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The Public Utilities Commission of Ohio
180 East Broad Street
Columbus, OH 43215

11-2748-EL-AIS

April 28, 2011

Re: **OHIO VALLEY ELECTRIC CORPORATION**

Gentlemen:

Enclosed on behalf of Ohio Valley Electric Corporation are one executed and five conformed copies of an Application for authority to refinance and amend senior unsecured long-term notes and to enter into interest rate management agreements.

An additional copy of the Application is also enclosed. Please indicate by file-stamp the Commission's receipt and return the extra copy so marked to the undersigned.

Very truly yours,

David C. House

DCH/jml

Enclosures

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Before
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the application of
OHIO VALLEY ELECTRIC CORPORATION
for authority to refinance and amend senior unsecured
long-term notes and to enter into interest rate
management agreements

2748
Case No. 11-____-EL-AIS

APPLICATION AND STATEMENT

TO THE HONORABLE

THE PUBLIC UTILITIES COMMISSION OF OHIO:

Your Applicant, Ohio Valley Electric Corporation, respectfully shows:

FIRST: Applicant is an Ohio corporation, which owns and operates facilities for the generation, transmission and sale of electric power and energy in the State of Ohio and owns and operates facilities for the transmission of electric power and energy in the Commonwealth of Kentucky, Applicant being a public utility, as defined in the Ohio Revised Code ("Revised Code"). Applicant's wholly-owned subsidiary, Indiana-Kentucky Electric Corporation ("IKEC"), owns and operates facilities for the generation, transmission and sale of electric power and energy in the State of Indiana. The combined electric production capability of the generating stations owned and operated by Applicant and IKEC (which are known as the Kyger Creek and Clifty Creek Plants) is approximately 2,256 megawatts.

Applicant was organized on October 1, 1952 by the ten (now twelve) participating companies, which are the owners of all of the capital stock of Applicant, to supply, together with the Sponsoring Companies (as defined below), the entire power requirements of the gaseous diffusion plant near Portsmouth, Ohio, owned and operated initially by the United States Atomic Energy Commission until January 19, 1975, and then, from that date until September 30, 1977,

by the United States Energy Research and Development Administration, which, under the Energy Reorganization Act of 1974 succeeded to certain of the functions of the Atomic Energy Commission, and thereafter by the United States Department of Energy ("DOE") which, on October 1, 1977, pursuant to the Department of Energy Organization Act, succeeded to the functions of the Energy Research and Development Administration. Effective August 31, 2001, DOE became no longer entitled to any power generated by Applicant's and IKEC's generating stations, and the Sponsoring Companies have instead purchased that power.

The twelve participating companies that own all of Applicant's common stock are currently as follows: Allegheny Energy, Inc., a subsidiary of FirstEnergy Corp.; American Electric Power Company, Inc. ("AEP"); Buckeye Power Generating, LLC, an affiliate of Buckeye Power, Inc.; Duke Energy Ohio, Inc. (formerly known as The Cincinnati Gas & Electric Company), a subsidiary of Duke Energy Corporation; Columbus Southern Power Company, a subsidiary of AEP; The Dayton Power and Light Company, a subsidiary of DPL Inc.; Kentucky Utilities Company, a subsidiary of PPL Corporation; Louisville Gas and Electric Company, also a subsidiary of PPL Corporation; Ohio Edison Company, a subsidiary of FirstEnergy Corp.; Peninsula Generation Cooperative, a subsidiary of Wolverine Power Supply Cooperative, Inc.; Southern Indiana Gas and Electric Company, a subsidiary of Vectren Corporation; and The Toledo Edison Company, also a subsidiary of FirstEnergy Corp. All of these participating companies or their affiliates ("Sponsoring Companies") currently purchase power from Applicant according to the terms of that certain Amended and Restated Inter-Company Power Agreement dated as of March 13, 2006 (as amended, the "Inter-Company Power Agreement"). The current term of the Inter-Company Power Agreement ends on March 13, 2026. The Sponsoring Companies and Applicant have agreed to extend such term to June 30, 2040, subject

to receipt of necessary approvals from the Federal Energy Regulatory Commission ("FERC") and other regulatory agencies.¹

Applicant is a public utility, within the meaning of Section 4905.02 of the Revised Code, being engaged in the business of supplying electricity for light, heat or power purposes within the State of Ohio, and is subject to the jurisdiction of your Honorable Commission. Applicant is also engaged in the business of transmitting electricity within the Commonwealth of Kentucky, the electric power and energy so transmitted being delivered in interstate commerce.

Reference is made herein to your Honorable Commission's Findings and Orders in Case Nos. 05-977-EL-AIS, 06-1196-EL-AIS, 07-1105-EL-AIS, 08-1286-EL-AIS, 09-977-EL-AIS and 10-2630-EL-AIS (collectively, the "Previous Financing Orders"), in which your Honorable Commission authorized Applicant in consecutive terms, the most recent of which extends through December 31, 2011, to, among other things, issue and sell secured or unsecured promissory notes, debentures or other debt securities ("Notes"), in one or more series, consistent with the parameters specified in the applications made in such proceedings and the exhibits thereto.

SECOND: Attached hereto as Exhibit A are financial statements, including a balance sheet and statements of income and retained earnings of Applicant, as of December 31, 2010.

THIRD: Pursuant to authority granted by your Honorable Commission in the Previous Financing Orders, the Company has issued certain senior unsecured long-term notes as set forth in Exhibit B hereto (such notes, the "Senior Unsecured Notes"). As set forth in Exhibit B, the outstanding principal amount of the Senior Unsecured Notes as of March 31, 2011 was \$964,414,644.

¹ On March 23, 2011, Applicant submitted to FERC, pursuant to Section 205 of the Federal Power Act, the Inter-Company Power Agreement and requested acceptance for filing by May 23, 2011.

FOURTH: Applicant requests the authority through May 31, 2012, to repay, refinance, refund or redeem any or all of the outstanding Senior Unsecured Notes through (i) the issuance and sale or entering into of new Notes; by borrowing from, or entering into other financing arrangements with, the Ohio Air Quality Development Authority, any statutory successor thereto or any other authorized issuer of tax-exempt bonds (including but not limited to the Indiana Finance Authority or any statutory successor thereto) (each an "Authority"); by entering into one or more secured or unsecured term loan or revolving credit arrangements (which may include increasing the amount available for borrowing under Applicant's existing revolving credit arrangement) ("Credit Facilities"); or through the issuance and sale or entering into any combination of Notes and Credit Facilities, to or with one or more commercial banks, financial institutions or other institutional investors; by borrowing from, or entering into other financing arrangements with, one of more Authorities; and (ii) the renegotiation or restructuring of the terms of any or all of the indebtedness evidenced by the Senior Unsecured Notes (each of the transactions described in clauses (i) and (ii) above, a "Refinancing", and all such instruments reflecting any Refinancing, collectively, "Refinancing Instruments"), in each case in clauses (i) and (ii) above in order to permit the extension of the amortization and final maturity of the indebtedness evidenced by such Senior Unsecured Notes in connection with the extension of the term of the Inter-Company Power Agreement. The authority requested herein is in addition to the authority granted in Case No. 10-2630-EL-AIS insofar as the authority to repay, refinance, refund or redeem all of the outstanding Senior Unsecured Notes was not granted by your Honorable Commission in Case No. 10-2630-EL-AIS. Notwithstanding the foregoing, no such Refinancing of the Senior Unsecured Notes will cause the aggregate principal amount of Applicant's outstanding debt (excluding debt issued by Applicant pursuant to Revised Code §

4905.401) to exceed that which has been authorized by your Honorable Commission in past proceedings to date.

A. Notes

Applicant proposes that any Refinancing Instrument constituting a Note ("Refinancing Note") be governed by the parameters contained herein. Refinancing Notes will mature in not less than twelve (12) months and not more than sixty (60) years after issuance. The interest rate of any Refinancing Note may be fixed or variable or some combination of fixed and variable rates. Any fixed rate Refinancing Note will be sold by Applicant at a yield to maturity which shall not exceed by more than 4.5% the yield to maturity on United States Treasury obligations of comparable maturity at the time of pricing. The interest rate on any variable rate Refinancing Note will not exceed the London Interbank Offered Rate for U.S. dollar deposits of similar duration at the time of pricing by 450 basis points, and the initial interest rate on any variable rate Refinancing Note will not exceed 12.0% per annum. Applicant will agree to specific redemption provisions, if any, including redemption premiums, at the time of the pricing. No compensating balances shall be maintained with, or fees in the form of substitute interest paid to, a lender or holder with respect to any Refinancing Note provided that any such lenders or holders may receive up-front, arrangement or similar fees not to exceed in the aggregate 3.0% of the principal amount of the total borrowing. In addition, in the event a bank or financial institution arranges for a borrowing from a third party, such bank or institution may charge Applicant a placement fee, not to exceed 4.0% of the principal amount of such borrowing.

