

KENTUCKY UTILITIES CO
 Form 10-Q
 November 08, 2012

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

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
 SECURITIES EXCHANGE ACT OF 1934 for the quarterly period ended
 September 30, 2012
 OR
 TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
 SECURITIES EXCHANGE ACT OF 1934 for the transition period from
 _____ to _____

| Commission File Number | Registrant; State of Incorporation; Address and Telephone Number | IRS Employer Identification No. |
|---------------------------|--|--|
| 1-11459 | PPL Corporation (Exact name of Registrant as specified in its charter) (Pennsylvania) Two North Ninth Street Allentown, PA 18101-1179 (610) 774-5151 | 23-2758192 |
| 1-32944 | PPL Energy Supply, LLC (Exact name of Registrant as specified in its charter) (Delaware) Two North Ninth Street Allentown, PA 18101-1179 (610) 774-5151 | 23-3074920 |
| 1-905 | PPL Electric Utilities Corporation (Exact name of Registrant as specified in its charter) (Pennsylvania) Two North Ninth Street Allentown, PA 18101-1179 (610) 774-5151 | 23-0959590 |
| 333-173665 | LG&E and KU Energy LLC (Exact name of Registrant as specified in its charter) (Kentucky) 220 West Main Street Louisville, KY 40202-1377 (502) 627-2000 | 20-0523163 |
| 1-2893 | Louisville Gas and Electric Company | 61-0264150 |

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

(Exact name of Registrant as specified in its charter)

(Kentucky)

220 West Main Street

Louisville, KY 40202-1377

(502) 627-2000

1-3464

Kentucky Utilities Company

61-0247570

(Exact name of Registrant as specified in its charter)

(Kentucky and Virginia)

One Quality Street

Lexington, KY 40507-1462

(502) 627-2000

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

Indicate by check mark whether the registrants (1) have filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrants were required to file such reports), and (2) have been subject to such filing requirements for the past 90 days.

| | | | |
|-------------------------------------|-----|-------------------------------------|----|
| PPL Corporation | Yes | <input checked="" type="checkbox"/> | No |
| PPL Energy Supply, LLC | Yes | <input checked="" type="checkbox"/> | No |
| PPL Electric Utilities Corporation | Yes | <input checked="" type="checkbox"/> | No |
| LG&E and KU Energy LLC | Yes | <input checked="" type="checkbox"/> | No |
| Louisville Gas and Electric Company | Yes | <input checked="" type="checkbox"/> | No |
| Kentucky Utilities Company | Yes | <input checked="" type="checkbox"/> | No |

Indicate by check mark whether the registrants have submitted electronically and posted on their corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrants were required to submit and post such files).

| | | | |
|-------------------------------------|-----|-------------------------------------|----|
| PPL Corporation | Yes | <input checked="" type="checkbox"/> | No |
| PPL Energy Supply, LLC | Yes | <input checked="" type="checkbox"/> | No |
| PPL Electric Utilities Corporation | Yes | <input checked="" type="checkbox"/> | No |
| LG&E and KU Energy LLC | Yes | <input checked="" type="checkbox"/> | No |
| Louisville Gas and Electric Company | Yes | <input checked="" type="checkbox"/> | No |
| Kentucky Utilities Company | Yes | <input checked="" type="checkbox"/> | No |

Indicate by check mark whether the registrants are large accelerated filers, accelerated filers, non-accelerated filers, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

| | Large accelerated filer | Accelerated filer | Non-accelerated filer | Smaller reporting company |
|-------------------------------------|-------------------------------------|--------------------------|-------------------------------------|---------------------------------|
| PPL Corporation | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| PPL Energy Supply, LLC | <input type="checkbox"/> | <input type="checkbox"/> | <input checked="" type="checkbox"/> | <input type="checkbox"/> |
| PPL Electric Utilities Corporation | <input type="checkbox"/> | <input type="checkbox"/> | <input checked="" type="checkbox"/> | <input type="checkbox"/> |
| LG&E and KU Energy LLC | <input type="checkbox"/> | <input type="checkbox"/> | <input checked="" type="checkbox"/> | <input type="checkbox"/> |
| Louisville Gas and Electric Company | <input type="checkbox"/> | <input type="checkbox"/> | <input checked="" type="checkbox"/> | <input type="checkbox"/> |
| Kentucky Utilities Company | <input type="checkbox"/> | <input type="checkbox"/> | <input checked="" type="checkbox"/> | <input type="checkbox"/> |

Indicate by check mark whether the registrants are shell companies (as defined in Rule 12b-2 of the Exchange Act).

| | | | |
|-------------------------------------|-----|----|-------------------------------------|
| PPL Corporation | Yes | No | <input checked="" type="checkbox"/> |
| PPL Energy Supply, LLC | Yes | No | <input checked="" type="checkbox"/> |
| PPL Electric Utilities Corporation | Yes | No | <input checked="" type="checkbox"/> |
| LG&E and KU Energy LLC | Yes | No | <input checked="" type="checkbox"/> |
| Louisville Gas and Electric Company | Yes | No | <input checked="" type="checkbox"/> |
| Kentucky Utilities Company | Yes | No | <input checked="" type="checkbox"/> |

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

| | |
|-------------------------------------|---|
| PPL Corporation | Common stock, \$0.01 par value, 581,705,916 shares outstanding at October 31, 2012. |
| PPL Energy Supply, LLC | PPL Corporation indirectly holds all of the membership interests in PPL Energy Supply, LLC. |
| PPL Electric Utilities Corporation | Common stock, no par value, 66,368,056 shares outstanding and all held by PPL Corporation at October 31, 2012. |
| LG&E and KU Energy LLC | PPL Corporation directly holds all of the membership interests in LG&E and KU Energy LLC. |
| Louisville Gas and Electric Company | Common stock, no par value, 21,294,223 shares outstanding and all held by LG&E and KU Energy LLC at October 31, 2012. |
| Kentucky Utilities Company | Common stock, no par value, 37,817,878 shares outstanding and all held by LG&E and KU Energy LLC at October 31, 2012. |

This document is available free of charge at the Investor Center on PPL Corporation's website at www.pplweb.com. However, information on this website does not constitute a part of this Form 10-Q.

PPL CORPORATION
PPL ENERGY SUPPLY, LLC
PPL ELECTRIC UTILITIES CORPORATION
LG&E AND KU ENERGY LLC
LOUISVILLE GAS AND ELECTRIC COMPANY
KENTUCKY UTILITIES COMPANY

FORM 10-Q
FOR THE QUARTER ENDED SEPTEMBER 30, 2012

Table of Contents

This combined Form 10-Q is separately filed by the following individual registrants: PPL Corporation, PPL Energy Supply, LLC, PPL Electric Utilities Corporation, LG&E and KU Energy LLC, Louisville Gas and Electric Company and Kentucky Utilities Company. Information contained herein relating to any individual registrant is filed by such registrant solely on its own behalf, and no registrant makes any representation as to information relating to any other registrant, except that information under "Forward-Looking Information" relating to PPL Corporation subsidiaries is also attributed to PPL Corporation and information relating to the subsidiaries of LG&E and KU Energy LLC is also attributed to LG&E and KU Energy LLC.

Unless otherwise specified, references within this Report, individually, to PPL Corporation, PPL Energy Supply, LLC, PPL Electric Utilities Corporation, LG&E and KU Energy LLC, Louisville Gas and Electric Company and Kentucky Utilities Company are references to such entities directly or to one or more of their subsidiaries, as the case may be, the financial results of which are consolidated into such Registrants in accordance with GAAP. This presentation has been applied where identification of particular subsidiaries is not material to the matter being disclosed, and to conform narrative disclosures to the presentation of financial information on a consolidated basis.

| | Page |
|--|------|
| GLOSSARY OF TERMS AND ABBREVIATIONS | i |
| FORWARD-LOOKING INFORMATION | 1 |
| PART I. FINANCIAL INFORMATION | |
| Item 1. Financial Statements | |
| PPL Corporation and Subsidiaries | |
| <u>Condensed Consolidated Statements of Income</u> | 3 |
| <u>Condensed Consolidated Statements of Comprehensive Income</u> | 4 |
| <u>Condensed Consolidated Statements of Cash Flows</u> | 5 |
| <u>Condensed Consolidated Balance Sheets</u> | 6 |
| <u>Condensed Consolidated Statements of Equity</u> | 8 |
| PPL Energy Supply, LLC and Subsidiaries | |
| <u>Condensed Consolidated Statements of Income</u> | 9 |
| <u>Condensed Consolidated Statements of Comprehensive Income</u> | 10 |
| <u>Condensed Consolidated Statements of Cash Flows</u> | 11 |

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| | | |
|---|--|----|
| | <u>Condensed Consolidated Balance Sheets</u> | 12 |
| | <u>Condensed Consolidated Statements of Equity</u> | 14 |
| PPL Electric Utilities Corporation and Subsidiaries | | |
| | <u>Condensed Consolidated Statements of</u> | |
| | <u>Income</u> | 16 |
| | <u>Condensed Consolidated Statements of Cash</u> | |
| | <u>Flows</u> | 17 |
| | <u>Condensed Consolidated Balance Sheets</u> | 18 |
| | <u>Condensed Consolidated Statements of</u> | |
| | <u>Shareowners' Equity</u> | 20 |
| LG&E and KU Energy LLC and Subsidiaries | | |
| | <u>Condensed Consolidated Statements of</u> | |
| | <u>Income</u> | 22 |
| | <u>Condensed Consolidated Statements of Cash</u> | |
| | <u>Flows</u> | 23 |
| | <u>Condensed Consolidated Balance Sheets</u> | 24 |
| | <u>Condensed Consolidated Statements of Equity</u> | 26 |
| Louisville Gas and Electric Company | | |
| | <u>Condensed Statements of Income</u> | 28 |
| | <u>Condensed Statements of Cash Flows</u> | 29 |
| | <u>Condensed Balance Sheets</u> | 30 |
| | <u>Condensed Statements of Equity</u> | 32 |

| | |
|--|-----|
| Kentucky Utilities Company | |
| <u>Condensed Statements of Income</u> | 34 |
| <u>Condensed Statements of Cash Flows</u> | 35 |
| <u>Condensed Balance Sheets</u> | 36 |
| <u>Condensed Statements of Equity</u> | 38 |
| Combined Notes to Condensed Financial Statements (Unaudited) | |
| <u>1. Interim Financial Statements</u> | 39 |
| <u>2. Summary of Significant Accounting Policies</u> | 39 |
| <u>3. Segment and Related Information</u> | 40 |
| <u>4. Earnings Per Share</u> | 41 |
| <u>5. Income Taxes</u> | 42 |
| <u>6. Utility Rate Regulation</u> | 46 |
| <u>7. Financing Activities</u> | 52 |
| <u>8. Acquisitions, Development and Divestitures</u> | 56 |
| <u>9. Defined Benefits</u> | 59 |
| <u>10. Commitments and Contingencies</u> | 61 |
| <u>11. Related Party Transactions</u> | 77 |
| <u>12. Other Income (Expense) - net</u> | 79 |
| <u>13. Fair Value Measurements and Credit Concentration</u> | 80 |
| <u>14. Derivative Instruments and Hedging Activities</u> | 87 |
| <u>15. Goodwill</u> | 100 |
| <u>16. Asset Retirement Obligations</u> | 100 |
| <u>17. Available-for-Sale Securities</u> | 101 |
| <u>18. New Accounting Guidance Pending Adoption</u> | 102 |
| Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations | |
| <u>PPL Corporation and Subsidiaries</u> | 103 |
| <u>PPL Energy Supply, LLC and Subsidiaries</u> | 132 |
| <u>PPL Electric Utilities Corporation and Subsidiaries</u> | 146 |
| <u>LG&E and KU Energy LLC and Subsidiaries</u> | 155 |
| <u>Louisville Gas and Electric Company</u> | 164 |
| <u>Kentucky Utilities Company</u> | 171 |
| Item 3. Quantitative and Qualitative Disclosures About Market Risk | 178 |
| Item 4. Controls and Procedures | 178 |
| PART II. OTHER INFORMATION | |
| <u>Item 1. Legal Proceedings</u> | 179 |
| <u>Item 1A. Risk Factors</u> | 179 |
| <u>Item 4. Mine Safety Disclosures</u> | 179 |
| <u>Item 6. Exhibits</u> | 180 |
| <u>SIGNATURES</u> | 182 |
| <u>COMPUTATIONS OF RATIO OF EARNINGS TO FIXED CHARGES</u> | 183 |
| <u>CERTIFICATES OF PRINCIPAL EXECUTIVE OFFICER AND PRINCIPAL FINANCIAL OFFICER</u> <u>PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002</u> | 189 |
| <u>CERTIFICATES OF PRINCIPAL EXECUTIVE OFFICER AND PRINCIPAL FINANCIAL OFFICER</u> <u>PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002</u> | 201 |

GLOSSARY OF TERMS AND ABBREVIATIONS

PPL Corporation and its current and former subsidiaries

Central Networks - collectively Central Networks East plc, Central Networks Limited and certain other related assets and liabilities. On April 1, 2011, PPL WEM Holdings plc (formerly WPD Investment Holdings Limited) purchased all of the outstanding ordinary share capital of these companies from E.ON AG subsidiaries. Central Networks West plc (subsequently renamed Western Power Distribution (West Midlands) plc), wholly owned by Central Networks Limited (subsequently renamed WPD Midlands Holdings Limited), and Central Networks East plc (subsequently renamed Western Power Distribution (East Midlands) plc) are British regional electricity distribution utility companies.

KU - Kentucky Utilities Company, a public utility subsidiary of LKE engaged in the regulated generation, transmission, distribution and sale of electricity, primarily in Kentucky. The subsidiary was acquired by PPL through the acquisition of LKE in November 2010.

LG&E - Louisville Gas and Electric Company, a public utility subsidiary of LKE engaged in the regulated generation, transmission, distribution and sale of electricity and the distribution and sale of natural gas in Kentucky. The subsidiary was acquired by PPL through the acquisition of LKE in November 2010.

LKE - LG&E and KU Energy LLC (formerly E.ON U.S. LLC), a subsidiary of PPL and the parent of LG&E, KU and other subsidiaries. PPL acquired E.ON U.S. LLC in November 2010 and changed the name to LG&E and KU Energy LLC. Within the context of this document, references to LKE also relate to the consolidated entity.

LKS - LG&E and KU Services Company (formerly E.ON U.S. Services Inc.), a subsidiary of LKE that provides services for LKE and its subsidiaries. The subsidiary was acquired by PPL through the acquisition of LKE in November 2010.

PPL - PPL Corporation, the parent holding company of PPL Electric, PPL Energy Funding, LKE and other subsidiaries.

PPL Brunner Island - PPL Brunner Island, LLC, a subsidiary of PPL Generation that owns generating operations in Pennsylvania.

PPL Capital Funding - PPL Capital Funding, Inc., a wholly owned financing subsidiary of PPL.

PPL Electric - PPL Electric Utilities Corporation, a public utility subsidiary of PPL that transmits and distributes electricity in its Pennsylvania service area and provides electric supply to retail customers in this area as a PLR.

PPL Energy Funding - PPL Energy Funding Corporation, a subsidiary of PPL and the parent holding company of PPL Energy Supply, PPL Global (effective January 2011) and other subsidiaries.

PPL EnergyPlus - PPL EnergyPlus, LLC, a subsidiary of PPL Energy Supply that markets and trades wholesale and retail electricity and gas, and supplies energy and energy services in competitive markets.

PPL Energy Supply - PPL Energy Supply, LLC, a subsidiary of PPL Energy Funding and the parent company of PPL Generation, PPL EnergyPlus and other subsidiaries. In January 2011, PPL Energy Supply distributed its membership interest in PPL Global, representing 100% of the outstanding membership interests of PPL Global, to PPL Energy Supply's parent, PPL Energy Funding.

PPL Generation - PPL Generation, LLC, a subsidiary of PPL Energy Supply that owns and operates U.S. generating facilities through various subsidiaries.

PPL Global - PPL Global, LLC, a subsidiary of PPL Energy Funding that primarily owns and operates a business in the U.K., WPD, that is focused on the regulated distribution of electricity. In January 2011, PPL Energy Supply, PPL Global's former parent, distributed its membership interest in PPL Global, representing 100% of the outstanding membership interest of PPL Global, to its parent, PPL Energy Funding.

PPL Martins Creek - PPL Martins Creek, LLC, a subsidiary of PPL Generation that owns generating operations in Pennsylvania.

PPL Montana - PPL Montana, LLC, an indirect subsidiary of PPL Generation that generates electricity for wholesale sales in Montana and the Pacific Northwest.

PPL Montour - PPL Montour, LLC, a subsidiary of PPL Generation that owns generating operations in Pennsylvania.

PPL Services - PPL Services Corporation, a subsidiary of PPL that provides services for PPL and its subsidiaries.

PPL Susquehanna - PPL Susquehanna, LLC, the nuclear generating subsidiary of PPL Generation.

PPL WEM - PPL WEM Holdings plc (formerly WPD Investment Holdings Limited), an indirect, wholly owned U.K. subsidiary of PPL Global. PPL WEM indirectly wholly owns both WPD (East Midlands) and WPD (West Midlands).

PPL WW - PPL WW Holdings Limited (formerly Western Power Distribution Holdings Limited), an indirect, wholly owned U.K. subsidiary of PPL Global. PPL WW Holdings indirectly wholly owns WPD (South Wales) and WPD (South West).

WPD - refers to PPL WW and PPL WEM and their subsidiaries.

WPD (East Midlands) - Western Power Distribution (East Midlands) plc, a British regional electricity distribution utility company. The company (formerly Central Networks East plc) was acquired and renamed in April 2011.

WPD Midlands - refers to Central Networks, which was renamed after the acquisition.

WPD (South Wales) - Western Power Distribution (South Wales) plc, a British regional electricity distribution utility company.

WPD (South West) - Western Power Distribution (South West) plc, a British regional electricity distribution utility company.

WPD (West Midlands) - Western Power Distribution (West Midlands) plc, a British regional electricity distribution utility company. The company (formerly Central Networks West plc) was acquired and renamed in April 2011.

WKE - Western Kentucky Energy Corp., a subsidiary of LKE that leased certain non-utility generating plants in western Kentucky until July 2009. The subsidiary was acquired by PPL through the acquisition of LKE in November 2010.

Other terms and abbreviations

£ - British pound sterling.

2010 Equity Unit(s) - a PPL equity unit, issued in June 2010, consisting of a 2010 Purchase Contract and, initially, a 5.0% undivided beneficial ownership interest in \$1,000 principal amount of PPL Capital Funding 4.625% Junior Subordinated Notes due 2018.

2010 Purchase Contract(s) - a contract that is a component of a 2010 Equity Unit that requires holders to purchase shares of PPL common stock on or prior to July 1, 2013.

2011 Bridge Facility - the £3.6 billion Senior Bridge Term Loan Credit Agreement between PPL Capital Funding and PPL WEM, as borrowers, and PPL, as guarantor, and lenders party thereto, used to fund the April 1, 2011 acquisition of Central Networks, as amended by Amendment No. 1 thereto dated April 15, 2011.

2011 Equity Unit(s) - a PPL equity unit, issued in April 2011, consisting of a 2011 Purchase Contract and, initially, a 5.0% undivided beneficial ownership interest in \$1,000 principal amount of PPL Capital Funding 4.32% Junior Subordinated Notes due 2019.

2011 Form 10-K - Annual Report to the SEC on Form 10-K for the year ended December 31, 2011.

2011 Purchase Contract(s) - a contract that is a component of a 2011 Equity Unit that requires holders to purchase shares of PPL common stock on or prior to May 1, 2014.

Act 129 - became effective in October 2008. The law amends the Pennsylvania Public Utility Code and creates an energy efficiency and conservation program and smart metering technology requirements, adopts new PLR electricity supply procurement rules, provides remedies for market misconduct and makes changes to the existing Alternative Energy Portfolio Standard.

AFUDC - Allowance for Funds Used During Construction, the cost of equity and debt funds used to finance construction projects of regulated businesses, which is capitalized as part of construction costs.

AOCI - accumulated other comprehensive income or loss.

ARO - asset retirement obligation.

Baseload generation - includes the output provided by PPL's nuclear, coal, hydroelectric and qualifying facilities.

Basis - when used in the context of derivatives and commodity trading, the commodity price differential between two locations, products or time periods.

Bcf - billion cubic feet.

Bluegrass CTs - three natural gas combustion turbines owned by Bluegrass Generation. In 2011, LG&E and KU entered into an asset purchase agreement with Bluegrass Generation for the purchase of these combustion turbines, subject to certain conditions including receipt of applicable regulatory approvals and clearances. In June 2012, LG&E and KU terminated the asset purchase agreement.

Bluegrass Generation - Bluegrass Generation Company, L.L.C., an exempt wholesale electricity generator in LaGrange, Kentucky.

BREC - Big Rivers Electric Corporation, a power-generating rural electric cooperative in western Kentucky.

CAIR - the EPA's Clean Air Interstate Rule.

Clean Air Act - federal legislation enacted to address certain environmental issues related to air emissions, including acid rain, ozone and toxic air emissions.

COLA - license application for a combined construction permit and operating license from the NRC for a nuclear plant.

CPCN - Certificate of Public Convenience and Necessity. Authority granted by the KPSC pursuant to Kentucky Revised Statute 278.020 to provide utility service to or for the public or the construction of any plant, equipment, property or facility for furnishing of utility service to the public.

CSAPR - Cross-State Air Pollution Rule, the CSAPR implements Clean Air Act requirements concerning the transport of air pollution from power plants across state boundaries. The CSAPR replaces the 2005 CAIR, which the U.S. Court of Appeals for the D.C. Circuit ordered the EPA to revise in 2008. The court has granted a stay allowing CAIR to remain in place pending a ruling on the legal challenges to the CSAPR. In August 2012, the court remanded CSAPR to the EPA for further action.

Customer Choice Act - the Pennsylvania Electricity Generation Customer Choice and Competition Act, legislation enacted to restructure the state's electric utility industry to create retail access to a competitive market for generation of electricity.

Depreciation not normalized - the flow-through income tax impact related to the state regulatory treatment of depreciation-related timing differences.

Dodd-Frank Act - the Dodd-Frank Wall Street Reform and Consumer Protection Act that was signed into law in July 2010.

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

DOE - Department of Energy, a U.S. government agency.

DPCR4 - Distribution Price Control Review 4, the U.K. 5-year rate review period applicable to WPD that commenced April 1, 2005.

DPCR5 - Distribution Price Control Review 5, the U.K. 5-year rate review period applicable to WPD that commenced April 1, 2010.

DRIP - Dividend Reinvestment and Direct Stock Purchase Plan.

iii

DSM - Demand Side Management. Pursuant to Kentucky Revised Statute 278.285, the KPSC may determine the reasonableness of DSM plans proposed by any utility under its jurisdiction. Proposed DSM mechanisms may seek full recovery of DSM programs and revenues lost by implementing those programs and/or incentives designed to provide financial rewards to the utility for implementing cost-effective DSM programs. The cost of such programs shall be assigned only to the class or classes of customers which benefit from the programs.

ECR - Environmental Cost Recovery. Pursuant to Kentucky Revised Statute 278.183, effective January 1993, Kentucky electric utilities are entitled to the current recovery of costs of complying with the Clean Air Act, as amended, and those federal, state or local environmental requirements which apply to coal combustion and by-products from the production of energy from coal.

E.ON AG - a German corporation and the parent of E.ON UK plc, the former parent of Central Networks, and the indirect parent of E.ON US Investments Corp., the former parent of LKE.

EPA - Environmental Protection Agency, a U.S. government agency.

EPS - earnings per share.

Equity Units - refers collectively to the 2011 and 2010 Equity Units.

ESOP - Employee Stock Ownership Plan.

Euro - the basic monetary unit among participating members of the European Union.

E.W. Brown - a generating station in Kentucky with capacity of 1,631 MW.

FERC - Federal Energy Regulatory Commission, the federal agency that regulates, among other things, interstate transmission and wholesale sales of electricity, hydroelectric power projects and related matters.

Fitch - Fitch, Inc., a credit rating agency.

FTRs - financial transmission rights, which are financial instruments established to manage price risk related to electricity transmission congestion. They entitle the holder to receive compensation or require the holder to remit payment for certain congestion-related transmission charges based on the level of congestion in the transmission grid.

Fundamental Change - as it relates to the terms of the 2011 and 2010 Equity Units, will be deemed to have occurred if any of the following occurs with respect to PPL, subject to certain exceptions: (i) a change of control; (ii) a consolidation with or merger into any other entity; (iii) common stock ceases to be listed or quoted; or (iv) a liquidation, dissolution or termination.

GAAP - Generally Accepted Accounting Principles in the U.S.

GBP - British pound sterling.

GHG - greenhouse gas(es).

GWh - gigawatt-hour, one million kilowatt-hours.

Intermediate and peaking generation - includes the output provided by PPL's oil- and natural gas-fired units.

Ironwood Acquisition - In April 2012, PPL Ironwood Holdings, LLC, an indirect, wholly owned subsidiary of PPL Energy Supply, completed the acquisition from a subsidiary of The AES Corporation of all of the equity interests of AES Ironwood, L.L.C. (subsequently renamed PPL Ironwood, LLC) and AES Prescott, L.L.C. (subsequently renamed PPL Prescott, LLC), which own and operate, respectively, the Ironwood Facility.

Ironwood Facility - a natural gas-fired power plant in Lebanon, Pennsylvania with a summer rating of 657 MW.

IRS - Internal Revenue Service, a U.S. government agency.

ISO - Independent System Operator.

KPSC - Kentucky Public Service Commission, the state agency that has jurisdiction over the regulation of rates and service of utilities in Kentucky.

kV - kilovolt

LIBOR - London Interbank Offered Rate.

Long Island generation business - includes a 79.9 MW gas-fired plant in the Edgewood section of Brentwood, New York and a 79.9 MW oil-fired plant in Shoreham, New York and related tolling agreements. This business was sold in February 2010.

Moody's - Moody's Investors Service, Inc., a credit rating agency.

MW - megawatt, one thousand kilowatts.

NDT - PPL Susquehanna's nuclear plant decommissioning trust.

NERC - North American Electric Reliability Corporation.

NGCC - natural gas-fired combined-cycle turbine.

NPDES - National Pollutant Discharge Elimination System.

NPNS - the normal purchases and normal sales exception as permitted by derivative accounting rules. Derivatives that qualify for this exception receive accrual accounting treatment.

NRC - Nuclear Regulatory Commission, the federal agency that regulates nuclear power facilities.

OCI - other comprehensive income or loss.

Ofgem - Office of Gas and Electricity Markets, the British agency that regulates transmission, distribution and wholesale sales of electricity and related matters.

Opacity - the degree to which emissions reduce the transmission of light and obscure the view of an object in the background. There are emission regulations that limit the opacity in power plant stack gas emissions.

OVEC - Ohio Valley Electric Corporation, located in Piketon, Ohio, an entity in which LKE indirectly owns an 8.13% interest (consists of LG&E's 5.63% and KU's 2.50% interests), which is accounted for as a cost-method investment. OVEC owns and operates two coal-fired power plants, the Kyger Creek plant in Ohio and the Clifty Creek plant in Indiana, with combined nameplate capacities of 2,390 MW.

PADEP - the Pennsylvania Department of Environmental Protection, a state government agency.

PJM - PJM Interconnection, L.L.C., operator of the electric transmission network and electric energy market in all or parts of Delaware, Illinois, Indiana, Kentucky, Maryland, Michigan, New Jersey, North Carolina, Ohio, Pennsylvania, Tennessee, Virginia, West Virginia and the District of Columbia.

PLR - Provider of Last Resort, the role of PPL Electric in providing default electricity supply to retail customers within its delivery area who have not chosen to select an alternative electricity supplier under the Customer Choice

Act.

PP&E - property, plant and equipment.

Predecessor - refers to the LKE, LG&E and KU pre-acquisition activity covering the time period prior to November 1, 2010.

PUC - Pennsylvania Public Utility Commission, the state agency that regulates certain ratemaking, services, accounting and operations of Pennsylvania utilities.

Purchase Contract(s) - refers collectively to the 2010 and 2011 Purchase Contracts.

RAV - regulatory asset value. This term is also commonly known as RAB or regulatory asset base.

v

RECs - renewable energy credits.

Registrants - PPL, PPL Energy Supply, PPL Electric, LKE, LG&E and KU, collectively.

Regulation S-X - SEC regulation governing the form and content of and requirements for financial statements required to be filed pursuant to the federal securities laws.

RFC - Reliability First Corporation, one of eight regional entities with delegated authority from NERC that work to safeguard the reliability of the bulk power systems throughout North America.

Rev. Proc(s) - Revenue Procedure(s), an official published statement by the IRS of a matter of procedural importance to both taxpayers and the IRS concerning administration of the tax laws.

RMC - Risk Management Committee.

S&P - Standard & Poor's Ratings Services, a credit rating agency.

Sarbanes-Oxley - Sarbanes-Oxley Act of 2002, which sets requirements for management's assessment of internal controls for financial reporting. It also requires an independent auditor to make its own assessment.

SCR - selective catalytic reduction, a pollution control process for the removal of nitrogen oxide from exhaust gases.

Scrubber - an air pollution control device that can remove particulates and/or gases (such as sulfur dioxide) from exhaust gases.

SEC - the U.S. Securities and Exchange Commission, a U.S. government agency whose primary mission is to protect investors and maintain the integrity of the securities markets.

Securities Act of 1933 - the Securities Act of 1933, 15 U.S. Code, Sections 77a-77aa, as amended.

SERC - SERC Reliability Corporation, one of eight regional entities with delegated authority from NERC that work to safeguard the reliability of the bulk power systems throughout North America.

SIFMA Index - the Securities Industry and Financial Markets Association Municipal Swap Index.

Smart meter - an electric meter that utilizes smart metering technology.

Smart metering technology - technology that can measure, among other things, time of electricity consumption to permit offering rate incentives for usage during lower cost or demand intervals. The use of this technology also strengthens network reliability.

SMGT - Southern Montana Electric Generation & Transmission Cooperative, Inc., a Montana cooperative and purchaser of electricity under a long-term supply contract with PPL EnergyPlus that was terminated effective April 1, 2012.

SNCR - selective non-catalytic reduction, a pollution control process for the removal of nitrogen oxide from exhaust gases using ammonia.

Successor - refers to the LKE, LG&E and KU post-acquisition activity covering the time period after October 31, 2010.

Superfund - federal environmental legislation that addresses remediation of contaminated sites; states also have similar statutes.

TC2 - Trimble County Unit 2, a coal-fired plant located in Kentucky with a net summer capacity of 732 MW. LKE indirectly owns a 75% interest (consists of LG&E's 14.25% and KU's 60.75% interests) in TC2 or 549 MW of the capacity.

Tolling agreement - agreement whereby the owner of an electric generating facility agrees to use that facility to convert fuel provided by a third party into electricity for delivery back to the third party.

TRA - Tennessee Regulatory Authority, the state agency that has jurisdiction over the regulation of rates and service of utilities in Tennessee.

Utilization Factor - a measure reflecting the percentage of electricity actually generated by plants compared with the electricity the plants could produce at full capacity when available.

VaR - value-at-risk, a statistical model that attempts to estimate the value of potential loss over a given holding period under normal market conditions at a given confidence level.

VIE - variable interest entity.

Volumetric risk - the risk that the actual load volumes provided under full-requirement sales contracts could vary significantly from forecasted volumes.

VSCC - Virginia State Corporation Commission, the state agency that has jurisdiction over the regulation of Virginia corporations, including utilities.

VWAP - as it relates to the 2011 and 2010 Equity Units issued by PPL, the per share volume-weighted-average price as displayed under the heading Bloomberg VWAP on Bloomberg page "PPL <EQUITY> AQR" (or its equivalent successor if such page is not available) in respect of the period from the scheduled open of trading on the relevant trading day until the scheduled close of trading on the relevant trading day (or if such volume-weighted-average price is unavailable, the market price of one share of PPL common stock on such trading day determined, using a volume-weighted-average method, by a nationally recognized independent investment banking firm retained for this purpose by PPL).

(THIS PAGE LEFT BLANK INTENTIONALLY.)

FORWARD-LOOKING INFORMATION

Statements contained in this Form 10-Q concerning expectations, beliefs, plans, objectives, goals, strategies, future events or performance and underlying assumptions and other statements which are other than statements of historical fact are "forward-looking statements" within the meaning of the federal securities laws. Although the Registrants believe that the expectations and assumptions reflected in these statements are reasonable, there can be no assurance that these expectations will prove to be correct. Forward-looking statements are subject to many risks and uncertainties, and actual results may differ materially from the results discussed in forward-looking statements. In addition to the specific factors discussed in each Registrant's 2011 Form 10-K and in "Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations" in this Form 10-Q report, the following are among the important factors that could cause actual results to differ materially from the forward-looking statements.

- fuel supply cost and availability;
- continuing ability to recover fuel costs and environmental expenditures in a timely manner at LG&E and KU, and natural gas supply costs at LG&E;
- weather conditions affecting generation, customer energy use and operating costs;
- operation, availability and operating costs of existing generation facilities;
- the length and cost of scheduled and unscheduled outages at our generating facilities;
- transmission and distribution system conditions and operating costs;
- expansion of alternative sources of electricity generation;
- collective labor bargaining negotiations;
- the outcome of litigation against the Registrants and their subsidiaries;
- potential effects of threatened or actual terrorism, war or other hostilities, cyber-based intrusions or natural disasters;
- the commitments and liabilities of the Registrants and their subsidiaries;
- market demand and prices for energy, capacity, transmission services, emission allowances, RECs and delivered fuel;
- competition in retail and wholesale power and natural gas markets;
- liquidity of wholesale power markets;
- defaults by counterparties under energy, fuel or other power product contracts;
- market prices of commodity inputs for ongoing capital expenditures;
- capital market conditions, including the availability of capital or credit, changes in interest rates and certain economic indices, and decisions regarding capital structure;
- stock price performance of PPL;
- volatility in the fair value of debt and equity securities and its impact on the value of assets in the NDT funds and in defined benefit plans, and the potential cash funding requirements if fair value declines;
- interest rates and their effect on pension, retiree medical, and nuclear decommissioning liabilities, and interest payable on certain debt securities;
- volatility in or the impact of other changes in financial or commodity markets and economic conditions;
- new accounting requirements or new interpretations or applications of existing requirements;
- changes in securities and credit ratings;
- foreign currency exchange rates;
- current and future environmental conditions, regulations and other requirements and the related costs of compliance, including environmental capital expenditures, emission allowance costs and other expenses;
- legal, regulatory, political, market or other reactions to the 2011 incident at the nuclear generating facility at Fukushima, Japan, including additional NRC requirements;
- political, regulatory or economic conditions in states, regions or countries where the Registrants or their subsidiaries conduct business;
- receipt of necessary governmental permits, approvals and rate relief;

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

- new state, federal or foreign legislation or regulatory developments;
- the outcome of any rate cases or other cost recovery filings by PPL Electric at the PUC or the FERC, by LG&E at the KPSC or the FERC, by KU at the KPSC, VSCC, TRA or the FERC, or by WPD at Ofgem in the U.K.;
- the impact of any state, federal or foreign investigations applicable to the Registrants and their subsidiaries and the energy industry;
- the effect of any business or industry restructuring;
- development of new projects, markets and technologies;
- performance of new ventures; and
- business dispositions or acquisitions and our ability to successfully operate such acquired businesses and realize expected benefits from business acquisitions, including PPL's 2011 acquisition of WPD Midlands and 2010 acquisition of LKE.

Any such forward-looking statements should be considered in light of such important factors and in conjunction with other documents of the Registrants on file with the SEC.

New factors that could cause actual results to differ materially from those described in forward-looking statements emerge from time to time, and it is not possible for the Registrants to predict all such factors, or the extent to which any such factor or combination of factors may cause actual results to differ from those contained in any forward-looking statement. Any forward-looking statement speaks only as of the date on which such statement is made, and the Registrants undertake no obligation to update the information contained in such statement to reflect subsequent developments or information.

PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

PPL Corporation and Subsidiaries

(Unaudited)

(Millions of Dollars, except share data)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|--------------|------------------------------------|--------------|
| | 2012 | 2011 | 2012 | 2011 |
| Operating Revenues | | | | |
| Utility | \$ 1,693 | \$ 1,675 | \$ 5,012 | \$ 4,695 |
| Unregulated retail electric and gas | 218 | 189 | 620 | 517 |
| Wholesale energy marketing | | | | |
| Realized | 1,076 | 907 | 3,367 | 2,677 |
| Unrealized economic activity (Note 14) | (716) | 216 | (322) | 229 |
| Net energy trading margins | (11) | (7) | 7 | 14 |
| Energy-related businesses | 143 | 140 | 380 | 387 |
| Total Operating Revenues | 2,403 | 3,120 | 9,064 | 8,519 |
| Operating Expenses | | | | |
| Operation | | | | |
| Fuel | 570 | 603 | 1,405 | 1,492 |
| Energy purchases | | | | |
| Realized | 583 | 362 | 2,253 | 1,467 |
| Unrealized economic activity (Note 14) | (569) | 176 | (420) | 49 |
| Other operation and maintenance | 650 | 735 | 2,095 | 2,041 |
| Depreciation | 278 | 252 | 813 | 697 |
| Taxes, other than income | 90 | 90 | 268 | 238 |
| Energy-related businesses | 137 | 135 | 363 | 368 |
| Total Operating Expenses | 1,739 | 2,353 | 6,777 | 6,352 |
| Operating Income | 664 | 767 | 2,287 | 2,167 |
| Other Income (Expense) - net | (44) | 37 | (31) | (2) |
| Other-Than-Temporary Impairments | | 5 | 1 | 6 |
| Interest Expense | 248 | 240 | 714 | 678 |
| Income from Continuing Operations Before Income Taxes | 372 | 559 | 1,541 | 1,481 |
| Income Taxes | 17 | 110 | 364 | 429 |
| | 355 | 449 | 1,177 | 1,052 |

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

Income from Continuing Operations After Income Taxes

| | | | | |
|--|--------|--------|----------|----------|
| Income (Loss) from Discontinued Operations (net of income taxes) | | | (6) | 2 |
| Net Income | 355 | 449 | 1,171 | 1,054 |
| Net Income Attributable to Noncontrolling Interests | | 5 | 4 | 13 |
| Net Income Attributable to PPL Shareowners | \$ 355 | \$ 444 | \$ 1,167 | \$ 1,041 |

Amounts Attributable to PPL Shareowners:

| | | | | |
|--|--------|--------|----------|----------|
| Income from Continuing Operations After Income Taxes | \$ 355 | \$ 444 | \$ 1,173 | \$ 1,039 |
| Income (Loss) from Discontinued Operations (net of income taxes) | | | (6) | 2 |
| Net Income | \$ 355 | \$ 444 | \$ 1,167 | \$ 1,041 |

Earnings Per Share of Common Stock:

| | | | | |
|---|---------|---------|---------|---------|
| Income from Continuing Operations After Income Taxes Available to PPL | | | | |
| Common Shareowners: | | | | |
| Basic | \$ 0.61 | \$ 0.76 | \$ 2.01 | \$ 1.91 |
| Diluted | \$ 0.61 | \$ 0.76 | \$ 2.01 | \$ 1.91 |
| Net Income Available to PPL Common Shareowners: | | | | |
| Basic | \$ 0.61 | \$ 0.76 | \$ 2.00 | \$ 1.92 |
| Diluted | \$ 0.61 | \$ 0.76 | \$ 2.00 | \$ 1.91 |
| Dividends Declared Per Share of Common Stock | \$ 0.36 | \$ 0.35 | \$ 1.08 | \$ 1.05 |

Weighted-Average Shares of Common Stock

| | | | | |
|----------------------------|---------|---------|---------|---------|
| Outstanding (in thousands) | | | | |
| Basic | 580,585 | 577,595 | 579,847 | 541,135 |
| Diluted | 582,636 | 578,054 | 580,930 | 541,480 |

The accompanying Notes to Condensed Financial Statements are an integral part of the financial statements.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

PPL Corporation and Subsidiaries

(Unaudited)

(Millions of Dollars)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|--------|------------------------------------|----------|
| | 2012 | 2011 | 2012 | 2011 |
| Net income | \$ 355 | \$ 449 | \$ 1,171 | \$ 1,054 |
| Other comprehensive income (loss): | | | | |
| Amounts arising during the period - gains (losses), net of tax (expense) | | | | |
| benefit: | | | | |
| Foreign currency translation adjustments, net of tax of \$1, (\$2), \$1, (\$1) | 152 | (4) | 49 | 156 |
| Available-for-sale securities, net of tax of (\$14), \$28, (\$34), \$15 | 13 | (26) | 28 | (13) |
| Qualifying derivatives, net of tax of \$14, (\$19), (\$41), (\$30) | (41) | 41 | 27 | 48 |
| Equity investees' other comprehensive income (loss), net of tax of \$0, \$0, \$2, \$0 | | | (3) | (1) |
| Defined benefit plans: | | | | |
| Net actuarial gain (loss), net of tax of \$0, \$0, \$28, \$0 | | 1 | (85) | 1 |
| Reclassifications to net income - (gains) losses, net of tax expense | | | | |
| (benefit): | | | | |
| Available-for-sale securities, net of tax of \$0, \$0, \$3, \$5 | | 2 | (4) | (6) |
| Qualifying derivatives, net of tax of \$51, \$57, \$222, \$163 | (61) | (94) | (323) | (252) |
| Equity investees' other comprehensive (income) loss, net of tax of \$0, \$0, \$0, \$0 | | | | 3 |
| Defined benefit plans: | | | | |
| Prior service costs, net of tax of (\$1), (\$2), (\$4), (\$5) | 1 | 2 | 6 | 7 |
| Net actuarial loss, net of tax of (\$6), (\$4), (\$17), (\$14) | 17 | 13 | 54 | 36 |
| Total other comprehensive income (loss) attributable to PPL | | | | |
| Shareowners | 81 | (65) | (251) | (21) |
| Comprehensive income (loss) | 436 | 384 | 920 | 1,033 |
| Comprehensive income attributable to noncontrolling interests | | 5 | 4 | 13 |

| | | | | | | | | |
|---|----|-----|----|-----|----|-----|----|-------|
| Comprehensive income (loss) attributable to PPL Shareowners | \$ | 436 | \$ | 379 | \$ | 916 | \$ | 1,020 |
|---|----|-----|----|-----|----|-----|----|-------|

The accompanying Notes to Condensed Financial Statements are an integral part of the financial statements.

4

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

PPL Corporation and Subsidiaries

(Unaudited)

(Millions of Dollars)

| | Nine Months Ended September 30, | |
|--|---------------------------------|----------|
| | 2012 | 2011 |
| Cash Flows from Operating Activities | | |
| Net income | \$ 1,171 | \$ 1,054 |
| Adjustments to reconcile net income to net cash provided by operating activities | | |
| Depreciation | 813 | 697 |
| Amortization | 144 | 180 |
| Defined benefit plans - expense | 123 | 165 |
| Deferred income taxes and investment tax credits | 298 | 403 |
| Unrealized (gains) losses on derivatives, and other hedging activities | 21 | (190) |
| Other | 34 | 110 |
| Change in current assets and current liabilities | | |
| Accounts receivable | 19 | (134) |
| Accounts payable | (175) | (164) |
| Unbilled revenues | 121 | 236 |
| Prepayments | (11) | 286 |
| Counterparty collateral | 13 | (273) |
| Taxes | 29 | (64) |
| Accrued interest | 43 | 111 |
| Other | 15 | 87 |
| Other operating activities | | |
| Defined benefit plans - funding | (526) | (565) |
| Other assets | 1 | (22) |
| Other liabilities | (39) | (71) |
| Net cash provided by operating activities | 2,094 | 1,846 |
| Cash Flows from Investing Activities | | |
| Expenditures for property, plant and equipment | (2,078) | (1,685) |
| Proceeds from the sale of certain non-core generation facilities | | 381 |
| Ironwood Acquisition, net of cash acquired | (84) | |
| Acquisition of WPD Midlands | | (5,763) |
| Purchases of nuclear plant decommissioning trust investments | (112) | (144) |
| Proceeds from the sale of nuclear plant decommissioning trust investments | 102 | 134 |
| Proceeds from the sale of other investments | 20 | 163 |
| Net (increase) decrease in restricted cash and cash equivalents | 62 | (51) |
| Other investing activities | (26) | (74) |
| Net cash provided by (used in) investing activities | (2,116) | (7,039) |
| Cash Flows from Financing Activities | | |
| Issuance of long-term debt | 824 | 5,245 |
| Retirement of long-term debt | (105) | (708) |
| Issuance of common stock | 54 | 2,281 |

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| | | |
|--|--------|----------|
| Payment of common stock dividends | (623) | (543) |
| Redemption of preference stock of a subsidiary | (250) | |
| Debt issuance and credit facility costs | (10) | (84) |
| Contract adjustment payments | (71) | (49) |
| Net increase (decrease) in short-term debt | (51) | (322) |
| Other financing activities | (8) | (16) |
| Net cash provided by (used in) financing activities | (240) | 5,804 |
| Effect of Exchange Rates on Cash and Cash Equivalents | 6 | (25) |
| Net Increase (Decrease) in Cash and Cash Equivalents | (256) | 586 |
| Cash and Cash Equivalents at Beginning of Period | 1,202 | 925 |
| Cash and Cash Equivalents at End of Period | \$ 946 | \$ 1,511 |

The accompanying Notes to Condensed Financial Statements are an integral part of the financial statements.

CONDENSED CONSOLIDATED BALANCE SHEETS

PPL Corporation and Subsidiaries

(Unaudited)

(Millions of Dollars, shares in thousands)

| | September 30, 2012 | December 31, 2011 |
|--|-----------------------|----------------------|
| Assets | | |
| Current Assets | | |
| Cash and cash equivalents | \$ 946 | \$ 1,202 |
| Short-term investments | | 16 |
| Restricted cash and cash equivalents | 88 | 152 |
| Accounts receivable (less reserve: 2012, \$63; 2011, \$54) | | |
| Customer | 763 | 736 |
| Other | 51 | 91 |
| Unbilled revenues | 711 | 830 |
| Fuel, materials and supplies | 663 | 654 |
| Prepayments | 167 | 160 |
| Price risk management assets | 1,768 | 2,548 |
| Regulatory assets | 21 | 9 |
| Other current assets | 49 | 28 |
| Total Current Assets | 5,227 | 6,426 |
| Investments | | |
| Nuclear plant decommissioning trust funds | 711 | 640 |
| Other investments | 67 | 78 |
| Total Investments | 778 | 718 |
| Property, Plant and Equipment | | |
| Regulated utility plant | 24,415 | 22,994 |
| Less: accumulated depreciation - regulated utility plant | 4,011 | 3,534 |
| Regulated utility plant, net | 20,404 | 19,460 |
| Non-regulated property, plant and equipment | | |
| Generation | 11,190 | 10,514 |
| Nuclear fuel | 524 | 457 |
| Other | 698 | 637 |
| Less: accumulated depreciation - non-regulated property, plant and equipment | 5,875 | 5,676 |
| Non-regulated property, plant and equipment, net | 6,537 | 5,932 |
| Construction work in progress | 2,106 | 1,874 |
| Property, Plant and Equipment, net (a) | 29,047 | 27,266 |
| Other Noncurrent Assets | | |
| Regulatory assets | 1,323 | 1,349 |
| Goodwill | 4,130 | 4,114 |
| Other intangibles (a) | 913 | 1,065 |
| Price risk management assets | 860 | 920 |
| Other noncurrent assets | 962 | 790 |
| Total Other Noncurrent Assets | 8,188 | 8,238 |

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| | | | | |
|--------------|----|--------|----|--------|
| Total Assets | \$ | 43,240 | \$ | 42,648 |
|--------------|----|--------|----|--------|

(a) At September 30, 2012 and December 31, 2011, includes \$428 million and \$416 million of PP&E, consisting primarily of "Generation," including leasehold improvements, and \$10 million and \$11 million of "Other intangibles" from the consolidation of a VIE that is the owner/lessor of the Lower Mt. Bethel plant.

The accompanying Notes to Condensed Financial Statements are an integral part of the financial statements.

CONDENSED CONSOLIDATED BALANCE SHEETS

PPL Corporation and Subsidiaries

(Unaudited)

(Millions of Dollars, shares in thousands)

| | September 30, 2012 | December 31, 2011 |
|---|-----------------------|----------------------|
| Liabilities and Equity | | |
| Current Liabilities | | |
| Short-term debt | \$ 526 | \$ 578 |
| Long-term debt due within one year | 313 | |
| Accounts payable | 1,071 | 1,214 |
| Taxes | 95 | 65 |
| Interest | 335 | 287 |
| Dividends | 210 | 207 |
| Price risk management liabilities | 1,184 | 1,570 |
| Regulatory liabilities | 65 | 73 |
| Other current liabilities | 1,088 | 1,261 |
| Total Current Liabilities | 4,887 | 5,255 |
| Long-term Debt | 18,711 | 17,993 |
| Deferred Credits and Other Noncurrent Liabilities | | |
| Deferred income taxes | 3,705 | 3,326 |
| Investment tax credits | 315 | 285 |
| Price risk management liabilities | 884 | 840 |
| Accrued pension obligations | 1,086 | 1,313 |
| Asset retirement obligations | 500 | 484 |
| Regulatory liabilities | 999 | 1,010 |
| Other deferred credits and noncurrent liabilities | 921 | 1,046 |
| Total Deferred Credits and Other Noncurrent Liabilities | 8,410 | 8,304 |
| Commitments and Contingent Liabilities (Notes 6 and 10) | | |
| Equity | | |
| PPL Shareowners' Common Equity | | |
| Common stock - \$0.01 par value (a) | 6 | 6 |
| Additional paid-in capital | 6,912 | 6,813 |
| Earnings reinvested | 5,335 | 4,797 |
| Accumulated other comprehensive loss | (1,039) | (788) |
| Total PPL Shareowners' Common Equity | 11,214 | 10,828 |
| Noncontrolling Interests | 18 | 268 |
| Total Equity | 11,232 | 11,096 |
| Total Liabilities and Equity | \$ 43,240 | \$ 42,648 |

(a) 780,000 shares authorized; 580,970 and 578,405 shares issued and outstanding at September 30, 2012 and December 31, 2011.

The accompanying Notes to Condensed Financial Statements are an integral part of the financial statements.

CONDENSED CONSOLIDATED STATEMENTS OF EQUITY

PPL Corporation and Subsidiaries

(Unaudited)

(Millions of Dollars)

| | PPL Shareowners | | | | | | | Total |
|--|---|-----------------|----------------------------------|------------------------|---|----------------------------------|-----------|-------|
| | Common stock shares outstanding (a) | Common stock | Additional paid-in capital | Earnings reinvested | Accumulated other comprehensive loss | Non- controlling interests | | |
| June 30, 2012 | 580,213 | \$ 6 | \$ 6,886 | \$ 5,190 | \$ (1,120) | \$ 18 | \$ 10,980 | |
| Common stock issued (b) | 757 | | 21 | | | | 21 | |
| Stock-based compensation (c) | | | 5 | | | | 5 | |
| Net income | | | | 355 | | | 355 | |
| Dividends, dividend equivalents, redemptions and distributions (e) | | | | (210) | | | (210) | |
| Other comprehensive income (loss) | | | | | 81 | | 81 | |
| September 30, 2012 | 580,970 | \$ 6 | \$ 6,912 | \$ 5,335 | \$ (1,039) | \$ 18 | \$ 11,232 | |
| December 31, 2011 | 578,405 | \$ 6 | \$ 6,813 | \$ 4,797 | \$ (788) | \$ 268 | \$ 11,096 | |
| Common stock issued (b) | 2,565 | | 71 | | | | 71 | |
| Stock-based compensation (c) | | | 28 | | | | 28 | |
| Net income | | | | 1,167 | | 4 | 1,171 | |
| Dividends, dividend equivalents, redemptions and distributions (e) | | | | (629) | | (254) | (883) | |

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| | | | | | | | | | | |
|---|---------|----|---|----|-------|-------|-------|------------|--------|-----------|
| Other comprehensive income (loss) | | | | | | (251) | | (251) | | |
| September 30, 2012 | 580,970 | \$ | 6 | \$ | 6,912 | \$ | 5,335 | \$ (1,039) | \$ 18 | \$ 11,232 |
| June 30, 2011 | 577,265 | \$ | 6 | \$ | 6,774 | \$ | 4,306 | \$ (435) | \$ 268 | \$ 10,919 |
| Common stock issued (b) | 579 | | | | 16 | | | | | 16 |
| Stock-based compensation (c) | | | | | 5 | | | | | 5 |
| Net income | | | | | | | 444 | | 5 | 449 |
| Dividends, dividend equivalents and distributions (e) | | | | | | | (203) | | (5) | (208) |
| Other comprehensive income (loss) | | | | | | | | (65) | | (65) |
| September 30, 2011 | 577,844 | \$ | 6 | \$ | 6,795 | \$ | 4,547 | \$ (500) | \$ 268 | \$ 11,116 |
| December 31, 2010 | 483,391 | \$ | 5 | \$ | 4,602 | \$ | 4,082 | \$ (479) | \$ 268 | \$ 8,478 |
| Common stock issued (b) | 94,453 | | 1 | | 2,328 | | | | | 2,329 |
| Purchase Contracts (d) | | | | | (141) | | | | | (141) |
| Stock-based compensation (c) | | | | | 6 | | | | | 6 |
| Net income | | | | | | | 1,041 | | 13 | 1,054 |
| Dividends, dividend equivalents and distributions (e) | | | | | | | (576) | | (13) | (589) |
| Other comprehensive income (loss) | | | | | | | | (21) | | (21) |
| September 30, 2011 | 577,844 | \$ | 6 | \$ | 6,795 | \$ | 4,547 | \$ (500) | \$ 268 | \$ 11,116 |

- (a) Shares in thousands. Each share entitles the holder to one vote on any question presented at any shareholders' meeting.
- (b) Each period includes shares of common stock issued through various stock and incentive compensation plans. The nine months ended September 30, 2011 includes the April issuance of 92 million shares of common stock.
- (c) The three and nine months ended September 30, 2012 include \$7 million and \$42 million and the three and nine months ended September 30, 2011 include \$5 million and \$27 million of stock-based compensation expense related to new and existing unvested equity awards. The three and nine months ended September 30, 2012 include \$(2) million and \$(14) million and the nine months ended September 30, 2011 includes \$(21) million related primarily to the reclassification from "Stock-based compensation" to "Common stock issued" for the issuance of common stock after applicable equity award vesting periods and tax adjustments related to stock-based compensation.
- (d) The nine months ended September 30, 2011 include \$123 million for the 2011 Purchase Contracts and \$18 million of related fees and expenses, net of tax.
- (e) "Earnings reinvested" includes dividends and dividend equivalents on PPL Corporation common stock and restricted stock units. "Noncontrolling interests" includes dividends, redemptions and distributions to noncontrolling interests. In June 2012, PPL Electric redeemed all of its outstanding preference stock at par value, \$250 million in the aggregate. See Note 7 for additional information.

The accompanying Notes to Condensed Financial Statements are an integral part of the financial statements.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

PPL Energy Supply, LLC and Subsidiaries

(Unaudited)

(Millions of Dollars)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|--------|------------------------------------|----------|
| | 2012 | 2011 | 2012 | 2011 |
| Operating Revenues | | | | |
| Wholesale energy marketing | | | | |
| Realized | \$ 1,076 | \$ 907 | \$ 3,367 | \$ 2,677 |
| Unrealized economic activity (Note 14) | (716) | 216 | (322) | 229 |
| Wholesale energy marketing to affiliate | 23 | 5 | 61 | 15 |
| Unregulated retail electric and gas | 219 | 190 | 623 | 518 |
| Net energy trading margins | (11) | (7) | 7 | 14 |
| Energy-related businesses | 128 | 130 | 336 | 354 |
| Total Operating Revenues | 719 | 1,441 | 4,072 | 3,807 |
| Operating Expenses | | | | |
| Operation | | | | |
| Fuel | 321 | 358 | 728 | 826 |
| Energy purchases | | | | |
| Realized | 421 | 161 | 1,715 | 701 |
| Unrealized economic activity (Note 14) | (569) | 176 | (420) | 49 |
| Energy purchases from affiliate | 1 | 1 | 2 | 3 |
| Other operation and maintenance | 220 | 208 | 769 | 741 |
| Depreciation | 73 | 62 | 206 | 181 |
| Taxes, other than income | 18 | 18 | 53 | 50 |
| Energy-related businesses | 125 | 130 | 326 | 350 |
| Total Operating Expenses | 610 | 1,114 | 3,379 | 2,901 |
| Operating Income | 109 | 327 | 693 | 906 |
| Other Income (Expense) - net | 4 | 2 | 14 | 20 |
| Other-Than-Temporary Impairments | | 5 | 1 | 6 |
| Interest Income from Affiliates | 1 | 2 | 2 | 6 |
| Interest Expense | 43 | 52 | 123 | 150 |
| Income from Continuing Operations Before Income Taxes | 71 | 274 | 585 | 776 |
| Income Taxes | 16 | 104 | 202 | 305 |
| Income from Continuing Operations After Income Taxes | 55 | 170 | 383 | 471 |

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| | | | | | |
|--|-------|--------|--------|--------|---|
| Income (Loss) from Discontinued Operations (net of income taxes) | | | | | 2 |
| Net Income | 55 | 170 | 383 | 473 | |
| Net Income Attributable to Noncontrolling Interests | 1 | 1 | 1 | 1 | |
| Net Income Attributable to PPL Energy Supply Member | \$ 54 | \$ 169 | \$ 382 | \$ 472 | |
| Amounts Attributable to PPL Energy Supply Member: | | | | | |
| Income from Continuing Operations After Income Taxes | \$ 54 | \$ 169 | \$ 382 | \$ 470 | |
| Income (Loss) from Discontinued Operations (net of income taxes) | | | | | 2 |
| Net Income | \$ 54 | \$ 169 | \$ 382 | \$ 472 | |

The accompanying Notes to Condensed Financial Statements are an integral part of the financial statements.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

PPL Energy Supply, LLC and Subsidiaries

(Unaudited)

(Millions of Dollars)

| | Three Months Ended | | Nine Months Ended | |
|---|--------------------|--------|-------------------|--------|
| | September 30, | | September 30, | |
| | 2012 | 2011 | 2012 | 2011 |
| Net income | \$ 55 | \$ 170 | \$ 383 | \$ 473 |
| Other comprehensive income (loss): | | | | |
| Amounts arising during the period - gains (losses), net of tax (expense) benefit: | | | | |
| Available-for-sale securities, net of tax of (\$14), \$28, (\$34), \$15 | 13 | (26) | 28 | (13) |
| Qualifying derivatives, net of tax of (\$1), (\$27), (\$53), (\$48) | (1) | 39 | 46 | 68 |
| Defined benefit plans: | | | | |
| Net actuarial gain (loss), net of tax of \$0, \$0, \$0, \$0 | | 1 | | 1 |
| Reclassifications to net income - (gains) losses, net of tax expense (benefit): | | | | |
| Available-for-sale securities, net of tax of \$0, \$0, \$3, \$5 | | 2 | (4) | (6) |
| Qualifying derivatives, net of tax of \$62, \$50, \$230, \$153 | (92) | (73) | (339) | (220) |
| Equity investee's other comprehensive (income) loss, net of tax of \$0, \$0, \$0, \$0 | | | | 3 |
| Defined benefit plans: | | | | |
| Prior service costs, net of tax of (\$1), (\$1), (\$2), (\$3) | 1 | 1 | 4 | 3 |
| Net actuarial loss, net of tax of (\$1), (\$1), (\$1), (\$2) | 2 | 1 | 8 | 3 |
| Total other comprehensive income (loss) attributable to PPL Energy Supply Member | (77) | (55) | (257) | (161) |
| Comprehensive income (loss) | (22) | 115 | 126 | 312 |
| Comprehensive income attributable to noncontrolling interests | 1 | 1 | 1 | 1 |
| Comprehensive income (loss) attributable to PPL Energy Supply Member | \$ (23) | \$ 114 | \$ 125 | \$ 311 |

The accompanying Notes to Condensed Financial Statements are an integral part of the financial statements.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

PPL Energy Supply, LLC and Subsidiaries

(Unaudited)

(Millions of Dollars)

| | Nine Months Ended September 30, | |
|--|------------------------------------|--------|
| | 2012 | 2011 |
| Cash Flows from Operating Activities | | |
| Net income | \$ 383 | \$ 473 |
| Adjustments to reconcile net income to net cash provided by operating activities | | |
| Depreciation | 206 | 182 |
| Amortization | 93 | 96 |
| Defined benefit plans - expense | 33 | 26 |
| Deferred income taxes and investment tax credits | 132 | 226 |
| Unrealized (gains) losses on derivatives, and other hedging activities | (37) | (155) |
| Other | 33 | 42 |
| Change in current assets and current liabilities | | |
| Accounts receivable | (26) | (43) |
| Accounts payable | (110) | (163) |
| Unbilled revenues | 78 | 116 |
| Counterparty collateral | 12 | (273) |
| Other | (48) | 92 |
| Other operating activities | | |
| Defined benefit plans - funding | (70) | (136) |
| Other assets | (16) | (31) |
| Other liabilities | 11 | (12) |
| Net cash provided by operating activities | 674 | 440 |
| Cash Flows from Investing Activities | | |
| Expenditures for property, plant and equipment | (460) | (499) |
| Proceeds from the sale of certain non-core generation facilities | | 381 |
| Ironwood Acquisition, net of cash acquired | (84) | |
| Expenditures for intangible assets | (36) | (45) |
| Purchases of nuclear plant decommissioning trust investments | (112) | (144) |
| Proceeds from the sale of nuclear plant decommissioning trust investments | 102 | 134 |
| Net (increase) decrease in notes receivable from affiliates | 198 | |
| Net (increase) decrease in restricted cash and cash equivalents | 70 | (36) |
| Other investing activities | 14 | 7 |
| Net cash provided by (used in) investing activities | (308) | (202) |
| Cash Flows from Financing Activities | | |
| Retirement of long-term debt | (6) | (250) |
| Contributions from member | 472 | 361 |
| Distributions to member | (733) | (209) |
| Cash included in net assets of subsidiary distributed to member | | (325) |

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| | | |
|--|--------|--------|
| Net increase (decrease) in short-term debt | (45) | (100) |
| Other financing activities | (1) | (1) |
| Net cash provided by (used in) financing activities | (313) | (524) |
| Net Increase (Decrease) in Cash and Cash Equivalents | 53 | (286) |
| Cash and Cash Equivalents at Beginning of Period | 379 | 661 |
| Cash and Cash Equivalents at End of Period | \$ 432 | \$ 375 |

The accompanying Notes to Condensed Financial Statements are an integral part of the financial statements.

CONDENSED CONSOLIDATED BALANCE SHEETS

PPL Energy Supply, LLC and Subsidiaries

(Unaudited)

(Millions of Dollars)

| | September 30, 2012 | December 31, 2011 |
|--|-----------------------|----------------------|
| Assets | | |
| Current Assets | | |
| Cash and cash equivalents | \$ 432 | \$ 379 |
| Restricted cash and cash equivalents | 80 | 145 |
| Accounts receivable (less reserve: 2012, \$23; 2011, \$15) | | |
| Customer | 190 | 169 |
| Other | 25 | 31 |
| Accounts receivable from affiliates | 101 | 89 |
| Unbilled revenues | 324 | 402 |
| Notes receivable from affiliates | | 198 |
| Fuel, materials and supplies | 318 | 298 |
| Prepayments | 20 | 14 |
| Price risk management assets | 1,767 | 2,527 |
| Other current assets | 6 | 11 |
| Total Current Assets | 3,263 | 4,263 |
| Investments | | |
| Nuclear plant decommissioning trust funds | 711 | 640 |
| Other investments | 43 | 40 |
| Total Investments | 754 | 680 |
| Property, Plant and Equipment | | |
| Non-regulated property, plant and equipment | | |
| Generation | 11,199 | 10,517 |
| Nuclear fuel | 524 | 457 |
| Other | 260 | 245 |
| Less: accumulated depreciation - non-regulated property, plant and equipment | 5,750 | 5,573 |
| Non-regulated property, plant and equipment, net | 6,233 | 5,646 |
| Construction work in progress | 935 | 840 |
| Property, Plant and Equipment, net (a) | 7,168 | 6,486 |
| Other Noncurrent Assets | | |
| Goodwill | 86 | 86 |
| Other intangibles (a) | 249 | 386 |
| Price risk management assets | 837 | 896 |
| Other noncurrent assets | 379 | 382 |
| Total Other Noncurrent Assets | 1,551 | 1,750 |
| Total Assets | \$ 12,736 | \$ 13,179 |

(a)

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

At September 30, 2012 and December 31, 2011, includes \$428 million and \$416 million of PP&E, consisting primarily of "Generation," including leasehold improvements, and \$10 million and \$11 million of "Other intangibles" from the consolidation of a VIE that is the owner/lessor of the Lower Mt. Bethel plant.

The accompanying Notes to Condensed Financial Statements are an integral part of the financial statements.

CONDENSED CONSOLIDATED BALANCE SHEETS

PPL Energy Supply, LLC and Subsidiaries

(Unaudited)

(Millions of Dollars)

| | September 30, 2012 | December 31, 2011 |
|---|-----------------------|----------------------|
| Liabilities and Equity | | |
| Current Liabilities | | |
| Short-term debt | \$ 355 | \$ 400 |
| Long-term debt due within one year | 313 | |
| Accounts payable | 384 | 472 |
| Accounts payable to affiliates | 1 | 14 |
| Taxes | 62 | 90 |
| Interest | 55 | 30 |
| Price risk management liabilities | 1,141 | 1,560 |
| Counterparty collateral | 160 | 148 |
| Deferred income taxes | 190 | 315 |
| Other current liabilities | 209 | 196 |
| Total Current Liabilities | 2,870 | 3,225 |
| Long-term Debt | 2,962 | 3,024 |
| Deferred Credits and Other Noncurrent Liabilities | | |
| Deferred income taxes | 1,301 | 1,223 |
| Investment tax credits | 171 | 136 |
| Price risk management liabilities | 806 | 785 |
| Accrued pension obligations | 161 | 214 |
| Asset retirement obligations | 360 | 349 |
| Other deferred credits and noncurrent liabilities | 204 | 186 |
| Total Deferred Credits and Other Noncurrent Liabilities | 3,003 | 2,893 |
| Commitments and Contingent Liabilities (Note 10) | | |
| Equity | | |
| Member's equity | 3,883 | 4,019 |
| Noncontrolling interests | 18 | 18 |
| Total Equity | 3,901 | 4,037 |
| Total Liabilities and Equity | \$ 12,736 | \$ 13,179 |

The accompanying Notes to Condensed Financial Statements are an integral part of the financial statements.

CONDENSED CONSOLIDATED STATEMENTS OF EQUITY

PPL Energy Supply, LLC and Subsidiaries

(Unaudited)

(Millions of Dollars)

| | Member's equity | Non- controlling interests | Total |
|--|--------------------|----------------------------------|----------|
| June 30, 2012 | \$ 3,982 | \$ 18 | \$ 4,000 |
| Net income | 54 | 1 | 55 |
| Other comprehensive income (loss) | (77) | | (77) |
| Distributions | (76) | (1) | (77) |
| September 30, 2012 | \$ 3,883 | \$ 18 | \$ 3,901 |
| December 31, 2011 | \$ 4,019 | \$ 18 | \$ 4,037 |
| Net income | 382 | 1 | 383 |
| Other comprehensive income (loss) | (257) | | (257) |
| Contributions from member | 472 | | 472 |
| Distributions | (733) | (1) | (734) |
| September 30, 2012 | \$ 3,883 | \$ 18 | \$ 3,901 |
| June 30, 2011 | \$ 3,434 | \$ 18 | \$ 3,452 |
| Net income | 169 | 1 | 170 |
| Other comprehensive income (loss) | (55) | | (55) |
| Contributions from member | 193 | | 193 |
| Distributions | (75) | (1) | (76) |
| September 30, 2011 | \$ 3,666 | \$ 18 | \$ 3,684 |
| December 31, 2010 | \$ 4,491 | \$ 18 | \$ 4,509 |
| Net income | 472 | 1 | 473 |
| Other comprehensive income (loss) | (161) | | (161) |
| Contributions from member | 361 | | 361 |
| Distributions | (209) | (1) | (210) |
| Distribution of membership interest in PPL Global (a) | (1,288) | | (1,288) |
| September 30, 2011 | \$ 3,666 | \$ 18 | \$ 3,684 |

(a) In January 2011, PPL Energy Supply distributed its entire membership interest in PPL Global to PPL Energy Supply's parent, PPL Energy Funding. The distribution was made based on the book value of the assets and liabilities of PPL Global with financial effect as of January 1, 2011, and no gains or losses were recognized on the distribution.

The accompanying Notes to Condensed Financial Statements are an integral part of the financial statements.

(THIS PAGE LEFT BLANK INTENTIONALLY.)

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

PPL Electric Utilities Corporation and Subsidiaries

(Unaudited)

(Millions of Dollars)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|------------------------------------|-------------------------------------|--------|------------------------------------|----------|
| | 2012 | 2011 | 2012 | 2011 |
| Operating Revenues | | | | |
| Retail electric | \$ 443 | \$ 454 | \$ 1,303 | \$ 1,444 |
| Electric revenue from affiliate | 1 | 1 | 3 | 9 |
| Total Operating Revenues | 444 | 455 | 1,306 | 1,453 |
| Operating Expenses | | | | |
| Operation | | | | |
| Energy purchases | 137 | 171 | 410 | 591 |
| Energy purchases from affiliate | 23 | 5 | 61 | 15 |
| Other operation and maintenance | 148 | 146 | 431 | 402 |
| Depreciation | 41 | 38 | 119 | 108 |
| Taxes, other than income | 24 | 26 | 72 | 83 |
| Total Operating Expenses | 373 | 386 | 1,093 | 1,199 |
| Operating Income | 71 | 69 | 213 | 254 |
| Other Income (Expense) - net | 3 | 3 | 6 | 4 |
| Interest Expense | 25 | 26 | 73 | 74 |
| Income Before Income Taxes | 49 | 46 | 146 | 184 |
| Income Taxes | 16 | 14 | 47 | 56 |
| Net Income (a) | 33 | 32 | 99 | 128 |
| Distributions on Preference Stock | | 4 | 4 | 12 |
| Net Income Available to PPL | \$ 33 | \$ 28 | \$ 95 | \$ 116 |

(a) Net income approximates comprehensive income.

The accompanying Notes to Condensed Financial Statements are an integral part of the financial statements.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

PPL Electric Utilities Corporation and Subsidiaries

(Unaudited)

(Millions of Dollars)

| | Nine Months Ended September 30, | |
|--|------------------------------------|--------|
| | 2012 | 2011 |
| Cash Flows from Operating Activities | | |
| Net income | \$ 99 | \$ 128 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities | | |
| Depreciation | 119 | 108 |
| Amortization | 13 | 5 |
| Defined benefit plans - expense | 17 | 13 |
| Deferred income taxes and investment tax credits | 72 | 9 |
| Other | 3 | 2 |
| Change in current assets and current liabilities | | |
| Accounts receivable | 48 | (5) |
| Accounts payable | (43) | (105) |
| Unbilled revenues | 18 | 53 |
| Prepayments | 2 | 58 |
| Regulatory assets and liabilities | (1) | 95 |
| Taxes | | 19 |
| Other | (5) | (7) |
| Other operating activities | | |
| Defined benefit plans - funding | (54) | (102) |
| Other assets | | (1) |
| Other liabilities | (27) | (9) |
| Net cash provided by (used in) operating activities | 261 | 261 |
| Cash Flows from Investing Activities | | |
| Expenditures for property, plant and equipment | (407) | (357) |
| Net (increase) decrease in notes receivable from affiliates | (210) | |
| Other investing activities | 3 | 4 |
| Net cash provided by (used in) investing activities | (614) | (353) |
| Cash Flows from Financing Activities | | |
| Issuance of long-term debt | 249 | 645 |
| Retirement of long-term debt | | (458) |
| Contributions from parent | 150 | 56 |
| Redemption of preference stock | (250) | |
| Payment of common stock dividends to parent | (75) | (76) |
| Other financing activities | (10) | (18) |
| Net cash provided by (used in) financing activities | 64 | 149 |

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| | | |
|--|-------|--------|
| Net Increase (Decrease) in Cash and Cash Equivalents | (289) | 57 |
| Cash and Cash Equivalents at Beginning of Period | 320 | 204 |
| Cash and Cash Equivalents at End of Period | \$ 31 | \$ 261 |

The accompanying Notes to Condensed Financial Statements are an integral part of the financial statements.

CONDENSED CONSOLIDATED BALANCE SHEETS

PPL Electric Utilities Corporation and Subsidiaries

(Unaudited)

(Millions of Dollars, shares in thousands)

| | September 30, 2012 | December 31, 2011 |
|--|-----------------------|----------------------|
| Assets | | |
| Current Assets | | |
| Cash and cash equivalents | \$ 31 | \$ 320 |
| Accounts receivable (less reserve: 2012, \$17; 2011, \$17) | | |
| Customer | 259 | 271 |
| Other | 6 | 9 |
| Accounts receivable from affiliates | 3 | 35 |
| Notes receivable from affiliates | 210 | |
| Unbilled revenues | 80 | 98 |
| Materials and supplies | 38 | 42 |
| Prepayments | 76 | 78 |
| Other current assets | 30 | 30 |
| Total Current Assets | 733 | 883 |
| Property, Plant and Equipment | | |
| Regulated utility plant | 6,104 | 5,830 |
| Less: accumulated depreciation - regulated utility plant | 2,300 | 2,217 |
| Regulated utility plant, net | 3,804 | 3,613 |
| Other, net | 2 | 2 |
| Construction work in progress | 348 | 242 |
| Property, Plant and Equipment, net | 4,154 | 3,857 |
| Other Noncurrent Assets | | |
| Regulatory assets | 733 | 729 |
| Intangibles | 164 | 155 |
| Other noncurrent assets | 82 | 81 |
| Total Other Noncurrent Assets | 979 | 965 |
| Total Assets | \$ 5,866 | \$ 5,705 |

The accompanying Notes to Condensed Financial Statements are an integral part of the financial statements.

CONDENSED CONSOLIDATED BALANCE SHEETS

PPL Electric Utilities Corporation and Subsidiaries

(Unaudited)

(Millions of Dollars, shares in thousands)

| | September 30, 2012 | December 31, 2011 |
|---|-----------------------|----------------------|
| Liabilities and Equity | | |
| Current Liabilities | | |
| Accounts payable | \$ 173 | \$ 171 |
| Accounts payable to affiliates | 57 | 64 |
| Interest | 19 | 24 |
| Regulatory liabilities | 52 | 53 |
| Customer deposits and prepayments | 26 | 39 |
| Vacation | 23 | 22 |
| Other current liabilities | 50 | 47 |
| Total Current Liabilities | 400 | 420 |
| Long-term Debt | 1,967 | 1,718 |
| Deferred Credits and Other Noncurrent Liabilities | | |
| Deferred income taxes | 1,187 | 1,115 |
| Investment tax credits | 4 | 5 |
| Accrued pension obligations | 142 | 186 |
| Regulatory liabilities | 12 | 7 |
| Other deferred credits and noncurrent liabilities | 109 | 129 |
| Total Deferred Credits and Other Noncurrent Liabilities | 1,454 | 1,442 |
| Commitments and Contingent Liabilities (Notes 6 and 10) | | |
| Shareowners' Equity | | |
| Preference stock | | 250 |
| Common stock - no par value (a) | 364 | 364 |
| Additional paid-in capital | 1,129 | 979 |
| Earnings reinvested | 552 | 532 |
| Total Equity | 2,045 | 2,125 |
| Total Liabilities and Equity | \$ 5,866 | \$ 5,705 |

(a) 170,000 shares authorized; 66,368 shares issued and outstanding at September 30, 2012 and December 31, 2011.

The accompanying Notes to Condensed Financial Statements are an integral part of the financial statements.

CONDENSED CONSOLIDATED STATEMENTS OF SHAREOWNERS' EQUITY

PPL Electric Utilities Corporation and Subsidiaries

(Unaudited)

(Millions of Dollars)

| | Common stock shares outstanding (a) | Preference stock | Common stock | Additional paid-in capital | Earnings reinvested | Total |
|--|---|---------------------|-----------------|----------------------------------|------------------------|----------|
| June 30, 2012 | 66,368 | \$ | \$ 364 | \$ 979 | \$ 538 | \$ 1,881 |
| Net income | | | | | 33 | 33 |
| Capital contributions from PPL | | | | 150 | | 150 |
| Cash dividends declared on common stock | | | | | (19) | (19) |
| September 30, 2012 | 66,368 | \$ | \$ 364 | \$ 1,129 | \$ 552 | \$ 2,045 |
| December 31, 2011 | 66,368 | \$ 250 | \$ 364 | \$ 979 | \$ 532 | \$ 2,125 |
| Net income | | | | | 99 | 99 |
| Redemption of preference stock (b) | | (250) | | | | (250) |
| Capital contributions from PPL | | | | 150 | | 150 |
| Cash dividends declared on preference stock | | | | | (4) | (4) |
| Cash dividends declared on common stock | | | | | (75) | (75) |
| September 30, 2012 | 66,368 | \$ | \$ 364 | \$ 1,129 | \$ 552 | \$ 2,045 |
| June 30, 2011 | 66,368 | \$ 250 | \$ 364 | \$ 879 | \$ 487 | \$ 1,980 |
| Net income | | | | | 32 | 32 |
| Capital contributions from PPL | | | | 56 | | 56 |
| Cash dividends declared on preference stock | | | | | (4) | (4) |
| Cash dividends declared on common stock | | | | | (24) | (24) |
| September 30, 2011 | 66,368 | \$ 250 | \$ 364 | \$ 935 | \$ 491 | \$ 2,040 |
| December 31, 2010 | 66,368 | \$ 250 | \$ 364 | \$ 879 | \$ 451 | \$ 1,944 |
| Net income | | | | | 128 | 128 |
| Capital contributions from PPL | | | | 56 | | 56 |
| Cash dividends declared on preference stock | | | | | (12) | (12) |
| Cash dividends declared on common stock | | | | | (76) | (76) |
| September 30, 2011 | 66,368 | \$ 250 | \$ 364 | \$ 935 | \$ 491 | \$ 2,040 |

(a) Shares in thousands. All common shares of PPL Electric stock are owned by PPL.

