

Ohio Valley Electric Corporation and Subsidiary Company

Consolidated Financial Statements as of and for the
Years Ended December 31, 2009 and 2008, and
Independent Auditors' Report

INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Ohio Valley Electric Corporation:

We have audited the accompanying consolidated balance sheets of Ohio Valley Electric Corporation and subsidiary company (the "Companies"), as of December 31, 2009 and 2008, and the related consolidated statements of income and retained earnings and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Companies' management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Companies' internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Companies as of December 31, 2009 and 2008, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Deloitte + Touche LLP

April 14, 2010

OHIO VALLEY ELECTRIC CORPORATION AND SUBSIDIARY COMPANY

CONSOLIDATED BALANCE SHEETS AS OF DECEMBER 31, 2009 AND 2008

	2009	2008
ASSETS		
ELECTRIC PLANT:		
At original cost	\$1,260,793,337	\$1,237,629,673
Less — accumulated provisions for depreciation	<u>949,382,858</u>	<u>907,307,285</u>
	311,410,479	330,322,388
Construction in progress	<u>967,123,450</u>	<u>767,848,855</u>
Total electric plant	<u>1,278,533,929</u>	<u>1,098,171,243</u>
CURRENT ASSETS:		
Cash and cash equivalents	14,709,175	45,176,266
Accounts receivable	42,441,385	35,586,985
Fuel in storage — at average cost	81,102,751	52,220,614
Materials and supplies — at average cost	21,984,752	19,223,210
Property taxes applicable to future years	2,364,600	2,348,400
Emission allowances	5,215,651	2,244,126
Deferred tax assets	10,372,692	10,982,423
Regulatory assets	378,717	1,034,148
Prepaid expenses and other	<u>1,976,234</u>	<u>1,937,142</u>
Total current assets	<u>180,545,957</u>	<u>170,753,314</u>
REGULATORY ASSETS:		
Asset retirement costs	6,520,890	14,642,782
Unrecognized postemployment benefits	3,211,580	2,236,997
Deferred depreciation	10,149,660	27,047,875
Pension benefits	<u>7,831,705</u>	<u>27,261,510</u>
Total regulatory assets	<u>27,713,835</u>	<u>71,189,164</u>
DEFERRED CHARGES AND OTHER:		
Unamortized debt expense	12,108,055	9,549,916
Deferred tax assets	53,327,361	37,524,839
Long-term investments	82,432,063	53,609,545
Special deposits — restricted	13,513,206	-
Other	<u>39,135</u>	<u>141,090</u>
Total deferred charges and other	<u>161,419,820</u>	<u>100,825,390</u>
TOTAL	<u><u>\$1,648,213,541</u></u>	<u><u>\$1,440,939,111</u></u>

(Continued)

OHIO VALLEY ELECTRIC CORPORATION AND SUBSIDIARY COMPANY

CONSOLIDATED BALANCE SHEETS AS OF DECEMBER 31, 2009 AND 2008

	2009	2008
CAPITALIZATION AND LIABILITIES		
CAPITALIZATION:		
Common stock, \$100 par value — authorized, 300,000 shares; outstanding, 100,000 shares in 2009 and 2008	\$ 10,000,000	\$ 10,000,000
Long-term debt	1,272,222,726	1,009,864,781
Line of credit borrowings	-	50,000,000
Retained earnings	<u>2,242,366</u>	<u>2,506,811</u>
Total capitalization	<u>1,284,465,092</u>	<u>1,072,371,592</u>
CURRENT LIABILITIES:		
Current portion of long-term debt	37,642,056	35,453,528
Line of credit borrowings	65,000,000	-
Accounts payable	49,395,340	99,405,252
Deferred revenue — advances for construction	22,034,078	26,670,003
Accrued other taxes	7,063,321	9,822,786
Regulatory liabilities	2,630,963	4,230,400
Accrued interest and other	<u>22,976,026</u>	<u>20,837,485</u>
Total current liabilities	<u>206,741,784</u>	<u>196,419,454</u>
COMMITMENTS AND CONTINGENCIES (Note 13)		
REGULATORY LIABILITIES:		
Postretirement benefits	31,275,265	13,670,062
Investment tax credits	3,393,146	3,393,146
Net antitrust settlement	1,823,929	1,823,929
Income taxes refundable to customers	<u>48,593,284</u>	<u>47,070,877</u>
Total regulatory liabilities	<u>85,085,624</u>	<u>65,958,014</u>
OTHER LIABILITIES:		
Pension liability	7,831,705	27,261,510
Asset retirement obligations	29,439,057	34,162,393
Postretirement benefits obligation	31,438,699	42,529,151
Postemployment benefits obligation	<u>3,211,580</u>	<u>2,236,997</u>
Total other liabilities	<u>71,921,041</u>	<u>106,190,051</u>
TOTAL	<u>\$1,648,213,541</u>	<u>\$1,440,939,111</u>

See notes to consolidated financial statements.

(Concluded)

**OHIO VALLEY ELECTRIC CORPORATION
AND SUBSIDIARY COMPANY**

**CONSOLIDATED STATEMENTS OF INCOME AND RETAINED EARNINGS
FOR THE YEARS ENDED DECEMBER 31, 2009 AND 2008**

	2009	2008
OPERATING REVENUES — Sales of electric energy to:		
Department of Energy	\$ 11,450,964	\$ 18,539,153
Sponsoring companies	<u>637,142,180</u>	<u>603,273,999</u>
Total operating revenues	<u>648,593,144</u>	<u>621,813,152</u>
OPERATING EXPENSES:		
Fuel and emission allowances consumed in operation	329,448,104	340,212,739
Purchased power	10,683,963	17,903,608
Other operation	80,118,637	69,414,118
Maintenance	84,292,246	71,513,450
Depreciation	68,039,793	56,946,744
Taxes — other than income taxes	9,877,156	9,784,455
Income taxes	<u>2,421,167</u>	<u>1,023,381</u>
Total operating expenses	<u>584,881,066</u>	<u>566,798,495</u>
OPERATING INCOME	63,712,078	55,014,657
OTHER INCOME	<u>7,207,538</u>	<u>4,714,761</u>
INCOME BEFORE INTEREST CHARGES	<u>70,919,616</u>	<u>59,729,418</u>
INTEREST CHARGES:		
Amortization of debt expense	1,021,186	532,119
Interest expense	<u>67,012,875</u>	<u>54,106,130</u>
Total interest charges	<u>68,034,061</u>	<u>54,638,249</u>
NET INCOME	2,885,555	5,091,169
RETAINED EARNINGS — Beginning of year	2,506,811	2,915,642
CASH DIVIDENDS ON COMMON STOCK	<u>(3,150,000)</u>	<u>(5,500,000)</u>
RETAINED EARNINGS — End of year	<u>\$ 2,242,366</u>	<u>\$ 2,506,811</u>

See notes to consolidated financial statements.

