DUKE ENERGY CORPORATION

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VIA OVERNIGHT DELIVERY

March 25, 2011

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

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

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

Dear Mr. Cline:

I have enclosed Duke Energy Kentucky, Inc.'s Financial Statements as of December 31, 2010 and Auditors' Report per order by the Commission in the above-referenced cases.

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

If you have any questions regarding the financial statements, please contact Mr. Jay Baucom, Manager, Accounting at (980) 373-2147.

Very truly yours,

Kristen Cocanougher

Enclosure

cc: Jay Baucom

405389

Duke Energy Kentucky, Inc.
Financial Statements as of December 31, 2010 and 2009
and Auditors' Report

Deloitte.

Deloitte & Touche LLP
550 South Tryon Street
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INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Stockholder of
Duke Energy Kentucky, Inc.
Charlotte, North Carolina

We have audited the accompanying balance sheets of Duke Energy Kentucky, Inc. (the "Company") as of December 31, 2010 and 2009, and the related statements of operations, common stockholder's equity and comprehensive income, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with 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. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also 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, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2010 and 2009, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

March 16, 2011

DUKE ENERGY KENTUCKY, INC.
STATEMENTS OF OPERATIONS

(In thousands)

	Years Ended December 31,	
	2010	2009
Operating Revenues		
Electric	$348,803	$ 342,656
Gas	139,333	119,453
Total Operating Revenues	488,136	462,109
Operating Expenses		
Fuel used in electric generation and purchased power	140,596	147,922
Natural gas purchased	68,010	71,791
Operation, maintenance and other	136,057	124,974
Depreciation and amortization	54,100	43,166
Property and other taxes	10,849	13,091
Total operating expenses	409,612	400,944
Operating Income	78,524	61,165
Other Income and Expenses, net	3,325	2,828
Interest Expense	16,182	16,448
Income Before Income Taxes	65,667	47,545
Income Tax Expense	22,406	19,477
Net Income	$ 43,261	$ 28,068

See Notes to Financial Statements

DUKE ENERGY KENTUCKY, INC.
BALANCE SHEETS
(In thousands)

	December 31, 2010	December 31, 2009
ASSETS		
Current Assets		
Cash and cash equivalents	$ 32,798	$ 26,883
Receivables (net of allowance for doubtful accounts of $340 at December 31, 2010 and $318 at December 31, 2009)	109,036	70,978
Inventory	43,418	48,452
Other	5,696	5,187
Total current assets	190,948	151,500
Investments and Other Assets		
Intangibles, net	3,756	6,884
Other	6,715	5,649
Total investments and other assets	10,471	12,533
Property, Plant and Equipment		
Cost	1,632,076	1,584,117
Less accumulated depreciation and amortization	669,682	641,260
Net property, plant and equipment	962,394	942,857
Regulatory Assets and Deferred Debits		
Deferred debt expense	5,559	5,787
Other	40,763	46,351
Total regulatory assets and deferred debits	46,322	52,138
Total Assets	$ 1,210,135	$ 1,159,028

See Notes to Financial Statements

DUKE ENERGY KENTUCKY, INC.
BALANCE SHEETS - (Continued)
(In thousands, except share and per-share amounts)

	December 31, 2010	2009
LIABILITIES AND COMMON STOCKHOLDER'S EQUITY		
Current Liabilities		
Accounts payable	$ 52,042	$ 53,025
Taxes accrued	10,156	14,871
Interest accrued	3,513	3,703
Current maturities of long-term debt	1,813	1,879
Other	14,602	14,217
Total current liabilities	82,126	87,695
Long-term Debt	342,776	343,665
Deferred Credits and Other Liabilities		
Deferred income taxes	215,544	199,926
Investment tax credits	2,555	3,514
Regulatory liabilities	57,764	47,240
Accrued pension and other post-retirement benefit costs	25,339	28,685
Asset retirement obligations	5,512	7,063
Other	13,165	19,147
Total deferred credits and other liabilities	319,879	305,575
Commitments and Contingencies		
Common Stockholder's Equity		
Common Stock, $15.00 par value, 1,000,000 shares authorized and 585,333 shares outstanding at December 31, 2010 and December 31, 2009	8,780	8,780
Additional paid-in-capital	167,494	167,494
Retained earnings	289,080	245,819
Total common stockholder's equity	465,354	422,093
Total Liabilities and Common Stockholder's Equity	$ 1,210,135	$ 1,159,028

See Notes to Financial Statements

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

	Years Ended December 31,	
	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 43,261	$ 28,068
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	54,744	43,719
Deferred income taxes	13,445	33,281
Accrued pension and other post-retirement benefit costs	1,996	1,278
Contributions to qualified pension plans	(5,404)	(20,854)
(Increase) decrease in		
Net realized and unrealized mark-to-market and hedging transactions	1,311	595
Receivables	(6,458)	17,287
Inventory	5,034	(6,978)
Other current assets	318	11,830
Increase (decrease) in		
Accounts payable	2,164	(6,271)
Taxes accrued	(4,429)	3,565
Other current liabilities	475	(173)
Other assets	(4,954)	1,595
Other liabilities	(1,817)	2,742
Net cash provided by operating activities	99,686	109,684
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(60,981)	(68,230)
Sales of emission allowances	11	22
Notes due from affiliate, net	(31,600)	(29,045)
Other	113	43
Net cash used in investing activities	(92,457)	(97,210)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from the issuance of long-term debt	27,675	103,055
Payments for the redemption of long-term debt	(28,721)	(96,209)
Notes payable to affiliate, net	-	(3,241)
Other	(268)	(964)
Net cash (used in) provided by financing activities	(1,314)	2,641
Net increase in cash and cash equivalents	5,915	15,115
Cash and cash equivalents at beginning of period	26,883	11,768
Cash and cash equivalents at end of period	$ 32,798	$ 26,883
Supplemental Disclosures		
Cash paid for interest, net of amount capitalized	$ 15,639	$ 15,998
Cash paid (refunded) for income taxes	$ 11,962	$ (17,748)
Significant non-cash transactions:		
Accrued capital expenditures	$ 3,053	$ 6,268

See Notes to Financial Statements

DUKE ENERGY KENTUCKY, INC.

STATEMENTS OF COMMON STOCKHOLDER'S EQUITY AND COMPREHENSIVE INCOME
(In thousands)

	Common Stock	Additional Paid-in Capital	Retained Earnings	Total
Balance at December 31, 2008	**$ 8,780**	**$ 167,494**	**$ 217,751**	**$ 394,025**
Net income and total comprehensive income	-	-	28,068	28,068
Balance at December 31, 2009	**$ 8,780**	**$ 167,494**	**$ 245,819**	**$ 422,093**
Net income and total comprehensive income	-	-	43,261	43,261
Balance at December 31, 2010	**$ 8,780**	**$ 167,494**	**$ 289,080**	**$ 465,354**

See Notes to Financial Statements

1. Summary of Significant Accounting Policies

Nature of Operations. Duke Energy Kentucky, Inc. (Duke Energy Kentucky) is a combination electric and gas public utility company that provides service in northern Kentucky. Duke Energy Kentucky's principal lines of business include generation, transmission and distribution of electricity, as well as the sale of and/or transportation of natural gas which are subject to the regulatory provisions of the Kentucky Public Service Commission (KPSC) and the Federal Energy Regulatory Commission (FERC). Duke Energy Kentucky's common stock is wholly owned by Duke Energy Ohio, Inc. (Duke Energy Ohio), which is wholly owned by Cinergy Corp. (Cinergy). Cinergy is a wholly-owned subsidiary of Duke Energy Corporation (Duke Energy). Duke Energy Kentucky operates one reportable business segment, Franchised Electric.

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

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

Cash and Cash Equivalents. All highly liquid investments with maturities of three months or less at the date of acquisition are considered cash equivalents.

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

Components of Inventory

	December 31, 2010	December 31, 2009
	(in thousands)	
Coal held for electric generation	$ 16,057	$ 21,205
Materials and supplies	19,867	19,081
Gas held in storage	7,494	8,166
Total Inventory	$ 43,418	$ 48,452

Cost-Based Regulation. Duke Energy Kentucky accounts for its regulated operations in accordance with applicable regulatory accounting guidance. The economic effects of regulation can result in a regulated company recording assets for costs that have been or are expected to be approved for recovery from customers in a future period or recording liabilities for amounts that are expected to be returned to customers in the rate-setting process in a period different from the period in which the amounts would be recorded by an unregulated enterprise. Accordingly, Duke Energy Kentucky records assets and liabilities that result from the regulated ratemaking process that would not be recorded under GAAP for non-regulated entities. Regulatory assets and liabilities are amortized consistent with the treatment of the related costs in the ratemaking process. Management continually assesses whether regulatory assets are probable of future recovery by considering factors such as applicable regulatory changes, recent rate orders applicable to other regulated entities and the status of any pending or potential deregulation legislation. Additionally, management continually assesses whether any regulatory liabilities have been incurred. Based on this continual assessment, management believes the existing regulatory assets are probable of recovery and that no regulatory liabilities, other than those recorded, have been incurred. These regulatory assets and liabilities are primarily classified in the Balance Sheets as Regulatory Assets and Deferred Debits, and Deferred Credits and Other Liabilities, respectively. Duke Energy Kentucky periodically evaluates the applicability of regulatory accounting treatment, and considers factors such as regulatory changes and the impact of competition. If cost-based regulation ends or competition increases, Duke Energy Kentucky may have to reduce its asset balances to reflect a market basis less than cost and write-off their associated regulatory assets and liabilities. For further information see Note 2.

In order to apply regulatory accounting treatment and record regulatory assets and liabilities, certain criteria must be met. In determining whether the criteria are met for its operations, management makes significant judgments, including determining whether revenue rates for services provided to customers are subject to approval by an independent, third-party regulator, whether the regulated rates are designed to recover specific costs of providing the regulated service, and a determination of whether, in view of the demand for the regulated services and the level of competition, it is reasonable to assume that rates are set at levels that will recover the operations' costs and can be charged to and collected from customers. This final criterion requires consideration of anticipated changes in levels of demand or competition, direct and indirect, during the recovery period for any capitalized costs.

Fuel Cost Deferrals. Fuel expense includes fuel costs or other recoveries that are deferred through fuel clauses established by Duke Energy Kentucky's regulators. These clauses allow Duke Energy Kentucky to recover fuel costs, fuel-related costs and portions of purchased power costs through surcharges on customer rates. These deferred fuel costs are recognized in revenues and fuel expenses as they are billable to customers.

Property, Plant and Equipment. Property, plant and equipment are stated at the lower of historical cost less accumulated depreciation or fair value, if impaired. Duke Energy Kentucky capitalizes all construction-related direct labor and material costs, as well as indirect construction costs. Indirect costs include general engineering, taxes and the cost of funds used during construction (see "Allowance for Funds Used During Construction (AFUDC) and Interest Capitalized," discussed below). The cost of renewals and betterments that extend the useful life of property, plant and equipment are also capitalized. The cost of repairs, replacements and major maintenance projects, which do not extend the useful life or increase the expected output of the asset, are expensed as incurred. Depreciation is generally computed over the estimated useful life of the asset using the composite straight-line method. The composite weighted-average depreciation rate was 2.8 % and 2.6% for the year ended December 31, 2010 and 2009, respectively. Depreciation studies are conducted periodically to update the composite rates and are approved by the KPSC.

When Duke Energy Kentucky retires its regulated property, plant and equipment, it charges the original cost plus the cost of retirement, less salvage value, to accumulated depreciation and amortization. When it sells entire regulated operating units, the cost is removed from the property account and the related accumulated depreciation and amortization accounts are reduced. Any gain or loss is recorded in earnings, unless otherwise required by the applicable regulatory body.

See Note 11 for further information on the components and estimated useful lives of Duke Energy Kentucky's property, plant and equipment balance.

AFUDC and Interest Capitalized. In accordance with applicable regulatory accounting guidance, Duke Energy Kentucky records AFUDC, which represents the estimated debt and equity costs of capital funds necessary to finance the construction of new regulated facilities. Both the debt and equity components of AFUDC are non-cash amounts within the Statements of Operations. AFUDC is capitalized as a component of the cost of Property, Plant and Equipment, with an offsetting credit on the Statement of Operations to Other Income and Expenses, net for the equity component and to Interest Expense for the debt component. After construction is completed, Duke Energy Kentucky is permitted to recover these costs through inclusion in the rate base and the corresponding depreciation expense.

AFUDC equity is recorded in the Statements of Operations on an after-tax basis and is a permanent difference item for income tax purposes (i.e. a permanent difference between financial statement and income tax reporting), thus reducing Duke Energy Kentucky's effective tax rate during the construction phase in which AFUDC equity is being recorded. The effective tax rate is subsequently increased in future periods when the completed property, plant and equipment is placed in service and depreciation of the AFUDC equity commences.

