**Britt T. McKinney**
Sr. Vice President & Chief Nuclear Officer

**PPL Susquehanna, LLC**
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JUL 10 2006

U. S. Nuclear Regulatory Commission
Attn: Document Control Desk
Mail Sop OP1-17
Washington, DC 20555

**SUSQUEHANNA STEAM ELECTRIC STATION**
**ANNUAL FINANCIAL REPORT**
**PLA-6079**

**Docket Nos. 50-387**
**and 50-388**

In accordance with 10 CFR 50.71(b), enclosed is the 2005 Annual Report for PPL Corporation, the parent company of PPL Susquehanna, LLC, and the 2005Annual Report for Allegheny Electric Cooperative, Inc.

Please contact Rocco R. Sgarro, Manager, Nuclear Regulatory Affairs at (610) 774-7552, if you have any questions concerning the reports.

Sincerely,

B. T. McKinney

Enclosure 1 – PPL Corporation 2005 Annual Report
Enclosure 2 – Allegheny Electric Cooperative Inc., 2005 Annual Report

cc: NRC Region I
Mr. A. J. Blamey, NRC Sr. Resident Inspector
Mr. R. V. Guzman, NRC Project Manager
Mr. R. Janati, DEP/BRP

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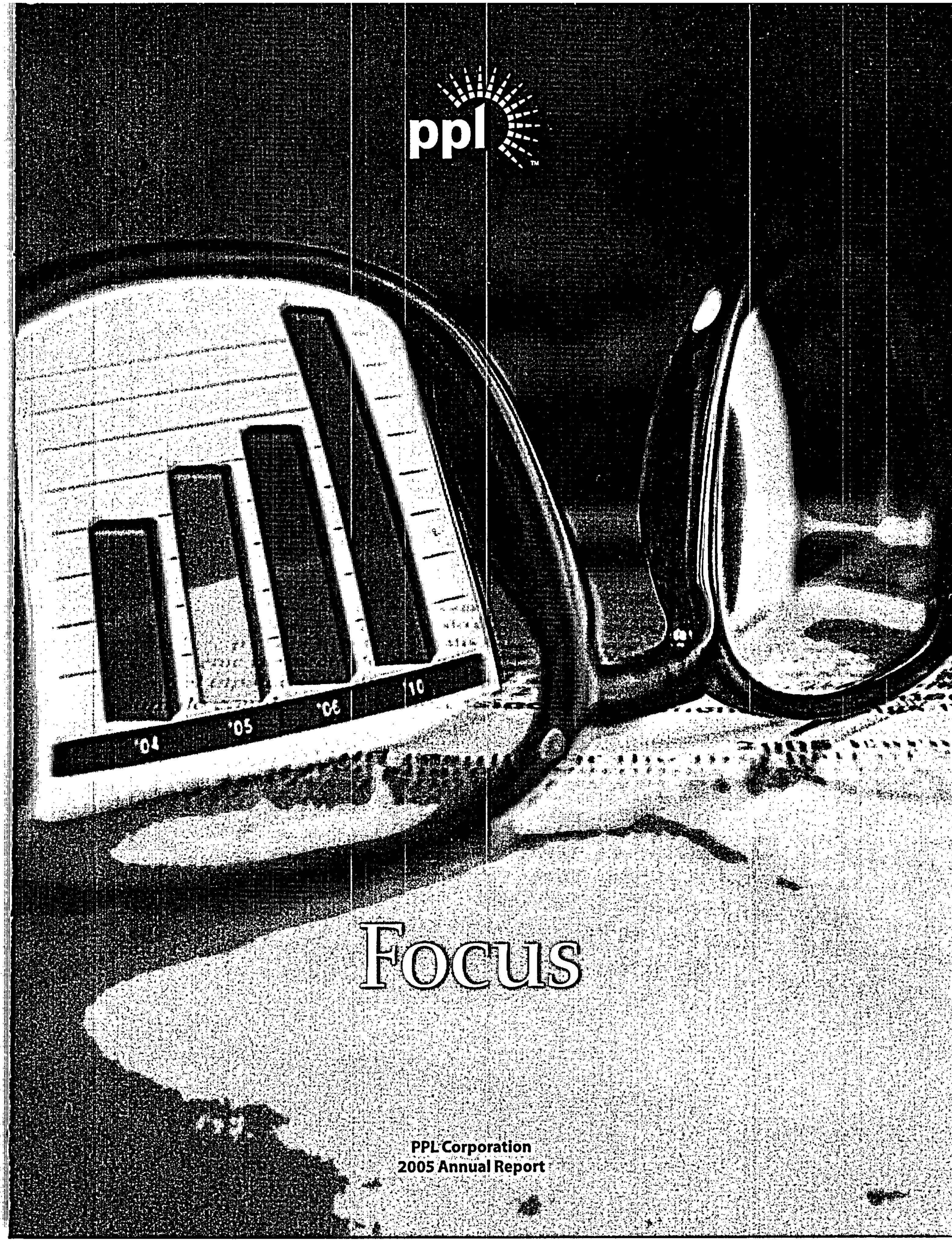



# Focus

PPL Corporation
2005 Annual Report

In the past decade, PPL has grown dramatically, more than doubling its annual revenues; increasing its number of customers by 300 percent; expanding its geographic reach to three continents; and growing its generation capacity by 50 percent. Through this strategic transformation, PPL has built a record of quality customer service and well-above-average returns to its shareowners. The company now forecasts double-digit compound annual earnings growth through 2010. How? By remaining focused on the basics, on five principles that drive both strategic planning and day-to-day actions.

1. Cost-effective, reliable operations
2. Highest-quality customer service
3. Quantitative risk management
4. Anticipation of opportunities and change
5. Constructive public policy relationships

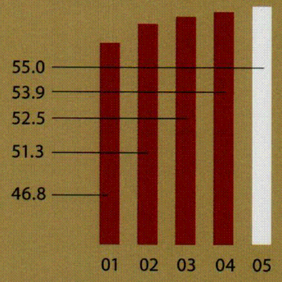
1. COST-EFFECTIVE, RELIABLE OPERATIONS

**We are continuing to improve our operations, reducing costs, improving the availability of our power plants and the reliability of our delivery businesses. In all cases, we measure our safety performance against the best in all industries.**

# Employees have taken personal ownership.

**Bryce L. Shriver, President–PPL Generation,** *in a meeting at the Montour power plant.*

**Record-setting Performance at PPL Power Plants**
(billions of kwh)




We have a lofty vision — to become the best integrated generating fleet in the United States.

We can achieve this vision because we have well-designed, well-maintained plants and we have employees who take a great deal of personal pride in the success of our company. And, we understand the value of a clear purpose, of persistence and of hard work.

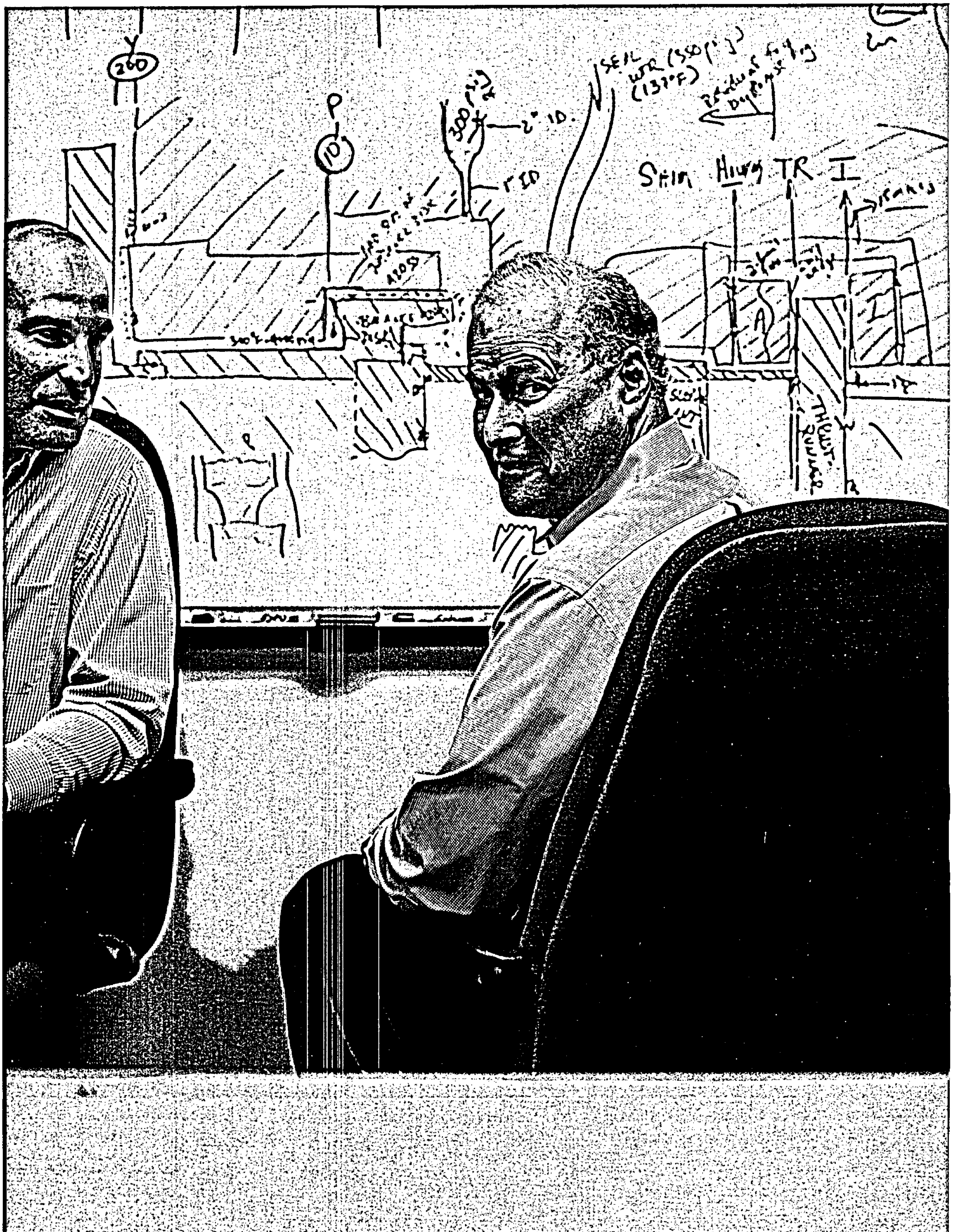
We also are intelligently investing in equipment upgrades that increase our electricity-producing capacity and reduce our maintenance expenses without increasing fuel costs.

