

Supplement, dated May 2, 2011 to Reoffering Circular dated December 10, 2008, as supplemented as of December 16, 2008, October 29, 2010 and December 1, 2010 (the “Reoffering Circular”)

**\$12,900,000**

**County of Mercer, Kentucky**

**Solid Waste Disposal Facility Revenue Bonds, 2000 Series A  
(Kentucky Utilities Company Project)**

Effective as of May 2, 2011, through April 22, 2014 (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

**SUMITOMO MITSUI BANKING CORPORATION, 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) up to a maximum rate of 10% per annum for at least 45 days.

The Bonds will continue to bear interest at a Weekly Rate, determined by the Remarketing Agent, Morgan Stanley & Co. Incorporated, in accordance with the Indenture, payable on the first Business Day of each calendar month, commencing on June 1, 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 Sumitomo Mitsui Banking Corporation, New York Branch, the issuer of the Letter of Credit. For purposes of the Reoffering Circular, the Letter of Credit is a “Credit Facility” and Sumitomo Mitsui Banking Corporation, New York Branch 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 May 2, 2011, the Company will cause to be delivered an irrevocable transferable direct pay letter of credit (the “Letter of Credit”), issued by Sumitomo Mitsui Banking Corporation, 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 10% 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 Reimbursement Agreement, to be dated as of May 2, 2011 (the “Reimbursement Agreement”), between the Company and the Bank. The Letter of Credit will expire on April 22, 2014, 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 maximum rate of 10% 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 the Bonds at an assumed rate of 10% 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 that 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 \$198,309,583.05 Letter of Credit Agreement dated as of April 29, 2011 among the Company, the lenders from time to time thereto, and Banco Bilbao Vizcaya Argentaria, S.A., New York Branch, as Administrative Agent (the "Credit 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 April 22, 2014 (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 Credit Agreement and instructing the Trustee to draw under the Letter of Credit.

Pursuant to the Credit 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 and the Administrative Agent fees for issuing and maintaining the Letter of Credit.

### **The Reimbursement Agreement**

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; (iii) disposition of assets and (iv) capitalization ratios. 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 Company shall fail to pay when due any principal on any Reimbursement Obligations; or

(ii) the Company shall fail to pay when due any interest on the Reimbursement Obligations, any fee or any other amount payable under the Credit Agreement 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 other Loan Document (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 other Loan Document 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 Material Debt or a trustee on its or their behalf to cause, such Material 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 (within the meaning of Rule 13d-3 of the Securities and Exchange Commission under the Securities Exchange Act of 1934, as amended) 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.

“Material Debt” means debt (other than debt under the Loan Documents) 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:*

### **Sumitomo Mitsui Banking Corporation, New York Branch**

*The information under this heading has been provided solely by Sumitomo Mitsui Banking Corporation, New York Branch 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.*

### **Sumitomo Mitsui Banking Corporation**

Sumitomo Mitsui Banking Corporation (*Kabushiki Kaisha Mitsui Sumitomo Ginko*) (“SMBC”) is a joint stock corporation with limited liability (*Kabushiki Kaisha*) under the laws of Japan. The registered head office of SMBC is located at 1-2, Yurakucho 1-chome, Chiyoda-ku, Tokyo, Japan.

SMBC was established in April 2001 through the merger of two leading banks, The Sakura Bank, Limited and The Sumitomo Bank, Limited. In December 2002, Sumitomo Mitsui Financial Group, Inc. (“SMFG”) was established through a stock transfer as a holding company under which SMBC became a wholly owned subsidiary. SMFG reported ¥ 123,159,513 million in consolidated total assets as of March 31, 2010.

SMBC is one of the world’s leading commercial banks and provides an extensive range of banking services to its customers in Japan and overseas. In Japan, SMBC accepts deposits, makes loans and extends guarantees to corporations, individuals, governments and governmental entities. It also offers financing solutions such as syndicated lending, structured finance and project finance. SMBC also underwrites and deals in bonds issued by or under the guarantee of the Japanese government and local government authorities, and acts in various administrative and advisory capacities for certain types of corporate and government bonds. Internationally, SMBC operates through a network of branches, representative offices, subsidiaries and affiliates to provide many financing products including syndicated lending and project finance.

The New York Branch of SMBC is licensed by the State of New York Banking Department to conduct branch banking business at 277 Park Avenue, New York, New York, and is subject to examination by the State of New York Banking Department and the Federal Reserve Bank of New York.

### **Financial and Other Information**

Audited consolidated financial statements for SMFG and its consolidated subsidiaries for the fiscal years ended March 31, 2010, as well as certain unaudited financial information for SMFG and SMBC for the fiscal period ended through December 31, 2010, as well as other corporate data, financial information and analyses are available in English on the website of the Parent at [www.smfg.co.jp/english](http://www.smfg.co.jp/english).

The information herein has been obtained from SMBC, which is solely responsible for its content. The delivery of the Reoffering Circular shall not create any implication that there has been no change in the affairs of SMBC since the date hereof, or that the information contained or referred herein is correct as of any time subsequent to its date.

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



**Appendix A****Kentucky Utilities Company – Financial****Statements and Additional Information**

*This Appendix A includes a description of the Business of Kentucky Utilities Company (“KU”), certain risk factors associated with KU, Selected Financial Information, Management’s Discussion and Analysis, and the Consolidated Financial Statements as of December 31, 2010 and 2009 and for the Years Ended December 31, 2010, 2009, and 2008 (Audited).*

*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 utility engaged in the generation, transmission, distribution and sale of electric energy in Kentucky, Virginia and Tennessee. KU provides electric service to approximately 514,000 customers in 77 counties in central, southeastern and western Kentucky, to approximately 30,000 customers in 5 counties in southwestern Virginia and to less than 10 customers in Tennessee. Our service area covers approximately 6,600 noncontiguous square miles. Approximately 98% of the electricity generated by us is produced by our coal-fired electric generating stations. The remainder is generated by natural gas and oil fueled combustion turbines and a hydroelectric power plant. 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.

**Kentucky Utilities Company**

Financial Statements and Additional Information

As of December 31, 2010 and 2009 and

for the years ended December 31, 2010, 2009 and 2008

## Index of Abbreviations

AG	Attorney General of Kentucky
ARO	Asset Retirement Obligation
ASC	Accounting Standards Codification
BART	Best Available Retrofit Technology
CAIR	Clean Air Interstate Rule
CAMR	Clean Air Mercury Rule
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
Company	Kentucky Utilities Company
CT DSM	Combustion Turbine Demand
ECR	Side Management Environmental
EEI EKPC	Cost Recovery Electric Energy, Inc.
E.ON	East Kentucky Power Cooperative, Inc.
E.ON U.S.	E.ON AG
EPA	E.ON U.S. LLC and Subsidiaries
EPAct 2005	U.S. Environmental Protection Agency
FAC	Energy Policy Act of 2005
FASB	Fuel Adjustment Clause
FERC	Financial Accounting Standards Board
FGD	Federal Energy Regulatory Commission
Fidelia	Flue Gas Desulfurization
GAAP	Fidelia Corporation (an E.ON affiliate)
GAC	U.S. Generally Accepted Accounting Principles
GHG	Group Annuity Contract
Gwh	Greenhouse Gas
IBEW	Gigawatt hours or one thousand Mwh
IMEA	International Brotherhood of Electrical Workers
IMPA	Illinois Municipal Electric Agency
IRS	Indiana Municipal Power Agency
KCCS	Internal Revenue Service
KDAQ	Kentucky Consortium for Carbon Storage
Kentucky Commission	Kentucky Division for Air Quality
KIUC	Kentucky Public Service Commission
KU	Kentucky Industrial Utility Consumers, Inc.
kWh	Kentucky Utilities Company
LG&E	Kilowatt hours
LIBOR	Louisville Gas and Electric Company
LKE	London Interbank Offered Rate
	LG&E and KU Energy LLC and Subsidiaries (formerly E.ON U.S. LLC and Subsidiaries)
MISO	Midwest Independent Transmission System Operator, Inc.
MMBtu	Million British thermal units

## Index of Abbreviations

Moody's	Moody's Investor Services, Inc.
MVA	Megavolt-ampere
Mw	Megawatts
Mwh	Megawatt hours
NAAQS	National Ambient Air Quality Standards
NERC	North American Electric Reliability Corporation
NO <sub>2</sub>	Nitrogen Dioxide
NOV	Notice of Violation
NO <sub>x</sub>	Nitrogen Oxide
OATT	Open Access Transmission Tariff
OMU	Owensboro Municipal Utilities
OVEC	Ohio Valley Electric Corporation
PPL	PPL Corporation
Predecessor	The Company during the time period prior to November 1, 2010
PUHCA 2005	Public Utility Holding Company Act of 2005
RSG	Revenue Sufficiency Guarantee
S&P	Standard & Poor's Rating Service
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
SPP	Southwest Power Pool, Inc
Successor	The Company during the time period after October 31, 2010
TC1	Trimble County Unit 1
TC2	Trimble County Unit 2
TVA	Tennessee Valley Authority
Utilities	KU and LG&E
VDT	Value Delivery Team Process
Virginia Commission	Virginia State Corporation Commission

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### Forward-Looking Information

KU uses forward-looking statements in this annual report. Statements that are not historical facts are forward-looking statements, and are based on beliefs and assumptions of management, and on information currently available to management. Forward-looking statements include statements preceded by, followed by or using such words as “believe,” “expect,” “anticipate,” “plan,” “estimate” or similar expressions. Such statements speak only as of the date they are made, and the Company undertakes no obligation to update publicly any of them in light of new information or future events. Actual results may materially differ from those implied by forward-looking statements due to known and unknown risks and uncertainties. Factors that could cause actual results to differ materially from those indicated in any forward-looking statement include, but are not limited to:

- fuel supply availability;
- weather conditions affecting generation production, customer energy use and operating costs;
- operation, availability and operating costs of existing generation facilities;
- transmission and distribution system conditions and operating costs;
- collective labor bargaining negotiations;
- the outcome of litigation against the Company;
- potential effects of threatened or actual terrorism or war or other hostilities;
- commitments and liabilities;
- market demand and prices for energy, capacity, transmission services, emission allowances and delivered fuel;
- competition in retail and wholesale power markets;
- liquidity of wholesale power markets;
- defaults by counterparties under the Company’s energy, fuel or other power product contracts;
- market prices of commodity inputs for ongoing capital expenditures;
- capital market conditions, including the availability of capital or credit, changes in interest rates, and decisions regarding capital structure;
- the fair value of debt and equity securities and the impact on defined benefit costs and resultant cash funding requirements for defined benefit plans;
- interest rates and their effect on pension and retiree medical liabilities;
- volatility in or the impact of other changes in financial or commodity markets and economic conditions;
- profitability and liquidity, including access to capital markets and credit facilities;
- new accounting requirements or new interpretations or applications of existing requirements;
- securities and credit ratings;
- current and future environmental conditions and requirements and the related costs of compliance, including environmental capital expenditures, emission allowance costs and other expenses;
- political, regulatory or economic conditions in states, regions or countries where the Company conducts business;
- receipt of necessary governmental permits, approvals and rate relief;
- new state or federal legislation, including new tax, environmental, health care or pension-related legislation;
- state or federal regulatory developments;
- the impact of any state or federal investigations applicable to the Company and the energy industry;
- the effect of any business or industry restructuring;
- development of new projects, markets and technologies;

- performance of new ventures; and
- asset acquisitions and dispositions.

In light of these risks and uncertainties, the events described in the forward-looking statements might not occur or might occur to a different extent or at a different time than the Company has described. For additional details regarding these and other risks and uncertainties, see Risk Factors.



## Business

### General

KU, incorporated in Kentucky in 1912 and in Virginia in 1991, is a regulated utility engaged in the generation, transmission, distribution and sale of electric energy in Kentucky, Virginia and Tennessee. KU provides electric service to approximately 514,000 customers in 77 counties in central, southeastern and western Kentucky, to approximately 30,000 customers in five counties in southwestern Virginia and less than ten customers in Tennessee. KU's service area covers approximately 6,600 noncontiguous square miles. Approximately 98% of the electricity generated by KU is produced by its coal-fired electric generating stations. The remainder is generated by natural gas and oil fueled CTs and a hydroelectric power plant. In Virginia, KU operates under the name Old Dominion Power Company. KU also sells wholesale electric energy to 12 municipalities.

On November 1, 2010, KU became an indirect wholly owned subsidiary of PPL, when PPL acquired all of the outstanding limited liability company interests in the Company's direct parent, LKE, from E.ON US Investments Corp. LKE, a Kentucky limited liability company, also owns the affiliate, LG&E, a regulated utility engaged in the generation, transmission, distribution and sale of electric energy and distribution and sale of natural gas in Kentucky. Following the acquisition, the Company's business has not changed. KU and LG&E are continuing as subsidiaries of LKE, which is now an intermediary holding company in the PPL group of companies.

Headquartered in Allentown, Pennsylvania, PPL is an energy and utility holding company that was incorporated in 1994. Through its subsidiaries, PPL owns or controls about 19,000 megawatts of generating capacity in the U.S., sells energy in key U.S. markets and delivers electricity and natural gas to about 5.3 million customers in the U.S. and the U.K.

### *Predecessor and Successor*

KU's historical financial results are presented using "Predecessor" or "Successor" to designate the periods before or after PPL's acquisition of LKE. Predecessor covers the time period prior to November 1, 2010. Successor covers the time period after October 31, 2010. Certain accounting and presentation methods were changed to acceptable alternatives to conform to PPL accounting policies and the cost basis of certain assets and liabilities were changed as of November 1, 2010, as a result of the application of push-down accounting. Consequently, the financial position, results of operations and cash flows for the Successor period are not comparable to the Predecessor period.

Despite the separate presentation, the core operations of the Company have not changed. See Note 1, Summary of Significant Accounting Policies, for the major differences in Predecessor and Successor accounting policies. See Note 2, Acquisition by PPL, for information regarding the acquisition and the purchase accounting adjustments.

### Operations

*Dollars are in millions unless otherwise noted.*

Arbough

The sources of operating revenues and volumes of sales for the following periods in 2010, 2009 and 2008 were as follows:

	<u>Successor</u>		<u>Predecessor</u>					
	November 1, 2010 through December 31, 2010		January 1, 2010 through October 31, 2010		Year Ended December 31, 2009		Year Ended December 31, 2008	
	<u>Revenues</u>	<u>Volumes (Gwh)</u>	<u>Revenues</u>	<u>Volumes (Gwh)</u>	<u>Revenues</u>	<u>Volumes (Gwh)</u>	<u>Revenues</u>	<u>Volumes (Gwh)</u>
Residential	\$ 106	1,394	\$ 440	5,788	\$ 480	6,594	\$ 462	6,803
Industrial and commercial	117	1,876	588	9,152	637	10,171	636	10,709
Municipals	15	326	88	1,676	91	1,848	92	1,971
Other retail	20	273	114	1,453	118	1,647	108	1,707
Wholesale	5	68	18	376	29	660	107	2,894
	<u>\$ 263</u>	<u>3,937</u>	<u>\$ 1,248</u>	<u>18,445</u>	<u>\$ 1,355</u>	<u>20,920</u>	<u>\$ 1,405</u>	<u>24,084</u>

KU's peak load in 2010 was 4,517 Mw on December 15, 2010, when the temperature dropped to a low of 3 degrees Fahrenheit in Lexington. KU's all time peak load was 4,640 Mw and occurred on January 16, 2009, when the temperature dropped to a low of -2 degrees Fahrenheit in Lexington.

The Company's power generating system includes coal-fired steam generating stations, with natural gas and oil fueled CTs which supplement the system during peak or emergency periods. As of December 31, 2010, KU's system capacity was:

<u>Fuel/Plant</u>	<u>Total Summer Mw Capacity (a)</u>	<u>% Ownership</u>	<u>Ownership or Lease Interest in Mw</u>	<u>Location</u>
<b>Coal (steam)</b>				
Ghent	1,918	100.00	1,918	Carroll County, KY
E.W. Brown	684	100.00	684	Mercer County, KY
Green River	163	100.00	163	Muhlenberg County, KY
Tyrone	71	100.00	71	Woodford County, KY
OVEC - Clifty Creek (b)	1,304	2.50	33	Jefferson County, IN
OVEC - Kyger Creek (b)	1,086	2.50	27	Gallia County, OH
<b>Total steam</b>	<b>5,226</b>		<b>2,896</b>	
<b>Natural gas/oil (combustion turbines)</b>				
E.W. Brown Units 8-11	480	100.00	480	Mercer County, KY
Trimble County Units 7-10 (c)	640	63.00	403	Trimble County, KY
Trimble County Units 5-6 (c)	320	71.00	227	Trimble County, KY
E.W. Brown Units 6-7 (c)	338	62.00	214	Mercer County, KY
Paddy's Run (c)	158	47.00	74	Jefferson County, KY
E.W. Brown Unit 5	129	47.00	63	Mercer County, KY
Haefling	36	100.00	36	Fayette County, KY
<b>Total combustion turbines</b>	<b>2,101</b>		<b>1,497</b>	

<u>Fuel/Plant</u>	<u>Total Summer Mw Capacity (a)</u>	<u>% Ownership</u>	<u>Ownership or Lease Interest in Mw</u>	<u>Location</u>
Hydro				
Dix Dam Hydroelectric Station	<u>24</u>	100.00	<u>24</u>	Mercer County, KY
Total hydro	<u>24</u>		<u>24</u>	
Total system capacity	<u><u>7,351</u></u>		<u><u>4,417</u></u>	

- (a) The capacity of generation units is based on a number of factors, including the operating experience and physical conditions of the units and may be revised periodically to reflect changed circumstances.
- (b) KU is contractually entitled to 2.50% of OVEC's output based on a power purchase agreement which is comprised of annual minimum debt service payments, as well as contractually-required reimbursement of plant operating, maintenance and other expenses. OVEC's capacity is shown at unit nameplate ratings.
- (c) Units are jointly owned with LG&E. See Note 14, Jointly Owned Electric Utility Plant, for further information.

With limited exceptions the Company took care, custody and control of TC2 on January 22, 2011, and has dispatched the unit to meet customer demand since that date. KU and the contractor agreed to a further amendment of the construction agreement whereby the contractor will complete certain actions relating to identifying and completing any necessary modifications to allow operation of TC2 on all fuels in accordance with initial specifications prior to certain dates, and amending the provisions relating to liquidated damages. Unit 2 is coal-fired and has a capacity of 760 Mw, of which KU's share is 462 Mw.

On December 31, 2010, KU's transmission system included 132 substations (54 of which are shared with the distribution system) with transformer capacity of approximately 13,136 MVA and approximately 4,076 miles of lines. The distribution system included 480 substations (54 of which are shared with the transmission system) with transformer capacity of approximately 7,044 MVA, and approximately 14,123 miles of overhead lines and 2,221 miles of underground conduit.

KU had a power supply contract with OMU that was terminated by OMU in May 2010. KU owns 20% of EEI's common stock and 2.5% of OVEC's common stock. KU has power purchase rights for its portion of OVEC's output. Additional information regarding this relationship is provided in Note 1, Summary of Significant Accounting Policies and Note 13, Commitments and Contingencies.

KU contracts with the TVA to act as KU's transmission reliability coordinator and SPP to function as KU's independent transmission operator, pursuant to FERC requirements. The TVA and SPP contracts provide services through August 31, 2011 and August 31, 2012, respectively. See Note 3, Rates and Regulatory Matters, for further information.

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

increases would take effect before January 1, 2013. The KU rate increases that took effect on **Arbough August 1, 6**

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 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 Utilities. The volume of energy each company has to sell to the other is dependent on its native load needs and its available generation.

Substantially all of KU's real and tangible property located in Kentucky is subject to a mortgage lien, securing its first mortgage bonds. See Note 11, Long-Term Debt, for further information.

### Rates and Regulations

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

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

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 Corp., PPL and E.ON.

The transaction was 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 the FERC and state regulators in Kentucky, Virginia and Tennessee) and the absence of injunctions or restraints imposed by governmental entities.

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 committed that no base rate

2010, were not impacted by the settlement. Under the terms of the settlement, KU retains 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 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 KU 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. On September 30, 2010, the Kentucky Commission issued an Order approving the transfer of ownership of KU 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 other applicants in the FERC change of control proceeding reached an agreement with the protesters, whereby such protests have been withdrawn. The agreement, which was 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 KU agreed not to 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, and the transaction was completed on November 1, 2010.

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. In June 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, including a return on equity range of 9.75-10.75%. The new rates became effective on August 1, 2010.

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%. As permitted, pursuant to a Virginia Commission Order, KU elected to implement the proposed rates effective November 1, 2009, on an interim basis. During December 2009, KU and the Virginia Commission Staff agreed to a Stipulation and Recommendation authorizing a base rate revenue increase of \$11 million annually and a return on rate base of 7.846% based on a 10.5% return on common equity. In March 2010, the Virginia Commission 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.

In January 2009, a significant ice storm passed through KU’s service area 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. KU received approval in its 2010 base rate case to recover this asset over a ten year period with recovery beginning August 1, 2010.

In September 2008, high winds from the remnants of Hurricane Ike passed through the service area 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.

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 rates 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 adjustments to the formula rates, which incorporated certain proposed increases. Updated rates, including certain further adjustments from a review process involving wholesale requirements customers, became effective as of July 1, 2010.

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. 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.

In July 2008, KU filed an application with the Kentucky Commission requesting an increase in electric base 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 electric base 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.

For a further discussion of regulatory matters, see Note 3, Rates and Regulatory Matters.

### Coal Supply

Coal-fired generating units provided approximately 98% of KU's net kWh generation for 2010. The remaining net generation was provided by natural gas and oil fueled CTs and a hydroelectric plant. Coal is expected to be the predominant fuel used by KU in the foreseeable future, with natural gas and oil

being used for peaking capacity and flame stabilization in coal-fired boilers or in emergencies. The Company has no nuclear generating units and has no plans to build any in the foreseeable future.

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

KU has entered into coal supply agreements with various suppliers for coal deliveries for 2011 and beyond and normally augments its coal supply agreements with spot market purchases. The Company has a coal inventory policy which it believes provides adequate protection under most contingencies.

KU expects to continue purchasing most of its coal, which has sulfur content in the 0.7% - 3.5% range, from western and eastern Kentucky, West Virginia, southern Indiana, southern Illinois, Ohio and Wyoming for the foreseeable future. This supply, in combination with the installation of FGDs (SO<sub>2</sub> removal systems), KU expects its use of higher sulfur coal to increase, the combination of which is expected to enable KU to continue to provide electric service in compliance with existing environmental laws and regulations. Coal is delivered to KU's generating stations by a mix of transportation modes, including barge, truck and rail.

#### Seasonality

Demand for and market prices for electricity are affected by weather. As a result, KU's overall operating results in the future may fluctuate substantially on a seasonal basis, especially when more severe weather conditions such as heat waves or winter storms make such fluctuations more pronounced. The pattern of this fluctuation may change depending on the type and location of the facilities KU owns and the terms of its contracts to purchase or sell electricity.

#### Environmental Matters

##### *General*

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

##### *Climate Change*

Recent developments continue to indicate an increased possibility of significant climate change or GHG legislation or regulation, at the international, federal, regional and state levels. During December 2009, as part of the United Nation's Copenhagen Accord, the United States agreed to a non-binding goal to reduce GHG emissions to 17% below 2005 levels by 2020. Additionally, during 2009, the U.S. House of Representatives passed comprehensive GHG legislation, which included a number of measures to limit GHG emissions and achieve GHG emission reduction targets below 2005 levels of 3% by 2012, 17% by 2020 and 83% by 2050. Similar legislation has been considered in the U.S. Senate, but the prospects for

passage remain uncertain. In late 2009, the EPA issued a final endangerment finding relating to mobile sources of GHGs and a GHG reporting requirement beginning in 2010. In 2010, the EPA issued a final rule requiring implementation of best available control technology for GHG emissions from new or modified power plants, effective January 2011. In December 2010, the EPA announced that it intends to propose New Source Performance Standards addressing GHG emissions from new and existing power plants, with a proposed rule expected in July 2011. Finally, a number of U.S. states, although not currently including Kentucky, have adopted GHG-reduction legislation or regulation of various sorts. The developing GHG initiatives include a number of differing structures and formats, including direct limitations on GHG sources, issuance of allowances for GHG emissions, cap-and-trade programs for such allowances, renewable or alternative generation portfolio standards and mechanisms relating to demand reduction, energy efficiency, smart-grid, transmission expansion, carbon-sequestration or other GHG-reducing efforts. While the final terms and impacts of such initiatives cannot be estimated, KU, as a primarily coal-fired utility, could be highly affected by such proceedings.

Among other emissions, GHGs include carbon-dioxide, which is produced via the combustion of fossil fuels such as coal and natural gas. KU's generating fleet is approximately 66% coal-fired, 34% oil/natural gas-fired and less than 1% hydroelectric based on capacity. During 2010, KU produced approximately 98% of its electricity from coal, 2% from natural gas combustion and less than 1% from hydroelectric generation, based on Mwh. During 2010, KU's emissions of GHGs were approximately 16.4 million metric tons of carbon-dioxide equivalents from KU's owned or controlled generation sources. While its generation activities account for the bulk of its GHG emissions, other GHG sources at KU include operation of motor vehicles and powered equipment, leakage or evaporation associated with natural gas pipelines, refrigerating equipment and similar activities.

Ultimately, environmental matters or potential environmental matters can represent an important element of current or future potential capital requirements, future unit retirement or replacement decisions, supply and demand for electricity, operating and maintenance expenses or compliance risks for the Company. Based on prior regulatory precedent, KU currently anticipates that many of such direct costs may be recoverable through rates or other regulatory mechanisms, particularly with respect to coal-related generation, but the availability, timing or completeness of such rate recovery cannot be assured. Ultimately, climate change and other environmental matters will likely increase the level of capital expenditures and operating and maintenance costs incurred by the Company during the next several years. 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. In order to comply with the coal combustion residual rules and the above referenced air rules, capital expenditures for KU are preliminarily estimated to be in the \$1.5 to \$1.7 billion range over the next ten years, although final costs may substantially vary. This estimate does not include compliance with GHG rules or contemplated water-related environmental changes. See Risk Factors, Management's Discussion and Analysis and Note 13, Commitments and Contingencies, for further information.



### State Executive or Legislative Matters

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

- Improve the energy efficiency of Kentucky's homes, buildings, industries and transportation fleet
- Increase Kentucky's use of renewable energy
- Sustainably grow Kentucky's production of biofuels
- Develop a coal-to-liquids industry in Kentucky to replace petroleum-based liquids
- Implement a major and comprehensive effort to increase natural gas supplies, including coal- to-natural 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 natural gas taxes and state tax credits to support biomass development.

In January 2010, a state-established Kentucky Climate Action Plan Council (the "Council") commenced formal activities. The Council, which includes governmental, industry, consumer and other representatives, seeks to identify possible Kentucky responses to potential climate change and federal legislation, including increasing statewide energy efficiency, energy independence and economic growth. The Council has established various technical work groups, including in the areas of energy supply and energy efficiency/conservation, to provide input, data and recommendations.

During the current session of the Kentucky General Assembly, as during prior legislative sessions, legislators have introduced or are expected to introduce various bills with respect to environmental or utility matters, including potential requirements relating to renewable energy portfolios, energy conservation measures, coal mining or coal byproduct operations and other matters. The current session is scheduled to end in March 2011 and until such time the prospects and final terms of any such legislation cannot be determined. Legislative and regulatory actions as a result of these proposals and their impact on KU, which may be significant, cannot currently be predicted.

