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BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

PUCO

In the Matter of Application of Duke)
Energy Ohio, Inc. for Authority to Establish)
a Standard Service Offer Pursuant to R.C.) Case No. 14-841-EL-SSO
4928.143, in the Form of an Electric)
Security Plan, Accounting Modifications,)
and Tariffs for Generation Service.)

In the Matter of Application of Duke) Case No. 14-842-EL-ATA
Energy Ohio, Inc. for Authority to Amend)
its Certified Supplier Tariff, P.U.C.O. No.)
20.

DIRECT TESTIMONY OF TIM HAMILTON

PUBLIC VERSION

On behalf of Interstate Gas Supply, Inc.

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1 **I. INTRODUCTION AND PURPOSE OF TESTIMONY**

2 **Q. Please introduce yourself.**

3 A. My name is Tim Hamilton and I am employed by Interstate Gas Supply, Inc d/b/a
4 IGS Energy ("IGS"). I am the Power Supply Director, responsible for IGS
5 Energy's power supply and risk. My business address is 6100 Emerald Parkway,
6 Dublin, Ohio 43016.

7 **Q. Please describe your educational background and work history.**

8 A. I graduated from the Pennsylvania State University in 1990 with a B.S. in
9 Business Logistics. Prior to working at IGS, I was Director at Enron Energy
10 Services, and I held the position of Manager of Retail Operations at American
11 Electric Power. Immediately preceding my current role, I was Senior Vice
12 President with Accent Energy, which was acquired by IGS in 2011. In my role at
13 Accent Energy and in my current role as Power Supply Director, I have managed
14 the electricity procurement, scheduling, pricing, settlements and risk
15 management functions, which includes profit and loss responsibilities. As part of
16 my responsibilities, I have managed a team of schedulers and traders for
17 servicing nearly 300,000 electricity customers in Ohio, Maryland, Illinois,
18 Pennsylvania, New York and Texas.

19 **Q. What is the nature of IGS's business?**

20 A. IGS Energy has over 25 years' experience serving customers in Ohio's
21 competitive markets. IGS Energy serves over 1 million customers nationwide
22 and sells natural gas and electricity to customers in 11 states and in over 40

1 utility service territories. In Ohio, IGS currently serves electric customers in the
2 AEP, Duke Energy Ohio, FirstEnergy and the Dayton Power & Light service
3 territories. The IGS family of companies (which include IGS Generation, IGS
4 Home Services and IGS CNG Services) also provides customers focused energy
5 solutions that complement IGS Energy's core commodity business including
6 distributed generation, demand response, CNG refueling, back-up generation
7 and utility line protection.

8 **Q. Have you testified previously?**

9 A. Yes, I submitted testimony in Case Nos. 13-2385-EL-SSO, *et al.* regarding Ohio
10 Power Company's application for approval of an electric security plan.

11 **Q. What is the purpose of your testimony?**

12 The purpose of my testimony is to recommend that the Commission reject Duke
13 Energy Ohio's ("Duke") proposal for a Price Stabilization Rider ("PSR") for the
14 following reasons:

- 15 • It would insulates Duke and its shareholders from the risk of the
16 competitive market associated with Duke's investment in the Ohio Valley
17 Electric Corporation ("OVEC"). Ohio law requires that the utility shall be
18 fully on its own in the competitive market;
- 19 • It would provide a subsidy from distribution customers to support Duke's
20 interest in a competitive service;

- 1 • It would require the Commission to regulate wholesale energy and
- 2 capacity prices, which are in the exclusive jurisdiction of the Federal
- 3 Energy Regulatory Commission ("FERC")
- 4 • According to Duke, the Commission would have no authority to regulate
- 5 the costs that OVEC charges to Duke or Duke's obligation to pay such
- 6 charges;
- 7 • Duke's internal projections of the impact of the PSR on customers are
- 8 flawed.
- 9 • It would be more prudent and reasonable for Duke to transfer its interest
- 10 in OVEC to an affiliate or a third party. As OVEC's Chief Financial Officer
- 11 testified, the sponsoring companies are powerless to stop Duke from
- 12 transferring its interest to an affiliate or third party so long as it has a
- 13 sufficient credit rating.
- 14

15 **VII. The Unlawful Purchased Power Rider (the PSR)**

16 **Q. Could you explain Duke's relationship with OVEC?**

17 A. Duke has a 9% stock ownership interest in OVEC, which consists of two
18 generating units, Kyger Creek and Clifty Creek.¹ The contract that controls
19 Duke's ownership interest and obligations as a "sponsoring company" in OVEC is
20 the Inter-Company Power Agreement or "ICPA."² The ICPA in effect is a

¹ Ex. TH-1 at 1 (containing the 2013 OVEC Annual Report).

² See Amended and Restated Inter-Company Power Agreement and Amended and Restated OVEC-IKEC Power Agreement, FERC Docket Nos. ER11-3181-000, et al. (Mar. 23, 2011) (approved on May 23, 2011) (hereinafter "ICPA").

1 purchased power agreement with OVEC. Under the ICPA, Duke is required to
2 pay OVEC a traditional cost-based rate (including a return on and return of
3 investment).³ Thus, regardless of the amount of power that Duke takes from
4 OVEC, Duke is required to pay the embedded cost of the OVEC units. Because
5 Duke is one of the owners of OVEC, its payment of a cost-based rate ensures
6 that its investment is protected.

7 **Q. Could you explain Duke's PSR proposal?**

8 A. Duke has proposed to sell the energy and capacity from OVEC into PJM
9 Interconnection, LLC's ("PJM") wholesale capacity and energy markets.⁴ But, if
10 the wholesale market revenues that Duke receives are less than the cost-based
11 rate that Duke must pay to OVEC under the ICPA, then Duke would collect the
12 difference from its distribution customers through the PSR.⁵ Conversely, if the
13 wholesale revenues are greater than the cost-based rate that Duke must pay to
14 OVEC, then Duke would provide a credit to its distribution customers through the
15 PSR. Under either of these scenarios, Duke is made whole for the amount of
16 money it is required to pay OVEC. Accordingly, Duke's request for approval of
17 the PSR is effectively a request that the Commission approve a different level of
18 compensation than what Duke will receive from the wholesale energy and
19 capacity markets.

20 **Q. Do you believe the Commission should approve the PSR?**

³ Ex. TH-1 at 8 (containing the 2013 OVEC Annual Report); See Direct Testimony of Don Wathen at 13.

⁴ Direct Testimony of Don Wathen at 16.

⁵ *Id.*

1 A. No. For several reasons, I do not recommend that the Commission approve the
2 PSR. While Duke claims that the purpose of the PSR is to hedge against market
3 volatility, the actual function of the PSR is to insulate Duke from the risk of the
4 market and ensure that it achieves adequate compensation to protect its
5 investment in OVEC. Duke's proposal is also inconsistent with the Commission's
6 directive that Duke divest its generating assets. As part of Duke's last ESP
7 proceeding, Duke agreed in a stipulation approved by the Commission to divest
8 all of its electric generation assets, stating, "[t]he Parties agree that Duke Energy
9 Ohio will transfer title, at net book value, to all of its Generation Assets out of
10 Duke Energy Ohio."⁶ This divestiture is consistent with Ohio's transition to
11 competitive retail electric markets. Allowing Duke to maintain its ownership
12 interest in OVEC and to continue its associated purchased power agreement
13 would essentially require all customers to pay for the cost of Duke's generation,
14 including a guaranteed rate of return. Duke's generation should be required to
15 stand on its own, just like all other generation in the market. Further, allowing
16 certain generating units (Duke's) to receive guaranteed recovery of costs from all
17 Duke customers would harm all other generators that do not get guaranteed cost
18 recovery.

19 **Q. Do you believe that the PSR would provide an unlawful subsidy of**
20 **generation service?**

⁶ See *In the matter of the application, motion for protective order and memorandum in support of Duke Energy Ohio for authority to establish a Standard Service Offer pursuant to Section 4928.143, Revised Code, in the form of an Electric Security Plan, Accounting Modifications and Tariffs for Generation Service, Stipulation and Recommendation* at 25-26 (Oct. 24, 2011).

1 A. Yes, I do. R.C. 4928.02(H) states that it is the state policy to "[e]nsure effective
2 competition in the provision of retail electric service by avoiding anticompetitive
3 subsidies flowing from a noncompetitive retail electric service to a competitive
4 retail electric service or to a product or service other than retail electric service,
5 and vice versa, including by prohibiting the recovery of any generation-related
6 costs through distribution or transmission rates." On advice of counsel,
7 generation service is a competitive service under Ohio law. R.C. 4928.03. If
8 OVEC is uneconomic, the PSR would require Duke's distribution customers to
9 subsidize Duke's out-of-market interest in OVEC and its associated purchased
10 power agreement for wholesale generation service. Conversely, if the PSR
11 were a credit, the PSR would require a competitive service to subsidize
12 distribution customers—on advice of counsel, either of the above scenarios
13 would run afoul of the law.

14 **Q. Do you believe Mr. Wathen's claim that the PSR is not a subsidy?**

15 A. No. I do not. Mr. Wathen claims that the PSR is not a subsidy "because Duke
16 Energy Ohio will have no generation business of its own. As such, there cannot
17 be any subsidy between its non-competitive electric business and its generation
18 business."⁷ Initially, Duke is incorrect that it would no longer own generation
19 assets under its proposal. Duke is a 9% owner of OVEC.⁸ Thus, the PSR would
20 provide a subsidy to make Duke whole for its out-of-market investment in
21 generation resources.

22 **Q. Are there any other reasons the Commission should not approve the PSR?**

⁷ Direct Testimony of Don Wathen at 15.

⁸ Ex. TH-1 at 1.

1 A. Yes. The Commission should not approve the PSR because it would require the
2 Commission to regulate the wholesale price of capacity and energy, which, on
3 advice of counsel, are within the exclusive jurisdiction of the Federal Energy
4 Regulatory Commission ("FERC"). The Third Circuit and Fourth Circuit U.S.
5 Court of Appeals recently determined that states lack authority to authorize
6 "contracts for differences" which provide supplemental compensation in addition
7 to the amounts a generation resource can obtain from participating in PJM
8 interconnection, LLC's ("PJM") wholesale markets. Specifically, the Third Circuit
9 held that a contract for differences is preempted because it "supplements what
10 the generators receive from PJM with an additional payment financed by
11 payments from electric distribution companies Because electricity
12 distribution companies do not participate in PJM's capacity auction, and because
13 PJM still pays generators the auction clearing price [the contract for differences]
14 artfully steps around the capacity transactions facilitated by PJM." *PPL Energy*
15 *Plus v. Soloman*, p. 28 Case No. 13-4330 (3rd Cir.) (Sep. 11, 2014). The Court
16 further stated that "[I]f FERC has jurisdiction over a subject, the States cannot
17 have jurisdiction over the same subject." *Id.* (quoting *Miss. Power & Light Co. v*
18 *Miss. ex rel. Moore*, 487 U.S. 354, 377 (1988) (Scalia, J., concurring)).

19 **Q. Does Duke agree that the Commission is preempted from regulating**
20 **transactions with OVEC?**

21 A. Yes, in part. While Duke claims that the Commission should approve the PSR,
22 Duke provided deposition testimony regarding the Commission's jurisdiction in
23 the event that the Commission approves the PSR. Specifically, Duke's Vice

1 President of Midwest Generation, Charles Whitlock, indicated that once the PSR
2 is approved, "I don't think the PUCO has any say in what Duke Energy Ohio pays
3 to OVEC."⁹ Thus, it is Duke's position that the Commission lacks any authority
4 over the amounts that Duke will pay to OVEC under the ICPA. Thus, for
5 example, if OVEC were to imprudently invest \$5 billion in environmental controls,
6 the Commission would be powerless to stop Duke from paying OVEC under the
7 terms of the ICPA. If the Commission were to disallow costs OVEC charged to
8 Duke, the loss would merely be recorded at the distribution utility level, without
9 recourse to OVEC. Mr. Whitlock stated "think I was pretty clear in the first
10 answer. The hypothetical to me, \$5 billion, the terms of the ICPA are spelled out
11 in the ICPA. We have an obligation to pay though money because we are a
12 signator of the ICPA. If the ICPA can be amended and changed as you go
13 through time, we are going to pay that money."¹⁰

14 **Q. Do you believe that the PSR is necessary for the OVEC units to continue to**
15 **operate?**

16 **A.** No. Duke's Witness Wathen claims that OVEC represents "actual steel in the
17 ground" and that "the continued access to the benefit of the reliable power
18 available from the OVEC generating assets is positive for Ohio."¹¹ However,
19 Duke cannot unilaterally determine the fate of OVEC. On the advice of counsel
20 and based upon my review of the ICPA, and OVEC's and Duke's public

⁹ Ex. TH-2, Transcript of Deposition of Charles Whitlock at 135-136.

¹⁰ *Id.* at 139; *see also id.* at 136-138,

¹¹ Direct Testimony of Don Wathen at 15.

1 representations, no single party can decide OVEC's fate.¹² Duke witness
2 Wathen agreed in his deposition:

3 Q: you agree this proceeding will have no impact on whether or not

4 OVEC continues to run

5 A: That's correct."¹³

6 Moreover, several other sponsoring companies operate in regulated
7 jurisdictions that guarantee cost recovery.¹⁴ Because Duke cannot dictate
8 OVEC's fate, whether or not the Commission approves or rejects the PSR will
9 have no bearing on OVEC's existence. Further, Witness Wathen does not take
10 into account the dollars that will be lost in Ohio due to Ohio ratepayers assuming
11 the cost and risk of OVEC.

12 **Q. Do you believe that the PSR presents good value for customers?**

13 A. No, I do not. During discovery, Duke provided a spreadsheet which allegedly
14 provides a forecasted cost vs. revenue (cash flow analysis) for the OVEC units
15 during a defined time frame.¹⁵ Duke developed the projection internally using
16 what it calls the "Commercial Business Model" The main inputs in Duke's
17 analysis are as follows:

- 18 • Generation output;

¹² Ex. TH-3, Transcript of Deposition of Don Wathen at 136 (objection omitted).