B. Authority Financing Arrangements

Applicant proposes that any Refinancing Instrument reflecting a financing arrangement with an Authority will be entered into in connection with the issuance of revenue bonds by such Authority ("Refinancing Authority Bonds") and will be governed by the parameters contained

herein. Such a financing arrangement will be in the form of a loan agreement (including a promissory note evidencing Applicant's obligations under such loan agreement), a conditional or installment sale agreement, or a lease with an option to purchase (each, an "Authority Financing Agreement") and be for a term or terms of not more than sixty (60) years. Applicant's obligations under any Authority Financing Agreement will include the making of payments sufficient to repay all the principal of, the premium, if any, and the interest on, the Refinancing Authority Bonds issued in connection with such Authority Financing Agreement. Any Refinancing Authority Bonds will be special obligations payable solely out of revenues derived from the payments by Applicant under the related Authority Financing Agreements. In connection with any Refinancing Authority Bonds, Applicant may enter into one or more guaranty agreements, bond insurance agreements and other similar undertakings guaranteeing repayment of all or any part of the obligations with respect to all or any part of such Refinancing Authority Bonds and the related Authority Financing Agreements and may give mortgages and other liens and security to secure such obligations.

Any Refinancing Authority Bonds may be issued as taxable or tax-exempt bonds or once issued may be converted from taxable to tax-exempt bonds. The interest rate of any Refinancing Authority Bond may be fixed or variable or some combination of fixed and variable rates. Any fixed rate Refinancing Authority Bond will be sold at a yield to maturity which shall not exceed by more than 6.0% the yield to maturity on United States Treasury obligations of comparable maturity at the time of pricing, and the initial interest rate on any variable rate Refinancing Authority Bond will not exceed 12.0% per annum. Applicant will agree to specific redemption provisions, if any, including redemption premiums, at the time of the pricing. Applicant may

also agree to up-front, arrangement or similar fees not to exceed in the aggregate 4.0% of the principal amount of the total borrowing.

Because of the historical spread between long-term fixed interest rates and short-term rates, all or a portion of any Refinancing Authority Bond may be issued initially with an interest rate that fluctuates on a weekly, monthly or other basis, as determined from time to time by Applicant.

Applicant would reserve the option to convert any variable rate Refinancing Authority Bond at a later date to other interest rate modes, including a fixed rate of interest. Variable rate Refinancing Authority Bonds also may be issued subject to tender by the holders thereof for redemption or purchase. In order to provide funds to pay the purchase price of such tendered variable rate Refinancing Authority Bonds, Applicant may enter into one or more remarketing agreements with one or more remarketing agents whereby the remarketing agent would use its best efforts to remarket such tendered variable rate Refinancing Authority Bonds to other purchasers at a price equal to the purchase price of such variable rate Refinancing Authority Bonds, which will be 100% of the par amount of such variable rate Refinancing Authority Bonds. It is expected that the fees of the remarketing agent would not exceed approximately 25 basis points.

Also, in the event that variable rate Refinancing Authority Bonds are issued, Applicant may enter into one or more liquidity or credit facilities (each, a "Bank Liquidity Facility") with a bank or banks (each, a "Bank") to be selected by Applicant. Any Bank Liquidity Facility would be a credit agreement designed to provide Applicant with immediately available funds with which to make payments with respect to any variable rate Refinancing Authority Bonds that have been tendered for purchase and are not remarketed. Pursuant to a Bank Liquidity Facility,

Applicant may be required to execute and deliver to the applicable Bank a note evidencing Applicant's obligation to such Bank under such Bank Liquidity Facility.

In order to obtain terms and conditions more favorable to Applicant than those provided in a Bank Liquidity Facility or to provide for additional liquidity or credit support to enhance the marketability of variable rate Refinancing Authority Bonds, Applicant may desire to be able to replace a Bank Liquidity Facility with (or to initially use) one or more substitute liquidity support and/or credit support facilities (the instrument providing the liquidity support and/or credit support and any subsequent replacement support facility thereof, including any replacement facility which would replace a replacement facility, is hereinafter referred to as a "Liquidity Facility") with one or more banks, insurance companies (including municipal bond insurance companies) or other financial institutions to be selected by Applicant from time to time (each such financial institution hereinafter referred to as a "Liquidity Facility Provider"). A Liquidity Facility may be in the nature of a letter of credit, revolving credit agreement, standby credit agreement, bond purchase agreement or other similar arrangement designed to provide liquidity or credit support, or both, for variable rate Refinancing Authority Bonds. It is contemplated that, in the event variable rate Refinancing Authority Bonds are converted to bear interest at a fixed rate to maturity, any Bank Liquidity Facility (if not already replaced or terminated) or, if applicable, any Liquidity Facility (unless earlier terminated) may be terminated, in whole or in part, following the date of conversion of such series of variable rate Refinancing Authority Bonds. It is expected that the fees with respect to any Bank Liquidity Facility or Liquidity Facility would not exceed approximately 400 basis points.

In order to obtain terms and conditions more favorable to Applicant or to provide for additional liquidity or credit support to enhance the marketability of the Refinancing Authority

Bonds (including variable rate Refinancing Authority Bonds), Applicant may desire to obtain bond insurance with one or more insurance companies (including municipal bond insurance companies) or other financial institutions to be selected by Applicant from time to time. Applicant would use bond insurance only if it would be anticipated to reduce Applicant's cost of financing.

Applicant's obligations with respect to any Authority Financing Agreement or Refinancing Authority Bonds (or any related Credit Enhancement (as defined below), Bank Liquidity Facility or Liquidity Facility) may be secured by a mortgage or other secured bonds or other debt issued by Applicant. Any such bonds or other debt would correspond directly with the related Authority Financing Agreement and series of Refinancing Authority Bonds (including in principal amount), and any payments made with respect to the related Refinancing Authority Bonds would be considered also as payments made with respect to such bonds or other debt. Accordingly, any such bonds or other debt would not themselves separately count against or otherwise reduce the financing authority available to Applicant, over and above the effect of the related Refinancing Authority Bonds and Authority Financing Agreements.

C. Credit Facilities

Any Refinancing Instrument constituting a Credit Facility ("Refinancing Credit Facility") will be for periods of not more than ten (10) years, and Applicant may in connection with any Refinancing Credit Facility issue notes ("Credit Notes") that will mature not later than the maturity or termination date with respect to such Refinancing Credit Facility. The commitment or facility fees on the unused portion of any line of credit in connection with any Refinancing Credit Facility will not exceed 1.50% per annum. Other fees and commissions will not exceed 4.0% of such Refinancing Credit Facility. The interest rate applicable to a loan under any Refinancing Credit Facility (including with respect to any Credit Note) (excluding any

adjustment that may be required to take into account changes in reserve or capital adequacy requirements or other requirements of law which add to a lender's cost in making or maintaining the loan or reducing its return thereon, or, in the case of foreign banks, withholding taxes) will not exceed (i) the most recently available London Interbank Offered Rate for U.S. dollar deposits of similar duration by 450 basis points; (ii) the then offered rate for certificates of deposit by a selected U.S. major money center bank plus 450 basis points; or (iii) the then prime rate of a selected U.S. major money center bank plus 350 basis points, unless a pricing option based on one or more of these benchmarks is not then available to Applicant. In that case, the interest rate applicable to a loan under any Refinancing Credit Facility (including with respect to any Credit Note) will not exceed the lowest of the pricing options based on those benchmarks that are available.