Asset Retirement Obligations. Duke Energy Kentucky recognizes asset retirement obligations for legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and/or normal use of the asset, and for conditional asset retirement obligations. The term conditional asset retirement obligation refers to a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and (or) method of settlement. Thus, the timing and (or) method of settlement may be conditional on a future event. When recording an asset retirement obligation, the present value of the projected liability is recognized in the period in which it is incurred, if a reasonable estimate of fair value can be made. The present value of the liability is added to the carrying amount of the associated asset. This additional carrying amount is then depreciated over the estimated useful life of the asset. See Note 5 for further information regarding Duke Energy Kentucky's asset retirement obligations.

Unamortized Debt Premium, Discount and Expense. Premiums, discounts and expenses incurred with the issuance of outstanding long-term debt are amortized over the terms of the debt issues. Any call premiums or unamortized expenses associated with refinancing higher-cost debt obligations to finance regulated assets and operations are amortized consistent with regulatory treatment of those items, where appropriate. The amortization expense is recorded as a component of interest expense in the Statements of Operations and is reflected as Depreciation and amortization within Net cash provided by operating activities on the Statements of Cash Flows.

Loss Contingencies and Environmental Liabilities. Duke Energy Kentucky is involved in certain legal and environmental matters that arise in the normal course of business. Contingent losses are recorded when it is determined that it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. When a range of the probable loss exists and no amount within the range is a better estimate than any other amount, Duke Energy Kentucky records a loss contingency at the minimum amount in the range. Unless otherwise required by GAAP, legal fees are expensed as incurred.

Environmental liabilities are recorded on an undiscounted basis when the necessity for environmental remediation becomes probable and the costs can be reasonably estimated, or when other potential environmental liabilities are reasonably estimable and probable. Duke Energy Kentucky expenses environmental expenditures related to conditions caused by past operations that do not generate current or future revenues. Certain environmental expenses receive regulatory accounting treatment, under which the expenses are recorded as regulatory assets. Environmental expenditures related to operations that generate current or future revenues are expensed or capitalized, as appropriate.

See Note 13 for further information.

Pension and Other Post-Retirement Benefit Plans. Duke Energy Kentucky participates in Duke Energy's qualified, non-qualified and other post-retirement benefit plans and is allocated its proportionate share of benefit costs. See Note 14 for information related to Duke Energy Kentucky's participation in these benefit plans, including certain accounting policies associated with these plans.

Severance and Special Termination Benefits. Duke Energy Kentucky has an ongoing severance plan under which, in general, the longer a terminated employee worked prior to termination the greater the amount of severance benefits. Duke Energy Kentucky records a liability for involuntary severance once an involuntary severance plan is committed to by management, or sooner, if involuntary severances are probable and the related severance benefits can be reasonably estimated. For involuntary severance benefits that are incremental to its ongoing severance plan benefits, Duke Energy Kentucky measures the obligation and records the expense at its fair value at the communication date if there are no future service requirements, or, if future service is required to receive the termination benefit, ratably over the service period. From time to time, Duke Energy Kentucky offers special termination benefits under voluntary severance programs. Special termination benefits are measured upon employee acceptance and recorded immediately absent a significant retention period. If a significant retention period exists, the cost of the special termination benefits are recorded ratably over the remaining service periods of the affected employees. Employee acceptance of voluntary severance benefits is determined by management based on the facts and circumstances of the special termination benefits being offered. See Note 16 for further information

Revenue Recognition and Unbilled Revenue. Revenues on sales of electricity and gas are recognized when either the service is provided or the product is delivered. Unbilled retail revenues are estimated by applying an average revenue per kilowatt-hour or per thousand cubic feet (Mcf) for all customer classes to the number of estimated kilowatt-hours or Mcfs delivered but not billed. Unbilled wholesale energy revenues are calculated by applying the contractual rate per megawatt hour (MWh) to the number of estimated MWh delivered, but not yet billed. Unbilled wholesale demand revenues are calculated by applying the contractual rate per megawatt (MW) to the MW volume not yet billed. The amount of unbilled revenues can vary significantly from period to period as a result of factors including seasonality, weather, customer usage patterns and customer mix.

Cinergy Receivables Company LLC (Cinergy Receivables) is a bankruptcy remote, special purpose entity that is a wholly-owned limited liability company of Cinergy. Unbilled revenues, which are primarily recorded as Receivables on the Balance Sheets and exclude receivables sold to Cinergy Receivables, primarily relate to wholesale sales and were $1 million at both December 31, 2010 and 2009.

Additionally, Duke Energy Kentucky sells, on a revolving basis, nearly all of its retail accounts receivable and related collections to Cinergy Receivables. As discussed further in Notes 8 and 13, Duke Energy Kentucky meets the revised sales/derecognition criteria of the new accounting rules adopted January 1, 2010 and, therefore, continues to account for the transfers of receivables to Cinergy Receivables as sales. Accordingly, the receivables sold are not reflected on the Balance Sheets of Duke Energy Kentucky. Receivables for unbilled revenues related to retail accounts receivable at Duke Energy Kentucky included in the sales of accounts receivable to Cinergy Receivables at both December 31, 2010 and 2009 were $23 million.

Accounting for Risk Management and Hedging Activities and Financial Instruments. Duke Energy Kentucky may use a number of different derivative and non-derivative instruments in connection with its interest rate and commodity price risk management activities, including swaps, futures, forwards and options. All derivative instruments not designated as hedges and not qualifying for the normal purchase/normal sale (NPNS) exception within the accounting guidance for derivatives are recorded on the Balance Sheets at their fair value. Duke Energy Kentucky may designate qualifying derivative instruments as either cash flow hedges or fair value hedges, while others either have not been designated as hedges or do not qualify as a hedge (hereinafter referred to as undesignated contracts).

For all contracts accounted for as a hedge, Duke Energy Kentucky prepares formal documentation of the hedge in accordance with the accounting guidance for derivatives. In addition, at inception and at least every three months thereafter, Duke Energy Kentucky formally

assesses whether the hedge contract is highly effective in offsetting changes in cash flows or fair values of hedged items. Duke Energy Kentucky documents hedging activity by transaction type (futures/swaps) and risk management strategy (interest rate risk).

See Note 6 for additional information and disclosures regarding risk management activities and derivative transactions and balances.

Accounting For Purchases and Sales of Emission Allowances. Emission allowances are issued by the Environmental Protection Agency (EPA) at zero cost and permit the holder of the allowance to emit certain gaseous by-products of fossil fuel combustion, including sulfur dioxide (SO_2) and nitrogen oxide (NO_x). Allowances may also be bought and sold via third party transactions or consumed as the emissions are generated. Allowances allocated to or acquired by Duke Energy Kentucky are held primarily for consumption. Duke Energy Kentucky records emission allowances as Intangibles, net in Investments and Other Assets on its Balance Sheets at cost and recognizes the allowances in earnings as they are consumed or sold. Any gains or losses on sales of recoverable emission allowances are returned to customers via profit sharing mechanism riders included in the rate structure of the regulated entity and are deferred as a regulatory asset or liability. Purchases and sales of emission allowances are presented gross as investing activities on the Statements of Cash Flows.

Income Taxes. Duke Energy Kentucky entered into a tax sharing agreement with Duke Energy, where the separate return method is used to allocate tax expenses and benefits to the subsidiaries whose investments or results of operations provide these tax expenses or benefits. The accounting for income taxes essentially represents the income taxes that Duke Energy Kentucky would incur if Duke Energy Kentucky were a separate company filing its own federal tax return as a C-Corporation. Deferred income taxes have been provided for temporary differences between the GAAP and tax carrying amounts of assets and liabilities. These differences create taxable or tax-deductible amounts for future periods. Investment tax credits (ITC) associated with regulated operations are deferred and are amortized as a reduction of income tax expense over the estimated useful lives of the related properties.

Duke Energy Kentucky records tax benefits for uncertain positions taken or expected to be taken on tax returns, including the decision to exclude certain income or transactions from a return, when a more-likely-than-not threshold is met for a tax position and management believes that the position will be sustained upon examination by the taxing authorities. Management evaluates each position based solely on the technical merits and facts and circumstances of the position, assuming the position will be examined by a taxing authority having full knowledge of all relevant information. Duke Energy Kentucky records the largest amount of the uncertain tax benefit that is greater than 50% likely of being realized upon settlement or effective settlement. Management considers a tax position effectively settled for the purpose of recognizing previously unrecognized tax benefits when the following conditions exist: (i) the taxing authority has completed its examination procedures, including all appeals and administrative reviews that the taxing authority is required and expected to perform for the tax positions, (ii) Duke Energy Kentucky does not intend to appeal or litigate any aspect of the tax position included in the completed examination, and (iii) it is remote that the taxing authority would examine or reexamine any aspect of the tax position. See Note 4 for further information.

Duke Energy Kentucky records, as it relates to taxes, interest expense as Interest Expense and interest income and penalties in Other Income and Expenses, net, in the Statements of Operations.

New Accounting Standards. The following new accounting standards were adopted by Duke Energy Kentucky during the year ended December 31, 2010 and the impact of such adoption, if applicable, has been presented in the accompanying Financial Statements:

Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 860—Transfers and Servicing (ASC 860). In June 2009, the FASB issued revised accounting guidance for transfers and servicing of financial assets and extinguishment of liabilities, to require additional information about transfers of financial assets, including securitization transactions, as well as additional information about an enterprise's continuing exposure to the risks related to transferred financial assets. This revised accounting guidance eliminated the concept of a QSPE and required those entities which were not subject to consolidation under previous accounting rules to now be assessed for consolidation. In addition, this accounting guidance clarified and amended the derecognition criteria for transfers of financial assets (including transfers of portions of financial assets) and required additional disclosures about a transferor's continuing involvement in transferred financial assets. For Duke Energy Kentucky, this revised accounting guidance was effective prospectively for transfers of financial assets occurring on or after January 1, 2010, and early adoption of this statement was prohibited. Since 2002, Duke Energy Kentucky has sold, on a revolving basis, nearly all of its accounts receivable and related collections through Cinergy Receivables, a bankruptcy-remote QSPE. The securitization transaction was structured to meet the criteria for sale accounting treatment, and accordingly, Duke Energy Kentucky did not consolidate Cinergy Receivables, and the transfers were accounted for as sales. Duke Energy Kentucky's sales of accounts receivable and related financial statement presentation were not impacted by the adoption of ASC 860. See Note 10 for additional information.

ASC 810—Consolidations (ASC 810). In June 2009, the FASB amended existing consolidation accounting guidance to eliminate the exemption from consolidation for QSPEs, and clarified, but did not significantly change, the criteria for determining whether an entity meets the definition of a Variable Interest Entity (VIE). This revised accounting guidance also required an enterprise to qualitatively assess the determination of the primary beneficiary of a VIE based on whether that enterprise has both the power to direct the activities that most significantly impact the economic performance of a VIE and the obligation to absorb losses or the right to receive benefits of a VIE that could potentially be significant to a VIE. In addition, this revised accounting guidance modified existing accounting guidance to require an ongoing evaluation of a VIE's primary beneficiary and amended the types of events that trigger a reassessment of whether an entity is a VIE. Furthermore, this accounting guidance required enterprises to provide additional disclosures about their involvement with VIEs and any significant changes in their risk exposure due to that involvement.

For Duke Energy Kentucky, this accounting guidance was effective beginning on January 1, 2010, and is applicable to all entities in which Duke Energy Kentucky is involved, including entities previously subject to existing accounting guidance for VIEs, as well as any QSPEs that existed as of the effective date. Duke Energy Kentucky's sales of accounts receivable and related financial statement presentation were not impacted by the adoption of ASC 810. See Note 10 for additional disclosures required by the revised accounting guidance in ASC 810.

ASC 820—Fair Value Measurements and Disclosures (ASC 820). In January 2010, the FASB amended existing fair value measurements and disclosures accounting guidance to clarify certain existing disclosure requirements and to require a number of additional disclosures, including amounts and reasons for significant transfers between the three levels of the fair value hierarchy, and presentation of certain information in the reconciliation of recurring Level 3 measurements on a gross basis. For Duke Energy Kentucky, certain portions of this revised accounting guidance were effective on January 1, 2010, with additional disclosures effective for periods beginning January 1, 2011. The initial adoption of this accounting guidance resulted in additional disclosure in the notes to the financial statements but did not have an impact on Duke Energy Kentucky's results of operations, cash flows or financial position.

