

Ohio Valley Electric Corporation and Subsidiary Company

Consolidated Financial Statements as of and for
the Years Ended December 31, 2020 and 2019,
and Independent Auditors' Report

INDEPENDENT AUDITORS' REPORT

To the Board of Directors of Ohio Valley Electric Corporation

We have audited the accompanying consolidated financial statements of Ohio Valley Electric Corporation and its subsidiary company, Indiana-Kentucky Electric Corporation (the "Companies"), which comprise the consolidated balance sheets as of December 31, 2020 and 2019, and the related consolidated statements of income, retained earnings, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Companies' preparation and fair presentation of the consolidated financial statements in order to design 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. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Companies as of December 31, 2020 and 2019, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Deloitte + Touche LLP

April 27, 2021

OHIO VALLEY ELECTRIC CORPORATION AND SUBSIDIARY COMPANY

CONSOLIDATED BALANCE SHEETS AS OF DECEMBER 31, 2020 AND 2019

| | 2020 | 2019 |
|--|--------------------------------|--------------------------------|
| ASSETS | | |
| ELECTRIC PLANT: | | |
| At original cost | \$ 2,869,460,850 | \$ 2,793,490,793 |
| Less—accumulated provisions for depreciation | <u>1,648,697,601</u> | <u>1,563,780,062</u> |
| | 1,220,763,249 | 1,229,710,731 |
| Construction in progress | <u>18,727,452</u> | <u>13,208,832</u> |
| Total electric plant | <u>1,239,490,701</u> | <u>1,242,919,563</u> |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | 50,835,059 | 32,241,171 |
| Accounts receivable | 44,900,548 | 74,486,689 |
| Fuel in storage | 79,328,652 | 61,351,858 |
| Emission allowances | 143,905 | 291,681 |
| Materials and supplies | 40,428,263 | 40,931,063 |
| Income taxes receivable | - | 2,307,853 |
| Property taxes applicable to future years | 3,255,000 | 3,150,000 |
| Prepaid expenses and other | <u>4,031,567</u> | <u>2,817,715</u> |
| Total current assets | <u>222,922,994</u> | <u>217,578,030</u> |
| REGULATORY ASSETS: | | |
| Unrecognized postemployment benefits | 6,833,166 | 5,201,536 |
| Unrecognized pension benefits | 34,784,688 | 32,170,308 |
| Income taxes billable to customers | <u>10,751,917</u> | <u>-</u> |
| Total regulatory assets | <u>52,369,771</u> | <u>37,371,844</u> |
| DEFERRED CHARGES AND OTHER: | | |
| Unamortized debt expense | 382,580 | 688,643 |
| Long-term investments | 273,951,093 | 240,739,279 |
| Income taxes receivable | - | 2,307,341 |
| Other | <u>1,488,586</u> | <u>2,510,636</u> |
| Total deferred charges and other | <u>275,822,259</u> | <u>246,245,899</u> |
| TOTAL | <u><u>\$ 1,790,605,725</u></u> | <u><u>\$ 1,744,115,336</u></u> |

(Continued)

OHIO VALLEY ELECTRIC CORPORATION AND SUBSIDIARY COMPANY

CONSOLIDATED BALANCE SHEETS AS OF DECEMBER 31, 2020 AND 2019

| | 2020 | 2019 |
|---|-------------------------|-------------------------|
| CAPITALIZATION AND LIABILITIES | | |
| CAPITALIZATION: | | |
| Common stock, \$100 par value—authorized, 300,000 shares; outstanding, 100,000 shares in 2020 and 2019 | \$ 10,000,000 | \$ 10,000,000 |
| Long-term debt | 1,009,833,026 | 1,119,568,409 |
| Line of credit borrowings | 60,000,000 | 80,000,000 |
| Retained earnings | <u>20,104,306</u> | <u>17,294,023</u> |
| Total capitalization | <u>1,099,937,332</u> | <u>1,226,862,432</u> |
| CURRENT LIABILITIES: | | |
| Current portion of long-term debt | 194,982,570 | 141,387,803 |
| Accounts payable | 37,908,306 | 34,871,926 |
| Accrued other taxes | 11,247,988 | 10,527,047 |
| Regulatory liabilities | 20,718,951 | 7,677,404 |
| Accrued interest and other | <u>26,547,150</u> | <u>27,532,934</u> |
| Total current liabilities | <u>291,404,965</u> | <u>221,997,114</u> |
| COMMITMENTS AND CONTINGENCIES (Notes 3, 9, 11, and 12) | | |
| REGULATORY LIABILITIES: | | |
| Postretirement benefits | 64,415,536 | 76,162,798 |
| Income taxes refundable to customers | - | 8,658,897 |
| Advance billing of debt reserve | 120,000,000 | 90,000,000 |
| Decommissioning, demolition and other | <u>-</u> | <u>14,718,161</u> |
| Total regulatory liabilities | <u>184,415,536</u> | <u>189,539,856</u> |
| OTHER LIABILITIES: | | |
| Pension liability | 34,784,688 | 32,170,308 |
| Deferred income tax liability | 19,410,815 | - |
| Asset retirement obligations | 138,933,456 | 63,487,038 |
| Postretirement benefits obligation | 11,995,106 | 4,242,848 |
| Postemployment benefits obligation | 6,833,166 | 5,201,536 |
| Other non-current liabilities | <u>2,890,661</u> | <u>614,204</u> |
| Total other liabilities | <u>214,847,892</u> | <u>105,715,934</u> |
| TOTAL | <u>\$ 1,790,605,725</u> | <u>\$ 1,744,115,336</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, 2020 AND 2019

| | 2020 | 2019 |
|---|----------------------|----------------------|
| REVENUES FROM CONTRACTS WITH CUSTOMERS—Sales of electric energy to: | | |
| Department of Energy | \$ 3,265,537 | \$ 4,641,167 |
| Sponsoring Companies | 547,668,086 | 606,993,408 |
| Other | <u>784,078</u> | <u>3,033,066</u> |
| Total revenues from contracts with customers | <u>551,717,701</u> | <u>614,667,641</u> |
| OPERATING EXPENSES: | | |
| Fuel and emission allowances consumed in operation | 231,316,036 | 274,843,402 |
| Purchased power | 2,545,280 | 3,735,333 |
| Other operation | 73,452,698 | 91,611,162 |
| Maintenance | 78,628,228 | 87,208,116 |
| Depreciation | 82,237,657 | 88,825,066 |
| Taxes—other than income taxes | 12,203,087 | 11,330,963 |
| Income taxes | <u>-</u> | <u>(2,912,531)</u> |
| Total operating expenses | <u>480,382,986</u> | <u>554,641,511</u> |
| OPERATING INCOME (LOSS) | 71,334,715 | 60,026,130 |
| OTHER INCOME (EXPENSE) | <u>86,805</u> | <u>24,280,007</u> |
| INCOME BEFORE INTEREST CHARGES | <u>71,421,520</u> | <u>84,306,137</u> |
| INTEREST CHARGES: | | |
| Amortization of debt expense | 4,288,807 | 4,204,163 |
| Interest expense | <u>64,322,430</u> | <u>77,046,683</u> |
| Total interest charges | <u>68,611,237</u> | <u>81,250,846</u> |
| NET INCOME | 2,810,283 | 3,055,291 |
| RETAINED EARNINGS—Beginning of year | <u>17,294,023</u> | <u>14,238,732</u> |
| RETAINED EARNINGS—End of year | <u>\$ 20,104,306</u> | <u>\$ 17,294,023</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, 2020 AND 2019

| | 2020 | 2019 |
|---|-----------------------|-----------------------|
| OPERATING ACTIVITIES: | | |
| Net income | \$ 2,810,283 | \$ 3,055,291 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | |
| Depreciation | 82,237,657 | 88,825,066 |
| Amortization of debt expense | 4,288,807 | 4,204,163 |
| Loss (gain) on marketable securities | - | (16,672,791) |
| Changes in assets and liabilities: | | |
| Accounts receivable | 29,586,141 | (10,207,793) |
| Fuel in storage | (17,976,794) | (27,877,672) |
| Materials and supplies | 502,800 | (296,420) |
| Property taxes applicable to future years | (105,000) | (87,500) |
| Emissions allowances | 147,776 | 6,674 |
| Income tax receivable | 2,307,853 | 2,382,211 |
| Prepaid expenses and other | (1,213,852) | (641,810) |
| Other regulatory assets | (4,246,010) | 9,392,126 |
| Other noncurrent assets | 3,329,391 | 1,042,342 |
| Accounts payable | 1,215,500 | (5,360,967) |
| Accrued taxes | 720,941 | (198,718) |
| Accrued interest and other | (950,127) | 6,869,743 |
| Decommissioning, demolition and other | 12,914,757 | 11,899,339 |
| Other liabilities | 15,277,153 | (3,242,134) |
| Other regulatory liabilities | 17,373,170 | 15,662,796 |
| Net cash provided by operating activities | <u>148,220,446</u> | <u>78,753,946</u> |
| INVESTING ACTIVITIES: | | |
| Electric plant additions | (12,899,927) | (12,474,714) |
| Proceeds from sale of long-term investments | 198,124,748 | 55,360,283 |
| Purchases of long-term investments | <u>(234,468,776)</u> | <u>(98,155,238)</u> |
| Net cash (used in) provided by investing activities | <u>(49,243,955)</u> | <u>(55,269,669)</u> |
| FINANCING ACTIVITIES: | | |
| Debt issuance and maintenance costs | (2,068,564) | (3,849,380) |
| Repayment of Senior 2006 Notes | (23,333,029) | (22,029,278) |
| Repayment of Senior 2007 Notes | (16,591,089) | (15,648,462) |
| Repayment of Senior 2008 Notes | (18,130,679) | (16,992,682) |
| Reissuance 2009A Bonds | - | 25,000,000 |
| Redemption of 2009E Bonds | - | (100,000,000) |
| Issuance of 2019A Bonds | - | 100,000,000 |
| Proceeds from line of credit | 25,000,000 | 10,000,000 |
| Payments on line of credit | (45,000,000) | (15,000,000) |
| Principal payments under capital leases | <u>(259,242)</u> | <u>(246,860)</u> |
| Net cash (used in) provided by financing activities | <u>(80,382,603)</u> | <u>(38,766,662)</u> |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | \$ 18,593,888 | \$ (15,282,385) |
| CASH AND CASH EQUIVALENTS—Beginning of year | <u>32,241,171</u> | <u>47,523,556</u> |
| CASH AND CASH EQUIVALENTS—End of year | <u>\$ 50,835,059</u> | <u>\$ 32,241,171</u> |
| SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION: | | |
| Interest paid | <u>\$ 64,526,922</u> | <u>\$ 75,703,531</u> |
| Income taxes (received) paid—net | <u>\$ (4,615,202)</u> | <u>\$ (4,690,064)</u> |
| Non-cash electric plant additions included in accounts payable at December 31 | <u>\$ 2,102,982</u> | <u>\$ 58,516</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, 2020 AND 2019