### Franchises and Licenses

KU provides electric delivery service in its various service areas pursuant to certain franchises, licenses, statutory service areas, easements and other rights or permissions granted by state legislatures, cities or municipalities or other entities.

### Competition

There are currently no other electric utilities operating within the electric service areas of KU. 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 any legislative or regulatory actions regarding industry restructuring and their impact on KU, which may be significant, cannot currently be predicted. Virginia, formerly a competitive jurisdiction, has enacted legislation which implements a hybrid model of cost-based regulation. See Note 3, Rates and Regulatory Matters, for further information.

### Employees and Labor Relations

KU had 974 employees at December 31, 2010, consisting of 973 full-time employees and 1 part-time employee. Of the total employees, 145, or 15%, were operating, maintenance and construction employees represented by the IBEW Local 2100 and the United Steelworkers of America (“USWA”) Local 9447-01. In August 2009, the Company and its employees represented by the IBEW Local 2100 entered into a three-year collective bargaining agreement that provides for negotiated increases or changes to wages, benefits or other provisions and annual wage re-openers. In August 2008, the Company and its employees represented by the USWA Local 9447-01 entered into a three-year collective bargaining agreement that provides for negotiated increases or changes to wages, benefits or other provisions and annual wage re-openers.

Officers of the Company

Officers are elected annually by the Board of Directors. There are no family relationships among any of the executive officers, nor is there any arrangement or understanding between any executive officer and any other person pursuant to which the officer was selected.

Except as may be set forth in Legal Proceedings, there have been no events under any bankruptcy act, no criminal proceedings and no judgments or injunctions material to the evaluation of the ability and integrity of any executive officer during the past five years.

Listed below are the executive officers at December 31, 2010.

Name	Age	Positions Held During the Past Five Years	Dates
Victor A. Staffieri	55	Chairman of the Board, President and Chief Executive Officer	May 2001 – present
John R. McCall	67	Executive Vice President, General Counsel, Corporate Secretary and Chief Compliance Officer	July 1994 – present
Chris Hermann	63	Senior Vice President – Energy Delivery	February 2003 – present
Paula H. Pottinger	53	Senior Vice President – Human Resources	January 2006 – present
S. Bradford Rives	52	Chief Financial Officer	September 2003 – present
Paul W. Thompson	53	Senior Vice President – Energy Services	June 2000 – present

Officers generally serve in the same capacities at the Company, LKE and LG&E.

## Risk Factors

*Any of the events or circumstances described as risks below could result in a significant or material adverse effect on the business, results of operations, cash flows or financial condition. The risks and uncertainties described below may not be the only risks and uncertainties that KU faces. Additional risks and uncertainties not currently known or that KU currently deems immaterial may also result in a significant or material adverse effect on the business, results of operations, cash flow or financial condition.*

### **KU's business is subject to significant and complex governmental regulation.**

Various federal and state entities, including but not limited to the FERC, Kentucky Commission, Virginia Commission and the Tennessee Regulatory Authority, regulate many aspects of utility operations of KU, including the following:

- the rates that KU may charge and the terms and conditions of the Company's 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 KU to higher operating costs or increased capital expenditures and failure to comply could result in sanctions or possible penalties. In any rate-setting proceedings, federal or state agencies, intervenors and other permitted parties may challenge rate requests and ultimately reduce, alter or limit the rates the Company seeks.

The profitability of KU is highly dependent on its ability to recover the costs of providing energy and utility services to its customers and earn an adequate return on its capital investments. KU currently provides services to 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 their costs incurred in a base year, the rates KU is allowed to charge may or may not match its 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 the 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 KU's costs or an adequate return on KU's capital investments. If the Company's costs are not adequately recovered through rates, it could have an adverse affect on the business, results of operations, cash flows or financial condition.

As part of the PPL acquisition commitments, KU has agreed, subject to certain limited exceptions such as fuel and environmental cost recoveries, that no base rate increase would take effect for Kentucky retail customers before January 1, 2013.

emissions, water discharges and the management of hazardous and solid waste, among other areas; and 15

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

KU 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, RSG resettlements in the MISO market, mandatory reliability standards and natural gas transportation regulation can affect the earnings, operations or other activities of KU.

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

Wholesale sales 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 KU participates.

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

KU's 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 the following:

- 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 capital projects on schedule or on budget, or at all, could adversely affect the Company's financial performance, operations and future growth.

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

Extensive federal, state and local environmental laws and regulations are applicable to KU's air

the costs of compliance or alleged non-compliance cannot be predicted with certainty but could be material. In addition, KU's 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 key suppliers, or customers, such as coal producers, industrial power users, etc., and may impact the costs of their products or their demand for KU's services.

**KU is subject to operational and financial risks regarding certain on-going developments concerning environmental regulation.**

A number of regulatory initiatives have been implemented or are under development which could have the effect of significantly increasing the environmental regulation or operational or compliance costs related to a number of emissions or operating activities which are associated with the combustion of coal as occurs at the Company's generating stations. Such developments could include potential new or revised federal or state legislation or regulation regarding emissions of NO<sub>x</sub>, SO<sub>2</sub>, mercury and other particulates generally and regarding storage of coal combustion byproducts. Additional regulatory initiatives may occur in other areas involving the Company's operations, including revision of limitations on water discharge or intake activities or increased standards relating to polychlorinated biphenyl usage. Compliance with any new laws or regulations in these matters could result in significant changes to KU's operations, significant capital expenditures by the Company or significant increases in the cost of conducting business.

**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 the finances or operations of KU by changing demand levels; causing outages; damaging infrastructure or requiring significant repair costs; affecting capital markets and general economic conditions or impacting future growth.

**KU is 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 GHGs, which are emitted from the combustion of fossil fuels such as coal and natural gas, as occurs at the Company's 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. The generation fleet of KU 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 KU's operations, significant capital expenditures by the Company and a significant increase in the cost of conducting business. KU may face strong

competition for, or difficulty in obtaining, required GHG-compliance related goods and services, including construction services, emissions allowances and financing, insurance and other inputs relating thereto. Increases in KU's costs or prices of producing or selling electric power due to GHG-related developments could materially reduce or otherwise affect the demand, revenue or margin levels applicable to its power, thus adversely affecting its financial condition or results of operations.

**KU is 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 KU. 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 the service area of KU, both in general and specific to certain industries and consumers accustomed to previously low-cost power, could reduce demand for KU's electricity. Also, demand for 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.

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

**KU's business is concentrated in the Midwest United States, specifically Kentucky and Virginia.**

Although the business of KU is concentrated in Kentucky and Virginia, it also operates in Tennessee. 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 KU's results of operations. Significant industries and activities in the service area of KU include aluminum and steel smelting and fabrication; chemical processing; coal, mineral and ceramic related activities; educational institutions; health care facilities; paper and pulp processing; metal fabrication; and water and sewer utilities. Any significant downturn in these industries or activities or in local and regional economic conditions in KU's service area may adversely affect the demand for electricity in the service area.

**KU is subject to operational risks relating to KU's generating plants, transmission facilities, distribution equipment, information technology systems and other assets and activities.**

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

Although KU maintains customary insurance coverage for certain of these risks common to utilities, it does not have insurance covering the transmission and distribution systems, other than substations, because it has found the cost of such insurance to be prohibitive. If KU is unable to recover the costs incurred in restoring transmission and distribution properties following damage resulting from ice storms, tornados or other natural disasters or to recover the costs of other liabilities arising from the risks of its business, through a change in rates or otherwise, or if such recovery is not received on a timely basis, it may not be able to restore losses or damages to its properties without an adverse effect on its financial condition, results of operations or its reputation.

**KU is subject to liability risks relating to its generation, transmission, distribution and retail businesses.**

The conduct of the physical and commercial operations of KU subjects it 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.

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

In the ordinary course of business, KU is reliant upon adequate long-term and short-term financing means to fund significant capital expenditures, debt interest or maturities and operating needs. As a capital-intensive business, the Company is sensitive to developments in interest rate levels; credit rating considerations; insurance, security or collateral requirements; market liquidity and credit availability and



refinancing steps necessary or advisable to respond to credit market changes. Changes in these conditions could result in increased costs and decreased liquidity available to the Company.

**KU is subject to commodity price risk, credit risk, counterparty risk and other risks associated with the energy business.**

General market or pricing developments or failures by counterparties to perform their obligations relating to energy, fuels, other commodities, goods, services or payments could result in potential increased costs to the Company.

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

KU sponsors pension and postretirement benefit plans for its 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 current or future funding requirements or liabilities. Without sustained growth in respective investments over time to increase the value of plan assets, KU could be required to fund plans with significant amounts of cash. KU is 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.

**KU is subject to risks associated with federal and state tax regulations.**

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

## Legal Proceedings

### Rates and Regulatory Matters

For a discussion of current rates and regulatory matters, including recent electric base rate increase proceedings, rate commitments in change-of-control proceedings, TC2 proceedings, FERC, Kentucky Commission and Virginia Commission proceedings and other rates or regulatory matters affecting KU, see Note 3, Rates and Regulatory Matters, and Note 13, Commitments and Contingencies.

### Environmental

For a discussion of environmental matters, including potential coal combustion byproduct or ash pond regulation; additional reductions in SO<sub>2</sub>, NO<sub>x</sub> and other regulated emissions; NOVs and other emissions proceedings; environmental permit challenges; and other environmental items affecting KU, see Risk Factors, Note 3, Rates and Regulatory Matters, and Note 13, Commitments and Contingencies.

### Climate Change

For a discussion of matters relating to potential climate change, GHG emission or global warming developments, including increased legislative and regulatory activity which could limit or increase costs applicable to fossil fuel generation sources, legal proceedings claiming damages relating to global warming, GHG reporting requirements and other matters, see Business, Risk Factors, Management's Discussion and Analysis and Note 13, Commitments and Contingencies.

### Litigation

In connection with an administrative proceeding alleging a violation by a former Argentine affiliate under that country's 2002-2003 emergency currency exchange laws, claims are pending against the affiliate'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 affiliate 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. LKE has standard indemnification arrangements with its executive officers. The former affiliate is now owned by a third party, which has agreed to indemnify LKE and the relevant executive officers.

For a discussion of litigation matters, see Note 13, Commitments and Contingencies.

### Other

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

**Selected Financial Data***Dollars are in millions unless otherwise noted.*

	Successor	Predecessor				
	November 1, 2010 through December 31, 2010	January 1, 2010 through October 31, 2010	Year Ended December 31,			
			2009	2008	2007	2006
Operating revenues	\$ <u>263</u>	\$ <u>1,248</u>	\$ <u>1,355</u>	\$ <u>1,405</u>	\$ <u>1,272</u>	\$ <u>1,210</u>
Operating income	\$ <u>65</u>	\$ <u>285</u>	\$ <u>269</u>	\$ <u>260</u>	\$ <u>267</u>	\$ <u>235</u>
Net income	\$ <u>35</u>	\$ <u>140</u>	\$ <u>133</u>	\$ <u>158</u>	\$ <u>167</u>	\$ <u>152</u>
Total assets	\$ <u>6,059</u>	\$ <u>5,145</u>	\$ <u>4,956</u>	\$ <u>4,518</u>	\$ <u>3,796</u>	\$ <u>3,148</u>
Long-term debt obligations (including amounts due within one year)	\$ 1,841	\$ <u>1,682</u>	\$ 1,682	\$ 1,532	\$ 1,264	\$ 843

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

## Management's Discussion and Analysis

*Management's Discussion and Analysis should be read in conjunction with the Financial Statements and Notes for the years ended December 31, 2010, 2009 and 2008. Dollars are in millions unless otherwise noted.*

The purpose of "Management's Discussion and Analysis" is to provide information about KU's performance in implementing its' strategies and managing risks and challenges. Specifically:

- "Overview" provides background regarding KU's business and identifies significant matters with which management is primarily concerned in evaluation of KU's financial condition and operating results.
- "Results of Operations" provides a description of KU's operating results in 2010, 2009 and 2008, including a review of earnings and a brief outlook for 2011.
- "Financial Condition" provides an analysis of KU's liquidity position and credit profile, including its sources of cash (including bank credit facilities and sources of operating cash flow) and uses of cash (including contractual obligations and capital expenditure requirements) and the key risks and uncertainties that impact KU's past and future liquidity position and financial condition. This subsection also includes a discussion of KU's current credit ratings.
- "Application of Critical Accounting Policies and Estimates" provides an overview of the accounting policies that are particularly important to the results of operations and financial condition of KU and that require its management to make significant estimates, assumptions and other judgments.

### Overview

KU is a regulated utility engaged in the generation, transmission, distribution and sale of electric energy in Kentucky, Virginia and Tennessee. See the Business section for a description of the business. The rates KU charges its customers requires approval of the appropriate regulatory government agency. See Note 3, Rates and Regulatory Matters, for information regarding rate cases, regulatory assets and liabilities and other regulatory matters.

KU and its affiliate, LG&E, are wholly owned subsidiaries of LKE, a Kentucky limited liability company. PPL acquired LKE on November 1, 2010. Headquartered in Allentown, Pennsylvania, PPL is an energy and utility holding company that was incorporated in 1994. Through its subsidiaries, PPL owns or controls about 19,000 megawatts of generating capacity in the U.S., sells energy in key U.S. markets and delivers electricity and natural gas to about 5.3 million customers in the U.S. and the U.K. Following the acquisition, both KU and LG&E continue operating as subsidiaries of LKE, which is now an intermediary holding company in the PPL group of companies. See Note 2, Acquisition by PPL, for further information regarding the acquisition.

In operating its business, the Company faces several risks including credit risks, liquidity risks, interest rate risks and commodity and price risks. For instance, the Company has credit risks from counterparties, customers and effects of its' own credit ratings. KU attempts to manage these risks through the adoption of financial and operational risk management programs that, among other things, are designed to monitor and reduce its' exposure to these risks. Identified within "Management's

Discussion and Analysis” of “Financial Condition” and “Results of Operations” are risks KU’s management currently consider material; these risks are not the only risks faced by KU. Additional risks not presently known or currently deemed immaterial may also impair KU’s business operations. See Risk Factors and Financial Condition - Risk Management for further discussion.

#### Predecessor and Successor Financial Presentation

KU’s financial statements and related financial and operating data include the periods before or after PPL’s acquisition of LKE on November 1, 2010, and are labeled as Predecessor or Successor. KU applied push-down accounting to account for the acquisition. For accounting purposes only, push-down accounting is considered to create a new entity due to new cost basis assigned to assets, liabilities and equity as of the acquisition date. Consequently, KU’s results of operations and cash flows for the Predecessor and Successor periods in 2010 are shown separately, rather than combined, in its audited financial statements.

In the “Management’s Discussion and Analysis” of “Results of Operations” and “Financial Condition”, the Company has included disclosure of the combined Predecessor and Successor results of operations and cash flows. Such presentation is considered to be a non-GAAP disclosure. KU has included such disclosure because the Company believes it facilitates the comparison of 2010 operating and financial performance to 2009 and 2008, and because the core operations of the Company have not changed as a result of the acquisition.

#### Competition

See the Business section for information concerning competition.

#### Environmental Matters

##### *General*

Protection of the environment is a major priority for KU and a significant element of its business activities. Extensive federal, state and local environmental laws and regulations are applicable to KU’s air emissions, water discharges and the management of hazardous and solid waste, among other areas; and the costs of compliance or alleged non-compliance cannot be predicted with certainty but could be material. In addition, costs may increase significantly if the requirements or scope of environmental laws or regulations, or similar rules, are expanded or changed from prior versions by the relevant agencies.

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

##### *Climate Change*

Recent developments continue to indicate an increased possibility of significant climate change or GHG legislation or regulation, at the international, federal, regional and state levels. During December 2009, the U.S. House of Representatives passed legislation to reduce GHG emissions to 17% below 2005 levels by 2020. Additionally, during 2009, the U.S. House of Representatives, as part of the United Nation’s Copenhagen Accord, the United States agreed to a non-binding goal to

Representatives passed comprehensive GHG legislation, which included a number of measures to limit GHG emissions and achieve GHG emission reduction targets below 2005 levels of 3% by 2012, 17% by 2020 and 83% by 2050. Similar legislation has been considered in the U.S. Senate, but the prospects for passage remain uncertain. In late 2009, the EPA issued a final endangerment finding relating to mobile sources of GHGs and a GHG reporting requirement beginning in 2010. In 2010, the EPA issued a final rule requiring implementation of best available control technology for GHG emissions from new or modified power plants, effective January 2011. In December 2010, the EPA announced that it intends to propose New Source Performance Standards addressing GHG emissions from new and existing power plants, with a proposed rule expected in July 2011. Finally, a number of U.S. states, although not currently including Kentucky, have adopted GHG-reduction legislation or regulation of various sorts. The developing GHG initiatives include a number of differing structures and formats, including direct limitations on GHG sources, issuance of allowances for GHG emissions, cap-and-trade programs for such allowances, renewable or alternative generation portfolio standards and mechanisms relating to demand reduction, energy efficiency, smart-grid, transmission expansion, carbon-sequestration or other GHG-reducing efforts. While the final terms and impacts of such initiatives cannot be estimated, KU, primarily a coal-fired utility, could be highly affected by such proceedings.

#### *Other Environmental Regulatory Initiatives*

The EPA has proposed or announced that it intends to propose a number of additional environmental regulations that could substantially impact utilities with coal-fired generating assets. These regulatory initiatives include revisions to the ambient air quality standards for SO<sub>2</sub>, NO<sub>2</sub>, ozone and particulate matter 2.5 microns in size or less, rules aimed at mitigating the interstate transport of SO<sub>2</sub> and NO<sub>x</sub>, a program governing emissions of hazardous air pollutants from utility generating units, a program for the management of coal combustion residuals, revised effluent guidelines for utility generating facilities and standards for cooling water intake structures. Such requirements could potentially mandate upgrade of existing emission controls, installation of additional emission controls such as FGDs, SCRs, fabric filter bag houses, activated carbon injection, wet electrostatic precipitators, closure of ash ponds and retrofit of landfills, installation of cooling towers, deployment of new water treatment technologies and retirement of facilities that cannot be retrofitted on a cost effective basis.

The cost to KU and the effect on KU's business of complying with potential GHG restrictions and other environmental regulatory initiatives will depend upon provisions of any final rules and how the rules are implemented by the EPA. Some of the design elements which may have the greatest effect on KU include (a) the required levels and timing of emissions caps, discharge limits or similar standards, (b) the sources covered by such requirements, (c) transition and mitigation provisions, such as phase-in periods, free allowances or price caps, (d) the availability and pricing of relevant mitigation or control technologies, goods or services and (e) economic, market and customer reaction to electricity price and demand changes due to environmental concerns.

Ultimately, environmental matters or potential environmental matters can 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. Based on prior regulatory precedent, KU currently anticipates that many of such direct costs may be recoverable through rates or other regulatory mechanisms, particularly with respect to coal-related generation, but the availability, timing or completeness of such rate recovery cannot be assured. Ultimately, climate change and other environmental matters will likely increase the level of

capital expenditures and operating and maintenance costs incurred by the Company during the next several years. 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. In order to comply with the coal combustion residual rules and the above referenced air rules, capital expenditures for KU are preliminarily estimated to be in the \$1.5 to \$1.7 billion range over the next ten years, although final costs may substantially vary. This estimate does not include compliance with GHG rules or contemplated water-related environmental changes. See Risk Factors and Note 13, Commitments and Contingencies, for further information.

## Results of Operations

The utility business is affected by seasonal temperatures. As a result, operating revenues (and associated operating expenses) are not generated evenly throughout the year. Revenue and earnings are generally highest during the first and third quarters, and lowest in the second quarter, due to weather.

### Net Income

The following table summarizes the significant components of net income for 2010, 2009 and 2008 and the changes therein:

	Combined	Successor	Predecessor		
	Year Ended December 31, 2010	November 1, 2010 through December 31, 2010	January 1, 2010 through October 31, 2010	Year Ended December 31, 2009	2008
Total operating revenues	\$ 1,511	\$ 263	\$ 1,248	\$1,355	\$ 1,405
Total operating expenses	<u>1,161</u>	<u>198</u>	<u>963</u>	<u>1,086</u>	<u>1,145</u>
Operating income	350	65	285	269	260
Equity in earnings of unconsolidated venture	3	-	3	1	30
Interest expense	14	8	6	6	14
Interest expense to affiliated companies	64	2	62	69	58
Other income (expense) – net	<u>(2)</u>	<u>-</u>	<u>(2)</u>	<u>5</u>	<u>8</u>
Income before income taxes	273	55	218	200	226
Income tax expense	<u>98</u>	<u>20</u>	<u>78</u>	<u>67</u>	<u>68</u>
Net income	<u>\$ 175</u>	<u>\$ 35</u>	<u>\$ 140</u>	<u>\$ 133</u>	<u>\$ 158</u>

The change in KU's net income was as follows:

	Increase (Decrease)	
	2010 vs. 2009	2009 vs. 2008
Total operating revenues	\$ 156	\$ (50)
Total operating expenses	75	(59)
Operating income	81	9
Equity in earnings of unconsolidated venture Interest expense	2	(29)
Interest expense to affiliated companies	8	(8)
Other income (expense) – net	(5)	11
Income (loss) before income taxes	(7)	(3)
Income taxes	73	(26)
Net income	31	(1)
	\$ 42	\$ (25)

### Operating Revenues

The \$156 million increase from 2009 to 2010 and \$50 million decrease from 2008 to 2009 in operating revenues were primarily due to:

	Increase (Decrease)	
	2010 vs. 2009	2009 vs. 2008
Retail sales volumes (a)	\$ 73	\$ (43)
Base rate price variance (b)	39	(5)
Demand revenue (c)	16	(1)
Sales to municipal customers (d)	12	(1)
Increased recoverable capital spending billed through the ECR	8	50
Other operating revenue primarily due to late payment charges	6	6
FAC price variance (e)	5	(2)
Merger surcredit termination in February 2009	2	13
Transmission sales	1	-
Increased recoverable program spending billed through the DSM	1	9
Wholesale sales (f)	(7)	(77)
VDT surcredit termination in August 2008	-	1
	\$ 156	\$ (50)

- (a) Retail sales volumes increased during 2010 compared to 2009 as a result of increased consumption primarily due to increased heating degree days during the first and fourth quarters of 2010 and increased cooling degree days during the second and third quarters of 2010. Additionally, improved economic conditions in 2010 and significant storm outages in 2009 contributed to the increased volumes.

The decrease in retail sales volumes during 2009 compared to 2008 was attributable to reduced consumption by retail customers, as a result of milder weather and weakened economic conditions, in addition to significant storm outages during 2009.



- (b) The increase in revenues due to the base rate price variance during 2010 compared to 2009 resulted from higher base rates effective August 1, 2010. See Note 3, Rates and Regulatory Matters, for further discussion of the 2010 Kentucky rate case.

The decrease in revenues due to the base rate price variance during 2009 compared to 2008 resulted from a reduction in base energy rates effective February 6, 2009. See Note 3, Rates and Regulatory Matters, for further discussion of the 2008 Kentucky rate case.

- (c) Demand revenues increased during 2010 compared to 2009 as a result of higher demand rates effective August 1, 2010 and higher customer peak demand. See Note 3, Rates and Regulatory Matters, for further discussion of the 2010 Kentucky rate case.
- (d) The increase in sales to municipal customers during 2010 compared to 2009 was primarily due to increased volumes as a result of increased cooling and heating degree days, improved economic conditions and a decline in storm outages.
- (e) FAC revenues increased during 2010 compared to 2009 as a result of increased recoverable fuel costs billed to customers through the FAC due to higher fuel prices.

The decrease in the FAC revenue during 2009 compared to 2008 resulted from lower fuel costs billed to customers through the FAC (\$2 million) due to a refund of power purchased costs from OMU (\$6 million) partially offset by increased recoverable fuel costs (\$4 million) billed to retail customers through the FAC.

- (f) The decrease in wholesale sales during 2010 compared to 2009 was primarily due to increased consumption by industrial customers, as a result of improved economic conditions, increased consumption by residential customers, as a result of increased cooling and heating degree days and an increase in LG&E's coal-fired generation outages in the first six months of 2010. See Note 15, Related Party Transactions, for further discussion of the mutual agreement for wholesale sales and purchases between KU and LG&E.

The decrease in wholesale sales during 2009 compared to 2008 was primarily due to lower sales volumes to LG&E and third-parties due to lower economic capacity, caused by low spot market pricing and higher scheduled coal-fired generation outages. See Note 15, Related Party Transactions, for further discussion of the mutual agreement for wholesale sales and purchases between KU and LG&E.

Operating 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 FERC, Kentucky Commission, Virginia Commission and the Tennessee Regulatory Authority. Operating expenses and the changes therein for 2010, 2009 and 2008 follow:

	Combined	Successor	Predecessor	
	Year Ended December 31, 2010	November 1, 2010 through December 31, 2010	January 1, 2010 through October 31, 2010	Year Ended December 31, 2009      2008
Fuel for electric generation	\$ 495	\$ 78	\$ 417	\$ 434    \$ 513
Power purchased	175	28	147	199      221
Other operation and maintenance expenses	346	66	280	320      275
Depreciation and amortization	<u>145</u>	<u>26</u>	<u>119</u>	<u>133</u> <u>136</u>
	<u>\$ 1,161</u>	<u>\$ 198</u>	<u>\$ 963</u>	<u>\$ 1,086</u> <u>\$ 1,145</u>

The changes in operating expenses were as follows:

	Increase (Decrease)	
	2010 vs. 2009	2009 vs. 2008
Fuel for electric generation	\$ 61	\$ (79)
Power purchased	(24)	(22)
Other operation and maintenance expenses	26	45
Depreciation and amortization	<u>12</u>	<u>(3)</u>
	<u>\$ 75</u>	<u>\$ (59)</u>

*Fuel for Electric Generation*

The \$61 million increase from 2009 to 2010 and \$79 million decrease from 2008 to 2009 were primarily due to:

	Increase (Decrease)	
	2010 vs. 2009	2009 vs. 2008
Fuel usage volumes (a)	\$ 77	\$ (97)
Commodity costs for coal	(15)	18
Other	<u>(1)</u>	<u>-</u>
	<u>\$ 61</u>	<u>\$ (79)</u>

- (a) Fuel usage volumes increased in 2010 compared 2009 due to increased native load sales. Fuel usage volumes decreased in 2009 compared to 2008 due to decreased native load and wholesale sales.

*Power Purchased Expense*

The \$24 million decrease from 2009 to 2010 and \$22 million decrease from 2008 to 2009 were primarily due to:

	Increase (Decrease)	
	2010 vs. 2009	2009 vs. 2008
Power purchased from OMU	\$ (40)	\$ 12
Purchases from LG&E due to volume (a)	(5)	(2)
Demand payments for third party purchases	(2)	1
Prices for purchases used to serve retail customers	7	(14)
Third party purchased volumes for native load (b)	7	(6)
OMU settlement received in 2009	6	(6)
Purchases from LG&E due to prices	3	(7)
	\$ (24)	\$ (22)

- (a) Purchased volumes from LG&E decreased in 2010 compared to 2009 primarily due to increased consumption by residential customers at LG&E as the result of increased cooling and heating degree days, 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.

Purchased volumes from LG&E decreased in 2009 compared to 2008 due to LG&E's increased scheduled outages at coal-fired generation units during the fourth quarter of 2009. See Note 15, Related Party Transactions, for further discussion of the mutual agreement for wholesale sales and purchases between the Utilities.