(b) In June 2012, PPL Electric redeemed all of its outstanding preference stock. See Note 7 for additional information.

The accompanying Notes to Condensed Financial Statements are an integral part of the financial statements.

(THIS PAGE LEFT BLANK INTENTIONALLY.)

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

LG&E and KU Energy LLC and Subsidiaries

(Unaudited)

(Millions of Dollars)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|--------|------------------------------------|----------|
| | 2012 | 2011 | 2012 | 2011 |
| Operating Revenues | \$ 732 | \$ 736 | \$ 2,095 | \$ 2,140 |
| Operating Expenses | | | | |
| Operation | | | | |
| Fuel | 249 | 245 | 677 | 666 |
| Energy purchases | 27 | 32 | 135 | 179 |
| Other operation and maintenance | 186 | 187 | 589 | 566 |
| Depreciation | 87 | 84 | 259 | 249 |
| Taxes, other than income | 11 | 10 | 34 | 28 |
| Total Operating Expenses | 560 | 558 | 1,694 | 1,688 |
| Operating Income | 172 | 178 | 401 | 452 |
| Other Income (Expense) - net | (4) | | (14) | (1) |
| Interest Expense | 37 | 36 | 112 | 108 |
| Income from Continuing Operations Before Income Taxes | 131 | 142 | 275 | 343 |
| Income Taxes | 48 | 52 | 89 | 125 |
| Income from Continuing Operations After Income Taxes | 83 | 90 | 186 | 218 |
| Income (Loss) from Discontinued Operations (net of income taxes) | | (1) | (6) | (1) |
| Net Income (a) | \$ 83 | \$ 89 | \$ 180 | \$ 217 |

(a) Net income approximates comprehensive income.

The accompanying Notes to Condensed Financial Statements are an integral part of the financial statements.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

LG&E and KU Energy LLC and Subsidiaries

(Unaudited)

(Millions of Dollars)

| | Nine Months Ended September 30, | |
|--|---------------------------------|--------|
| | 2012 | 2011 |
| Cash Flows from Operating Activities | | |
| Net income | \$ 180 | \$ 217 |
| Adjustments to reconcile net income to net cash provided by operating activities | | |
| Depreciation | 259 | 249 |
| Amortization | 20 | 20 |
| Defined benefit plans - expense | 30 | 38 |
| Deferred income taxes and investment tax credits | 92 | 206 |
| Other | (5) | (14) |
| Change in current assets and current liabilities | | |
| Accounts receivable | (25) | 1 |
| Accounts payable | 4 | (28) |
| Unbilled revenues | 26 | 58 |
| Fuel, materials and supplies | 4 | 30 |
| Income tax receivable | 3 | 40 |
| Taxes | 51 | 2 |
| Other | 48 | 19 |
| Other operating activities | | |
| Defined benefit plans - funding | (66) | (159) |
| Other assets | (3) | (8) |
| Other liabilities | 28 | 12 |
| Net cash provided by operating activities | 646 | 683 |
| Cash Flows from Investing Activities | | |
| Expenditures for property, plant and equipment | (525) | (296) |
| Proceeds from the sale of other investments | | 163 |
| Net (increase) decrease in notes receivable from affiliates | 9 | 8 |
| Net (increase) decrease in restricted cash and cash equivalents | (3) | (11) |
| Net cash provided by (used in) investing activities | (519) | (136) |
| Cash Flows from Financing Activities | | |
| Issuance of long-term debt | | 250 |
| Net increase (decrease) in short-term debt | | (163) |
| Debt issuance and credit facility costs | (1) | (6) |
| Distributions to member | (95) | (469) |
| Net cash provided by (used in) financing activities | (96) | (388) |
| Net Increase (Decrease) in Cash and Cash Equivalents | 31 | 159 |
| Cash and Cash Equivalents at Beginning of Period | 59 | 11 |
| Cash and Cash Equivalents at End of Period | \$ 90 | \$ 170 |

The accompanying Notes to Condensed Financial Statements are an integral part of the financial statements.

CONDENSED CONSOLIDATED BALANCE SHEETS

LG&E and KU Energy LLC and Subsidiaries

(Unaudited)

(Millions of Dollars)

| | September 30, 2012 | December 31, 2011 |
|--|-----------------------|----------------------|
| Assets | | |
| Current Assets | | |
| Cash and cash equivalents | \$ 90 | \$ 59 |
| Accounts receivable (less reserve: 2012, \$19; 2011, \$17) | | |
| Customer | 158 | 129 |
| Other | 10 | 20 |
| Unbilled revenues | 120 | 146 |
| Fuel, materials and supplies | 278 | 283 |
| Prepayments | 21 | 22 |
| Notes receivable from affiliates | 6 | 15 |
| Income taxes receivable | | 3 |
| Deferred income taxes | 148 | 17 |
| Regulatory assets | 21 | 9 |
| Other current assets | 6 | 3 |
| Total Current Assets | 858 | 706 |
| Investments | 20 | 31 |
| Property, Plant and Equipment | | |
| Regulated utility plant | 7,865 | 7,519 |
| Less: accumulated depreciation - regulated utility plant | 458 | 277 |
| Regulated utility plant, net | 7,407 | 7,242 |
| Other, net | 3 | 2 |
| Construction work in progress | 650 | 557 |
| Property, Plant and Equipment, net | 8,060 | 7,801 |
| Other Noncurrent Assets | | |
| Regulatory assets | 590 | 620 |
| Goodwill | 996 | 996 |
| Other intangibles | 278 | 314 |
| Other noncurrent assets | 114 | 108 |
| Total Other Noncurrent Assets | 1,978 | 2,038 |
| Total Assets | \$ 10,916 | \$ 10,576 |

The accompanying Notes to Condensed Financial Statements are an integral part of the financial statements.

CONDENSED CONSOLIDATED BALANCE SHEETS
 LG&E and KU Energy LLC and Subsidiaries
 (Unaudited)
 (Millions of Dollars)

| | September 30, 2012 | December 31, 2011 |
|---|-----------------------|----------------------|
| Liabilities and Equity | | |
| Current Liabilities | | |
| Accounts payable | \$ 206 | \$ 224 |
| Accounts payable to affiliates | 2 | 2 |
| Customer deposits | 47 | 45 |
| Taxes | 76 | 25 |
| Regulatory liabilities | 13 | 20 |
| Interest | 51 | 23 |
| Salaries and benefits | 67 | 59 |
| Other current liabilities | 47 | 35 |
| Total Current Liabilities | 509 | 433 |
| Long-term Debt | 4,074 | 4,073 |
| Deferred Credits and Other Noncurrent Liabilities | | |
| Deferred income taxes | 645 | 413 |
| Investment tax credits | 140 | 144 |
| Accrued pension obligations | 316 | 359 |
| Asset retirement obligations | 118 | 116 |
| Regulatory liabilities | 987 | 1,003 |
| Price risk management liabilities | 57 | 55 |
| Other deferred credits and noncurrent liabilities | 248 | 239 |
| Total Deferred Credits and Other Noncurrent Liabilities | 2,511 | 2,329 |
| Commitments and Contingent Liabilities (Notes 6 and 10) | | |
| Member's equity | 3,822 | 3,741 |
| Total Liabilities and Equity | \$ 10,916 | \$ 10,576 |

The accompanying Notes to Condensed Financial Statements are an integral part of the financial statements.

CONDENSED CONSOLIDATED STATEMENTS OF EQUITY

LG&E and KU Energy LLC and Subsidiaries

(Unaudited)

(Millions of Dollars)

| | | Member's Equity |
|-----------------------------------|----|--------------------|
| June 30, 2012 | \$ | 3,774 |
| Net income | | 83 |
| Distributions to member | | (35) |
| September 30, 2012 | \$ | 3,822 |
| December 31, 2011 | \$ | 3,741 |
| Net income | | 180 |
| Distributions to member | | (95) |
| Other comprehensive income (loss) | | (4) |
| September 30, 2012 | \$ | 3,822 |
| June 30, 2011 | \$ | 3,991 |
| Net income | | 89 |
| Distributions to member | | (323) |
| September 30, 2011 | \$ | 3,757 |
| December 31, 2010 | \$ | 4,011 |
| Net income | | 217 |
| Distributions to member | | (469) |
| Other comprehensive income (loss) | | (2) |
| September 30, 2011 | \$ | 3,757 |

The accompanying Notes to Condensed Financial Statements are an integral part of the financial statements.

(THIS PAGE LEFT BLANK INTENTIONALLY.)

CONDENSED STATEMENTS OF INCOME

Louisville Gas and Electric Company

(Unaudited)

(Millions of Dollars)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---------------------------------|-------------------------------------|--------|------------------------------------|--------|
| | 2012 | 2011 | 2012 | 2011 |
| Operating Revenues | | | | |
| Retail and wholesale | \$ 324 | \$ 323 | \$ 939 | \$ 974 |
| Electric revenue from affiliate | 9 | 17 | 51 | 61 |
| Total Operating Revenues | 333 | 340 | 990 | 1,035 |
| Operating Expenses | | | | |
| Operation | | | | |
| Fuel | 100 | 98 | 281 | 265 |
| Energy purchases | 18 | 24 | 110 | 155 |
| Energy purchases from affiliate | 3 | 7 | 9 | 25 |
| Other operation and maintenance | 87 | 91 | 277 | 272 |
| Depreciation | 38 | 37 | 114 | 110 |
| Taxes, other than income | 6 | 5 | 17 | 14 |
| Total Operating Expenses | 252 | 262 | 808 | 841 |
| Operating Income | 81 | 78 | 182 | 194 |
| Other Income (Expense) - net | (3) | | (3) | |
| Interest Expense | 10 | 11 | 31 | 34 |
| Income Before Income Taxes | 68 | 67 | 148 | 160 |
| Income Taxes | 25 | 24 | 54 | 58 |
| Net Income (a) | \$ 43 | \$ 43 | \$ 94 | \$ 102 |

(a) Net income approximates comprehensive income.

The accompanying Notes to Condensed Financial Statements are an integral part of the financial statements.

CONDENSED STATEMENTS OF CASH FLOWS

Louisville Gas and Electric Company

(Unaudited)

(Millions of Dollars)

| | Nine Months Ended September 30, | |
|--|---------------------------------|--------|
| | 2012 | 2011 |
| Cash Flows from Operating Activities | | |
| Net income | \$ 94 | \$ 102 |
| Adjustments to reconcile net income to net cash provided by operating activities | | |
| Depreciation | 114 | 110 |
| Amortization | 8 | 9 |
| Defined benefit plans - expense | 14 | 16 |
| Deferred income taxes and investment tax credits | 40 | 38 |
| Other | (11) | 2 |
| Change in current assets and current liabilities | | |
| Accounts receivable | (5) | 21 |
| Accounts payable | 2 | (16) |
| Unbilled revenues | 16 | 39 |
| Fuel, materials and supplies | (10) | 16 |
| Taxes | 21 | 9 |
| Other | 13 | 3 |
| Other operating activities | | |
| Defined benefit plans - funding | (26) | (68) |
| Other assets | (2) | (7) |
| Other liabilities | (1) | 5 |
| Net cash provided by operating activities | 267 | 279 |
| Cash Flows from Investing Activities | | |
| Expenditures for property, plant and equipment | (193) | (127) |
| Proceeds from the sale of other investments | | 163 |
| Net (increase) decrease in restricted cash and cash equivalents | (3) | (11) |
| Net cash provided by (used in) investing activities | (196) | 25 |
| Cash Flows from Financing Activities | | |
| Net increase (decrease) in notes payable with affiliates | | (12) |
| Net increase (decrease) in short-term debt | | (163) |
| Debt issuance and credit facility costs | (1) | (1) |
| Payment of common stock dividends to parent | (47) | (55) |
| Net cash provided by (used in) financing activities | (48) | (231) |
| Net Increase (Decrease) in Cash and Cash Equivalents | 23 | 73 |
| Cash and Cash Equivalents at Beginning of Period | 25 | 2 |
| Cash and Cash Equivalents at End of Period | \$ 48 | \$ 75 |

The accompanying Notes to Condensed Financial Statements are an integral part of the financial statements.

CONDENSED BALANCE SHEETS

Louisville Gas and Electric Company

(Unaudited)

(Millions of Dollars, shares in thousands)

| | September 30, 2012 | December 31, 2011 |
|--|-----------------------|----------------------|
| Assets | | |
| Current Assets | | |
| Cash and cash equivalents | \$ 48 | \$ 25 |
| Accounts receivable (less reserve: 2012, \$1; 2011, \$2) | | |
| Customer | 68 | 60 |
| Other | 5 | 9 |
| Unbilled revenues | 49 | 65 |
| Accounts receivable from affiliates | 12 | 11 |
| Fuel, materials and supplies | 152 | 142 |
| Prepayments | 6 | 7 |
| Income taxes receivable | | 4 |
| Deferred income taxes | 2 | 2 |
| Regulatory assets | 17 | 9 |
| Total Current Assets | 359 | 334 |
| Property, Plant and Equipment | | |
| Regulated utility plant | 3,142 | 2,956 |
| Less: accumulated depreciation - regulated utility plant | 196 | 116 |
| Regulated utility plant, net | 2,946 | 2,840 |
| Other, net | 1 | |
| Construction work in progress | 186 | 215 |
| Property, Plant and Equipment, net | 3,133 | 3,055 |
| Other Noncurrent Assets | | |
| Regulatory assets | 384 | 403 |
| Goodwill | 389 | 389 |
| Other intangibles | 149 | 166 |
| Other noncurrent assets | 44 | 40 |
| Total Other Noncurrent Assets | 966 | 998 |
| Total Assets | \$ 4,458 | \$ 4,387 |

The accompanying Notes to Condensed Financial Statements are an integral part of the financial statements.

CONDENSED BALANCE SHEETS

Louisville Gas and Electric Company

(Unaudited)

(Millions of Dollars, shares in thousands)

| | September 30, 2012 | December 31, 2011 |
|---|-----------------------|----------------------|
| Liabilities and Equity | | |
| Current Liabilities | | |
| Accounts payable | \$ 89 | \$ 94 |
| Accounts payable to affiliates | 24 | 26 |
| Customer deposits | 23 | 22 |
| Taxes | 34 | 13 |
| Regulatory liabilities | 5 | 10 |
| Interest | 11 | 6 |
| Salaries and benefits | 18 | 14 |
| Other current liabilities | 14 | 14 |
| Total Current Liabilities | 218 | 199 |
| Long-term Debt | 1,112 | 1,112 |
| Deferred Credits and Other Noncurrent Liabilities | | |
| Deferred income taxes | 520 | 475 |
| Investment tax credits | 41 | 43 |
| Accrued pension obligations | 71 | 95 |
| Asset retirement obligations | 55 | 55 |
| Regulatory liabilities | 467 | 478 |
| Price risk management liabilities | 57 | 55 |
| Other deferred credits and noncurrent liabilities | 108 | 113 |
| Total Deferred Credits and Other Noncurrent Liabilities | 1,319 | 1,314 |
| Commitments and Contingent Liabilities (Notes 6 and 10) | | |
| Stockholder's Equity | | |
| Common stock - no par value (a) | 424 | 424 |
| Additional paid-in capital | 1,278 | 1,278 |
| Earnings reinvested | 107 | 60 |
| Total Equity | 1,809 | 1,762 |
| Total Liabilities and Equity | \$ 4,458 | \$ 4,387 |

(a) 75,000 shares authorized; 21,294 shares issued and outstanding at September 30, 2012 and December 31, 2011.

The accompanying Notes to Condensed Financial Statements are an integral part of the financial statements.

CONDENSED STATEMENTS OF EQUITY

Louisville Gas and Electric Company

(Unaudited)

(Millions of Dollars)

| | Common stock shares outstanding (a) | | Common stock | | Additional paid-in capital | | Earnings reinvested | | Total |
|--|---|----|-----------------|----|----------------------------------|----|------------------------|----|-------|
| June 30, 2012 | 21,294 | \$ | 424 | \$ | 1,278 | \$ | 80 | \$ | 1,782 |
| Net income | | | | | | | 43 | | 43 |
| Cash dividends declared on common stock | | | | | | | (16) | | (16) |
| September 30, 2012 | 21,294 | \$ | 424 | \$ | 1,278 | \$ | 107 | \$ | 1,809 |
| December 31, 2011 | 21,294 | \$ | 424 | \$ | 1,278 | \$ | 60 | \$ | 1,762 |
| Net income | | | | | | | 94 | | 94 |
| Cash dividends declared on common stock | | | | | | | (47) | | (47) |
| September 30, 2012 | 21,294 | \$ | 424 | \$ | 1,278 | \$ | 107 | \$ | 1,809 |
| June 30, 2011 | 21,294 | \$ | 424 | \$ | 1,278 | \$ | 36 | \$ | 1,738 |
| Net income | | | | | | | 43 | | 43 |
| Cash dividends declared on common stock | | | | | | | (13) | | (13) |
| September 30, 2011 | 21,294 | \$ | 424 | \$ | 1,278 | \$ | 66 | \$ | 1,768 |
| December 31, 2010 | 21,294 | \$ | 424 | \$ | 1,278 | \$ | 19 | \$ | 1,721 |
| Net income | | | | | | | 102 | | 102 |
| Cash dividends declared on common stock | | | | | | | (55) | | (55) |
| September 30, 2011 | 21,294 | \$ | 424 | \$ | 1,278 | \$ | 66 | \$ | 1,768 |

(a) Shares in thousands. All common shares of LG&E stock are owned by LKE.

The accompanying Notes to Condensed Financial Statements are an integral part of the financial statements.

(THIS PAGE LEFT BLANK INTENTIONALLY.)

CONDENSED STATEMENTS OF INCOME

Kentucky Utilities Company

(Unaudited)

(Millions of Dollars)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---------------------------------|-------------------------------------|--------|------------------------------------|----------|
| | 2012 | 2011 | 2012 | 2011 |
| Operating Revenues | | | | |
| Retail and wholesale | \$ 408 | \$ 413 | \$ 1,156 | \$ 1,166 |
| Electric revenue from affiliate | 3 | 7 | 9 | 25 |
| Total Operating Revenues | 411 | 420 | 1,165 | 1,191 |
| Operating Expenses | | | | |
| Operation | | | | |
| Fuel | 149 | 147 | 396 | 401 |
| Energy purchases | 9 | 8 | 25 | 24 |
| Energy purchases from affiliate | 9 | 17 | 51 | 61 |
| Other operation and maintenance | 93 | 90 | 286 | 274 |
| Depreciation | 49 | 47 | 145 | 139 |
| Taxes, other than income | 5 | 5 | 17 | 14 |
| Total Operating Expenses | 314 | 314 | 920 | 913 |
| Operating Income | 97 | 106 | 245 | 278 |
| Other Income (Expense) - net | 1 | | (5) | 1 |
| Interest Expense | 18 | 18 | 52 | 53 |
| Income Before Income Taxes | 80 | 88 | 188 | 226 |
| Income Taxes | 30 | 32 | 70 | 82 |
| Net Income (a) | \$ 50 | \$ 56 | \$ 118 | \$ 144 |

(a) Net income approximates comprehensive income.

The accompanying Notes to Condensed Financial Statements are an integral part of the financial statements.

CONDENSED STATEMENTS OF CASH FLOWS

Kentucky Utilities Company

(Unaudited)

(Millions of Dollars)

| | Nine Months Ended September 30, | |
|--|---------------------------------|--------|
| | 2012 | 2011 |
| Cash Flows from Operating Activities | | |
| Net income | \$ 118 | \$ 144 |
| Adjustments to reconcile net income to net cash provided by operating activities | | |
| Depreciation | 145 | 139 |
| Amortization | 9 | 10 |
| Defined benefit plans - expense | 9 | 11 |
| Deferred income taxes and investment tax credits | 78 | 78 |
| Other | 1 | (16) |
| Change in current assets and current liabilities | | |
| Accounts receivable | (34) | 8 |
| Accounts payable | 9 | 5 |
| Accounts payable to affiliates | (4) | (21) |
| Unbilled revenues | 10 | 19 |
| Fuel, materials and supplies | 16 | 14 |
| Taxes | 26 | (5) |
| Other | 32 | 15 |
| Other operating activities | | |
| Defined benefit plans - funding | (20) | (46) |
| Other assets | (1) | (1) |
| Other liabilities | 16 | 5 |
| Net cash provided by operating activities | 410 | 359 |
| Cash Flows from Investing Activities | | |
| Expenditures for property, plant and equipment | (331) | (168) |
| Net cash provided by (used in) investing activities | (331) | (168) |
| Cash Flows from Financing Activities | | |
| Net increase (decrease) in notes payable with affiliates | | (10) |
| Debt issuance and credit facility costs | | (2) |
| Payment of common stock dividends to parent | (68) | (88) |
| Net cash provided by (used in) financing activities | (68) | (100) |
| Net Increase (Decrease) in Cash and Cash Equivalents | 11 | 91 |
| Cash and Cash Equivalents at Beginning of Period | 31 | 3 |
| Cash and Cash Equivalents at End of Period | \$ 42 | \$ 94 |

The accompanying Notes to Condensed Financial Statements are an integral part of the financial statements.

CONDENSED BALANCE SHEETS

Kentucky Utilities Company

(Unaudited)

(Millions of Dollars, shares in thousands)

| | September 30, 2012 | December 31, 2011 |
|--|-----------------------|----------------------|
| Assets | | |
| Current Assets | | |
| Cash and cash equivalents | \$ 42 | \$ 31 |
| Accounts receivable (less reserve: 2012, \$2; 2011, \$2) | | |
| Customer | 90 | 69 |
| Other | 5 | 9 |
| Unbilled revenues | 71 | 81 |
| Accounts receivable from affiliates | 14 | |
| Fuel, materials and supplies | 126 | 141 |
| Prepayments | 9 | 7 |
| Income taxes receivable | | 5 |
| Deferred income taxes | 5 | 5 |
| Regulatory assets | 4 | |
| Other current assets | 6 | 3 |
| Total Current Assets | 372 | 351 |
| Investments | 19 | 31 |
| Property, Plant and Equipment | | |
| Regulated utility plant | 4,723 | 4,563 |
| Less: accumulated depreciation - regulated utility plant | 262 | 161 |
| Regulated utility plant, net | 4,461 | 4,402 |
| Construction work in progress | 463 | 340 |
| Property, Plant and Equipment, net | 4,924 | 4,742 |
| Other Noncurrent Assets | | |
| Regulatory assets | 206 | 217 |
| Goodwill | 607 | 607 |
| Other intangibles | 129 | 148 |
| Other noncurrent assets | 60 | 60 |
| Total Other Noncurrent Assets | 1,002 | 1,032 |
| Total Assets | \$ 6,317 | \$ 6,156 |

The accompanying Notes to Condensed Financial Statements are an integral part of the financial statements.

CONDENSED BALANCE SHEETS

Kentucky Utilities Company

(Unaudited)

(Millions of Dollars, shares in thousands)

| | September 30, 2012 | December 31, 2011 |
|---|-----------------------|----------------------|
| Liabilities and Equity | | |
| Current Liabilities | | |
| Accounts payable | \$ 107 | \$ 112 |
| Accounts payable to affiliates | 29 | 33 |
| Customer deposits | 24 | 23 |
| Taxes | 37 | 11 |
| Regulatory liabilities | 8 | 10 |
| Interest | 25 | 11 |
| Salaries and benefits | 14 | 15 |
| Other current liabilities | 30 | 13 |
| Total Current Liabilities | 274 | 228 |
| Long-term Debt | 1,842 | 1,842 |
| Deferred Credits and Other Noncurrent Liabilities | | |
| Deferred income taxes | 563 | 484 |
| Investment tax credits | 99 | 101 |
| Accrued pension obligations | 72 | 83 |
| Asset retirement obligations | 63 | 61 |
| Regulatory liabilities | 520 | 525 |
| Other deferred credits and noncurrent liabilities | 93 | 87 |
| Total Deferred Credits and Other Noncurrent Liabilities | 1,410 | 1,341 |
| Commitments and Contingent Liabilities (Notes 6 and 10) | | |
| Stockholder's Equity | | |
| Common stock - no par value (a) | 308 | 308 |
| Additional paid-in capital | 2,348 | 2,348 |
| Accumulated other comprehensive income (loss) | (4) | |
| Earnings reinvested | 139 | 89 |
| Total Equity | 2,791 | 2,745 |
| Total Liabilities and Equity | \$ 6,317 | \$ 6,156 |

(a) 80,000 shares authorized; 37,818 shares issued and outstanding at September 30, 2012 and December 31, 2011.

The accompanying Notes to Condensed Financial Statements are an integral part of the financial statements.

CONDENSED STATEMENTS OF EQUITY

Kentucky Utilities Company

(Unaudited)

(Millions of Dollars)

| | Common stock shares outstanding (a) | Common stock | Additional paid-in capital | Earnings reinvested | Accumulated other comprehensive income (loss) | Total |
|---|---|-----------------|----------------------------------|------------------------|---|----------|
| June 30, 2012 | 37,818 | \$ 308 | \$ 2,348 | \$ 109 | \$ (4) | \$ 2,761 |
| Net income | | | | 50 | | 50 |
| Cash dividends declared on common stock | | | | (20) | | (20) |
| September 30, 2012 | 37,818 | \$ 308 | \$ 2,348 | \$ 139 | \$ (4) | \$ 2,791 |
| December 31, 2011 | 37,818 | \$ 308 | \$ 2,348 | \$ 89 | | \$ 2,745 |
| Net income | | | | 118 | | 118 |
| Cash dividends declared on common stock | | | | (68) | | (68) |
| Other comprehensive income (loss) | | | | | \$ (4) | (4) |
| September 30, 2012 | 37,818 | \$ 308 | \$ 2,348 | \$ 139 | \$ (4) | \$ 2,791 |
| June 30, 2011 | 37,818 | \$ 308 | \$ 2,348 | \$ 55 | \$ (1) | \$ 2,710 |
| Net income | | | | 56 | | 56 |
| Cash dividends declared on common stock | | | | (20) | | (20) |
| Other comprehensive income (loss) | | | | | 1 | 1 |
| September 30, 2011 | 37,818 | \$ 308 | \$ 2,348 | \$ 91 | \$ | \$ 2,747 |
| December 31, 2010 | 37,818 | \$ 308 | \$ 2,348 | \$ 35 | | \$ 2,691 |
| Net income | | | | 144 | | 144 |
| Cash dividends declared on common stock | | | | (88) | | (88) |
| September 30, 2011 | 37,818 | \$ 308 | \$ 2,348 | \$ 91 | \$ | \$ 2,747 |

(a) Shares in thousands. All common shares of KU stock are owned by LKE.

The accompanying Notes to Condensed Financial Statements are an integral part of the financial statements.

Combined Notes to Condensed Financial Statements (Unaudited)

1. Interim Financial Statements

(PPL, PPL Energy Supply, PPL Electric, LKE, LG&E and KU)

Capitalized terms and abbreviations appearing in the unaudited combined notes to condensed financial statements are defined in the glossary. Dollars are in millions, except per share data, unless otherwise noted.

The accompanying unaudited condensed financial statements have been prepared in accordance with accounting principles generally accepted in the U.S. for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X and, therefore, do not include all of the information and footnotes required by accounting principles generally accepted in the U.S. for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation in accordance with accounting principles generally accepted in the U.S. are reflected in the condensed financial statements. All adjustments are of a normal recurring nature, except as otherwise disclosed. Each Registrant's Balance Sheet at December 31, 2011 is derived from that Registrant's 2011 audited Balance Sheet. The financial statements and notes thereto should be read in conjunction with the financial statements and notes contained in each Registrant's 2011 Form 10-K. The results of operations for the three and nine months ended September 30, 2012, are not necessarily indicative of the results to be expected for the full year ending December 31, 2012, or other future periods, because results for interim periods can be disproportionately influenced by various factors, developments and seasonal variations.

The classification of certain prior period amounts has been changed to conform to the presentation in the September 30, 2012 financial statements.

(PPL)

On April 1, 2011, PPL, through its indirect, wholly owned subsidiary PPL WEM, completed its acquisition of all of the outstanding ordinary share capital of Central Networks East plc and Central Networks Limited, the sole owner of Central Networks West plc, together with certain other related assets and liabilities (collectively referred to as Central Networks and subsequently renamed WPD Midlands), from subsidiaries of E.ON AG. PPL consolidates WPD, including WPD Midlands, on a one-month lag. Material intervening events, such as debt issuances that occur in the lag period, are recognized in the current period financial statements. Events that are significant but not material are disclosed. Therefore, the periods ended September 30, 2012 include three and nine months of WPD Midlands' results, compared with three and five months for the same periods in 2011. See Note 8 for additional information on the acquisition.

(PPL and PPL Energy Supply)

In April 2012, an indirect, wholly owned subsidiary of PPL Energy Supply completed the Ironwood Acquisition. See Note 8 for additional information.

2. Summary of Significant Accounting Policies

(PPL, PPL Energy Supply, PPL Electric, LKE, LG&E and KU)

The following accounting policy disclosures represent updates to Note 1 in each Registrant's 2011 Form 10-K and should be read in conjunction with those disclosures.

Accounts Receivable (PPL, PPL Energy Supply and PPL Electric)

PPL Electric's customers may choose an alternative supplier for their generation supply. In accordance with a PUC-approved purchase of accounts receivable program, PPL Electric continues to purchase certain accounts receivable from alternative suppliers at a nominal discount, which reflects a provision for uncollectible accounts. The alternative suppliers (including PPL Electric's affiliate, PPL EnergyPlus) have no continuing involvement or interest in the purchased accounts receivable. The purchased accounts receivable are initially recorded at fair value using a market approach based on the purchase price paid and are classified as Level 2 in the fair value hierarchy. PPL Electric receives a nominal fee for administering its program. During the three and nine months ended September 30, 2012, PPL Electric purchased \$225 million and \$647 million of accounts receivable from unaffiliated third parties and \$81 million and \$237 million from its affiliate, PPL EnergyPlus. During the three and nine months ended September 30, 2011, PPL Electric purchased \$222 million and \$674 million of accounts receivable from unaffiliated third parties and \$71 million and \$191 million from its affiliate, PPL EnergyPlus.

New Accounting Guidance Adopted (PPL, PPL Energy Supply, PPL Electric, LKE, LG&E and KU)

Fair Value Measurements

Effective January 1, 2012, the Registrants prospectively adopted accounting guidance that was issued to clarify existing fair value measurement guidance and to enhance fair value disclosures. The additional disclosures required by this guidance include quantitative information about significant unobservable inputs used for Level 3 measurements, qualitative information about the sensitivity of recurring Level 3 measurements, information about any transfers between Levels 1 and 2 of the fair value hierarchy, information about when the current use of a non-financial asset is different from the highest and best use, and the fair value hierarchy classification for assets and liabilities whose fair value is disclosed only in the notes to the financial statements.

The adoption of this standard resulted in additional footnote disclosures but did not have a significant impact on the Registrants. See Note 13 for additional disclosures required by this guidance.

Testing Goodwill for Impairment

Effective January 1, 2012, the Registrants prospectively adopted accounting guidance which allows an entity to elect the option to first make a qualitative evaluation about the likelihood of an impairment of goodwill. If, based on this assessment, the entity determines it is not more likely than not that the fair value of a reporting unit is less than the carrying amount, the two-step goodwill impairment test is not necessary. However, the first step of the impairment test is required if an entity concludes it is more likely than not that the fair value of a reporting unit is less than the carrying amount based on the qualitative assessment.

The adoption of this standard did not have a significant impact on the Registrants.

3. Segment and Related Information

(PPL)

See Note 2 in PPL's 2011 Form 10-K for a discussion of reportable segments. In 2012, the International Regulated segment was renamed the U.K. Regulated segment to more specifically reflect the focus of this segment. Other than the name change, there were no other changes to this segment. Because the acquisition of WPD Midlands occurred on April 1, 2011, and PPL consolidates WPD Midlands on a one-month lag, the 2011 operating results of the U.K. Regulated segment for the nine-month period include five months of WPD Midlands results.

Financial data for the segments for the periods ended September 30 are:

| | Three Months | | Nine Months | |
|----------------------------------|-----------------|-----------------|-----------------|-----------------|
| | 2012 | 2011 | 2012 | 2011 |
| Income Statement Data | | | | |
| Revenues from external customers | | | | |
| Kentucky Regulated | \$ 732 | \$ 736 | \$ 2,095 | \$ 2,140 |
| U.K. Regulated | 528 | 493 | 1,647 | 1,138 |
| Pennsylvania Regulated | 443 | 454 | 1,303 | 1,444 |
| Supply (a) | 700 | 1,437 | 4,019 | 3,797 |
| Total | \$ 2,403 | \$ 3,120 | \$ 9,064 | \$ 8,519 |
| Intersegment electric revenues | | | | |

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| | | | | | | | | |
|---|----|-----|----|-----|----|-------|----|-------|
| Pennsylvania Regulated | \$ | 1 | \$ | 1 | \$ | 3 | \$ | 9 |
| Supply | | 23 | | 5 | | 61 | | 15 |
| Net Income Attributable to PPL Shareowners | | | | | | | | |
| Kentucky Regulated | \$ | 72 | \$ | 78 | \$ | 148 | \$ | 184 |
| U.K. Regulated | | 202 | | 138 | | 563 | | 231 |
| Pennsylvania Regulated | | 33 | | 28 | | 95 | | 116 |
| Supply (a) | | 48 | | 200 | | 361 | | 510 |
| Total | \$ | 355 | \$ | 444 | \$ | 1,167 | \$ | 1,041 |

| | | September 30, December 31, | |
|--------------------|------------------------|----------------------------|------------------|
| | | 2012 | 2011 |
| Balance Sheet Data | | | |
| Assets | | | |
| | Kentucky Regulated | \$ 10,546 | \$ 10,229 |
| | U.K. Regulated | 14,015 | 13,364 |
| | Pennsylvania Regulated | 5,823 | 5,610 |
| | Supply | 12,856 | 13,445 |
| | Total assets | \$ 43,240 | \$ 42,648 |

(a) Includes unrealized gains and losses from economic activity. See Note 14 for additional information.

4. Earnings Per Share

(PPL)

Basic EPS is computed by dividing income available to PPL common shareowners by the weighted-average number of common shares outstanding during the period. Diluted EPS is computed by dividing income available to PPL common shareowners by the weighted-average number of shares outstanding that are increased for additional shares that would be outstanding if potentially dilutive non-participating securities were converted to common shares as calculated using the treasury stock method. For the three and nine months ended September 30, 2012 and 2011, these securities included stock options and performance units granted under incentive compensation plans and the Purchase Contracts associated with Equity Units. For the three and nine months ended September 30, 2012, these securities also included the PPL common stock forward sale agreements. See Note 7 for additional information on the forward sale agreements.

The forward sale agreements were dilutive under the treasury stock method for the three and nine months ended September 30, 2012 because the average stock price of PPL's common shares exceeded the forward sale price indicated in the forward sale agreements.

The Purchase Contracts are dilutive under the treasury stock method if the average VWAP of PPL common stock for a certain period exceeds approximately \$30.99 and \$28.80 for the 2011 and 2010 Purchase Contracts. The 2010 Purchase Contracts were dilutive for the three and nine months ended September 30, 2012. Subject to antidilution adjustments at September 30, 2012, the maximum number of shares issuable to settle the Purchase Contracts was 95.8 million shares, including 86.5 million shares that could be issued under standard provisions of the Purchase Contracts and 9.3 million shares that could be issued under make-whole provisions in the event of early settlement upon a Fundamental Change.

Reconciliations of the amounts of income and shares of PPL common stock (in thousands) for the periods ended September 30 used in the EPS calculation are:

| | Three Months | | Nine Months | |
|--|--------------|--------|-------------|----------|
| | 2012 | 2011 | 2012 | 2011 |
| Income (Numerator) | | | | |
| Income from continuing operations after income taxes attributable to PPL | | | | |
| | \$ 355 | \$ 444 | \$ 1,173 | \$ 1,039 |
| Less amounts allocated to participating securities | 2 | 2 | 7 | 4 |

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| | | | | | | | | |
|--|----|---------|----|---------|----|---------|----|---------|
| Income from continuing operations after income taxes available to PPL | | | | | | | | |
| common shareowners | \$ | 353 | \$ | 442 | \$ | 1,166 | \$ | 1,035 |
| Income (loss) from discontinued operations (net of income taxes) available | | | | | | | | |
| to PPL common shareowners | \$ | | \$ | | \$ | (6) | \$ | 2 |
| Net income attributable to PPL shareowners | \$ | 355 | \$ | 444 | \$ | 1,167 | \$ | 1,041 |
| Less amounts allocated to participating securities | | 2 | | 2 | | 7 | | 4 |
| Net income available to PPL common shareowners | \$ | 353 | \$ | 442 | \$ | 1,160 | \$ | 1,037 |
| Shares of Common Stock (Denominator) | | | | | | | | |
| Weighted-average shares - Basic EPS | | 580,585 | | 577,595 | | 579,847 | | 541,135 |
| Add incremental non-participating securities: | | | | | | | | |
| Stock options and performance units | | 635 | | 459 | | 522 | | 345 |
| 2010 Purchase Contracts | | 439 | | | | 146 | | |
| Forward sale agreements | | 977 | | | | 415 | | |
| Weighted-average shares - Diluted EPS | | 582,636 | | 578,054 | | 580,930 | | 541,480 |

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| | Three Months | | Nine Months | |
|--|--------------|---------|-------------|---------|
| | 2012 | 2011 | 2012 | 2011 |
| Basic EPS | | | | |
| Available to PPL common shareowners: | | | | |
| Income from continuing operations after income taxes | \$ 0.61 | \$ 0.76 | \$ 2.01 | \$ 1.91 |
| Income (loss) from discontinued operations (net of income taxes) | | | (0.01) | 0.01 |
| Net Income | \$ 0.61 | \$ 0.76 | \$ 2.00 | \$ 1.92 |

Diluted EPS

| | | | | |
|--|---------|---------|---------|---------|
| Available to PPL common shareowners: | | | | |
| Income from continuing operations after income taxes | \$ 0.61 | \$ 0.76 | \$ 2.01 | \$ 1.91 |
| Income (loss) from discontinued operations (net of income taxes) | | | (0.01) | |
| Net Income | \$ 0.61 | \$ 0.76 | \$ 2.00 | \$ 1.91 |

For the periods ended September 30, 2012, PPL issued common stock related to stock-based compensation plans, ESOP and DRIP as follows:

| (Shares in thousands) | Three Months | Nine Months |
|------------------------------------|--------------|-------------|
| Stock-based compensation plans (a) | 159 | 512 |
| ESOP | | 280 |
| DRIP | 598 | 1,773 |

(a) Includes stock options exercised, vesting of restricted stock and restricted stock units and conversion of stock units granted to directors.

For the periods ended September 30, the following options to purchase PPL common stock and performance units were excluded from the computations of diluted EPS because the effect would have been antidilutive.

| (Shares in thousands) | Three Months | | Nine Months | |
|-----------------------|--------------|-------|-------------|-------|
| | 2012 | 2011 | 2012 | 2011 |
| Stock options | 4,935 | 4,473 | 5,622 | 5,377 |
| Performance units | | 3 | 76 | 3 |

5. Income Taxes

Reconciliations of income tax expense for the periods ended September 30 are:

(PPL)

| | Three Months | | Nine Months | |
|--------------------------------------|--------------|------|-------------|------|
| | 2012 | 2011 | 2012 | 2011 |
| Reconciliation of Income Tax Expense | | | | |

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

Federal income tax on Income from Continuing
Operations Before

| Income Taxes at statutory tax rate - 35% | \$ 130 | \$ 196 | \$ 539 | \$ 518 |
|---|--------------|---------------|---------------|---------------|
| Increase (decrease) due to: | | | | |
| State income taxes, net of federal income tax benefit | 6 | 8 | 38 | 47 |
| State valuation allowance adjustments (a) | 2 | | 2 | 11 |
| Impact of lower U.K. income tax rates (b) | (30) | (12) | (75) | (31) |
| U.S. income tax on foreign earnings - net of foreign tax credit (c) | 1 | (10) | 2 | (25) |
| Federal and state tax reserve adjustments | (2) | 4 | (7) | 1 |
| Foreign tax reserve adjustments (d) | | 2 | (5) | 2 |
| Enactment of the U.K.'s Finance Acts 2012 and 2011 (b) | (74) | (69) | (74) | (69) |
| Federal income tax credits | (5) | (4) | (12) | (11) |
| Amortization of investment tax credit | (2) | (2) | (7) | (6) |
| Depreciation not normalized (a) | (2) | (1) | (6) | (7) |
| State deferred tax rate change (e) | (6) | | (17) | |
| Net operating loss carryforward adjustments (f) | | | (9) | |
| Nondeductible acquisition-related costs (g) | | 1 | | 9 |
| Other | (1) | (3) | (5) | (10) |
| Total increase (decrease) | (113) | (86) | (175) | (89) |
| Total income taxes from continuing operations | \$ 17 | \$ 110 | \$ 364 | \$ 429 |

(a) In February 2011, the Pennsylvania Department of Revenue issued interpretive guidance on the treatment of bonus depreciation for Pennsylvania income tax purposes. In accordance with Corporation Tax Bulletin 2011-01, Pennsylvania allows 100% bonus depreciation for qualifying assets in the same year bonus depreciation is allowed for federal tax purposes. Due to the decrease in projected taxable income related to bonus depreciation, PPL recorded state deferred income tax expense during the nine months ended September 30, 2011 related to valuation allowances.

Additionally, the 100% Pennsylvania bonus depreciation deduction created a current state income tax benefit for the flow-through impact of Pennsylvania regulated state tax depreciation. The federal provision for 100% bonus depreciation generally applies to property placed into service before January 1, 2012. The placed in-service deadline is extended to January 1, 2013 for property that exceeds \$1 million, has a production period longer than one year and has a tax life of at least ten years.

(b) The U.K. Finance Act of 2012, enacted in July 2012, reduced the U.K. statutory income tax rate from 25% to 24% retroactive to April 1, 2012 and from 24% to 23% effective April 1, 2013. As a result, PPL reduced its net deferred tax liabilities and recognized a deferred tax benefit in the third quarter of 2012 related to both rate decreases.

The U.K. Finance Act of 2011, enacted in July 2011, reduced the U.K. statutory income tax rate from 27% to 26% retroactive to April 1, 2011 and from 26% to 25% effective April 1, 2012. As a result, PPL reduced its net deferred tax liabilities and recognized a deferred tax benefit in the third quarter of 2011 related to both rate decreases.

(c) During the three and nine months ended September 30, 2011, PPL recorded a \$7 million and \$21 million federal income tax benefit related to U.K. pension contributions.

(d) During the nine months ended September 30, 2012, PPL recorded a tax benefit following resolution of a U.K. tax issue related to interest expense.

(e) During the three and nine months ended September 30, 2012, PPL recorded adjustments related to state deferred tax liabilities.

(f) During the nine months ended September 30, 2012, PPL recorded adjustments to deferred taxes related to net operating loss carryforwards of LKE based on income tax return adjustments.

(g) During the three and nine months ended September 30, 2011, PPL recorded non-deductible acquisition-related costs (primarily the U.K. stamp duty tax) associated with its acquisition of WPD Midlands.

(PPL Energy Supply)

| | Three Months | | Nine Months | |
|--|--------------|--------|-------------|--------|
| | 2012 | 2011 | 2012 | 2011 |
| Reconciliation of Income Tax Expense | | | | |
| Federal income tax on Income from Continuing Operations Before | | | | |
| Income Taxes at statutory tax rate - 35% | \$ 25 | \$ 96 | \$ 205 | \$ 272 |
| Increase (decrease) due to: | | | | |
| State income taxes, net of federal income tax benefit | 1 | 11 | 25 | 38 |
| State valuation allowance adjustments (a) | 2 | | 2 | 6 |
| Federal and state tax reserve adjustments | | 1 | | 2 |
| Federal income tax credits | (4) | (5) | (10) | (11) |
| State deferred tax rate change (b) | (6) | | (17) | |
| Other | (2) | 1 | (3) | (2) |
| Total increase (decrease) | (9) | 8 | (3) | 33 |
| Total income taxes from continuing operations | \$ 16 | \$ 104 | \$ 202 | \$ 305 |

(a) In February 2011, the Pennsylvania Department of Revenue issued interpretive guidance on the treatment of bonus depreciation for Pennsylvania income tax purposes. In accordance with Corporation Tax Bulletin 2011-01, Pennsylvania allows 100% bonus depreciation for qualifying assets in the same year bonus depreciation is allowed for federal tax purposes. Due to the decrease in projected taxable income related to bonus depreciation, PPL Energy Supply recorded state deferred income tax expense during the nine months ended September 30, 2011 related to valuation allowances on state net operating loss carryforwards.

(b) During the three and nine months ended September 30, 2012, PPL Energy Supply recorded adjustments related to state deferred tax liabilities.

(PPL Electric)

| | Three Months | | Nine Months | |
|---|--------------|-------|-------------|-------|
| | 2012 | 2011 | 2012 | 2011 |
| Reconciliation of Income Tax Expense | | | | |
| Federal income tax on Income Before Income Taxes at statutory | | | | |
| tax rate - 35% | \$ 17 | \$ 16 | \$ 51 | \$ 64 |
| Increase (decrease) due to: | | | | |
| State income taxes, net of federal income tax benefit | 2 | 2 | 7 | 9 |
| Federal and state tax reserve adjustments | (2) | (2) | (5) | (6) |
| Federal and state income tax return adjustments (a) | | | | (2) |
| Depreciation not normalized (a) | (1) | (1) | (5) | (6) |
| Other | | (1) | (1) | (3) |
| Total increase (decrease) | (1) | (2) | (4) | (8) |
| Total income taxes | \$ 16 | \$ 14 | \$ 47 | \$ 56 |

(a) In February 2011, the Pennsylvania Department of Revenue issued interpretive guidance on the treatment of bonus depreciation for Pennsylvania income tax purposes. In accordance with Corporation Tax Bulletin 2011-01, Pennsylvania allows 100% bonus depreciation for qualifying assets in the same year bonus depreciation is allowed for federal tax purposes. The 100% Pennsylvania bonus depreciation deduction created a current state income tax benefit for the flow-through impact of Pennsylvania regulated state tax depreciation. The federal provision for 100% bonus depreciation generally applies to property placed in service before January 1, 2012.

(LKE)

| | Three Months | | Nine Months | |
|--|--------------|-------|-------------|--------|
| | 2012 | 2011 | 2012 | 2011 |
| Reconciliation of Income Tax Expense | | | | |
| Federal income tax on Income from Continuing Operations Before | | | | |
| Income Taxes at statutory tax rate - 35% | \$ 46 | \$ 50 | \$ 96 | \$ 120 |
| Increase (decrease) due to: | | | | |
| State income taxes, net of federal income tax benefit | 5 | 4 | 7 | 11 |
| Amortization of investment tax credit | (1) | (1) | (4) | (4) |
| Net operating loss carryforward adjustments (a) | | | (9) | |
| Other | (2) | (1) | (1) | (2) |
| Total increase (decrease) | 2 | 2 | (7) | 5 |
| Total income taxes from continuing operations | \$ 48 | \$ 52 | \$ 89 | \$ 125 |

(a) During the nine months ended September 30, 2012, LKE recorded adjustments to deferred taxes related to net operating loss carryforwards based on income tax return adjustments.

(LG&E)

| | Three Months | | Nine Months | |
|---|--------------|-------|-------------|-------|
| | 2012 | 2011 | 2012 | 2011 |
| Reconciliation of Income Tax Expense | | | | |
| Federal income tax on Income Before Income Taxes at statutory | | | | |
| tax rate - 35% | \$ 24 | \$ 23 | \$ 52 | \$ 56 |
| Increase (decrease) due to: | | | | |
| State income taxes, net of federal income tax benefit | 2 | 2 | 5 | 5 |
| Other | (1) | (1) | (3) | (3) |
| Total increase (decrease) | 1 | 1 | 2 | 2 |
| Total income taxes | \$ 25 | \$ 24 | \$ 54 | \$ 58 |

(KU)

| | Three Months | | Nine Months | |
|---|--------------|-------|-------------|-------|
| | 2012 | 2011 | 2012 | 2011 |
| Reconciliation of Income Tax Expense | | | | |
| Federal income tax on Income Before Income Taxes at statutory | | | | |
| tax rate - 35% | \$ 28 | \$ 31 | \$ 66 | \$ 79 |
| Increase (decrease) due to: | | | | |
| State income taxes, net of federal income tax benefit | 3 | 3 | 6 | 7 |
| Other | (1) | (2) | (2) | (4) |
| Total increase (decrease) | 2 | 1 | 4 | 3 |
| Total income taxes | \$ 30 | \$ 32 | \$ 70 | \$ 82 |

Unrecognized Tax Benefits (PPL, PPL Energy Supply, PPL Electric, LKE, LG&E and KU)

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

Changes to unrecognized tax benefits for the periods ended September 30 were as follows.

| PPL | Three Months | | Nine Months | |
|---|--------------|--------|-------------|--------|
| | 2012 | 2011 | 2012 | 2011 |
| Beginning of period | \$ 113 | \$ 250 | \$ 145 | \$ 251 |
| Additions based on tax positions of prior years | 2 | 1 | 6 | 2 |
| Reductions based on tax positions of prior years | | (14) | (31) | (14) |
| Additions based on tax positions related to the current year | | 4 | | 4 |
| Reductions based on tax positions related to the current year | (1) | (1) | (2) | (3) |
| Lapse of applicable statutes of limitations | (2) | (3) | (6) | (8) |
| Effects of foreign currency translation | | (2) | | 3 |
| End of period (a) | \$ 112 | \$ 235 | \$ 112 | \$ 235 |

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| | Three Months | | Nine Months | |
|---|--------------|-------|-------------|--------|
| | 2012 | 2011 | 2012 | 2011 |
| PPL Energy Supply | | | | |
| Beginning of period | \$ 31 | \$ 28 | \$ 28 | \$ 183 |
| Additions based on tax positions of prior years | | | 4 | |
| Reductions based on tax positions of prior years | | | (1) | |
| Derecognize unrecognized tax benefits (b) | | | | (155) |
| End of period | \$ 31 | \$ 28 | \$ 31 | \$ 28 |
| PPL Electric | | | | |
| Beginning of period | \$ 43 | \$ 56 | \$ 73 | \$ 62 |
| Reductions based on tax positions of prior years | (1) | | (28) | |
| Additions based on tax positions related to the current year | | | 1 | |
| Reductions based on tax positions related to the current year | | | | (1) |
| Lapse of applicable statutes of limitations | (2) | (3) | (6) | (8) |
| End of period | \$ 40 | \$ 53 | \$ 40 | \$ 53 |

(a) Unrecognized tax benefits at September 30, 2011 included \$146 million of U.K. capital losses related to positions previously recorded on U.K. income tax returns. In October 2011, the U.K. tax authority accepted these capital loss positions. As a result, capital loss carryforwards were increased. PPL reversed the unrecognized tax benefit and recorded a deferred tax asset in the fourth quarter of 2011. Simultaneously, PPL recorded a valuation allowance against the deferred tax asset related to the increase in capital loss carryforwards.

(b) Represents unrecognized tax benefits derecognized as a result of PPL Energy Supply's distribution of its membership interest in PPL Global to PPL Energy Supply's parent, PPL Energy Funding. See Note 9 in PPL Energy Supply's 2011 Form 10-K for additional information on the distribution.

LKE's, LG&E's and KU's unrecognized tax benefits and changes in those unrecognized tax benefits are insignificant for the three and nine months ended September 30, 2012 and 2011.

At September 30, 2012, it was reasonably possible that during the next 12 months the total amount of unrecognized tax benefits could increase or decrease by the following amounts. For LKE, LG&E and KU, no significant changes in unrecognized tax benefits are projected over the next 12 months.

| | Increase | Decrease |
|-------------------|----------|----------|
| PPL | \$ 21 | \$ 105 |
| PPL Energy Supply | 1 | 31 |
| PPL Electric | 22 | 38 |

These potential changes could result from subsequent recognition, derecognition and/or changes in the measurement of uncertain tax positions related to the creditability of foreign taxes, the timing and utilization of foreign tax credits and the related impact on alternative minimum tax and other credits, the timing and/or valuation of certain deductions,

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

intercompany transactions and unitary filing groups. The events that could cause these changes are direct settlements with taxing authorities, litigation, legal or administrative guidance by relevant taxing authorities and the lapse of an applicable statute of limitation.

At September 30, the total unrecognized tax benefits and related indirect effects that, if recognized, would decrease the effective tax rate were as follows. The amounts for LKE, LG&E and KU were insignificant.

| | 2012 | 2011 |
|-------------------|-------|--------|
| PPL | \$ 34 | \$ 172 |
| PPL Energy Supply | 14 | 12 |
| PPL Electric | 4 | 9 |

Other (PPL, PPL Energy Supply and PPL Electric)

PPL changed its method of accounting for repair expenditures for tax purposes effective for its 2008 tax year for the Pennsylvania generation, transmission and distribution operations. The same change was made for the Montana generation operations for 2009.

In August 2011, the IRS issued Rev. Procs. 2011-42 and 2011-43. Rev. Proc. 2011-42 provides guidance regarding the use and evaluation of statistical samples and sampling estimates. Rev. Proc. 2011-43 provides a safe harbor method of determining whether the repair expenditures for electric transmission and distribution property can be currently deducted for tax purposes. PPL adopted the safe harbor method with the filing of its 2011 federal income tax return.

The IRS has not issued guidance to provide a safe harbor method for repair expenditures for generation property. The IRS may assert and ultimately conclude that PPL's deduction for generation-related expenditures should be disallowed in whole or in part. PPL believes that it has established an adequate reserve for this contingency.

Tax Litigation (PPL)

In 1997, the U.K. imposed a Windfall Profits Tax (WPT) on privatized utilities, including WPD. PPL filed its tax returns for years subsequent to its 1997 and 1998 claims for refund on the basis that the U.K. WPT was creditable. In September 2010, the U.S. Tax Court (Tax Court) ruled in PPL's favor in a dispute with the IRS, concluding that the U.K. WPT is a creditable tax for U.S. tax purposes. As a result, and with finalization of other issues, PPL recorded a \$42 million tax benefit in 2010. In January 2011, the IRS appealed the Tax Court's decision to the U.S. Court of Appeals for the Third Circuit (Third Circuit). In December 2011, the Third Circuit issued its opinion reversing the Tax Court's decision, holding that the U.K. WPT is not a creditable tax. As a result of the Third Circuit's adverse determination, PPL recorded a \$39 million expense in the fourth quarter of 2011. In February 2012, PPL filed a petition for rehearing of the Third Circuit's opinion. In March 2012, the Third Circuit denied PPL's petition. In June 2012, the U.S. Court of Appeals for the Fifth Circuit issued a contrary opinion in an identical case involving another company. In July 2012, PPL filed a petition for a writ of certiorari seeking U.S. Supreme Court review of the Third Circuit's opinion. The Supreme Court granted PPL's petition on October 29, 2012, and PPL is assessing what impact, if any, this development will have on its results of operations in the fourth quarter of 2012. PPL expects the case to be decided before the end of the Supreme Court's current term in June 2013 and cannot predict the outcome of this matter.

6. Utility Rate Regulation

(PPL, PPL Electric, LKE, LG&E and KU)

The following table provides information about the regulatory assets and liabilities of cost-based rate-regulated utility operations.

| | PPL | | PPL Electric | |
|--|-----------------------|----------------------|-----------------------|----------------------|
| | September 30, 2012 | December 31, 2011 | September 30, 2012 | December 31, 2011 |
| Current Regulatory Assets: | | | | |
| Gas supply clause | \$ 6 | \$ 6 | | |
| Fuel adjustment clause | 13 | 3 | | |
| Other | 2 | | | |
| Total current regulatory assets | \$ 21 | \$ 9 | | |
| Noncurrent Regulatory Assets: | | | | |
| Defined benefit plans | \$ 583 | \$ 615 | \$ 266 | \$ 276 |
| Taxes recoverable through future rates | 299 | 289 | 299 | 289 |
| Storm costs | 143 | 154 | 31 | 31 |

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| | | | | |
|---|----------|----------|--------|--------|
| Unamortized loss on debt | 99 | 110 | 68 | 77 |
| Interest rate swaps | 71 | 69 | | |
| Accumulated cost of removal of utility plant | 67 | 53 | 67 | 53 |
| Coal contracts (a) | 5 | 11 | | |
| AROs | 26 | 18 | | |
| Other | 30 | 30 | 2 | 3 |
| Total noncurrent regulatory assets | \$ 1,323 | \$ 1,349 | \$ 733 | \$ 729 |

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| | PPL | | PPL Electric | |
|---|-----------------------|----------------------|-----------------------|----------------------|
| | September 30, 2012 | December 31, 2011 | September 30, 2012 | December 31, 2011 |
| Current Regulatory Liabilities: | | | | |
| Generation supply charge | \$ 24 | \$ 42 | \$ 24 | \$ 42 |
| ECR | 7 | 7 | | |
| Gas supply clause | 5 | 6 | | |
| Transmission service charge | 5 | 2 | 5 | 2 |
| Transmission formula rate | 8 | 5 | 8 | 5 |
| Universal service rider | 12 | 1 | 12 | 1 |
| Other | 4 | 10 | 3 | 3 |
| Total current regulatory liabilities | \$ 65 | \$ 73 | \$ 52 | \$ 53 |

| | | | | |
|--|---------------|-----------------|--------------|-------------|
| Noncurrent Regulatory Liabilities: | | | | |
| Accumulated cost of removal of utility plant | \$ 673 | \$ 651 | | |
| Coal contracts (a) | 151 | 180 | | |
| Power purchase agreement - OVEC (a) | 110 | 116 | | |
| Net deferred tax assets | 35 | 39 | | |
| Act 129 compliance rider | 12 | 7 | \$ 12 | \$ 7 |
| Defined benefit plans | 10 | 9 | | |
| Other | 8 | 8 | | |
| Total noncurrent regulatory liabilities | \$ 999 | \$ 1,010 | \$ 12 | \$ 7 |

| | LKE | | LG&E | | KU | |
|---|-----------------------|----------------------|-----------------------|----------------------|-----------------------|----------------------|
| | September 30, 2012 | December 31, 2011 | September 30, 2012 | December 31, 2011 | September 30, 2012 | December 31, 2011 |
| Current Regulatory Assets: | | | | | | |
| Gas supply clause | \$ 6 | \$ 6 | \$ 6 | \$ 6 | | |
| Fuel adjustment clause | 13 | 3 | 10 | 3 | \$ 3 | |
| Other | 2 | | 1 | | 1 | |
| Total current regulatory assets | \$ 21 | \$ 9 | \$ 17 | \$ 9 | \$ 4 | |
| Noncurrent Regulatory Assets: | | | | | | |
| Defined benefit plans | \$ 317 | \$ 339 | \$ 210 | \$ 225 | \$ 107 | \$ 114 |
| Storm costs | 112 | 123 | 61 | 66 | 51 | 57 |
| Unamortized loss on debt | 31 | 33 | 20 | 21 | 11 | 12 |
| Interest rate swaps | 71 | 69 | 71 | 69 | | |
| Coal contracts (a) | 5 | 11 | 2 | 5 | 3 | 6 |
| AROs | 26 | 18 | 14 | 11 | 12 | 7 |
| Other | 28 | 27 | 6 | 6 | 22 | 21 |
| Total noncurrent regulatory assets | \$ 590 | \$ 620 | \$ 384 | \$ 403 | \$ 206 | \$ 217 |

| | | | | |
|--|------|------|------|------|
| Current Regulatory Liabilities: | | | | |
| ECR | \$ 7 | \$ 7 | \$ 7 | \$ 7 |

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| | | | | | | | | |
|---|--------|----------|----|-----|----|-----|----|------------|
| Gas supply clause | 5 | 6 | \$ | 5 | \$ | 6 | | |
| Other | 1 | 7 | | | | 4 | 1 | 3 |
| Total current regulatory liabilities | \$ 13 | \$ 20 | \$ | 5 | \$ | 10 | \$ | 8 \$ 10 |
| Noncurrent Regulatory Liabilities: | | | | | | | | |
| Accumulated cost of removal | | | | | | | | |
| of utility plant | \$ 673 | \$ 651 | \$ | 294 | \$ | 286 | \$ | 379 \$ 365 |
| Coal contracts (a) | 151 | 180 | | 66 | | 78 | | 85 102 |
| Power purchase agreement - OVEC | | | | | | | | |
| (a) | 110 | 116 | | 76 | | 80 | | 34 36 |
| Net deferred tax assets | 35 | 39 | | 28 | | 31 | | 7 8 |
| Defined benefit plans | 10 | 9 | | | | | | 10 9 |
| Other | 8 | 8 | | 3 | | 3 | | 5 5 |
| Total noncurrent regulatory liabilities | \$ 987 | \$ 1,003 | \$ | 467 | \$ | 478 | \$ | 520 \$ 525 |

(a) These regulatory assets and liabilities were recorded as offsets to certain intangible assets and liabilities that were recorded at fair value upon the acquisition of LKE.

Regulatory Matters

Kentucky Activities (PPL, LKE, LG&E and KU)

CPCN Filing

In September 2011, LG&E and KU filed a CPCN with the KPSC requesting approval to build a 640 MW NGCC at the existing Cane Run plant site in Kentucky. In May 2012, the KPSC issued an order approving the request to build the NGCC.

LG&E will own a 22% undivided interest and KU will own a 78% undivided interest in the new NGCC. A formal request for recovery of the costs associated with the NGCC construction was not included in the CPCN filing with the KPSC but is expected to be included in future rate proceedings. See Note 8 for additional information.

In conjunction with this construction and to meet new, stricter EPA regulations with a 2015 compliance date, LG&E and KU anticipate retiring three coal-fired generating units at LG&E's Cane Run plant, one coal-fired generating unit at KU's Tyrone plant and two coal-fired generating units at KU's Green River plant. These generating units represent 797 MW of combined summer capacity.

The CPCN application also requested approval to purchase the Bluegrass CTs. The May 2012 KPSC approval included authority to complete the Bluegrass CT acquisition. In November 2011, LG&E and KU filed an application with the FERC under the Federal Power Act requesting approval to purchase the Bluegrass CTs. In May 2012, the FERC issued an order conditionally authorizing the acquisition of the Bluegrass CTs, subject to approval by the FERC of satisfactory mitigation measures to address market-power concerns. After a review of potentially available mitigation options, LG&E and KU determined that the options were not commercially justifiable. In June 2012, LG&E and KU terminated the asset purchase agreement for the Bluegrass CTs in accordance with its terms and made applicable filings with the KPSC and FERC. LG&E and KU are currently assessing the impact of the asset purchase agreement termination and potential future generation capacity options. See Note 8 for additional information.

Kentucky Acquisition Commitments

In connection with the September 2010 approval of PPL's acquisition of LKE, LG&E and KU agreed to implement the Acquisition Savings Sharing Deferral (ASSD) methodology whereby LG&E's and KU's adjusted jurisdictional revenues, expenses, and net operating income are calculated each year. If LG&E's or KU's actual earned rate of return on common equity exceeds 10.75%, half of the excess amount will be deferred as a regulatory liability and ultimately returned to customers. The first ASSD filing with the KPSC was made on March 30, 2012 based on the 2011 calendar year. On July 2, 2012, the KPSC issued an order approving the calculations contained in the 2011 ASSD filing and determined that such calculations produced no deferral amounts for the purpose of establishing regulatory liabilities and are proper and in accordance with the settlement agreement. The ASSD methodology for each of LG&E's and KU's utility operations will terminate on the earlier of the end of 2015 or the first day of the calendar year during which new base rates go into effect, currently expected to be 2013. Therefore, due to the timing of the current rate case in Kentucky, no further ASSD filings are expected.

Rate Case Proceedings

In June 2012, LG&E and KU filed requests with the KPSC for increases in annual base electric rates of approximately \$62 million at LG&E and approximately \$82 million at KU and an increase in annual base gas rates of approximately \$17 million at LG&E. The proposed base rate increases would result in electric rate increases of 6.9% at LG&E and 6.5% at KU and a gas rate increase of 7.0% at LG&E and would be effective in January 2013. LG&E's and KU's applications include requests for authorized returns-on-equity at LG&E and KU of 11% each. In November 2012, the KPSC issued an order for a settlement conference to begin on November 13, 2012. A hearing on the original application and subsequent testimony is scheduled to begin on November 27, 2012. LG&E and KU cannot predict the outcome of these proceedings, including the possibility of any agreed stipulations or settlement, which would remain subject to KPSC approval. A final order may be issued in December 2012 or January 2013.

Independent Transmission Operators

In September 2012, LG&E and KU completed the transition of their independent transmission operator contractual arrangements from Southwest Power Pool, Inc. to TranServ International, Inc. This change had previously received

approvals of the FERC and the KPSC.

Storm Costs (PPL, LKE and LG&E)

In August 2011, a strong storm hit LG&E's service area causing significant damage and widespread outages for approximately 139,000 customers. LG&E filed an application with the KPSC in September 2011, requesting approval of a regulatory asset recorded to defer, for future recovery, \$7 million in incremental operation and maintenance expenses related to the storm restoration. An order was received in December 2011 granting the request, while the recovery of the regulatory asset will be determined within the current base rate case discussed above in "Rate Case Proceedings".

Pennsylvania Activities

(PPL and PPL Electric)

PUC Investigation of Retail Market

In April 2011, the PUC opened an investigation of Pennsylvania's retail electricity market to be conducted in two phases. Phase one addressed the status of the existing retail market and explored potential changes. Questions issued by the PUC for this phase of the investigation focused primarily on default service issues. Phase two was initiated in July 2011 to develop specific proposals for changes to the retail market and default service model. In December 2011, the PUC issued a final order providing guidance to Electric Distribution Companies (EDCs) on the design of their next default service procurement plan filings. In December 2011, the PUC also issued a tentative order proposing an intermediate work plan to address issues raised in the investigation. In March 2012, the PUC entered a final order on the intermediate work plan, issued three possible models for the default service "end state" and held a hearing regarding those three models. In September 2012, the PUC issued a Secretarial Letter setting forth an "RMI End State Proposal" for discussion. The PUC is expected to issue a tentative implementation order in early November 2012, following which parties will have 30 days to provide comment. A final implementation order is expected to be issued in the first quarter of 2013. PPL and PPL Electric cannot predict the outcome of the investigation or its impact on their financial condition, or results of operations.

Legislation - Regulatory Procedures and Mechanisms

In June 2011, the Pennsylvania House Consumer Affairs Committee approved legislation authorizing the PUC to approve regulatory procedures and mechanisms to provide more timely recovery of a utility's costs. In the first quarter of 2012, the Governor signed an amended version of the legislation (Act 11 of 2012), which became effective April 14, 2012. The legislation authorizes the PUC to approve two specific ratemaking mechanisms -- a fully projected future test year and, subject to certain conditions, a distribution system improvements charge (DSIC). Such alternative ratemaking procedures and mechanisms are important to PPL Electric as it begins a period of significant capital investment to maintain and enhance the reliability of its delivery system, including the replacement of aging distribution assets. In August 2012, the PUC issued a Final Implementation Order adopting procedures, guidelines and a model tariff for the implementation of Act 11 of 2012. In September 2012, PPL Electric filed its Long Term Infrastructure Improvement Plan (LTIIIP) describing projects eligible for inclusion in the DSIC. In October 2012, several parties filed comments to the LTIIIP but none of the comments requested evidentiary hearings on the LTIIIP. A decision on the LTIIIP is expected in January 2013. PPL Electric expects to file a petition requesting permission to establish a DSIC in January 2013, with rates proposed to be effective in April 2013.

Rate Case Proceeding

In March 2012, PPL Electric filed a request with the PUC to increase distribution rates by approximately \$105 million, effective January 1, 2013. The proposed distribution rate increase would result in a 2.9% increase over PPL Electric's total rates at the time of the request. PPL Electric's application includes a request for an authorized return on equity of 11.25%. On October 19, 2012, the presiding Administrative Law Judge (ALJ) issued a decision recommending a rate increase of approximately \$64 million, which represents an allowed return on equity of 9.74%. Exceptions to the ALJ's recommendation are due November 8, 2012. PPL Electric expects to file exceptions, together with certain other parties, to the ALJ's recommended decision. The PUC, which is expected to issue its order on the rate request in December 2012, can accept, reject or modify the ALJ's recommendation. PPL and PPL Electric cannot predict the outcome of this proceeding.

ACT 129

Act 129 requires Pennsylvania EDCs to meet specified goals for reduction in customer electricity usage and peak demand by specified dates. EDCs not meeting the requirements of Act 129 are exposed to significant penalties.

Under Act 129, EDCs must file an energy efficiency and conservation plan (EE&C Plan) with the PUC and contract with conservation service providers to implement all or a portion of the EE&C Plan. Act 129 requires EDCs to reduce overall electricity consumption by 1.0% by May 2011 and 3.0% by May 2013, and reduce peak demand by 4.5% for the 100 hours of highest demand by May 2013 (which is determined by actual demand reduction during the June 2012 through September 2012 period). EDCs will be able to recover the costs (capped at 2% of the EDC's 2006 revenue) of implementing their EE&C Plans. In October 2009, the PUC approved PPL Electric's EE&C Plan. The PUC has confirmed that PPL Electric has met the 2011 requirement.

Act 129 requires the PUC to evaluate the costs and benefits of the EE&C program by November 30, 2013 and adopt additional reductions if the benefits of the program exceed the costs. In March 2012, the PUC began the process of designing Phase II of the EE&C program. In August 2012, after receiving input from stakeholders, the PUC issued a Final Implementation Order establishing a three-year Phase II program, ending May 31, 2016, with consumption reduction targets for each EDC. PPL Electric's reduction target is 2.1%. The PUC did not establish any demand reduction targets for the Phase II program. In August 2012 PPL Electric filed a Petition for Reconsideration of the PUC's Order, which the PUC denied. In August 2012, PPL Electric also filed a Petition for an Evidentiary Hearing regarding its consumption reduction target. The PUC assigned the petition to an ALJ. A hearing on the petition was held on October 18, 2012. The ALJ will certify the record of the hearing to the PUC for a decision. EDCs must file Phase II plans with the PUC by November 15, 2012. PPL and PPL Electric cannot predict the outcome of the foregoing proceedings.

Act 129 also requires the Default Service Provider (DSP) to provide electric generation supply service to customers pursuant to a PUC-approved default service procurement plan through auctions, requests for proposal and bilateral contracts at the sole discretion of the DSP. Act 129 requires a mix of spot market purchases, short-term contracts and long-term contracts (4 to 20 years), with long-term contracts limited to 25% of the load unless otherwise approved by the PUC. The DSP will be able to recover the costs associated with a competitive procurement plan.

The PUC has approved PPL Electric's procurement plan for the period January 1, 2011 through May 31, 2013, and PPL Electric continues to procure power for its PLR obligations under that plan.

The PUC has directed all EDCs to file default service procurement plans for the period June 1, 2013 through May 31, 2015. PPL Electric filed its plan in May 2012. In that plan, PPL Electric proposed a process to obtain supply for its default service customers and a number of initiatives designed to encourage more customers to purchase electricity from the competitive retail market. The PUC assigned PPL Electric's plan to an ALJ. Hearings were held in September 2012 and a recommended decision is expected in the fourth quarter of 2012. The PUC is expected to rule on the plan in early 2013.

Storm Costs

PPL Electric experienced several PUC-reportable storms during the three and nine months ended September 30, 2011 resulting in total restoration costs of \$34 million and \$59 million, of which \$23 million and \$39 million were recorded in "Other operation and maintenance" on the Statement of Income. Although PPL Electric has storm insurance with a PPL affiliate, the costs associated with the unusually high number of PUC-reportable storms exceeded policy limits. Probable recoveries on insurance claims of \$26.5 million were recorded at September 30, 2011, of which \$7 million and \$16 million were recorded during the three and nine months ended September 30, 2011 in "Other operation and maintenance" on the Statement of Income, with the remainder recorded in PP&E on the Balance Sheet. In December 2011, PPL Electric received orders from the PUC granting permission to defer qualifying storm costs in excess of insurance recoveries associated with Hurricane Irene and a late October 2011 snowstorm. In the recommended decision in the distribution rate proceeding discussed above in "Pennsylvania Activities - Rate Case Proceeding," the presiding ALJ recommended that PPL Electric be allowed to recover deferred storm costs of approximately \$27 million over a five-year period. The PUC, which is expected to issue its order in December 2012, can accept, reject or modify the ALJ's recommendation. New rates will become effective on January 1, 2013. PPL and PPL Electric cannot predict the outcome of this proceeding. In 2012, PPL Electric increased the deductible under its insurance policy to \$15.75 million and, therefore, would only request insurance recovery of reportable storm costs exceeding that amount. During the three and nine months ended September 30, 2012, PPL Electric incurred \$13 million in restoration costs, of which \$9 million was recorded in "Other operation and maintenance" on the Statement of Income.

In late October 2012, PPL Electric experienced widespread significant damage to its transmission and distribution network from Hurricane Sandy. The total costs associated with the restoration efforts are still being finalized but are estimated to be in excess of \$60 million. PPL Electric has insurance coverage that could cover a portion of the costs incurred from Hurricane Sandy. PPL Electric will have the ability to file a request with the PUC for permission to defer for future recovery certain of the costs incurred to repair the distribution network in excess of the insurance coverage. Costs incurred to repair the transmission network are recoverable through the FERC Formula Rate mechanism which is updated annually.

Transmission Service Charge Adjustment (PPL Electric)

During the three and nine months ended September 30, 2011, PPL Electric recorded a \$7 million (\$4 million after-tax) charge to "Retail electric" revenue on the Statement of Income to reduce a portion of the transmission service charge regulatory asset associated with a 2005 undercollection that was not included in any subsequent rate reconciliations filed with the PUC. The impact of this charge was not material to any previously reported financial statements and was not material to the financial statements for the full year of 2011.

Federal Matters (PPL and PPL Electric)

FERC Formula Rates

Transmission rates are regulated by the FERC. PPL Electric's transmission revenues are billed in accordance with a FERC-approved PJM open access transmission tariff that utilizes a formula-based rate recovery mechanism.

In May 2010, PPL Electric initiated its formula rate 2010 Annual Update. In November 2010, a group of municipal customers taking transmission service in PPL Electric's transmission zone filed a preliminary challenge to the update and, in December 2010, filed a formal challenge. In August 2011, the FERC issued an order substantially rejecting the formal challenge and accepting PPL Electric's 2010 Annual Update. The group of municipal customers filed a request for rehearing of that order.

In May 2011, PPL Electric initiated its formula rate 2011 Annual Update. In October 2011, the group of municipal customers filed a preliminary challenge to the update and, in December 2011, filed a formal challenge. In January 2012, PPL Electric filed a response to that formal challenge. In September 2012, the FERC issued an order setting for evidentiary hearings a number of issues raised in the 2010 formal challenge and a number of issues raised in the 2011 formal challenge. The FERC held the hearings in abeyance for settlement judge proceedings and assigned a settlement judge. PPL Electric filed a request for rehearing of the September 2012 order in late October 2012. An initial settlement meeting will be scheduled in November 2012.

In May 2012, PPL Electric initiated its formula rate 2012 Annual Update which currently is in the 180-day review and challenge period. In October 2012, the group of municipal customers filed a preliminary challenge to the 2012 Annual Update. PPL Electric will meet with representatives of the customers in an attempt to resolve the challenge. PPL and PPL Electric cannot predict the outcome of the foregoing proceedings, which remain pending before the FERC.

In March 2012, PPL Electric filed a request with the FERC seeking recovery, over a 34-year period beginning in June 2012, of its unrecovered regulatory asset related to the deferred state tax liability that existed at the time of the transition from the flow-through treatment of state income taxes to full normalization. This change in tax treatment occurred in 2008 as a result of prior FERC initiatives that transferred regulatory jurisdiction of certain transmission assets from the PUC to FERC. A regulatory asset of approximately \$50 million related to this transition, classified as taxes recoverable through future rates, is included in "Other Noncurrent Assets - Regulatory assets" on the Balance Sheets at September 30, 2012 and December 31, 2011. In May 2012, the FERC issued an order approving PPL Electric's request effective June 1, 2012.

U. K. Activities (PPL)

Ofgem Review of Line Loss Calculation

WPD has a \$172 million liability recorded at September 30, 2012 compared with \$170 million at December 31, 2011, calculated in accordance with Ofgem's accepted methodology, related to the close-out of line losses for the prior price control period, DPCR4. Ofgem is currently consulting on the methodology to be used by all network operators to calculate the final line loss incentive/penalty for DPCR4. In October 2011, Ofgem issued a consultation paper citing two potential changes to the methodology, both of which would result in a reduction of the liability. In March 2012, Ofgem issued a decision regarding the preferred methodology. In July 2012, Ofgem issued a consultation paper regarding certain aspects of the preferred methodology as it relates to the DPCR4 line loss incentive/penalty and a proposal to delay the target date for making a final decision until April 2013 together with a proposal to remove the line loss incentive/penalty for DPCR5. In October 2012, a license modification was issued to allow Ofgem to publish

the final decisions on these matters by April 2013. PPL cannot predict the outcome of this matter.

European Market Infrastructure Regulation

Regulation No. 648/2012 of the European Parliament and of the Council, commonly referred to as the European Market Infrastructure Regulation (EMIR), entered into force on August 16, 2012 and, subject to approval by the European Commission of final technical standards, is expected to become effective in January 2013. The EMIR establishes certain transaction clearing and other recordkeeping requirements for parties to over-the-counter derivatives transactions. Included in the derivative transactions that are subject to EMIR are certain interest rate and currency derivative contracts utilized by WPD. Generally, WPD is expected to qualify under the EMIR as a non-financial counterparty to the transactions in which it engages and further to qualify for certain exemptions that will relieve WPD from the mandatory clearing obligations imposed by the EMIR. Although the EMIR will potentially impose significant additional recordkeeping requirements on WPD, the effect of the EMIR is not currently expected to have a significant adverse impact on WPD's financial condition or results of operation.