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 two affiliates of generation and transmission rural electric cooperatives. These entities or 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 has a current termination date of June 30, 2040. Approximately 24% of the Companies' employees are covered by a collective bargaining agreement that expires on August 31, 2021.

Prior to 2004, OVEC's primary commercial customer was the U.S. Department of Energy (DOE). The contract to provide OVEC-generated power to the DOE was terminated in 2003 and all obligations were settled at that time. Currently, OVEC has an agreement to arrange for the purchase of power (Arranged Power), under the direction of the DOE, for resale directly to the DOE. The current agreement with the DOE was executed on July 11, 2018, for one year, with the option for the DOE to extend the agreement at the anniversary date. The agreement was extended on July 11, 2020, for one year. OVEC anticipates that this agreement could continue to 2027. All purchase costs are billable by OVEC to the DOE.

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 June 30, 2040, 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 in the accompanying consolidated balance sheets and are recognized as 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, 2020 and 2019, were as follows:

| | 2020 | 2019 |
|--|-----------------------|-----------------------|
| Regulatory assets: | | |
| Noncurrent regulatory assets: | | |
| Unrecognized postemployment benefits | \$ 6,833,166 | \$ 5,201,536 |
| Unrecognized pension benefits | 34,784,688 | 32,170,308 |
| Income taxes billable to customers | <u>10,751,917</u> | <u>-</u> |
| Total | <u>52,369,771</u> | <u>37,371,844</u> |
| Total regulatory assets | <u>\$ 52,369,771</u> | <u>\$ 37,371,844</u> |
| Regulatory liabilities: | | |
| Current regulatory liabilities: | | |
| Deferred revenue—advances for construction | \$ 19,371,880 | \$ 6,182,811 |
| Deferred credit—advance collection of interest | <u>1,347,071</u> | <u>1,494,593</u> |
| Total | <u>20,718,951</u> | <u>7,677,404</u> |
| Noncurrent regulatory liabilities: | | |
| Postretirement benefits | 64,415,536 | 76,162,798 |
| Income taxes refundable to customers | - | 8,658,897 |
| Advance billing of debt reserve | 120,000,000 | 90,000,000 |
| Decommissioning, demolition and other | <u>-</u> | <u>14,718,161</u> |
| Total | <u>184,415,536</u> | <u>189,539,856</u> |
| Total regulatory liabilities | <u>\$ 205,134,487</u> | <u>\$ 197,217,260</u> |

Regulatory Assets—Regulatory assets consist primarily of pension benefit costs, postemployment benefit costs, income taxes, and accrued decommissioning and demolition costs to be billed to the Sponsoring Companies in future years. The Companies' current billing policy for pension and postemployment benefit costs is to bill its actual plan funding.

Regulatory Liabilities—The regulatory liabilities classified as current in the accompanying consolidated balance sheet as of December 31, 2020, consist primarily of interest expense collected from customers in advance of expense recognition and customer billings for construction in progress. These amounts will be credited to customer bills during 2021. Other regulatory liabilities consist primarily of postretirement benefit costs and advanced billings collected from the Sponsoring Companies for debt service.

The regulatory liability for postretirement benefits recorded at December 31, 2020 and 2019, represents amounts collected in historical billings in excess of the accounting principles generally accepted in the United States of America (GAAP) net periodic benefit costs, including a termination payment from the DOE in 2003 for unbilled postretirement benefit costs, and incremental unfunded plan obligations recognized in the balance sheets but not yet recognizable in GAAP net periodic benefit costs.

In January 2017, the Companies started advance billing the Sponsoring Companies for debt service as allowed under the ICPA. As of December 31, 2020 and 2019, \$120 million and \$90 million, respectively, had been advance billed to the Sponsoring Companies. As the Companies have not yet incurred the related costs, a regulatory liability was recorded which will be credited to customer bills on a long-term basis.

Cash and Cash Equivalents—Cash and cash equivalents primarily consist of cash and money market funds and their carrying value approximates fair value. 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. 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, as well as emission allowances, for use in the generation of electricity 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 decommissioning and demolition costs, debt service, potential postretirement funding, and other costs. These debt securities have been classified as trading securities in accordance with the provisions of the accounting guidance for Investments—Debt and Equity Securities. Debt and equity securities reflected in long-term investments are carried at fair value. Beginning in 2020, the unrealized gain or loss is reported in Regulatory Liability (Asset). 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, the Companies 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 10. Long-term investments primarily consist of municipal bonds, money market mutual fund investments, and mutual funds. Net unrealized gains (losses) recognized during 2020 and 2019 on securities still held at the balance sheet date were \$3,840,821 and \$16,445,716, respectively.

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.

Unamortized Debt Expense—Unamortized debt expense relates to costs incurred in connection with obtaining revolving credit agreements. These costs are being amortized over the term of the related revolving credit agreement and are recorded as an asset in the consolidated balance sheets. Costs incurred to issue debt are recorded as a reduction to long-term debt as presented in Note 6.

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, including the impacts of the coal combustion residuals rule.

| | |
|---------------------------|-----------------------|
| Balance—January 1, 2019 | \$ 60,246,682 |
| Accretion | 3,275,262 |
| Liabilities settled | (34,906) |
| Revisions to cash flows | <u>-</u> |
| Balance—December 31, 2019 | 63,487,038 |
| Accretion | 3,476,310 |
| Liabilities settled | - |
| Revisions to cash flows | <u>71,970,108</u> |
| Balance—December 31, 2020 | <u>\$ 138,933,456</u> |

In 2020, the U.S. EPA finalized several changes to the regulations for coal combustion residuals. These changes included a final rule that all unlined surface impoundments are required to retrofit or close, not just those that have detected groundwater contamination above regulatory levels. The rule also changes the classification of certain surface impoundments from “lined” to “unlined.” Finally, the rule establishes a revised date, April 11, 2021, by which unlined surface impoundments and units that failed the aquifer location restriction must cease receiving waste and initiate closure or retrofit, unless a company files for an extension of that date, which the Companies have done and is further discussed in Note 9. As a result of these rule changes and the potential for new, more restrictive rules under a new presidential administration, the Companies decided to accelerate the timing of remediation activities related to their coal ash ponds and landfills. This resulted in an upward revision to projected cash flows and an increase in the resulting asset retirement obligations in 2020, as disclosed in the table above. Changes in the regulations, or in the remediation technologies could potentially result in material increases in the asset retirement obligation. The Companies will revisit the

studies as appropriate throughout the process of executing remediation related to the coal ash ponds and landfills to maintain an accurate estimated cost of remediation.

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. 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 GAAP 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.

Revenue Recognition—Revenue is recognized when the Companies transfer promised goods or services to customers in an amount that reflects the consideration to which the Companies expect to be entitled in exchange for those goods or services. Performance obligations related to the sale of electric energy are satisfied over time as system resources are made available to customers and as energy is delivered to customers and the Companies recognize revenue upon billing the customer.

The Companies have three contracts with customers resulting in three types of revenue. These three contracted revenue types are:

- 1) Sales of Electric Energy to Department of Energy
- 2) Sales of Electric Energy to Sponsoring Companies
- 3) Sales of Electric Energy to Pennsylvania, Jersey, Maryland Power Pool (PJM)

The performance obligations and recognition of revenue are similar and both individually and, in the aggregate, were not materially impacted by the implementation of Topic 606. The Companies have no contract assets or liabilities as of December 31, 2020. The following table provides information about the Companies' receivables from contracts with customers:

| | Accounts Receivable |
|---|--------------------------------|
| Beginning balance as of January 1, 2019 | \$ 64,278,896 |
| Ending balance as of December 31, 2019 | <u>74,486,689</u> |
| Increase/(decrease) | <u>\$ 10,207,793</u> |
| Beginning balance as of January 1, 2020 | \$ 74,486,689 |
| Ending balance as of December 31, 2020 | <u>\$ 44,900,548</u> |
| | <u>\$ (29,586,141)</u> |

Recently Issued Accounting Standards—In June 2016, the FASB issued ASU 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. The pronouncement changes the impairment model for most financial assets, replacing the current “incurred loss” model. ASU 2016-13 will require the use of an “expected loss” model for instruments measured at amortized cost and will also require entities to record allowances for available-for-sale debt securities rather than reduce the carrying amount. The Companies adopted ASC 326 effective January 1, 2020, using a modified retrospective method of adoption. Results for the reporting periods beginning after January 1, 2020, are presented under ASC 326, while prior periods are not adjusted.

