additional covenants and agreements of the Issuer for the protection of the Bondholders or to surrender or limit any rights, powers or authorities reserved to or conferred upon the Issuer, (vi) to make any other modification or change to the Indenture which, in the sole judgment of the Trustee, does not adversely affect the Trustee or any Bondholder, (vii) to make other amendments not otherwise permitted by (i), (ii), (iii), (iv) or (vi) of this paragraph to provisions relating to federal income tax matters under the Code or other relevant provisions if, in the opinion of Bond Counsel, those amendments would not adversely affect the exclusion of the interest on the Bonds from gross income for federal income tax purposes, (viii) to make any modifications or changes to the Indenture necessary to provide the securing of a Credit Facility or Alternate Credit Facility or any liquidity or credit support of any kind for the security of the Bonds (including without limitation any line of credit, letter of credit, guaranty agreement or insurance coverage), including any modifications of the Indenture or the Agreement necessary to upgrade or maintain

the then applicable ratings on the Bonds or (ix) to permit the issuance of the Bonds in other than book-entry-only form or to provide changes to or for the book-entry system.

Subject to the consent of the Credit Facility Issuer, if any, exclusive of supplemental indentures for the purposes set forth in the preceding paragraph, the consent of registered owners holding a majority in aggregate principal amount of all Bonds then outstanding is required to approve any supplemental indenture, except no such supplemental indenture may permit, without the consent of all of the registered owners of the Bonds then outstanding, (i) an extension of the maturity of the principal of or the interest on any Bond issued under the Indenture or a reduction in the principal amount of any Bond or the rate of interest or time of redemption or redemption premium thereon, (ii) a privilege or priority of any Bond or Bonds over any other Bond or Bonds, (iii) a reduction in the aggregate principal amount of the Bonds required for consent to such supplemental indenture or (iv) the deprivation of any registered owners of the lien of the Indenture.

If at any time the Issuer requests the Trustee to enter into any supplemental indenture requiring the consent of the registered owners of the Bonds, the Trustee, upon being satisfactorily indemnified with respect to expenses, must notify all such registered owners. Such notice must set forth the nature of the proposed supplemental indenture and must state that copies thereof are on file at the principal office of the Trustee for inspection. If, within sixty days (or such longer period as prescribed by the Issuer or the Company) following the mailing of such notice, the registered owners holding the requisite amount of the Bonds outstanding have consented to the execution thereof, no Bondholder will have any right to object or question the execution thereof.

No supplemental indenture will become effective unless the Company consents to the execution and delivery of such supplemental indenture. The Company will be deemed to have consented to the execution and delivery of any supplemental indenture if the Trustee does not receive a notice of protest or objection signed by the Company on or before 4:30 p.m., local time in the city in which the principal office of the Trustee is located, on the fifteenth day after the mailing to the Company of a notice of the proposed changes and a copy of the proposed supplemental indenture.

Notwithstanding the foregoing, any Supplemental Indenture that requires the consent of the Bondholders that (i) is to become effective while a Credit Facility is in place or while any amounts are outstanding under any Reimbursement Agreement and (ii) adversely affects the Credit Facility Issuer will not become effective unless and until the Credit Facility Issuer consents in writing to the execution and delivery of such Supplemental Indenture.

#### **Cancellation of Credit Facility; Delivery of Alternate Credit Facility**

The Trustee will, at the written direction of the Company but subject to the conditions described in this paragraph and the receipt of an Opinion of Bond Counsel stating that the cancellation of such Credit Facility is authorized under the Indenture and under the Act and will not adversely affect the exclusion from gross income of interest on the Bonds for federal income tax purposes, cancel any Credit Facility in accordance with the terms thereof which cancellation may be without substitution therefor or replacement thereof; provided, that any such cancellation

will not become effective, surrender of such Credit Facility will not take place and that Credit Facility will not terminate, in any event, until (i) payment by the Credit Facility Issuer has been made for any and all drawings by the Trustee effected on or before such cancellation date (including, if applicable, any drawings for payment of the purchase price of Bonds to be purchased pursuant to the Indenture in connection with such cancellation) and (ii) if the Bonds are in an Long Term Rate Period, only if the then current Long Term Rate Period for the Bonds is ending on, or the Bonds are subject to optional redemption on, the Interest Payment Date immediately preceding the date of such cancellation. Upon written notice given by the Company to the Trustee at least 20 days (35 days if the Bonds are bearing interest at the Long Term Rate) prior to the date of cancellation of any Credit Facility of such cancellation and the effective date of such cancellation, the Trustee will surrender such Credit Facility to the Credit Facility Issuer by which it was issued on or promptly after the effective date of such cancellation in accordance with its terms; provided, that such notice will not be given in any event, if the purchase price of any Bonds to be purchased pursuant to the Indenture in connection with such cancellation includes any premium unless the Company has certified in such notice that the Trustee can draw under a Credit Facility (other than any Alternate Credit Facility being delivered in connection with such cancellation) on the purchase date related to such purchase of Bonds in an aggregate amount sufficient to pay the premium due upon such purchase of Bonds on such purchase date.

The Company may, at its option, provide for the delivery to the Trustee of an Alternate Credit Facility in replacement of any Credit Facility then in effect. At least 20 days (35 days if the Interest Rate on the Bonds is a Long Term Rate) prior to the date of delivery of an Alternate Credit Facility to the Trustee, the Company must give notice, which notice will also be given to the Remarketing Agent, of such replacement to the Trustee, together with an Opinion of Bond Counsel to the effect that the delivery of such Alternate Credit Facility to the Trustee is authorized under the Indenture and the Act and complies with the terms thereof and that the delivery of such Alternate Credit Facility will not adversely affect the exclusion from gross income of interest on the Bonds for federal income tax purposes. The Trustee will then accept such Alternate Credit Facility and surrender the previously held Credit Facility, if any, to the previous Credit Facility Issuer for cancellation promptly on or after the 5th day after the Alternate Credit Facility becomes effective; provided, however, that such Alternate Credit Facility must become effective on an Interest Payment Date and, if the Bonds are in a Long Term Rate Period, such Alternate Credit Facility may only become effective on either the last Interest Payment Date for such Long Term Rate Period or an Interest Payment Date on which the Bonds are subject to optional redemption. The notice given to the Trustee shall also be given to the Issuer, the then current Credit Facility Issuer, Moody's, if the Bonds are then rated by Moody's, and S&P, if the Bonds are then rated by S&P; provided that the notice will not be given if the purchase price of any Bonds to be purchased pursuant to the Indenture in connection with such cancellation includes any premium unless the Company has certified in such notice that the Trustee can draw under a Credit Facility then in effect on the purchase date related to such purchase of Bonds in an aggregate amount sufficient to pay the premium due upon such purchase of Bonds on such purchase date and until payment under the Credit Facility to be surrendered shall have been made for any and all drawings by the Trustee effected on or before the date of such surrender for cancellation (including, if applicable, any drawings for payment of the purchase price of Bonds to be purchased pursuant to the Indenture in connection with such cancellation).