- (b) Third party purchase volumes with counterparties other than OMU increased in 2010 compared to 2009 primarily due to the termination of the OMU agreement. Third party purchase volumes with counterparties other than OMU decreased in 2009 compared to 2008 primarily due to availability of power for native load customers from the OMU agreement. See Note 13, Commitments and Contingencies, for further discussion of the OMU settlement.

*Other Operation and Maintenance Expenses*

The \$26 million increase from 2009 to 2010 was primarily due to \$22 million of increased other operation expenses and \$4 million of increased maintenance expenses. The \$45 million increase from 2008 to 2009 was primarily due to \$30 million of increased other operation expenses and \$15 million of increased maintenance expenses.

## Other Operation Expenses:

The \$22 million increase from 2009 to 2010 and \$30 million increase from 2008 to 2009 were primarily due to:

	Increase (Decrease)	
	2010 vs. 2009	2009 vs. 2008
Administrative and general expense (a)	\$ 9	\$ 3
Transmission expense (b)	5	-
Bad debt expense (c)	4	(1)
Steam expense (d)	4	7
Generation expense	2	(2)
DSM program spending	-	9
Legal expenses (e)	-	(6)
Other power supply	(1)	-
Pension expense (f)	(2)	20
Other	1	-
	<u>\$ 22</u>	<u>\$ 30</u>

- (a) Administrative and general expense increased in 2010 compared 2009 primarily due to higher labor expense and insurance expense, partially offset by lower IT expense related to the implementation of the Customer Care Solution system in 2009. Administrative and general expense increased in 2009 compared to 2008 primarily due to increased consulting fees for software training and increased labor and benefit costs.
- (b) Transmission expense increased in 2010 compared to 2009 primarily due to a settlement agreement with a third party and the establishment of a regulatory asset approved by the Kentucky Commission for the EKPC settlement in 2009, net of twelve months of amortization expense recorded in 2010.
- (c) Bad debt expense increased in 2010 compared to 2009 due to higher billed revenues, higher late payment charges and a higher net charge-off percentage.
- (d) Steam expense increased in 2010 compared to 2009 primarily due to increased generation in 2010. Steam expense increased in 2009 compared to 2008 primarily due to the utilization of SCRs year-round.
- (e) Legal expenses decreased in 2009 compared to 2008 primarily due to OMU expenses in 2008. See Note 13, Commitments and Contingencies, for further information regarding the OMU settlement.
- (f) Pension expense decreased in 2010 compared to 2009 primarily due to favorable asset performance in 2009 and increased in 2009 compared to 2008 primarily due to unfavorable asset performance in 2008.

## Other Maintenance Expenses:

The \$4 million increase from 2009 to 2010 and \$15 million increase from 2008 to 2009 were primarily due to:

	Increase (Decrease)	
	2010 vs. 2009	2009 vs. 2008
Generation expense (a)	\$ 3	\$ -
Steam expense (b)	2	7
Administrative and general expense	2	1
Transmission expense	-	2
Distribution expense (c)	<u>(3)</u>	<u>5</u>
	\$ 4	\$ 15

- (a) Generation expense increased in 2010 compared to 2009 primarily due to the overhaul of Paddy's Run Unit 13.
- (b) Steam expense increased in 2009 compared to 2008 due to increased scope of work for scheduled outages.
- (c) Distribution expense decreased in 2010 compared to 2009 primarily due to higher storm cost in 2009, partially offset by higher tree trimming expense in 2010. Distribution expense increased in 2009 compared to 2008 primarily due to increased repairs, higher tree trimming expense and higher storm related expense.

Equity in Earnings of Unconsolidated Venture

The \$2 million increase in equity in earnings of unconsolidated venture, from 2009 to 2010, was primarily due to higher earnings from EEI resulting from increased market prices for electric energy and the \$29 million decrease from 2008 to 2009 was primarily due to lower earnings resulting from decreased market prices for electric energy.

Interest Expense

The \$3 million increase from 2009 to 2010 and \$3 million increase from 2008 to 2009 were primarily due to:

	Increase (Decrease)	
	2010 vs. 2009	2009 vs. 2008
Bond interest expense (a)	\$ 8	\$ (8)
Interest expense to affiliated companies (b)	<u>(5)</u>	<u>11</u>
	\$ 3	\$ 3

- (a) Bond interest expense increased in 2010 compared to 2009 due to the issuance of first mortgage bonds in November 2010. Bond interest expense decreased in 2009 compared to 2008 due to lower interest rates on pollution control bonds. See Note 11, Long-Term Debt, for further information.
- (b) Interest expense to affiliated companies decreased in 2010 compared to 2009 primarily due to notes payable to Fidelia being paid in full in November 2010, as a result of the PPL acquisition. Interest expense to affiliated companies increased in 2009 compared to 2008 primarily due to the

issuance of additional debt (\$13 million), which was partially offset by lower interest rates on intercompany short-term borrowings.

### Other Income (Expense) – Net

The \$7 million decrease in other income (expense) – net from 2009 to 2010 and the \$3 million decrease in other income (expense) – net from 2008 to 2009 were primarily due to the discontinuance of the allowance for funds used during construction on ECR projects as a result of the FERC rate case.

### Income Tax Expense

See Note 10, Income Taxes, for a reconciliation of differences between the U.S. federal income tax expense at statutory rates and KU's income tax expense.

### 2011 Outlook

KU projects higher earnings in 2011 compared with 2010 as a net result of higher retail revenues and lower financing costs due to the issuance of first mortgage bonds in late 2010, partially offset by higher operation and maintenance expenses and depreciation. Retail revenues are expected to increase as a result of the 2010 Kentucky rate case and recoveries associated with its environmental investments. Operation and maintenance expenses and depreciation are expected to increase due to placing TC2 in service in January 2011. See Risk Factors for a discussion of the risk factors that may impact the 2011 outlook.

## **Financial Condition**

### Liquidity and Capital Resources

KU expects to continue to have adequate liquidity available through operating cash flows, cash and cash equivalents and its credit facilities. KU currently has no plans to access debt capital markets in 2011.

KU's cash flows from operations and access to cost-effective bank and capital markets are subject to risks and uncertainties including, but not limited to, the following:

- changes in market prices for electricity;
- potential ineffectiveness of the trading, marketing and risk management policy and programs used to mitigate KU's risk exposure to adverse electricity and fuel prices and interest rates;
- operational and credit risks associated with selling and marketing products in the wholesale power markets;
- unusual or extreme weather that may damage KU's transmission and distribution facilities or affect energy sales to customers;
- unavailability of generating units (due to unscheduled or longer than anticipated generation outages, weather and natural disasters) and the resulting loss of revenues and additional costs of replacement electricity;
- ability to recover and timeliness and adequacy of recovery of costs;
- costs of compliance with existing and new environmental laws;

- any adverse outcome of legal proceedings and investigations with respect to KU's current and past business activities;
- deterioration in the financial markets that could make obtaining new sources of bank and capital markets funding more difficult and more costly; and
- a downgrade in KU's credit ratings that could adversely affect its ability to access capital and increase the cost of credit facilities and any new debt.

See the Risk Factors section for further discussion of risks and uncertainties affecting KU's cash flows.

At December 31, KU had the following:

	<u>Successor</u> 2010	<u>Predecessor</u> 2009
Cash and cash equivalents	\$ <u>3</u>	\$ <u>2</u>
Current portion of long-term debt (a)	\$ -	\$ 228
Current portion of long-term debt to affiliated company (b)	-	33
Notes payable to affiliated companies (c)	<u>10</u>	<u>45</u>
	<u>\$ 10</u>	<u>\$ 306</u>

- (a) 2009 amount represents 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 pollution control bonds subject to tender for purchase at the option of the holder and to mandatory tender for purchase upon the occurrence of certain events. The Successor has classified these bonds as long-term because the Company has the intent and ability to utilize its \$400 million credit facility which matures in December 2014, to fund any mandatory purchases. The Predecessor classified these bonds as the current portion of long-term debt due to the tender for purchase provisions. The Predecessor presentation and the Successor presentation are both appropriate under GAAP. See Note 1, Summary of Significant Accounting Policies, and Note 11, Long-Term Debt, for further information.
- (b) 2009 amount represents debt owed to an E.ON affiliate, which was repaid in November 2010. See Note 11, Long-Term Debt, for further information.
- (c) Amounts represent borrowings under KU's intercompany money pool agreement wherein LKE and/or LG&E make funds available to KU at market-based rates of up to \$400 million. See Note 12, Notes Payable and Other Short-Term Obligations, for further information.

A condensed table of cash flows for the following periods in 2010, 2009 and 2008 is presented below. The Predecessor period, January 1, 2010 through October 31, 2010, and the Successor period, November 1, 2010 through December 31, 2010, were aggregated without further adjustment for purposes of comparison with the same periods in 2009 and 2008.

	Combined	Successor	Predecessor	
	Year Ended December 31, 2010	November 1, 2010 through December 31, 2010	January 1, 2010 through October 31, 2010	Year Ended December 31, 2009    2008
Net cash provided by (used in) operating activities	\$ 372	\$ 28	\$ 344	\$ 253    \$ 292
Net cash provided by (used in) investing activities	(427)	(87)	(340)	(507)    (695)
Net cash provided by (used in) financing activities	<u>56</u>	<u>58</u>	<u>(2)</u>	<u>254</u> <u>405</u>
Change in cash and cash equivalents	<u>\$ 1</u>	<u>\$ (1)</u>	<u>\$ 2</u>	<u>\$ -</u> <u>\$ 2</u>

#### *Operating Activities*

Net cash provided by operating activities increased by 47%, or \$119 million, in 2010 compared with 2009, primarily as a result of increased earnings, increased collections from the ECR mechanism and lower storm expenses. These increases in cash flow were partially offset by higher interest payments due to an accelerated settlement with the previous owner and higher 2010 income tax payments due to higher taxable income and investment tax credit benefits received in 2009.

Net cash provided by operating activities decreased by 13%, or \$39 million, in 2009 compared with 2008, primarily as a result of higher storm expenses, decreased earnings and unfavorable changes in working capital. These decreases in cash flow were partially offset by lower income tax payments due to lower taxable income and investment tax credit benefits received.

KU expects to achieve relatively stable cash flows from operations during the next three years although future cash flows may be significantly impacted by changes in economic conditions or new environmental and tax regulations.

#### *Investing Activities*

The primary use of cash in investing activities is capital expenditures. See "Forecasted Uses of Cash" for detail regarding projected capital expenditures for the years 2011 through 2013.

Net cash used in investing activities decreased by 16%, or \$80 million, in 2010 compared with 2009, primarily as a result of a decrease of \$89 million in capital expenditures, partially offset by a decrease of \$9 million from restricted cash collections.



Net cash used in investing activities decreased by 27%, or \$188 million, in 2009 compared with 2008, primarily as a result of a decrease of \$180 million in capital expenditures and a increase of \$8 million from restricted cash collections.

#### *Financing Activities*

Net cash provided by financing activities was \$56 million in 2010 compared with \$254 million in 2009. In spite of significant new debt issuances associated with the repayments to E.ON affiliates in connection with PPL's acquisition of the Company, cash provided by financing was less in 2010 due to lower increases in debt in 2010 and the payment of dividends in 2010; whereas, KU received equity contributions in 2009.

Net cash provided by financing activities was \$254 million in 2009 compared with \$405 million in 2008. The lower level of cash provided by financing in 2009 was the result of lower debt issuance to affiliated companies and lower levels of equity contributions received.

In the two months of 2010 following the acquisition, cash provided by financing activities of the Successor primarily consisted of the issuance of first mortgage bonds totaling \$1,489 million after discounts and the issuance of intercompany notes totaling \$1,331 million to a PPL subsidiary to repay debt due to an E.ON affiliate upon the closing of the sale. These amounts were offset by the repayment of \$1,331 million to an E.ON affiliate upon the closing of the sale, the repayment of \$1,331 million to a PPL affiliate upon the issuance of the first mortgage bonds, the repayment of \$83 million of short-term borrowings due to an affiliated company and the payment of \$17 million of debt issuance costs.

In 2010, cash used in financing activities by the Predecessor primarily consisted of the payment of \$50 million of dividends to LKE mostly offset by increases in short-term borrowings due to an affiliated company totaling \$48 million.

In 2009, cash provided by financing activities primarily consisted of the issuance of \$150 million of intercompany notes to an E.ON affiliate, the receipt of capital contributions from LKE totaling \$75 million and a \$29 million increase in short-term borrowings due to an affiliated company.

In 2008, cash provided by financing activities primarily consisted of the issuance of \$250 million of intercompany notes to an E.ON affiliate, the receipt of capital contributions from LKE totaling \$145 million and a \$7 million reduction in short-term borrowings due to an affiliated company. In addition, KU reacquired pollution control bonds totaling \$80 million, reissued \$63 million of that \$80 million and issued \$77 million of new pollution control bonds. Of the \$77 million, \$60 million was used to retire prior pollution control bonds, including the remaining \$17 million which had been reacquired by the Company. This resulted in a cash receipt of \$17 million to KU.

KU's debt financing activity in 2010 was:

	<u>Issuances (a)</u>	<u>Retirements</u>
Short-term borrowings from affiliated company – net change	\$ -	\$ (35)
Other borrowings from affiliated company	1,331	(1,331)
Borrowings from an E.ON affiliate	-	(1,331)
Issuance of bonds	<u>1,489</u>	<u>-</u>
Net change in debt financing	<u>\$ 2,820</u>	<u>\$ (2,697)</u>

(a) Issuances are net of pricing discounts, where applicable. See Note 11, Long-Term Debt, for further information. Working Capital Deficiency

As of December 31, 2009, KU had a working capital deficiency of \$203 million, primarily due to the current portion of long-term debt to affiliated company totaling \$33 million and \$228 million of tax-exempt bonds which allow the investors to put the bonds back to the Company causing them to be classified as “Current portion of long-term debt.” As of December 31, 2010, the Company no longer had a working capital deficiency because the current portion of long-term debt to affiliated company was paid off in conjunction with the PPL acquisition, and the \$228 million of tax-exempt bonds were no longer classified as “Other current liabilities” by the Successor because the Company has the intent and ability to utilize its \$400 million credit facility which expires in December 2014 to fund any mandatory purchases. See Note 11, Long-Term Debt, for further information.

#### Auction Rate Securities

Auctions for auction rate securities issued by KU continued to fail throughout 2010. See Note 11, Long-Term Debt, for further discussion.

#### Forecasted Sources of Cash

KU expects to continue to have adequate sources of cash available in the near term, including access to external financing, financing from affiliates and/or infusions of capital from LKE. Regulatory approvals are required for KU to incur additional debt. The FERC and the Virginia Commission authorize the issuance of short-term debt while the Kentucky Commission, Virginia Commission and the Tennessee Regulatory Authority authorize the issuance of long-term debt. In November 2009, KU received a two-year authorization from the FERC to borrow up to \$400 million in short-term funds. KU also has authorization from the Virginia Commission that expires at the end of 2011, allowing short-term borrowing of up to \$400 million. Short-term funds are made available via the Company’s participation in an intercompany money pool agreement wherein LKE and/or LG&E make funds available to KU at market-based rates (based on highly rated commercial paper issues) up to \$400 million or via the \$400 million Revolving Credit Agreement discussed below. KU currently believes this authorization and these facilities, together with the Company’s credit facilities discussed below, provide the necessary flexibility to address any liquidity needs.

#### *Credit Facilities*

On November 1, 2010, KU entered into a \$400 million unsecured Revolving Credit Agreement with a group of banks. Under this new credit facility, which expires on December 31, 2014, KU has 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 KU’s senior unsecured long-term debt rating. The new credit facility contains financial covenants requiring KU’s debt to total capitalization to not exceed 70% and other customary covenants. As of December 31, 2010, KU’s debt to total capitalization was 41% as calculated pursuant to the credit agreement. Under certain conditions, KU 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 November 1, 2010. As of December 31, 2010, there was no outstanding balance under the new credit facility, but there were \$198 million of letters of credit outstanding to support outstanding bonds totaling \$195 million. KU will utilize unused credit facility and money pool balances to fund working capital needs as they arise. See Note 12, Notes Payable and Other Short-Term Obligations, for further information regarding the Company's credit facilities.

#### *Contributions from LKE*

LKE may make capital contributions to KU, which can be used for general business purposes.

#### *Long-Term Debt*

KU currently does not plan to issue any new long-term debt in 2011.

#### Forecasted Uses of Cash

In addition to expenditures required for normal operating activities, such as fuel for electric generation, power purchased, payroll and taxes; KU currently expects to incur future cash outflows for capital expenditures, various contractual obligations and the payment of dividends.

#### *Capital Requirements*

KU's construction program is designed to ensure that there will be adequate capacity and reliability to meet the electric needs of its service area and to comply with environmental regulations. These needs are continually being reassessed and appropriate revisions are made, when necessary, in construction schedules. KU plans to fund capital expenditures through operating cash flows, the credit facility and, if needed, the issuance of long-term debt. KU expects its capital expenditures for the three year period ending December 31, 2013, to total approximately \$1,406 million, consisting primarily of the following:

Construction of coal combustion residual storage structures	\$ 346
Construction of environmental controls and capacity replacement	302
Construction of distribution and metering assets	260
Construction of generation assets	206
Construction of transmission assets	129
Recoverable environmental assets	99
Information technology projects	39
Other projects	25
	<u>\$ 1,406</u>

The Company's capital program will focus primarily on compliance with existing or anticipated EPA environmental regulations, aging infrastructure and the need for increased storage capacity for coal combustion by-product materials over the next several years. This program may also 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 and other regulatory requirements. In particular, climate change initiatives, whether via legislative, regulatory or market channels, could restrict or disadvantage power generation from higher-

carbon sources. Therefore, KU has included estimates regarding significant additional capital expenditures related to pending environmental regulations and legislation. These estimates are subject to final regulations and least cost analysis based on engineering studies. To the extent financial markets see climate change as a potential risk, KU may face reduced access to or increased costs in capital markets. Capital expenditures for KU associated with such actions are preliminarily estimated to be in the \$1.5 to \$1.7 billion range over the next ten years, although final costs may substantially vary.

See the Contractual Obligations table below and Note 13, Commitments and Contingencies, for further information concerning commitments.

### *Contractual Obligations*

The following is provided to summarize contractual cash obligations for periods after December 31, 2010. KU anticipates cash from operations and external financing will be sufficient to fund future obligations. See the Statements of Capitalization.

	Payments Due by Period						Total
	2011	2012	2013	2014	2015	Thereafter	
Short-term debt (a)	\$ 10	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 10
Long-term debt (b)	-	-	-	-	250	1,601	1,851
Interest on long-term debt (c)	67	69	72	75	78	1,414	1,775
Operating leases (d)	8	7	5	5	3	1	29
Unconditional power purchase obligations (e)	9	10	10	10	10	114	163
Coal and natural gas purchase obligations (f)	439	200	144	93	91	14	981
Pension benefit plan obligations (g)	18	24	28	10	7	60	147
Postretirement benefit plan obligations (h)	5	6	6	6	6	33	62
Construction obligations (i)	113	3	-	-	-	-	116
Other obligations (j)	3	3	-	-	-	-	6
	<u>\$ 672</u>	<u>\$ 322</u>	<u>\$ 265</u>	<u>\$ 199</u>	<u>\$ 445</u>	<u>\$ 3,237</u>	<u>\$ 5,140</u>

This table does not reflect contingent obligations. See Note 13, Commitments and Contingencies, for further information on contingent obligations.

- (a) Represents borrowings due to affiliates within one year.
- (b) Reflects principal maturities only based on legal maturity dates and includes the current portion of long-term debt.
- (c) Assumes interest payments through maturity. The payments herein are subject to change as payments for debt that is or becomes variable-rate debt have been estimated.
- (d) Represents future operating lease payments.
- (e) Represents future minimum payments under OVEC power purchase agreements through March 13, 2026.
- (f) Represents contracts to purchase coal, natural gas and natural gas transportation.

- (g) Represents projected cash flows for funding the pension benefit plans as calculated by the actuary. For pension funding information see Note 9, Pension and Other Postretirement Benefit Plans.
- (h) Represents projected cash flows for the postretirement benefit plan as calculated by the actuary. For postretirement funding information, see Note 9, Pension and Other Postretirement Benefit Plans.
- (i) Represents construction commitments, including commitments for the Brown SCR and the Brown and Ghent landfill construction including associated material transport systems for coal combustion residual.
- (j) Represents other contractual obligations including the SPP and TVA coordination agreements.

#### *Pension and Postretirement Benefit Plans*

See Application of Critical Accounting Policies and Estimates for discussion regarding discretionary contributions to the pension and postretirement benefit plans in 2011.

#### *Dividends*

Future dividends may be declared at the discretion of KU's Board of Directors, payable to its sole shareholder, LKE. As discussed in Note 12, Notes Payable and Other Short-Term Obligations, KU's dividend payments are limited under a covenant in its \$400 million revolving line of credit facility. This covenant restricts the debt to total capital ratio to not more than 70%. KU is subject to Section 305(a) of the Federal Power Act, which makes it unlawful for a public utility to make or pay a dividend from any funds "properly included in capital account." The meaning of this limitation has never been clarified under the Federal Power Act. KU believes, however, that this statutory restriction, as applied to its circumstances, would not be construed or applied by the FERC to prohibit the payment from retained earnings of dividends that are not excessive and are for lawful and legitimate business purposes.

#### *Purchase, Redemption or Remarketing of Debt Securities*

KU will continue to evaluate purchasing, redeeming or remarketing outstanding debt securities and may decide to take action depending upon prevailing market conditions and available cash.

#### Credit Ratings

KU's credit ratings reflect the views of three national rating agencies. A security rating is not a recommendation to buy, sell or hold securities and is subject to revision or withdrawal at any time by the rating agency. In October 2010, one national rating agency revised downward the short-term credit rating of the pollution control bonds and the issuer rating of the Company as a result of the then pending acquisition by PPL. Another raised the long-term rating of the pollution control bonds as a result of the addition of the first mortgage bonds as collateral. In October 2010, a third national rating agency provided an initial rating of the Company's pollution control bonds and first mortgage bonds. See Note 11, Long-Term Debt, for a discussion of downgrade actions in 2009 and 2008 related to the pollution control bonds caused by a change in the rating of the entity insuring those bonds.

### Ratings Triggers

KU has various derivative and non-derivative contracts, including contracts for the sale and purchase of electricity and fuel and commodity transportation, which contain provisions requiring KU to post additional collateral, or permit the counterparty to terminate the contract if KU's credit rating were to fall below investment grade. See Note 5, Derivative Financial Instruments, for a discussion of Credit Risk Related Contingent Features, including a discussion of the potential additional collateral that would have been required for derivative contracts in a net liability position at December 31, 2010. At December 31, 2010, if KU's credit ratings had been below investment grade, KU would have been required to prepay or post an additional \$16 million of collateral to counterparties for both derivative and non-derivative commodity and commodity-related contracts used in its generation, marketing and trading operations.

### Off-Balance Sheet Arrangements

KU has very limited off-balance sheet activity. See Note 13, Commitments and Contingencies, for further discussion.

### Risk Management

#### *Credit Risk*

KU is exposed to potential losses as a result of nonperformance by counterparties of their contractual obligations. KU maintains credit policies and procedures to limit counterparty credit risk including evaluating credit ratings and financial information along with having certain counterparties post margin if the credit exposure exceeds certain thresholds. See Note 5, Derivative Financial Instruments, for information regarding risk management activities.

KU is exposed to potential losses as a result of nonpayment by customers. The Company maintains an allowance for doubtful accounts composed of accounts aged more than four months. Accounts are written off as management determines them uncollectible. See Application of Critical Accounting Policies and Estimates and Note 1, Summary of Significant Accounting Policies, for further discussion.

Certain of the Company's derivative instruments contain provisions that require it 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. See Note 5, Derivative Financial Instruments, for information regarding exposure and the risk management activities.

#### *Liquidity Risk*

KU expects to continue to have access to adequate sources of liquidity through operating cash flows, cash and cash equivalents, credit facilities and/or infusion of capital from its parent. See Financial Condition - Liquidity and Capital Resources for an expanded discussion of KU's liquidity position and a discussion of its forecasted sources of cash.

*Securities Price Risk*

KU has securities price risk through its participation in defined benefit pension and postretirement benefit plans. Declines in the market price of debt and equity securities could impact contribution requirements. See Application of Critical Accounting Policies and Estimates - Defined Benefits for a discussion of the assumptions and sensitivities regarding the defined benefit pension and postretirement benefit plans assumptions.

*Interest Rate and Commodity Price Risk*

KU is subject to interest rate and commodity price risk related to on-going business operations. It currently manages commodity risks using derivative instruments, including swaps and forward contracts. The Company's policies allow for the interest rate risk to be managed through the use of fixed rate debt, floating rate debt and interest rate swaps. At December 31, 2010, no interest rate swaps were in effect for KU. At December 31, 2010, the Company's annual exposure to increased interest expense, based on a 10% increase in interest rates, was less than \$1 million.

KU manages price risk by conducting energy trading activities through forward financial transactions. The following chart sets forth the net fair value of KU's commodity derivative contracts. See Note 5 Derivative Financial Instruments, for further information.

	Successor	Predecessor	
	December 31, 2010 (a)	October 31, 2010 (a)	December 31, 2009
Fair value of contracts outstanding at the beginning of the period	\$ -	\$ -	\$ 1
Contracts realized or otherwise settled during the period	-	-	
Fair value of new contracts entered into during the period	-	-	-
Changes in fair value attributable to changes in valuation techniques	-	-	-
Other changes in fair value	-	-	(1)
Fair value of contracts outstanding at the end of the period	\$ -	\$ -	\$ -

(a) 2010 activity is less than \$1 million.

Related Party Transactions

KU and its Parent, LKE and subsidiaries of LKE engage in related party transactions. See Note 15, Related Party Transactions, for further information.

KU is not aware of any material ownership interest or operating responsibility by the executive officers of KU in outside partnerships, including leasing transactions with variable interest entities, or entities doing business with KU.

### Acquisitions, Development and Divestitures

KU and LG&E have been constructing a new 760-Mw capacity base-load, coal-fired unit, TC2, which is jointly owned by KU (60.75%) and LG&E (14.25%), together with IMEA and IMPA (combined 25%). With limited exceptions the Company took care, custody and control of TC2 on January 22, 2011, and has dispatched the unit to meet customer demand since that date. KU and the contractor agreed to a further amendment of the construction agreement whereby the contractor will complete certain actions relating to identifying and completing any necessary modifications to allow operation of TC2 on all fuels in accordance with initial specifications prior to certain dates, and amending the provisions relating to liquidated damages. See Note 13, Commitments and Contingencies, for further information.

KU continuously re-examines development projects based on market conditions and other factors to determine whether to proceed, to cancel or to expand the projects.

### **Application of Critical Accounting Policies and Estimates**

The financial statements of KU are prepared in compliance with GAAP. The application of these principles 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 also 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. KU's senior management has reviewed the significant and critical accounting policies with the relevant governing bodies of the Company and its parent, as applicable.

An accounting policy is deemed to be critical if it requires an accounting estimate to be made based on assumptions about matters that are highly uncertain at the time the estimate is made, if different estimates reasonably could have been used or if changes in the estimate that are reasonably possible could materially impact the financial statements. Management believes the following critical accounting policies reflect the significant estimates and assumptions used in the preparation of the Financial Statements.

### Price Risk Management

See Financial Condition - Risk Management.