ASC 310—Receivables (ASC 310). In July 2010, the FASB issued revised disclosure requirements related to financing receivables to address concerns about the sufficiency, transparency, and robustness of credit risk disclosures for financing receivables and the related allowance for credit losses. This revised accounting guidance requires disclosure information at disaggregated levels and requires roll-forward schedules of the allowance for credit losses and information regarding the credit quality of receivables. For Duke Energy Kentucky, certain portions of these revised disclosure requirements were effective for the year ended December 31, 2010, with additional disclosures effective for periods beginning January 1, 2011. The initial adoption of these revised disclosure requirements did not result in any significant impact to the notes to the financial statements or on Duke Energy Kentucky's results of operations, cash flows or financial position.

The following new accounting standards have been issued, but have not yet been adopted by Duke Energy Kentucky as of December 31, 2010:

ASC 605—Revenue Recognition (ASC 605). In October 2009, the FASB issued new revenue recognition accounting guidance in response to practice concerns related to the accounting for revenue arrangements with multiple deliverables. This new accounting guidance primarily applies to all contractual arrangements in which a vendor will perform multiple revenue generating activities, and addresses the unit of accounting for arrangements involving multiple deliverables, as well as how arrangement consideration should be allocated to the separate units of accounting. For Duke Energy Kentucky, the new accounting guidance is effective January 1, 2011 and will be applied prospectively. Duke Energy Kentucky does not expect this new accounting guidance to have a material impact to its results of operations, cash flows or financial position.

ASC 350—Intangibles – Goodwill and Other (ASC 350). In December 2010, the FASB amended the accounting guidance related to annual impairment tests. The revised accounting guidance requires entities which have reporting units with a zero or negative carrying value to assess, considering qualitative factors such as those described in existing accounting guidance, whether it is more likely than not that a goodwill impairment exists. If an entity concludes that it is more likely than not that a goodwill impairment exists for the applicable reporting unit, the entity must perform step 2 of the goodwill impairment test. For Duke Energy Kentucky, the revised accounting guidance is effective January 1, 2011 and will be applied prospectively. Duke Energy Kentucky is currently evaluating the potential impact of the adoption of this revised accounting guidance on its annual impairment test of goodwill and is unable to estimate at this time the impact of adoption on its results of operations, cash flows or financial position. None of Duke Energy Kentucky's reporting units had a negative carrying value as of December 31, 2010.

ASC 805. In November 2010, the FASB issued new accounting guidance in response to diversity in the interpretation of pro forma information requirements for business combinations. The new accounting guidance requires an entity to present pro forma financial information as if the business combination occurred at the beginning of the earliest period presented as well as additional disclosures describing the nature and amount of material, nonrecurring pro forma adjustments. For Duke Energy Kentucky, this new accounting guidance is effective January 1, 2011 and will be applied to all business combinations consummated after that date.

ASC 820—Fair Value Measurements and Disclosures (ASC 820). In January 2010, the FASB amended existing fair value measurements and disclosures accounting guidance to clarify certain existing disclosure requirements and to require a number of additional disclosures, including amounts and reasons for significant transfers between the three levels of the fair value hierarchy, and presentation of certain information in the reconciliation of recurring Level 3 measurements on a gross basis. For Duke Energy Kentucky, certain portions of this revised accounting guidance were effective on January 1, 2010, with additional disclosures effective for periods beginning January 1, 2011. The initial adoption of this accounting guidance resulted in additional disclosure in the notes to the financial statements but did not have an impact on Duke Energy Kentucky's results of operations, cash flows or financial position. The adoption of the remaining portions of this accounting guidance will result in additional disclosure in the notes to the financial statements but is not expected to have an impact on Duke Energy Kentucky's results of operations, cash flows or financial position.

ASC 310—Receivables (ASC 310). In July 2010, the FASB issued revised disclosure requirements related to financing receivables to address concerns about the sufficiency, transparency, and robustness of credit risk disclosures for finance receivables and the related allowance for credit losses. This revised accounting guidance requires disclosure information at disaggregated levels and requires roll-forward schedules of the allowance for credit losses and information regarding the credit quality of receivables. For Duke Energy Kentucky, certain portions of these revised disclosure requirements were effective for the year ended December 31, 2010, with additional disclosures effective for periods beginning January 1, 2011. The initial adoption of these revised disclosure requirements did not result in any significant impact to the notes to the financial statements or on Duke Energy Kentucky's results of operations, cash flows or financial position. The adoption of the remaining portions of this revised accounting guidance may result in additional disclosure in the notes to the financial statements but is not expected to have an impact on Duke Energy Kentucky's results of operations, cash flows or financial position.

2. Regulatory Matters

Regulatory Assets and Liabilities. Duke Energy Kentucky's regulated operations apply regulatory accounting. Accordingly, Duke Energy Kentucky records assets and liabilities that result from the regulated ratemaking process that would not be recorded under GAAP for non-regulated entities. See Note 1 for further information.

Duke Energy Kentucky's Regulatory Assets and Liabilities:

	As of December 31,		Recovery/Refund Period Ends
	2010	2009	
	(in thousands)		
Regulatory Assets[a]			
Accrued pension and post retirement[b]	$ 31,614	$ 33,444	[c]
Merger costs[b]	-	1,269	2010
Vacation accrual[f]	2,064	2,185	2011
Storm cost deferrals[b]	4,913	4,913	[c]
Hedge costs and other deferrals[b]	4,198	6,264	[c]
Deferred debt expense[d]	3,097	3,380	2027
Other[b]	577	2,101	[c]
Total Regulatory Assets	$ 46,463	$ 53,556	

Regulatory Liabilities[a]			
Removal costs[d][h]	$ 52,111	$ 42,563	[e]
Over-recovery of fuel costs[i]	3,957	7,449	2011
Accrued pension and other post-retirement benefits[g]	3,194	3,463	[c]
Demand side management[h]	2,734	-	[c]
Other[h]	2,919	4,708	[c]
Total Regulatory Liabilities	$ 64,915	$ 58,183	

(a) All regulatory assets and liabilities are excluded from rate base unless otherwise noted.
(b) Included in Other within Regulatory Assets and Deferred Debits on the Balance Sheets.
(c) Recovery/refund period varies for these items with some currently unknown.
(d) Included in rate base.
(e) Recovery/refund is over the life of the associated asset or liability.
(f) Included in Other within Current Assets on the Balance Sheets.
(g) Included in Other within Deferred Credits and Other Liabilities on the Balance Sheets.
(h) Included in Other within Current Liabilities and Other within Deferred Credits and Other Liabilities on the Balance Sheets.
(i) Included in Accounts Payable on the Balance Sheets.

Restrictions on the Ability of Duke Energy Kentucky to Make Dividends, Advances and Loans to Duke Energy. As a condition of the merger between Duke Energy and Cinergy in 2006 , the KPSC imposed conditions on the ability of Duke Energy Kentucky to transfer funds to Duke Energy through loans or advances, as well as restricted amounts available to pay dividends to Duke Energy. Pursuant to these conditions, Duke Energy Kentucky is required to pay dividends solely out of retained earnings and to maintain a minimum of 35% equity in its capital structure.

Rate Related Information. The KPSC approves rates for retail electric and gas services within the Commonwealth of Kentucky. The FERC approves rates for electric sales to wholesale customers served under cost-based rates, as well as sales of transmission service.

Energy Efficiency. On January 27, 2010, Duke Energy Kentucky withdrew the application to implement save-a-watt. Energy efficiency programs continue under Duke Energy Kentucky's existing demand-side management program.

Gas Rate Cases. In 2002 and 2005, the KPSC approved Duke Energy Kentucky's gas base rate cases which included, among other things, recovery of costs associated with an accelerated gas main replacement program. The approvals authorized a tracking mechanism to recover certain costs including depreciation and a rate of return on the program's capital expenditures. The Kentucky Attorney General appealed to the Franklin Circuit Court the KPSC's 2002 approval of the tracking mechanism as well as the KPSC's subsequent approval of annual rate adjustments under this tracking mechanism. The Kentucky Attorney General appealed the KPSC's 2005 order to the Franklin Circuit Court, claiming that the order improperly allows Duke Energy Kentucky to increase its rates for gas main replacement costs in between general rate cases, and also claiming that the order improperly allows Duke Energy Kentucky to earn a return on investment for the costs recovered under the tracking mechanism which permits Duke Energy Kentucky to recover its gas main replacement costs.

In August 2007, the Franklin Circuit Court consolidated all the pending appeals and ruled that the KPSC lacks legal authority to approve the gas main replacement tracking mechanism, which was approved prior to the enactment of Kentucky Revised Statute 278.509 in 2005 which specifically authorizes the KPSC to approve tracker recovery for utilities' gas main replacement programs. Duke Energy Kentucky and the KPSC requested that the Kentucky Court of Appeals grant a rehearing of its decision. On February 5, 2009, the Kentucky Court of Appeals denied the rehearing requests of both Duke Energy Kentucky and the KPSC.

Duke Energy Kentucky filed a motion for discretionary review to the Kentucky Supreme Court in March 2009. The Kentucky Supreme Court accepted discretionary review of this case. On October 21, 2010, the Kentucky Supreme Court ruled that the KPSC has broad ratemaking authority to allow Duke Energy Kentucky to adjust its rates, outside of a general rate case, by imposing a surcharge or rider aimed at recovering costs associated with the utility's program to accelerate improvement of its gas distribution mains as long as the rates established are fair, just and reasonable.

Other Matters.

Regional Transmission Organization. On May 20, 2010, Duke Energy Kentucky filed an application with the KPSC requesting permission to transfer control of certain of its transmission assets to effect a Regional Transmission Organization (RTO) realignment from Midwest Independent Transmission System Operator, Inc. (Midwest ISO) to PJM Interconnection, LLC (PJM). There may be significant costs associated with this transition related to Midwest ISO transmission expansion costs and exit obligations. A hearing was held on November 3, 2010, and briefs were filed by November 19, 2010. On December 22, 2010, the KPSC issued an order granting approval for the transition, subject to several conditions. On January 25, 2011, the KPSC issued an order stating that the order had been satisfied and is now unconditional. The order further requires Duke Energy Kentucky to submit to the KPSC internal procedures for the receipt and tracking of notices from PJM regarding customer requests to participate in PJM demand-response programs.

On June 25, 2010, Duke Energy Ohio and Duke Energy Kentucky submitted an Initial Filing to the FERC requesting that it issue an order by November 1, 2010 determining that the RTO realignment meets FERC standards for withdrawal from the RTO and approving the participation of Duke Energy Ohio and Duke Energy Kentucky load and resources in certain PJM reliability pricing model auctions. The FERC issued an order which approved Duke Energy Ohio and Duke Energy Kentucky's request on October 21, 2010, and authorized Duke Energy Ohio and Duke Energy Kentucky to terminate their existing obligations to the Midwest ISO, subject to certain conditions.

On December 16, 2010, FERC issued an order related to the Midwest ISO's cost allocation methodology surrounding Multi-Value Projects (MVP), a type of Midwest ISO transmission expansion cost. The Midwest ISO expects that MVP will fund the costs of large transmission projects designed to bring renewable generation from the upper Midwest to load centers in the eastern portion of the Midwest ISO footprint. The order provides for the allocation of MVP costs to withdrawing transmission owners for projects approved by the Midwest ISO up to date of the withdrawing transmission owners' exit from the Midwest ISO. The basis for allocating such MVP costs will be the withdrawing transmission owners' historical usage of the Midwest ISO system. The impact of this order could result in an increase in the Midwest ISO transmission expansion costs incurred by Duke Energy Ohio and Duke Energy Kentucky subsequent to a withdrawal from Midwest ISO. Duke Energy Ohio and Duke Energy Kentucky, among other parties, is seeking rehearing of the FERC MVP order.

3. Joint Ownership of Generating Facilities

Duke Energy Kentucky and Dayton Power & Light jointly own an electric generating unit. Duke Energy Kentucky's share in the jointly-owned plant included on the December 31, 2010 Balance Sheet was as follows:

	Ownership Share	Property, Plant, and Equipment	Accumulated Depreciation	Construction Work in Progress
		(in thousands)		
Duke Energy Kentucky				
Production:				
East Bend Station	69.0%	$ 432,686	$ 227,438	$ 2,596

Duke Energy Kentucky's share of revenues and operating costs of the above jointly owned generating facilities are included within the corresponding line on the Statements of Operations. Each participant in the jointly owned facilities must provide its own financing.

4. Income Taxes

The following details the components of income tax expense:

Income Tax Expense

	Years Ended December 31, 2010	2009
	(in thousands)	
Current income taxes		
Federal	$ 6,543	$ (12,072)
State	2,418	(1,732)
Total current income taxes[a]	8,961	(13,804)
Deferred income taxes		
Federal	14,651	29,415
State	(504)	4,626
Total deferred income taxes	14,147	34,041
Investment tax credit amortization	(702)	(760)
Total income tax expense presented in Statements of Operations	$ 22,406	$ 19,477

(a) Included is an uncertain tax benefit relating primarily to certain temporary differences of $1,478 thousand for 2010 and $5,654 thousand for 2009.