7. Financing Activities

Credit Arrangements and Short-term Debt

(PPL, PPL Energy Supply, PPL Electric, LKE, LG&E and KU)

The Registrants maintain credit facilities to enhance liquidity, provide credit support, and provide a backstop to commercial paper programs. For reporting purposes, on a consolidated basis, the credit facilities of PPL Energy Supply, PPL Electric, LG&E and KU also apply to PPL and the credit facilities of LG&E and KU also apply to LKE. The following credit facilities were in place at:

| | Expiration Date | Capacity | September 30, 2012 | | | December 31, 2011 | | |
|--|-----------------|-----------------|--------------------|--|-----------------|-------------------|--|--|
| | | | Borrowed (a) | Letters of Credit Issued and Commercial Paper Backstop | Unused Capacity | Borrowed (a) | Letters of Credit Issued and Commercial Paper Backstop | |
| PPL | | | | | | | | |
| WPD Credit Facilities | | | | | | | | |
| PPL WW Syndicated | | | | | | | | |
| Credit Facility (b) | Jan. 2013 | £ 150 | £ 107 | n/a | £ 43 | £ 111 | n/a | |
| WPD (South West) | | | | | | | | |
| Syndicated Credit Facility (c) | Jan. 2017 | 245 | | n/a | 245 | | n/a | |
| WPD (East Midlands) | | | | | | | | |
| Syndicated Credit Facility | Apr. 2016 | 300 | | | 300 | | £ 70 | |
| WPD (West Midlands) | | | | | | | | |
| Syndicated Credit Facility | Apr. 2016 | 300 | | | 300 | | 71 | |
| Uncommitted Credit Facilities | | 84 | | £ 4 | 80 | | 3 | |
| Total WPD Credit Facilities (d) | | £ 1,079 | £ 107 | £ 4 | £ 968 | £ 111 | £ 144 | |
| PPL Energy Supply | | | | | | | | |
| Syndicated Credit Facility (e) | Oct. 2016 | \$ 3,000 | | \$ 468 | \$ 2,532 | | \$ 541 | |
| Letter of Credit Facility | Mar. 2013 | 200 | n/a | 126 | 74 | n/a | 89 | |
| Uncommitted Credit Facilities (f) | | 175 | n/a | 32 | 143 | n/a | n/a | |
| Total PPL Energy Supply Credit Facilities | | \$ 3,375 | | \$ 626 | \$ 2,749 | | \$ 630 | |
| PPL Electric | | | | | | | | |
| Syndicated Credit Facility (e) (g) | Oct. 2016 | \$ 300 | | \$ 1 | \$ 299 | | \$ 1 | |

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| | | | | | |
|---|---------------|---------------|---------------|---------------|---------------|
| Asset-backed Credit Facility (h) | Sept. 2013 | 100 | n/a | 100 | n/a |
| Total PPL Electric Credit Facilities | | \$ 400 | \$ 1 | \$ 399 | \$ 1 |
| LG&E | | | | | |
| Syndicated Credit Facility (e) | Oct. 2016 | \$ 400 | | \$ 400 | |
| KU | | | | | |
| Syndicated Credit Facility (e) | Oct. 2016 | \$ 400 | | \$ 400 | |
| Letter of Credit Facility (i) | Apr. 2014 | 198 | \$ 198 | | n/a \$ 198 |
| Total KU Credit Facilities | | \$ 598 | \$ 198 | \$ 400 | \$ 198 |

- (a) Amounts borrowed are recorded as "Short-term debt" on the Balance Sheets.
- (b) The amount outstanding at September 30, 2012 was a USD-denominated borrowing of \$171 million, which equated to £107 million at the time of borrowing and bore interest at 0.8818%.
- (c) In January 2012, WPD (South West) entered into a £245 million 5-year syndicated credit facility to replace the previous £210 million 3-year syndicated credit facility that was set to expire in July 2012. Under the facility, WPD (South West) has the ability to make cash borrowings but cannot request the lenders to issue letters of credit. WPD (South West) pays customary commitment fees under this facility and borrowings bear interest at LIBOR-based rates plus a margin. The credit facility contains financial covenants that require WPD (South West) to maintain an interest coverage ratio of not less than 3.0 times consolidated earnings before income taxes, depreciation and amortization and total net debt not in excess of 85% of its RAV, in each case calculated in accordance with the credit facility.
- (d) At September 30, 2012, the U.S. dollar equivalent of unused capacity under WPD's credit facilities was \$1.5 billion.
- (e) In November 2012, the syndicated credit facilities were amended to extend the expiration dates to November 2017 for PPL Energy Supply, LG&E and KU and to October 2017 for PPL Electric. In addition, LG&E increased the credit facility capacity to \$500 million.

(f) In July 2012, PPL Energy Supply entered into two uncommitted letter of credit facilities with available capacity of \$75 million and \$100 million, respectively, which expire in July 2014 and July 2015. Both facilities contain a financial covenant requiring PPL Energy Supply's debt to capitalization not to exceed 65%, as calculated in accordance with the agreements. PPL Energy Supply will pay customary fees for letters of credit issued under these facilities.

(g) In April 2012, PPL Electric increased the capacity of its syndicated credit facility from \$200 million.

(h) PPL Electric participates in an asset-backed commercial paper program through which PPL Electric obtains financing by selling and contributing its eligible accounts receivable and unbilled revenue to a special purpose, wholly owned subsidiary on an ongoing basis. The subsidiary has pledged these assets to secure loans from a commercial paper conduit sponsored by a financial institution.

At September 30, 2012 and December 31, 2011, \$240 million and \$251 million of accounts receivable and \$80 million and \$98 million of unbilled revenue were pledged by the subsidiary under the credit agreement related to PPL Electric's and the subsidiary's participation in the asset-backed commercial paper program. Based on the accounts receivable and unbilled revenue pledged at September 30, 2012, the amount available for borrowing under the facility was \$100 million. PPL Electric's sale to its subsidiary of the accounts receivable and unbilled revenue is an absolute sale of assets, and PPL Electric does not retain an interest in these assets. However, for financial reporting purposes, the subsidiary's financial results are consolidated in PPL Electric's financial statements. PPL Electric performs certain record-keeping and cash collection functions with respect to the assets in return for a servicing fee from the subsidiary.

In July 2012, PPL Electric and the subsidiary reduced the capacity from \$150 million and in September 2012 extended the agreement to September 2013.

(i) In August 2012, the KU letter of credit facility agreement was amended and restated to allow for certain payments under the letter of credit facility to be converted to loans rather than requiring immediate payment.

(PPL and PPL Energy Supply)

PPL Energy Supply maintains a \$500 million Facility Agreement expiring June 2017, whereby PPL Energy Supply has the ability to request up to \$500 million of committed letter of credit capacity at fees to be agreed upon at the time of each request, based on certain market conditions. At September 30, 2012, PPL Energy Supply has not requested any capacity for the issuance of letters of credit under this arrangement.

PPL Energy Supply, PPL EnergyPlus, PPL Montour and PPL Brunner Island maintain an \$800 million secured energy marketing and trading facility, whereby PPL EnergyPlus will receive credit to be applied to satisfy collateral posting obligations related to its energy marketing and trading activities with counterparties participating in the facility. The credit amount is guaranteed by PPL Energy Supply, PPL Montour and PPL Brunner Island. PPL Montour and PPL Brunner Island have granted liens on their respective generating facilities to secure any amount they may owe under their guarantees. The facility expires in November 2016, but is subject to automatic one-year renewals under certain conditions. There were no secured obligations outstanding under this facility at September 30, 2012.

In April 2012, PPL Energy Supply increased the capacity of its commercial paper program from \$500 million to \$750 million to provide an additional financing source to fund its short-term liquidity needs, if and when necessary. Commercial paper issuances are supported by PPL Energy Supply's Syndicated Credit Facility. At September 30, 2012, PPL Energy Supply had \$355 million of commercial paper outstanding, included in "Short-term debt" on the Balance Sheet, at a weighted-average interest rate of 0.48%.

(PPL and PPL Electric)

In May 2012, PPL Electric increased the capacity of its commercial paper program from \$200 million to \$300 million to provide an additional financing source to fund its short-term liquidity needs, if and when necessary. Commercial paper issuances are supported by PPL Electric's Syndicated Credit Facility. PPL Electric had no commercial paper outstanding at September 30, 2012.

(PPL, LKE, LG&E and KU)

In February 2012, LG&E and KU each established a commercial paper program for up to \$250 million to provide an additional financing source to fund their short-term liquidity needs, if and when necessary. Commercial paper issuances are supported by LG&E's and KU's Syndicated Credit Facilities. LG&E and KU had no commercial paper outstanding at September 30, 2012.

(PPL Energy Supply, PPL Electric, LKE, LG&E and KU)

See Note 11 for discussion of intercompany borrowings.

Long-term Debt and Equity Securities

(PPL)

In April 2012, PPL made a registered underwritten public offering of 9.9 million shares of its common stock. In conjunction with that offering, the underwriters exercised an option to purchase 591 thousand additional shares of PPL common stock solely to cover over-allotments.

In connection with the registered public offering, PPL entered into forward sale agreements with two counterparties covering the 9.9 million shares of PPL common stock. Settlement of these initial forward sale agreements will occur no later than April 2013. As a result of the underwriters' exercise of the overallotment option, PPL entered into additional forward sale agreements covering the additional 591 thousand shares of PPL common stock. Settlement of the subsequent forward sale agreements will occur in July 2013. Upon any physical settlement of any forward sale agreement, PPL will issue and deliver to the forward counterparties shares of its common stock in exchange for cash proceeds per share equal to the forward sale price. The forward sale price will be calculated based on an initial forward price of \$27.02 per share reduced during the period the contracts are outstanding as specified in the forward sale agreements. PPL may, in certain circumstances, elect cash settlement or net share settlement for all or a portion of its rights or obligations under the forward sale agreements.

PPL will not receive any proceeds or issue any shares of common stock until settlement of the forward sale agreements. PPL intends to use any net proceeds that it receives upon settlement to repay short-term debt obligations and for other general corporate purposes.

The forward sale agreements are classified as equity transactions. As a result, no amounts will be recorded in the consolidated financial statements until the settlement of the forward sale agreements. Prior to those settlements, the only impact to the financial statements will be the inclusion of incremental shares within the calculation of diluted EPS using the treasury stock method. See Note 4 for information on the forward sale agreements impact on the calculation of diluted EPS.

In April 2012, WPD (East Midlands) issued £100 million aggregate principal amount of 5.25% Senior Notes due 2023. WPD (East Midlands) received proceeds of £111 million, which equated to \$178 million at the time of issuance, net of underwriting fees. The net proceeds were used for general corporate purposes.

In June 2012, PPL Capital Funding issued \$400 million of 4.20% Senior Notes due 2022. The notes may be redeemed at PPL Capital Funding's option any time prior to maturity at make-whole redemption prices. PPL Capital Funding received proceeds of \$396 million, net of a discount and underwriting fees, which were used for general corporate purposes.

In August 2012, PPL Capital Funding redeemed at par, plus accrued interest, the \$99 million outstanding principal amount of its 6.85% Senior Notes due 2047.

In October 2012, PPL Capital Funding issued \$400 million of 3.50% Senior Notes due 2022. The notes may be redeemed at PPL Capital Funding's option any time prior to maturity at make-whole redemption prices. PPL Capital Funding received proceeds of \$397 million, net of a discount and underwriting fees, which will be used to repay short-term debt obligations, including commercial paper borrowings, and for general corporate purposes.

See Note 7 in PPL's 2011 Form 10-K for information on the 2010 Equity Units (with respect to which the related \$1.150 billion of Notes are expected to be remarketed in 2013), the 2011 Bridge Facility, the 2011 Equity Units and the April 2011 issuance of common stock.

(PPL and PPL Energy Supply)

In April 2012, an indirect, wholly owned subsidiary of PPL Energy Supply completed the Ironwood Acquisition. See Note 8 for information on the transaction and the long-term debt of PPL Ironwood, LLC assumed through consolidation as part of the acquisition.

(PPL and PPL Electric)

In June 2012, PPL Electric redeemed all 2.5 million shares of its 6.25% Series Preference Stock, par value \$100 per share. The price paid for the redemption was the par value, without premium (\$250 million in the aggregate). At December 31, 2011, the preference stock was reflected in "Noncontrolling Interests" on PPL's Balance Sheet and in "Preference stock" on PPL Electric's Balance Sheet.

In August 2012, PPL Electric issued \$250 million of 2.50% First Mortgage Bonds due 2022. The notes may be redeemed at PPL Electric's option any time prior to maturity at make-whole redemption prices. PPL Electric received proceeds of \$247 million, net of a discount and underwriting fees. The net proceeds were used to repay short-term indebtedness incurred to fund PPL Electric's redemption of its 6.25% Series Preference Stock in June 2012 and for other general corporate purposes.

(PPL and LKE)

In June 2012, LKE completed an exchange of all its outstanding 4.375% Senior Notes due 2021 issued in September 2011 in a transaction not registered under the Securities Act of 1933, for similar securities that were issued in a transaction registered with the SEC. See Note 7 in PPL's and LKE's 2011 Form 10-K for additional information.

Legal Separateness

(PPL, PPL Energy Supply, PPL Electric and LKE)

The subsidiaries of PPL are separate legal entities. PPL's subsidiaries are not liable for the debts of PPL. Accordingly, creditors of PPL may not satisfy their debts from the assets of PPL's subsidiaries absent a specific contractual undertaking by a subsidiary to pay PPL's creditors or as required by applicable law or regulation. Similarly, absent a specific contractual undertaking or as required by applicable law or regulation, PPL is not liable for the debts of its subsidiaries, nor are its subsidiaries liable for the debts of one another. Accordingly, creditors of PPL's subsidiaries may not satisfy their debts from the assets of PPL or its other subsidiaries absent a specific contractual undertaking by PPL or its other subsidiaries to pay the creditors or as required by applicable law or regulation.

Similarly, the subsidiaries of PPL Energy Supply, PPL Electric and LKE are each separate legal entities. These subsidiaries are not liable for the debts of PPL Energy Supply, PPL Electric and LKE. Accordingly, creditors of PPL Energy Supply, PPL Electric and LKE may not satisfy their debts from the assets of their subsidiaries absent a specific contractual undertaking by a subsidiary to pay the creditors or as required by applicable law or regulation. Similarly, absent a specific contractual undertaking or as required by applicable law or regulation, PPL Energy Supply, PPL Electric and LKE are not liable for the debts of their subsidiaries, nor are their subsidiaries liable for the debts of one another. Accordingly, creditors of these subsidiaries may not satisfy their debts from the assets of PPL Energy Supply, PPL Electric and LKE (or their other subsidiaries) absent a specific contractual undertaking by that parent or other subsidiary to pay such creditors or as required by applicable law or regulation.

Distributions and Capital Contributions

(PPL)

In August 2012, PPL declared its quarterly common stock dividend, payable October 1, 2012, at 36.0 cents per share (equivalent to \$1.44 per annum). Future dividends, declared at the discretion of the Board of Directors, will be dependent upon future earnings, cash flows, financial and legal requirements and other factors.

(PPL Energy Supply, PPL Electric, LKE, LG&E and KU)

During the nine months ended September 30, 2012, the following distributions and capital contributions occurred:

| PPL Energy Supply | LKE | LG&E | KU |
|----------------------|-----|------|----|
|----------------------|-----|------|----|

PPL
Electric

| | | | | | | | | | | |
|---|----|-----|----|-----|----|----|----|----|----|----|
| Dividends/distributions paid to parent/member | \$ | 733 | \$ | 75 | \$ | 95 | \$ | 47 | \$ | 68 |
| Capital contributions received from parent/member | | 472 | | 150 | | | | | | |

(PPL, LKE, LG&E and KU)

Since the payment of dividends from jurisdictional public utilities is governed by the Federal Power Act, LG&E and KU petitioned the FERC requesting authorization to pay dividends in the future based on retained earnings balances calculated without giving effect to the impact of purchase accounting adjustments for the acquisition of LKE by PPL. In May 2012, FERC approved the petitions; however, each utility's adjusted equity ratio must equal or exceed 30% of total capitalization in order to pay dividends. LG&E and KU do not intend to change their dividend practices as a result of this order.

8. Acquisitions, Development and Divestitures

(PPL, PPL Energy Supply, PPL Electric, LKE, LG&E and KU)

The Registrants periodically evaluate opportunities for potential acquisitions, divestitures and development projects. Development projects are periodically reexamined based on market conditions and other factors to determine whether to proceed with the projects, sell, cancel or expand them, execute tolling agreements or pursue other options. Any resulting transactions may impact future financial results.

Acquisitions

Ironwood Acquisition (PPL and PPL Energy Supply)

On April 13, 2012, an indirect, wholly owned subsidiary of PPL Energy Supply completed the acquisition of all of the equity interests of two subsidiaries of The AES Corporation, AES Ironwood, L.L.C. (subsequently renamed PPL Ironwood, LLC) and AES Prescott, L.L.C. (subsequently renamed PPL Prescott, LLC), which own and operate, respectively, the Ironwood Facility. The Ironwood Facility began operation in 2001 and, since 2008, PPL EnergyPlus has supplied natural gas for the facility and received the facility's full electricity output and capacity value pursuant to a tolling agreement that expires in 2021. See Note 11 in PPL's and PPL Energy Supply's 2011 Form 10-K for additional information on the tolling agreement. The acquisition provides PPL Energy Supply, through its subsidiaries, operational control of additional combined-cycle gas generation in PJM.

The consideration paid for this acquisition, subject to finalization of net indebtedness and fair value adjustments, was as follows.

| | |
|--|--------|
| Aggregate enterprise consideration | \$ 326 |
| Less: Estimated fair value of long-term debt outstanding assumed through consolidation (a) | 258 |
| Plus: Restricted cash debt service reserves | 17 |
| Cash consideration paid for equity interests (including working capital adjustments) | \$ 85 |

(a) The estimated long-term debt assumed through consolidation consisted of \$226 million aggregate principal amount of 8.857% senior secured bonds to be fully repaid by 2025, plus \$8 million of debt service reserve loans, and a \$24 million estimated fair value adjustment.

Preliminary Purchase Price Allocation

The following table summarizes the preliminary allocation of the purchase price to the estimated fair value of the major classes of assets acquired and liabilities assumed through consolidation, and the effective settlement of the tolling agreement through consolidation.

| | |
|---|--------|
| PP&E | \$ 505 |
| Long-term debt (current and noncurrent) (a) | (258) |
| Tolling agreement assets eliminated (b) | (170) |
| Other net assets | 8 |
| Net identifiable assets acquired (c) | \$ 85 |

(a) Represents non-cash activity excluded from the Statement of Cash Flows for the nine months ended September 30, 2012.

- (b) Primarily an intangible asset, which represented PPL EnergyPlus' rights to and the related accounting for the tolling agreement with PPL Ironwood, LLC prior to the acquisition. On the acquisition date, PPL Ironwood, LLC recorded a liability, recognized at estimated fair value, for its obligation to PPL EnergyPlus. The tolling agreement assets of PPL EnergyPlus and the tolling agreement liability of PPL Ironwood, LLC eliminate in consolidation for PPL and PPL Energy Supply as a result of the acquisition, and therefore the agreement is considered effectively settled. Any difference between the tolling agreement assets and liability will result in a gain or loss on the effective settlement of the agreement. That amount is currently estimated to be insignificant.
- (c) Goodwill is currently estimated to be insignificant.

At the date of acquisition, total future minimum lease payments to be made by PPL EnergyPlus to PPL Ironwood, LLC under the tolling agreement were \$270 million. These payments, which were included in the total minimum lease payments disclosed in Note 11 of PPL's and PPL Energy Supply's 2011 Form 10-K, will continue to be made by PPL EnergyPlus to PPL Ironwood, LLC following the acquisition, but will eliminate in consolidation.

In addition, Note 20 of PPL's and PPL Energy Supply's 2011 Form 10-K included annual forecasted amortization expense of \$15 million for each of the years 2012 through 2016 related to the PPL EnergyPlus tolling agreement intangible asset. This amortization will eliminate in consolidation for PPL and PPL Energy Supply as PPL Ironwood, LLC is now a subsidiary of PPL Energy Supply as a result of the acquisition.

The purchase price allocation is preliminary and could change in subsequent periods. The preliminary purchase price allocation was based on PPL Energy Supply's best estimates using information obtained as of the reporting date. Any changes to the purchase price allocation that result in material changes to the consolidated financial results will be adjusted retrospectively. The final purchase price allocation is expected to be completed by the end of 2012. The items pending finalization include, but are not limited to, the valuation of PP&E, long-term debt, certain contractual liabilities, including the tolling agreement, the resulting gain (loss) and goodwill.

Acquisition of WPD Midlands (PPL)

See Notes 1 and 10 in PPL's 2011 Form 10-K for information on PPL's April 1, 2011 acquisition of WPD Midlands.

Separation Benefits - U.K. Regulated Segment

In connection with the 2011 acquisition, PPL completed a reorganization designed to transition WPD Midlands from a functional operating structure to a regional operating structure requiring a smaller combined support structure, reducing duplication and implementing more efficient procedures. More than 700 employees of WPD Midlands will have received separation benefits as a result of the reorganization by the end of 2012.

Separation benefits totaling \$104 million, pre-tax, were associated with the reorganization. For the three and nine months ended September 30, 2011, \$84 million of separation benefits were recorded, of which \$41 million related to severance compensation and \$43 million related to Early Retirement Deficiency Costs (ERDC). The accrued severance compensation is reflected in "Other current liabilities" and the ERDC reduced "Other noncurrent assets" on the Balance Sheets. Severance compensation of \$7 million and ERDC of \$2 million also were recorded in the fourth quarter of 2011. All separation benefits are included in "Other operation and maintenance" on the Statements of Income.

These amounts do not include \$3 million and \$9 million recorded in the three and nine months ended September 30, 2011 for separation benefits related to certain employees who separated from the WPD Midlands companies, but were not part of the reorganization.

Additional severance compensation was recorded during the three and nine months ended September 30, 2012, as shown in the table below.

The changes in the carrying amounts of accrued severance for the periods ended September 30, 2012 were as follows:

| | Three Months | Nine Months |
|--|-----------------|-------------|
| Accrued severance at the beginning of period | \$ 8 | \$ 21 |
| Severance compensation | 2 | 12 |
| Severance paid | (2) | (25) |
| Accrued severance at the end of period | \$ 8 | \$ 8 |

Pro forma Information

The pro forma financial information for the nine months ended September 30, 2011, which includes WPD Midlands as if the acquisition had occurred January 1, 2010, is as follows.

| | |
|--|----------|
| Operating Revenues - PPL consolidated pro forma | \$ 8,922 |
| Net Income Attributable to PPL Shareowners - PPL consolidated pro forma | 1,322 |

The pro forma financial information presented above has been derived from the historical consolidated financial statements of PPL and from the historical combined financial statements of WPD Midlands. Income (loss) from discontinued operations (net of income taxes), which was not significant, was excluded from the pro forma amounts above.

The pro forma financial information presented above includes adjustments to depreciation, net periodic pension costs, interest expense and the related income tax effects to reflect the impact of the acquisition. The pre-tax nonrecurring credits (expenses) for the nine months ended September 30, 2011 presented in the following table were directly attributable to the WPD Midlands acquisition and adjustments were included in the calculation of pro forma operating revenue and net income to remove the effect of these nonrecurring items and the related income tax effects.

| | Income Statement Line Item | Nine Months |
|--|------------------------------------|-------------|
| 2011 Bridge Facility costs (a) | Interest Expense | \$ (43) |
| | Other Income | |
| Foreign currency loss on 2011 Bridge Facility (b) | (Expense) - net | (57) |
| Net hedge gains associated with the 2011 Bridge Facility (c) | Other Income (Expense) - net | 55 |
| Hedge ineffectiveness (d) | Interest Expense | (12) |
| | Other Income | |
| U.K. stamp duty tax (e) | (Expense) - net | (21) |
| | Other operation and maintenance | (92) |
| Separation benefits (f) | Other Income | |
| Other acquisition-related adjustments (g) | (Expense) - net | (45) |

- (a) The 2011 Bridge Facility costs, primarily commitment and structuring fees, were incurred to establish a bridge facility for purposes of funding the WPD Midlands acquisition purchase price.
- (b) The 2011 Bridge Facility was denominated in GBP. The amount includes a \$42 million foreign currency loss on PPL Capital Funding's repayment of its 2011 Bridge Facility borrowing and a \$15 million foreign currency loss associated with proceeds received on the U.S. dollar-denominated senior notes issued by PPL WEM in April 2011 that were used to repay a portion of PPL WEM's borrowing under the 2011 Bridge Facility.
- (c) The repayment of borrowings on the 2011 Bridge Facility was economically hedged to mitigate the effects of changes in foreign currency exchange rates with forward contracts to purchase GBP, which resulted in net hedge gains.
- (d) The hedge ineffectiveness includes a combination of ineffectiveness associated with closed out interest rate swaps and a charge recorded as a result of certain interest rate swaps failing hedge effectiveness testing, both associated with the acquisition financing.
- (e) The U.K. stamp duty tax represents a tax on the transfer of ownership of property in the U.K. incurred in connection with the acquisition.
- (f) See "Separation Benefits - U.K. Regulated Segment" above.
- (g) Primarily includes acquisition-related advisory, accounting and legal fees.

Terminated Bluegrass CTs Acquisition (PPL, LKE, LG&E and KU)

In September 2011, LG&E and KU entered into an asset purchase agreement with Bluegrass Generation for the purchase of the Bluegrass CTs, aggregating approximately 495 MW, plus limited associated contractual arrangements required for operation of the units, for a purchase price of \$110 million, pending receipt of applicable regulatory approvals. In May 2012, the KPSC issued an order approving the request to purchase the Bluegrass CTs. Also in May 2012, the FERC issued an order conditionally authorizing the acquisition of the Bluegrass CTs, subject to approval by the FERC of satisfactory mitigation measures to address market-power concerns. After a review of potentially available mitigation options, LG&E and KU determined that the options were not commercially justifiable. In June 2012, LG&E and KU terminated the asset purchase agreement for the Bluegrass CTs in accordance with its terms and made applicable filings with the KPSC and FERC. LG&E and KU are currently assessing the impact of the asset purchase agreement termination and potential future generation capacity options.

Development

NGCC Construction (PPL, LKE, LG&E and KU)

In September 2011, LG&E and KU filed a CPCN with the KPSC requesting approval to build a 640 MW NGCC at the existing Cane Run plant site in Kentucky. In May 2012, the KPSC issued an order approving the request. LG&E will own a 22% undivided interest, and KU will own a 78% undivided interest in the new NGCC. LG&E and KU commenced preliminary construction activities in the third quarter of 2012 and project construction is expected to be completed by May 2015. The project, which includes building a natural gas supply pipeline and related transmission projects, has an estimated cost of approximately \$600 million.

In conjunction with this construction and to meet new, more stringent federal EPA regulations with a 2015 compliance date, LG&E and KU anticipate retiring six older coal-fired electric generating units at the Cane Run, Green River and Tyrone plants, which have a combined summer capacity rating of 797 MW. See Note 6 for additional information.

Bell Bend COLA (PPL and PPL Energy Supply)

The NRC continues to review the COLA submitted by a PPL Energy Supply subsidiary, PPL Bell Bend, LLC (PPL Bell Bend) for the proposed Bell Bend nuclear generating unit (Bell Bend) to be built adjacent to the Susquehanna plant. PPL Bell Bend has made no decision to proceed with construction of Bell Bend and expects that such decision will not be made for several years given the anticipated lengthy NRC license approval process. Additionally, PPL Bell Bend has announced that it does not expect to proceed with construction absent favorable economics, a joint arrangement with other interested parties and a federal loan guarantee or other acceptable financing. PPL Bell Bend is currently authorized to spend up to \$162 million through 2012 on the COLA and other permitting costs (including land costs) necessary for construction. At September 30, 2012 and December 31, 2011, \$148 million and \$131 million of costs, which includes capitalized interest, associated with the licensing application were capitalized and are included on the Balance Sheets in noncurrent "Other intangibles." PPL Bell Bend believes that the estimated fair value of the COLA currently exceeds the costs expected to be

capitalized associated with the licensing application. PPL Bell Bend remains active in the DOE loan guarantee application process. See Note 8 in PPL's and PPL Energy Supply's 2011 Form 10-K for additional information.

Susquehanna-Roseland Transmission Line (PPL and PPL Electric)

On October 1, 2012, the National Park Service (NPS) issued its Record of Decision (ROD) on the proposed Susquehanna-Roseland transmission line affirming the route chosen by PPL Electric and Public Service Electric & Gas as the preferred alternative under the NPS's National Environmental Policy Act review. On October 15, 2012, a complaint was filed in the United States District Court for the District of Columbia by various environmental groups, including the Sierra Club, challenging the ROD and seeking to prohibit its implementation. Construction activities have begun on portions of the 101-mile route in Pennsylvania. The line is expected to be in service before the peak summer demand period of 2015. The chosen route had previously been approved by the PUC and New Jersey Board of Public Utilities. An appeal of the New Jersey Board of Public Utilities approval is pending before the New Jersey Superior Court Appellate Division. PPL Electric cannot predict the ultimate outcome or timing of any further legal challenges to the project. PJM has developed a strategy to manage potential reliability problems until the line is built. PPL and PPL Electric cannot predict what additional actions, if any, PJM might take in the event of a further delay to its scheduled in-service date for the new line.

At September 30, 2012, PPL Electric's estimated share of the project cost was \$560 million, an increase from approximately \$500 million at December 31, 2011, due primarily to increased material costs.

See Note 8 in PPL's and PPL Electric's 2011 Form 10-K for additional information.

9. Defined Benefits

(PPL, PPL Energy Supply and PPL Electric)

Prior to January 1, 2012, the majority of PPL's Montana and Pennsylvania employees were eligible for pension benefits under PPL Montana's cash balance pension plan or PPL's qualified and non-qualified non-contributory defined benefit pension plans with benefits based on length of service and final average pay, as defined by the plans. Effective January 1, 2012, these plans were closed to newly hired salaried employees. Newly hired bargaining unit employees will continue to be eligible under these plans based on their collective bargaining agreements. Salaried employees hired on or after January 1, 2012 will be eligible to participate in the new PPL Retirement Savings Plan, a 401(k) savings plan with enhanced employer matching.

(PPL, PPL Energy Supply, LKE and LG&E)

Following are the net periodic defined benefit costs (credits) of the plans sponsored by PPL, PPL Energy Supply, LKE and LG&E for the periods ended September 30:

| | Pension Benefits | | | | | | | | | | | | | | | |
|--------------------------------|------------------|------|------|------|------|-------------|------|-------|------|-------|----|-------|----|-------|----|-------|
| | Three Months | | | | | Nine Months | | | | | | | | | | |
| | U.S. | | U.K. | | | U.S. | | U.K. | | | | | | | | |
| | 2012 | 2011 | 2012 | 2011 | 2012 | 2011 | 2012 | 2011 | 2012 | 2011 | | | | | | |
| PPL | | | | | | | | | | | | | | | | |
| Service cost | \$ | 25 | \$ | 24 | \$ | 13 | \$ | 14 | \$ | 77 | \$ | 71 | \$ | 40 | \$ | 31 |
| Interest cost | | 55 | | 54 | | 85 | | 88 | | 165 | | 163 | | 254 | | 200 |
| Expected return on plan assets | | (65) | | (61) | | (115) | | (103) | | (195) | | (184) | | (340) | | (243) |

Amortization of:

| | | | | | | | | |
|--|-------|-------|------|-------|-------|-------|-------|-------|
| Prior service cost | 6 | 6 | 1 | 1 | 18 | 18 | 3 | 3 |
| Actuarial (gain) loss | 11 | 7 | 19 | 15 | 32 | 21 | 59 | 44 |
| Net periodic defined benefit costs (credits) prior to termination benefits | 32 | 30 | 3 | 15 | 97 | 89 | 16 | 35 |
| Termination benefits (a) | | | | 45 | | | | 47 |
| Net periodic defined benefit costs (credits) | \$ 32 | \$ 30 | \$ 3 | \$ 60 | \$ 97 | \$ 89 | \$ 16 | \$ 82 |

- (a) In 2011, WPD Midlands recorded early retirement deficiency costs payable under applicable pension plans related to employees leaving the WPD Midlands companies. See Note 8 for additional information.

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| | Pension Benefits | | | |
|--|------------------|-------|-------------|-------|
| | Three Months | | Nine Months | |
| | 2012 | 2011 | 2012 | 2011 |
| PPL Energy Supply | | | | |
| Service cost | \$ 1 | \$ 1 | \$ 4 | \$ 3 |
| Interest cost | 2 | 1 | 6 | 5 |
| Expected return on plan assets | (2) | (2) | (7) | (6) |
| Amortization of: | | | | |
| Actuarial (gain) loss | 1 | 1 | 2 | 2 |
| Net periodic defined benefit costs (credits) | \$ 2 | \$ 1 | \$ 5 | \$ 4 |
| LKE | | | | |
| Service cost | \$ 5 | \$ 6 | \$ 16 | \$ 18 |
| Interest cost | 16 | 16 | 48 | 50 |
| Expected return on plan assets | (17) | (16) | (52) | (48) |
| Amortization of: | | | | |
| Prior service cost | 2 | 2 | 4 | 4 |
| Actuarial (gain) loss | 5 | 6 | 16 | 17 |
| Net periodic defined benefit costs (credits) | \$ 11 | \$ 14 | \$ 32 | \$ 41 |
| LG&E | | | | |
| Service cost | | | \$ 1 | \$ 1 |
| Interest cost | \$ 4 | \$ 4 | 11 | 11 |
| Expected return on plan assets | (5) | (4) | (14) | (13) |
| Amortization of: | | | | |
| Prior service cost | 1 | | 2 | 1 |
| Actuarial (gain) loss | 3 | 3 | 8 | 9 |
| Net periodic defined benefit costs (credits) | \$ 3 | \$ 3 | \$ 8 | \$ 9 |

| | Other Postretirement Benefits | | | |
|--|-------------------------------|------|-------------|-------|
| | Three Months | | Nine Months | |
| | 2012 | 2011 | 2012 | 2011 |
| PPL | | | | |
| Service cost | \$ 3 | \$ 3 | \$ 9 | \$ 9 |
| Interest cost | 7 | 9 | 23 | 25 |
| Expected return on plan assets | (6) | (6) | (17) | (17) |
| Amortization of: | | | | |
| Transition obligation | | | 1 | 1 |
| Prior service cost | 1 | | 1 | |
| Actuarial (gain) loss | 1 | 1 | 3 | 4 |
| Net periodic defined benefit costs (credits) | \$ 6 | \$ 7 | \$ 20 | \$ 22 |
| LKE | | | | |
| Service cost | \$ 1 | \$ 1 | \$ 3 | \$ 3 |
| Interest cost | 3 | 3 | 7 | 8 |
| Expected return on plan assets | (1) | (1) | (3) | (3) |
| Amortization of: | | | | |
| Transition obligation | | | 1 | 1 |

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| | | | | | | | | |
|--|----|---|----|---|----|-----|----|----|
| Prior service cost | | | | 1 | | 2 | | 2 |
| Actuarial (gain) loss | | | | | | (1) | | |
| Net periodic defined benefit costs (credits) | \$ | 3 | \$ | 4 | \$ | 9 | \$ | 11 |

(PPL Energy Supply, PPL Electric, LG&E and KU)

In addition to the specific plans they sponsor, PPL Energy Supply subsidiaries are also allocated costs of defined benefit plans sponsored by PPL Services and LG&E is allocated costs of defined benefit plans sponsored by LKE based on their participation in those plans, which management believes are reasonable. PPL Electric and KU do not directly sponsor any defined benefit plans. PPL Electric is allocated costs of defined benefit plans sponsored by PPL Services and KU is allocated costs of defined benefit plans sponsored by LKE based on their participation in those plans, which management believes are reasonable. For the periods ended September 30, PPL Services allocated the following net periodic benefit costs to PPL Energy Supply subsidiaries and PPL Electric, and LKE allocated the following net periodic benefit costs to LG&E and KU, including amounts applied to accounts that are further distributed between capital and expense.

| | Three Months | | Nine Months | |
|-------------------|--------------|------|-------------|-------|
| | 2012 | 2011 | 2012 | 2011 |
| PPL Energy Supply | \$ 10 | \$ 8 | \$ 29 | \$ 23 |
| PPL Electric | 8 | 6 | 23 | 18 |
| LG&E | 3 | 5 | 9 | 13 |
| KU | 4 | 6 | 13 | 17 |

Expected Cash Flows - U.K. Pension Plans

(PPL)

At September 30, 2012, WPD's expected pension contributions for 2012 are \$344 million compared with \$161 million as disclosed in PPL's 2011 Form 10-K. During the nine months ended September 30, 2012, contributions of \$302 million were made. The additional contributions are being made to prepay future contribution requirements to fund pension plan deficits.

10. Commitments and Contingencies

Energy Purchase Commitments

(PPL and PPL Energy Supply)

PPL Energy Supply enters into long-term purchase contracts to supply the coal requirements for its coal-fired generating facilities. These contracts include commitments to purchase coal through 2019. As a result of lower electricity and natural gas prices, coal unit utilization has decreased. To mitigate the risk of exceeding available coal storage, PPL Energy Supply incurred pre-tax charges of \$17 million and \$29 million during the three and nine months ended September 30, 2012 to reduce its 2012 and 2013 contracted coal deliveries. These charges were recorded to "Fuel" on the Statement of Income.

(PPL and PPL Electric)

In 2009, the PUC approved PPL Electric's procurement plan for the period January 2011 through May 2013. To date, PPL Electric has conducted 13 of its 14 planned competitive solicitations. The solicitations include a mix of short-term and long-term purchases, ranging from five months to ten years, to fulfill PPL Electric's obligation to provide for customer supply as a PLR. In May 2012, PPL Electric filed a plan with the PUC to purchase its electric supply for default customers for the period June 2013 through May 2015. The plan proposes to procure this electricity twice a year, beginning in April 2013.

(PPL Energy Supply and PPL Electric)

See Note 11 for information on the power supply agreements between PPL EnergyPlus and PPL Electric.

Legal Matters

(PPL, PPL Energy Supply, PPL Electric, LKE, LG&E and KU)

PPL and its subsidiaries are involved in legal proceedings, claims and litigation in the ordinary course of business. PPL and its subsidiaries cannot predict the outcome of such matters, or whether such matters may result in material liabilities, unless otherwise noted.

TC2 Construction (PPL, LKE, LG&E and KU)

In June 2006, LG&E and KU, as well as the Indiana Municipal Power Agency and Illinois Municipal Electric Agency (collectively, TC2 Owners), entered into a construction contract regarding the TC2 project. The contract is generally in the form of a turnkey agreement for the design, engineering, procurement, construction, commissioning, testing and delivery of the project, according to designated specifications, terms and conditions. The contract price and its

components are subject to a number of potential adjustments which may increase or decrease the ultimate construction price. During 2009 and 2010, the TC2 Owners received contractual notices from the TC2 construction contractor asserting historical force majeure and excusable event claims for a number of adjustments to the contract price, construction schedule, commercial operations date, liquidated damages or other relevant provisions. In September 2010, the TC2 Owners and the construction contractor agreed to a settlement to resolve the force majeure and excusable event claims occurring through July 2010 under the TC2 construction contract, which settlement provided for a limited, negotiated extension of the contractual commercial operations date and/or relief from liquidated damage calculations. With limited exceptions, the TC2 Owners took care, custody and control of TC2 in January 2011. Pursuant to certain amendments to the construction agreement, the contractor has made and may be required to make additional modifications to the combustion or other systems to allow operation of TC2 on all specified fuels categories. The provisions of the construction agreement relating to liquidated damages were also amended. In September 2011, the TC2 Owners and the construction contractor entered into subsequent adjustments to the construction agreement addressing, among other matters, certain historical change order, labor rate and prior period liquidated damages amounts. The remaining issues and disputes, including the nature and status of modifications to the combustion and other systems, plus certain potential warranty matters, are still under discussion with the contractor. PPL, LKE, LG&E and KU cannot currently predict the outcome of this matter or the potential impact on the capital costs of this project.

WKE Indemnification (PPL and LKE)

See footnote (m) to the table in "Guarantees and Other Assurances" in this Note 10 for information on an LKE indemnity relating to its former WKE lease, including related legal proceedings.

(PPL and PPL Energy Supply)

Montana Hydroelectric Litigation

In November 2004, PPL Montana, Avista Corporation (Avista) and PacifiCorp commenced an action for declaratory judgment in Montana First Judicial District Court seeking a determination that no lease payments or other compensation for their hydroelectric facilities' use and occupancy of certain riverbeds in Montana can be collected by the State of Montana. This lawsuit followed dismissal on jurisdictional grounds of an earlier federal lawsuit seeking such compensation in the U.S. District Court of Montana. The federal lawsuit alleged that the beds of Montana's navigable rivers became state-owned trust property upon Montana's admission to statehood, and that the use of them should, under a 1931 regulatory scheme enacted after all but one of the hydroelectric facilities in question were constructed, trigger lease payments for use of land beneath. In July 2006, the Montana state court approved a stipulation by the State of Montana that it was not seeking compensation for the period prior to PPL Montana's December 1999 acquisition of the hydroelectric facilities.

Following a number of adverse trial court rulings, in 2007 Pacificorp and Avista each entered into settlement agreements with the State of Montana providing, in pertinent part, that each company would make prospective lease payments for use of the State's navigable riverbeds (subject to certain future adjustments), resolving the State's claims for past and future compensation.

Following an October 2007 trial of this matter on damages, in June 2008, the Montana District Court awarded the State retroactive compensation of approximately \$35 million for the 2000-2006 period and approximately \$6 million for 2007 compensation. Those unpaid amounts accrued interest at 10% per year. The Montana District Court also deferred determination of compensation for 2008 and future years to the Montana State Land Board. In October 2008, PPL Montana appealed the decision to the Montana Supreme Court, requesting a stay of judgment and a stay of the Land Board's authority to assess compensation for 2008 and future periods. In March 2010, the Montana Supreme Court substantially affirmed the 2008 Montana District Court decision.

In August 2010, PPL Montana filed a petition for a writ of certiorari with the U.S. Supreme Court requesting review of this matter. In June 2011, the U.S. Supreme Court granted PPL Montana's petition, and in February 2012 the U.S. Supreme Court issued a decision overturning the Montana Supreme Court decision and remanded the case to the Montana Supreme Court for further proceedings consistent with the U.S. Supreme Court's opinion. As a result, in the fourth quarter of 2011, PPL Montana reversed its total loss accrual of \$89 million (\$53 million after-tax) which had been recorded prior to the U.S. Supreme Court decision. PPL Montana believes the U.S. Supreme Court decision resolves certain questions of liability in this case in favor of PPL Montana and leaves open for reconsideration by Montana courts, consistent with the findings of the U.S. Supreme Court, certain other questions. In March 2012, the case was returned to the Montana Supreme Court and in April 2012 remanded to the Montana First Judicial District Court. Further proceedings have not yet been scheduled by the District Court. PPL Montana has concluded it is no longer probable, but it remains reasonably possible, that a loss has been incurred. While unable to estimate a range of loss, PPL Montana believes that any such amount would not be material.

Bankruptcy of SMGT

In October 2011, SMGT, a Montana cooperative and purchaser of electricity under a long-term supply contract with PPL EnergyPlus expiring in June 2019 (SMGT Contract), filed for protection under Chapter 11 of the U.S. Bankruptcy Code in the U.S. Bankruptcy Court for the District of Montana. At the time of the bankruptcy filing, SMGT was PPL EnergyPlus' largest unsecured credit exposure.

The SMGT Contract provided for fixed volume purchases on a monthly basis at established prices. Pursuant to a court order and subsequent stipulations entered into between the SMGT bankruptcy trustee and PPL EnergyPlus, since the date of its Chapter 11 filing through January 2012, SMGT continued to purchase electricity from PPL EnergyPlus at the price specified in the SMGT Contract, and made timely payments for such purchases, but at lower volumes than as prescribed in the SMGT Contract. In January 2012, the trustee notified PPL EnergyPlus that SMGT would not purchase electricity under the SMGT Contract for the month of February. In March 2012, the U.S. Bankruptcy Court for the District of Montana issued an order approving the request of the SMGT trustee and PPL EnergyPlus to terminate the SMGT Contract. As a result, the SMGT Contract was terminated effective April 1, 2012, allowing PPL EnergyPlus to resell the electricity previously contracted to SMGT under the SMGT Contract to other customers.

PPL EnergyPlus' receivable under the SMGT Contract totaled approximately \$21 million at September 30, 2012, which has been fully reserved.

In July 2012, PPL EnergyPlus filed its proof of claim in the SMGT bankruptcy proceeding. The total claim is approximately \$375 million, predominantly an unsecured claim representing the value for energy sales that will not occur as a result of the termination of the SMGT Contract. No assurance can be given as to the collectability of the claim.

PPL Energy Supply cannot predict any amounts that it may recover in connection with the SMGT bankruptcy or the prices and other terms on which it will be able to market to third parties the power that SMGT will not purchase from PPL EnergyPlus due to the termination of the SMGT Contract.

Notice of Intent to Sue Colstrip Owners

On July 30, 2012, PPL Montana received a Notice of Intent to Sue for violations of the Clean Air Act at Colstrip Steam Electric Station (Notice) from counsel on behalf of the Sierra Club and the Montana Environmental Information Center (MEIC). An Amended Notice was received on September 4, 2012, and a Second Amended Notice was received on October 1, 2012. The Notice, Amended Notice and Second Amended Notice were all addressed to the Owner or Managing Agent of Colstrip, and to the other Colstrip co-owners: Avista Corporation, Puget Sound Energy, Portland General Electric Company, NorthWestern Energy and PacifiCorp. The Notice alleges certain violations of the Clean Air Act, including New Source Review, Title V and opacity requirements. The Amended Notice alleges additional opacity violations at Colstrip, and the Second Amended Notice alleges additional Title V violations. All three notices state that Sierra Club and MEIC will request a United States District Court to impose injunctive relief and civil penalties, require a beneficial environmental project in the areas affected by the alleged air pollution and require reimbursement of Sierra Club's and MEIC's costs of litigation and attorney's fees. Under the Clean Air Act, lawsuits cannot be filed until 60 days after the applicable notice date. PPL is evaluating the allegations set forth in the Notice, Amended Notice and Second Amended Notice, and cannot at this time predict the outcome of this matter.

Regulatory Issues

(PPL, PPL Electric, LKE, LG&E and KU)

See Note 6 for information on regulatory matters related to utility rate regulation.

Enactment of Financial Reform Legislation (PPL, PPL Energy Supply, PPL Electric, LKE, LG&E and KU)

In July 2010, the Dodd-Frank Act was signed into law. The Dodd-Frank Act includes provisions that impose derivative transaction reporting requirements and require most over-the-counter derivative transactions to be executed through an exchange and to be centrally cleared. The Dodd-Frank Act also provides that the U.S. Commodity Futures Trading Commission (CFTC) may impose collateral and margin requirements for over-the-counter derivative transactions, as well as capital requirements for certain entity classifications. Final rules on major provisions in the Dodd-Frank Act are being established through rulemakings. The rulemakings are scheduled to become effective at different times beginning on the October 12, 2012 effective date of the definitional rule for the term "swap". In particular, the CFTC's Final Rule (Final Rule), defining key terms such as "swap dealer" and "major swap participant", took effect with the effectiveness of the swap definitional rule. The heightened thresholds and requirements for these entity classifications set forth in the Final Rule resulted in the Registrants currently being designated neither swap dealers nor major swap participants. The Dodd-Frank Act and its implementing regulations, however, will impose on the Registrants significant additional and costly recordkeeping and reporting

requirements. Also, the Registrants could face significantly higher operating costs or may be required to post additional collateral if they or their counterparties are subject to capital or margin requirements as ultimately adopted in the implementing regulations of the Dodd-Frank Act. The Registrants will continue to evaluate the provisions of the Dodd-Frank Act and its implementing regulations. At this time, the Registrants cannot predict the full impact that the law or its implementing regulations will have on their businesses or operations, or the markets in which they transact business, but could incur material costs related to compliance with the Dodd-Frank Act.

(PPL, PPL Energy Supply and PPL Electric)

New Jersey Capacity Legislation

In January 2011, New Jersey enacted a law that intervenes in the wholesale capacity market exclusively regulated by the FERC: S. No. 2381, 214th Leg. (N.J. 2011) (the Act). To create incentives for the development of new, in-state electric generation facilities, the Act implements a "long-term capacity agreement pilot program (LCAPP)." The Act requires New Jersey utilities to pay a guaranteed fixed price for wholesale capacity, imposed by the New Jersey Board of Public Utilities (BPU), to certain new generators participating in PJM, with the ultimate costs of that guarantee to be borne by New Jersey

ratepayers. PPL believes the intent and effect of the LCAPP is to encourage the construction of new generation in New Jersey even when, under the FERC-approved PJM economic model, such new generation would not be economic. The Act could depress capacity prices in PJM in the short term, impacting PPL Energy Supply's revenues, and harm the long-term ability of the PJM capacity market to incent necessary generation investment throughout PJM. In February 2011, the PJM Power Providers Group (P3), an organization in which PPL is a member, filed a complaint before the FERC seeking changes in PJM's capacity market rules designed to ensure that subsidized generation, such as the generation that may result from the implementation of the LCAPP, will not be able to set capacity prices artificially low as a result of their exercise of buyer market power. In April 2011, the FERC issued an order granting in part and denying in part P3's complaint and ordering changes in PJM's capacity rules consistent with a significant portion of P3's requested changes. Several parties have filed appeals of the FERC's order. PPL, PPL Energy Supply and PPL Electric cannot predict the outcome of this proceeding or the economic impact on their businesses or operations, or the markets in which they transact business.

In addition, in February 2011, PPL and several other generating companies and utilities filed a complaint in U.S. District Court in New Jersey challenging the Act on the grounds that it violates well-established principles under the Supremacy Clause and the Commerce Clause of the U.S. Constitution. In this action, the plaintiffs request declaratory and injunctive relief barring implementation of the Act by the Commissioners of the BPU. In October 2011, the court denied the BPU's motion to dismiss the proceeding. In September 2012, the court denied all summary judgment motions, and the litigation is continuing. Trial has been scheduled for January 17, 2013. PPL, PPL Energy Supply and PPL Electric cannot predict the outcome of this proceeding or the economic impact on their businesses or operations, or the markets in which they transact business.

Maryland Capacity Order

In April 2012, the Maryland Public Service Commission (MD PSC) ordered three electric utilities in Maryland to enter into long-term contracts to support the construction of new electric generating facilities in Maryland, specifically a 661 MW natural gas-fired combined-cycle generating facility to be owned by CPV Maryland, LLC. PPL believes the intent and effect of the action by the MD PSC is to encourage the construction of new generation in Maryland even when, under the FERC-approved PJM economic model, such new generation would not be economic. The MD PSC action could depress capacity prices in PJM in the short term, impacting PPL Energy Supply's revenues, and harm the long-term ability of the PJM capacity market to encourage necessary generation investment throughout PJM.

In April 2012, PPL and several other generating companies filed a complaint in U.S. District Court in Maryland challenging the MD PSC order on the grounds that it violates well-established principles under the Supremacy and Commerce clauses of the U.S. Constitution. In this action, the plaintiffs request declaratory and injunctive relief barring implementation of the order by the Commissioners of the MD PSC. In August 2012, the court denied the MD PSC and CPV Maryland, LLC motions to dismiss the proceeding and the litigation is continuing. PPL, PPL Energy Supply, and PPL Electric cannot predict the outcome of this proceeding or the economic impact on their businesses or operations, or the markets in which they transact business.

Pacific Northwest Markets (PPL and PPL Energy Supply)

Through its subsidiaries, PPL Energy Supply made spot market bilateral sales of power in the Pacific Northwest during the period from December 2000 through June 2001. Several parties subsequently claimed refunds at FERC as a result of these sales. In June 2003, the FERC terminated proceedings to consider whether to order refunds for spot market bilateral sales made in the Pacific Northwest, including sales made by PPL Montana, during the period December 2000 through June 2001. In August 2007, the U.S. Court of Appeals for the Ninth Circuit reversed the FERC's decision and ordered the FERC to consider additional evidence. In October 2011, FERC initiated proceedings to consider additional evidence. At June 30, 2012, there were two remaining claims against PPL Energy Supply

totaling \$73 million. In July 2012, PPL Montana and the City of Tacoma, one of the parties claiming refunds at FERC, reached a settlement whereby PPL Montana would pay \$75 thousand to resolve the City of Tacoma's \$23 million claim, \$9 million of which represents interest. The settlement does not resolve the remaining claim outstanding at September 30, 2012 of approximately \$50 million.

Although PPL and its subsidiaries believe that they have not engaged in any improper trading or marketing practices affecting the Pacific Northwest markets, PPL and PPL Energy Supply cannot predict the outcome of the above-described proceedings or whether any subsidiaries will be the subject of any additional governmental investigations or named in other lawsuits or refund proceedings. Consequently, PPL and PPL Energy Supply cannot estimate a range of reasonably possible losses, if any, related to this matter.

(PPL, PPL Energy Supply, PPL Electric, LKE, LG&E and KU)

FERC Market-Based Rate Authority

In 1998, the FERC authorized LG&E and KU and PPL EnergyPlus to make wholesale sales of electric power and related products at market-based rates. In those orders, the FERC directed LG&E, KU and PPL EnergyPlus, respectively, to file an updated market analysis within three years after the order, and every three years thereafter. Since then, periodic market-based rate filings with the FERC have been made by LG&E, KU, PPL EnergyPlus, PPL Electric, PPL Montana and most of PPL Generation's subsidiaries. These filings consisted of a Northwest market-based rate filing for PPL Montana and a Northeast market-based rate filing for most of the other PPL subsidiaries in PJM's region. In June 2011, FERC approved PPL's market-based rate update for the Eastern region and PPL's market-based rate update for the Western region. Also, in June 2011, PPL filed its market-based rate update for the Southeast region, including LG&E and KU in addition to PPL EnergyPlus. In June 2011, the FERC issued an order approving LG&E's and KU's request for a determination that they no longer be deemed to have market power in the BREC balancing area and removing restrictions on their market-based rate authority in such region.

Currently, a seller granted FERC market-based rate authority may enter into power contracts during an authorized time period. If the FERC determines that the market is not workably competitive or that the seller possesses market power or is not charging "just and reasonable" rates, it may institute prospective action, but any contracts entered into pursuant to the FERC's market-based rate authority remain in effect and are generally subject to a high standard of review before the FERC can order changes. Recent court decisions by the U.S. Court of Appeals for the Ninth Circuit have raised issues that may make it more difficult for the FERC to continue its program of promoting wholesale electricity competition through market-based rate authority. These court decisions permit retroactive refunds and a lower standard of review by the FERC for changing power contracts, and could have the effect of requiring the FERC in advance to review most, if not all, power contracts. In June 2008, the U.S. Supreme Court reversed one of the decisions of the U.S. Court of Appeals for the Ninth Circuit, thereby upholding the higher standard of review for modifying contracts. At this time, PPL, PPL Energy Supply, PPL Electric, LKE, LG&E and KU cannot predict the impact of these court decisions on the FERC's future market-based rate authority program or on their businesses.

Energy Policy Act of 2005 - Reliability Standards

The NERC is responsible for establishing and enforcing mandatory reliability standards (Reliability Standards) regarding the bulk power system. The FERC oversees this process and independently enforces the Reliability Standards. The Reliability Standards have the force and effect of law and apply to certain users of the bulk power electricity system, including electric utility companies, generators and marketers. Under the Federal Power Act, the FERC may assess civil penalties of up to \$1 million per day, per violation, for certain violations.

LG&E, KU, PPL Electric and certain subsidiaries of PPL Energy Supply monitor their compliance with the Reliability Standards and continue to self-report potential violations of certain applicable reliability requirements and submit accompanying mitigation plans, as required. The resolution of a number of potential violations is pending. Any RFC or SERC determination concerning the resolution of violations of the Reliability Standards remains subject to the approval of the NERC and the FERC.

In the course of implementing their programs to ensure compliance with the Reliability Standards by those PPL affiliates subject to the standards, certain other instances of potential non-compliance may be identified from time to time. The Registrants cannot predict the outcome of these matters, and cannot estimate a range of reasonably possible losses, if any, other than the amounts currently recorded.

On October 18, 2012, the FERC issued a Notice of Proposed Rulemaking (NOPR) concerning Reliability Standards for Geomagnetic Disturbances. The FERC proposes to direct NERC to submit for approval Reliability Standards that address the impact of geomagnetic disturbances on the reliable operation of the bulk-power system. The FERC proposes to direct NERC to file one or more Reliability Standards that include measures to protect against damage to the bulk-power system, such as the installation of equipment that blocks geomagnetically induced currents on implicated transformers. If the NOPR is adopted by the FERC, it is expected to require the Registrants to make significant expenditures in new equipment and/or modifications to their facilities. The Registrants are unable to predict whether the NOPR will be adopted as proposed by the FERC or the amount of any expenditures that may be required as a result of the adoption of any Reliability Standards for geomagnetic disturbances.

Settled Litigation (PPL and PPL Energy Supply)

Spent Nuclear Fuel Litigation

In May 2011, PPL Susquehanna entered into a settlement agreement with the U.S. Government relating to PPL Susquehanna's lawsuit, seeking damages for the Department of Energy's failure to accept spent nuclear fuel from the PPL Susquehanna plant. PPL Susquehanna recorded credits totaling \$56 million to "Fuel" on the Statement of Income during the nine months ended September 30, 2011 to recognize recovery, under the settlement agreement, of certain costs to store spent nuclear fuel at the Susquehanna plant. The amounts recorded through September 2011 cover costs incurred from 1998 through December 2010.

Environmental Matters - Domestic

(PPL, PPL Energy Supply, PPL Electric, LKE, LG&E and KU)

Due to the environmental issues discussed below or other environmental matters, it may be necessary for the Registrants to modify, curtail, replace or cease operating certain facilities or operations to comply with statutes, regulations and other requirements of regulatory bodies or courts. In addition, legal challenges to new environmental permits or rules add to the uncertainty of estimating the future cost impact of these permits and rules.

LG&E and KU are entitled to recover, through the ECR mechanism, the cost of complying with the Federal Clean Air Act as amended and those federal, state, or local environmental requirements which apply to coal combustion wastes and by-products from facilities utilized for production of energy from coal in accordance with their approved compliance plans. Costs not covered by the ECR for LG&E and KU and all such costs for PPL Electric are subject to rate recovery before their respective state regulatory authorities, or the FERC, if applicable. Because PPL Electric does not own any generating plants, its exposure to environmental compliance costs is reduced. As PPL Energy Supply is not a rate regulated entity, it does not have any mechanism for seeking rate recovery of environmental compliance costs. PPL, PPL Electric, LKE, LG&E and KU can provide no assurances as to the ultimate outcome of future environmental or rate proceedings before regulatory authorities.

(PPL, PPL Energy Supply, LKE, LG&E and KU)

Air

CSAPR (formerly Clean Air Transport Rule)

In July 2011, the EPA adopted the CSAPR, which finalizes and renames the Clean Air Transport Rule (Transport Rule) proposed in August 2010. The CSAPR replaces the EPA's previous CAIR which was invalidated by the U.S. Court of Appeals for the District of Columbia Circuit (the Court) in July 2008. CAIR subsequently was effectively reinstated by the Court in December 2008, pending finalization of the Transport Rule. Like CAIR, CSAPR only applied to PPL's fossil-fueled generating plants located in Kentucky and Pennsylvania.

The CSAPR was meant to facilitate attainment of ambient air quality standards for ozone and fine particulates by requiring reductions in sulfur dioxide and nitrogen oxides. The CSAPR established new sulfur dioxide and nitrogen oxide emission allowance cap-and-trade programs that were more restrictive than previously under CAIR. The CSAPR provided for two-phased programs of sulfur dioxide and nitrogen oxide emissions reductions, with initial reductions in 2012 and more stringent reductions in 2014.

In December 2011, the Court stayed implementation of the CSAPR and left CAIR in effect pending a final decision on the validity of the rule. In August 2012 the Court issued a ruling invalidating CSAPR, remanding the rule to the EPA for further action, and leaving CAIR in place during the interim. That ruling will not become effective until the Court rules on a pending motion for rehearing. A further revised rule is not expected from the EPA for at least two years.

The Kentucky fossil-fueled generating plants can meet the CAIR sulfur dioxide emission requirements by utilizing sulfur dioxide allowances (including banked allowances). To meet nitrogen oxide standards, under the CAIR, the Kentucky companies will need to buy allowances and/or make operational changes. LG&E and KU do not currently anticipate the costs of meeting these reinstated CAIR requirements or standards to be significant.

PPL Energy Supply's fossil-fueled generating plants can meet the CAIR sulfur dioxide emission requirements with the existing scrubbers that were placed in service in 2008 and 2009. To meet nitrogen oxide standards, under the CAIR, PPL Energy Supply will need to buy allowances and/or make operational changes, the costs of which are not anticipated to be significant.

National Ambient Air Quality Standards

In addition to the reductions in sulfur dioxide and nitrogen oxide emissions required under the CAIR for its Pennsylvania and Kentucky plants, PPL's fossil-fueled generating plants, including those in Montana, may face further reductions in sulfur dioxide and nitrogen oxide emissions as a result of more stringent national ambient air quality standards for ozone, nitrogen oxide, sulfur dioxide and/or fine particulates.

In 2010, the EPA finalized a new one-hour standard for sulfur dioxide, and states are required to identify areas that meet those standards and areas that are in non-attainment. For non-attainment areas, states are required to develop plans by 2014 to achieve attainment by 2017. For areas that are in attainment or are unclassifiable, states are required to develop maintenance plans by mid-2013 that demonstrate continued attainment. In June 2012, the EPA proposed a rule that strengthens the particulate standards. States would have until 2014 to identify initial non-attainment areas and have until 2020 to achieve attainment status for those areas. States could request an extension to 2025 to comply with the rule. Until the particulate matter (PM) rule is finalized and the sulfur dioxide maintenance and compliance plans are developed, PPL, PPL Energy Supply, LKE, LG&E and KU cannot predict which of their facilities may be located in a non-attainment area and what measures would be required to meet attainment status.

PPL, PPL Energy Supply, LKE, LG&E and KU anticipate that some of the measures required for compliance with the CAIR, the Mercury and Air Toxic Standards (MATS), or the Regional Haze requirements, such as upgraded or new sulfur dioxide scrubbers at some of their plants and, in the case of LG&E and KU, the previously announced retirement of coal-fired generating units at the Cane Run, Green River, and Tyrone plants, will help achieve compliance with the new one-hour sulfur dioxide standard. If additional reductions were to be required, the financial impact could be significant.

Mercury and Other Hazardous Air Pollutants

In May 2011, the EPA published a proposed regulation providing for stringent reductions of mercury and other hazardous air pollutants. In February 2012, the EPA published the final rule, known as the MATS, with an effective date of April 16, 2012. The rule is being challenged by industry groups and states.

The rule provides for a three-year compliance deadline with the potential for a one-year extension as provided under the statute. Based on their assessment of the need to install pollution control equipment to meet the provisions of the proposed rule, LG&E and KU filed requests with the KPSC for environmental cost recovery to facilitate moving forward with plans to install environmental controls including chemical additive and fabric-filter baghouses to remove certain hazardous air pollutants. Recovery of the cost of certain controls was granted by the KPSC in December 2011. See Note 6 for information on LG&E's and KU's anticipated retirement of certain coal-fired electric generating units in response to this and other environmental regulation. With the publication of the final MATS rule, LG&E and KU are currently assessing whether changes in the final rule warrant revision of their approved compliance plans.

With respect to PPL Energy Supply's Pennsylvania plants, PPL Energy Supply believes that certain coal-fired plants may require installation of chemical additive systems, the cost of which is not expected to be significant. With respect to PPL Energy Supply's Montana plants, modifications to the current air pollution controls installed on Colstrip may be required, the cost of which is not expected to be significant. For the Corette plant, PPL Energy Supply announced in September 2012 its intention, beginning in April 2015, to place the plant in long-term reserve status, suspending the

plant's operation, due to expected market conditions and the costs to comply with the MATS requirements. The Corette plant's carrying value at September 30, 2012 was approximately \$67 million. Although the Corette plant was not determined to be impaired at September 30, 2012, it is reasonably possible that an impairment charge could be recorded in the fourth quarter of 2012 or in future periods, as higher priced sales contracts settle, adversely impacting projected cash flows. PPL Energy Supply, LG&E and KU are continuing to conduct in-depth reviews of the MATS, including the potential implications to scrubber wastewater discharges. See the discussion of effluent limitations guidelines and standards below.

Regional Haze and Visibility

In January 2012, the EPA proposed limited approval of the Pennsylvania regional haze State Implementation Plan (SIP). That proposal would essentially approve PPL's analysis that further particulate controls at PPL Energy Supply's Pennsylvania plants are not warranted. The limited approval does not address deficiencies of the state plan arising from the remand of the CAIR rule. Previously, the EPA had determined that implementation of the CAIR requirements would meet regional haze

Best Available Retrofit Technology (BART) requirements for sulfur dioxide and nitrogen oxides. In 2012, the EPA finalized a rule providing that implementation of the CSAPR would also meet the BART. This rule also addresses the Pennsylvania SIP deficiency arising from the CAIR remand; however, in August 2012, the U.S. Court of Appeals for the District of Columbia Circuit (Court) vacated and remanded the CSAPR back to the EPA for further rulemaking. In September 2012, several environmental groups filed a petition for review with the Court challenging the EPA's approval of the Pennsylvania SIP. At this time, it is not known whether the EPA will reinstate its previous determination that CAIR satisfies the BART requirement or will require states to conduct source-specific BART studies.

In Montana, the EPA Region 8 developed the regional haze plan as the Montana Department of Environmental Quality declined to develop a BART SIP at this time. PPL submitted to the EPA its analyses of the visibility impacts of sulfur dioxide, nitrogen oxides and particulate emissions for Colstrip Units 1 and 2 and Corette. PPL's analyses concluded that further reductions are not warranted. PPL has also submitted data and analyses of various air emission control options under the rules to reduce air emissions related to the non-BART-affected emission sources of Colstrip Units 3 and 4. The analyses show that any incremental reductions would not be cost-effective and that further analysis is not warranted.

In March and September 2012, the EPA issued its draft and final Federal Implementation Plans (FIP) for the Montana regional haze rule. The final FIP indicated that no additional controls were required for Corette or Colstrip Units 3 and 4 but proposed tighter limits for Corette and Colstrip Units 1 and 2. PPL Energy Supply expects to meet these tighter permit limits at Corette without any significant changes to operations, although other requirements have led to the planned suspension of operations at Corette beginning in April 2015. See "Mercury and Other Hazardous Air Pollutants" discussion above. Under the final FIP, Colstrip Units 1 and 2 will require additional controls, including the possible installation of an SNCR and spare scrubber vessel, to meet more stringent nitrogen oxide and sulfur dioxide limits. The cost of these potential additional controls, if required, could be significant. PPL Energy Supply plans to challenge this FIP.

LG&E and KU also submitted analyses of the visibility impacts of their Kentucky BART-eligible sources to the Kentucky Division for Air Quality (KDAQ). Only LG&E's Mill Creek plant was determined to have a significant regional haze impact. The KDAQ has submitted a regional haze SIP to the EPA which requires the Mill Creek plant to reduce its sulfuric acid mist emissions from Units 3 and 4, the costs of which are not expected to be significant. After approval of the Kentucky SIP by the EPA and revision of the Mill Creek plant's air permit under Title V, LG&E intends to install sorbent injection controls at the plant to reduce sulfuric acid mist emissions.

New Source Review (NSR)

The EPA has continued its NSR enforcement efforts targeting coal-fired generating plants. The EPA has asserted that modification of these plants has increased their emissions and, consequently, that they are subject to stringent NSR requirements under the Clean Air Act. In April 2009, PPL received EPA information requests for its Montour and Brunner Island plants. The requests are similar to those that PPL received in the early 2000s for its Colstrip, Corette and Martins Creek plants. PPL and the EPA have exchanged certain information regarding this matter. In January 2009, PPL and other companies that own or operate the Keystone plant in Pennsylvania received a notice of violation from the EPA alleging that certain projects were undertaken without proper NSR compliance. In May 2012, PPL Montana received an information request regarding projects undertaken during the Spring 2012 maintenance outage at Colstrip Unit 1. PPL and PPL Energy Supply cannot predict the outcome of these matters, and cannot estimate a range of reasonably possible losses, if any.

In addition, in August 2007, LG&E received information requests for the Mill Creek and Trimble County plants, and KU received requests for the Ghent plant, but they have received no further communications from the EPA since

providing their responses. PPL, LKE, LG&E and KU cannot predict the outcome of these matters, and cannot estimate a range of reasonably possible losses, if any.

In March 2009, KU received a notice alleging that KU violated certain provisions of the Clean Air Act's rules governing NSR and prevention of significant deterioration by installing sulfur dioxide scrubbers and SCR controls at its Ghent plant without assessing potential increased sulfuric acid mist emissions. KU contends that the work in question, as pollution control projects, was exempt from the requirements cited by the EPA. In December 2009, the EPA issued an information request on this matter. In September 2012, the parties reached a tentative settlement addressing the Ghent NSR matter and a September 2007 notice of violation alleging opacity violations at the plant. The settlement is subject to various administrative and judicial approvals. PPL, LKE and KU cannot predict the outcome of this matter until a final consent decree is entered by the U.S. District Court for the Eastern District of Kentucky, but currently do not expect such outcome to result in material losses above the amounts accrued by KU.

If PPL subsidiaries are found to have violated NSR regulations, PPL, PPL Energy Supply, LKE, LG&E and KU would, among other things, be required to meet permit limits reflecting Best Available Control Technology (BACT) for the emissions of any pollutant found to have significantly increased due to a major plant modification. The costs to meet such limits, including installation of technology at certain units, could be significant.

States and environmental groups also have initiated enforcement actions and litigation alleging violations of the NSR regulations by coal-fired generating plants. See "Legal Matters" above for information on a notice of intent to sue received in July 2012 by PPL Montana and other owners of Colstrip. PPL, PPL Energy Supply, LKE, LG&E and KU are unable to predict whether such actions will be brought against any of their other plants.

TC2 Air Permit (PPL, LKE, LG&E and KU)

The Sierra Club and other environmental groups petitioned the Kentucky Environmental and Public Protection Cabinet to overturn the air permit issued for the TC2 baseload generating unit, but the agency upheld the permit in an order issued in September 2007. In response to subsequent petitions by environmental groups, the EPA ordered certain non-material changes to the permit which were incorporated into a final revised permit issued by the KDAQ in January 2010. In March 2010, the environmental groups petitioned the EPA to object to the revised state permit. Until the EPA issues a final ruling on the pending petition and all available appeals are exhausted, PPL, LKE, LG&E and KU cannot predict the outcome of this matter or the potential impact on the capital costs of this project, if any.

(PPL, PPL Energy Supply, LKE, LG&E and KU)

Greenhouse Gas Regulations and Tort Litigation

As a result of the April 2007 U.S. Supreme Court decision that the EPA has authority under the Clean Air Act to regulate GHG emissions from new motor vehicles, in April 2010, the EPA and the U.S. Department of Transportation issued light-duty vehicle emissions standards that apply to 2012 model year vehicles. The EPA has also clarified that this standard, beginning in 2011, also authorized regulation of GHG emissions from stationary sources under the NSR and Title V operating permit provisions of the Clean Air Act. As a result, any new sources or major modifications to existing GHG sources causing a net significant emissions increase requires the BACT permit limits for GHGs. These rules were challenged, and in June 2012 the U.S. Court of Appeals for the District of Columbia Circuit upheld the EPA's regulations.

In addition, in April 2012, the EPA proposed New Source Performance Standards for carbon dioxide emissions from new coal-fired generating units, combined-cycle natural gas units, and integrated gasification combined-cycle units. The proposal would require new coal plants to achieve the same stringent limitations on carbon-dioxide emissions as the best performing new gas plants. There presently is no commercially available technology to allow new coal plants to achieve these limitations and, as a result, the EPA's proposal would effectively preclude construction of new coal-fired generation in the future.

At the regional level, ten northeastern states signed a Memorandum of Understanding (MOU) agreeing to establish a GHG emission cap-and-trade program, called the Regional Greenhouse Gas Initiative (RGGI). The program commenced in January 2009 and calls for stabilizing carbon dioxide emissions, at base levels established in 2005, from electric power plants with capacity greater than 25 MW. The MOU also provides for a 10% reduction, by 2019, in carbon dioxide emissions from base levels.

Pennsylvania has not stated an intention to join the RGGI, but enacted the Pennsylvania Climate Change Act of 2008 (PCCA). The PCCA established a Climate Change Advisory Committee to advise the PADEP on the development of

a Climate Change Action Plan. In December 2009, the Advisory Committee finalized its Climate Change Action Report which identifies specific actions that could result in reducing GHG emissions by 30% by 2020. Some of the proposed actions, such as a mandatory 5% efficiency improvement at power plants, could be technically unachievable. To date, there have been no regulatory or legislative actions taken to implement the recommendations of the report. In addition, legislation has been introduced that would, if enacted, accelerate solar supply requirements and restrict eligible solar projects to those located in Pennsylvania. PPL and PPL Energy Supply cannot predict at this time whether this legislation will be enacted.

Eleven western states and certain Canadian provinces established the Western Climate Initiative (WCI) in 2003. The WCI established a goal of reducing carbon dioxide emissions by 15% below 2005 levels by 2020 and developed GHG emission allocations, offsets, and reporting recommendations. Montana was once a partner in the WCI, but by 2011 had withdrawn, along with several other western states.

In November 2008, the Governor of Kentucky issued a comprehensive energy plan including non-binding targets aimed at promoting improved energy efficiency, development of alternative energy, development of carbon capture and sequestration projects and other actions to reduce GHG emissions. In December 2009, the Kentucky Climate Action Plan Council was established to develop an action plan addressing potential GHG reductions and related measures. To date, the state has not issued a final plan. The impact of any such plan is not now determinable, but the costs to comply with the plan could be significant.

A number of lawsuits have been filed asserting common law claims including nuisance, trespass and negligence against various companies with GHG emitting plants, and the law remains unsettled on these claims. In September 2009, the U.S. Court of Appeals for the Second Circuit in the case of *AEP v. Connecticut* reversed a federal district court's decision and ruled that several states and public interest groups, as well as the City of New York, could sue five electric utility companies under federal common law for allegedly causing a public nuisance as a result of their emissions of GHGs. In June 2011, the U.S. Supreme Court overturned the lower court and held that such federal common law claims were displaced by the Clean Air Act and regulatory actions of the EPA. In addition, in *Comer v. Murphy Oil* (Comer case), the U.S. Court of Appeals for the Fifth Circuit (Fifth Circuit) declined to overturn a district court ruling that plaintiffs did not have standing to pursue state common law claims against companies that emit GHGs. The complaint in the Comer case named the previous indirect parent of LKE as a defendant based upon emissions from the Kentucky plants. In January 2011, the Supreme Court denied a petition to reverse the Fifth Circuit's ruling. In May 2011, the plaintiffs in the Comer case filed a substantially similar complaint in federal district court in Mississippi against 87 companies, including KU and three other indirect subsidiaries of LKE, under a Mississippi statute that allows the re-filing of an action in certain circumstances. In March 2012, the Mississippi federal court granted defendants' motions to dismiss the state common law claims because plaintiffs had previously raised the same claims, plaintiffs lacked standing, plaintiffs' claims were displaced by the Clean Air Act, and other grounds. In April 2012, plaintiffs filed a notice of appeal in the Fifth Circuit. Additional litigation in federal and state courts over these issues is continuing. PPL, LKE and KU cannot predict the outcome of this litigation or estimate a range of reasonably possible losses, if any.

Renewable Energy Legislation (PPL, PPL Energy Supply, LKE, LG&E and KU)

There has been interest in renewable energy legislation at both the state and federal levels. In the 112th Congress, the Clean Energy Standard Act of 2012 (S.2146) was introduced which would mandate electric utilities to supply 24% of their electricity sales from qualified resources by 2015, increasing 3% per year up to 84% by 2035. This legislation will not likely be addressed in the remaining days of this Congress. In Pennsylvania, bills were introduced in both the Senate and House amending the existing Alternative Energy Portfolio Standard to accelerate the current solar obligation, but no action was taken before the end of the 2011-2012 legislative session.

PPL and PPL Energy Supply believe there are financial, regulatory and logistical uncertainties related to GHG reductions and the implementation of renewable energy mandates that will need to be resolved before the impact of such requirements on PPL and PPL Energy Supply can be estimated. Such uncertainties, among others, include the need to provide back-up supply to augment intermittent renewable generation, potential generation over-supply that could result from such renewable generation and back-up, impacts to PJM's capacity market and the need for substantial changes to transmission and distribution systems to accommodate renewable energy sources. These uncertainties are not directly addressed by proposed legislation. PPL and PPL Energy Supply cannot predict at this time the effect on their future competitive position, results of operation, cash flows and financial position of renewable energy mandates that may be adopted, although the costs to implement and comply with any such requirements could be significant.

Water/Waste

Coal Combustion Residuals (CCRs) (PPL, PPL Energy Supply, LKE, LG&E and KU)

In June 2010, the EPA proposed two approaches to regulating the disposal and management of CCRs under the Resource Conservation and Recovery Act (RCRA). CCRs include fly ash, bottom ash and sulfur dioxide scrubber wastes. The first approach would regulate CCRs as a hazardous waste under Subtitle C of the RCRA. This approach would materially increase costs and result in early retirements of many coal-fired plants, as it would require plants to retrofit their operations to comply with full hazardous waste requirements for the generation of CCRs and associated waste waters through generation, transportation and disposal. This would also have a negative impact on the beneficial use of CCRs and could eliminate existing markets for CCRs. The second approach would regulate CCRs as a solid waste under Subtitle D of the RCRA. This approach would mainly affect disposal and most significantly affect any wet disposal operations. Under this approach, many of the current markets for beneficial uses would not be affected. Currently, PPL expects that several of its plants in Kentucky and Montana could be significantly impacted by the requirements of Subtitle D of the RCRA, as these plants are using surface impoundments for management and disposal of CCRs.

The EPA has issued information requests on CCR management practices at numerous plants throughout the power industry as it considers whether or not to regulate CCRs as hazardous waste. PPL has provided information on CCR management practices at most of its plants in response to the EPA's requests. In addition, the EPA has conducted follow-up inspections to evaluate the structural stability of CCR management facilities at several PPL plants and PPL has implemented certain actions in response to recommendations from these inspections.

The EPA is continuing to evaluate the unprecedented number of comments it received on its June 2010 proposed regulations. In October 2011, the EPA issued a Notice of Data Availability (NODA) that requests comments on selected documents that the EPA received during the comment period for the proposed regulations. In addition, the U.S. House of Representatives in September 2012 approved a bill that was revised in the Senate to modify Subtitle D of the RCRA to provide for the proper management and disposal of CCRs and to preclude the EPA from regulating CCRs under Subtitle C of the RCRA. This revised bill is being considered in the Senate, and the prospect for passage of this legislation is uncertain.