Subsequent Events—In preparing the accompanying financial statements and disclosures, the Companies reviewed subsequent events through April 27, 2021, which is the date the consolidated financial statements were issued.

2. RELATED-PARTY TRANSACTIONS

Transactions with the Sponsoring Companies during 2020 and 2019 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 DOE'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.

At December 31, 2020 and 2019, balances due from the Sponsoring Companies are as follows:

| | 2020 | 2019 |
|---------------------|---------------------|---------------------|
| Accounts receivable | <u>\$37,633,208</u> | <u>\$66,926,922</u> |

During 2020 and 2019, American Electric Power accounted for approximately 44% of operating revenues from Sponsoring Companies and Buckeye Power accounted for 18%. No other Sponsoring Company accounted for more than 10%.

American Electric Power Company, Inc. and subsidiary companies owned 43.47% of the common stock of OVEC as of December 31, 2020. 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:

| | 2020 | 2019 |
|-------------------|---------------------|---------------------|
| General services | \$ 2,761,173 | \$ 4,830,104 |
| Specific projects | <u>257,787</u> | <u>119,157</u> |
| Total | <u>\$ 3,018,960</u> | <u>\$ 4,949,261</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 2020 through 2023. Pricing for coal under these contracts is subject to contract provisions and adjustments. The Companies currently have 100% of their 2020 coal requirements under contract. These contracts are based on rates in effect at the time of contract execution. The Companies' total obligations under these agreements as of December 31, 2020, are included in the table below:

| | |
|------|---------------|
| 2021 | \$181,692,000 |
| 2022 | 112,722,000 |
| 2023 | 41,100,000 |

4. ELECTRIC PLANT

Electric plant at December 31, 2020 and 2019, consists of the following:

| | 2020 | 2019 |
|-------------------------------|-------------------------|-------------------------|
| Steam production plant | \$ 2,774,455,039 | \$ 2,698,568,508 |
| Transmission plant | 81,986,558 | 81,986,558 |
| General plant | 12,992,689 | 12,909,163 |
| Intangible | <u>26,564</u> | <u>26,564</u> |
| | 2,869,460,850 | 2,793,490,793 |
| Less accumulated depreciation | <u>1,648,697,601</u> | <u>1,563,780,062</u> |
| | 1,220,763,249 | 1,229,710,731 |
| Construction in progress | <u>18,727,452</u> | <u>13,208,832</u> |
| Total electric plant | <u>\$ 1,239,490,701</u> | <u>\$ 1,242,919,563</u> |

All property additions and replacements are fully depreciated on the date the property is placed in service, unless the addition or replacement relates to a financed project. As the Companies' policy is to bill in accordance with the debt service schedule under the debt agreements, all financed projects are being depreciated in amounts equal to the principal payments on outstanding debt.

5. BORROWING ARRANGEMENTS AND NOTES

OVEC has a revolving credit facility of \$185 million set to expire on April 25, 2022. At December 31, 2020 and 2019, OVEC had borrowed \$60 million and \$80 million, respectively, under lines of credit. Interest expense related to lines of credit borrowings was \$1,860,768 in 2020 and \$3,757,148 in 2019. During 2020 and 2019, OVEC incurred annual commitment fees of \$308,303 and \$268,285, respectively, based on the borrowing limits of the line of credit.

6. LONG-TERM DEBT

The following amounts were outstanding at December 31, 2020 and 2019:

| | Interest Rate Type | Interest Rate | 2020 | 2019 |
|--|-----------------------|------------------|-------------------------|-------------------------|
| Senior 2006 Notes: | | | | |
| 2006A due February 15, 2026 | Fixed | 5.80 % | \$ 146,533,289 | \$ 168,569,904 |
| 2006B due June 15, 2040 | Fixed | 6.40 | 52,846,460 | 54,142,874 |
| Senior 2007 Notes: | | | | |
| 2007A-A due February 15, 2026 | Fixed | 5.90 | 64,250,051 | 74,610,818 |
| 2007A-B due February 15, 2026 | Fixed | 5.90 | 16,180,745 | 18,790,003 |
| 2007A-C due February 15, 2026 | Fixed | 5.90 | 16,309,586 | 18,939,620 |
| 2007B-A due June 15, 2040 | Fixed | 6.50 | 26,354,033 | 27,012,831 |
| 2007B-B due June 15, 2040 | Fixed | 6.50 | 6,637,764 | 6,802,916 |
| 2007B-C due June 15, 2040 | Fixed | 6.50 | 6,690,005 | 6,857,084 |
| Senior 2008 Notes: | | | | |
| 2008A due February 15, 2026 | Fixed | 5.92 | 20,059,786 | 23,292,665 |
| 2008B due February 15, 2026 | Fixed | 6.71 | 40,716,172 | 47,301,931 |
| 2008C due February 15, 2026 | Fixed | 6.71 | 42,874,648 | 49,367,759 |
| 2008D due June 15, 2040 | Fixed | 6.91 | 38,486,303 | 39,387,935 |
| 2008E due June 15, 2040 | Fixed | 6.91 | 39,155,024 | 40,072,323 |
| Series 2009 Bonds: | | | | |
| 2009A due February 1, 2026 | Fixed | 2.88 | 25,000,000 | 25,000,000 |
| 2009B due February 1, 2026 | Floating | 2.01 | 25,000,000 | 25,000,000 |
| 2009C due February 1, 2026 | Floating | 2.01 | 25,000,000 | 25,000,000 |
| 2009D due February 1, 2026 | Fixed | 2.88 | 25,000,000 | 25,000,000 |
| Series 2010 Bonds: | | | | |
| 2010A due November 1, 2030 | Fixed | 3.00 | 50,000,000 | 50,000,000 |
| 2010B due February 1, 2040 | Floating | 2.01 | 50,000,000 | 50,000,000 |
| Series 2012 Bonds: | | | | |
| 2012A due June 1, 2032 | Fixed | 5.00 | 76,800,000 | 76,800,000 |
| 2012A due June 1, 2039 | Fixed | 5.00 | 123,200,000 | 123,200,000 |
| 2012B due November 1, 2030 | Fixed | 3.00 | 50,000,000 | 50,000,000 |
| 2012C due November 1, 2030 | Fixed | 3.00 | 50,000,000 | 50,000,000 |
| Series 2017 Notes: | | | | |
| 2017A due September 6, 2022 | Floating | 4.37 | 100,000,000 | 100,000,000 |
| Series 2019 Bonds: | | | | |
| 2019A due September 1, 2029 | Fixed | 3.25 | <u>100,000,000</u> | <u>100,000,000</u> |
| Total debt | | | 1,217,093,866 | 1,275,148,663 |
| Total premiums and discounts (net) | | | (415,266) | (437,865) |
| Less unamortized debt expense | | | <u>(11,863,004)</u> | <u>(13,754,586)</u> |
| Total debt net of premiums, discounts, and unamortized debt expense | | | 1,204,815,596 | 1,260,956,212 |
| Current portion of long-term debt | | | <u>194,982,570</u> | <u>141,387,803</u> |
| Total long-term debt | | | <u>\$ 1,009,833,026</u> | <u>\$ 1,119,568,409</u> |

All of the OVEC amortizing unsecured senior notes have maturities scheduled for February 15, 2026, or June 15, 2040, as noted in the previous table.

In 2009, the Ohio Air Quality Development Authority (the "OAQDA") issued the variable-rate, non-amortizing, tax-exempt State of Ohio Air Quality Revenue Bonds (Ohio Valley Electric Corporation Project) in four series (the "Series 2009A", the "Series 2009B", the "Series 2009C", and the "Series 2009D") of \$25 million each and \$100 million fixed-rate non-amortizing tax-exempt State of Ohio Air Quality Revenue Bonds (Ohio Valley Electric Corporation Project) (the "Series 2009E Bonds"), the proceeds of which were used to finance a portion of OVEC's costs of acquiring, constructing and installing certain solid waste disposal facilities comprising "air quality facilities," as defined in Chapter 3706, Ohio Revised Code, as amended, for Units 1-5 of the Kyger Creek Plant. OVEC is obligated to make payments under loan agreements between OVEC and OAQDA equal to the principal and interest payments due on such bonds, among other payments.

The Series 2009B and Series 2009C Bonds were remarketed in August 2016, for a five-year interest period that extends to August 25, 2021. On August 14, 2019, the Series 2009A Bonds and Series 2009D Bonds were each reoffered with a fixed interest rate of 2.875% per annum for the period beginning on August 28, 2019 and ending on February 1, 2026. In addition, in August 2019, the OAQDA issued the State of Ohio Air Quality Revenue Refunding Bonds (Ohio Valley Electric Corporation Project), Series 2019A in an aggregate principal amount of \$100 million (the "Series 2019A Bonds"), with a fixed interest rate of 3.25% per annum for the period beginning August 28, 2019 to September 1, 2029, the proceeds of which were used to refund the Series 2009E, which were scheduled to mature on October 1, 2019. The Series 2019A bonds begin amortizing in 2026. The Series 2009B and the Series 2009C Bonds are to be remarketed in 2021.

In December 2010, OVEC established a borrowing facility under which OVEC borrowed, in 2011, \$100 million variable-rate bonds due on February 1, 2040. In June 2011, the \$100 million variable-rate bonds were reissued by the Indiana Finance Authority (the "IFA") as two series of \$50 million variable-rate, non-amortizing, tax-exempt bonds: the Series 2010A Bonds, with an interest period of three years and the Series 2010B Bonds, with an interest period of five years. The Series 2010B Bonds were remarketed in August 2016 for another five-year interest period ending on August 25, 2021. The Series 2010A Bonds were remarketed in June 2014 for a three-year period and in September 2017 for another three-year period that extended to August 4, 2020. The Series 2010A Bonds wereremarketed in July 2020 with a fixed interest rate of 3.0% per annum for the period beginning July 9, 2020 to November 1, 2030. The Series 2010A Bonds begin amortizing in 2026. The Series 2010B Bonds are to be remarketed in 2021.