OHIO VALLEY ELECTRIC CORPORATION AND SUBSIDIARY COMPANY

CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2009 AND 2008

	2009	2008
OPERATING ACTIVITIES:		
Net income	\$ 2,885,555	\$ 5,091,169
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation	68,039,793	56,946,744
Amortization of debt expense	1,021,186	532,119
Deferred taxes	(13,670,384)	364,509
Gain on disposal of assets	-	(300,000)
Gain on marketable securities	(4,632,659)	(638,007)
Changes in assets and liabilities:		
Accounts receivable	(6,854,400)	(6,607,947)
Fuel in storage	(28,882,137)	11,692,717
Materials and supplies	(2,761,542)	(2,359,883)
Property taxes applicable to subsequent years	(16,200)	(120,480)
Emission allowances	(2,971,525)	9,543,838
Refundable state income taxes	-	849,123
Prepaid expenses and other	(39,092)	(232,007)
Other assets	(501,194)	15,532,270
Regulatory assets	28,218,008	(27,835,827)
Accounts payable	8,407,294	(22,535,520)
Deferred revenue	(4,635,925)	2,080,981
Accrued taxes	(2,759,465)	2,143,148
Accrued interest and other	2,138,541	4,054,237
Regulatory liabilities	15,020,303	(21,226,286)
Other liabilities	(34,269,010)	34,969,007
Net cash provided by operating activities	<u>23,737,147</u>	<u>61,943,905</u>
INVESTING ACTIVITIES:		
Electric plant additions	(289,921,469)	(435,783,038)
Proceeds from sale of marketable securities	62,416,930	24,286,124
Purchases of marketable securities	(99,516,847)	(76,871,172)
Proceeds from sale of transformers	-	300,000
Net cash used in investing activities	<u>(327,021,386)</u>	<u>(488,068,086)</u>
FINANCING ACTIVITIES:		
Issuance of Senior 2009 Bonds	200,000,000	-
Issuance of Senior 2009 Notes	100,000,000	-
Issuance of Senior 2008 Notes	-	350,000,000
Loan origination costs	(3,579,325)	(3,250,954)
Repayment of Senior 2006 Notes	(14,130,741)	(13,345,479)
Repayment of Senior 2007 Notes	(10,033,212)	(9,463,928)
Repayment of Senior 2008 Notes	(11,289,574)	(4,833,687)
Proceeds from line of credit	255,000,000	100,000,000
Payments on line of credit	(240,000,000)	(50,000,000)
Dividends on common stock	(3,150,000)	(5,500,000)
Net cash provided by financing activities	<u>272,817,148</u>	<u>363,605,952</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(30,467,091)	(62,518,229)
CASH AND CASH EQUIVALENTS — Beginning of year	<u>45,176,266</u>	<u>107,694,495</u>
CASH AND CASH EQUIVALENTS — End of year	<u>\$ 14,709,175</u>	<u>\$ 45,176,266</u>
SUPPLEMENTAL DISCLOSURES:		
Interest paid	<u>\$ 65,698,244</u>	<u>\$ 49,379,342</u>
Income taxes paid (received) — net	<u>\$ 17,757,000</u>	<u>\$ (710,829)</u>
Non-cash electric plant additions included in accounts payable at December 31	<u>\$ 4,807,848</u>	<u>\$ 63,225,054</u>

See notes to consolidated financial statements.

OHIO VALLEY ELECTRIC CORPORATION AND SUBSIDIARY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2009 AND 2008

1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Consolidated Financial Statements — The consolidated financial statements include the accounts of Ohio Valley Electric Corporation (OVEC) and its wholly owned subsidiary, Indiana-Kentucky Electric Corporation (IKEC), collectively, the “Companies.” All intercompany transactions have been eliminated in consolidation.

Organization — The Companies own two generating stations located in Ohio and Indiana with a combined electric production capability of approximately 2,256 megawatts. OVEC is owned by several investor-owned utilities or utility holding companies and an affiliate of a generation and transmission rural electric cooperative. These entities and their affiliates comprise the Sponsoring Companies. The Sponsoring Companies purchase power from OVEC according to the terms of the Inter-Company Power Agreement (ICPA), which in 2004 was extended for an additional 20 years from March 13, 2006 to March 13, 2026. Approximately 30% of the Companies’ employees are covered by a collective bargaining agreement that expires August 31, 2011.

Rate Regulation — The proceeds from the sale of power to the Sponsoring Companies are designed to be sufficient for OVEC to meet its operating expenses and fixed costs, as well as earn a return on equity before federal income taxes. In addition, the proceeds from power sales are designed to cover debt amortization and interest expense associated with financings. The Companies have continued and expect to continue to operate pursuant to the cost plus rate of return recovery provisions at least to March 13, 2026, the date of termination of the ICPA.

The accounting guidance for “Regulated Operations,” provides that rate-regulated utilities account for and report assets and liabilities consistent with the economic effect of the way in which rates are established, if the rates established are designed to recover the costs of providing the regulated service and it is probable that such rates can be charged and collected. The Companies follow the accounting and reporting requirements in accordance with the guidance for “Regulated Operations.” Certain expenses and credits subject to utility regulation or rate determination normally reflected in income are deferred on the accompanying consolidated balance sheets and are recognized in income as the related amounts are included in service rates and recovered from or refunded to customers.

The Companies' regulatory assets, liabilities, and amounts authorized for recovery through Sponsor billings at December 31, 2009 and 2008, were as follows:

	2009	2008
Regulatory assets:		
Current assets:		
Income taxes billable to customers	\$ -	\$ 1,034,148
Deferred debt costs	<u>378,717</u>	<u>-</u>
Total	<u>378,717</u>	<u>1,034,148</u>
Other assets:		
Asset retirement costs	6,520,890	14,642,782
Unrecognized postemployment benefits	3,211,580	2,236,997
Deferred depreciation	10,149,660	27,047,875
Pension benefits	<u>7,831,705</u>	<u>27,261,510</u>
Total	<u>27,713,835</u>	<u>71,189,164</u>
Total regulatory assets	<u>\$28,092,552</u>	<u>\$72,223,312</u>
Regulatory liabilities:		
Current liabilities:		
Deferred credit — EPA emission allowance proceeds	\$ -	\$ 1,577,431
Advance collection of interest	<u>2,630,963</u>	<u>2,652,969</u>
Total	<u>2,630,963</u>	<u>4,230,400</u>
Other liabilities:		
Postretirement benefits	31,275,265	13,670,062
Investment tax credits	3,393,146	3,393,146
Net antitrust settlement	1,823,929	1,823,929
Income taxes refundable to customers	<u>48,593,284</u>	<u>47,070,877</u>
Total	<u>85,085,624</u>	<u>65,958,014</u>
Total regulatory liabilities	<u>\$87,716,587</u>	<u>\$70,188,414</u>

Regulatory Assets — Regulatory assets consist primarily of deferred depreciation, asset retirement costs, and pension benefits. Deferred depreciation is recovered over the life of the debt that was used to fund the related plant additions. The Companies follow the sinking fund depreciation method for ratemaking purposes, and the difference between straight-line depreciation and the debt principal payments billed to customers is recorded as deferred depreciation. With the exception of deferred debt costs, which will be recovered during 2010, other regulatory assets are being recovered on a long-term basis.