Any Alternate Credit Facility delivered to the Trustee must be accompanied by an opinion of counsel to the issuer or provider of such Credit Facility stating that such Credit Facility is a legal, valid, binding and enforceable obligation of such issuer or obligor in accordance with its terms.

The Bonds will be subject to mandatory tender for purchase on the date of cancellation of a Credit Facility and on the date of the delivery of an Alternate Credit Facility. See “Summary of the Bonds — Mandatory Purchases of Bonds.”

### **Enforceability of Remedies**

The remedies available to the Trustee, the Issuer and the owners upon an event of default under the Loan Agreement or the Indenture are in many respects dependent upon judicial actions which are often subject to discretion and delay. Under existing constitutional and statutory law and judicial decisions, the remedies specified by the Loan Agreement or the Indenture may not be readily available or may be limited. The various legal opinions to be delivered concurrently with the delivery of the Bonds will be qualified as to the enforceability of the various legal instruments by limitations imposed by principles of equity, bankruptcy, reorganization, insolvency, moratorium or other similar laws affecting the rights of creditors generally.

### **Reoffering**

Subject to the terms and conditions of the Remarketing and Bond Purchase Agreement (the “Remarketing Agreement”), between the Company and Banc of America Securities LLC, as Remarketing Agent, the Remarketing Agent has agreed to purchase and reoffer the Bonds delivered to the Paying Agent for purchase, at a price equal to 100% of the principal amount of the Bonds, plus accrued interest (if any), and in connection therewith will receive compensation in the amount of \$135,000, plus reimbursement of certain expenses. Under the terms of the Remarketing Agreement, the Company has agreed to indemnify the Remarketing Agent against certain civil liabilities, including liabilities under federal securities laws.

In the ordinary course of its business, the Remarketing Agent and certain of its affiliates, have engaged, and may in the future engage, in investment banking or commercial banking transactions with the Company.

### **Tax Treatment**

On each of February 23, 2007, the date of original issuance and delivery of the 2006 Series B Bonds, and October 17, 2008, the date of original issuance and delivery of the 2008 Series A Bonds, Bond Counsel delivered its opinions stating that under existing law, including current statutes, regulations, administrative rulings and official interpretations, subject to the qualifications and exceptions set forth below, interest on the Bonds would be excluded from the gross income of the recipients thereof for federal income tax purposes, except that no opinion would be expressed regarding such exclusion from gross income with respect to any Bond during any period in which it is held by a “substantial user” of the applicable Project or a “related person” as such terms are used in Section 147(a) of the Code. Interest on the Bonds will be an item of tax preference in determining alternative minimum taxable income for individuals and corporations under the Code. Bond Counsel further opined that, subject to the assumptions

stated in the preceding sentence, (i) interest on the Bonds would be excluded from gross income of the owners thereof for Kentucky income tax purposes and (ii) the Bonds would be exempt from all ad valorem taxes in Kentucky. Such opinions have not been updated as of the date hereof and no continuing tax exemption opinions are expressed by Bond Counsel.

Bond Counsel also will deliver opinions in connection with this reoffering to the effect that the conversion of the interest rate on the Bonds to the Weekly Rate and the delivery of the Letter of Credit (i) is authorized or permitted by Sections 103.200 to 103.285, inclusive, of the Kentucky Revised Statutes (the "Act") and the Indenture and (ii) will not adversely affect the validity of the Bonds or any exclusion from gross income of interest on the Bonds for federal income tax purposes to which interest on the Bonds would otherwise be entitled.

The opinions of Bond Counsel as to the excludability of interest from gross income for federal income tax purposes were based upon and assumed the accuracy of certain representations of facts and circumstances, including with respect to the Projects, which were within the knowledge of the Company and compliance by the Company with certain covenants and undertakings set forth in the proceedings authorizing the Bonds which are intended to assure that the Bonds are and will remain obligations the interest on which is not includable in gross income of the recipients thereof under the law in effect on the date of such opinion. Bond Counsel did not independently verify the accuracy of the certifications and representations made by the Company and the Issuer. On the date of the applicable opinions and subsequent to the original delivery of the 2006 Series B Bonds on February 23, 2007 and the 2008 Series A Bonds on October 17, 2008, as applicable, such representations of facts and circumstances must be accurate and such covenants and undertakings must continue to be complied with in order that interest on the Bonds be and remain excludable from gross income of the recipients thereof for federal income tax purposes under existing law. Bond Counsel expressed no opinion (i) regarding the exclusion of interest on any Bond from gross income for federal income tax purposes on or after the date on which any change, including any interest rate conversion, permitted by the documents other than with the approval of Bond Counsel is taken which adversely affects the tax treatment of the Bonds or (ii) as to the treatment for purposes of federal income taxation of interest on the Bonds upon a Determination of Taxability.

Bond Counsel further opined that the Code prescribed a number of qualifications and conditions for the interest on state and local government obligations to be and to remain excluded from gross income for federal income tax purposes, some of which, including provisions for potential payments by the Issuers to the federal government, require future or continued compliance after issuance of the Bonds in order for the interest to be and to continue to be so excluded from the date of issuance. Noncompliance with certain of these requirements by the Company or the Issuer with respect to the Bonds could cause the interest on the Bonds to be included in gross income for federal income tax purposes and to be subject to federal income taxation retroactively to the date of their issuance. The Company and the Issuer each covenanted to take all actions required of each to assure that the interest on the Bonds shall be and remain excluded from gross income for federal income tax purposes, and not to take any actions that would adversely affect that exclusion.

The opinions of Bond Counsel as to the exclusion of interest on the Bonds from gross income for federal income tax purposes and federal tax treatment of interest on the Bonds was subject to the following exceptions and qualifications:

(a) The Code provides for a “branch profits tax” which subjects to tax, at a rate of 30%, the effectively connected earnings and profits of a foreign corporation which engages in a United States trade or business. Interest on the Bonds would be includable in the amount of effectively connected earnings and profits and thus would increase the branch profits tax liability.

(b) The Code also provides that passive investment income, including interest on the Bonds, may be subject to taxation for any S corporation with Subchapter C earnings and profits at the close of its taxable year if greater than 25% of its gross receipts is passive investment income.