During 2012, the IFA issued \$200 million fixed-rate, tax-exempt Midwestern Disaster Relief Revenue Bonds (Ohio Valley Electric Corporation Project) (the "Series 2012A Bonds") and two series of \$50 million each, variable-rate, tax-exempt bonds: the Series 2012B Bonds and the Series 2012C Bonds. The Series 2012A Bonds will begin amortizing on June 1, 2027, up to its maturity date. OVEC is obligated to make payments under loan agreements between OVEC and the IFA equal to the principal and interest payments due on such bonds, among other payments.

In 2017, the Series 2012B Bonds and the Series 2012C Bonds, which had been secured by irrevocable transferable direct-pay letters of credit, were remarketed with four-year and five-year interest periods expiring August 4, 2021 and August 4, 2022, respectively. In July 2020, the Series 2012B and Series 2012C Bonds were refinanced with a fixed

interest rate of 3.0% per annum for the period beginning July 9, 2020 to November 1, 2030. The Series 2012B Bonds and the Series 2012C bonds begin amortizing in 2026.

During 2017, OVEC issued \$100 million 2017A variable-rate non-amortizing unsecured senior notes ("2017A Notes") to refinance and retire a 2013 series of notes ("2013A Notes"). The 2013A Notes had an original maturity date of February 15, 2018. The 2017A Notes have an annual repayment of \$33,333,333 on September 6, 2020, September 6, 2021, and at the maturity date of September 6, 2022. In 2020, pursuant to the 2017A Notes agreement, the lenders executed their consent to decline the first installment payment and defer payment of such amount until maturity.

The annual maturities of long-term debt as of December 31, 2020, are as follows:

| | |
|-----------|------------------------|
| 2021 | \$ 194,982,570 |
| 2022 | 132,134,224 |
| 2023 | 69,523,395 |
| 2024 | 73,831,592 |
| 2025 | 78,243,501 |
| 2026–2041 | <u>668,378,584</u> |
| Total | <u>\$1,217,093,866</u> |

Note that the 2021 maturities include \$100 million variable-rate bonds subject to remarketing in August 2021.

7. 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:

| | 2020 | 2019 |
|--|--------------|-----------------------|
| Income tax expense at statutory rate (21%) | \$ 590,159 | \$ 29,980 |
| Temporary differences flowed through to customer bills | (591,673) | (2,948,492) |
| Permanent differences and other | <u>1,514</u> | <u>5,981</u> |
| Income tax provision | <u>\$ -</u> | <u>\$ (2,912,531)</u> |

Components of the income tax provision were as follows:

| | 2020 | 2019 |
|---|-------------|-----------------------|
| Current income tax expense—federal | \$ - | \$ (2,912,531) |
| Current income tax (benefit)/expense—state | - | - |
| Deferred income tax expense/(benefit)—federal | <u>-</u> | <u>-</u> |
| Total income tax provision | <u>\$ -</u> | <u>\$ (2,912,531)</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.

To the extent that the Companies have not reflected charges or credits in customer billings for deferred tax assets and liabilities, they have recorded a regulatory asset or liability representing income taxes billable or refundable to customers under the applicable agreements among the parties. These temporary differences will be billed or credited to the Sponsoring Companies through future billings. The regulatory asset was \$10,751,917 and regulatory liability was \$8,658,898 at December 31, 2020 and 2019, respectively.

Deferred income tax assets (liabilities) at December 31, 2020 and 2019, consisted of the following:

| | 2020 | 2019 |
|---|------------------------|---------------------|
| Deferred tax assets: | | |
| Deferred revenue—advances for construction | \$ 4,072,606 | \$ 1,299,537 |
| Federal net operating loss carryforwards | 26,854,145 | 39,691,784 |
| Postretirement benefit obligation | 2,521,765 | 891,785 |
| Pension liability | 7,418,001 | 7,034,974 |
| Postemployment benefit obligation | 1,436,556 | 1,093,288 |
| Asset retirement obligations | 29,208,377 | 13,344,057 |
| Advanced collection of interest and debt service | 25,511,141 | 19,230,828 |
| Miscellaneous accruals | 1,146,349 | 1,154,630 |
| Regulatory liability—postretirement benefits | 13,542,262 | 16,008,318 |
| Regulatory liability—asset retirement costs | - | 3,093,544 |
| Regulatory liability—income taxes refundable to customers | - | 4,549,301 |
| | <u>111,711,201</u> | <u>107,392,046</u> |
| Total deferred tax assets | | |
| Deferred tax liabilities: | | |
| Prepaid expenses | (501,970) | (384,597) |
| Electric plant | (90,448,307) | (81,887,070) |
| Unrealized gain/loss on marketable securities | (4,184,852) | (4,348,230) |
| Regulatory asset—pension benefits | (7,312,884) | (6,719,696) |
| Regulatory asset—asset retirement costs | - | - |
| Regulatory asset—unrecognized postemployment benefits | (1,436,556) | (1,093,288) |
| Regulatory asset—income taxes billable to customers | (2,257,902) | - |
| | <u>(106,142,472)</u> | <u>(94,432,881)</u> |
| Total deferred tax liabilities | | |
| Valuation allowance | <u>(24,979,544)</u> | <u>(12,959,165)</u> |
| Deferred income tax liability | <u>\$ (19,410,815)</u> | <u>\$ -</u> |

Because future taxable income may prove to be insufficient to recover the Companies' gross deferred tax assets, the Companies have recorded a valuation allowance for their deferred tax assets as of December 31, 2020 and 2019. The valuation allowance required against the gross deferred tax assets results in the Companies recording an overall deferred tax liability in 2020.

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 50% likelihood of being realized upon ultimate settlement. The Companies have not identified any uncertain tax positions as of December 31, 2020 and 2019, and accordingly, no liabilities for uncertain tax positions have been recognized.

The Companies file income tax returns with the Internal Revenue Service and the states of Ohio, Indiana, and the Commonwealth of Kentucky. The Companies are no longer subject to federal tax examinations for tax years 2016 and earlier. The Companies are no longer subject to State of Indiana tax examinations for tax years 2016 and earlier. The Companies are no longer subject to Ohio and the Commonwealth of Kentucky examinations for tax years 2015 and earlier. The Companies have \$127,876,880 of Federal Net Operating Loss carryovers that begin to expire in 2034.

8. PENSION PLAN AND OTHER POSTRETIREMENT AND POSTEMPLOYMENT BENEFITS

The Companies have a noncontributory qualified defined benefit pension plan (the Pension Plan) covering substantially all of their employees hired prior to January 1, 2015. 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, as amended.

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 hired prior to January 1, 2015, 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 VEBA trusts. In January 2011, the Companies established an Internal Revenue Code Section 401(h) account under the Pension Plan.

The full cost of the pension benefits and other postretirement benefits has been allocated to OVEC and IKEC in the accompanying consolidated financial statements. The allocated amounts represent approximately a 53% and 47% split between OVEC and IKEC, respectively, as of December 31, 2020, and approximately a 56% and 44% split between OVEC and IKEC, respectively, as of December 31, 2019.

The Pension Plan's assets as of December 31, 2020, consist of investments in equity and debt securities. 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 % |
| International and global equity | 15 |
| Fixed income | 68 |
| Cash | 2 |

| VEBA Plan Assets | Target |
|---------------------------------|---------------|
| Domestic equity | 20 % |
| International and global equity | 20 |
| Fixed income | 60 |

Each benefit plan contains various investment limitations. These limitations are described in the investment policy statement and detailed in customized investment guidelines. 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.

Fixed-Income Limitations—As of December 31, 2020, the Pension Plan fixed-income allocation consists of managed accounts composed of U.S. Government, corporate, and municipal obligations. The VEBA benefit plans’ fixed-income allocation is composed of a variety of fixed-income securities and 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, 2020 and 2019, are as follows:

| | Pension Plan | | Other Postretirement Benefits | |
|---|------------------------|------------------------|----------------------------------|-----------------------|
| | 2020 | 2019 | 2020 | 2019 |
| Change in projected benefit obligation: | | | | |
| Projected benefit obligation— | | | | |
| beginning of year | \$ 244,541,899 | \$ 234,099,137 | \$ 159,833,696 | \$ 151,305,246 |
| Service cost | 6,919,404 | 6,078,450 | 3,867,790 | 3,428,368 |
| Interest cost | 8,652,849 | 10,082,144 | 5,595,528 | 6,571,166 |
| Plan participants’ contributions | - | - | 1,339,527 | 1,312,941 |
| Benefits paid | (13,391,815) | (8,079,496) | (6,912,071) | (6,795,047) |
| Net actuarial loss (gain) | 29,783,513 | 30,255,836 | 14,510,766 | 21,462 |
| Plan amendments (1) | - | - | - | 3,989,560 |
| Settlement (2) | - | (27,857,703) | - | - |
| Expenses paid from assets | (71,538) | (36,469) | - | - |
| Projected benefit obligation— | <u>276,434,312</u> | <u>244,541,899</u> | <u>178,235,236</u> | <u>159,833,696</u> |
| end of year | | | | |
| Change in fair value of plan assets: | | | | |
| Fair value of plan assets—beginning | | | | |
| of year | 212,371,591 | 200,204,812 | 155,590,848 | 141,118,649 |
| Actual return on plan assets | 32,441,386 | 42,540,447 | 16,186,032 | 19,940,452 |
| Expenses paid from assets | (71,538) | (36,469) | - | - |
| Employer contributions | 10,300,000 | 5,600,000 | 35,794 | 13,853 |
| Plan participants’ contributions | - | - | 1,339,527 | 1,312,941 |
| Benefits paid | (13,391,815) | (8,079,496) | (6,912,071) | (6,795,047) |
| Settlement | - | (27,857,703) | - | - |
| Fair value of plan assets— | <u>241,649,624</u> | <u>212,371,591</u> | <u>166,240,130</u> | <u>155,590,848</u> |
| end of year | | | | |
| Underfunded status—end of year | <u>\$ (34,784,688)</u> | <u>\$ (32,170,308)</u> | <u>\$ (11,995,106)</u> | <u>\$ (4,242,848)</u> |

(1) The \$3.9M plan amendment is the result of the change of the long-term retiree cost sharing through retiree contributions for pre-65 retirees from 20% to 12%.