In January 2012, a coalition of environmental groups filed a 60-day notice of intent to sue the EPA for failure to perform nondiscretionary duties under RCRA, which could require a deadline for the EPA to issue strict CCR regulations. In February 2012, two CCR recycling companies also issued a 60-day notice of intent to sue the EPA over its timeliness in issuing CCR regulations, but they requested that the EPA take a Subtitle D approach that would allow for continued recycling of CCRs. The coalition filed its lawsuit in April 2012 and litigation is continuing.

PPL, PPL Energy Supply, LKE, LG&E and KU cannot predict at this time the final requirements of the EPA's CCR regulations or potential changes to the RCRA and what impact they would have on their facilities, but the financial impact could be material if regulated as a hazardous waste under Subtitle C and significant if regulated under Subtitle D.

Martins Creek Fly Ash Release (PPL and PPL Energy Supply)

In 2005, approximately 100 million gallons of water containing fly ash was released from a disposal basin at the Martins Creek plant used in connection with the operation of the plant's two 150 MW coal-fired generating units. This resulted in ash being deposited onto adjacent roadways and fields, into a nearby creek and the Delaware River. PPL determined that the release was caused by a failure in the disposal basin's discharge structure. PPL conducted extensive clean-up and completed studies, in conjunction with a group of natural resource trustees and the Delaware River Basin Commission, evaluating the effects of the release on the river's sediment, water quality and ecosystem.

The PADEP filed a complaint in Pennsylvania Commonwealth Court against PPL Martins Creek and PPL Generation, alleging violations of various state laws and regulations and seeking penalties and injunctive relief. PPL and the PADEP have settled this matter. The settlement also required PPL to submit a report on the completed studies of possible natural resource damages. PPL subsequently submitted the assessment report to the Pennsylvania and New Jersey regulatory agencies and has continued discussing potential natural resource damages and mitigation options with the agencies. Subsequently, in August 2011 the PADEP submitted its National Resource Damage Assessment report to the court and to the interveners. In December 2011, the interveners commented on the PADEP report and in February 2012 the PADEP and PPL filed separate responses with the court. In March 2012, the court dismissed the interveners' case, but the interveners have appealed the dismissal to the Pennsylvania Supreme Court. The settlement agreement for the Natural Resources Damage Claim has not yet been submitted for public comments, which is the next phase in the process of finalizing the claim.

Through September 30, 2012, PPL Energy Supply has spent \$28 million for remediation and related costs and an insignificant remediation liability remains on the balance sheet. PPL and PPL Energy Supply cannot be certain of the

outcome of the natural resource damage assessment or the associated costs, the outcome of any lawsuit that may be brought by citizens or businesses or the nature of any other regulatory or legal actions that may be initiated against PPL, PPL Energy Supply or their subsidiaries as a result of the disposal basin release. However, PPL and PPL Energy Supply currently do not expect such outcomes to result in significant losses above the amounts currently recorded.

Seepages and Groundwater Infiltration - Pennsylvania, Montana and Kentucky

(PPL, PPL Energy Supply, LKE, LG&E and KU)

Seepages or groundwater infiltration have been detected at active and retired wastewater basins and landfills at various PPL, PPL Energy Supply, LKE, LG&E and KU plants. PPL, PPL Energy Supply, LKE, LG&E and KU have completed or are completing assessments of seepages or groundwater infiltration at various facilities and have completed or are working with agencies to implement abatement measures, where required. A range of reasonably possible losses cannot currently be estimated.

(PPL and PPL Energy Supply)

In 2007, six plaintiffs filed a lawsuit in the Montana Sixteenth Judicial District Court against the Colstrip plant owners asserting property damage due to seepage from plant wastewater ponds. A settlement agreement was reached in July 2010, which would have resulted in a payment by PPL Montana, but certain of the plaintiffs later argued the settlement was not final. The Colstrip plant owners filed a motion to enforce the settlement and in October 2011 the court granted the motion and ordered the settlement to be completed in 60 days. The plaintiffs appealed the October 2011 order to the Montana Supreme Court, and the court's decision is expected in the second half of 2012. Therefore, the settlement ordered by the district court is not final. PPL and PPL Energy Supply cannot predict the outcome of the appeal, although PPL Montana's share of any final settlement is not expected to be significant.

In August 2012, PPL Montana entered into an Administrative Order on Consent (AOC) with the Montana Department of Environmental Quality (MDEQ) which establishes a comprehensive process to investigate and remediate groundwater seepage impacts related to the wastewater facilities at the Colstrip power plant. The AOC requires that within five years, PPL Montana is to provide financial assurance to MDEQ for the costs associated with closure and future monitoring of the waste-water treatment facilities. PPL Montana cannot predict at this time if the actions required under the AOC will create the need to adjust the existing ARO related to these facilities.

In September 2012, Earthjustice filed an affidavit pursuant to Montana's Major Facility Siting Act (MFSA) that sought review of the AOC by Montana's Board of Environmental Review (BER), on behalf of environmental groups Sierra Club, the Montana Environmental Information Center (MEIC), and the National Wildlife Federation (NWF). In September 2012, PPL Montana filed an election with the BER to have this proceeding conducted in Montana state district court as contemplated by the MFSA. In October 2012, Earthjustice filed a petition for review of the AOC in the Montana state district court in Rosebud County.

In late October 2012, Earthjustice filed a second complaint against MDEQ and PPL Montana in state district court in Lewis and Clark County on behalf of Sierra Club, MEIC and NWF. This complaint alleges that the defendants have failed to take action under the MFSA and the Montana Water Quality Act to effectively monitor and correct issues of coal ash disposal and wastewater ponds at the Colstrip plant. The complaint seeks a declaration that the operations of the impoundments violate the statutes addressed above, requests a writ of mandamus directing MDEQ to enforce the same, and seeks recovery of attorneys' fees and costs. PPL and PPL Energy Supply cannot predict the outcome of this matter.

Clean Water Act 316(b) (PPL, PPL Energy Supply, LKE, LG&E and KU)

The EPA finalized requirements in 2004 for new or modified cooling water intake structures. These requirements affect where generating plants are built, establish intake design standards and could lead to requirements for cooling towers at new and modified power plants. In 2009, however, the U.S. Supreme Court ruled that the EPA has discretion to use cost-benefit analysis in determining the best technology available for minimizing adverse environmental impact to aquatic organisms. The EPA published the proposed rule on new or modified cooling water intake structures in April 2011. The industry and PPL reviewed the proposed rule and submitted comments. The EPA is evaluating comments and meeting with industry groups to discuss options. Two NODAs have been issued on the rule that indicate the EPA may be willing to amend the rule based on certain industry group comments and the EPA's comment period on the NODAs has ended. The final rule is expected to be issued in 2013. The proposed rule contains two requirements to reduce impact to aquatic organisms. The first requires all existing facilities to meet standards for the reduction of mortality of aquatic organisms that become trapped against water intake screens regardless of the levels of mortality actually occurring or the cost of achieving the requirements. The second requirement is to determine and install the best technology available to reduce mortality of aquatic organisms that are pulled through the plant's cooling water system. A form of cost-benefit analysis is allowed for this second

requirement. This process involves a site-specific evaluation based on nine factors, including impacts to energy delivery reliability and the remaining useful life of the plant. PPL, PPL Energy Supply, LKE, LG&E and KU cannot reasonably estimate a range of reasonably possible costs, if any, until a final rule is issued, the required studies have been completed, and each state in which they operate has decided how to implement the rule.

Effluent Limitations Guidelines and Standards (PPL, PPL Energy Supply, LKE, LG&E and KU)

In October 2009, the EPA released its Final Detailed Study of the Steam Electric Power Generating effluent limitations guidelines and standards. The EPA is expected to issue the final regulations in 2014. PPL, PPL Energy Supply, LKE, LG&E and KU expect the revised guidelines and standards to be more stringent than the current standards especially for sulfur dioxide scrubber wastewater and ash basin discharges, which could result in more stringent discharge permit limits. In the interim, states may impose more stringent limits on a case-by-case basis under existing authority as permits are renewed. Under the Clean Water Act, permits are subject to renewal every five years. PPL, PPL Energy Supply, LKE, LG&E and KU

are unable to predict the outcome of this matter or estimate a range of reasonably possible costs, but the costs could be significant.

Other Issues (PPL, PPL Energy Supply, PPL Electric, LKE, LG&E and KU)

In 2006, the EPA significantly decreased to 10 parts per billion (ppb) the drinking water standards related to arsenic. In Pennsylvania, Montana and Kentucky, this arsenic standard has been incorporated into the states' water quality standards and could result in more stringent limits in NPDES permits for PPL's Pennsylvania, Montana and Kentucky plants. Subsequently, the EPA developed a draft risk assessment for arsenic that increases the cancer risk exposure by more than 20 times, which would lower the current standard from 10 ppb to 0.1 ppb. If the lower standard becomes effective, costly treatment would be required to attempt to meet the standard and, at this time, there is no assurance that it could be achieved. PPL, PPL Energy Supply, LKE, LG&E and KU cannot predict the outcome of the draft risk assessment and what impact, if any, it would have on their plants, but the costs could be significant.

The EPA is reassessing its polychlorinated biphenyls (PCB) regulations under the Toxics Substance Control Act, which currently allow certain PCB articles to remain in use. In April 2010, the EPA issued an Advanced Notice of Proposed Rulemaking for changes to these regulations. This rulemaking could lead to a phase-out of all PCB-containing equipment. The EPA is planning to propose the revised regulations in late 2012 or 2013. PCBs are found, in varying degrees, in all of the Registrants' operations. The Registrants cannot predict at this time the outcome of these proposed EPA regulations and what impact, if any, they would have on their facilities, but the costs could be significant.

A PPL Energy Supply subsidiary signed a Consent Order and Agreement (COA) with the PADEP in July 2008 under which it agreed, under certain conditions, to take further actions to minimize the possibility of fish kills at its Brunner Island plant. Fish are attracted to warm water in the power plant discharge channel, especially during cold weather. Debris at intake pumps can result in a unit trip or reduction in load, causing a sudden change in water temperature. A barrier has been constructed to prevent debris from entering the river water intake area at a cost that was not significant.

PPL Energy Supply's subsidiary has also investigated alternatives to exclude fish from the discharge channel and submitted three alternatives to the PADEP. The subsidiary and the PADEP have now concluded that a barrier method to exclude fish is not workable. In June 2012, a new COA (the Brunner COA) was signed that allows the subsidiary to study a change in cooling tower operational methods that may keep fish from entering the channel. Should this approach fail, the Brunner COA requires a retrofit of impingement control technology at the intakes to the cooling towers, the cost of which could be significant.

In March 2012, the subsidiary received a draft NPDES permit (renewed) for the Brunner Island plant from the PADEP. This permit includes new water quality-based limits for the scrubber wastewater plant. Some of these limits may not be achievable with the existing treatment system. Several agencies and environmental groups commented on the draft permit, raising issues that must be resolved in order to obtain a final permit for the plant. PPL Energy Supply cannot predict the outcome of the final resolution of the permit issues at this time or what impact, if any, they would have on this facility, but the costs could be significant.

In May 2010, the Kentucky Waterways Alliance and other environmental groups filed a petition with the Kentucky Energy and Environment Cabinet challenging the Kentucky Pollutant Discharge Elimination System permit issued in April 2010, which covers water discharges from the Trimble County plant. In November 2010, the Cabinet issued a final order upholding the permit. In December 2010, the environmental groups appealed the order to the Trimble Circuit Court, but the case was subsequently transferred to the Franklin Circuit Court. PPL, LKE, LG&E, and KU are unable to predict the outcome of this matter or estimate a range of reasonably possible losses, if any.

The EPA and the Army Corps of Engineers are working on a guidance document that will expand the federal government's interpretation of what constitutes "waters of the United States" subject to regulation under the Clean Water Act. This change has the potential to affect generation and delivery operations, with the most significant effect being the potential elimination of the existing regulatory exemption for plant waste water treatment systems. The costs that may be imposed on the Registrants as a result of any eventual expansion of this interpretation cannot reliably be estimated at this time.

Superfund and Other Remediation (PPL, PPL Energy Supply, PPL Electric, LKE, LG&E and KU)

PPL Electric is potentially responsible for costs at several sites listed by the EPA under the federal Superfund program, including the Columbia Gas Plant site, the Metal Bank site and the Ward Transformer site. Clean-up actions have been or are being undertaken at all of these sites, the costs of which have not been significant to PPL Electric. However, should the EPA require different or additional measures in the future, or should PPL Electric's share of costs at multi-party sites increase substantially more than currently expected, the costs could be significant.

PPL Electric, LG&E and KU are remediating or have completed the remediation of several sites that were not addressed under a regulatory program such as Superfund, but for which PPL Electric, LG&E and KU may be liable for remediation. These include a number of former coal gas manufacturing plants in Pennsylvania and Kentucky previously owned or operated or currently owned by predecessors or affiliates of PPL Electric, LG&E and KU. There are additional sites, formerly owned or operated by PPL Electric, LG&E and KU predecessors or affiliates, for which PPL Electric, LG&E and KU lack information on current site conditions and are therefore unable to predict what, if any, potential liability they may have.

Depending on the outcome of investigations at sites where investigations have not begun or been completed or developments at sites for which PPL Electric, LG&E and KU currently lack information, the costs of remediation and other liabilities could be material. PPL, PPL Electric, LKE, LG&E and KU are unable to estimate a range of reasonably possible losses, if any, related to these matters.

The EPA is evaluating the risks associated with polycyclic aromatic hydrocarbons and naphthalene, chemical by-products of coal gas manufacturing. As a result of the EPA's evaluation, individual states may establish more stringent standards for water quality and soil cleanup. This could require several PPL subsidiaries to take more extensive assessment and remedial actions at former coal gas manufacturing plants. PPL, PPL Electric, LKE, LG&E and KU cannot estimate a range of reasonably possible losses, if any, related to these matters.

From time to time, PPL Energy Supply, PPL Electric, LG&E and KU undertake remedial action in response to spills or other releases at various on-site and off-site locations, negotiate with the EPA and state and local agencies regarding actions necessary for compliance with applicable requirements, negotiate with property owners and other third parties alleging impacts from PPL's operations, and undertake similar actions necessary to resolve environmental matters which arise in the course of normal operations. Based on analyses to date, resolution of these environmental matters is not expected to have a significant impact on their operations.

Future cleanup or remediation work at sites currently under review, or at sites not currently identified, may result in significant additional costs for the Registrants.

Environmental Matters - WPD (PPL)

WPD's distribution businesses are subject to environmental regulatory and statutory requirements. PPL believes that WPD has taken and continues to take measures to comply with the applicable laws and governmental regulations for the protection of the environment.

Other

Nuclear Insurance (PPL and PPL Energy Supply)

PPL Susquehanna is a member of certain insurance programs that provide coverage for property damage to members' nuclear generating plants. Facilities at the Susquehanna plant are insured against property damage losses up to \$2.75 billion under these programs. PPL Susquehanna is also a member of an insurance program that provides insurance coverage for the cost of replacement power during prolonged outages of nuclear units caused by certain specified conditions.

Under the property and replacement power insurance programs, PPL Susquehanna could be assessed retroactive premiums in the event of the insurers' adverse loss experience. At September 30, 2012, this maximum assessment was \$48 million.

In the event of a nuclear incident at the Susquehanna plant, PPL Susquehanna's public liability for claims resulting from such incident would be limited to \$12.6 billion under provisions of The Price-Anderson Act Amendments under the Energy Policy Act of 2005. PPL Susquehanna is protected against this liability by a combination of commercial insurance and an industry assessment program.

In the event of a nuclear incident at any of the reactors covered by The Price-Anderson Act Amendments under the Energy Policy Act of 2005, PPL Susquehanna could be assessed up to \$235 million per incident, payable at \$35 million per year.

Employee Relations (PPL, LKE and KU)

In July 2012, KU and the IBEW Local 2100 ratified a three-year labor agreement containing a 2.5% wage increase through July 2013, a subsequent 2.5% wage increase for July 2013 through July 2014 and a wage reopener for July 2014. The agreement covers approximately 70 employees.

Guarantees and Other Assurances

(PPL, PPL Energy Supply, PPL Electric, LKE, LG&E and KU)

In the normal course of business, the Registrants enter into agreements that provide financial performance assurance to third parties on behalf of certain subsidiaries. Such agreements include, for example, guarantees, stand-by letters of credit issued by financial institutions and surety bonds issued by insurance companies. These agreements are entered into primarily to support or enhance the creditworthiness attributed to a subsidiary on a stand-alone basis or to facilitate the commercial activities in which these subsidiaries enter.

(PPL)

PPL fully and unconditionally guarantees all of the debt securities of PPL Capital Funding.

(PPL, PPL Energy Supply, PPL Electric, LKE, LG&E and KU)

The table below details guarantees provided at September 30, 2012. The total recorded liability at September 30, 2012 and December 31, 2011, was \$24 million and \$14 million for PPL and \$20 million and \$11 million for LKE. The probability of expected payment/performance under each of these guarantees is remote except for "WPD guarantee of pension and other obligations of unconsolidated entities" and "Indemnification of lease termination and other divestitures." For reporting purposes, on a consolidated basis, all guarantees of PPL Energy Supply (other than the letters of credit), PPL Electric, LKE, LG&E and KU also apply to PPL, and all guarantees of LG&E and KU also apply to LKE.

| | Exposure at September 30, 2012 (a) | Expiration Date |
|---|--|--------------------|
| PPL | | |
| Indemnifications related to the WPD Midlands acquisition | (b) | |
| WPD indemnifications for entities in liquidation and sales of assets | \$ 298 (c) | 2014 - 2018 |
| WPD guarantee of pension and other obligations of unconsolidated entities | 91 (d) | 2015 |
| Tax indemnification related to unconsolidated WPD affiliates | (e) | |
| PPL Energy Supply | | |
| Letters of credit issued on behalf of affiliates | 21 (f) | 2012 - 2014 |
| Retrospective premiums under nuclear insurance programs | 48 (g) | |
| Nuclear claims assessment under The Price-Anderson Act Amendments under The Energy Policy Act of 2005 | 235 (h) | |
| Indemnifications for sales of assets | 262 (i) | 2012 - 2025 |
| Indemnification to operators of jointly owned facilities | 6 (j) | |
| Guarantee of a portion of a divested unconsolidated entity's debt | 22 (k) | 2018 |
| PPL Electric | | |
| Guarantee of inventory value | 22 (l) | 2016 |

LKE

| | | |
|---|---------|--------|
| | | 2021 - |
| Indemnification of lease termination and other divestitures | 301 (m) | 2023 |

LG&E and KU

| | |
|--|-----|
| LG&E and KU guarantee of shortfall related to OVEC | (n) |
|--|-----|

- (a) Represents the estimated maximum potential amount of future payments that could be required to be made under the guarantee.
- (b) Prior to PPL's acquisition, WPD Midlands Holdings Limited had agreed to indemnify certain former directors of a Turkish entity, in which WPD Midlands Holdings Limited previously owned an interest, for any liabilities that may arise as a result of an investigation by Turkish tax authorities, and PPL WEM has received a cross-indemnity from E.ON AG with respect to these indemnification obligations. Additionally, PPL subsidiaries agreed to provide indemnifications to subsidiaries of E.ON AG for certain liabilities relating to properties and assets owned by affiliates of E.ON AG that were transferred to WPD Midlands in connection with the acquisition. The maximum exposure and expiration of these indemnifications cannot be estimated because the maximum potential liability is not capped and the expiration date is not specified in the transaction documents.
- (c) In connection with the liquidation of wholly owned subsidiaries that have been deconsolidated upon turning the entities over to the liquidators, certain affiliates of PPL Global have agreed to indemnify the liquidators, directors and/or the entities themselves for any liabilities or expenses arising during the liquidation process, including liabilities and expenses of the entities placed into liquidation. In some cases, the indemnifications are limited to a maximum amount that is based on distributions made from the subsidiary to its parent either prior or subsequent to being placed into liquidation. In other cases, the maximum amount of the indemnifications is not explicitly stated in the agreements. The indemnifications generally expire two to seven years subsequent to the date of dissolution of the entities. The exposure noted only includes those cases in which the agreements provide for a specific limit on the amount of the indemnification, and the expiration date was based on an estimate of the dissolution date of the entities.

In connection with their sales of various businesses, WPD and its affiliates have provided the purchasers with indemnifications that are standard for such transactions, including indemnifications for certain pre-existing liabilities and environmental and tax matters. In addition, in connection with certain of these sales, WPD and its affiliates have agreed to continue their obligations under existing third-party guarantees, either for a set period of time following the transactions or upon the condition that the purchasers make reasonable efforts to terminate the guarantees. Finally, WPD and its affiliates remain secondarily responsible for lease payments under certain leases that they have assigned to third parties.

- (d) As a result of the privatization of the utility industry in the U.K., certain electric associations' roles and responsibilities were discontinued or modified. As a result, certain obligations, primarily pension-related, associated with these organizations have been guaranteed by the participating members. Costs are allocated to the members based on predetermined percentages as outlined in specific agreements. However, if a member becomes insolvent, costs can be reallocated to and are guaranteed by the remaining members. At September 30, 2012, WPD has recorded an estimated discounted liability based on its current allocated percentage of the total expected costs for which the expected payment/performance is probable. Neither the expiration date nor the maximum amount of potential payments for certain obligations is explicitly stated in the related agreements. Therefore, they have been estimated based on the types of obligations.
- (e) Two WPD unconsolidated affiliates were refinanced during 2005. Under the terms of the refinancing, WPD indemnified the lender against certain tax and other liabilities. These indemnifications expired in the second quarter of 2012.
- (f) Standby letter of credit arrangements under PPL Energy Supply's credit facilities for the purposes of protecting various third parties against nonperformance by PPL. This is not a guarantee by PPL on a consolidated basis.
- (g) PPL Susquehanna is contingently obligated to pay this amount related to potential retrospective premiums that could be assessed under its nuclear insurance programs. See "Nuclear Insurance" above for additional information.
- (h) This is the maximum amount PPL Susquehanna could be assessed for each incident at any of the nuclear reactors covered by this Act. See "Nuclear Insurance" above for additional information.
- (i) PPL Energy Supply's maximum exposure with respect to certain indemnifications and the expiration of the indemnifications cannot be estimated because, in the case of certain indemnification provisions, the maximum potential liability is not capped by the transaction documents and the expiration date is based on the applicable statute of limitations. The exposure and expiration dates noted are only for those cases in which the agreements provide for specific limits. The indemnification provisions described below are in each case subject to certain customary limitations, including thresholds for allowable claims, caps on aggregate liability, and time limitations for claims arising out of breaches of most representations and warranties.

A subsidiary of PPL Energy Supply has agreed to provide indemnification to the purchaser of the Long Island generation business for damages arising out of any breach of the representations, warranties and covenants under the related transaction agreement and for damages arising out of certain other matters, including liabilities relating to certain renewable energy facilities which were previously owned by one of the PPL subsidiaries sold in the transaction but which were unrelated to the Long Island generation business. The indemnification provisions for most representations and warranties expired in the third quarter of 2011.

A subsidiary of PPL Energy Supply has agreed to provide indemnification to the purchasers of the Maine hydroelectric facilities for damages arising out of any breach of the representations, warranties and covenants under the respective transaction agreements and for damages arising out of certain other matters, including liabilities of the PPL Energy Supply subsidiary relating to the pre-closing ownership or operation of those hydroelectric facilities. The indemnification provisions for certain representations and warranties expired in the second quarter of 2011.

Subsidiaries of PPL Energy Supply have agreed to provide indemnification to the purchasers of certain non-core generation facilities sold in March 2011 for damages arising out of any breach of the representations, warranties and covenants under the related transaction agreements and for damages arising out of certain other matters relating to the facilities that were the subject of the transaction, including certain reduced capacity payments (if any) at one of the facilities in the event specified PJM rule changes are proposed and become effective. The indemnification provisions for most representations and warranties expired in the first quarter of 2012.

- (j) In December 2007, a subsidiary of PPL Energy Supply executed revised owners agreements for two jointly owned facilities, the Keystone and Conemaugh generating plants. The agreements require that in the event of any default by an owner, the other owners fund contributions for the operation of the generating plants, based upon their ownership percentages. The non-defaulting owners, who make up the defaulting owner's obligations, are entitled to

the generation entitlement of the defaulting owner, based upon their ownership percentage. The exposure shown reflects the PPL Energy Supply subsidiary's share of the maximum obligation. The agreements do not have an expiration date.

- (k) A PPL Energy Supply subsidiary owned a one-third equity interest in Safe Harbor Water Power Corporation (Safe Harbor) that was sold in March 2011. Beginning in 2008, PPL Energy Supply guaranteed one-third of any amounts payable with respect to certain senior notes issued by Safe Harbor. Under the terms of the sale agreement, PPL Energy Supply continues to guarantee the portion of Safe Harbor's debt, but received a cross-indemnity from the purchaser, secured by a lien on the purchaser's stock of Safe Harbor, in the event PPL Energy Supply is required to make a payment under the guarantee. The exposure noted reflects principal only.
- (l) PPL Electric entered into a contract with a third party logistics firm that provides inventory procurement and fulfillment services. Under the contract, the logistics firm has title to the inventory purchased for PPL Electric's use. Upon termination of the contract, PPL Electric has guaranteed to purchase any remaining inventory that has not been used or sold by the logistics firm at the weighted-average cost at which the logistics firm purchased the inventory, thus protecting the logistics firm from reductions in the fair value of the inventory.
- (m) LKE provides certain indemnifications, the most significant of which relate to the termination of the WKE lease in July 2009. These guarantees cover the due and punctual payment, performance and discharge by each party of its respective present and future obligations. The most comprehensive of these guarantees is the LKE guarantee covering operational, regulatory and environmental commitments and indemnifications made by WKE under the WKE Transaction Termination Agreement. This guarantee has a term of 12 years ending July 2021, and a cumulative maximum exposure of \$200 million. Certain items such as government fines and penalties fall outside the cumulative cap. LKE has contested the applicability of the indemnification requirement relating to one matter presented by a counterparty under this guarantee. Another guarantee with a maximum exposure of \$100 million covering other indemnifications expires in 2023. In May 2012, LKE's indemnitee received an arbitration panel's decision affecting this matter, which granted LKE's indemnitee certain rights of first refusal to purchase excess power at a market-based price rather than at an absolute fixed price. In July 2012, LKE's indemnitee filed a judicial action in the Henderson Circuit Court, seeking to vacate the arbitration decision and will present oral arguments in November 2012. LKE believes its indemnification obligations in this matter remain subject to various uncertainties, including the legal status of the court's review of the arbitration decision as well as future prices, availability and demand for the subject excess power. LKE continues to evaluate various legal and commercial options with respect to this indemnification matter. The ultimate outcomes of the WKE termination-related indemnifications cannot be predicted at this time. Additionally, LKE has indemnified various third parties related to historical obligations for other divested subsidiaries and affiliates. The indemnifications vary by entity and the maximum exposures range from being capped at the sale price to no specified maximum; however, LKE is not aware of formal claims under such indemnities made by any party at this time. LKE could be required to perform on these indemnifications in the event of covered losses or liabilities being claimed by an indemnified party. In the second quarter of 2012, LKE adjusted its estimated liability for certain of these indemnifications by \$9 million (\$5 million after-tax), which is reflected in "Income (Loss) from Discontinued Operations (net of income taxes)" on the Statement of Income. The adjustment was recorded in the Kentucky Regulated segment for PPL. No additional material loss is anticipated by reason of such indemnifications.
- (n) Pursuant to the OVEC power purchase contract, expiring in June 2040, LG&E and KU are obligated to pay a demand charge which includes, among other charges, debt service and amortization toward principal retirement, decommissioning costs, post-retirement and post-employment benefits costs (other than pensions), and reimbursement of plant operating, maintenance and other expenses. The demand charge is expected to cover LG&E's and KU's shares of the cost of the listed items over the term of the contract. However, in the event there is a shortfall in covering these costs, LG&E and KU are obligated to pay their share of the excess debt service, post-retirement and post-employment and decommissioning costs. The maximum exposure and the expiration date of these potential obligations are not presently determinable.

The Registrants provide other miscellaneous guarantees through contracts entered into in the normal course of business. These guarantees are primarily in the form of indemnification or warranties related to services or equipment and vary in duration. The amounts of these guarantees often are not explicitly stated, and the overall maximum amount of the obligation under such guarantees cannot be reasonably estimated. Historically, no significant payments have been made with respect to these types of guarantees and the probability of payment/performance under these guarantees is remote.

PPL, on behalf of itself and certain of its subsidiaries, maintains insurance that covers liability assumed under contract for bodily injury and property damage. The coverage requires a maximum \$4 million deductible per occurrence and provides maximum aggregate coverage of \$200 million. This insurance may be applicable to obligations under certain of these contractual arrangements.

11. Related Party Transactions

PLR Contracts/Purchase of Accounts Receivable (PPL Energy Supply and PPL Electric)

PPL Electric holds competitive solicitations for PLR generation supply. PPL EnergyPlus has been awarded a portion of the PLR generation supply through these competitive solicitations. See Note 10 for additional information on the solicitations. PPL Electric's purchases from PPL EnergyPlus totaled \$22 million and \$60 million for the three and nine months ended September 30, 2012 and \$5 million and \$15 million during the same periods in 2011. The sales and purchases are included in the Statements of Income as "Wholesale energy marketing to affiliate" by PPL Energy Supply and as "Energy purchases from affiliate" by PPL Electric.

Under the standard Supply Master Agreement for the solicitation process, PPL Electric requires all suppliers to post collateral once credit exposures exceed defined credit limits. PPL EnergyPlus is required to post collateral with PPL Electric when the aggregate credit exposure with respect to electricity, capacity and other related products to be delivered by PPL EnergyPlus exceeds a contractual credit limit. Based on the current credit rating and tangible net worth of PPL Energy Supply, as guarantor, PPL EnergyPlus' credit limit was \$35 million at September 30, 2012. In no instance is PPL Electric required to post collateral to suppliers under these supply contracts.

PPL Electric's customers may choose an alternative supplier for their generation supply. See Note 2 for additional information regarding PPL Electric's purchases of accounts receivable from alternative suppliers, including PPL EnergyPlus.

At September 30, 2012, PPL Energy Supply had a net credit exposure of \$39 million from PPL Electric from its commitment as a PLR supplier and from the sale of its accounts receivable to PPL Electric.

Wholesale Sales and Purchases (LG&E and KU)

LG&E and KU jointly dispatch their generation units with the lowest cost generation used to serve their retail native load. When LG&E has excess generation capacity after serving its own retail native load and its generation cost is lower than that of KU, KU purchases electricity from LG&E. When KU has excess generation capacity after serving its own retail native load and its generation cost is lower than that of LG&E, LG&E purchases electricity from KU. These transactions are reflected in the Statements of Income as "Electric revenue from affiliate" and "Energy purchases from affiliate" and are recorded at a price equal to the seller's fuel cost. Savings realized from such intercompany transactions are shared equally between the two companies. The volume of energy each company has to sell to the other is dependent on its native load needs and its available generation.

Allocations of Corporate Service Costs (PPL Energy Supply, PPL Electric and LKE)

PPL Services provides corporate functions such as financial, legal, human resources and information technology services. PPL Services charges the respective PPL subsidiaries for the cost of such services when they can be specifically identified. The cost of the services that is not directly charged to PPL subsidiaries is allocated to applicable subsidiaries based on an average of the subsidiaries' relative invested capital, operation and maintenance expenses and number of employees. PPL Services charged the following amounts for the periods ended September 30, which PPL management believes are reasonable, including amounts applied to accounts that are further distributed between capital and expense:

| | Three Months | | Nine Months | |
|-------------------|--------------|-------|-------------|--------|
| | 2012 | 2011 | 2012 | 2011 |
| PPL Energy Supply | \$ 49 | \$ 44 | \$ 159 | \$ 138 |
| PPL Electric | 35 | 34 | 116 | 108 |
| LKE | 3 | 3 | 11 | 12 |

Intercompany Billings by LKS (LG&E and KU)

LKS provides LG&E and KU with a variety of centralized administrative, management and support services. The cost of these services is directly charged to the company or, for general costs that cannot be directly attributed, charged based on predetermined allocation factors, including the following measures: number of customers, total assets, revenues, number of employees and/or other statistical information. LKS charged the amounts in the table below for the periods ended September 30, which LKE management believes are reasonable, including amounts that are further distributed between capital and expense:

| | Three Months | | Nine Months | |
|------|--------------|-------|-------------|--------|
| | 2012 | 2011 | 2012 | 2011 |
| LG&E | \$ 51 | \$ 51 | \$ 132 | \$ 134 |
| KU | 33 | 44 | 114 | 148 |

Intercompany Borrowings

(PPL Energy Supply)

A PPL Energy Supply subsidiary periodically holds revolving demand notes from certain affiliates. At September 30, 2012, there were no balances outstanding. At December 31, 2011, a note with PPL Energy Funding had an outstanding balance of \$198 million with an interest rate of 3.77% that was reflected in "Notes receivable from affiliates" on the Balance Sheet. Interest earned on these revolving facilities is included in "Interest Income from Affiliates" on the Statements of Income. The interest rates on borrowings are equal to one-month LIBOR plus a spread. Interest earned on borrowings was not significant for the three and nine months ended September 30, 2012 and the three months ended September 30, 2011. For the nine months ended September 30, 2011, interest earned on the borrowings was \$6 million, substantially all of which was attributable to borrowings by PPL Energy Funding.

(PPL Electric)

A PPL Electric subsidiary periodically holds revolving demand notes from certain affiliates. At September 30, 2012, there was a \$210 million balance outstanding and no balance was outstanding at December 31, 2011. The note is reflected in "Notes receivable from affiliates" on the Balance Sheet. The interest rate on borrowings is equal to one-month LIBOR plus a spread. The interest rate on the outstanding borrowings at September 30, 2012 was 1.98%. For the three and nine months ended September 30, 2012 and 2011, the interest earned on these revolving facilities was not significant.

(LKE)

LKE maintains a \$300 million revolving demand note with a PPL Energy Supply subsidiary whereby LKE can borrow funds on a short-term basis at market-based rates. The interest rates on borrowings are equal to one-month LIBOR plus a spread. At September 30, 2012 and December 31, 2011, there were no balances outstanding. Interest expense incurred on the revolving demand note with the PPL Energy Supply subsidiary was not significant for the three and nine months ended September 30, 2012 and 2011.

LKE holds a note receivable from a PPL affiliate that has a \$300 million borrowing limit whereby LKE can loan funds on a short-term basis at market-based rates. At September 30, 2012 and December 31, 2011, \$6 million and \$15 million were outstanding and were reflected in "Notes receivable from affiliates" on the Balance Sheets. The interest rates on loans are based on the PPL affiliate's credit rating and are currently equal to one-month LIBOR plus a

spread. The interest rates on the outstanding borrowings at September 30, 2012 and December 31, 2011 were 2.23% and 2.27%. Interest income on the note receivable was not significant for the three and nine months ended September 30, 2012 and 2011.

(LG&E)

LG&E participates in an intercompany money pool agreement whereby LKE and/or KU make available to LG&E funds up to \$500 million at an interest rate based on a market index of commercial paper issues. At September 30, 2012 and December 31, 2011, there was no balance outstanding. Interest expense and interest income on the money pool agreement with LKE and/or KU was not significant for the three and nine months ended September 30, 2012 and 2011.

(KU)

KU participates in an intercompany money pool agreement whereby LKE and/or LG&E make available to KU funds up to \$500 million at an interest rate based on a market index of commercial paper issues. At September 30, 2012 and December 31, 2011, there was no balance outstanding. Interest expense and interest income on the money pool agreement with LKE and/or LG&E was not significant for the three and nine months ended September 30, 2012 and 2011.

Trademark Royalties (PPL Energy Supply)

A PPL subsidiary owns PPL trademarks and billed certain affiliates for their use under a licensing agreement. This agreement was terminated in December 2011. PPL Energy Supply was charged \$10 million and \$30 million of license fees for the three and nine months ended September 30, 2011. These charges are primarily included in "Other operation and maintenance" on the Statement of Income.

Intercompany Insurance (PPL Electric)

PPL Power Insurance Ltd. (PPL Power Insurance) is a subsidiary of PPL that provides insurance coverage to PPL and its subsidiaries for property damage, general/public liability and workers' compensation.

Due to damages resulting from several PUC-reportable storms that occurred in 2011, PPL Electric exceeded its deductible for the 2011 policy year. Probable recoveries on insurance claims with PPL Power Insurance of \$26.5 million were recorded at September 30, 2011, of which \$7 million and \$16 million were recorded during the three and nine months ended September 30, 2011 in "Other operation and maintenance" on the Statement of Income, with the remainder recorded in PP&E on the Balance Sheet. In September 2012, PPL Electric received \$26.5 million from the settlement of its 2011 claims.

Other (PPL Energy Supply, PPL Electric, LKE, LG&E and KU)

See Note 7 for a discussion regarding capital transactions by PPL Energy Supply, PPL Electric, LKE, LG&E and KU. For PPL Energy Supply, PPL Electric, LG&E and KU, refer to Note 9 for discussions regarding intercompany allocations associated with defined benefits.

12. Other Income (Expense) - net

(PPL, PPL Energy Supply, PPL Electric, LKE, LG&E and KU)

The breakdown of "Other Income (Expense) - net" for the periods ended September 30 was:

| | Three Months | | Nine Months | |
|--|--------------|-------|-------------|-------|
| | 2012 | 2011 | 2012 | 2011 |
| PPL | | | | |
| Other Income | | | | |
| Gain on redemption of debt (a) | | \$ 22 | | \$ 22 |
| Earnings on securities in NDT funds | \$ 5 | 2 | \$ 17 | 20 |
| Interest income | 1 | 1 | 4 | 5 |
| AFUDC - equity component | 2 | 2 | 7 | 5 |
| Net hedge gains associated with the 2011 Bridge Facility (b) | | | | 55 |

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| | | | | |
|---|----------------|--------------|----------------|---------------|
| Earnings (losses) from equity method investments | (1) | 1 | (7) | 1 |
| Miscellaneous - Domestic | 3 | 2 | 8 | 9 |
| Miscellaneous - U.K. | (1) | | 1 | 1 |
| Total Other Income | 9 | 30 | 30 | 118 |
| Other Expense | | | | |
| Economic foreign currency exchange contracts (Note 14) | 47 | (11) | 40 | (11) |
| Charitable contributions | 1 | 2 | 7 | 7 |
| WPD Midlands acquisition-related costs (Note 8) | | | | 36 |
| Foreign currency loss on 2011 Bridge Facility (c) | | | | 57 |
| U.K. stamp duty tax (Note 8) | | | | 21 |
| Miscellaneous - Domestic | 4 | 2 | 12 | 7 |
| Miscellaneous - U.K. | 1 | | 2 | 3 |
| Total Other Expense | 53 | (7) | 61 | 120 |
| Other Income (Expense) - net | \$ (44) | \$ 37 | \$ (31) | \$ (2) |

| | Three Months | | Nine Months | |
|-------------------------------------|--------------|------|-------------|-------|
| | 2012 | 2011 | 2012 | 2011 |
| PPL Energy Supply | | | | |
| Other Income | | | | |
| Earnings on securities in NDT funds | \$ 5 | \$ 2 | \$ 17 | \$ 20 |
| Interest income | | 1 | 1 | 1 |
| Miscellaneous | 1 | | 3 | 5 |
| Total Other Income | 6 | 3 | 21 | 26 |
| Other Expense | | | | |
| Charitable contributions | 1 | 1 | 2 | 2 |
| Miscellaneous | 1 | | 5 | 4 |
| Total Other Expense | 2 | 1 | 7 | 6 |
| Other Income (Expense) - net | \$ 4 | \$ 2 | \$ 14 | \$ 20 |

(a) In July 2011, as a result of PPL Electric's redemption of 7.125% Senior Secured Bonds due 2013, PPL recorded a gain on the accelerated amortization of the fair value adjustment to the debt recorded in connection with previously settled fair value hedges.

(b) Represents a gain on foreign currency contracts that hedged the repayment of the 2011 Bridge Facility borrowing.

(c) Represents a foreign currency loss related to the repayment of the 2011 Bridge Facility borrowing.

"Other Income (Expense) - net" for the three and nine months ended September 30, 2012 and 2011 for PPL Electric is primarily the equity component of AFUDC. "Other Income (Expense) - net" for the nine months ended September 30, 2012 for LKE and KU is primarily losses from an equity method investment. The components of "Other Income (Expense) - net" for the three months ended September 30, 2012 and 2011 and for the nine months ended September 30, 2011 for LKE and KU are not significant. The components of "Other Income (Expense) - net" for the three and nine months ended September 30, 2012 and 2011 for LG&E are not significant.

13. Fair Value Measurements and Credit Concentration

(PPL, PPL Energy Supply, PPL Electric, LKE, LG&E and KU)

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price). A market approach (generally, data from market transactions), an income approach (generally, present value techniques and option-pricing models), and/or a cost approach (generally, replacement cost) are used to measure the fair value of an asset or liability, as appropriate. These valuation approaches incorporate inputs such as observable, independent market data and/or unobservable data that management believes are predicated on the assumptions market participants would use to price an asset or liability. These inputs may incorporate, as applicable, certain risks such as nonperformance risk, which includes credit risk. The fair value of a group of financial assets and liabilities is measured on a net basis. Transfers between levels are recognized at end-of-reporting-period values. During the three and nine months ended September 30, 2012, there were no transfers between Level 1 and Level 2.

Recurring Fair Value Measurements

The assets and liabilities measured at fair value were:

| | September 30, 2012 | | | | December 31, 2011 | | | |
|-----|--------------------|---------|---------|---------|-------------------|---------|---------|---------|
| | Total | Level 1 | Level 2 | Level 3 | Total | Level 1 | Level 2 | Level 3 |
| PPL | | | | | | | | |

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

Assets

| | | | | | | | | | |
|--|----|-------|----|-----|----|-------|-------|----|-------|
| Cash and cash equivalents | \$ | 946 | \$ | 946 | | \$ | 1,202 | \$ | 1,202 |
| Restricted cash and cash equivalents (a) | | 169 | | 169 | | | 209 | | 209 |
| Price risk management assets: | | | | | | | | | |
| Energy commodities | | 2,604 | | 5 | \$ | 2,569 | \$ | 30 | 3,423 |
| Interest rate swaps | | | | | | | | | 3 |
| Foreign currency contracts | | | | | | | | | 18 |
| Cross-currency swaps | | 24 | | | | 22 | | 2 | 24 |
| Total price risk management assets | | 2,628 | | 5 | | 2,591 | | 32 | 3,468 |
| | | | | | | | | | 3 |
| | | | | | | | | | 3,431 |
| | | | | | | | | | 34 |

80

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| | September 30, 2012 | | | | December 31, 2011 | | | |
|----------------------------------|--------------------|----------|----------|---------|-------------------|----------|----------|---------|
| | Total | Level 1 | Level 2 | Level 3 | Total | Level 1 | Level 2 | Level 3 |
| NDT funds: | | | | | | | | |
| Cash and cash equivalents | 12 | 12 | | | 12 | 12 | | |
| Equity securities | | | | | | | | |
| U.S. large-cap | 412 | 307 | 105 | | 357 | 267 | 90 | |
| U.S. mid/small-cap | 59 | 25 | 34 | | 52 | 22 | 30 | |
| Debt securities | | | | | | | | |
| U.S. Treasury | 95 | 95 | | | 86 | 86 | | |
| U.S. government sponsored agency | 9 | | 9 | | 10 | | 10 | |
| Municipality | 83 | | 83 | | 83 | | 83 | |
| Investment-grade corporate | 40 | | 40 | | 38 | | 38 | |
| Other | 2 | | 2 | | 2 | | 2 | |
| Receivables (payables), net | (1) | (3) | 2 | | | (3) | 3 | |
| Total NDT funds | 711 | 436 | 275 | | 640 | 384 | 256 | |
| Auction rate securities (b) | 19 | | 3 | 16 | 24 | | | 24 |
| Total assets | \$ 4,473 | \$ 1,556 | \$ 2,869 | \$ 48 | \$ 5,543 | \$ 1,798 | \$ 3,687 | \$ 58 |

Liabilities

| | | | | | | | | |
|---|----------|------|----------|------|----------|------|----------|-------|
| Price risk management liabilities: | | | | | | | | |
| Energy commodities | \$ 1,947 | \$ 5 | \$ 1,937 | \$ 5 | \$ 2,345 | \$ 1 | \$ 2,327 | \$ 17 |
| Interest rate swaps | 83 | | 83 | | 63 | | 63 | |
| Foreign currency contracts | 36 | | 36 | | | | | |
| Cross-currency swaps | 2 | | 2 | | 2 | | 2 | |
| Total price risk management liabilities | \$ 2,068 | \$ 5 | \$ 2,058 | \$ 5 | \$ 2,410 | \$ 1 | \$ 2,392 | \$ 17 |

PPL Energy Supply

Assets

| | | | | | | | | |
|--|--------|--------|----------|-------|--------|--------|----------|-------|
| Cash and cash equivalents | \$ 432 | \$ 432 | | | \$ 379 | \$ 379 | | |
| Restricted cash and cash equivalents (a) | 98 | 98 | | | 145 | 145 | | |
| Price risk management assets: | | | | | | | | |
| Energy commodities | 2,604 | 5 | \$ 2,569 | \$ 30 | 3,423 | 3 | \$ 3,390 | \$ 30 |
| Total price risk management assets | 2,604 | 5 | 2,569 | 30 | 3,423 | 3 | 3,390 | 30 |
| NDT funds: | | | | | | | | |
| Cash and cash equivalents | 12 | 12 | | | 12 | 12 | | |
| Equity securities | | | | | | | | |
| U.S. large-cap | 412 | 307 | 105 | | 357 | 267 | 90 | |
| U.S. mid/small-cap | 59 | 25 | 34 | | 52 | 22 | 30 | |
| Debt securities | | | | | | | | |
| U.S. Treasury | 95 | 95 | | | 86 | 86 | | |
| U.S. government sponsored agency | 9 | | 9 | | 10 | | 10 | |

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| | | | | | | | | |
|-----------------------------|----------|--------|----------|-------|----------|--------|----------|-------|
| Municipality | 83 | | 83 | | 83 | | 83 | |
| Investment-grade corporate | 40 | | 40 | | 38 | | 38 | |
| Other | 2 | | 2 | | 2 | | 2 | |
| Receivables (payables), net | (1) | (3) | 2 | | | (3) | 3 | |
| Total NDT funds | 711 | 436 | 275 | | 640 | 384 | 256 | |
| Auction rate securities (b) | 16 | | 3 | 13 | 19 | | | 19 |
| Total assets | \$ 3,861 | \$ 971 | \$ 2,847 | \$ 43 | \$ 4,606 | \$ 911 | \$ 3,646 | \$ 49 |

Liabilities

| | | | | | | | | |
|---|----------|------|----------|------|----------|------|----------|-------|
| Price risk management liabilities: | | | | | | | | |
| Energy commodities | \$ 1,947 | \$ 5 | \$ 1,937 | \$ 5 | \$ 2,345 | \$ 1 | \$ 2,327 | \$ 17 |
| Total price risk management liabilities | \$ 1,947 | \$ 5 | \$ 1,937 | \$ 5 | \$ 2,345 | \$ 1 | \$ 2,327 | \$ 17 |

PPL Electric

Assets

| | | | | | |
|--|-------|-------|--|--------|--------|
| Cash and cash equivalents | \$ 31 | \$ 31 | | \$ 320 | \$ 320 |
| Restricted cash and cash equivalents (c) | 13 | 13 | | 13 | 13 |
| Total assets | \$ 44 | \$ 44 | | \$ 333 | \$ 333 |

LKE

Assets

| | | | | | |
|--|--------|--------|--|-------|-------|
| Cash and cash equivalents | \$ 90 | \$ 90 | | \$ 59 | \$ 59 |
| Restricted cash and cash equivalents (e) | 32 | 32 | | 29 | 29 |
| Total assets | \$ 122 | \$ 122 | | \$ 88 | \$ 88 |

Liabilities

| | | | | | |
|------------------------------------|-------|-------|--|-------|-------|
| Price risk management liabilities: | | | | | |
| Interest rate swaps (d) | \$ 62 | \$ 62 | | \$ 60 | \$ 60 |
| Total liabilities | \$ 62 | \$ 62 | | \$ 60 | \$ 60 |

81

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| | September 30, 2012 | | | | December 31, 2011 | | | |
|--|--------------------|--------------|--------------|---------|-------------------|--------------|--------------|---------|
| | Total | Level 1 | Level 2 | Level 3 | Total | Level 1 | Level 2 | Level 3 |
| LG&E | | | | | | | | |
| Assets | | | | | | | | |
| Cash and cash equivalents | \$ 48 | \$ 48 | | | \$ 25 | \$ 25 | | |
| Restricted cash and cash equivalents (e) | 32 | 32 | | | 29 | 29 | | |
| Total assets | \$ 80 | \$ 80 | | | \$ 54 | \$ 54 | | |
| Liabilities | | | | | | | | |
| Price risk management liabilities: | | | | | | | | |
| Interest rate swaps (d) | \$ 62 | | \$ 62 | | \$ 60 | | \$ 60 | |
| Total liabilities | \$ 62 | | \$ 62 | | \$ 60 | | \$ 60 | |
| KU | | | | | | | | |
| Assets | | | | | | | | |
| Cash and cash equivalents | \$ 42 | \$ 42 | | | \$ 31 | \$ 31 | | |
| Total assets | \$ 42 | \$ 42 | | | \$ 31 | \$ 31 | | |

- (a) Current portion is included in "Restricted cash and cash equivalents" and the long-term portion is included in "Other noncurrent assets" on the Balance Sheets.
- (b) Included in "Other investments" on the Balance Sheets.
- (c) Current portion is included in "Other current assets" and the long-term portion is included in "Other noncurrent assets" on the Balance Sheets.
- (d) Current portion is included in "Other current liabilities" and the long-term portion is included in "Price risk management liabilities" on the Balance Sheets.
- (e) Included in "Other noncurrent assets" on the Balance Sheets.

A reconciliation of net assets and liabilities classified as Level 3 for the periods ended September 30, 2012 is as follows:

| | Fair Value Measurements Using Significant Unobservable Inputs (Level 3) | | | | | | | |
|---|---|-------------------------------|-----------------------------|-------|-------------------------------|-------------------------------|-----------------------------|-------|
| | Three Months | | | | Nine Months | | | |
| | Energy Commodities, net | Auction Rate Securities | Cross- Currency Swaps | Total | Energy Commodities, net | Auction Rate Securities | Cross- Currency Swaps | Total |
| PPL | | | | | | | | |
| Balance at beginning of period | \$ 34 | \$ 15 | \$ 10 | \$ 59 | \$ 13 | \$ 24 | \$ 4 | \$ 41 |
| Total realized/unrealized gains (losses) | | | | | | | | |
| Included in earnings | (17) | | | (17) | (1) | | (1) | (2) |
| Included in OCI (a) | | 1 | (8) | (7) | 1 | | 2 | 3 |
| Sales | | | | | | (5) | | (5) |
| Settlements | 2 | | | 2 | (9) | | | (9) |

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| | | | | | | | | | | |
|--|-------|-------|------|-------|-------|-------|------|-------|--|-------|
| Transfers into Level 3 | (2) | | | (2) | 12 | | | | | 12 |
| Transfers out of Level 3 | 8 | | | 8 | 9 | (3) | (3) | | | 3 |
| Balance at end of period | \$ 25 | \$ 16 | \$ 2 | \$ 43 | \$ 25 | \$ 16 | \$ 2 | \$ 43 | | |
| PPL Energy Supply | | | | | | | | | | |
| Balance at beginning of period | \$ 34 | \$ 12 | | \$ 46 | \$ 13 | \$ 19 | | | | \$ 32 |
| Total realized/unrealized gains (losses) | | | | | | | | | | |
| Included in earnings | (17) | | | (17) | (1) | | | | | (1) |
| Included in OCI (a) | | 1 | | 1 | 1 | | | | | 1 |
| Sales | | | | | | (3) | | | | (3) |
| Settlements | 2 | | | 2 | (9) | | | | | (9) |
| Transfers into Level 3 | (2) | | | (2) | 12 | | | | | 12 |
| Transfers out of Level 3 | 8 | | | 8 | 9 | (3) | | | | 6 |
| Balance at end of period | \$ 25 | \$ 13 | | \$ 38 | \$ 25 | \$ 13 | | \$ 38 | | |

(a) "Energy Commodities, net" and "Cross-Currency Swaps" are included in "Qualifying derivatives" and "Auction Rate Securities" are included in "Available-for-sale securities" on the Statements of Comprehensive Income.

A reconciliation of net assets and liabilities classified as Level 3 for the periods ended September 30, 2011 is as follows:

| | Fair Value Measurements Using Significant Unobservable Inputs (Level 3) | | | | | | | |
|--|---|-------------------------------|-----------------------------|-------------|-------------------------------|-------------------------------|-----------------------------|-------|
| | Three Months | | | Nine Months | | | | |
| | Energy Commodities, net | Auction Rate Securities | Cross- Currency Swaps | Total | Energy Commodities, net | Auction Rate Securities | Cross- Currency Swaps | Total |
| PPL | | | | | | | | |
| Balance at beginning of period | \$ 26 | \$ 25 | | \$ 51 | \$ (3) | \$ 25 | | \$ 22 |
| Total realized/unrealized gains (losses) | | | | | | | | |
| Included in earnings | 6 | | | 6 | 2 | | | 2 |
| Included in OCI (a) | 2 | (1) | | 1 | 6 | (1) | | 5 |
| Purchases | | | | | 2 | | | 2 |
| Sales | | | | | (4) | | | (4) |
| Settlements | (2) | | | (2) | 23 | | | 23 |
| Transfers into Level 3 | (1) | | \$ 14 | 13 | (1) | | \$ 14 | 13 |
| Transfers out of Level 3 | (5) | | | (5) | 1 | | | 1 |
| Balance at end of period | \$ 26 | \$ 24 | \$ 14 | \$ 64 | \$ 26 | \$ 24 | \$ 14 | \$ 64 |
| PPL Energy Supply | | | | | | | | |
| Balance at beginning of period | \$ 26 | \$ 20 | | \$ 46 | \$ (3) | \$ 20 | | \$ 17 |
| Total realized/unrealized gains (losses) | | | | | | | | |
| Included in earnings | 6 | | | 6 | 2 | | | 2 |
| Included in OCI (a) | 2 | (1) | | 1 | 6 | (1) | | 5 |
| Purchases | | | | | 2 | | | 2 |
| Sales | | | | | (4) | | | (4) |
| Settlements | (2) | | | (2) | 23 | | | 23 |
| Transfers into Level 3 | (1) | | | (1) | (1) | | | (1) |
| Transfers out of Level 3 | (5) | | | (5) | 1 | | | 1 |
| Balance at end of period | \$ 26 | \$ 19 | | \$ 45 | \$ 26 | \$ 19 | | \$ 45 |

(a) "Energy Commodities, net" are included in "Qualifying derivatives" and "Auction Rate Securities" are included in "Available-for-sale securities" on the Statements of Comprehensive Income.

The significant unobservable inputs used in the fair value measurement of assets and liabilities classified as Level 3 at September 30, 2012 are as follows:

Quantitative Information about Level 3 Fair Value Measurements
Range

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| | Fair Value, net Asset (Liability) | Valuation Technique | Unobservable Input(s) | (Weighted Average) (a) |
|--|-----------------------------------|----------------------|--|------------------------|
| PPL | | | | |
| Energy commodities | | | | |
| Retail natural gas sales contracts (b) | 22 | Discounted cash flow | Observable wholesale prices used as proxy for retail delivery points | 21% - 100% (88%) |
| FTRs (c) | 3 | Discounted cash flow | Historical settled prices used to model forward prices | 100% (100%) |
| Auction rate securities (d) | 16 | Discounted cash flow | Modeled from SIFMA Index | 53% - 75% (64%) |
| Cross-currency swaps (e) | 2 | Discounted cash flow | Credit valuation adjustment | 25% - 78% (45%) |
| PPL Energy Supply | | | | |
| Energy commodities | | | | |
| Retail natural gas sales contracts (b) | 22 | Discounted cash flow | Observable wholesale prices used as proxy for retail delivery points | 21% - 100% (88%) |
| FTRs (c) | 3 | Discounted cash flow | Historical settled prices used to model forward prices | 100% (100%) |
| Auction rate securities (d) | 13 | Discounted cash flow | Modeled from SIFMA Index | 58% - 75% (65%) |

(a) For energy commodities and auction rate securities, the range and weighted average represent the percentage of fair value derived from the unobservable inputs. For cross-currency swaps, the range and weighted average represent the percentage decrease in fair value due to the unobservable inputs used in the model to calculate the credit valuation adjustment.

(b) Retail natural gas sales contracts extend through 2017. \$8 million of the fair value is scheduled to deliver within the next 12 months. As the forward price of natural gas increases/(decreases), the fair value of the contracts (decreases)/increases.

(c) FTR purchase contracts extend through 2015. \$3 million of the fair value is scheduled to deliver within the next 12 months. As the forward implied spread increases/(decreases), the fair value of the contracts increases/(decreases).

- (d) Auction rate securities have a weighted average contractual maturity of 23 years. The model used to calculate fair value incorporates an assumption that the auctions will continue to fail. As the modeled forward rates of the SIFMA Index increase/(decrease), the fair value of the securities increases/(decreases).
- (e) Cross-currency swaps extend through 2021. The credit valuation adjustment incorporates projected probabilities of default and estimated recovery rates. As the credit valuation adjustment increases/(decreases), the fair value of the swaps (decreases)/increases.

Net gains and losses on assets and liabilities classified as Level 3 and included in earnings for the periods ended September 30 are reported in the Statements of Income as follows:

| | Three Months | | | | | | | | Cross-Currency Swaps | |
|--|-------------------------------------|-------|----------------------------|--------|----------------------------|--------|------------------|--------|----------------------|------|
| | Energy Commodities, net | | | | | | | | | |
| | Unregulated Retail Electric and Gas | | Wholesale Energy Marketing | | Net Energy Trading Margins | | Energy Purchases | | Interest Expense | |
| | 2012 | 2011 | 2012 | 2011 | 2012 | 2011 | 2012 | 2011 | 2012 | 2011 |
| PPL | | | | | | | | | | |
| Total gains (losses) included in earnings | \$ (3) | \$ 6 | \$ (4) | \$ (1) | \$ (8) | \$ 1 | \$ (2) | | | |
| Change in unrealized gains (losses) relating to positions still held at the reporting date | (2) | 3 | (1) | | 2 | 1 | | \$ 1 | | |
| PPL Energy Supply | | | | | | | | | | |
| Total gains (losses) included in earnings | \$ (3) | \$ 6 | \$ (4) | \$ (1) | \$ (8) | \$ 1 | \$ (2) | | | |
| Change in unrealized gains (losses) relating to positions still held at the reporting date | (2) | 3 | (1) | | 2 | 1 | | \$ 1 | | |
| | Nine Months | | | | | | | | Cross-Currency Swaps | |
| | Energy Commodities, net | | | | | | | | | |
| | Unregulated Retail Electric and Gas | | Wholesale Energy Marketing | | Net Energy Trading Margins | | Energy Purchases | | Interest Expense | |
| | 2012 | 2011 | 2012 | 2011 | 2012 | 2011 | 2012 | 2011 | 2012 | 2011 |
| PPL | | | | | | | | | | |
| Total gains (losses) included in earnings | \$ 16 | \$ 11 | \$ (7) | \$ (5) | \$ (9) | \$ (2) | \$ (1) | \$ (2) | \$ (1) | |
| Change in unrealized gains (losses) relating | | | | | | | | | | |

| | | | | | | | |
|--|-------|-------|--------|--------|--------|--------|--------|
| to positions still held at the reporting date | 29 | 6 | (6) | 2 | 1 | 1 | 20 |
| PPL Energy Supply | | | | | | | |
| Total gains (losses) included in earnings | \$ 16 | \$ 11 | \$ (7) | \$ (5) | \$ (9) | \$ (2) | \$ (2) |
| Change in unrealized gains (losses) relating | | | | | | | |
| to positions still held at the reporting date | 29 | 6 | (6) | 2 | 1 | 1 | 20 |

Price Risk Management Assets/Liabilities - Energy Commodities (PPL and PPL Energy Supply)

Energy commodity contracts are generally valued using the income approach, except for exchange-traded derivative gas and oil contracts, which are valued using the market approach and are classified as Level 1. When observable inputs are used to measure all or most of the value of a contract, the contract is classified as Level 2. Level 2 contracts are valued using quotes obtained from an exchange (where there is insufficient market liquidity to warrant inclusion in Level 1), binding and non-binding broker quotes, prices posted by ISOs or published tariff rates. Furthermore, independent quotes are obtained from the market to validate the forward price curves. These contracts include forwards, swaps, options and structured transactions for electricity, gas, oil, and/or emission allowances and may be offset with similar positions in exchange-traded markets. To the extent possible, fair value measurements utilize various inputs that include quoted prices for similar contracts or market-corroborated inputs. In certain instances, these contracts may be valued using models, including standard option valuation models and standard industry models. For example, the fair value of a full-requirement sales contract that delivers power to an illiquid delivery point may be measured by valuing the nearest liquid trading point plus the value of the basis between the two points. The basis input may be from market quotes or historical prices.

When unobservable inputs are significant to the fair value measurement, a contract is classified as Level 3. The fair value of contracts classified as Level 3 has been calculated using PPL proprietary models which include significant unobservable inputs such as delivery at a location where pricing is unobservable, assumptions for customer migration or delivery dates that are beyond the dates for which independent quotes are available. Forward transactions, including forward transactions classified as Level 3, are analyzed by PPL's Risk Management department, which reports to the Chief Financial Officer (CFO). Accounting personnel, who also report to the CFO, interpret the analysis quarterly to appropriately classify the forward transactions in the fair value hierarchy. Valuation techniques are evaluated periodically. Additionally, Level 2 and Level 3 fair value measurements include adjustments for credit risk based on PPL's own creditworthiness (for net liabilities) and its counterparties' creditworthiness (for net assets). PPL's credit department assesses all reasonably available market information which is used by accounting personnel to calculate the credit valuation adjustment.

In certain instances, energy commodity contracts are transferred between Level 2 and Level 3. The primary reasons for the transfers during 2012 and 2011 were changes in the availability of market information and changes in the significance of the unobservable portion of the contract. As the delivery period of a contract becomes closer, market information may become available. When this occurs, the model's unobservable inputs are replaced with observable market information.

Price Risk Management Assets/Liabilities - Interest Rate Swaps/Foreign Currency Contracts/Cross-Currency Swaps (PPL, LKE and LG&E)

To manage interest rate risk, PPL, LKE and LG&E use interest rate contracts such as forward-starting swaps, floating-to-fixed swaps and fixed-to-floating swaps. To manage foreign currency exchange risk, PPL uses foreign currency contracts such as forwards, options and cross-currency swaps that contain characteristics of both interest rate and foreign currency contracts. An income approach is used to measure the fair value of these contracts, utilizing readily observable inputs, such as forward interest rates (e.g., LIBOR and government security rates) and forward foreign currency exchange rates (e.g., GBP and Euro), as well as inputs that may not be observable, such as credit valuation adjustments. In certain cases, market information cannot practicably be obtained to value credit risk and therefore internal models are relied upon. These models use projected probabilities of default and estimated recovery rates based on historical observances. When the credit valuation adjustment is significant to the overall valuation, the contracts are classified as Level 3. The primary reason for the transfers during 2012 and 2011 was the change in the significance of the credit valuation adjustment. Cross-currency swaps classified as Level 3 are valued by PPL's Corporate Finance department, which reports to the CFO. Accounting personnel, who also report to the CFO, interpret the analysis quarterly to appropriately classify the contracts in the fair value hierarchy. Valuation techniques are evaluated periodically.

(PPL and PPL Energy Supply)

NDT Funds

The market approach is used to measure the fair value of equity securities held in the NDT funds.

- The fair value measurements of equity securities classified as Level 1 are based on quoted prices in active markets and are comprised of securities that are representative of the Wilshire 5000 Total Market Index.
- Investments in commingled equity funds are classified as Level 2 and represent securities that track the S&P 500 index, Dow Jones U.S. Total Stock Market Index and the Dow Jones U.S. Completion Total Stock Market Index. These fair value measurements are based on firm quotes of net asset values per share, which are not obtained from a quoted price in an active market.

Debt securities are generally measured using a market approach, including the use of matrix pricing. Common inputs include reported trades, broker/dealer bid/ask prices, benchmark securities and credit valuation adjustments. When necessary, the fair value of debt securities is measured using the income approach, which incorporates similar observable inputs as well as benchmark yields, credit valuation adjustments, reference data from market research publications, monthly payment data, collateral performance and new issue data.

The debt securities held by the NDT funds at September 30, 2012 have a weighted-average coupon of 4.19% and a weighted-average maturity of 8.3 years.

Auction Rate Securities

Auction rate securities include Federal Family Education Loan Program guaranteed student loan revenue bonds, as well as various municipal bond issues. The exposure to realize losses on these securities is not significant.

The fair value of auction rate securities is estimated using an income approach that includes readily observable inputs, such as principal payments and discount curves for bonds with credit ratings and maturities similar to the securities, and unobservable inputs, such as future interest rates that are estimated based on the SIFMA Index, creditworthiness, and liquidity assumptions driven by the impact of auction failures. When the present value of future interest payments is significant to the overall valuation, the auction rate securities are classified as Level 3. The primary reason for the transfer out of Level 3 in 2012 was the change in the significance of the present value of future interest payments as maturity dates approach.

Auction rate securities are valued by PPL's Treasury department, which reports to the CFO. Accounting personnel, who also report to the CFO, interpret the analysis quarterly to appropriately classify the contracts in the fair value hierarchy. Valuation techniques are evaluated periodically.

Financial Instruments Not Recorded at Fair Value (PPL, PPL Energy Supply, PPL Electric, LKE, LG&E and KU)

The carrying amounts of contract adjustment payments related to the Purchase Contract component of the Equity Units and long-term debt on the Balance Sheets and their estimated fair values are set forth below. The fair values of these instruments were estimated using an income approach by discounting future cash flows at estimated current cost of funding rates, which incorporate the credit risk of the Registrants. These instruments are classified as Level 2. The effect of third-party credit enhancements is not included in the fair value measurement.

| | September 30, 2012 | | December 31, 2011 | |
|----------------------------------|--------------------|------------|-------------------|------------|
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| PPL | | | | |
| Contract adjustment payments (a) | \$ 128 | \$ 116 | \$ 198 | \$ 198 |
| Long-term debt (b) | 19,024 | 21,091 | 17,993 | 19,392 |
| PPL Energy Supply | | | | |
| Long-term debt (b) | 3,275 | 3,691 | 3,024 | 3,397 |
| PPL Electric | | | | |
| Long-term debt | 1,967 | 2,252 | 1,718 | 2,012 |
| LKE | | | | |
| Long-term debt | 4,074 | 4,385 | 4,073 | 4,306 |
| LG&E | | | | |
| Long-term debt | 1,112 | 1,172 | 1,112 | 1,164 |
| KU | | | | |
| Long-term debt | 1,842 | 2,021 | 1,842 | 2,000 |

(a) Reflected in "Other current liabilities" and "Other deferred credits and noncurrent liabilities" on the Balance Sheets.

(b) Includes "Long-term Debt" and "Long-term debt due within one year" on the Balance Sheets.

The carrying value of short-term debt (including notes between affiliates), when outstanding, represents or approximates fair value due to the variable interest rates associated with the financial instruments and is classified as Level 2. The carrying value of held-to-maturity, short-term investments at December 31, 2011 approximated fair value due to the liquid nature and short-term duration of these instruments.

Credit Concentration Associated with Financial Instruments

(PPL, PPL Energy Supply, PPL Electric, LKE, LG&E and KU)

Contracts are entered into with many entities for the purchase and sale of energy. Many of these contracts qualify for NPNS and, as such, the fair value of these contracts is not reflected in the financial statements. However, the fair value of these contracts is considered when committing to new business from a credit perspective. See Note 14 for information on credit policies used to manage credit risk, including master netting arrangements and collateral requirements.

(PPL)

At September 30, 2012, PPL had credit exposure of \$2.1 billion from energy trading partners, excluding the effects of netting arrangements and collateral. As a result of netting arrangements and collateral, PPL's credit exposure was reduced to \$657 million. The top ten counterparties accounted for \$345 million, or 52%, of the net exposure and all

had investment grade credit ratings from S&P or Moody's.

(PPL Energy Supply)

At September 30, 2012, PPL Energy Supply had credit exposure of \$2.1 billion from energy trading partners, excluding exposure from related parties and the effects of netting arrangements and collateral. As a result of netting arrangements and collateral, this credit exposure was reduced to \$656 million. The top ten counterparties accounted for \$345 million, or 53%, of the net exposure and all had investment grade credit ratings from S&P or Moody's. See Note 11 for information regarding the related party credit exposure.

(PPL Electric)

At September 30, 2012, PPL Electric had no credit exposure under energy supply contracts (including its supply contracts with PPL EnergyPlus).

(LKE, LG&E and KU)

At September 30, 2012, LKE's, LG&E's and KU's credit exposure was not significant.

14. Derivative Instruments and Hedging Activities

Risk Management Objectives

(PPL, PPL Energy Supply, PPL Electric, LKE, LG&E and KU)

PPL has a risk management policy approved by the Board of Directors to manage market risk and counterparty credit risk. The RMC, comprised of senior management and chaired by the Chief Risk Officer, oversees the risk management function. Key risk control activities designed to ensure compliance with the risk policy and detailed programs include, but are not limited to, credit review and approval, validation of transactions and market prices, verification of risk and transaction limits, VaR analyses, portfolio stress tests, gross margin at risk analyses, sensitivity analyses, and daily portfolio reporting, including open positions, determinations of fair value, and other risk management metrics.

Market Risk

Market risk is the potential loss that may be incurred as a result of price changes associated with a particular financial or commodity instrument. Forward contracts, futures contracts, options, swaps and structured transactions, such as tolling agreements, are utilized as part of risk management strategies to minimize unanticipated fluctuations in earnings caused by changes in commodity prices, volumes of full-requirement sales contracts, basis exposure, interest rates and/or foreign currency exchange rates. Many of the contracts meet the definition of a derivative. All derivatives are recognized on the Balance Sheets at their fair value, unless they qualify for NPNS.

The table below summarizes the market risks that affect PPL and its subsidiaries.

| | PPL | PPL Energy Supply | PPL Electric | LKE | LG&E | KU |
|--|-----|-------------------------|-----------------|-----|------|----|
| Commodity price risk (including basis and volumetric risk) | X | X | M | M | M | M |
| Interest rate risk: | | | | | | |
| Debt issuances | X | X | M | M | M | M |
| Defined benefit plans | X | X | M | M | M | M |
| NDT securities | X | X | | | | |
| Equity securities price risk: | | | | | | |
| Defined benefit plans | X | X | M | M | M | M |
| NDT securities | X | X | | | | |
| Future stock transactions | X | | | | | |
| Foreign currency risk - WPD investment | X | | | | | |

X= PPL and PPL Energy Supply actively mitigate market risks through their risk management programs described above.

M= The regulatory environments for PPL's regulated entities, by definition, significantly mitigate market risk.

Commodity price risk

- PPL Energy Supply is exposed to commodity price, basis and volumetric risks for energy and energy-related products associated with the sale of electricity from its generating assets and other electricity and gas marketing activities (including full-requirement sales contracts) and the purchase of fuel and fuel-related commodities for generating assets, as well as for proprietary trading activities;
- PPL Electric is exposed to market and volumetric risks from its obligation as PLR; however, its PUC-approved cost recovery mechanism substantially eliminates its exposure to market risk. PPL Electric also mitigates its exposure to volumetric risk by entering into full-requirement supply agreements to serve its PLR customers. These supply agreements transfer the volumetric risk associated with the PLR obligation to the energy suppliers; and
- LG&E's and KU's rates include certain mechanisms for fuel, gas supply and environmental expenses. These mechanisms generally provide for timely recovery of market price and volumetric fluctuations associated with these expenses.

Interest rate risk

- PPL and its subsidiaries are exposed to interest rate risk associated with forecasted fixed-rate and existing floating-rate debt issuances. WPD holds over-the-counter cross currency swaps to limit exposure to market fluctuations on interest and principal payments from foreign currency exchange rates. LG&E utilizes over-the-counter interest rate swaps to limit exposure to market fluctuations on floating-rate debt.

- PPL and its subsidiaries are exposed to interest rate risk associated with debt securities held by defined benefit plans. Additionally, PPL Energy Supply is exposed to interest rate risk associated with debt securities held by the NDT.

Equity securities price risk

- PPL and its subsidiaries are exposed to equity securities price risk associated with equity securities held by defined benefit plans. Additionally, PPL Energy Supply is exposed to equity securities price risk in the NDT funds.
- PPL is exposed to equity securities price risk from future stock sales and/or purchases.

Foreign currency risk

- PPL is exposed to foreign currency exchange risk primarily associated with its investments in U.K. affiliates.

Credit Risk

Credit risk is the potential loss that may be incurred due to a counterparty's non-performance, including defaults on payments and energy commodity deliveries.

PPL is exposed to credit risk from interest rate and foreign currency derivatives with financial institutions, as well as additional credit risk through certain of its subsidiaries, as discussed below.

PPL Energy Supply is exposed to credit risk from commodity derivatives with its energy trading partners, which include other energy companies, fuel suppliers and financial institutions.

LKE and LG&E are exposed to credit risk from interest rate derivatives with financial institutions.

The majority of credit risk stems from commodity derivatives for multi-year contracts for energy sales and purchases. If PPL Energy Supply's counterparties fail to perform their obligations under such contracts and PPL Energy Supply could not replace the sales or purchases at the same or better prices as those under the defaulted contracts, PPL Energy Supply would incur financial losses. Those losses would be recognized immediately or through lower revenues or higher costs in future years, depending on the accounting treatment for the defaulted contracts. In the event a supplier of LKE (through its subsidiaries LG&E and KU) or PPL Electric defaults on its obligation, those entities would be required to seek replacement power or replacement fuel in the market. In general, incremental costs incurred by these entities would be recoverable from customers in future rates, thus mitigating this risk for these entities.

PPL and its subsidiaries have credit policies in place to manage credit risk, including the use of an established credit approval process, daily monitoring of counterparty positions and the use of master netting agreements. These agreements generally include credit mitigation provisions, such as margin, prepayment or collateral requirements. PPL and its subsidiaries may request additional credit assurance, in certain circumstances, in the event that the counterparties' credit ratings fall below investment grade or their exposures exceed an established credit limit. See Note 13 for credit concentration associated with energy trading partners.

Master Netting Arrangements

Net derivative positions are not offset against the right to reclaim cash collateral (a receivable) or the obligation to return cash collateral (a payable) under master netting arrangements.

PPL's and PPL Energy Supply's obligation to return counterparty cash collateral under master netting arrangements was \$160 million and \$147 million at September 30, 2012 and December 31, 2011.

PPL Electric, LKE and LG&E had no obligation to return cash collateral under master netting arrangements at September 30, 2012 and December 31, 2011.

PPL, LKE and LG&E had posted cash collateral under master netting arrangements of \$32 million and \$29 million at September 30, 2012 and December 31, 2011.

PPL Energy Supply and PPL Electric had not posted any cash collateral under master netting arrangements at September 30, 2012 and December 31, 2011.

(PPL and PPL Energy Supply)

Commodity Price Risk (Non-trading)

Commodity price risk, including basis and volumetric risk, is among PPL's and PPL Energy Supply's most significant risks due to the level of investment that PPL and PPL Energy Supply maintain in their competitive generation assets, as well as the extent of their marketing and proprietary trading activities. Several factors influence price levels and volatilities. These factors include, but are not limited to, seasonal changes in demand, weather conditions, available generating assets within regions, transportation/transmission availability and reliability within and between regions, market liquidity, and the nature and extent of current and potential federal and state regulations.

PPL and PPL Energy Supply enter into financial and physical derivative contracts, including forwards, futures, swaps and options, to hedge the price risk associated with electricity, natural gas, oil and other commodities. Certain contracts qualify for NPNS or are non-derivatives and are therefore not reflected in the financial statements until delivery. PPL and PPL Energy Supply segregate their remaining non-trading activities into two categories: cash flow hedges and economic activity, as discussed below.

Cash Flow Hedges

Certain derivative contracts have qualified for hedge accounting so that the effective portion of a derivative's gain or loss is deferred in AOCI and reclassified into earnings when the forecasted transaction occurs. The cash flow hedges that existed at September 30, 2012 range in maturity through 2016. At September 30, 2012, the accumulated net unrecognized after-tax gains (losses) that are expected to be reclassified into earnings during the next 12 months were \$199 million for PPL and PPL Energy Supply. Cash flow hedges are discontinued if it is no longer probable that the original forecasted transaction will occur by the end of the originally specified time periods and any amounts previously recorded in AOCI are reclassified into earnings once it is determined that the hedge transaction is probable of not occurring. For the three and nine months ended September 30, 2012 and 2011, such reclassifications were insignificant.

For the three and nine months ended September 30, 2012, hedge ineffectiveness associated with energy derivatives was insignificant. For the three and nine months ended September 30, 2011, hedge ineffectiveness associated with energy derivatives resulted in after-tax gains (losses) of \$(3) million and \$(17) million.

Certain cash flow hedge positions were dedesignated during the nine months ended September 30, 2012. The fair value of the hedges at December 31, 2011 remained in AOCI because the original forecasted transaction is still expected to occur. Pre-tax gains (losses) of \$40 million, representing the change in fair value of the remaining positions during the nine months ended September 30, 2012, were recorded in "Wholesale energy marketing unrealized economic activity" on the Statement of Income.

Economic Activity

Many derivative contracts economically hedge the commodity price risk associated with electricity, natural gas, oil and other commodities but do not receive hedge accounting treatment. These derivatives hedge a portion of the economic value of PPL Energy Supply's competitive generation assets and unregulated full-requirement and retail contracts, which are subject to changes in fair value due to market price volatility and volume expectations. Additionally, economic activity includes the ineffective portion of qualifying cash flow hedges (see "Cash Flow Hedges" above). The derivative contracts in this category that existed at September 30, 2012 range in maturity through 2019.