Except as stated above, Bond Counsel expressed no opinion as to any federal or Kentucky tax consequences resulting from the receipt of interest on the Bonds.

Owners of the Bonds should be aware that the ownership of the Bonds may result in collateral federal income tax consequences. For instance, the Code provides that property and casualty insurance companies will be required to reduce their loss reserve deductions by 15% of the tax-exempt interest received on certain obligations, such as the Bonds, acquired after August 7, 1986. (For purposes of the immediately preceding sentence, a portion of dividends paid to an affiliated insurance company may be treated as tax-exempt interest.) The Code further provides for the disallowance of any deduction for interest expenses incurred by banks and certain other financial institutions allocable to carrying certain tax-exempt obligations, such as the Bonds, acquired after August 7, 1986. The Code also provides that, with respect to taxpayers other than such financial institutions, such taxpayers will be unable to deduct any portion of the interest expenses incurred or continued to purchase or carry the Bonds. The Code also provides, with respect to individuals, that interest on tax-exempt obligations, including the Bonds, is included in modified adjusted gross income for purposes of determining the taxability of social security and railroad retirement benefits. Furthermore, the earned income tax credit is not allowed for individuals with an aggregate amount of disqualified income within the meaning of Section 32 of the Code, which exceeds \$2,200. Interest on the Bonds will be taken into account in the calculation of disqualified income. Prospective purchasers of the Bonds should consult their own tax advisors regarding such matters and any other tax consequences of holding the Bonds.

From time to time, there are legislative proposals in Congress which, if enacted, could alter or amend one or more of the federal tax matters referred to above or could adversely affect the market value of the Bonds. It cannot be predicted whether or in what form any such proposal might be enacted or whether, if enacted, it would apply to obligations (such as the Bonds) issued prior to enactment.

The opinions of Bond Counsel relating to conversion of the Bonds in substantially the forms in which they are expected to be delivered on the Conversion Date, redated to the Conversion Date, are attached as Appendices B-3 and B-4.

## **Legal Matters**

Certain legal matters in connection with the Conversion and reoffering of the Bonds will be passed upon by Stoll Keenon Ogden, Bond Counsel. Bond Counsel has in the past, and may in the future, act as counsel to the Company with respect to certain matters. Certain legal matters will be passed upon for the Issuer by its County Attorney. Certain legal matters will be passed upon for the Company by Jones Day, Chicago, Illinois, and John R. McCall, Esq., Executive Vice President, General Counsel, Corporate Secretary and Chief Compliance Officer for the Company. Winston & Strawn LLP, Chicago, Illinois, will pass upon certain legal matters for the Remarketing Agent.

## **Continuing Disclosure**

Because the Bonds are special and limited obligations of the Issuer, the Issuer is not an “obligated person” for purposes of Rule 15c2-12 (the “Rule”) promulgated by the SEC under the Exchange Act, and does not have any continuing obligations thereunder. Accordingly, the Issuer will not provide any continuing disclosure information with respect to the Bonds or the Issuer.

### **2006 Series B Bonds**

In order to enable the Remarketing Agent to comply with the requirements of the Rule, the Company has covenanted in a continuing disclosure undertaking agreement delivered to the Trustee for the benefit of the holders of the 2006 Series B Bonds (the “Continuing Disclosure Agreement”) to provide certain continuing disclosure for the benefit of the holders of such Bonds. Under its Continuing Disclosure Agreement, the Company has covenanted to take the following actions:

(a) The Company will provide to each nationally recognized municipal securities information repository (“NRMSIR”), recognized by the SEC pursuant to the Rule, and the state information depository, if any, of the Commonwealth of Kentucky (a “SID” and, together with the NRMSIR, a “Repository”) recognized by the SEC (1) annual financial information of the type set forth in Appendix A to this Reoffering Circular (including any information incorporated by reference therein) and (2) audited financial statements prepared in accordance with generally accepted accounting principles, in each case not later than 120 days after the end of the Company’s fiscal year.

(b) The Company will file in a timely manner with each NRMSIR or the Municipal Securities Rulemaking Board, and with the SID, if any, notice of the occurrence of any of the following events (if applicable) with respect to the 2006 Series B Bonds, if material: (i) principal and interest payment delinquencies; (ii) non-payment related defaults; (iii) any unscheduled draws on debt service reserves reflecting financial difficulties; (iv) unscheduled draws on credit enhancement facilities reflecting financial difficulties; (v) substitution of credit or liquidity providers, or their failure to perform; (vi) adverse tax opinions or events affecting the tax-exempt status of the 2006 Series B Bonds; (vii) modifications to rights of the holders of the 2006 Series B Bonds; (viii) the giving of notice of optional or unscheduled redemption of any 2006 Series B Bonds; (ix) defeasance of the 2006 Series B Bonds or any portion thereof; (x) release,

substitution, or sale of property securing repayment of the 2006 Series B Bonds; and (xi) rating changes with respect to the 2006 Series B Bonds or the Company or any obligated person, within the meaning of the Rule.

(c) The Company will file in a timely manner with each Repository notice of a failure by the Company to file any of the notices or reports referred to in paragraphs (a) and (b) above by the due date.

The Company may amend its Continuing Disclosure Agreement (and the Trustee shall agree to any amendment so requested by the Company that does not change the duties of the Trustee thereunder) or waive any provision thereof, but only with a change in circumstances that arises from a change in legal requirements, change in law, or change in the nature or status of the Company with respect to the 2006 Series B Bonds or the type of business conducted by the Company; provided that the undertaking, as amended or following such waiver, would have complied with the requirements of the Rule on the date of issuance of the 2006 Series B Bonds, after taking into account any amendments to the Rule as well as any change in circumstances, and the amendment or waiver does not materially impair the interests of the holders of the 2006 Series B Bonds to which such undertaking relates, in the opinion of the Trustee or counsel expert in federal securities laws acceptable to both the Company and the Trustee, or is approved by the Beneficial Owners of a majority in aggregate principal amount of the outstanding 2006 Series B Bonds. The Company acknowledges that its undertakings pursuant to the Rule described under this heading are intended to be for the benefit for the holders of the 2006 Series B Bonds and shall be enforceable by the holders of those 2006 Series B Bonds or by the Trustee on behalf of such holders. Any breach by the Company of these undertakings pursuant to the Rule will not constitute an event of default under the Indentures, the Loan Agreements or the 2006 Series B Bonds.