We are improving our processes for day-to-day operations and for power plant maintenance work by identifying the best practices not only in our own generation fleet, but also throughout our industry. A major focus is a reduction in the time it takes to perform scheduled maintenance work at all our plants.

I'm proud to say that, through an intensive effort involving everyone from frontline employees to senior management, nearly all of our operations have achieved a special status with OSHA that is reserved for only a handful of the safest industrial facilities in the country. Clearly, our commitment to safety is the right thing to do, and we have demonstrated that a strong safety culture is directly linked to strong performance in other areas. Excellent safety performance requires a systematic, disciplined approach that carries over into all aspects of the operation.

In PPL Generation and in other parts of the company, employees have taken personal ownership and accountability in the effort to be the best. They understand what we are working to accomplish and why our success is vital to building value for our shareowners.

— *Bryce Shriver*

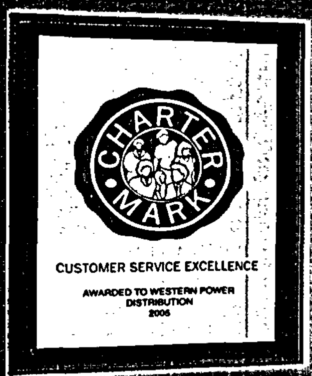


## 2. HIGHEST-QUALITY CUSTOMER SERVICE

**It is our objective to provide the highest levels of customer service, so that our operations regularly rank among the best in the countries in which we do business.**

# It's really not that complicated.

**Robert A. Symons,**
**Chief Executive–**
**Western Power Distribution,**
***in the WPD network control center in Wales, U.K.***
***(page 6)***




Western Power Distribution has won five Charter Mark awards, a top customer service award in the United Kingdom.

Inherently, people in our business want to do a good job. What they need is support and an understanding that management takes customer service very, very seriously.

Obviously, we are obsessed with pleasing customers. When I go out and talk with my peers, they would say we are excessive; they might even say that we are crazy. But, in this type of business, we are here to serve customers.

We believe that, at the end of the day, if you focus on the customer, the business will prosper both in the short term and, more important, in the long run. In fact, last year we were the only company to be recognized by the U.K. regulator for reliability and customer service. That recognition resulted directly in additional revenues in the setting of our rates.

Because everyone knows we are serious about customer service, we have great ideas flowing up from employees. A technician in one of our field locations developed a navigation system, based on our network diagrams and using the Global Positioning System, that enables staff to restore supplies and repair faults more quickly. And, we put the system in place in less than six months. It's not just about having a good idea, it's also about seeing it through.

We work very hard to keep the focus simple: It's about customer service, reliability, cost-efficiency and safety. It's really not that complicated. In fact, if the organization is focused, it's dead easy.

*—Robert Symons*

# What was good in the past is not good enough today.

We have been able to distinguish ourselves from others because PPL people put themselves in our customers' shoes. They treat customers the way that they would want to be treated themselves.

Our employees also take enormous pride in their work. They understand that they have inherited a legacy of superior customer service from the people who came before them. Every day, we are seeking better ways to serve our customers, to build upon a heritage of service that is more than eight decades old.

We know that what was good in the past is not good enough today. Customer expectations change. We won't continue to receive customer service awards unless we continue to find better ways to cost-effectively serve our customers.

To emphasize this need for improvement, we are continually measuring, against the best in the industry, our performance in customer satisfaction, reliability, safety and profitability. In each of our facilities, our year-to-date performance on these measures is clearly displayed. We always know where we stand.

Another key to our success is our commitment to anticipating customer and community needs. More often than not, people in this area of Pennsylvania know a PPL person they can talk to if they have a concern. PPL people have a long history of community involvement, of being good neighbors.

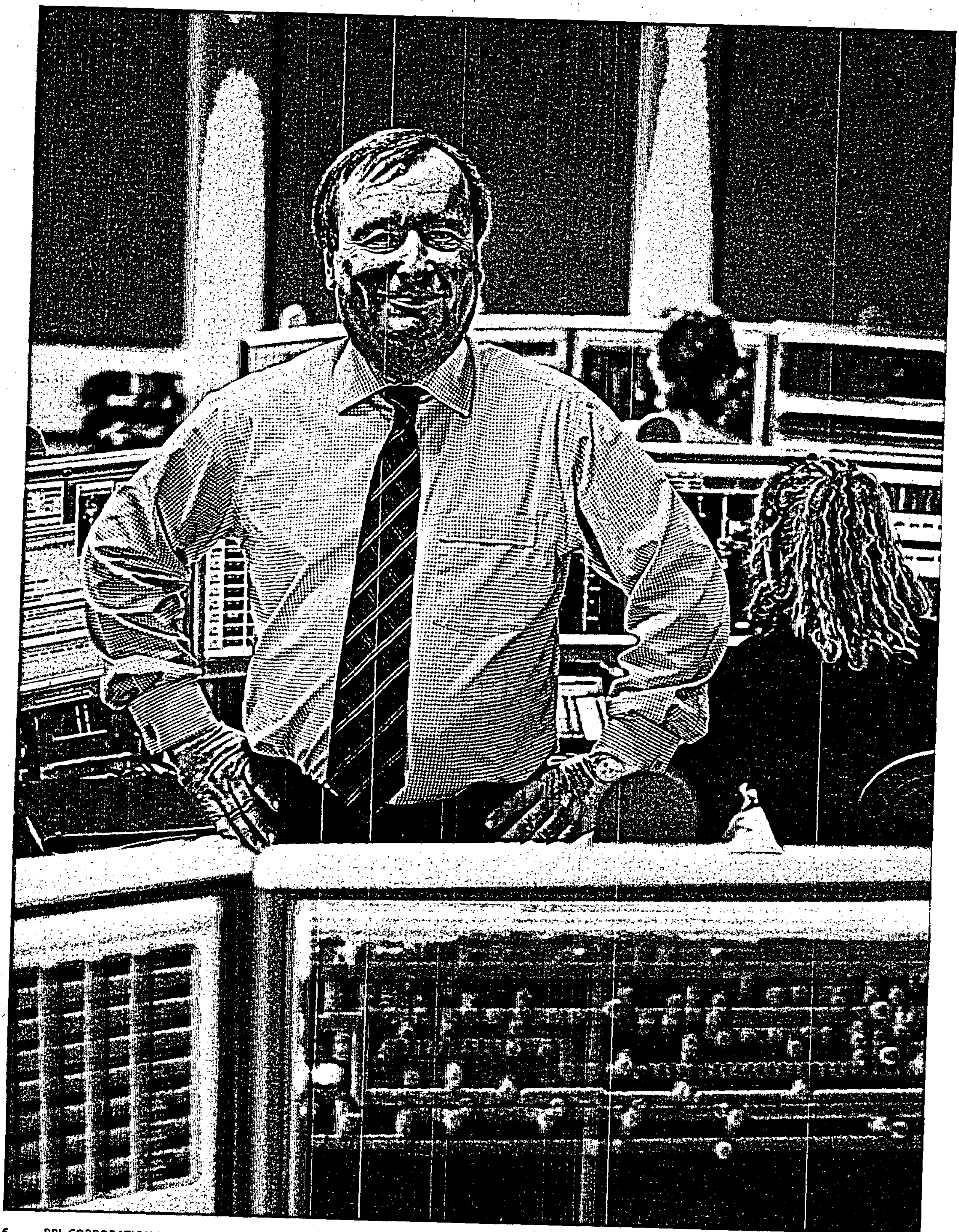
We're much more than a faceless company—and that makes all the difference.