Examples of economic activity include hedges on sales of baseload generation, dedesignations as discussed in "Cash Flow Hedges" above, certain purchase contracts used to supply full-requirement sales contracts, FTRs or basis swaps used to hedge basis risk associated with the sale of competitive generation or supplying unregulated full-requirement sales contracts, spark spreads (sale of electricity with the simultaneous purchase of fuel), retail electric and natural gas activities, and fuel oil swaps used to hedge price escalation clauses in coal transportation and other fuel-related contracts. PPL Energy Supply also uses options, which include both call and put options tied to a particular generating unit. Since the physical generating capacity is owned, price exposure is generally limited to the cost of the generating unit and does not expose PPL Energy Supply to uncovered market price risk.

Unrealized activity associated with monetizing certain full-requirement sales contracts was also included in economic activity during the three and nine months ended September 30, 2012 and 2011.

The net fair value of economic positions at September 30, 2012 and December 31, 2011 was a net asset (liability) of \$491 million and \$(63) million for PPL Energy Supply. The unrealized gains (losses) for economic activity for the periods ended September 30 were as follows.

| | Three Months | | Nine Months | |
|-------------------------------------|--------------|-------|-------------|------|
| | 2012 | 2011 | 2012 | 2011 |
| PPL Energy Supply | | | | |
| Operating Revenues | | | | |
| Unregulated retail electric and gas | \$ (13) | \$ 4 | \$ (15) | \$ 9 |
| Wholesale energy marketing | (716) | 216 | (322) | 229 |
| Operating Expenses | | | | |
| Fuel | 3 | (28) | (11) | (16) |
| Energy purchases | 569 | (176) | 420 | (49) |

The net gains (losses) recorded in "Wholesale energy marketing" resulted primarily from hedges of baseload generation, from certain full-requirement sales contracts for which PPL Energy Supply did not elect NPNS, from hedge ineffectiveness and from redesignations, as discussed in "Cash Flow Hedges" above, and from the monetization of certain full-requirement sales contracts in 2010. The net gains (losses) recorded in "Energy purchases" resulted primarily from certain purchase contracts to supply the full-requirement sales contracts noted above for which PPL Energy Supply did not elect hedge treatment, from hedge ineffectiveness, and from purchase contracts that no longer hedge the full-requirement sales contracts that were monetized in 2010.

Commodity Price Risk (Trading)

PPL Energy Supply also executes energy contracts to take advantage of market opportunities. As a result, PPL Energy Supply may at times create a net open position in its portfolio that could result in significant losses if prices do not move in the manner or direction anticipated. PPL Energy Supply's trading activity is shown in "Net energy trading margins" on the Statements of Income.

Commodity Volumetric Activity

PPL Energy Supply currently employs four primary strategies to maximize the value of its wholesale energy portfolio. As further discussed below, these strategies include the sales of competitive baseload generation, optimization of competitive intermediate and peaking generation, marketing activities, and proprietary trading activities. The tables within this section present the volumes of PPL Energy Supply's derivative activity, excluding those that qualify for NPNS, unless otherwise noted.

Sales of Competitive Baseload Generation

PPL Energy Supply has a formal hedging program for its competitive baseload generation fleet, which includes 7,252 MW (summer rating) of nuclear, coal and hydroelectric generating capacity. The objective of this program is to provide a reasonable level of near-term cash flow and earnings certainty while preserving upside potential of power price increases over the medium term.

PPL Energy Supply sells its expected generation output on a forward basis using both derivative and non-derivative instruments. The following table presents the expected sales, in GWh, from competitive baseload generation and power purchase agreements that are included in the baseload portfolio based on current forecasted assumptions for 2012-2014.

| 2012 (a) | 2013 | 2014 |
|----------|--------|--------|
| 12,928 | 49,593 | 50,401 |

(a) Represents expected sales for the balance of the current year.

The following table presents the percentage of expected competitive baseload generation sales shown above that has been sold forward under fixed price contracts and the related percentage of fuel that has been purchased or committed at September 30, 2012.

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| Year | Derivative Sales (a) | Total | Fuel Purchases (c) | |
|----------|----------------------|-----------------|--------------------|---------|
| | | Power Sales (b) | Coal | Nuclear |
| 2012 (d) | 93% | 100% | 105% | 100% |
| 2013 | 88% | 95% | 97% | 100% |
| 2014 (e) | 50% | 55% | 77% | 100% |

- (a) Excludes non-derivative contracts and contracts that qualify for NPNS. Volumes for option contracts factor in the probability of an option being exercised and may be less than the notional amount of the option.
- (b) Amount represents derivative (including contracts that qualify for NPNS) and non-derivative contracts. Volumes for option contracts factor in the probability of an option being exercised and may be less than the notional amount of the option. Percentages are based on fixed-price contracts only.
- (c) Coal and nuclear contracts receive accrual accounting treatment, as they are not derivative contracts. Percentages are based on both fixed- and variable-priced contracts.
- (d) Represents the balance of the current year.
- (e) Volumes for derivative sales contracts that deliver in future periods total 2,710 GWh and 4.0 Bcf.

In addition to the fuel purchases above, PPL Energy Supply attempts to economically hedge the fuel price risk that is within its fuel-related and coal transportation contracts, which are tied to changes in crude oil or diesel prices. PPL Energy Supply has also entered into contracts to financially hedge the physical sale of oil. The following table presents the net volumes, in thousands of barrels (bbls), of derivative (sales)/purchase contracts and contracts that qualify for NPNS used in support of these strategies at September 30, 2012.

| | 2012 (a) | 2013 | 2014 |
|---------------|----------|------|------|
| Oil Swaps (b) | (20) | 34 | 240 |

- (a) Represents the balance of the current year.
- (b) Net volumes that deliver in future periods are 480 bbls.

Optimization of Competitive Intermediate and Peaking Generation

In addition to its competitive baseload generation activities, PPL Energy Supply attempts to optimize the overall value of its competitive intermediate and peaking fleet, which includes 3,256 MW (summer rating) of natural gas and oil-fired generation. The following table presents the net volumes of derivative (sales)/purchase contracts used in support of this strategy at September 30, 2012.

| | Units | 2012 (a) | 2013 |
|----------------------------|-------|----------|-------|
| Net Power Sales (b) | GWh | (919) | (610) |
| Net Fuel Purchases (b) (c) | Bcf | 11.8 | 5.9 |

- (a) Represents the balance of the current year.
- (b) Volumes for derivative contracts used in support of these strategies that deliver in future periods are insignificant.
- (c) Included in these volumes are non-options and exercised option contracts that converted to non-option derivative contracts. Volumes associated with option contracts are insignificant.

Marketing Activities

PPL Energy Supply's marketing portfolio is comprised of full-requirement sales contracts and their related supply contracts, retail natural gas and electricity sales contracts and other marketing activities. The obligations under the full-requirement sales contracts include supplying a bundled product of energy, capacity, RECs, and other ancillary products. The full-requirement sales contracts PPL Energy Supply is awarded do not provide for specific levels of load, and actual load could vary significantly from forecasted amounts. PPL Energy Supply uses a variety of strategies to hedge its full-requirement sales contracts, including purchasing energy at a liquid trading hub or directly at the load delivery zone, purchasing capacity and RECs in the market and supplying the energy, capacity and RECs with its generation. The following table presents the volume of (sales)/purchase contracts, excluding FTRs, RECs, basis and capacity contracts, used in support of these activities at September 30, 2012.

| | Units | 2012 (a) | 2013 | 2014 |
|---------------------------------------|-------|----------|----------|---------|
| Energy sales contracts (b) | GWh | (5,426) | (10,960) | (5,052) |
| Related energy supply contracts | | | | |
| Energy purchases (b) | GWh | 3,766 | 6,725 | 2,480 |
| Volumetric hedges (c) | GWh | 161 | 382 | 72 |
| Generation supply (b) | GWh | 840 | 2,986 | 1,857 |
| Retail natural gas sales contracts | Bcf | (4.8) | (11.3) | (2.7) |
| Retail natural gas purchase contracts | Bcf | 4.7 | 11.2 | 2.7 |

- (a) Represents the balance of the current year.
- (b) Includes contracts that are not derivatives and/or contracts that are NPNS, which receive accrual accounting.
- (c) PPL Energy Supply uses power and gas options, swaps and futures to hedge the volumetric risk associated with sales contracts since the demand for power varies hourly. Volumes for option contracts factor in the probability of an option being exercised and may be less than the notional amount of the option.

Proprietary Trading Activity

At September 30, 2012, PPL Energy Supply's proprietary trading positions, excluding FTR, basis and capacity contract activity that are included in the tables below, were insignificant.

Other Energy-Related Positions

FTRs and Other Basis Positions

PPL Energy Supply buys and sells FTRs and other basis positions to mitigate the basis risk between delivery points related to the sales of its generation, the supply of its full-requirement sales contracts and retail contracts, as well as for proprietary trading purposes. The following table represents the net volumes of derivative FTR and basis (sales)/purchase contracts at September 30, 2012.

| | Units | 2012 (a) | 2013 | 2014 |
|---------------------------|-------|-------------|---------|---------|
| FTRs (b) | GWh | 13,843 | 21,078 | 2,727 |
| Power Basis Positions (c) | GWh | (3,854) | (8,278) | (2,628) |
| Gas Basis Positions (d) | Bcf | 2.2 | (5.0) | (3.9) |

- (a) Represents the balance of the current year.
- (b) Net volumes that deliver in future periods are 1,062 GWh.
- (c) Net volumes that deliver in future periods are (677) GWh.
- (d) Net volumes that deliver in future periods are (5.7) Bcf.

Capacity Positions

PPL Energy Supply buys and sells capacity related to the sales of its generation and the supply of its full-requirement sales contracts. PPL Energy Supply also buys and sells capacity for proprietary trading purposes. The following table presents the net volumes of derivative capacity (sales)/purchase contracts at September 30, 2012.

| | Units | 2012 (a) | 2013 | 2014 |
|--------------|-----------|-------------|---------|---------|
| Capacity (b) | MW-months | (3,098) | (5,446) | (2,078) |

(a) Represents the balance of the current year.

(b) Net volumes that deliver in future periods are 989 MW-months.

Interest Rate Risk

(PPL, PPL Energy Supply, LKE and LG&E)

PPL and its subsidiaries issue debt to finance their operations, which exposes them to interest rate risk. Various financial derivative instruments are utilized to adjust the mix of fixed and floating interest rates in their debt portfolio, adjust the duration of the debt portfolio and lock in benchmark interest rates in anticipation of future financing, when appropriate. Risk limits under PPL's risk management program are designed to balance risk exposure to volatility in interest expense and changes in the fair value of the debt portfolio due to changes in benchmark interest rates.

Cash Flow Hedges (PPL)

Interest rate risks include exposure to adverse interest rate movements for outstanding variable rate debt and for future anticipated financings. Financial interest rate swap contracts may be entered into to hedge floating interest rate risk associated with both existing and anticipated debt issuances. Outstanding interest rate swap contracts range in maturity through 2024 and had a notional amount of \$618 million. This amount includes £200 million (approximately \$318 million based on spot rates) at WPD.

PPL holds a notional position in cross-currency interest rate swaps totaling \$1.3 billion that range in maturity through 2028 to hedge the interest payments and principal of WPD's U.S. dollar-denominated senior notes.

For the three and nine months ended September 30, 2012, hedge ineffectiveness associated with interest rate derivatives was insignificant. For the three and nine months ended September 30, 2011, hedge ineffectiveness associated with interest rate derivatives was insignificant and an after-tax gain (loss) of \$(9) million, which included a gain (loss) of \$(4) million attributable to certain interest rate swaps that failed hedge effectiveness testing during the second quarter of 2011.

Cash flow hedges are discontinued if it is no longer probable that the original forecasted transaction will occur by the end of the originally specified time period and any amounts previously recorded in AOCI are reclassified into earnings once it is determined that the hedged transaction is probable of not occurring. PPL had no such reclassifications for the three and nine months ended September 30, 2012 and 2011.

At September 30, 2012, the accumulated net unrecognized after-tax gains (losses) on qualifying derivatives that are expected to be reclassified into earnings during the next 12 months were \$(13) million. Amounts are reclassified as the hedged interest payments are made.

Fair Value Hedges (PPL)

PPL is exposed to changes in the fair value of its debt portfolios. To manage this risk, financial contracts may be entered into to hedge fluctuations in the fair value of existing debt issuances due to changes in benchmark interest rates. In July 2012, contracts ranged in maturity through 2047 and had a notional value of \$99 million were canceled without penalties by the counterparties. PPL did not hold any such contracts at September 30, 2012. PPL did not recognize gains or losses resulting from the ineffective portion of fair value hedges or from a portion of the hedging instrument being excluded from the assessment of hedge effectiveness or from hedges of debt issuances that no longer qualified as fair value hedges for the three and nine months ended September 30, 2012 and 2011.

In July 2011, PPL Electric redeemed \$400 million of 7.125% Senior Secured Bonds due 2013. As a result of this redemption, PPL recorded a gain (loss) of \$22 million, or \$14 million after-tax, for the three and nine months ended September 30, 2011 in "Other Income (Expense) - net" on the Statement of Income as a result of accelerated amortization of the fair value adjustments to the debt in connection with previously settled fair value hedges.

Economic Activity (PPL, LKE and LG&E)

LG&E enters into interest rate swap contracts that economically hedge interest payments on variable rate debt. Because realized gains and losses from the swaps, including a terminated swap contract, are recoverable through regulated rates, any subsequent changes in fair value of these derivatives are included in regulatory assets or liabilities until they are realized as interest expense. Realized gains and losses are recognized in "Interest Expense" on the Statements of Income when the hedged transaction occurs. At September 30, 2012, LG&E held contracts with a notional amount of \$179 million that range in maturity through 2033. The fair values of these contracts were recorded

as liabilities of \$62 million and \$60 million at September 30, 2012 and December 31, 2011 with equal offsetting amounts recorded as regulatory assets.

Foreign Currency Risk (PPL)

PPL is exposed to foreign currency risk, primarily through investments in U.K. affiliates. PPL has adopted a foreign currency risk management program designed to hedge certain foreign currency exposures, including net investments, firm commitments, recognized assets or liabilities and anticipated transactions. In addition, PPL enters into financial instruments to protect against foreign currency translation risk of expected earnings.

Net Investment Hedges

PPL enters into foreign currency contracts on behalf of a subsidiary to protect the value of a portion of its net investment in WPD. The contracts outstanding at September 30, 2012 had a notional amount of £163 million (approximately \$263 million based on contracted rates). The settlement dates of these contracts range from December 2012 through November 2013. The net fair value of these contracts at September 30, 2012 was insignificant and at December 31, 2011 was an asset (liability) of \$7 million.

Additionally, a PPL Global subsidiary that has a U.S. dollar functional currency entered into a GBP intercompany loan payable with a PPL WEM subsidiary that has a GBP functional currency. The loan qualifies as a net investment hedge for the PPL Global subsidiary. As such, the foreign currency gains and losses on the intercompany loan for the PPL Global subsidiary are recorded to the foreign currency translation adjustment component of AOCI. At September 30, 2012, the intercompany loan outstanding was £62 million (approximately \$100 million based on spot rates).

For the three and nine months ended September 30, 2012 and 2011, PPL recognized insignificant amounts of activity in the foreign currency translation adjustment component of AOCI. At September 30, 2012, PPL included \$15 million of accumulated net investment hedge gains (losses), after-tax, in the foreign currency translation adjustment component of AOCI, compared to \$19 million of gains (losses), after-tax, recorded by PPL at December 31, 2011.

Cash Flow Hedges

PPL held no foreign currency derivatives that qualified as cash flow hedges during the three and nine months ended September 30, 2012 and 2011.

Fair Value Hedges

PPL held no foreign currency derivatives that qualified as fair value hedges during the three and nine months ended September 30, 2012 and 2011.

Economic Activity

PPL enters into foreign currency contracts on behalf of a subsidiary to economically hedge GBP-denominated anticipated earnings. At September 30, 2012, the total exposure hedged by PPL was approximately £1.2 billion (approximately \$1.9 billion based on contracted rates) and the net fair value of these positions was an asset (liability) of \$(35) million. These contracts had termination dates ranging from October 2012 through November 2014. Realized and unrealized gains (losses) on these contracts are included in "Other Income (Expense) - net" on the Statements of Income and were \$(47) million and \$(40) million for the three and nine months ended September 30, 2012. At December 31, 2011, the total exposure hedged by PPL was £288 million and the net fair value of these positions was an asset (liability) of \$11 million. Realized and unrealized gains (losses) were \$11 million for the three and nine months ended September 30, 2011.

In anticipation of the repayment of a portion of the borrowings under the 2011 Bridge Facility with U.S. dollar proceeds received from PPL's April 2011 issuance of common stock and 2011 Equity Units and the issuance of senior notes by PPL WEM, PPL entered into forward contracts to purchase GBP to economically hedge the foreign currency exchange rate risk related to the repayment. These contracts were settled in April 2011. Realized and unrealized gains (losses) on these contracts are included in "Other Income (Expense) - net" on the Statement of Income. PPL recorded insignificant losses and \$55 million of pre-tax, net gains (losses) for the three and nine months ended September 30, 2011.

Accounting and Reporting

(PPL, PPL Energy Supply, PPL Electric, LKE, LG&E and KU)

All derivative instruments are recorded at fair value on the Balance Sheet as an asset or liability unless they qualify for NPNS. NPNS contracts for PPL and PPL Energy Supply include full-requirement sales contracts, other physical purchase and sales contracts and certain retail energy and physical capacity contracts, and for PPL Electric include certain full-requirement purchase contracts and other physical purchase contracts. Changes in the fair value of derivatives not designated as NPNS are recognized currently in earnings unless specific hedge accounting criteria are met, except for the change in fair value of LG&E's interest rate swaps that are recognized as regulatory assets. See Note 6 for amounts recorded in regulatory assets at September 30, 2012 and December 31, 2011.

See Notes 1 and 19 in each Registrant's 2011 Form 10-K for additional information on accounting policies related to derivative instruments.

(PPL)

The following tables present the fair value and location of derivative instruments recorded on the Balance Sheets.

| | September 30, 2012 | | | | December 31, 2011 | | | |
|----------------------------|---|-------------|---|-------------|---|-------------|---|-------------|
| | Derivatives designated as hedging instruments | | Derivatives not designated as hedging instruments (a) | | Derivatives designated as hedging instruments | | Derivatives not designated as hedging instruments (a) | |
| | Assets | Liabilities | Assets | Liabilities | Assets | Liabilities | Assets | Liabilities |
| Current: | | | | | | | | |
| Price Risk Management | | | | | | | | |
| Assets/Liabilities (b): | | | | | | | | |
| Interest rate swaps | | \$ 16 | | \$ 5 | \$ 3 | \$ 3 | | \$ 5 |
| Cross-currency swaps | \$ 1 | 2 | | | | 2 | | |
| Foreign currency contracts | | 1 | | 19 | 7 | | \$ 11 | |
| Commodity contracts | 66 | 1 | \$ 1,701 | 1,140 | 872 | 3 | 1,655 | 1,557 |
| Total current | 67 | 20 | 1,701 | 1,164 | 882 | 8 | 1,666 | 1,562 |
| Noncurrent: | | | | | | | | |
| Price Risk Management | | | | | | | | |
| Assets/Liabilities (b): | | | | | | | | |
| Interest rate swaps | | 5 | | 57 | | | | 55 |
| Cross-currency swaps | 23 | | | | 24 | | | |

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| | | | | | | | | | |
|----------------------------|--------|-------|----------|----------|--------|-------|----------|----------|--|
| Foreign currency contracts | 16 | | | | | | | | |
| Commodity contracts | 30 | 1 | 807 | 805 | 42 | 2 | 854 | 783 | |
| Total noncurrent | 53 | 6 | 807 | 878 | 66 | 2 | 854 | 838 | |
| Total derivatives | \$ 120 | \$ 26 | \$ 2,508 | \$ 2,042 | \$ 948 | \$ 10 | \$ 2,520 | \$ 2,400 | |

(a) \$479 million and \$237 million of net gains associated with derivatives that were no longer designated as hedging instruments are recorded in AOCI at September 30, 2012 and December 31, 2011.

(b) Represents the location on the Balance Sheet.

The after-tax balances of accumulated net gains (losses) (excluding net investment hedges) in AOCI were \$231 million and \$527 million at September 30, 2012 and December 31, 2011. The after-tax balances of accumulated net gains (losses) (excluding net investment hedges) in AOCI were \$491 million and \$695 million at September 30, 2011 and December 31, 2010.

The following tables present the pre-tax effect of derivative instruments recognized in income, OCI or regulatory assets for the periods ended September 30, 2012.

| Derivatives in Fair Value Hedging Relationships | Hedged Items in Fair Value Hedging Relationships | Location of Gain (Loss) Recognized in Income | Gain (Loss) Recognized | | Gain (Loss) Recognized | |
|---|--|--|--------------------------------------|-------------|--|-------------|
| | | | in Income on Derivative Three Months | Nine Months | in Income on Related Item Three Months | Nine Months |
| Interest rate swaps | Fixed rate debt | Interest expense | \$ (1) | \$ | 1 | \$ 3 |

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| Derivative Relationships | Derivative Gain (Loss) Recognized in OCI (Effective Portion) | | Location of Gain (Loss) Recognized in Income | Three Months | Nine Months | | |
|---|--|--------------|---|--|--|--|--|
| | Three Months | Nine Months | | Gain (Loss) Recognized in Income on Derivative | Gain (Loss) Recognized in Income on Derivative | Gain (Loss) Recognized in Income on Derivative | |
| | | | | Gain (Loss) Recognized in Income (Effective Portion) | Amount Excluded from Effectiveness Testing) | Amount Excluded from Effectiveness Testing) | |
| Cash Flow Hedges: | | | | | | | |
| Interest rate swaps | \$ (6) | \$ (28) | Interest expense | \$ (4) | | \$ (13) | |
| | | | Other income (expense) - net | 1 | | 1 | |
| Cross-currency swaps | (49) | (3) | Interest expense | | | (1) | |
| | | | Other income (expense) - net | (40) | | (12) | |
| Commodity contracts | | 99 | Wholesale energy marketing | 174 | | 673 \$ (1) | |
| | | | Depreciation | 1 | | 2 | |
| | | | Energy purchases | (20) | \$ 1 | (105) (2) | |
| Total | \$ (55) | \$ 68 | | \$ 112 | \$ 1 | \$ 545 \$ (3) | |
| Net Investment Hedges: | | | | | | | |
| Foreign currency contracts | \$ (4) | \$ (5) | | | | | |
| Derivatives Not Designated as Hedging Instruments: | | | | | | | |
| | | | Location of Gain (Loss) Recognized in Income on Derivatives | Three Months | Nine Months | | |
| Foreign currency contracts | | | Other income (expense) - net | \$ (47) | \$ (40) | | |

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| | | | |
|---------------------|-------------------------------------|----------|--------|
| Interest rate swaps | Interest expense | (2) | (4) |
| Commodity contracts | Unregulated retail electric and gas | (3) | 20 |
| | Wholesale energy marketing | (476) | 900 |
| | Net energy trading margins (a) | (10) | 12 |
| | Fuel | 6 | |
| | Energy purchases | 364 | (717) |
| | Total | \$ (168) | \$ 171 |

| Derivatives Not Designated as Hedging Instruments: | Location of Gain (Loss) Recognized as | | Three Months | Nine Months |
|--|---------------------------------------|----|--------------|-------------|
| | Regulatory Liabilities/Assets | | | |
| Interest rate swaps | Regulatory assets - noncurrent | \$ | (9) | \$ (3) |

(a) Differs from the Statement of Income due to intra-month transactions that PPL defines as spot activity, which is not accounted for as a derivative.

The following tables present the pre-tax effect of derivative instruments recognized in income or OCI for the periods ended September 30, 2011.

| Derivatives in Fair Value Hedging Relationships | Hedged Items in Fair Value Hedging Relationships | Location of Gain (Loss) Recognized in Income | Gain (Loss) Recognized in Income on Derivative | | Gain (Loss) Recognized in Income on Related Item | |
|---|--|--|--|-------------|--|-------------|
| | | | Three Months | Nine Months | Three Months | Nine Months |
| Interest rate swaps | Fixed rate debt | Interest expense | \$ 2 | \$ 5 | \$ 23 | |
| | | Other income (expense) - net | | | 22 | 22 |

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| Derivative Relationships | Derivative Gain (Loss) Recognized in OCI (Effective Portion) | | Location of Gain (Loss) Recognized in Income | Three Months | | Nine Months | |
|--------------------------|--|--------------|--|--|--|--|--|
| | Three Months | Nine Months | | Gain (Loss) Recognized in Income on Derivative | Gain (Loss) Recognized in Income on Derivative | Gain (Loss) Recognized in Income on Derivative | Gain (Loss) Recognized in Income on Derivative |
| | | | | Reclassified from AOCI into Income (Effective Portion) | Amount Excluded from Effectiveness Testing) | Reclassified into Income (Effective Portion) | Amount Excluded from Effectiveness Testing) |
| Cash Flow Hedges: | | | | | | | |
| Interest rate swaps | \$ (52) | \$ (51) | Interest expense | \$ (4) | | \$ (10) | \$ (13) |
| Cross-currency swaps | 46 | 13 | Interest expense | | | 3 | |
| | | | Other income (expense) - net | 32 | | 49 | |
| Commodity contracts | 66 | 116 | Wholesale energy marketing | 163 | \$ (9) | 530 | (31) |
| | | | Fuel | 1 | | 1 | |
| | | | Depreciation | 1 | | 1 | |
| | | | Energy purchases | (42) | | (159) | 1 |
| Total | \$ 60 | \$ 78 | | \$ 151 | \$ (9) | \$ 415 | \$ (43) |

Net Investment

Hedges:

| | | | | | | | |
|----------------------------|------|------|--|--|--|--|--|
| Foreign currency contracts | \$ 5 | \$ 4 | | | | | |
|----------------------------|------|------|--|--|--|--|--|

| Derivatives Not Designated as Hedging Instruments: | Location of Gain (Loss) Recognized in Income on Derivatives | Three Months | Nine Months |
|--|---|--------------|-------------|
| Foreign currency contracts | Other income (expense) - net | \$ 11 | \$ 66 |
| Interest rate swaps | Interest expense | (2) | (6) |
| Commodity contracts | Utility | 1 | (2) |
| | | 6 | 11 |

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| | | |
|-------------------------------------|---------|-------|
| Unregulated retail electric and gas | | |
| Wholesale energy marketing | 193 | 167 |
| Net energy trading margins (a) | (2) | 9 |
| Fuel | (27) | (12) |
| Energy purchases | (192) | (156) |
| Total | \$ (12) | \$ 77 |

| | | | | |
|--|-------------------------------|----|--------------|-------------|
| | Location of Gain (Loss) | | | |
| Derivatives Not Designated as Hedging Instruments: | Recognized as | | | |
| | Regulatory Liabilities/Assets | | Three Months | Nine Months |
| Interest rate swaps | Regulatory assets | \$ | (22) | \$ (23) |

(a) Differs from the Statement of Income due to intra-month transactions that PPL defines as spot activity, which is not accounted for as a derivative.

(PPL Energy Supply)

The following table presents the fair value and location of derivative instruments recorded on the Balance Sheets.

| | September 30, 2012 | | | | December 31, 2011 | | | | |
|-------------------------|---|-------------|---|-------------|---|-------------|---|-------------|--|
| | Derivatives designated as hedging instruments | | Derivatives not designated as hedging instruments (a) | | Derivatives designated as hedging instruments | | Derivatives not designated as hedging instruments (a) | | |
| | Assets | Liabilities | Assets | Liabilities | Assets | Liabilities | Assets | Liabilities | |
| Current: | | | | | | | | | |
| Price Risk Management | | | | | | | | | |
| Assets/Liabilities (b): | | | | | | | | | |
| Commodity contracts | \$ 66 | \$ 1 | \$ 1,701 | \$ 1,140 | \$ 872 | \$ 3 | \$ 1,655 | \$ 1,557 | |
| Total current | 66 | 1 | 1,701 | 1,140 | 872 | 3 | 1,655 | 1,557 | |
| Noncurrent: | | | | | | | | | |
| Price Risk Management | | | | | | | | | |
| Assets/Liabilities (b): | | | | | | | | | |
| Commodity contracts | 30 | 1 | 807 | 805 | 42 | 2 | 854 | 783 | |
| Total noncurrent | 30 | 1 | 807 | 805 | 42 | 2 | 854 | 783 | |
| Total derivatives | \$ 96 | \$ 2 | \$ 2,508 | \$ 1,945 | \$ 914 | \$ 5 | \$ 2,509 | \$ 2,340 | |

(a) \$479 million and \$237 million of net gains associated with derivatives that were no longer designated as hedging instruments are recorded in AOCI at September 30, 2012 and December 31, 2011.

(b) Represents the location on the balance sheet.

The after-tax balances of accumulated net gains (losses) (excluding net investment hedges) in AOCI were \$312 million and \$605 million at September 30, 2012 and December 31, 2011. The after-tax balances of accumulated net gains (losses) (excluding net investment hedges) in AOCI were \$539 million and \$733 million at September 30, 2011 and December 31, 2010. At September 30, 2011, AOCI reflects the effect of PPL Energy Supply's January 2011 distribution of its membership interest in PPL Global to its parent, PPL Energy Funding.

The following tables present the pre-tax effect of derivative instruments recognized in income or OCI for the nine months ended September 30, 2012.

| Derivative Relationships | Derivative Gain | | Location of Gains (Losses) Recognized in Income | Three Months | | Nine Months | | | | | |
|--------------------------|---|---|---|--|--|--|--|----|-----|----|-----|
| | (Loss) Recognized in OCI (Effective Portion) Three Months | Recognized in OCI (Effective Portion) Nine Months | | Gain (Loss) Recognized in Income on Derivative | Gain (Loss) (Ineffective Portion and Amount Excluded from Effectiveness Testing) | Gain (Loss) Recognized in Income on Derivative | Gain (Loss) (Ineffective Portion and Amount Excluded from Effectiveness Testing) | | | | |
| Commodity contracts | \$ | 99 | Wholesale energy marketing | \$ | 174 | \$ | 673 | \$ | (1) | | |
| | | | Depreciation | | | | 1 | | | | |
| | | | Energy purchases | | (20) | \$ | 1 | | (2) | | |
| Total | \$ | 99 | | \$ | 154 | \$ | 1 | \$ | 569 | \$ | (3) |

| Derivatives Not Designated as Hedging Instruments: | Location of Gain (Loss) Recognized in | | Three Months | | Nine Months | |
|--|---------------------------------------|--|--------------|-------------|--------------|-------------|
| | Income on Derivatives | | Three Months | Nine Months | Three Months | Nine Months |
| Commodity contracts | Unregulated retail electric and gas | | \$ | (3) | \$ | 20 |
| | Wholesale energy marketing | | | (476) | | 900 |
| | Net energy trading margins (a) | | | (10) | | 12 |
| | Fuel | | | 6 | | |
| | Energy purchases | | | 364 | | (717) |
| | Total | | \$ | (119) | \$ | 215 |

(a)

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

Differs from the Statement of Income due to intra-month transactions that PPL Energy Supply defines as spot activity, which is not accounted for as a derivative.

The following tables present the pre-tax effect of derivative instruments recognized in income or OCI for the periods ended September 30, 2011.

| Derivatives in Fair Value Hedging Relationships | Hedged Items in Fair Value Hedging Relationships | Location of Gain (Loss) Recognized in Income | Gain (Loss) Recognized in Income on Derivative | | Gain (Loss) Recognized in Income on Related Item | | |
|---|--|--|---|--|--|--|--|
| | | | Three Months | Nine Months | Three Months | Nine Months | |
| Interest rate swaps | Fixed rate debt | Interest expense | | | | \$ 1 | |
| Derivative Relationships | (Loss) Recognized in OCI (Effective Portion) | Derivative Gain (Loss) Recognized in OCI (Effective Portion) | Location of Gains (Losses) Recognized in Income | Gain (Loss) Recognized in Income on Derivative | Gain (Loss) Recognized in Income on Derivative | Gain (Loss) Recognized in Income on Related Item | Gain (Loss) Recognized in Income on Related Item |
| | | | | Reclassified from AOCI into Income (Effective Portion) | Amount Excluded from Effectiveness Testing) | Reclassified from AOCI into Income (Effective Portion) | Amount Excluded from Effectiveness Testing) |
| Cash Flow Hedges: | | | | | | | |
| Commodity contracts | \$ 66 | \$ 116 | Wholesale energy marketing | \$ 163 | \$ (9) | \$ 530 | \$ (31) |
| | | | Fuel | 1 | | 1 | |
| | | | Depreciation | 1 | | 1 | |
| | | | Energy purchases | (42) | | (159) | 1 |
| Total | \$ 66 | \$ 116 | | \$ 123 | \$ (9) | \$ 373 | \$ (30) |

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| Derivatives Not Designated as Hedging Instruments: | Location of Gain (Loss) Recognized in Income on Derivatives | Three Months | | Nine Months | |
|--|---|--------------|-------|-------------|-------|
| | | | | | |
| Commodity contracts | Unregulated retail electric and gas | \$ | 6 | \$ | 11 |
| | Wholesale energy marketing | | 193 | | 167 |
| | Net energy trading margins (a) | | (2) | | 9 |
| | Fuel | | (27) | | (12) |
| | Energy purchases | | (192) | | (156) |
| | Total | \$ | (22) | \$ | 19 |

(a) Differs from the Statement of Income due to intra-month transactions that PPL Energy Supply defines as spot activity, which is not accounted for as a derivative.

(LKE and LG&E)

The following table presents the fair value and location of derivative instruments recorded on the Balance Sheets.

| | September 30, 2012 | | | | December 31, 2011 | | | |
|-------------------------|---|-------------|---|-------------|---|-------------|---|-------------|
| | Derivatives designated as hedging instruments | | Derivatives not designated as hedging instruments | | Derivatives designated as hedging instruments | | Derivatives not designated as hedging instruments | |
| | Assets | Liabilities | Assets | Liabilities | Assets | Liabilities | Assets | Liabilities |
| Current: | | | | | | | | |
| Other Current | | | | | | | | |
| Assets/Liabilities (a): | | | | | | | | |
| Interest rate swaps | | | \$ | 5 | | | \$ | 5 |
| Total current | | | | 5 | | | | 5 |
| Noncurrent: | | | | | | | | |
| Price Risk Management | | | | | | | | |
| Assets/Liabilities (a): | | | | | | | | |
| Interest rate swaps | | | | 57 | | | | 55 |
| Total noncurrent | | | | 57 | | | | 55 |
| Total derivatives | | | \$ | 62 | | | \$ | 60 |

(a) Represents the location on the Balance Sheet.

The following tables present the pre-tax effect of derivative instruments recognized in income or regulatory assets for the periods ended September 30, 2012.

| Derivatives Not Designated as Hedging Instruments: | Location of Gain (Loss) Recognized in Income on Derivatives | Three Months | | Nine Months | |
|--|---|--------------|-----|-------------|-----|
| | | | | | |
| Interest rate swaps | Interest expense | \$ | (2) | \$ | (6) |

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| Derivatives Not Designated as Hedging Instruments: | Location of Gain (Loss) Recognized as | | Three Months | Nine Months |
|---|--|----|--------------|-------------|
| | Regulatory Liabilities/Assets | | | |
| Interest rate swaps | Regulatory assets | \$ | 1 | \$ (2) |

The following tables present the pre-tax effect of derivative instruments recognized in income or regulatory assets for the periods ended September 30, 2011.

| Derivatives Not Designated as Hedging Instruments: | Location of Gain (Loss) Recognized in | | Three Months | Nine Months |
|---|--|----|--------------|-------------|
| | Income on Derivatives | | | |
| Interest rate swaps | Interest expense | \$ | (2) | \$ (6) |
| Commodity contracts | Operating revenues | | 1 | (2) |
| | Total | \$ | (1) | \$ (8) |

| Derivatives Not Designated as Hedging Instruments: | Location of Gain (Loss) Recognized as | | Three Months | Nine Months |
|---|--|----|--------------|-------------|
| | Regulatory Liabilities/Assets | | | |
| Interest rate swaps | Regulatory assets | \$ | (22) | \$ (23) |

Credit Risk-Related Contingent Features (PPL, PPL Energy Supply, LKE and LG&E)

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

Additionally, certain derivative contracts contain credit risk-related contingent provisions that require "adequate assurance" of performance be provided if the other party has reasonable grounds for insecurity regarding the performance of PPL's obligation under the contract. A counterparty demanding adequate assurance could require a transfer of additional collateral or other security, including letters of credit, cash and guarantees from a creditworthy entity. This would typically involve negotiations among the parties. However, amounts disclosed below represent assumed immediate payment or immediate and ongoing full collateralization for derivative instruments in net liability positions with "adequate assurance" provisions.

At September 30, 2012, the effect of a decrease in credit ratings below investment grade on derivative contracts that contain credit contingent features and were in a net liability position is summarized as follows:

| | PPL | PPL Energy Supply | LKE | LG&E |
|--|--------|-------------------------|-------|-------|
| Aggregate fair value of derivative instruments in a net liability position with credit contingent provisions | \$ 225 | \$ 127 | \$ 40 | \$ 40 |
| Aggregate fair value of collateral posted on these derivative instruments | 33 | 1 | 32 | 32 |
| Aggregate fair value of additional collateral requirements in the event of | | | | |
| a credit downgrade below investment grade (a) | 201 | 134 | 9 | 9 |

(a) Includes the effect of net receivables and payables already recorded on the Balance Sheet.

15. Goodwill

(PPL)

The change in the carrying amount of goodwill for the nine months ended September 30, 2012 was primarily due to the effect of foreign currency exchange rates on the U.K. Regulated segment.

16. Asset Retirement Obligations

(PPL, PPL Energy Supply, LKE, LG&E and KU)

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

The changes in the carrying amounts of AROs were as follows.

| | PPL | PPL Energy Supply | LKE | LG&E | KU |
|--|--------|-------------------------|--------|-------|-------|
| Balance at December 31, 2011 | \$ 497 | \$ 359 | \$ 118 | \$ 57 | \$ 61 |
| Accretion expense | 27 | 21 | 5 | 2 | 3 |
| Obligations incurred | 3 | 3 | | | |
| Changes in estimated cash flow or settlement date | (7) | (7) | | | |
| Obligations settled | (7) | (5) | (2) | (2) | |
| Balance at September 30, 2012 | \$ 513 | \$ 371 | \$ 121 | \$ 57 | \$ 64 |

Substantially all of the ARO balances are classified as noncurrent at September 30, 2012 and December 31, 2011.

(PPL, LKE, LG&E and KU)

Accretion and depreciation expense recorded by LG&E and KU is offset with a regulatory credit on the income statement, such that there is no net earnings impact.

(PPL and PPL Energy Supply)

The most significant ARO recorded by PPL and PPL Energy Supply relates to the decommissioning of the Susquehanna nuclear plant. The accrued nuclear decommissioning obligation was \$310 million and \$292 million at September 30, 2012 and December 31, 2011.

Assets in the NDT funds are legally restricted for purposes of settling PPL's and PPL Energy Supply's ARO related to the decommissioning of the PPL Susquehanna nuclear plant. The aggregate fair value of these assets was \$711 million and \$640 million at September 30, 2012 and December 31, 2011, and is included in "Nuclear plant decommissioning trust funds" on the Balance Sheets. See Notes 13 and 17 for additional information on these assets.

17. Available-for-Sale Securities

(PPL, PPL Energy Supply, LKE and LG&E)

Certain short-term investments, securities held by the NDT funds and auction rate securities are classified as available-for-sale. Available-for-sale securities are carried on the Balance Sheets at fair value. Unrealized gains and losses on these securities are reported, net of tax, in OCI or are recognized currently in earnings when a decline in fair value is determined to be other-than-temporary. The specific identification method is used to calculate realized gains and losses.

(PPL and PPL Energy Supply)

The following table shows the amortized cost, the gross unrealized gains and losses recorded in AOCI, and the fair value of available-for-sale securities.

| | September 30, 2012 | | | December 31, 2011 | | | Fair Value |
|----------------------------------|--------------------|------------------------|-------------------------|-------------------|------------------------|-------------------------|------------|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | |
| PPL | | | | | | | |
| NDT funds: | | | | | | | |
| Cash and cash equivalents | \$ 12 | | | \$ 12 | | | \$ 12 |
| Equity securities: | | | | | | | |
| U.S. large-cap | 219 | \$ 193 | | 211 | \$ 146 | | 357 |
| U.S. mid/small-cap | 30 | 29 | | 29 | 23 | | 52 |
| Debt securities: | | | | | | | |
| U.S. Treasury | 85 | 10 | | 76 | 10 | | 86 |
| U.S. government sponsored agency | 8 | 1 | | 9 | 1 | | 10 |
| Municipality | 79 | 5 | \$ 1 | 83 | 4 | \$ 1 | 83 |
| Investment-grade corporate | 36 | 4 | | 35 | 3 | | 38 |
| Other | 2 | | | 2 | | | 2 |
| | (1) | | | (1) | | | |

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| | | | | | | | | | |
|------------------------------|--------|--------|------|--------|--------|--------|------|--------|--|
| Receivables/payables, net | | | | | | | | | |
| Total NDT funds | 470 | 242 | 1 | 711 | 454 | 187 | 1 | 640 | |
| Auction rate securities | 20 | | 1 | 19 | 25 | | 1 | 24 | |
| Total | \$ 490 | \$ 242 | \$ 2 | \$ 730 | \$ 479 | \$ 187 | \$ 2 | \$ 664 | |

PPL Energy Supply

NDT funds:

| | | | | | | | | |
|-------------------------------|--------|--------|------|--------|--------|--------|------|--------|
| Cash and cash equivalents | \$ 12 | | | \$ 12 | \$ 12 | | | \$ 12 |
| Equity securities: | | | | | | | | |
| U.S. large-cap | 219 | \$ 193 | | 412 | 211 | \$ 146 | | 357 |
| U.S. mid/small-cap | 30 | 29 | | 59 | 29 | 23 | | 52 |
| Debt securities: | | | | | | | | |
| U.S. Treasury | 85 | 10 | | 95 | 76 | 10 | | 86 |
| U.S. government sponsored | | | | | | | | |
| agency | 8 | 1 | | 9 | 9 | 1 | | 10 |
| Municipality | 79 | 5 | \$ 1 | 83 | 80 | 4 | \$ 1 | 83 |
| Investment-grade corporate | 36 | 4 | | 40 | 35 | 3 | | 38 |
| Other | 2 | | | 2 | 2 | | | 2 |
| Receivables/payables, net | (1) | | | (1) | | | | |
| Total NDT funds | 470 | 242 | 1 | 711 | 454 | 187 | 1 | 640 |
| Auction rate securities | 17 | | 1 | 16 | 20 | | 1 | 19 |
| Total | \$ 487 | \$ 242 | \$ 2 | \$ 727 | \$ 474 | \$ 187 | \$ 2 | \$ 659 |

There were no securities with credit losses at September 30, 2012 and December 31, 2011.

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

The following table shows the scheduled maturity dates of debt securities held at September 30, 2012.

| | Maturity Less Than 1 Year | Maturity 1-5 Years | Maturity 5-10 Years | Maturity in Excess of 10 Years | Total |
|--------------------------|---------------------------------|--------------------------|---------------------------|--------------------------------------|--------|
| PPL | | | | | |
| Amortized cost | \$ 11 | \$ 81 | \$ 61 | \$ 77 | \$ 230 |
| Fair value | 11 | 85 | 67 | 85 | 248 |
| PPL Energy Supply | | | | | |
| Amortized cost | \$ 11 | \$ 81 | \$ 61 | \$ 74 | \$ 227 |
| Fair value | 11 | 85 | 67 | 82 | 245 |

The following table shows proceeds from and realized gains and losses on sales of available-for-sale securities for the periods ended September 30.

| | Three Months | | Nine Months | |
|---|--------------|-------|-------------|--------|
| | 2012 | 2011 | 2012 | 2011 |
| PPL | | | | |
| Proceeds from sales of NDT securities (a) | \$ 23 | \$ 34 | \$ 102 | \$ 134 |
| Other proceeds from sales | | | 5 | 163 |
| Gross realized gains (b) | 2 | 3 | 15 | 26 |
| Gross realized losses (b) | 2 | 4 | 8 | 15 |
| PPL Energy Supply | | | | |
| Proceeds from sales of NDT securities (a) | \$ 23 | \$ 34 | \$ 102 | \$ 134 |
| Other proceeds from sales | | | 3 | |
| Gross realized gains (b) | 2 | 3 | 15 | 26 |
| Gross realized losses (b) | 2 | 4 | 8 | 15 |

(a) These proceeds are used to pay income taxes and fees related to managing the trust. Remaining proceeds are reinvested in the trust.

(b) Excludes the impact of other-than-temporary impairment charges recognized in the Statements of Income.

(PPL, LKE and LG&E)

At December 31, 2010, LG&E held \$163 million aggregate principal amount of tax-exempt revenue bonds issued by Louisville/Jefferson County, Kentucky on behalf of LG&E that were purchased from the remarketing agent in 2008. During the nine months ended September 30, 2011, LG&E received \$163 million for its investments in these bonds when they were remarketed to unaffiliated investors. No realized or unrealized gains (losses) were recorded on these securities, as the difference between carrying value and fair value was not significant.

18. New Accounting Guidance Pending Adoption

(PPL, PPL Energy Supply, PPL Electric, LKE, LG&E and KU)

Improving Disclosures about Offsetting Balance Sheet Items

Effective January 1, 2013, the Registrants will retrospectively adopt accounting guidance issued to enhance disclosures about financial instruments and derivative instruments that either (1) offset on the balance sheet or (2) are subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are offset on the balance sheet.

Upon adoption, the enhanced disclosure requirements are not expected to have a significant impact on the Registrants.

Testing Indefinite-Lived Intangible Assets for Impairment

Effective January 1, 2013, the Registrants will prospectively adopt accounting guidance that allows an entity to elect the option to first make a qualitative evaluation about the likelihood of an impairment of an indefinite-lived intangible asset. If, based on this assessment, the entity determines that it is more likely than not that the fair value of the indefinite-lived intangible asset exceeds the carrying amount, the fair value of that asset does not need to be calculated. If the entity concludes otherwise, a quantitative impairment test must be performed by determining the fair value of the asset and comparing it with the carrying value. The entity would record an impairment charge, if necessary.

Upon adoption, this guidance is not expected to have a significant impact on the Registrants.

PPL CORPORATION AND SUBSIDIARIES

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following should be read in conjunction with PPL's Condensed Consolidated Financial Statements and the accompanying Notes and with PPL's 2011 Form 10-K. Capitalized terms and abbreviations are defined in the glossary. Dollars are in millions, except per share data, unless otherwise noted.

"Management's Discussion and Analysis of Financial Condition and Results of Operations" includes the following information:

- "Overview" provides a description of PPL and its business strategy, a summary of Net Income Attributable to PPL Shareowners and a discussion of certain events related to PPL's results of operations and financial condition.
- "Results of Operations" provides a review of results by reportable segment and a description of factors by segment expected to impact future earnings. This section ends with explanations of significant changes in principal items on PPL's Statements of Income, comparing the three and nine months ended September 30, 2012 with the same periods in 2011.
- "Financial Condition - Liquidity and Capital Resources" provides an analysis of PPL's liquidity position and credit profile. This section also includes a discussion of rating agency actions.
- "Financial Condition - Risk Management" provides an explanation of PPL's risk management programs relating to market and credit risk.

Overview

Introduction

PPL is an energy and utility holding company with headquarters in Allentown, Pennsylvania. Through subsidiaries, PPL generates electricity from power plants in the northeastern, northwestern and southeastern U.S., markets wholesale and retail energy primarily in the northeastern and northwestern portions of the U.S., delivers electricity to customers in Pennsylvania, Kentucky, Virginia, Tennessee and the U.K. and delivers natural gas to customers in Kentucky.

PPL's principal subsidiaries are shown below (* denotes an SEC registrant):

PPL Corporation*

PPL Global
Engages in the
regulated
operations of
electricity
distribution

PPL Energy
Supply*

PPL Electric*
Engages in the
regulated transmission
and distribution of
electricity in
Pennsylvania

LKE*

businesses in the
U.K.

PPL EnergyPlus
Performs marketing
and trading activities
Purchases fuel

PPL Generation
Engages in the
competitive
generation of
electricity,
primarily in
Pennsylvania and
Montana

LG&E*
Engages in the
regulated
generation,
transmission,
distribution and
sale of electricity in
Kentucky, and
distribution and
sale of natural gas
in Kentucky

KU*
Engages in the
regulated
generation,
transmission,
distribution and
sale of electricity
primarily in
Kentucky

U.K. Regulated
Segment

Supply Segment

Pennsylvania
Regulated Segment

Kentucky
Regulated
Segment

Business Strategy

PPL's overall strategy is to achieve stable, long-term growth in its regulated electricity delivery businesses through efficient operations and strong customer and regulatory relations, and disciplined optimization of energy supply margins in its energy supply business while mitigating volatility in both cash flows and earnings. In pursuing this strategy, PPL acquired LKE in November 2010 and WPD Midlands in April 2011. These acquisitions have reduced PPL's overall business risk profile and reapportioned the mix of PPL's regulated and competitive businesses by increasing the regulated portion of its business and enhancing rate-regulated growth opportunities as the regulated businesses make investments to improve infrastructure and customer reliability. As a result of these acquisitions, approximately 70% of PPL's assets were in its regulated businesses at September 30, 2012 and approximately 69% of "Net Income Attributable to PPL Shareowners" was from regulated businesses for the nine months ended September 30, 2012.

The increase in regulated assets is expected to provide earnings stability through regulated returns and the ability to recover costs of capital investments, in contrast to the competitive energy supply business where earnings and cash flows are subject to commodity market volatility. Results for periods prior to the acquisition of WPD Midlands are not comparable with, or indicative of, results for periods subsequent to the acquisition.

With the acquisition of WPD Midlands and the related growth of the portion of PPL's overall earnings translated from British pounds sterling, the related foreign currency risk is more substantial. The U.K. subsidiaries also have currency exposure to the U.S. dollar associated with their U.S. dollar-denominated debt. To manage these risks, PPL generally uses contracts such as forwards, options and cross currency swaps that contain characteristics of both interest rate and foreign currency exchange contracts.

PPL's strategy for its competitive energy supply business is to optimize the value from its competitive generation and marketing portfolios. PPL endeavors to do this by matching energy supply with load, or customer demand, under contracts of varying durations with creditworthy counterparties to capture profits while effectively managing exposure to energy and fuel price risk, counterparty credit risk and operational risk.

To manage financing costs and access to credit markets, a key objective of PPL's business strategy is to maintain a strong credit profile. PPL continually focuses on maintaining an appropriate capital structure and liquidity position. In addition, PPL has adopted financial and operational risk management programs that, among other things, are designed to monitor and manage its exposure to earnings and cash flow volatility related to changes in energy and fuel prices, interest rates, counterparty credit quality and the operating performance of its generating units.

Financial and Operational Developments

Net Income Attributable to PPL Shareowners

Net Income Attributable to PPL Shareowners for the three and nine months ended September 30, 2012 was \$355 million and \$1.2 billion compared to \$444 million and \$1.0 billion for the same periods in 2011, representing a 20% decrease from and 12% increase over 2011. Net Income Attributable to PPL Shareowners for the periods ended September 30 by segment was:

| | Three Months | | Nine Months | |
|--------------------|--------------|-------|-------------|--------|
| | 2012 | 2011 | 2012 | 2011 |
| Kentucky Regulated | \$ 72 | \$ 78 | \$ 148 | \$ 184 |
| U.K. Regulated (a) | 202 | 138 | 563 | 231 |

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| | | | | |
|--|---------|---------|----------|----------|
| Pennsylvania Regulated | 33 | 28 | 95 | 116 |
| Supply | 48 | 200 | 361 | 510 |
| Net Income Attributable to PPL Shareowners | \$ 355 | \$ 444 | \$ 1,167 | \$ 1,041 |
| EPS - basic | \$ 0.61 | \$ 0.76 | \$ 2.00 | \$ 1.92 |
| EPS - diluted | \$ 0.61 | \$ 0.76 | \$ 2.00 | \$ 1.91 |

(a) WPD Midlands was acquired on April 1, 2011 and its results are recorded on a one-month lag. Therefore, the 2012 periods include three and nine months of WPD Midlands' results while the 2011 periods include three and five months of WPD Midlands' results.

The changes in Net Income Attributable to PPL Shareowners from period to period were, in part, attributable to certain items that management considers special. See "Results of Operations" for further discussion of the results of PPL's business segments, details of special items and analysis of the consolidated results of operations.

Economic and Market Conditions

Unregulated gross energy margins associated with PPL Energy Supply's competitive generation and marketing business are impacted by changes in market prices and demand for electricity and natural gas, power plant availability, competition in the markets for retail customers, fuel costs and availability, fuel transportation costs and other costs. Current depressed wholesale market prices for electricity and natural gas have resulted from general weak economic conditions and other factors, including the impact of expanded domestic shale gas development. As a result of these factors, PPL Energy Supply has experienced a shift in the dispatching of its competitive generation from coal-fired to combined-cycle gas-fired generation as illustrated in the following table:

| | Average Utilization Factors (a) | |
|---------------------------|---------------------------------|------|
| | 2009 - 2011 | 2012 |
| Pennsylvania coal plants | 89% | 70% |
| Montana coal plants | 87% | 59% |
| Combined-cycle gas plants | 70% | 96% |

(a) All periods reflect the nine months ending September 30.

This reduction in coal-fired generation output had resulted in a surplus of coal inventory at certain of PPL Energy Supply's Pennsylvania coal plants. To mitigate the risk of exceeding available coal storage, PPL Energy Supply incurred pre-tax charges of \$17 million and \$29 million during the three and nine months ended September 30, 2012 to reduce its 2012 and 2013 contracted coal deliveries. PPL Energy Supply will continue to manage its coal inventory to mitigate the financial impact and physical implications of an oversupply.

In addition, current economic and commodity market conditions indicate a lower value of unhedged future energy margins (primarily in 2014 and forward years) compared to the hedged energy margins in 2012. As has been PPL Energy Supply's practice in periods of changing business conditions, PPL Energy Supply continues to review its future business and operational plans, including capital and operation and maintenance expenditures, as well as its hedging strategies.

PPL's businesses are also subject to extensive federal, state and local environmental laws, rules and regulations. Although PPL Energy Supply's competitive generation assets are well positioned to meet these requirements, certain regulated generation assets at LG&E and KU will require substantial capital investment. See Note 10 to the Financial Statements in this Form 10-Q and Note 15 to the Financial Statements in PPL's 2011 Form 10-K for additional information on these requirements. These requirements have resulted in LKE's anticipated retirement of six coal-fired units with a combined summer capacity rating of 797 MW by 2015. See Notes 6 and 8 to the Financial Statements for additional information regarding the anticipated retirement of these units as well as certain regulatory approvals to build a combined-cycle natural gas facility in Kentucky. In addition, PPL announced in September 2012 its intention, beginning in April 2015, to place its Corette plant in long-term reserve status, suspending the plant's operation due to expected market conditions and the costs to comply with the Mercury and Air Toxics Standards. The Corette plant's carrying value at September 30, 2012 was approximately \$67 million. Although the Corette plant was not determined to be impaired at September 30, 2012, it is reasonably possible that an impairment charge could be recorded in the fourth quarter of 2012 or in future periods, as higher priced sales contracts settle, adversely impacting projected cash flows.

In light of these economic and market conditions, as well as current and projected environmental regulatory requirements, PPL considered whether certain of its other generating assets were impaired, and determined that no impairment charges were required at September 30, 2012. PPL is unable to predict whether future environmental

requirements or market conditions will result in impairment charges for other generating assets or additional retirements.

PPL and its subsidiaries may also be impacted in future periods by the uncertainty in the worldwide financial and credit markets partially caused by the European sovereign debt crisis. In addition, PPL may be impacted by reductions in the credit ratings of financial institutions and evolving regulations in the financial sector. Collectively, these factors could reduce availability or restrict PPL and its subsidiaries' ability to maintain sufficient levels of liquidity, reduce capital market activities, change collateral posting requirements and increase the associated costs to PPL and its subsidiaries.

PPL cannot predict the future impact that these economic and market conditions and regulatory requirements may have on its financial condition or results of operations.

Susquehanna Turbine Blade Inspection

PPL previously announced that a shutdown of Unit 1 of its Susquehanna nuclear power plant in October 2012 will include an inspection of that unit's turbine blades that could lead to the finalization of a plan to resolve the issue of turbine blade cracking that was first identified in 2011. Unit 1 is expected to resume operations by November 8, 2012. PPL plans to take an inspection outage for Unit 2. The projected pre-tax earnings impact of these inspections, including reduced energy-sales margins and possible repair expenses, is estimated in the range of \$43 million to \$58 million (\$26 million to \$35 million, after-tax), and the ultimate financial impact will depend on the duration of the Unit 2 outage.

Ironwood Acquisition

In April 2012, an indirect, wholly owned subsidiary of PPL Energy Supply completed the acquisition of the equity interests in the owner and operator of the Ironwood Facility. The Ironwood Facility began operation in 2001 and, since 2008, PPL EnergyPlus has supplied natural gas for the facility and received the facility's full electricity output and capacity value pursuant to a tolling agreement that expires in 2021. The acquisition provides PPL Energy Supply, through its subsidiaries, operational control of additional combined-cycle gas generation in PJM. See Note 8 to the Financial Statements for additional information.

Bankruptcy of SMGT

In October 2011, SMGT, a Montana cooperative and purchaser of electricity under a long-term supply contract with PPL EnergyPlus expiring in June 2019 (SMGT Contract), filed for protection under Chapter 11 of the U.S. Bankruptcy Code in the U.S. Bankruptcy Court for the District of Montana. At the time of the bankruptcy filing, SMGT was PPL EnergyPlus' largest unsecured credit exposure.

The SMGT Contract provided for fixed volume purchases on a monthly basis at established prices. Pursuant to a court order and subsequent stipulations entered into between the SMGT bankruptcy trustee and PPL EnergyPlus, since the date of its Chapter 11 filing through January 2012, SMGT continued to purchase electricity from PPL EnergyPlus at the price specified in the SMGT Contract, and made timely payments for such purchases, but at lower volumes than as prescribed in the SMGT Contract. In January 2012, the trustee notified PPL EnergyPlus that SMGT would not purchase electricity under the SMGT Contract for the month of February. In March 2012, the U.S. Bankruptcy Court for the District of Montana issued an order approving the request of the SMGT bankruptcy trustee and PPL EnergyPlus to terminate the SMGT Contract. As a result, the SMGT Contract was terminated effective April 1, 2012, allowing PPL EnergyPlus to resell the electricity previously contracted to SMGT under the SMGT Contract to other customers.

PPL EnergyPlus' receivable under the SMGT Contract totaled approximately \$21 million at September 30, 2012, which has been fully reserved.

In July 2012, PPL EnergyPlus filed its proof of claim in the SMGT bankruptcy proceeding. The total claim is approximately \$375 million, predominantly an unsecured claim representing the value for energy sales that will not occur as a result of the termination of the SMGT Contract. No assurance can be given as to the collectability of the claim.

PPL Energy Supply cannot predict any amounts that it may recover in connection with the SMGT bankruptcy or the prices and other terms on which it will be able to market to third parties the power that SMGT will not purchase from PPL EnergyPlus due to the termination of the SMGT Contract.

Tax Litigation

In 1997, the U.K. imposed a Windfall Profits Tax (WPT) on privatized utilities, including WPD. PPL filed its tax returns for years subsequent to its 1997 and 1998 claims for refund on the basis that the U.K. WPT was creditable. In September 2010, the U.S. Tax Court (Tax Court) ruled in PPL's favor in a dispute with the IRS, concluding that the U.K. WPT is a creditable tax for U.S. tax purposes. As a result, and with finalization of other issues, PPL recorded a \$42 million tax benefit in 2010. In January 2011, the IRS appealed the Tax Court's decision to the U.S. Court of Appeals for the Third Circuit (Third Circuit). In December 2011, the Third Circuit issued its opinion reversing the Tax Court's decision, holding that the U.K. WPT is not a creditable tax. As a result of the Third Circuit's adverse determination, PPL recorded a \$39 million expense in the fourth quarter of 2011. In February 2012, PPL filed its petition for rehearing of the Third Circuit's opinion. In March 2012, the Third Circuit denied PPL's petition. In June 2012, the U.S. Court of Appeals for the Fifth Circuit issued a contrary opinion in an identical case involving another company. In July 2012, PPL filed a petition for a writ of certiorari seeking U.S. Supreme Court review of the Third Circuit's opinion. The Supreme Court granted PPL's petition on October 29, 2012, and PPL is assessing what impact, if any, this development will have on its results of operations in the fourth quarter of 2012. PPL

expects the case to be decided before the end of the Supreme Court's current term in June 2013 and cannot predict the outcome of this matter.

Terminated Bluegrass CTs Acquisition

In September 2011, LG&E and KU entered into an asset purchase agreement with Bluegrass Generation for the purchase of the Bluegrass CTs, aggregating approximately 495 MW, plus limited associated contractual arrangements required for operation of the units, for a purchase price of \$110 million, pending receipt of applicable regulatory approvals. In May 2012, the KPSC issued an order approving the request to purchase the Bluegrass CTs. Also, in May 2012, the FERC issued an order conditionally authorizing the acquisition of the Bluegrass CTs, subject to approval by the FERC of satisfactory mitigation measures to address market-power concerns. After a review of potentially available mitigation options, LG&E and KU determined that the options were not commercially justifiable. In June 2012, LG&E and KU terminated the asset purchase agreement for the Bluegrass CTs in accordance with its terms and made applicable filings with the KPSC and FERC. LG&E and KU are currently assessing the impact of the asset purchase agreement termination and potential future generation capacity options.

NGCC Construction

In September 2011, LG&E and KU filed a CPCN with the KPSC requesting approval to build a 640 MW NGCC at the existing Cane Run plant site in Kentucky. In May 2012, the KPSC issued an order approving the request. LG&E and KU commenced preliminary construction activities in the third quarter of 2012 and project construction is expected to be completed by May 2015. The project, which includes building a natural gas supply pipeline and related transmission projects, has an estimated cost of approximately \$600 million.

Hurricane Sandy

In late October 2012, PPL Electric experienced widespread significant damage to its transmission and distribution network from Hurricane Sandy. The total costs associated with the restoration efforts are still being finalized but are estimated to be in excess of \$60 million. PPL Electric has insurance coverage that could cover a portion of the costs incurred from Hurricane Sandy. PPL Electric will have the ability to file a request with the PUC for permission to defer for future recovery certain of the costs incurred to repair the distribution network in excess of the insurance coverage. Costs incurred to repair the transmission network are recoverable through the FERC Formula Rate mechanism which is updated annually.

Regional Transmission Line Expansion Plan

On October 1, 2012, the National Park Service (NPS) issued its Record of Decision (ROD) on the proposed Susquehanna-Roseland transmission line affirming the route chosen by PPL Electric and Public Service Electric & Gas as the preferred alternative under the NPS's National Environmental Policy Act review. On October 15, 2012, a complaint was filed in the United States District Court for the District of Columbia by various environmental groups, including the Sierra Club, challenging the ROD and seeking to prohibit its implementation. Construction activities have begun on portions of the 101-mile route in Pennsylvania. The line is expected to be in service before the peak summer demand period of 2015. The chosen route had previously been approved by the PUC and New Jersey Board of Public Utilities. An appeal of the New Jersey Board of Public Utilities approval is pending before the New Jersey Superior Court Appellate Division. PPL Electric cannot predict the ultimate outcome or timing of any further legal challenges to the project. PJM has developed a strategy to manage potential reliability problems until the line is built. PPL Electric cannot predict what additional actions, if any, PJM might take in the event of a further delay to its scheduled in-service date for the new line.

At September 30, 2012, PPL Electric's estimated share of the project cost was \$560 million, an increase from approximately \$500 million at December 31, 2011, due primarily to increased material costs. See Note 8 in PPL's 2011 Form 10-K for additional information.

On October 9, 2012, the FERC issued an order in response to PPL Electric's December 2011 request for ratemaking incentives for the Northeast/Pocono Reliability project (a new 58-mile 230 kV transmission line, three new substations and upgrades to adjacent facilities). The incentives were specifically tailored to address the risks and challenges PPL Electric will face in building the project. The FERC granted the incentive for inclusion of 100% of prudently incurred construction work in progress (CWIP) costs in rate base and denied the request for a 100 basis point adder to the return on equity incentive. The order requires a follow-up compliance filing from PPL Electric to ensure proper accounting treatment of AFUDC and CWIP for the project. PPL Electric estimates the project costs to be approximately \$180 million.

Legislation - Regulatory Procedures and Mechanisms

In June 2011, the Pennsylvania House Consumer Affairs Committee approved legislation authorizing the PUC to approve regulatory procedures and mechanisms to provide more timely recovery of a utility's costs. In the first quarter of 2012, the Governor signed an amended version of the legislation (Act 11 of 2012), which became effective April 14, 2012. The legislation authorizes the PUC to approve two specific ratemaking mechanisms - a fully projected future test year and, subject to certain conditions, a distribution system improvements charge (DSIC). Such alternative ratemaking procedures and mechanisms are important to PPL Electric as it begins a period of significant capital investment to maintain and enhance the reliability of its delivery system, including the replacement of aging distribution assets. In August 2012, the PUC issued a Final Implementation Order adopting procedures, guidelines and a model tariff for the implementation of Act 11 of 2012. In September 2012, PPL Electric filed its Long Term Infrastructure Improvement Plan (LTIIP) describing projects eligible for inclusion in the DSIC. In October 2012, several parties filed comments to the LTIIP but none of the comments requested evidentiary hearings on the LTIIP. A decision on the LTIIP is expected in January 2013. PPL Electric expects to file a petition requesting permission to establish a DSIC in January 2013 with rates proposed to be effective in April 2013.

FERC Formula Rates

In March 2012, PPL Electric filed a request with the FERC seeking recovery, over a 34-year period beginning in June 2012, of its unrecovered regulatory asset related to the deferred state tax liability that existed at the time of the transition from the flow-through treatment of state income taxes to full normalization. This change in tax treatment occurred in 2008 as a result of prior FERC initiatives that transferred regulatory jurisdiction of certain transmission assets from the PUC to FERC. A regulatory asset of approximately \$50 million related to this transition, classified as taxes recoverable through future rates, is included in "Other Noncurrent Assets - Regulatory assets" on the Balance Sheets at September 30, 2012 and December 31, 2011. In May 2012, the FERC issued an order approving PPL Electric's request effective June 1, 2012.

U.K. Tax Rate Change

In July 2012, the U.K. Finance Act of 2012 (the Act) was enacted. The Act reduced the U.K.'s statutory income tax rate from 25% to 24%, effective April 1, 2012 and from 24% to 23%, effective April 1, 2013. As a result of these changes, PPL recognized a deferred tax benefit of \$74 million in the three and nine months ended September 30, 2012.

Ofgem Review of Line Loss Calculation

WPD has a \$172 million liability recorded at September 30, 2012 compared with \$170 million at December 31, 2011, calculated in accordance with Ofgem's accepted methodology, related to the close-out of line losses for the prior price control period, DPCR4. Ofgem is currently consulting on the methodology to be used by all network operators to calculate the final line loss incentive/penalty for DPCR4. In October 2011, Ofgem issued a consultation paper citing two potential changes to the methodology, both of which would result in a reduction of the liability. In March 2012, Ofgem issued a decision regarding the preferred methodology. In July 2012, Ofgem issued a consultation paper regarding certain aspects of the preferred methodology as it relates to the DPCR4 line loss incentive/penalty and a proposal to delay the target date for making a final decision until April 2013 together with a proposal to remove the line loss incentive/penalty for DPCR5. In October 2012, a license modification was issued to allow Ofgem to publish the final decisions on these matters by April 2013. PPL cannot predict the outcome of this matter.

Equity Forward Contract

In April 2012, PPL made a registered underwritten public offering of 9.9 million shares of its common stock. In conjunction with that offering, the underwriters exercised an option to purchase 591 thousand additional shares of PPL common stock solely to cover over-allotments.

In connection with the registered public offering, PPL entered into forward sale agreements with two counterparties covering the 9.9 million shares of PPL's common stock. Settlement of these initial forward sale agreements will occur no later than April 2013. As a result of the underwriters' exercise of the overallotment option, PPL entered into additional forward sale agreements covering the additional 591 thousand shares of PPL common stock. Settlement of the subsequent forward sale agreements will occur in July 2013.

PPL will not receive any proceeds or issue any shares of common stock until settlement of the forward sale agreements. PPL intends to use any net proceeds that it receives upon settlement to repay short-term debt obligations and for other general corporate purposes.

The forward sale agreements are classified as equity transactions. As a result, no amounts will be recorded in the consolidated financial statements until the settlement of the forward sale agreements. Prior to those settlements, the only impact to the financial statements will be the inclusion of incremental shares within the calculation of diluted EPS using the treasury stock method. See Note 7 to the Financial Statements for additional information.

Redemption of PPL Electric Preference Stock

In June 2012, PPL Electric redeemed all 2.5 million shares of its 6.25% Series Preference Stock, par value \$100 per share. The price paid for the redemption was the par value, without premium (\$250 million in the aggregate). At December 31, 2011, the preference stock was reflected in "Noncontrolling Interests" on PPL's Balance Sheet.

Results of Operations

The following discussion provides a review of results by reportable segment and a description of factors by segment expected to impact future earnings. This section ends with "Statement of Income Analysis," which includes explanations of significant changes in principal items on PPL's Statements of Income, comparing the three and nine months ended September 30, 2012 with the same periods in 2011.

On April 1, 2011, PPL, through its subsidiary PPL WEM, completed its acquisition of WPD Midlands. As PPL consolidates WPD Midlands on a one-month lag, consistent with its accounting policy on consolidation of foreign subsidiaries, PPL's 2011 results for the nine-month period include five months of WPD Midlands' results. When discussing PPL's results of operations for 2012 compared with 2011, the results of WPD Midlands for both the three and nine-month periods (which includes PPL WEM for this purpose) are isolated for purposes of comparability. Significant drivers, if any, are disclosed for the comparable three-month periods. WPD Midlands' results are included within the U.K. Regulated segment (formerly the International Regulated segment, renamed in 2012). See Note 8 to the Financial Statements for additional information regarding the acquisition.

The results for interim periods can be disproportionately influenced by numerous factors and developments and by seasonal variations. As such, the results of operations for interim periods do not necessarily indicate results or trends for the year or future periods.

Tables analyzing changes in amounts between periods within "Segment Results" and "Statement of Income Analysis" are presented on a constant U.K. foreign currency exchange rate basis, where applicable, in order to isolate the impact of the change in the exchange rate on the item being explained. Results computed on a constant U.K. foreign currency exchange rate basis are calculated by translating current year results at the prior year weighted-average U.K. foreign currency exchange rate.

Segment Results

Kentucky Regulated Segment

The Kentucky Regulated segment consists primarily of LKE's results from the operation of regulated electricity generation, transmission and distribution assets, primarily in Kentucky, as well as in Virginia and Tennessee. This segment also includes LKE's results from the regulated distribution and sale of natural gas in Kentucky.

Net Income Attributable to PPL Shareowners for the periods ended September 30 includes the following results:

| | Three Months | | Nine Months | |
|--|--------------|------|-------------|------|
| | 2012 | 2011 | 2012 | 2011 |

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| | | | % | | | % |
|--|--------|--------|--------|----------|----------|--------|
| | | | Change | | | Change |
| Utility revenues | \$ 732 | \$ 736 | (1) | \$ 2,095 | \$ 2,140 | (2) |
| Fuel | 249 | 245 | 2 | 677 | 666 | 2 |
| Energy purchases | 27 | 32 | (16) | 135 | 179 | (25) |
| Other operation and maintenance | 186 | 187 | (1) | 589 | 566 | 4 |
| Depreciation | 87 | 84 | 4 | 259 | 249 | 4 |
| Taxes, other than income | 11 | 10 | 10 | 34 | 28 | 21 |
| Total operating expenses | 560 | 558 | | 1,694 | 1,688 | |
| Other Income (Expense) - net | (4) | | n/a | (14) | (1) | 1,300 |
| Interest Expense (a) | 54 | 53 | 2 | 163 | 161 | 1 |
| Income Taxes | 42 | 46 | (9) | 70 | 105 | (33) |
| Income (Loss) from Discontinued Operations | | (1) | (100) | (6) | (1) | 500 |
| Net Income Attributable to PPL Shareowners | \$ 72 | \$ 78 | (8) | \$ 148 | \$ 184 | (20) |

(a) Includes allocated interest expense of \$17 million and \$51 million for the three and nine months ended September 30, 2012 and \$17 million and \$53 million for the three and nine months ended September 30, 2011 related to the 2010 Equity Units and interest rate swaps.

The changes in the components of the Kentucky Regulated segment's results between these periods were due to the following factors, which reflect reclassifications for items included in gross margins and certain items that management considers special. See additional detail of these special items in the table below.

| | Three Months | Nine Months |
|---------------------------------|-----------------|-------------|
| Kentucky gross margins | \$ (4) | \$ (22) |
| Other operation and maintenance | 3 | (12) |
| Depreciation | (2) | (8) |
| Taxes, other than income | (1) | (6) |
| Other Income (Expense) - net | (4) | (13) |
| Other | (2) | (3) |
| Income Taxes | 4 | 29 |
| Special items, after-tax | | (1) |
| Total | \$ (6) | \$ (36) |

- See "Statement of Income Analysis - Margins - Changes in Non-GAAP Financial Measures" for an explanation of Kentucky Gross Margins.
- Higher other operation and maintenance for the nine-month period, primarily due to \$12 million of higher coal plant maintenance costs resulting from an increased scope of scheduled plant outages.
- Higher depreciation for the nine-month period, primarily due to PP&E additions.
- Higher taxes, other than income for the nine-month period, primarily due to an increase in property taxes resulting from property additions, higher assessed values, and changes in property classifications to categories with higher tax rates.
- Lower other income (expense) - net for the nine-month period, primarily due to losses from an equity method investment.
- Lower income taxes for the nine-month period, primarily due to lower pre-tax income.

The following after-tax gains (losses), which management considers special items, also impacted the Kentucky Regulated segment's results during the periods ended September 30.

| | Income Statement Line Item | Three Months 2012 | 2011 | Nine Months 2012 | 2011 |
|--|-------------------------------|----------------------|------|---------------------|------|
| Adjusted energy-related economic activity, net, net of tax of \$0, (\$1), \$0, \$0 | Utility Revenues | \$ | 1 | | \$ 1 |
| LKE acquisition-related adjustments: | | | | | |
| Net operating loss carryforward and other tax-related adjustments | Income Taxes and Other O&M | | | \$ | 4 |

Other:

| | | | | | |
|-------|--|------------------|-----|-----|-----|
| | LKE discontinued operations, net of tax of \$0, \$1, \$4, \$0 (a) | Disc. Operations | (1) | (5) | (1) |
| Total | | | \$ | (1) | |

(a) The nine months ended September 30, 2012 includes an adjustment to an indemnification liability.

Outlook

Excluding special items, PPL projects lower segment earnings in 2012 compared with 2011, primarily driven by higher other operation and maintenance expense, higher depreciation, higher property taxes and losses from an equity method investment.

In June 2012, LG&E and KU filed requests with the KPSC for increases in annual base electric rates of approximately \$62 million at LG&E and approximately \$82 million at KU and an increase in annual base gas rates of approximately \$17 million at LG&E. The proposed base rate increases would result in electric rate increases of 6.9% at LG&E and 6.5% at KU and a gas rate increase of 7.0% at LG&E and would be effective in January 2013. LG&E's and KU's applications include requests for authorized returns-on-equity at LG&E and KU of 11% each. In November 2012, the KPSC issued an order for a settlement conference to begin on November 13, 2012. A hearing on the original application and subsequent testimony is scheduled to begin on November 27, 2012. LG&E and KU cannot predict the outcome of these proceedings, including the possibility of any agreed stipulations or settlement, which would remain subject to KPSC approval. A final order may be issued in December 2012 or January 2013.

Earnings in 2012 and future periods are subject to various risks and uncertainties. See "Forward-Looking Information," the rest of this Item 2 and Notes 6 and 10 to the Financial Statements in this Form 10-Q and "Item 1. Business" and "Item 1A. Risk Factors" in PPL's 2011 Form 10-K for a discussion of the risks, uncertainties and factors that may impact future earnings.

U.K. Regulated Segment

The U.K. Regulated segment consists primarily of the electric distribution operations of WPD in the U.K.

Net Income Attributable to PPL Shareowners for the periods ended September 30 includes the following results:

| | Three Months | | | Nine Months | | |
|--|--------------|--------|-------------|-------------|--------|-------------|
| | 2012 | 2011 | % Change | 2012 | 2011 | % Change |
| Utility revenues | \$ 207 | \$ 194 | 7 | \$ 644 | \$ 613 | 5 |
| Energy-related businesses | 9 | 8 | 13 | 27 | 27 | |
| Total operating revenues | 216 | 202 | 7 | 671 | 640 | 5 |
| Other operation and maintenance | 52 | 45 | 16 | 159 | 136 | 17 |
| Depreciation | 32 | 32 | | 96 | 94 | 2 |
| Taxes, other than income | 13 | 14 | (7) | 39 | 40 | (3) |
| Energy-related businesses | 5 | 4 | 25 | 16 | 12 | 33 |
| Total operating expenses | 102 | 95 | 7 | 310 | 282 | 10 |
| Other Income (Expense) - net | (49) | 10 | (590) | (39) | 13 | (400) |
| Interest Expense (a) | 45 | 47 | (4) | 138 | 145 | (5) |
| Income Taxes | (34) | (14) | 143 | 6 | 14 | (57) |
| WPD Midlands, net of tax (b) | 151 | 118 | 28 | 392 | 183 | 114 |
| WPD Midlands acquisition-related adjustments, net of tax | (3) | (64) | (95) | (7) | (164) | (96) |
| Net Income Attributable to PPL Shareowners | \$ 202 | \$ 138 | 46 | \$ 563 | \$ 231 | 144 |

- (a) Includes allocated interest expense of \$12 million and \$35 million for the three and nine months ended September 30, 2012 and \$12 million and \$26 million for the three and nine months ended September 30, 2011, primarily related to the 2011 Equity Units.
- (b) The nine months ended September 30, 2011 represent the results of operations of WPD Midlands for the period from the April 1, 2011 acquisition date through September 30, 2011, recorded on a one month lag. These amounts exclude acquisition-related adjustments. WPD Midlands' revenue from external customers was \$312 million and \$976 million for the three and nine months ended September 30, 2012 and \$292 million and \$499 million for the three and nine months ended September 30, 2011 (pre-tax).