Reconciliation of Income Tax Expense at the U.S. Federal Statutory Tax Rate to the Actual Tax Expense (Statutory Rate Reconciliation)

	Years Ended December 31, 2010	2009
	(in thousands)	
Income tax expense, computed at the statutory rate of 35%	$ 22,984	$ 16,641
State income tax, net of federal income tax effect	1,244	1,881
Manufacturing Deduction	(1,016)	(545)
Other items, net	(806)	1,500
Total income tax expense	$ 22,406	$ 19,477
Effective Tax Rates[a]	34.1%	41.0%

(a) The decrease in the effective tax rate for year ended December 31, 2010 compared to December 31, 2009 is primarily due to a prior year tax adjustment related to the manufacturing deduction.

Net Deferred Income Tax Liability Components

	As of December 31,	
	2010	2009
	(in thousands)	
Deferred credits and other liabilities	$ 2,968	$ 4,095
Investments and other assets	445	—
Other	2,602	—
Total deferred income tax assets	6,015	4,095
Investments and other assets	—	(1,824)
Accelerated depreciation rates	(211,173)	(193,858)
Regulatory assets and deferred debits	(8,777)	(4,726)
Other	—	(2,831)
Total deferred income tax liabilities	(219,950)	(203,239)
Total net deferred income tax liabilities	$ (213,935)	$ (199,144)

The above amounts have been classified in the Balance Sheets as follows:

Net Deferred Income Tax Liabilities

	As of December 31,	
	2010	2009
	(in thousands)	
Current deferred tax assets, included in other current assets	$ 1,609	$ 782
Non-current deferred tax liabilities	(215,544)	(199,926)
Total net deferred income tax liabilities	$ (213,935)	$ (199,144)

Changes to Unrecognized Tax Benefits

	2010 Increase/(Decrease)	2009 Increase/(Decrease)
	(in thousands)	(in thousands)
Unrecognized Tax Benefits – January 1	$ 5,559	$ —
Unrecognized Tax Benefits Changes		
Gross increases – tax positions in prior periods	1,495	5,478
Gross decreases—tax positions in prior periods	(402)	(467)
Gross increases – current period tax positions	386	548
Total Changes	1,479	5,559
Unrecognized Tax Benefits – December 31	$ 7,038	$ 5,559

At December 31, 2010 and 2009, no portion of the total unrecognized tax benefits would, if recognized, affect the effective tax rate. Duke Energy Kentucky does not anticipate a significant increase or decrease in unrecognized tax benefits in the next twelve months.

During the years ended December 31, 2010 and 2009, Duke Energy Kentucky recognized net interest expense related to income taxes of $324 thousand and $147 thousand, respectively. At December 31, 2010 and 2009, Duke Energy Kentucky had $324 thousand and an immaterial amount of interest payable, respectively, which reflects all interest related to income taxes. No amount has been accrued for the payment of penalties in the Balance Sheets.

Duke Energy Kentucky is no longer subject to U.S. federal examination for years before 2006. The Internal Revenue Service (IRS) is currently auditing the federal income tax returns for years 2006 and 2007. With few exceptions, Duke Energy Kentucky is no longer subject to state, local or non-U.S. income tax examinations by tax authorities for years before 2005.

5. Asset Retirement Obligations

Asset retirement obligations, which represent legal obligations associated with the retirement of certain tangible long-lived assets, are computed as the present value of the projected costs for the future retirement of specific assets and are recognized in the period in which the liability is incurred, if a reasonable estimate of fair value can be made. The present value of the liability is added to the carrying amount of the associated asset in the period the liability is incurred, and this additional carrying amount is depreciated over the remaining life of the asset. Subsequent to the initial recognition, the liability is adjusted for any revisions to the estimated future cash flows associated with the asset retirement obligation (with corresponding adjustments to property, plant, and equipment), which can occur due to a number of factors including, but not limited to, cost escalation, changes in technology applicable to the assets to be retired and changes in federal, state or local regulations, as well as for accretion of the liability due to the passage of time until the obligation is settled. Depreciation expense is adjusted prospectively for any increases or decreases to the carrying amount of the associated asset. The recognition of asset retirement obligations has no impact on the earnings of Duke Energy Kentucky's regulated electric operations as the effects of the recognition and subsequent accounting for an asset retirement obligation are offset by the establishment of regulatory assets and liabilities pursuant to regulatory accounting.

Asset retirement obligations at Duke Energy Kentucky relate primarily to the retirement of gas mains, asbestos abatement at certain generating stations and closure and post-closure activities of landfills. Certain assets of Duke Energy Kentucky have an indeterminate life, and, thus, the fair value of the retirement obligation is not reasonably estimable. A liability for these asset retirement obligations will be recorded when a fair value is determinable.

The following table presents the changes to liability associated with asset retirement obligations during the years ended December 31, 2010 and 2009:

Reconciliation of Asset Retirement Obligation Liability

	Years Ended December 31,	
	2010	2009
	(In thousands)	
Balance as of January 1,	$ 7,063	$ 6,390
Accretion expense	101	335
Revisions to estimates of cash flows	(1,652)	338
Balance as of December 31,	$ 5,512	$ 7,063

Duke Energy Kentucky's regulated electric and regulated natural gas operations accrue costs of removal for property that does not have an associated legal retirement obligation based on regulatory orders from the KPSC. These costs of removal are recorded as a regulatory liability in accordance with regulatory accounting treatment. The total amount of removal costs included in Regulatory Liabilities within Deferred Credits and Other Liabilities on the Balance Sheets was $52 million and $43 million as of December 31, 2010 and 2009, respectively.

6. Risk Management, Derivative Instruments, and Hedging Activities

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

Duke Energy Kentucky does not have any significant commodity derivatives.

Interest Rate Risk. Changes in interest rates expose Duke Energy Kentucky to risk as a result of its issuance of variable and fixed-rate debt. Duke Energy Kentucky manages its interest rate exposure by limiting its variable-rate exposures to a percentage of total debt and by monitoring the effects of market changes in interest rates. Duke Energy Kentucky also enters into financial derivative instruments such as interest rate swaps and U.S. Treasury lock agreements to manage and mitigate interest rate risk exposure. Duke Energy Kentucky's existing interest rate derivative instruments and related ineffectiveness were insignificant to its results of operations, cash flows and financial position in 2010 and 2009. The notional amount for Duke Energy Kentucky's interest rate swap was $27 million at December 31, 2010 and December 31, 2009. Regulatory accounting treatment is applied to this swap, and therefore, there is no mark-to-market impact on earnings.

Credit Risk. Where exposed to credit risk, Duke Energy Kentucky analyzes the counterparties' financial condition prior to entering into an agreement, establishes credit limits and monitors the appropriateness of those limits on an ongoing basis.

Duke Energy Kentucky's industry has historically operated under negotiated credit lines for physical delivery contracts. Duke Energy Kentucky may use master collateral agreements to mitigate certain credit exposures. The collateral agreements provide for a counterparty to post cash or letters of credit to the exposed party for exposure in excess of an established threshold. The threshold amount represents an unsecured credit limit, determined in accordance with the corporate credit policy. Collateral agreements also provide that the inability to post collateral is sufficient cause to terminate contracts and liquidate all positions.

Duke Energy Kentucky also obtains cash or letters of credit from customers to provide credit support outside of collateral agreements, where appropriate, based on its financial analysis of the customer and the regulatory or contractual terms and conditions applicable to each transaction.

See Note 7 for additional information on fair value disclosures related to derivatives.

7. Fair Value of Financial Assets and Liabilities

Under the accounting guidance for fair value, fair value is considered to be the exchange price in an orderly transaction between market participants to sell an asset or transfer a liability at the measurement date. The fair value definition focuses on an exit price, which is the price that would be received to sell an asset or paid to transfer a liability versus an entry price, which would be the price paid to acquire an asset or received to assume a liability. Although the accounting guidance for fair value does not require additional fair value measurements, it applies to other accounting pronouncements that require or permit fair value measurements.

Recurring and non-recurring fair value measurements are classified based on the following fair value hierarchy, as prescribed by the accounting guidance for fair value, which prioritizes the inputs to valuation techniques used to measure fair value into three levels:

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

Level 2 – a fair value measurement utilizing inputs other than a quoted market price that are observable, either directly or indirectly, for the asset or liability. Level 2 inputs include, but are not limited to, quoted prices for similar assets or liabilities in an active market, quoted prices for identical or similar assets or liabilities in markets that are not active and inputs other than quoted market prices that are observable for the asset or liability, such as interest rate curves and yield curves observable at commonly quoted intervals, volatilities,

credit risk and default rates. A level 2 measurement cannot have more than an insignificant portion of the valuation based on unobservable inputs.

Level 3 – any fair value measurements which include unobservable inputs for the asset or liability for more than an insignificant portion of the valuation. A level 3 measurement may be based primarily on level 2 inputs.

There are no financial assets or financial liabilities that are not required to be accounted for at fair value under GAAP for which the option to record at fair value has been elected. However, in the future, Duke Energy Kentucky may elect to measure certain financial instruments at fair value in accordance with this accounting guidance.

The following tables provide the fair value measurement amounts for assets and liabilities recorded on Duke Energy Kentucky's Balance Sheets at fair value at December 31, 2010 and December 31, 2009:

	Total Fair Value Amounts at December 31, 2010	Level 1	Level 2	Level 3
		(in thousands)		
Description				
Derivative Liabilities	$(4,671)	$ —	$(4,628)	$(43)

	Total Fair Value Amounts at December 31, 2009	Level 1	Level 2	Level 3
		(in thousands)		
Description				
Derivative Liabilities	$(3,359)	$ —	$(3,344)	$(15)

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

Rollforward of Level 3 Measurements

	Derivatives (net)
	(in thousands)
Balance at January 1, 2010	$(15)
Total gains included on balance sheet	526
Net purchases, sales, issuances and settlements	(554)
Balance at December 31, 2010	$(43)
Balance at January 1, 2009	$178
Total gains included on balance sheet	309
Net purchases, sales, issuances and settlements	(502)
Balance at December 31, 2009	$(15)

Additional fair value disclosures. The fair value of financial instruments, excluding financial assets and certain financial liabilities included in the scope of the accounting guidance for fair value measurements disclosed in the tables above, is summarized in the following table. Judgment is required in interpreting market data to develop the estimates of fair value.

	As of December 31, 2010		As of December 31, 2009	
	Book Value	Approximate Fair Value	Book Value	Approximate Fair Value
	(in thousands)			
Long-term debt, including current maturities	$ 344,589	$ 364,384	$ 345,544	$ 340,487

At both December 31, 2010 and December 31, 2009, the fair value of cash and cash equivalents, accounts receivable, accounts payable and notes payable are not materially different from their carrying amounts because of the short-term nature of these instruments and/or because the stated rates approximate market rates.

8. Intangibles

The carrying amount of emission allowances in Intangibles, net on the Balance Sheets as of December 31, 2010 and December 31, 2009 was $4 million and $7 million, respectively.

The carrying values of emission allowances sold or consumed were $3 million and $4 million during the years ended December 31, 2010 and December 31, 2009, respectively.

The table below shows the expected amortization expense for the next five years for intangible assets as of December 31, 2010. The expected amortization expense includes estimates of emission allowances consumption. The amortization amounts discussed below are estimates. Actual amounts may differ from these estimates due to such factors as changes in consumption patterns, sales or impairments of emission allowances or other intangible assets, additional intangible acquisitions and other events.

	2011	2012-2015
	(in thousands)	
Expected Amortization expense	$ 3,756	—

9. Related Party Transactions

Duke Energy Kentucky engages in related party transactions, which are generally performed at cost and in accordance with the KPSC and FERC regulations. Balances due to or due from related parties included in the Balance Sheets as of December 31, 2010 and December 31, 2009 are as follows:

	December 31, 2010[a]	December 31, 2009[a]
	(in thousands)	
Current assets [b]	$ 4,488	$ 4,084
Non-current assets[c]	3,357	3,305
Current liabilities[d]	(16,687)	(22,058)
Non-current liabilities[e]	(7,038)	(5,560)
Net deferred tax liabilities[f]	(213,935)	(199,144)

(a) Balances exclude assets or liabilities associated with accrued pension and other post-retirement benefits, Cinergy Receivables and money pool arrangements as discussed below.