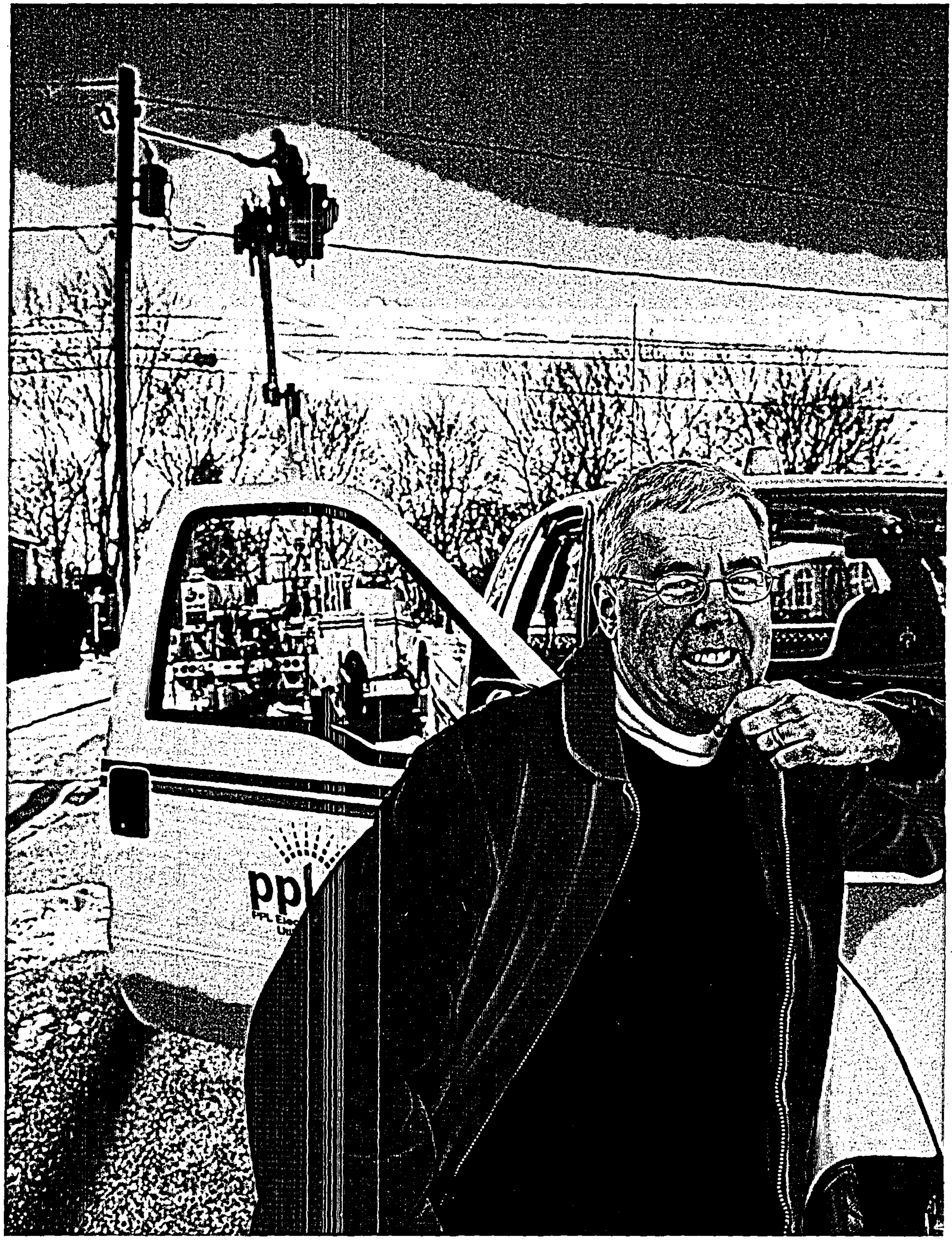
—*John Sipics*

**John F. Sipics,**
**President–PPL Electric Utilities,**
*at a Pennsylvania work site.*
*(page 7)*


"Highest in customer satisfaction with residential electric service in the Eastern U.S., five years in a row."

*J.D. Power and Associates 2001-2005 Electric Utility Residential Customer Satisfaction Studies℠. 2005 study based on a total of 26,782 consumer responses. The 15 largest electric companies were ranked in the study. (www.jdpower.com)*

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3. QUANTITATIVE RISK MANAGEMENT

**Without risk, there is no reward. Through our sophisticated quantitative analysis, we determine which risks are appropriate for PPL, which opportunities provide the best long-term benefits. We undertake this analysis on a range of issues.**

# Numbers can be very useful or useless.

**Vijay Singh,**
**Vice President–Risk Management,**
*in the company's energy marketing center.*

Risk management is an important part of our very disciplined and consistent way of measuring, monitoring and managing our business.

There has to be a context. Numbers can be very useful or useless, depending on how you choose to integrate them and use them for decision-making purposes.

Because we have people in our risk management group who understand the business context, we go well beyond simply informing the energy marketing center on how much risk is added by different types of transactions. We advise on the optimum way to manage the risk under a variety of projected outcomes.

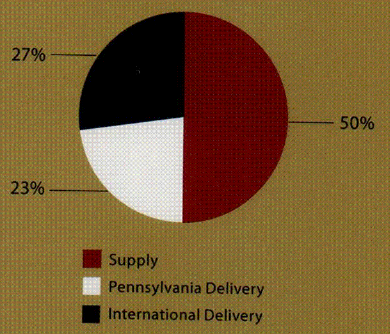
Risk management is fairly new to the energy industry. It was originally adapted from certain methods first used in the financial services industry. While it is more difficult to apply this rigor to energy markets, we have been successful in designing state-of-the-art measures that apply well to the energy industry in identification and measurement of risks.

Nor do we stop running these scenarios after a deal is made. Market conditions can change and positions might need to be adjusted, so we continue to test the appropriateness of the positions in our portfolio.

We also make recommendations on how the company should hedge its risk in a variety of areas, including foreign exchange, for example. These hedges not only reduce the company's risk, they also reduce the level of "noise" in our earnings so that investors can, appropriately, make decisions about PPL based on the performance of our generation and distribution businesses.

*— Vijay Singh*

**2005 Ongoing Earnings by Business Segment***




*See page 98 for a reconciliation of business segment earnings from ongoing operations and reported earnings.

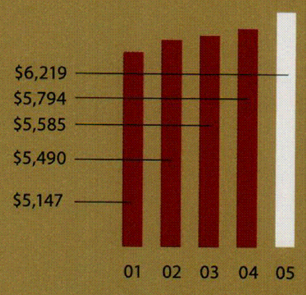
4. ANTICIPATION OF OPPORTUNITIES AND CHANGE

**An external focus is absolutely essential. Employees not only are experts in their particular function, they also are responsible for taking a step back to anticipate changes in our business.**

# Constantly scanning the external environment.

**James H. Miller,**
**PPL Corporation President**
**and COO,**
*at the Corette power plant in Montana.*

**Revenues Continue to Set Records**
(in millions)




In today's world, one of the qualities that a management team requires is an ability to recognize change and react quickly. Our sector faces numerous uncertainties, and these uncertainties bring opportunities as well as challenges.

Our managers are constantly scanning the external environment. They understand the expectation that they be experts in our business —both in terms of the industry as a whole and in their specialty.

Change and opportunity come in four major categories: regulatory, environmental, technical and political.

On the regulatory front, how will federal and state decision-makers proceed with deregulation of electricity markets? Will they move forward or will we remain partially regulated and partially deregulated? Will there be an effective policy to justify investment in construction of new power plants?

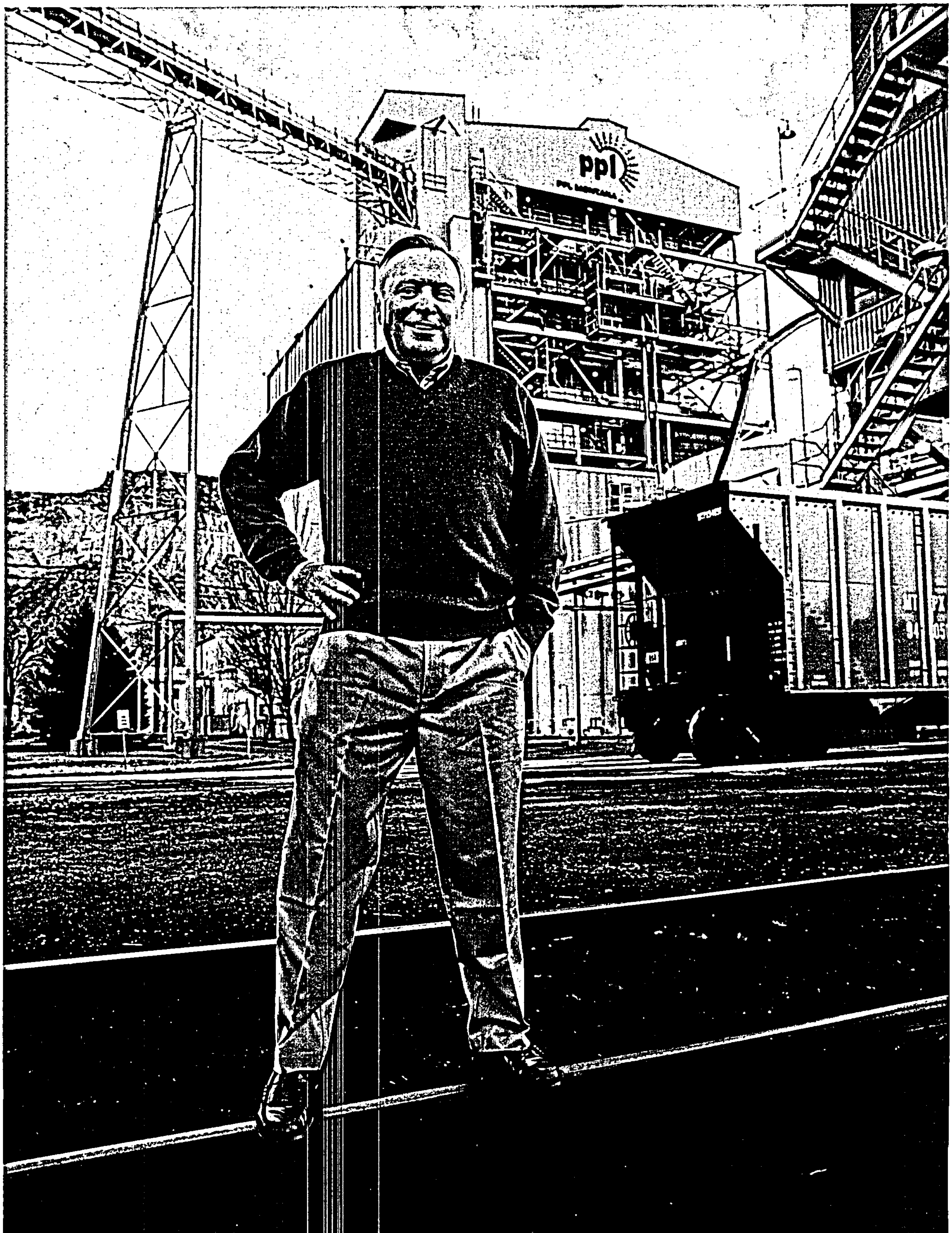
Environmental issues continue to dominate our business. Based on our assessment of the marketplace for emission allowances, we are spending $1.5 billion to install new pollution control equipment at five of our Pennsylvania generating units. Yet, uncertainty remains about the impact of future environmental regulation.