FIFTH: The price, maturity dates, interest rates, the redemption provisions and other parameters of each series of any Refinancing Instruments will be determined by the Applicant, the issuer and the purchasers of such Refinancing Instruments, as applicable. Notwithstanding the foregoing, Applicant will not agree, without further Order of this Commission, to the issuance or entering into of any Refinancing Instrument to refinance any Senior Unsecured Notes or to the renegotiation or restructuring of the terms of any or all of the indebtedness evidenced by any Senior Unsecured Notes and amending accordingly such Senior Unsecured Notes, unless the terms thereof are consistent with the parameters proposed and described in this Application, and (ii) do not violate or conflict with the relevant authority herein granted.

SIXTH: All proceeds realized from the issuance and sale of or entering into Refinancing Instruments will be used to repay, refinance, refund or redeem amounts owing under the Senior Unsecured Notes.

SEVENTH: Applicant proposes to treat any premium on reacquisition of any indebtedness as an issuance expense of the Refinancing Instruments and all unamortized costs associated with the series of indebtedness reacquired (e.g., premium, discount, expense or loss on reacquisition of a prior issue or series), if any, as an issuance expense of the Refinancing Instruments to be amortized over the life of such Refinancing Instruments. Applicant intends to utilize deferred tax accounting for the premium expense, in order to properly match the amortization of the expense and the related tax effect.

EIGHTH: The actual cost of the Refinancing Instruments will be determined at the time of the sale or sales thereof.

NINTH: The issuance and entering into of Refinancing Instruments to Refinance any Senior Unsecured Note or any indebtedness evidenced thereby, will be effected in compliance with all applicable indenture, charter and other standards relating to debt and equity securities and capitalization ratios of Applicant.

TENTH: Applicant proposes, with the consent and approval of your Honorable Commission, to utilize interest rate management techniques and enter into interest rate management agreements ("Interest Rate Management Agreements") in connection with the Refinancing Instruments. Such authority will allow Applicant sufficient alternatives and flexibility when striving to reduce its effective interest cost and manage interest cost on financings.

A. Interest Rate Management Agreements

The Interest Rate Management Agreements will be products commonly used in today's capital markets, consisting of "interest rate swaps," "caps," "collars," "floors," "options," or hedging products such as "forwards" or "futures," or similar products, the purpose of which is to manage and minimize interest costs. Applicant expects to enter into these agreements with

counterparties that are highly rated financial institutions. The transactions will be for a fixed period and a stated principal amount, and may be for underlying fixed or variable obligations of Applicant. Applicant will not agree to any covenant more restrictive than those contained in the underlying obligation.

1. Pricing Parameters

Applicant proposes that the pricing parameters for Interest Rate Management Agreements be governed by the parameters contained herein. Fees and commissions in connection with any Interest Rate Management Agreement will be in addition to such parameters and will not exceed 2.0% of the amount of the underlying obligation involved.

2. Accounting

Applicant proposes to account for these transactions in accordance with generally accepted accounting principles.

3. Commission Authorization

Since market opportunities for these interest rate management alternatives are transitory, Applicant must be able to execute interest rate management transactions when the opportunity arises to obtain the most competitive pricing. Thus, Applicant seeks approval to enter into any or all of the described transactions within the parameters discussed above prior to the time Applicant reaches agreement with respect to the terms of such transactions.

If Applicant utilizes Interest Rate Management Agreements, Applicant's annual long-term interest charges could change. The authorization of the Interest Rate Management Agreements consistent with the parameters herein in no way relieves Applicant of its responsibility to obtain the best terms available for the product selected and, therefore, it is

appropriate and reasonable for this Commission to authorize Applicant to agree to such terms and prices consistent with said parameters.

The authorization which Applicant requests herein to enter into Interest Rate Management Agreements is consistent with the authority granted by your Honorable Commission to Applicant most recently in Case No. 10-2630-EL-AIS.

B. General

1. Lender Assignments and Participations

A lender may desire to assign, or to sell participations in, Refinancing Instruments to other commercial banks, financial institutions or institutional investors. Such assignee would have the same rights, benefits and obligations under such Refinancing Instruments as the assigning lender.

2. Restrictive Covenants

In connection with the sale or entering into of any Refinancing Instruments, Applicant may agree to restrictive covenants which would prohibit it from, among other things: (i) creating or permitting to exist any liens on its property, with certain stated exceptions; (ii) creating indebtedness except as specified therein; (iii) failing to maintain a specified financial condition; (iv) entering into certain mergers, consolidations and dispositions of assets; (v) permitting certain events to occur in connection with pension plans; and (vi) terminating or replacing the Inter-Company Power Agreement among Applicant and the Sponsoring Companies or amending, modifying or waiving certain provisions thereof. In addition, Applicant may be required to prepay such Refinancing Instruments after certain specified events, including an ownership change.

3. Credit Enhancement

Applicant may provide certain of the Refinancing Instruments issued or entered into by Applicant to refund or amend the same, some form of credit enhancement such as a letter of credit, bond insurance, surety bond or other insurance ("Credit Enhancement") if deemed advisable. Applicant would use Credit Enhancement only if it would be anticipated to reduce Applicant's cost of financing.

* * *

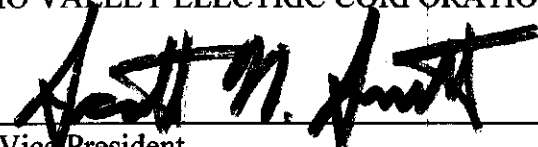
WHEREFORE: Applicant prays for authority from your Honorable Commission through May 31, 2012, (i) to Refinance any or all of the Senior Unsecured Notes, and to apply the proceeds thereof, all as proposed and described in this Application, (ii) to provide for any of the Refinancing Instruments to receive some form of Credit Enhancement, if deemed advisable by Applicant, and (iii) to enter into Interest Rate Management Agreements within the parameters proposed in this Application.

Applicant prays for all other and further relief necessary and appropriate in the premises.

Respectfully submitted this 28th day of April, 2011.

OHIO VALLEY ELECTRIC CORPORATION


By


Vice President

STATE OF OHIO)
) SS:
COUNTY OF FRANKLIN)

Before me, a Notary Public in and for Franklin County in the State of Ohio, personally appeared Scott Smith, Vice President of Ohio Valley Electric Corporation, Applicant in the foregoing application, and being duly sworn says that the facts and allegations herein contained are true to the best of his knowledge and belief.

Sworn to and subscribed to before me this 28th day of April, 2011.



Notary Public



David C. House, Attorney At Law
NOTARY PUBLIC - STATE OF OHIO
My commission has no expiration date
Sec. 147.03 R.C.

EXHIBIT A

Financial Statements of Applicant as of December 31, 2010

Ohio Valley Electric Corporation and Subsidiary Company

Consolidated Financial Statements
as of and for the Years Ended
December 31, 2010 and 2009, and
Independent Auditors' Report



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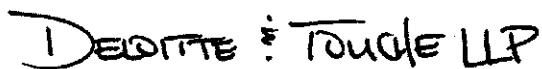
INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Ohio Valley Electric Corporation:

We have audited the accompanying consolidated balance sheets of Ohio Valley Electric Corporation and subsidiary company (the "Companies"), as of December 31, 2010 and 2009, and the related consolidated statements of income and retained earnings and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Companies' management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

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

DELOITTE & TOUCHE LLP

April 14, 2011

OHIO VALLEY ELECTRIC CORPORATION AND SUBSIDIARY COMPANY

CONSOLIDATED BALANCE SHEETS AS OF DECEMBER 31, 2010 AND 2009

	2010	2009
ASSETS		
ELECTRIC PLANT:		
At original cost	\$1,287,997,778	\$1,260,793,337
Less — accumulated provisions for depreciation	<u>990,504,164</u>	<u>949,382,858</u>
	297,493,614	311,410,479
Construction in progress	<u>1,011,794,145</u>	<u>967,123,450</u>
Total electric plant	<u>1,309,287,759</u>	<u>1,278,533,929</u>
CURRENT ASSETS:		
Cash and cash equivalents	22,004,436	14,709,175
Accounts receivable	44,418,458	42,441,385
Fuel in storage	62,837,327	81,102,751
Materials and supplies	22,952,901	21,984,752
Property taxes applicable to future years	2,502,000	2,364,600
Emission allowances	641,329	5,215,651
Regulatory assets	-	378,717
Deferred tax assets	7,141,504	10,372,692
Income taxes receivable	13,872,259	-
Prepaid expenses and other	<u>2,404,520</u>	<u>1,976,234</u>
Total current assets	<u>178,774,734</u>	<u>180,545,957</u>
REGULATORY ASSETS:		
Asset retirement costs	1,977,532	6,520,890
Unrecognized postemployment benefits	2,958,768	3,211,580
Deferred depreciation	-	10,149,660
Pension benefits	<u>23,754,843</u>	<u>7,831,705</u>
Total regulatory assets	<u>28,691,143</u>	<u>27,713,835</u>
DEFERRED CHARGES AND OTHER:		
Unamortized debt expense	11,385,593	12,108,055
Deferred tax assets	36,744,159	53,327,361
Long-term investments	87,355,165	82,432,063
Special deposits — restricted	-	13,513,206
Other	<u>240</u>	<u>39,135</u>
Total deferred charges and other	<u>135,485,157</u>	<u>161,419,820</u>
TOTAL	<u>\$1,652,238,793</u>	<u>\$1,648,213,541</u>