### Regulatory Mechanisms

KU is a cost-based rate-regulated utility. As a result, the financial statements reflect the effects of regulatory actions. Regulatory assets are recognized for the effect of transactions or events where future recovery is probable in regulated customer rates. The effect of such accounting is to defer certain or qualifying costs that would otherwise be charged to expense. Likewise, regulatory liabilities are recognized for obligations expected to be returned through future regulated customer rates. The effect of such transactions or events would otherwise be reflected as income. In certain cases, regulatory liabilities are recorded based on the understanding with the regulator that current rates are being set to recover costs that are expected to be incurred in the future. The regulated entity is accountable for any amounts charged pursuant to such rates and not yet expended for the intended purpose. The accounting



for regulatory assets and liabilities is based on specific ratemaking decisions or precedent for each transaction or event as prescribed by the FERC, the Kentucky Commission, the Virginia Commission or the Tennessee Regulatory Authority. See Note 3, Rates and Regulatory Matters, for additional detail regarding regulatory assets and liabilities.

### Defined Benefits

KU employees benefit from both funded and unfunded retirement benefit plans. See Note 1, Summary of Significant Accounting Policies, for information about policy changes between the Predecessor and Successor and the accounting for defined benefits including KU's method of amortizing gains and losses. KU makes various assumptions in arriving at pension and other postretirement benefit costs and obligations. The major assumptions include:

- KU's selection of discount rates is based on the Mercer Pension Discount Yield Curve (Predecessor) and the Towers Watson Yield Curve (Successor).
- KU's selection of rate of salary growth is based on historical data that includes employees' periodic pay increases and promotions, which are used to project employees' pension benefits at retirement.
- KU determines the expected long-term return on plan assets based on the current level of expected return 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 is then weighted based on the current asset allocation.
- KU's management projects health care cost trends based on past health care costs, the near-term outlook and an assessment of likely long-term trends.

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 return on investments within the plans was approximately 12% for the year ended December 31, 2010. The benefit plan assets and obligations are re-measured annually using a December 31 measurement date. Due to the PPL acquisition, the benefit plan assets and obligations were also re-measured at October 31, 2010. The Company's 2010 pension cost was approximately \$3 million less than 2009. The Company anticipates its 2011 pension cost will be approximately \$3 million less than the 2010 expense. The amount of future funding will depend upon the actual return on plan assets, the discount rate and other factors, but the Company funds its pension obligations in a manner consistent with the Pension Protection Act of 2006. The Company made discretionary contributions to its pension plan of \$13 million in 2010 and 2009, respectively. In January 2011, KU contributed \$43 million to its pension plan. See Note 18, Subsequent Events, for further information.

See Note 9, Pension and Other Postretirement Benefit Plans, for further information on defined benefits including sensitivity analysis expressing potential changes in expected returns that would result from hypothetical changes to assumptions and estimates, expected rate of return assumptions and health care trends.

### Asset Impairment

KU performs a quarterly review to determine if an impairment analysis is required for long-lived assets that are subject to depreciation or amortization. This review identifies changes in circumstances indicating that a long-lived asset's carrying value may not be recoverable. An impairment analysis will be performed if warranted based on the review. For these long-lived assets, such events or changes in circumstances which may indicate an impairment analysis is required include:

- a significant decrease in the market price of an asset;
- a significant adverse change in the manner in which an asset is being used or in its physical condition;
- a significant adverse change in legal factors or in the business climate;
- an accumulation of costs significantly in excess of the amount originally expected for the acquisition or construction of an asset;
- a current-period operating or cash flow loss combined with a history of losses or a forecast that demonstrates continuing losses;
- a current expectation that, more likely than not, an asset will be sold or otherwise disposed of before the end of its previously estimated useful life; and
- a significant change in the physical condition of an asset.

For a long-lived asset, impairment is recognized when the carrying amount of the asset is not recoverable and exceeds its fair value. The carrying amount is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset. If the asset is impaired, an impairment loss is recorded to adjust the asset's carrying value to its estimated fair value. Management must make significant judgments to estimate future cash flows including the useful lives of long-lived assets, the fair value of the assets and management's intent to use the assets. KU did not recognize an impairment of any long-lived asset in 2010.

Effective with PPL's acquisition of LKE on November 1, 2010, KU recorded \$607 million of goodwill. At December 31, 2010, KU's goodwill remained unchanged. GAAP requires goodwill to be tested for impairment on an annual basis or more frequently if events or circumstances indicate that assets may be impaired. KU performs its annual goodwill impairment test in the fourth quarter. See Note 7, Goodwill and Intangible Assets, for further discussion.

Goodwill is tested for impairment using a two-step approach. In step 1, the Company identifies a potential impairment by comparing the estimated fair value of the Company (the goodwill reporting unit) to its carrying value, including goodwill, on the measurement date. If the estimated fair value exceeds its carrying amount, goodwill is not considered impaired. If the carrying amount exceeds the estimated fair value, the second step is performed to measure the amount of impairment loss, if any.

The second step requires a calculation of the implied fair value of goodwill. The implied fair value of goodwill is determined in the same manner as the amount of goodwill in a business combination. That is, the estimated fair value is allocated to all of KU's assets and liabilities as if KU had been acquired in a business combination and the estimated fair value of KU was the price paid. The excess of the estimated fair value of KU over the amounts assigned to its assets and liabilities is the implied fair value of goodwill. The implied fair value of goodwill is then compared with the carrying amount of that goodwill. If the

carrying amount exceeds the implied fair value, an impairment loss is recognized in an amount equal to that excess. The loss recognized cannot exceed the carrying amount of the reporting unit's goodwill.

Determining the fair value of KU is judgmental in nature and involves the use of significant estimates and assumptions. These estimates and assumptions can include revenue growth rates and operating margins used to calculate projected future cash flows, risk adjusted discount rates and future economic and market conditions.

KU tested goodwill for impairment in the fourth quarter of 2010 and no impairment was recognized. See Note 7, Goodwill and Intangible Assets, for further discussion.

### Loss Accruals

KU accrues losses for the estimated impacts of various conditions, situations or circumstances involving uncertain or contingent future outcomes. For loss contingencies, the loss must be accrued if (1) information is available that indicates it is probable that a loss has been incurred, given the likelihood of the uncertain future events and (2) the amount of the loss can be reasonably estimated. Accounting guidance defines "probable" as cases in which "the future event or events are likely to occur." KU does not record the accrual of contingencies that might result in gains, unless recovery is assured. KU continuously assesses potential loss contingencies for environmental remediation, litigation claims, regulatory penalties and other events.

The accounting aspects of estimated loss accruals include (1) the initial identification and recording of the loss, (2) the determination of triggering events for reducing a recorded loss accrual and (3) the ongoing assessment as to whether a recorded loss accrual is sufficient. All three of these aspects require significant judgment by KU's management. KU uses its internal expertise and outside experts (such as lawyers and engineers), as necessary, to help estimate the probability that a loss has been incurred and the amount or range of the loss.

KU has identified certain other events that could give rise to a loss, but that do not meet the conditions for accrual. Such events are disclosed, but not recorded, when it is reasonably possible that a loss has been incurred. Accounting guidance defines "reasonably possible" as cases in which "the future event or events occurring is more than remote, but less than likely to occur." See Note 13, Commitments and Contingencies, for disclosure of other potential loss contingencies that have not met the criteria for accrual.

When an estimated loss is accrued, KU identifies, where applicable, the triggering events for subsequently adjusting the loss accrual. The triggering events generally occur when the contingency has been resolved and the actual loss is incurred, or when the risk of loss has diminished or been eliminated. The following are some of the triggering events that provide for the adjustment of certain recorded loss accruals:

- Allowances for uncollectible accounts are reduced when accounts are written off after prescribed collection procedures have been exhausted, a better estimate of the allowance is determined or underlying amounts are ultimately collected.
- Environmental and other litigation contingencies are reduced when the contingency is resolved, KU makes actual payments, a better estimate of the loss is determined or the loss is no longer considered probable.

KU reviews its loss accruals on a regular basis to assure that the recorded potential loss exposures are appropriate. This involves ongoing communication and analyses with internal and external legal counsel, engineers, operation management and other parties. This review may result in the increase or decrease of the loss accrual.

#### Asset Retirement Obligations

KU is required to recognize a liability for legal obligations associated with the retirement of long-lived assets. The initial obligation is measured at its estimated fair value. An equivalent amount is recorded as an increase in the value of the capitalized asset and allocated to expense over the useful life of the asset. Until the obligation is settled, the liability is increased, through the recognition of accretion expense in the Statements of Income, for changes in the obligation due to the passage of time. An offsetting regulatory asset is recognized to reverse the depreciation and accretion expense related to the ARO such that there is no income statement impact. The regulatory asset is relieved when the ARO has been settled. An ARO must be recognized when incurred if the fair value of the ARO can be reasonably estimated.

In determining AROs, management must make significant judgments and estimates to calculate fair value. Fair value is developed using an expected present value technique based on assumptions of market participants that considers estimated retirement costs in current period dollars that are inflated to the anticipated retirement date and then discounted back to the date the ARO was incurred. Changes in assumptions and estimates included within the calculations of the fair value of AROs could result in significantly different results than those identified and recorded in the financial statements. Estimated ARO costs and settlement dates, which affect the carrying value of various AROs and the related assets, are reviewed periodically to ensure that any material changes are incorporated into the estimate of the obligations. Any change to the capitalized asset is amortized over the remaining life of the associated long-lived asset. See Note 4, Asset Retirement Obligations, for further information on AROs.

At December 31, 2010, KU had AROs totaling \$54 million recorded on the Balance Sheets. Of the total amount, \$35 million, or 65%, relates to KU's ash ponds and landfills. The most significant assumptions surrounding AROs are the forecasted retirement costs, the discount rates and the inflation rates. A variance in the forecasted retirement costs, the discount rates or the inflation rates could have a significant impact on the ARO liabilities.

The following chart reflects the sensitivities related to KU's ARO liabilities for ash ponds and landfills as of December 31, 2010:

	<u>Change in Assumption</u>	<u>Impact on ARO Liability</u>
Retirement cost	10%/(10)%	\$4/\$ (4)
Discount rate	0.25%/(0.25)%	\$(2)/\$1
Inflation rate	0.25%/(0.25)%	\$2/\$ (2)

### Income Tax Uncertainties

Significant management judgment is required in developing KU's provision for income taxes primarily due to the uncertainty related to tax positions taken or expected to be taken in tax returns and the determination of deferred tax assets, liabilities and valuation allowances.

Significant management judgment is required to determine the amount of benefit recognized related to an uncertain tax position. KU evaluates its tax positions following a two-step process. The first step requires an entity to determine whether, based on the technical merits supporting a particular tax position, it is more likely than not (greater than a 50% chance) that the tax position will be sustained. This determination assumes that the relevant taxing authority will examine the tax position and is aware of all the relevant facts surrounding the tax position. The second step requires an entity to recognize in the financial statements the benefit of a tax position that meets the more-likely-than-not recognition criterion. The benefit recognized is measured at the largest amount of benefit that has a likelihood of realization, upon settlement, that exceeds 50%. KU's management considers a number of factors in assessing the benefit to be recognized, including negotiation of a settlement.

On a quarterly basis, KU reassesses its uncertain tax positions by considering information known at the reporting date. Based on management's assessment of new information, KU may subsequently recognize a tax benefit for a previously unrecognized tax position, de-recognize a previously recognized tax position or re-measure the benefit of a previously recognized tax position. The amounts ultimately paid upon resolution of issues raised by taxing authorities may differ materially from the amounts accrued and may materially impact KU financial statements in the future.

The balance sheet classification of unrecognized tax benefits and the need for valuation allowances to reduce deferred tax assets also require significant management judgment. KU classifies unrecognized tax benefits as current, to the extent management expects to settle an uncertain tax position, by payment or receipt of cash, within one year of the reporting date. Valuation allowances are initially recorded and reevaluated each reporting period by assessing the likelihood of the ultimate realization of a deferred tax asset. Management considers a number of factors in assessing the realization of a deferred tax asset, including the reversal of temporary differences, future taxable income and ongoing prudent and feasible tax planning strategies. Any tax planning strategy utilized in this assessment must meet the recognition and measurement criteria utilized by KU to account for an uncertain tax position. See Note 10, Income Taxes, for the required disclosures.

At December 31, 2010, KU's existing reserve exposure to either increases or decreases in unrecognized tax benefits during the next 12 months is less than \$1 million. This change could result from subsequent recognition, de-recognition and/or changes in the measurement of uncertain tax positions. The events that could cause these changes are direct settlements with taxing authorities, litigation, legal or administrative guidance by relevant taxing authorities and the lapse of an applicable statute of limitations.

### Purchase Price Allocation

On November 1, 2010, PPL completed the acquisition of KU's parent. In accordance with accounting guidance on business combinations, the identifiable assets acquired and the liabilities assumed were measured at fair value at the acquisition date. 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. The excess of the purchase price over the estimated fair value of the identifiable net assets is recorded as goodwill.

The determination and allocation of fair value to the identifiable assets acquired and liabilities assumed was based on various assumptions and valuation methodologies requiring considerable management judgment, including estimates based on key assumptions of the acquisition and historical and current market data. The most significant variables in these valuations were the discount rates, the number of years on which to base cash flow projections, as well as the assumptions and estimates used to determine cash inflows and outflows. Although the assumptions applied were reasonable based on information available at the date of acquisition, actual results may differ from the forecasted amounts and the difference could be material.

For purposes of measuring the fair value of the majority of property, plant and equipment and regulatory assets acquired and regulatory liabilities assumed, KU determined that fair value was equal to net book value at the acquisition date because KU's operations are conducted in a regulated environment and the regulatory commissions allow for earning a rate of return on the book value of a majority of the regulated asset bases at rates determined to be fair and reasonable. As there is no current prospect for deregulation in KU's operating area, it is expected that these operations will remain in a regulated environment for the foreseeable future, therefore management has concluded that the use of these assets in the regulatory environment represents their highest and best use and a market participant would measure the fair value of these assets using the regulatory rate of return as the discount rate, thus resulting in fair value equal to book value.

The fair value of intangible assets and liabilities (e.g. contracts that have favorable or unfavorable terms relative to market), including coal contracts and power purchase agreements, as well as emission allowances, have been reflected on the Balance Sheets with offsetting regulatory assets or liabilities. Prior to the acquisition, KU recovered the cost of the coal contracts, power purchases and emission allowances and this rate treatment will continue after the acquisition. As a result, management believes the regulatory assets and liabilities created to offset the fair value adjustments meet the recognition criteria established by existing accounting guidance and eliminate any ratemaking impact of the fair value adjustments. KU's customer rates will continue to reflect these items (e.g. coal, purchased power, emission allowances) at their original contracted prices.

KU also considered whether a separate fair value should be assigned to KU's rights to operate within its various electric service areas but concluded that these rights only provided the opportunity to earn a regulated return and barriers to market entry, which in management's judgment is not considered a separately identifiable intangible asset under applicable accounting guidance; rather, it is considered going-concern value, or goodwill.

See Note 2, Acquisition by PPL and Note 7, Goodwill and Intangible Assets, for further information.

#### New Accounting Guidance

Recent accounting pronouncements affecting KU are detailed in Note 1, Summary of Significant Accounting Policies.

Other Information

PPL's Audit Committee has approved the audit fees and audit-related services. The audit-related services include services in connection with regulatory filings, reviews of offering documents and registration statements and internal control reviews.

### Management's Report of Internal Controls Over Financial Reporting

Through December 31, 2010, the Company was not subject to the internal control and other requirements of the Sarbanes-Oxley Act of 2002 and associated rules (the "Act") and consequently is not required to evaluate the effectiveness of its internal control over financial reporting pursuant to Section 404 of the Act. However, management is responsible for establishing and maintaining adequate internal control over financial reporting. 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 reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. 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 GAAP 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.

Management has assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2010, 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, 2010, the Company's internal control over financial reporting was effective based on those criteria.

The effectiveness of the Company's internal control over financial reporting as of December 31, 2010, has been audited by PricewaterhouseCoopers LLP, an independent accounting firm, as stated in its report which is included herein.



**Kentucky Utilities Company**  
Statements of Income  
(millions)

	Successor	Predecessor		
	November 1 2010 through December 31, 2010	January 1, 2010 through October 31, 2010	Year Ended December 31 2009    2008	
Operating revenues (Note 15) .....	\$ 263	\$ 1,248	\$ 1,355	\$ 1,405
Operating expenses:				
Fuel for electric generation .....	78	417	434	513
Power purchased (Notes 13 and 15).....	28	147	199	221
Other operation and maintenance expenses.....	66	280	320	275
Depreciation and amortization .....	<u>26</u>	<u>119</u>	<u>133</u>	<u>136</u>
Total operating expenses .....	<u>198</u>	<u>963</u>	<u>1,086</u>	<u>1,145</u>
Operating income .....	65	285	269	260
Equity in earnings of unconsolidated venture (Note 1) .....	-	3	1	30
Interest expense (Notes 11 and 12) .....	8	6	6	14
Interest expense to affiliated companies (Notes 11, 12 and 15).....	2	62	69	58
Other income (expense) - net .....	<u>-</u>	<u>(2)</u>	<u>5</u>	<u>8</u>
Income before income taxes .....	55	218	200	226
Income tax expense (Note 10).....	<u>20</u>	<u>78</u>	<u>67</u>	<u>68</u>
Net income.....	<u>\$ 35</u>	<u>\$ 140</u>	<u>\$ 133</u>	<u>\$ 158</u>

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

**Kentucky Utilities Company**  
Statements of Retained Earnings  
(millions)

	Successor	Predecessor		
	November 1, 2010 through December 31, 2010	January 1, 2010 through October 31, 2010	Year Ended December 31, 2009      2008	
Balance at beginning of period.....	\$ 1,418	\$ 1,328	\$ 1,195	\$ 1,037
Effect of PPL acquisition.....	(1,418)	-	-	-
Balance at November 1, 2010.....	-	1,328	1,195	1,037
Net income .....	35	140	133	158
Cash dividends declared (Note 15).....	-	(50)	-	-
Balance at end of period .....	\$ 35	\$ 1,418	\$ 1,328	\$ 1,195

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

**Kentucky Utilities Company**  
Statements of Comprehensive Income  
(millions)

	Successor	Predecessor		
	November 1, 2010 through December 31, 2010	January 1, 2010 through October 31, 2010	Year Ended December 31, 2009    2008	
Net income .....	\$ 35	\$ 140	\$ 133	\$ 158
Equity investee's other comprehensive loss, net of tax expense of \$0, \$1, \$0 and \$0, respectively (Note 1).....	-	(2)	-	-
Comprehensive income .....	<u>\$ 35</u>	<u>\$ 138</u>	<u>\$ 133</u>	<u>\$ 158</u>

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

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

	Successor December 31, 2010	Predecessor December 31, 2009
Assets		
Current assets:		
Cash and cash equivalents.....	\$ 3	\$ 2
Accounts receivable (less allowance for doubtful accounts: 2010, \$6; 2009, \$3):		
Customer .....	90	79
Affiliated companies .....	12	9
Other.....	20	18
Unbilled revenues.....	89	76
Fuel, materials and supplies:		
Fuel (predominantly coal).....	95	98
Other materials and supplies .....	41	39
Other intangible assets .....	22	-
Regulatory assets (Note 3) .....	9	32
Prepayments and other current assets.....	<u>15</u>	<u>13</u>
Total current assets .....	<u>396</u>	<u>366</u>
Investment in unconsolidated venture (Note 1).....	<u>30</u>	<u>12</u>
Property, plant and equipment:	3,630	4,892
Regulated utility plant – electric .....		
Accumulated depreciation.....	<u>(14)</u>	<u>(1,838)</u>
Net regulated utility plant.....	3,616	3,054
Construction work in progress .....	<u>955</u>	<u>1,257</u>
Property, plant and equipment – net.....	<u>4,571</u>	<u>4,311</u>
Deferred debits and other assets:		
Regulatory assets (Notes 3 and 9):		
Pension benefits .....	117	105
Other regulatory assets.....	105	117
Goodwill (Notes 2 and 7) .....	607	-
Other intangibles assets (Notes 2 and 7) .....	175	-
Cash surrender value of key man life insurance.....	39	38
Other assets .....	<u>19</u>	<u>7</u>
Total deferred debits and other assets.....	<u>1,062</u>	<u>267</u>
Total assets .....	<u>\$ 6,059</u>	<u>\$ 4,956</u>

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

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

	Successor December 31, 2010	Predecessor December 31, 2009
Liabilities and Equity		
Current liabilities:		
Current portion of long-term debt (Note 11).....	\$ -	\$ 228
Current portion of long-term debt to affiliated company (Notes 11 and 15) .....	-	33
Notes payable to affiliated companies (Notes 12 and 15).....	10	45
Accounts payable .....	67	107
Accounts payable to affiliated companies (Note 15) .....	45	88
Accrued taxes .....	25	14
Customer deposits .....	23	22
Regulatory liabilities (Note 3).....	41	4
Accrued interest .....	8	1
Employee accruals.....	15	13
Other current liabilities.....	18	14
Total current liabilities .....	252	569
Long-term debt:		
Long-term bonds (Note 11).....	1,841	123
Long-term debt to affiliated company (Notes 11 and 15).....	-	1,298
Total long-term debt.....	1,841	1,421
Deferred credits and other liabilities:		
Deferred income taxes (Note 10) .....	376	336
Accumulated provision for pensions (Note 9) .....	113	160
Investment tax credits (Note 10) .....	104	104
Asset retirement obligations (Notes 3 and 4).....	54	34
Regulatory liabilities (Note 3):		
Accumulated cost of removal of utility plant.....	348	335
Other regulatory liabilities .....	186	25
Other liabilities.....	94	20
Total deferred credits and other liabilities.....	\$ 1,275	\$ 1,014

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

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

	Successor December 31, 2010	Predecessor December 31, 2009
Equity:		
Common stock, without par value – authorized 80,000,000 shares, outstanding 37,817,878 shares .....	\$ 308	\$ 308
Additional paid-in capital .....	2,348	316
Retained earnings:		
Retained earnings .....	35	1,318
Undistributed earnings from unconsolidated venture .....	-	10
Total equity .....	2,691	1,952
Total liabilities and equity .....	\$ 6,059	\$ 4,956
The accompanying notes are an integral part of these financial statements.		

**Kentucky Utilities Company**  
Statements of Cash Flows  
(millions)

	Successor	Predecessor		
	November 1, 2010 through December 31, 2010	January 1, 2010 through October 31, 2010	Year Ended December 31, 2009    2008	
Cash flows from operating activities:				
Net income .....	\$ 35	\$ 140	\$ 133	\$ 158
Adjustments to reconcile net income to net cash provided by (used in) operating activities: .....				
Depreciation and amortization .....	26	119	133	136
Deferred income taxes – net.....	4	23	50	(13)
Investment tax credits (Note 10).....	-	-	24	25
Provision for pension and postretirement benefits.....	5	13	26	10
Other – net.....	2	(3)	-	1
Change in current assets and liabilities:				
Accounts receivable .....	(15)	13	11	13
Unbilled revenues.....	(32)	19	(15)	(1)
Fuel, materials and supplies .....	5	(6)	(28)	(33)
Regulatory assets.....	(2)	19	-	-
Other current assets .....	9	(9)	(3)	(1)
Accounts payable .....	9	(17)	(32)	2
Accounts payable to affiliated companies .....	(41)	46	29	7
Accrued taxes .....	15	(5)	6	8
Regulatory liabilities .....	12	3	-	-
Other current liabilities.....	(2)	2	2	(3)
Pension and postretirement funding (Note 9).....	(2)	(18)	(20)	(5)
Storm restoration regulatory asset (Note 3) .....	-	-	(57)	(2)
Other regulatory assets .....	1	8	-	-
Other regulatory liabilities .....	-	(10)	-	-
Other – net.....	(1)	7	(6)	(10)
Net cash provided by (used in) operating activities .....	<u>28</u>	<u>344</u>	<u>253</u>	<u>292</u>
Cash flows from investing activities:				
Construction expenditures.....	(87)	(292)	(516)	(686)
Purchases of assets from affiliate.....	-	(48)	-	(10)
Change in restricted cash.....	-	-	9	1
Net cash provided by (used in) investing activities .....	<u>\$ (87)</u>	<u>\$ (340)</u>	<u>\$ (507)</u>	<u>\$ (695)</u>

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

**Kentucky Utilities Company**  
Statements of Cash Flows (continued)  
(millions)

	Successor	Predecessor		
	November 1, 2010 through December 31, 2010,	January 1, 2010 through October 31, 2010	Year Ended December 31, 2009      2008	
Cash flows from financing activities: Issuance of bonds (Note 11).....	\$ 1,489	\$ -	\$ -	\$ 77
Short-term borrowings from affiliated company – net (Note 12).....	(83)	48	29	(7)
Other borrowings from affiliated companies (Note 11).....	1,331	-	150	250
Repayments on other borrowings from affiliated companies (Note 11).....	(1,331)	-	-	-
Repayments to E.ON affiliate (Note 11)...	(1,331)	-	-	-
Debt issuance costs.....	(17)	-	-	-
Retirement of pollution control bonds.....	-	-	-	(60)
Acquisition of outstanding bonds.....	-	-	-	(80)
Reissuance of reacquired bonds.....	-	-	-	63
Retirement of reacquired bonds.....	-	-	-	17
Payment of dividends.....	-	(50)	-	-
Capital contribution (Note 15).....	-	-	75	145
Net cash provided by (used in) financing activities.....	<u>58</u>	<u>(2)</u>	<u>254</u>	<u>405</u>
Change in cash and cash equivalents.....	(1)	2	-	2
Cash and cash equivalents at beginning of period.....	<u>4</u>	<u>2</u>	<u>2</u>	<u>-</u>
Cash and cash equivalents at end of period...	\$ 3	<u>\$ 4</u>	<u>\$ 2</u>	<u>\$ 2</u>
Supplemental disclosures of cash flow information:				
Cash paid (received) during the year for:				
Interest – net of amount capitalized.....	\$ 22	\$ 62	\$ 70	\$ 66
Income taxes – net.....	(12)	74	(9)	46

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



**Kentucky Utilities Company**  
Statements of Capitalization  
(millions)

	Successor December 31, 2010	Predecessor December 31, 2009
Long-term debt (Note 11):		
Pollution control series:		
Mercer Co. 2000 Series A, due May 1, 2023, variable % .....	\$ 13	\$ 13
Carroll Co. 2007 Series A, due February 1, 2026, 5.75% .....	18	18
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. 2008 Series A, due February 1, 2032, variable % .....	78	78
Carroll Co. 2002 Series C, due October 1, 2032, variable % .....	96	96
Carroll Co. 2006 Series B, due October 1, 2034, variable % .....	54	54
Trimble Co. 2007 Series A, due March 1, 2037, 6.0% .....	9	9
Carroll Co. 2004 Series A, due October 1, 2034, variable % .....	<u>50</u>	<u>50</u>
Total pollution control series .....	<u>351</u>	<u>351</u>
First mortgage bonds:		
First mortgage bond 2015 Series, due November 1, 2015, 1.625% .....	250	-
First mortgage bond 2020 Series, due November 1, 2020, 3.25% .....	500	-
First mortgage bond 2040 Series, due November 1, 2040, 5.125% .....	<u>750</u>	<u>-</u>
Total first mortgage bonds .....	<u>\$ 1,500</u>	<u>\$ -</u>

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

**Kentucky Utilities Company**  
**Statements of Capitalization**  
(continued) (millions)

	Successor December 31, 2010	Predecessor December 31, 2009
Long-term debt to affiliated company:		
Due November 24, 2010, 4.24%, unsecured.....	\$ -	\$ 33
Due January 16, 2012, 4.39%, unsecured .....	-	50
Due April 30, 2013, 4.55%, unsecured .....	-	100
Due August 15, 2013, 5.31%, unsecured .....	-	75
Due December 19, 2014, 5.45%, unsecured .....	-	100
Due July 8, 2015, 4.735%, unsecured .....	-	50
Due December 21, 2015, 5.36%, unsecured .....	-	75
Due October 25, 2016, 5.675%, unsecured.....	-	50
Due April 24, 2017, 5.28%, unsecured .....	-	50
Due June 20, 2017, 5.98%, unsecured .....	-	50
Due July 25, 2018, 6.16%, unsecured .....	-	50
Due August 27, 2018, 5.645%, unsecured .....	-	50
Due December 17, 2018, 7.035%, unsecured .....	-	75
Due July 29, 2019, 4.81%, unsecured .....	-	50
Due October 25, 2019, 5.71%, unsecured.....	-	70
Due November 25, 2019, 4.445%, unsecured.....	-	50
Due February 7, 2022, 5.69%, unsecured .....	-	53
Due May 22, 2023, 5.85%, unsecured .....	-	75
Due September 14, 2028, 5.96%, unsecured .....	-	100
Due June 23, 2036, 6.33%, unsecured .....	-	50
Due March 30, 2037, 5.86%, unsecured .....	-	75
Total long-term debt to affiliated company .....	<u>-</u>	<u>1,331</u>
Total long-term debt outstanding .....	1,851	1,682
Purchase accounting adjustments and discounts .....	(10)	-
Less current portion of long-term debt.....	<u>-</u>	<u>261</u>
Long-term debt .....	<u>\$ 1,841</u>	<u>\$ 1,421</u>

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

**Kentucky Utilities Company**  
**Statements of Capitalization**  
 (continued) (millions)

	Successor December 31, 2010	Predecessor December 31, 2009
Common equity:		
Common stock, without par value – authorized 80,000,000 shares, outstanding 37,817,878 shares.....	\$ 308	\$ 308
Additional paid-in-capital .....	2,348	316
Retained earnings:		
Retained earnings .....	35	1,318
Undistributed subsidiary earnings.....	-	10
Total retained earnings .....	<u>35</u>	<u>1,328</u>
Total common equity.....	<u>2,691</u>	<u>1,952</u>
Total capitalization .....	<u>\$ 4,532</u>	<u>\$ 3,373</u>

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

**Kentucky Utilities Company**  
Notes to Financial Statements

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

**General**

Terms and abbreviations are explained in the index of abbreviations. Dollars are in millions unless otherwise noted.