### **2008 Series A Bonds**

The Rule generally requires that “obligated persons” such as the Company agree to provide (i) continuing disclosure on an annual basis of certain financial information and operating data and (ii) notices of certain specified events that could affect the credit underlying the payment obligations of the securities. However, offerings of securities that are subject purchase by the issuer on the demand of the holder, such as will be the case with respect to the 2008 Series A Bonds while bearing interest in a Daily Rate Period or a Weekly Rate Period, or while bearing interest in a Flexible Rate Period of 270 days or less, are exempt from these requirements. If the 2008 Series A Bonds are remarketed in a mode other than the Daily Rate Period, the Weekly Rate Period or the Flexible Rate Period, the Company may in the future become subject to these continuing disclosure obligations of the Rule with respect to such 2008 Series A Bonds.

This Reoffering Circular has been duly approved, executed and delivered by the Company.

KENTUCKY UTILITIES COMPANY

By: /s/ Daniel K. Arbough  
Daniel K. Arbough  
Treasurer

**Appendix A**

[DELETED AND REPLACED- SEE APPENDIX A TO SUPPLEMENT DATED DECEMBER 1, 2010]

**APPENDIX B**

**Opinions of Bond Counsel and  
Forms of Conversion Opinions of Bond Counsel**



**APPENDIX B-1**

**Opinion of Bond Counsel dated February 23, 2007 relating to the 2006 Series B Bonds**



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February 23, 2007

Re: \$54,000,000 County of Carroll, Kentucky, Environmental Facilities Revenue Refunding Bonds, 2006 Series B (Kentucky Utilities Company Project)

We hereby certify that we have examined certified copies of the proceedings of record of the County of Carroll, Kentucky (the "County"), acting by and through its Fiscal Court as its duly authorized governing body, preliminary to and in connection with the issuance by the County of its Environmental Facilities Revenue Refunding Bonds, 2006 Series B (Kentucky Utilities Company Project), dated their date of issuance, in the aggregate principal amount of \$54,000,000 (the "Bonds"). The Bonds are issued under the provisions of Sections 103.200 to 103.285, inclusive, of the Kentucky Revised Statutes (the "Act"), for the purpose of providing funds which will be used, with other funds provided by Kentucky Utilities Company (the "Company") for the current refunding of \$54,000,000 aggregate principal amount of the County's Collateralized Solid Waste Disposal Facilities Revenue Bonds (Kentucky Utilities Company Project) 1994 Series A, dated November 23, 1994 (the "Prior Bonds"), which were issued for the purpose of financing a portion of the costs of construction, acquisition, installation and equipping of certain solid waste disposal facilities to serve the Ghent Generating Station of the Company in Carroll County, Kentucky (the "Project") in order to provide for the collection, storage, treatment, processing and final disposal of solid wastes, as provided by the Act.

The Bonds mature on October 1, 2034 and bear interest initially at the Dutch Auction Rate, as defined in the Indenture, hereinafter described, subject to change as provided in such Indenture. The Bonds will be subject to optional and mandatory redemption prior to maturity at the times, in the manner and upon the terms set forth in the Bonds. From such examination of the proceedings of the Fiscal Court of the County referred to above and from an examination of the Act, we are of the opinion that the County is duly authorized and empowered to issue the Bonds under the laws of the Commonwealth of Kentucky now in force.

We have examined an executed counterpart of a certain Loan Agreement, dated as of October 1, 2006 (the "Loan Agreement"), between the County and the Company and a certified copy of the proceedings of record of the Fiscal Court of the County preliminary to and in connection with the execution and delivery of the Loan Agreement, pursuant to which the County has agreed to issue the Bonds and to lend the proceeds thereof to the Company to provide funds to pay and discharge, with other funds provided by the Company, the Prior Bonds.

The Company has agreed to make Loan payments to the Trustee at times and in amounts fully adequate to pay maturing principal of, interest on and redemption premium, if any, on the Bonds as same become due and payable. From such examination, we are of the opinion that such proceedings of the Fiscal Court of the County show lawful authority for the execution and delivery of the Loan Agreement; that the Loan Agreement has been duly authorized, executed and delivered by the County; and that the Loan Agreement is a legal, valid and binding obligation of the County, enforceable in accordance with its terms, subject to the qualification that the enforcement thereof may be limited by laws relating to bankruptcy, insolvency or other similar laws affecting creditors' rights generally, including equitable provisions where equitable remedies are sought.

We have also examined an executed counterpart of a certain Indenture of Trust, dated as of October 1, 2006 (the "Indenture"), by and between the County and Deutsche Bank Trust Company Americas, as trustee (the "Trustee"), securing the Bonds and setting forth the covenants and undertakings of the County in connection with the Bonds and a certified copy of the proceedings of record of the Fiscal Court of the County preliminary to and in connection with the execution and delivery of the Indenture. Pursuant to the Indenture, certain of the County's rights under the Loan Agreement, including the right to receive payments thereunder, and all moneys and securities held by the Trustee in accordance with the Indenture (except moneys and securities in the Rebate Fund created thereby) have been assigned to the Trustee, as security for the holders of the Bonds. From such examination, we are of the opinion that such proceedings of the Fiscal Court of the County show lawful authority for the execution and delivery of the Indenture; that the Indenture has been duly authorized, executed and delivered by the County; and that the Indenture is a legal, valid and binding obligation upon the parties thereto according to its terms, subject to the qualification that the enforcement thereof may be limited by laws relating to bankruptcy, insolvency or other similar laws affecting creditors' rights generally, including equitable provisions where equitable remedies are sought.

In our opinion the Bonds have been validly authorized, executed and issued in accordance with the laws of the Commonwealth of Kentucky now in full force and effect, and constitute legal, valid and binding special obligations of the County entitled to the benefit of the security provided by the Indenture and enforceable in accordance with their terms, subject to the qualification that the enforcement thereof may be limited by laws relating to bankruptcy, insolvency or other similar laws affecting creditors' rights generally, including equitable provisions where equitable remedies are sought. The Bonds are payable by the County solely and only from payments and other amounts derived from the Loan Agreement and as provided in the Indenture.