(2) The \$27.9M settlement is the result of an annuity purchase of about \$22.7M for 162 retirees and beneficiaries which was paid on November 25, 2019 and the lump sums payments totaling about \$5.2M during 2019.

See Note 1 for information regarding regulatory assets related to the Pension Plan and Other Postretirement Benefits plan.

The accumulated benefit obligation for the Pension Plan was \$246,035,532 and \$218,590,886 at December 31, 2020 and 2019, 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 generally accepted accounting principles, 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 | |
|---|---------------------|---------------------|--|---------------------|
| | 2020 | 2019 | 2020 | 2019 |
| Service cost | \$ 6,919,404 | \$ 6,078,450 | \$ 3,867,790 | \$ 3,428,368 |
| Interest cost | 8,652,849 | 10,082,144 | 5,595,528 | 6,571,166 |
| Expected return on plan assets | (12,231,210) | (11,867,776) | (7,948,184) | (7,515,431) |
| Amortization of prior service cost | (416,565) | (416,565) | (2,781,539) | (3,145,420) |
| Recognized actuarial loss (gain) | 815,085 | 1,234,195 | (766,517) | - |
| Cost of settlements | - | 3,570,924 | - | - |
| Total benefit cost | <u>\$ 3,739,563</u> | <u>\$ 8,681,372</u> | <u>\$ (2,032,922)</u> | <u>\$ (661,317)</u> |
| Pension and other postretirement benefits expense recognized in the consolidated statements of income and retained earnings and billed to Sponsoring Companies under the ICPA | <u>\$ 5,800,000</u> | <u>\$ 5,600,000</u> | <u>\$ -</u> | <u>\$ -</u> |

The following table presents the classification of Pension Plan assets within the fair value hierarchy at December 31, 2020 and 2019:

| | Fair Value Measurements at Reporting Date Using | | | Total |
|---|---|---|---|-----------------------|
| | Quoted Prices in Active Market for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | |
| 2020 | | | | |
| Common stock | \$ 11,191,580 | \$ - | \$ - | \$ 11,191,580 |
| Equity mutual funds | 53,315,439 | - | - | 53,315,439 |
| Index futures | - | 232 | - | 232 |
| Fixed-income securities | - | 157,072,275 | - | 157,072,275 |
| Commodities | - | 43 | - | 43 |
| Cash equivalents | <u>5,718,922</u> | <u>-</u> | <u>-</u> | <u>5,718,922</u> |
| Subtotal benefit plan assets | <u>\$ 70,225,941</u> | <u>\$ 157,072,550</u> | <u>\$ -</u> | 227,298,491 |
| Investments measured at net asset value (NAV) | | | | <u>14,351,133</u> |
| Total benefit plan assets | | | | <u>\$ 241,649,624</u> |
| 2019 | | | | |
| Common stock | \$ 8,792,346 | \$ - | \$ - | \$ 8,792,346 |
| Equity mutual funds | 42,776,633 | - | - | 42,776,633 |
| Index futures | - | 230 | - | 230 |
| Fixed-income securities | - | 140,413,999 | - | 140,413,999 |
| Commodities | - | 43 | - | 43 |
| Cash equivalents | <u>7,154,484</u> | <u>-</u> | <u>-</u> | <u>7,154,484</u> |
| Subtotal benefit plan assets | <u>\$ 58,723,463</u> | <u>\$ 140,414,272</u> | <u>\$ -</u> | 199,137,735 |
| Investments measured at net asset value (NAV) | | | | <u>13,233,857</u> |
| Total benefit plan assets | | | | <u>\$ 212,371,592</u> |

The following table presents the classification of VEBA and 401(h) account assets within the fair value hierarchy at December 31, 2020 and 2019:

| | Fair Value Measurements at Reporting Date Using | | | Total |
|---|---|---|---|-----------------------|
| | Quoted Prices in Active Market for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | |
| 2020 | | | | |
| Equity mutual funds | \$ 61,519,280 | \$ - | \$ - | \$ 61,519,280 |
| Fixed-income mutual funds | 79,992,711 | - | - | 79,992,711 |
| Fixed-income securities | - | 19,910,040 | - | 19,910,040 |
| Cash equivalents | <u>1,403,900</u> | <u>-</u> | <u>-</u> | <u>1,403,900</u> |
| Benefit plan assets | <u>\$ 142,915,891</u> | <u>\$ 19,910,040</u> | <u>\$ -</u> | 162,825,931 |
| Uncleared cash disbursements from benefits paid | | | | (5,536,750) |
| Investments measured at net asset value (NAV) | | | | <u>8,950,949</u> |
| Total benefit plan assets | | | | <u>\$ 166,240,130</u> |
| 2019 | (Level 1) | (Level 2) | (Level 3) | Total |
| Equity mutual funds | \$ 54,952,087 | \$ - | \$ - | \$ 54,952,087 |
| Fixed-income mutual funds | 75,428,176 | - | - | 75,428,176 |
| Fixed-income securities | - | 21,122,393 | - | 21,122,393 |
| Cash equivalents | <u>1,175,475</u> | <u>-</u> | <u>-</u> | <u>1,175,475</u> |
| Benefit plan assets | <u>\$ 131,555,738</u> | <u>\$ 21,122,393</u> | <u>\$ -</u> | 152,678,131 |
| Uncleared cash disbursements from benefits paid | | | | (5,468,253) |
| Investments measured at net asset value (NAV) | | | | <u>8,380,969</u> |
| Total benefit plan assets | | | | <u>\$ 155,590,847</u> |

Investments that were measured at net asset value (NAV) per share (or its equivalent) as a practical expedient have not been classified in the fair value hierarchy. These investments represent holdings in a single private investment fund that are redeemable at the election of the holder upon no more than 30 days' notice. The values reported above are based on information provided by the fund manager.

Pension Plan and Other Postretirement Benefit Assumptions—Actuarial assumptions used to determine benefit obligations at December 31, 2020 and 2019, were as follows:

| | Pension Plan | | Other Postretirement Benefits | | | |
|-------------------------------|---------------------|-------------|--------------------------------------|-------------|----------------|-------------|
| | 2020 | 2019 | 2020 | | 2019 | |
| | | | Medical | Life | Medical | Life |
| Discount rate | 2.85 % | 3.58 % | 2.82 % | 2.82 % | 3.55 % | 3.55 % |
| Rate of compensation increase | 3.00 | 3.00 | N/A | 3.00 | N/A | 3.00 |

Actuarial assumptions used to determine net periodic benefit cost for the years ended December 31, 2020 and 2019, were as follows:

| | 2020 | 2019 | 2020 | | 2019 | |
|--|---------------|-------------|----------------|-------------|----------------|-------------|
| | | | Medical | Life | Medical | Life |
| | Discount rate | 3.58 % | 4.40 % | 3.55 % | 3.55 % | 4.40 % |
| Expected long-term return on plan assets | 5.75 | 6.00 | 5.11 | 5.75 | 5.33 | 6.00 |
| Rate of compensation increase | 3.00 | 3.00 | N/A | 3.00 | N/A | 3.00 |

In selecting the expected long-term rate of return on assets, the Companies considered the average rate of earnings expected on the funds invested to provide for plan benefits. This included considering the Pension Plan and VEBA trusts' asset allocation, 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, 2020 and 2019, were as follows:

| | 2020 | 2019 |
|---|-------------|-------------|
| Health care trend rate assumed for next year—participants under 65 | | |
| Health care trend rate assumed for next year—participants over 65 | 6.50 % | 7.00 % |
| Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)—participants under 65 | 6.80 | 7.30 |
| 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 | 5.00 | 5.00 |
| | 2024 | 2024 |

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 | \$ 1,167,960 | \$ (957,902) |
| Effect on postretirement benefit obligation | 21,697,182 | (17,801,770) |

Pension Plan and Other Postretirement Benefit Assets—The asset allocation for the Pension Plan and VEBA trusts at December 31, 2020 and 2019, by asset category was as follows:

| | <u>Pension Plan</u> | | <u>VEBA Trusts</u> | |
|-------------------|---------------------|------|--------------------|------|
| | 2020 | 2019 | 2020 | 2019 |
| Asset category: | | | | |
| Equity securities | 33 % | 31 % | 41 % | 39 % |
| Debt securities | 67 | 69 | 59 | 61 |

Pension Plan and Other Postretirement Benefit Contributions—The Companies expect to contribute \$6,000,000 to their Pension Plan and \$25,400 to their Other Postretirement Benefits plan in 2021.