The changes in the components of the U.K. Regulated segment's results between these periods were due to the following factors, which reflect reclassifications for certain items that management considers special. See additional detail of these special items in the table below. The amounts for PPL WW and WPD Midlands are presented on a constant U.K. foreign currency exchange rate basis in order to isolate the impact of the change in the exchange rate.

| | |
|-----------------|----------------|
| Three Months | Nine Months |
|-----------------|----------------|

PPL WW

| | | | | | |
|--|---------------------------------|----|-----|----|------|
| | Utility revenues | \$ | 20 | \$ | 47 |
| | Other operation and maintenance | | (6) | | (24) |
| | Interest expense | | 2 | | 13 |
| | Other | | (3) | | (5) |
| | Income taxes | | 4 | | 8 |
| WPD Midlands, after-tax | | | 29 | | 214 |
| U.S. | | | | | |
| | Interest expense and other | | | | (15) |
| | Income taxes | | (3) | | (17) |
| Foreign currency exchange rates, after-tax (a) | | | (7) | | (15) |
| Special items, after-tax | | | 28 | | 126 |
| Total | | \$ | 64 | \$ | 332 |

(a) Includes the effect of realized gains/(losses) on foreign currency economic hedges.

PPL WW

- Higher utility revenues for the three-month period due to the April 1, 2012 price increase which resulted in \$14 million of higher utility revenues and \$3 million of lower regulatory recovery in 2011.

Higher utility revenues for the nine-month period due to the April 1, 2011 and 2012 price increases which resulted in \$69 million of higher utility revenues, partially offset by \$17 million of lower volumes due primarily to a downturn in the economy and the unfavorable effect of weather, and \$8 million of lower regulatory recovery due to a 2012 charge to income for the over-recovery of revenues from customers.

- Higher other operation and maintenance for the nine-month period primarily due to \$15 million of higher pension expense resulting from an increase in amortization of actuarial losses and \$8 million of higher network maintenance expense.
- Lower interest expense for the nine-month period due to \$11 million of lower interest expense on index-linked notes.
- Lower income taxes for the three-month period primarily due to an income tax benefit related to the tax deductibility of interest on acquisition financing.

Lower income taxes for the nine-month period primarily due to a \$13 million income tax benefit related to the tax deductibility of interest on acquisition financing, partially offset by higher income taxes of \$8 million arising from higher pre-tax income.

WPD Midlands

- Higher earnings for the three-month period due to the April 1, 2012 price increase, which resulted in \$32 million of higher utility revenues.
- The nine-month period ended September 30, 2012 is not comparable to 2011 as 2011 includes only five months of WPD Midlands' results.

U.S.

- Higher interest expense and other for the nine-month period due to \$13 million of higher interest expense associated with the 2011 Equity Units issued to finance the WPD Midlands acquisition due to 2012 including nine months of interest expense compared to five months in 2011.
- Higher income taxes for the nine-month period due to \$21 million of income tax benefits recorded in 2011 as a result of U.K. pension plan contributions.

Foreign Currency Exchange Rates

- Changes in foreign currency exchange rates negatively affected earnings for the three and nine-month periods. The weighted-average exchange rates for British pound sterling, including the effects of foreign currency economic hedges, were approximately \$1.57 in 2012 and \$1.63 in 2011 for the three-month period and \$1.58 in 2012 and \$1.61 in 2011 for the nine-month period.

The following after-tax gains (losses), which management considers special items, also impacted the U.K. Regulated segment's results during the periods ended September 30.

| | Income Statement Line Item | Three Months 2012 | 2011 | Nine Months 2012 | 2011 |
|--|----------------------------------|----------------------|------|---------------------|------|
| Foreign currency-related economic hedges, net of tax of \$18, (\$3), Other \$17, (\$4) (a) | Income-net | \$ (30) | \$ 8 | \$ (28) | \$ 8 |
| WPD Midlands acquisition-related adjustments: | | | | | |
| 2011 Bridge Facility costs, net of tax of \$0, \$0, \$0, \$13 (b) | Interest Expense | | | | (30) |

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| | | | | | | |
|--|---------------------|-------|-------|-------|--|---------|
| Foreign currency loss on 2011 Bridge Facility, net of tax of \$0, \$0, \$0, \$19 (c) | Other Income-net | | | | | (38) |
| Net hedge gains, net of tax of \$0, \$0, \$0, (\$17) (c) | Other Income-net | | | | | 38 |
| Hedge ineffectiveness, net of tax of \$0, \$0, \$0, \$3 (d) | Interest Expense | | | | | (9) |
| U.K. stamp duty tax, net of tax of \$0, \$0, \$0, \$0 (e) | Other Income-net | | | | | (21) |
| Separation benefits, net of tax of \$1, \$22, \$3, \$24 (Note 8) | Other O&M | (1) | (64) | (9) | | (68) |
| Other acquisition-related adjustments, net of tax of \$0, (\$2), (\$1), \$9 | (f) | (2) | | 2 | | (36) |
| Other: | | | | | | |
| Change in U.K. tax rate (g) | Income Taxes | 74 | 69 | 74 | | 69 |
| Total | | \$ 41 | \$ 13 | \$ 39 | | \$ (87) |

(a) Represents unrealized gains (losses) on contracts that economically hedge anticipated earnings denominated in GBP.

(b) Represents fees incurred in connection with establishing the 2011 Bridge Facility.

(c) Represents the foreign currency loss on the repayment of the 2011 Bridge Facility, including a pre-tax foreign currency loss of \$15 million associated with proceeds received on the U.S. dollar-denominated senior notes issued by PPL WEM in April 2011 that were used to repay a portion of PPL WEM's borrowing under the 2011 Bridge Facility. The foreign currency risk was economically hedged with forward contracts to purchase GBP, which resulted in pre-tax gains of \$55 million. See Note 14 to the Financial Statements for additional information.

(d) Represents a combination of ineffectiveness associated with closed out interest rate swaps and a charge recorded as a result of certain interest rate swaps failing hedge effectiveness testing.

(e) Tax on the transfer of ownership of property in the U.K. which is not tax deductible for income tax purposes.

- (f) The nine months ended September 30, 2011 primarily includes \$36 million, pre-tax, of advisory, accounting and legal fees which are reflected in "Other Income (Expense) - net" on the Statements of Income. In addition, \$9 million, pre-tax, of costs were recorded to "Other operation and maintenance" on the Statements of Income.
- (g) The U.K. Finance Act of 2011, enacted in July 2011, reduced the U.K. statutory income tax rate from 27% to 26% retroactive to April 1, 2011 and from 26% to 25% effective April 1, 2012. The U.K. Finance Act of 2012, enacted in July 2012, reduced the U.K. statutory income tax rate from 25% to 24% retroactive to April 1, 2012 and from 24% to 23% effective April 1, 2013. As a result, PPL reduced its net deferred tax liability and recognized a deferred tax benefit in the three and nine-month periods of 2012 and 2011. WPD Midlands' portion of the deferred tax benefit was \$42 million for both periods in 2012 and \$35 million for both periods in 2011.

Outlook

Excluding special items, PPL projects higher segment earnings in 2012 compared with 2011, primarily driven by four additional months of earnings from WPD Midlands and higher electricity delivery revenue. Partially offsetting these positive earnings drivers are higher other operation and maintenance expense, higher depreciation, higher interest expense, higher income taxes and a less favorable currency exchange rate.

Earnings in 2012 and future periods are subject to various risks and uncertainties. See "Forward-Looking Information," the rest of this Item 2 and Notes 6 and 10 to the Financial Statements in this Form 10-Q and "Item 1. Business" and "Item 1A. Risk Factors" in PPL's 2011 Form 10-K for a discussion of the risks, uncertainties and factors that may impact future earnings.

Pennsylvania Regulated Segment

The Pennsylvania Regulated segment includes the regulated electric delivery operations of PPL Electric.

Net Income Attributable to PPL Shareowners for the periods ended September 30 includes the following results:

| | Three Months | | | Nine Months | | |
|---|--------------|--------|-------------|-------------|----------|-------------|
| | 2012 | 2011 | % Change | 2012 | 2011 | % Change |
| Operating revenues | | | | | | |
| External | \$ 443 | \$ 454 | (2) | \$ 1,303 | \$ 1,444 | (10) |
| Intersegment | 1 | 1 | | 3 | 9 | (67) |
| Total operating revenues | 444 | 455 | (2) | 1,306 | 1,453 | (10) |
| Energy purchases | | | | | | |
| External | 137 | 171 | (20) | 410 | 591 | (31) |
| Intersegment | 23 | 5 | 360 | 61 | 15 | 307 |
| Other operation and maintenance | 148 | 146 | 1 | 431 | 402 | 7 |
| Depreciation | 41 | 38 | 8 | 119 | 108 | 10 |
| Taxes, other than income | 24 | 26 | (8) | 72 | 83 | (13) |
| Total operating expenses | 373 | 386 | (3) | 1,093 | 1,199 | (9) |
| Other Income (Expense) - net | 3 | 3 | | 6 | 4 | 50 |
| Interest Expense | 25 | 26 | (4) | 73 | 74 | (1) |
| Income Taxes | 16 | 14 | 14 | 47 | 56 | (16) |
| Net Income | 33 | 32 | 3 | 99 | 128 | (23) |
| Net Income Attributable to Noncontrolling Interests | | 4 | (100) | 4 | 12 | (67) |
| | \$ 33 | \$ 28 | 18 | \$ 95 | \$ 116 | (18) |

Net Income Attributable to PPL
Shareowners

The changes in the components of the Pennsylvania Regulated segment's results between these periods were due to the following factors, which reflect reclassifications for items included in gross delivery margins.

| | Three Months | Nine Months |
|-------------------------------------|-----------------|-------------|
| Pennsylvania gross delivery margins | \$ 11 | \$ 1 |
| Other operation and maintenance | (7) | (32) |
| Depreciation | (3) | (11) |
| Other | 2 | 4 |
| Income Taxes | (2) | 9 |
| Noncontrolling Interests | 4 | 8 |
| Total | \$ 5 | \$ (21) |

- See "Statement of Income Analysis - Margins - Changes in Non-GAAP Financial Measures" for an explanation of Pennsylvania Gross Delivery Margins.
- Higher other operation and maintenance for the three-month period, primarily due to \$9 million of higher payroll-related costs, \$2 million of higher vegetation management costs and \$2 million of higher corporate service costs, partially offset by \$6 million of lower PUC-reportable storm costs.

Higher other operation and maintenance for the nine-month period, primarily due to \$16 million of higher payroll-related costs, \$10 million of higher vegetation management costs, \$7 million of higher corporate service costs and \$4 million of higher contractor costs, partially offset by \$13 million of lower PUC-reportable storm costs.

- Higher depreciation for the nine-month period, primarily due to the impact of PP&E additions related to the ongoing efforts to ensure the reliability of the delivery system and replace aging infrastructure.
- Lower income taxes for the nine-month period, primarily due to lower pre-tax income.
- Lower noncontrolling interests for the three and nine-month periods due to the preference stock redemption in June 2012.

Outlook

PPL projects lower segment earnings in 2012 compared with 2011, primarily driven by higher other operation and maintenance expense, higher depreciation and lower distribution revenue, which are expected to be partially offset by higher transmission revenue, lower financing costs, and lower income taxes.

In March 2012, PPL Electric filed a request with the PUC to increase distribution rates by approximately \$105 million effective January 1, 2013. The proposed distribution rate increase would result in a 2.9% increase over PPL Electric's total rates at the time of the request. PPL Electric's application includes a request for an authorized return-on-equity of 11.25%. On October 19, 2012, the presiding Administrative Law Judge (ALJ) issued a decision recommending a rate increase of approximately \$64 million, which represents an allowed return on equity of 9.74%. Exceptions to the ALJ's recommendation are due November 8, 2012. PPL Electric expects to file exceptions, together with certain other parties, to the ALJ's recommended decision. The PUC, which is expected to issue its order on the rate request in December 2012, can accept, reject or modify the ALJ's recommendation. PPL cannot predict the outcome of this proceeding.

Earnings in 2012 and future periods are subject to various risks and uncertainties. See "Forward-Looking Information," the rest of this Item 2 and Notes 6 and 10 to the Financial Statements in this Form 10-Q and "Item 1. Business" and "Item 1A. Risk Factors" in PPL's 2011 Form 10-K for a discussion of the risks, uncertainties and factors that may impact future earnings.

Supply Segment

The Supply segment primarily consists of the energy marketing and trading activities, as well as the competitive generation and development operations of PPL Energy Supply.

Net Income Attributable to PPL Shareowners for the periods ended September 30 includes the following results:

| | Three Months | | | Nine Months | | |
|---------------------------|--------------|----------|-------------|-------------|----------|-------------|
| | 2012 | 2011 | % Change | 2012 | 2011 | % Change |
| Energy revenues | | | | | | |
| External (a) | \$ 567 | \$ 1,305 | (57) | \$ 3,673 | \$ 3,437 | 7 |
| Intersegment | 23 | 5 | 360 | 61 | 15 | 307 |
| Energy-related businesses | 133 | 132 | 1 | 346 | 360 | (4) |
| Total operating revenues | 723 | 1,442 | (50) | 4,080 | 3,812 | 7 |
| Fuel (a) | 321 | 358 | (10) | 728 | 826 | (12) |

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| | | | | | | | |
|---------------------------------|-------|--------|-------|--------|--------|-------|--|
| Energy purchases | | | | | | | |
| External (a) | (150) | 335 | (145) | 1,288 | 746 | 73 | |
| Intersegment | 1 | 2 | (50) | 2 | 3 | (33) | |
| Other operation and maintenance | 215 | 191 | 13 | 750 | 707 | 6 | |
| Depreciation | 81 | 66 | 23 | 229 | 194 | 18 | |
| Taxes, other than income | 19 | 18 | 6 | 54 | 49 | 10 | |
| Energy-related businesses | 129 | 131 | (2) | 339 | 356 | (5) | |
| Total operating expenses | 616 | 1,101 | (44) | 3,390 | 2,881 | 18 | |
| Other Income (Expense) - net | 6 | 22 | (73) | 15 | 41 | (63) | |
| Other-Than-Temporary | | | | | | | |
| Impairments | | 5 | (100) | 1 | 6 | (83) | |
| Interest Expense | 62 | 59 | 5 | 163 | 159 | 3 | |
| Income Taxes | 3 | 99 | (97) | 180 | 299 | (40) | |
| Income (Loss) from Discontinued | | | | | | | |
| Operations | | 1 | (100) | | 3 | (100) | |
| Net Income | 48 | 201 | (76) | 361 | 511 | (29) | |
| Net Income Attributable to | | | | | | | |
| Noncontrolling Interests | | 1 | (100) | | 1 | (100) | |
| Net Income Attributable to PPL | | | | | | | |
| Shareowners | \$ 48 | \$ 200 | (76) | \$ 361 | \$ 510 | (29) | |

(a) Includes the impact from energy-related economic activity. See "Commodity Price Risk (Non-trading) - Economic Activity" in Note 14 to the Financial Statements for additional information.

The changes in the components of the Supply segment's results between these periods were due to the following factors, which reflect reclassifications for items included in unregulated gross energy margins and certain items that management considers special. See additional detail of these special items in the table below.

| | Three Months | Nine Months |
|------------------------------------|-----------------|-------------|
| Unregulated gross energy margins | \$ (38) | \$ (125) |
| Other operation and maintenance | (23) | (42) |
| Depreciation | (15) | (35) |
| Other Income (Expense) - net | (18) | (30) |
| Other | 7 | 1 |
| Income Taxes | 33 | 106 |
| Discontinued operations, after-tax | (1) | 2 |
| Special items, after-tax | (97) | (26) |
| Total | \$ (152) | \$ (149) |

- See "Statement of Income Analysis - Margins - Changes in Non-GAAP Financial Measures" for an explanation of Unregulated Gross Energy Margins.
 - Higher other operation and maintenance for the three-month period due to \$8 million of higher costs at PPL Susquehanna, \$7 million due to a planned outage at PPL Brunner Island in September 2012 and \$4 million of higher costs from Ironwood as a result of the acquisition.
- Higher other operation and maintenance for the nine-month period primarily due to \$27 million of higher costs at PPL Susquehanna including refueling outage costs, payroll-related costs and timing of projects and \$13 million of higher costs from Ironwood as a result of the acquisition.
- Higher depreciation for the three and nine-month periods due to the impact of PP&E additions, and \$7 million and \$11 million due to the Ironwood Acquisition.
 - Lower other income (expense) - net for the three and nine-month periods primarily due to a \$22 million gain on the redemption of debt in the third quarter of 2011.
 - Lower income taxes for the three-month period primarily due to lower pre-tax income.

Lower income taxes for the nine-month period due to lower pre-tax income, which reduced income taxes by \$73 million, \$15 million of net deferred tax benefits from state tax adjustments recorded in 2012 and \$11 million of Pennsylvania net operating loss valuation allowance adjustments recorded in 2011, driven primarily by the impact of bonus depreciation.

The following after-tax gains (losses), which management considers special items, also impacted the Supply segment's results during the periods ended September 30.

| Income Statement | Three Months | Nine Months |
|---------------------|--------------|-------------|
|---------------------|--------------|-------------|

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| | Line Item | 2012 | 2011 | 2012 | 2011 |
|---|---------------------|-----------------|---------------|-------------|--------------|
| Adjusted energy-related economic activity, net, net of tax of \$63, \$8, (\$16), (\$2) | (a) | \$ (95) | \$ (10) | \$ 23 | \$ 4 |
| Impairments: | | | | | |
| Emission allowances, net of tax of \$0, \$0, \$0, \$1 | Other O&M | | | | (1) |
| Renewable energy credits, net of tax of \$0, \$0, \$0, \$2 | Other O&M | | | | (3) |
| Adjustments - nuclear decommissioning trust investments, net of tax of \$0, \$2, (\$2), \$2 | Other Income-net | | (1) | 1 | |
| LKE acquisition-related adjustments: | | | | | |
| Sale of certain non-core generation facilities, net of tax of \$0, \$0, \$0, \$0 | Disc. Operations | | | | (2) |
| Other: | | | | | |
| Montana hydroelectric litigation, net of tax of \$0, \$0, \$0, \$1 | Interest Expense | | (1) | | (2) |
| Litigation settlement - spent nuclear fuel storage, net of tax of \$0, (\$2), \$0, (\$23) (b) | Fuel | | 4 | | 33 |
| Counterparty bankruptcy, net of tax of \$0, \$0, \$5, \$0 (c) | Other O&M | | | (6) | |
| Wholesale supply cost reimbursement, net of tax of \$0, \$0, \$0, \$0 | (d) | | | 1 | |
| Ash basin leak remediation adjustment, net of tax of \$0, \$0, (\$1), \$0 | Other O&M | | | 1 | |
| Coal contract modification payments, net of tax of \$7, \$0, \$12, \$0 (e) | Fuel | (10) | | (17) | |
| Total | | \$ (105) | \$ (8) | \$ 3 | \$ 29 |

- (a) See "Reconciliation of Economic Activity" below.
- (b) In May 2011, PPL Susquehanna entered into a settlement agreement with the U.S. Government relating to PPL Susquehanna's lawsuit, seeking damages for the DOE's failure to accept spent nuclear fuel from the PPL Susquehanna plant. PPL Susquehanna recorded credits to fuel expense to recognize recovery, under the settlement agreement, of certain costs to store spent nuclear fuel at the Susquehanna plant. The amounts recorded through September 2011 cover the costs incurred from 1998 through December 2010.
- (c) In October 2011, a wholesale customer, SMGT, filed for bankruptcy protection under Chapter 11 of the U.S. Bankruptcy code. In 2012, PPL EnergyPlus recorded an additional allowance for unpaid amounts under the long-term power contract. In March 2012, the U.S. Bankruptcy Court for the District of Montana approved the request to terminate the contract, effective April 1, 2012.
- (d) Recorded in "Wholesale energy marketing - Realized" on the Statement of Income.
- (e) As a result of lower electricity and natural gas prices, coal unit utilization has decreased. Contract modification payments were incurred to reduce 2012 and 2013 contracted coal deliveries.

Reconciliation of Economic Activity

The following table reconciles unrealized pre-tax gains (losses) for the periods ended September 30, from the table within "Commodity Price Risk (Non-trading) - Economic Activity" in Note 14 to the Financial Statements to the special item identified as "Adjusted energy-related economic activity, net."

| | Three Months | | Nine Months | |
|---|--------------|---------|-------------|------|
| | 2012 | 2011 | 2012 | 2011 |
| Operating Revenues | | | | |
| Unregulated retail electric and gas | \$ (13) | \$ 4 | \$ (15) | \$ 9 |
| Wholesale energy marketing | (716) | 216 | (322) | 229 |
| Operating Expenses | | | | |
| Fuel | 3 | (28) | (11) | (16) |
| Energy Purchases | 569 | (176) | 420 | (49) |
| Energy-related economic activity (a) | (157) | 16 | 72 | 173 |
| Option premiums (b) | | 6 | 1 | 17 |
| Adjusted energy-related economic activity | (157) | 22 | 73 | 190 |
| Less: Economic activity realized, associated with the monetization of | | | | |
| certain full-requirement sales contracts in 2010 | 1 | 40 | 34 | 184 |
| Adjusted energy-related economic activity, net, pre-tax | \$ (158) | \$ (18) | \$ 39 | \$ 6 |
| Adjusted energy-related economic activity, net, after-tax | \$ (95) | \$ (10) | \$ 23 | \$ 4 |

- (a) See Note 14 to the Financial Statements for additional information.
- (b) Adjustment for the net deferral and amortization of option premiums over the delivery period of the item that was hedged or upon realization. Option premiums are recorded in "Wholesale energy marketing - Realized" and "Energy purchases - Realized" on the Statements of Income.

Outlook

Excluding special items, PPL projects lower segment earnings in 2012 compared with 2011. The decrease is primarily driven by lower energy margins as a result of lower energy and capacity prices and lower generation volumes, higher other operation and maintenance expense and higher depreciation.

Earnings in 2012 and future periods are subject to various risks and uncertainties. See "Forward-Looking Information," the rest of this Item 2 and Note 10 to the Financial Statements in this Form 10-Q and "Item 1. Business" and "Item 1A. Risk Factors" in PPL's 2011 Form 10-K for a discussion of the risks, uncertainties and factors that may impact future earnings.

Statement of Income Analysis --

Margins

Non-GAAP Financial Measures

The following discussion includes financial information prepared in accordance with GAAP, as well as three non-GAAP financial measures: "Kentucky Gross Margins," "Pennsylvania Gross Delivery Margins" and "Unregulated Gross Energy Margins." These measures are not intended to replace "Operating Income," which is determined in accordance with GAAP, as an indicator of overall operating performance. Other companies may use different measures to analyze and to report on the results of their operations. PPL believes that these measures provide additional criteria to make investment decisions. These performance measures are used, in conjunction with other information, internally by senior management and the Board of Directors to manage the Kentucky Regulated, Pennsylvania Regulated and Supply segment operations, analyze each respective segment's actual results compared with budget and, in certain cases, to measure certain corporate financial goals used in determining variable compensation.

PPL's three non-GAAP financial measures include:

- "Kentucky Gross Margins" is a single financial performance measure of the Kentucky Regulated segment's electricity generation, transmission and distribution operations as well as its distribution and sale of natural gas. In calculating this measure, utility revenues and expenses associated with approved cost recovery tracking mechanisms are offset. Certain costs associated with these mechanisms, primarily ECR and DSM, are recorded as "Other operation and maintenance" and "Depreciation." These mechanisms allow for recovery of certain expenses, returns on capital investments and performance incentives. As a result, this measure represents the net revenues from the Kentucky Regulated segment's operations.
- "Pennsylvania Gross Delivery Margins" is a single financial performance measure of the Pennsylvania Regulated segment's electric delivery operations, which includes transmission and distribution activities. In calculating this measure, utility revenues and expenses associated with approved recovery mechanisms, including energy provided as a PLR, are offset with minimal impact on earnings. Costs associated with these mechanisms are recorded in "Energy purchases," "Other operation and maintenance," which is primarily Act 129 costs, and "Taxes, other than income," which is primarily gross receipts tax. This performance measure includes PLR energy purchases by PPL Electric from PPL EnergyPlus, which are reflected in "PLR intersegment utility revenue (expense)" in the table below. As a result, this measure represents the net revenues from the Pennsylvania Regulated segment's electric delivery operations.
- "Unregulated Gross Energy Margins" is a single financial performance measure of the Supply segment's competitive energy non-trading and trading activities. In calculating this measure, the Supply segment's energy revenues, which include operating revenues associated with certain Supply segment businesses that are classified as discontinued operations, are offset by the cost of fuel, energy purchases, certain other operation and maintenance expenses, primarily ancillary charges, gross receipts tax, which is recorded in "Taxes, other than income," and operating expenses associated with certain Supply segment businesses that are classified as discontinued operations. This performance measure is relevant to PPL due to the volatility in the individual revenue and expense lines on the Statements of Income that comprise "Unregulated Gross Energy Margins." This volatility stems from a number of factors, including the required netting of certain transactions with ISOs and significant swings in unrealized gains and losses. Such factors could result in gains or losses being recorded in either "Wholesale energy marketing" or "Energy purchases" on the Statements of Income. This performance measure includes PLR revenues from energy sales to PPL Electric by PPL EnergyPlus, which are reflected in "PLR intersegment utility revenue (expense)" in the table below. PPL excludes from "Unregulated Gross Energy Margins" the Supply segment's adjusted energy-related economic activity, which includes the changes in fair value of positions used to economically hedge a portion of the economic value of PPL's competitive generation assets, full-requirement sales contracts and retail activities. This economic value is subject to changes in fair value due to market price volatility of the input and output commodities (e.g., fuel and power) prior to the delivery period that was hedged. Also included in adjusted energy-related economic activity is the ineffective portion of qualifying cash flow hedges, the monetization of certain full-requirement sales contracts and premium amortization associated with options. This economic activity is deferred, with the exception of the full-requirement sales contracts that were monetized, and included in unregulated gross energy margins over the delivery period that was hedged or upon realization.

Reconciliation of Non-GAAP Financial Measures

The following tables reconcile "Operating Income" to PPL's three non-GAAP financial measures for the periods ended September 30.

2012 Three Months
Unregulated

2011 Three Months
Unregulated

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| | PA | | | | PA | | | | |
|--|----------|----------|-----------|------------|----------|----------|-----------|-----------|---------------------|
| | Kentucky | Gross | Gross | | Kentucky | Gross | Gross | | Operating |
| | Gross | Delivery | Energy | Operating | Gross | Delivery | Energy | Operating | Income |
| | Margins | Margins | Margins | Income | Margins | Margins | Margins | Income | Income |
| | | | Other (a) | (b) | | | Other (a) | (b) | |
| Operating Revenues | | | | | | | | | |
| Utility | \$ 732 | \$ 443 | | \$ 518 (c) | \$ 1,693 | \$ 734 | \$ 454 | | \$ 487 (c) \$ 1,675 |
| PLR intersegment utility revenue (expense) (d) | | (23) | \$ 23 | | | (5) | \$ 5 | | |
| Unregulated retail electric and gas | | | 232 | (14)(g) | 218 | | 186 | 3 (g) | 189 |
| Wholesale energy marketing | | | | | | | | | |
| Realized | | | 1,074 | 2 (f) | 1,076 | | 897 | 10 (f) | 907 |
| Unrealized economic activity | | | | (716)(g) | (716) | | | 216 (g) | 216 |
| Net energy trading margins | | | (11) | | (11) | | (7) | | (7) |
| Energy-related businesses | | | | 143 | 143 | | | 140 | 140 |
| Total Operating Revenues | 732 | 420 | 1,318 | (67) | 2,403 | 734 | 449 | 1,081 | 856 3,120 |

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| | 2012 Three Months Unregulated | | | | | 2011 Three Months Unregulated | | | | |
|---------------------------------|----------------------------------|-------------------|-----------------|-----------|---------------------|----------------------------------|-------------------|-----------------|-----------|---------------------|
| | PA | | Gross Energy | Other (a) | Operating Income | PA | | Gross Energy | Other (a) | Operating Income |
| | Kentucky Gross | Gross Delivery | | | | Kentucky Gross | Gross Delivery | | | |
| | Margins | Margins | Margins | (b) | Margins | Margins | Margins | (b) | | |
| Operating Expenses | | | | | | | | | | |
| Fuel | 249 | | 310 | 11 (e) | 570 | 245 | | 338 | 20 (e) | 603 |
| Energy purchases | | | | | | | | | | |
| Realized | 27 | 137 | 418 | 1 (f) | 583 | 32 | 171 | 119 | 40 (f) | 362 |
| Unrealized economic activity | | | | (569)(g) | (569) | | | | 176 (g) | 176 |
| Other operation and maintenance | 28 | 25 | 1 | 596 | 650 | 26 | 30 | | 679 | 735 |
| Depreciation | 13 | | | 265 | 278 | 12 | | | 240 | 252 |
| Taxes, other than income | | 23 | 11 | 56 | 90 | | 24 | 8 | 58 | 90 |
| Energy-related businesses | | | | 137 | 137 | | | | 135 | 135 |
| Intercompany eliminations | | (1) | 1 | | | | (1) | 1 | | |
| Total Operating Expenses | 317 | 184 | 741 | 497 | 1,739 | 315 | 224 | 466 | 1,348 | 2,353 |
| Total | \$ 415 | \$ 236 | \$ 577 | \$ (564) | \$ 664 | \$ 419 | \$ 225 | \$ 615 | \$ (492) | \$ 767 |

| | 2012 Nine Months Unregulated | | | | | 2011 Nine Months Unregulated | | | | |
|--|---------------------------------|-------------------|-----------------|--------------|---------------------|---------------------------------|-------------------|-----------------|--------------|---------------------|
| | PA | | Gross Energy | Other (a) | Operating Income | PA | | Gross Energy | Other (a) | Operating Income |
| | Kentucky Gross | Gross Delivery | | | | Kentucky Gross | Gross Delivery | | | |
| | Margins | Margins | Margins | (b) | Margins | Margins | Margins | (b) | | |
| Operating Revenues | | | | | | | | | | |
| Utility | \$ 2,095 | \$ 1,303 | | \$ 1,614 (c) | \$ 5,012 | \$ 2,139 | \$ 1,444 | | \$ 1,112 (c) | \$ 4,695 |
| PLR intersegment utility revenue (expense) (d) | | (61) | \$ 61 | | | | (15) | \$ 15 | | |

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| | | | | | | | | | | |
|---------------------------------|----------|--------|----------|------------|----------|----------|--------|----------|------------|----------|
| Unregulated retail | | | | | | | | | | |
| electric and gas | | | 638 | (18)(g) | 620 | | | 509 | 8 (g) | 517 |
| Wholesale energy marketing | | | | | | | | | | |
| Realized | | | 3,353 | 14 (f) | 3,367 | | | 2,635 | 42 (f) | 2,677 |
| Unrealized economic activity | | | | (322)(g) | (322) | | | | 229 (g) | 229 |
| Net energy trading margins | | | 7 | | 7 | | | 14 | | 14 |
| Energy-related businesses | | | | 380 | 380 | | | | 387 | 387 |
| Total Operating Revenues | 2,095 | 1,242 | 4,059 | 1,668 | 9,064 | 2,139 | 1,429 | 3,173 | 1,778 | 8,519 |
| Operating Expenses | | | | | | | | | | |
| Fuel | 677 | | 695 | 33 (e) | 1,405 | 666 | | 872 | (46)(e) | 1,492 |
| Energy purchases | | | | | | | | | | |
| Realized | 135 | 410 | 1,669 | 39 (f) | 2,253 | 179 | 591 | 496 | 201 (f) | 1,467 |
| Unrealized economic activity | | | | (420)(g) | (420) | | | | 49 (g) | 49 |
| Other operation and maintenance | 76 | 74 | 12 | 1,933 | 2,095 | 67 | 77 | 13 | 1,884 | 2,041 |
| Depreciation | 39 | | | 774 | 813 | 37 | | | 660 | 697 |
| Taxes, other than income | | 67 | 27 | 174 | 268 | | 77 | 22 | 139 | 238 |
| Energy-related businesses | | | | 363 | 363 | | | | 368 | 368 |
| Intercompany eliminations | | (3) | 2 | 1 | | | (9) | 3 | 6 | |
| Total Operating Expenses | 927 | 548 | 2,405 | 2,897 | 6,777 | 949 | 736 | 1,406 | 3,261 | 6,352 |
| Discontinued operations | | | | | | | | 12 | (12)(h) | |
| Total | \$ 1,168 | \$ 694 | \$ 1,654 | \$ (1,229) | \$ 2,287 | \$ 1,190 | \$ 693 | \$ 1,779 | \$ (1,495) | \$ 2,167 |

- (a) Represents amounts excluded from Margins.
(b) As reported on the Statements of Income.
(c) Primarily represents WPD's utility revenue.

- (d) Primarily related to PLR supply sold by PPL EnergyPlus to PPL Electric.
- (e) Includes economic activity related to fuel as described in "Commodity Price Risk (Non-trading) - Economic Activity" within Note 14 to the Financial Statements. The three and nine months ended September 30, 2012, include pre-tax losses of \$17 million and \$29 million related to coal contract modification payments. The three and nine months ended September 30, 2011 include pre-tax credits of \$6 million and \$56 million for the spent nuclear fuel litigation settlement.
- (f) Represents energy-related economic activity as described in "Commodity Price Risk (Non-trading) - Economic Activity" within Note 14 to the Financial Statements. For the three and nine months ended September 30, 2012, "Wholesale energy marketing - Realized" and "Energy purchases - Realized" include net pre-tax losses of \$1 million and \$34 million related to the monetization of certain full-requirement sales contracts. The three and nine months ended September 30, 2011 include net pre-tax losses of \$40 million and \$184 million related to the monetization of certain full-requirement sales contracts and net pre-tax gains of \$6 million and \$17 million related to the amortization of option premiums.
- (g) Represents energy-related economic activity, which is subject to fluctuations in value due to market price volatility, as described in "Commodity Price Risk (Non-trading) - Economic Activity" within Note 14 to the Financial Statements.
- (h) Represents the net of certain revenues and expenses associated with certain businesses that are classified as discontinued operations. These revenues and expenses are not reflected in "Operating Income" on the Statements of Income.

Changes in Non-GAAP Financial Measures

The following table shows PPL's three non-GAAP financial measures for the periods ended September 30 as well as the change between periods. The factors that gave rise to the changes are described below the table.

| | Three Months | | | Nine Months | | |
|--|--------------|--------|---------|-------------|----------|----------|
| | 2012 | 2011 | Change | 2012 | 2011 | Change |
| Kentucky Gross Margins | \$ 415 | \$ 419 | \$ (4) | \$ 1,168 | \$ 1,190 | \$ (22) |
| PA Gross Delivery Margins by Component | | | | | | |
| Distribution | \$ 185 | \$ 179 | \$ 6 | \$ 544 | \$ 560 | \$ (16) |
| Transmission | 51 | 46 | 5 | 150 | 133 | 17 |
| Total | \$ 236 | \$ 225 | \$ 11 | \$ 694 | \$ 693 | \$ 1 |
| Unregulated Gross Energy Margins by Region | | | | | | |
| Non-trading | | | | | | |
| Eastern U.S. | \$ 521 | \$ 530 | \$ (9) | \$ 1,417 | \$ 1,502 | \$ (85) |
| Western U.S. | 67 | 92 | (25) | 230 | 263 | (33) |
| Net energy trading | (11) | (7) | (4) | 7 | 14 | (7) |
| Total | \$ 577 | \$ 615 | \$ (38) | \$ 1,654 | \$ 1,779 | \$ (125) |

Kentucky Gross Margins

Margins decreased for the nine months ended September 30, 2012 compared with the same period in 2011, primarily due to \$16 million of lower retail margins, as volumes were impacted by unseasonably mild weather during the first four months of 2012, and \$6 million of lower wholesale margins, as volumes were impacted by lower market prices. Total heating degree days decreased 24% compared to the same period in 2011.

Pennsylvania Gross Delivery Margins

Distribution

Margins decreased for the nine months ended September 30, 2012 compared with the same period in 2011, primarily due to an \$18 million unfavorable effect of mild weather early in 2012. The three and nine-month periods were impacted by a \$7 million charge recorded in 2011 to reduce a portion of the transmission service charge regulatory asset associated with a 2005 undercollection that was not included in any subsequent rate reconciliations filed with the PUC.

Transmission

Margins increased for the three and nine-month periods ended September 30, 2012, compared with the same periods in 2011, primarily due to increased investment in plant and the recovery of additional costs through the FERC formula-based rates.

Unregulated Gross Energy Margins

Eastern U.S.

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

The changes in non-trading margins for the periods ended September 30, 2012 compared with 2011 were due to:

| | Three Months | Nine Months |
|--|--------------|-------------|
| Baseload energy prices | \$ (44) | \$ (132) |
| Baseload capacity prices | 3 | (47) |
| Intermediate and peaking capacity prices | 5 | (22) |
| Impact of non-core generation facilities sold in the first quarter of 2011 | | (12) |
| Full-requirement sales contracts | 3 | (10) |
| Net economic availability of coal and hydroelectric units | (7) | 12 |
| Retail electric | 5 | 12 |
| Ironwood acquisition which eliminates tolling expense (a) | 14 | 27 |
| Nuclear generation volume (b) | 11 | 93 |
| Other | 1 | (6) |
| | \$ (9) | \$ (85) |

(a) See Note 8 to the Financial Statements for additional information.

(b) Volumes were higher for the nine-month period due to a shorter outage period for blade inspections, an unplanned outage in March 2011 and an uprate in the third quarter of 2011. Volumes were higher for the three-month period due to higher availability in 2012.

Western U.S.

Non-trading margins for the three and nine months ended September 30, 2012 compared with the same periods in 2011 were lower due to \$14 million and \$31 million of lower wholesale sales, including \$10 million and \$23 million related to the bankruptcy of SMGT. The three-month period was also lower due to \$5 million of higher fuel costs.

Utility Revenues

The increase (decrease) in utility revenues for the periods ended September 30, 2012 compared with 2011 was due to:

| | Three Months | Nine Months |
|----------------------------------|--------------|-------------|
| Domestic: | | |
| PPL Electric (a) | \$ (11) | \$ (141) |
| LKE (b) | (4) | (45) |
| Total Domestic | (15) | (186) |
| U.K.: | | |
| PPL WW | | |
| Price (c) | 14 | 69 |
| Volume (d) | (2) | (17) |
| Recovery of allowed revenues (e) | 3 | (8) |
| Foreign currency exchange rates | (7) | (15) |
| Other | 5 | 2 |
| Total PPL WW | 13 | 31 |
| WPD Midlands (f) | 20 | 472 |
| Total U.K. | 33 | 503 |
| Total | \$ 18 | \$ 317 |

(a) See "Pennsylvania Gross Delivery Margins" for further information.

(b) See "Kentucky Gross Margins" for further information.

(c) The three- and nine-month periods were impacted by a price increase effective April 1, 2012. The nine-month period was also impacted by a price increase effective April 1, 2011.

(d) The decrease for the nine-month period is primarily due to the downturn in the economy and the unfavorable effect of weather.

(e) The decrease for the nine-month period is primarily due to a 2012 charge to income for the over-recovery of revenues from customers.

(f) The increase for the three-month period is primarily due to a price increase effective April 1, 2012. The nine-month period ended September 30, 2012 is not comparable to 2011 as 2011 includes only five months of WPD Midlands' results.

Other Operation and Maintenance

The increase (decrease) in other operation and maintenance expense for the periods ended September 30, 2012 compared with 2011 were due to:

| Three Months | Nine Months |
|--------------|-------------|
|--------------|-------------|

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

Domestic:

| | | | | |
|---|----|-----|----|------|
| Uncollectible accounts (a) | \$ | (5) | \$ | 11 |
| LKE coal plant maintenance costs (b) | | 2 | | 13 |
| LKE storm costs (c) | | | | 6 |
| PPL Susquehanna nuclear plant costs (d) | | 8 | | 27 |
| Ironwood Acquisition (e) | | 4 | | 13 |
| PUC-reportable storm costs, net of insurance recoveries | | (3) | | (18) |
| Costs at Western fossil and hydroelectric plants | | (4) | | (9) |
| Costs at Eastern fossil and hydroelectric plants (f) | | 9 | | (4) |
| Payroll-related costs - PPL Electric | | 9 | | 16 |
| Vegetation management | | 3 | | 12 |
| Stock based compensation | | 2 | | 15 |
| Other | | | | 20 |

U.K.:

| | | | | |
|------------------|----|-------|----|------|
| PPL WW (g) | | 4 | | 21 |
| WPD Midlands (h) | | (114) | | (69) |
| Total | \$ | (85) | \$ | 54 |

- (a) In October 2011, SMGT filed for bankruptcy protection under Chapter 11 of the U.S. Bankruptcy Code. The increase for the nine-month period primarily reflects an \$11 million increase to a reserve on SMGT unpaid amounts.
- (b) The increase for the nine-month period is primarily due to an increased scope of scheduled outages.
- (c) A credit to establish a regulatory asset was recorded in the first quarter of 2011 related to 2009 storm costs.
- (d) Primarily due to refueling outage costs, payroll-related costs and timing of projects.
- (e) There are no comparable amounts in the 2011 periods as the Ironwood Acquisition occurred in April 2012.
- (f) The increase for the three-month period is primarily due to a planned outage at PPL Brunner Island in September 2012.
- (g) The increase for the nine-month period includes \$15 million of higher pension expense resulting from an increase in amortization of actuarial losses and \$8 million of higher network maintenance expense.

(h) The decrease for the three-month period is primarily due to lower charges recorded as a result of the acquisition, including \$85 million for severance compensation, early retirement deficiency costs and outplacement services for employees separating from WPD Midlands and \$5 million of other acquisition-related adjustments, and a decrease in pension costs of \$6 million. The nine-month period ended September 30, 2012 is not comparable to 2011 as 2011 includes only five months of WPD Midlands' results. The nine-month period also reflects \$81 million of lower charges recorded as a result of the acquisition for severance compensation, early retirement deficiency costs and outplacement services for employees separating from WPD Midlands and \$12 million of lower other acquisition-related costs.

Depreciation

The increase (decrease) in depreciation expense for the periods ended September 30, 2012 compared with 2011 was due to:

| | Three Months | Nine Months |
|-------------------------------|--------------|-------------|
| Additions to PP&E | \$ 16 | \$ 52 |
| WPD Midlands (a) | 6 | 59 |
| Ironwood Acquisition (Note 8) | 7 | 11 |
| Other | (3) | (6) |
| Total | \$ 26 | \$ 116 |

(a) The nine-month period ended September 30, 2012 is not comparable to 2011 as 2011 includes only five months of WPD Midlands' results.

Taxes, Other Than Income

The increase in taxes, other than income for the nine months ended September 30, 2012 compared with 2011 was due to:

| | Nine Months |
|-------------------------------------|-------------|
| Pennsylvania gross receipts tax (a) | \$ (14) |
| Domestic property tax | 7 |
| WPD Midlands (b) | 31 |
| Other | 6 |
| Total | \$ 30 |

(a) The decrease for the nine-month period is primarily due to a decrease in taxable electric revenue. This tax is included in "Unregulated Gross Energy Margins" and "Pennsylvania Gross Delivery Margins."

(b) The nine-month period ended September 30, 2012 is not comparable to 2011 as 2011 includes only five months of WPD Midlands' results.

Other Income (Expense) - net

The increase (decrease) in other income (expense) - net for the periods ended September 30, 2012 compared with 2011 was due to:

| Three Months | Nine Months |
|--------------|-------------|
|--------------|-------------|

| | | | | |
|--|----|------|----|------|
| Change in the fair value of economic foreign currency exchange contracts (Note 14) | \$ | (58) | \$ | (51) |
| Net hedge gains associated with the 2011 Bridge Facility (a) | | | | (55) |
| Foreign currency loss on 2011 Bridge Facility (b) | | | | 57 |
| Gain on redemption of debt (c) | | (22) | | (22) |
| WPD Midlands acquisition-related adjustments in 2011 (Note 8) | | | | 57 |
| Earnings (losses) from equity method investments | | (2) | | (8) |
| Other | | 1 | | (7) |
| Total | \$ | (81) | \$ | (29) |

(a) Represents a gain on foreign currency contracts that hedged the repayment of the 2011 Bridge Facility borrowing.

(b) Represents a foreign currency loss related to the repayment of the 2011 Bridge Facility borrowing.

(c) In July 2011, as a result of PPL Electric's redemption of 7.125% Senior Secured Bonds due 2013, PPL recorded a gain on the accelerated amortization of the fair value adjustment to the debt recorded in connection with previously settled fair value hedges.

See Note 12 to the Financial Statements for further details.

Interest Expense

The increase (decrease) in interest expense for the periods ended September 30, 2012 compared with 2011 was due to:

| | Three Months | Nine Months |
|---|-----------------|----------------|
| 2011 Bridge Facility costs related to financing the acquisition of WPD Midlands | | \$ (43) |
| 2011 Equity Units (a) | | 13 |
| Long-term debt interest expense (b) | \$ (1) | (11) |
| Short-term debt interest expense (c) | (4) | (11) |
| Hedging activity and ineffectiveness | 6 | 25 |
| Inflation adjustment on U.K. Index-linked Senior Unsecured Notes | (3) | (11) |
| Net amortization of debt discounts, premiums and issuance costs | (6) | (5) |
| WPD Midlands (d) | 9 | 77 |
| Ironwood Acquisition (Note 8) | 4 | 8 |
| Other | 3 | (6) |
| Total | \$ 8 | \$ 36 |

- (a) Interest related to the issuance in April 2011 to support the WPD Midlands acquisition.
- (b) The decrease was primarily due to the redemption of \$250 million of 7.0% Senior Notes due 2046 in July 2011 along with the repayment of \$500 million of 6.4% Senior Notes and subsequent issuance of \$500 million of 4.6% Senior Notes, both in the fourth quarter of 2011.
- (c) The decrease was primarily due to lower interest rates on 2012 short-term borrowings.
- (d) The nine-month period ended September 30, 2012 is not comparable to 2011 as 2011 includes only five months of WPD Midlands' results.

Income Taxes

The increase (decrease) in income taxes for the periods ended September 30, 2012 compared with 2011 was due to:

| | Three Months | Nine Months |
|---|--------------|-------------|
| Lower pre-tax book income | \$ (108) | \$ (131) |
| State valuation allowance adjustments (a) | 2 | (9) |
| Federal and state tax reserve adjustments | (6) | (8) |
| Federal and state tax return adjustments | | 2 |
| U.S. income tax on foreign earnings net of foreign tax credit (b) | 9 | 27 |
| Foreign tax reserve adjustments (c) | | (5) |
| Net operating loss carryforward adjustments (d) | | (9) |
| Depreciation not normalized (a) | (1) | 1 |
| WPD Midlands (e) | 25 | 86 |
| State deferred tax rate change (f) | (6) | (17) |
| Other | (8) | (2) |
| Total | \$ (93) | \$ (65) |

- (a) In February 2011, the Pennsylvania Department of Revenue issued interpretive guidance on the treatment of bonus depreciation for Pennsylvania income tax purposes. In accordance with Corporation Tax Bulletin 2011-01, Pennsylvania allows 100% bonus depreciation for qualifying assets in the same year bonus depreciation is allowed for federal income tax purposes. Due to the decrease in projected taxable income related to bonus depreciation, PPL recorded an \$11 million state deferred income tax expense during the nine months ended September 30, 2011

related to valuation allowances.

Additionally, the 100% Pennsylvania bonus depreciation deduction created a current state income tax benefit for the flow-through impact of Pennsylvania regulated state tax depreciation. The federal provision for 100% bonus depreciation generally applies to property placed in service before January 1, 2012. The placed in-service deadline is extended to January 1, 2013 for property that exceeds \$1 million, has a production period longer than one year and has a tax life of at least 10 years.

- (b) During the three and nine months ended September 30, 2011, PPL recorded a \$7 million and \$21 million federal income tax benefit related to U.K. pension contributions.
- (c) During the nine months ended September 30, 2012, PPL recorded a tax benefit following resolution of a U.K. tax issue related to interest expense.
- (d) During the nine months ended September 30, 2012, PPL recorded adjustments to deferred taxes related to net operating loss carryforwards of LKE based on income tax return adjustments.
- (e) The increase for the three-month period was due to an increase in pre-tax book income, which increased taxes by \$30 million, partially offset by an incremental \$6 million deferred tax benefit related to the 2012 U.K. Finance Act compared with the 2011 U.K. Finance Act. The nine-month period ended September 30, 2012 is not comparable to 2011 as 2011 includes only five months of WPD Midlands' results.
- (f) During the three and nine months ended September 30, 2012, PPL recorded adjustments related to state deferred tax liabilities.

See Note 5 to the Financial Statements for additional information on income taxes.

Income (Loss) from Discontinued Operations (net of income taxes)

Loss from discontinued operations increased by \$8 million for the nine months ended September 30, 2012, compared with 2011. The increase was primarily related to an adjustment to a liability for indemnifications related to the termination of the WKE lease in 2009.

Noncontrolling Interests

"Net Income Attributable to Noncontrolling Interests" decreased by \$5 million and \$9 million for the three and nine months ended September 30, 2012 compared with 2011. The decrease is primarily due to PPL Electric's June 2012 redemption of all 2.5 million shares of its preference stock. The price paid was the par value, without premium (\$250 million in the aggregate).

Financial Condition

Liquidity and Capital Resources

PPL had the following at:

| | September 30, 2012 | December 31, 2011 |
|---------------------------|--------------------|-------------------|
| Cash and cash equivalents | \$ 946 | \$ 1,202 |
| Short-term investments | | 16 |
| | \$ 946 | \$ 1,218 |
| Short-term debt | \$ 526 | \$ 578 |

At September 30, 2012, \$360 million of cash and cash equivalents were denominated in GBP. If these amounts would be remitted as dividends, PPL may be subject to additional U.S. taxes, net of allowable foreign tax credits. Historically, dividends paid by foreign subsidiaries have been distributions of the current year's earnings. See Note 5 to the Financial Statements in PPL's 2011 Form 10-K for additional information on undistributed earnings of WPD.

The \$256 million decrease in PPL's cash and cash equivalents position was primarily the net result of:

- capital expenditures of \$2.1 billion;
- the payment of \$623 million of common stock dividends;
- the redemption of preference stock of a subsidiary of \$250 million;
- the retirement of long-term debt of \$105 million;
- the Ironwood Acquisition for \$84 million, net of cash acquired;
- net cash provided by operating activities of \$2.1 billion; and
- proceeds of \$824 million from the issuance of long-term debt.

PPL's cash provided by operating activities increased by \$248 million for the nine months ended September 30, 2012 compared with 2011. The increase was primarily due to:

- an increase of \$185 million in net income, when adjusted for non-cash components; and
- a decrease of \$39 million in defined benefit plan funding.

Credit Facilities

PPL maintains credit facilities to provide liquidity and to backstop commercial paper issuances. At September 30, 2012, PPL's total committed borrowing capacity under its credit facilities and the use of this borrowing capacity were:

Letters of
Credit Issued

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| | Committed Capacity | Borrowed | and Commercial Paper Backstop | Unused Capacity |
|--|-----------------------|----------|--|--------------------|
| PPL Energy Supply Credit Facilities | \$ 3,200 | | \$ 594 | \$ 2,606 |
| PPL Electric Credit Facilities (a) | 400 | | 1 | 399 |
| LG&E Credit Facility | 400 | | | 400 |
| KU Credit Facilities (b) | 598 | | 198 | 400 |
| Total Domestic Credit Facilities (c) (d) | \$ 4,598 | | \$ 793 | \$ 3,805 |
| PPL WW Credit Facility (e) | £ 150 | £ 107 | n/a | £ 43 |
| WPD (South West) Credit Facility (f) | 245 | | n/a | 245 |
| WPD (East Midlands) Credit Facility | 300 | | | 300 |
| WPD (West Midlands) Credit Facility | 300 | | | 300 |
| Total WPD Credit Facilities (g) | £ 995 | £ 107 | | £ 888 |

(a) In April 2012, PPL Electric increased the capacity of its syndicated credit facility from \$200 million to \$300 million.

Committed capacity includes a \$100 million credit facility related to an asset-backed commercial paper program through which PPL Electric obtains financing by selling and contributing its eligible accounts receivable and unbilled revenue to a special purpose, wholly owned subsidiary on an ongoing basis. The subsidiary pledges these assets to secure loans of up to an aggregate of \$100 million from a commercial paper conduit sponsored by a financial institution. At September 30, 2012, based on accounts receivable and unbilled revenue pledged, the amount available for borrowing under the facility was \$100 million. In July 2012, PPL Electric and the subsidiary reduced the capacity from \$150 million and in September 2012 extended the agreement to September 2013.

(b) In August 2012, the KU letter of credit facility agreement was amended and restated to allow for certain payments under the letter of credit facility to be converted to loans rather than requiring immediate payment.

(c) The commitments under PPL's domestic credit facilities are provided by a diverse bank group, with no one bank and its affiliates providing an aggregate commitment of more than 9% of the total committed capacity.

(d) In November 2012, the syndicated credit facilities were amended to extend the expiration dates to November 2017 for PPL Energy Supply, LG&E and KU and to October 2017 for PPL Electric. In addition, LG&E increased the credit facility capacity to \$500 million.

(e) The amount outstanding at September 30, 2012 was a USD-denominated borrowing of \$171 million, which equated to £107 million at the time of borrowing and bore interest at 0.8818%.

(f) In January 2012, WPD (South West) entered into a £245 million 5-year syndicated credit facility to replace its previous £210 million 3-year syndicated credit facility. Under the facility, WPD (South West) has the ability to make cash borrowings but cannot request the lenders to issue letters of credit. WPD (South West) pays customary commitment fees under this facility and borrowings bear interest at LIBOR-based rates plus a margin. The credit facility contains financial covenants that require WPD (South West) to maintain an interest coverage ratio of not less than 3.0 times consolidated earnings before income taxes, depreciation and amortization and total net debt not in excess of 85% of its RAV, in each case calculated in accordance with the credit facility.

(g) At September 30, 2012, the U.S. dollar equivalent of unused capacity under WPD's committed credit facilities was \$1.4 billion. The commitments under WPD's credit facilities are provided by a diverse bank group with no one bank providing more than 16% of the total committed capacity.

See Note 7 to the Financial Statements for further discussion of PPL's credit facilities.

Commercial Paper

In February 2012, LG&E and KU each established a commercial paper program for up to \$250 million to provide an additional financing source to fund their short-term liquidity needs, if and when necessary. Commercial paper issuances are supported by LG&E's and KU's Syndicated Credit Facilities. LG&E and KU had no commercial paper outstanding at September 30, 2012.

In April 2012, PPL Energy Supply increased the capacity of its commercial paper program from \$500 million to \$750 million to provide an additional financing source to fund its short-term liquidity needs, if and when necessary. Commercial paper issuances are supported by PPL Energy Supply's Syndicated Credit Facility. At September 30, 2012, PPL Energy Supply had \$355 million of commercial paper outstanding, included in "Short-term debt" on the Balance Sheet, at a weighted-average interest rate of 0.48%.

In May 2012, PPL Electric increased the capacity of its commercial paper program from \$200 million to \$300 million to provide an additional financing source to fund its short-term liquidity needs, if and when necessary. Commercial paper issuances are supported by PPL Electric's Syndicated Credit Facility. PPL Electric had no commercial paper outstanding at September 30, 2012.

Long-term Debt and Equity Securities

In April 2012, PPL made a registered underwritten public offering of 9.9 million shares of its common stock. In conjunction with that offering, the underwriters exercised an option to purchase 591 thousand additional shares of PPL common stock solely to cover over-allotments.

In connection with the registered public offering, PPL entered into forward sale agreements with two counterparties covering the 9.9 million shares of PPL common stock. Settlement of these initial forward sale agreements will occur no later than April 2013. As a result of the underwriters' exercise of the overallotment option, PPL entered into additional forward sale agreements covering the additional 591 thousand shares of PPL common stock. Settlement of the subsequent forward sale agreements will occur in July 2013. Upon any physical settlement of any forward sale agreement, PPL will issue and deliver to the forward counterparties shares of its common stock in exchange for cash proceeds per share equal to the forward sale price. The forward sale price will be calculated based on an initial forward price of \$27.02 per share reduced during the period the contracts are outstanding as specified in the forward sale agreements. PPL may, in certain circumstances, elect cash settlement or net share settlement for all or a portion of its rights or obligations under the forward sale agreements.

PPL will not receive any proceeds or issue any shares of common stock until settlement of the forward sale agreements. PPL intends to use any net proceeds that it receives upon settlement to repay short-term debt obligations and for other general corporate purposes.

The forward sale agreements are classified as equity transactions. As a result, no amounts will be recorded in the consolidated financial statements until the settlement of the forward sale agreements. Prior to those settlements, the only impact to the financial statements will be the inclusion of incremental shares within the calculation of diluted EPS using the treasury stock method.

In April 2012, an indirect, wholly owned subsidiary of PPL Energy Supply completed the Ironwood Acquisition. See Note 8 to the Financial Statements for information on the transaction and the long-term debt of PPL Ironwood, LLC assumed through consolidation as part of the acquisition.

In April 2012, WPD (East Midlands) issued £100 million aggregate principal amount of 5.25% Senior Notes due 2023. WPD (East Midlands) received proceeds of approximately £111 million, which equated to \$178 million at the time of issuance, net of underwriting fees. The net proceeds were used for general corporate purposes.

In June 2012, LKE completed an exchange of all its outstanding 4.375% Senior Notes due 2021 issued in September 2011 in a transaction not registered under the Securities Act of 1933, for similar securities that were issued in a transaction registered with the SEC. See Note 7 in PPL's and LKE's 2011 Form 10-K for additional information.

In June 2012, PPL Capital Funding issued \$400 million of 4.20% Senior Notes due 2022. The notes may be redeemed at PPL Capital Funding's option any time prior to maturity at make-whole redemption prices. PPL Capital Funding received proceeds of \$396 million, net of a discount and underwriting fees, which were used for general corporate purposes.

In June 2012, PPL Electric redeemed all 2.5 million shares of its 6.25% Series Preference Stock, par value \$100 per share. The price paid for the redemption was the par value, without premium (\$250 million in the aggregate). At December 31, 2011, the preference stock was reflected in "Noncontrolling Interests" on PPL's Balance Sheet.

In August 2012, PPL Capital Funding redeemed at par, plus accrued interest, the \$99 million outstanding principal amount of its 6.85% Senior Notes due 2047.

In August 2012, PPL Electric issued \$250 million of 2.50% First Mortgage Bonds due 2022. The notes may be redeemed at PPL Electric's option any time prior to maturity at make-whole redemption prices. PPL Electric received proceeds of \$247 million, net of a discount and underwriting fees. The net proceeds were used to repay short-term indebtedness incurred to fund PPL Electric's redemption of its 6.25% Series Preference Stock in June 2012 and for other general corporate purposes.

In October 2012, PPL Capital Funding issued \$400 million of 3.50% Senior Notes due 2022. The notes may be redeemed at PPL Capital Funding's option any time prior to maturity at make-whole redemption prices. PPL Capital Funding received proceeds of \$397 million, net of an underwriting discount and fees, which will be used to repay short-term debt obligations, including commercial paper borrowings and for general corporate purposes.

See Note 7 in PPL's 2011 Form 10-K for information on the 2010 Equity Units (with respect to which the related \$1.150 billion of Notes are expected to be remarketed in 2013), the 2011 Bridge Facility, the 2011 Equity Units and the April 2011 issuance of common stock.

Common Stock Dividends

In August 2012, PPL declared its quarterly common stock dividend, payable October 1, 2012, at 36.0 cents per share (equivalent to \$1.44 per annum). Future dividends, declared at the discretion of the Board of Directors, will be dependent upon future earnings, cash flows, financial and legal requirements and other factors.

Rating Agency Actions

Moody's, S&P and Fitch periodically review the credit ratings on the debt securities of PPL and its subsidiaries. Based on their respective independent reviews, the rating agencies may make certain ratings revisions or ratings affirmations.

A credit rating reflects an assessment by the rating agency of the creditworthiness associated with an issuer and particular securities that it issues. The credit ratings of PPL and its subsidiaries are based on information provided by PPL and other sources. The ratings of Moody's, S&P and Fitch are not a recommendation to buy, sell or hold any securities of PPL or its subsidiaries. Such ratings may be subject to revisions or withdrawal by the agencies at any time and should be evaluated independently of each other and any other rating that may be assigned to the securities. A downgrade in PPL's or its subsidiaries' credit ratings could result in higher borrowing costs and reduced access to capital markets.

As a result of the passage of the Dodd-Frank Act, PPL is limiting its credit rating disclosure to a description of the actions taken by the rating agencies with respect to PPL's ratings, but without stating what ratings have been assigned to PPL or its subsidiaries, or their securities. The ratings assigned by the rating agencies to PPL and its subsidiaries and their respective securities may be found, without charge, on each of the respective rating agencies' websites, which ratings together with all other information contained on such rating agency websites is, hereby, explicitly not incorporated by reference in this report.

The rating agencies took the following actions related to PPL and its subsidiaries:

In January 2012, S&P affirmed its rating and revised its outlook for PPL Montana's Pass Through Certificates due 2020.

In February 2012, Fitch assigned ratings to the two newly established commercial paper programs for LG&E and KU.

In March 2012, Moody's affirmed the following ratings:

- the long-term ratings of the First Mortgage Bonds for LG&E and KU;
- the issuer ratings for LG&E and KU; and
- the bank loan ratings for LG&E and KU.

Also in March 2012, Moody's and S&P each assigned short-term ratings to the two newly established commercial paper programs for LG&E and KU.

In March and May 2012, Moody's, S&P and Fitch affirmed the long-term ratings for LG&E's 2003 Series A and 2007 Series B pollution control bonds.

Following the announcement of the then-pending acquisition of AES Ironwood, L.L.C. in February 2012, the rating agencies took the following actions:

- In March 2012, Moody's placed AES Ironwood, L.L.C.'s senior secured bonds under review for possible ratings upgrade.
- In April 2012, S&P affirmed the rating of AES Ironwood, L.L.C.'s senior secured bonds.

In May 2012, Fitch downgraded its rating and revised its outlook for PPL Montana's Pass Through Certificates due 2020.

In June 2012, Fitch assigned a rating and outlook to PPL Capital Funding's \$400 million of 4.20% Senior Notes.

In August 2012, Fitch assigned a rating and outlook to PPL Electric's \$250 million First Mortgage Bonds.

In August 2012, S&P and Moody's assigned a rating to PPL Electric's \$250 million First Mortgage Bonds.

In October 2012, Fitch affirmed the long-term issuer default rating and senior unsecured rating of PPL WW, WPD (South Wales) and WPD (South West).

In October 2012, Moody's, S&P and Fitch assigned a rating to PPL Capital Funding's \$400 million of 3.50% Senior Notes.

In October 2012, S&P affirmed its rating for PPL.

In November 2012, S&P revised its outlook for PPL Montana's Pass Through Certificates due 2020.

Ratings Triggers

PPL and PPL Energy Supply have various derivative and non-derivative contracts, including contracts for the sale and purchase of electricity and fuel, commodity transportation and storage, tolling agreements and interest rate and foreign currency instruments, which contain provisions that require PPL and PPL Energy Supply to post additional collateral or permit the counterparty to terminate the contract, if PPL's or PPL Energy Supply's credit rating were to fall below investment grade. See Note 14 to the Financial Statements for a discussion of "Credit Risk-Related Contingent Features," including a discussion of the potential additional collateral that would have been required for derivative contracts in a net liability position at September 30, 2012. At September 30, 2012, if PPL's and its subsidiaries' credit ratings had been below investment grade, PPL would have been required to prepay or post an additional \$486 million of collateral to counterparties for both derivative and non-derivative commodity and commodity-related contracts used in its generation, marketing and trading operations and interest rate and foreign currency contracts.

Capital Expenditures

Capital expenditure plans are revised periodically to reflect changes in operational, market and regulatory conditions. PPL has lowered its projected environmental capital spending for the period 2012 through 2016 by approximately \$0.5 billion from the previously disclosed \$3.4 billion projection of environmental capital spending included in PPL's 2011 Form 10-K. The lower projected capital spending is based on current project evaluations and pricing contained in contracts executed to date for environmental construction projects. PPL continues to evaluate potential new generation supply sources, including self-build options and power sourced from the market, as an alternative to installing additional emission control equipment at E.W. Brown, which is jointly dispatched for LG&E and KU, and in lieu of the terminated Bluegrass CTs acquisition discussed in Notes 6 and 8 to the Financial Statements. PPL expects to complete its evaluation during the first half of 2013. The outcome of that evaluation may lead to additional changes in projected capital spending.

For additional information on PPL's liquidity and capital resources, see "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations," in PPL's 2011 Form 10-K.

Risk Management

Market Risk

See Notes 13 and 14 to the Financial Statements for information about PPL's risk management objectives, valuation techniques and accounting designations.

The forward-looking information presented below provides estimates of what may occur in the future, assuming certain adverse market conditions and model assumptions. Actual future results may differ materially from those presented. These disclosures are not precise indicators of expected future losses, but only indicators of possible losses under normal market conditions at a given confidence level.

Commodity Price Risk (Non-trading)

PPL segregates its non-trading activities into two categories: hedge activity and economic activity. Transactions that are accounted for as hedge activity qualify for hedge accounting treatment. The economic activity category includes transactions that address a specific risk, but were not eligible for hedge accounting or for which hedge accounting was not elected. This activity includes the changes in fair value of positions used to hedge a portion of the economic value of PPL's generation assets, full-requirement sales contracts and retail contracts. This economic activity is subject to changes in fair value due to market price volatility of the input and output commodities (e.g., fuel and power). Although they do not receive hedge accounting treatment, these transactions are considered non-trading activity. The fair value of economic positions at September 30, 2012 and December 31, 2011 was a net asset/(liability) of \$491 million and \$(63) million. The change in fair value is largely attributable to the dedesignation of cash flow hedges that are now classified as economic hedges. See Note 14 to the Financial Statements for additional information.

To hedge the impact of market price volatility on PPL's energy-related assets, liabilities and other contractual arrangements, PPL both sells and purchases physical energy at the wholesale level under FERC market-based tariffs throughout the U.S. and enters into financial exchange-traded and over-the-counter contracts. PPL's non-trading commodity derivative contracts range in maturity through 2019.

The following table sets forth the changes in the net fair value of non-trading commodity derivative contracts for the periods ended September 30. See Notes 13 and 14 to the Financial Statements for additional information.

| | Gains (Losses) | | | |
|--|----------------|--------|-------------|--------|
| | Three Months | | Nine Months | |
| | 2012 | 2011 | 2012 | 2011 |
| Fair value of contracts outstanding at the beginning of the period | \$ 961 | \$ 894 | \$ 1,082 | \$ 956 |
| Contracts realized or otherwise settled during the period | (224) | (100) | (764) | (237) |
| Fair value of new contracts entered into during the period (a) | (11) | 4 | 1 | 19 |
| Other changes in fair value | (101) | 46 | 306 | 106 |
| Fair value of contracts outstanding at the end of the period | \$ 625 | \$ 844 | \$ 625 | \$ 844 |

(a) Represents the fair value of contracts at the end of the quarter of their inception.

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

The following table segregates the net fair value of non-trading commodity derivative contracts at September 30, 2012, based on the level of observability of the information used to determine the fair value.

| Source of Fair Value | Net Asset (Liability) | | | | Total Fair Value |
|--|---------------------------|--------------------|--------------------|-------------------------------|------------------|
| | Maturity Less Than 1 Year | Maturity 1-3 Years | Maturity 4-5 Years | Maturity in Excess of 5 Years | |
| Prices based on significant observable inputs (Level 2) | \$ 520 | \$ 94 | \$ (19) | \$ 7 | \$ 602 |
| Prices based on significant unobservable inputs (Level 3) | 11 | 8 | 4 | | 23 |
| Fair value of contracts outstanding at the end of the period | \$ 531 | \$ 102 | \$ (15) | \$ 7 | \$ 625 |

PPL sells electricity, capacity and related services and buys fuel on a forward basis to hedge the value of energy from its generation assets. If PPL were unable to deliver firm capacity and energy or to accept the delivery of fuel under its agreements, under certain circumstances it could be required to pay liquidating damages. These damages could be based on the difference between the market price and the contract price of the commodity. Depending on price changes in the wholesale energy markets, such damages could be significant. Extreme weather conditions, unplanned power plant outages, transmission disruptions, nonperformance by counterparties (or their own counterparties) with which it has energy contracts and other factors could affect PPL's ability to meet its obligations, or cause significant increases in the market price of replacement energy. Although PPL attempts to mitigate these risks, there can be no assurance that it will be able to fully meet its firm obligations, that it will not be required to pay damages for failure to perform, or that it will not experience counterparty nonperformance in the future. In connection with its bankruptcy proceedings, a significant counterparty, SMGT, had been purchasing lower volumes of electricity than prescribed in the contract and effective April 1, 2012 the contract was terminated. PPL Energy Supply cannot predict the prices or other terms on which it will be able to market to third parties the power that SMGT will not purchase from PPL EnergyPlus due to the termination of this contract. See Note 10 to the Financial Statements for additional information.

Commodity Price Risk (Trading)

PPL's trading commodity derivative contracts range in maturity through 2017. The following table sets forth changes in the net fair value of trading commodity derivative contracts for the periods ended September 30. See Notes 13 and 14 to the Financial Statements for additional information.

| | Gains (Losses) | | | |
|--|----------------|-------|-------------|------|
| | Three Months | | Nine Months | |
| | 2012 | 2011 | 2012 | 2011 |
| Fair value of contracts outstanding at the beginning of the period | \$ 17 | \$ 15 | \$ (4) | \$ 4 |
| Contracts realized or otherwise settled during the period | 17 | (10) | 16 | (7) |
| Fair value of new contracts entered into during the period (a) | 13 | (2) | 18 | 6 |
| Other changes in fair value | (15) | 4 | 2 | 4 |
| | \$ 32 | \$ 7 | \$ 32 | \$ 7 |

Fair value of contracts outstanding at the end of the period

(a) Represents the fair value of contracts at the end of the quarter of their inception.

Unrealized gains of approximately \$4 million will be reversed over the next three months as the transactions are realized.

The following table segregates the net fair value of trading commodity derivative contracts at September 30, 2012, based on the level of observability of the information used to determine the fair value.

| Source of Fair Value | Net Asset (Liability) | | | | Total Fair Value |
|--|---------------------------|--------------------|--------------------|-------------------------------|------------------|
| | Maturity Less Than 1 Year | Maturity 1-3 Years | Maturity 4-5 Years | Maturity in Excess of 5 Years | |
| Prices based on significant observable inputs (Level 2) | \$ 18 | \$ 11 | \$ 1 | | \$ 30 |
| Prices based on significant unobservable inputs (Level 3) | 2 | | | | 2 |
| Fair value of contracts outstanding at the end of the period | \$ 20 | \$ 11 | \$ 1 | | \$ 32 |

VaR Models

A VaR model is utilized to measure commodity price risk in domestic gross energy margins for the non-trading and trading portfolios. VaR is a statistical model that attempts to estimate the value of potential loss over a given holding period under normal market conditions at a given confidence level. VaR is calculated using a Monte Carlo simulation technique based on a five-day holding period at a 95% confidence level. Given the company's conservative hedging program, the non-trading VaR exposure is expected to be limited in the short-term. The VaR for portfolios using end-of-month results for the period was as follows.

| | Trading VaR | | Non-Trading VaR | |
|---|--|---|--|---|
| | Nine Months Ended September 30, 2012 | Twelve Months Ended December 31, 2011 | Nine Months Ended September 30, 2012 | Twelve Months Ended December 31, 2011 |
| 95% Confidence Level, Five-Day Holding Period | | | | |
| Period End | \$ 6 | \$ 1 | \$ 10 | \$ 6 |
| Average for the Period | 3 | 3 | 9 | 5 |
| High | 8 | 6 | 11 | 7 |
| Low | 1 | 1 | 7 | 4 |

The trading portfolio includes all speculative positions, regardless of the delivery period. All positions not considered speculative are considered non-trading. The non-trading portfolio includes the entire portfolio, including generation, with delivery periods through the next 12 months. Both the trading and non-trading VaR computations exclude FTRs due to the absence of reliable spot and forward markets. The fair value of the non-trading and trading FTR positions was insignificant at September 30, 2012.

Interest Rate Risk

PPL and its subsidiaries issue debt to finance their operations, which exposes them to interest rate risk. PPL utilizes various financial derivative instruments to adjust the mix of fixed and floating interest rates in its debt portfolio, adjust the duration of its debt portfolio and lock in benchmark interest rates in anticipation of future financing, when appropriate. Risk limits under the risk management program are designed to balance risk exposure to volatility in interest expense and changes in the fair value of PPL's debt portfolio due to changes in the absolute level of interest rates.

At September 30, 2012, PPL's potential annual exposure to increased interest expense, based on a 10% increase in interest rates, was not significant.

PPL is also exposed to changes in the fair value of its domestic and international debt portfolios. PPL estimated that a 10% decrease in interest rates at September 30, 2012 would increase the fair value of its debt portfolio by \$609 million.

At September 30, 2012, PPL had the following interest rate hedges outstanding:

| Exposure | Fair Value, Net - Asset | Effect of a 10% Adverse Movement |
|----------|----------------------------|---|
| | | |

| | | Hedged | (Liability) (a) | in Rates (b) |
|--------------------------|----|--------|--------------------|--------------|
| Cash flow hedges | | | | |
| Interest rate swaps (c) | \$ | 618 | \$ (21) | \$ (14) |
| Cross-currency swaps (d) | | 1,262 | 20 | (180) |
| Economic hedges | | | | |
| Interest rate swaps (e) | | 179 | (62) | (3) |

- (a) Includes accrued interest, if applicable.
- (b) Effects of adverse movements decrease assets or increase liabilities, as applicable, which could result in an asset becoming a liability.
- (c) PPL utilizes various risk management instruments to reduce its exposure to the expected future cash flow variability of its debt instruments. These risks include exposure to adverse interest rate movements for outstanding variable rate debt and for future anticipated financing. While PPL is exposed to changes in the fair value of these instruments, any changes in the fair value of such cash flow hedges are recorded in equity. The changes in fair value of these instruments are then reclassified into earnings in the same period during which the item being hedged affects earnings. Sensitivities represent a 10% adverse movement in interest rates. The positions outstanding at September 30, 2012 mature through 2024.
- (d) PPL utilizes cross-currency swaps to hedge the interest payments and principal of WPD's U.S. dollar-denominated senior notes. While PPL is exposed to changes in the fair value of these instruments, any change in the fair value of these instruments is recorded in equity and reclassified into earnings in the same period during which the item being hedged affects earnings. Sensitivities represent a 10% adverse movement in both interest rates and foreign currency exchange rates. The positions outstanding at September 30, 2012 mature through 2028.
- (e) PPL utilizes various risk management instruments to reduce its exposure to the expected future cash flow variability of its debt instruments. These risks include exposure to adverse interest rate movements for outstanding variable rate debt and for future anticipated financing. While PPL is exposed to changes in the fair value of these instruments, any realized changes in the fair value of such economic hedges are recoverable through regulated rates and any subsequent changes in fair value of these derivatives are included in regulatory assets or liabilities. Sensitivities represent a 10% adverse movement in interest rates. The positions outstanding at September 30, 2012 mature through 2033.

Foreign Currency Risk

PPL is exposed to foreign currency risk, primarily through investments in U.K. affiliates. In addition, PPL's domestic operations may make purchases of equipment in currencies other than U.S. dollars.

PPL has adopted a foreign currency risk management program designed to hedge certain foreign currency exposures, including firm commitments, recognized assets or liabilities, anticipated transactions and net investments. In addition, PPL enters into financial instruments to protect against foreign currency translation risk of expected earnings.

At September 30, 2012, PPL had the following foreign currency hedges outstanding:

| | Exposure Hedged | Fair Value, Net - Asset (Liability) | Effect of a 10% Adverse Movement in Foreign Currency Exchange Rates (a) |
|---------------------------|-----------------|-------------------------------------|---|
| Net investment hedges (b) | £ 163 | \$ (1) | \$ (26) |
| Economic hedges (c) | 1,199 | (35) | (185) |

(a) Effects of adverse movements decrease assets or increase liabilities, as applicable, which could result in an asset becoming a liability.

(b) To protect the value of a portion of its net investment in WPD, PPL executes forward contracts to sell GBP. The positions outstanding at September 30, 2012 mature through 2013. Excludes the amount of an intercompany loan classified as a net investment hedge. See Note 14 to the Financial Statements for additional information.

(c) To economically hedge the translation of expected income denominated in GBP to U.S. dollars, PPL enters into a combination of average rate forwards and average rate options to sell GBP. The positions outstanding at September 30, 2012 mature through 2014.

NDT Funds - Securities Price Risk

In connection with certain NRC requirements, PPL Susquehanna maintains trust funds to fund certain costs of decommissioning the PPL Susquehanna nuclear plant (Susquehanna). At September 30, 2012, these funds were invested primarily in domestic equity securities and fixed-rate, fixed-income securities and are reflected at fair value on the Balance Sheet. The mix of securities is designed to provide returns sufficient to fund Susquehanna's decommissioning and to compensate for inflationary increases in decommissioning costs. However, the equity securities included in the trusts are exposed to price fluctuation in equity markets, and the values of fixed-rate, fixed-income securities are primarily exposed to changes in interest rates. PPL actively monitors the investment performance and periodically reviews asset allocation in accordance with its NDT policy statement. At September 30, 2012, a hypothetical 10% increase in interest rates and a 10% decrease in equity prices would have resulted in an estimated \$49 million reduction in the fair value of the trust assets. See Notes 13 and 17 to the Financial Statements for additional information regarding the NDT funds.

Credit Risk

See Notes 13 and 14 to the Financial Statements in this Form 10-Q and "Risk Management - Energy Marketing & Trading and Other - Credit Risk" in PPL's 2011 Form 10-K for additional information.