¹³ *Id.*

¹⁴ TH-1 at numbered page 1 (Containing a list of sponsoring companies, several of which operate in jurisdictions that guarantee cost recovery of generation resources).

¹⁵ See Ex. TH-4 (containing Duke's response to IGS POD-01-003-Highly Conf Attach).

- Capacity prices;
- Unforced capacity, which is the amount of derated capacity that may clear in a base residual auction;
- Wholesale energy prices;
- Production costs (marginal cost).

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

Q. What are the flaws in Duke's economic projections for OVEC?

A. There are many flaws in Duke's economic projections for OVEC which cause [REDACTED] as I further explain.

Duke made several errors in its analysis. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

¹⁶ Mr. Dougherty's deposition transcript was not completed at the time I prepared this testimony.

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[REDACTED]

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Q. Are there any other problems with Duke's projections regarding capacity revenue generated for OVEC?

A. Yes. The Clifty Creek and Kyger Creek plants do not participate in the base residual auction as typical capacity resources. In fact, to my knowledge neither is located in PJM. Charles Whitlock confirmed this in his deposition.²⁰ Clifty Creek is located in Indiana in territory that is traditionally referred to as part of the Midcontinent ISO. And while Kyger Creek is located in Ohio, it is not considered a PJM plant. Both resources clear, for energy purposes at the OVEC node,

¹⁷ Ex. TH-5 (containing Duke's response to OCC INT-9-169).
¹⁸ Ex. TH-6, Transcript of Deposition of John Brodt at 135-136.
¹⁹ *Id.*
²⁰ Ex. TH-2, Transcript of Deposition of Charles Whitlock at 121-123; 149-151 (Mr. Whitlock discussed Clifty Creek, but his answers are applicable to both plants).

1 which is an external interface. Because these resources are in fact considered
2 external resources, there is a risk that, at some point, they may not be permitted
3 to participate in the base residual auction (or PJM energy markets) and receive
4 capacity compensation.²¹ The removal of this revenue stream would negatively
5 impact the cash flow of these plants, because MISO, the most likely alternative
6 market, does not have a comparable capacity market and generally lower energy
7 prices.²²

8 **Q. Do you believe that the PSR would provide a hedge to cost increases in the**
9 **future?**

10 **A.** No, I do not. Duke witness Wathen claims that when market prices are low, the
11 PSR will be a charge, but when market prices are high, the PSR will be a credit.
12 As Mr. Wathen indicated in his deposition, his claim is based upon the
13 assumption that OVEC's cost of production will remain constant as market prices
14 increase.²³ During discovery, Duke provided a spreadsheet which allegedly
15 provides a forecasted cash flow vs. cost analysis for the OVEC units during a
16 defined time frame. [REDACTED]

17 [REDACTED]

18 [REDACTED]

19 [REDACTED]

20 [REDACTED]

²¹ *Id.*

²² *Id.*

²³ Ex. TH-3, Transcript of Deposition of Don Wathen at 136.

²⁴ See Ex. TH-4 (containing Duke's response to IGS POD-01-003-Highly Conf Attach).

1 [REDACTED]
2 [REDACTED]
3 [REDACTED]
4 [REDACTED]
5 [REDACTED]
6 [REDACTED]
7 [REDACTED]
8 [REDACTED]

9 **Q. Are there any other problems with Duke's analysis?**

10 **A. Yes.** [REDACTED]
11 [REDACTED]
12 [REDACTED]
13 [REDACTED]
14 [REDACTED] Moreover, the EPAs proposed carbon emissions
15 regulations for existing coal power plants are intended to limit the amount of
16 carbon emissions that power plants may produce. Emissions are generally
17 correlated to output. Thus, it is possible that the EPA's carbon regulations will
18 decrease the output from coal power plants relative to existing levels [REDACTED]
19 [REDACTED]
20 [REDACTED]

²⁵ See Ex. TH-7 (containing Duke's response to IGS INT-1-11).

²⁶ See Ex. TH-7.

²⁷ Ex. TH-4.

1 [REDACTED]
2 [REDACTED]
3 [REDACTED]
4 [REDACTED]
5 [REDACTED]
6 [REDACTED]
7 [REDACTED]

8 **Q. Are there any other reasons why the PSR does not represent a good**
9 **deal for customers?**

10 **A. Yes, Duke** [REDACTED]
11 [REDACTED]
12 [REDACTED]
13 [REDACTED]
14 [REDACTED]
15 [REDACTED]
16 [REDACTED]
17 [REDACTED]
18 [REDACTED]
19 [REDACTED]
20 [REDACTED]

21 **Q. Can you summarize the flaws in Duke's analysis?**

²⁸ Ex. TH-8.

²⁹ Ex. TH-9.

1 A. Yes, it appears that Duke's analysis contains the following flaws:

2 [REDACTED]
3 [REDACTED]
4 [REDACTED]
5 [REDACTED]
6 [REDACTED]
7 [REDACTED]
8 [REDACTED]

- 9 • It does not consider that, as an external resource, there is a risk that OVEC
10 will not be able to continue to participate in PJM energy markets under the
11 same terms.

12 **Q. Should the Commission guarantee Duke's recovery of OVEC-related**
13 **investment that was made after Ohio restructured in electricity market?**

14 A. No. Duke entered into the ICPA with OVEC in 1953 to serve the energy needs of
15 the DOE's uranium enrichment facility in Portsmouth, Ohio. The DOE, however,
16 terminated its agreement to take energy from OVEC in 2000 (effective 2003). At
17 that point in time, the OVEC units had been in operation for nearly 50 years and
18 were likely completely depreciated and the Ohio General Assembly had passed
19 Senate Bill 3 eliminating economic regulation of generation service.³⁰ While
20 having full knowledge that the DOE would no longer purchase power from OVEC
21 and that Ohio law no longer guaranteed cost recovery of generation resources,

³⁰ Ex. TH-1 at numbered page 1. See ICPA.

1 Duke and the remaining sponsoring companies retrofitted these half-century old
2 coal plants with expensive environmental controls.³¹ Duke should bear the
3 economic risk of its decisions.

4 **Q. What should the Commission direct Duke to do with its OVEC entitlement?**

5 A. Ohio law and policy favors competition and requires electric distribution utilities to
6 structurally separate their generation assets. The PSR contravenes state policy
7 and mimics the type of regulatory framework that the General Assembly left
8 behind when it passed Senate Bill 3. From a policy perspective, Duke should not
9 retain its OVEC purchased power entitlement. Thus, the Commission should
10 direct Duke to explore all possible options to transfer the OVEC purchased power
11 entitlement to an affiliate or third party.

12 **Q. Is there any reason why Duke cannot transfer its interest in OVEC to an**
13 **affiliate or third party?**

14 No. On advice of counsel and testimony from the chief financial officer of OVEC,
15 John Brodt, there are two paths that Duke could pursue to transfer its interest in
16 OVEC that do not require approval of the other companies that participate in the
17 OVEC joint venture. First, Duke could transfer its rights to an affiliate that "has a
18 Standard & Poor's credit rating of at least BBB and a Moody's Investors Service,
19 Inc. credit rating of at least Baa3." See ICPA at 1.0115 and 9.182. Second,
20 Duke could seek to transfer its interest to a third party. According to the ICPA
21 Duke would be required offer the other companies that participate in the OVEC

³¹ TH-1 at numbered pages 2, 27-30; see TH-2.

1 joint venture a right of first refusal to purchase Duke's OVEC interests. But if the
2 other participating companies decline to purchase Duke's interest, Duke could
3 transfer the asset to a third party. See ICPA at 9.183. OVEC's Chief Financial
4 Officer confirmed that this is his understanding in his deposition:

5 Q. And is it your understanding when a transfer occurs through a right of
6 first refusal, if the transferee that's identified has a sufficient credit rating,
7 you do not need the approval of the other sponsoring companies?

8 A. That's correct.

9 Q. So let me ask you a hypothetical. Assuming Duke Energy Ohio brought
10 a proposal to the board -- or, to the other sponsoring companies that it
11 wanted to transfer its interest in OVEC to a third party and that third party
12 had a sufficient credit rating, no other party could stop Duke from
13 transferring its interest.

14 A. That's correct.³²

15 Under either of these options, the other sponsoring companies would be
16 powerless to stop Duke from transferring its ownership interest in OVEC to either
17 an affiliate or third party.

18 **Q. If the Commission approves the PSR, should it be limited to recovery of**
19 **just OVEC costs?**

³² Ex. TH-6, Transcript of Deposition of John Brodt at 63-64.

1 A. Yes. If the Commission approves Duke's proposed PSR it should be limited to
2 just OVEC costs. Authorizing Duke to recover costs other than OVEC costs
3 through the PPA would be beyond the scope of the proceeding.

4 **Q. If the Commission approves Duke's proposed PSR, should it be**
5 **bypassable?**

6 A. Yes, if the Commission authorizes Duke to recover costs through the PSR of
7 generation owned by Duke, then those charges or credits should be bypassable
8 and apply to SSO customers only and only for the term of the ESP. As
9 previously discussed, generation service is competitive under Ohio law. CRES
10 suppliers are already obligated to provide their customers with generation
11 service, and thus CRES customers would receive no benefit from Duke's electric
12 generation and should not have to pay for such generation. Moreover, approving
13 non-bypassable cost recovery for generation-related service would send a signal
14 to competitive suppliers that the regulatory landscape in Ohio is not conducive to
15 competition or investment.

16 **Q. Does this conclude your testimony?**

17 A. Yes it does.

18

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing *Direct Testimony of Tim Hamilton on Behalf of Interstate Gas Supply, Inc.* was served upon the following parties of record this 26th day of September 2014, via electronic transmission, hand-delivery or first class mail, U.S. postage prepaid.

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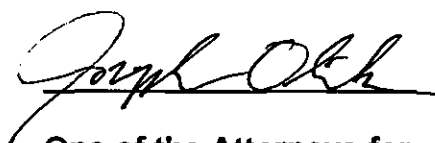
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A handwritten signature in black ink, appearing to read "Joseph O'Leary", written over a horizontal line.

**One of the Attorneys for
Interstate Gas Supply, Inc.**

ANNUAL REPORT — 2013

OHIO VALLEY ELECTRIC CORPORATION

and subsidiary

INDIANA-KENTUCKY ELECTRIC CORPORATION

Ohio Valley Electric Corporation

GENERAL OFFICES, 3932 U.S. Route 23, Piketon, Ohio 45661

Ohio Valley Electric Corporation (OVEC) and its wholly owned subsidiary, Indiana-Kentucky Electric Corporation (IKEC), collectively, the Companies, were organized on October 1, 1952. The Companies were formed by investor-owned utilities furnishing electric service in the Ohio River Valley area and their parent holding companies for the purpose of providing the large electric power requirements projected for the uranium enrichment facilities then under construction by the Atomic Energy Commission (AEC) near Portsmouth, Ohio.

OVEC, AEC and OVEC's owners or their utility-company affiliates (called Sponsoring Companies) entered into power agreements to ensure the availability of the AEC's substantial power requirements. On October 15, 1952, OVEC and AEC executed a 25-year agreement, which was later extended through December 31, 2005 (DOE Power Agreement). On September 29, 2000, the DOE gave OVEC notice of cancellation of the DOE Power Agreement. On April 30, 2003, the DOE Power Agreement terminated in accordance with the notice of cancellation.

OVEC and the Sponsoring Companies signed an Inter-Company Power Agreement (ICPA) on July 10, 1953, to support the DOE Power Agreement and provide for excess energy sales to the Sponsoring Companies of power not utilized by the DOE or its predecessors. Since the termination of the DOE Power Agreement on April 30, 2003, OVEC's entire generating capacity has been available to the Sponsoring Companies under the terms of the ICPA. The Sponsoring Companies and OVEC entered into an Amended and Restated ICPA, effective as of August 11, 2011, which extends its term to June 30, 2040.

OVEC's Kyger Creek Plant at Cheshire, Ohio, and IKEC's Clifty Creek Plant at Madison, Indiana, have nameplate generating capacities of 1,086,300 and 1,303,560 kilowatts, respectively. These two generating stations, both of which began operation in 1955, are connected by a network of 705 circuit miles of 345,000-volt transmission lines. These lines also interconnect with the major power transmission networks of several of the utilities serving the area.

The current Shareholders and their respective percentages of equity in OVEC are:

Allegheny Energy, Inc. ¹	3.50
American Electric Power Company, Inc.*	39.17
Buckeye Power Generating, LLC ²	18.00
The Dayton Power and Light Company ³	4.90
Duke Energy Ohio, Inc. ⁴	9.00
Kentucky Utilities Company ⁵	2.50
Louisville Gas and Electric Company ⁵	5.63
Ohio Edison Company ¹	0.85
Ohio Power Company** ⁶	4.30
Peninsula Generation Cooperative ⁷	6.65
Southern Indiana Gas and Electric Company ⁸	1.50
The Toledo Edison Company ¹	<u>4.00</u>
	<u>100.00</u>

These investor-owned utilities comprise the Sponsoring Companies and currently share the OVEC power participation benefits and requirements in the following percentages:

Allegheny Energy Supply Company LLC ¹	3.01
Appalachian Power Company ⁶	15.69
Buckeye Power Generating, LLC ²	18.00
The Dayton Power and Light Company ³	4.90
Duke Energy Ohio, Inc. ⁴	9.00
FirstEnergy Solutions Corp. ¹	4.85
Indiana Michigan Power Company ⁶	7.85
Kentucky Utilities Company ⁵	2.50
Louisville Gas and Electric Company ⁵	5.63
Monongahela Power Company ¹	0.49
Ohio Power Company ⁶	19.93
Peninsula Generation Cooperative ⁷	6.65
Southern Indiana Gas and Electric Company ⁸	<u>1.50</u>
	<u>100.00</u>

Some of the Common Stock issued in the name of:

- *American Gas & Electric Company
- **Columbus and Southern Ohio Electric Company

Subsidiary or affiliate of:

- ¹FirstEnergy Corp.
- ²Buckeye Power, Inc.
- ³The AES Corporation
- ⁴Duke Energy Corporation
- ⁵PPL Corporation
- ⁶American Electric Power Company, Inc.
- ⁷Wolverine Power Supply Cooperative, Inc.
- ⁸Vectren Corporation

OHIO VALLEY ELECTRIC CORPORATION AND SUBSIDIARY COMPANY

A Message from the President

Ohio Valley Electric Corporation and its subsidiary, Indiana-Kentucky Electric Corporation, have begun a new journey competing in a volatile power market equipped with new environmental controls and new human performance improvement tools to adapt to a challenging future. We are partnering with our employees to ensure a zero harm workplace, address our challenges, operate our facilities efficiently and be the provider of choice for our owners.