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 |
|-------------------------------------|-------------------------|--|
| 2021 | \$ 10,340,070 | \$ 7,163,164 |
| 2022 | 11,128,901 | 7,606,599 |
| 2023 | 11,750,475 | 8,114,635 |
| 2024 | 12,727,758 | 8,667,211 |
| 2025 | 12,723,903 | 9,162,833 |
| Five years thereafter | 69,056,395 | 50,538,385 |

Postemployment Benefits—The Companies follow the accounting guidance in FASB ASC 712, *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 37% and 63% split between OVEC and IKEC, respectively, as of December 31, 2020, and approximately a 42% and 58% split between OVEC and IKEC, respectively, as of December 31, 2019. 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 \$6,833,166 and \$5,201,536 at December 31, 2020 and 2019, 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' pay contributed. In addition, the Companies provide contributions to eligible employees, hired on or after January 1, 2015, of 3% to 5% of pay based on age and service. 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 2020 and 2019 were \$1,920,461 and \$1,966,847, respectively.

9. ENVIRONMENTAL MATTERS

Air Regulations

On March 10, 2005, the United States Environmental Protection Agency (the U.S. EPA) issued the Clean Air Interstate Rule (CAIR) that required 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 rules. Following completion of the necessary engineering and permitting, construction was started on the FGD systems, and the two Kyger Creek FGD systems were placed into service in 2011 and 2012, while the two Clifty Creek FGD systems were placed into service in 2013.

After the promulgation of CAIR and CAMR, a series of legal challenges to those rules resulted in their replacement with additional rules. CAMR was replaced with a rule referred to as the Mercury and Air Toxics Standards (MATS) rule. The rule became final on April 16, 2012, and the Companies had to demonstrate compliance with MATS emission limits on April 16, 2015. The MATS rule has also undergone legal challenges since it went into effect, and there are a few remaining legal issues pending. The controls the Companies have installed have proven to be adequate to meet the stringent emissions requirements outlined in the MATS rule.

After CAIR was promulgated, legal challenges resulted in that rule being remanded back to the U.S. EPA. The U.S. EPA subsequently promulgated a replacement rule to CAIR called the Cross-State Air Pollution Rule (CSAPR). CSAPR was issued on July 6, 2011, and it was scheduled to go into effect on January 1, 2012. However, a legal challenge of that rule resulted in a stay. The stay was lifted by the D.C. Circuit Court in 2014 and CSAPR, which requires significant NO_x and SO₂ emissions reductions, became effective on January 1, 2015. Further legal challenges of CSAPR resulted in the U.S. Supreme Court remanding portions of the CSAPR rule back to the D.C. Circuit Court for additional review and subsequent action by the U.S. EPA. This resulted in U.S. EPA issuing the CSAPR Update rule which became final on September 7, 2016, and went into effect beginning with the May 1, 2017 to September 30, 2017 ozone season. The CSAPR Update did not replace CSAPR, it only required additional reductions in NO_x emissions from utilities in 22 states (including Ohio and Indiana) during the ozone season. The Companies prepared for and implemented a successful compliance strategy for the CSAPR Update rule requirements in the 2017 ozone season. That strategy was standardized to meet future ozone season compliance obligations, and its execution provided for another successful ozone season in 2019. The CSAPR Update Rule has also been subject to extensive litigation, and the D.C. Circuit Court of Appeals issued a decision on September 13, 2019, on one of those legal challenges that remanded portions of this rule back to U.S. EPA to address. On October 15, 2020, the EPA issued a proposed revision to the CSAPR Update in response to the court remand; and on March 15, 2021, U.S. EPA Administrator Regan signed a final rule revising the CSAPR Update. This rule will go into effect in the summer of 2021, 60-days after it is formally published in the *Federal Register*. The Companies are not currently anticipating that this new rule will impact our near term compliance strategy or materially change future operations.

As a result of the installation and effective operation of the FGD systems and the SCR systems at each plant, management did not need to purchase additional annual SO₂ allowances, annual NO_x allowances or ozone season NO_x allowances in 2020 to cover actual emissions. The Companies also maintain a bank of allowances for all three programs as a hedge to cover future emissions in the event of any short-term operating events or other external factors. Depending on a variety of operational and economic factors, management may elect to consume a portion of these banked allowances and/or strategically purchase additional CSAPR annual and ozone season allowances in 2021 and beyond for compliance with the CSAPR and the recently revised CSAPR Update rules.

With all FGD systems fully operational, the Companies continue to expect to have adequate SO₂ allowances available every year without having to rely on market purchases to comply with the CSAPR rules in their current form. Given the success of the Companies' NO_x ozone season compliance strategy, the purchase of additional NO_x allowances is less likely in the short term as well; however, the Companies did implement changes in unit dispatch criteria for Clifty Creek Unit 6 during the 2017 and subsequent ozone seasons and are continuing to evaluate the need for additional NO_x controls for this unit to provide additional flexibility in operating this unit in light of recent changes to the CSAPR Update rules that are expected to go into effect during the 2021 NO_x ozone season.

CCR Rule

In 2010, the U.S. EPA published a proposed rule to regulate the disposal and beneficial reuse of coal combustion residuals (CCRs), including fly ash and boiler slag generated at coal-fired electric generating units as well as FGD gypsum generated at some coal-fired plants. The proposed rule contained two alternative proposals. One proposal would impose federal hazardous waste disposal and management standards on these materials and another would allow states to retain primary authority to regulate the beneficial reuse and disposal of these materials under state solid waste management standards, including minimum federal standards for disposal and management. Both proposals would impose stringent requirements for the construction of new coal ash landfills and existing unlined surface impoundments.

Various environmental organizations and industry groups filed a petition seeking to establish deadlines for a final rule. To comply with a court-ordered deadline, the U.S. EPA issued a prepublication copy of its final rule in December 2014. The rule was published in the Federal Register in April 2015 and became effective in October 2015.

In the final rule, the U.S. EPA elected to regulate CCR as a nonhazardous solid waste and issued new minimum federal solid waste management standards. The rule applies to new and existing active CCR landfills and CCR surface impoundments at operating electric utility or independent power production facilities. The rule imposes new and additional construction and operating obligations, including location restrictions, liner criteria, structural integrity requirements for impoundments, operating criteria, and additional groundwater monitoring requirements. The rule is self-implementing and currently does not require state action for the states of Indiana or Ohio. As a result of this self-implementing feature, the rule contains extensive recordkeeping, notice, and Internet posting requirements.

The Companies have been systematically implementing the applicable provisions of the CCR rule. The Companies have completed all compliance obligations associated with the rule to date and are continuing to evaluate what, if any, impacts groundwater quality will

have on the South Fly Ash Pond and landfill at Kyger Creek and the West Boiler Slag Pond and landfill at Clifty Creek. To date, these four CCR units continue to meet the groundwater monitoring standards of the CCR rule. The Companies have been evaluating potential impacts to groundwater quality near the boiler slag pond at Kyger Creek and the landfill runoff collection pond at Clifty Creek as required by the CCR rule. The Companies have determined that statistically significant increases (SSIs) in certain groundwater parameters are present at the two identified locations, and additional steps as defined by the CCR rule were taken. The evaluation of whether an SSI exists is a required component of the groundwater monitoring conditions of the CCR rule. A determination that an SSI appears to be present requires additional evaluation to be undertaken by the facility to determine if there are alternative sources that are influencing groundwater quality and to evaluate the extent of the groundwater quality impact. Concurrently, a facility must continue to evaluate groundwater quality as required by the CCR rule, and determine what potential corrective actions are feasible to address the SSIs. The Companies conducted Alternative Source Demonstrations (ASD) to determine if groundwater was being influenced from sources other than the CCR unit. The ASDs were unable to definitively prove that alternative sources were directly influencing groundwater quality. As a result, the Companies worked with their Qualified Professional Engineer (QPE) to determine what corrective actions were feasible for each CCR unit, and then held a public meeting to discuss these options with the public prior to selecting a remedy. The Companies continue to work through the compliance requirements of the CCR Rule and remain in compliance.

Since the initial publication of the CCR rules in 2015, several legal, legislative and regulatory events impacting the scope, applicability and future CCR compliance obligations and timelines have also taken place. Final actions include: 1.) federal legislation (i.e., the WIIN Act) that provides a pathway for states to seek approval for administering and enforcing the federal CCR program; 2.) U.S. EPA's issuance of a Phase I, Part I revision to the CCR rules on March 1, 2018; 3.) the D.C. Circuit Court's August 21, 2018, ruling vacating and remanding portions of the CCR rule; 4.) U.S. EPA's issuance of a final CCR Rule, Part A, which was published in the *Federal Register* on August 28, 2020. This final rule introduced a significant revision to the 2015 CCR rule requiring all impoundments that do not meet the liner requirements outlined in the rule to cease receiving CCR material and initiate closure by April 11, 2021, regardless of their overall compliance status. If that date is not technically feasible, an alternate date to cease receiving CCR material and initiate closure can be secured from U.S. EPA through a proposed extension request process, which was required by U.S. EPA no later than November 30, 2020. The surface impoundments at Kyger Creek and Clifty Creek were not constructed in a manner that meets the definition of a liner under the 2015 CCR rule. As a result, the Companies completed an engineering evaluation to develop preliminary closure designs for the impoundments and to determine a technically feasible timeline for discontinuing placement of CCR and non-CCR waste streams in these impoundments and to initiate closure of the CCR impoundments consistent with the requirements of the rule. The Companies submitted technical justification documents to U.S. EPA in compliance with the November 30, 2020, deadline that demonstrated why additional time is needed to cease placement of CCR and non-CCR waste streams in the surface impoundments and initiate closure. The Companies anticipate U.S. EPA will approve the alternative schedule at this time. However, U.S. EPA is still reviewing the Companies' justifications at the time of the development of this footnote. The Companies anticipate that U.S. EPA will provide feedback in the first half of 2021. Separately, the proposed Part B revisions to the 2015 CCR rule outline the development of a federal permitting program to regulate and enforce the CCR rule at all applicable facilities consistent with the Congressional mandate outlined in the WIIN Act. This federal permit program would

replace the current enforcement mechanism of a self-implementing rule enforced through citizen suits and place it back with U.S. EPA or any state regulatory that receives primacy to implement the CCR permitting within their respective state. The Companies are actively monitoring these developments and adapting their CCR compliance program to ensure compliance obligations and timelines are adjusted accordingly. Changes in regulations or in the Companies' strategies for mitigating the impact of coal combustion residuals could potentially result in material increases to the asset retirement obligations. The Companies will revisit the demolition and decommissioning studies as appropriate throughout the process of executing closure of the CCR surface impoundments to maintain an accurate estimated cost of ultimate facility closure and decommissioning.