(b) Of the balance at December 31, 2010, $4,443 thousand is classified as Receivables and $45 thousand is classified as Other within Current Assets on the Balance Sheets. The balance at December 31, 2009 is classified as Receivables on the Balance Sheets.

(c) The balances at December 31, 2010 and December 31, 2009 are classified as Other within Investments and Other Assets on the Balance Sheets.

(d) The balances at December 31, 2010 and December 31, 2009 are classified as Accounts Payable and Taxes Accrued on the Balance Sheets.

(e) The balances at December 31, 2010 and December 31, 2009 are classified as Other within Deferred Credits and Other Liabilities on the Balance Sheets.

(f) Of the balance at December 31, 2010, $(215,544) thousand is classified as Deferred Income Taxes and $1,609 thousand is classified as Other within Current Assets on the Balance Sheets. Of the balance at December 31, 2009, $(199,926) thousand is classified as Deferred Income Taxes and $782 thousand is classified as Other within Current Assets on the Balance Sheets.

Duke Energy Kentucky is charged its proportionate share of corporate governance and other costs by a consolidated affiliate of Duke Energy. Corporate governance and other shared services costs are primarily related to human resources, legal and accounting fees, as well as other third party costs. The expenses associated with certain allocated corporate governance and other shared service costs for Duke Energy Kentucky, which are recorded in Operation, Maintenance and Other within Operating Expenses on the Statements of Operations were $92 million and $83 million, respectively, for the years ended December 31, 2010 and 2009.

Duke Energy Kentucky incurs expenses from Duke Energy Ohio related to purchasing network integration transmission service from the Midwest ISO and ancillary services. These expenses, which are recorded in Operation, Maintenance and other within Operating Expenses on the Statements of Operations, were $16 million and $15 million for the years ended December 31, 2010 and 2009, respectively.

See Note 14 for detail on expense amounts allocated from Duke Energy to Duke Energy Kentucky related to Duke Energy Kentucky's participation in Duke Energy's qualified and non-qualified defined benefit pension plans and post-retirement health care and insurance benefits. Additionally, Duke Energy Kentucky has been allocated accrued pension and other post-retirement and post-employment benefit obligations from Duke Energy of $26 million and $29 million at December 31, 2010 and December 31, 2009, respectively. The above amounts have been classified in the Balance Sheet as follows:

	December 31, 2010	December 31, 2009
	(in thousands)	
Other current liabilities	$ 355	$ 118
Accrued pension and other postretirement benefit costs	$ 25,339	$ 28,685

Additionally, as discussed in Note 10, certain trade receivables have been sold by Duke Energy Kentucky to Cinergy Receivables, a consolidated entity formed by Cinergy. The proceeds obtained from the sales of receivables are largely cash, but do include a subordinated note from Cinergy Receivables for a portion of the purchase price. This subordinated note is classified as Receivables in the Balance Sheets and was $41 million and $33 million as of December 31, 2010 and December 31, 2009, respectively. The interest income associated with the subordinated note, which is recorded in Other Income and Expenses, net on the Statements of Operations, was $3 million and $2 million for the years ended December 31, 2010 and 2009, respectively.

As discussed further in Note 12, Duke Energy Kentucky participates in a money pool arrangement with Duke Energy and other Duke Energy subsidiaries. As of December 31, 2010, Duke Energy Kentucky was in a receivable position of $61 million. As of December 31, 2009, Duke Energy Kentucky was in a receivable position of $29 million.

10. Variable Interest Entities

A VIE is an entity that is evaluated for consolidation by more than a simple analysis of voting control. The analysis to determine whether an entity is a VIE considers contracts with an entity, credit support for an entity, the adequacy of the equity investment of an entity and the relationship of voting power to the amount of equity invested in an entity. This analysis is performed either upon the creation of a legal entity or upon the occurrence of an event requiring reevaluation, such as a significant change in an entity's assets or activities. If an entity is determined to be a VIE, a qualitative analysis of control determines the party that consolidates a VIE based on what party has the power to direct the most significant activities of a legal entity that impact its economic performance as well as what party has rights to receive benefits or is obligated to absorb losses that are significant to the VIE. The analysis of the party that consolidates a VIE is a continual reassessment.

As discussed in Note 1, Duke Energy Kentucky adopted new accounting rules associated with VIEs effective January 1, 2010. There were no material changes in decisions on consolidation of VIEs for Duke Energy Kentucky.

NON-CONSOLIDATED VIEs

The table below shows the VIE that Duke Energy Kentucky does not consolidate and how this entity impacts Duke Energy Kentucky's Balance Sheets. As discussed below, Duke Energy Kentucky does not consolidate Cinergy Receivables as it is not the primary beneficiary. The adoption of new accounting rules related to VIEs effective January 1, 2010 did not have any impact on the presentation of this non-consolidated VIE on any of Duke Energy Kentucky's Financial Statements.

	Cinergy Receivables
(in thousands)	
At December 31, 2010	
Balance Sheets	
Receivables	$41,215

Duke Energy Kentucky is not aware of any situations where the maximum exposure to loss significantly exceeds the carrying values shown.

No financial support was provided to Cinergy Receivables during the year ended December 31, 2010, or is expected to be provided in the future, that was not previously contractually required.

Cinergy Receivables. Cinergy Receivables was formed in order to secure low cost financing for Duke Energy Kentucky and other operating subsidiaries of Cinergy. Duke Energy Kentucky sells on a revolving basis, at a discount, nearly all of their customer accounts receivable and related collections to Cinergy Receivables. The receivables which are sold are selected in order to avoid any significant concentration of credit risk and exclude delinquent receivables. The receivables sold are securitized by Cinergy Receivables through a facility managed by two unrelated third parties and the receivables are used as collateral for commercial paper issued by the unrelated third parties. These loans provide the cash portion of the proceeds paid by Cinergy Receivables to Duke Energy Kentucky. The proceeds obtained by Duke Energy Kentucky from the sales of receivables are cash and a subordinated note from Cinergy Receivables (subordinated retained interest in the sold receivables) for a portion of the purchase price (typically approximates 25% of the total proceeds). The amount borrowed by Cinergy Receivables against these receivables is non-recourse to the general credit of Cinergy, and the associated cash collections from the accounts receivables sold is the sole source of funds to satisfy the related debt obligation. Borrowing is limited to 75% of the transferred receivables. Losses on collection in excess of the discount are first absorbed by the equity of Cinergy Receivables and next by the subordinated retained interests held by Duke Energy Kentucky and the other operating subsidiaries who sell receivables to Cinergy Receivables. The discount on the receivables reflects interest expense plus an allowance for bad debts net of a servicing fee charged by Duke Energy Kentucky. Duke Energy Kentucky is responsible for the servicing of the receivables (collecting and applying the cash to the appropriate receivables). Depending on the experience with collections, additional equity infusions to Cinergy Receivables may be required to be made by Duke Energy in order to maintain a minimum equity balance of $3 million. The amount borrowed fluctuates based on the amount of receivables sold. The debt is classified as short-term because the facility has an expiration date of less than one year from the balance sheet date. The expiration date is October 2011.

Cinergy Receivables is considered a VIE because the equity capitalization is insufficient to support its operations, the power to direct the most significant activities of the entity are not performed by the equity holder, Cinergy, and deficiencies in the net worth of Cinergy Receivables are not funded by Cinergy. The most significant activity of Cinergy Receivables relates to the decisions made with respect to the management of delinquent receivables. These decisions, as well as the requirement to make up deficiencies in net worth, are made by Duke Energy and not by Cinergy. Accordingly, Cinergy Receivables is consolidated by Duke Energy and not by Duke Energy Kentucky.

The subordinated note, which is classified within Receivables in the Balance Sheets, amounts to $41 million and $33 million at December 31, 2010 and 2009, respectively, is subordinate to senior loans that Cinergy Receivables obtains from commercial paper conduits controlled by unrelated financial institutions. The retained interest reflected on the Balance Sheets of Duke Energy Kentucky approximates fair value.

The carrying value of the retained interest is determined by allocating the carrying value of the receivables between the assets sold and the interests retained based on relative fair value. The key assumptions used in estimating the fair value for Duke Energy Kentucky in 2010 were an anticipated credit loss ratio of 0.9%, a discount rate of 2.7% and a receivable turnover rate of 12.1%. Because the receivables generally turnover in less than two months, credit losses are reasonably predictable due to the broad customer base and lack of significant concentration, and the purchased beneficial interest (equity in Cinergy Receivables) is subordinate to all retained interests and thus would absorb losses first, the allocated bases of the subordinated notes are not materially different than their face value. The hypothetical effect on the fair value of the retained interest assuming both a 10% and a 20% unfavorable variation in credit losses or discount rates is not material due to the short turnover of receivables and historically low credit loss history. Interest accrues to Duke Energy Kentucky on the retained interest using the accretable yield method, which generally approximates the stated rate on the notes since the allocated basis and the face value are nearly equivalent. An impairment charge is recorded against the carrying value of both the retained interest and purchased beneficial interest whenever it is determined that an other-than-temporary impairment has occurred.

The following tables show the gross and net receivables sold, retained interests, sales, and cash flows during the years ended December 31, 2010 and 2009.

	Year Ended December 31, 2010	Year Ended December 31, 2009
	(in thousands)	
Receivables sold as of December 31,	$67,820	$60,942
Less: Retained interest	41,215	33,319
Net receivables sold as of December 31,	$26,605	$27,623
Sales		
Receivables sold	$515,783	$501,433
Loss recognized on sale	4,452	4,172
Cash flows		
Cash proceeds from receivables sold	$503,434	$492,470
Collection fees received	258	251
Return received on retained interest	2,656	2,446

Cash flows from the sale of receivables are reflected within Operating Activities on Duke Energy Kentucky's Statements of Cash Flows.

Collection fees received in connection with the servicing of transferred accounts receivable are included in Operation, maintenance and other on Duke Energy Kentucky's Statements of Operations.

The loss recognized on the sale of receivables is calculated monthly by multiplying the receivables sold during the month by the required discount which is derived monthly utilizing a three year weighted average formula that considers charge-off history, late charge history, and turnover history on the sold receivables, as well as a component for the time value of money. The discount rate, or component for the time value of money, is calculated monthly by summing the prior month-end London Interbank Offered Rate (LIBOR) plus a fixed rate of 2.39%.

11. Property, Plant and Equipment

	Estimated Useful Life	December 31, 2010	December 31, 2009
	(Years)	(in thousands)	
Land	—	$ 19,492	$ 19,245
Plant			
Electric generation, distribution and transmission[a]	8 – 100	1,133,237	1,110,271
Natural gas transmission and distribution[a]	12 – 60	389,078	373,546
Other buildings and improvements[a]	25 – 100	31,710	31,451
Equipment	5 – 25	12,567	10,358
Vehicles	10 – 20	314	314
Construction in process	—	14,510	18,215
Other	5 – 10	31,168	20,717
Total property, plant and equipment		1,632,076	1,584,117
Total accumulated depreciation[b]		(669,682)	(641,260)
Total net property, plant and equipment		$ 962,394	$ 942,857

(a) Includes capitalized leases, for which the totals were $33 million for 2010 and $32 million for 2009.
(b) Includes accumulated amortization of capitalized leases: $3 million for 2010 and $4 million for 2009.

Interest capitalized, which includes the debt component of AFUDC, was less than $500 thousand for the years ended December 31, 2010 and 2009.

12. Debt and Credit Facilities

Summary of Debt and Related Terms

	Weighted-Average Rate	Year Due	December 31, 2010	December 31, 2009
			(in thousands)	
Unsecured debt	5.3%	2014 – 2036	$ 255,000	$ 255,000
Capital leases	5.3%	2011 – 2020	12,819	13,864
Other debt[a]	.4%	2027	77,571	77,571
Unamortized debt discount and premium, net			(801)	(891)
Total debt			344,589	345,544
Current maturities of long-term debt			(1,813)	(1,879)
Total long-term debt			$ 342,776	$ 343,665

(a) Includes $77 million of Duke Energy Kentucky pollution control bonds as of both December 31, 2010 and 2009. Of the $77 million at December 31, 2010, $27 million is also backstopped by Duke Energy's master credit facility.

Unsecured Debt. In September 2009, Duke Energy Kentucky issued $100 million of senior debentures, which carry a fixed interest rate of 4.65% and mature October 1, 2019. Proceeds from the issuance were used to repay Duke Energy Kentucky's borrowings under Duke Energy's master credit facility, to replenish cash used to repay $20 million principal amount of debt due September 15, 2009 and for general corporate purposes.

Other Debt. In November 2010, Duke Energy Kentucky refunded $27 million of tax-exempt auction rate bonds through the issuance of tax-exempt variable rate demand bonds, which are supported by a direct pay letter of credit. The variable-rate demand bonds, which are due August 2027, had an initial interest rate of 0.29% which is reset on a weekly basis.