Regulatory Liabilities — The regulatory liabilities classified as current in the accompanying consolidated balance sheet as of December 31, 2009, represents interest expense collected from customers in advance of expense recognition. These amounts outstanding will be credited to customer bills during 2010. Other regulatory liabilities consist primarily of income taxes refundable to customers

and postretirement benefits. Income taxes refundable to customers are credited to customer bills in the period when the related deferred tax assets are realized. The Companies' current ratemaking policy recovers postretirement benefits in an amount equal to estimated service cost. As a result, related regulatory liabilities are being credited to customer bills on a long-term basis. The remaining regulatory liabilities are awaiting credit to customer bills in a future period that is yet to be determined.

Cash and Cash Equivalents — For purposes of these statements, the Companies consider temporary cash investments to be cash equivalents since they are readily convertible into cash and have original maturities of less than three months.

Electric Plant — Property additions and replacements are charged to utility plant accounts. Depreciation expense is recorded at the time property additions and replacements are billed to customers or at the date the property is placed in service if the in-service date occurs subsequent to the customer billing. Customer billings for construction in progress are recorded as deferred revenue-advances for construction. These amounts are closed to revenue at the time the related property is placed in service. Deferred depreciation, depreciation expense, and accumulated depreciation are recorded when financed property additions and replacements are recovered over a period of years through customer debt retirement billing. All depreciable property will be fully billed and depreciated prior to the expiration of the ICPA. Repairs of property are charged to maintenance expense.

Fuel in Storage, Emission Allowances, and Materials and Supplies — The Companies maintain coal, reagent, and oil inventories for use in the generation of electricity and emission allowance inventories for regulatory compliance purposes due to the generation of electricity. These inventories are valued at average cost. Materials and supplies consist primarily of replacement parts necessary to maintain the generating facilities and are valued at average cost.

Long-Term Investments — Long-term investments consist of marketable securities that are held for the purpose of funding postretirement benefits and decommissioning and demolition costs. These securities have been classified as trading securities in accordance with the provisions of "Investments — Debt and Equity Securities" accounting guidance. Trading securities reflected in Long-Term Investments are carried at fair value with the unrealized gain or loss, reported in Other Income. The cost of securities sold is based on the specific identification cost method. The fair value of most investment securities is determined by reference to currently available market prices. Where quoted market prices are not available, we use the market price of similar types of securities that are traded in the market to estimate fair value. See "Fair Value Measurements" in Note 11. Due to tax limitations, the amounts held in the postretirement benefits portfolio have not yet been transferred to the Voluntary Employee Beneficiary Association (VEBA) trusts (see Note 9). Long-term investments primarily consist of municipal bonds, money market mutual fund investments, and mutual funds. Net unrealized gains recognized during 2009 and 2008 on securities still held at the balance sheet date were \$4,632,659 and \$638,007, respectively.

Special Deposits — Special deposits consist of money market mutual funds held by trustees primarily restricted for use in specific construction projects.

Money market mutual funds reflected in special deposits are carried at fair value with the related investment income, reported in Other Income. The cost of securities sold is based on the specific identification method. The fair value of money market mutual funds is determined by reference to currently available market prices. There were no unrealized gains or losses recognized on this portfolio during 2009.

Fair Value Measurements of Assets and Liabilities — The accounting guidance for “Fair Value Measurements and Disclosures” establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). Where observable inputs are available, pricing may be completed using comparable securities, dealer values and general market conditions to determine fair value. Valuation models utilize various inputs that include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in inactive markets and other observable inputs for the asset or liability.

OVEC utilizes its trustee’s external pricing service in its estimate of the fair value of the underlying investments held in the benefit plan trusts and investment portfolios. The Companies’ management reviews and validates the prices utilized by the trustee to determine fair value. Equities are classified as Level 1 holdings if they are actively traded on exchanges. Fixed income securities do not trade on an exchange and do not have an official closing price. Pricing vendors calculate bond valuations using financial models and matrices. Fixed income securities are typically classified as Level 2 holdings because their valuation inputs are based on observable market data. Observable inputs used for valuing fixed income securities are benchmark yields, reported trades, broker/dealer quotes, issuer spreads, bids, offers, and economic events. Other securities with model-derived valuation inputs that are observable are also classified as Level 2 investments. Investments with unobservable valuation inputs are classified as Level 3 investments. OVEC’s only level 3 investment is the John Hancock Group Annuity Contract held in the Pension Trust (Note 9). The fair value of the insurance contract is calculated based on estimated redemption value of the policy.

Unamortized Debt Expense — Unamortized debt expense relates to loan origination costs incurred to secure financing. These costs are being amortized using the effective yield method over the life of the related loans.

Asset Retirement Obligations and Asset Retirement Costs — The Companies recognize the fair value of legal obligations associated with the retirement or removal of long-lived assets at the time the obligations are incurred and can be reasonably estimated. The initial recognition of this liability is accompanied by a corresponding increase in depreciable electric plant. Subsequent to the initial recognition, the liability is adjusted for any revisions to the expected value of the retirement obligation (with corresponding adjustments to electric plant) and for accretion of the liability due to the passage of time.

These asset retirement obligations are primarily related to obligations associated with future asbestos abatement at certain generating stations and certain plant closure costs. As of December 31, 2009 and 2008, the Companies had a regulatory asset of \$6.5 million and \$14.6 million, respectively, related to asset retirement obligations.

Balance — December 31, 2007	\$ 32,223,528
Accretion	<u>1,938,865</u>
Balance — December 31, 2008	34,162,393
Accretion	2,049,744
Liabilities settled	(3,264,559)
Revision in cash flow estimates	<u>(3,508,521)</u>
Balance — December 31, 2009	<u><u>\$ 29,439,057</u></u>

During 2009 the Companies completed an updated study to estimate the asset retirement costs described above. The revised estimated costs are recorded in the accompanying balance sheets.

The Companies do not recognize liabilities for asset retirement obligations for which the fair value cannot be reasonably estimated. The Companies have asset retirement obligations associated with transmission assets at certain generating stations. However, the retirement date for these assets cannot be determined; therefore, the fair value of the associated liability currently cannot be estimated and no amounts are recognized in the consolidated financial statements herein.

Income Taxes — The Companies use the liability method of accounting for income taxes. Under the liability method, the Companies provide deferred income taxes for all temporary differences between the book and tax basis of assets and liabilities which will result in a future tax consequence.

The Companies account for uncertain tax positions in accordance with the accounting guidance for “Income Taxes.”

Use of Estimates — The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Subsequent Events — In preparing the accompanying financial statements and disclosures, the Companies reviewed subsequent events through April 14, 2010.

2. RELATED-PARTY TRANSACTIONS

Transactions with the Sponsoring Companies during 2009 and 2008 included the sale of all generated power to them, the purchase of Arranged Power from them and other utility systems in order to meet the Department of Energy’s power requirements, contract barging services, railcar services, and minor transactions for services and materials. The Companies have Power Agreements with Louisville Gas and Electric Company, Duke Energy Ohio, Inc., The Dayton Power and Light Company, Kentucky Utilities Company, Ohio Edison Company, and American Electric Power Service Corporation as agent for the American Electric Power System Companies; and Transmission Service Agreements with Louisville

Gas and Electric Company, Duke Energy Ohio, Inc., The Dayton Power and Light Company, The Toledo Edison Company, Ohio Edison Company, Kentucky Utilities Company, and American Electric Power Service Corporation as agent for the American Electric Power System Companies.