In our opinion, under existing laws, including current statutes, regulations, administrative rulings and official interpretations by the Internal Revenue Service, subject to the exceptions and qualifications contained in the succeeding paragraphs, interest on the Bonds is excluded from the gross income of the recipients thereof for federal income tax purposes, except that no opinion is expressed regarding such exclusion from gross income with respect to any Bond during any period in which it is held by a "substantial user" of the Project or a "related person," as such terms are used in Section 147(a) of the Internal Revenue Code of 1986, as amended (the "Code"). Interest on the Bonds is a separate item of tax preference in determining alternative

minimum taxable income for individuals and corporations under the Code. In arriving at this opinion, we have relied upon representations, factual statements and certifications of the Company with respect to certain material facts which are solely within the Company's knowledge in reaching our conclusion, inter alia, that not less than 95% of the net proceeds of the Prior Bonds were used to finance solid waste disposal facilities qualified for financing under Section 142(a)(6) of the Code and the Act. Further, in arriving at the opinion set forth in this paragraph as to the exclusion from gross income of interest on the Bonds, we have assumed and this opinion is conditioned on, the accuracy of and continuing compliance by the Company and the County with representations and covenants set forth in the Loan Agreement and the Indenture which are intended to assure compliance with certain tax-exempt interest provisions of the Code. Such representations and covenants must be accurate and must be complied with subsequent to the issuance of the Bonds in order that interest on the Bonds be excluded from gross income for federal income tax purposes. Failure to comply with certain of such representations and covenants in respect of the Bonds subsequent to the issuance of the Bonds could cause the interest thereon to be included in gross income for federal income tax purposes retroactively to the date of issuance of the Bonds. We express no opinion (i) regarding the exclusion of interest on any Bond from gross income for federal income tax purposes on or after the date on which any change, including any interest rate conversion, permitted by the documents (other than with approval of this firm) is taken which adversely affects the tax treatment of the Bonds or (ii) as to the treatment for purposes of federal income taxation of interest on the Bonds upon a Determination of Taxability. We are further of the opinion that interest on the Bonds is excluded from gross income of the recipients thereof for Kentucky income tax purposes and that the Bonds are exempt from ad valorem taxation by the Commonwealth of Kentucky and all political subdivisions thereof.

Our opinion as to the exclusion of interest on the Bonds from gross income for federal income tax purposes and federal tax treatment of interest on the Bonds is further subject to the following exceptions and qualifications:

(a) The Code provides for a "branch profits tax" which subjects to tax, at a rate of 30%, the effectively connected earnings and profits of a foreign corporation which engages in a United States trade or business. Interest on the Bonds would be includable in the amount of effectively connected earnings and profits and thus would increase the branch profits tax liability.

(b) The Code also provides that passive investment income, including interest on the Bonds, may be subject to taxation for any S corporation with Subchapter C earnings and profits at the close of its taxable year if greater than 25% of its gross receipts is passive investment income.

Except as stated above, we express no opinion as to any federal or Kentucky tax consequences resulting from the receipt of interest on the Bonds.

Holders of the Bonds should be aware that the ownership of the Bonds may result in collateral federal income tax consequences. For instance, the Code provides that, for taxable years beginning after December 31, 1986, property and casualty insurance companies will be

required to reduce their loss reserve deductions by 15% of the tax-exempt interest received on certain obligations, such as the Bonds, acquired after August 7, 1986. (For purposes of the immediately preceding sentence, a portion of dividends paid to an affiliated insurance company may be treated as tax-exempt interest.) The Code further provides for the disallowance of any deduction for interest expenses incurred by banks and certain other financial institutions allocable to carrying certain tax-exempt obligations, such as the Bonds, acquired after August 7, 1986. The Code also provides that, with respect to taxpayers other than such financial institutions, such taxpayers will be unable to deduct any portion of the interest expenses incurred or continued to purchase or carry the Bonds. The Code also provides, with respect to individuals, that interest on tax-exempt obligations, including the Bonds, is included in modified adjusted gross income for purposes of determining the taxability of social security and railroad retirement benefits. Furthermore, the earned income credit is not allowed for individuals with an aggregate amount of disqualified income within the meaning of section 32 of the Code, which exceeds \$2,200. Interest on the Bonds will be taken into account in the calculation of disqualified income.

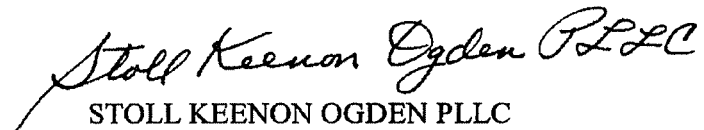
We have received opinions of John R. McCall, Esq., General Counsel of the Company and Jones Day, Chicago, Illinois, counsel to the Company, of even date herewith. In rendering this opinion, we have relied upon said opinions with respect to the matters therein. We have also received an opinion of even date herewith of Hon. James C. Monk, County Attorney of the County and relied upon said opinion with respect to the matters therein. Said opinions are in forms satisfactory to us as to both scope and content.

We express no opinion as to the title to, the description of, or the existence or priority of any liens, charges or encumbrances on, the Project.

In rendering the foregoing opinions, we are passing upon only those matters specifically set forth in such opinions and are not passing upon the investment quality of the Bonds or the accuracy or completeness of any statements made in connection with any offer or sale thereof. The opinions herein are expressed as of the date hereof and we assume no obligation to supplement or update such opinions to reflect any facts or circumstances that may hereafter come to our attention or any changes in law that may hereafter occur.

We are members of the Bar of the Commonwealth of Kentucky and do not purport to be experts on the laws of any jurisdiction other than the Commonwealth of Kentucky and the United States of America, and we express no opinion as to the laws of any jurisdiction other than those specified.

Respectfully submitted,

  
STOLL KEENON OGDEN PLLC

**APPENDIX B-2**

**Opinion of Bond Counsel dated October 17, 2008 relating to the 2008 Series A Bonds**



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October 17, 2008

Re: \$77,947,405 "County of Carroll, Kentucky, Environmental Facilities Revenue Bonds, 2008 Series A (Kentucky Utilities Company Project)"