Business

KU, incorporated in Kentucky in 1912 and in Virginia in 1991, is a regulated utility engaged in the generation, transmission, distribution and sale of electric energy in Kentucky, Virginia and Tennessee. KU provides electric service to approximately 514,000 customers in 77 counties in central, southeastern and western Kentucky, to approximately 30,000 customers in five counties in southwestern Virginia and less than ten customers in Tennessee. KU's service area covers approximately 6,600 noncontiguous square miles. Approximately 98% of the electricity generated by KU is produced by its coal-fired electric generating stations. The remainder is generated by natural gas and oil fueled CTs and a hydroelectric power plant. In Virginia, KU operates under the name Old Dominion Power Company. KU also sells wholesale electric energy to 12 municipalities.

On November 1, 2010, KU became an indirect wholly owned subsidiary of PPL, when PPL acquired all of the outstanding limited liability company interests in the Company's direct parent, LKE, from E.ON US Investments Corp. LKE, a Kentucky limited liability company, also owns the affiliate, LG&E, a regulated utility engaged in the generation, transmission, distribution and sale of electric energy and distribution and sale of natural gas in Kentucky. Following the acquisition, the Company's business has not changed. KU and LG&E are continuing as subsidiaries of LKE, which is now an intermediary holding company in the PPL group of companies.

Headquartered in Allentown, Pennsylvania, PPL is an energy and utility holding company that was incorporated in 1994. Through its subsidiaries, PPL owns or controls about 19,000 megawatts of generating capacity in the U.S., sells energy in key U.S. markets and delivers electricity and natural gas to about 5.3 million customers in the U.S. and the U.K.

Basis of Accounting

KU's basis of accounting incorporates the business combinations guidance of the FASB ASC as of the date of the acquisition, which requires the recognition and measurement of identifiable assets acquired and liabilities assumed at fair value as of the acquisition date. KU's financial statements and accompanying footnotes have been segregated to present pre-acquisition activity as the Predecessor and post-acquisition activity as the Successor. Predecessor covers the time period prior to November 1, 2010. Successor covers the time period after October 31, 2010. Certain accounting and presentation methods were changed to acceptable alternatives to conform to PPL accounting policies, which are discussed below, and the cost basis of certain assets and liabilities were changed as of November 1, 2010, as a result of the application of push-down accounting. Consequently, the financial position, results of operations and cash flows for the Predecessor period are not comparable to the Successor period.

Despite the separate presentation, the core operations of the Company have not changed. See Note 2, Acquisition by PPL, for information regarding the acquisition and the purchase accounting adjustments.

#### Changes in Classification

Certain reclassification entries have been made to the Predecessor's previous years' financial statements to conform to the 2010 presentation with no impact on net assets, liabilities and capitalization or previously reported net income and cash flows. These reclassifications mainly consist of those necessary to identify amounts for prior periods that are separately disclosed in the financial statements.

#### Regulatory Accounting

KU is a cost-based rate-regulated utility. As a result, the financial statements reflect the effects of regulatory actions. Regulatory assets are recognized for the effect of transactions or events where future recovery is probable in regulated customer rates. The effect of such accounting is to defer certain or qualifying costs that would otherwise be charged to expense. Likewise, regulatory liabilities may be recognized for obligations expected to be returned through future regulated customer rates. The effect of such transactions or events would otherwise be reflected as income, or, in certain cases, regulatory liabilities are recorded based on the understanding with the regulator that current rates are being set to recover costs that are expected to be incurred in the future. The regulated entity is accountable for any amounts charged pursuant to such rates and not yet expended for the intended purpose. Offsetting regulatory assets or liabilities for fair value purchase accounting adjustments have also been recorded to eliminate any ratemaking impact of the fair value adjustments. The accounting for regulatory assets and liabilities is based on specific ratemaking decisions or precedent for each transaction or event as prescribed by the FERC, Kentucky Commission, Virginia Commission or the Tennessee Regulatory Authority. See Note 3, Rates and Regulatory Matters, for additional detail regarding regulatory assets and liabilities.

#### Management's Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported assets and liabilities, the disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

#### **Derivative Financial Instruments**

KU enters into energy trading contracts to manage price risk and to maximize the value of power sales from the physical assets it owns. The energy trading contracts are non-hedging derivatives and the change in value is recognized in earnings on a mark-to-market basis. The Predecessor and Successor presentation are both appropriate under GAAP. The Predecessor and Successor determine the classification of energy trading contracts based on the settlement date of the individual contracts. Energy trading contracts classified as current are recognized in "Prepayments and other current assets" or "Other current liabilities" on the Balance Sheets. Energy trading contracts classified as non-current are recognized in "Other assets" or "Other liabilities" on the Balance Sheets. Cash inflows and outflows

related to derivative instruments are included as a component of operating activity on the Statements of Cash Flows, due to the underlying nature of the hedged items.

The Company does not net collateral against derivative instruments.

See Note 5, Derivative Financial Instruments, and Note 6, Fair Value Measurements, for further information on derivative instruments.

### Revenue and Accounts Receivable

The operating revenues line item in the Statements of Income contains revenues from the following:

	Successor	Predecessor		
	November 1, 2010 through December 31, 2010	January 1, 2010 through October 31, 2010	Year Ended December 31,	
			2009	2008
Residential	\$ 106	\$ 440	\$ 480	\$ 462
Industrial and commercial	117	588	637	636
Municipals	15	88	91	92
Other retail	20	114	118	108
Wholesale	5	18	29	107
	\$ 263	\$ 1,248	\$ 1,355	\$ 1,405

### Revenue Recognition

Revenues are recorded based on service rendered to customers through month-end. Operating revenues are recorded based on energy deliveries through the end of the calendar month. Unbilled retail revenues result because customers' meters are read and bills are rendered throughout the month, rather than all being read at the end of the month. Unbilled revenues for a month are calculated by multiplying an estimate of unbilled kWh by the estimated average cents per kWh.

### Accounts Receivable

Accounts receivable are reported in the Balance Sheets at the gross outstanding amount adjusted for an allowance for doubtful accounts.

### Allowance for Doubtful Accounts

The allowance for doubtful accounts included in "Accounts receivable – customer" 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 "Accounts receivable – other" is composed of accounts aged more than four months. Accounts are written off as management determines them uncollectible.

The changes in the allowance for doubtful accounts were:

	Successor	Predecessor		
	December 31, 2010	October 31, 2010	December 31, 2009	December 31, 2008
Balance at beginning of period (a) \$	-	\$ 3	\$ 3	\$ 2
Charged to income	1	(6)	(4)	(2)
Charged to balance sheets	5	6	4	3
Balance at end of period	\$ 6	\$ 3	\$ 3	\$ 3

(a) Successor beginning of period reflects revaluation of accounts receivable due to purchase accounting.

## Cash

### Cash Equivalents

All highly liquid investments with an original maturity of three months or less are considered to be cash equivalents.

### Restricted Cash

Bank deposits and other cash equivalents that are restricted by agreement or that have been clearly designated for a specific purpose are classified as restricted cash. The change in restricted cash is reported as an investing activity on the Statements of Cash Flows. On the Balance Sheets, restricted cash is included in "Prepayments and other current assets". For KU, the December 31, 2010, balance of restricted cash was less than \$1 million.

## Fair Value Measurements

KU values certain financial assets and liabilities at fair value. Generally, the most significant fair value measurements relate to derivative assets and liabilities, investments in securities including investments in the pension and postretirement benefit plans and cash and cash equivalents. KU uses, as appropriate, a market approach (generally, data from market transactions), an income approach (generally, present value techniques) and/or a cost approach (generally, replacement cost) to measure the fair value of an asset or liability. These valuation approaches incorporate inputs such as observable, independent market data and/or unobservable data that management believes are predicated on the assumptions that market participants would use to price an asset or liability. These inputs may incorporate, as applicable, certain risks such as nonperformance risk, which includes credit risk.

KU prioritizes fair value measurements for disclosure by grouping them into one of three levels in the fair value hierarchy. The highest priority is given to measurements using level 1 inputs. The appropriate level assigned to a fair value measurement is based on the lowest level input that is significant to the fair value measurement in its entirety. The three levels of the fair value hierarchy are as follows:

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

Assessing the significance of a particular input requires judgment that considers factors specific to the asset or liability. As such, KU's assessment of the significance of a particular input may affect how the assets and liabilities are classified within the fair value hierarchy. See Note 5, Derivatives Financial Instruments, and Note 6, Fair Value Measurements, for further information on fair value measurements.

## Investments

### Equity Method Investment

KU's equity method investment, included in "Investment in unconsolidated venture" on the Balance Sheets, consists of its investment in EEI. KU owns 20% of the common stock of EEI, which owns and operates a 1,002 Mw summer capacity coal-fired plant and a 74 Mw summer capacity natural gas facility in southern Illinois. Through a power marketer affiliated with its majority owner, EEI sells its output to third parties. Although KU holds investment interest in EEI, it is not the primary beneficiary and is therefore not consolidated into the Company's financial statements. KU's investment in EEI is accounted for under the equity method of accounting and as of December 31, 2010 and 2009, totaled \$30 million and \$12 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. See Note 2, Acquisition by PPL, for further discussion regarding purchase accounting adjustments recognized for KU's investment in EEI.

The results of operations and financial position of EEI, KU's equity method investment, are summarized below.

Condensed income statement information for the years ended December 31 is as follows:

	2010		
	<u>(unaudited)</u>	<u>2009</u>	<u>2008</u>
Net sales	\$ 343	\$ 297	\$ 514
Net income	16	10	142
KU's equity in earnings of EEI	3	1	30



Condensed balance sheet information as of December 31 is as follows:

	2010 <u>(unaudited)</u>	<u>2009</u>
Current assets	\$ 62	\$ 84
Long-lived assets	<u>181</u>	<u>178</u>
Total assets	<u>\$ 243</u>	<u>\$ 262</u>
Current liabilities	\$ 113	\$ 166
Long-term liabilities	72	50
Equity	<u>58</u>	<u>46</u>
Total liabilities and equity	<u>\$ 243</u>	<u>\$ 262</u>
<u>Cost Method Investment</u>		

KU's cost method investment, included in "Investments in unconsolidated venture" on the Balance Sheets, consists of the Company's investment in OVEC. KU and 11 other electric utilities are owners of OVEC, which is located in Piketon, Ohio. OVEC owns and operates two coal-fired power plants, Kyger Creek Station in Ohio and Clifty Creek Station in Indiana with combined nameplate generating capacities of 2,390 Mw. OVEC's power is currently supplied to KU and 13 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. Based on nameplate generating capacity, this would be approximately 60 Mw.

As of December 31, 2010 and 2009, KU's investment in OVEC totaled less than \$1 million. KU is not the primary beneficiary of OVEC; therefore, it is not consolidated into the Company's financial statements and is accounted for under the cost method of accounting. The direct exposure to loss as a result of the Company's involvement with OVEC is generally limited to the value of its investment; however, KU may be conditionally responsible for a pro-rata share of certain OVEC obligations. See Note 2, Acquisition by PPL, and Note 13, Commitments and Contingencies, for further discussion regarding purchase accounting adjustments recognized, and KU's ownership interest and power purchase rights.

### **Long-Lived and Intangible Assets**

#### Regulated Utility Plant

Regulated utility plant was stated at original cost for the Predecessor and adjusted to the net book value on November 1, 2010, the acquisition date, for the Successor. KU determined that fair value was equal to net book value at the acquisition date since KU's operations are conducted in a regulated environment. Original cost includes payroll-related costs such as taxes, fringe benefits and administrative and general costs. Construction work in progress has been included in the rate base for determining retail customer rates. KU has not recorded significant allowance for funds used during construction in accordance with FERC.

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.

### Capitalized Software Cost

Included in “Property, plant and equipment” on the Balance Sheets are capitalized costs of software projects that were developed or obtained for internal use. These capitalized costs are amortized ratably over the expected lives of the projects when they become operational, generally not to exceed five years. Following are capitalized software costs and the accumulated amortization:

<u>Successor</u>		<u>Predecessor</u>	
<u>December 31, 2010</u>		<u>December 31, 2009</u>	
<u>Carrying Amount</u>	<u>Accumulated Amortization (a)</u>	<u>Carrying Amount</u>	<u>Accumulated Amortization</u>
\$ 40	\$ 1	\$ 52	\$ 13

- (a) The accumulated amortization as of November 1, 2010, was netted against the carrying amount of the software as the fair value was determined to be equal to net book value for property, plant and equipment.

Amortization expense of capitalized software costs was as follows:

<u>Successor</u>	<u>Predecessor</u>	
<u>November 1, 2010 through December 31, 2010</u>	<u>January 1, 2010 through October 31, 2010</u>	<u>Year Ended December 31, 2009 2008</u>
\$ 1	\$ 6	\$ 6 \$ 5

The amortization of capitalized software is included in “Depreciation and amortization” on the Statements of Income.

### Depreciation and Amortization

Depreciation is provided on the straight-line method over the estimated service lives of depreciable plant. The amounts provided as a percentage of depreciable plant were approximately:

<u>Year</u>	<u>Percentage</u>
2010	4.1%
2009	2.6%
2008	3.0%

Of the amount provided for depreciation, the following were related to the retirement, removal and disposal costs of long lived assets:

<u>Year</u>	<u>Percentage</u>
2010	0.6%
2009	0.4%
2008	0.5%

#### Goodwill, Intangible Assets and Asset Impairment

KU performs a quarterly review to determine if an impairment analyses is required for long-lived assets that are subject to depreciation or amortization. This review identifies changes in circumstances indicating that a long-lived asset's carrying value may not be recoverable. An impairment analysis will be performed if warranted, based on the review.

For a long-lived asset to be held and used, impairment exists when the carrying amount exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset. If the asset is impaired, an impairment loss is recorded to adjust the asset's carrying amount to its fair value.

KU, as the result of PPL's acquisition of LKE, recorded the fair value of its coal contracts, emission allowances, EEI investment and OVEC power purchase contract. The difference between the fair value and the cost for these assets is being amortized over their useful lives based upon the pattern in which the economic benefits of the intangible assets are consumed or otherwise used. When determining the useful life of an intangible asset, including intangible assets that are renewed or extended, KU considers the expected use of the asset, the expected useful life of other assets to which the useful life of the intangible asset may relate and legal, regulatory, or contractual provisions that may limit the useful life. See Note 2, Acquisition by PPL, for methods used to determine the long-lived intangible assets' fair values. See Note 7, Goodwill and Intangible Assets, for the fair value amounts and amortization periods. The current intangible assets and long-term intangible assets are included in "Other intangible assets" on the Balance Sheets.

The Predecessor reported emission allowances in "Other materials and supplies" on the Balance Sheets. The emission allowances were not amortized; rather, they were expensed when consumed. The Predecessor did not recognize the coal contracts or the OVEC power purchase contract as these intangible assets were not derivatives.

In connection with PPL's acquisition of LKE, KU recorded goodwill on November 1, 2010. Goodwill represents the excess of the purchase price paid over the estimated fair value of the assets acquired and liabilities assumed in the acquisition of a business. Goodwill is tested annually for impairment during the fourth quarter and more frequently if management determines that a triggering event may have occurred that would more likely than not reduce the fair value of an operating unit below its carrying value. Goodwill impairment charges are not subject to rate recovery. See Note 7, Goodwill and Intangible Assets, for further discussion regarding the Company's goodwill and current test results.

### Asset Retirement Obligations

KU recognizes various legal obligations associated with the retirement of long-lived assets as liabilities in the financial statements. Initially this obligation is measured at fair value. An equivalent amount is recorded as an increase in the value of the capitalized asset and allocated to expense over the useful life of the asset. Until the obligation is settled, the liability is increased, through the recognition of accretion expense in the Statements of Income, for changes in the obligation due to the passage of time. An offsetting regulatory asset is recognized to reverse the depreciation and accretion expense related to the ARO such that there is no income statement impact. The regulatory asset is relieved when the ARO has been settled. Estimated ARO costs and settlement dates, which affect the carrying value of various AROs and the related assets, are reviewed periodically to ensure that any material changes are incorporated into the latest estimate of the obligations. See Note 4, Asset Retirement Obligations, for further information on AROs.

### **Defined Benefits**

KU employees benefit from both funded and unfunded retirement benefit plans. An asset or liability is recorded to recognize the funded status of all defined benefit plans with an offsetting entry to regulatory assets or regulatory liabilities. Consequently, the funded status of all defined benefit plans is fully recognized on the Balance Sheets.

The expected return on plan assets is determined based on the current level of expected return 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 is then weighted based on the current asset allocation.

The discount rate used for pensions, postretirement and post-employment plans by the Predecessor was determined using the Mercer Yield Curve. The expected return on assets assumption was 7.75%. Gains and losses in excess of 10% of the greater of the plan's projected benefit obligation or market value of assets were amortized on a straight-line basis over the average future service period of active participants. The market-related value of assets was equal to the fair market value of the assets.

The discount rate used by the Successor was determined by the Towers Watson Yield Curve based on the individual plan cash flows. The expected return on assets was reduced from 7.75% to 7.25%. The amortization period for the recognition of gains and losses for retirement plans was changed to reflect the Successor's amortization policy. Under the Successor's method, gains and losses in excess of 10% but less than 30% of the greater of the plan's projected benefit obligation or market-related value of assets, are amortized on a straight-line basis over the average future service period of active participants. Gains and losses in excess of 30% of the plan's projected benefit obligation or market-related value of assets are amortized on a straight-line basis over a period equal to one-half of the average future service period of active participants. The market-related value of assets for the qualified retirement plans will be equal to a five year smoothed asset value. Gains and losses in excess of the expected return will be phased-in over a five-year period, prospectively from November 1, 2010.

See Note 9, Pension and Other Postretirement Benefit Plans, for further information.

## Other

### Loss Accruals

Potential losses are accrued when information is available that indicates it is “probable” that a loss has been incurred, given the likelihood of uncertain future events, and the amount of the loss can be reasonably estimated. Accounting guidance defines “probable” as cases in which “the future event or events are likely to occur.” KU continuously assesses potential loss contingencies for environmental remediation, litigation claims, regulatory penalties and other events.

KU does not record the accrual of contingencies that might result in gains unless recovery is assured.

### Income Taxes

For the periods ended on or before October 31, 2010, KU was a subsidiary of E.ON U.S. and was part of E.ON U.S.’s direct parent’s, E.ON US Investments Corp., consolidated U.S. federal income tax return. On November 1, 2010, KU became a part of PPL’s consolidated U.S. federal income tax return.

Significant management judgment is required in developing KU’s provision for income taxes primarily due to the uncertainty related to tax positions taken or expected to be taken in tax returns and the determination of deferred tax assets, liabilities and valuation allowances.

KU evaluates tax positions following a two-step process. The first step requires an entity to determine whether, based on the technical merits supporting a particular tax position, it is more likely than not (greater than a 50% chance) that the tax position will be sustained. This determination assumes that the relevant taxing authority will examine the tax position and is aware of all the relevant facts surrounding the tax position. The second step requires an entity to recognize in the financial statements the benefit of a tax position that meets the more-likely-than-not recognition criterion. The benefit recognized is measured at the largest amount of benefit that has a likelihood of realization, upon settlement, that exceeds 50%. The amounts ultimately paid upon resolution of issues raised by taxing authorities may differ materially from the amounts accrued and may materially impact the financial statements of KU.

Deferred income taxes reflect the net future tax effects of temporary differences between the carrying amounts of assets and liabilities for accounting purposes and their basis for income tax purposes, as well as the tax effects of net operating losses and tax credit carryforwards.

KU records valuation allowances to reduce deferred tax assets to the amounts that are more likely than not to be realized. KU considers the reversal of temporary differences, future taxable income and ongoing prudent and feasible tax planning strategies in initially recording and subsequently reevaluating the need for valuation allowances. If KU determines that it is able to realize deferred tax assets in the future in excess of recorded net deferred tax assets, adjustments to the valuation allowances increase income by reducing tax expense in the period that such determination is made. Likewise, if KU determines that it is not able to realize all or part of net deferred tax assets in the future, adjustments to the valuation allowances would decrease income by increasing tax expense in the period that such determination is made.

The provision for KU's deferred income taxes for regulated assets and liabilities is based upon the ratemaking principles reflected in rates established by the regulators. The difference in the provision for deferred income taxes for regulated assets and liabilities and the amount that otherwise would be recorded under GAAP is deferred and included on the Balance Sheets in "Regulatory liabilities".

KU defers investment tax credits when the credits are utilized and amortizes the deferred amounts over the average lives of the related assets.

See Note 10, Income Taxes, for further discussion regarding income taxes.

### Leases

KU evaluates whether arrangements entered into contain leases for accounting

purposes. Materials and Supplies

Fuel and other materials and supplies inventories are accounted for using the average-cost method.

### Fuel Costs

The cost of fuel for electric generation is charged to expense as used. See Note 3, Rates and Regulatory Matters, for a description of the FAC.

### Debt

The Company's long-term debt includes \$228 million of pollution control bonds, which are subject to tender for purchase at the option of the holder and to mandatory tender for purchase on the occurrence of certain events. The Successor has classified these bonds as long term because the Company has the intent and ability to utilize its \$400 million credit facility, which matures in December 2014, to fund any mandatory purchases. Predecessor classified these bonds as current portion of long-term debt due to the tender for purchase provisions. The Predecessor presentation and the Successor presentation are both appropriate under GAAP. See Note 11, Long-Term Debt, and Note 12, Notes Payable and Other Short-Term Obligations, for more information on the Company's debt and credit facilities.

### Unamortized Debt Expense

Debt expense is capitalized and amortized over the lives of the related bond issues using the straight line method, which approximates the effective interest method. Depending on the type of expense, the Successor capitalized debt expenses in long-term other regulatory assets or long-term other assets to align with the term of the debt the expenses were related. The Predecessor capitalized debt expenses in current or long-term other regulatory assets or other current or long-term other assets based on the amount of expense expected to be recovered within the next year through rate recovery. Both the Predecessor and the Successor amortize debt expenses over the lives of the related bond issues. The Predecessor presentation and the Successor presentation are both appropriate under regulatory practices and GAAP.

**Recent Accounting Pronouncements**

The following recent accounting pronouncement affected KU:

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 - Acquisition by PPL**

On November 1, 2010, PPL completed its acquisition of LKE and its subsidiaries. The push-down basis of accounting was used to record the fair value adjustments of assets and liabilities on LKE at the acquisition date. PPL paid a cash consideration for LKE and its subsidiaries of \$2,493 million as well as a capital contribution on November 1, 2010, of \$1,565 million; included within this was the consideration paid for KU of \$2,656 million. The allocation of the KU purchase price was based on the fair value of assets acquired and liabilities assumed.

The allocation of the purchase price to the fair value of assets acquired and liabilities assumed is as follows:

Current assets	\$	364
Investments		30
Property, plant and equipment		4,531
Other intangible assets		178
Regulatory and other non-current assets		274
Current liabilities (excluding current portion of long-term debt)		(367)
Affiliated debt		(1,331)
Debt (current and non-current)		(352)
Other non-current liabilities		(1,278)
Net identifiable assets acquired		2,049
Goodwill		607
Total purchase price	\$	<u>2,656</u>

Goodwill represents value paid for the rate regulated business of KU, which is located in a defined service area with a constructive regulatory environment, which provides for future investment, earnings and cash flow growth, as well as the talented and experienced workforce. KU's franchise values are being attributed to the going concern value of the business, and thus were recorded as goodwill rather than a separately identifiable intangible asset. None of the goodwill recognized is deductible for income tax purposes or included in regulated customer rates.

Adjustments to KU's assets and liabilities that contributed to goodwill were as follows:

The fair value adjustment on the EEI investment was calculated using the discounted cash flow valuation method. The result was an increase in KU's value of the investment in EEI; the fair value of EEI was calculated to be \$30 million and a fair value adjustment of \$18 million was recorded on KU. The fair value adjustment to EEI is amortized over the expected remaining useful life of plant and equipment at EEI, which is estimated to be over 20 years.

The pollution control bonds on KU had a fair value adjustment of \$1 million. All variable bonds were valued at par while the fixed rate bonds were valued with a yield curve based on average credit spreads for similar bonds.

As a result of the purchase accounting associated with the acquisition, the following items had a fair value adjustment but no effect on goodwill as the offset was either a regulatory asset or liability. The regulatory asset or liability has been recorded to eliminate any ratemaking impact of the fair value adjustments:

- The value of OVEC was determined to be \$39 million based upon an announced transaction by another owner. KU's stock was valued at less than \$1 million and the power purchase agreement has been valued at \$39 million. An intangible asset was recorded with the offset to regulatory liability and will be amortized using the units of production method until the power purchase agreement ends in March 2026.
- KU recorded an emission allowance intangible asset and regulatory liability as the result of adjusting the fair value of the emission allowances at KU. The emission allowance intangible of \$9 million represents allocated and purchased SO<sub>2</sub> and NO<sub>x</sub> emission allowances that are unused as of the valuation date or allocated for use in future years. KU had previously recorded emission allowances as other materials and supplies. To conform to PPL's accounting policy all emission allowances are now recorded as intangible assets. The emission allowance intangible asset is amortized as the emission allowances are consumed, which is expected to occur through 2040.
- KU recorded a coal contract intangible asset of \$145 million and non-current liability of \$22 million on the Balance Sheets. An offsetting regulatory asset was recorded for those contracts with unfavorable terms relative to market. An offsetting regulatory liability was recorded for those contracts that had favorable terms relative to market. All coal contracts held by KU, wherein it had entered into arrangements to buy amounts of coal at fixed prices from counterparties at a future date, were fair valued. The intangible assets and other liabilities, as well as the regulatory assets and liabilities, are being amortized over the same terms as the related contracts, which expire through 2016.