In February 2014, the U.S. EPA completed a risk evaluation of the beneficial uses of coal fly ash in concrete and FGD gypsum in wallboard and concluded that the U.S. EPA supports these beneficial uses. Currently, approximately 65 percent of the coal ash and other residual products from the Companies' generating facilities are reused in the production of cement and wallboard, as soil amendments, as abrasives or road treatment materials, and for other beneficial uses.

NAAQS Compliance for SO₂

On June 22, 2010, the U.S. EPA revised the Clean Air Act by developing and publishing a new one-hour SO₂ NAAQS of 75 parts per billion, which replaced the previously existing 24-hour and annual standards, and became effective on August 23, 2010. States with areas failing to meet the standard were required to develop state implemented plans to expeditiously attain and maintain the standard.

On August 15, 2013, the U.S. EPA published its initial non-attainment area designations for the new one-hour SO₂, which did not include the areas around Kyger Creek or Clifty Creek. However, the amended rule does establish that at a minimum, sources that emit 2,000 tons SO₂ or more per year be characterized by their respective states using either modeling of actual source emissions or through appropriately sited ambient air quality monitors.

In addition, U.S. EPA entered into a settle agreement with Sierra Club/NRDC in the U.S. District Court for the Northern District of California requiring U.S. EPA to take certain actions, including completing area designation by July 2, 2016, for areas with either monitored violations based on 2013-15 air quality monitoring or sources not announced for retirement that emitted more than 16,000 tons SO₂ or more than 2,600 tons with a 0.45 SO₂/mmBtu emission rate in 2012.

Both Kyger Creek and Clifty Creek directly or indirectly triggered one of the criteria and have been evaluated by the respective state regulatory agencies through modeling. The modeling results showed Clifty Creek could meet the new one-hour SO₂ limit using their current scrubber systems without any additional investment or modifications. Kyger Creek's modeling data was rejected by U.S. EPA as inconclusive in 2016. As a result, U.S. EPA required Kyger Creek install an SO₂ monitoring network around the plant and monitor ambient air quality beginning on January 1, 2017. Based on the first three years of data from that network, Ohio EPA prepared an updated petition to U.S. EPA in early 2020 requesting that the area in the county surrounding the plant be re-designated to attainment/unclassifiable with the one-hour SO₂ standard. U.S. EPA subsequently acted on this request and published a notice in the *Federal Register* proposing to make this re-designation. A final rulemaking approving the re-designation is expected in 2021. Finally, on February 26, 2019, the U.S. EPA issued a final decision that it is retaining the existing

primary SO₂ NAAQS at 75 parts per billion for the next five-year NAAQS review cycle. Given this decision, combined with current scrubber performance, the Companies expect to avoid more restrictive permit limits relative to its SO₂ emissions or the need for additional capital investment in major scrubber upgrades or modifications.

Steam Electric ELGs

On September 30, 2015, the U.S. EPA signed a new final rule governing Effluent Limitations Guidelines (ELGs) for the wastewater discharges from steam electric power generating plants. The rule, which was formally published in the Federal Register on November 3, 2015, impacted future wastewater discharges from both the Kyger Creek and Clifty Creek stations.

The rule was intended to require the Companies to modify the way they handle a number of wastewater processes at both power plants. Specifically, the new ELG standards were going to affect the following wastewater processes in three ways listed below; however, in April 2017, the U.S. EPA issued an administrative stay on the ELG rule; and then in June 2017, the U.S. EPA issued a separate rulemaking staying the compliance deadlines for portions of the ELG rule applicable to bottom ash sluice water and to FGD wastewater discharges. The U.S. EPA revised the rule redefining what constitutes “best available technology” for these two wastewater discharges and issued an updated final rule in the Federal Register on October 13, 2020. Based on the original rule and revisions captured in the 2020 update, the following impacts to each wastewater discharge are expected:

1. Kyger Creek will need to convert to dry fly ash handling by no later than December 31, 2023. The U.S. EPA stay on portions of the ELG rule does not impact the need to convert Kyger Creek station to dry fly ash handling or the associated timeline. The Clifty Creek station already has a dry fly ash handling system in place, so this provision of the rule will not impact Clifty Creek’s operations.
2. The new ELG rules originally prohibited the discharge of bottom ash sluice water from boiler slag/bottom ash waste water treatment systems. For Clifty Creek and Kyger Creek, this will result in the conversion of each plant’s boiler slag pond to a closed-loop sluicing system for boiler slag, with up to a ten percent purge based on the volume of each facilities’ total wetted volume. The Companies conducted a Phase I engineering study in 2016 to determine options and costs associated with retrofitting the plants’ boiler slag treatment systems, but postponed the study until more information was available from U.S. EPA on the technologies being considered in the revised rule. After reviewing the new rule in draft, the Companies resumed the engineering study needed to formulate an overall compliance strategy based on this updated information. This study includes a further evaluation of technologies or retrofits capable of complying with the requirements of the revised rule, which included preliminary engineering, design, and schedule development that were initiated late in 2019. The Companies have completed the required evaluation associated with each facilities’ boiler slag/bottom ash transport waste water treatment in 2020. This feed information was used to develop design and to initiate the bid process to conduct the work. Both Kyger Creek and Clifty Creek Stations are securing various environmental permits necessary to commence construction on the boiler slag/bottom ash handling systems, with work at both locations expected to initiate sometime in 2021.
3. The new ELG rules originally established new internal limitations for the FGD system

wastewater discharges. Specifically, there were to be new internal limits for arsenic, mercury, selenium, and nitrate/nitrite nitrogen from the FGD chlorides purge stream wastewater treatment plant at each plant. After reviewing the requirements of the 2015 edition of the rule, the Companies expected both Clifty Creek and Kyger Creek stations to be able to meet the mercury and arsenic limitations with the current wastewater treatment technology; however, the Companies anticipated the potential to add some form of biological (or equivalent nonbiological) treatment system downstream of each station's existing FGD waste water treatment plant to meet the new nitrate/nitrite nitrogen and selenium limitations. Installation of new controls to meet the final effluent limitations contained in the revised rule were placed on hold while the U.S. EPA reconsidered the 2015 ELG rule to ensure that the compliance strategy ultimately selected would be able to meet any revised requirements in the updated ELG rule. With the finalization of the October 13, 2020 ELG Revision, the Companies resumed evaluation of the appropriate technology, design, and schedule to achieve compliance with the new requirements, which included a change in the final effluent limitations for arsenic, nitrate/nitrite, mercury and selenium. The most significant change to the rule is associated with the final effluent limitation for mercury, which was ultimately lower than the final limit in the 2015 version of the rule, resulting in the Companies needing to re-evaluate and pilot technologies to determine what technology is capable of achieving this reduced mercury limit on the FGD discharges from each station. The Companies have been working with outside engineering resources to develop preliminary design reports and to schedule pilots since late 2020. Further, the Companies have been working with state agencies to request the revised ELG applicability date for FGD waste water of no later than December 31, 2025.

Any new ELG limits will be implemented through each station's waste water discharge permit, which is typically renewed on a five-year basis. The final compliance dates are expected to be facility-specific and negotiated with the Companies' state permit agencies based on the time needed to plan, secure funding, design, procure, and install necessary control technologies once the new rulemaking has been completed. The Companies will continue to monitor EPA regulatory actions on this rule and will respond as necessary.

316(b) Compliance

The 316(b) rule was published as a final rule in the Federal Register on August 15, 2014, and impacts facilities that use cooling water intake structures designed to withdraw at least 2 million gallons per day from waters of the U.S., and those facilities who also have an NPDES permit. The rule requires such facilities to choose one of seven options specified by the rule to reduce impingement to fish and other aquatic organisms. Additionally, facilities that withdraw 125 million gallons or more per day must conduct entrainment studies to assist state permitting authorities in determining what site-specific controls are required to reduce the number of aquatic organisms entrained by each respective cooling water system.

The Companies have completed the required two-year fish entrainment studies and filed the reports with the respective state regulatory agencies consistent with regulatory requirements under 40 CFR Section 122.21(r).

The timeline for determining if retrofits may be required to the cooling water systems at either Clifty Creek or Kyger Creek, as well as the type of retrofit required, will be negotiated with each state regulatory agency during future NPDES Permit renewals consistent with state regulatory obligations under 40 CFR Section 125.98(f).

The environmental rules and regulations discussed throughout the Environmental Matters footnote could require additional capital expenditures or maintenance expenses in future periods.

10. 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.

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 and fixed-income securities are classified as Level 1 holdings if they are actively traded on exchanges. In addition, mutual funds are classified as Level 1 holdings because they are actively traded at quoted market prices. Certain 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.

As of December 31, 2020, and 2019, the Companies held certain assets that are required to be measured at fair value on a recurring basis. These consist of investments recorded within long-term investments. The investments consist of money market mutual funds, equity mutual funds, and fixed-income 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.

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.