(Continued)

OHIO VALLEY ELECTRIC CORPORATION AND SUBSIDIARY COMPANY

CONSOLIDATED BALANCE SHEETS AS OF DECEMBER 31, 2010 AND 2009

	2010	2009
CAPITALIZATION AND LIABILITIES		
CAPITALIZATION:		
Common stock, \$100 par value — authorized, 300,000 shares; outstanding, 100,000 shares in 2010 and 2009	\$ 10,000,000	\$ 10,000,000
Long-term debt	1,132,256,484	1,272,222,726
Line of credit borrowings	105,000,000	-
Retained earnings	2,367,174	2,242,366
Total capitalization	<u>1,249,623,658</u>	<u>1,284,465,092</u>
CURRENT LIABILITIES:		
Current portion of long-term debt	139,966,242	37,642,056
Line of credit borrowings	-	65,000,000
Accounts payable	44,503,491	49,395,340
Deferred revenue — advances for construction	14,225,575	22,034,078
Accrued other taxes	8,512,570	7,063,321
Regulatory liabilities	2,802,249	2,630,963
Accrued interest and other	22,674,489	22,976,026
Total current liabilities	<u>232,684,616</u>	<u>206,741,784</u>
COMMITMENTS AND CONTINGENCIES (Note 13)		
REGULATORY LIABILITIES:		
Postretirement benefits	32,179,668	31,275,265
Decommissioning and demolition	289,004	-
Investment tax credits	3,393,146	3,393,146
Net antitrust settlement	1,823,929	1,823,929
Income taxes refundable to customers	43,207,303	48,593,284
Total regulatory liabilities	<u>80,893,050</u>	<u>85,085,624</u>
OTHER LIABILITIES:		
Pension liability	23,754,843	7,831,705
Asset retirement obligations	30,999,653	29,439,057
Postretirement benefits obligation	31,324,205	31,438,699
Postemployment benefits obligation	2,958,768	3,211,580
Total other liabilities	<u>89,037,469</u>	<u>71,921,041</u>
TOTAL	<u>\$1,652,238,793</u>	<u>\$1,648,213,541</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, 2010 AND 2009**

	2010	2009
OPERATING REVENUES — Sales of electric energy to:		
Department of Energy	\$ 11,207,298	\$ 11,450,964
Sponsoring Companies	<u>679,479,766</u>	<u>637,142,180</u>
Total operating revenues	<u>690,687,064</u>	<u>648,593,144</u>
OPERATING EXPENSES:		
Fuel and emission allowances consumed in operation	358,507,444	329,448,104
Purchased power	10,521,978	10,683,963
Other operation	80,169,542	80,118,637
Maintenance	86,912,195	84,292,246
Depreciation	71,471,136	68,039,793
Taxes — other than income taxes	10,431,363	9,877,156
Income taxes	<u>776,616</u>	<u>2,421,167</u>
Total operating expenses	<u>618,790,274</u>	<u>584,881,066</u>
OPERATING INCOME	71,896,790	63,712,078
OTHER INCOME	<u>3,238,229</u>	<u>7,207,538</u>
INCOME BEFORE INTEREST CHARGES	<u>75,135,019</u>	<u>70,919,616</u>
INTEREST CHARGES:		
Amortization of debt expense	2,638,699	1,021,186
Interest expense	<u>70,321,512</u>	<u>67,012,875</u>
Total interest charges	<u>72,960,211</u>	<u>68,034,061</u>
NET INCOME	2,174,808	2,885,555
RETAINED EARNINGS — Beginning of year	2,242,366	2,506,811
CASH DIVIDENDS ON COMMON STOCK	<u>(2,050,000)</u>	<u>(3,150,000)</u>
RETAINED EARNINGS — End of year	<u>\$ 2,367,174</u>	<u>\$ 2,242,366</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, 2010 AND 2009

	2010	2009
OPERATING ACTIVITIES:		
Net income	\$ 2,174,808	\$ 2,885,555
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation	71,471,136	68,039,793
Amortization of debt expense	2,638,699	1,021,186
Deferred taxes	14,428,409	(13,670,384)
(Gain)/Loss on marketable securities	380,940	(4,632,659)
Changes in assets and liabilities:		
Accounts receivable	(1,977,073)	(6,854,400)
Fuel in storage	18,265,424	(28,882,137)
Materials and supplies	(968,149)	(2,761,542)
Property taxes applicable to subsequent years	(137,400)	(16,200)
Emission allowances	4,574,322	(2,971,525)
Income taxes receivable	(13,872,259)	-
Prepaid expenses and other	(428,286)	(39,092)
Other regulatory assets	(10,748,251)	28,218,008
Other assets	(84,052)	(501,194)
Other noncurrent assets	38,895	-
Accounts payable	(15,718,789)	8,407,294
Deferred revenue	(7,808,503)	(4,635,925)
Accrued taxes	1,449,249	(2,759,465)
Accrued interest and other	(301,537)	2,138,541
Other liabilities	17,116,428	(34,269,010)
Other regulatory liabilities	1,364,693	15,020,303
Net cash provided by operating activities	<u>81,858,704</u>	<u>23,737,147</u>
INVESTING ACTIVITIES:		
Electric plant additions	(81,248,366)	(289,921,469)
Proceeds from sale of marketable securities	29,983,338	62,416,930
Purchases of marketable securities	(21,690,122)	(99,516,847)
Net cash used in investing activities	<u>(72,955,150)</u>	<u>(327,021,386)</u>
FINANCING ACTIVITIES:		
Issuance of Senior 2009 Bonds	-	200,000,000
Issuance of Senior 2009 Notes	-	100,000,000
Loan origination costs	(1,916,237)	(3,579,325)
Repayment of Senior 2006 Notes	(14,962,207)	(14,130,741)
Repayment of Senior 2007 Notes	(10,633,904)	(10,033,212)
Repayment of Senior 2008 Notes	(12,045,945)	(11,289,574)
Proceeds from line of credit	140,000,000	255,000,000
Payments on line of credit	(100,000,000)	(240,000,000)
Dividends on common stock	(2,050,000)	(3,150,000)
Net cash provided by (used in) financing activities	<u>(1,608,293)</u>	<u>272,817,148</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	<u>7,295,261</u>	<u>(30,467,091)</u>
CASH AND CASH EQUIVALENTS — Beginning of year	<u>14,709,175</u>	<u>45,176,266</u>
CASH AND CASH EQUIVALENTS — End of year	<u>\$ 22,004,436</u>	<u>\$ 14,709,175</u>
SUPPLEMENTAL DISCLOSURES:		
Interest paid	\$ 70,980,338	\$ 65,698,244
Income taxes paid (received) — net	\$ (774,024)	\$ 17,757,000
Non-cash electric plant additions included in accounts payable at December 31	\$ 15,634,788	\$ 4,807,848

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, 2010 AND 2009

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 March 13, 2026. The Sponsoring Companies recently agreed to an extension of the ICPA to June 30, 2040 (ICPA Extension), which is subject to federal and state regulatory approval. Approximately 30% of the Companies' employees are covered by a collective bargaining agreement that expires August 31, 2011.

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, under the direction of the DOE, for resale directly to the DOE. 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 March 13, 2026, the date of termination of the ICPA. The rate recovery terms of the ICPA Extension are the same as the terms of the current ICPA.