The fair value of intangible assets and liabilities (e.g. contracts that have favorable or unfavorable terms relative to market), including coal contracts and power purchase agreements, as well as emission allowances, have been reflected on the Balance Sheets with offsetting regulatory assets or liabilities. Prior to the acquisition, KU recovered the cost of the coal contracts, power purchases and emission allowances and this rate treatment will continue after the acquisition. As a result, management believes the regulatory assets and liabilities created to offset the fair value adjustments meet the recognition criteria established by existing accounting guidance and eliminate any ratemaking impact of the fair



value adjustments. KU's customer rates will continue to reflect these items (e.g. coal, purchased power, emission allowances) at their original contracted prices.

KU also considered whether a separate fair value should be assigned to KU's rights to operate within its various electric service areas but concluded that these rights only provided the opportunity to earn a regulated return and barriers to market entry, which in management's judgment is not considered a separately identifiable intangible asset under applicable accounting guidance; rather, it is considered going-concern value, or goodwill.

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

The Company is subject to the jurisdiction of the FERC, Kentucky Commission, Virginia Commission and the Tennessee Regulatory Authority 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.

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. No regulatory assets or regulatory liabilities recorded at the time base rates were determined were excluded from the return on capitalization utilized in the calculation of Kentucky base rates. Therefore, a return is earned on all Kentucky regulatory assets existing at the time base rates were determined, except where such regulatory assets were offset by associated liabilities and thus, have no net impact on capitalization.

As a result of purchase accounting, certain fair value amounts, reflecting contracts that have favorable or unfavorable terms relative to market, were recorded on the Balance Sheets with offsetting regulatory assets or liabilities. Prior to the acquisition, KU recovered in customer rates the cost of the coal contracts, power purchases and emission allowances and this rate treatment will continue after the recognition criteria established by existing accounting guidance and eliminate any ratemaking impact of the fair value adjustments. KU's customer rates will continue to reflect these items (e.g. coal, purchased power, emission allowances) at their original contracted prices.

KU's Virginia base rates are calculated based on a return on rate base. All regulatory assets and liabilities are excluded from the return on rate base utilized in the calculation of Virginia base rates.

KU's wholesale requirements rates for municipal customers are calculated based on annual updates to a rate formula that utilizes a return on rate base. All regulatory assets and liabilities are excluded from the return on rate base utilized in the development of municipal rates.

#### 2010 Purchase and Sale Agreement with PPL

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 Corp., PPL and E.ON.

The transaction was 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 the FERC and state regulators in Kentucky, Virginia and Tennessee) and the absence of injunctions or restraints imposed by governmental entities.

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 committed that no base rate increases would take effect before January 1, 2013. The KU rate increases that took effect on August 1, 2010, were not impacted by the settlement. Under the terms of the settlement, KU retains 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 Utilities 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 KU 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. On September 30, 2010, the Kentucky Commission issued an Order approving the transfer of ownership of KU 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 other applicants in the FERC change of control proceeding reached an agreement with the protesters, whereby such protests have been withdrawn. The agreement, which was 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 KU has agreed not to seek the same transaction-related costs 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 and the transaction was completed November 1, 2010.

### 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. In June 2010, KU and all of the intervenors, except the AG, agreed to stipulations 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 stipulations, including a return on equity range of 9.75 – 10.75%. 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. 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 \$1 million in interim rate amounts in excess of the ultimate approved rates.

### 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 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 adjustments to the formula rates which incorporated certain proposed increases. Updated rates, including certain further adjustments from a review process involving wholesale requirements customers, became effective as of July 1, 2010, subject to certain review procedures by the wholesale requirements customers and the FERC.

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. 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.

### 2008 Kentucky Rate Case

In July 2008, KU filed an application with the Kentucky Commission requesting an increase in electric base 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 electric base 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.

Regulatory Assets and Liabilities

The following regulatory assets and liabilities were included in the Balance Sheets as of December 31:

	Successor <u>2010</u>	Predecessor <u>2009</u>
Current regulatory assets:		
ECR (a)	\$ -	\$ 28
FAC (a)	-	1
Coal contracts (b)	4	-
MISO exit (c)	-	2
Other (d)	5	1
Total current regulatory assets	<u>\$ 9</u>	<u>\$ 32</u>
Non-current regulatory assets:	\$ 117	\$ 105
Pension and postretirement benefits (e)		
Other non-current regulatory assets:	57	59
Storm restoration (c)		
ARO (f)	2	30
Unamortized loss on bonds (c)	12	12
Coal contracts (b)	14	-
MISO exit (a)	5	9
Unamortized debt expense	5	-
Other (d)	10	7
Subtotal other non-current regulatory assets	<u>105</u>	<u>117</u>
Total non-current regulatory assets	<u>\$ 222</u>	<u>\$ 222</u>
Current regulatory liabilities:		
Coal contracts	\$ 16	\$ -
ECR	12	-
FAC	2	-
DSM	5	3
Emission allowances	6	-
Other (g)	-	1
Total current regulatory liabilities	<u>\$ 41</u>	<u>\$ 4</u>
Non-current regulatory liabilities:		
Accumulated cost of removal of utility plant	\$ 348	\$ 335
Other non-current regulatory liabilities:		
Coal contracts	126	-
OVEC power purchase contract	38	-
Deferred income taxes – net	6	9
Postretirement benefits	10	9
Other (g)	6	7
Subtotal other non-current regulatory liabilities	<u>186</u>	<u>25</u>
Total non-current regulatory liabilities	<u>\$ 534</u>	<u>\$ 360</u>

- (a) The FAC and ECR regulatory assets have separate recovery mechanisms with recovery within twelve months.
- (b) Offsetting regulatory asset for fair value purchase accounting adjustments. See Note 2, Acquisition by PPL, for information on the purchase accounting adjustments.
- (c) These regulatory assets are recovered through base rates.
- (d) Other regulatory assets include:
  - The CMRG and KCCS contributions, an EKPC FERC transmission settlement agreement and rate case expenses, which are recovered through base rates.
  - The FERC jurisdictional portion of the EKPC FERC transmission settlement agreement included in current and non-current regulatory assets, recovered through the application of the annual OATT formula rate updates.
  - FERC jurisdictional pension expense, which will be requested in a future FERC rate case.
  - Offsetting regulatory asset for fair value purchase accounting adjustment for leases. See Note 2, Acquisition by PPL, for information on the purchase accounting adjustments.
  - The Virginia levelized fuel factor, which is a separate recovery mechanism with recovery within twelve months.
- (e) KU generally recovers this asset through pension expense included in the calculation of base rates.
- (f) 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.
- (g) Other regulatory liabilities includes the emission allowance purchase accounting offset, MISO exit and a change in accounting method for FERC jurisdictional spare parts.

### *ECR*

KU recovers the costs of complying with the Federal Clean Air Act pursuant to Kentucky Revised Statute 278-183 as amended and those federal, state or local environmental requirements which apply to coal combustion wastes and by-products from facilities utilized for production of energy from coal, 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 2010, the Kentucky Commission initiated a six-month review of the Utilities' environmental surcharge for the billing period ending October 2010. An order is expected in the second quarter of 2011. Also, in December 2010, an Order was issued approving the charges and credits billed through the ECR during the six-month period ending April 2010, as well as approving billing adjustments for under-recovered costs and the rate of return on capital. In May 2010, an Order was issued approving the amounts billed through the ECR during the six-month period ending October 2009, and the rate of return on capital and allowing recovery of the under-recovery position in subsequent monthly filings. 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 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 December 31, 2010, the regulatory liability balance was \$12 million.

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%. The 10.63% return on equity for the ECR mechanism was affirmed in the 2010 rate case.

#### *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 billed amounts 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 December 2010, May 2010, 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 2010, August 2009, April 2009, April 2008, October 2007 and April 2007, respectively. In January 2009 the Kentucky Commission initiated routine examinations of the FAC for the two-year periods November 1, 2006 through October 31, 2008. The Kentucky Commission issued an Order in June 2009 approving the charges and credits billed through the FAC during the review periods.

KU also employs an FAC mechanism for Virginia customers using an average fuel cost factor based primarily on projected fuel costs. The Virginia levelized fuel factor allows fuel recovery based on projected fuel costs for the coming year plus an adjustment for any over- or under-recovery of fuel expenses from the prior year. At December 31, 2010 and 2009, KU had a regulatory asset of \$5 million and less than \$1 million, respectively.

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 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 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.

#### *Coal Contracts*

In November 2010, purchase accounting adjustments were recorded for the fair value of KU's coal contracts. Offsetting regulatory asset or liability for fair value purchase accounting adjustments eliminate any ratemaking impact of the fair value adjustments.

#### *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 OATT. KU now contracts with the TVA to act as its transmission reliability coordinator and SPP to function as its independent transmission operator, pursuant to FERC requirements. The contractual obligations with the TVA extend through August 2011 and with SPP through August 2012.

KU and the MISO 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 providing KU with recovery of \$4 million, of which \$1 million was immediately recovered in 2008, with the remainder to be recovered over the seven years from 2008 through 2014 for credits realized from other payments the MISO will receive, plus interest.

In accordance with Kentucky Commission Orders approving the MISO exit, KU established a regulatory asset for the MISO exit fee, net of former MISO administrative charges collected via base rates through the base rate case test year ended April 30, 2008. The net MISO exit fee is subject to adjustment for possible future MISO credits and a regulatory liability for certain revenues associated with former MISO administrative charges, which were collected via base rates until February 6, 2009. The approved 2008 base rate case settlement provided for MISO administrative charges collected through base rates from May 1, 2008 to February 6, 2009, and any future adjustments to the MISO exit fee, to be established as a regulatory liability until the amounts can be amortized in future base rate cases. This regulatory liability balance as of October 31, 2009, was 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. The MISO began refunding the amounts to the Company in June 2009 with full repayment 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.

In November 2009, the Utilities filed an application with the FERC to approve certain independent transmission operator arrangements to be effective upon the expiration of their current contract with SPP in September 2010. The application sought authority for KU and LG&E to function after such date as the administrators of their own OATT for most purposes. However, due to the lack of FERC approval for such an approach and the approaching expiration of the SPP contract, the Utilities determined the approach was no longer reasonably achievable without unacceptable delay and uncertainty. In July 2010, the Utilities entered into a new agreement with SPP to provide independent transmission operator



services for a specified, limited time and removed its application for authority of administering its own OATT. The TVA, which currently acts as reliability coordinator, has also been retained under the existing service contract. The new agreement extends TVA services to August 2011 with no alterations or changes to the party's duties or responsibilities.

In August 2010, the FERC issued three Orders accepting most facets of several MISO 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 the 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.

#### *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 on the Balance Sheets 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 its pension plan that is expected to be recovered and a regulatory liability representing the change in funded status of its postretirement benefit plan. 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.

#### *Storm Restoration*

In January 2009, a significant ice storm passed through KU's service area causing approximately 199,000 customer outages, followed closely by a severe wind storm in February 2009, causing approximately 44,000 customer outages. An application was filed 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 establishment of a regulatory asset of up to \$62 million based on actual costs for storm damages and service restoration due to the January and February 2009 storms. In September 2009, a regulatory asset of \$57 million was established for actual costs incurred and approval was received in KU's 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 area causing significant outages and system damage. In October 2008, an application was filed with the

Kentucky Commission requesting approval to establish regulatory assets 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 establishment a regulatory asset of up to \$3 million based on actual costs for storm damages and service restoration due to Hurricane Ike. In December 2008, a regulatory asset of \$2 million was established for actual costs incurred and KU received approval in its 2010 base rate case to recover this asset over a ten year period, beginning August 1, 2010.

#### *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.

#### *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 \$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. KU received approval from the Kentucky Commission in the Company's 2010 Kentucky base rate case to recover these regulatory assets over the requested period beginning August 1, 2010.

#### *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.

KU incurred \$2 million in expenses related to the development and support of the 2010 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 August 2010.

#### *FERC Jurisdictional Pension Costs*

Other regulatory assets include pension costs of \$5 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.

*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.

*DSM*

DSM consists of energy efficiency programs which are intended to reduce peak demand and delay the investment in additional power plant construction, provide customers with tools and information to become better managers of their energy usage and prepare for potential future legislation governing energy efficiency. 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.

*Emission Allowances*

In November 2010, purchase accounting adjustments were recorded for the fair market value of KU's SO<sub>2</sub>, NO<sub>x</sub> ozone season and NO<sub>x</sub> annual emission allowances. Offsetting regulatory assets or liabilities for fair value purchase accounting adjustments eliminate any ratemaking impact of the fair value adjustments. KU is granted SO<sub>2</sub> emission allowances through 2040 and NO<sub>x</sub> ozone season and NO<sub>x</sub> annual emission allowances through 2011.

*Accumulated Cost of Removal of Utility Plant*

As of December 31, 2010 and 2009, KU segregated the cost of removal, previously embedded in accumulated depreciation, of \$348 million and \$335 million, respectively, in accordance with FERC Order No. 631. For reporting purposes on the Balance Sheets, KU presented this cost of removal as a "Regulatory liability" pursuant to the regulated operations guidance of the FASB ASC.

*OVEC Power Purchase Contract*

In November 2010, purchase accounting adjustments were recorded for the fair value of the power purchase agreement between KU and OVEC. Offsetting regulatory liability for fair value purchase accounting adjustment eliminate any ratemaking impact of the fair value adjustments.

### *Deferred Income Taxes – Net*

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

### 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 Utilities 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 were 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 Utilities filed an application and supporting testimony with the Kentucky Commission. In October 2009, the Kentucky Commission issued an Order denying the Utilities' 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 provided 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 Utilities delivered notices of termination under provisions of the wind power contracts. The Utilities also filed a motion with the Kentucky Commission noting the termination of the contracts and seeking withdrawal of their application in the related regulatory proceeding. In April 2010, the Kentucky Commission issued an Order allowing the Utilities to withdraw their pending application.

#### *Trimble County Asset Purchase and Depreciation*

In July 2009, the Utilities notified the Kentucky Commission of the proposed sale from the Utilities of certain ownership interests in certain existing Trimble County generating station assets which were

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 sold provide KU an ownership interest in these common assets proportional to its interest in TC2 and the assets' role in supporting both TC1 and TC2. In December 2009, the Utilities 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, the Utilities jointly filed an application with the Kentucky Commission to approve new 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 Utilities 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.

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. Certain proceedings relating to CCN challenging and federal historic preservation permit requirements have concluded with outcomes in the Utilities' favor.

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

With respect to the remaining on-going dispute, KU obtained various successful rulings during 2008 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 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.

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 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 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.

Consistent with the regulatory authorizations and the favorable outcome of the legal proceedings, the Utilities completed construction activities on the permanent transmission line easements. During 2010, the Utilities placed the transmission line into operation. While the Utilities are not currently able to predict the ultimate outcome and possible financial effects of the remaining legal proceedings, the Utilities do not believe the matter involves relevant or continuing risks to operations.

#### *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 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 balancing areas in which it may be deemed to have market power, subject to a restriction that such power will not be collusively re-sold back into such balancing areas. However, restrictions exist on sales by KU of power at market-based rates in the KU and LG&E and Big Rivers Electric Company balancing 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 balancing 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 triennial 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 balancing area interfaces or into balancing 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 Company balancing 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 balancing 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, 2010.

#### *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 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. The Utilities are members of the SERC, which acts as KU's and LG&E's RRO. During December 2009 and April, July and August 2010, the Utilities submitted ten self-reports relating to various standards, which self-reports remain in the early stages of RRO review, and therefore, the Utilities 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 Utilities believe they are in compliance with the mandatory reliability standards, events of potential non-compliance may be identified from time-to-time. The Utilities cannot predict such potential violations or the outcome of self-reports 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. KU expects to file their next IRP in April 2011.

#### *PUHCA 2005*

PPL, KU's ultimate parent, is a holding company under PUHCA 2005. PPL, its utility subsidiaries, including KU, and certain of its non-utility subsidiaries, are subject to extensive regulation by the FERC

**Energy Assistance program. During September 2007, the Kentucky Commission approved the**

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five-year 90**

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 were required to file real-time pricing pilot programs for their large commercial and industrial customers. KU developed a real-time pricing pilot program 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. 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 three-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. In February 2010, the Kentucky Commission approved the Utilities' application, as filed.

#### *Home Energy Assistance Program*

In July 2007, KU filed an application with the Kentucky Commission for the establishment of a Home



program as filed, effective in October 2007. The programs were scheduled to terminate 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. As a condition in the settlement in the change of control proceeding before the Kentucky Commission in the PPL acquisition, the program was extended to September 2015.

#### *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, in its rate case filed on July 29, 2008, 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 agreements approved in the rate cases 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 agreements in the rate cases 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 future base rate cases 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 non-regulated 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. 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. A public hearing has not been scheduled in this matter.

#### **Note 4 - Asset Retirement Obligations**

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:

	ARO Net <u>Assets</u>	ARO <u>Liabilities</u>	Regulatory <u>Assets</u>
As of December 31, 2008, Predecessor	\$ 5	\$ (32)	\$ 28
ARO accretion and depreciation	<u>(1)</u>	<u>(2)</u>	<u>2</u>
As of December 31, 2009, Predecessor	4	(34)	30
ARO accretion and depreciation	-	(2)	2
Reclassification for retired assets	(1)	-	1
ARO revaluation - change in estimates	<u>22</u>	<u>(24)</u>	<u>2</u>
As of October 31, 2010, Predecessor	25	(60)	35
ARO accretion and depreciation	(1)	-	1
Purchase accounting - fair value adjustment	<u>28</u>	<u>6</u>	<u>(34)</u>
As of December 31, 2010, Successor	\$ 52	\$ <u>(54)</u>	\$ <u>2</u>

In September 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.

In November 2010, the Company recorded a purchase accounting adjustment to fair value AROs due to the PPL acquisition.

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 Statements of Income for the Successor of \$1 million in 2010 and \$2 million for the Predecessor for the ARO accretion and depreciation expense. The offsetting regulatory credit recorded was \$2 million in 2009 and 2008 for the ARO accretion and depreciation expense. The ARO liabilities are offset by cash settlements that have not yet been applied. Therefore, ARO net assets, ARO liabilities and regulatory assets balances do not net to zero due to the cash settlements.

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 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.

#### **Note 5 – Derivative Financial Instruments**

KU is subject to interest rate and commodity price risk related to on-going business operations. The Company's policies allow for the interest rate risk to be managed through the use of fixed rate debt, floating rate debt and interest rate swaps. Although the Company's policies allow for the use of interest rate swaps, as of December 31, 2010 and 2009, KU had no interest rate swaps outstanding. At December 31, 2010, KU's potential annual exposure to increased interest expense, based on a 10% increase in interest rates, was less than \$1 million.

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 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 data 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 December 31, 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 ratings of 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, 2010, 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 KU's own creditworthiness (for net liabilities) and its counterparty's creditworthiness (for net assets). The Company applies historical default rates within varying credit ratings over time provided by S&P or Moody's. At December 31, 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 December 31, 2010 and December 31, 2009, was 129,199 Mwh and 315,600 Mwh, respectively. Cash collateral related to the energy trading and risk management contracts was less than \$1 million at December 31, 2010 and December 31, 2009. Cash collateral related to the energy trading and risk management contracts is recorded in "Prepayments and other current assets" on the 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; therefore, realized and unrealized gains and losses are included in the Statements of Income.

The following table presents the effect of market-traded forward contract derivatives not designated as hedging instruments on income:

Loss Recognized in Income	Location	Successor	Predecessor	
		November 1, 2010 through December 31, 2010	January 1, 2010 through October 31, 2010	Year Ended December 31, 2009 2008
Unrealized gain (loss)	Electric revenues	\$ -	\$ -	\$ (1) \$ 1

Net realized gains and losses were zero for the period ended December 31, 2010 and less than \$1 million for the periods ended October 31, 2010, December 31, 2009 and December 31, 2008.

### Credit Risk Related Contingent Features

Certain of KU's derivative contracts contain credit contingent provisions which would permit the counterparties with which KU is in a net liability position to require the transfer of additional collateral upon a decrease in KU's credit rating. Some of these provisions would require KU to transfer additional collateral or permit the counterparty to terminate the contract if KU's credit rating were to fall below investment grade. Some of these provisions also allow the counterparty to require additional collateral upon each decrease in the credit rating at levels that remain above investment grade. In either case, if KU's credit rating were to fall below investment grade (i.e., below BBB- for S&P or Baa3 for Moody's), and assuming no assignment to an investment grade affiliate were allowed, most of these credit contingent provisions require either immediate payment of the net liability as a termination payment or immediate and ongoing full collateralization by KU on derivative instruments in net liability positions.

Additionally, certain of KU's derivative contracts contain credit contingent provisions that require KU to provide "adequate assurance" of performance if the other party has reasonable grounds for insecurity regarding KU's performance of its obligation under the contract. A counterparty demanding adequate assurance could require a transfer of additional collateral or other security, including letters of credit, cash and guarantees from a creditworthy entity. A demand for additional assurance would typically involve negotiations among the parties.

To determine net liability positions, KU uses the fair value of each agreement. At December 31, 2010, there were no energy trading and risk management derivative contracts with credit risk related contingent features that are in a liability position and collateral of less than \$1 million was posted in the normal course of business. At December 31, 2010, a downgrade of the Company's credit rating below investment grade would have no effect on the energy trading and risk management derivative contracts or collateral required.

### **Note 6 - 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 effective 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 financial instruments follow:

	Successor		Predecessor	
	December 31, 2010		December 31, 2009	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Long-term bonds	\$ 1,841	\$ 1,728	\$ 351	\$ 351
Long-term debt to affiliated company	-	-	1,331	1,401

The long-term fixed rate pollution control bond valuations reflect prices quoted by investment banks, which are active in the market for these instruments. First mortgage bond valuations reflect prices quoted from a third party service. 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 guidance of the FASB ASC, as discussed in Note 1, Summary of Significant Accounting Policies.

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 December 31, 2010 and 2009, arising from energy trading and risk management contracts accounted for at fair value on a recurring basis total less than \$1 million. Cash collateral related to the energy trading and risk management contracts was less than \$1 million at December 31, 2010 and December 31, 2009 each year.

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

### **Note 7 - Goodwill and Intangible Assets**

In connection with PPL's acquisition of LKE, KU recorded goodwill on November 1, 2010. In addition, as of November 1, 2010, certain intangible assets were adjusted to their fair value and new intangible assets were recorded. See Note 2, Acquisition by PPL, for further information.

#### Goodwill

The Company performs its required annual goodwill impairment test in the fourth quarter. Impairment tests are performed between the annual tests when the Company determines that a triggering event has occurred that would, more likely than not, reduce the fair value of a reporting unit below its carrying value. The goodwill impairment test is comprised of a two-step process. In step 1, the Company identifies a potential impairment by comparing the estimated fair value of the regulated utilities (the

goodwill reporting unit) to their carrying value, including goodwill, on the measurement date. If the estimated fair value exceeds its carrying amount, goodwill is not considered impaired. If the fair value is less than the carrying value, then step 2 is performed to measure the amount of impairment loss, if any. The step 2 calculation compares the implied fair value of the goodwill to the carrying value of the goodwill. The implied fair value of goodwill is equal to the excess of the Company estimated fair value over the fair values of its identified assets and liabilities. If the carrying value of goodwill exceeds the implied fair value of goodwill, an impairment loss is recognized in an amount equal to that excess (but not in excess of the carrying value).

In connection with PPL's acquisition of LKE on November 1, 2010, goodwill of \$607 million was recorded on November 1, 2010. The allocation of the goodwill to KU was based on the net asset value of the Company. The goodwill represents value paid for the rate regulated business located in a defined service area with a constructive regulatory environment, which provides for future investment, earnings and cash flow growth, as well as the talented and experienced workforce. KU's franchise values are being attributed to the going concern value of the business and thus were recorded as goodwill rather than a separately identifiable intangible asset. None of the goodwill recognized is expected to be deductible for income tax purposes or included in customer rates. See Note 2, Acquisition by PPL, for further information.

For the 2010 annual impairment test, the primary valuation technique used was an income methodology based on management's estimates of forecasted cash flows for the Company, with those cash flows discounted to present value using rates commensurate with the risks of those cash flows. Management also took into consideration the acquisition price paid by PPL. The discounted cash flows for the Company was based on discrete financial forecasts developed by management for planning purposes and consistent with those given to PPL. Cash flows beyond the discrete forecasts were estimated using a terminal-value calculation, which incorporated historical and forecasted financial trends for the Company. No impairment resulted from the fourth quarter test, as the determined fair value of the Company was greater than its carrying value.

#### Other Intangible Assets

The gross carrying amount and the accumulated amortization of other intangible assets were as follows:

	<u>Successor</u>	
	<u>December 31, 2010</u>	
	<u>Gross Carrying Amount</u>	<u>Accumulated Amortization</u>
Subject to amortization:		
Coal contracts (a)	\$ 145	\$ 3
Land rights (b)	8	-
Emission allowances (c)	9	-
OVEC power purchase agreement (d)	<u>39</u>	<u>1</u>
Total other intangible assets	\$ 201	<u>\$ 4</u>

- (a) The gross carrying amount represents the fair value of coal contracts recognized as a result of the 2010 acquisition by PPL. The weighted average amortization period of these contracts is 3 years. See Note 2, Acquisition by PPL, for further information.

- (b) The gross carrying amount represents the fair value of land rights recognized as a result of adopting PPL's accounting policies in the Successor period. The weighted average amortization period of these rights is 17 years. See Note 1, Summary of Significant Accounting Policies, for further information.
- (c) The gross carrying amount represents the fair value of emission allowances recognized as a result of the 2010 acquisition by PPL, as well as the reclassification of amounts from inventory to intangible assets as a result of adopting PPL's accounting policies in the Successor period. The weighted average amortization period of these emission allowances is 3 years. See Note 2, Acquisition by PPL, for further information.
- (d) The gross carrying amount represents the fair value of the OVEC power purchase contract recognized as a result of the 2010 acquisition by PPL. The weighted average amortization period of the power purchase agreement is 8 years. See Note 2, Acquisition by PPL, for further information.

Current intangible assets and long-term intangible assets are included in "Other intangible assets" in their respective areas on the Balance Sheets in 2010. Intangible assets resulting from purchase accounting adjustments are not recoverable in rates.

Amortization expense, excluding consumption of emission allowances, was \$4 million for the Successor in 2010. The estimated aggregate amortization expense for each of the next five years is as follows:

	Estimated Expense in Period Ended				
	2011	2012	2013	2014	2015
Aggregate amortization expense	\$ 43	\$ 25	\$ 27	\$ 24	\$ 26

### Note 8 - 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.

All of KU's customer receivables arise from deliveries of electricity. During 2010, the Company's ten largest customers accounted for less than 19% of volumes.

Effective August 4, 2009, KU 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 its 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, 2010.