SAFETY

OVEC and IKEC are committed to providing a safe and healthy place to work for all employees. In 2013, the Companies continued making progress on their transition to a culture that leads with safety. Safety training on human performance improvement tools was initiated in 2012 and continued in 2013. Strong leadership and the involvement of all employees and our contractors will help ensure that we achieve and sustain the desired goal of zero harm.

FLUE GAS DESULFURIZATION (FGD) PROJECTS AND FUTURE ENVIRONMENTAL COMPLIANCE OBLIGATIONS

The two FGD scrubbers at Kyger Creek were successfully placed into service in November 2011 and February 2012. The two Clifty Creek plant FGD systems were successfully placed into service in March 2013 and May 2013. All four scrubbers continue to meet our environmental performance expectations. The pollution control systems installed at both plants are also expected to meet emission limitations under the Mercury and Air Toxics Standards (MATS) beginning in April 2015 as well as future requirements under the Cross-State Air Pollution Rule (CSAPR), which was recently upheld by the U.S. Supreme Court.

ENERGY SALES

OVEC's use factor — the ratio of power scheduled by the Sponsoring Companies to power available — for the combined on- and off-peak periods averaged 75.1 percent in 2013 compared with 69.4 percent in 2012. The on-peak use factor averaged 89.0 percent in 2013 compared with

82.9 percent in 2012. The off-peak use factor averaged 57.4 percent in 2013 and 52.4 percent in 2012.

In 2013, OVEC delivered 10.3 million MWh to the Sponsoring Companies, which is the same amount delivered in 2012.

POWER COSTS

In 2013, OVEC's average power cost to the Sponsoring Companies was \$65.183 per MWh compared with \$62.862 per MWh in 2012. The total Sponsoring Company power costs were \$672 million in 2013 compared with \$650 million in 2012. The lack of energy sales in 2013 continued to account for the majority of the increased cost per MWh in 2013. Mild weather, low energy market prices and competitive natural gas generation were all contributing factors for lower-than-average energy sales in 2013.

2014 ENERGY SALES OUTLOOK

In 2014, the demand for energy improved significantly due to below average temperatures during the first quarter of 2014 and the increase in the cost of natural gas generation. OVEC projects that higher natural gas prices will have a significant impact on the Sponsors scheduling more of OVEC's power in 2014. As a result, OVEC anticipates the combined use factor for 2014 will be approximately 90 percent, which will result in increased energy sales estimated at 12 million MWh and average power costs less than \$55 per MWh.

COST CONTROL INITIATIVES

In 2013, OVEC continued its engagement of employees in a continuous improvement initiative to control costs, improve operating performance and explore opportunities to enhance the value of the OVEC investment. These lean activities, developed and implemented by OVEC employees, are producing process improvements and sustainable savings that translate into meaningful improvements. The continuous improvement team efforts are changing the culture of our Company,

impacting our decision making and leading the way toward how we plan to do business in the future.

ENTERPRISE ASSET MANAGEMENT SYSTEM

The OVEC Enterprise Asset Management (EAM) System was placed into service on August 12, 2013, after a team of OVEC employees spent over one year at the vendor's location developing and installing the system. The use of an EAM System allows the integration of core functionality within OVEC, including work management, labor entry, inventory management, purchasing and contracts management, project management and various accounting functions. Some of the benefits of the system include a transition from reactive maintenance to proactive maintenance, better data for informed decision making and standardized work practices and processes.

OVEC FERC ORDER 1000 COMPLIANCE

The Federal Energy Regulatory Commission (FERC) Order 1000 issued in July 2011 requires transmission providers, including OVEC, to participate in regional and interregional transmission planning. Because OVEC is not a member of a Regional Transmission Organization that provides such planning to its members, OVEC partnered with LG&E/KU to join the Southeast Regional Transmission Planning (SERTP) group. The SERTP had been formed in 2007 by a group of utilities led by Southern Company. Working with this group, OVEC was able to submit a compliance filing to the FERC for the regional planning portion of Order 1000 in February 2013. On July 18, 2013, FERC issued a ruling on this filing accepting in part and rejecting in part certain provisions of the regional filing. Among the terms rejected were the Cost Allocation Methodology based on avoided construction costs and addressing Public Policy Requirements. On January 14, 2014, OVEC and its SERTP partners filed revisions to correct the issues identified by FERC. A ruling on this filing is expected later this summer. A ruling on the interregional filing made last July is also expected this summer.

DOE ARRANGEMENTS WITH OVEC

In 2013, OVEC purchased 230,042 MWh of power and energy from other electricity suppliers for delivery and use by the Department of Energy (DOE) for its Portsmouth facility. At the request of the DOE, OVEC makes these limited purchases of

power and energy under the terms and conditions of an Arranged Power Agreement with the DOE.

As ordered by the FERC, the North American Electric Reliability Corporation (NERC) registered OVEC as the load-serving entity for the DOE load at the Portsmouth facility. OVEC is working with Sponsor representatives to mitigate any impacts, other than additional NERC compliance obligations, that could result from this additional NERC registration. Discussions continue with the DOE on assuming responsibility for the remaining high-voltage substation at the facility. OVEC continues to explore other options for providing power and energy to the DOE.

ENVIRONMENTAL COMPLIANCE

OVEC and IKEC have a strong commitment to maintain compliance with all applicable federal, state and local environmental rules and regulations. During 2013, the Kyger Creek and Clifty Creek plants operated in compliance with their respective air emission limits. The Companies received no enforcement actions or fines from any of the environmental agencies responsible for overseeing the status of our environmental compliance activities. In addition, we have begun marketing the gypsum generated from our new scrubber operations as an agricultural soil amendment and are preparing to meet boiler tuning and optimization obligations under MATS.

BOARD OF DIRECTORS AND OFFICERS CHANGES

In August 2013, Philip R. Herrington, president, competitive generation of AES U.S. Strategic Business Unit, was elected to serve as a director of OVEC following the resignation of Dennis A. Lantzy. Mr. Lantzy had served on the OVEC board since 2012. In June 2014, William S. Doty, executive vice president – utility operations of Vectren Corporation, resigned as a director of OVEC and IKEC.

In January 2014, David E. Jones retired as vice president-operations of OVEC and IKEC. He had served as vice president-operations of both Companies since 1990.



Nicholas K. Akins
President

June 30, 2014

OHIO VALLEY ELECTRIC CORPORATION AND SUBSIDIARY COMPANY

CONSOLIDATED BALANCE SHEETS AS OF DECEMBER 31, 2013 AND 2012

	2013	2012
ASSETS		
ELECTRIC PLANT:		
At original cost	\$ 2,671,807,219	\$ 1,985,645,118
Less — accumulated provisions for depreciation	<u>1,182,491,224</u>	<u>1,115,363,691</u>
	1,489,315,995	870,281,427
Construction in progress	<u>30,583,795</u>	<u>645,484,896</u>
Total electric plant	<u>1,519,899,790</u>	<u>1,515,766,323</u>
CURRENT ASSETS:		
Cash and cash equivalents	70,757,710	19,924,318
Accounts receivable	35,332,653	36,952,825
Fuel in storage	43,020,394	79,550,095
Materials and supplies	32,564,435	27,464,418
Property taxes applicable to future years	2,702,905	2,503,440
Emission allowances	62,428	86,649
Deferred tax assets	9,980,768	18,302,793
Income taxes receivable	3,331,536	15,832,666
Regulatory assets	371,297	8,277,357
Prepaid expenses and other	<u>2,244,413</u>	<u>2,168,143</u>
Total current assets	<u>200,368,539</u>	<u>211,062,704</u>
REGULATORY ASSETS:		
Unrecognized postemployment benefits	2,078,864	2,498,759
Pension benefits	8,542,293	30,561,325
Postretirement benefits	<u>-</u>	<u>1,324,775</u>
Total regulatory assets	<u>10,621,157</u>	<u>34,384,859</u>
DEFERRED CHARGES AND OTHER:		
Unamortized debt expense	13,401,209	14,485,787
Deferred tax assets	19,432,479	22,265,884
Long-term investments	117,106,668	120,351,712
Special deposits — restricted	-	57,938,752
Other	<u>488,407</u>	<u>103,107</u>
Total deferred charges and other	<u>150,428,763</u>	<u>215,145,242</u>
TOTAL	<u>\$ 1,881,318,249</u>	<u>\$ 1,976,359,128</u>

(Continued)

OHIO VALLEY ELECTRIC CORPORATION AND SUBSIDIARY COMPANY

CONSOLIDATED BALANCE SHEETS AS OF DECEMBER 31, 2013 AND 2012

	2013	2012
CAPITALIZATION AND LIABILITIES		
CAPITALIZATION:		
Common stock, \$100 par value — authorized, 300,000 shares; outstanding, 100,000 shares in 2013 and 2012	\$ 10,000,000	\$ 10,000,000
Long-term debt	1,267,873,554	1,358,347,337
Line of credit borrowings	30,000,000	60,000,000
Retained earnings	6,478,234	5,293,968
Total capitalization	1,314,351,788	1,433,641,305
CURRENT LIABILITIES:		
Current portion of long-term debt	290,496,381	238,138,903
Accounts payable	50,131,367	53,916,997
Accrued other taxes	9,062,813	8,651,108
Regulatory liabilities	27,406,208	21,975,974
Accrued interest and other	28,145,464	25,822,574
Total current liabilities	405,242,233	348,505,556
COMMITMENTS AND CONTINGENCIES (Notes 3, 11, 12)		
REGULATORY LIABILITIES:		
Postretirement benefits	32,619,457	-
Decommissioning and demolition	19,140,730	14,230,459
Investment tax credits	3,393,146	3,393,146
Net antitrust settlement	1,823,929	1,823,929
Income taxes refundable to customers	28,380,282	38,645,647
Total regulatory liabilities	85,357,544	58,093,181
OTHER LIABILITIES:		
Pension liability	8,542,293	30,561,325
Asset retirement obligations	22,230,109	20,961,379
Postretirement benefits obligation	42,173,401	82,097,623
Postemployment benefits obligation	2,078,864	2,498,759
Other non-current liabilities	1,342,017	-
Total other liabilities	76,366,684	136,119,086
TOTAL	\$1,881,318,249	\$1,976,359,128

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, 2013 AND 2012**

	2013	2012
OPERATING REVENUES — Sales of electric energy to:		
Department of Energy	\$ 9,281,567	\$ 9,097,306
Sponsoring Companies	<u>666,367,706</u>	<u>661,721,951</u>
Total operating revenues	<u>675,649,273</u>	<u>670,819,257</u>
OPERATING EXPENSES:		
Fuel and emission allowances consumed in operation	311,899,995	302,925,697
Purchased power	8,763,157	8,552,565
Other operation	98,197,470	101,967,242
Maintenance	83,396,811	89,645,354
Depreciation	80,172,750	85,140,820
Taxes — other than income taxes	11,421,154	10,765,327
Income taxes	<u>890,377</u>	<u>893,533</u>
Total operating expenses	<u>594,741,714</u>	<u>599,890,538</u>
OPERATING INCOME	80,907,559	70,928,719
OTHER INCOME	<u>530,109</u>	<u>10,920,111</u>
INCOME BEFORE INTEREST CHARGES	<u>81,437,668</u>	<u>81,848,830</u>
INTEREST CHARGES:		
Amortization of debt expense	5,166,736	4,606,617
Interest expense	<u>74,086,666</u>	<u>74,985,523</u>
Total interest charges	<u>79,253,402</u>	<u>79,592,140</u>
NET INCOME	2,184,266	2,256,690
RETAINED EARNINGS — Beginning of year	5,293,968	4,037,278
CASH DIVIDENDS ON COMMON STOCK	<u>(1,000,000)</u>	<u>(1,000,000)</u>
RETAINED EARNINGS — End of year	<u>\$ 6,478,234</u>	<u>\$ 5,293,968</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, 2013 AND 2012

	2013	2012
OPERATING ACTIVITIES:		
Net income	\$ 2,184,266	\$ 2,256,690
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation	80,172,750	85,140,820
Amortization of debt expense	5,166,736	4,606,617
Deferred taxes/refundable taxes	890,065	2,908,239
(Gain) on marketable securities	4,331,444	(6,345,075)
Changes in assets and liabilities:		
Accounts receivable	1,620,172	3,948,625
Fuel in storage	36,529,701	(7,853,097)
Materials and supplies	(5,100,017)	341,497
Property taxes applicable to future years	(199,465)	18,480
Emission allowances	24,221	(58,130)
Income taxes receivable	12,501,130	(14,391,215)
Prepaid expenses and other	(76,270)	(260,491)
Other regulatory assets	46,467,540	11,638,471
Other assets	-	-
Other noncurrent assets	(385,300)	119,375
Accounts payable	(829,201)	2,571,729
Deferred revenue — advances for construction	-	(11,694,904)
Accrued taxes	411,706	(160,864)
Accrued interest and other	2,322,890	2,912,675
Other liabilities	(59,752,402)	(13,943,822)
Other regulatory liabilities	28,162,184	5,248,035
Net cash provided by operating activities	<u>154,442,150</u>	<u>67,003,655</u>
INVESTING ACTIVITIES:		
Electric plant additions	(87,262,647)	(203,169,352)
Proceeds from sale of LT investments	97,023,136	20,342,154
Purchases of long-term investments	<u>(40,170,784)</u>	<u>(86,110,337)</u>
Net cash used in investing activities	<u>(30,410,295)</u>	<u>(268,937,535)</u>
FINANCING ACTIVITIES:		
Issuance of Senior 2012 Bonds	-	299,403,938
Issuance of Senior 2010 Bonds	-	-
Loan origination cost	(4,059,559)	(5,377,779)
Repayment of Senior 2006 Notes	(15,602,389)	(14,730,774)
Repayment of Senior 2007 Notes	(11,017,149)	(10,392,343)
Repayment of Senior 2008 Notes	(11,519,366)	(10,797,067)
Proceeds from line of credit	10,000,000	160,000,000
Payments on line of credit	(40,000,000)	(200,000,000)
Dividends on common stock	<u>(1,000,000)</u>	<u>(1,000,000)</u>
Net cash provided by financing activities	<u>(73,198,463)</u>	<u>217,105,975</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	50,833,392	15,172,095
CASH AND CASH EQUIVALENTS — Beginning of year	<u>19,924,318</u>	<u>4,752,223</u>
CASH AND CASH EQUIVALENTS — End of year	\$ <u>70,757,710</u>	\$ <u>19,924,318</u>
SUPPLEMENTAL DISCLOSURES:		
Interest paid	\$ <u>74,902,175</u>	\$ <u>74,160,307</u>
Income taxes paid (received) — net	\$ <u>(12,501,572)</u>	\$ <u>12,504,500</u>
Non-cash electric plant additions included in accounts payable at December 31	\$ <u>5,697,686</u>	\$ <u>8,654,116</u>

See notes to consolidated financial statements.