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

The Companies' regulatory assets, liabilities, and amounts authorized for recovery through Sponsor billings at December 31, 2010 and 2009, were as follows:

	2010	2009
Regulatory assets:		
Current assets:		
Deferred debt costs	\$ -	\$ 378,717
Total	-	378,717
Other assets:		
Asset retirement costs	1,977,532	6,520,890
Unrecognized postemployment benefits	2,958,768	3,211,580
Deferred depreciation	-	10,149,660
Pension benefits	23,754,843	7,831,705
Total	28,691,143	27,713,835
Total regulatory assets	<u>\$ 28,691,143</u>	<u>\$ 28,092,552</u>
Regulatory liabilities:		
Current liabilities:		
Deferred credit — EPA emission allowance proceeds	\$ 265,643	\$ -
Advance collection of interest	2,536,606	2,630,963
Total	2,802,249	2,630,963
Other liabilities:		
Postretirement benefits	32,179,668	31,275,265
Decommissioning and demolition	289,004	-
Investment tax credits	3,393,146	3,393,146
Net antitrust settlement	1,823,929	1,823,929
Income taxes refundable to customers	43,207,303	48,593,284
Total	80,893,050	85,085,624
Total regulatory liabilities	<u>\$ 83,695,299</u>	<u>\$ 87,716,587</u>

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

Regulatory Liabilities — The regulatory liabilities classified as current in the accompanying consolidated balance sheet as of December 31, 2010, consists primarily of interest expense collected from customers in advance of expense recognition. These amounts outstanding will be credited to customer bills during 2011. Other regulatory liabilities consist primarily of income taxes refundable to customers and postretirement benefits. Income taxes refundable to customers are credited to customer

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

In 2003, the DOE terminated the DOE Power Agreement with OVEC, entitling the Sponsoring Companies to 100% of OVEC's generating capacity under the terms of the ICPA. Under the terms of the DOE Power Agreement, OVEC was entitled to receive a "termination payment" from the DOE to recover unbilled costs upon termination of the agreement. The termination payment included unbilled postretirement benefit costs. In 2003, OVEC recorded a settlement payment of \$97 million for the DOE obligation related to postretirement benefit costs. The regulatory liability for postretirement benefits recorded at December 31, 2010 and December 31, 2009 represents amounts collected in historical billings in excess of the Generally Accepted Accounting Principles net periodic benefit costs, including the DOE termination payment.

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

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

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

Long-Term Investments — Long-term investments consist of marketable securities that are held for the purpose of funding postretirement benefits and decommissioning and demolition costs. These securities have been classified as trading securities in accordance with the provisions of Investments — Debt and Equity Securities accounting guidance. Trading securities reflected in Long-Term Investments are carried at fair value with the unrealized gain or loss, reported in Other Income. The cost of securities sold is based on the specific identification cost method. The fair value of most investment securities is determined by reference to currently available market prices. Where quoted market prices are not available, we use the market price of similar types of securities that are traded in the market to estimate fair value. See Fair Value Measurements in Note 11. Due to tax limitations, the amounts held in the postretirement benefits portfolio have not yet been transferred to the Voluntary Employee Beneficiary Association (VEBA) trusts (see Note 9). Long-term investments primarily consist of municipal bonds, money market mutual fund investments, and mutual funds. Net unrealized gains (losses) recognized during 2010 and 2009 on securities still held at the balance sheet date were (\$341,250) and \$4,632,659, respectively.

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

Money market mutual funds reflected in special deposits are carried at fair value with the related investment income, reported in Other Income. The cost of securities sold is based on the specific identification method. The fair value of money market mutual funds is determined by reference to currently available market prices. There were no material unrealized gains or losses recognized on this portfolio during 2010 or 2009.

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

OVEC utilizes its trustee's external pricing service in its estimate of the fair value of the underlying investments held in the benefit plan trusts and investment portfolios. The Companies' management reviews and validates the prices utilized by the trustee to determine fair value. Equities and fixed income securities are classified as Level 1 holdings if they are actively traded on exchanges. 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. At December 31, 2009, the Companies' only Level 3 investment was the John Hancock Group Annuity Contract held in the Pension Trust (Note 9). The fair value of the insurance contract was calculated based on estimated redemption value of the policy.

Unamortized Debt Expense — Unamortized debt expense relates to loan origination costs incurred to secure financing. These costs are being amortized using the effective yield method over the life of the related loans, except for approximately \$1.5 million of costs related to the 2010 line of credit facility that were billed to Sponsors and expensed upon renewal of the line of credit.

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

These asset retirement obligations are primarily related to obligations associated with future asbestos abatement at certain generating stations and certain plant closure costs. As of December 31, 2010 and 2009, the Companies had a regulatory asset of \$2.0 million and \$6.5 million, respectively, related to asset retirement obligations.

Balance — December 31, 2008	\$ 34,162,393
Accretion	2,049,744
Liabilities settled	(3,264,559)
Revision in cash flow estimates	<u>(3,508,521)</u>
Balance — December 31, 2009	29,439,057
Accretion	2,125,025
Liabilities settled	(564,429)
Revision in cash flow estimates	<u>-</u>
Balance — December 31, 2010	<u>\$ 30,999,653</u>

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

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

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

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

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

2. RELATED-PARTY TRANSACTIONS

Transactions with the Sponsoring Companies during 2010 and 2009 included the sale of all generated power to them, the purchase of Arranged Power from them and other utility systems in order to meet the Department of Energy's power requirements, contract barging services, railcar services, and minor transactions for services and materials. The Companies have Power Agreements with Louisville Gas and Electric Company, Duke Energy Ohio, Inc., The Dayton Power and Light Company, Kentucky Utilities Company, Ohio Edison Company, and American Electric Power Service Corporation as agent for the American Electric Power System Companies; and Transmission Service Agreements with Louisville Gas and Electric Company, Duke Energy Ohio, Inc., The Dayton Power and Light Company, The Toledo Edison Company, Ohio Edison Company, Kentucky Utilities Company, and American Electric Power Service Corporation as agent for the American Electric Power System Companies.

At December 31, 2010 and 2009, balances due from or to the Sponsoring Companies are as follows:

	2010	2009
Accounts receivable	<u>\$ 40,855,687</u>	<u>\$ 35,699,802</u>

American Electric Power Company, Inc. and subsidiary company owned 43.47% of the common stock of OVEC as of December 31, 2010. 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:

	2010	2009
General services	\$ 2,836,519	\$ 2,762,461
Specific projects	<u>3,192,761</u>	<u>11,973,067</u>
Total	<u>\$ 6,029,280</u>	<u>\$ 14,735,528</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 2011 through 2017. Pricing for coal under these contracts is subject to contract provisions and adjustments. The Companies currently have approximately 93% of their 2011 coal requirements under long-term agreements of one year or greater.

4. INVENTORIES

Inventories — At December 31, 2010 and 2009, consist of the following:

	2010	2009
Fuel in storage	\$ 62,837,327	\$ 81,102,751
Materials and supplies	22,952,901	21,984,752
Emission allowances	641,329	5,215,651
Total inventories	<u>\$ 86,431,557</u>	<u>\$ 108,303,154</u>

5. ELECTRIC PLANT

Electric plant at December 31, 2010 and 2009, consists of the following:

	2010	2009
Intangible	\$ 26,564	\$ 26,564
Steam production plant	1,202,331,620	1,174,766,135
Transmission plant	73,767,336	73,709,826
General plant	11,872,258	12,290,812
	1,287,997,778	1,260,793,337
Less accumulated depreciation	<u>990,504,164</u>	<u>949,382,858</u>
	297,493,614	311,410,479
Construction in progress	<u>1,011,794,145</u>	<u>967,123,450</u>
Total electric plant	<u>\$ 1,309,287,759</u>	<u>\$ 1,278,533,929</u>

6. BORROWING ARRANGEMENTS AND NOTES

OVEC has an unsecured bank revolving line of credit agreement with a borrowing limit of \$225 million as of December 31, 2010. The \$225 million line of credit was renewed in June 2010 and has an expiration date of June 18, 2013. At December 31, 2010 and 2009, OVEC had borrowed \$105 million and \$65 million, respectively, under this line of credit. Interest expense related to line of credit borrowings was \$2,011,926 in 2010 and \$1,138,063 in 2009. During 2010 and 2009, OVEC incurred annual commitment fees of \$451,351 and \$220,622, respectively, based on the borrowing limits of the line of credit.