In September 2006, the Companies sold two transformers and associated equipment to Duke Energy Ohio, Inc. for a total maximum purchase price of \$3 million, which, subject to the terms of the asset purchase agreement, was contingently payable in equal annual installments over ten years. The annual purchase price payment obligation was contingent on the performance of the transformers, and as such, no receivable was recognized for future anticipated payment obligations. In 2008, the Companies were informed that one of the transformers failed, and as such, no further sales proceeds are anticipated.

At December 31, 2009 and 2008, balances due from or to the Sponsoring Companies are as follows:

	2009	2008
Accounts receivable	\$ 35,699,802	\$ 31,668,608

American Electric Power Company, Inc. and subsidiary company owned 43.47% of the common stock of OVEC as of December 31, 2009. The following is a summary of the principal services received from the American Electric Power Service Corporation as authorized by the Companies' Boards of Directors:

	2009	2008
General services	\$ 2,762,461	\$ 2,198,238
Specific projects	<u>11,973,067</u>	<u>21,274,966</u>
Total	<u>\$ 14,735,528</u>	<u>\$ 23,473,204</u>

General services consist of regular recurring operation and maintenance services. Specific projects primarily represent nonrecurring plant construction projects and engineering studies, which are approved by the Companies' Boards of Directors. The services are provided in accordance with the service agreement dated December 15, 1956, between the Companies and the American Electric Power Service Corporation.

3. COAL SUPPLY

The Companies have coal supply agreements with certain nonaffiliated companies that expire at various dates from the year 2010 through 2017. Pricing for coal under these contracts is subject to contract provisions and adjustments. The Companies currently have approximately 90% of their 2010 coal requirements under long-term agreements of one year or greater.

4. INVENTORIES

Inventories — Net of reserves, at December 31, 2009 and 2008, consist of the following:

	2009	2008
Fuel in storage — at average cost	\$ 81,102,751	\$ 52,220,614
Materials and supplies — at average cost	21,984,752	19,223,210
Emission allowances	<u>5,215,651</u>	<u>2,244,126</u>
Total inventories	<u>\$ 108,303,154</u>	<u>\$ 73,687,950</u>

5. ELECTRIC PLANT

Electric plant at December 31, 2009 and 2008, consists of the following:

	2009	2008
Intangible	\$ 26,564	\$ 26,564
Steam production plant	1,174,766,135	1,152,457,582
Transmission plant	73,709,826	60,191,487
General plant	<u>12,290,812</u>	<u>24,954,040</u>
	1,260,793,337	1,237,629,673
Less accumulated depreciation	<u>949,382,858</u>	<u>907,307,285</u>
	311,410,479	330,322,388
Construction in progress	<u>967,123,450</u>	<u>767,848,855</u>
Total electric plant	<u>\$ 1,278,533,929</u>	<u>\$ 1,098,171,243</u>

6. BORROWING ARRANGEMENTS AND NOTES

OVEC has an unsecured bank revolving line of credit agreement with a borrowing limit of \$200 million as of December 31, 2009. The \$200 million line of credit has an expiration date of August 4, 2010. At December 31, 2009 and 2008, OVEC had borrowed \$65 million and \$50 million, respectively, under this line of credit. Interest expense related to line of credit borrowings was \$1,138,063 in 2009 and \$255,699 in 2008. During 2009 and 2008, OVEC incurred annual commitment fees of \$220,622 and \$343,729, respectively, based on the borrowing limits of the line of credit.

7. LONG-TERM DEBT

The following amounts were outstanding at December 31, 2009 and 2008:

	Interest Rate	2009	2008
Senior 2006 Notes due February 15, 2026	5.80 %	\$ 398,883,135	\$ 413,013,876
Senior 2007 Notes:			
Tranche A due February 15, 2026	5.90	184,039,494	190,703,342
Tranche B due February 15, 2026	5.90	46,349,039	48,027,572
Tranche C due February 15, 2026	5.90	46,716,375	48,407,206
Senior 2008 Notes:			
Tranche A due February 15, 2026	5.92	47,078,351	48,780,045
Tranche B due February 15, 2026	6.71	142,330,117	147,157,899
Tranche C due February 15, 2026	6.71	144,468,271	149,228,369
Series 2009 Notes and Bonds:			
2009A due February 15, 2013	2.034	100,000,000	-
2009A due February 1, 2026	0.22	25,000,000	-
2009B due February 1, 2026	0.30	25,000,000	-
2009C due February 1, 2026	0.25	25,000,000	-
2009D due February 1, 2026	0.30	25,000,000	-
2009E due October 1, 2019	5.625	100,000,000	-
		<u>1,309,864,782</u>	<u>1,045,318,309</u>
Total debt			
		<u>37,642,056</u>	<u>35,453,528</u>
Current portion of long-term debt			
		<u>\$1,272,222,726</u>	<u>\$1,009,864,781</u>
Total long-term debt			

During 2008, OVEC issued \$350 million unsecured senior notes (Senior 2008 Notes) in private placements in three tranches. The \$50 million Tranche A notes were issued in March 2008, the \$150 million Tranche B notes were issued in June 2008, and the \$150 million Tranche C notes were issued in August 2008.

During 2009, OVEC issued \$100 million variable rate unsecured senior notes (2009A Notes) in private placement, a series of four variable rate tax exempt pollution control bonds (2009A, B, C, and D Bonds), and fixed rate tax exempt pollution control bonds (2009E Bonds). The 2009A, B, C, and D Bonds, in the amount of \$25 million each, were issued in August 2009. In October 2009, the non-amortizing 2009E Bonds were issued in the amount of \$100 million. The 2009A Notes and 2009A, B, C, and D Bonds are non-amortizing issues and pay interest at variable rates. The rates listed above reflect the interest rate in effect at December 31, 2009.

All of the OVEC amortizing senior notes have maturities scheduled for February 15, 2026. The \$100 million non-amortizing senior notes will mature on February 1, 2013 with the principal amount due on that date. The tax exempt variable rate bonds all mature on February 15, 2026, with the aggregate \$100 million principal amount due on that date. The tax exempt fixed rate bonds mature on October 1, 2019 with an amount of \$100 million principal due on that date. The annual maturities of long-term debt as of December 31, 2009, are as follows:

2010	\$ 37,642,056
2011	39,966,242
2012	42,434,535
2013	145,055,904
2014	47,839,885
2015–2026	<u>996,926,160</u>
Total	<u>\$1,309,864,782</u>

8. INCOME TAXES

OVEC and IKEC file a consolidated federal income tax return. The effective tax rate varied from the statutory federal income tax rate due to differences between the book and tax treatment of various transactions as follows:

	2009	2008
Income tax expense at 35% statutory rate	\$1,857,353	\$ 2,140,093
State income taxes net of federal benefit	817,024	66,042
Temporary differences flowed through to customer bills	(267,941)	(1,218,762)
Permanent differences	<u>14,731</u>	<u>36,008</u>
Income tax provision	<u>\$2,421,167</u>	<u>\$ 1,023,381</u>
Effective tax rate	<u>45.6 %</u>	<u>16.7 %</u>

Components of the income tax provision were as follows:

	2009	2008
Current income tax expense	\$ 15,678,705	\$ 977,761
Deferred income tax expense	<u>(13,257,538)</u>	<u>45,620</u>
Total income tax provision	<u>\$ 2,421,167</u>	<u>\$1,023,381</u>

OVEC and IKEC record deferred tax assets and liabilities based on differences between book and tax basis of assets and liabilities measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. Deferred tax assets and liabilities are adjusted for changes in tax rates. The deferred tax assets recorded in the accompanying consolidated balance sheets consist primarily of the net deferred taxes on depreciation, postretirement benefits obligation, net operating loss carryforwards, asset retirement obligations, regulatory assets and regulatory liabilities.