We hereby certify that we have examined certified copies of the proceedings of record of the County of Carroll, Kentucky (the "County"), acting by and through its Fiscal Court as its duly authorized governing body, preliminary to and in connection with the issuance by the County of its Environmental Facilities Revenue Bonds, 2008 Series A (Kentucky Utilities Company Project), dated their date of issuance, in the aggregate principal amount of \$77,947,405 (the "Bonds"). The Bonds are issued under the provisions of Sections 103.200 to 103.285, inclusive, of the Kentucky Revised Statutes (the "Act"), for the purpose of providing funds which will be used, with other funds provided by Kentucky Utilities Company (the "Company") for the purposes of (i) financing a portion of the costs of construction, acquisition, installation and equipping of certain solid waste disposal facilities to serve the Ghent Generating Station of the Company in Carroll County, Kentucky (the "Construction Project") in order to provide for the collection, storage, treatment and final disposal of solid wastes, as provided by the Act in the principal amount of \$18,026,265, and (ii) currently refunding (a) \$13,266,950 outstanding principal amount of County of Carroll, Kentucky, Environmental Facilities Revenue Bonds, 2005 Series A (Kentucky Utilities Company Project) (the "2005 Series A Bonds"), (b) \$13,266,950 outstanding principal amount of County of Carroll, Kentucky, Environmental Facilities Revenue Bonds, 2005 Series B (Kentucky Utilities Company Project) (the "2005 Series B Bonds"), (c) \$16,693,620 outstanding principal amount of County of Carroll, Kentucky, Environmental Facilities Revenue Bonds, 2006 Series A (Kentucky Utilities Company Project) (the "2006 Series A Bonds") and (d) \$16,693,620 outstanding principal amount of County of Carroll, Kentucky, Environmental Facilities Revenue Bonds, 2006 Series C (Kentucky Utilities Company Project) (the "2006 Series C Bonds" and, together with the 2005 Series A Bonds, the 2005 Series B Bonds and the 2006 Series A Bonds, the "Refunded Bonds"), which were issued for the purpose of financing all or a portion of the qualified costs of acquisition, construction, installation and equipping of certain solid waste disposal facilities to serve the Ghent Generating Station of Company in Carroll County, Kentucky (the "Refunding Project" and, together with the Construction Project, the "Project"), as provided by the Act.

The Bonds mature on February 1, 2032, and bear interest initially at the Flexible Rate, as defined in the Indenture, hereinafter described, subject to change as provided in such Indenture. The Bonds will be subject to optional and mandatory redemption prior to maturity at the times, in the manner and upon the terms set forth in the Bonds. From such examination of the proceedings of the Fiscal Court of the County referred to above and from an examination of the Act, we are of the opinion that the County is duly authorized and empowered to issue the Bonds under the laws of the Commonwealth of Kentucky now in force.

We have examined an executed counterpart of a certain Loan Agreement, dated as of August 1, 2008 (the "Loan Agreement"), between the County and the Company and a certified copy of the proceedings of record of the Fiscal Court of the County preliminary to and in connection with the execution and delivery of the Loan Agreement, pursuant to which the County has agreed to issue the Bonds and to lend the proceeds thereof to the Company to provide funds to finance a portion of the costs of the acquisition, construction, installation and equipping of the Construction Project and to pay and discharge with other funds provided by the Company, the Refunded Bonds. The Company has agreed to make Loan payments to the Trustee at times and in amounts fully adequate to pay maturing principal of, interest on and redemption premium, if any, on the Bonds as same become due and payable. From such examination, we are of the opinion that such proceedings of the Fiscal Court of the County show lawful authority for the execution and delivery of the Loan Agreement; that the Loan Agreement has been duly authorized, executed and delivered by the County; and that the Loan Agreement is a legal, valid and binding obligation of the County, enforceable in accordance with its terms, subject to the qualification that the enforcement thereof may be limited by laws relating to bankruptcy, insolvency or other similar laws affecting creditors' rights generally, including equitable provisions where equitable remedies are sought.

We have also examined an executed counterpart of a certain Indenture of Trust, dated as of August 1, 2008 (the "Indenture"), by and between the County and Deutsche Bank Trust Company Americas, as trustee (the "Trustee"), securing the Bonds and setting forth the covenants and undertakings of the County in connection with the Bonds and a certified copy of the proceedings of record of the Fiscal Court of the County preliminary to and in connection with the execution and delivery of the Indenture. Pursuant to the Indenture, certain of the County's rights under the Loan Agreement, including the right to receive payments thereunder, and all moneys and securities held by the Trustee in accordance with the Indenture (except moneys and securities in the Rebate Fund created thereby) have been assigned to the Trustee, as security for the holders of the Bonds. From such examination, we are of the opinion that such proceedings of the Fiscal Court of the County show lawful authority for the execution and delivery of the Indenture; that the Indenture has been duly authorized, executed and delivered by the County; and that the Indenture is a legal, valid and binding obligation upon the parties thereto according to its terms, subject to the qualification that the enforcement thereof may be limited by laws relating to bankruptcy, insolvency or other similar laws affecting creditors' rights generally, including equitable provisions where equitable remedies are sought.



In our opinion the Bonds have been validly authorized, executed and issued in accordance with the laws of the Commonwealth of Kentucky now in full force and effect, and constitute legal, valid and binding special obligations of the County entitled to the benefit of the security provided by the Indenture and enforceable in accordance with their terms, subject to the qualification that the enforcement thereof may be limited by laws relating to bankruptcy, insolvency or other similar laws affecting creditors' rights generally, including equitable provisions where equitable remedies are sought. The Bonds are payable by the County solely and only from payments and other amounts derived from the Loan Agreement and as provided in the Indenture.

In our opinion, under existing laws, including current statutes, regulations, administrative rulings and official interpretations by the Internal Revenue Service, subject to the exceptions and qualifications contained in the succeeding paragraphs, (i) interest on the Bonds is excluded from the gross income of the recipients thereof for federal income tax purposes, except that no opinion is expressed regarding such exclusion from gross income with respect to any Bond during any period in which it is held by a "substantial user" of the Project or a "related person," as such terms are used in Section 147(a) of the Internal Revenue Code of 1986, as amended (the "Code") and (ii) interest on the Bonds is a separate item of tax preference in determining alternative minimum taxable income for individuals and corporations under the Code. In arriving at this opinion, we have relied upon representations, factual statements and certifications of the Company with respect to certain material facts which are solely within the Company's knowledge in reaching our conclusion, inter alia, that not less than 95% of the proceeds of the Bonds will be used to finance or refinance solid waste disposal facilities qualified for financing under Section 142(a)(6) of the Code and the Act. Further, in arriving at the opinion set forth in this paragraph as to the exclusion from gross income of interest on the Bonds, we have assumed and this opinion is conditioned on, the accuracy of and continuing compliance by the Company and the County with representations and covenants set forth in the Loan Agreement and the Indenture which are intended to assure compliance with certain tax-exempt interest provisions of the Code. Such representations and covenants must be accurate and must be complied with subsequent to the issuance of the Bonds in order that interest on the Bonds be excluded from gross income for federal income tax purposes. Failure to comply with certain of such representations and covenants in respect of the Bonds subsequent to the issuance of the Bonds could cause the interest thereon to be included in gross income for federal income tax purposes retroactively to the date of issuance of the Bonds. We express no opinion (i) regarding the exclusion of interest on any Bond from gross income for federal income tax purposes on or after the date on which any change, including any interest rate conversion, permitted by the documents (other than with approval of this firm) is taken which adversely affects the tax treatment of the Bonds or (ii) as to the treatment for purposes of federal income taxation of interest on the Bonds upon a Determination of Taxability. We are further of the opinion that interest on the Bonds is excluded from gross income of the recipients thereof for Kentucky income tax purposes and that the Bonds are exempt from ad valorem taxation by the Commonwealth of Kentucky and all political subdivisions thereof.