OHIO VALLEY ELECTRIC CORPORATION AND SUBSIDIARY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012

1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

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

Organization — The Companies own two generating stations located in Ohio and Indiana with a combined electric production capability of approximately 2,256 megawatts. OVEC is owned by several investor-owned utilities or utility holding companies and two affiliates of generation and transmission rural electric cooperatives. These entities or their affiliates comprise the Sponsoring Companies. The Sponsoring Companies purchase power from OVEC according to the terms of the Inter-Company Power Agreement (ICPA), which has a current termination date of June 30, 2040. Approximately 27% of the Companies' employees are covered by a collective bargaining agreement that expires August 31, 2014.

Prior to 2004, OVEC's primary commercial customer was the U.S. Department of Energy (DOE). The contract to provide OVEC-generated power to the DOE was terminated in 2003 and all obligations were settled at that time. Currently, OVEC has an agreement to arrange for the purchase of power (Arranged Power), under the direction of the DOE, for resale directly to the DOE. All purchase costs are billable by OVEC to the DOE.

Rate Regulation — The proceeds from the sale of power to the Sponsoring Companies are designed to be sufficient for OVEC to meet its operating expenses and fixed costs, as well as earn a return on equity before federal income taxes. In addition, the proceeds from power sales are designed to cover debt amortization and interest expense associated with financings. The Companies have continued and expect to continue to operate pursuant to the cost plus rate of return recovery provisions at least to June 30, 2040, the date of termination of the ICPA.

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

OHIO VALLEY ELECTRIC CORPORATION AND SUBSIDIARY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012

The Companies' regulatory assets, liabilities, and amounts authorized for recovery through Sponsor billings at December 31, 2013 and 2012, were as follows:

	2013	2012
Regulatory assets:		
Current assets:		
Lease termination costs/liquidated damages	\$ 371,297	\$ 5,225,467
Unrecognized loss on coal sales	-	3,051,890
Total	371,297	8,277,357
Other assets:		
Unrecognized postemployment benefits	2,078,864	2,498,759
Pension benefits	8,542,293	30,561,325
Postretirement benefits	-	1,324,775
Total	10,621,157	34,384,859
Total regulatory assets	\$ 10,992,454	\$ 42,662,216
Regulatory liabilities:		
Current liabilities:		
Deferred credit — EPA emission allowance proceeds	\$ 275,108	\$ 274,687
Deferred revenue — voluntary severance	1,510,609	-
Deferred revenue — advances for construction	23,158,632	19,389,380
Deferred credit — gain on coal sale	246,701	-
Deferred credit — advance collection of interest	2,215,158	2,311,907
Total	27,406,208	21,975,974
Other liabilities:		
Post retirement benefits	32,619,457	-
Decommissioning and demolition	19,140,730	14,230,459
Investment tax credits	3,393,146	3,393,146
Net antitrust settlement	1,823,929	1,823,929
Income taxes refundable to customers	28,380,282	38,645,647
Total	85,357,544	58,093,181
Total regulatory liabilities	\$ 112,763,752	\$ 80,069,155

Regulatory Assets — Regulatory assets consist primarily of pension benefit costs, postretirement benefit costs and income taxes billable to customers. Income taxes billable to customers are billed to customers in the period when the related deferred tax liabilities are realized. The fuel related costs, including railcar lease termination costs and liquidated damages, will be billed to customers in 2014. All other regulatory assets are being recovered on a long-term basis.

OHIO VALLEY ELECTRIC CORPORATION AND SUBSIDIARY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012

Regulatory Liabilities — The regulatory liabilities classified as current in the accompanying consolidated balance sheet as of December 31, 2013, consist primarily of interest expense collected from customers in advance of expense recognition, customer billings for construction in progress, and voluntary severance payments collected in advance of expense recognition. These amounts will be credited to customer bills during 2014. In October 2013, OVEC announced a voluntary severance program for active employees who would be retirement-eligible by the end of 2014. Approved employees in the program are entitled to receive a one-time severance payment and would retire on an agreed-upon date after they are retirement-eligible, but not later than January 1, 2015. Total expected costs related to the one-time payments are \$4.6 million for OVEC and \$1.6 million for IKEC, of which \$3.5 million for OVEC and \$1.2 million for IKEC has been expensed in 2013 recorded in the Other Operation under Operating Expenses. As the Companies have collected the entire expected costs from Sponsor Companies as of December 31, 2013, the remaining \$1.1 million for OVEC and \$0.4 million for IKEC to be expensed during 2014 has been recorded as a current regulatory liability at December 31, 2013. Other regulatory liabilities consist primarily of income taxes refundable to customers, postretirement benefits, and decommissioning and demolition costs. Income taxes refundable to customers are credited to customer bills in the period when the related deferred tax assets are realized. The Companies' ratemaking policy will recover postretirement benefits in an amount equal to estimated benefit accrual cost plus amortization of unfunded liabilities, if any. 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, 2013 and December 31, 2012, represents amounts collected in historical billings in excess of the Generally Accepted Accounting Principles (GAAP) net periodic benefit costs, including the DOE termination payment and incremental unfunded plan obligations recognized in the balance sheets but not yet recognizable in GAAP net periodic benefit costs.

Cash and Cash Equivalents — Cash and cash equivalents primarily consist of cash and money market funds and their carrying value approximates fair value. For purposes of these statements, the Companies consider temporary cash investments to be cash equivalents since they are readily convertible into cash and have original maturities of less than three months.

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

OHIO VALLEY ELECTRIC CORPORATION AND SUBSIDIARY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012

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 the accounting guidance for Investments — Debt and Equity Securities. Trading securities reflected in Long-Term Investments are carried at fair value with the unrealized gain or loss, reported in Other Income (Expense). 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 10. 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 8). Long-term investments primarily consist of municipal bonds, money market mutual fund investments, and mutual funds. Net unrealized gains (losses) recognized during 2013 and 2012 on securities still held at the balance sheets date were \$(3,698,604) and \$6,250,092, respectively.

Special Deposits — Special deposits at December 31, 2012 consisted of money market mutual funds held by trustees restricted for use in specific construction projects. The fair value of special deposits was \$0 and \$57,938,752 at December 31, 2013 and December 31, 2012, respectively.

Money market mutual funds reflected in special deposits were 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 and, as such, is considered Level 1. There were no unrealized gains or losses recognized on this portfolio during 2013 or 2012. These funds were used for construction in 2013.

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

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

OHIO VALLEY ELECTRIC CORPORATION AND SUBSIDIARY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012

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.

Balance — January 1, 2012	\$19,809,316
Accretion	1,429,394
Liabilities settled	<u>(277,331)</u>
Balance — December 31, 2012	20,961,379
Accretion	1,450,943
Liabilities settled	<u>(182,213)</u>
Balance — December 31, 2013	<u>\$22,230,109</u>

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

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

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

Subsequent Events — In preparing the accompanying financial statements and disclosures, the Companies reviewed subsequent events through April 16, 2014, which is the date the consolidated financial statements were issued.

OHIO VALLEY ELECTRIC CORPORATION AND SUBSIDIARY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012

2. RELATED-PARTY TRANSACTIONS

Transactions with the Sponsoring Companies during 2013 and 2012 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, 2013 and 2012, balances due from the Sponsoring Companies are as follows:

	2013	2012
Accounts receivable	<u>\$31,129,486</u>	<u>\$34,343,741</u>

During 2013 and 2012, American Electric Power accounted for approximately 43% of operating revenues from Sponsoring Companies and Buckeye Power accounted for approximately 18%. No other Sponsoring Company accounted for more than 10%.

American Electric Power Company, Inc. and subsidiary company owned 43.47% of the common stock of OVEC as of December 31, 2013. 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:

	2013	2012
General services	\$ 3,384,509	\$ 3,216,482
Specific projects	<u>10,964,133</u>	<u>12,746,357</u>
Total	<u>\$14,348,642</u>	<u>\$15,962,839</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 2014 through 2017. Pricing for coal under these contracts is subject to contract provisions and adjustments. The Companies currently have approximately 90% of their 2014 coal requirements under contract. These contracts are based on rates in effect at the time of purchase.

OHIO VALLEY ELECTRIC CORPORATION AND SUBSIDIARY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012

4. ELECTRIC PLANT

Electric plant at December 31, 2013 and 2012, consists of the following:

	2013	2012
Steam production plant	\$2,582,429,102	\$1,898,140,562
Transmission plant	76,855,762	74,777,994
General plant	12,495,791	12,699,998
Intangible	<u>26,564</u>	<u>26,564</u>
	2,671,807,219	1,985,645,118
Less accumulated depreciation	<u>1,182,491,224</u>	<u>1,115,363,691</u>
	1,489,315,995	870,281,427
Construction in progress	<u>30,583,795</u>	<u>645,484,896</u>
Total electric plant	<u>\$1,519,899,790</u>	<u>\$1,515,766,323</u>

All property additions and replacements are fully depreciated on the date the property is placed in service, unless the addition or replacement relates to a financed project. The majority of financed projects placed in service over the past 5 years have been recorded to steam production plant with depreciable lives ranging from 32 to 45 years. However, as the Companies' policy is to bill in accordance with the principal billings of the debt agreements, all financed projects are being depreciated in line with principal payments on outstanding debt.

5. BORROWING ARRANGEMENTS AND NOTES

OVEC has an unsecured bank revolving line of credit agreement with a borrowing limit of \$275 million as of December 31, 2013 and December 31, 2012. The \$275 million line of credit has an expiration date of June 18, 2015. At December 31, 2013 and 2012, OVEC had borrowed \$30 million and \$60 million, respectively, under this line of credit. Interest expense related to line of credit borrowings was \$634,109 in 2013 and \$3,139,158 in 2012. During 2013 and 2012, OVEC incurred annual commitment fees of \$737,792 and \$412,458, respectively, based on the borrowing limits of the line of credit.

OHIO VALLEY ELECTRIC CORPORATION AND SUBSIDIARY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012

6. LONG-TERM DEBT

The following amounts were outstanding at December 31, 2013 and 2012:

	Interest Rate	2013	2012
Senior 2006 Notes:			
2006A due February 15, 2026	5.80 %	\$ 277,326,804	\$ 292,095,074
2006B due June 15, 2040	6.40	60,418,362	61,252,481
Senior 2007 Notes:			
2007A-A due February 15, 2026	5.90	125,578,853	132,475,263
2007A-B due February 15, 2026	5.90	31,625,801	33,362,594
2007A-C due February 15, 2026	5.90	31,877,625	33,628,247
2007B-A due June 15, 2040	6.50	30,188,693	30,609,314
2007B-B due June 15, 2040	6.50	7,602,725	7,708,654
2007B-C due June 15, 2040	6.50	7,663,261	7,770,034
Senior 2008 Notes:			
2008A due February 15, 2026	5.92	39,185,975	41,334,943
2008B due February 15, 2026	6.71	78,865,206	83,014,206
2008C due February 15, 2026	6.71	80,487,688	84,578,521
2008D due June 15, 2040	6.91	43,681,707	44,242,121
2008E due June 15, 2040	6.91	44,440,700	45,010,851
Series 2009 Notes:			
2009A due February 15, 2013	1.96	-	100,000,000
Series 2009 Bonds:			
2009A due February 1, 2026	0.48	25,000,000	25,000,000
2009B due February 1, 2026	0.48	25,000,000	25,000,000
2009C due February 1, 2026	0.60	25,000,000	25,000,000
2009D due February 1, 2026	0.60	25,000,000	25,000,000
2009E due October 1, 2019	5.63	100,000,000	100,000,000
Series 2010 Bonds:			
2010A due June 29, 2014	2.16	50,000,000	50,000,000
2010B due June 29, 2016	2.16	50,000,000	50,000,000
Series 2012 Bonds:			
2012A due June 1, 2032 (a)	5.00	77,080,192	77,091,234
2012A due June 1, 2039 (a)	5.00	122,346,343	122,312,703
2012B due June 1, 2040	0.60	50,000,000	50,000,000
2012C due June 1, 2040	0.60	50,000,000	50,000,000
Series 2013 Notes:			
2013A due February 15, 2018	1.67	100,000,000	-
Total debt		1,558,369,935	1,596,486,240
Current portion of long-term debt		290,496,381	238,138,903
Total long-term debt		<u>\$ 1,267,873,554</u>	<u>\$ 1,358,347,337</u>

(a) 2012A Bonds are net of unamortized discount of \$573,465 at December 31, 2013 and \$596,063 at December 31, 2012

OHIO VALLEY ELECTRIC CORPORATION AND SUBSIDIARY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012

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

During 2009, OVEC issued \$100 million variable rate non-amortizing unsecured senior notes (2009A Notes) in private placement, a series of four \$25 million variable rate non-amortizing tax exempt pollution control bonds (2009A, B, C, and D Bonds), and \$100 million fixed rate non-amortizing tax exempt pollution control bonds (2009E Bonds). The variable rates listed above reflect the interest rate in effect at December 31, 2013.