Technical advances continue and can change the thinking about everything from the appropriate fuel sources for new power plants to the way meters are read in the distribution businesses.

As we've seen over the past several years, fuel and power prices can become a political issue, resulting in new regulations, seemingly overnight.

PPL's strategy is designed to accommodate new opportunities and the changes that are inherent in our business today. We evaluate all opportunities with a focused discipline and an understanding of our strengths.

*— Jim Miller*



5. CONSTRUCTIVE PUBLIC POLICY RELATIONSHIPS

**We believe in developing good working relationships with regulators, legislators and other decision-makers who affect our business. Public officials have a difficult job to do, and we seek to provide them with information that will help in their deliberations.**

# Searching for constructive outcomes.

**Joanne H. Raphael,**
**Vice President–External Affairs,**
***In Washington, D.C.***

When we talk about constructive relationships with public officials, we don't mean that we always will prevail in a policy discussion. We do mean, however, that we will have the opportunity to be heard, that we have an open door with public officials.

As a company, we have a well-deserved reputation for very diligently thinking through positions. Particularly in areas where we have done business for some time, we have a reputation for providing credible, useful information to decision-makers, who are continually confronted with a wide range of issues and a host of divergent interests.

We search for constructive outcomes, avoiding the "just-say-no" approach to emerging issues. We realize that there are significant pressures on both elected officials and regulators. We are committed to ethically seeking outcomes that are in the best long-term interests of our shareowners, our customers and the communities we serve.

There are certain things for which PPL is clearly known: We support competitive wholesale electricity markets, mandatory reliability standards for electric transmission and distribution companies and the highest customer service standards. We support continual improvement in nuclear power plant operations and environmental stewardship. We support a pro-business agenda that encourages private sector investment that results in economic development and jobs.

Our relationships with public officials mirror the way we do business. We seek to be known as a credible, honest and well-run company, one that is committed to improving the quality of life for the millions of people we serve around the world.

*—Joanne Raphael*

## Financial Highlights

| For the years ended December 31 | 2005 | 2004[a] |
|---|---|---|
| **Financial** | | |
| Operating revenues (millions) [b] | $ 6,219 | $ 5,794 |
| Net income (millions) [c] | 678 | 698 |
| Earnings from ongoing operations (millions) [c] | 798 | 690 |
| Basic earnings per share | 1.79 | 1.89 |
| Diluted earnings per share | 1.77 | 1.89 |
| Basic earnings per share – ongoing operations [c][f] | 2.10 | 1.87 |
| Diluted earnings per share – ongoing operations [c][f] | 2.08 | 1.87 |
| Dividends declared per share | 0.96 | 0.82 |
| Total assets (millions) [d] | 17,926 | 17,733 |
| Book value per share [d] | 11.62 | 11.21 |
| Market price per share [d] | 29.40 | 26.64 |
| Dividend yield [d] | 3.27% | 3.08% |
| Dividend payout ratio [e] | 54% | 44% |
| Dividend payout ratio – ongoing operations [e][f] | 46% | 44% |
| Market/book value ratio [d] | 253% | 238% |
| Price/earnings ratio [d][e] | 16.61 | 14.10 |
| Price/earnings ratio – ongoing operations [d][e][f] | 14.13 | 14.25 |
| Ratio of earnings to fixed charges | 2.6 | 2.7 |
| Return on average common equity | 15.65% | 18.14% |
| Return on average common equity – ongoing operations [f] | 18.16% | 18.09% |
| **Operating** | | |
| Domestic – Electric energy supplied – retail (millions of kwh) | 39,413 | 37,673 |
| Domestic – Electric energy supplied – wholesale (millions of kwh) | 33,768 | 37,394 |
| Domestic – Electric energy delivered (millions of kwh) | 37,358 | 35,906 |
| International – Electric energy delivered (millions of kwh) | 33,146 | 32,846 |
| Net system capacity (megawatts) [d] | 11,830 | 12,274 |
| Number of customers (millions) [d] | 5.2 | 5.1 |
| Construction expenditures (millions) | $ 811 | $ 734 |

(a) Per share amounts have been adjusted for the 2-for-1 common stock split in August 2005.

(b) 2004 amount reclassified to conform to the current presentation.

(c) Net income, or earnings, is a financial measure reported in accordance with generally accepted accounting principles (GAAP). Net income in 2005 and 2004 was affected by several unusual items. Earnings from ongoing operations excludes the impact of these unusual items. Earnings from ongoing operations should not be considered as an alternative to net income, which is determined in accordance with GAAP, as an indicator of operating performance. PPL believes that earnings from ongoing operations, although a non-GAAP measure, is also useful and meaningful to investors because it provides them with PPL's underlying earnings performance as another criterion in making their investment decisions. PPL's management also uses earnings from ongoing operations in measuring certain corporate performance goals. Other companies may use different measures to present financial performance. See page 98 for a reconciliation of earnings from ongoing operations and net income.

(d) End of period.

(e) Based on diluted earnings per share.

(f) Calculated using earnings from ongoing operations.

William F. Hecht–Chairman and Chief Executive Officer

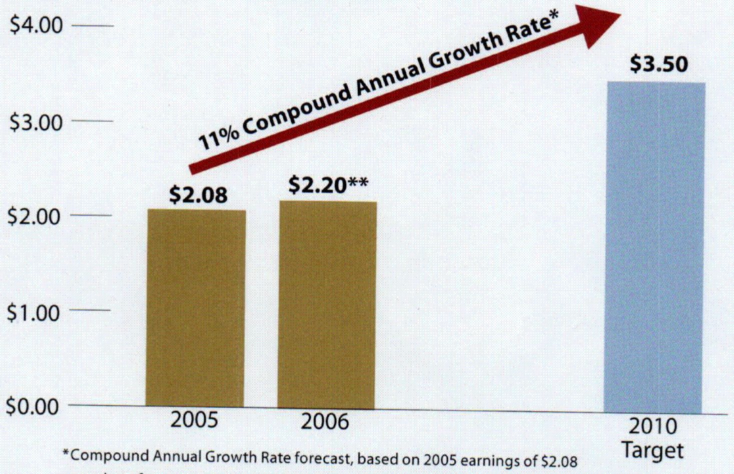
**Dear Shareowners,**

In 2005, as much as in any year during the decade-long transformation of your company, the benefits of our efforts came into focus.

In late summer, we announced that we were doubling our long-term earnings growth forecast, splitting our stock and increasing our dividend. Early this year, we increased the dividend again—for the third time in 13 months—and significantly increased our long-term forecast once again.

Our annualized dividend is now $1.10 per share, more than double its level of just five years ago.

## Earnings per Share Growth Projection




*Compound Annual Growth Rate forecast, based on 2005 earnings of $2.08 per share from ongoing operations. See page 98 for the definition of earnings from ongoing operations, a reconciliation of reported earnings from ongoing operations and key assumptions in this forecast.

**Midpoint of $2.15 to $2.25 forecast.

As I write to you today, I am very pleased to tell you that we now project an 11 percent compound annual growth in earnings per share through 2010. This forecast is based on very visible growth prospects, driven primarily by our supply operation, which includes our generation and marketing functions.

We are able to make these exceptionally strong growth forecasts because we have in place a business model that provides us with opportunities to succeed in a wide variety of market and economic conditions.

In 2005, for instance, we were able to improve our earnings from ongoing operations by 11 percent despite very tight margins in wholesale electricity markets and some unexpected outages at our power plants. This was largely due to the strong performance of our electricity delivery operations in Pennsylvania and internationally, which contributed nearly half of our earnings from ongoing operations, up from about 40 percent in 2004.

As you know, however, any business model is only as good as an organization's ability to execute — to ensure each day that it is getting the most out of the resources entrusted to it. PPL's continued attention to its business fundamentals has been a major contributor as we have built the company into a successful electricity delivery, generation and marketing company.

In this year's annual report, some of our executives tell the story of PPL's focus, of the principles of execution that underpin our success in the very competitive electricity business.

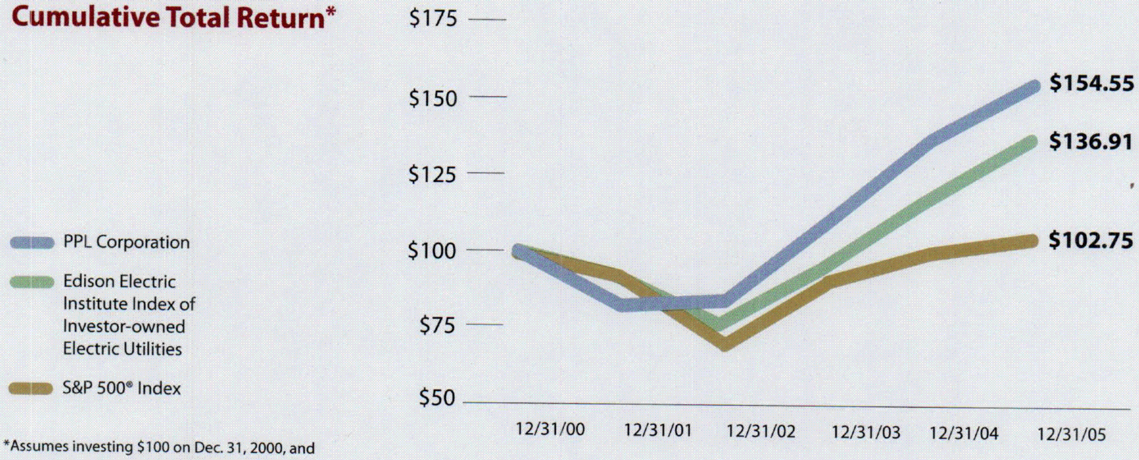
These discussions also underscore another strength of PPL — the experience, insight and enthusiasm of our employees. Through our long-standing commitment to attracting and developing the best talent available, we have assembled a superb employee team — one that is extraordinarily well-prepared to continue to grow value for you.