**Note 9 - Pension and Other Postretirement Benefit Plans**

KU employees benefit from both funded and unfunded retirement benefit plans. Its defined benefit pension plan covers employees hired by December 31, 2005. Employees hired after this date participate in the Retirement Income Account ("RIA"), a defined contribution plan. The postretirement plan includes health care benefits that 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, the fair value of assets and the funded status of the plans for November 1, 2010 through December 31, 2010, for the Successor, and for January 1, 2010 through October 31, 2010, and January 1, 2009 through December 31, 2009, for the Predecessor:

	Pension Benefits			Other Postretirement Benefits		
	Successor 2010	Predecessor 2010	Predecessor 2009	Successor 2010	Predecessor 2010	Predecessor 2009
Change in benefit obligation:	\$ 355	\$ 316	\$ 306	\$ 84	\$ 80	\$ 75
Benefit obligation at beginning of period						
Service cost	1	5	6	-	1	2
Interest cost	3	16	18	1	4	4
Benefits paid, net of retiree contributions	(3)	(14)	(18)	(1)	(4)	(5)
Actuarial (gain) loss and other	(2)	32	4	(1)	3	4
Benefit obligation at end of period	\$ 354	\$ 355	\$ 316	\$ 83	\$ 84	\$ 80

	Pension Benefits			Other Postretirement Benefits		
	Successor 2010	Predecessor 2010	Predecessor 2009	Successor 2010	Predecessor 2010	Predecessor 2009
Change in plan assets:						
Fair value of plan assets at beginning of period	\$ 237	\$ 219	\$ 183	\$ 20	\$ 17	\$ 12
Actual return on plan assets	7	20	41	-	1	3
Employer contributions	-	13	13	2	6	7
Benefits paid, net of retiree contributions	(3)	(14)	(18)	(1)	(4)	(5)
Administrative expenses and other	-	(1)	-	-	-	-
Fair value of plan assets at end of period	\$ 241	\$ 237	\$ 219	\$ 21	\$ 20	\$ 17
Funded status at end of period	\$ (113)	\$ (118)	\$ (97)	\$ (62)	\$ (64)	\$ (63)

Amounts Recognized in the Balance Sheets

The following tables provide the amounts recognized in the Balance Sheets and information for plans with benefit obligations in excess of plan assets plans for November 1, 2010 through December 31, 2010, for the Successor, and for January 1, 2010 through October 31, 2010, and January 1, 2009 through December 31, 2009, for the Predecessor:

	Pension Benefits			Other Postretirement Benefits		
	Successor	Predecessor		Successor	Predecessor	
	2010	2010	2009	2010	2010	2009
Regulatory assets	\$ 117	\$ 125	\$ 105	\$ -	\$ -	\$ -
Regulatory liabilities	-	-	-	(10)	(9)	(9)
Accrued benefit liability (non-current)	(113)	(118)	(97)	(62)	(64)	(63)

Amounts recognized in regulatory assets and liabilities for November 1, 2010 through December 31, 2010, for the Successor, and for January 1, 2010 through October 31, 2010, and January 1, 2009 through December 31, 2009, for the Predecessor:

	Pension Benefits			Other Postretirement Benefits		
	Successor	Predecessor		Successor	Predecessor	
	2010	2010	2009	2010	2010	2009
Transition obligation	\$ -	\$ -	\$ -	\$ 2	\$ 2	\$ 3
Prior service cost	3	4	5	1	1	2
Accumulated loss (gain)	114	121	100	(13)	(12)	(14)
Total regulatory assets and liabilities	\$ 117	\$ 125	\$ 105	\$ (10)	\$ (9)	\$ (9)

Additional information for plans with accumulated benefit obligations in excess of plan assets for November 1, 2010 through December 31, 2010, for the Successor, and for January 1, 2010 through October 31, 2010, and January 1, 2009 through December 31, 2009, for the Predecessor:

	Pension Benefits			Other Postretirement Benefits		
	Successor	Predecessor		Successor	Predecessor	
	2010	2010	2009	2010	2010	2009
Benefit obligation	\$ 354	\$ 355	\$ 316	\$ 83	\$ 84	\$ 80
Accumulated benefit obligation Fair value of plan assets	299	299	268	-	-	-
	241	237	219	21	20	17

The amounts recognized in regulatory assets and liabilities for November 1, 2010 through December 31, 2010, for the Successor, and for January 1, 2010 through October 31, 2010, and January 1, 2009 through December 31, 2009, for the Predecessor:

	Pension Benefits			Other Postretirement Benefits		
	Successor	Predecessor		Successor	Predecessor	
	2010	2010	2009	2010	2010	2009
Net (gain) loss arising during the period	\$ (6)	\$ 26	\$ (22)	\$ (1)	\$ 2	\$ 2
Amortization of prior service cost	-	(1)	(1)	-	-	-
Amortization of transitional obligation	-	-	-	-	(2)	(1)
Amortization of loss	(2)	(5)	(9)	-	-	-
Total amounts recognized in regulatory assets and liabilities	<u>\$ (8)</u>	<u>\$ 20</u>	<u>\$ (32)</u>	<u>\$ (1)</u>	<u>\$ -</u>	<u>\$ 1</u>

For discussion of the pension and postretirement regulatory assets, see Note 3, Rates and Regulatory Matters.

#### Components of Net Periodic Benefit Cost

The following tables provide the components of net periodic benefit cost for pension and other postretirement benefit plans. The tables include the costs associated with both KU employees and Servco employees who provide services to KU. The Servco costs are allocated to KU based on employees' labor charges and are approximately 51%, 49% and 46% of Servco's costs for 2010, 2009 and 2008, respectively.

	Pension Benefits					
	Successor			Predecessor		
	November 1, 2010 through December 31, 2010			January 1, 2010 through October 31, 2010		
	KU	Servco Allocation to KU		KU	Servco Allocation to KU	
to KU		Total KU	KU		Total KU	
Service cost	\$ 1	\$ 1	\$ 2	\$ 5	\$ 5	\$ 10
Interest cost	3	2	5	16	6	22
Expected return on plan assets	(3)	(1)	(4)	(14)	(5)	(19)
Amortization of prior service cost	-	-	-	1	1	2
Amortization of actuarial gain	2	-	2	5	2	7
Net periodic benefit cost	<u>\$ 3</u>	<u>\$ 2</u>	<u>\$ 5</u>	<u>\$ 13</u>	<u>\$ 9</u>	<u>\$ 22</u>

## Pension Benefits

	Predecessor - Year Ended December 31, 2009			Predecessor - Year Ended December 31, 2008		
	KU	Servco Allocation to KU		KU	Servco Allocation to KU	
		Total KU	Total KU		Total KU	
Service cost	\$ 6	\$ 5	\$ 11	\$ 6	\$ 4	\$ 10
Interest cost	18	7	25	18	6	24
Expected return on plan assets	(15)	(4)	(19)	(21)	(5)	(26)
Amortization of prior service cost	1	1	2	1	1	2
Amortization of actuarial gain	9	2	11	-	-	-
Net periodic benefit cost	<u>\$ 19</u>	<u>\$ 11</u>	<u>\$ 30</u>	<u>\$ 4</u>	<u>\$ 6</u>	<u>\$ 10</u>

## Other Postretirement Benefits

	Successor November 1, 2010 through December 31, 2010			Predecessor January 1, 2010 through October 31, 2010		
	KU	Servco Allocation to KU		KU	Servco Allocation to KU	
		Total KU	Total KU		Total KU	
Service cost	\$ -	\$ -	\$ -	\$ 1	\$ 1	\$ 2
Interest cost	1	-	1	4	-	4
Expected return on plan assets	-	-	-	(1)	-	(1)
Amortization of transition obligation	-	-	-	1	-	1
Net periodic benefit cost	<u>\$ 1</u>	<u>\$ -</u>	<u>\$ 1</u>	<u>\$ 5</u>	<u>\$ 1</u>	<u>\$ 6</u>

	Other Postretirement Benefits					
	Predecessor - Year Ended December 31, 2009			Predecessor Year Ended December 31, 2008		
	KU	Servco Allocation to KU	Total KU	KU	Servco Allocation to KU	Total KU
Service cost	\$ 1	\$ 1	\$ 2	\$ 1	\$ 1	\$ 2
Interest cost	5	-	5	5	-	5
Expected return on plan assets	(1)	-	(1)	(1)	-	(1)
Amortization of transition obligation	1	-	1	1	-	1
Net periodic benefit cost	\$ 6	\$ 1	\$ 7	\$ 6	\$ 1	\$ 7

The estimated amounts that will be amortized from regulatory assets and liabilities into net periodic benefit cost in 2011 are shown in the following table:

	<u>Pension Benefits</u>	<u>Other Postretirement Benefits</u>
Regulatory assets and liabilities:		
Net actuarial loss	\$ 8	\$ -
Prior service cost	1	1
Transition obligation	-	1
Total regulatory assets and liabilities amortized during 2011	<u>\$ 9</u>	<u>\$ 2</u>

The weighted average assumptions used in the measurement of KU's pension and postretirement benefit obligations for November 1, 2010 through December 31, 2010, for the Successor, and for January 1, 2010 through October 31, 2010, and January 1, 2009 through December 31, 2009, for the Predecessor are shown in the following table:

	Successor	Predecessor	
	December 31, 2010	October 31, 2010	December 31, 2009
Discount rate – pension benefits	5.52%	5.46%	6.13%
Discount rate – postretirement benefits	5.12%	4.96%	5.82%
Rate of compensation increase	5.25%	5.25%	5.25%

For the first ten months of 2010, the discount rates used to determine the pension and postretirement benefit obligations and the period expense were determined using the Mercer Pension Discount Yield Curve. This model takes the plans' cash flows and matches them to a yield curve that provides the equivalent yields on zero-coupon corporate bonds for each maturity. The discount rate is the single rate

that produces the same present value of cash flows. The selection of the various discount rates represents the equivalent single rate under a broad-market AA yield curve constructed by Mercer.

For the last two months of 2010, the Towers Watson Yield Curve was used to determine the discount rate. This model also starts with an analysis of the expected benefit payment stream for its plans. This information is first matched against a spot-rate yield curve. A portfolio of Aa-graded non-callable (or callable with make-whole provisions) bonds, with a total amount outstanding in excess of \$667 billion, serves as the base from which those with the lowest and highest yields are eliminated to develop the ultimate yield curve. The results of this analysis are considered together with other economic data and movements in various bond indices to determine the discount rate assumption.

The weighted average assumptions used in the measurement of KU's pension and postretirement net periodic benefit costs for November 1, 2010 through December 31, 2010, for the Successor, and for January 1, 2010 through October 31, 2010, and January 1, 2009 through December 31, 2009, for the Predecessor are shown in the following table:

	Successor	Predecessor		
	2010	2010	2009	2008
Discount rate - pension	5.45%	5.46%	6.25%	6.66%
Discount rate - postretirement	4.94%	5.82%	6.36%	6.56%
Expected long-term return on plan assets	7.25%	7.75%	8.25%	8.25%
Rate of compensation increase	5.25%	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 current asset allocation to develop the expected long-term rate of return on assets assumption for the portfolio. The Company has determined that the 2011 expected long-term rate of return on assets assumption should be 7.25%.

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

- A 1% change in the assumed discount rate would have a \$39 million positive or negative impact to the 2010 accumulated benefit obligation and an approximate \$51 million positive or negative impact to the 2010 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 to 2010 pension expense.
- A 25 basis point increase in the rate of compensation increase would have a \$3 million negative impact to the 2010 projected benefit obligation.

#### 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 the first ten months of 2010. The rate was assumed to decrease gradually to 4.5% by 2029 and remain at that level thereafter. For the last two months of 2010, an 8% annual increase in the

per capita cost of covered health care benefits was assumed and the rate was assumed to decrease gradually to 5.5% by 2019. For 2011, a 9% annual increase in the per capita cost of covered health care benefits is assumed and the rate is assumed to decrease gradually to 5.5% by 2019. This change in the length of the health care trend was made to conform to PPL's accounting policies.

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 to the 2010 total of service and interest costs components and an increase or decrease of \$4 million in year end 2010 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 costs and the estimated gross amount of Medicare subsidy receipts:

	Pension Benefits	Other Postretirement Benefits	Medicare Subsidy Receipts
2011	\$ 18	\$ 6	\$ 1
2012	18	6	-
2013	18	6	1
2014	18	7	-
2015	18	7	1
2016-2020	106	36	3

#### Plan Assets

The following table shows the pension plan's weighted average asset allocation by asset category at December 31:

	Target Range	Successor 2010	Predecessor 2009
Equity securities	45% - 75%	56%	59%
Debt securities	30% - 50%	24%	40%
Other	0% - 10%	20%	1%
Totals		100%	100%

The investment policy of the pension plans was developed in conjunction with financial and actuarial consultants, investment advisors and legal counsel. The goal of the investment policy is to preserve the capital of the pension plans' assets and maximize investment earnings in excess of inflation with acceptable levels of volatility. 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 over rolling three and five-year periods. 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 6, Fair Value Measurements, for further information.

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 funds:* 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 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.

Prior to the acquisition, the GAC was considered an immediate participation guarantee contract which was not included in the fair value table. In accordance with the plan accounting guidance of the FASB ASC, the cost incurred to purchase the GAC prior to March 20, 1992, was permitted to be carried at contract value, since it is a contract with an insurance company and prior to the acquisition it was excluded from the table above. The cost incurred to fund the GAC after March 20, 1992, was carried at contract value in accordance with the plan accounting guidance of the FASB ASC, since it was a contract that incorporates mortality and morbidity risk. Contract value represents cost plus interest income less distributions for benefits and administrative expenses. To conform to PPL's accounting methods, the John Hancock GAC was classified in the fair value table as a level 3 and as "other" rather than "debt securities" in the asset allocation table for the period ended December 31, 2010.

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

	Successor		Predecessor	
	Level 2	Level 3	Level 2	Level 3
Money market funds	\$ 2	\$ -	\$ 2	\$ -
Common/collective trusts	213	-	186	-
John Hancock - GAC	-	47	-	-
Total investments at fair value	<u>\$ 215</u>	<u>\$ 47</u>	<u>\$ 188</u>	<u>\$ -</u>

The following table sets forth a reconciliation of changes in the fair value of the plan's level 3 assets for the following period:

	Successor
Balance at November 1, 2010	\$ -
Purchases	1
Transfers into level 3	46
Balance at December 31, 2010	<u>\$ 47</u>

There are no assets categorized as level 1 as of December 31, 2010 and December 31, 2009.

### Contributions

KU made discretionary contributions to the pension plan of \$13 million in 2010 and 2009. Servco made \$9 million and \$8 million in discretionary contributions to its pension plan in 2010 and 2009, 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. The Company made contributions totaling \$43 million in January 2011. See Note 18, Subsequent Events, for further information.

The Company made contributions to its other postretirement benefit plan of \$8 million in 2010 and \$7 million in 2009. In 2011, the Company 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, 2010 and 2009.

### 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 employees' contributions. The costs of this matching were \$3 million in 2010, 2009 and 2008.

KU also makes contributions to RIAs within the thrift savings plans for certain employees not covered by the non-contributory defined benefit pension plan. These employees consist 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 makes them in addition to the matching contributions discussed above. The amounts contributed by the Company under this arrangement were less than \$1 million in 2010, 2009 and 2008.

### 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 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.

The Company has evaluated these provisions of Health Care Reform on its benefit programs in consultation with its actuarial consultants and has determined that the excise tax will not have an impact on its postretirement medical plans. The requirement to extend dependent coverage up to age 26 is not expected to have a significant impact on active or retiree medical costs. The Company will continue to monitor the potential impact of any changes to the existing provisions and implementation guidance related to Health Care Reform on its benefit programs.

#### **Note 10 - Income Taxes**

KU's federal income tax return is included in a United States consolidated income tax return filed by LKE's direct parent. Prior to October 31, 2010 the return was included in the consolidated return of E.ON US Investments Corp. Due to the acquisition by PPL, the return will be included in the consolidated PPL return beginning November 1, 2010, 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 2007-2008 have been received from the IRS, effectively closing these years to additional audit adjustments. Tax years beginning with 2007 were examined under an IRS program, 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 tax return. For 2008, the IRS allowed additional deductions in connection with the Company's application for a change in repair deductions and disallowed certain bonus depreciation claimed on the original return. The net temporary tax impact for the Company was a \$12 million reduction in tax and was recorded in the second quarter of 2010. The 2009 federal return was filed in the third quarter of 2010 and the IRS issued a Partial Acceptance Letter in connection with CAP. The IRS is continuing to review bonus depreciation, storms and other repairs. No net material adverse impact is expected from these remaining areas. The short tax year beginning January 1, 2010 through October 31, 2010, is also being examined under CAP. No material items have been raised by the IRS at this time. The two month period beginning November 1, 2010 and ending December 31, 2010 is not currently under examination.

Additions and reductions of uncertain tax positions during 2010, 2009 and 2008 were less than \$1 million. Possible amounts of uncertain tax positions for KU that may decrease within the next 12 months total less than \$1 million and are based on the expiration of the audit periods as defined in the statutes. If recognized, the less than \$1 million of unrecognized tax benefits would reduce the effective income tax rate.

The amount KU recognized as interest expense and interest accrued related to unrecognized tax benefits was less than \$1 million for the twelve month periods ended and as of December 31, 2010, 2009 and 2008. The interest expense and interest accrued is based on IRS and Kentucky Department of Revenue

large corporate interest rates for underpayment of taxes. At the date of adoption, the Company accrued less than \$1 million in interest expense on uncertain tax positions. KU records the interest as “Interest expense” and penalties, if any, as “Operating expenses” on the Statements of Income and “Other current liabilities” on the Balance Sheets, on a pre-tax basis. No penalties were accrued by the Company through December 31, 2010.

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

	Successor	Predecessor		
	November 1, 2010 through December 31, 2010	January 1, 2010 through October 31, 2010	Year Ended December 31,	
			2009	2008
Current:				
Federal	\$ 13	\$ 46	\$ (5)	\$ 46
State	3	9	1	10
Deferred:				
Federal – net	4	20	43	(10)
State – net	-	3	7	(3)
Investment tax credit – deferred	-	-	21	25
Total income tax expense	<u>\$ 20</u>	<u>\$ 78</u>	<u>\$ 67</u>	<u>\$ 68</u>

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 an investment tax credit 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, which includes a full depreciation basis adjustment for the amount of the credit. KU’s portion of the TC2 tax credit is approximately \$101 million. Based on eligible construction expenditures incurred, KU recorded an investment tax credit of \$21 million and \$25 million in 2009 and 2008, respectively, 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 this credit over the life of the related property began when the facility was placed in service in January 2011.

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.

Components of deferred income taxes included in the Balance Sheets are shown below:

	<u>Successor</u> December 31, 2010	<u>Predecessor</u> December 31, 2009
Deferred income tax liabilities:		
Depreciation and other plant-related items	\$ 347	\$ 303
Regulatory assets and other	133	69
Total deferred income tax liabilities	<u>480</u>	<u>372</u>
Deferred income tax assets:	80	-
Regulatory liabilities and other		
Income taxes due to customers	2	4
Pensions and related benefits	9	17
Liabilities and other	19	18
Total deferred income tax assets	<u>110</u>	<u>39</u>
Net deferred income tax liabilities	<u>\$ 370</u>	<u>\$ 333</u>
Balance sheet classification:		
Prepayments and other current assets	\$ (6)	\$ (3)
Deferred income taxes (non-current)	376	336
Net deferred income tax liabilities	<u>\$ 370</u>	<u>\$ 333</u>

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

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

	Successor	Predecessor		
	November 1, 2010 through December 31, 2010	January 1, 2010 through October 31, 2010	Year Ended December 31,	
			2009	2008
Statutory federal income tax expense	\$ 19	\$ 77	\$ 70	\$ 79
State income taxes – net of federal benefit	2	8	5	5
Qualified production activities deduction	(1)	(4)	(1)	(3)
Dividends received deduction related to EEI investment	-	-	(3)	(8)
Reversal of excess deferred taxes	-	(2)	(2)	(1)
Other differences – net	-	(1)	(2)	(4)
Income tax expense	<u>\$ 20</u>	<u>\$ 78</u>	<u>\$ 67</u>	<u>\$ 68</u>
Effective income tax rate	<u>36.4%</u>	<u>35.8%</u>	<u>33.5%</u>	<u>30.1%</u>

The Tax Relief, Unemployment Reauthorization and Job Creation Act of 2010, enacted December 17, 2010 provided, among other provisions, certain incentives related to bonus depreciation and 100% expensing of qualifying capital expenditures. KU benefited from these new provisions by reducing its 2010 current federal income tax expense. This reduction in federal taxable income for KU does, however, result in a reduction of KU's Section 199 Manufacturing deduction, which is based on manufacturing taxable income and correspondingly increases income tax expense. The impact from these changes on 2010 was not material; however, KU anticipates a significant reduction of taxable income in 2011 and 2012 and a corresponding loss of most, if not all, of the Section 199 Manufacturing deduction for the following two years.

**Note 11 - Long-Term Debt**

As summarized below, at December 31, 2010, long-term debt consisted of first mortgage bonds and secured pollution control bonds. At December 31, 2009, long-term debt and the current portion of long-term debt consisted primarily of pollution control bonds and long-term loans from affiliated companies.

	<u>Successor</u> 2010	<u>Predecessor</u> 2009
Current portion of long-term debt to affiliates	\$ -	\$ 33
Long-term debt to affiliated companies	-	1,298
Secured first mortgage bonds, net of debt discount and amortization of debt discount	1,500	-
Pollution control revenue bonds, collateralized by first mortgage bonds	351	351
Fair value adjustment from purchase accounting	1	-
Unamortized discount	(11)	-
Total long-term debt	<u>1,841</u>	<u>1,682</u>
Less current portion	-	261
Long-term debt, excluding current portion	<u>\$ 1,841</u>	<u>\$ 1,421</u>

	<u>Stated Interest Rates</u>	<u>Maturities</u>	<u>Debt</u> <u>Amounts</u>
<u>Successor</u>			
Outstanding at December 31, 2010:			
Current portion	N/A	N/A	\$ -
Non-current portion	Variable – 6.00%	2015-2040	1,841
<u>Predecessor</u>			
Outstanding at December 31, 2009:			
Current portion	Variable – 4.240%	2010-2034	\$ 261
Non-current portion	Variable – 7.035%	2011-2037	1,421

As of December 31, 2009, long-term debt includes \$228 million of pollution control bonds that were 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. As of December 31, 2009, the bonds were classified as current portion of long-term debt because investors could put the bonds back to the Company within one year. As of December 31, 2010, the bonds were reclassified as long-term debt. See Note 1, Summary of Significant Accounting Policies, for changes in classification.

Pollution control bonds are obligations of KU issued in connection with tax-exempt pollution control bonds by various counties in Kentucky. A loan agreement obligates the Company to make debt service payments to the counties in amounts equal to the debt service due from the counties on the related pollution control bonds. Depending on the type of expense, the Successor capitalized debt expenses in long-term other regulatory assets or long-term other assets to align with the term of the debt for which the

expenses were related. The Predecessor capitalized debt expenses in current or long-term other regulatory assets or other current or long-term other assets based on the amount of expense expected to be recovered within the next year through rate recovery. Both Predecessor and Successor amortized debt expenses over the lives of the related bond issues. The Predecessor presentation and the Successor presentation are both appropriate under regulatory practices and GAAP.

In October 2010, in order to secure their respective obligations with respect to the pollution control bonds, KU issued first mortgage bonds to the pollution control bond trustees. KU's first mortgage bonds contain terms and conditions that are substantially parallel to the terms and conditions of the counties' debt, but provide that obligations are deemed satisfied to the extent of payments under the related loan agreement, and thus generally require no separate payment of principal and interest except under certain circumstances, including should KU default on the respective loan agreement. 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 series of KU's 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, 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, 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.

The average annualized interest rates on the auction rate bonds follow:

Successor	Predecessor	
November 1, 2010 through December 31, 2010	January 1, 2010 through October 31, 2010	December 31, 2009
0.53%	0.51%	0.44%

The instruments governing this auction rate bond permit KU to convert the bond 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.

As a result of downgrades of the monoline insurers by all of the rating agencies to levels below that of the Company's rating, the debt ratings of the Company's insured bonds are all based on the Company's senior secured debt rating and are not influenced by the monoline bond insurer ratings.

In connection with the PPL acquisition, on November 1, 2010, KU borrowed \$1,331 million from a PPL subsidiary, in order to repay loans from a subsidiary of E.ON. KU used the net proceeds received from the sale of the first mortgage bonds to repay the debt owed to the PPL subsidiary arising from the borrowing.



In November 2010, KU issued first mortgage bonds totaling \$1,500 million and used the proceeds to repay the loans from a PPL subsidiary mentioned above and for general corporate purposes. The first mortgage bonds were issued at a discount as described in the table below:

<u>First Mortgage Bonds</u>	<u>Principal</u>	<u>Discount Price</u>	<u>First Mortgage Bonds Proceeds (a)</u>
Series due 2015	\$ 250	99.650%	\$ 249
Series due 2020	500	99.622%	498
Series due 2040	<u>750</u>	98.915%	<u>742</u>
Total	\$ 1,500		<u>\$ 1,489</u>

(a) Before expenses other than discount to Purchaser

The first mortgage bonds were issued by KU in accordance with the rules of Section 144A of the Securities Act of 1933. KU has entered into a registration rights agreement in which it has agreed to file a registration statement with the SEC relating to an offer to exchange the first mortgage bonds for publicly tradable securities having substantially identical terms. If ultimate registration and/or certain milestones are not completed by certain dates in mid- and late 2011, the Company has agreed to pay liquidated damages to the bondholders. The liquidated damages would total 0.25% per annum of the principal amount of the bonds for the first 90 days and 0.50% per annum of the principal amount thereafter until the conditions described above have been cured.

There were no redemptions or maturities of long-term debt for 2009. Redemptions and maturities of long-term debt for 2010 are summarized below:

<u>Year</u>	<u>Description</u>	<u>Principal Amount</u>	<u>Rate</u>	<u>Secured/Unsecured</u>	<u>Maturity</u>
<u>Successor</u>					
2010	Due to PPL Investment Corp.	\$ 1,331	4.24%-7.035%	Unsecured	2010-2037
2010	Due to E.ON affiliates	1,331	4.24%-7.035%	Unsecured	2010-2037

Issuances of long-term debt for 2010 and 2009 are summarized below:

<u>Year</u>	<u>Description</u>	<u>Principal Amount</u>	<u>Rate</u>	<u>Secured/Unsecured</u>	<u>Maturity</u>
<u>Successor</u>					
2010	Due to PPL Investment Corp.	\$ 1,331	4.24%-7.035%	Unsecured	2010-2037
2010	First mortgage bonds	250	1.625%	Secured	2015
2010	First mortgage bonds	500	3.25%	Secured	2020
2010	First mortgage bonds	750	5.125%	Secured	2040
<u>Predecessor</u>					
2009	Due to E.ON affiliates	50	4.445%	Unsecured	2019
2009	Due to E.ON affiliates	50	4.81%	Unsecured	2019
2009	Due to E.ON affiliates	50	5.28%	Unsecured	2017

As of December 31, 2010, all of the Company's long-term debt is secured by a first mortgage lien on substantially all of the real and tangible personal property of the Company located in Kentucky.

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

2011	\$	-
2012		-
2013		-
2014		-
2015		250
Thereafter		<u>1,601</u>
	\$	<u>1,851</u>

KU was in compliance with all debt covenants at December 31, 2010.