The 2009 Series A, B, C, and D Bonds are secured by irrevocable transferable direct-pay letters of credit, expiring August 12, 2016, and August 21, 2016, issued for the benefit of the owners of the bonds. The interest rates 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. The 2009A, B, C, and D Series Bonds are current, as they are callable at any time.

In December 2010, OVEC established a borrowing facility under which OVEC borrowed, in 2011, \$100 million variable rate bonds due February 1, 2040. In June 2011, the \$100 million variable rate bonds were issued as two \$50 million non-amortizing pollution control revenue bonds (Series 2010A and 2010B) with initial interest periods of three years and five years, respectively.

During 2012, OVEC issued \$200 million fixed rate tax-exempt midwestern disaster relief revenue bonds (2012A Bonds) and two series of \$50 million variable rate tax-exempt midwestern disaster relief revenue bonds (2012B and 2012C Bonds). The 2012A, 2012B, and 2012C Bonds will begin amortizing June 1, 2027, to their respective maturity dates. The variable rates listed above reflect the interest rate in effect at December 31, 2013.

The 2012B and 2012C Bonds are secured by irrevocable transferable direct-pay letters of credit, expiring June 28, 2014, and June 28, 2015, issued for the benefit of the owners of the bonds. The interest rates 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 agreements to provide for the remarketing of the bonds if such repurchase is required. The 2012B and 2012C Bonds are current, as they are callable at any time.

In 2013, the \$100 million 2009A Notes were retired on February 15, 2013, with funding from the issuance of \$100 million 2013A variable rate non-amortizing unsecured senior notes (2013A Notes). The 2013A Notes mature on February 15, 2018.

OHIO VALLEY ELECTRIC CORPORATION AND SUBSIDIARY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012

The annual maturities of long-term debt as of December 31, 2013, are as follows:

2014	\$ 290,496,381
2015	42,977,594
2016	95,536,872
2017	48,461,307
2018	51,460,006
2019-2040	<u>1,029,437,775</u>
Total	<u>\$1,558,369,935</u>

Note that the 2014 current maturities of long-term debt include \$200 million of remarketable variable-rate bonds. The Companies expect cash maturities of only \$40,496,382 to the extent the remarketing agents are successful in their ongoing efforts to remarket the bonds through the contractual maturity dates in February 2026 and June 2040.

7. INCOME TAXES

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

	2013	2012
Income tax expense at 35% statutory rate	\$ 1,076,125	\$ 1,102,283
State income taxes — net of federal benefit	-	549
Temporary differences flowed through to customer bills	(212,144)	(224,609)
Permanent differences and other	<u>26,396</u>	<u>15,310</u>
Income tax provision	<u>\$ 890,377</u>	<u>\$ 893,533</u>

Components of the income tax provision were as follows:

	2013	2012
Current income tax (benefit)/expense	\$ -	\$ (9,609,247)
Deferred income tax expense/(benefit)	<u>890,377</u>	<u>10,502,780</u>
Total income tax provision	<u>\$ 890,377</u>	<u>\$ 893,533</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, asset retirement obligations, regulatory assets, and regulatory liabilities.

OHIO VALLEY ELECTRIC CORPORATION AND SUBSIDIARY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012

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 regulatory liability was \$28,380,282 and \$38,645,647 at December 31, 2013 and 2012, respectively.

Deferred income tax assets (liabilities) at December 31, 2012 and 2011, consisted of the following:

	2013	2012
Deferred tax assets:		
Deferred revenue — advances for construction	\$ 8,110,780	\$ 6,789,730
AMT credit carryforwards	2,574,572	2,574,572
Federal net operating loss	61,312,280	9,392,878
Postretirement benefit obligation	14,770,267	28,748,763
Pension liability	1,684,610	9,207,805
Postemployment benefit obligation	728,074	875,010
Asset retirement obligations	7,785,586	7,340,209
Miscellaneous accruals	2,131,262	2,742,592
Regulatory liability — other	1,288,943	-
Regulatory liability — investment tax credits	1,188,372	1,188,204
Regulatory liability — net antitrust settlement	638,789	638,700
Regulatory liability — asset retirement costs	6,703,602	4,983,191
Regulatory liability — postretirement benefits	10,283,147	-
Regulatory liability — income taxes refundable to customers	<u>13,856,458</u>	<u>13,844,317</u>
Total deferred tax assets	<u>133,056,742</u>	<u>88,325,971</u>
Deferred tax liabilities:		
Prepaid expenses	(679,165)	(622,408)
Electric plant	(85,468,227)	(29,477,415)
Unrealized gain/loss on marketable securities	(3,580,925)	(5,616,658)
Regulatory asset — postretirement benefits	-	(463,906)
Regulatory asset — pension benefits	(2,991,742)	(10,701,897)
Regulatory asset — unrecognized postemployment benefits	<u>(728,074)</u>	<u>(875,010)</u>
Total deferred tax liabilities	<u>(93,448,133)</u>	<u>(47,757,294)</u>
Valuation allowance	<u>(10,195,362)</u>	<u>-</u>
Deferred income tax assets	<u>\$ 29,413,247</u>	<u>\$ 40,568,677</u>
Current deferred income taxes	\$ 9,980,768	\$ 18,302,793
Non-current deferred income taxes	19,432,479	22,265,884

During 2013, due to trends in market factors surrounding U.S. coal-fired generation and wholesale power prices, the Companies recorded a valuation allowance in order to recognize only those deferred tax assets that are more likely than not of realization through the end of the ICPA contract term in 2040.

OHIO VALLEY ELECTRIC CORPORATION AND SUBSIDIARY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012

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, 2013 and 2012, 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. As the law has been in effect for 2013, there is no additional adjustment in 2013 or going forward.

During 2013 and 2012, the passage of the PPAC Act resulted in a reduction of the postemployment benefits deferred tax asset of approximately \$0 and \$80,000 and a reduction to the related regulatory liability (income taxes refundable to customers) of approximately \$0 and \$80,000, respectively.

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 2007 and earlier. The Companies are currently under audit by the Internal Revenue Service for the tax years ended December 31, 2008 through December 31, 2012. The Companies are no longer subject to State of Indiana tax examinations for tax years 2007 and earlier. The Companies are no longer subject to Ohio and the Commonwealth of Kentucky examinations for tax years 2006 and earlier.

8. 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

OHIO VALLEY ELECTRIC CORPORATION AND SUBSIDIARY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012

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 57% and 43% split between OVEC and IKEC, respectively, as of December 31, 2013, and approximately a 57% and 43% split between OVEC and IKEC, respectively, as of December 31, 2012. The Pension Plan's assets as of December 31, 2013, consist of investments in equity and debt securities.

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. In January 2011, the Companies established an IRC Section 401(h) account under the Pension Plan.

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.

OHIO VALLEY ELECTRIC CORPORATION AND SUBSIDIARY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012

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. These investment guidelines require appropriate portfolio diversification and define security concentration limits. Each investment manager's portfolio is compared to an appropriate diversified benchmark index.

Equity investment limitations:

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

Fixed Income Limitations — As of December 31, 2013, the Pension Plan fixed income allocation consists of managed accounts composed of U.S. Government, corporate, and municipal obligations. The VEBA benefit plans' fixed income allocation is composed of a variety of fixed income managed accounts and mutual funds. Investment limitations for these fixed income funds are defined by manager prospectus.

OHIO VALLEY ELECTRIC CORPORATION AND SUBSIDIARY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012

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, 2013 and 2012, are as follows:

	Pension Plan		Other Postretirement Benefits	
	2013	2012	2013	2012
Change in projected benefit obligation:				
Projected benefit obligation — beginning of year	\$ 195,007,159	\$ 192,294,158	\$ 190,323,891	\$ 171,866,123
Service cost	6,825,230	7,050,298	7,375,556	6,411,493
Interest cost	8,357,208	8,383,604	8,180,654	7,442,065
Plan participants' contributions	-	-	979,846	908,758
Benefits paid	(4,289,481)	(3,536,952)	(5,067,595)	(4,449,852)
Net actuarial (gain)/loss	(23,604,558)	(9,114,566)	(39,654,091)	7,821,460
Medicare subsidy	-	-	300,508	323,844
Plan amendments	(3,173,345)	-	305,374	-
Expenses paid from assets	(75,251)	(69,383)	-	-
Projected benefit obligation — end of year	<u>179,046,962</u>	<u>195,007,159</u>	<u>162,744,143</u>	<u>190,323,891</u>
Change in fair value of plan assets:				
Fair value of plan assets — beginning of year	164,445,834	141,371,363	108,226,268	94,948,011
Actual return on plan assets	4,000,880	21,180,806	9,279,474	10,538,257
Expenses paid from assets	(75,251)	(69,383)	-	-
Employer contributions	6,422,687	5,500,000	6,852,241	5,957,250
Plan participants' contributions	-	-	979,846	908,758
Medicare subsidy	-	-	300,508	323,844
Benefits paid	(4,289,481)	(3,536,952)	(5,067,595)	(4,449,852)
Fair value of plan assets — end of year	<u>170,504,669</u>	<u>164,445,834</u>	<u>120,570,742</u>	<u>108,226,268</u>
(Underfunded) status — end of year	<u>\$ (8,542,293)</u>	<u>\$ (30,561,325)</u>	<u>\$ (42,173,401)</u>	<u>\$ (82,097,623)</u>

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

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 \$300,508 and \$323,844 for 2013 and 2012, respectively. The Companies have

OHIO VALLEY ELECTRIC CORPORATION AND SUBSIDIARY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012

accounted for the subsidy as a reduction of the benefit obligation detailed in the above table. In June 2013, the Companies converted the prescription drug program for retirees over the age of 65 to a group-based company sponsored Medicare Part D program, or Employer Group Waiver Plan, or EGWP. Beginning in June 2013, the Companies use the Part D subsidies delivered through the EGWP each year to reduce net company retiree medical costs. Accordingly, the Companies no longer receive subsidies directly from the Medicare program and no subsidies have been included in the benefit obligation.

The accumulated benefit obligation for the Pension Plan was \$156,748,676 and \$167,595,378 at December 31, 2013 and 2012, 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	
	2013	2012	2013	2012
Service cost	\$ 6,825,230	\$ 7,050,298	\$ 7,375,556	\$ 6,411,493
Interest cost	8,357,208	8,383,604	8,180,654	7,442,065
Expected return on plan assets	(9,088,934)	(8,522,609)	(5,562,089)	(5,516,937)
Amortization of prior service cost	189,437	189,437	(385,000)	(379,000)
Recognized actuarial loss	<u>428,567</u>	<u>2,086,365</u>	<u>1,828,893</u>	<u>1,577,730</u>
Total benefit cost	<u>\$ 6,711,508</u>	<u>\$ 9,187,095</u>	<u>\$11,438,014</u>	<u>\$ 9,535,351</u>
Pension and other postretirement benefits expense recognized in the consolidated statements of income and retained earnings and billed to Sponsoring Companies under the ICPA	<u>\$ 6,422,687</u>	<u>\$ 5,500,000</u>	<u>\$ 5,400,000</u>	<u>\$ 5,500,000</u>

OHIO VALLEY ELECTRIC CORPORATION AND SUBSIDIARY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012

The following table presents the classification of Pension Plan assets within the fair value hierarchy at December 31, 2013 and 2012:

	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)
2013			
Domestic equity mutual funds	\$ 16,572,985	\$ -	\$ -
Common stock - domestic	8,480,137	-	-
International and global equity mutual funds	24,557,818	-	-
International and global private investment funds	-	5,102,504	-
Cash equivalents	5,211,961	-	-
U.S. Treasury securities	-	7,505,362	-
Corporate debt securities	-	94,537,258	-
Municipal debt securities	-	8,536,644	-
Total fair value	<u>\$ 54,822,901</u>	<u>\$ 115,681,768</u>	<u>\$ -</u>
2012			
Domestic equity	\$ 23,558,247	\$ -	\$ -
International and global equity	17,292,251	8,550,837	-
Cash equivalents	4,924,712	-	-
U.S. Treasury securities	-	6,804,928	-
Corporate debt securities	-	92,091,492	-
Municipal debt securities	-	11,223,367	-
Total fair value	<u>\$ 45,775,210</u>	<u>\$ 118,670,624</u>	<u>\$ -</u>

OHIO VALLEY ELECTRIC CORPORATION AND SUBSIDIARY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012

The following table presents the classification of VEBA and 401(h) account assets within the fair value hierarchy at December 31, 2013 and 2012:

	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)
2013			
Domestic equity mutual funds	\$ 40,105,729	\$ -	\$ -
International and global equity mutual funds	22,737,909	-	-
International and global private investment funds	-	4,267,427	-
Fixed income mutual funds	33,485,886	-	-
Fixed income securities	-	13,940,290	-
Cash equivalents	<u>6,033,501</u>	<u>-</u>	<u>-</u>
Total fair value	<u>\$ 102,363,025</u>	<u>\$ 18,207,717</u>	<u>\$ -</u>
2012			
Domestic equity mutual funds	\$ 21,360,870	\$ -	\$ -
International and global equity	22,601,305	-	-
Fixed income mutual funds	48,177,536	-	-
Fixed income securities	-	13,581,890	-
Cash equivalents	<u>2,504,667</u>	<u>-</u>	<u>-</u>
Total fair value	<u>\$ 94,644,378</u>	<u>\$ 13,581,890</u>	<u>\$ -</u>

Pension Plan and Other Postretirement Benefit Assumptions— Actuarial assumptions used to determine benefit obligations at December 31, 2013 and 2012, were as follows:

	Pension Plan		Other Postretirement Benefits			
	2013	2012	2013		2012	
			Medical	Life	Medical	Life
Discount rate	5.15 %	4.29 %	5.20 %	5.20 %	4.40 %	4.30 %
Rate of compensation increase	3.00	3.00	N/A	3.00	N/A	3.00

OHIO VALLEY ELECTRIC CORPORATION AND SUBSIDIARY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012

Actuarial assumptions used to determine net periodic benefit cost for the years ended December 31, 2013 and 2012, were as follows:

	Pension Plan		Other Postretirement Benefits			
	2013	2012	2013		2012	
			Medical	Life	Medical	Life
Discount rate	4.29 %	4.40 %	4.40 %	4.30 %	4.40 %	4.40 %
Expected long-term return on plan assets	5.50	6.00	4.95	5.75	5.60	6.50
Rate of compensation increase	3.00	4.00	N/A	3.00	N/A	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, 2013 and 2012, were as follows.