In December 2008, Duke Energy Kentucky refunded $50 million of tax-exempt auction rate bonds through the issuance of $50 million of tax-exempt variable-rate demand bonds, which are supported by a direct-pay letter of credit. The variable-rate demand bonds, which are due August 2027, had an initial interest rate of 0.65% which is reset on a weekly basis.

Money Pool. Duke Energy Kentucky receives support for its short-term borrowing needs through participation with Duke Energy and other Duke Energy subsidiaries in a money pool arrangement. Under this arrangement, those companies with short-term funds may provide short-term loans to affiliates participating under this arrangement. The money pool is structured such that Duke Energy Kentucky separately manages its cash needs and working capital requirements. Accordingly, there is no net settlement of receivables and payables between the money pool participants, as each of these entities independently participate in the money pool.

As of December 31, 2010 and 2009, Duke Energy Kentucky had short-term money pool receivables of $61 million and $29 million, respectively, which are classified within Receivables in Duke Energy Kentucky's Balance Sheets.

Increases or decreases in money pool receivables are reflected within investing activities on Duke Energy Kentucky's Statement of Cash Flows, while increases or decreases in money pool borrowings are reflected within financing activities on Duke Energy Kentucky's Statement of Cash Flows.

Floating Rate Debt. Unsecured debt and other debt included $77 million of floating-rate debt as of both December 31, 2010 and 2009. Floating-rate debt is primarily based on commercial paper rates or a spread relative to an index such as LIBOR. As of December 31, 2010 and 2009, the average interest rate associated with floating-rate debt was 0.31% and .28%, respectively.

Maturities, Call Options and Acceleration Clauses.
Annual Maturities as of December 31, 2010

	(in thousands)
2011	$ 1,813
2012	1,847
2013	1,655
2014	41,491
2015	1,405
Thereafter	296,378
Total long-term debt (including current maturities)	$ 344,589

Duke Energy Kentucky has the ability under certain debt facilities to call and repay the obligation prior to its scheduled maturity. Therefore, the actual timing of future cash repayments could be materially different than the above as a result of Duke Energy Kentucky's ability to repay these obligations prior to their scheduled maturity.

Available Credit Facilities. The total capacity under Duke Energy's master credit facility, which expires in June 2012, is $3.14 billion. The credit facility contains an option allowing borrowing up to the full amount of the facility on the day of initial expiration for up to one year. Duke Energy and certain of its wholly-owned subsidiaries, including Duke Energy Kentucky, each have borrowing capacity under the master credit facility up to specified sub limits for each borrower. However, Duke Energy has the unilateral ability to increase or decrease the borrowing sub limits of each borrower, subject to per borrower maximum cap limitations, at any time. At December 31, 2010, Duke Energy Kentucky had borrowing sub limits under Duke Energy's master credit facility of $100 million. The amount available to Duke Energy Kentucky under its sub limits to Duke Energy's master credit facility may be reduced by draw downs of cash, borrowings through the money pool arrangement, or use of the master credit facility to backstop the issuances of letters of credit and certain tax-exempt bonds.

At December 31, 2010 and 2009, respectively, $77 million and $50 million of tax-exempt bonds, which are short-term obligations by nature, were classified as Long-Term Debt on the Balance Sheets due to Duke Energy Kentucky's intent and ability to utilize such borrowings as long-term financing. Duke Energy's credit facilities with non-cancelable terms in excess of one year as of the balance sheet date give Duke Energy Kentucky the ability to refinance these short-term obligations on a long-term basis. Of the $77 million of tax-exempt bonds outstanding at December 31, 2010, $77 million were backstopped by a letter of credit. Of the $50 million of tax-exempt bonds outstanding at December 31, 2009, $50 million were backstopped by a letter of credit.

In September 2008, Duke Energy Kentucky and Duke Energy Indiana, Inc. (Duke Energy Indiana), a wholly-owned subsidiary of Duke Energy, collectively entered into a $330 million three-year letter of credit agreement with a syndicate of banks. Under this letter of credit agreement, Duke Energy Kentucky may request the issuance of letters of credit up to $51 million on its behalf to support various series of variable rate demand bonds issued or to be issued on behalf of Duke Energy Kentucky. In September 2010 the letter of credit agreement was amended to reduce the size to $327 million and extend the maturity date to September 2012.This credit facility, which is not part of Duke Energy's master credit facility, may not be used for any purpose other than to support variable rate demand bonds issued by Duke Energy Kentucky and Duke Energy Indiana.

Restrictive Debt Covenants. Duke Energy Kentucky's debt and credit agreements contain various financial and other covenants. Failure to meet those covenants beyond applicable grace periods could result in accelerated due dates and/or termination of the agreements. As of December 31, 2010, Duke Energy Kentucky was in compliance with all covenants related to its significant debt agreements. In addition, some credit agreements may allow for acceleration of payments or termination of the agreements due to nonpayment, or the acceleration of other significant indebtedness of the borrower or some of its subsidiaries.

13. Commitments and Contingencies

General Insurance

Duke Energy Kentucky carries, either directly or through Duke Energy's captive insurance company, Bison Insurance Company Limited, insurance and reinsurance coverage consistent with companies engaged in similar commercial operations with similar type

properties. Duke Energy Kentucky's insurance coverage includes (i) commercial general liability coverage for liabilities arising to third parties for bodily injury and property damage resulting from Duke Energy Kentucky's operations; (ii) workers' compensation liability coverage to statutory limits; (iii) automobile liability coverage for all owned, non-owned and hired vehicles covering liabilities to third parties for bodily injury and property damage; (iv) insurance policies in support of the indemnification provisions of Duke Energy Kentucky's by-laws and (v) property coverage for all real and personal property damage, excluding electric transmission and distribution lines, including damages arising from boiler and machinery breakdowns, earthquake, flood damage and extra expense. All coverage is subject to certain deductibles or retentions, sublimits, terms and conditions common for companies with similar types of operations.

Duke Energy Kentucky also maintains excess liability insurance coverage above the established primary limits for commercial general liability and automobile liability insurance. Limits, terms, conditions and deductibles are comparable to those carried by other energy companies of similar size.

The cost of Duke Energy Kentucky's coverage can fluctuate year to year reflecting the changing conditions of the insurance and reinsurance markets.

Environmental

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

Clean Water Act 316(b). The EPA finalized its cooling water intake structures rule in July 2004. The rule established aquatic protection requirements for existing facilities that withdraw 50 million gallons or more of water per day from rivers, streams, lakes, reservoirs, estuaries, oceans, or other U.S. waters for cooling purposes. Coal-fired generating facilities in which Duke Energy Kentucky is either a whole or partial owner are affected sources under that rule. On April 1, 2009, the U.S. Supreme Court ruled in favor of the appellants that the EPA may consider costs when determining which technology option each site should implement. Depending on how the cost-benefit analysis is incorporated into the revised EPA rule, the analysis could change the range of technology options required for the affected facilities. The EPA has indicated it plans to issue a proposed rule in March 2011 and finalize the rule in July 2012. Because of the wide range of potential outcomes, Duke Energy Kentucky is unable to estimate its costs to comply at this time.

Clean Air Interstate Rule (CAIR). The EPA finalized the CAIR in May 2005. The CAIR limits total annual and summertime nitrogen oxide (NO_x) emissions and annual sulfur dioxide (SO_2) emissions from electric generating facilities across the Eastern U.S. through a two-phased cap-and-trade program. Phase 1 began in 2009 for NO_x and in 2010 for SO_2. Phase 2 begins in 2015 for both NO_x and SO_2. On March 25, 2008, the U.S. Court of Appeals for the District of Columbia (D.C. Circuit) heard oral argument in a case involving multiple challenges to the CAIR. On July 11, 2008, the D.C. Circuit issued its decision in *North Carolina v. EPA* No. 05-1244 vacating the CAIR. The EPA filed a petition for rehearing on September 24, 2008 with the D.C. Circuit asking the court to reconsider various parts of its ruling vacating CAIR. In December 2008, the D.C. Circuit issued a decision remanding the CAIR to the EPA without vacatur. The EPA must now conduct a new rulemaking to modify the CAIR in accordance with the court's July 11, 2008 opinion. This decision means that the CAIR as initially finalized in 2005 remains in effect until the new EPA rule takes effect. On August 2, 2010, the EPA published a proposed Transport Rule in the Federal Register that will replace the CAIR. The EPA proposed to establish state-level SO_2 and NO_x caps that would take effect in 2012. The SO_2 caps would be reduced in 2014 for 15 of the 31 affected states. The EPA proposes to allow limited interstate trading and asked for comment on two more restrictive alternatives. Duke Energy Kentucky cannot predict the outcome of this rulemaking, however, the potential cost of complying with the final regulation may be significant and impairments may result of if any of Duke Energy Kentucky's SO_2 emission allowances book value exceeds their fair market value. The EPA has indicated that it plans on finalizing the Transport Rule in June 2011. The emission controls Duke Energy Kentucky has installed to comply with state specific clean air legislation contribute significantly to achieving compliance with the CAIR and future Transport Rule requirements.

Coal Combustion Product (CCP) Management. The EPA and a number of states are considering additional regulatory measures that will contain specific and more detailed requirements for the management and disposal of CCP, primarily ash, from Duke Energy Kentucky's coal-fired power plants. Duke Energy Kentucky will install synthetic caps and liners at existing and new CCP landfills and to convert some of its CCP handling systems from wet to dry systems to comply with current regulations.

On June 21, 2010, the EPA issued a proposal to regulate, under the Resource Conservation and Recovery Act (RCRA), coal combustion residuals (CCRs), a term the EPA uses to describe the CCPs associated with the generation of electricity. The EPA proposal contains two regulatory options whereby CCRs not employed in approved beneficial use would either be regulated as hazardous waste or would continue to be regulated as non-hazardous waste. Duke Energy Kentucky cannot predict the outcome of this rulemaking, however, potential cost of complying with the final regulation may be significant. The EPA could issue a final rule by the end of 2011 or early 2012.

Duke Energy Kentucky currently estimates that it will spend $13 million over the period 2011-2015 to comply with Phase 1 of the CAIR and current CCP regulations.

Utility Boiler Maximum Achievable Control Technology (MACT) Standards. The EPA is currently planning to propose a MACT rule in March 2011 and finalize the rule in November 2011. The rule will establish emission limits for hazardous air pollutants that will apply to all coal-fired electric generating units. Based on this rulemaking schedule and the requirements of the Clean Air Act (CAA), compliance with final MACT emission limits would be required in early 2015, although the CAA provides for possible extensions of the compliance date of up to two years. Duke Energy Kentucky cannot predict the outcome of this rulemaking. However, the potential cost of compliance with the final regulation may be significant.

Litigation

Section 126 Petitions. In March 2004, the state of North Carolina filed a petition under Section 126 of the CAA in which it alleges that sources in 13 upwind states, including Kentucky, significantly contribute to North Carolina's non-attainment with certain ambient air quality standards. In August 2005, the EPA issued a proposed response to the petition. The EPA proposed to deny the ozone portion of the petition based upon a lack of contribution to air quality by the named states. The EPA also proposed to deny the particulate matter portion of the petition based upon the CAIR Federal Implementation Plan (FIP) that would address the air quality concerns from neighboring states. On April 28, 2006, the EPA denied North Carolina's petition based upon the final CAIR FIP described above. North Carolina has filed a legal challenge to the EPA's denial. On March 5, 2009 the D.C. Circuit remanded the case to the EPA for reconsideration. While the EPA has conceded to the D.C. Circuit's July 18, 2008 decision in the CAIR litigation, *North Carolina v. EPA* No. 05-1244, discussed above, and a subsequent order issued by the D.C. Circuit on December 23, 2008, has eliminated the legal basis for the EPA's denial of North Carolina's Section 126 petition. The EPA has taken no action on the North Carolina petition. With the EPA's development of the Transport Rule as a replacement for the CAIR, it is not expected that any action the EPA might take in the future in response to the North Carolina petition would result in emission reduction requirements more stringent than the Transport Rule Requirements.