To the extent that the Companies have not reflected credits in customer billings for deferred tax assets, they have recorded a regulatory liability representing income taxes refundable to customers under the applicable agreements among the parties. The liability was \$48,593,284 at December 31, 2009, and \$47,070,877 at December 31, 2008.

Deferred income tax assets (liabilities) consisted of the following at December 31, 2009 and 2008:

	2009	2008
Deferred tax assets:		
Deferred revenue — advances for construction	\$ 7,888,820	\$ 9,619,159
Federal net operating loss carryforwards	-	4,456,189
State net operating loss carryforwards	-	39,212
AMT credit carryforwards	-	2,532,919
Postretirement benefit obligation	15,914,071	20,445,933
Pension liability	2,803,971	9,832,499
Postemployment benefit obligation	1,149,836	806,825
Asset retirement obligations	10,648,464	12,321,464
Miscellaneous accruals	2,784,832	2,649,351
Regulatory liability — postretirement benefits	11,197,425	4,930,427
Regulatory liability — investment tax credits	1,214,842	1,223,817
Regulatory liability — net antitrust settlement	653,018	657,843
Regulatory liability — income taxes refundable to customers	<u>17,660,365</u>	<u>16,977,211</u>
Total deferred tax assets	<u>71,915,644</u>	<u>86,492,849</u>
Deferred tax liabilities:		
Regulatory asset — income taxes billable to customers	-	(361,952)
Prepaid expenses	(613,978)	(582,702)
Electric plant	(1,204,691)	(21,120,348)
Regulatory asset — pension benefits	(2,803,971)	(9,832,499)
Regulatory asset — unrecognized postemployment benefits	(1,149,836)	(806,825)
Regulatory asset — asset retirement costs	<u>(2,443,115)</u>	<u>(5,281,261)</u>
Total deferred tax liabilities	<u>(8,215,591)</u>	<u>(37,985,587)</u>
Deferred income tax assets (liabilities)	<u>\$63,700,053</u>	<u>\$ 48,507,262</u>

The accounting guidance for “Income Taxes” addresses the determination of whether the tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under this guidance, the Companies may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate settlement. The Companies have not identified any uncertain tax positions as of December 31, 2009 and 2008 and accordingly, no liabilities for uncertain tax positions have been recognized.

On March 23, 2010, President Obama signed into law the Patient Protection and Affordable Care Act (the PPAC Act). The PPAC Act is a comprehensive health care reform bill that includes revenue-raising provisions for nearly \$400 billion over 10 years through tax increases on high-income individuals, excise taxes on high-cost group health plans and new fees on selected health-care-related industries. In addition, on March 30, 2010, President Obama signed into law the reconciliation measure, which modifies certain provisions of the PPAC Act.

An employer offering retiree prescription drug coverage that is at least as valuable as Medicare Part D coverage is currently entitled to a federal retiree drug subsidy. Employers can claim a deduction for the entire cost of providing the prescription drug coverage even though a portion of the cost is offset by the subsidy they receive. The PPAC Act repeals the current rule permitting deduction of the portion of the drug coverage expense that is offset by the Medicare Part D subsidy. This provision of the PPAC Act as modified by the reconciliation measure is effective for taxable years beginning after December 31, 2012.

As OVEC & IKEC currently receive a Medicare Part D subsidy the passage of the PPAC Act will result in an estimated reduction of the postemployment benefits deferred tax asset of approximately \$6 million and a reduction to the related regulatory liability (income taxes refundable to customer) of approximately \$6 million.

The Companies file income tax returns with the Internal Revenue Service, the states of Ohio, Indiana and the Commonwealth of Kentucky. The Companies are no longer subject to federal tax examinations for tax years 2005 and earlier. The Companies are no longer subject to states of Ohio and Indiana tax examinations for tax years 2005 and earlier. The Companies are no longer subject to the Commonwealth of Kentucky examinations for tax years 2004 and earlier.

9. PENSION PLAN, OTHER POSTRETIREMENT AND POSTEMPLOYMENT BENEFITS

The Companies have a noncontributory qualified defined benefit pension plan (the Pension Plan) covering substantially all of their employees. The benefits are based on years of service and each employee's highest consecutive 36-month compensation period. Employees are vested in the Pension Plan after five years of service with the Companies.

Funding for the Pension Plan is based on actuarially determined contributions, the maximum of which is generally the amount deductible for income tax purposes and the minimum being that required by the Employee Retirement Income Security Act of 1974 (ERISA), as amended. The full cost of the pension benefits and related obligations has been allocated to OVEC and IKEC in the accompanying consolidated financial statements. The allocated amounts represent approximately a 54% and 46% split for OVEC and IKEC, respectively, as of December 31, 2009 and 2008. The Pension Plan's assets consist of an insurance contract and investments in equity and debt securities. In the following disclosures, the insurance contract is treated as a debt security because its long-term yield is tied to the debt markets.

In addition to the Pension Plan, the Companies provide certain health care and life insurance benefits (Other Postretirement Benefits) for retired employees. Substantially all of the Companies' employees become eligible for these benefits if they reach retirement age while working for the Companies. These and similar benefits for active employees are provided through employer funding and insurance policies. In December 2004, the Companies established Voluntary Employee Beneficiary Association (VEBA) trusts.

All of the trust funds' investments for the pension and postemployment benefit plans are diversified and managed in compliance with all laws and regulations. Management regularly reviews the actual asset allocation and periodically rebalances the investments to targeted allocation when appropriate. The investments are reported at fair value under the "Fair Value Measurements and Disclosures" accounting guidance.

All benefit plan assets are invested in accordance with each plan's investment policy. The investment policy outlines the investment objectives, strategies and target asset allocations by plan. Benefit plan assets are reviewed on a formal basis each quarter by the OVEC/IKEC Qualified Plan Trust Committee.

The investment philosophies for the benefit plans support the allocation of assets to minimize risks and optimize net returns.

Investment strategies include:

- Maintaining a long-term investment horizon.
- Diversifying assets to help control volatility of returns at acceptable levels.
- Managing fees, transaction costs and tax liabilities to maximize investment earnings.
- Using active management of investments where appropriate risk/return opportunities exist.
- Keeping portfolio structure style-neutral to limit volatility compared to applicable benchmarks.