Long-Term Investments—Assets measured at fair value on a recurring basis at December 31, 2020 and 2019, were as follows:

| | Fair Value Measurements at Reporting Date Using | | |
|-----------------------------------|--|--|--|
| | Quoted Prices in Active Market for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| 2020 | | | |
| Equity mutual funds | \$ 55,782,673 | \$ - | \$ - |
| Fixed-income mutual funds | - | - | - |
| Fixed-income municipal securities | - | 96,555,122 | - |
| Cash equivalents | <u>121,616,295</u> | <u>-</u> | <u>-</u> |
| Total fair value | <u>\$ 177,398,968</u> | <u>\$ 96,555,122</u> | <u>\$ -</u> |
| 2019 | (Level 1) | (Level 2) | (Level 3) |
| Equity mutual funds | \$ 99,982,734 | \$ - | \$ - |
| Fixed-income mutual funds | 37,002,850 | - | - |
| Fixed-income municipal securities | - | 101,374,099 | - |
| Cash equivalents | <u>2,379,596</u> | <u>-</u> | <u>-</u> |
| Total fair value | <u>\$ 139,365,180</u> | <u>\$ 101,374,099</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 sheets. The fair values and recorded values of the senior notes and fixed- and variable-rate bonds as of December 31, 2020 and 2019, are as follows:

| | 2020 | | 2019 | |
|-------|-------------------------|-------------------------|-------------------------|-------------------------|
| | Fair Value | Recorded Value | Fair Value | Recorded Value |
| Total | <u>\$ 1,364,602,177</u> | <u>\$ 1,217,093,866</u> | <u>\$ 1,390,779,759</u> | <u>\$ 1,275,148,664</u> |

11. LEASES

OVEC has various operating leases for the use of other property and equipment.

On January 1, 2019, the Companies adopted ASC 842, "Leases" which, among other changes, requires the Companies to record liabilities classified as operating leases on the balance sheet along with a corresponding right-of-use asset. The Companies elected the package of practical expedients available for expired or existing contracts, which allowed them to carryforward their historical assessments of whether contracts are or contain leases, lease classification tests and treatment of initial direct costs. Further, the Companies elected to not separate lease components from non-lease components for all fixed payments, and excluded variable lease payments in the measurement of right-of-use assets and lease obligations.

Upon adoption of ASC 842, the impact was a \$22,000 increase in ROU assets and operating lease obligations. These adjustments are the result of assigning a right-of-use asset and related lease liability to the Companies operating leases. There were no cumulative effect adjustments to opening retained earnings, and adoption of the lease standard had no impact to cash from or used in operating, financing, or investing activities on the cash flow statement.

The Companies determine whether an arrangement is, or includes, a lease at contract inception. Leases with an initial term of 12 months or less are not recognized on the balance sheet. The Companies recognize lease expense for these leases on a straight-line basis over the lease term.

Operating lease right-of-use assets and liabilities are recognized at commencement date and initially measured based on the present value of lease payments over the defined lease term.

The leases typically do not provide an implicit rate; therefore, the Companies use the estimated incremental borrowing rate at the time of lease commencement to discount the present value of lease payments. In order to apply the incremental borrowing rate, a portfolio approach with a collateralized rate is utilized. Assets were grouped based on similar lease terms and economic environments in a manner whereby the Companies reasonably expect that the application is not expected to differ materially from a lease-by-lease approach.

The Companies have operating and finance leases for the use of vehicles, property, and equipment. The leases have remaining terms of 0 year to 6 years. The components of lease expense were as follows:

| December 31 | 2020 |
|-------------------------------|-------------------|
| Operating lease cost | <u>\$ 7,512</u> |
| Finance lease cost: | |
| Amortization of leased assets | \$ 386,089 |
| Interest on lease liabilities | <u>62,702</u> |
| Total finance lease cost | <u>\$ 448,791</u> |

Supplemental cash flow information related to leases was as follows:

| | |
|--|----------|
| Operating cash flows from operating leases | \$ 7,512 |
| Operating cash flows from finance leases | 65,300 |
| Financing cash flows from finance leases | 259,242 |

Weighted average remaining lease term:

| | |
|------------------|----------|
| Operating leases | < 1 year |
| Finance leases | 5 years |

Weighted average discount rate:

| | |
|------------------|-------|
| Operating leases | 2.5 % |
| Finance leases | 5.4 % |

The amount of operating lease ROU assets and liabilities is \$0 and \$7,431 as of December 31, 2020 and 2019, respectively.

The amount in property under finance leases is \$4,081,933 and \$1,545,051 with accumulated depreciation of \$610,556 and \$669,164 as of December 31, 2020 and 2019, respectively.

Future cash flows of operating leases, and maturities of finance lease liabilities are as follows:

| Years Ending December 31 | Operating | Finance |
|--|------------------|---------------------|
| 2021 | \$ - | \$ 803,802 |
| 2022 | - | 732,870 |
| 2023 | - | 667,913 |
| 2024 | - | 620,873 |
| 2025 | - | 520,679 |
| Thereafter | - | <u>50,528</u> |
| Total future minimum lease payments | <u>\$ -</u> | 3,396,665 |
| Less estimated interest element | | <u>355,432</u> |
| Estimated present value of future minimum lease payments | | <u>\$ 3,041,233</u> |

12. 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.

On March 31, 2018, FirstEnergy Solutions Corp. (FES), one of the Sponsoring Companies under the ICPA, filed for Chapter 11 bankruptcy protection under the United States

Bankruptcy Code in the United States Bankruptcy Court for the Northern District of Ohio (the "Bankruptcy Court"). OVEC made a preemptive filing on March 26, 2018, at the Federal Energy Regulatory Commission (FERC) requesting either (i) an order finding that FES's anticipated rejection of the ICPA would constitute a violation of that agreement's terms and would not satisfy the Federal Power Act's "public interest" standard, or, (ii) an order declaring that FERC has exclusive jurisdiction over the proposed rejection of the ICPA (the "FERC Action"). On April 1, 2018, FES filed in the Bankruptcy Court a motion to reject the ICPA and separately obtained an order temporarily enjoining the FERC Action. On May 11, 2018, the Bankruptcy Court granted a preliminary injunction enjoining FERC from reviewing FES's requested rejection of the ICPA under the public interest standard. FERC subsequently filed an appeal of this decision with the United States Court of Appeals for the Sixth Circuit (the "Injunction Appeal"), which OVEC joined as an intervenor. On July 31, 2018, the Bankruptcy Court granted FES's motion to reject the ICPA using the "business judgement" standard used to evaluate contract rejection under the Bankruptcy Code (the "Rejection Order"). Per the ICPA, upon

rejection, OVEC made available to all other Sponsoring Companies FES's entitlement to available energy under the ICPA. OVEC appealed the Rejection Order to the Sixth Circuit (the "Rejection Appeal"). The Rejection Appeal was ultimately consolidated with the Injunction Appeal (together as consolidated, the "Sixth Circuit Rejection Appeal"). On October 14, 2018, OVEC filed with the Bankruptcy Court its rejection damages claim of approximately \$540 million against FES.

On July 31, 2019, OVEC and FES entered into a stipulation with respect to OVEC's objection to confirmation of the FES plan of reorganization, stipulating that FES (a) would not seek to dismiss OVEC's Sixth Circuit appeal, or, if applicable, OVEC's appeal of an order with respect to an objection by OVEC to confirmation of the plan arising under section 1129(a)(6) of the Bankruptcy Code or oppose further review by the United States Supreme Court, on the grounds of mootness. OVEC objected to confirmation of the FES plan under section 1129(a)(6) of the Bankruptcy Code, which requires any governmental regulatory commission with jurisdiction, after confirmation of the plan, over the rates of a debtor to approve any rate change provided for in the plan, or that such rate change is expressly conditioned on such regulatory approval. OVEC's objection was overruled at the confirmation hearing on August 21, 2019. The FES plan of reorganization was confirmed on October 16, 2019. On October 29, 2019, OVEC moved to certify a direct appeal of the Bankruptcy Court's confirmation order to the Sixth Circuit. On November 27, 2019, the Bankruptcy Court granted OVEC's motion to certify the confirmation order for direct appeal to the Sixth Circuit which was granted on March 24, 2020. The Sixth Circuit granted OVEC's petition for direct appeal of the confirmation order.

On December 12, 2019, the U.S. Court of Appeals for Sixth Circuit ruled on the Sixth Circuit Rejection Appeal by (1) affirming the Bankruptcy Court's jurisdiction over the rejection of the ICPA and (2) finding that the Bankruptcy Court should have considered the public interest in the standard for rejection and remanding to the Bankruptcy Court for further consideration under a heightened standard, after giving FERC a reasonable opportunity to weigh in. OVEC filed a petition for rehearing "en banc," and on March 13, 2020, the Sixth Circuit denied the petition.

On May 18, 2020, Energy Harbor LLC (EH), successor to FES, filed a motion to approve a stipulation between itself and OVEC with respect to the parties' outstanding disputes (the "Stipulation"). The material terms of the Stipulation provided, among other things, that (a) EH shall assume the ICPA, (b) shall continue to perform its obligations under the ICPA arising on or after June 1, 2020, pursuant to the terms of the ICPA, (c) EH shall pay OVEC \$32,500,000 in cash as full and final settlement of any cure amounts required to be paid in connection with the assumption of the ICPA, and (d) OVEC's claims in the bankruptcy cases shall be deemed withdrawn with prejudice and expunged, OVEC shall withdraw and dismiss, with prejudice, its appeal of the confirmation order and shall withdraw any of its actions, pleadings, or positions, with prejudice, taken before FERC with respect to FERC's proceedings arising from the Sixth Circuit's decision in connection with the Rejection Order. On June 15, 2020, the Bankruptcy Court entered an order approving the Stipulation, and the Stipulation became effective shortly thereafter.

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