Foreign Currency Translation

The value of the British pound sterling fluctuates in relation to the U.S. dollar. Changes in these exchange rates resulted in a foreign currency translation gain of \$53 million for the nine months ended September 30, 2012, which primarily reflected a \$93 million increase to PP&E offset by an increase of \$40 million to net liabilities. Changes in these exchange rates resulted in a foreign currency translation gain of \$154 million for the nine months ended September 30, 2011, which primarily reflected a \$242 million increase to PP&E offset by an increase of \$88 million to net liabilities. The impact of foreign currency translation is recorded in AOCI.

Related Party Transactions

PPL is not aware of any material ownership interests or operating responsibility by senior management of PPL, PPL Energy Supply, PPL Electric, LKE, LG&E or KU in outside partnerships, including leasing transactions with variable interest entities or other entities doing business with PPL. See Note 11 to the Financial Statements for additional information on related party transactions.

Acquisitions, Development and Divestitures

See Note 8 to the Financial Statements for information on the April 2012 Ironwood Acquisition and LG&E's and KU's June 2012 termination of the asset purchase agreement for the Bluegrass CTs.

See Note 8 to the Financial Statements in this Form 10-Q and Note 10 to the Financial Statements in PPL's 2011 Form 10-K for information on PPL's April 2011 acquisition of WPD Midlands.

Development projects are continuously reexamined based on market conditions and other factors to determine whether to proceed with the projects, sell, cancel or expand them, execute tolling agreements or pursue other options. See Note 8 to the Financial Statements for additional information on the more significant activities.

Environmental Matters

Extensive federal, state and local environmental laws and regulations are applicable to PPL's air emissions, water discharges and the management of hazardous and solid waste, among other areas; and the cost of compliance or alleged non-compliance cannot be predicted with certainty but could be material. In addition, costs may increase significantly if the requirements or scope of environmental laws or regulations, or similar rules, are expanded or changed by the relevant regulatory agencies. Costs may take the form of increased capital or operating and maintenance expenses; monetary fines, penalties or other restrictions. Many of these environmental law considerations are also applicable to the operations of key suppliers, or customers, such as coal producers and industrial power users, and may impact the cost of their products or their demand for PPL's services. See Note 10 to the Financial Statements in this Form 10-Q and "Item 1. Business - Environmental Matters" in PPL's 2011 Form 10-K for a discussion of environmental matters.

New Accounting Guidance

See Notes 2 and 18 to the Financial Statements for a discussion of new accounting guidance adopted and pending adoption.

Application of Critical Accounting Policies

Financial condition and results of operations are impacted by the methods, assumptions and estimates used in the application of critical accounting policies. The following accounting policies are particularly important to the financial condition or results of operations, and require estimates or other judgments of matters inherently uncertain: price risk management, defined benefits, asset impairment, loss accruals, AROs, income taxes, regulatory assets and liabilities and business combinations - purchase price allocation. See "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" in PPL's 2011 Form 10-K for a discussion of each critical accounting policy.

PPL ENERGY SUPPLY, LLC AND SUBSIDIARIES

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following should be read in conjunction with PPL Energy Supply's Condensed Consolidated Financial Statements and the accompanying Notes and with PPL Energy Supply's 2011 Form 10-K. Capitalized terms and abbreviations are defined in the glossary. Dollars are in millions, unless otherwise noted.

"Management's Discussion and Analysis of Financial Condition and Results of Operations" includes the following information:

- "Overview" provides a description of PPL Energy Supply and its business strategy, a summary of Net Income Attributable to PPL Energy Supply Member and a discussion of certain events related to PPL Energy Supply's results of operations and financial condition.
- "Results of Operations" provides a summary of PPL Energy Supply's earnings and a description of factors expected to impact future earnings. This section ends with explanations of significant changes in principal items on PPL Energy Supply's Statements of Income, comparing the three and nine months ended September 30, 2012 with the same periods in 2011.
- "Financial Condition - Liquidity and Capital Resources" provides an analysis of PPL Energy Supply's liquidity position and credit profile. This section also includes a discussion of rating agency actions.
- "Financial Condition - Risk Management" provides an explanation of PPL Energy Supply's risk management programs relating to market and credit risk.

Overview

Introduction

PPL Energy Supply is an energy company with headquarters in Allentown, Pennsylvania. Through its subsidiaries, PPL Energy Supply is primarily engaged in the generation and marketing of electricity in two key markets - the northeastern and northwestern U.S.

Business Strategy

PPL Energy Supply's overall strategy is to achieve disciplined optimization of energy supply margins while mitigating volatility in both cash flows and earnings. More specifically, PPL Energy Supply's strategy is to optimize the value from its competitive generation and marketing portfolios. PPL Energy Supply endeavors to do this by matching energy supply with load, or customer demand, under contracts of varying durations with creditworthy counterparties to capture profits while effectively managing exposure to energy and fuel price risk, counterparty credit risk and operational risk.

To manage financing costs and access to credit markets, a key objective of PPL Energy Supply's business strategy is to maintain a strong credit profile. PPL Energy Supply continually focuses on maintaining an appropriate capital structure and liquidity position. In addition, PPL Energy Supply has financial and operational risk management programs that, among other things, are designed to monitor and manage its exposure to earnings and cash flow volatility related to changes in energy and fuel prices, interest rates, counterparty credit quality and the operating performance of its generating units.

Financial and Operational Developments

Net Income Attributable to PPL Energy Supply Member

Net Income Attributable to PPL Energy Supply Member for the three and nine months ended September 30, 2012 was \$54 million and \$382 million compared to \$169 million and \$472 million for the same periods in 2011, representing decreases of 68% and 19% from the same periods in 2011.

See "Results of Operations" for details of special items and analysis of the consolidated results of operations.

Economic and Market Conditions

Unregulated gross energy margins associated with PPL Energy Supply's competitive generation and marketing business are impacted by changes in market prices and demand for electricity and natural gas, power plant availability, competition in the markets for retail customers, fuel costs and availability, fuel transportation costs and other costs. Current depressed wholesale market prices for electricity and natural gas have resulted from general weak economic conditions and other factors, including the impact of expanded domestic shale gas development. As a result of these factors, PPL Energy Supply has experienced a shift in the dispatching of its competitive generation from coal-fired to combined-cycle gas-fired generation as illustrated in the following table:

| | Average Utilization Factors (a) | |
|---------------------------|---------------------------------|-------------|
| | 2009 - 2011 | YTD 2012 |
| Pennsylvania coal plants | 89% | 70% |
| Montana coal plants | 87% | 59% |
| Combined-cycle gas plants | 70% | 96% |

(a) All periods reflect the nine months ending September 30.

This reduction in coal-fired generation output had resulted in a surplus of coal inventory at certain of PPL Energy Supply's Pennsylvania coal plants. To mitigate the risk of exceeding available coal storage, PPL Energy Supply incurred pre-tax charges of \$17 million and \$29 million during the three and nine months ended September 30, 2012 to reduce its 2012 and 2013 contracted coal deliveries. PPL Energy Supply will continue to manage its coal inventory to mitigate the financial impact and physical implications of an oversupply.

In addition, current economic and commodity market conditions indicated a lower value of unhedged future energy margins (primarily in 2014 and forward years) compared to the hedged energy margins in 2012. As has been PPL Energy Supply's practice in periods of changing business conditions, PPL Energy Supply continues to review its future business and operational plans, including capital and operation and maintenance expenditures, as well as its hedging strategies.

PPL Energy Supply's businesses are also subject to extensive federal, state and local environmental laws, rules and regulations. PPL Energy Supply's competitive generation assets are well positioned to meet these requirements. See Note 10 to the Financial Statements in this Form 10-Q and Note 15 to the Financial Statements in PPL Energy Supply's 2011 Form 10-K for additional information on these requirements. As a result of these requirements, PPL Energy Supply announced in September 2012 its intention, beginning in April 2015, to place its Corette plant in long-term reserve status, suspending the plant's operation due to expected market conditions and the costs to comply with the Mercury and Air Toxics Standards. The Corette plant's carrying value at September 30, 2012 was approximately \$67 million. Although the Corette plant was not determined to be impaired at September 30, 2012, it is reasonably possible that an impairment charge could be recorded in the fourth quarter of 2012 or in future periods, as higher priced sales contracts settle, adversely impacting projected cash flows.

In light of these economic and market conditions, as well as current and projected environmental regulatory requirements, PPL Energy Supply considered whether certain of its other generating assets were impaired, and determined that no impairment charges were required at September 30, 2012. PPL Energy Supply is unable to predict whether future environmental requirements or market conditions will result in impairment charges for other generating assets or additional retirements.

PPL Energy Supply and its subsidiaries may also be impacted in future periods by the uncertainty in the worldwide financial and credit markets partially caused by the European sovereign debt crisis. In addition, PPL Energy Supply may be impacted by reductions in the credit ratings of financial institutions and evolving regulations in the financial sector. Collectively, these factors could reduce availability or restrict PPL Energy Supply and its subsidiaries' ability to maintain sufficient levels of liquidity, reduce capital market activities, change collateral posting requirements and increase the associated costs to PPL Energy Supply and its subsidiaries.

PPL Energy Supply cannot predict the future impact that these economic and market conditions and regulatory requirements may have on its financial condition or results of operations.

Susquehanna Turbine Blade Inspection

PPL Energy Supply previously announced that a shutdown of Unit 1 of its Susquehanna nuclear power plant in October 2012 will include an inspection of that unit's turbine blades that could lead to the finalization of a plan to resolve the issue of turbine blade cracking that was first identified in 2011. Unit 1 is expected to resume operations by November 8, 2012. PPL Energy Supply plans to take an inspection outage for Unit 2. The projected pre-tax earnings impact of these inspections, including reduced energy-sales margins and possible repair expenses, is estimated in the range of \$43 million to \$58 million (\$26 million to \$35 million, after-tax), and the ultimate financial impact will depend on the duration of the Unit 2 outage.

Ironwood Acquisition

In April 2012, an indirect, wholly owned subsidiary of PPL Energy Supply completed the acquisition of the equity interests in the owner and operator of the Ironwood Facility. The Ironwood Facility began operation in 2001 and, since 2008, PPL EnergyPlus has supplied natural gas for the operation of the facility and received the facility's full electricity output and capacity value pursuant to a tolling agreement that expires in 2021. The acquisition provides PPL Energy Supply, through its subsidiaries, operational control of additional combined-cycle gas generation in PJM. See Note 8 to the Financial Statements for additional information.

Bankruptcy of SMGT

In October 2011, SMGT, a Montana cooperative and purchaser of electricity under a long-term supply contract with PPL EnergyPlus expiring in June 2019 (SMGT Contract), filed for protection under Chapter 11 of the U.S. Bankruptcy Code in the U.S. Bankruptcy Court for the District of Montana. At the time of the bankruptcy filing, SMGT was PPL EnergyPlus' largest unsecured credit exposure.

The SMGT Contract provided for fixed volume purchases on a monthly basis at established prices. Pursuant to a court order and subsequent stipulations entered into between the SMGT bankruptcy trustee and PPL EnergyPlus, since the date of its Chapter 11 filing through January 2012, SMGT continued to purchase electricity from PPL EnergyPlus at the price specified in the SMGT Contract, and made timely payments for such purchases, but at lower volumes than as prescribed in the SMGT Contract. In January 2012, the trustee notified PPL EnergyPlus that SMGT would not purchase electricity under the SMGT Contract for the month of February. In March 2012, the U.S. Bankruptcy Court for the District of Montana issued an order approving the request of the SMGT bankruptcy trustee and PPL EnergyPlus to terminate the SMGT Contract. As a result, the SMGT Contract was terminated effective April 1, 2012, allowing PPL EnergyPlus to resell the electricity previously contracted to SMGT under the SMGT Contract to other customers.

PPL EnergyPlus' receivable under the SMGT Contract totaled approximately \$21 million at September 30, 2012, which has been fully reserved.

In July 2012, PPL EnergyPlus filed its proof of claim in the SMGT bankruptcy proceeding. The total claim is approximately \$375 million, predominantly an unsecured claim representing the value for energy sales that will not occur as a result of the termination of the SMGT Contract. No assurance can be given as to the collectability of the claim.

PPL Energy Supply cannot predict any amounts that it may recover in connection with the SMGT bankruptcy or the prices and other terms on which it will be able to market to third parties the power that SMGT will not purchase from PPL EnergyPlus due to the termination of the SMGT Contract.

Results of Operations

The following discussion provides a summary of PPL Energy Supply's earnings and a description of factors that are expected to impact future earnings. This section ends with "Statement of Income Analysis," which includes explanations of significant changes in principal items on PPL Energy Supply's Statements of Income, comparing the three and nine months ended September 30, 2012 with the same periods in 2011.

The results for interim periods can be disproportionately influenced by numerous factors and developments and by seasonal variations. As such, the results of operations for interim periods do not necessarily indicate results or trends for the year or future periods.

Earnings

Net Income Attributable to PPL Energy Supply Member for the periods ended September 30 was:

| | Three Months | | Nine Months | |
|---|--------------|--------|-------------|--------|
| | 2012 | 2011 | 2012 | 2011 |
| Net Income Attributable to PPL Energy Supply Member | \$ 54 | \$ 169 | \$ 382 | \$ 472 |

The changes in the components of Net Income Attributable to PPL Energy Supply Member between these periods were due to the following factors, which reflect reclassifications for items included in unregulated gross energy margins and certain items that management considers special. See additional detail of these special items in the tables below.

| | Three Months | Nine Months |
|------------------------------------|--------------|-------------|
| Unregulated gross energy margins | \$ (38) | \$ (125) |
| Other operation and maintenance | (11) | (27) |
| Depreciation | (11) | (25) |
| Other Income (Expense) - net | | (10) |
| Interest Expense | 8 | 24 |
| Other | 9 | 6 |
| Income Taxes | 25 | 90 |
| Discontinued operations, after-tax | | 3 |
| Special items, after-tax | (97) | (26) |
| Total | \$ (115) | \$ (90) |

- See "Statement of Income Analysis - Unregulated Gross Energy Margins - Changes in Non-GAAP Financial Measures" for an explanation of Unregulated Gross Energy Margins.
- Higher other operation and maintenance for the three-month period primarily due to \$8 million of higher costs at PPL Susquehanna, \$7 million due to a planned outage at PPL Brunner Island in September 2012 and \$4 million of higher costs from Ironwood as a result of the acquisition, partially offset by \$9 million of trademark royalties with an affiliate in 2011 for which the agreement was terminated December 31, 2011.

Higher other operation and maintenance for the nine-month period primarily due to \$27 million of higher costs at PPL Susquehanna including refueling outage costs, payroll-related costs and timing of projects, \$17 million from higher systems-related costs and timing of projects and \$13 million of higher costs from Ironwood as a result of the acquisition, partially offset by \$26 million of trademark royalties with an affiliate in 2011 for which the agreement was terminated December 31, 2011.

- Higher depreciation for the three and nine-month periods due to the impact of PP&E additions, including \$7 million and \$11 million due to the Ironwood Acquisition.
- Lower other income (expense) - net for the nine-month period partly due to lower earnings on securities in the NDT funds.

- Lower interest expense for the three and nine-month periods due to 2011 including the acceleration of deferred financing fees of \$7 million related to the July 2011 redemption of \$250 million of 7.00% Senior Notes. In addition, the nine-month period was lower due to a \$10 million impact of not replacing the \$250 million of debt, a \$7 million impact from \$500 million in debt that matured in 2011 being replaced with debt at a lower interest rate, and a \$10 million impact from less short-term debt in 2012, partially offset by an \$8 million increase related to the debt assumed through consolidation as a result of the Ironwood Acquisition.
- Lower income taxes for the three-month period primarily due to lower pre-tax income.

Lower income taxes for the nine-month period due to lower pre-tax income, which reduced income taxes by \$67 million, \$15 million of net deferred tax benefits from state tax adjustments recorded in 2012 and \$6 million of Pennsylvania net operating loss valuation allowance adjustments recorded in 2011, driven primarily by the impact of bonus depreciation.

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

The following after-tax gains (losses), which management considers special items, also impacted the results during the periods ended September 30.

| | Income Statement Line Item | Three Months 2012 | 2011 | Nine Months 2012 | 2011 |
|---|----------------------------------|----------------------|---------------|---------------------|--------------|
| Adjusted energy-related economic activity, net, net of tax of \$63, \$8, (\$16), (\$2) | (a) | \$ (95) | \$ (10) | \$ 23 | \$ 4 |
| Impairments: | | | | | |
| Emission allowances, net of tax of \$0, \$0, \$0, \$1 | Other O&M | | | | (1) |
| Renewable energy credits, net of tax of \$0, \$0, \$0, \$2 | Other O&M | | | | (3) |
| Adjustments - nuclear decommissioning trust investments, net of tax of \$0, \$2, (\$2), \$2 | Other Income-net | | (1) | 1 | |
| LKE acquisition-related adjustments: | | | | | |
| Sale of certain non-core generation facilities, net of tax of \$0, \$0, \$0, \$0 | Disc. Operations | | | | (2) |
| Other: | | | | | |
| Montana hydroelectric litigation, net of tax of \$0, \$0, \$0, \$1 | Interest Expense | | (1) | | (2) |
| Litigation settlement - spent nuclear fuel storage, net of tax of \$0, (\$2), \$0, (\$23) (b) | Fuel Other | | 4 | | 33 |
| Counterparty bankruptcy, net of tax of \$0, \$0, \$5, \$0 (c) | O&M | | | (6) | |
| Wholesale supply cost reimbursement, net of tax of \$0, \$0, \$0, \$0 (d) | | | | 1 | |
| Ash basin leak remediation adjustment, net of tax of \$0, \$0, (\$1), \$0 | Other O&M | | | 1 | |
| Coal contract modification payments, net of tax of \$7, \$0, \$12, \$0 (e) | Fuel | (10) | | (17) | |
| Total | | \$ (105) | \$ (8) | \$ 3 | \$ 29 |

- (a) See "Reconciliation of Economic Activity" below.
- (b) In May 2011, PPL Susquehanna entered into a settlement agreement with the U.S. Government relating to PPL Susquehanna's lawsuit, seeking damages for the DOE's failure to accept spent nuclear fuel from the PPL Susquehanna plant. PPL Susquehanna recorded credits to fuel expense to recognize recovery, under the settlement agreement, of certain costs to store spent nuclear fuel at the Susquehanna plant. The amounts recorded through September 2011 cover the costs incurred from 1998 through December 2010.
- (c) In October 2011, a wholesale customer, SMGT, filed for bankruptcy protection under Chapter 11 of the U.S. Bankruptcy code. In 2012, PPL EnergyPlus recorded an additional allowance for unpaid amounts under the long-term power contract. In March 2012, the U.S. Bankruptcy Court for the District of Montana approved the request to terminate the contract, effective April 1, 2012.
- (d) Recorded in "Wholesale energy marketing - Realized" on the Statement of Income.
- (e) As a result of lower electricity and natural gas prices, coal unit utilization has decreased. Contract modification payments were incurred to reduce 2012 and 2013 contracted coal deliveries.

Reconciliation of Economic Activity

The following table reconciles unrealized pre-tax gains (losses) for the periods ended September 30, from the table within "Commodity Price Risk (Non-trading) - Economic Activity" in Note 14 to the Financial Statements to the special item identified as "Adjusted energy-related economic activity, net."

| | Three Months | | Nine Months | |
|---|--------------|---------|-------------|------|
| | 2012 | 2011 | 2012 | 2011 |
| Operating Revenues | | | | |
| Unregulated retail electric and gas | \$ (13) | \$ 4 | \$ (15) | \$ 9 |
| Wholesale energy marketing | (716) | 216 | (322) | 229 |
| Operating Expenses | | | | |
| Fuel | 3 | (28) | (11) | (16) |
| Energy Purchases | 569 | (176) | 420 | (49) |
| Energy-related economic activity (a) | (157) | 16 | 72 | 173 |
| Option premiums (b) | | 6 | 1 | 17 |
| Adjusted energy-related economic activity | (157) | 22 | 73 | 190 |
| Less: Economic activity realized, associated with the monetization of | | | | |
| certain full-requirement sales contracts in 2010 | 1 | 40 | 34 | 184 |
| Adjusted energy-related economic activity, net, pre-tax | \$ (158) | \$ (18) | \$ 39 | \$ 6 |
| Adjusted energy-related economic activity, net, after-tax | \$ (95) | \$ (10) | \$ 23 | \$ 4 |

(a) See Note 14 to the Financial Statements for additional information.

(b) Adjustment for the net deferral and amortization of option premiums over the delivery period of the item that was hedged or upon realization. Option premiums are recorded in "Wholesale energy marketing - Realized" and "Energy purchases - Realized" on the Statements of Income.

Outlook

Excluding special items, PPL Energy Supply projects lower earnings in 2012 compared with 2011. The decrease is primarily driven by lower energy margins as a result of lower energy and capacity prices and lower generation volumes, higher other operation and maintenance expense and higher depreciation.

Earnings in 2012 are subject to various risks and uncertainties. See "Forward-Looking Information," the rest of this Item 2 and Note 10 to the Financial Statements in this Form 10-Q and "Item 1. Business" and "Item 1A. Risk Factors" in PPL Energy Supply's 2011 Form 10-K for a discussion of the risks, uncertainties and factors that may impact future earnings.

Statement of Income Analysis --

Unregulated Gross Energy Margins

Non-GAAP Financial Measure

The following discussion includes financial information prepared in accordance with GAAP, as well as a non-GAAP financial measure, "Unregulated Gross Energy Margins." "Unregulated Gross Energy Margins" is a single financial performance measure of PPL Energy Supply's competitive energy non-trading and trading activities. In calculating this measure, PPL Energy Supply's energy revenues, which include operating revenues associated with certain PPL Energy Supply businesses that are classified as discontinued operations, are offset by the cost of fuel, energy purchases, certain other operation and maintenance expenses, primarily ancillary charges, gross receipts tax, which is recorded in "Taxes, other than income," and operating expenses associated with certain PPL Energy Supply businesses that are classified as discontinued operations. This performance measure is relevant to PPL Energy Supply due to the volatility in the individual revenue and expense lines on the Statements of Income that comprise "Unregulated Gross Energy Margins." This volatility stems from a number of factors, including the required netting of certain transactions with ISOs and significant swings in unrealized gains and losses. Such factors could result in gains or losses being recorded in either "Wholesale energy marketing" or "Energy purchases" on the Statements of Income. This performance measure includes PLR revenues from energy sales to PPL Electric by PPL EnergyPlus, which are recorded in "Wholesale energy marketing to affiliate" revenue. PPL Energy Supply excludes from "Unregulated Gross Energy Margins" adjusted energy-related economic activity, which includes the changes in fair value of positions used to economically hedge a portion of the economic value of PPL Energy Supply's competitive generation assets, full-requirement sales contracts and retail activities. This economic value is subject to changes in fair value due to market price volatility of the input and output commodities (e.g., fuel and power) prior to the delivery period that was hedged. Also included in adjusted energy-related economic activity is the ineffective portion of qualifying cash flow hedges, the monetization of certain full-requirement sales contracts and premium amortization associated with options. This economic activity is deferred, with the exception of the full-requirement sales contracts that were monetized, and included in "Unregulated Gross Energy Margins" over the delivery period that was hedged or upon realization. This measure is not intended to replace "Operating Income," which is determined in accordance with GAAP, as an indicator of overall operating performance. Other companies may use different measures to analyze and to report on the results of their operations. PPL Energy Supply believes that "Unregulated Gross Energy Margins" provides another criterion to make investment decisions. This performance measure is used, in conjunction with other information, internally by senior management to manage PPL Energy Supply's operations, analyze actual results compared with budget and measure certain corporate financial goals used in determining variable compensation.

Reconciliation of Non-GAAP Financial Measures

The following tables reconcile "Operating Income" to "Unregulated Gross Energy Margins" as defined by PPL Energy Supply for the periods ended September 30.

| 2012 Three Months | | 2011 Three Months | |
|-------------------|-----------|-------------------|-----------|
| Unregulated | Operating | Unregulated | Operating |

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| | Gross Energy Margins | Other (a) | Income (b) | Gross Energy Margins | Other (a) | Income (b) |
|--|----------------------------|-----------|------------|----------------------------|-----------|------------|
| Operating Revenues | | | | | | |
| Wholesale energy marketing | | | | | | |
| Realized | \$ 1,074 | \$ 2 (c) | \$ 1,076 | \$ 897 | \$ 10 (c) | \$ 907 |
| Unrealized economic activity | | (716) (d) | (716) | | 216 (d) | 216 |
| Wholesale energy marketing to affiliate | 23 | | 23 | 5 | | 5 |
| Unregulated retail electric and gas | 232 | (13) (d) | 219 | 186 | 4 (d) | 190 |
| Net energy trading margins | (11) | | (11) | (7) | | (7) |
| Energy-related businesses | | 128 | 128 | | 130 | 130 |
| Total Operating Revenues | 1,318 | (599) | 719 | 1,081 | 360 | 1,441 |

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| | 2012 Three Months | | | 2011 Three Months | | |
|------------------------------------|---|-----------------|-------------------------|---|-----------------|-------------------------|
| | Unregulated Gross Energy Margins | Other (a) | Operating Income (b) | Unregulated Gross Energy Margins | Other (a) | Operating Income (b) |
| Operating Expenses | | | | | | |
| Fuel | 310 | 11 (e) | 321 | 338 | 20 (e) | 358 |
| Energy purchases | | | | | | |
| Realized | 418 | 3 (c) | 421 | 119 | 42 (c) | 161 |
| Unrealized economic activity | | (569) (d) | (569) | | 176 (d) | 176 |
| Energy purchases from affiliate | 1 | | 1 | 1 | | 1 |
| Other operation and maintenance | 1 | 219 | 220 | | 208 | 208 |
| Depreciation | | 73 | 73 | | 62 | 62 |
| Taxes, other than income | 11 | 7 | 18 | 8 | 10 | 18 |
| Energy-related businesses | | 125 | 125 | | 130 | 130 |
| Total Operating Expenses | 741 | (131) | 610 | 466 | 648 | 1,114 |
| Total | \$ 577 | \$ (468) | \$ 109 | \$ 615 | \$ (288) | \$ 327 |

| | 2012 Nine Months | | | 2011 Nine Months | | |
|--|---|-----------|-------------------------|---|-----------|-------------------------|
| | Unregulated Gross Energy Margins | Other (a) | Operating Income (b) | Unregulated Gross Energy Margins | Other (a) | Operating Income (b) |
| Operating Revenues | | | | | | |
| Wholesale energy marketing | | | | | | |
| Realized | \$ 3,353 | \$ 14 (c) | \$ 3,367 | \$ 2,635 | \$ 42 (c) | \$ 2,677 |
| Unrealized economic activity | | (322) (d) | (322) | | 229 (d) | 229 |
| Wholesale energy marketing to affiliate | 61 | | 61 | 15 | | 15 |
| Unregulated retail electric and gas | 638 | (15) (d) | 623 | 509 | 9 (d) | 518 |
| Net energy trading margins | 7 | | 7 | 14 | | 14 |
| Energy-related businesses | | 336 | 336 | | 354 | 354 |
| Total Operating Revenues | 4,059 | 13 | 4,072 | 3,173 | 634 | 3,807 |
| Operating Expenses | | | | | | |
| Fuel | 695 | 33 (e) | 728 | 872 | (46) (e) | 826 |
| Energy purchases | | | | | | |
| Realized | 1,669 | 46 (c) | 1,715 | 496 | 205 (c) | 701 |
| Unrealized economic activity | | (420) (d) | (420) | | 49 (d) | 49 |

| | Unrealized economic activity | | | | | |
|---------------------------------|------------------------------|----------|--------|----------|----------|--------|
| Energy purchases from affiliate | 2 | | 2 | 3 | | 3 |
| Other operation and maintenance | 12 | 757 | 769 | 13 | 728 | 741 |
| Depreciation | | 206 | 206 | | 181 | 181 |
| Taxes, other than income | 27 | 26 | 53 | 22 | 28 | 50 |
| Energy-related businesses | | 326 | 326 | | 350 | 350 |
| Total Operating Expenses | 2,405 | 974 | 3,379 | 1,406 | 1,495 | 2,901 |
| Discontinued Operations | | | | 12 | (12) (f) | |
| Total | \$ 1,654 | \$ (961) | \$ 693 | \$ 1,779 | \$ (873) | \$ 906 |

- (a) Represents amounts excluded from Margins.
- (b) As reported on the Statements of Income.
- (c) Represents energy-related economic activity as described in "Commodity Price Risk (Non-trading) - Economic Activity" within Note 14 to the Financial Statements. For the three and nine months ended September 30, 2012, "Wholesale energy marketing - Realized" and "Energy purchases - Realized" include net pre-tax losses of \$1 million and \$34 million related to the monetization of certain full-requirement sales contracts. The three and nine months ended September 30, 2011 include net pre-tax losses of \$40 million and \$184 million related to the monetization of certain full-requirement sales contracts and net pre-tax gains of \$6 million and \$17 million related to the amortization of option premiums.
- (d) Represents energy-related economic activity, which is subject to fluctuations in value due to market price volatility, as described in "Commodity Price Risk (Non-trading) - Economic Activity" within Note 14 to the Financial Statements.
- (e) Includes economic activity related to fuel as described in "Commodity Price Risk (Non-trading) - Economic Activity" within Note 14 to the Financial Statements. The three and nine months ended September 30, 2012 include pre-tax losses of \$17 million and \$29 million related to coal contract modification payments. The three and nine months ended September 30, 2011 include pre-tax credits of \$6 million and \$56 million for the spent nuclear fuel litigation settlement.
- (f) Represents the net of certain revenues and expenses associated with certain businesses that are classified as discontinued operations. These revenues and expenses are not reflected in "Operating Income" on the Statements of Income.

Changes in Non-GAAP Financial Measures

Unregulated Gross Energy Margins are generated through PPL Energy Supply's competitive non-trading and trading activities. PPL Energy Supply's non-trading energy business is managed on a geographic basis that is aligned with its generation fleet. The following table shows PPL Energy Supply's non-GAAP financial measure, Unregulated Gross Energy Margins, for the periods ended September 30, as well as the change between periods. The factors that gave rise to the changes are described below the table.

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| | Three Months | | | Nine Months | | |
|--------------------|--------------|--------|---------|-------------|----------|----------|
| | 2012 | 2011 | Change | 2012 | 2011 | Change |
| Non-trading | | | | | | |
| Eastern U.S. | \$ 521 | \$ 530 | \$ (9) | \$ 1,417 | \$ 1,502 | \$ (85) |
| Western U.S. | 67 | 92 | (25) | 230 | 263 | (33) |
| Net energy trading | (11) | (7) | (4) | 7 | 14 | (7) |
| Total | \$ 577 | \$ 615 | \$ (38) | \$ 1,654 | \$ 1,779 | \$ (125) |

Eastern U.S.

The changes in non-trading margins for the periods ended September 30, 2012 compared with 2011 were due to:

| | Three Months | Nine Months |
|--|--------------|-------------|
| Baseload energy prices | \$ (44) | \$ (132) |
| Baseload capacity prices | 3 | (47) |
| Intermediate and peaking capacity prices | 5 | (22) |
| Impact of non-core generation facilities sold in the first quarter of 2011 | | (12) |
| Full-requirement sales contracts | 3 | (10) |
| Net economic availability of coal and hydroelectric units | (7) | 12 |
| Retail electric | 5 | 12 |
| Ironwood acquisition which eliminates tolling expense (a) | 14 | 27 |
| Nuclear generation volume (b) | 11 | 93 |
| Other | 1 | (6) |
| Total | \$ (9) | \$ (85) |

(a) See Note 8 to the Financial Statements for additional information.

(b) Volumes were higher for the nine-month period due to a shorter outage period for blade inspections, an unplanned outage in March 2011 and an uprate in the third quarter of 2011. Volumes were higher for the three-month period due to higher availability in 2012.

Western U.S.

Non-trading margins for the three and nine months ended September 30, 2012 compared with the same periods in 2011 were lower due to \$14 million and \$31 million of lower wholesale sales, including \$10 million and \$23 million related to the bankruptcy of SMGT. The three-month period was also lower due to \$5 million of higher fuel costs.

Other Operation and Maintenance

The increase (decrease) in other operation and maintenance expense for the periods ended September 30, 2012 compared with 2011 was due to:

| | Three Months | Nine Months |
|-------------------------------------|--------------|-------------|
| Susquehanna nuclear plant costs (a) | \$ 8 | \$ 27 |

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| | | |
|--|-------|-------|
| Uncollectible accounts (b) | (2) | 9 |
| Ironwood acquisition (c) | 4 | 13 |
| Costs at Western fossil and hydroelectric plants | (4) | (9) |
| Costs at Eastern fossil and hydroelectric plants (d) | 9 | (4) |
| Gain on disposition of RECs | (2) | (8) |
| Trademark royalties (e) | (9) | (26) |
| Corporate service costs (f) | 5 | 19 |
| Other | 3 | 7 |
| Total | \$ 12 | \$ 28 |

- (a) Primarily due to refueling outage costs, payroll-related costs and timing of projects.
- (b) In October 2011, SMGT filed for bankruptcy protection under Chapter 11 of the U.S. Bankruptcy Code. The increase for the nine-month period primarily reflects an \$11 million increase to a reserve on SMGT unpaid amounts.
- (c) There are no comparable amounts in the 2011 periods as the Ironwood Acquisition occurred in April 2012.
- (d) Increase for the three-month period primarily due to a planned outage at PPL Brunner Island in September 2012.
- (e) In 2011, PPL Energy Supply was charged trademark royalties by an affiliate. The agreement was terminated December 31, 2011.
- (f) Primarily due to systems-related costs and timing of projects.

Depreciation

The increase (decrease) in depreciation expense for the periods ended September 30, 2012 compared with 2011 was due to:

| | Three Months | Nine Months |
|-------------------------------|--------------|-------------|
| Additions to PP&E | \$ 4 | \$ 14 |
| Ironwood Acquisition (Note 8) | 7 | 11 |
| Total | \$ 11 | \$ 25 |

Other Income (Expense) - net

See Note 12 to the Financial Statements for details.

Interest Expense

The increase (decrease) in interest expense for the periods ended September 30, 2012 compared with 2011 was due to:

| | Three Months | Nine Months |
|---|--------------|-------------|
| Long-term debt interest expense (a) | \$ (3) | \$ (13) |
| Short-term debt interest expense (b) | (3) | (10) |
| Ironwood Acquisition (Note 8) | 4 | 8 |
| Net amortization of debt discounts, premiums and issuance costs | | |
| (c) | (8) | (9) |
| Other | 1 | (3) |
| Total | \$ (9) | \$ (27) |

(a) The decrease was primarily due to the redemption of \$250 million of 7.0% Senior Notes due 2046 in July 2011 along with the repayment of \$500 million of 6.4% Senior Notes and subsequent issuance of \$500 million of 4.6% Senior Notes, both in the fourth quarter of 2011.

(b) The decrease was primarily due to lower interest rates on 2012 short-term borrowings.

(c) The three and nine-month periods include the impact of accelerating the amortization of deferred financing fees of \$7 million in 2011, due to the July 2011 redemption.

Income Taxes

The increase (decrease) in income taxes for the periods ended September 30, 2012 compared with 2011 was due to:

| | Three Months | Nine Months |
|---|--------------|-------------|
| Lower pre-tax book income | \$ (82) | \$ (80) |
| State valuation allowance adjustments (a) | 2 | (4) |
| State deferred tax rate change (b) | (6) | (17) |

| | | | | |
|-------|----|------|----|-------|
| Other | | (2) | | (2) |
| Total | \$ | (88) | \$ | (103) |

- (a) In February 2011, the Pennsylvania Department of Revenue issued interpretive guidance on the treatment of bonus depreciation for Pennsylvania income tax purposes. In accordance with Corporation Tax Bulletin 2011-01, Pennsylvania allows 100% bonus depreciation for qualifying assets in the same year bonus depreciation is allowed for federal tax purposes. Due to the decrease in projected taxable income related to bonus depreciation, PPL Energy Supply recorded \$6 million of state deferred income tax expense during the nine months ended September 30, 2011 related to valuation allowances on state net operating loss carryforwards.
- (b) During the three and nine months ended September 30, 2012, PPL Energy Supply recorded adjustments related to state deferred tax liabilities.

See Note 5 to the Financial Statements for additional information on income taxes.

Financial Condition

Liquidity and Capital Resources

PPL Energy Supply had the following at:

| | | September 30, 2012 | | December 31, 2011 |
|---------------------------|----|--------------------|----|-------------------|
| Cash and cash equivalents | \$ | 432 | \$ | 379 |
| Short-term debt | \$ | 355 | \$ | 400 |

The \$53 million increase in PPL Energy Supply's cash and cash equivalents position was primarily the net result of:

- net cash provided by operating activities of \$674 million;
- contributions from Member of \$472 million;
- a net decrease in notes receivable from affiliate of \$198 million;
- distributions to Member of \$733 million;
- capital expenditures of \$460 million; and
- the Ironwood Acquisition for \$84 million, net of cash acquired.

PPL Energy Supply's cash provided by operating activities increased by \$234 million for the nine months ended September 30, 2012, compared with 2011. This was primarily due to a \$177 million increase in cash from components of working capital (primarily due to changes in counterparty collateral, partially offset by changes in unbilled revenues and accrued taxes) and a \$66 million decrease in defined benefit plan funding.

Credit Facilities

PPL Energy Supply maintains credit facilities to provide liquidity and to backstop commercial paper issuances. At September 30, 2012, PPL Energy Supply's total committed borrowing capacity under its credit facilities and the use of this borrowing capacity were:

| | Committed Capacity | Borrowed | Letters of Credit Issued and Commercial Paper Backstop | Unused Capacity |
|---|-----------------------|----------|---|--------------------|
| Syndicated Credit Facility (a) | \$ 3,000 | | \$ 468 | \$ 2,532 |
| Letter of Credit Facility | 200 | n/a | 126 | 74 |
| Total PPL Energy Supply Credit Facilities (b) | \$ 3,200 | | \$ 594 | \$ 2,606 |

(a) In November 2012, PPL Energy Supply amended its syndicated credit facility to extend the expiration date to November 2017.

(b) The commitments under PPL Energy Supply's credit facilities are provided by a diverse bank group, with no one bank and its affiliates providing an aggregate commitment of more than 11% of the total committed capacity.

See Note 7 to the Financial Statements for further discussion of PPL Energy Supply's credit facilities.

Commercial Paper

In April 2012, PPL Energy Supply increased the capacity of its commercial paper program from \$500 million to \$750 million to provide an additional financing source to fund its short-term liquidity needs, if and when necessary. Commercial paper issuances are supported by PPL Energy Supply's Syndicated Credit Facility. At September 30, 2012, PPL Energy Supply had \$355 million of commercial paper outstanding, included in "Short-term debt" on the Balance Sheet, at a weighted-average interest rate of 0.48%.

Long-term Debt Securities

In April 2012, an indirect, wholly owned subsidiary of PPL Energy Supply completed the Ironwood Acquisition. See Note 8 to the Financial Statements for information on the transaction and the debt of PPL Ironwood, LLC assumed through consolidation as part of the acquisition.

Rating Agency Actions

Moody's, S&P and Fitch periodically review the credit ratings on the debt securities of PPL Energy Supply and its subsidiaries. Based on their respective independent reviews, the rating agencies may make certain ratings revisions or ratings affirmations.

A credit rating reflects an assessment by the rating agency of the creditworthiness associated with an issuer and particular securities that it issues. The credit ratings of PPL Energy Supply and its subsidiaries are based on information provided by PPL Energy Supply and other sources. The ratings of Moody's, S&P and Fitch are not a recommendation to buy, sell or hold any securities of PPL Energy Supply or its subsidiaries. Such ratings may be subject to revisions or withdrawal by the agencies at any time and should be evaluated independently of each other and any other rating that may be assigned to the securities. A downgrade in PPL Energy Supply's or its subsidiaries' credit ratings could result in higher borrowing costs and reduced access to capital markets.

As a result of the passage of the Dodd-Frank Act, PPL Energy Supply is limiting its credit rating disclosure to a description of the actions taken by the rating agencies with respect to PPL Energy Supply's ratings, but without stating what ratings have been assigned to PPL Energy Supply or its subsidiaries, or their securities. The ratings assigned by the rating agencies to PPL Energy Supply and its subsidiaries and their respective securities may be found, without charge, on each of the respective rating agencies' websites, which ratings together with all other information contained on such rating agency websites is, hereby, explicitly not incorporated by reference in this report.

The rating agencies took the following actions related to PPL Energy Supply and its subsidiaries:

In January 2012, S&P affirmed its rating and revised its outlook for PPL Montana's Pass Through Certificates due 2020.

Following the announcement of the then-pending acquisition of AES Ironwood, L.L.C. in February 2012, the rating agencies took the following actions:

- In March 2012, Moody's placed AES Ironwood, L.L.C.'s senior secured bonds under review for possible ratings upgrade.
- In April 2012, S&P affirmed the rating of AES Ironwood, L.L.C.'s senior secured bonds.
- In May 2012, Fitch downgraded its rating and revised its outlook for PPL Montana's Pass Through Certificates due 2020.
- In November 2012, S&P revised its outlook for PPL Montana's Pass Through Certificates due 2020.

Ratings Triggers

PPL Energy Supply has various derivative and non-derivative contracts, including contracts for the sale and purchase of electricity and fuel, commodity transportation and storage, tolling agreements and interest rate instruments, which contain provisions that require PPL Energy Supply to post additional collateral or permit the counterparty to terminate the contract, if PPL Energy Supply's credit rating were to fall below investment grade. See Note 14 to the Financial Statements for a discussion of "Credit Risk-Related Contingent Features," including a discussion of the potential additional collateral that would have been required for derivative contracts in a net liability position at September 30, 2012. At September 30, 2012, if PPL Energy Supply's credit rating had been below investment grade, PPL Energy Supply would have been required to prepay or post an additional \$341 million of collateral to counterparties for both derivative and non-derivative commodity and commodity-related contracts used in its generation, marketing and trading operations and interest rate contracts.

For additional information on PPL Energy Supply's liquidity and capital resources, see "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations," in PPL Energy Supply's 2011 Form 10-K.

Risk Management

Market Risk

See Notes 13 and 14 to the Financial Statements for information about PPL Energy Supply's risk management objectives, valuation techniques and accounting designations.

The forward-looking information presented below provides estimates of what may occur in the future, assuming certain adverse market conditions and model assumptions. Actual future results may differ materially from those presented. These disclosures are not precise indicators of expected future losses, but only indicators of possible losses under normal market conditions at a given confidence level.

Commodity Price Risk (Non-trading)

PPL Energy Supply segregates its non-trading activities into two categories: hedge activity and economic activity. Transactions that are accounted for as hedge activity qualify for hedge accounting treatment. The economic activity category includes transactions that address a specific risk, but were not eligible for hedge accounting or for which hedge accounting was not elected. This activity includes the changes in fair value of positions used to hedge a portion of the economic value of PPL Energy Supply's competitive generation assets, full-requirement sales contracts and retail contracts. This economic activity is subject to changes in fair value due to market price volatility of the input and output commodities (e.g., fuel and power). Although they do not receive hedge accounting treatment, these transactions are considered non-trading activity. The fair value of economic positions at September 30, 2012 and December 31, 2011 was a net asset/(liability) of \$491

million and \$(63) million. The change in fair value is largely attributable to the dedesignation of cash flow hedges that are now classified as economic hedges. See Note 14 to the Financial Statements for additional information.

To hedge the impact of market price volatility on PPL Energy Supply's energy-related assets, liabilities and other contractual arrangements, PPL Energy Supply both sells and purchases physical energy at the wholesale level under FERC market-based tariffs throughout the U.S. and enters into financial exchange-traded and over-the-counter contracts. PPL Energy Supply's non-trading commodity derivative contracts range in maturity through 2019.

The following table sets forth the changes in the net fair value of non-trading commodity derivative contracts for the periods ended September 30. See Notes 13 and 14 to the Financial Statements for additional information.

| | Gains (Losses) | | | |
|--|----------------|--------|-------------|--------|
| | Three Months | | Nine Months | |
| | 2012 | 2011 | 2012 | 2011 |
| Fair value of contracts outstanding at the beginning of the period | \$ 961 | \$ 896 | \$ 1,082 | \$ 958 |
| Contracts realized or otherwise settled during the period | (224) | (99) | (764) | (234) |
| Fair value of new contracts entered into during the period (a) | (11) | 4 | 1 | 19 |
| Other changes in fair value | (101) | 43 | 306 | 101 |
| Fair value of contracts outstanding at the end of the period | \$ 625 | \$ 844 | \$ 625 | \$ 844 |

(a) Represents the fair value of contracts at the end of the quarter of their inception.

The following table segregates the net fair value of non-trading commodity derivative contracts at September 30, 2012, based on the level of observability of the information used to determine the fair value.

| Source of Fair Value | Net Asset (Liability) | | | | |
|--|---------------------------|--------------------|--------------------|-------------------------------|------------------|
| | Maturity Less Than 1 Year | Maturity 1-3 Years | Maturity 4-5 Years | Maturity in Excess of 5 Years | Total Fair Value |
| Prices based on significant observable inputs (Level 2) | \$ 520 | \$ 94 | \$ (19) | \$ 7 | \$ 602 |
| Prices based on significant unobservable inputs (Level 3) | 11 | 8 | 4 | | 23 |
| Fair value of contracts outstanding at the end of the period | \$ 531 | \$ 102 | \$ (15) | \$ 7 | \$ 625 |

PPL Energy Supply sells electricity, capacity and related services and buys fuel on a forward basis to hedge the value of energy from its generation assets. If PPL Energy Supply were unable to deliver firm capacity and energy or to accept the delivery of fuel under its agreements, under certain circumstances it could be required to pay liquidating damages. These damages could be based on the difference between the market price and the contract price of the commodity. Depending on price changes in the wholesale energy markets, such damages could be significant. Extreme weather conditions, unplanned power plant outages, transmission disruptions, nonperformance by counterparties (or their own counterparties) with which it has energy contracts and other factors could affect PPL Energy Supply's ability to meet its obligations, or cause significant increases in the market price of replacement

energy. Although PPL Energy Supply attempts to mitigate these risks, there can be no assurance that it will be able to fully meet its firm obligations, that it will not be required to pay damages for failure to perform, or that it will not experience counterparty nonperformance in the future. In connection with its bankruptcy proceedings, a significant counterparty, SMGT, had been purchasing lower volumes of electricity than prescribed in the contract and effective April 1, 2012 the contract was terminated. PPL Energy Supply cannot predict the prices or other terms on which it will be able to market to third parties the power that SMGT will not purchase from PPL EnergyPlus due to the termination of this contract. See Note 10 to the Financial Statements for additional information.

Commodity Price Risk (Trading)

PPL Energy Supply's trading commodity derivative contracts range in maturity through 2017. The following table sets forth changes in the net fair value of PPL Energy Supply's trading commodity derivative contracts for the periods ended September 30. See Notes 13 and 14 to the Financial Statements for additional information.

| | Gains (Losses) | | | |
|--|----------------|-------|-------------|------|
| | Three Months | | Nine Months | |
| | 2012 | 2011 | 2012 | 2011 |
| Fair value of contracts outstanding at the beginning of the period | \$ 17 | \$ 15 | \$ (4) | \$ 4 |
| Contracts realized or otherwise settled during the period | 17 | (10) | 16 | (7) |
| Fair value of new contracts entered into during the period (a) | 13 | (2) | 18 | 6 |
| Other changes in fair value | (15) | 4 | 2 | 4 |
| Fair value of contracts outstanding at the end of the period | \$ 32 | \$ 7 | \$ 32 | \$ 7 |

(a) Represents the fair value of contracts at the end of the quarter of their inception.

Unrealized gains of approximately \$4 million will be reversed over the next three months as the transactions are realized.

The following table segregates the net fair value of trading commodity derivative contracts at September 30, 2012, based on the level of observability of the information used to determine the fair value.

| Source of Fair Value | Net Asset (Liability) | | | | Total Fair Value |
|--|---------------------------|--------------------|--------------------|-------------------------------|------------------|
| | Maturity Less Than 1 Year | Maturity 1-3 Years | Maturity 4-5 Years | Maturity in Excess of 5 Years | |
| Prices based on significant observable inputs (Level 2) | \$ 18 | \$ 11 | \$ 1 | | \$ 30 |
| Prices based on significant unobservable inputs (Level 3) | 2 | | | | 2 |
| Fair value of contracts outstanding at the end of the period | \$ 20 | \$ 11 | \$ 1 | | \$ 32 |

VaR Models

A VaR model is utilized to measure commodity price risk in domestic gross energy margins for the non-trading and trading portfolios. VaR is a statistical model that attempts to estimate the value of potential loss over a given holding period under normal market conditions at a given confidence level. VaR is calculated using a Monte Carlo simulation technique based on a five-day holding period at a 95% confidence level. Given the company's conservative hedging program, the non-trading VaR exposure is expected to be limited in the short-term. The VaR for portfolios using end-of-month results for the period was as follows.

| | Trading VaR | | Non-Trading VaR | |
|---|--------------------------------------|---------------------------------------|--------------------------------------|---------------------------------------|
| | Nine Months Ended September 30, 2012 | Twelve Months Ended December 31, 2011 | Nine Months Ended September 30, 2012 | Twelve Months Ended December 31, 2011 |
| 95% Confidence Level, Five-Day Holding Period | | | | |
| Period End | \$ 6 | \$ 1 | \$ 10 | \$ 6 |
| Average for the Period | 3 | 3 | 9 | 5 |
| High | 8 | 6 | 11 | 7 |
| Low | 1 | 1 | 7 | 4 |

The trading portfolio includes all speculative positions, regardless of the delivery period. All positions not considered speculative are considered non-trading. The non-trading portfolio includes the entire portfolio, including generation, with delivery periods through the next 12 months. Both the trading and non-trading VaR computations exclude FTRs due to the absence of reliable spot and forward markets. The fair value of the non-trading and trading FTR positions was insignificant at September 30, 2012.

Interest Rate Risk

PPL Energy Supply and its subsidiaries issue debt to finance their operations, which exposes them to interest rate risk. PPL and PPL Energy Supply utilize various financial derivative instruments to adjust the mix of fixed and floating interest rates in PPL Energy Supply's debt portfolio, adjust the duration of its debt portfolio and lock in benchmark interest rates in anticipation of future financing, when appropriate. Risk limits under the risk management program are designed to balance risk exposure to volatility in interest expense and changes in the fair value of PPL Energy Supply's debt portfolio due to changes in the absolute level of interest rates. PPL Energy Supply had no interest rate hedges outstanding at September 30, 2012.

At September 30, 2012, PPL Energy Supply's potential annual exposure to increased interest expense, based on a 10% increase in interest rates, was not significant.

PPL Energy Supply is also exposed to changes in the fair value of its debt portfolio. PPL Energy Supply estimated that a 10% decrease in interest rates at September 30, 2012 would increase the fair value of its debt portfolio by \$56 million.

NDT Funds - Securities Price Risk

In connection with certain NRC requirements, PPL Susquehanna maintains trust funds to fund certain costs of decommissioning the PPL Susquehanna nuclear plant (Susquehanna). At September 30, 2012, these funds were invested primarily in domestic equity securities and fixed-rate, fixed-income securities and are reflected at fair value on the Balance Sheet. The mix of securities is designed to provide returns sufficient to fund Susquehanna's decommissioning and to compensate for inflationary increases in decommissioning costs. However, the equity securities included in the trusts are exposed to price fluctuation in equity markets, and the values of fixed-rate, fixed-income securities are primarily exposed to changes in interest rates. PPL actively monitors the investment performance and periodically reviews asset allocation in accordance with its NDT policy statement. At September 30, 2012, a hypothetical 10% increase in interest rates and a 10% decrease in equity prices would have resulted in an estimated \$49 million reduction in the fair value of the trust assets. See Notes 13 and 17 to the Financial Statements for additional information regarding the NDT funds.

Credit Risk

See Notes 11, 13 and 14 to the Financial Statements in this Form 10-Q and "Risk Management - Energy Marketing & Trading and Other - Credit Risk" in PPL Energy Supply's 2011 Form 10-K for additional information.

Related Party Transactions

PPL Energy Supply is not aware of any material ownership interests or operating responsibility by senior management of PPL Energy Supply in outside partnerships, including leasing transactions with variable interest entities or other entities doing business with PPL Energy Supply. See Note 11 to the Financial Statements for additional information on related party transactions.

Acquisitions, Development and Divestitures

Development projects are continuously reexamined based on market conditions and other factors to determine whether to proceed with the projects, sell, cancel or expand them, execute tolling agreements or pursue other options. See Note 8 to the Financial Statements for information on the more significant activities, including the April 2012 Ironwood Acquisition.

Environmental Matters

Extensive federal, state and local environmental laws and regulations are applicable to PPL Energy Supply's air emissions, water discharges and the management of hazardous and solid waste, among other areas; and the costs of compliance or alleged non-compliance cannot be predicted with certainty but could be material. In addition, cost may increase significantly if the requirements or scope of environmental laws or regulations, or similar rules, are expanded or changed by the relevant regulatory agencies. Costs may take the form of increased capital or operating and maintenance expenses; monetary fines, penalties or other restrictions. Many of these environmental law considerations are also applicable to the operations of key suppliers, or customers, such as coal producers and industrial power users, and may impact the costs of their products or their demand for PPL Energy Supply's services. See Note 10 to the Financial Statements in this Form 10-Q and "Item 1. Business - Environmental Matters" in PPL Energy Supply's 2011 Form 10-K for a discussion of environmental matters.

New Accounting Guidance

See Notes 2 and 18 to the Financial Statements for a discussion of new accounting guidance adopted and pending adoption.

Application of Critical Accounting Policies

Financial condition and results of operations are impacted by the methods, assumptions and estimates used in the application of critical accounting policies. The following accounting policies are particularly important to the financial condition or results of operations, and require estimates or other judgments of matters inherently uncertain: price risk management, defined benefits, asset impairment, loss accruals, AROs and income taxes. See "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" in PPL Energy Supply's 2011 Form 10-K for a discussion of each critical accounting policy.

PPL ELECTRIC UTILITIES CORPORATION AND SUBSIDIARIES

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following should be read in conjunction with PPL Electric's Condensed Consolidated Financial Statements and the accompanying Notes and with PPL Electric's 2011 Form 10-K. Capitalized terms and abbreviations are defined in the glossary. Dollars are in millions, unless otherwise noted.

"Management's Discussion and Analysis of Financial Condition and Results of Operations" includes the following information:

- "Overview" provides a description of PPL Electric and its business strategy, a summary of Net Income Available to PPL and a discussion of certain events related to PPL Electric's results of operations and financial condition.
 - "Results of Operations" provides a summary of PPL Electric's earnings and a description of factors expected to impact future earnings. This section ends with explanations of significant changes in principal items on PPL Electric's Statements of Income, comparing the three and nine months ended September 30, 2012 with the same periods in 2011.
- "Financial Condition - Liquidity and Capital Resources" provides an analysis of PPL Electric's liquidity position and credit profile. This section also includes a discussion of rating agency actions.
- "Financial Condition - Risk Management" provides an explanation of PPL Electric's risk management programs relating to market and credit risk.

Overview

Introduction

PPL Electric is an electricity transmission and distribution service provider in eastern and central Pennsylvania with headquarters in Allentown, Pennsylvania. PPL Electric is subject to regulation as a public utility by the PUC, and certain of its transmission activities are subject to the jurisdiction of FERC under the Federal Power Act. PPL Electric delivers electricity in its Pennsylvania service area and provides electricity supply to retail customers in that area as a PLR under the Customer Choice Act.

Business Strategy

PPL Electric's strategy and principal challenge is to own and operate its electricity delivery business at the most efficient cost while maintaining high quality customer service and reliability. PPL Electric anticipates that it will have significant capital expenditure requirements for at least the next five years. In order to manage financing costs and access to credit markets, a key objective for PPL Electric's business strategy is to maintain a strong credit profile. PPL Electric continually focuses on maintaining an appropriate capital structure and liquidity position.

Timely recovery of costs to maintain and enhance the reliability of its delivery system including the replacement of aging distribution assets is required in order to maintain strong cash flows and a strong credit profile. Traditionally, such cost recovery would be pursued through periodic base rate case proceedings with the PUC. As such costs continue to increase, more frequent rate case proceedings may be required or an alternative rate making process would need to be implemented in order to achieve more timely recovery. See "Regulatory Matters - Pennsylvania Activities

- Legislation - Regulatory Procedures and Mechanisms" in Note 6 to the Financial Statements for information on Pennsylvania's new alternative rate-making mechanism.

Transmission costs are recovered through a FERC Formula Rate mechanism, which is updated annually for costs incurred and assets placed in service. Accordingly, increased costs including those related to the replacement of aging transmission assets and the PJM-approved Regional Transmission Line Expansion Plan are recovered on a timely basis.

Financial and Operational Developments

Net Income Available to PPL

Net Income Available to PPL for the three and nine months ended September 30, 2012 was \$33 million and \$95 million compared to \$28 million and \$116 million for the same periods in 2011, representing an 18% increase over and an 18% decrease from the same periods in 2011.

See "Results of Operations" for a discussion and analysis of PPL Electric's earnings.

Redemption of Preference Stock

In June 2012, PPL Electric redeemed all 2.5 million shares of its 6.25% Series Preference Stock, par value \$100 per share. The price paid for the redemption was the par value, without premium (\$250 million in the aggregate). At December 31, 2011, the preference stock was reflected on PPL Electric's Balance Sheets in "Preference stock."

Hurricane Sandy

In late October 2012, PPL Electric experienced widespread significant damage to its transmission and distribution network from Hurricane Sandy. The total costs associated with the restoration efforts are still being finalized but are estimated to be in excess of \$60 million. PPL Electric has insurance coverage that could cover a portion of the costs incurred from Hurricane Sandy. PPL Electric will have the ability to file a request with the PUC for permission to defer for future recovery certain of the costs incurred to repair the distribution network in excess of the insurance coverage. Costs incurred to repair the transmission network are recoverable through the FERC Formula Rate mechanism which is updated annually.

Regional Transmission Line Expansion Plan

On October 1, 2012, the National Park Service (NPS) issued its Record of Decision (ROD) on the proposed Susquehanna-Roseland transmission line affirming the route chosen by PPL Electric and Public Service Electric & Gas as the preferred alternative under the NPS's National Environmental Policy Act review. On October 15, 2012, a complaint was filed in the United States District Court for the District of Columbia by various environmental groups, including the Sierra Club, challenging the ROD and seeking to prohibit its implementation. Construction activities have begun on portions of the 101-mile route in Pennsylvania. The line is expected to be in service before the peak summer demand period of 2015. The chosen route had previously been approved by the PUC and New Jersey Board of Public Utilities. An appeal of the New Jersey Board of Public Utilities approval is pending before the New Jersey Superior Court Appellate Division. PPL Electric cannot predict the ultimate outcome or timing of any further legal challenges to the project. PJM has developed a strategy to manage potential reliability problems until the line is built. PPL Electric cannot predict what additional actions, if any, PJM might take in the event of a further delay to its scheduled in-service date for the new line.

At September 30, 2012, PPL Electric's estimated share of the project cost was \$560 million, an increase from approximately \$500 million at December 31, 2011, due primarily to increased material costs. See Note 8 in PPL Electric's 2011 Form 10-K for additional information.

On October 9, 2012, the FERC issued an order in response to PPL Electric's December 2011 request for ratemaking incentives for the Northeast/Pocono Reliability project (a new 58-mile 230 kV transmission line, three new substations and upgrades to adjacent facilities). The incentives were specifically tailored to address the risks and challenges PPL Electric will face in building the project. The FERC granted the incentive for inclusion of 100% of

prudently incurred construction work in progress (CWIP) costs in rate base and denied the request for a 100 basis point adder to the return on equity incentive. The order requires a follow-up compliance filing from PPL Electric to ensure proper accounting treatment of AFUDC and CWIP for the project. PPL Electric estimates the project costs to be approximately \$180 million.

Legislation - Regulatory Procedures and Mechanisms

In June 2011, the Pennsylvania House Consumer Affairs Committee approved legislation authorizing the PUC to approve regulatory procedures and mechanisms to provide more timely recovery of a utility's costs. In the first quarter of 2012, the Governor signed an amended version of the legislation (Act 11 of 2012), which became effective April 14, 2012. The legislation authorizes the PUC to approve two specific ratemaking mechanisms - a fully projected future test year and, subject to certain conditions, a distribution system improvements charge (DSIC). Such alternative ratemaking procedures and mechanisms are important to PPL Electric as it begins a period of significant capital investment to maintain and enhance the reliability of its delivery system, including the replacement of aging distribution assets. In August 2012, the PUC issued a Final Implementation Order adopting procedures, guidelines and a model tariff for the implementation of Act 11 of 2012.

In September 2012, PPL Electric filed its Long Term Infrastructure Improvement Plan (LTIIP) describing projects eligible for inclusion in the DSIC. In October 2012, several parties filed comments to the LTIIP but none of the comments requested evidentiary hearings on the LTIIP. A decision on the LTIIP is expected in January 2013. PPL Electric expects to file a petition requesting permission to establish a DSIC in January 2013 with rates proposed to be effective in April 2013.

FERC Formula Rates

In March 2012, PPL Electric filed a request with the FERC seeking recovery, over a 34-year period beginning in June 2012, of its unrecovered regulatory asset related to the deferred state tax liability that existed at the time of the transition from the flow-through treatment of state income taxes to full normalization. This change in tax treatment occurred in 2008 as a result of prior FERC initiatives that transferred regulatory jurisdiction of certain transmission assets from the PUC to FERC. A regulatory asset of approximately \$50 million related to this transition, classified as taxes recoverable through future rates, is included in "Other Noncurrent Assets - Regulatory assets" on the Balance Sheets at September 30, 2012 and December 31, 2011. In May 2012, the FERC issued an order approving PPL Electric's request effective June 1, 2012.

Results of Operations

The following discussion provides a summary of PPL Electric's earnings and a description of factors that management expects may impact future earnings. This section ends with "Statement of Income Analysis," which includes explanations of significant changes in principal items on PPL Electric's Statements of Income, comparing the three and nine months ended September 30, 2012 with the same periods in 2011.

The results for interim periods can be disproportionately influenced by numerous factors and developments and by seasonal variations. As such, the results of operations for interim periods do not necessarily indicate results or trends for the year or future periods.

Earnings

Net Income Available to PPL for the periods ended September 30 was:

| | Three Months | | Nine Months | |
|-----------------------------|--------------|-------|-------------|--------|
| | 2012 | 2011 | 2012 | 2011 |
| Net Income Available to PPL | \$ 33 | \$ 28 | \$ 95 | \$ 116 |

The changes in the components of Net Income Available to PPL between these periods were due to the following factors which reflect reclassifications for items included in gross delivery margins.

| | Three Months | Nine Months |
|-------------------------------------|--------------|-------------|
| Pennsylvania gross delivery margins | \$ 11 | \$ 1 |
| Other operation and maintenance | (7) | (32) |
| Depreciation | (3) | (11) |
| Other | 2 | 4 |
| Income Taxes | (2) | 9 |
| Distributions on preference stock | 4 | 8 |

| | | | | |
|-------|----|---|----|------|
| Total | \$ | 5 | \$ | (21) |
|-------|----|---|----|------|

- See "Statement of Income Analysis - Pennsylvania Gross Delivery Margins - Changes in Non-GAAP Financial Measures" for an explanation of Pennsylvania Gross Delivery Margins.
 - Higher other operation and maintenance for the three-month period, primarily due to \$9 million of higher payroll-related costs, \$2 million of higher vegetation management costs and \$2 million of higher corporate service costs, partially offset by \$6 million of lower PUC-reportable storm costs.
- Higher other operation and maintenance for the nine-month period, primarily due to \$16 million of higher payroll-related costs, \$10 million of higher vegetation management costs, \$7 million of higher corporate service costs and \$4 million of higher contractor costs, partially offset by \$13 million of lower PUC-reportable storm costs.
- Higher depreciation for the nine-month period, primarily due to the impact of PP&E additions related to the ongoing efforts to ensure the reliability of the delivery system and replace aging infrastructure.
 - Lower income taxes for the nine-month period, primarily due to lower pre-tax income.

- Lower distributions on preference stock for the three and nine month periods due to the preference stock redemption in June 2012.

Outlook

PPL Electric projects lower earnings in 2012 compared with 2011, primarily driven by higher other operation and maintenance expense, higher depreciation and lower distribution revenue, which are expected to be partially offset by higher transmission revenue, lower financing costs, and lower income taxes.

In March 2012, PPL Electric filed a request with the PUC to increase distribution rates by approximately \$105 million effective January 1, 2013. The proposed distribution rate increase would result in a 2.9% increase over PPL Electric's total rates at the time of the request. PPL Electric's application includes a request for an authorized return-on-equity of 11.25%. On October 19, 2012, the presiding Administrative Law Judge (ALJ) issued a decision recommending a rate increase of approximately \$64 million, which represents an allowed return on equity of 9.74%. Exceptions to the ALJ's recommendation are due November 8, 2012. PPL Electric expects to file exceptions, together with certain other parties, to the ALJ's recommended decision. The PUC, which is expected to issue its order on the rate request in December 2012, can accept, reject or modify the ALJ's recommendation. PPL Electric cannot predict the outcome of this proceeding.

Earnings in 2012 and future periods are subject to various risks and uncertainties. See "Forward-Looking Information," the rest of this Item 2 and Notes 6 and 10 to the Financial Statements in this Form 10-Q and "Item 1. Business" and "Item 1A. Risk Factors" in PPL Electric's 2011 Form 10-K for a discussion of the risks, uncertainties and factors that may impact future earnings.

Statement of Income Analysis --

Pennsylvania Gross Delivery Margins

Non-GAAP Financial Measure

The following discussion includes financial information prepared in accordance with GAAP, as well as a non-GAAP financial measure, "Pennsylvania Gross Delivery Margins." "Pennsylvania Gross Delivery Margins" is a single financial performance measure of PPL Electric's Pennsylvania regulated electric delivery operations, which includes transmission and distribution activities. In calculating this measure, utility revenues and expenses associated with approved recovery mechanisms, including energy provided as a PLR, are offset with minimal impact on earnings. Costs associated with these mechanisms are recorded in "Energy purchases," "Energy purchases from affiliate," "Other operation and maintenance," which is primarily Act 129 costs, and "Taxes, other than income" which is primarily gross receipts tax. As a result, this measure represents the net revenues from PPL Electric's Pennsylvania regulated electric delivery operations. This measure is not intended to replace "Operating Income," which is determined in accordance with GAAP, as an indicator of overall operating performance. Other companies may use different measures to analyze and to report on the results of their operations. PPL Electric believes that "Pennsylvania Gross Delivery Margins" provides another criterion to make investment decisions. This performance measure is used, in conjunction with other information, internally by senior management to manage PPL Electric's operations and analyze actual results to budget.

Reconciliation of Non-GAAP Financial Measures

The following tables reconcile "Operating Income" to "Pennsylvania Gross Delivery Margins" as defined by PPL Electric for the periods ended September 30.

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| | 2012 Three Months | | | 2011 Three Months | | |
|-------------------------------------|---------------------------------|-----------|-------------------------|---------------------------------|--------------|-------------------------|
| | PA Gross Delivery Margins | Other (a) | Operating Income (b) | PA Gross Delivery Margins | Other (a) | Operating Income (b) |
| Operating Revenues | | | | | | |
| Retail electric | \$ 443 | | \$ 443 | \$ 454 | | \$ 454 |
| Electric revenue from affiliate | 1 | | 1 | 1 | | 1 |
| Total Operating Revenues | 444 | | 444 | 455 | | 455 |

149

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| | 2012 Three Months | | | 2011 Three Months | | |
|---------------------------------|---------------------------|-----------------|----------------------|---------------------------|-----------------|----------------------|
| | PA Gross Delivery Margins | Other (a) | Operating Income (b) | PA Gross Delivery Margins | Other (a) | Operating Income (b) |
| Operating Expenses | | | | | | |
| Energy purchases | 137 | | 137 | 171 | | 171 |
| Energy purchases from affiliate | 23 | | 23 | 5 | | 5 |
| Other operation and maintenance | 25 | \$ 123 | 148 | 30 | \$ 116 | 146 |
| Depreciation | | 41 | 41 | | 38 | 38 |
| Taxes, other than income | 23 | 1 | 24 | 24 | 2 | 26 |
| Total Operating Expenses | 208 | 165 | 373 | 230 | 156 | 386 |
| Total | \$ 236 | \$ (165) | \$ 71 | \$ 225 | \$ (156) | \$ 69 |

| | 2012 Nine Months | | | 2011 Nine Months | | |
|---------------------------------|---------------------------|-----------|----------------------|---------------------------|-----------|----------------------|
| | PA Gross Delivery Margins | Other (a) | Operating Income (b) | PA Gross Delivery Margins | Other (a) | Operating Income (b) |
| Operating Revenues | | | | | | |
| Retail electric | \$ 1,303 | | \$ 1,303 | \$ 1,444 | | \$ 1,444 |
| Electric revenue from affiliate | 3 | | 3 | 9 | | 9 |
| Total Operating Revenues | 1,306 | | 1,306 | 1,453 | | 1,453 |

| | 2012 Nine Months | | | 2011 Nine Months | | |
|---------------------------------|---------------------------|-----------------|----------------------|---------------------------|-----------------|----------------------|
| | PA Gross Delivery Margins | Other (a) | Operating Income (b) | PA Gross Delivery Margins | Other (a) | Operating Income (b) |
| Operating Expenses | | | | | | |
| Energy purchases | 410 | | 410 | 591 | | 591 |
| Energy purchases from affiliate | 61 | | 61 | 15 | | 15 |
| Other operation and maintenance | 74 | \$ 357 | 431 | 77 | \$ 325 | 402 |
| Depreciation | | 119 | 119 | | 108 | 108 |
| Taxes, other than income | 67 | 5 | 72 | 77 | 6 | 83 |
| Total Operating Expenses | 612 | 481 | 1,093 | 760 | 439 | 1,199 |
| Total | \$ 694 | \$ (481) | \$ 213 | \$ 693 | \$ (439) | \$ 254 |

(a) Represents amounts excluded from Margins.

(b) As reported on the Statements of Income.

Changes in Non-GAAP Financial Measures

The following table shows PPL Electric's non-GAAP financial measure, "Pennsylvania Gross Delivery Margins" for the periods ended September 30, as well as the change between periods. The factors that gave rise to the change are described below the table.

| | Three Months | | | Nine Months | | |
|--|--------------|------|--------|-------------|------|--------|
| | 2012 | 2011 | Change | 2012 | 2011 | Change |
| | | | | | | |

PA Gross Delivery Margins by
Component

| | | | | | | |
|--------------|--------|--------|-------|--------|--------|---------|
| Distribution | \$ 185 | \$ 179 | \$ 6 | \$ 544 | \$ 560 | \$ (16) |
| Transmission | 51 | 46 | 5 | 150 | 133 | 17 |
| Total | \$ 236 | \$ 225 | \$ 11 | \$ 694 | \$ 693 | \$ 1 |

Distribution

Margins decreased for the nine months ended September 30, 2012 compared with the same period in 2011, primarily due to an \$18 million unfavorable effect of mild weather early in 2012. The three and nine-month periods were impacted by a \$7 million charge recorded in 2011 to reduce a portion of the transmission service charge regulatory asset associated with a 2005 undercollection that was not included in any subsequent rate reconciliations filed with the PUC.

Transmission

Margins increased for the three and nine-month periods ended September 30, 2012, compared with the same periods in 2011, primarily due to increased investment in plant and the recovery of additional costs through the FERC formula-based rates.

Other Operation and Maintenance

The increase (decrease) in other operation and maintenance expense for the periods ended September 30, 2012 compared with 2011 was due to:

| | Three Months | Nine Months |
|---|--------------|--------------|
| Payroll-related costs | \$ 9 | \$ 16 |
| Contractor-related expenses | 1 | 4 |
| Vegetation management | 2 | 10 |
| PUC-reportable storm costs, net of insurance recovery | (6) | (13) |
| Act 129 costs | (5) | (6) |
| Uncollectible accounts | (1) | 3 |
| Allocation of certain corporate support group costs | 2 | 7 |
| Other | | 8 |
| Total | \$ 2 | \$ 29 |

Depreciation

Depreciation expense increased by \$11 million for the nine months ended September 30, 2012 compared with 2011, primarily due to PP&E additions related to PPL Electric's ongoing efforts to ensure the reliability of its delivery system and replace aging infrastructure.

Taxes, Other Than Income

Taxes, other than income decreased by \$11 million for the nine months ended September 30, 2012 compared with 2011, primarily due to lower Pennsylvania gross receipts tax expense due to a decrease in taxable electric revenue. This tax is included in "Pennsylvania Gross Delivery Margins."

Financing Costs

The increase (decrease) in financing costs for the periods ended September 30, 2012 compared with 2011 was due to:

| | Three Months | Nine Months |
|---------------------------------------|---------------|---------------|
| Long-term debt interest expense | \$ 1 | \$ (1) |
| Distributions on preference stock (a) | (4) | (8) |
| Amortization of debt issuance costs | (2) | 1 |
| Other | | (1) |
| Total | \$ (5) | \$ (9) |

(a) Decreases for both periods are due to the June 2012 redemption of all 2.5 million shares of preference stock.

Income Taxes

The increase (decrease) in income taxes for the periods ended September 30, 2012 compared with 2011 was due to:

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| | Three Months | | Nine Months | |
|--|--------------|---|-------------|------|
| Higher (lower) pre-tax book income | \$ | 1 | \$ | (15) |
| Federal and state tax reserve adjustments | | | | 1 |
| Federal and state tax return adjustments (a) | | | | 2 |
| Depreciation not normalized (a) | | | | 1 |
| Other | | 1 | | 2 |
| Total | \$ | 2 | \$ | (9) |

- (a) In February 2011, the Pennsylvania Department of Revenue issued interpretive guidance on the treatment of bonus depreciation for Pennsylvania income tax purposes. In accordance with Corporation Tax Bulletin 2011-01, Pennsylvania allows 100% bonus depreciation for qualifying assets in the same year bonus depreciation is allowed for federal income tax purposes. The 100% Pennsylvania bonus depreciation deduction created a current state income tax benefit for the flow-through impact of Pennsylvania regulated state tax depreciation. The federal provision for 100% bonus depreciation generally applies to property placed in service before January 1, 2012.

See Note 5 to the Financial Statements for additional information on income taxes.

Financial Condition

Liquidity and Capital Resources

PPL Electric had the following at:

| | September 30, 2012 | December 31, 2011 |
|---------------------------|--------------------|-------------------|
| Cash and cash equivalents | \$ 31 | \$ 320 |

The \$289 million decrease in PPL Electric's cash and cash equivalents position was primarily the net result of:

- capital expenditures of \$407 million;
- redemption of preference stock of \$250 million;
- a net increase in notes receivable from affiliate of \$210 million;
- the payment of \$75 million of common stock dividends to parent;
- net cash provided by operating activities of \$261 million;
- long-term debt issuance of \$249 million; and
- contributions from parent of \$150 million.

Credit Facilities

PPL Electric maintains credit facilities to provide liquidity and to backstop commercial paper issuances. At September 30, 2012, PPL Electric's total committed borrowing capacity under its credit facilities and the use of this borrowing capacity were:

| | Committed Capacity | Borrowed | Letters of Credit Issued and Commercial Paper Backstop | Unused Capacity |
|--------------------------------------|-----------------------|----------|---|--------------------|
| Syndicated Credit Facility (a) (b) | \$ 300 | | \$ 1 | \$ 299 |
| Asset-backed Credit Facility (c) | 100 | | n/a | 100 |
| Total PPL Electric Credit Facilities | \$ 400 | | \$ 1 | \$ 399 |

- (a) The commitments under this credit facility are provided by a diverse bank group, with no one bank and its affiliates providing an aggregate commitment of more than 7% of the total committed capacity.
- (b) In November 2012, PPL Electric amended its syndicated credit facility to extend the expiration date to October 2017.
- (c) PPL Electric obtains financing by selling and contributing its eligible accounts receivable and unbilled revenue to a special purpose, wholly owned subsidiary on an ongoing basis. The subsidiary pledges these assets to secure loans of up to an aggregate of \$100 million from a commercial paper conduit sponsored by a financial institution. At September 30, 2012, based on accounts receivable and unbilled revenue pledged, the amount available for borrowing under the facility was \$100 million. In July 2012, PPL Electric and the subsidiary extended this agreement to September 2012 and reduced the capacity from \$150 million. In September 2012, the agreement was extended to September 2013.

See Note 7 to the Financial Statements for further discussion of PPL Electric's credit facilities.

Commercial Paper

In May 2012, PPL Electric increased the capacity of its commercial paper program from \$200 million to \$300 million to provide an additional financing source to fund its short-term liquidity needs, if and when necessary. Commercial paper issuances are supported by PPL Electric's Syndicated Credit Facility. PPL Electric had no commercial paper outstanding at September 30, 2012.

Long-term Debt and Equity Securities

In June 2012, PPL Electric redeemed all 2.5 million shares of its 6.25% Series Preference Stock, par value \$100 per share. The price paid for the redemption was the par value, without premium (\$250 million in the aggregate). At December 31, 2011, the preference stock was reflected in "Preference stock" on PPL Electric's Balance Sheet.

In August 2012, PPL Electric issued \$250 million of 2.50% First Mortgage Bonds due 2022. The notes may be redeemed at PPL Electric's option any time prior to maturity at make-whole redemption prices. PPL Electric received proceeds of \$247 million, net of a discount and underwriting fees. The net proceeds were used to repay short-term indebtedness incurred to fund PPL Electric's redemption of its 6.25% Series Preference Stock in June 2012 and for other general corporate purposes.

Rating Agency Actions

Moody's, S&P and Fitch periodically review the credit ratings on the debt of PPL Electric. Based on their respective independent reviews, the rating agencies may make certain ratings revisions or ratings affirmations.

A credit rating reflects an assessment by the rating agency of the creditworthiness associated with an issuer and particular securities that it issues. The credit ratings of PPL Electric are based on information provided by PPL Electric and other sources. The ratings of Moody's, S&P and Fitch are not a recommendation to buy, sell or hold any securities of PPL Electric. Such ratings may be subject to revisions or withdrawal by the agencies at any time and should be evaluated independently of each other and any other rating that may be assigned to the securities. A downgrade in PPL Electric's credit ratings could result in higher borrowing costs and reduced access to capital markets.