The target asset allocation for each portfolio is as follows:

Pension Plan Assets	Target
Domestic equity	15.0 %
International and global equity	15.0
Guaranteed annuity contract	70.0
VEBA Plan Assets	Target
Domestic equity	20.0 %
International and global equity	20.0
Fixed income	57.0
Cash	3.0

Each benefit plan contains various investment limitations. These limitations are described in the investment policy statement and detailed in customized investment guidelines or documented by mutual fund prospectus. These investment guidelines require appropriate portfolio diversification and define security concentration limits. Each investment manager's portfolio is compared to an appropriate diversified benchmark index.

Equity investment limitations:

- No security in excess of 5% of all equities.
- Cash equivalents must be less than 10% of each investment manager's equity portfolio.
- Individual securities must be less than 15% of each manager's equity portfolio.
- No investment in excess of 5% of an outstanding class of any company.
- No securities may be bought or sold on margin or other use of leverage.
- As otherwise defined by fund prospectus.

Fixed income limitations:

The Pension Plan fixed income allocation consists of a Guaranteed Annuity Contract issued by the John Hancock Life Insurance Company. The VEBA benefit plans' fixed income allocation is comprised of a variety of fixed income mutual funds. Investment limitations for these fixed income funds are defined by manager prospectus.

Cash limitations:

Cash and cash equivalents are held in each trust to provide liquidity and meet short-term cash needs. Cash equivalent funds are used to provide diversification and preserve principal. The underlying holdings in the cash funds are investment grade money market instruments including money market mutual funds, certificates of deposit, treasury bills and other types of investment grade short-term debt securities. The cash funds are valued each business day and provide daily liquidity.

Projected Pension Plan and Other Postretirement Benefits obligations and funded status as of December 31, 2009 and 2008:

	Pension Plan		Other Postretirement Benefits	
	2009	2008	2009	2008
Change in projected benefit obligation:				
Projected benefit obligation — beginning of year	\$ 168,926,587	\$ 153,972,014	\$ 104,956,170	\$ 97,431,448
Service cost	4,309,555	3,899,052	3,135,170	2,781,098
Interest cost	10,215,241	9,799,772	6,030,604	6,173,680
Plan participants' contributions	-	-	670,264	613,383
Benefits paid	(8,385,160)	(7,755,609)	(4,166,111)	(3,286,320)
Net actuarial (gain) loss	7,453,646	9,056,558	2,214,103	1,242,881
Medicare subsidy	-	-	492,641	-
Expenses paid from assets	(55,301)	(45,200)	-	-
Projected benefit obligation — end of year	<u>182,464,568</u>	<u>168,926,587</u>	<u>113,332,841</u>	<u>104,956,170</u>
Change in fair value of plan assets:				
Fair value of plan assets — beginning of year	141,665,077	170,022,263	62,427,019	60,656,532
Actual return on plan assets	35,708,247	(26,056,377)	18,567,123	(728,513)
Expenses paid from assets	(55,301)	(45,200)	-	-
Employer contributions	5,700,000	5,500,000	3,903,206	5,171,937
Plan participants' contributions	-	-	670,264	613,383
Medicare subsidy	-	-	492,641	-
Benefits paid	(8,385,160)	(7,755,609)	(4,166,111)	(3,286,320)
Fair value of plan assets — end of year	<u>174,632,863</u>	<u>141,665,077</u>	<u>81,894,142</u>	<u>62,427,019</u>
Funded (underfunded) status — end of year	<u>\$ (7,831,705)</u>	<u>\$ (27,261,510)</u>	<u>\$ (31,438,699)</u>	<u>\$ (42,529,151)</u>

On December 8, 2003, the President of the United States of America signed into law the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act). The Act introduced a prescription drug benefit to retirees as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a prescription drug benefit that is actuarially equivalent to the benefit provided by Medicare. The Companies believe that the coverage for prescription drugs is at least actuarially equivalent to the benefits provided by Medicare for most current retirees because the benefits for that group substantially exceed the benefits provided by Medicare, thereby allowing the Companies to qualify for the subsidy. The Companies' employer contributions for Other Postretirement Benefits in the above table are net of subsidies received of \$492,641 and \$0 for 2009 and 2008, respectively. The Companies have accounted for the subsidy as a reduction of the benefit obligation detailed in the above table. The benefit obligation was reduced by approximately \$13 million and \$14.2 million as of December 31, 2009 and 2008. Refer to the Income Taxes footnote (Note 8) for changes in the tax law surrounding the new health care bill.

The accumulated benefit obligation for the Pension Plan was \$156,891,866 and \$144,698,788 at December 31, 2009 and 2008, respectively.

Components of Net Periodic Benefit Cost — The Companies record the expected cost of Other Postretirement Benefits over the service period during which such benefits are earned.

Pension expense is recognized as amounts are contributed to the Pension Plan and billed to customers. The accumulated difference between recorded pension expense and the yearly net periodic pension expense as calculated under the accounting guidance for “Compensation — Retirement Benefits,” is billable as a cost of operations under the ICPA when contributed to the pension fund. This accumulated difference has been recorded as a regulatory asset in the accompanying consolidated balance sheets.

	Pension Plan		Other Postretirement Benefits	
	2009	2008	2009	2008
Service cost	\$ 4,309,555	\$ 3,899,052	\$ 3,135,170	\$ 2,781,098
Interest cost	10,215,241	9,799,772	6,030,604	6,173,680
Expected return on plan assets	(8,374,411)	(11,049,029)	(3,585,115)	(2,880,712)
Amortization of prior service cost	329,437	531,437	(379,000)	(379,000)
Recognized actuarial loss	<u>1,318,607</u>	<u>-</u>	<u>(94,810)</u>	<u>(263,945)</u>
Net periodic benefit cost	<u>\$ 7,798,429</u>	<u>\$ 3,181,232</u>	<u>\$ 5,106,849</u>	<u>\$ 5,431,121</u>
Pension and Other Postretirement Benefits expense recognized in the consolidated statement of income and retained earnings and billed to sponsoring companies under the ICPA	<u>\$ 5,700,000</u>	<u>\$ 5,500,000</u>	<u>\$ 3,260,000</u>	<u>\$ 3,260,000</u>

The following table presents the classification of Pension Plan assets within the fair value hierarchy at December 31, 2009:

	Fair Value Measurements at Reporting Date Using		
	Quoted Prices in Active for Market Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
2009			
Domestic equity	<u>\$41,331,372</u>	<u>\$ -</u>	<u>\$ -</u>
International and global equity	<u>\$ 8,366,973</u>	<u>\$ -</u>	<u>\$ -</u>
Cash and cash equivalents	<u>\$ 863,051</u>	<u>\$ -</u>	<u>\$ -</u>
Group Annuity Contract — John Hancock	<u>\$ -</u>	<u>\$ -</u>	<u>\$123,998,162</u>

See rollforward for the Group Annuity Contract with John Hancock below:

Balance — January 1, 2009	\$ 107,810,562
Redemptions	(9,219,040)
Realized/unrealized gains	<u>25,406,640</u>
Balance — December 31, 2009	<u>\$ 123,998,162</u>

The following table presents the classification of Pension Plan assets within the fair value hierarchy at December 31, 2009:

	Fair Value Measurements at Reporting Date Using		
	Quoted Prices in Active for Market Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
2009			
Domestic equity	<u>\$ 34,393,753</u>	<u>\$ -</u>	<u>\$ -</u>
International and global equity	<u>\$ 10,136,800</u>	<u>\$ -</u>	<u>\$ -</u>
Fixed income	<u>\$ 33,902,168</u>	<u>\$ -</u>	<u>\$ -</u>
Cash and cash equivalents	<u>\$ 3,338,776</u>	<u>\$ -</u>	<u>\$ -</u>

Pension Plan and Other Postretirement Benefit Assumptions — Actuarial assumptions used to determine benefit obligations at December 31, 2009 and 2008, were as follows:

	Pension Plan		Other Postretirement Benefits	
	2009	2008	2009	2008
Discount rate	5.90 %	6.10 %	6.00 %	5.90 %
Rate of compensation increase	4.00	4.00	4.00	4.00

Actuarial assumptions used to determine net periodic benefit cost for the years ended December 31, 2009 and 2008, were as follows:

	Pension Plan		Other Postretirement Benefits	
	2009	2008	2009	2008
Discount rate	6.10 %	6.50 %	5.90 %	6.50 %
Expected long-term return on plan assets	6.00	6.50	5.60	4.70
Rate of compensation increase	4.00	4.00	4.00	4.00

In selecting the expected long-term rate of return on assets, the Companies considered the average rate of earnings expected on the funds invested or to be invested to provide for plan benefits. This included considering the Pension Plan and VEBA trusts' asset allocation, as well as the target asset allocations for the future, and the expected returns likely to be earned over the life of the Pension Plan and the VEBAs.

Assumed health care cost trend rates at December 31, 2009 and 2008, were as follows:

	2009	2008
Health care trend rate assumed for next year — participants under 65	9.50 %	8.00 %
Health care trend rate assumed for next year — participants over 65	9.50	9.50
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate) — participants under 65	5.00	5.00
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate) — participants over 65	5.00	5.00
Year that the rate reaches the ultimate trend rate	2015	2015

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A one-percentage-point change in assumed health care cost trend rates would have the following effects:

	One-Percentage Point Increase	One-Percentage Point Decrease
Effect on total service and interest cost	\$ 1,719,802	\$ (1,348,696)
Effect on postretirement benefit obligation	17,371,743	(13,915,748)

Pension Plan and Other Postretirement Benefit Assets — The asset allocation for the Pension Plan and VEBA trusts at December 31, 2009 and 2008, by asset category was as follows:

	Pension Plan		VEBA Trusts	
	2009	2008	2009	2008
Asset category:				
Equity securities	29 %	24 %	40 %	24 %
Debt securities	71	76	60	76

The target asset allocation for the Pension Plan is 30% equity securities and 70% debt securities and for the VEBA trust is 40% equity securities and 60% debt securities.

Pension Plan and Other Postretirement Benefit Contributions — The Companies expect to contribute \$5,700,000 to their Pension Plan and \$7,500,000 to their Other Postretirement Benefits plan in 2010.

Estimated Future Benefit Payments — The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

Years Ending December 31	Pension Plan	Other Postretirement Benefits	
		With Medicare Subsidy	Without Medicare Subsidy
2010	\$ 8,846,797	\$ 4,297,419	\$ 4,611,468
2011	9,055,395	4,667,862	5,013,600
2012	9,446,150	5,077,960	5,461,505
2013	9,829,262	5,443,102	5,865,104
2014	10,278,614	5,919,263	6,376,655
Five years thereafter	61,096,710	37,684,162	40,634,280

Postemployment Benefits — The Companies follow the accounting guidance in “Compensation — Non-Retirement Postemployment Benefits,” and accrue the estimated cost of benefits provided to former or inactive employees after employment but before retirement. Such benefits include, but are not limited to, salary continuations, supplemental unemployment, severance, disability (including workers’ compensation), job training, counseling, and continuation of benefits, such as health care and life insurance coverage. The cost of such benefits and related obligations has been allocated to OVEC and IKEC in the accompanying consolidated financial statements. The allocated amounts represent approximately a 34% and 66% split between OVEC and IKEC, respectively, as of December 31, 2009, and approximately a 42% and 58% split between OVEC and IKEC, respectively, as of December 31, 2008. The liability is offset with a corresponding regulatory asset and represents unrecognized postemployment benefits billable in the future to customers. The accrued cost of such benefits was \$3,211,580 and \$2,236,997 at December 31, 2009 and 2008, respectively.

Defined Contribution Plan — The Companies have a trustee-defined contribution supplemental pension and savings plan that includes 401(k) features and is available to employees who have met eligibility requirements. The Companies’ contributions to the savings plan equal 100% of the first 1% and 50% of the next 5% of employee-participants’ contributions based upon total compensation. Benefits to participating employees are based solely upon amounts contributed to the participants’ accounts and investment earnings. By its nature, the plan is fully funded at all times. The employer contributions for 2009 and 2008 were \$1,712,262 and \$1,634,334, respectively.

10. ENVIRONMENTAL MATTERS

Title IV of the 1990 Clean Air Act Amendments (CAAA) required the Companies to reduce sulfur dioxide (SO₂) emissions in two phases: Phase I in 1995 and Phase II in 2000. The Companies selected a fuel switching strategy to comply with the emission reduction requirements. The Companies also purchased additional SO₂ allowances. The cost of these purchased allowances has been inventoried and included on an average cost basis in the cost of fuel consumed when used. The cost of unused allowances at December 31, 2009 and 2008 was \$5,215,651 and \$2,244,126, respectively.

Title IV of the 1990 CAAAs also required the Companies to comply with a nitrogen oxides (NO_x) emission rate limit of 0.84 lb/mmBtu in 2000. The Companies installed overfire air systems on all eleven units at the plants to comply with this limit. The total capital cost of the eleven overfire air systems was approximately \$8.2 million.

During 2002 and 2003, Ohio and Indiana finalized respective NO_x State Implementation Plan (SIP) Call regulations that required further significant NO_x emission reductions for coal-burning power plants during the ozone control period. The Companies installed selective catalytic reduction (SCR) systems on ten of their eleven units to comply with these rules. The total capital cost of the ten SCR systems was approximately \$355 million.

On March 10, 2005, the U.S. EPA issued the Clean Air Interstate Rule (CAIR) that required further significant reductions of SO₂ and NO_x emissions from coal-burning power plants. On March 15, 2005, the U.S. EPA also issued the Clean Air Mercury Rule (CAMR) that required significant mercury emission reductions for coal-burning power plants. These emission reductions were required in two phases: 2009 and 2015 for NO_x; 2010 and 2015 for SO₂; and 2010 and 2018 for mercury. Ohio and Indiana subsequently finalized their respective versions of CAIR and CAMR. In response, the Companies determined that it would be necessary to install flue gas desulfurization (FGD) systems at both plants to comply with these new rules. Following completion of the necessary engineering and permitting, construction was started on the new FGD systems.