Our opinion as to the exclusion of interest on the Bonds from gross income for federal income tax purposes and federal tax treatment of interest on the Bonds is further subject to the following exceptions and qualifications:

(a) The Code provides for a "branch profits tax" which subjects to tax, at a rate of 30%, the effectively connected earnings and profits of a foreign corporation which engages in a United States trade or business. Interest on the Bonds would be includable in the amount of effectively connected earnings and profits and thus would increase the branch profits tax liability.

(b) The Code also provides that passive investment income, including interest on the Bonds, may be subject to taxation for any S corporation with Subchapter C earnings and profits at the close of its taxable year if greater than 25% of its gross receipts is passive investment income.

Except as stated above, we express no opinion as to any federal or Kentucky tax consequences resulting from the receipt of interest on the Bonds.

Holders of the Bonds should be aware that the ownership of the Bonds may result in collateral federal income tax consequences. For instance, the Code provides that, for taxable years beginning after December 31, 1986, property and casualty insurance companies will be required to reduce their loss reserve deductions by 15% of the tax-exempt interest received on certain obligations, such as the Bonds, acquired after August 7, 1986. (For purposes of the immediately preceding sentence, a portion of dividends paid to an affiliated insurance company may be treated as tax-exempt interest.) The Code further provides for the disallowance of any deduction for interest expenses incurred by banks and certain other financial institutions allocable to carrying certain tax-exempt obligations, such as the Bonds, acquired after August 7, 1986. The Code also provides that, with respect to taxpayers other than such financial institutions, such taxpayers will be unable to deduct any portion of the interest expenses incurred or continued to purchase or carry the Bonds. The Code also provides, with respect to individuals, that interest on tax-exempt obligations, including the Bonds, is included in modified adjusted gross income for purposes of determining the taxability of social security and railroad retirement benefits. Furthermore, the earned income credit is not allowed for individuals with an aggregate amount of disqualified income within the meaning of Section 32 of the Code, which exceeds \$2,200. Interest on the Bonds will be taken into account in the calculation of disqualified income.

We have received opinions of John R. McCall, Esq., General Counsel of the Company, and Jones Day, Chicago, Illinois, counsel to the Company, of even date herewith. In rendering this opinion, we have relied upon said opinions with respect to the matters therein. We have also received an opinion of even date herewith of Hon. James C. Monk, County Attorney of the County and relied upon said opinion with respect to the matters therein. Said opinions are in forms satisfactory to us as to both scope and content.

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October 17, 2008

Page 5

We express no opinion as to the title to, the description of, or the existence or priority of any liens, charges or encumbrances on, the Project.

In rendering the foregoing opinions, we are passing upon only those matters specifically set forth in such opinions and are not passing upon the investment quality of the Bonds or the accuracy or completeness of any statements made in connection with any offer or sale thereof. The opinions herein are expressed as of the date hereof and we assume no obligation to supplement or update such opinions to reflect any facts or circumstances that may hereafter come to our attention or any changes in law that may hereafter occur.

We are members of the Bar of the Commonwealth of Kentucky and do not purport to be experts on the laws of any jurisdiction other than the Commonwealth of Kentucky and the United States of America, and we express no opinion as to the laws of any jurisdiction other than those specified.

Respectfully submitted,

  
STOLL KEENON OGDEN PLLC

**(Form of Conversion Opinion of Bond Counsel)  
(2006 Series B Bonds)**

December 19, 2008

County of Carroll, Kentucky  
Carrollton, Kentucky 41008

Deutsche Bank Trust Company Americas,  
as Trustee  
Summit, New Jersey 07901

Re: Conversion to Weekly Rate Period of \$54,000,000 “County of Carroll, Kentucky, Environmental Facilities Revenue Refunding Bonds, 2006 Series B (Kentucky Utilities Company Project)”

Ladies and Gentlemen:

This opinion is being furnished in accordance with the requirements of the Indenture of Trust, dated as of October 1, 2006 (the “Indenture”), between the County of Carroll, Kentucky (the “Issuer”) and Deutsche Bank Trust Company Americas, as Trustee (the “Trustee”), pertaining to \$54,000,000 principal amount of County of Carroll, Kentucky, Environmental Facilities Revenue Refunding Bonds, 2006 Series B (Kentucky Utilities Company Project), dated February 23, 2007 (the “Bonds”), in order to satisfy certain requirements of Section 2.02(e)(i) of the Indenture. Pursuant to Section 2.02(e)(i) of the Indenture, the interest rate on the Bonds is being converted from a Dutch Auction Rate to a Weekly Rate effective on December 19, 2008, the Conversion Date. The terms used herein denoted by initial capitals and not otherwise defined shall have the meanings specified in the Indenture.

We have examined the law and such documents and matters as we have deemed necessary to provide this opinion. As to questions of fact material to the opinions expressed herein, we have relied upon the provisions of the Indenture and related documents, and upon representations made to us without undertaking to verify the same by independent investigation.

Based upon the foregoing, as of the date hereof, we are of the opinion that the conversion of the interest rate on the Bonds as described herein (a) is authorized or permitted by the Act and the Indenture and (b) will not adversely affect the validity of the Bonds or any exclusion from gross income for federal income tax purposes to which interest on the Bonds would otherwise be entitled. Interest on the Bonds is not and will not be excluded from gross income during any period when the Bonds are held by the Company or a “related person” of the Company as defined in Section 147(a) of the Internal Revenue Code of 1986, as amended.

In rendering this opinion, we assume, without verifying, that the Issuer and the Company have complied and will comply with all covenants contained in the Indenture, the Loan Agreement between the Issuer and the Company, dated October 1, 2006, and other documents relating to the Bonds. We rendered our approving opinion at the time of the issuance of the

Bonds relating to, among other things, the validity of the Bonds and the exclusion from federal income taxation of interest on the Bonds. We have not been requested to update or continue such opinion and have not undertaken to do so. Accordingly, we do not express any opinion with respect to the Bonds except as set forth above.

Our opinion represents our legal judgment based upon our review of the law and the facts that we deem relevant to render such opinion and is not a guarantee of a result. This opinion is given as of the date hereof and we assume no obligation to review or supplement this opinion to reflect any facts or circumstances that may hereafter come to our attention or any changes in law that may hereafter occur.