Heading the team is Jim Miller, our current president, who will replace me as chairman and chief executive officer of your company when I retire later this year.

I have had the pleasure of working daily with Jim over the past five years, and I know that I speak for the entire board of directors in expressing our confidence that Jim has the insight, intelligence and management talent to meet the challenges of tomorrow, capitalizing on the right opportunities for you. Jim brought decades of executive experience to PPL when he came here and has been instrumental in fashioning the business model that permits us to forecast double-digit annual earnings growth through the remainder of this decade.

Jim also shares my conviction that our prospects for future success are only as good as our ability to execute the strategies we have in place.

## Comparison of 5-year Cumulative Total Return*




*Assumes investing $100 on Dec. 31, 2000, and reinvesting dividends in PPL common stock, S&P 500® Index and EEI Index of Investor-owned Electric Utilities.

That's why we've worked tirelessly to ensure that PPL people, at all levels of our organization, are committed to achieving the challenging objectives that we have laid out for ourselves. Objectives like industry-leading performance of our power plants, customer service ratings that are unsurpassed in the countries in which we do business and superior safety performance. Our employees understand that achievement of best-in-the-sector performance is our objective in everything we do.

Inherent in our high expectations is an understanding that we are prepared to cope with unexpected challenges and capitalize on unexpected opportunities; that we are adept at calculating our risk and at developing contingency plans in advance of the potential need. While it is a truism that no one can hope to predict the future, we can—and do—anticipate a range of outcomes, meaning we are ready to act when the need arises.

Thus, in 2005, we were able to respond affirmatively and comprehensively to a range of events, from an uncharacteristic environmental problem at our Martins Creek power plant to providing crews to help Gulf Coast utilities restore service following severe hurricanes to avoiding unexpected cost pressures when fuel prices rose.

Our persistent focus on fundamentals permits us to confidently forecast growth that would improve our earnings to $3.50 per share in 2010, an increase of more than 65 percent from 2005 earnings from ongoing operations. Our focus also has enabled us to significantly outperform the Standard & Poor's 500 Index® and the Edison Electric Institute Index of Investor-Owned Electric Utilities over both the past five years and the past 10 years.

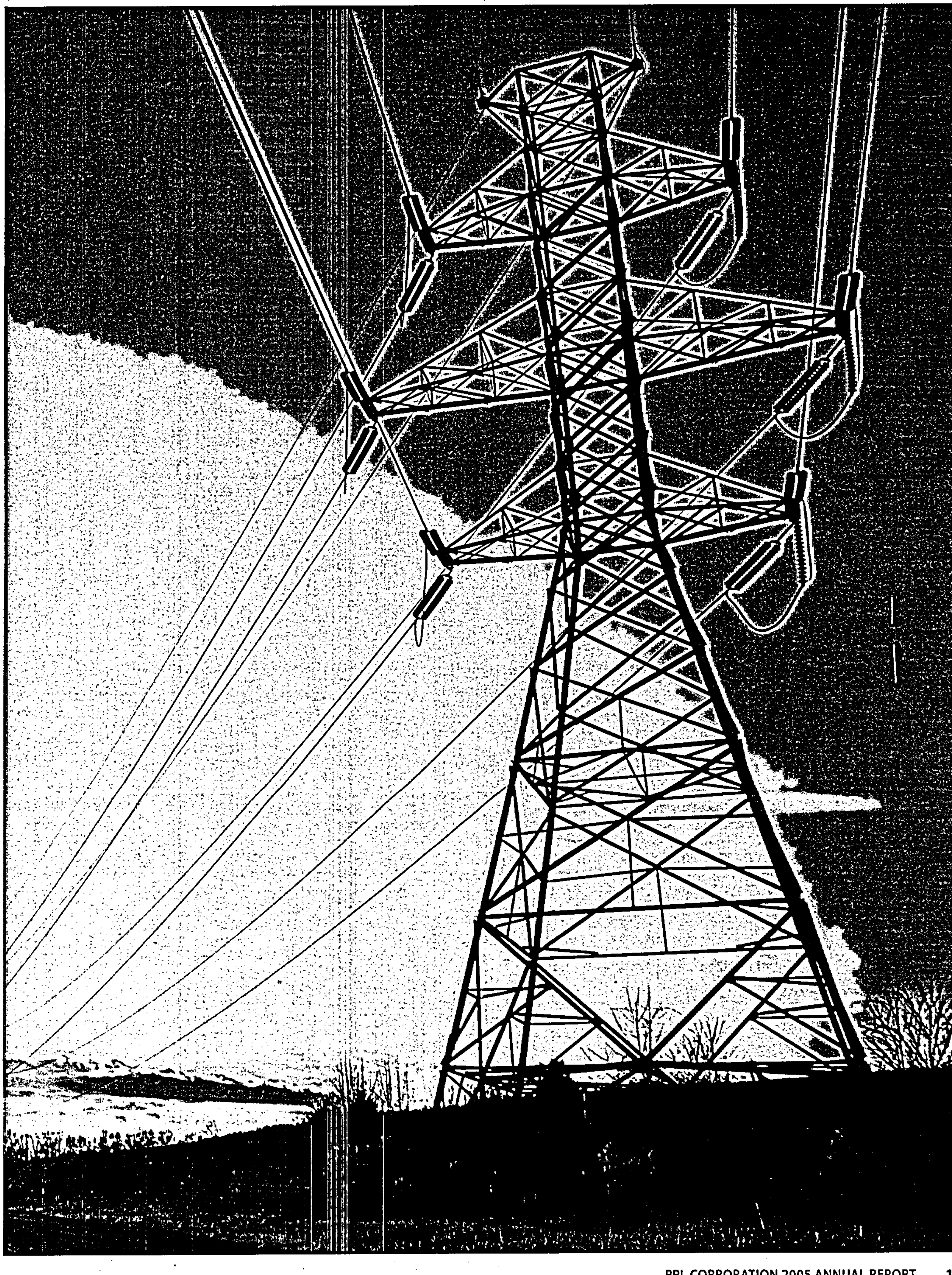
As we look to the future, I am confident that the people of PPL will continue to identify—and take advantage of—opportunities to grow your company in a sustainable way. PPL will continue to be a major electricity supplier in key markets. We also will continue to provide the best in electricity delivery services to more than 5 million customers on three continents.

Speaking on behalf of the 12,000 employees of your company, I thank you for the confidence you have placed in us. I pledge our continued hard work—and a steadfast focus on the principles that continue to grow value for you.

**William F. Hecht**
Chairman and Chief Executive Officer
March 20, 2006

# Our business: At-a-glance.

| Major Businesses | Locations | Customers | Employees | President | Business Advantage |
|---|---|---|---|---|---|
| **PPL EnergyPlus** Wholesale/retail energy marketing; energy services | Pennsylvania<br>Montana<br>New York<br>Massachusetts<br>Connecticut<br>New Jersey | Wholesale customers in key U.S. markets; retail or energy services customers in 10 states | 2,000 | Paul T. Champagne | Superior understanding of markets; ability to hedge risk; wide range of energy services to support retail services |
| **PPL Generation** Electricity generation | Pennsylvania<br>Montana<br>Maine<br>Connecticut<br>Arizona<br>New York<br>Illinois | PPL EnergyPlus; wholesale customers in western United States | 2,600 | Bryce L. Shriver | Eight decades of experience; dedication to continuous improvement and implementation of industry best practices |
| **PPL Global** Operation of international electricity delivery businesses | England<br>Wales<br>Chile<br>El Salvador<br>Bolivia | 3.7 million electricity delivery customers | 3,800 | Rick L. Klingensmith | Ability to deliver award-winning customer service while minimizing costs |
| **PPL Electric Utilities** Operation of U.S. electricity delivery business | Pennsylvania | 1.4 million electricity delivery customers | 2,200 | John F. Sipics | Ability to deliver award-winning customer service while minimizing costs |



*By John R. Biggar,*
*Executive Vice President*
*and Chief Financial Officer*

# Financially speaking

PPL is in the enviable position of being able to continue to grow its common stock dividend over the remainder of this decade while also strengthening its balance sheet.

We have grown our dividend substantially, increasing it by 108 percent over the past five years, including three increases since the beginning of 2005.

Looking to the future, we expect that the growth rate of our dividends over the next few years will continue to exceed the growth rate in our earnings per share, resulting in a dividend payout ratio above 50 percent after 2006.

Even while we continue to grow our dividend, we remain solidly focused on our balance sheet, which provides the foundation for PPL's overall financial strength. We expect PPL's equity to grow by about $1.9 billion over the balance of the decade — about $400 million a year after paying dividends.

We anticipate only a modest increase in overall debt during this period, driving significant improvement in the company's ratio of equity to total capitalization through 2010. This improvement in our balance sheet is a direct result of the strength of our cash flows and earnings power and is especially impressive when considering that, over this period, we will be investing $1.5 billion to install new state-of-the-art pollution control equipment at our largest coal-fired power plants. These investments demonstrate the company's ongoing commitment to the environment and provide the company with a stronger competitive position to drive earnings growth through 2010 and beyond.

For the remainder of the decade, we expect to be able to fund our currently anticipated capital expenditure program through a combination of internally generated funds and issuance of modest amounts of debt and preferred securities. This will allow us to maintain our credit rating profile without the need to issue any additional common stock and is projected to provide the capability for a common stock buy-back near the end of the decade.