Carbon Dioxide (CO_2) Litigation. In July 2004, the states of Connecticut, New York, California, Iowa, New Jersey, Rhode Island, Vermont, Wisconsin and the City of New York brought a lawsuit in the U.S. District Court for the Southern District of New York

against Cinergy, American Electric Power Company, Inc., American Electric Power Service Corporation, The Southern Company, Tennessee Valley Authority, and Xcel Energy Inc. A similar lawsuit was filed in the U.S. District Court for the Southern District of New York against the same companies by Open Space Institute, Inc., Open Space Conservancy, Inc., and The Audubon Society of New Hampshire. These lawsuits allege that the defendants' emissions of CO_2 from the combustion of fossil fuels at electric generating facilities contribute to global warming and amount to a public nuisance. The complaints also allege that the defendants could generate the same amount of electricity while emitting significantly less CO_2. The plaintiffs are seeking an injunction requiring each defendant to cap its CO_2 emissions and then reduce them by a specified percentage each year for at least a decade. In September 2005, the District Court granted the defendants' motion to dismiss the lawsuit. The plaintiffs have appealed this ruling to the Second Circuit Court of Appeals. Oral arguments were held before the Second Circuit Court of Appeals on June 7, 2006. In September 2009, the Court of Appeals issued a ruling reversing the district court and reinstating the lawsuit. Defendants filed a petition for rehearing en banc, which was subsequently denied. Defendants filed a petition for certiorari to the U.S. Supreme Court on August 2, 2010. The Solicitor General filed a brief in which it agreed that the matter should have been dismissed but raised different arguments than did the defendants. On December 6, 2010, the Supreme Court granted certiorari. Argument on this matter is scheduled for April 19, 2011. It is not possible to predict with certainty whether Duke Energy Kentucky will incur any liability or to estimate the damages, if any, that Duke Energy Kentucky might incur in connection with this matter.

Hurricane Katrina Lawsuit. In April 2006, Cinergy was named in the third amended complaint of a purported class action lawsuit filed in the U.S. District Court for the Southern District of Mississippi. Plaintiffs, for and on behalf of a putative class of all residents of Mississippi, claim that Cinergy, along with numerous other utilities, oil companies, coal companies and chemical companies, are liable for unquantified compensatory and punitive damages relating to losses suffered by victims of Hurricane Katrina. Plaintiffs claim that defendants' greenhouse gas emissions contributed to the frequency and intensity of storms such as Hurricane Katrina. On August 30, 2007, the court dismissed the case and plaintiffs filed a notice of appeal. In October 2009, the Court of Appeals issued an opinion reversing the district court and reinstating the lawsuit. Defendants filed a petition for rehearing en banc, which was granted. The Court of Appeals granted defendants' petition for rehearing en banc and a hearing was set, but subsequently taken off the calendar when an additional judge recused herself, leaving the court without a quorum. On May 28, 2010, after briefing on the issue, the court held it could not proceed with rehearing en banc, the original 5th Circuit opinion was properly vacated and the court can no longer reinstate it. As a result, the district court's decision dismissing the case was reinstated and is now the controlling decision in the case. On August 26, 2010, plaintiffs filed a petition for a Writ of Mandamus asking the Supreme Court to either reinstate the panel's decision or to hold in abeyance its action dismissing the appeal. On January 9, 2011, the Supreme Court denied the Mandamus petition which ended the case.

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

Duke Energy Kentucky has exposure to certain legal matters that are described herein. As of both December 31, 2010 and 2009, Duke Energy Kentucky has recorded insignificant reserves for these proceedings and exposures. Duke Energy Kentucky expenses legal costs related to the defense of loss contingencies as incurred.

Other Commitments and Contingencies

General. Duke Energy Kentucky enters into various commitments to purchase or sell power or capacity. As of December 31, 2010, most of these commitments are designated as non-derivative or normal purchases and sales and therefore not recognized on the Balance Sheets.

Operating and Capital Lease Commitments

Duke Energy Kentucky leases assets in several areas of its operations. Rental expense for operating leases, which is included in Operation, Maintenance and Other on the Statements of Operations, was $3 million for the year ended December 31, 2010 and $3 million for the year ended December 31, 2009. Capitalized lease obligations are classified as debt on the Balance Sheets (see Note 12). Amortization of assets recorded under capital leases is included in Depreciation and Amortization on the Statements of Operations. The following is a summary of future minimum lease payments under operating leases, which at inception had a noncancelable term of more than one year, and capital leases as of December 31, 2010:

	Operating Leases	Capital Leases
	(in thousands)	
2011	$ 2,490	$ 1,904
2012	1,984	1,937
2013	1,664	1,745
2014	1,341	1,580
2015	1,104	1,457
Thereafter	2,085	4,196
Total future minimum lease payments	$ 10,668	$ 12,819

14. Employee Benefit Plans

Duke Energy Retirement Plans. Duke Energy Kentucky participates in qualified and non-qualified defined benefit pension plans and other post-retirement benefit plans sponsored by Duke Energy. Duke Energy allocates pension and other post-retirement obligations and costs related to these plans to Duke Energy Kentucky.

Net periodic benefit cost disclosed in the tables below for the qualified, non-qualified and other post-retirement benefit plans represent the cost of the respective plan for the periods presented. However, portions of the net periodic benefit cost disclosed in the tables have been capitalized as a component of property, plant and equipment.

As required by the applicable accounting rules, Duke Energy uses a December 31 measurement date for its defined benefit retirement plan assets and obligations.

Amounts presented in the tables below represent the amounts of pension and other post-retirement benefit cost allocated by Duke Energy for employees of Duke Energy Kentucky. Additionally, Duke Energy Kentucky is allocated its proportionate share of pension and other post-retirement benefit cost for employees of Duke Energy's shared services affiliate that provides support to Duke Energy Kentucky. These allocated amounts are included in the governance and shared services costs discussed in Note 9.

Qualified Pension Plans

Duke Energy's qualified defined benefit pension plans cover substantially all employees meeting certain minimum age and service requirements. The plans cover most employees using a cash balance formula. Under a cash balance formula, a plan participant accumulates a retirement benefit consisting of pay credits that are based upon a percentage (which varies with age and years of service) of current eligible earnings and current interest credits. Certain legacy Cinergy employees are covered under plans that use a final average earnings formula. Under a final average earnings formula, a plan participant accumulates a retirement benefit equal to a percentage of their highest 3-year average earnings, plus a percentage of their highest 3-year average earnings in excess of covered compensation per year of participation (maximum of 35 years), plus a percentage of their highest 3-year average earnings times years of participation in excess of 35 years.

Duke Energy's policy is to fund amounts on an actuarial basis to provide assets sufficient to meet benefits to be paid to plan participants. In 2010, Duke Energy Kentucky made a cash contribution of $5 million, which represented its proportionate share of an approximate $400 million total contribution to Duke Energy's qualified pension plans. In 2009, Duke Energy Kentucky made a cash contribution of $21 million, which represented its proportionate share of an approximate $800 million total contribution to Duke Energy's qualified pension plans.

Actuarial gains and losses are amortized over the average remaining service period of the active employees. The average remaining service period of the active employees covered by the qualified retirement plan is ten years. Duke Energy determines the market-related value of plan assets using a calculated value that recognizes changes in fair value of the plan assets over five years.

Components of Net Periodic Pension Costs as allocated by Duke Energy: Qualified Pension Plans

	For the Years Ended December 31,	
	2010	2009
	(in thousands)	
Service cost	$1,459	$1,483
Interest cost on projected benefit obligation	4,738	4,854
Expected return on plan assets	(6,773)	(6,416)
Amortization of prior service cost	123	185
Amortization of actuarial loss	1,358	210
Settlement and contractual termination benefit cost	170	—
Other	280	280
Net periodic pension costs	$1,355	$ 596

Other Changes in Plan Assets and Projected Benefit Obligations Recognized in Regulatory Assets: Qualified Pension Plans

	For the Year Ended December 31,	
	2010	2009
	(in thousands)	
Regulatory assets, net (decrease) increase	$ (1,131)	$ 327

Reconciliation of Funded Status to Net Amount Recognized: Qualified Pension Plans

	As of and for the Years Ended December 31,	
	2010	2009
	(in thousands)	
Change in Projected Benefit Obligation		
Obligation at prior measurement date	$ 89,885	$ 67,722
Service cost	1,459	1,483
Interest cost	4,738	4,854
Actuarial losses	4,067	9,582
Plan amendments	—	(339)
Transfers	(867)	10,989
Settlement and contractual termination benefit cost	169	—
Benefits paid	(5,239)	(4,406)

	As of and for the Years Ended December 31,	
	2010	2009
Obligation at measurement date	$ 94,212	$ 89,885

The accumulated benefit obligation allocated by Duke Energy to Duke Energy Kentucky was $87,156 thousand and $85,744 thousand at December 31, 2010 and 2009, respectively.

	As of and for the Years Ended December 31,	
	2010	2009
	(in thousands)	
Change in Fair Value of Plan Assets		
Plan assets at prior measurement date	$ 77,641	$ 35,548
Actual return on plan assets	10,209	14,657
Benefits paid	(5,239)	(4,406)
Transfers	(867)	10,989
Employer contributions	5,403	20,853
Plan assets at measurement date	$ 87,147	$ 77,641

Amounts Recognized in the Balance Sheets: Qualified Pension Plans

The following table provides the amounts related to Duke Energy Kentucky's qualified pension plans that are reflected in Accrued pension and other post-retirement benefit costs on the Balance Sheets at December 31, 2010 and 2009

	As of December 31,	
	2010	2009
	(in thousands)	
Accrued pension liability	$ (7,065)	$ (12,244)

The following table provides the amounts related to Duke Energy Kentucky's qualified pension plans that are reflected in Other within Regulatory Assets and Deferred Debits on the Consolidated Balance Sheets at December 31, 2010 and 2009:

	As of December 31,	
	2010	2009
	(in thousands)	
Regulatory Assets	$ 26,993	$ 28,124

Of the amounts above, approximately $1,776 thousand in unrecognized net actuarial losses and $123 thousand in prior service cost will be recognized in net periodic pension costs in 2011.

Additional Information: Qualified Pension Plans

Information for Plans with Accumulated Benefit Obligation in Excess of Plan Assets as allocated by Duke Energy

	As of December 31,	
	2010	2009
	(in thousands)	
Projected benefit obligation	$ 76,373	$ 89,885
Accumulated benefit obligation	69,866	81,338
Fair value of plan assets	71,043	77,641

Assumptions Used for Duke Energy's Pension Benefits Accounting

	As of December 31,	
	2010	2009
	(percentages)	
Benefit Obligations		
Discount rate	5.00	5.50
Salary increase	4.10	4.50
Net Periodic Benefit Cost		
Discount rate	5.50	6.50
Salary increase	4.50	4.50
Expected long-term rate of return on plan assets	8.50	8.50

The discount rate used to determine the current year pension obligation and following year's pension expense is based on a yield curve approach. Under the yield curve approach, expected future benefit payments for each plan are discounted by a rate on a third-party bond yield curve corresponding to each duration. The yield curve is based on a bond universe of AA and AAA-rated long-term corporate bonds. A single discount rate is calculated that would yield the same present value as the sum of the discounted cash flows.

Non-Qualified Pension Plans

Duke Energy also maintains, and Duke Energy Kentucky participates in, non-qualified, non-contributory defined benefit retirement plans. Actuarial gains and losses are amortized over the average remaining service period of the active employees. The average remaining service period of active employees covered by the non-qualified retirement plans is nine years.

Components of Net Periodic Pension Costs as allocated by Duke Energy: Non-Qualified Pension Plans

	For the Years Ended December 31,	
	2010	2009
	(in thousands)	
Interest cost on projected benefit obligation	$ 8	8
Amortization of actuarial loss	10	11
Net periodic pension costs	$ 18	$ 19

Other Changes in Plan Assets and Projected Benefit Obligations Recognized in Regulatory Assets: Non-Qualified Pension Plans

	For the Years Ended December 31,	
	2010	2009
	(in thousands)	
Regulatory assets, net (decrease) increase	$ (12)	$ 6

Reconciliation of Funded Status to Net Amount Recognized: Non-Qualified Pension Plans

	As of and for the Years Ended December 31,	
	2010	2009
	(in thousands)	
Change in Projected Benefit Obligation		
Obligation at prior measurement date	$ 148	$ 133
Service cost	—	—
Interest cost	8	8
Actuarial losses	2	13
Benefits paid	(11)	(6)
Obligation at measurement date	$ 147	$ 148

	As of and for the Years Ended December 31,	
	2010	2009
	(in thousands)	
Change in Fair Value of Plan Assets		
Benefits paid	$ (11)	$ (6)
Employer contributions	11	6
Plan assets at measurement date	$ —	$ —

The accumulated benefit obligation was $147 thousand and $148 thousand at December 31, 2010 and 2009, respectively.

Amounts Recognized in the Balance Sheets: Non-Qualified Pension Plans

The following table provides the amounts related to Duke Energy Kentucky's non-qualified pension plans that are reflected in Other within Deferred Credits and Other Liabilities on the Balance Sheets at December 31, 2010 and 2009:

	As of December 31,	
	2010	2009
	(in thousands)	
Accrued pension liability[(a)]	$ (147)	$ (148)

(a) Includes $10 thousand and $11 thousand recognized in Other within Current Liabilities on the Consolidated Balance Sheets as of December 31, 2010 and 2009, respectively.