We express no opinion herein as to the investment quality of the Bonds or the adequacy, accuracy or completeness of any information furnished to any person in connection with any offer or sale of the Bonds.

Respectfully submitted,

STOLL KEENON OGDEN PLLC

**(Form of Conversion Opinion of Bond Counsel)  
(2008 Series A Bonds)**

December 19, 2008

County of Carroll, Kentucky  
Carrollton, Kentucky 41008

Deutsche Bank Trust Company Americas,  
as Trustee  
Summit, New Jersey 07901

Re: Conversion to Weekly Rate Period of \$77,947,405 “County of Carroll, Kentucky, Environmental Facilities Revenue Bonds, 2008 Series A (Kentucky Utilities Company Project)”

Ladies and Gentlemen:

This opinion is being furnished in accordance with the requirements of the Indenture of Trust, dated as of August 1, 2008 (the “Indenture”), between the County of Carroll, Kentucky (the “Issuer”) and Deutsche Bank Trust Company Americas, as Trustee (the “Trustee”), pertaining to \$77,947,405 principal amount of County of Carroll, Kentucky, Environmental Facilities Revenue Bonds, 2008 Series A (Kentucky Utilities Company Project), dated October 17, 2008 (the “Bonds”), in order to satisfy certain requirements of Section 2.02(e)(i) of the Indenture. Pursuant to Section 2.02(e)(i) of the Indenture, the interest rate on the Bonds is being converted from a Flexible Rate to a Weekly Rate effective on December 19, 2008, the Conversion Date. The terms used herein denoted by initial capitals and not otherwise defined shall have the meanings specified in the Indenture.

We have examined the law and such documents and matters as we have deemed necessary to provide this opinion. As to questions of fact material to the opinions expressed herein, we have relied upon the provisions of the Indenture and related documents, and upon representations made to us without undertaking to verify the same by independent investigation.

Based upon the foregoing, as of the date hereof, we are of the opinion that the conversion of the interest rate on the Bonds as described herein (a) is authorized or permitted by the Act and the Indenture and (b) will not adversely affect the validity of the Bonds or any exclusion from gross income for federal income tax purposes to which interest on the Bonds would otherwise be entitled. Interest on the Bonds is not and will not be excluded from gross income during any period when the Bonds are held by the Company or a “related person” of the Company as defined in Section 147(a) of the Internal Revenue Code of 1986, as amended.

In rendering this opinion, we assume, without verifying, that the Issuer and the Company have complied and will comply with all covenants contained in the Indenture, the Loan Agreement between the Issuer and the Company, dated August 1, 2008, and other documents relating to the Bonds. We rendered our approving opinion at the time of the issuance of the

Bonds relating to, among other things, the validity of the Bonds and the exclusion from federal income taxation of interest on the Bonds. We have not been requested to update or continue such opinion and have not undertaken to do so. Accordingly, we do not express any opinion with respect to the Bonds except as set forth above.

Our opinion represents our legal judgment based upon our review of the law and the facts that we deem relevant to render such opinion and is not a guarantee of a result. This opinion is given as of the date hereof and we assume no obligation to review or supplement this opinion to reflect any facts or circumstances that may hereafter come to our attention or any changes in law that may hereafter occur.

We express no opinion herein as to the investment quality of the Bonds or the adequacy, accuracy or completeness of any information furnished to any person in connection with any offer or sale of the Bonds.

Respectfully submitted,

STOLL KEENON OGDEN PLLC

**Commerzbank AG, New York Branch**

Commerzbank Aktiengesellschaft (“Commerzbank” or the “Bank”) is a major German private-sector bank. Its products and services for retail and corporate customers extend to all aspects of banking. The Bank is also active in specialized fields - partially covered by its subsidiaries - such as mortgage banking and real-estate business, leasing and asset management. Its services are concentrated on managing customers’ accounts and handling payment transactions, loan, savings and investment plans, and also on securities transactions. Additional financial services are offered within the framework of the Bank’s “bancassurance” strategy of cooperating with leading companies in finance-related sectors, including home loan savings schemes and insurance products. The Commerzbank Group’s operating business has been categorized into six segments: Private and Business Customers, Mittelstandsbank, Central & Eastern Europe, Corporates & Markets, Commercial Real Estate as well as Public Finance and Treasury. On August 31, 2008, Commerzbank announced that Commerzbank and Allianz SE have agreed upon the sale of 100% of Dresdner Bank AG to Commerzbank. The transaction will occur in two steps and is expected to be completed by the end of 2009, subject to regulatory and antitrust approvals.

As of September 30, 2008, the Commerzbank Group had total assets of approximately 595.6 billion euros and total shareholders’ equity of approximately \$15.257 billion euros. The shares of Commerzbank are fully paid-up and are in bearer form. They are listed on all seven German stock exchanges as well as on the London Stock Exchange and the Swiss Exchange based in Zurich. There is also a sponsored-ADR program in the USA.

In the Federal Republic of Germany (“Germany”), Commerzbank manages a nationwide branch network covering all customer segments from its headquarters in Frankfurt am Main. Abroad, Commerzbank has branches, representative offices and key subsidiaries in approximately 50 countries.

Commerzbank conducts extensive banking business in the United States, concentrating primarily in corporate lending, letter of credit and bankers’ acceptance facilities, syndicated loan transactions and treasury operations including foreign exchange transactions. Commerzbank has branches in New York, Chicago and Los Angeles and has an agency office in Atlanta.

For further information on the Commerzbank Group, a copy of Commerzbank’s annual report can be obtained by contacting Ms. Karin Rapaglia at 2 World Financial Center, New York, New York 10281.

Commerzbank is authorized to conduct general banking business and to provide financial services under and, subject to the requirements set forth in, the German Banking Act (Kreditwesengesetz). The Bank is subject to comprehensive regulation and supervision by the German Financial Services Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht) and by the German central bank (Deutsche Bundesbank). The European Central Bank regulates Commerzbank in relation to minimum reserves on deposits. In addition, Commerzbank is subject to regulation by the countries in which it operates.



The New York Branch of Commerzbank is licensed by the Superintendent of Banks of the State of New York. It is subject to the banking laws of the State of New York and is examined annually by the New York State Banking Department. Commerzbank's branches in Chicago and Los Angeles are subject to similar regulation by the states in which they operate. In addition to being subject to state laws and regulations, Commerzbank is also subject to federal regulation under the International Banking Act, as amended, (the "IBA") and, through the IBA, the Bank Holding Company Act, as amended, (the "BHCA"). In this regard, the Commerzbank U.S. branches and the Atlanta Agency are also examined annually by the Federal Reserve Banks in the states in which they are located.