	2013	2012
Health care trend rate assumed for next year — participants under 65	7.50 %	8.00 %
Health care trend rate assumed for next year — participants over 65	7.50	8.00
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	2019

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	\$ 3,631,271	\$ (2,784,708)
Effect on postretirement benefit obligation	28,284,656	(22,171,247)

Pension Plan and Other Postretirement Benefit Assets — The asset allocation for the Pension Plan and VEBA trusts at December 31, 2013 and 2012, by asset category was as follows:

Asset category:	Pension Plan		VEBA Trusts	
	2013	2012	2013	2012
Equity securities	32 %	30 %	42 %	41 %
Debt securities	68	70	58	59

OHIO VALLEY ELECTRIC CORPORATION AND SUBSIDIARY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012

Pension Plan and Other Postretirement Benefit Contributions — The Companies expect to contribute \$6,600,000 to their Pension Plan and \$7,759,496 to their Other Postretirement Benefits plan in 2014.

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
2014	\$5,416,910	\$5,923,496
2015	6,126,992	6,300,880
2016	7,042,389	6,852,055
2017	7,848,396	7,425,451
2018	8,664,325	7,890,713
Five years thereafter	56,948,180	47,510,450

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 56% and 44% split between OVEC and IKEC, respectively, as of December 31, 2013, and approximately a 45% and 55% split between OVEC and IKEC, respectively, as of December 31, 2012. 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 \$2,078,864 and \$2,498,759 at December 31, 2013 and 2012, 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. 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 2013 and 2012 were \$1,956,546 and \$1,942,045, respectively.

9. ENVIRONMENTAL MATTERS

Title IV of the 1990 Clean Air Act Amendments (CAAAAs) 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. Historically, the cost of these purchased allowances has been inventoried and included on an average cost basis in the cost of fuel consumed when used.

OHIO VALLEY ELECTRIC CORPORATION AND SUBSIDIARY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012

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 United States Environmental Protection Agency (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. The U.S. EPA has subsequently written a replacement rule for the regulation of coal-fired utility emissions of mercury and other hazardous air pollutants. This replacement rule was published in the Federal Register on February 16, 2012, and it is referred to as the Mercury and Air Toxics Standards (or MATS) rule. The rule became final on April 16, 2012, and OVEC-IKEC must be in compliance with MATS emission limits by April 15, 2015. Management expects that, with the SCRs and FGD systems fully functional, OVEC-IKEC will be able to meet the emissions requirements outlined in the Mercury and Air Toxics Standards (MATS) rule by the April 15, 2015, compliance deadline.

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. Following the remand, the U.S. EPA promulgated a replacement rule to CAIR. This new rule is called the Cross-State Air Pollution Rule (CSAPR) and it was issued on July 6, 2011, and it was scheduled to go into effect on January 1, 2012. However, on December 30, 2011, the D.C. Circuit Court issued an indefinite "stay" of the CSAPR

OHIO VALLEY ELECTRIC CORPORATION AND SUBSIDIARY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012

rule until the Court considered the numerous state, trade association, and industry petitions filed to have the rule either stayed or reviewed. The Court also instructed the U.S. EPA to keep CAIR in place while they considered the numerous petitions. On August 21, 2012, in a 2-1 decision, the D.C. Circuit Court vacated the CSAPR rule and ordered the U.S. EPA to keep CAIR in effect until a CSAPR replacement rule is promulgated. The U.S. EPA and other parties filed a petition seeking rehearing before the entire D.C. Circuit Court on October 5, 2012. That petition was denied by the D.C. Circuit Court on January 24, 2013; however, the U.S. Solicitor General petitioned the U.S. Supreme Court to review the D.C. Circuit Court's decision on CSAPR in March of 2013, and the Supreme Court granted that petition in June of 2013. Oral arguments were presented before the Supreme Court in December of 2013, and we now await a decision from the Supreme Court. That decision is expected to be issued in the summer of 2014. In the interim, CAIR will remain in effect.

The first Kyger Creek plant FGD system became fully operational in November 2011 and the second FGD system began operation in February 2012. Clifty Creek's two FGD scrubbers were placed into service in March and May of 2013. As a result, OVEC-IKEC is positioned to meet the anticipated reductions in SO₂ and NO_x emissions that are required under the CSAPR rule if the U.S. EPA ultimately prevails on its appeal and the rule is reinstated. Alternatively, OVEC-IKEC is also positioned to meet comparable emissions reductions that may be required by an equivalent replacement rule if the D.C. Circuit Court decision is ultimately upheld and the U.S. EPA is required to develop a replacement rule.

Additional SO₂ and NO_x allowances were purchased to operate the Clifty Creek generating units to comply with the reinstated CAIR environmental emission rules during the 2012 compliance period. With the Kyger Creek FGD and the Clifty Creek FGD systems now fully operational, and with the 10 SCR systems operational at both plants, management did not need to purchase additional SO₂ allowances in 2013; however, there were limited NO_x purchases and there may be a need to purchase limited NO_x allowances in 2014 and beyond.

Now that all FGD systems are fully operational, OVEC-IKEC expects to have adequate SO₂ allowances available without having to rely on market purchases if the CSAPR rules are upheld in their current form; however, additional NO_x allowances or additional NO_x controls may be necessary for Clifty Creek Unit 6 either under a reinstated CSAPR rule or any promulgated replacement rule.

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.

In late December 2011, OVEC-IKEC received a letter dated December 21, 2011, from the U.S. EPA requesting follow-up information. Specifically, the U.S. EPA asked for an update on the status of the FGD scrubber projects at both plants as well as additional information on any other new emissions controls that either have been installed or are planned for installation since the last submittal we filed on March 8, 2012. This information was prepared and filed with the U.S. EPA in late January 2012. In the fall of 2012, following an on-site visit, the U.S. EPA made an informal request that OVEC-IKEC provide the agency with a monthly email progress report on the Clifty Creek FGD project until both FGD systems are

OHIO VALLEY ELECTRIC CORPORATION AND SUBSIDIARY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012

operational in 2013. As of this date, the only communication OVEC-IKEC has had with the U.S. EPA related to either the original Section 114 data submittal or the supplemental data filing made in 2011 are the monthly email progress reports. Those monthly email progress reports were discontinued once the second of the two FGD scrubbers at Clifty Creek was placed into service in May of 2013.

10. FAIR VALUE MEASUREMENTS

The accounting guidance for Financial Instruments requires disclosure of the fair value of certain financial instruments. The estimates of fair value under this guidance require the application of broad assumptions and estimates. Accordingly, any actual exchange of such financial instruments could occur at values significantly different from the amounts disclosed. 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.

OVEC utilizes its trustee's external pricing service in its estimate of the fair value of the underlying investments held in the benefit plan trusts and investment portfolios. The Companies' management reviews and validates the prices utilized by the trustee to determine fair value. Equities and fixed income securities are classified as Level 1 holdings if they are actively traded on exchanges. In addition, mutual funds are classified as Level 1 holdings because they are actively traded at quoted market prices. Certain fixed income securities do not trade on an exchange and do not have an official closing price. Pricing vendors calculate bond valuations using financial models and matrices. Fixed income securities are typically classified as Level 2 holdings because their valuation inputs are based on observable market data. Observable inputs used for valuing fixed income securities are benchmark yields, reported trades, broker/dealer quotes, issuer spreads, bids, offers, and economic events. Other securities with model-derived valuation inputs that are observable are also classified as Level 2 investments. Investments with unobservable valuation inputs are classified as Level 3 investments.

As of December 31, 2013 and 2012, 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 special deposits consist of money market mutual funds restricted for use on certain projects. 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.

OHIO VALLEY ELECTRIC CORPORATION AND SUBSIDIARY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012

Long-Term Investments — Assets measured at fair value on a recurring basis at December 31, 2013 and 2012, 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)
2013			
Equity mutual funds	\$ 24,795,074	\$ -	\$ -
Fixed income municipal securities	-	88,696,555	-
Cash equivalents	<u>3,615,039</u>	<u>-</u>	<u>-</u>
Total fair value	<u>\$ 28,410,113</u>	<u>\$ 88,696,555</u>	<u>\$ -</u>
2012			
Equity mutual funds	\$ 21,192,480	\$ -	\$ -
Fixed income municipal securities	-	96,088,024	-
Cash equivalents	<u>61,009,960</u>	<u>-</u>	<u>-</u>
Total fair value	<u>\$ 82,202,440</u>	<u>\$ 96,088,024</u>	<u>\$ -</u>

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

The fair values and recorded values of the senior notes and fixed and variable rate bonds as of December 31, 2013 and 2012, are as follows:

	2013		2012	
	Fair Value	Recorded Value	Fair Value	Recorded Value
Total	<u>\$ 1,684,165,978</u>	<u>\$ 1,558,369,935</u>	<u>\$ 1,848,202,504</u>	<u>\$ 1,596,486,240</u>

11. 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. OVEC also has various other operating leases with other property and equipment. During 2013, OVEC terminated certain railcar lease agreements, which resulted in lease termination costs of \$3,497,300. As of December 31, 2013, OVEC had billed Sponsor Companies \$3,126,003 resulting in a balance of \$371,297 that will be recovered from the Sponsor Companies within the next 12 months. This amount is recorded in current regulatory assets (see Note 1) and is not included in the lease payments below.

OHIO VALLEY ELECTRIC CORPORATION AND SUBSIDIARY COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012

The amount in property under capital leases is \$2,793,119 with accumulated depreciation of \$905,642 and \$460,693 as of December 31, 2013 and 2012, respectively.

Future minimum lease payments for capital and operating leases at December 31, 2013, are as follows:

Years Ending December 31	Operating	Capital
2014	\$ 1,072,266	\$ 677,352
2015	814,895	528,896
2016	13,081	264,693
2017	-	216,247
2018	-	137,643
Thereafter	-	499,596
	<u>\$ 1,900,242</u>	<u>2,324,427</u>
Total future minimum lease payments		
		<u>549,901</u>
Less estimated interest element		
		<u>\$1,774,526</u>
Estimated present value of future minimum lease payments		

The annual operating lease cost incurred was \$1,862,319 and \$3,310,227 for 2013 and 2012, respectively, and the annual capital lease cost incurred (depreciation expense) was \$593,456 and \$437,084 for 2013 and 2012, respectively.

12. COMMITMENTS AND CONTINGENCIES

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

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OHIO VALLEY ELECTRIC CORPORATION AND SUBSIDIARY COMPANY

INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Ohio Valley Electric Corporation:

We have audited the accompanying consolidated financial statements of Ohio Valley Electric Corporation and its subsidiary company, Indiana-Kentucky Electric Corporation (the "Companies"), which comprise the consolidated balance sheets as of December 31, 2013 and 2012, and the related consolidated statements of income and retained earnings and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Companies' preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Companies' internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Companies as of December 31, 2013 and 2012, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

DELOITTE & TOUCHE LLP

DELOITTE & TOUCHE LLP

April 16, 2014

OHIO VALLEY ELECTRIC CORPORATION AND SUBSIDIARY COMPANY

OVEC PERFORMANCE—A 5-YEAR COMPARISON

	2013	2012	2011	2010	2009
Net Generation (MWh)	10,471,693	10,514,762	14,468,168	14,634,079	15,260,922
Energy Delivered (MWh) to:					
DOE	195,470	207,692	253,157	249,139	264,664
Sponsors	10,304,107	10,340,568	14,199,025	14,421,180	15,069,699
Maximum Scheduled (MW) by:					
DOE	33	36	39	39	39
Sponsors	2,160	2,165	2,247	2,223	2,212
Power Costs to:					
DOE	\$9,282,000	\$9,097,000	\$11,643,000	\$11,207,000	\$11,451,000
Sponsors	\$671,648,000	\$650,027,000	\$722,153,000	\$671,671,000	\$632,506,000
Average Price (MWh):					
DOE	\$47.483	\$43.802	\$45.993	\$44.984	\$43.266
Sponsors	\$65.183	\$62.862	\$50.859	\$46.575	\$41.972
Operating Revenues	\$675,649,000	\$670,819,000	\$716,938,000	\$690,687,000	\$648,593,000
Operating Expenses	\$594,742,000	\$599,891,000	\$653,696,000	\$618,790,000	\$584,881,000
Cost of Fuel Consumed	\$311,900,000	\$302,926,000	\$397,543,000	\$358,507,000	\$329,448,000
Taxes (federal, state, and local)	\$12,312,000	\$11,659,000	\$12,059,000	\$11,208,000	\$12,298,000
Payroll	\$63,175,000	\$61,907,000	\$57,141,000	\$55,609,000	\$56,589,000
Fuel Burned (tons)	4,958,872	5,290,009	7,310,107	7,506,530	7,900,894
Heat Rate (Btu per kWh, net generation)	10,715	10,581	10,467	10,310	10,299
Unit Cost of Fuel Burned (per mmBtu)	\$2.78	\$2.72	\$2.63	\$2.38	\$2.10
Equivalent Availability (percent)	73.9	78.9	83.0	81.0	81.6
Power Use Factor (percent)	75.05	69.40	89.61	92.82	96.29
Employees (year-end)	781	828	810	783	809

OHIO VALLEY ELECTRIC CORPORATION AND SUBSIDIARY COMPANY

DIRECTORS

Ohio Valley Electric Corporation

^{1,2} **ANTHONY J. AHERN**, Columbus, Ohio
President and Chief Executive Officer
Buckeye Power Generating, LLC

¹ **NICHOLAS K. AKINS**, Columbus, Ohio
Chairman, President and Chief Executive Officer
American Electric Power Company, Inc.