In February 2008, the D.C. Circuit Court of Appeals issued a decision which vacated the federal CAMR and remanded the rule to the U.S. EPA with a determination that the rule be rewritten under the maximum achievable control technologies (MACT) provision of Section 112(d) of the Clean Air Act. A group of electric utilities and the U.S. EPA requested a rehearing of the decision, which was denied by the court. Following those denials, both the group of electric utilities and the U.S. EPA requested that the U.S. Supreme Court hear the case. However, in February 2009, the U.S. EPA withdrew its request and the group of utilities' request was denied. These actions left the original court decision in place, which vacated the federal CAMR and remanded the rule to the U.S. EPA with a determination that the rule be rewritten under the MACT provision of Section 112(d) of the Clean Air Act.

In July 2008, the D.C. Circuit Court of Appeals issued a decision that vacated the federal CAIR and remanded the rule to the U.S. EPA. In September 2008, the U.S. EPA, a group of electric utilities and other parties filed petitions for rehearing. In December 2008, the D.C. Circuit Court of Appeals granted the U.S. EPA's petition and remanded the rule to the U.S. EPA without vacatur, allowing the federal CAIR to remain in effect while a new rule was developed and promulgated. Since that time, U.S. EPA has been working on the CAIR replacement rule and is expected to issue a draft of the new rule for comment in the near future.

In December 2008, the Boards of Directors of the Companies authorized a delay in construction of the FGD at the Clifty Creek plant of at least 18 months due to economic uncertainty in the capital markets.

In March 2009, the Boards of Directors also authorized a delay in the tie-in of the FGD systems of all five generating units at the Kyger Creek plant pending an investigation into the structural integrity of the internal components of two newly constructed jet bubbling reactors (JBRs), which are major components of the FGD system. Since that time, extensive studies have been conducted relating to this design issue, which affects the FGD construction projects at both the Kyger Creek and Clifty Creek plants, and the Board of Directors have authorized a complete redesign and replacement of the JBR internal components to resolve this structural integrity issue. A schedule for completing the Kyger Creek and Clifty Creek FGD construction projects is currently under review.

Additional SO₂ allowances will be purchased to operate the Clifty Creek and Kyger Creek generating units to comply with the current environmental emission rules during the delays.

The total cost to complete the new Kyger Creek and Clifty Creek FGD systems and the associated landfills is currently estimated not to exceed \$1.4 billion, including the amounts expended to date and included in construction in progress in the accompanying balance sheets.

On November 6, 2009, the Companies received a Section 114 Information Request from the U.S. EPA. The stated purpose of the information request was for the U.S. EPA to obtain the necessary information to determine if the Kyger Creek and Clifty Creek plants have been operating in compliance with the Federal Clean Air Act. Attorneys for the Companies subsequently contacted the U.S. EPA and established a schedule for submission of the requested information. Based on this schedule, all requested information was submitted to the U.S. EPA by March 8, 2010.

11. FAIR VALUE MEASUREMENTS

The accounting guidance for “Financial Instruments,” requires disclosure of the fair value of certain financial instruments. The estimates of fair value under this guidance require the application of broad assumptions and estimates. Accordingly, any actual exchange of such financial instruments could occur at values significantly different from the amounts disclosed. As cash and cash equivalents, current receivables, current payables, and line of credit borrowings are all short term in nature, their carrying amounts approximate fair value.

As of December 31, 2009, the Companies held certain assets that are required to be measured at fair value on a recurring basis. These consist of investments recorded within special deposits and long-term investments. The investments consist of money market mutual funds and municipal securities. Changes in the observed trading prices and liquidity of money market funds are monitored as additional support for determining fair value, and unrealized gains and losses are recorded in earnings.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Companies believe their valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

Special Deposits and Long-Term Investments — Assets measured at fair value on a recurring basis at December 31, 2009 and 2008, were as follows:

	Fair Value Measurements at Reporting Date Using		
	Quoted Prices in Active for Market Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
2009			
Cash equivalents	<u>\$ 14,630,118</u>	<u>\$ -</u>	<u>\$ -</u>
Marketable securities	<u>\$ -</u>	<u>\$ 82,432,063</u>	<u>\$ -</u>
Money market mutual funds	<u>\$ 13,511,206</u>	<u>\$ -</u>	<u>\$ -</u>
2008			
Cash equivalents	<u>\$ -</u>	<u>\$ 45,118,305</u>	<u>\$ -</u>
Marketable securities	<u>\$ -</u>	<u>\$ 53,609,545</u>	<u>\$ -</u>

Long-Term Debt — The fair values of the senior notes and fixed rate bonds were estimated using discounted cash flow analyses based on current incremental borrowing rates for similar types of borrowing arrangements. These fair values are not reflected in the balance sheet.

The fair values and recorded values of the senior notes, fixed and variable rate bonds as of December 31, 2009 and 2008, are as follows:

	2009		2008	
	Fair Value	Recorded Value	Fair Value	Recorded Value
Senior 2006 Notes	\$ 417,418,759	\$ 398,883,135	\$ 365,930,295	\$ 413,013,876
Senior 2007 Notes	291,985,441	277,104,908	256,988,617	287,138,120
Senior 2008 Notes	368,508,300	333,876,739	324,385,533	345,166,313
Senior 2009A Notes	98,560,000	100,000,000	-	-
2009A Bonds	25,000,000	25,000,000	-	-
2009B Bonds	25,000,000	25,000,000	-	-
2009C Bonds	25,000,000	25,000,000	-	-
2009D Bonds	25,000,000	25,000,000	-	-
2009E Bonds	<u>102,000,000</u>	<u>100,000,000</u>	<u>-</u>	<u>-</u>
Total	<u>\$ 1,378,472,500</u>	<u>\$ 1,309,864,782</u>	<u>\$ 947,304,445</u>	<u>\$ 1,045,318,309</u>

12. LEASES

OVEC has entered into operating leases to secure railcars for the transportation of coal in connection with the fuel switching modifications at the OVEC and the IKEC generating stations. OVEC has railcar lease agreements that extend to as long as December 31, 2025, with options to exit the leases under certain conditions. The amount in property under capital leases is \$76,931 with accumulated depreciation of \$8,614 as of December 31, 2009. There were no capital leases as of December 31, 2008. OVEC also has various other operating leases with other property and equipment.

Future minimum lease payments for capital and operating leases at December 31, 2009, are as follows:

Years Ending December 31	Operating	Capital
2010	\$ 4,782,390	\$ 19,600
2011	3,395,658	19,600
2012	3,284,021	18,638
2013	3,215,364	11,813
2014	3,280,104	3,442
Thereafter	<u>22,194,510</u>	<u>-</u>
Total future minimum lease payments	<u>\$40,152,047</u>	73,093
Less estimated interest element		<u>(4,776)</u>
Estimated present value of future minimum lease payments		<u>\$ 68,317</u>

The annual operating lease cost incurred was \$4,749,821 and \$4,761,224 for 2009 and 2008, respectively and the annual capital lease cost incurred was \$9,335 and \$0 for 2009 and 2008, respectively.

13. COMMITMENTS AND CONTINGENCIES

The Companies are party to or may be affected by various matters under litigation. Management believes that the ultimate outcome of these matters will not have a significant adverse effect on either the Companies' future results of operation or financial position.

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