As a result of the passage of the Dodd-Frank Act, PPL Electric is limiting its credit rating disclosure to a description of the actions taken by the rating agencies with respect to PPL Electric's ratings, but without stating what ratings have been assigned to PPL Electric or its securities. The ratings assigned by the rating agencies to PPL Electric and its respective securities may be found, without charge, on each of the respective rating agencies' websites, which ratings together with all other information contained on such rating agency websites is, hereby, explicitly not incorporated by reference in this report.

The rating agencies took the following actions related to PPL Electric:

In August 2012, Fitch assigned a rating and outlook to PPL Electric's \$250 million First Mortgage Bonds.

In August 2012, S&P and Moody's assigned a rating to PPL Electric's \$250 million First Mortgage Bonds.

For additional information on PPL Electric's liquidity and capital resources, see "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations," in PPL Electric's 2011 Form 10-K.

Risk Management

Market Risk and Credit Risk

PPL Electric issues debt to finance its operations, which exposes it to interest rate risk. At September 30, 2012, PPL Electric had no potential annual exposure to increased interest expense based on its current debt portfolio.

PPL Electric is also exposed to changes in the fair value of its debt portfolio. PPL Electric estimated that a 10% decrease in interest rates at September 30, 2012 would increase the fair value of its debt portfolio by \$97 million.

See Notes 13 and 14 to the Financial Statements in this Form 10-Q and "Risk Management" in PPL Electric's 2011 Form 10-K for additional information on market and credit risk.

Related Party Transactions

PPL Electric is not aware of any material ownership interests or operating responsibility by senior management of PPL Electric in outside partnerships, including leasing transactions with variable interest entities or other entities doing business with PPL Electric. See Note 11 to the Financial Statements for additional information on related party transactions.

Environmental Matters

See Note 10 to the Financial Statements in this Form 10-Q and "Item 1. Business - Environmental Matters" in PPL Electric's 2011 Form 10-K for a discussion of environmental matters.

153

New Accounting Guidance

See Notes 2 and 18 to the Financial Statements for a discussion of new accounting guidance adopted and pending adoption.

Application of Critical Accounting Policies

Financial condition and results of operations are impacted by the methods, assumptions and estimates used in the application of critical accounting policies. The following accounting policies are particularly important to the financial condition or results of operations, and require estimates or other judgments of matters inherently uncertain: defined benefits, loss accruals, income taxes, regulatory assets and liabilities and revenue recognition - unbilled revenue. See "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" in PPL Electric's 2011 Form 10-K for a discussion of each critical accounting policy.

LG&E AND KU ENERGY LLC AND SUBSIDIARIES

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following should be read in conjunction with LKE's Condensed Consolidated Financial Statements and the accompanying Notes and with LKE's 2011 Form 10-K. Capitalized terms and abbreviations are defined in the glossary. Dollars are in millions, unless otherwise noted.

"Management's Discussion and Analysis of Financial Condition and Results of Operations" includes the following information:

- "Overview" provides a description of LKE and its business strategy, a summary of Net Income and a discussion of certain events related to LKE's results of operations and financial condition.
 - "Results of Operations" provides a summary of LKE's earnings and a description of factors expected to impact future earnings. This section ends with explanations of significant changes in principal items on LKE's Statements of Income, comparing the three and nine months ended September 30, 2012 with the same periods in 2011.
- "Financial Condition - Liquidity and Capital Resources" provides an analysis of LKE's liquidity position and credit profile. This section also includes a discussion of rating agency actions.
- "Financial Condition - Risk Management" provides an explanation of LKE's risk management programs relating to market and credit risk.

Overview

Introduction

LKE, headquartered in Louisville, Kentucky, is a holding company with utility operations through its subsidiaries, LG&E and KU. LG&E and KU, which constitute substantially all of LKE's operations, are regulated utilities engaged in the generation, transmission, distribution and sale of electricity, in Kentucky, Virginia and Tennessee. LG&E also engages in the distribution and sale of natural gas in Kentucky.

Business Strategy

LKE's overall strategy is to provide reliable, safe and competitively priced energy to its customers.

A key objective for LKE is to maintain a strong credit profile through managing financing costs and access to credit markets. LKE continually focuses on maintaining an appropriate capital structure and liquidity position.

Financial and Operational Developments

Net Income

Net Income for the three and nine months ended September 30, 2012 was \$83 million and \$180 million compared to \$89 million and \$217 million for the same periods in 2011 representing decreases of 7% and 17% from the same periods in 2011.

See "Results of Operations" for a discussion and analysis of LKE's earnings.

Terminated Bluegrass CTs Acquisition

In September 2011, LG&E and KU entered into an asset purchase agreement with Bluegrass Generation for the purchase of the Bluegrass CTs, aggregating approximately 495 MW, plus limited associated contractual arrangements required for operation of the units, for a purchase price of \$110 million, pending receipt of applicable regulatory approvals. In May 2012, the KPSC issued an order approving the request to purchase the Bluegrass CTs. Also in May 2012, the FERC issued an order conditionally authorizing the acquisition of the Bluegrass CTs, subject to approval by the FERC of satisfactory mitigation measures to address market-power concerns. After a review of potentially available mitigation options, LG&E and KU determined that the options were not commercially justifiable. In June 2012, LG&E and KU terminated the asset purchase agreement for the Bluegrass CTs in accordance with its terms and made applicable filings with

the KPSC and FERC. LG&E and KU are currently assessing the impact of the asset purchase agreement termination and potential future generation capacity options.

NGCC Construction

In September 2011, LG&E and KU filed a CPCN with the KPSC requesting approval to build a 640 MW NGCC at the existing Cane Run plant site in Kentucky. In May 2012, the KPSC issued an order approving the request. LG&E will own a 22% undivided interest and KU will own a 78% undivided interest in the new NGCC. LG&E and KU commenced preliminary construction activities in the third quarter of 2012 and project construction is expected to be completed by May 2015. The project, which includes building a natural gas supply pipeline and related transmission projects, has an estimated cost of approximately \$600 million.

In conjunction with this construction and to meet new, more stringent federal EPA regulations with a 2015 compliance date, LG&E and KU anticipate retiring six older coal-fired electric generating units at the Cane Run, Green River and Tyrone plants, which have a combined summer capacity rating of 797 MW.

Capital Expenditures

Capital expenditure plans are revised periodically to reflect changes in operational, market and regulatory conditions. LKE has lowered its projected environmental capital spending for the period 2012 through 2016 by approximately \$0.5 billion from the previously disclosed \$3.1 billion projection included in LKE's 2011 Form 10-K. The lower projected capital spending is based on current project evaluations and pricing contained in contracts executed to date for environmental construction projects. LKE continues to evaluate potential new generation supply sources, including self-build options and power sourced from the market, as alternatives to installing additional emission control equipment at E.W. Brown, which is jointly dispatched for LG&E and KU, and in lieu of the terminated Bluegrass CTs acquisition discussed in Notes 6 and 8 to the Financial Statements. LKE expects to complete its evaluation during the first half of 2013. The outcome of that evaluation may lead to additional changes in projected capital spending.

Registered Debt Exchange Offer by LKE

In June 2012, LKE completed an exchange of all its outstanding 4.375% Senior Notes due 2021 issued in September 2011 in a transaction not registered under the Securities Act of 1933, for similar securities that were issued in a transaction registered with the SEC. See Note 7 in LKE's 2011 Form 10-K for additional information.

Commercial Paper

In February 2012, LG&E and KU each established a commercial paper program for up to \$250 million to provide an additional financing source to fund their short-term liquidity needs, if and when necessary. Commercial paper issuances are supported by LG&E's and KU's Syndicated Credit Facilities. LG&E and KU had no commercial paper outstanding at September 30, 2012.

Results of Operations

The following discussion provides a summary of LKE's earnings and a description of factors that management expects may impact future earnings. This section ends with "Statement of Income Analysis," which includes explanations of significant changes in principal items on LKE's Statements of Income, comparing the three and nine months ended September 30, 2012 with the same periods in 2011.

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

The results for interim periods can be disproportionately influenced by numerous factors and developments and by seasonal variations. As such, the results of operations for interim periods do not necessarily indicate results or trends for the year or for future periods.

Earnings

Net Income for the periods ended September 30
was:

| | Three Months | | Nine Months | |
|------------|--------------|-------|-------------|--------|
| | 2012 | 2011 | 2012 | 2011 |
| Net Income | \$ 83 | \$ 89 | \$ 180 | \$ 217 |

The changes in the components of Net Income between these periods were due to the following factors, which reflect reclassifications for items included in margins and certain items that management considers special. See additional detail of these special items in the table below.

| | Three Months | Nine Months |
|---------------------------------|-----------------|-------------|
| Margins | \$ (4) | \$ (22) |
| Other operation and maintenance | 3 | (12) |
| Depreciation | (2) | (8) |
| Taxes, other than income | (1) | (6) |
| Other | (2) | (5) |
| Other Income (Expense) - net | (4) | (13) |
| Income Taxes | 4 | 30 |
| Special items | | (1) |
| Total | \$ (6) | \$ (37) |

- See "Statement of Income Analysis - Margins - Changes in Non-GAAP Financial Measures" for an explanation of margins.
- Higher other operation and maintenance for the nine-month period, primarily due to \$12 million of higher coal plant maintenance costs resulting from an increased scope of scheduled plant outages.
- Higher depreciation for the nine-month period, primarily due to PP&E additions.
- Higher taxes, other than income for the nine-month period, primarily due to an increase in property taxes resulting from property additions, higher assessed values, and changes in property classifications to categories with higher tax rates.
- Lower other income (expense) - net for the nine-month period, primarily due to losses from an equity method investment.
- Lower income taxes for the nine-month period, primarily due to lower pre-tax income.

The following after-tax gains (losses), which management considers special items, also impacted earnings during the periods ended September 30.

| | Income Statement Line Item | Three Months 2012 | 2011 | Nine Months 2012 | 2011 |
|----------------------------------|--|----------------------|--------|---------------------|--------|
| Acquisition-related adjustments: | | | | | |
| | Net operating loss carryforward and other tax related adjustments | | | \$ 4 | |
| Other: | | | | | |
| | Discontinued Operations, net of tax of \$0, \$1, \$4, \$1 (a) | | \$ (1) | (5) | \$ (1) |
| | Energy-related economic activity, net of tax of \$0, (\$1), \$0, \$0 | | | 1 | 1 |
| Total | | | | \$ (1) | |

- (a) The nine months ended September 30, 2012 includes an adjustment to an indemnification liability.

Outlook

Excluding special items, LKE projects lower earnings in 2012 compared with 2011 as a result of higher other operation and maintenance expense, higher depreciation, higher property taxes and losses from an equity method investment.

In June 2012, LG&E and KU filed requests with the KPSC for increases in annual base electric rates of approximately \$62 million at LG&E and approximately \$82 million at KU and an increase in annual base gas rates of approximately \$17 million at LG&E. The proposed base rate increases would result in electric rate increases of 6.9% at LG&E and 6.5% at KU and a gas rate increase of 7.0% at LG&E and would be effective in January 2013. LG&E's and KU's applications include requests for authorized returns-on-equity at LG&E and KU of 11% each. In November 2012, the KPSC issued an order for a settlement conference to begin on November 13, 2012. A hearing on the original application and subsequent testimony is scheduled to begin on November 27, 2012. LG&E and KU cannot predict the outcome of these proceedings, including the possibility of any agreed stipulations or settlement, which would remain subject to KPSC approval. A final order may be issued in December 2012 or January 2013.

Earnings in 2012 and future periods are subject to various risks and uncertainties. See "Forward-Looking Information," the rest of this Item 2, Notes 6 and 10 to the Financial Statements in this Form 10-Q and "Item 1. Business" and "Item 1A. Risk Factors" in LKE's 2011 Form 10-K for a discussion of the risks, uncertainties and factors that may impact future earnings.

Statement of Income Analysis --

Margins

Non-GAAP Financial Measure

The following discussion includes financial information prepared in accordance with GAAP, as well as a non-GAAP financial measure, "Margins." Margins is not intended to replace "Operating Income," which is determined in accordance with GAAP as an indicator of overall operating performance. Other companies may use different measures to analyze and to report on the results of their operations. Margins is a single financial performance measure of LKE's operations. In calculating this measure, utility revenues and expenses associated with approved cost recovery tracking mechanisms are offset. These mechanisms allow for recovery of certain expenses, returns on capital investments associated with environmental regulations and performance incentives. Certain costs associated with these mechanisms, primarily ECR and DSM, are recorded as "Other operation and maintenance" and "Depreciation." As a result, this measure represents the net revenues from LKE's operations. This performance measure is used, in conjunction with other information, internally by senior management to manage operations and analyze actual results compared to budget.

Reconciliation of Non-GAAP Financial Measures

The following tables reconcile "Operating Income" to "Margins" as defined by LKE for the periods ended September 30.

| | 2012 Three Months | | | 2011 Three Months | | |
|---------------------------------|-------------------|-----------|----------------------|-------------------|-----------|----------------------|
| | Margins | Other (a) | Operating Income (b) | Margins | Other (a) | Operating Income (b) |
| Operating Revenues | \$ 732 | | \$ 732 | \$ 734 | \$ 2 | \$ 736 |
| Operating Expenses | | | | | | |
| Fuel | 249 | | 249 | 245 | | 245 |
| Energy purchases | 27 | | 27 | 32 | | 32 |
| Other operation and maintenance | 28 | \$ 158 | 186 | 26 | 161 | 187 |
| Depreciation | 13 | 74 | 87 | 12 | 72 | 84 |
| Taxes, other than income | | 11 | 11 | | 10 | 10 |
| Total Operating Expenses | 317 | 243 | 560 | 315 | 243 | 558 |
| Total | \$ 415 | \$ (243) | \$ 172 | \$ 419 | \$ (241) | \$ 178 |

| | 2012 Nine Months | | | 2011 Nine Months | | |
|---------------------------------|------------------|-----------|----------------------|------------------|-----------|----------------------|
| | Margins | Other (a) | Operating Income (b) | Margins | Other (a) | Operating Income (b) |
| Operating Revenues | \$ 2,095 | | \$ 2,095 | \$ 2,139 | \$ 1 | \$ 2,140 |
| Operating Expenses | | | | | | |
| Fuel | 677 | | 677 | 666 | | 666 |
| Energy purchases | 135 | | 135 | 179 | | 179 |
| Other operation and maintenance | 76 | \$ 513 | 589 | 67 | 499 | 566 |

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| | | | | | | |
|--------------------------|----------|----------|--------|----------|----------|--------|
| Depreciation | 39 | 220 | 259 | 37 | 212 | 249 |
| Taxes, other than income | | 34 | 34 | | 28 | 28 |
| Total Operating Expenses | 927 | 767 | 1,694 | 949 | 739 | 1,688 |
| Total | \$ 1,168 | \$ (767) | \$ 401 | \$ 1,190 | \$ (738) | \$ 452 |

(a) Represents amounts excluded from Margins.

(b) As reported on the Statements of Income.

Changes in Non-GAAP Financial Measures

Margins decreased by \$22 million for the nine months ended September 30, 2012 compared with the same period in 2011, primarily due to \$16 million of lower retail margins, as volumes were impacted by unseasonably mild weather during the first four months of 2012, and \$6 million of lower wholesale margins, as volumes were impacted by lower market prices. Total heating degree days decreased 24% compared to the same period in 2011.

Other Operation and Maintenance

Other operation and maintenance increased by \$23 million for the nine months ended September 30, 2012 compared with 2011, primarily due to:

- a \$13 million increase in coal plant maintenance costs, including certain amounts included in margins, primarily resulting from an increased scope of scheduled outages;
- a \$6 million credit to establish a regulatory asset was recorded in the first quarter of 2011 related to 2009 storm costs; and
- a \$3 million increase in restricted stock awards.

Depreciation

Depreciation increased by \$3 million and \$10 million for the three and nine months ended September 30, 2012 compared with 2011, primarily due to PP&E additions.

Taxes, Other Than Income

Taxes, other than income increased by \$6 million for the nine months ended September 30, 2012 compared with 2011, primarily due to an increase in property taxes resulting from property additions, higher assessed values, and changes in property classifications to categories with higher tax rates.

Other Income (Expense) - net

Other income (expense) - net decreased by \$13 million for the nine months ended September 30, 2012, compared with 2011, primarily due to \$8 million in losses from an equity method investment.

Income Taxes

Income taxes decreased by \$36 million for the nine months ended September 30, 2012, compared with 2011, primarily due to a \$68 million decrease in pre-tax income and \$9 million of adjustments to deferred taxes related to net operating loss carryforwards based on income tax return adjustments.

See Note 5 to the Financial Statements for additional information on income taxes.

Income (Loss) from Discontinued Operations (net of income taxes)

Loss from discontinued operations increased by \$5 million for the nine months ended September 30, 2012, compared with 2011. The increase was primarily related to an adjustment to the estimated liability for indemnifications related to the termination of the WKE lease in 2009.

Financial Condition

Liquidity and Capital Resources

LKE had the following at:

September 30, 2012

December 31, 2011

| | | | | |
|---------------------------|----|----|----|----|
| Cash and cash equivalents | \$ | 90 | \$ | 59 |
|---------------------------|----|----|----|----|

The \$31 million increase in LKE's cash and cash equivalents position was primarily the net result of:

- cash provided by operating activities of \$646 million;
- capital expenditures of \$525 million; and
- distributions to member of \$95 million.

LKE's cash provided by operating activities decreased by \$37 million for the nine months ended September 30, 2012, compared with 2011, primarily due to:

- a decrease in net income of \$37 million due to unseasonably mild weather during the first four months of 2012 and higher operation and maintenance expenses, adjusted for non-cash effects of \$103 million (deferred income taxes and investment tax credits of \$114 million and defined benefit plans - expense of \$8 million, partially offset by depreciation of \$10 million and other noncash items of \$9 million); and
- a decrease in cash inflows related to income tax receivable of \$37 million due to fewer income tax payments received from member; partially offset by
- a decrease in cash outflows related to accrued taxes of \$49 million primarily due to the timing of property and income tax payments; and
- a decrease in cash outflows of \$93 million due to a reduction in discretionary defined benefit plan contributions.

LKE's cash used in investing activities increased by \$383 million for the nine months ended September 30, 2012, compared with 2011, primarily due to proceeds from the sale of other investments of \$163 million in 2011 and an increase in capital expenditures of \$229 million as a result of increased environmental spending, primarily related to landfills; and infrastructure improvements at generation, distribution and transmission facilities.

LKE's cash used in financing activities decreased by \$292 million for the nine months ended September 30, 2012, compared with 2011, primarily due to the issuance of long-term debt of \$250 million and a repayment on a revolving line of credit of \$163 million in 2011 and lower distributions to member of \$374 million in 2012.

Credit Facilities

At September 30, 2012, LKE's total committed borrowing capacity under its credit facilities and the use of this borrowing capacity were:

| | Committed Capacity | Borrowed | Letters of Credit Issued | Unused Capacity |
|--|-----------------------|----------|--------------------------------|--------------------|
| LKE Credit Facility with a subsidiary of PPL Energy Supply | \$ 300 | | | \$ 300 |
| LG&E Credit Facility (a) | 400 | | | 400 |
| KU Credit Facilities (a) (b) | 598 | | \$ 198 | 400 |
| Total Credit Facilities (c) | \$ 1,298 | | \$ 198 | \$ 1,100 |

(a) In November 2012, LG&E and KU amended the syndicated credit facility to extend the expiration dates to November 2017. In addition, LG&E increased the credit facility capacity to \$500 million.

(b) In August 2012, the KU letter of credit facility agreement was amended and restated to allow for certain payments under the letter of credit facility to be converted to loans rather than requiring immediate payment.

(c) The commitments under LKE's domestic credit facilities are provided by a diverse bank group, with no one bank and its affiliates providing an aggregate commitment of more than 10% of the total committed capacity; however, the PPL affiliate provides a commitment of approximately 23% of the total facilities listed above.

See Note 7 to the Financial Statements for further discussion of LKE's credit facilities.

Long-term Debt Securities

LKE's long-term debt securities activity through September 30, 2012 was:

| | Debt Issuances | Debt Retirement |
|--|-------------------|--------------------|
|--|-------------------|--------------------|

Non-cash Exchanges (a)

| | | | | |
|----------------------------|----|-----|----|-------|
| LKE Senior Unsecured Notes | \$ | 250 | \$ | (250) |
|----------------------------|----|-----|----|-------|

(a) In June 2012, LKE completed an exchange of all of its outstanding 4.375% Senior Notes due 2021 issued in September 2011, in a transaction not registered under the Securities Act of 1933, for similar securities that were issued in a transaction registered with the SEC.

See Note 7 to the Financial Statements for additional information about long-term debt securities.

Rating Agency Actions

Moody's, S&P and Fitch periodically review the credit ratings on the debt securities of LKE and its subsidiaries. Based on their respective independent reviews, the rating agencies may make certain ratings revisions or ratings affirmations.

A credit rating reflects an assessment by the rating agency of the creditworthiness associated with an issuer and particular securities that it issues. The credit ratings of LKE and its subsidiaries are based on information provided by LKE and other sources. The ratings of Moody's, S&P and Fitch are not a recommendation to buy, sell or hold any securities of LKE or its subsidiaries. Such ratings may be subject to revisions or withdrawal by the agencies at any time and should be evaluated independently of each other and any other rating that may be assigned to the securities. A downgrade in LKE's or its subsidiaries' credit ratings could result in higher borrowing costs and reduced access to capital markets.

As a result of the passage of the Dodd-Frank Act and the attendant uncertainties relating to the extent to which issuers of non-asset backed securities may disclose credit ratings without being required to obtain rating agency consent to the inclusion of such disclosure, or incorporation by reference of such disclosure, in a registrant's registration statement or section 10(a) prospectus, LKE is limiting its credit rating disclosure to a description of the actions taken by the rating agencies with respect to LKE's ratings, but without stating what ratings have been assigned to LKE or its subsidiaries, or their securities. The ratings assigned by the rating agencies to LKE and its subsidiaries and their respective securities may be found, without charge, on each of the respective rating agencies' websites, which ratings together with all other information contained on such rating agency websites is, hereby, explicitly not incorporated by reference in this report.

The rating agencies took the following actions related to LKE and its subsidiaries:

In February 2012, Fitch assigned ratings to the two newly established commercial paper programs for LG&E and KU.

In March 2012, Moody's affirmed the following ratings:

- the long-term ratings of the First Mortgage Bonds for LG&E and KU;
- the issuer ratings for LG&E and KU; and
- the bank loan ratings for LG&E and KU.

Also in March 2012, Moody's and S&P each assigned short-term ratings to the two newly established commercial paper programs for LG&E and KU.

In March and May 2012, Moody's, S&P and Fitch affirmed the long-term ratings for LG&E's 2003 Series A and 2007 Series B pollution control bonds.

Ratings Triggers

LKE and its subsidiaries have various derivative and non-derivative contracts, including contracts for the sale and purchase of electricity, fuel, commodity transportation and storage and interest rate instruments, which contain provisions requiring LKE and its subsidiaries to post additional collateral, or permitting the counterparty to terminate the contract, if LKE's or its subsidiaries' credit ratings were to fall below investment grade. See Note 14 to the Financial Statements for a discussion of "Credit Risk-Related Contingent Features," including a discussion of the potential additional collateral that would have been required for derivative contracts in a net liability position at September 30, 2012. At September 30, 2012, if LKE and its subsidiaries' credit ratings had been below investment grade, the maximum amount that LKE would have been required to post as additional collateral to counterparties was \$87 million for both derivative and non-derivative commodity and commodity-related contracts used in its generation and marketing operations, gas supply and interest rate contracts.

Risk Management

Market Risk

See Notes 13 and 14 to the Financial Statements for information about LKE's risk management objectives, valuation techniques and accounting designations.

The forward-looking information presented below provides estimates of what may occur in the future, assuming certain adverse market conditions and model assumptions. Actual future results may differ materially from those presented. These disclosures are not precise indicators of expected future losses, but only indicators of possible losses under normal market conditions at a given confidence level.

Commodity Price Risk

LG&E's and KU's rates are set by regulatory commissions and the fuel costs incurred are directly recoverable from customers. As a result, LG&E and KU are subject to commodity price risk for only a small portion of on-going business operations. LKE conducts energy trading and risk management activities to maximize the value of the physical assets at times when the assets are not required to serve LG&E's and KU's customers. See Note 14 to the Financial Statements for additional disclosures.

Interest Rate Risk

LKE and its subsidiaries issue debt to finance their operations, which exposes them to interest rate risk. LKE utilizes various financial derivative instruments to adjust the mix of fixed and floating interest rates in its debt portfolio when appropriate. Risk limits under LKE's risk management program are designed to balance risk, exposure to volatility in interest expense and changes in the fair value of LKE's debt portfolio due to changes in the absolute level of interest rates.

At September 30, 2012, LKE's potential annual exposure to increased interest expense, based on a 10% increase in interest rates, was not significant.

LKE is also exposed to changes in the fair value of its debt portfolio. LKE estimated that a 10% decrease in interest rates at September 30, 2012, would increase the fair value of its debt portfolio by \$117 million.

At September 30, 2012, LKE had the following interest rate hedges outstanding:

| | Exposure | Fair Value, Net - Asset (Liability) | Effect of a 10% Adverse Movement in Rates |
|-------------------------|----------|---|---|
| | Hedged | (a) | |
| Economic hedges | | | |
| Interest rate swaps (b) | \$ 179 | \$ (62) | \$ (3) |

(a) Includes accrued interest.

(b) LKE utilizes various risk management instruments to reduce its exposure to the expected future cash flow variability of its debt instruments. These risks include exposure to adverse interest rate movements for outstanding variable rate debt and for future anticipated financing. While LKE is exposed to changes in the fair value of these instruments, any realized changes in the fair value of such economic hedges are recoverable through regulated rates and any subsequent changes in fair value of these derivatives are included in regulatory assets or liabilities. Sensitivities represent a 10% adverse movement in interest rates. The positions outstanding at September 30, 2012 mature through 2033.

Credit Risk

See Notes 13 and 14 to the Financial Statements in this Form 10-Q and "Risk Management - Energy Marketing & Trading and Other - Credit Risk" in LKE's 2011 Form 10-K for additional information.

Related Party Transactions

LKE is not aware of any material ownership interest or operating responsibility by senior management of LKE, LG&E or KU in outside partnerships, including leasing transactions with variable interest entities, or other entities doing business with LKE. See Note 11 to the Financial Statements for additional information on related party transactions.

Environmental Matters

Protection of the environment is a major priority for LKE and a significant element of its business activities. Extensive federal, state and local environmental laws and regulations are applicable to LKE's air emissions, water discharges and the management of hazardous and solid waste, among other areas, and the costs of compliance or alleged non-compliance cannot be predicted with certainty but could be material. In addition, costs may increase significantly if the requirements or scope of environmental laws or regulations, or similar rules, are expanded or changed from prior versions by the relevant agencies. Costs may take the form of increased capital or operating and maintenance expenses; monetary fines, penalties or forfeitures; or other restrictions. Many of these environmental law considerations are also applicable to the operations of key suppliers, or customers, such as coal producers, industrial power users, etc. and may impact the costs for their products or their demand for LKE's services. See "Item 1. Business - Environmental Matters" in LKE's 2011 Form 10-K and Note 10 to the Financial Statements for a discussion of environmental matters.

New Accounting Guidance

See Notes 2 and 18 to the Financial Statements for a discussion of new accounting guidance adopted and pending adoption.

Application of Critical Accounting Policies

Financial condition and results of operations are impacted by the methods, assumptions and estimates used in the application of critical accounting policies. The following accounting policies are particularly important to the financial condition or results of operations and require estimates or other judgments of matters inherently uncertain: revenue recognition - unbilled revenue, price risk management, defined benefits, asset impairment, loss accruals, AROs, income taxes, and regulatory assets and liabilities. See "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" in LKE's 2011 Form 10-K for a discussion of each critical accounting policy.

LOUISVILLE GAS AND ELECTRIC COMPANY

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following should be read in conjunction with LG&E's Condensed Financial Statements and the accompanying Notes and with LG&E's 2011 Form 10-K. Capitalized terms and abbreviations are defined in the glossary. Dollars are in millions, unless otherwise noted.

"Management's Discussion and Analysis of Financial Condition and Results of Operations" includes the following information:

- "Overview" provides a description of LG&E and its business strategy, a summary of Net Income and a discussion of certain events related to LG&E's results of operations and financial condition.
- "Results of Operations" provides a summary of LG&E's earnings and a description of factors expected to impact future earnings. This section ends with explanations of significant changes in principal items on LG&E's Statements of Income, comparing the three and nine months ended September 30, 2012 with the same periods in 2011.
- "Financial Condition - Liquidity and Capital Resources" provides an analysis of LG&E's liquidity position and credit profile. This section also includes a discussion of rating agency actions.
- "Financial Condition - Risk Management" provides an explanation of LG&E's risk management programs relating to market and credit risk.

Overview

Introduction

LG&E, headquartered in Louisville, Kentucky, is a regulated utility engaged in the generation, transmission, distribution and sale of electricity and the distribution and sale of natural gas in Kentucky.

Business Strategy

LG&E's overall strategy is to provide reliable, safe and competitively priced energy to its customers.

A key objective for LG&E is to maintain a strong credit profile through managing financing costs and access to credit markets. LG&E continually focuses on maintaining an appropriate capital structure and liquidity position.

Financial and Operational Developments

Net Income

Net Income for the three and nine months ended September 30, 2012 was \$43 million and \$94 million compared to \$43 million and \$102 million for the same periods in 2011 representing an 8% decrease from the nine-month period in 2011.

See "Results of Operations" for a discussion and analysis of LG&E's earnings.

Terminated Bluegrass CTs Acquisition

In September 2011, LG&E and KU entered into an asset purchase agreement with Bluegrass Generation for the purchase of the Bluegrass CTs, aggregating approximately 495 MW, plus limited associated contractual arrangements required for operation of the units, for a purchase price of \$110 million, pending receipt of applicable regulatory approvals. In May 2012, the KPSC issued an order approving the request to purchase the Bluegrass CTs. Also in May 2012, the FERC issued an order conditionally authorizing the acquisition of the Bluegrass CTs, subject to approval by the FERC of satisfactory mitigation measures to address market-power concerns. After a review of potentially available mitigation options, LG&E and KU determined that the options were not commercially justifiable. In June 2012, LG&E and KU terminated the asset purchase agreement for the Bluegrass CTs in accordance with its terms and made applicable filings with the KPSC and FERC. LG&E and KU are currently assessing the impact of the asset purchase agreement termination and potential future generation capacity options.

NGCC Construction

In September 2011, LG&E and KU filed a CPCN with the KPSC requesting approval to build a 640 MW NGCC at the existing Cane Run plant site in Kentucky. In May 2012, the KPSC issued an order approving the request. LG&E will own a 22% undivided interest and KU will own a 78% undivided interest in the new NGCC. LG&E and KU commenced preliminary construction activities in the third quarter of 2012 and project construction is expected to be completed by May 2015. The project, which includes building a natural gas supply pipeline and related transmission projects, has an estimated cost of approximately \$600 million.

In conjunction with this construction and to meet new, more stringent federal EPA regulations with a 2015 compliance date, LG&E and KU anticipate retiring six older coal-fired electric generating units at the Cane Run, Green River and Tyrone plants, which have a combined summer capacity rating of 797 MW.

Capital Expenditures

Capital expenditure plans are revised periodically to reflect changes in operational, market and regulatory conditions. LG&E has lowered its projected environmental capital spending for the period 2012 through 2016 by approximately \$0.4 billion from the previously disclosed \$1.6 billion projection included in LG&E's 2011 Form 10-K. The lower projected capital spending is based on current project evaluations and pricing contained in contracts executed to date for environmental construction projects. LG&E continues to evaluate potential new generation supply sources, including self-build options and power sourced from the market, as alternatives to installing additional emission control equipment at E.W. Brown, which is jointly dispatched for LG&E and KU, and in lieu of the terminated Bluegrass CTs acquisition discussed in Notes 6 and 8 to the Financial Statements. LG&E expects to complete its evaluation during the first half of 2013. The outcome of that evaluation may lead to additional changes in projected capital spending.

Commercial Paper

In February 2012, LG&E established a commercial paper program for up to \$250 million to provide an additional financing source to fund its short-term liquidity needs, if and when necessary. Commercial paper issuances are supported by LG&E's Syndicated Credit Facility. LG&E had no commercial paper outstanding at September 30, 2012.

Results of Operations

The following discussion provides a summary of LG&E's earnings and a description of factors that management expects may impact future earnings. This section ends with "Statement of Income Analysis," which includes explanations of significant changes in principal items on LG&E's Statements of Income, comparing the three and nine months ended September 30, 2012 with the same periods in 2011.

The results for interim periods can be disproportionately influenced by numerous factors and developments and by seasonal variations. As such, the results of operations for interim periods do not necessarily indicate results or trends for the year or for future periods.

Earnings

Net Income for the periods ended September 30 was:

Three Months

Nine Months

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| | 2012 | 2011 | 2012 | 2011 |
|------------|-------|-------|-------|--------|
| Net Income | \$ 43 | \$ 43 | \$ 94 | \$ 102 |

The changes in the components of Net Income between these periods were due to the following factors, which reflect reclassifications for items included in margins.

| | Three Months | Nine Months |
|---------------------------------|-----------------|-------------|
| Margin | \$ (1) | \$ (5) |
| Other operation and maintenance | 7 | 1 |
| Depreciation | (1) | (4) |
| Taxes, other than income | (1) | (3) |
| Other | (4) | 3 |
| Total | \$ (8) | \$ (8) |

- See "Statement of Income Analysis - Margins - Changes in Non-GAAP Financial Measures" for an explanation of margins.
- Lower other operation and maintenance for the three-month period, due to less storm restoration and tree trimming costs, less gas operation and maintenance costs, lower bad debt expenses as a result of milder weather and improving economy and lower pension expenses.

Outlook

LG&E projects lower earnings in 2012 compared with 2011 as a result of higher other operation and maintenance expense, higher depreciation and higher property taxes.

In June 2012, LG&E filed a request with the KPSC for an increase in annual base electric rates of approximately \$62 million and an increase in annual base gas rates of approximately \$17 million. The proposed request would result in a 6.9% increase in the base electric rates and a 7.0% increase in the base gas rates, and would be effective in January 2013. LG&E's application includes a request for authorized return-on-equity of 11%. In November 2012, the KPSC issued an order for a settlement conference to begin on November 13, 2012. A hearing on the original application and subsequent testimony is scheduled to begin on November 27, 2012. LG&E cannot predict the outcome of these proceedings, including the possibility of any agreed stipulations or settlement, which would remain subject to KPSC approval. A final order may be issued in December 2012 or January 2013.

Earnings in 2012 and future periods are subject to various risks and uncertainties. See "Forward-Looking Information," the rest of this Item 2, Notes 6 and 10 to the Financial Statements in this Form 10-Q and "Item 1. Business" and "Item 1A. Risk Factors" in LG&E's 2011 Form 10-K for a discussion of the risks, uncertainties and factors that may impact future earnings.

Statement of Income Analysis --

Margins

Non-GAAP Financial Measure

The following discussion includes financial information prepared in accordance with GAAP, as well as a non-GAAP financial measure, "Margins." Margins is not intended to replace "Operating Income," which is determined in accordance with GAAP as an indicator of overall operating performance. Other companies may use different measures to analyze and to report on the results of their operations. Margins is a single financial performance measure of LG&E's operations. In calculating this measure, utility revenues and expenses associated with approved cost recovery tracking mechanisms are offset. These mechanisms allow for recovery of certain expenses, returns on capital investments associated with environmental regulations and performance incentives. Certain costs associated with these mechanisms, primarily ECR and DSM, are recorded as "Other operation and maintenance" and "Depreciation." As a result, this measure represents the net revenues from LG&E's operations. This performance measure is used, in conjunction with other information, internally by senior management to manage operations and analyze actual results compared to budget.

Reconciliation of Non-GAAP Financial Measures

The following tables reconcile "Operating Income" to "Margins" as defined by LG&E for the periods ended September 30.

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| | 2012 Three Months | | | 2011 Three Months | | |
|------------------------------------|-------------------|-----------|-------------------------|-------------------|-----------|-------------------------|
| | Margins | Other (a) | Operating Income (b) | Margins | Other (a) | Operating Income (b) |
| Operating Revenues | \$ 333 | | \$ 333 | \$ 339 | \$ 1 | \$ 340 |
| Operating Expenses | | | | | | |
| Fuel | 100 | | 100 | 98 | | 98 |
| Energy purchases | 21 | | 21 | 31 | | 31 |
| Other operation and maintenance | 13 | \$ 74 | 87 | 10 | 81 | 91 |
| Depreciation | 1 | 37 | 38 | 1 | 36 | 37 |
| Taxes, other than income | | 6 | 6 | | 5 | 5 |
| Total Operating Expenses | 135 | 117 | 252 | 140 | 122 | 262 |
| Total | \$ 198 | \$ (117) | \$ 81 | \$ 199 | \$ (121) | \$ 78 |

166

| | 2012 Nine Months | | | 2011 Nine Months | | |
|---------------------------------|------------------|-----------|----------------------|------------------|-----------|----------------------|
| | Margins | Other (a) | Operating Income (b) | Margins | Other (a) | Operating Income (b) |
| Operating Revenues | \$ 990 | | \$ 990 | \$ 1,034 | \$ 1 | \$ 1,035 |
| Operating Expenses | | | | | | |
| Fuel | 281 | | 281 | 265 | | 265 |
| Energy purchases | 119 | | 119 | 180 | | 180 |
| Other operation and maintenance | 36 | \$ 241 | 277 | 30 | 242 | 272 |
| Depreciation | 2 | 112 | 114 | 2 | 108 | 110 |
| Taxes, other than income | | 17 | 17 | | 14 | 14 |
| Total Operating Expenses | 438 | 370 | 808 | 477 | 364 | 841 |
| Total | \$ 552 | \$ (370) | \$ 182 | \$ 557 | \$ (363) | \$ 194 |

(a) Represents amounts excluded from Margins.

(b) As reported on the Statements of Income.

Changes in Non-GAAP Financial Measures

Margins decreased by \$5 million during the nine months ended September 30, 2012 compared with the same period in 2011, primarily due to \$4 million of lower wholesale margins, as volumes were impacted by lower market prices. Retail margins were consistent with the prior year as increased industrial sales offset declines associated with unseasonably mild weather during the first four months of 2012. Total heating degree days decreased 28% compared to the same period in 2011.

Other Operation and Maintenance

Other operation and maintenance increased by \$5 million for the nine months ended September 30, 2012 compared with 2011, primarily due to an \$8 million increase in coal plant maintenance costs, primarily resulting from an increased scope of scheduled outages. This increase was offset by a \$2 million decrease in pension expense.

Financial Condition

Liquidity and Capital Resources

LG&E had the following at:

| | September 30, 2012 | December 31, 2011 |
|---------------------------|--------------------|-------------------|
| Cash and cash equivalents | \$ 48 | \$ 25 |

The \$23 million increase in LG&E's cash and cash equivalents position was primarily the net result of:

- cash provided by operating activities of \$267 million, partially offset by
- capital expenditures of \$193 million; and
- common stock dividends of \$47 million.

LG&E's cash provided by operating activities decreased by \$12 million for the nine months ended September 30, 2012, compared with 2011, primarily due to:

- a decrease in cash inflows from accounts receivable of \$26 million which is primarily the result of a decrease in accounts receivable from affiliates of \$20 million for receivables from KU for TC2 coal inventory and other shared costs and from LKE for income tax settlements; and
- a decrease in coal consumption resulting primarily from lower coal-fired generation due to the mild winter weather and an increase in combustion turbine generation that led to an increase of \$34 million in coal inventory, partially offset by a \$7 million greater decline in gas storage in comparison to 2011; partially offset by
- a decrease in cash outflows of \$42 million due to a reduction in discretionary defined benefit plan contributions.

LG&E's cash used in investing activities increased by \$221 million for the nine months ended September 30, 2012, compared with 2011, primarily due to proceeds from the sale of other investments of \$163 million in 2011 and an increase in capital expenditures of \$66 million as a result of increased environmental spending, primarily related to landfills; and infrastructure improvements at generation, distribution and transmission facilities.

LG&E's cash used in financing activities decreased by \$183 million for the nine months ended September 30, 2012, compared with 2011, primarily due to a repayment on a revolving line of credit of \$163 million and a net decrease in notes payable with affiliates of \$12 million in 2011, along with lower common stock dividends paid to LKE of \$8 million in 2012.

Credit Facilities

At September 30, 2012, LG&E's committed borrowing capacity under its credit facilities and the use of this borrowing capacity were:

| | Committed Capacity | Borrowed | Letters of Credit Issued | Unused Capacity |
|------------------------------------|-----------------------|----------|--------------------------------|--------------------|
| Syndicated Credit Facility (a) (b) | \$ 400 | | | \$ 400 |

(a) The commitments under LG&E's Syndicated Credit Facility are provided by a diverse bank group, with no one bank and its affiliates providing an aggregate commitment of more than 6% of the total committed capacity available to LG&E.

(b) In November 2012, LG&E amended the syndicated credit facility to extend the expiration date to November 2017. In addition, LG&E increased the credit facility capacity to \$500 million.

LG&E participates in an intercompany money pool agreement whereby LKE and/or KU make available to LG&E funds up to \$500 million at an interest rate based on a market index of commercial paper issues. At September 30, 2012 and December 31, 2011, there was no balance outstanding.

See Note 7 to the Financial Statements for further discussion of LG&E's credit facilities.

Rating Agency Actions

Moody's, S&P and Fitch periodically review the credit ratings on the debt securities of LG&E. Based on their respective independent reviews, the rating agencies may make certain ratings revisions or ratings affirmations.

A credit rating reflects an assessment by the rating agency of the creditworthiness associated with an issuer and particular securities that it issues. The credit ratings of LG&E are based on information provided by LG&E and other sources. The ratings of Moody's, S&P and Fitch are not a recommendation to buy, sell or hold any securities of LG&E. Such ratings may be subject to revisions or withdrawal by the agencies at any time and should be evaluated independently of each other and any other rating that may be assigned to the securities. A downgrade in LG&E's credit ratings could result in higher borrowing costs and reduced access to capital markets.

As a result of the passage of the Dodd-Frank Act and the attendant uncertainties relating to the extent to which issuers of non-asset backed securities may disclose credit ratings without being required to obtain rating agency consent to the inclusion of such disclosure, or incorporation by reference of such disclosure, in a registrant's registration statement or section 10(a) prospectus, LG&E is limiting its credit rating disclosure to a description of the actions taken by the rating agencies with respect to LG&E's ratings, but without stating what ratings have been assigned to LG&E's securities. The ratings assigned by the rating agencies to LG&E and its securities may be found, without charge, on each of the respective rating agencies' websites, which ratings together with all other information contained on such rating agency websites is, hereby, explicitly not incorporated by reference in this report.

The rating agencies took the following actions related to LG&E:

In February 2012, Fitch assigned ratings to LG&E's newly established commercial paper program.

In March 2012, Moody's affirmed the following ratings:

- the long-term ratings of the First Mortgage Bonds for LG&E;
- the issuer ratings for LG&E; and
- the bank loan ratings for LG&E.

Also in March 2012, Moody's and S&P each assigned short-term ratings to LG&E's newly established commercial paper program.

In March and May 2012, Moody's, S&P and Fitch affirmed the long-term ratings for LG&E's 2003 Series A and 2007 Series B pollution control bonds.

Ratings Triggers

LG&E has various derivative and non-derivative contracts, including contracts for the sale and purchase of electricity, fuel, commodity transportation and storage and interest rate instruments, which contain provisions requiring LG&E to post additional collateral, or permitting the counterparty to terminate the contract, if LG&E's credit rating were to fall below investment grade. See Note 14 to the Financial Statements for a discussion of "Credit Risk-Related Contingent Features," including a discussion of the potential additional collateral that would have been required for derivative contracts in a net liability position at September 30, 2012. At September 30, 2012, if LG&E's credit ratings had been below investment grade, the maximum amount that LG&E would have been required to post as additional collateral to counterparties was \$62 million for both derivative and non-derivative commodity and commodity-related contracts used in its generation and marketing operations, gas supply and interest rate contracts.

Risk Management

Market Risk

See Notes 13 and 14 to the Financial Statements for information about LG&E's risk management objectives, valuation techniques and accounting designations.

The forward-looking information presented below provides estimates of what may occur in the future, assuming certain adverse market conditions and model assumptions. Actual future results may differ materially from those presented. These disclosures are not precise indicators of expected future losses, but only indicators of possible losses under normal market conditions at a given confidence level.

Commodity Price Risk

LG&E's rates are set by a regulatory commission and the fuel costs incurred are directly recoverable from customers. As a result, LG&E is subject to commodity price risk for only a small portion of on-going business operations. LG&E conducts energy trading and risk management activities to maximize the value of the physical assets at times when the assets are not required to serve LG&E's or KU's customers. See Note 14 to the Financial Statements for additional disclosures.

Interest Rate Risk

LG&E issues debt to finance its operations, which exposes it to interest rate risk. LG&E utilizes various financial derivative instruments to adjust the mix of fixed and floating interest rates in its debt portfolio when appropriate. Risk limits under LG&E's risk management program are designed to balance risk, exposure to volatility in interest expense and changes in the fair value of LG&E's debt portfolio due to changes in the absolute level of interest rates.

At September 30, 2012, LG&E's potential annual exposure to increased interest expense, based on a 10% increase in interest rates, was not significant.

LG&E is also exposed to changes in the fair value of its debt portfolio. LG&E estimated that a 10% decrease in interest rates at September 30, 2012, would increase the fair value of its debt portfolio by \$27 million.

At September 30, 2012, LG&E had the following interest rate hedges outstanding:

| Fair Value, | Effect of a |
|-------------|-------------|
|-------------|-------------|

| | Exposure | Net - Asset | 10% |
|-------------------------|----------|-------------|----------|
| | Hedged | (Liability) | Adverse |
| | | (a) | Movement |
| Economic hedges | | | in Rates |
| Interest rate swaps (b) | \$ 179 | \$ (62) | \$ (3) |

(a) Includes accrued interest.

(b) LG&E utilizes various risk management instruments to reduce its exposure to the expected future cash flow variability of its debt instruments. These risks include exposure to adverse interest rate movements for outstanding variable rate debt and for future anticipated financing. While LG&E is exposed to changes in the fair value of these instruments, any realized changes in the fair value of such economic hedges are recoverable through regulated rates and any subsequent changes in fair value of these derivatives are included in regulatory assets or liabilities. Sensitivities represent a 10% adverse movement in interest rates. The positions outstanding at September 30, 2012 mature through 2033.

Credit Risk

See Notes 13 and 14 to the Financial Statements in this Form 10-Q and "Risk Management - Energy Marketing & Trading and Other - Credit Risk" in LG&E's 2011 Form 10-K for additional information.

Related Party Transactions

LG&E is not aware of any material ownership interest or operating responsibility by senior management of LG&E in outside partnerships, including leasing transactions with variable interest entities, or other entities doing business with LG&E. See Note 11 to the Financial Statements for additional information on related party transactions.

Environmental Matters

Protection of the environment is a major priority for LG&E and a significant element of its business activities. Extensive federal, state and local environmental laws and regulations are applicable to LG&E's air emissions, water discharges and the management of hazardous and solid waste, among other areas, and the costs of compliance or alleged non-compliance cannot be predicted with certainty but could be material. In addition, costs may increase significantly if the requirements or scope of environmental laws or regulations, or similar rules, are expanded or changed from prior versions by the relevant agencies. Costs may take the form of increased capital or operating and maintenance expenses; monetary fines, penalties or forfeitures; or other restrictions. Many of these environmental law considerations are also applicable to the operations of key suppliers, or customers, such as coal producers, industrial power users, etc. and may impact the costs for their products or their demand for LG&E's services. See "Item 1. Business - Environmental Matters" in LG&E's 2011 Form 10-K and Note 10 to the Financial Statements for a discussion of environmental matters.

New Accounting Guidance

See Notes 2 and 18 to the Financial Statements for a discussion of new accounting guidance adopted and pending adoption.

Application of Critical Accounting Policies

Financial condition and results of operations are impacted by the methods, assumptions and estimates used in the application of critical accounting policies. The following accounting policies are particularly important to the financial condition or results of operations and require estimates or other judgments of matters inherently uncertain: revenue recognition - unbilled revenue, price risk management, defined benefits, asset impairment, loss accruals, AROs, income taxes, and regulatory assets and liabilities. See "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" in LG&E's 2011 Form 10-K for a discussion of each critical accounting policy.

KENTUCKY UTILITIES COMPANY

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following should be read in conjunction with KU's Condensed Financial Statements and the accompanying Notes and with KU's 2011 Form 10-K. Capitalized terms and abbreviations are defined in the glossary. Dollars are in millions, unless otherwise noted.

"Management's Discussion and Analysis of Financial Condition and Results of Operations" includes the following information:

- "Overview" provides a description of KU and its business strategy, a summary of Net Income and a discussion of certain events related to KU's results of operations and financial condition.
- "Results of Operations" provides a summary of KU's earnings and a description of factors expected to impact future earnings. This section ends with explanations of significant changes in principal items on KU's Statements of Income, comparing the three and nine months ended September 30, 2012 with the same periods in 2011.
- "Financial Condition - Liquidity and Capital Resources" provides an analysis of KU's liquidity position and credit profile. This section also includes a discussion of rating agency actions.
- "Financial Condition - Risk Management" provides an explanation of KU's risk management programs relating to market and credit risk.

Overview

Introduction

KU, headquartered in Lexington, Kentucky, is a regulated utility engaged in the generation, transmission, distribution and sale of electricity, in Kentucky, Virginia and Tennessee.

Business Strategy

KU's overall strategy is to provide reliable, safe and competitively priced energy to its customers.

A key objective for KU is to maintain a strong credit profile through managing financing costs and access to credit markets. KU continually focuses on maintaining an appropriate capital structure and liquidity position.

Financial and Operational Developments

Net Income

Net Income for the three and nine months ended September 30, 2012 was \$50 million and \$118 million compared to \$56 million and \$144 million for the same periods in 2011 representing decreases of 11% and 18% from the same periods in 2011.

See "Results of Operations" for a discussion and analysis of KU's earnings.

Terminated Bluegrass CTs Acquisition

In September 2011, KU and LG&E entered into an asset purchase agreement with Bluegrass Generation for the purchase of the Bluegrass CTs, aggregating approximately 495 MW, plus limited associated contractual arrangements required for operation of the units, for a purchase price of \$110 million, pending receipt of applicable regulatory approvals. In May 2012, the KPSC issued an order approving the request to purchase the Bluegrass CTs. Also in May 2012, the FERC issued an order conditionally authorizing the acquisition of the Bluegrass CTs, subject to approval by the FERC of satisfactory mitigation measures to address market-power concerns. After a review of potentially available mitigation options, KU and LG&E determined that the options were not commercially justifiable. In June 2012, KU and LG&E terminated the asset purchase agreement for the Bluegrass CTs in accordance with its terms and made applicable filings with the KPSC and FERC. KU and LG&E are currently assessing the impact of the asset purchase agreement termination and potential future generation capacity options.

NGCC Construction

In September 2011, KU and LG&E filed a CPCN with the KPSC requesting approval to build a 640 MW NGCC at the existing Cane Run plant site in Kentucky. In May 2012, the KPSC issued an order approving the request. KU will own a 78% undivided interest and LG&E will own a 22% undivided interest in the new NGCC. KU and LG&E commenced preliminary construction activities in the third quarter of 2012 and project construction is expected to be completed by May 2015. The project, which includes building a natural gas supply pipeline and related transmission projects, has an estimated cost of approximately \$600 million.

In conjunction with this construction and to meet new, more stringent federal EPA regulations with a 2015 compliance date, KU and LG&E anticipate retiring six older coal-fired electric generating units at the Cane Run, Green River and Tyrone plants, which have a combined summer capacity rating of 797 MW.

Capital Expenditures

Capital expenditure plans are revised periodically to reflect changes in operational, market and regulatory conditions. KU has lowered its projected environmental capital spending for the period 2012 through 2016 by approximately \$0.1 billion from the previously disclosed \$1.5 billion projection included in KU's 2011 Form 10-K. The lower projected capital spending is based on current project evaluations and pricing contained in contracts executed to date for environmental construction projects. KU continues to evaluate potential new generation supply sources, including self-build options and power sourced from the market, as alternatives to installing additional emission control equipment at E.W. Brown, which is jointly dispatched for KU and LG&E, and in lieu of the terminated Bluegrass CTs acquisition discussed in Notes 6 and 8 to the Financial Statements. KU expects to complete its evaluation during the first half of 2013. The outcome of that evaluation may lead to additional changes in projected capital spending.

Commercial Paper

In February 2012, KU established a commercial paper program for up to \$250 million to provide an additional financing source to fund its short-term liquidity needs, if and when necessary. Commercial paper issuances are supported by KU's Syndicated Credit Facility. KU had no commercial paper outstanding at September 30, 2012.

Results of Operations

The following discussion provides a summary of KU's earnings and a description of factors that management expects may impact future earnings. This section ends with "Statement of Income Analysis," which includes explanations of significant changes in principal items on KU's Statements of Income, comparing the three and nine months ended September 30, 2012 with the same periods in 2011.

The results for interim periods can be disproportionately influenced by numerous factors and developments and by seasonal variations. As such, the results of operations for interim periods do not necessarily indicate results or trends for the year or for future periods.

Earnings

Net Income for the periods ended September 30 was:

Three Months

Nine Months

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| | 2012 | 2011 | 2012 | 2011 |
|------------|-------|-------|--------|--------|
| Net Income | \$ 50 | \$ 56 | \$ 118 | \$ 144 |

The changes in the components of Net Income between these periods were due to the following factors, which reflect reclassifications for items included in margins.

172

| | Three Months | Nine Months |
|---------------------------------|-----------------|-------------|
| Margin | \$ (5) | \$ (17) |
| Other operation and maintenance | (1) | (8) |
| Depreciation | (2) | (5) |
| Other | (1) | (2) |
| Other Income (Expense) - net | 1 | (6) |
| Income Taxes | 2 | 12 |
| Total | \$ (6) | \$ (26) |

- See "Statement of Income Analysis - Margins - Changes in Non-GAAP Financial Measures" for an explanation of margins.
- Higher other operation and maintenance for the nine-month period primarily due to a \$6 million credit recorded in 2011 to establish a regulatory asset related to 2009 storm costs.
 - Higher depreciation for the three and nine-month periods primarily due to PP&E additions.
- Lower other income (expense) - net for the nine-month period primarily due to losses from an equity method investment.
 - Lower income taxes for the nine-month period primarily due to lower pre-tax income.

Outlook

KU projects lower earnings in 2012 compared with 2011 as a result of higher other operation and maintenance expense, higher depreciation, higher property taxes and losses from an equity method investment.

In June 2012, KU filed a request with the KPSC for an increase in annual base electric rates of approximately \$82 million. The proposed base electric rate increase would result in a 6.5% increase over KU's present rate and would be effective in January 2013. KU's application includes a request for authorized return-on-equity of 11%. In November 2012, the KPSC issued an order for a settlement conference to begin on November 13, 2012. A hearing on the original application and subsequent testimony is scheduled to begin on November 27, 2012. KU cannot predict the outcome of these proceedings, including the possibility of any agreed stipulations or settlement, which would remain subject to KPSC approval. A final order may be issued in December 2012 or January 2013.

Earnings in 2012 and future periods are subject to various risks and uncertainties. See "Forward-Looking Information," the rest of this Item 2, Notes 6 and 10 to the Financial Statements in this Form 10-Q and "Item 1. Business" and "Item 1A. Risk Factors" in KU's 2011 Form 10-K for a discussion of the risks, uncertainties and factors that may impact future earnings.

Statement of Income Analysis --

Margins

Non-GAAP Financial Measure

The following discussion includes financial information prepared in accordance with GAAP, as well as a non-GAAP financial measure, "Margins." Margins is not intended to replace "Operating Income," which is determined in accordance with GAAP as an indicator of overall operating performance. Other companies may use different measures to analyze and to report on the results of their operations. Margins is a single financial performance measure of KU's operations. In calculating this measure, utility revenues and expenses associated with approved cost recovery tracking mechanisms are offset. These mechanisms allow for recovery of certain expenses, returns on capital investments associated with environmental regulations and performance incentives. Certain costs associated with these mechanisms, primarily ECR and DSM, are recorded as "Other operation and maintenance" and "Depreciation." As a result, this measure represents the net revenues from KU's operations. This performance measure is used, in conjunction with other information, internally by senior management to manage operations and analyze actual results compared to budget.

Reconciliation of Non-GAAP Financial Measures

The following tables reconcile "Operating Income" to "Margins" as defined by KU for the periods ended September 30.

| | 2012 Three Months | | | 2011 Three Months | | |
|---------------------------------|-------------------|-----------|----------------------|-------------------|-----------|----------------------|
| | Margins | Other (a) | Operating Income (b) | Margins | Other (a) | Operating Income (b) |
| Operating Revenues | \$ 411 | | \$ 411 | \$ 419 | \$ 1 | \$ 420 |
| Operating Expenses | | | | | | |
| Fuel | 149 | | 149 | 147 | | 147 |
| Energy purchases | 18 | | 18 | 25 | | 25 |
| Other operation and maintenance | 16 | \$ 77 | 93 | 14 | 76 | 90 |
| Depreciation | 12 | 37 | 49 | 12 | 35 | 47 |
| Taxes, other than income | | 5 | 5 | | 5 | 5 |
| Total Operating Expenses | 195 | 119 | 314 | 198 | 116 | 314 |
| Total | \$ 216 | \$ (119) | \$ 97 | \$ 221 | \$ (115) | \$ 106 |

| | 2012 Nine Months | | | 2011 Nine Months | | |
|---------------------------------|------------------|-----------|----------------------|------------------|-----------|----------------------|
| | Margins | Other (a) | Operating Income (b) | Margins | Other (a) | Operating Income (b) |
| Operating Revenues | \$ 1,165 | | \$ 1,165 | \$ 1,191 | | \$ 1,191 |
| Operating Expenses | | | | | | |
| Fuel | 396 | | 396 | 401 | | 401 |
| Energy purchases | 76 | | 76 | 85 | | 85 |
| Other operation and maintenance | 41 | \$ 245 | 286 | 37 | \$ 237 | 274 |
| Depreciation | 36 | 109 | 145 | 35 | 104 | 139 |
| Taxes, other than income | | 17 | 17 | | 14 | 14 |
| Total Operating Expenses | 549 | 371 | 920 | 558 | 355 | 913 |
| Total | \$ 616 | \$ (371) | \$ 245 | \$ 633 | \$ (355) | \$ 278 |

(a) Represents amounts excluded from Margins.

(b) As reported on the Statements of Income.

Changes in Non-GAAP Financial Measures

Margins decreased by \$5 million for the three months ended September 30, 2012 compared with the same period in 2011, primarily due to \$4 million of lower retail margins.

Margins decreased by \$17 million for the nine months ended September 30, 2012 compared with the same period in 2011, primarily due to \$16 million of lower retail margins, as volumes were impacted by unseasonably mild weather during the first four months of 2012. Total heating degree days decreased 21% as compared to the same period in 2011.

Other Operation and Maintenance

Other operation and maintenance increased by \$12 million for the nine months ended September 30, 2012 compared with 2011, primarily due to a \$6 million credit to establish a regulatory asset was recorded in the first quarter of 2011 related to 2009 storm costs, and a \$5 million increase in coal plant maintenance costs, primarily resulting from an increased scope of scheduled outages.

Depreciation

Depreciation increased by \$2 million and \$6 million for the three and nine months ended September 30, 2012 compared with 2011, primarily due to PP&E additions.

Other Income (Expense) - net

Other income (expense) - net decreased by \$6 million for the nine months ended September 30, 2012, compared with 2011, primarily due to losses from an equity method investment.

Income Taxes

Income taxes decreased by \$12 million for the nine months ended September 30, 2012, compared with 2011, primarily due to a \$38 million decrease in pre-tax income.

See Note 5 to the Financial Statements for additional information on income taxes.

Financial Condition

Liquidity and Capital Resources

KU had the following at:

| | September 30, 2012 | December 31, 2011 |
|---------------------------|--------------------|-------------------|
| Cash and cash equivalents | \$ 42 | \$ 31 |

The \$11 million increase in KU's cash and cash equivalents position was the net result of:

- cash provided by operating activities of \$410 million; partially offset by
- capital expenditures of \$331 million; and
- common stock dividends of \$68 million.

KU's cash provided by operating activities increased by \$51 million for the nine months ended September 30, 2012, compared with 2011, primarily due to:

- a decrease in cash outflows for accounts payable to affiliates of \$17 million primarily as a result of payables to LG&E for TC2 coal inventory and other shared costs, partially offset by a decrease in income tax settlements with LKE in 2011;
- a decrease in cash outflows of \$26 million due to a reduction in discretionary defined benefit plan contributions; and
- a decrease in cash outflows related to accrued taxes of \$31 million primarily due to the timing of property and income tax payments; partially offset by
- a decrease in cash inflows for accounts receivable of \$42 million due to an increase in customer receivables in 2012 resulting from increased revenues in 2012 following unseasonably mild weather in December 2011 and the timing of cash receipts and payments, and an increase in accounts receivable from affiliates balance for income tax settlements with LKE in 2012.

KU's cash used in investing activities increased by \$163 million for the nine months ended September 30, 2012, compared with 2011, due to an increase in capital expenditures of \$163 million as a result of increased environmental spending, primarily related to landfills; and infrastructure improvements at generation, distribution and transmission facilities.

KU's cash used in financing activities decreased by \$32 million for the nine months ended September 30, 2012, compared with 2011, primarily due to lower common stock dividends paid to LKE of \$20 million in 2012.

Credit Facilities

At September 30, 2012, KU's committed borrowing capacity under its credit facilities and the use of this borrowing capacity were:

| | Committed Capacity | Borrowed | Letters of Credit Issued | Unused Capacity |
|--------------------------------|-----------------------|----------|--------------------------------|--------------------|
| Syndicated Credit Facility (a) | \$ 400 | | | \$ 400 |

Edgar Filing: KENTUCKY UTILITIES CO - Form 10-Q

| | | | | | |
|-------------------------------|-----|-----|-----|-----|--------|
| Letter of Credit Facility (b) | 198 | \$ | 198 | | |
| Total Credit Facilities (c) | \$ | 598 | \$ | 198 | \$ 400 |

- (a) In November 2012, KU amended the syndicated credit facility to extend the expiration date to November 2017.
- (b) In August 2012, the KU letter of credit facility agreement was amended and restated to allow for certain payments under the letter of credit facility to be converted to loans rather than requiring immediate payment.
- (c) The commitments under KU's credit facilities are provided by a diverse bank group, with no one bank and its affiliates providing an aggregate commitment of more than 19% of the total committed capacity available to KU.

KU participates in an intercompany money pool agreement whereby LKE and/or LG&E make available to KU funds up to \$500 million at an interest rate based on a market index of commercial paper issues. At September 30, 2012 and December 31, 2011, there was no balance outstanding.

See Notes 7 and 11 to the Financial Statements for further discussion of KU's credit facilities.

Rating Agency Actions

Moody's, S&P and Fitch periodically review the credit ratings on the debt securities of KU. Based on their respective independent reviews, the rating agencies may make certain ratings revisions or ratings affirmations.

A credit rating reflects an assessment by the rating agency of the creditworthiness associated with an issuer and particular securities that it issues. The credit ratings of KU are based on information provided by KU and other sources. The ratings of Moody's, S&P and Fitch are not a recommendation to buy, sell or hold any securities of KU. Such ratings may be subject to revisions or withdrawal by the agencies at any time and should be evaluated independently of each other and any other rating that may be assigned to the securities. A downgrade in KU's credit ratings could result in higher borrowing costs and reduced access to capital markets.

As a result of the passage of the Dodd-Frank Act and the attendant uncertainties relating to the extent to which issuers of non-asset backed securities may disclose credit ratings without being required to obtain rating agency consent to the inclusion of such disclosure, or incorporation by reference of such disclosure, in a registrant's registration statement or section 10(a) prospectus, KU is limiting its credit rating disclosure to a description of the actions taken by the rating agencies with respect to KU's ratings, but without stating what ratings have been assigned to KU's securities. The ratings assigned by the rating agencies to KU and its securities may be found, without charge, on each of the respective rating agencies' websites, which ratings together with all other information contained on such rating agency websites is, hereby, explicitly not incorporated by reference in this report.

The rating agencies took the following actions related to KU:

In February 2012, Fitch assigned ratings to KU's newly established commercial paper program.

In March 2012, Moody's affirmed the following ratings:

- the long-term ratings of the First Mortgage Bonds for KU;
- the issuer ratings for KU; and
- the bank loan ratings for KU.

Also in March 2012, Moody's and S&P each assigned short-term ratings to KU's newly established commercial paper program.

Ratings Triggers

KU has various derivative and non-derivative contracts, including contracts for the sale and purchase of electricity, fuel, and commodity transportation and storage, which contain provisions requiring KU to post additional collateral, or permitting the counterparty to terminate the contract, if KU's credit rating were to fall below investment grade. See Note 14 to the Financial Statements for a discussion of "Credit Risk-Related Contingent Features," including a discussion of the potential additional collateral that would have been required for derivative contracts in a net liability position at September 30, 2012. At September 30, 2012, if KU's credit ratings had been below investment grade, the maximum amount that KU would have been required to post as additional collateral to counterparties was \$25 million for both derivative and non-derivative commodity and commodity-related contracts used in its generation and marketing operations.

Risk Management

Market Risk

See Notes 13 and 14 to the Financial Statements for information about KU's risk management objectives, valuation techniques and accounting designations.

The forward-looking information presented below provides estimates of what may occur in the future, assuming certain adverse market conditions and model assumptions. Actual future results may differ materially from those presented. These disclosures are not precise indicators of expected future losses, but only indicators of possible losses under normal market conditions at a given confidence level.

Commodity Price Risk

KU's rates are set by regulatory commissions and the fuel costs incurred are directly recoverable from customers. As a result, KU is subject to commodity price risk for only a small portion of on-going business operations. KU conducts energy trading and risk management activities to maximize the value of the physical assets at times when the assets are not required to serve KU's or LG&E's customers. See Note 14 to the Financial Statements for additional disclosures.

Interest Rate Risk

KU issues debt to finance its operations, which exposes it to interest rate risk. At September 30, 2012, KU's potential annual exposure to increased interest expense, based on a 10% increase in interest rates, was not significant.

KU is also exposed to changes in the fair value of its debt portfolio. KU estimated that a 10% decrease in interest rates at September 30, 2012, would increase the fair value of its debt portfolio by \$70 million.

Credit Risk

See Notes 13 and 14 to the Financial Statements in this Form 10-Q and "Risk Management - Energy Marketing & Trading and Other - Credit Risk" in KU's 2011 Form 10-K for additional information.

Related Party Transactions

KU is not aware of any material ownership interest or operating responsibility by senior management of KU in outside partnerships, including leasing transactions with variable interest entities, or other entities doing business with KU. See Note 11 to the Financial Statements for additional information on related party transactions.

Environmental Matters

Protection of the environment is a major priority for KU and a significant element of its business activities. Extensive federal, state and local environmental laws and regulations are applicable to KU's air emissions, water discharges and the management of hazardous and solid waste, among other areas, and the costs of compliance or alleged non-compliance cannot be predicted with certainty but could be material. In addition, costs may increase significantly if the requirements or scope of environmental laws or regulations, or similar rules, are expanded or changed from prior versions by the relevant agencies. Costs may take the form of increased capital or operating and maintenance expenses; monetary fines, penalties or forfeitures; or other restrictions. Many of these environmental law considerations are also applicable to the operations of key suppliers, or customers, such as coal producers, industrial power users, etc. and may impact the costs for their products or their demand for KU's services. See "Item 1. Business - Environmental Matters" in KU's 2011 Form 10-K and Note 10 to the Financial Statements for a discussion of environmental matters.

New Accounting Guidance

See Notes 2 and 18 to the Financial Statements for a discussion of new accounting guidance adopted and pending adoption.

Application of Critical Accounting Policies

Financial condition and results of operations are impacted by the methods, assumptions and estimates used in the application of critical accounting policies. The following accounting policies are particularly important to the financial condition or results of operations and require estimates or other judgments of matters inherently uncertain: revenue recognition - unbilled revenue, price risk management, defined benefits, asset impairment, loss accruals, AROs, income taxes, and regulatory assets and liabilities. See "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" in KU's 2011 Form 10-K for a discussion of each critical accounting policy.

PPL Corporation
PPL Energy Supply, LLC
PPL Electric Utilities Corporation
LG&E and KU Energy LLC
Louisville Gas and Electric Company
Kentucky Utilities Company

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Reference is made to "Risk Management" in each Registrant's "Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations."

Item 4. Controls and Procedures

(a) Evaluation of disclosure controls and procedures.

PPL Corporation, PPL Energy Supply, LLC, PPL Electric Utilities Corporation, LG&E and KU Energy LLC, Louisville Gas and Electric Company, and Kentucky Utilities Company

The registrants' principal executive officers and principal financial officers, based on their evaluation of the registrants' disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e) of the Securities Exchange Act of 1934) have concluded that, as of September 30, 2012, the registrants' disclosure controls and procedures are effective to ensure that material information relating to the registrants and their consolidated subsidiaries is recorded, processed, summarized and reported within the time periods specified by the SEC's rules and forms, particularly during the period for which this quarterly report has been prepared. The aforementioned principal officers have concluded that the disclosure controls and procedures are also effective to ensure that information required to be disclosed in reports filed under the Exchange Act is accumulated and communicated to management, including the principal executive and principal financial officers, to allow for timely decisions regarding required disclosure.

(b) Change in internal controls over financial reporting.

PPL Corporation

The registrant's principal executive officer and principal financial officer have concluded that there were no changes in the registrant's internal control over financial reporting during the registrant's third fiscal quarter that have materially affected, or are reasonably likely to materially affect, the registrant's internal control over financial reporting.

As reported in the 2011 Form 10-K, PPL's principal executive officer and principal financial officer concluded that a systems migration related to the WPD Midlands acquisition created a material change to its internal control over financial reporting. Specifically, on December 1, 2011, the use of legacy information technology systems at WPD Midlands was discontinued and the related data, processes and internal controls were migrated to the systems, processes and controls currently in place at PPL WW.

Risks related to the systems migration were partially mitigated by PPL's expanded internal control over financial reporting that were implemented subsequent to the acquisition and PPL's existing policy of consolidating foreign subsidiaries on a one-month lag, which provided management additional time for review and analysis of WPD Midlands' results and their incorporation into PPL's consolidated financial statements.

PPL Energy Supply, LLC, PPL Electric Utilities Corporation, LG&E and KU Energy LLC, Louisville Gas and Electric Company, and Kentucky Utilities Company

The registrants' principal executive officers and principal financial officers have concluded that there were no changes in the registrants' internal control over financial reporting during the registrants' third fiscal quarter that have materially affected, or are reasonably likely to materially affect, the registrants' internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

For additional information regarding various pending administrative and judicial proceedings involving regulatory, environmental and other matters, which information is incorporated by reference into this Part II, see:

- "Item 3. Legal Proceedings" in each Registrant's 2011 Form 10-K; and
- Notes 5, 6 and 10 to the Financial Statements.

Item 1A. Risk Factors

There have been no material changes in the Registrant's risk factors from those disclosed in "Item 1A. Risk Factors" of the 2011 Form 10-K.

Item 4. Mine Safety Disclosures

Not applicable.

Item 6. Exhibits

The following Exhibits indicated by an asterisk preceding the Exhibit number are filed herewith. The balance of the Exhibits have heretofore been filed with the Commission and pursuant to Rule 12(b)-32 are incorporated herein by reference. Exhibits indicated by a [] are filed or listed pursuant to Item 601(b)(10)(iii) of Regulation S-K.

- | | | |
|---------------|---|--|
| 4(a) | - | Supplemental Indenture No. 14, dated as of August 1, 2012, made and entered into by and between PPL Electric Utilities Corporation and The Bank of New York Mellon, as Trustee, under the Indenture dated as of August 1, 2001 (Exhibit 4(a) to PPL Corporation Form 8-K Report (File No. 1-11459) dated August 24, 2012) |
| 4(b) | - | Supplemental Indenture No. 9, dated as of October 15, 2012, among PPL Capital Funding, Inc., PPL Corporation and The Bank of New York Mellon (as successor to JPMorgan Chase Bank, N. A. (formerly known as The Chase Manhattan Bank)), as Trustee (Exhibit 4(b) to PPL Corporation Form 8-K Report (File No. 1-11459) dated October 15, 2012) |
| <u>*10(a)</u> | - | Amendment No. 6 to Credit and Security Agreement, dated as of July 24, 2012, by and among PPL Receivables Corporation, as Borrower, PPL Electric Utilities Corporation, as Servicer, Victory Receivables Corporation, as a Lender, and The Bank of Tokyo-Mitsubishi UFJ, Ltd., New York Branch, as Liquidity Bank and as Agent |
| <u>*10(b)</u> | - | Amendment No. 7 to Credit and Security Agreement, dated as of September 24, 2012, by and among PPL Receivables Corporation, as Borrower, PPL Electric Utilities Corporation, as Servicer, Victory Receivables Corporation, as a Lender, and The Bank of Tokyo-Mitsubishi UFJ, Ltd., New York Branch, as Liquidity Bank and as Agent |
| <u>*10(c)</u> | - | Amendment and Restatement Agreement, dated as of August 16, 2012, to Letter of Credit Agreement, dated as of April 29, 2011, as amended, among Kentucky Utilities Company, the Borrower; the Lenders from time to time party thereto, the Lenders; Banco Bilbao Vizcaya Argentaria, S.A., New York Branch, the Agent and Sumitomo Mitsui Banking Corporation, New York Branch, the Issuing Lender and Lender |
| <u>*12(a)</u> | - | PPL Corporation and Subsidiaries Computation of Ratio of Earnings to Combined Fixed Charges and Preferred Stock Dividends |
| <u>*12(b)</u> | - | PPL Energy Supply, LLC and Subsidiaries Computation of Ratio of Earnings to Fixed Charges |
| <u>*12(c)</u> | - | PPL Electric Utilities Corporation and Subsidiaries Computation of Ratio of Earnings to Combined Fixed Charges and Preferred Stock Dividends |
| <u>*12(d)</u> | - | LG&E and KU Energy LLC and Subsidiaries Computation of Ratio of Earnings to Combined Fixed Charges and Preferred Stock Dividends |
| <u>*12(e)</u> | - | Louisville Gas and Electric Company Computation of Ratio of Earnings to Combined Fixed Charges and Preferred Stock |

*12(f) - Dividends
Kentucky Utilities Company Computation of Ratio of Earnings to
Fixed Charges

Certifications pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, for the quarterly period ended September 30, 2012, filed by the following officers for the following companies:

*31(a) - PPL Corporation's principal executive officer
*31(b) - PPL Corporation's principal financial officer
*31(c) - PPL Energy Supply, LLC's principal executive officer
*31(d) - PPL Energy Supply, LLC's principal financial officer
*31(e) - PPL Electric Utilities Corporation's principal executive officer
*31(f) - PPL Electric Utilities Corporation's principal financial officer
*31(g) - LG&E and KU Energy LLC's principal executive officer
*31(h) - LG&E and KU Energy LLC's principal financial officer
*31(i) - Louisville Gas and Electric Company's principal executive officer
*31(j) - Louisville Gas and Electric Company's principal financial officer

*31(k) - Kentucky Utilities Company's principal executive officer
*31(l) - Kentucky Utilities Company's principal financial officer

Certifications pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, for the quarterly period ended September 30, 2012, furnished by the following officers for the following companies:

*32(a) - PPL Corporation's principal executive officer and principal financial officer
*32(b) - PPL Energy Supply, LLC's principal executive officer and principal financial officer
*32(c) - PPL Electric Utilities Corporation's principal executive officer and principal financial officer
*32(d) - LG&E and KU Energy LLC's principal executive officer and principal financial officer
*32(e) - Louisville Gas and Electric Company's principal executive officer and principal financial officer
*32(f) - Kentucky Utilities Company's principal executive officer and principal financial officer

101.INS - XBRL Instance Document for PPL Corporation, PPL Energy Supply, LLC, PPL Electric Utilities Corporation, LG&E and KU Energy LLC, Louisville Gas and Electric Company and Kentucky Utilities Company
 101.SCH - XBRL Taxonomy Extension Schema for PPL Corporation, PPL Energy Supply, LLC, PPL Electric Utilities Corporation, LG&E and KU Energy LLC, Louisville Gas and Electric Company and Kentucky Utilities Company
 101.CAL - XBRL Taxonomy Extension Calculation Linkbase for PPL Corporation, PPL Energy Supply, LLC, PPL Electric Utilities Corporation, LG&E and KU Energy LLC, Louisville Gas and Electric Company and Kentucky Utilities Company
 101.DEF - XBRL Taxonomy Extension Definition Linkbase for PPL Corporation, PPL Energy Supply, LLC, PPL Electric Utilities Corporation, LG&E and KU Energy LLC, Louisville Gas and Electric Company and Kentucky Utilities Company
 101.LAB - XBRL Taxonomy Extension Label Linkbase for PPL Corporation, PPL Energy Supply, LLC, PPL Electric Utilities Corporation, LG&E and KU Energy LLC, Louisville Gas and Electric Company and Kentucky Utilities Company
 101.PRE - XBRL Taxonomy Extension Presentation Linkbase for PPL Corporation, PPL Energy Supply, LLC, PPL Electric Utilities Corporation, LG&E and KU Energy LLC, Louisville Gas and Electric Company and Kentucky Utilities Company

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrants have duly caused this report to be signed on their behalf by the undersigned thereunto duly authorized. The signature for each undersigned company shall be deemed to relate only to matters having reference to such company or its subsidiaries.

PPL Corporation
(Registrant)

PPL Energy Supply, LLC
(Registrant)

Date: November 8, 2012

/s/ Vincent Sorgi
Vincent Sorgi
Vice President and Controller
(Principal Accounting Officer)

PPL Electric Utilities Corporation
(Registrant)

Date: November 8, 2012

/s/ Vincent Sorgi
Vincent Sorgi
Vice President and
Chief Accounting Officer
(Principal Financial and
Accounting Officer)

LG&E and KU Energy LLC
(Registrant)

Louisville Gas and Electric Company
(Registrant)

Kentucky Utilities Company
(Registrant)

Date: November 8, 2012

/s/ Kent W. Blake
Kent W. Blake
Chief Financial Officer

(Principal Financial Officer and
Principal Accounting Officer)