7. LONG-TERM DEBT

The following amounts were outstanding at December 31, 2010 and 2009:

	Interest Rate	2010	2009
Senior 2006 Notes due February 15, 2026	5.80 %	\$ 383,920,928	\$ 398,883,135
Senior 2007 Notes:			
Tranche A due February 15, 2026	5.90	176,976,681	184,039,494
Tranche B due February 15, 2026	5.90	44,570,011	46,349,039
Tranche C due February 15, 2026	5.90	44,924,312	46,716,375
Senior 2008 Notes:			
Tranche A due February 15, 2026	5.92	45,274,425	47,078,351
Tranche B due February 15, 2026	6.71	137,172,957	142,330,117
Tranche C due February 15, 2026	6.71	139,383,412	144,468,271
Series 2009 Notes and Bonds:			
2009A due February 15, 2013	2.05	100,000,000	100,000,000
2009A due February 1, 2026	0.31	25,000,000	25,000,000
2009B due February 1, 2026	0.32	25,000,000	25,000,000
2009C due February 1, 2026	0.32	25,000,000	25,000,000
2009D due February 1, 2026	0.32	25,000,000	25,000,000
2009E due October 1, 2019	5.63	100,000,000	100,000,000
Total debt		1,272,222,726	1,309,864,782
Current portion of long-term debt		139,966,242	37,642,056
Total long-term debt		<u>\$1,132,256,484</u>	<u>\$1,272,222,726</u>

During 2009, OVEC issued \$100 million variable rate unsecured senior notes (2009A Notes) in private placement, a series of four variable rate tax exempt pollution control bonds (2009A, B, C, and D Bonds), and fixed rate tax exempt pollution control bonds (2009E Bonds). The 2009A, B, C, and D Bonds, in the amount of \$25 million each, were issued in August 2009. In October 2009, the non-amortizing 2009E Bonds were issued in the amount of \$100 million. The 2009A Notes and 2009A, B, C, and D Bonds are non-amortizing issues and pay interest at variable rates. The rates listed above reflect the interest rate in effect at December 31, 2010.

The 2009 Series A, B, C and D tax exempt pollution control bonds are secured by an irrevocable transferable direct-pay letter of credit, expiring August 12, 2013, issued for the benefit of the owners of the bonds. The interest rate on the bonds are adjusted weekly, and bondholders may require repurchase of the bonds at the time of such interest rate adjustments. OVEC has entered into an agreement to provide for the remarketing of the bonds if such repurchase is required.

All of the OVEC amortizing senior notes have maturities scheduled for February 15, 2026. The \$100 million non-amortizing senior note will mature on February 15, 2013, with the principal amount due on that date. The tax exempt variable rate pollution control bonds all mature on February 1, 2026, with the aggregate \$100 million principal amount due on that date. The tax exempt fixed rate pollution control bonds mature on October 1, 2019, with an amount of \$100 million principal due on that date. The annual maturities of long-term debt as of December 31, 2010, are as follows:

2011	\$ 39,966,242
2012	42,434,535
2013	145,055,904
2014	47,839,885
2015	50,796,613
2016-2026	<u>946,129,547</u>
Total	<u>\$ 1,272,222,726</u>

In December 2010, OVEC established a borrowing facility under which OVEC expects, in 2011, to undertake a \$100 million offering of variable rate bonds due February 1, 2040. No related borrowings have been recorded in the accompanying financial statements.

8. INCOME TAXES

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

	2010	2009
Income tax expense at 35% statutory rate	\$ 1,032,999	\$ 1,857,353
State income taxes net of federal benefit	(106,060)	817,024
Temporary differences flowed through to customer bills	(225,190)	(267,941)
Permanent differences and other	<u>74,867</u>	<u>14,731</u>
Income tax provision	<u>\$ 776,616</u>	<u>\$ 2,421,167</u>
Effective tax rate	<u>26.3 %</u>	<u>45.6 %</u>

Components of the income tax provision were as follows:

	2010	2009
Current income tax expense	\$ (13,471,404)	\$ 15,678,705
Deferred income tax expense	<u>14,248,020</u>	<u>(13,257,538)</u>
Total income tax provision	<u>\$ 776,616</u>	<u>\$ 2,421,167</u>

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

To the extent that the Companies have not reflected credits in customer billings for deferred tax assets, they have recorded a regulatory liability representing income taxes refundable to customers under the applicable agreements among the parties. The liability was \$43,207,303 at December 31, 2010, and \$48,593,284 at December 31, 2009.

Deferred income tax assets (liabilities) consisted of the following at December 31, 2010 and 2009:

	2010	2009
Deferred tax assets:		
Deferred revenue — advances for construction	\$ 5,054,015	\$ 7,888,820
AMT credit carryforwards	983,893	-
Postretirement benefit obligation	11,358,448	15,914,071
Pension liability	8,439,542	2,803,971
Postemployment benefit obligation	1,051,181	1,149,836
Asset retirement obligations	11,213,983	10,648,464
Miscellaneous accruals	2,696,520	2,784,832
Regulatory liability — postretirement benefits	11,432,686	11,197,425
Regulatory liability — investment tax credits	1,205,506	1,214,842
Regulatory liability — net antitrust settlement	648,000	653,018
Regulatory liability — income taxes refundable to customers	<u>17,025,284</u>	<u>17,660,365</u>
Total deferred tax assets	<u>71,109,058</u>	<u>71,915,644</u>
Deferred tax liabilities:		
Prepaid expenses	(594,319)	(613,978)
Electric plant	(14,586,719)	(1,204,691)
Unrealized gain/loss on marketable securities	(1,751,211)	-
Regulatory asset — pension benefits	(8,439,542)	(2,803,971)
Regulatory asset — unrecognized postemployment benefits	(1,051,181)	(1,149,836)
Regulatory asset — asset retirement costs	<u>(800,423)</u>	<u>(2,443,115)</u>
Total deferred tax liabilities	<u>(27,223,395)</u>	<u>(8,215,591)</u>
Deferred income tax assets (liabilities)	<u>\$ 43,885,663</u>	<u>\$ 63,700,053</u>
Current deferred income taxes	\$ 7,141,504	\$ 10,372,692
Non-current deferred income taxes	36,744,159	53,327,361

The accounting guidance for *Income Taxes* addresses the determination of whether the tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under this guidance, the Companies may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate settlement. The Companies have not identified any uncertain tax positions as of December 31, 2010 and 2009, and accordingly, no liabilities for uncertain tax positions have been recognized.

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

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

During 2010, the passage of the PPAC Act resulted in a reduction of the postemployment benefits deferred tax asset of approximately \$4.6 million and a reduction to the related regulatory liability (income taxes refundable to customers) of approximately \$4.6 million.

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 2006 and earlier. The Companies are no longer subject to state of Indiana tax examinations for tax years 2006 and earlier. The Companies are no longer subject to Ohio and the Commonwealth of Kentucky examinations for tax years 2005 and earlier.

9. PENSION PLAN, OTHER POSTRETIREMENT AND POSTEMPLOYMENT BENEFITS

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

Funding for the Pension Plan is based on actuarially determined contributions, the maximum of which is generally the amount deductible for income tax purposes and the minimum being that required by the Employee Retirement Income Security Act of 1974 (ERISA), as amended. The full cost of the pension benefits and related obligations has been allocated to OVEC and IKEC in the accompanying consolidated financial statements. The allocated amounts represent approximately a 55% and 45% split for OVEC and IKEC, respectively, as of December 31, 2010 and 2009. The Pension Plan's assets as of December 31, 2010 consist of investments in equity and debt securities. As of December 31, 2009, the assets included an insurance contract which was treated as a debt security because its long-term yield was tied to the debt markets. This contract was discontinued on December 27, 2010 and approximately 29% of the Pension Plan's Projected Benefit Obligation (PBO) was settled. The impact of the settlement was a reduction of the PBO by \$60,789,221, resulting from the purchase of an annuity used to settle the obligations to certain retirees. Additionally, a settlement expense of \$7,896,655 was incurred by the Plan to recognize previously unrecognized actuarial losses.