ERIC D. BAKER, Cadillac, Michigan
President and Chief Executive Officer
Wolverine Power Supply Cooperative, Inc.

JAMES R. HANEY, Akron, Ohio
Vice President, Compliance & Regulated Services
and Chief FERC Compliance Officer
FirstEnergy Corp.

PHILIP R. HERRINGTON, Dayton, Ohio
President, Competitive Generation
AES U.S. Strategic Business Unit

² **LANA L. HILLEBRAND**, Columbus, Ohio
Senior Vice President and Chief Administrative Officer
American Electric Power Company, Inc.

¹ **CHARLES D. LASKY**, Akron, Ohio
Vice President, Fossil Operations and Engineering
FirstEnergy Generation, LLC

² **MARK C. McCULLOUGH**, Columbus, Ohio
Executive Vice President - Generation
American Electric Power Company, Inc.

STEVEN K. NELSON, Coshocton, Ohio
Chairman, Buckeye Power Board of Trustees
The Frontier Power Company

PATRICK W. O'LOUGHLIN, Columbus, Ohio
Senior Vice President and Chief Operating Officer
Buckeye Power Generating, LLC

ROBERT P. POWERS, Columbus, Ohio
Executive Vice President and Chief Operating Officer
American Electric Power Company, Inc.

² **PAUL W. THOMPSON**, Louisville, Kentucky
Chief Operating Officer
LG&E and KU Energy LLC

¹ **JOHN N. VOYLES, JR.**, Louisville, Kentucky
Vice President, Transmission and Generation Services
LG&E and KU Energy LLC

¹ **CHARLES WHITLOCK**, Cincinnati, Ohio
President, Commercial Asset Management & Operations
Duke Energy Corporation

Indiana-Kentucky Electric Corporation

¹ **ANTHONY J. AHERN**, Columbus, Ohio
President and Chief Executive Officer
Buckeye Power Generating, LLC

¹ **NICHOLAS K. AKINS**, Columbus, Ohio
Chairman, President and Chief Executive Officer
American Electric Power Company, Inc.

PAUL CHODAK, Fort Wayne, Indiana
President and Chief Operating Officer
Indiana Michigan Power

WAYNE D. GAMES, Evansville, Indiana
Vice President - Power Supply
Vectren Corporation

¹ **CHARLES D. LASKY**, Akron, Ohio
Vice President, Fossil Operations and Engineering
FirstEnergy Generation, LLC

MARC E. LEWIS, Fort Wayne, Indiana
Vice President, External Relations
Indiana Michigan Power

OFFICERS—OVEC AND IKEC

NICHOLAS K. AKINS
President

MARK A. PEIFER
Vice President and
Chief Operating Officer

JOHN D. BRODT
Chief Financial Officer,
Secretary and Treasurer

RONALD D. COOK
Assistant Secretary, Assistant
Treasurer and Supply Chain Director

JULIE SLOAT
Assistant Secretary and
Assistant Treasurer

¹Member of Executive Committee.

²Member of Human Resources Committee.

Charles Whitlock

BEFORE THE PUBLIC UTILITIES COMMISSION OF OHIO

- - -

In the Matter of the :
 Application of Duke Energy:
 Ohio for Authority to :
 Establish a Standard :
 Service Offer Pursuant to :
 Section 4928.143, Revised : Case No. 14-841-EL-SSO
 Code, in the Form of an :
 Electric Security Plan, :
 Accounting Modifications :
 and Tariffs for Generation:
 Service. :

In the Matter of the :
 Application of Duke Energy:
 Ohio for Authority to : Case No. 14-842-EL-ATA
 Amend its Certified :
 Supplier Tariff, P.U.C.O. :
 No. 20. :

- - -

EXCERPT OF DEPOSITION

of Charles R. Whitlock, taken before me, Karen Sue
 Gibson, a Notary Public in and for the State of Ohio,
 at the offices of Duke Energy Ohio, 155 East Broad
 Street, 21st Floor, Columbus, Ohio, on Thursday,
 September 11, 2014, at 10 a.m.

- - -

ARMSTRONG & OKEY, INC.
 222 East Town Street, Second Floor
 Columbus, Ohio 43215-5201
 (614) 224-9481 - (800) 223-9481
 FAX - (614) 224-5724

- - -

1 Q. This discussion is about economic
2 dispatch.

3 A. Okay.

4 Q. PJM will take the least cost generating
5 assets to run, correct?

6 A. Subject to reliability constraints I
7 would say yes.

8 Q. Okay. And if Duke Energy Ohio or OVEC,
9 none of the assets formerly owned by Duke, OVEC, if
10 that doesn't run, PJM will just pick different
11 generating assets, and it will serve the load in
12 Duke's territory; isn't that correct?

13 MS. SPILLER: I am going to object to
14 relevance.

15 A. I think that's true.

16 Q. Okay. Now, let me ask another question
17 about that. OVEC consists of Clifty Creek and Kyger
18 Creek, correct?

19 A. Correct.

20 Q. Now, Kyger Creek is in Ohio, right?

21 A. Correct.

22 Q. Clifty Creek is in Indiana, correct?

23 A. Correct.

24 Q. Now, isn't it true Indiana is located in
25 MISO?

1 A. Yes.

2 Q. Are you aware, is Clifty Creek --

3 A. I think that's true, man. So, again, I
4 don't think about PJM by state, but I think that's
5 true.

6 Q. Is Clifty Creek pseudo tied to PJM?

7 A. I believe so.

8 Q. Does Clifty Creek have a firm
9 transmission path to PJM?

10 A. I don't know. I think -- I don't know.

11 Q. Okay. And for the record could you
12 please explain what it is to pseudo tie a generating
13 asset to a regional transmission operator.

14 A. So I can give you a layman's definition.
15 It's probably not the definition what a pseudo tie
16 is, but it essentially takes an electrical gen --
17 generator that's not connected electrically and makes
18 it look like it's connected electrically to that RTO.

19 Q. Okay. So although Clifty Creek is not
20 necessarily physically located in PJM, it is allowed
21 to bid into the PJM reliability pricing model
22 capacity auction, correct?

23 A. Yes.

24 Q. Are you aware of the rules and
25 circumstances that allow that to occur, if you know?

1 MS. SPILLER: Object to the relevance.

2 Go ahead.

3 A. We should -- is there a specific
4 provision of the tariff?

5 Q. I was hoping you could tell me.

6 A. Yeah. We could get PJM's tariff and look
7 at -- it's spelled out in PJM's tariff what's
8 required to participate in.

9 Q. Do you know if it's allowed to
10 participate as an external resource or as an internal
11 resource?

12 A. I don't. I believe it's an external
13 resource, but I don't know. I shouldn't speculate.

14 Q. Yeah, if you know. Thank you. Now,
15 talking about the Duke ownership structure of OVEC,
16 Duke owns stock in OVEC; isn't that correct?

17 A. Yes.

18 Q. And that's Duke Energy Ohio.

19 A. Yes.

20 Q. Okay. Isn't it true that Duke Energy
21 Ohio previously owned coal generating assets with DPL
22 and AEP?

23 MS. SPILLER: Objection, relevance.

24 A. Yes.

25 Q. Are you aware how the ownership of those

1 Q. Okay.

2 A. It's not a wish -- it's not determined by
3 their will to collect.

4 Q. I think you actually led to my next
5 question. This agreement, the OVEC agreement, the
6 ICPA, is binding on the sponsoring companies so
7 according to this FERC jurisdictional document they
8 have to pay pursuant to its terms no matter what may
9 happen regarding energy markets or the Public
10 Utilities Commission of Ohio decisions regarding what
11 they can collect from their customers.

12 A. I think that's true regardless of whether
13 it was FERC jurisdictional or not. It's a contract
14 that spells out terms and conditions of paying money.

15 Q. Okay. So let me take it one step
16 further. This is just a hypothetical.

17 A. Yeah. It's not hypothetical because you
18 are talking about the ICPA.

19 Q. It's a hypothetical for any FERC
20 jurisdictional energy contract.

21 A. Okay.

22 Q. Assuming Duke Energy Ohio has a contract
23 with another company and they have some rate
24 mechanism from the Ohio Commission to collect the
25 costs from that contract, but then because the

1 Commission has jurisdiction over that mechanism they
2 determine a certain amount of those costs should be
3 disallowed. Would you agree that that loss would be
4 recorded as Duke Energy Ohio, and Duke Energy Ohio
5 would still have to pay in accordance with the
6 wholesale contract terms?

7 A. So can we take it in pieces?

8 Q. Sure.

9 A. So if Duke Energy -- if Duke -- any
10 entity inside of Duke has a contract, they are
11 going -- Duke is going to abide by the terms of the
12 contract --

13 Q. Okay.

14 A. -- that's No. 1, and then the second
15 question is if I had -- if those were deemed
16 imprudent -- or what was the word that you used?

17 Q. Disallowance.

18 A. Disallowed, what would be -- what's the
19 question?

20 Q. If those costs were disallowed from
21 collection from ratepayers, then Duke Energy Ohio
22 would not be able to flow that disallowance upstream
23 to the other company that's in the other side of the
24 transaction. They would still have to pay the party
25 on the other side of the wholesale contract.

1 MS. SPILLER: Objection, relevance.

2 A. Upstream to what?

3 Q. I am trying to help you understand this,
4 the hypothetical. If there's a disallowance at the
5 Public Utilities' level --

6 A. Yes.

7 Q. -- it doesn't affect Duke's obligation to
8 pay the other party that's involved with the
9 wholesale contract; isn't that correct?

10 MS. SPILLER: I don't know that there are
11 enough facts to answer this hypothetical. You are
12 asking him to make a whole lot of assumptions as to
13 what that contract says.

14 Q. Let's assume it's the ICPA.

15 A. Okay. Let's assume it's the ICPA. So I
16 have an obligation to pay under the ICPA; I am going
17 to pay that money. And then what's the question?

18 Q. Okay. You have an obligation to pay
19 under the ICPA.

20 A. Correct.

21 Q. And then you sell all the revenue from
22 OVEC into the market. Those revenues are less than
23 the amount you have to pay to OVEC.

24 MS. SPILLER: Is this part of the
25 hypothetical?

1 MR. OLIKER: It's part of the
2 hypothetical.

3 A. Wait. I'm confused. So, now, we are
4 talking about the ICPA. Okay. We are saying it's
5 not a hypothetical.

6 Q. It's a hypothetical, but we are going to
7 use the ICPA to add additional facts to it.

8 A. Okay.

9 Q. Let's assume this wholesale contract is
10 the ICPA so Duke has an obligation to pay OVEC. But
11 then there's a collection mechanism for any
12 difference between the amount Duke has to pay to OVEC
13 and the amount of market-based revenues that they
14 receive. But then assume -- assume that, say, Duke
15 loses \$10 million in the market.

16 But then assume the Commission decides,
17 well, we thought what you were doing was imprudent.
18 That number is actually \$20 million. So then there
19 is \$10 million that Duke's allowed to collect from
20 ratepayers and \$10 million that they have to eat.
21 They don't get to collect that money from customers,
22 but they record a lose at the distribution utility;
23 isn't that correct? They still have to pay all of
24 that extra \$20 million to OVEC. I am trying to add
25 as many facts for you as possible.

1 A. I hate the hypothetical fact where you're
2 blending the ICPA and then a hypothetical situation
3 and then it's more complicated that you use \$10
4 million in both examples, right, where I was allowed
5 to collect 10 million and then not another 10
6 million. So we're paying -- Duke Energy Ohio is
7 going to pay under the ICPA contract.

8 Q. Okay.

9 A. That's No. 1. So can you ask a question
10 that goes to the second piece that you wanted?

11 Q. Sure. Let's use easier numbers then.

12 A. All right.

13 Q. Assume -- assume that embedded in the
14 amount that Duke has to pay under the ICPA is \$10
15 million that the Ohio Commission doesn't think Duke
16 should have paid. Then -- and then Duke, they still
17 have to pay the ICPA for the entire 10 million no
18 matter what, right? So assuming Duke can collect all
19 of its costs from the ICPA from customers but the
20 Commission disallows some of those costs, Duke still
21 has to pay OVEC, right?

22 A. So I think -- I think that's answered in
23 my first -- the answer I gave you in the first
24 question, that we are going to pay what we are
25 obligated under the ICPA.

1 Q. Okay. So if --

2 A. I feels like I answered that.

3 Q. So then the second question if you have
4 to pay but you have a loss, the loss is recorded at
5 the distribution utility.

6 A. And the loss is the difference between
7 what I paid and what the Commission allows me to
8 collect?

9 Q. That's correct.

10 A. I guess it would depend on what the -- so
11 the hypothetical is the Commission says you can't
12 collect it. Then I would be -- I am paying the
13 money. It feels like that's -- it feels like that's
14 answering the first question.