The following table provides the amounts related to Duke Energy Kentucky's non-qualified pension plans that are reflected in Other within Regulatory Assets and Deferred Debits on the Balance Sheets at December 31, 2010 and 2009:

	As of December 31,	
	2010	2009
	(in thousands)	
Regulatory assets	$ 91	$ 103

Of the amounts above, $2 thousand in unrecognized net actuarial losses will be recognized in net periodic pension costs in 2011.

Additional Information: Non-Qualified Pension Plans

Information for Plans with Accumulated Benefit Obligation in Excess of Plan Assets as allocated by Duke Energy

	As of December 31,	
	2010	2009
	(in thousands)	
Projected benefit obligation	$147	$ 148
Accumulated benefit obligation	147	148
Fair value of plan assets	—	—

Assumptions Used for Duke Energy's Pension Benefits Accounting

	As of December 31,	
	2010	2009
	(percentages)	
Benefit Obligations		
Discount rate	5.00	5.50
Salary increase	4.10	4.50
Net Periodic Benefit Cost		
Discount rate	5.50	6.50
Salary increase	4.50	4.50

The discount rate used to determine the current year pension obligation and following year's pension expense is based on a yield curve approach. Under the yield curve approach, expected future benefit payments for each plan are discounted by a rate on a third-party bond yield curve corresponding to each duration. The yield curve is based on a bond universe of AA and AAA-rated long-term corporate bonds. A single discount rate is calculated that would yield the same present value as the sum of the discounted cash flows.

Other Post-Retirement Benefit Plans

Duke Energy Kentucky participates in other post-retirement benefit plans sponsored by Duke Energy. Duke Energy provides certain health care and life insurance benefits to retired employees and their eligible dependents on a contributory and non-contributory basis. These benefits are subject to minimum age and service requirements. The health care benefits include medical coverage, dental coverage, and prescription drug coverage and are subject to certain limitations, such as deductibles and co-payments. These benefit costs are accrued over an employee's active service period to the date of full benefits eligibility. The net unrecognized transition obligation is amortized over 20 years. Actuarial gains and losses are amortized over the average remaining service period of the active employees. The average remaining service period of the active employees covered by the plan is 11 years.

Duke Energy did not make any contributions to its other post-retirement plans in 2010 or 2009.

Components of Net Periodic Other Post-Retirement Benefit Costs as allocated by Duke Energy

	For the Years Ended December 31,	
	2010	2009
	(in thousands)	
Service cost	$ 186	$187
Interest cost on projected benefit obligation	501	563
Expected return on plan assets	(78)	(78)
Amortization of prior service (credit) cost	(40)	(40)
Amortization of actuarial loss	54	31
Net periodic other post-retirement benefit costs	$623	$ 663

Other Changes in Plan Assets and Projected Benefit Obligations Recognized in Regulatory Assets and Regulatory Liabilities: Other Post-Retirement Benefit Plans

	For the year ended December 31,	
	2010	2009
	(in thousands)	
Regulatory assets, net (decrease) increase	$ (380)	$ 315
Regulatory liabilities, net decrease	(269)	(815)

Reconciliation of Funded Status to Accrued Other Post-Retirement Benefit Costs: Other Post-Retirement Benefit Plans

	As of and for the Years Ended December 31,	
	2010	2009
	(in thousands)	
Change in Benefit Obligation		
Accumulated post-retirement benefit obligation at prior measurement date	$ 9,868	$ 7,608
Service cost	186	187
Interest cost	501	563
Plan participants' contributions	135	1
Actuarial (gain) loss	(10)	563
Transfers	(238)	1,471
Accrued retiree drug subsidy	17	22
Benefits paid	(609)	(547)
Accumulated post-retirement benefit obligation at measurement date	$ 9,850	$ 9,868

	As of and for the Years Ended December 31,	
	2010	2009
	(in thousands)	
Change in Fair Value of Plan Assets		
Plan assets at prior measurement date	$ 798	$ 646
Actual return on plan assets	113	151
Plan participants' contributions	135	1
Benefits paid	(609)	(547)
Employer contributions	474	547
Plan assets at measurement date	$ 911	$ 798

Amounts Recognized in the Balance Sheets: Other Post-Retirement Benefit Plans

The following table provides the amounts related to Duke Energy Kentucky's other post-retirement benefit plans that are reflected in Other within Deferred Credits and Other Liabilities on the Balance Sheets at December 31, 2010 and 2009:

	As of December 31,	
	2010	2009
	(in thousands)	
Accrued other post-retirement liability[(a)]	$ (8,939)	$ (9,070)

(a) Includes $115 thousand and $107 thousand recognized in Other within Current Liabilities on the Consolidated Balance Sheets as of December 31, 2010 and 2009, respectively.

The following table provides the amounts related to Duke Energy Kentucky's other post-retirement benefit plans that are reflected in Other within Regulatory Assets Deferred Debits and Accrued pension and other post-retirement benefit costs on the Balance Sheets at December 31, 2010 and 2009:

	As of December 31,	
	2010	2009
	(in thousands)	
Regulatory assets	$ 4,530	$ 4,910
Regulatory liabilities	3,194	3,463

Of the amounts above, $226 thousand of unrecognized gains and $38 thousand of unrecognized prior service credit (which will reduce pension expense) will be recognized in net periodic pension costs in 2011.

Assumptions Used in Duke Energy's Other Post-retirement Benefits Accounting

	As of December 31,	
	2010	2009
	(percentages)	
Benefit Obligations		
Discount rate	5.00	5.50
Net Periodic Benefit Cost		
Discount rate	5.50	6.50
Expected long-term rate of return on plan assets	8.50	8.50

The discount rate used to determine the current year pension obligation and following year's pension expense is based on a yield curve approach. Under the yield curve approach, expected future benefit payments for each plan are discounted by a rate on a third-party bond yield curve corresponding to each duration. The yield curve is based on a bond universe of AA and AAA-rated long-term corporate bonds. A single discount rate is calculated that would yield the same present value as the sum of the discounted cash flows.

Assumed Health Care Cost Trend Rates[(a)]

	Medicare Trend Rate		Prescription Drug Trend Rate	
	2010	2009	2010	2009
Health care cost trend rate assumed for next year	8.50%	8.50%	9.80%	11.00%
Rate to which the cost trend is assumed to decline (the ultimate trend rate)	5.00%	5.00%	5.00%	5.00%
Year that the rate reaches the ultimate trend rate	2020	2019	2025	2024

(a) Health care cast trend rates include prescription drug trend rate due to the effect of the Modernization Act.

Expected Benefit Payments

The following table presents Duke Energy's expected benefit payments to participants on behalf of Duke Energy Kentucky in its qualified, non-qualified and other post-retirement benefit plans over the next 10 years, which are primarily paid out of the assets of various trusts. These benefit payments reflect expected future service, as appropriate.

	Qualified Plans	Non-Qualified Plans	Other Post-Retirement Plans	Total
		(in thousands)		
Years Ended December 31,				
2011	$ 7,223	$ 11	$ 743	$ 7,977
2012	6,567	11	807	7,385
2013	6,722	11	779	7,512
2014	6,589	11	770	7,370
2015	6,306	11	775	7,092
2016 – 2020	34,490	54	4,569	39,113

Master Retirement Trust. The assets for the Duke Energy Kentucky plans discussed above are derived from the Master Trust that is held by Duke Energy, as such, each are allocated their proportionate share of assets discussed below. Assets for both the qualified pension and other post-retirement benefits are maintained in a Master Retirement Trust (Master Trust). The investment objective of the Master Trust is to achieve reasonable returns, subject to a prudent level of portfolio risk, for the purpose of enhancing the security of benefits for plan participants. The long-term rate of return of 8.25% as of December 31, 2010 for the Master Trust was developed using a weighted-average calculation of expected returns based primarily on future expected returns across asset classes considering the use of active asset managers. The weighted-average returns expected by asset classes were 2.6% for U.S. equities, 1. 45% for Non-U.S. equities, 1.0% for Global equities, 2.0% for debt securities, 0.3% for global private equity, 0.3% for hedge funds, 0.3% for real estate and 0.3% for other global securities. The asset allocation targets were set after considering the investment objective and the risk profile. U.S. equities are held for their high expected return. Non-U.S. equities, debt securities, and real estate are held for diversification. Investments within asset classes are to be diversified to achieve broad market participation and reduce the impact of individual managers or investments. Cinergy regularly reviews its actual asset allocation and periodically rebalances its investments to the targeted allocation when considered appropriate. The following table presents target and actual asset allocations for the Master Trust at December 31, 2010 and 2009:

Asset Category	Target Allocation	Percentage at December 31, 2010	Percentage at December 31, 2009
U.S. equity securities	28%	30%	33%
Non-U.S. equity securities	15	19	20
Global equity securities	10	10	10
Debt securities	32	27	28
Global private equity securities	3	—	—
Hedge funds	4	3	—
Real estate and cash	4	7	9
Other global securities	4	4	—
Total	100%	100%	100%

Employee Savings Plans

Duke Energy sponsors, and Duke Energy Kentucky participates in, an employee savings plan that covers substantially all employees. Most employees participate in a matching contribution formula where Duke Energy provides a matching contribution generally equal to 100% of before-tax employee contributions, of up to 6% of eligible pay per pay period. Duke Energy Kentucky expensed pre-tax plan contributions, as allocated by Duke Energy, of $818 thousand in 2010 and $803 thousand in 2009.

15. Other Income and Expenses, net

The components of Other Income and Expenses, net on the Statements of Operations for the years ended December 31, 2010 and 2009 are as follows:

	December 31, 2010	December 31, 2009
	(in thousands)	
Income/(Expense):		
Interest Income	$ 2,918	$ 2,594
AFUDC Equity	353	245
Other	54	(11)
Total	$ 3,325	$ 2,828

16. Severance

In January 2010, Duke Energy announced plans to offer a voluntary severance plan to 8,750 eligible employees. As this is a voluntary plan, all severance benefits offered under this plan are considered special termination benefits under GAAP. Special termination benefits are measured upon employee acceptance and recorded immediately absent a significant retention period. If a significant retention period exists, the cost of the special termination benefits are recorded ratably over the remaining service periods of the affected employees. The window for employees to request to voluntarily end their employment under this plan opened on February 3, 2010 and closed on February 24, 2010 for 8,400 eligible employees, which included 15 Duke Energy Kentucky employees. Also in January 2010, Duke Energy announced that it would consolidate certain corporate office functions, resulting in transitioning 350 positions over the next two years from its offices in the Midwest to its corporate headquarters in Charlotte, North Carolina. Employees who do not relocate have the option to elect to participate in the voluntary plan discussed above, find a regional position within Duke Energy or remain with Duke Energy through a transition period, at which time a severance benefit would be paid under Duke Energy's ongoing severance plan. For employees affected by the consolidation of Duke Energy's corporate functions in Charlotte, North Carolina, the window closed March 31, 2010. One employee of Duke Energy Kentucky accepted the voluntary severance program.

Duke Energy Kentucky recorded total expense of $5 million for the year ended December 31, 2010. The severance costs associated with the voluntary severance program include an allocation of its proportionate share of severance costs for employees of Duke Energy's shared services affiliate that provides support to Duke Energy Kentucky. On December 28, 2010 Duke Energy Kentucky filed a request with the KPSC to defer for future recovery its total costs associated with this voluntary severance program. If approved, recovery of the deferred amounts will be addressed in Duke Energy Kentucky's future base rate case proceedings. An order on the request for deferral is expected during the second quarter of 2011.

17. Subsequent Events

On January 8, 2011, Duke Energy entered into an Agreement and Plan of Merger (Merger Agreement) between and among Diamond Acquisition Corporation, a North Carolina corporation and Duke Energy's wholly-owned subsidiary (Merger Sub) and Progress Energy, Inc. (Progress Energy), a North Carolina corporation. Completion of the merger is conditioned upon, among other things, approval by the shareholders of both companies as well as expiration or termination of any applicable waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 and

approval, to the extent required, by the FERC, the Federal Communication Commission (FCC), the North Carolina Utilities Commission (NCUC), the Public Service Commission of South Carolina (PSCSC), the Florida Public Service Commission (FPSC), the Indiana Utility Regulatory Commission (IURC), the KPSC, the Public Utilities Commission of Ohio (PUCO) and the Nuclear Regulatory Commission (NRC). Duke Energy is targeting completion of the merger by the end of 2011, but cannot assure completion by any particular date.

For information on subsequent events related to regulatory matters, see Note 2. Subsequent events have been evaluated through March 16, 2011, the date these financial statements were available to be issued.