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

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

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

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

Investment strategies include:

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

The target asset allocation for each portfolio is as follows:

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

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

Equity investment limitations:

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

Fixed Income Limitations — As of December 31, 2010, the Pension Plan fixed income allocation consists of managed accounts comprised of U.S. Government, corporate and municipal obligations. Prior to December 27, 2010, the fixed income allocation was a Guaranteed Annuity Contract issued by the John Hancock Life Insurance Company. The VEBA benefit plans' fixed income allocation is comprised of a variety of fixed income managed accounts 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, 2010 and 2009:

	Pension Plan		Other Postretirement Benefits	
	2010	2009	2010	2009
Change in projected benefit obligation:				
Projected benefit obligation — beginning of year	\$ 182,464,568	\$ 168,926,587	\$ 113,332,841	\$ 104,956,170
Service cost	4,881,471	4,309,555	3,792,611	3,135,170
Interest cost	10,516,131	10,215,241	6,749,106	6,030,604
Plan participants' contributions	-	-	752,175	670,264
Benefits paid	(8,633,587)	(8,385,160)	(4,415,967)	(4,166,111)
Net actuarial (gain) loss	22,453,315	7,453,646	3,447,584	2,214,103
Medicare subsidy	-	-	22,002	492,641
Settlement	(60,789,221)	-	-	-
Expenses paid from assets	(93,090)	(55,301)	-	-
Projected benefit obligation — end of year	<u>150,799,587</u>	<u>182,464,568</u>	<u>123,680,352</u>	<u>113,332,841</u>
Change in fair value of plan assets:				
Fair value of plan assets — beginning of year	174,632,863	141,665,077	81,894,142	62,427,019
Actual return on plan assets	15,602,779	35,708,247	9,362,005	18,567,123
Expenses paid from assets	(93,090)	(55,301)	-	-
Employer contributions	6,325,000	5,700,000	4,741,790	3,903,206
Plan participants' contributions	-	-	752,175	670,264
Medicare subsidy	-	-	22,002	492,641
Settlement	(60,789,221)	-	-	-
Benefits paid	<u>(8,633,587)</u>	<u>(8,385,160)</u>	<u>(4,415,967)</u>	<u>(4,166,111)</u>
Fair value of plan assets — end of year	<u>127,044,744</u>	<u>174,632,863</u>	<u>92,356,147</u>	<u>81,894,142</u>
Funded (underfunded) status — end of year	<u>(23,754,843)</u>	<u>(7,831,705)</u>	<u>(31,324,205)</u>	<u>(31,438,699)</u>

On December 8, 2003, the President of the United States of America signed into law the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act). The Act introduced a prescription drug benefit to retirees as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a prescription drug benefit that is actuarially equivalent to the benefit provided by Medicare. The Companies believe that the coverage for prescription drugs is at least actuarially

equivalent to the benefits provided by Medicare for most current retirees because the benefits for that group substantially exceed the benefits provided by Medicare, thereby allowing the Companies to qualify for the subsidy. The Companies' employer contributions for Other Postretirement Benefits in the above table are net of subsidies received of \$22,002 and \$492,641 for 2010 and 2009, respectively. The Companies have accounted for the subsidy as a reduction of the benefit obligation detailed in the above table. The benefit obligation was reduced by approximately \$13.6 million and \$13.0 million as of December 31, 2010 and 2009, respectively. Refer to the Income Taxes footnote (Note 8) for changes in the tax law surrounding the new health care bill.

The accumulated benefit obligation for the Pension Plan was \$121,427,105 and \$156,891,866 at December 31, 2010 and 2009, respectively.

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

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

	Pension Plan		Other Postretirement Benefits	
	2010	2009	2010	2009
Service cost	\$ 4,881,471	\$ 4,309,555	\$ 3,792,611	\$ 3,135,170
Interest cost	10,516,131	10,215,241	6,749,106	6,030,604
Expected return on plan assets	(10,382,188)	(8,374,411)	(4,702,519)	(3,585,115)
Amortization of prior service cost	190,437	329,437	(379,000)	(379,000)
Recognized actuarial loss	-	1,318,607	(248,323)	(94,810)
Net periodic benefit cost	5,205,851	7,798,429	5,211,875	5,106,849
Settlement expense	7,896,655	-	-	-
Total benefit cost	<u>\$ 13,102,506</u>	<u>\$ 7,798,429</u>	<u>\$ 5,211,875</u>	<u>\$ 5,106,849</u>
Pension and Other Postretirement Benefits expense recognized in the consolidated statement of income and retained earnings and billed to Sponsoring Companies under the ICPA	<u>\$ 6,325,000</u>	<u>\$ 5,700,000</u>	<u>\$ 4,915,000</u>	<u>\$ 3,260,000</u>

The following table presents the classification of Pension Plan assets within the fair value hierarchy at December 31, 2010 and 2009:

	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)
2010			
Domestic equity	\$ 18,415,260	\$ -	\$ -
International and global equity	19,491,321	-	-
Cash and cash equivalents	12,702,017	-	-
U.S. Treasury Security	-	76,436,146	-
2009			
Domestic equity	41,331,372	-	-
International and global equity	8,366,973	-	-
Cash and cash equivalents	863,051	-	-
Group Annuity Contract — John Hancock	-	-	123,998,162

The following table provides a reconciliation of beginning and ending balances of Pension Trust assets measured at fair value on a recurring basis where the determination of fair value includes significant unobservable inputs (Level 3) for the year ended December 31, 2010:

Pension Trust

Balance at January 1, 2010	\$ 123,998,162
Return on plan assets	6,138,339
Purchases, sales, issuances, and settlements (net)	<u>(130,136,501)</u>
Balance at December 31, 2010	<u>\$ -</u>

The following table provides a reconciliation of beginning and ending balances of Pension Trust assets measured at fair value on a recurring basis where the determination of fair value includes significant unobservable inputs (Level 3) for the year ended December 31, 2009:

Pension Trust

Balance at January 1, 2009	\$ 125,621,344
Return on plan assets	7,660,865
Purchases, sales, issuances, and settlements (net)	<u>(9,284,047)</u>
Balance at December 31, 2009	<u>\$ 123,998,162</u>

The following table presents the classification of VEBA assets within the fair value hierarchy at December 31, 2010 and 2009:

	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)
2010			
Domestic equity	\$ 20,332,914	\$ -	\$ -
International and global equity	19,281,036	-	-
Fixed income mutual funds	50,194,485	-	-
Cash and cash equivalents	2,547,712	-	-
2009			
Domestic equity	34,393,753	-	-
International and global equity	10,136,800	-	-
Fixed income mutual funds	33,902,168	-	-
Cash and cash equivalents	3,338,776	-	-

Pension Plan and Other Postretirement Benefit Assumptions — Actuarial assumptions used to determine benefit obligations at December 31, 2010 and 2009, were as follows:

	Pension Plan		Other Postretirement Benefits	
	2010	2009	2010	2009
Discount rate	5.50 %	5.90 %	5.50 %	6.00 %
Rate of compensation increase	4.00	4.00	4.00	4.00

Actuarial assumptions used to determine net periodic benefit cost for the years ended December 31, 2010 and 2009, were as follows:

	Pension Plan		Other Postretirement Benefits	
	2010	2009	2010	2009
Discount rate	5.90 %	6.10 %	6.00 %	5.90 %
Expected long-term return on plan assets	6.00	6.00	5.60	5.60
Rate of compensation increase	4.00	4.00	4.00	4.00

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

Assumed health care cost trend rates at December 31, 2010 and 2009, were as follows:

	2010	2009
Health care trend rate assumed for next year — participants under 65	9.00 %	9.50 %
Health care trend rate assumed for next year — participants over 65	9.00	9.50
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate) — participants under 65	5.00	5.00
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate) — participants over 65	5.00	5.00
Year that the rate reaches the ultimate trend rate	2019	2015

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

	One-Percentage Point Increase	One-Percentage Point Decrease
Effect on total service and interest cost	\$ 1,935,565	\$ (1,501,391)
Effect on postretirement benefit obligation	19,057,686	(15,202,623)

Pension Plan and Other Postretirement Benefit Assets — The asset allocation for the Pension Plan and VEBA trusts at December 31, 2010 and 2009, by asset category was as follows:

	Pension Plan		VEBA Trusts	
	2010	2009	2010	2009
Asset category:				
Equity securities	30 %	29 %	43 %	40 %
Debt securities	70	71	57	60

Pension Plan and Other Postretirement Benefit Contributions — The Companies expect to contribute \$6,100,000 to their Pension Plan and \$5,090,559 to their Other Postretirement Benefits plan in 2011.