15 Q. Okay. So -- so here's the summary
16 question which makes all of this much easier, the
17 fact that the Ohio Commission would have no control
18 over the amount of money Duke Energy Ohio pays to
19 OVEC.

20 MS. SPILLER: Under the ICPA.

21 Q. For the ICPA.

22 MS. SPILLER: Are there any hypothetical
23 facts here?

24 MR. OLIKER: No.

25 A. I don't think Duke Energy -- I don't

1 think the PUCO has any say in what Duke Energy Ohio
2 pays to OVEC.

3 Q. Thank you. I should have asked that
4 first.

5 A. That would have been a lot easier. There
6 were some great examples in there hypothetically,
7 great examples.

8 Q. Okay. Now, moving on from that let's --
9 actually let's do one more example. One more
10 example. Okay. Let's assume OVEC decides to install
11 an IGCC or a carbon captured sequestration facility,
12 and it costs \$5 million. Ohio Commission does not
13 agree with that decision. Would you agree that Duke
14 Energy Ohio would still have to pay?

15 A. So I'm not sure that the members would
16 agree to investing that money.

17 Q. Assuming they were ambitious.

18 A. Or crazy?

19 Q. Or crazy.

20 MS. SPILLER: Do you have enough assumed
21 facts to even?

22 THE WITNESS: I don't know.

23 A. Assume that it was approved as the
24 capital budget?

25 Q. Absolutely.

1 A. I would have to look at the rules, man,
2 about \$5 billion. I don't think -- I don't think
3 they could spend 5 -- that feels like that would
4 require unanimity among the members not a majority,
5 but I would have to look at what the --

6 Q. Assume there is -- assume there is
7 unanimity the whole way. Everybody wants to build
8 this. They are excited to build the CCS facilities.

9 A. I am assuming it makes economic sense.

10 Q. Okay. And I understand that but take all
11 those other facts off the table but if they do --

12 A. What other facts off the table?

13 Q. If they build a \$5 billion facility --

14 A. And it makes sense to build the \$5
15 billion dollar --

16 MS. SPILLER: Don't think about it making
17 sense.

18 Q. It's irrelevant for purposes of this
19 hypothetical. Say they think it makes sense but the
20 Ohio Commission doesn't and then there is a
21 disallowance in Ohio at the distribution level. The
22 distribution utility still has to pay though, right?

23 MS. SPILLER: What's the disallowance for
24 and under what mechanism?

25 A. Joe, that feels like the same question

1 you asked me before, right?

2 Q. It is pretty much. It's just more money.

3 A. So why are we asking it again?

4 Q. I am just trying to make sure it's still
5 the same.

6 A. I think I was pretty clear in the first
7 answer. The hypothetical to me, \$5 billion, the
8 terms of the ICPA are spelled out in the ICPA. We
9 have an obligation to pay though money because we are
10 a signator of the ICPA. If the ICPA can be amended
11 and changed as you go through time, we are going to
12 pay that money.

13 Q. Okay. Moving to a different subject, you
14 would agree that Clifty Creek and Kyger Creek are
15 both coal facilities, right?

16 A. I would.

17 Q. And you're familiar with the fact that
18 the EPA recently issued emission rules for --
19 proposed emission rules for existing power plants.

20 A. I am.

21 Q. And would you agree that those rules
22 could increase the production costs for both coal
23 power plants?

24 A. So I haven't read the rules in detail,
25 and I think it's yet to be determined what the impact

1 brought that request to the board?

2 A. How about -- yes.

3 MR. PRITCHARD: Could I have that
4 question and answer read back.

5 THE WITNESS: That "yes"?

6 MR. PRITCHARD: And the question.

7 THE WITNESS: Oh.

8 (Record read.)

9 Q. The answer was "yes"?

10 A. Yeah. I mean, I think I'm the board
11 member, right, so I think I would interface as other
12 people could come and do it, but I think I would be
13 the likely person to do it.

14 Q. Okay. This may really be the last
15 question.

16 A. I don't believe it.

17 Q. Five parts. I'm just kidding.

18 MS. GRADY: Hypothetical.

19 MS. SPILLER: No.

20 Q. Not a hypothetical but it's --

21 MS. SPILLER: Close?

22 MS. BOJKO: Two hypotheticals.

23 Q. We talked about the physical location of
24 I believe it's Clifty Creek. Now, isn't it possible
25 that PJM could change its capacity market rules and

1 no longer allow Clifty Creek to bid into the capacity
2 market?

3 MS. SPILLER: I am going to object to the
4 extent it calls for you to speculate.

5 A. I think there is potential PJM can change
6 their tariff, and if they change their tariff that
7 precluded OVEC from offering its generation, I don't
8 think it's likely, but they can change their tariff.
9 They are a creature of their tariff.

10 Q. And if that was the case, then OVEC would
11 be dispatched into MISO most likely, correct?

12 A. Now, that's kind of -- those aren't
13 the -- those aren't the only two choices.

14 Q. Okay. But would you agree MISO does not
15 have a functioning capacity market that's equivalent
16 to PJM?

17 A. I'll say since you added the word
18 "equivalent," I would say it's not equivalent to PJM.

19 Q. And by that I mean the compensation is --

20 A. They are different markets.

21 Q. Much less.

22 A. Historically they have been much less.

23 Q. Okay. Thank you.

24 A. But they're different and I think that's
25 important. One is three-year forward looking and one

1 is volunteer -- three-year forward looking and
2 binding, and the other one is elective and one year.
3 So they are different.

4 Q. Thank you for that clarification.

5 A. You're welcome.

6 MR. OLIKER: I think besides some small
7 foundational questions I think that's all I have for
8 the public record.

9 * * * * *

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1 CERTIFICATE

2 State of Ohio :
3 County of Franklin : SS:

4 I, Karen Sue Gibson, Notary Public in and for
5 the State of Ohio, duly commissioned and qualified,
6 certify that the within named Charles R. Whitlock was
7 by me duly sworn to testify to the whole truth in the
8 cause aforesaid; that the testimony was taken down by
9 me in stenotypy in the presence of said witness,
afterwards transcribed upon a computer; that the
foregoing is a true and correct transcript of the
testimony given by said witness taken at the time and
place in the foregoing caption specified and
completed without adjournment.

10 I certify that I am not a relative, employee,
11 or attorney of any of the parties hereto, or of any
attorney or counsel employed by the parties, or
financially interested in the action.

12 IN WITNESS WHEREOF, I have hereunto set my
13 hand and affixed my seal of office at Columbus, Ohio,
14 on this 24th day of September, 2014.

15 Karen Sue Gibson
16 Karen Sue Gibson, Registered
17 Merit Reporter and Notary Public
in and for the State of Ohio.

18 My commission expires August 14, 2015.

19 (KSG-5931)
20
21
22
23
24
25

William Don Wathen, Jr.

BEFORE THE PUBLIC UTILITIES COMMISSION OF OHIO

- - -

In the Matter of the :
 Application of Duke Energy:
 Ohio for Authority to :
 Establish a Standard :
 Service Offer Pursuant to :
 Section 4928.143, Revised : Case No. 14-841-EL-SSO
 Code, in the Form of an :
 Electric Security Plan, :
 Accounting Modifications :
 and Tariffs for Generation:
 Service. :

In the Matter of the :
 Application of Duke Energy:
 Ohio for Authority to : Case No. 14-842-EL-ATA
 Amend its Certified :
 Supplier Tariff, P.U.C.O. :
 No. 20. :

- - -

EXCERPT OF DEPOSITION

of William Don Wathen Jr., taken before me, Carolyn
 M. Burke, a Notary Public in and for the State of
 Ohio, at the offices of Duke Energy, 139 East Fourth
 Street, Cincinnati, Ohio, on Tuesday, September 16,
 2014, at 9:30 a.m.

- - -

ARMSTRONG & OKEY, INC.
 222 East Town Street, 2nd Floor
 Columbus, Ohio 43215-5201
 (614) 224-9481 - (800) 223-9481
 FAX - (614) 224-5724

- - -

1 Q. But would you agree that if OVEC's costs
2 to produce electricity rises at the same rate as the
3 wholesale energy price then OVEC will have no margin?

4 A. As I said, it's a probability not a
5 certainty that they will go up, they will be
6 profitable during high market prices.

7 Q. Okay. Now, in your testimony you
8 indicate that one of the benefits of having the PSR
9 is that there will be steel in the ground; is that
10 correct?

11 A. Yeah, that's the third time I've answered
12 that question, but yes.

13 Q. And I apologize if you answered this as
14 well, but it's not your position that this case will
15 have any impact on the continued operation of OVEC,
16 correct?

17 A. I did answer that question before, and
18 that is the case.

19 Q. When you say "that is the case," you
20 agree this proceeding will have no impact on whether
21 or not OVEC continues to run.

22 MS. SPILLER: Objection. Asked and
23 answered a couple times now.

24 A. That's correct.

25 Q. Okay. Mr. Wathen, you were in the room

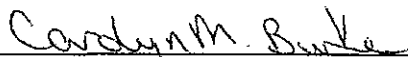
CERTIFICATE

State of Ohio :
County of Franklin : SS:

I, Carolyn M. Burke, Notary Public in and for the State of Ohio, duly commissioned and qualified, certify that the within named William Don Wathen Jr. was by me duly sworn to testify to the whole truth in the cause aforesaid; that the testimony was taken down by me in stenotypy in the presence of said witness, afterwards transcribed upon a computer; that the foregoing is a true and correct excerpt of the transcript of the testimony given by said witness taken at the time and place in the foregoing caption specified and completed without adjournment.

I certify that I am not a relative, employee, or attorney of any of the parties hereto, or of any attorney or counsel employed by the parties, or financially interested in the action.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my seal of office at Columbus, Ohio, on this 25th day of September, 2014.


Carolyn M. Burke, Registered
Professional Reporter, and
Notary Public in and for the
State of Ohio.

My commission expires July 17, 2018.

- - -

CONFIDENTIAL TH-4

CONFIDENTIAL TH-5

BEFORE THE PUBLIC UTILITIES COMMISSION OF OHIO

- - -

In the Matter of the :
Application of Duke Energy:
Ohio for Authority to :
Establish a Standard :
Service Offer Pursuant to :
Section 4928.143, Revised : Case No. 14-841-EL-SSO
Code, in the Form of an :
Electric Security Plan, :
Accounting Modifications :
and Tariffs for Generation:
Service. :

In the Matter of the :
Application of Duke Energy:
Ohio for Authority to : Case No. 14-842-EL-ATA
Amend its Certified :
Supplier Tariff, P.U.C.O. :
No. 20. :

- - -

EXCERPT OF DEPOSITION

of John D. Brodt, taken before me, Carolyn M. Burke,
a Notary Public in and for the State of Ohio, at the
offices of the Ohio Consumers' Counsel, 10 West Broad
Street, 18th, Floor, Columbus, Ohio, on Monday,
September 15, 2014, at 10:30 a.m.

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1 A. No. It was FirstEnergy --

2 Q. The electric distribution utility?

3 A. Yes.

4 Q. Prior to that, could you describe that
5 transfer?

6 A. Prior to that, it would have been
7 FirstEnergy to Buckeye Power.

8 Q. And when you say "FirstEnergy," do you
9 mean FirstEnergy the distribution utility or
10 FirstEnergy Generation?

11 A. Actually, I think it was Allegheny Power
12 which is now part of FirstEnergy to Buckeye Power was
13 the transaction.

14 Q. Okay. Thank you.

15 Now, the transfer -- let me take a step
16 back.

17 Were all of these transfers executed
18 through a right of first refusal?

19 A. My recollection was only the Wolverine
20 and the Buckeye Power transfers were right of first
21 refusal.

22 Q. Okay. And is it your understanding when
23 a transfer occurs through a right of first refusal,
24 if the transferee that's identified has a sufficient
25 credit rating, you do not need the approval of the

1 other sponsoring companies?

2 A. That's correct.

3 Q. So let me ask you a hypothetical.

4 Assuming Duke Energy Ohio brought a proposal to the
5 board -- or, to the other sponsoring companies that
6 it wanted to transfer its interest in OVEC to a third
7 party and that third party had a sufficient credit
8 rating, no other party could stop Duke from
9 transferring its interest.

10 A. That's correct.

11 MS. SPILLER: I'm going to object to the
12 form, the hypothetical, and the relevance.

13 Q. You may answer.

14 A. That's correct.

15 Q. Thank you.

16 Now, just a few questions about the
17 generating plants. We talked about Clifty Creek and
18 Kyger Creek; is that correct?

19 A. That's correct.

20 Q. And would you agree that Clifty Creek is
21 located in Indiana?

22 A. Yes, it is.

23 Q. And would you agree it's located in
24 Indiana that is actually a part of Indiana that's
25 actually in MISO?

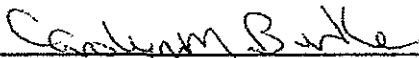
CERTIFICATE

State of Ohio :
County of Franklin : SS:

I, Carolyn M. Burke, Notary Public in and for the State of Ohio, duly commissioned and qualified, certify that the within named John D. Brodt was by me duly sworn to testify to the whole truth in the cause aforesaid; that the testimony was taken down by me in stenotypy in the presence of said witness, afterwards transcribed upon a computer; that the foregoing is a true and correct excerpt of the transcript of the testimony given by said witness taken at the time and place in the foregoing caption specified and completed without adjournment.

I certify that I am not a relative, employee, or attorney of any of the parties hereto, or of any attorney or counsel employed by the parties, or financially interested in the action.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my seal of office at Columbus, Ohio, on this 25th day of September, 2014.


Carolyn M. Burke, Registered
Professional Reporter, and
Notary Public in and for the
State of Ohio.

My commission expires July 17, 2018.

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CONFIDENTIAL PORTION OF TH-6

CONFIDENTIAL TH-7

CONFIDENTIAL TH-8

CONFIDENTIAL TH-9