# Financial Contents

## SELECTED FINANCIAL AND OPERATING DATA

| PPL Corporation[a] | 2005 | 2004 | 2003 | 2002 | 2001 |
|---|---|---|---|---|---|
| **Income Items – millions** | | | | | |
| Operating revenues[b] | **$ 6,219** | $ 5,794 | $ 5,585 | $ 5,490 | $ 5,147 |
| Operating income | **1,346** | 1,400 | 1,366 | 1,254 | 850 |
| Income from continuing operations | **737** | 713 | 733 | 366 | 169 |
| Net income | **678** | 698 | 734 | 208 | 179 |
| **Balance Sheet Items – millions[c]** | | | | | |
| Property, plant and equipment – net[b] | **10,916** | 11,149 | 10,593 | 9,733 | 5,947 |
| Recoverable transition costs | **1,165** | 1,431 | 1,687 | 1,946 | 2,172 |
| Total assets | **17,926** | 17,733 | 17,123 | 15,552 | 12,562 |
| Long-term debt | **7,081** | 7,658 | 7,859 | 6,267 | 5,579 |
| Long-term debt with affiliate trusts[d] | **89** | 89 | 681 | | |
| Company-obligated mandatorily redeemable preferred securities of subsidiary trusts holding solely company debentures[d] | | | | 661 | 825 |
| Preferred stock | **51** | 51 | 51 | 82 | 82 |
| Common equity | **4,418** | 4,239 | 3,259 | 2,224 | 1,857 |
| Short-term debt | **214** | 42 | 56 | 943 | 118 |
| Total capital provided by investors | **11,853** | 12,079 | 11,906 | 10,177 | 8,461 |
| Capital lease obligations | **11** | 11 | 12 | | |
| **Financial Ratios** | | | | | |
| Return on average common equity – % | **15.65** | 18.14 | 26.55 | 10.27 | 8.41 |
| Embedded cost rates[c] | | | | | |
| Long-term debt – % | **6.60** | 6.67 | 6.56 | 7.04 | 6.84 |
| Preferred stock – % | **5.14** | 5.14 | 5.14 | 5.81 | 5.81 |
| Preferred securities – %[d] | | | | 8.02 | 8.13 |
| Times interest earned before income taxes | **2.68** | 2.79 | 2.98 | 2.25 | 2.15 |
| Ratio of earnings to fixed charges – total enterprise basis[e] | **2.6** | 2.7 | 2.6 | 1.9 | 1.7 |
| **Common Stock Data[i]** | | | | | |
| Number of shares outstanding – thousands | | | | | |
| Year-end | **380,145** | 378,143 | 354,723 | 331,472 | 293,161 |
| Average | **379,132** | 368,456 | 345,589 | 304,984 | 291,948 |
| Number of shareowners of record[c] | **79,198** | 81,175 | 83,783 | 85,002 | 87,796 |
| Income from continuing operations – Basic EPS | **$ 1.94** | $ 1.93 | $ 2.12 | $ 1.20 | $ 0.58 |
| Income from continuing operations – Diluted EPS | **$ 1.92** | $ 1.93 | $ 2.12 | $ 1.20 | $ 0.58 |
| Net income – Basic EPS | **$ 1.79** | $ 1.89 | $ 2.13 | $ 0.68 | $ 0.61 |
| Net income – Diluted EPS | **$ 1.77** | $ 1.89 | $ 2.12 | $ 0.68 | $ 0.61 |
| Dividends declared per share | **$ 0.96** | $ 0.82 | $ 0.77 | $ 0.72 | $ 0.53 |
| Book value per share[c] | **$ 11.62** | $ 11.21 | $ 9.19 | $ 6.71 | $ 6.33 |
| Market price per share[c] | **$ 29.40** | $ 26.64 | $ 21.88 | $ 17.34 | $ 17.43 |
| Dividend payout rate – %[f] | **54** | 44 | 36 | 106 | 87 |
| Dividend yield – %[g] | **3.27** | 3.08 | 3.52 | 4.15 | 3.04 |
| Price earnings ratio[f][g] | **16.61** | 14.10 | 10.32 | 25.50 | 28.57 |
| **Sales Data – millions of kWh** | | | | | |
| Domestic – Electric energy supplied – retail | **39,413** | 37,673 | 36,774 | 36,746 | 37,395 |
| Domestic – Electric energy supplied – wholesale | **33,768** | 37,394 | 37,841 | 36,849 | 27,683 |
| Domestic – Electric energy delivered | **37,358** | 35,906 | 36,083 | 35,712 | 35,534 |
| International – Electric energy delivered[h] | **33,146** | 32,846 | 31,952 | 33,313 | 5,919 |

(a) The earnings each year were affected by items management considers unusual, which affected net income. See "Earnings" in Management's Discussion and Analysis for a description of unusual items in 2005, 2004 and 2003.

(b) Data for certain years are reclassified to conform to the current presentation.

(c) At year-end.

(d) On July 1, 2003, PPL adopted the provisions of SFAS 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity." The company-obligated mandatorily redeemable preferred securities are mandatorily redeemable financial instruments, as they require the issuer to redeem the securities for cash on a specified date. Thus, they should be classified as liabilities, as a component of long-term debt, instead of "mezzanine" equity on the Balance Sheet. However, as of December 31, 2005, 2004 and 2003, no amounts were included in "Long-term Debt" for these securities because PPL Capital Funding Trust I and SIUK Capital Trust I were deconsolidated effective December 31, 2003, in connection with the adoption of FIN 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51," for certain entities. Instead, the subordinated debt securities that support the company-obligated mandatorily redeemable preferred securities of the trusts are reflected in "Long-term Debt with Affiliate Trusts" as of December 31, 2005, 2004 and 2003, to the extent they were outstanding. See Notes 8 and 22 to the Financial Statements for additional information.

(e) Computed using earnings and fixed charges of PPL and its subsidiaries. Fixed charges consist of interest on short- and long-term debt, other interest charges, the estimated interest component of other rentals and preferred dividends.

(f) Based on diluted EPS.

(g) Based on year-end market prices.

(h) Deliveries for 2002 include the electricity deliveries of WPD for the full year and of CEMAR prior to deconsolidation.

(i) Share and per share information in prior periods has been adjusted to reflect PPL's 2-for-1 common stock split completed in August 2005.

## Forward-looking Information

Statements contained in this report concerning expectations, beliefs, plans, objectives, goals, strategies, future events or performance and underlying assumptions and other statements which are other than statements of historical facts are "forward-looking statements" within the meaning of the federal securities laws. Although PPL believes that the expectations and assumptions reflected in these statements are reasonable, there can be no assurance that these expectations will prove to be correct. These forward-looking statements involve a number of risks and uncertainties, and actual results may differ materially from the results discussed in the forward-looking statements. In addition to the specific factors discussed in the Management's Discussion and Analysis, the following are among the important factors that could cause actual results to differ materially from the forward-looking statements:

- market demand and prices for energy, capacity and fuel;
- market prices for crude oil and the potential impact on synthetic fuel tax credits and synthetic fuel operations;
- weather conditions affecting generation production, customer energy usage and operating costs;
- competition in retail and wholesale power markets;
- liquidity of wholesale power markets;
- the effect of any business or industry restructuring;
- the profitability and liquidity, including access to capital markets and credit facilities, of PPL and its subsidiaries;
- new accounting requirements or new interpretations or applications of existing requirements;
- operation and availability of existing generation facilities and operating costs;
- transmission and distribution system conditions and operating costs;
- current and future environmental conditions and requirements and the related costs of compliance, including environmental capital expenditures and emission allowance and other expenses;
- development of new projects, markets and technologies;
- performance of new ventures;
- asset acquisitions and dispositions;
- political, regulatory or economic conditions in states, regions or countries where PPL or its subsidiaries conduct business;
- any impact of 2005's hurricanes on PPL and its subsidiaries, including any impact on fuel prices;
- receipt of necessary governmental permits, approvals and rate relief;
- new state, federal or foreign legislation, including new tax legislation;
- state, federal and foreign regulatory developments;
- impact of state, federal or foreign investigations applicable to PPL and its subsidiaries and the energy industry;
- capital market conditions, including changes in interest rates, and decisions regarding capital structure;
- stock price performance;
- the market prices of equity securities and the impact on pension costs and resultant cash funding requirements for defined benefit pension plans;
- securities and credit ratings;
- foreign currency exchange rates;
- the outcome of litigation against PPL and its subsidiaries;
- potential effects of threatened or actual terrorism or war or other hostilities; and
- the commitments and liabilities of PPL and its subsidiaries.

Any such forward-looking statements should be considered in light of such important factors and in conjunction with PPL's Form 10-K and other reports on file with the SEC.

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

## Overview

PPL is an energy and utility holding company with headquarters in Allentown, PA. PPL's reportable segments are Supply, International Delivery and Pennsylvania Delivery. Through its subsidiaries, PPL is primarily engaged in the generation and marketing of electricity in two key markets – the northeastern and western U.S. – and in the delivery of electricity in Pennsylvania, the U.K. and Latin America. PPL's overall strategy is to achieve disciplined growth in energy supply margins while limiting volatility in both cash flows and earnings and to achieve stable, long-term growth in regulated delivery businesses through efficient operations and strong customer and regulatory relations. More specifically, PPL's strategy for its electricity generation and marketing business is to match energy supply with load, or customer demand, under contracts of varying lengths with creditworthy counterparties to capture profits while effectively managing exposure to movements in energy and fuel prices and counterparty credit risk. PPL's strategy for its electricity delivery businesses is to own and operate these businesses at the most efficient cost while maintaining the highest level of customer service and reliability.