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

Years Ending December 31	Pension Plan	Other Postretirement Benefits	
		With Medicare Subsidy	Without Medicare Subsidy
2011	\$ 3,293,775	\$ 4,645,559	\$ 4,952,117
2012	3,794,204	5,023,493	5,363,439
2013	4,381,501	5,344,945	5,720,330
2014	5,094,439	5,803,185	6,209,954
2015	5,885,388	6,211,014	6,656,951
Five years thereafter	44,235,819	41,477,242	42,479,868

Postemployment Benefits — The Companies follow the accounting guidance in Compensation — Non-Retirement Postemployment Benefits and accrue the estimated cost of benefits provided to former or inactive employees after employment but before retirement. Such benefits include, but are not limited to, salary continuations, supplemental unemployment, severance, disability (including workers' compensation), job training, counseling, and continuation of benefits, such as health care and life insurance coverage. The cost of such benefits and related obligations has been allocated to OVEC and IKEC in the accompanying consolidated financial statements. The allocated amounts represent approximately a 52% and 48% split between OVEC and IKEC, respectively, as of December 31, 2010, and approximately a 34% and 66% split between OVEC and IKEC, respectively, as of December 31, 2009. 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 \$2,958,768 and \$3,211,580 at December 31, 2010 and 2009, respectively.

Defined Contribution Plan — The Companies have a trustee-defined contribution supplemental pension and savings plan that includes 401(k) features and is available to employees who have met eligibility requirements. The Companies' contributions to the savings plan equal 100% of the first 1% and 50% of the next 5% of employee-participants' contributions based upon total compensation. Benefits to participating employees are based solely upon amounts contributed to the participants' accounts and investment earnings. By its nature, the plan is fully funded at all times. The employer contributions for 2010 and 2009 were \$1,744,254 and \$1,712,262, respectively.

10. ENVIRONMENTAL MATTERS

Title IV of the 1990 Clean Air Act Amendments (CAAA) required the Companies to reduce sulfur dioxide (SO₂) emissions in two phases: Phase I in 1995 and Phase II in 2000. The Companies selected a fuel switching strategy to comply with the emission reduction requirements. The Companies also purchased additional SO₂ allowances. The cost of these purchased allowances has been inventoried and included on an average cost basis in the cost of fuel consumed when used. The cost of unused allowances at December 31, 2010 and 2009, was \$641,329 and \$5,215,651, respectively.

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

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

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

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

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

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

In March 2009, the Boards of Directors also authorized a delay in the tie-in of the FGD systems of all five generating units at the Kyger Creek plant pending an investigation into the structural integrity of the internal components of two newly constructed jet bubbling reactors (JBRs), which are major components of the FGD system. Extensive studies were conducted relating to this design issue, which affected the FGD construction projects at both the Kyger Creek and Clifty Creek plants, and as a result, the Boards of Directors authorized a complete redesign and replacement of the JBR internal components to resolve this structural integrity issue.

In December 2010, the Boards of Directors authorized the completion of the FGD construction projects at the Kyger Creek and Clifty Creek plants with the redesign and replacement of the JBR internal components. The Kyger Creek plant FGD system is expected to be fully operational by the end of the second quarter of 2012 and the Clifty Creek plant FGD system is expected to be fully operational by the end of the second quarter of 2013.

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

The total cost to complete the new Kyger Creek and Clifty Creek FGD systems and the associated landfills is currently estimated not to exceed \$1.35 billion, including the amounts expended to date and included in construction in progress in the accompanying balance sheets.

On November 6, 2009, the Companies received a Section 114 Information Request from the U.S. EPA. The stated purpose of the information request was for the U.S. EPA to obtain the necessary information to determine if the Kyger Creek and Clifty Creek plants have been operating in compliance with the Federal Clean Air Act. Attorneys for the Companies subsequently contacted the U.S. EPA and established a schedule for submission of the requested information. Based on this schedule, all requested information was submitted to the U.S. EPA by March 8, 2010. As of this date, OVEC has not had any further contact with U.S. EPA related to this issue.

11. FAIR VALUE MEASUREMENTS

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

As of December 31, 2010 and 2009, the Companies held certain assets that are required to be measured at fair value on a recurring basis. These consist of investments recorded within special deposits and long-term investments. The investments consist of money market mutual funds, 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.

Special Deposits and Long-Term Investments — Assets measured at fair value on a recurring basis at December 31, 2010 and 2009, 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)
2010			
Equity mutual funds	\$ 18,550,343	\$ -	\$ -
Fixed income municipal securities	-	66,827,187	-
Money market mutual funds	915,376	-	-
2009			
Marketable securities	-	82,432,063	-
Money market mutual funds	13,511,206	-	-

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

The fair values and recorded values of the senior notes, fixed and variable rate bonds as of December 31, 2010 and 2009, are as follows:

	2010		2009	
	Fair Value	Recorded Value	Fair Value	Recorded Value
Senior 2006 Notes	\$ 399,815,254	\$ 383,920,928	\$ 417,418,759	\$ 398,883,135
Senior 2007 Notes	280,247,003	266,471,004	291,985,441	277,104,908
Senior 2008 Notes	361,514,174	321,830,794	368,508,300	333,876,739
Senior 2009A Notes	100,100,000	100,000,000	98,560,000	100,000,000
2009A Bonds	25,000,000	25,000,000	25,000,000	25,000,000
2009B Bonds	25,000,000	25,000,000	25,000,000	25,000,000
2009C Bonds	25,000,000	25,000,000	25,000,000	25,000,000
2009D Bonds	25,000,000	25,000,000	25,000,000	25,000,000
2009E Bonds	102,650,000	100,000,000	102,000,000	100,000,000
Total	<u>\$ 1,344,326,431</u>	<u>\$ 1,272,222,726</u>	<u>\$ 1,378,472,500</u>	<u>\$ 1,309,864,782</u>

12. LEASES

OVEC has entered into operating leases to secure railcars for the transportation of coal in connection with the fuel switching modifications at the OVEC and the IKEC generating stations. OVEC has railcar lease agreements that extend to as long as December 31, 2025, with options to exit the leases under certain conditions. The amount in property under capital leases is \$76,931 with accumulated depreciation of \$26,036 and \$8,614 as of December 31, 2010 and 2009, respectively. OVEC also has various other operating leases with other property and equipment.

Future minimum lease payments for capital and operating leases at December 31, 2010, are as follows:

Years Ending December 31	Operating	Capital
2011	\$ 3,416,666	\$ 19,600
2012	3,304,201	18,638
2013	3,227,215	11,813
2014	3,265,308	3,441
2015	3,093,654	-
Thereafter	<u>19,034,274</u>	<u>-</u>
Total future minimum lease payments	<u>\$35,341,318</u>	53,492
Less estimated interest element		<u>(2,540)</u>
Estimated present value of future minimum lease payments		<u>\$ 50,952</u>

The annual operating lease cost incurred was \$4,785,133 and \$4,749,821 for 2010 and 2009, respectively, and the annual capital lease cost incurred was \$19,600 and \$9,335 for 2010 and 2009, respectively.

13. COMMITMENTS AND CONTINGENCIES

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

* * * * *

EXHIBIT B

Senior Unsecured Notes as of March 31, 2011

Ohio Valley Electric Corporation

Senior Unsecured Notes

As of 3/31/11

Series Name	Interest Rate	Maturity Date	Original Issue	
			Amount	3/31/11 Balance
Senior Unsecured Notes - Series 2006-A	5.80%	2/15/2026	\$ 445,000,000	\$ 376,112,846
Senior Unsecured Notes - Series 2007-A,B,C	5.90%	2/15/2026	\$ 300,000,000	\$ 266,471,004
Senior Unsecured Notes - Series 2008-A	5.92%	2/15/2026	\$ 50,000,000	\$ 45,274,425
Senior Unsecured Notes - Series 2008-B	6.71%	2/15/2026	\$ 150,000,000	\$ 137,172,957
Senior Unsecured Notes - Series 2008-C	6.71%	2/15/2026	\$ 150,000,000	\$ 139,383,412
			\$ 1,095,000,000	\$ 964,414,644