See Note 1, Summary of Significant Accounting Policies, for certain debt refinancing and associated transactions completed by KU in connection with the PPL acquisition, Note 2, Acquisition by PPL, for the adjustment made to the pollution control bonds to reflect fair value and Note 15, Related Party Transactions, for long-term debt payable to affiliates.

## Note 12 - Notes Payable and Other Short-Term Obligations

### Intercompany Revolving Line of Credit

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

	Total Money Pool Available	Amount Outstanding	Balance Available	Average Interest Rate
December 31, 2010, Successor	\$ 400	\$ 10	\$ 390	0.25%
December 31, 2009, Predecessor	400	45	355	0.20%

LKE maintains revolving credit facilities totaling \$300 million at December 31, 2010 and \$313 million at December 31, 2009, to ensure funding availability for the money pool. At December 31, 2010, the LKE facility is with PPL Investment Corp. LKE pays PPL Investment Corp. an annual commitment fee based on the Utilities' current bond ratings on the unused portion of the commitment. At December 31, 2009, one facility, totaling \$150 million, was with E.ON North America, Inc., while the remaining line, totaling \$163 million, was with Fidelia, both affiliated companies of E.ON. The balances are as follows:

	Total Available	Amount Outstanding	Balance Available	Average Interest Rate
December 31, 2010, Successor	\$ 300	\$ -	\$ 300	N/A
December 31, 2009, Predecessor	313	276	37	1.25%

Bank Revolving Line of Credit

As of December 31, 2010, the Company maintained a \$400 million revolving line of credit with a group of banks maturing in December 2014. The revolving line of credit allows KU to issue letters of credit or borrow funds up to \$400 million. Outstanding letters of credit reduce the facility's available borrowing capacity. The Company pays the banks an annual commitment fee based on current bond ratings on the unused portion of the commitment. At December 31, 2010, there was no amount borrowed under this facility although letters of credit totaling \$198 million have been issued under this facility. This credit agreement contains financial covenants requiring the borrower's debt to total capitalization ratio to not exceed 70%, as calculated pursuant to the credit agreement, and other customary covenants.

As of December 31, 2009, the Company maintained a \$35 million bilateral line of credit with an unaffiliated financial institution maturing in June 2012. The Company paid the banks an annual commitment fee on the unused portion of the commitment. At December 31, 2009, there was no balance outstanding under this facility. This facility was terminated on November 1, 2010, in conjunction with the PPL acquisition.

On December 1, 2010, KU replaced the letters of credit issued under prior letter of credit facilities with letters of credit of the same amount issued under the revolving line of credit. The four letter of credit facilities were subsequently terminated.

KU was in compliance with all line of credit covenants at December 31, 2010.

See Note 1, Summary of Significant Accounting Policies, for certain debt refinancing and associated transactions completed by KU in connection with the PPL acquisition and Note 15, Related Party Transactions, for long-term debt payable to affiliates.

**Note 13 - 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, \$10 million and \$9 million for 2010, 2009 and 2008, respectively. The future minimum annual lease payments for operating leases for years subsequent to December 31, 2010, are shown in the following table:

2011	\$	8
2012		7
2013		5
2014		5
2015		3
Thereafter		1
		<u>\$ 29</u>

### Owensboro Contract Litigation and 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 KU has received the agreed settlement amounts. Pursuant to the settlement’s operation, the OMU Agreement terminated in May 2010.

### 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. The Utilities 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 the Utilities had retained its ownership interest. The leasing transaction was entered into following receipt of required state and federal regulatory approvals. At December 31, 2010, the Balance Sheets included these assets at a value of \$65 million, which is reflected in “Regulated utility plant – electric.”

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, 2010, the maximum aggregate amount of default fees or amounts was \$7 million, of which KU would be responsible for 62% (approximately \$4 million). The Company has made arrangements with LKE, via guarantee and regulatory commitment, for LKE to pay its full portion of any default fees or amounts.

### Letters of Credit

KU has provided letters of credit as of December 31, 2010 and 2009, for on-balance sheet obligations totaling \$198 million to support bonds of \$195 million and letters of credit for off-balance sheet obligations totaling less than \$1 million to support certain obligations related to workers’ compensation.

### Commodity Purchases

#### *OVEC*

KU has a contract for power purchases with OVEC, terminating in 2026, for various Mw capacities. KU holds a 2.5% investment interest in OVEC with ten 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 60 Mw of nameplate 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 postretirement benefits other than pension. KU's contingent potential proportionate share of OVEC's December 31, 2010 outstanding debt was \$35 million. Future obligations for power purchases from OVEC are demand payments, comprised of annual minimum debt service payments, as well as contractually required reimbursement of plant operating, maintenance and other expenses, and are shown in the following table:

2011	\$	9
2012		10
2013		10
2014		10
2015		10
Thereafter		114
	\$	<u>163</u>

#### *Coal and Natural Gas Transportation Purchase Obligations*

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

2011	\$	439
2012		200
2013		144
2014		93
2015		91
Thereafter		14
	\$	<u>981</u>

#### Construction Program

KU had approximately \$116 million of commitments in connection with its construction program at December 31, 2010.

In June 2006, KU entered into a construction contract regarding the TC2 project. The contract is generally in the form of a 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. During 2009 and 2010, KU 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, KU and the construction contractor agreed to a settlement to resolve the 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 damage calculations. With limited exceptions, the completion of TC2 in January 2011, and has dispatched the unit to meet customer demand

**plan, the EPA must develop and implement a plan. As the EPA increases the stringency of the**

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since that date. KU and the contractor agreed to a further amendment of the construction agreement whereby the contractor will complete certain actions relating to identifying and completing any necessary modifications to allow operation of TC2 on all fuels in accordance with initial specifications prior to certain dates, and amending the provisions relating to liquidated damages. KU cannot currently estimate the ultimate outcome of these matters.

### 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 two EPA objections. In March 2010, the Sierra Club 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.

### 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 upon 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

**initial reductions due by 2010 and final reductions due by 2018. The CAMR provided for  
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reductions of 121**

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 Utilities’ 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 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

**legislative and regulatory enactments, legal proceedings and advances in clean air technology. KU**  
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will 122

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 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 and continue to evaluate improvements to further reduce SO<sub>2</sub> emissions. 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



continue to monitor these developments to ensure that its environmental obligations are met in the most efficient and cost-effective manner. KU expects to incur additional capital expenditures currently approved in its ECR plans totaling approximately \$500 million during the 2011 through 2013 time period to achieve emissions reductions and manage coal combustion residuals. Monthly recovery is subject to periodic review by the Kentucky Commission.

### *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 met in Cancun, Mexico, in December 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 was a comprehensive energy bill containing the first-ever nation-wide GHG cap and trade program. The bill provided 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 have initially been allocated at no cost to the electric utility sector, with this allocation gradually declining to 7% in 2029 and zero thereafter. The bill would have also established a renewable electricity standard requiring utilities to meet 20% of their electricity demand through renewable energy and energy efficiency by 2020. The bill contained 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 was largely patterned on the House legislation, was introduced in the U.S. Senate. The Senate bill raised the emissions reduction target for 2020 to 20% below 2005 levels and did 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. Although Senators Kerry and Lieberman and others worked to reach a consensus on GHG legislation, no bill passed the Senate in 2010. The Company is closely monitoring the progress of pending energy legislation, but the prospect for passage of comprehensive GHG legislation in 2011 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 are required to submit annual reports commencing with calendar year 2010. In May 2010, the EPA issued a final GHG "tailoring" rule, effective January 2011, 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. In December 2010, the EPA announced that it plans to promulgate GHG New Source Performance Standards for power plants, including both new and existing facilities. A proposed rule is expected by July 2011, while a final rule is expected by May 2012. In the absence of either a proposed or final regulation, KU is unable to assess the potential impact of any future regulation.

### *GHG Litigation*

A number of lawsuits have been filed asserting common law claims including nuisance, trespass and negligence against various companies with GHG emitting facilities. In October 2009, a three judge panel of the United States Court of Appeals for the 5<sup>th</sup> Circuit in the case of *Comer v. Murphy Oil* reversed a lower court, holding that private plaintiffs have standing to assert certain common law claims against more than 30 utility, oil, coal and chemical companies. 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. In January 2011, the Supreme Court denied petitioner's petition for review, which effectively brings the case to an end. The *Comer* complaint alleged that GHG emissions from the defendants' facilities contributed to global warming which increased the intensity of Hurricane Katrina. E.ON, the former indirect parent of the Utilities, was named as a defendant in the complaint but was not a party to the proceedings due to the failure of the plaintiffs to pursue service under the applicable international procedures. KU continues to monitor relevant GHG litigation to identify judicial developments that may be potentially relevant to 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. Negotiations between the EPA and KU are ongoing. 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 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 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 upon 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 \$1.5 to \$1.7 billion range over the next ten 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 upon 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. In December 2010, the Secretary issued a final Order dismissing all claims and upholding the permit which petitioners subsequently appealed to Trimble County Circuit Court.

#### *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 review 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 obligations or 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 on-going 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 14 - Jointly Owned Electric Utility Plant**

TC2 is a jointly owned unit at the Trimble County site. KU and LG&E own undivided 60.75% and 14.25% interests, respectively. Of the remaining 25%, 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 is in-service. With limited exceptions the Company took care, custody and control of TC2 on January 22, 2011, and has dispatched the unit to meet customer demand since that date. KU and the contractor agreed to a further amendment of the construction agreement whereby the contractor will complete certain actions relating to identifying and completing any necessary modifications to allow operation of TC2 on all fuels in accordance with initial specifications prior to certain dates, and amending the provisions relating to liquidated damages. 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				
	KU	LG&E	IMPA	IMEA	Total
Ownership interest	60.75%	14.25%	12.88%	12.12%	100%
Mw capacity	509	119	108	102	838

KU's 60.75% ownership:

Plant held for future use	\$ 62
Construction work in progress	703
Accumulated depreciation	(1)
Net book value	\$ 764

LG&E's 14.25% ownership:

Plant held for future use	\$ 2
Construction work in progress	187
Accumulated depreciation	-
Net book value	\$ 189

KU and LG&E jointly own the following CTs and related equipment (capacity based on net summer capability) as of December 31, 2010:

Ownership Percentage	KU				LG&E				Total			
	Mw Capacity	Cost	Depr.	Net Book Value	Mw Capacity	Cost	Depr.	Net Book Value	Mw Capacity	Cost	Depr.	Net Book Value
KU 47%, LG&E 53% (a)	129	\$ 43	\$ -	\$ 43	146	\$ 48	\$ -	\$ 48	275	\$ 91	\$ -	\$ 91
KU 62%, LG&E 38% (b)	190	64	(2)	62	118	40	(2)	38	308	104	(4)	100
KU 71%, LG&E 29% (c)	228	63	(1)	62	92	26	-	26	320	89	(1)	88
KU 63%, LG&E 37% (d)	404	109	(1)	108	236	64	(1)	63	640	173	(2)	171
KU 71%, LG&E 29% (e)	n/a	4	-	4	n/a	2	-	2	n/a	6	-	6

- (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 Statements of Income (i.e., fuel, maintenance of plant, other operating expense).

### Note 15 - Related Party Transactions

KU and subsidiaries of LKE and PPL engage in related party transactions. Transactions between KU and LKE subsidiaries are eliminated on consolidation of LKE. Transactions between KU and PPL subsidiaries are eliminated on consolidation of PPL. These transactions are generally performed at cost and are in accordance with FERC regulations under PUHCA 2005 and the applicable Kentucky Commission and Virginia Commission regulations.

#### 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 Utilities. 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 expenses were as follows:

	Successor	Predecessor		
	November 1, 2010 through December 31, 2010	January 1, 2010 through October 31, 2010	Year Ended December 31, 2009      2008	
Electric operating revenues from LG&E	\$ 2	\$ 13	\$ 21	\$ 80
Power purchased and related operations and maintenance expenses from LG&E	21	79	101	109

Interest Charges

See Note 11, Long-Term Debt, and Note 12, 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 interest expense to affiliated companies was as follows:

	Successor	Predecessor		
	November 1, 2010 through December 31, 2010	January 1, 2010 through October 31, 2010	Year Ended December 31,	
			2009	2008
Interest on money pool loans	\$ -	\$ -	\$ -	\$ 2
Interest on PPL loans	2	-	-	-
Interest on Fidelia loans	-	62	69	56

Interest paid to LKE on the money pool arrangement was less than \$1 million for 2010 and

2009. Dividends

In September 2010, the Company paid dividends of \$50 million to its sole shareholder, LKE.

Capital Contributions

The Company received no capital contributions in 2010, but received capital contributions of \$75 million and \$145 million from its sole shareholder, LKE, in 2009 and 2008, respectively.

Sale of Assets

In 2010, KU sold and bought assets of less than \$1 million to and from LG&E. In December 2009, LG&E sold assets to KU related to the construction of TC2 with a net book value of \$48 million.

Other Intercompany Billings

Servco provides the Company with a variety of centralized administrative, management and support services. Associated charges 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/or other statistical information. These costs are charged on an actual cost basis.

In addition, the Utilities provide services to each other and to Servco. Billings between the Utilities 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, 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:

	Successor	Predecessor		
	November 1, 2010 through December 31, 2010	January 1, 2010 through October 31, 2010	Year Ended December 31,	
			2009	2008
Servco billings to KU	\$ 46	\$ 233	\$ 169	\$ 227
LG&E billings to KU	14	49	44	5
KU billings to Servco	12	11	14	3
KU billings to LG&E	-	-	78	75
<u>Intercompany Balances</u>				

The Company had the following balances with its affiliates:

	Successor	Predecessor
	December 31, 2010	December 31, 2009
Accounts receivable from LKE	\$ 12	\$ 9
Accounts payable to LG&E	22	53
Accounts payable to Servco	23	20
Accounts payable to Fidelia	-	15
Notes payable to LKE	10	45
Long-term debt to Fidelia	-	1,331

#### Note 16 - Selected Quarterly Data (Unaudited)

	For the 2010 Periods Ended (a)					Successor December 31
	Predecessor					
	March 31	June 30	September 30	October 31		
Operating revenues	\$ 380	\$ 350	\$ 416	\$ 102	\$ 263	
Operating income	87	71	105	22	65	
Net income	44	31	54	11	35	

- (a) Periods ended March 31, June 30 and September 30 represent three months then ended. Period ended October 31 represents one month then ended and period ended December 31 represents two months then ended.



	For the 2009 Quarters Ended			
	Predecessor			
	March 31	June 30	September 30	December 31
Operating revenues	\$ 363	\$ 305	\$ 341	\$ 346
Operating income	19	53	125	72
Net income	7	26	66	34

**Note 17 - Accumulated Other Comprehensive Income (Loss)**

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

	Pre-Tax	Income	
	Accumulated		
	Derivative		
	Gain (Loss)	Taxes	Net
Balance at December 31, 2009, Predecessor	\$ -	\$ -	\$ -
Equity investee's other comprehensive income (loss)	(3)	1	(2)
Balance at October 31, 2010, Predecessor	(3)	1	(2)
Effect of PPL acquisition	3	(1)	2
Balance at December 31, 2010, Successor	\$ -	\$ -	\$ -

**Note 18 - Subsequent Events**

Subsequent events have been evaluated through February 25, 2011, the date of issuance of these statements. These statements contain all necessary adjustments and disclosures resulting from that evaluation.

On January 31, 2011, KU filed a notice of intent to file a rate case with the Virginia Commission for the test year ended December 31, 2010. The case is expected to be filed on or after April 1, 2011.

With limited exceptions the Company took care, custody and control of TC2 on January 22, 2011, and has dispatched the unit to meet customer demand since that date. LG&E and KU and the contractor agreed to a further amendment of the construction agreement whereby the contractor will complete certain actions relating to identifying and completing any necessary modifications to allow operation of TC2 on all fuels in accordance with initial specifications prior to certain dates, and amending the provisions relating to liquidated damages.

On January 14, 2011, KU contributed \$43 million to its pension plan.



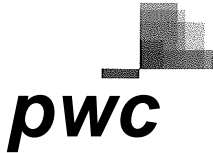
## Report of Independent Auditors

To Stockholder of Kentucky Utilities Company

In our opinion, the accompanying balance sheet and the related statements of income, retained earnings, comprehensive income, cash flows, and capitalization present fairly, in all material respects, the financial position of Kentucky Utilities Company (Successor Company) at December 31, 2010 and the results of its operations and its cash flows for the period from November 1, 2010 to December 31, 2010 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, 2010, 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 "Management's Report of Internal Controls Over Financial Reporting" which appears on page 50. Our responsibility is to express opinions on these financial statements and on the Company's internal control over financial reporting based on our integrated audit. We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States) and in accordance with the auditing and attestation standards established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform the audit 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 audit 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 audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

As discussed in Note 2 to the financial statements, on November 1, 2010, PPL Corporation completed its acquisition of LG&E and KU Energy LLC and its subsidiaries. The push-down basis of accounting was used at the acquisition date.

A company's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, 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 (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.

" *JUA-L LLP*

Louisville, Kentucky

February 25, 2011

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### Report of Independent Auditors

To Stockholder of Kentucky Utilities Company

In our opinion, the accompanying balance sheet and the related statements of income, retained earnings, comprehensive income, cash flows, and capitalization present fairly, in all material respects, the financial position of Kentucky Utilities Company (Predecessor Company) at December 31, 2009 and the results of its operations and its cash flows for the period from January 1, 2010 to October 31, 2010 and for each of the two years in the period ended December 31, 2009 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards as established by the Auditing Standards Board (United States) and in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 2 to the financial statements, on November 1, 2010, PPL Corporation completed its acquisition of LG&E and KU Energy LLC and its subsidiaries. The push-down basis of accounting was used at the acquisition date.

*PricewaterhouseCoopers LLP*

Louisville, Kentucky

February 25, 2011

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PricewaterhouseCoopers LLP, 500 West Main Street, Ste. 1800, Louisville, KY 40202-2941 - 134  
T: (502) 589 6100, F: (502) 585 7875, [www.pwc.com/us](http://www.pwc.com/us)

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”)

**\$12,900,000**

**County of Mercer, Kentucky**

**Solid Waste Disposal Facility Revenue Bonds, 2000 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 10% 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 10% 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 10% 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 10% 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:*

[DELETED AND REPLACED – SEE APPENDIX A TO SUPPLEMENT DATED MAY 2, 2011]

Supplement, dated October 29, 2010 to Reoffering Circular dated December 10, 2008, as supplemented as of December 16, 2008 (the “Reoffering Circular”)

**\$12,900,000**

**County of Mercer, Kentucky**

**Solid Waste Disposal Facility Revenue Bonds, 2000 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 The Bank of New York Mellon, 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" 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 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 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

On May 19, 2000, the date on which the Bonds were originally issued, Bond Counsel delivered its opinion that stated that, 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.

\$12,900,000  
 County of Mercer, Kentucky,  
 Solid Waste Disposal Facility Revenue Bonds,  
 2000 Series A  
 (Kentucky Utilities Company Project)  
 Due: May 1, 2023

**Reoffering Date: December 17, 2008**

The County of Mercer, Kentucky, Solid Waste Disposal Facility Revenue Bonds, 2000 Series A (Kentucky Utilities Company Project) (the "Bonds") are special and limited obligations of the County of Mercer, 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 May 19, 2000 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. Morgan Stanley & Co. 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 10% 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 The Bank of New York Mellon, 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 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.

MORGAN STANLEY

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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**\$12,900,000**  
**County of Mercer, Kentucky**  
**Solid Waste Disposal Facility Revenue Bonds,**  
**2000 Series A**  
**(Kentucky Utilities Company Project)**  
**Due: May 1, 2023**

**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 Mercer, Kentucky (the “Issuer”) of its Solid Waste Disposal Facility Revenue Bonds, 2000 Series A (Kentucky Utilities Company Project), in the aggregate principal amount of \$12,900,000 (the “Bonds”) issued on May 19, 2000 pursuant to an Indenture of Trust dated as of May 1, 2000 (the “Indenture”) between the Issuer and The Bank of New York Mellon (the “Trustee”), as Trustee, Paying Agent, Tender 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 May 1, 2000 (the “Loan Agreement”) (as the same has been amended and restated as of September 1, 2008 pursuant to an ordinance of the Issuer adopted October 14, 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 the current refunding of the outstanding principal amount of the \$12,900,000 “County of Mercer, Kentucky, Collateralized Solid Waste Disposal Facility Revenue Bonds (Kentucky Utilities Company Project), 1990 Series A,” 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 10% 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.

Morgan Stanley & Co. 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 and consists of certain solid waste disposal facilities of the Company used in connection with its Brown Generating Station situated in Mercer 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 May 1, 2023. 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) 10% 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 \$50,000 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, the Weekly Rate or the Semi-Annual 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 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 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 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 Insurance Policy (the "Bond Insurance Policy") issued by Ambac Assurance Corporation ("Ambac") on May 19, 2000 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 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

Morgan Stanley & Co. 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 10% 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 (i) a Saturday or Sunday or legal holiday or a day on which banking institutions located in the city in which the principal office of the Trustee, the Bond Registrar, the Tender Agent, the Paying Agent, the Company, the Credit Facility Issuer or the Remarketing Agent is located are authorized by law or executive order to close or (ii) a day on which the New York Stock Exchange is closed.

“*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 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 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 first Business Day following the last day of each Flexible Rate Period for such Bond, (iii) if the Interest Rate Mode is the Semi-Annual Rate, the Annual Rate or the Long Term Rate, May 1 and November 1; (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 the effective date of 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 April 30, 2023.

“*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 Bonds*); the dates on which 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.

	<u>FLEXIBLE RATE</u>	<u>DAILY RATE</u>	<u>WEEKLY RATE</u>
<b>Interest Payment Dates</b>	With respect to any Bond, the first Business Day following the last day of each Flexible Rate Period for that Bond.	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 1:00 p.m. 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 10:00 a.m. on the first day of each Weekly Rate Period or, if not a Business Day, on the next succeeding 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 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 60 days for notice of Conversion or redemption. 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 60 days for notice of Conversion or redemption. Not fewer than 15 days or greater than 45 days for notice of mandatory purchase.	Not fewer than 15 days (30 days notice of Conversion to the Semi-Annual, Annual or Long Term Rate) or greater than 60 days for notice of Conversion or redemption. Not fewer than 15 days or greater than 45 days for notice of mandatory purchase.
<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.



	<u>SEMI-ANNUAL</u>	<u>ANNUAL</u>	<u>LONG TERM</u>
<b>Interest Payment Date</b>	Each May 1 and November 1.	Each May 1 and November 1.	Each May 1 and November 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 12:00 noon 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 May 1 and November 1 to and including the day preceding the next Interest Payment Date.	Each one-year period from and including each May 1 and November 1 to and including the day immediately preceding the second Interest Payment Date 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 (May 1 and November 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 30 days or greater than 60 days for notice of Conversion or redemption. Not fewer than 15 days or greater than 45 days for notice of mandatory purchase.	Not fewer than 30 days or greater than 60 days for notice of Conversion or redemption. Not fewer than 15 days or greater than 45 days for notice of mandatory purchase.	Not fewer than 30 days or greater than 60 days for notice of Conversion or redemption. Not fewer than 15 days or greater than 45 days for notice of mandatory purchase.
<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 10:00 a.m. (New York City time) on the first day of such Weekly Rate Period or, if such first day is not a Business Day, on the next succeeding 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 1:00 p.m. (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 12:00 noon (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.

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 a May 1 or November 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.

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 60 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 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:

Original Length of Current Long Term Rate Period (Years)	Commencement of Redemption Period	Redemption Price as Percentage of Principal
More than or equal to 11 years	First Interest Payment Date on or after the tenth anniversary of commencement of Long Term Rate Period	101%, declining 1% on the next succeeding anniversary of the first day of the redemption period, and thereafter 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 Bonds were issued, 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 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, the Daily Rate, the Weekly Rate or the Flexible Rate) but not more than 60 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. 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 \$50,000 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 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, the Weekly Rate or the Semi-Annual 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

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.

### 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 10% 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 10% 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 (c)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 May 1, 2023, 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.

**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, 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 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 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 Morgan Stanley & Co. 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 \$32,250, 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 May 19, 2000, 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 May 19, 2000, 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 also 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.

Arbough

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

[DELETED AND REPLACED – SEE APPENDIX A TO SUPPLEMENT DATED MAY 2, 2011]



**APPENDIX B**

**Opinion of Bond Counsel and  
Form of Reoffering Opinion of Bond Counsel**

**APPENDIX B-1**

**Opinion of Bond Counsel dated May 19, 2000 relating to the Bonds**

**HARPER, FERGUSON & DAVIS**

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May 19, 2000

Re: \$12,900,000 County of Mercer, Kentucky, Solid Waste Disposal Facility Revenue Bonds, 2000 Series A (Kentucky Utilities Company Project)

We hereby certify that we have examined certified copies of the proceedings of record of the County of Mercer, 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 Solid Waste Disposal Facility Revenue Bonds, 2000 Series A (Kentucky Utilities Company Project), dated the date of the Bonds, in the aggregate principal amount of \$12,900,000 (the "Bonds"). The Bonds will be 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 \$12,900,000 aggregate principal amount of the County's Collateralized Solid Waste Disposal Facility Revenue Bonds (Kentucky Utilities Company Project) 1990 Series A, dated May 1, 1990 (the "Prior Bonds"), the proceeds of which were loaned to the Company to finance the construction of solid waste disposal facilities to serve the Brown Generating Station of the Company in Mercer County, Kentucky ("the Project") in order to provide for the collection, storage, treatment, processing and final disposal of solid waste, as provided by the Act .

The Bonds 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.

We have examined an executed counterpart of a certain Loan Agreement, dated as of May 1, 2000 (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 and the Company has agreed to make Loan payments to the Trustee at times and in amounts fully adequate to pay maturing principal of, interest

\$12,900,000 County of Mercer, Kentucky,  
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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 May 1, 2000 (the "Indenture"), by and between the County and The Bank of New York, New York, New York, 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.

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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 paragraph, 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 an 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 all of the proceeds of the Prior Bonds were used to finance solid waste disposal facilities qualified for financing under Section 142(a)(6) of the Internal Revenue Code of 1986, as amended. 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 payment and discharge of the Prior Bonds on or before the 90th day from the date of issuance of the Bonds, and 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 with the approval of bond counsel (other than 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 2000 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 subject to the following exceptions and qualifications:

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(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 Gardner, Carton & Douglas, 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. Douglas Greenburg, 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.

HARPER, FERGUSON & Arbough  
DAVIS

\$12,900,000 County of Mercer, Kentucky,  
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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.

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

By *cf* SPENCER E. HARPER JR'

APPENDIX B-2

(Form of Reoffering Opinion of Bond Counsel)

December 17, 2008

County of Mercer, Kentucky  
Harrodsburg, Kentucky 40330

The Bank of New York Mellon,  
as Trustee  
West Paterson, New Jersey 07424

Re: Reoffering of \$12,900,000 “County of Mercer, Kentucky, Solid Waste Disposal Facility Revenue Bonds, 2000 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 May 1, 2000 (the “Indenture”), between the County of Mercer, Kentucky (the “Issuer”) and The Bank of New York Mellon, as Trustee (the “Trustee”), pertaining to \$12,900,000 principal amount of County of Mercer, Kentucky, Solid Waste Disposal Facility Revenue Bonds, 2000 Series A (Kentucky Utilities Company Project), dated May 19, 2000 (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 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 May 1, 2000, 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

[DELETED AND REPLACED – SEE APPENDIX C TO SUPPLEMENT DATED MAY 2, 2011]