PPL faces several risks in its generation business. The principal risks are electricity wholesale price risk, fuel supply and price risk, power plant performance and counterparty credit risk. PPL attempts to manage these risks through various means. For instance, PPL operates a portfolio of generation assets that is diversified as to geography, fuel source, cost structure and operating characteristics. PPL is focused on the operating efficiency of these power plants and maintaining their availability. In addition, PPL has in place and continues to pursue contracts of varying lengths for energy sales and fuel supply, and other means, to mitigate the risks associated with adverse changes in the difference, or margin, between the cost to produce electricity and the price at which PPL sells it. Whether PPL decides to, or is able to, continue to enter into long-term or intermediate-term power sales and fuel purchase agreements or renew its existing agreements and the market conditions at that time will affect its future profitability. Currently, PPL's commitments for energy sales are substantially satisfied through its own generation assets – i.e., PPL primarily markets and trades around its physical portfolio of generating assets through integrated generation, marketing and trading functions. PPL has in place risk management programs that, among other things, are designed to monitor and manage its exposure to volatility of earnings and cash flows related to changes in energy and fuel prices, interest rates, foreign currency exchange rates, counterparty credit quality and the operational performance of its generating units.

PPL's electricity delivery businesses are rate-regulated. Accordingly, these businesses are subject to regulatory risk in terms of the costs that they may recover and the investment returns that they may collect in customer rates. The principal challenge that PPL faces in its electricity delivery businesses is to maintain high standards of customer service and reliability in a cost-effective manner.

PPL faces additional financial risks in conducting international operations, such as fluctuations in currency exchange rates. PPL attempts to manage these financial risks through its risk management programs.

A key challenge for PPL's business as a whole is to maintain a strong credit profile. Investors, analysts and rating agencies that follow companies in the energy industry continue to be focused on the credit quality and liquidity position of these companies. PPL continually focuses on strengthening its balance sheet and improving its liquidity position, thereby improving its credit profile.

The purpose of Management's Discussion and Analysis is to provide information concerning PPL's past and expected future performance in implementing the strategies and managing the risks and challenges mentioned above. Specifically:

- "Results of Operations" provides an overview of PPL's operating results in 2005, 2004 and 2003, including a review of earnings, with details of results by reportable segment. It also provides a brief outlook for 2006.
- "Financial Condition – Liquidity and Capital Resources" provides an analysis of PPL's liquidity position and credit profile, including its sources of cash (including bank credit facilities and sources of operating cash flow) and uses of cash (including contractual commitments and capital expenditure requirements) and the key risks and uncertainties that impact PPL's past and future liquidity position and financial condition. This subsection also includes a listing and discussion of PPL's current credit ratings.
- "Financial Condition – Risk Management – Energy Marketing & Trading and Other" provides an explanation of PPL's risk management programs relating to market risk and credit risk.
- "Application of Critical Accounting Policies" provides an overview of the accounting policies that are particularly important to the results of operations and financial condition of PPL and that require its management to make significant estimates, assumptions and other judgments. Although PPL's management believes that these estimates, assumptions and other judgments are appropriate, they relate to matters that are inherently uncertain. Accordingly, changes in the estimates, assumptions and other judgments applied to these accounting policies could have a significant impact on PPL's results of operations and financial condition as reflected in PPL's Financial Statements.

The information provided in Management's Discussion and Analysis should be read in conjunction with PPL's Financial Statements and the accompanying Notes.

# Results of Operations

**Earnings**

Net income and the related EPS were:

| | **2005** | 2004 | 2003 |
|---|---|---|---|
| Net income | **$ 678** | $ 698 | $ 734 |
| EPS – basic | **$1.79** | $1.89 | $2.13 |
| EPS – diluted | **$1.77** | $1.89 | $2.12 |

The changes in net income from year to year were, in part, attributable to several significant items that management considers unusual. Details of these unusual items are provided within the review of each segment's earnings.

The year-to-year changes in earnings components, including domestic gross energy margins by region and significant income statement line items, are explained in the "Statement of Income Analysis."

PPL's earnings beyond 2005 are subject to various risks and uncertainties. See the rest of Management's Discussion and Analysis and Note 14 to the Financial Statements for a discussion of the risks, uncertainties and factors that may impact PPL's future earnings.

**Segment Results**

Net income by segment was:

| | **2005** | 2004 | 2003 |
|---|---|---|---|
| Supply | **$311** | $421 | $502 |
| International Delivery | **215** | 197 | 196 |
| Pennsylvania Delivery | **152** | 80 | 36 |
| Total | **$678** | $698 | $734 |

*Supply Segment*

The Supply segment primarily consists of the domestic energy marketing, domestic generation and domestic development operations of PPL Energy Supply.

The Supply segment results in 2005, 2004 and 2003 reflect the reclassification of the Sundance plant operating losses from certain income statement line items to "Loss from Discontinued Operations." See Note 9 to the Financial Statements for further discussion.

Supply segment net income was:

| | 2005 | 2004 | 2003 |
|---|---|---|---|
| Energy revenues | | | |
| External | **$1,264** | $1,360 | $1,371 |
| Intersegment | **1,590** | 1,500 | 1,444 |
| Energy-related businesses | **550** | 463 | 417 |
| Total operating revenues | **3,404** | 3,323 | 3,232 |
| Fuel and energy purchases | | | |
| External | **1,205** | 1,141 | 1,154 |
| Intersegment | **152** | 156 | 161 |
| Other operation and maintenance | **737** | 634 | 608 |
| Depreciation | **144** | 144 | 120 |
| Taxes, other than income | **36** | 41 | 44 |
| Energy-related businesses | **620** | 523 | 447 |
| Total operating expenses | **2,894** | 2,639 | 2,534 |
| Other Income – net | **(2)** | (7) | 28 |
| Interest Expense | **116** | 114 | 38 |
| Income Taxes | **20** | 127 | 186 |
| Minority Interest | **2** | 2 | |
| Distributions on Preferred Securities | | | 21 |
| Loss from Discontinued Operations | **51** | 13 | 14 |
| Cumulative Effects of Changes in Accounting Principles | **(8)** | | 35 |
| Total | **$ 311** | $ 421 | $ 502 |

The after-tax change in net income was due to the following factors, including discontinued operations.

| | 2005 vs. 2004 | 2004 vs. 2003 |
|---|---|---|
| Eastern U.S. non-trading margins | **$ (45)** | $ 35 |
| Southwestern U.S. non-trading margins | **(5)** | (5) |
| Net energy trading margins | **8** | 7 |
| Operation and maintenance expenses | **(26)** | (7) |
| Earnings from synfuel projects | **25** | 11 |
| Depreciation | **3** | (19) |
| Interest expense | **(2)** | (14) |
| Interest income on 2004 IRS tax settlement | **(9)** | 9 |
| Energy-related businesses | **6** | (9) |
| Realized earnings on nuclear decommissioning trust (Note 16) | **7** | (16) |
| Contribution of property | | (10) |
| Income tax reserve adjustments (Note 5) | **21** | |
| Intersegment interest income | **3** | (26) |
| Other | **(11)** | 5 |
| Unusual items | **(85)** | (42) |
| | **$(110)** | $(81) |

The following items, that management considers unusual, had a significant impact on the Supply segment earnings.

| | 2005 | 2004 | 2003 |
|---|---|---|---|
| Off-site remediation of ash basin leak (Note 14) | **$(27)** | | |
| Sale of the Sundance plant (Note 9) | **(47)** | | |
| Acceleration of stock-based compensation expense for periods prior to 2005 (Note 1) | **(3)** | | |
| Settlement of NorthWestern litigation (Note 14) | **(6)** | | |
| Impairment of investment in technology supplier (Note 9) | | $(6) | |
| Recording of AROs (Note 21) | **(8)** | | $63 |
| Consolidation of variable interest entities (Note 22) | | | (27) |
| Total | **$(91)** | $(6) | $36 |

- In May 2005, a subsidiary of PPL Generation completed the sale of its 450 MW Sundance power plant located in Pinal County, Arizona, to Arizona Public Service Company for approximately $190 million in cash. Proceeds of the sale were used to reduce PPL's outstanding debt and improve liquidity. In May 2005, PPL recognized a non-cash after-tax loss on the sale of $47 million (or $0.12 per share).
- In August 2005, a leak from a disposal basin containing fly ash and water at the coal-fired Martins Creek generating station caused the discharge of approximately 100 million gallons of water containing ash from the basin onto adjacent roadways and fields and into a nearby creek and the Delaware River. In 2005, PPL recognized a charge of $31 million after tax (or $0.08 per share), in connection with the current expected on-site costs ($27 million after tax) and off-site costs ($4 million after tax) relating to the leak. PPL cannot predict the final costs to be incurred as a result of this matter.
- In September 2005, PPL and NorthWestern reached a final agreement to settle litigation. In the first quarter of 2005, PPL recognized a charge of $6 million after tax (or $0.02 per share) related to the settlement agreement.
- See "Domestic Gross Energy Margins" for an explanation of non-trading margins by geographic region and for an explanation of net energy trading margins.
- Higher operation and maintenance expenses in 2005 compared with 2004 were primarily due to more planned power plant outages in 2005. Higher operation and maintenance expenses in 2004 compared with 2003 were primarily due to gains in 2003 on the settlement of various property and environmental insurance claims and the higher cost of forced outages in 2004 at the Montour facility. These increases were partially offset by a decrease in lease expense due to the consolidation of the Sundance and University Park generation facilities in accordance with FIN 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51."
- Depreciation expense increased in 2004 compared with 2003 primarily due to the consolidation of the Sundance and University Park generation facilities in accordance with FIN 46 and depreciation on the Lower Mt. Bethel plant, which began commercial operation in May 2004.
- Interest expense increased in 2004 compared with 2003 primarily due to consolidation of the lessors of the Sundance, University Park and Lower Mt. Bethel generation facilities, in accordance with FIN 46.
- The improved earnings contribution from synfuel projects for both periods resulted primarily from higher synthetic fuel tax credits due to higher output at the Tyrone facility, which went into commercial operation in August 2004. Also contributing to the 2005 synthetic fuel earnings increase were unrealized gains on options purchased to hedge the risk associated with synthetic fuel tax credits for 2006 and 2007.

2006 Outlook

Based on current forward energy prices, PPL is projecting higher energy margins for its Supply segment in 2006 compared with 2005, primarily driven by the 8.4% increase in the generation prices under the PLR contracts. Higher generation output, higher-priced wholesale energy contracts that replace expiring contracts, and lower purchased power costs also are expected to improve energy margins. These benefits are expected to be partially offset by increased fuel and fuel transportation expenses, higher operation and maintenance expenses and reduced earnings from synfuel projects.

*International Delivery Segment*

The International Delivery segment includes operations of the international energy businesses of PPL Global that are primarily focused on the distribution of electricity. Virtually all of PPL Global's international businesses are located in the U.K., Chile, El Salvador and Bolivia.

International Delivery segment net income was:

| | 2005 | 2004 | 2003 |
|---|---|---|---|
| Utility revenues | **$1,130** | $1,032 | $ 934 |
| Energy-related businesses | **76** | 70 | 79 |
| Total operating revenues | **1,206** | 1,102 | 1,013 |
| Fuel and energy purchases | **266** | 215 | 199 |
| Other operation and maintenance | **250** | 208 | 184 |
| Depreciation | **157** | 146 | 147 |
| Taxes, other than income | **58** | 56 | 47 |
| Energy-related businesses | **28** | 41 | 41 |
| Total operating expenses | **759** | 666 | 618 |
| Other Income – net | **10** | 31 | 21 |
| Interest Expense | **203** | 203 | 218 |
| Income Taxes | **34** | 59 | (30) |
| Minority Interest | **5** | 6 | 7 |
| Distributions on Preferred Securities | | | 5 |
| Loss from Discontinued Operations | | 2 | 20 |
| Total | **$ 215** | $ 197 | $ 196 |

The after-tax change in net income was due to the following factors, including discontinued operations.

| | 2005 vs. 2004 | 2004 vs. 2003 |
|---|---|---|
| U.K. | | |
| Delivery margins | **$ 23** | $ 5 |
| Operation and maintenance expenses | **(36)** | 7 |
| Impact of changes in foreign currency exchange rates | **2** | 22 |
| Other | **5** | (2) |
| Latin America | **1** | 3 |
| U.S. income taxes | **36** | (22) |
| Interest expense | | 6 |
| Intersegment interest expense | **(3)** | 26 |
| Other | **4** | 3 |
| Unusual items | **(14)** | (47) |
| | **$ 18** | $ 1 |

The following items, that management considers unusual, had a significant impact on the International Delivery segment earnings.

| | 2005 | 2004 | 2003 |
|---|---|---|---|
| Sale of CGE (Note 9) | | $ (7) | |
| Sale of CEMAR (Note 9) | | 23 | |
| Sale of Latin American telecommunications company (Note 9) | | (2) | $(20) |
| CEMAR-related net tax benefit (Note 5) | | | 81 |
| Total | | $ 14 | $ 61 |

- The U.K.'s 2005 earnings were positively affected by higher delivery margins, partially due to favorable customer mix and an incentive revenue award from the regulator for outstanding customer service.
- Higher operation and maintenance expenses in 2005 compared with 2004 were primarily due to increased pension costs in the U.K.
- Changes in foreign exchange rates increased WPD's portion of revenue and expense line items by about 1% in 2005 compared with 2004, and by about 12% in 2004 compared with 2003.
- U.S. income taxes decreased in 2005 compared with 2004 in part due to greater utilization of foreign tax credits. U.S. income taxes increased in 2004 compared with 2003 due to lower domestic spending in 2004 and a favorable income tax return adjustment in 2003, primarily related to 2002 foreign earnings.

2006 Outlook

PPL projects that the International Delivery segment will experience increased operation and maintenance expenses in 2006 compared with 2005, primarily due to higher pension costs at PPL's electricity distribution companies in the U.K., higher U.S. income taxes and a potential unfavorable change in foreign currency exchange rates in 2006.

*Pennsylvania Delivery Segment*

The Pennsylvania Delivery segment includes the regulated electric and gas delivery operations of PPL Electric and PPL Gas Utilities.

Pennsylvania Delivery segment net income was:

| | 2005 | 2004 | 2003 |
|---|---|---|---|
| Operating revenues | | | |
| External | **$3,199** | $2,869 | $2,784 |
| Intersegment | **152** | 156 | 161 |
| Total operating revenues | **3,351** | 3,025 | 2,945 |
| Fuel and energy purchases | | | |
| External | **385** | 325 | 298 |
| Intersegment | **1,590** | 1,500 | 1,444 |
| Other operation and maintenance | **414** | 395 | 385 |
| Amortization of recoverable transition costs | **268** | 257 | 260 |
| Depreciation | **119** | 114 | 109 |
| Taxes, other than income | **185** | 152 | 165 |
| Energy-related businesses | **1** | 2 | 2 |
| Workforce reduction | | | 9 |
| Total operating expenses | **2,962** | 2,745 | 2,672 |
| Other Income – net | **21** | 15 | 6 |
| Interest Expense | **189** | 196 | 217 |
| Income Taxes | **67** | 17 | 23 |
| Distributions on Preferred Securities | **2** | 2 | 3 |
| Total | **$ 152** | $ 80 | $ 36 |

The after-tax change in net income was due to the following factors:

| | 2005 vs. 2004 | 2004 vs. 2003 |
|---|---|---|
| Delivery revenues (net of CTC/ITC amortization, interest expense on transition bonds and ancillary charges) | **$123** | $ 5 |
| Operation and maintenance expenses | **(9)** | (5) |
| Interest expense | **5** | 4 |
| Taxes, other than income (excluding gross receipts tax) | **(8)** | 9 |
| Depreciation | **(3)** | |
| Change in tax reserves associated with stranded costs securitization (Note 5) | **(15)** | 22 |
| Interest income on 2004 IRS tax settlement | **(5)** | 5 |
| Interest income on loans to affiliates | **6** | |
| Income tax reserve adjustments | **3** | |
| Other | **4** | (1) |
| Unusual items | **(29)** | 5 |
| | **$ 72** | $44 |

The following items, that management considers unusual, had a significant impact on the Pennsylvania Delivery segment earnings.

| | 2005 | 2004 | 2003 |
|---|---|---|---|
| PJM billing dispute (Note 14) | **$(27)** | | |
| Acceleration of stock-based compensation expense for periods prior to 2005 (Note 1) | **(2)** | | |
| Workforce reduction (Note 20) | | | $(5) |
| Total | **$(29)** | | $(5) |

- In December 2004, the PUC approved an increase in PPL Electric's distribution rates of approximately $137 million (based on a return on equity of 10.7%), and approved PPL Electric's proposed mechanism for collecting an additional $57 million in transmission-related charges, for a total annual increase of approximately $194 million, effective January 1, 2005.
- Delivery revenues also increased in 2005 compared with 2004 due to a 4.3% increase in electricity delivery sales volumes.
- In January 2005, severe ice storms hit PPL Electric's service territory. As a result, PPL Electric had to restore service to approximately 238,000 customers. The total cost of restoring service, excluding capitalized costs and regular payroll expenses, was approximately $16 million (or $0.02 per share).

  On February 11, 2005, PPL Electric filed a petition with the PUC for authority to defer and amortize for regulatory accounting and reporting purposes these storm costs. On August 26, 2005, the PUC issued an order granting PPL Electric's petition subject to certain conditions, including: (i) the PUC's authorization of deferred accounting is not an assurance of future rate recovery of the storm costs, (ii) PPL Electric must request recovery of the deferred storm costs in its next distribution base rate case, and (iii) PPL Electric must begin immediately to expense the deferred storm costs on a ten-year amortization schedule for regulatory accounting and reporting purposes. As a result of the PUC Order and in accordance with SFAS 71, "Accounting for the Effects of Certain Types of Regulation," in the third quarter of 2005, PPL Electric deferred approximately $12 million (or $0.02 per share) of its previously expensed storm costs. The deferral was based on its assessment of the timing and likelihood of recovering the deferred costs in PPL Electric's next distribution base rate case. At this time, PPL Electric cannot be certain that it will recover the storm costs, nor can it predict whether future incidents of severe weather will cause significant facility damage and service disruptions that would also result in significant costs.
- PPL Electric recognized an after-tax charge of $27 million (or $0.07 per share) in the first quarter of 2005 for a loss contingency related to the PJM billing dispute. See Note 14 for information concerning the proposed settlement agreement reached by PPL Electric and Exelon Corporation, which is subject to approval by the FERC. PPL cannot be certain of the outcome of this matter or the impact on PPL and its subsidiaries.
- Operation and maintenance expense increased in 2005 compared with 2004, primarily due to increased system reliability work and tree trimming costs. Operation and maintenance expenses increased in 2004 compared with 2003, primarily due to the write-off of certain Hurricane Isabel costs not approved for recovery by the PUC, and higher pension costs.

2006 Outlook

PPL projects the Pennsylvania Delivery segment will have flat delivery revenues in 2006 compared with 2005 due to projected modest load growth in 2006 and because of higher sales in 2005 as a result of unusually warm weather. This segment is expected to experience increased operation and maintenance expenses in 2006.

**Statement of Income Analysis – Domestic Gross Energy Margins**

The following table provides pre-tax changes in the income statement line items that comprise domestic gross energy margins.

| | 2005 vs. 2004 | 2004 vs. 2003 |
|---|---|---|
| Utility | **$ 429** | $ 183 |
| Unregulated retail electric and gas | **(13)** | (34) |
| Wholesale energy marketing | **(96)** | 10 |
| Net energy trading margins | **13** | 13 |
| Other revenue adjustments (a) | **(309)** | (115) |
| Total revenues | **24** | 57 |
| Fuel | **162** | 122 |
| Energy purchases | **13** | (92) |
| Other cost adjustments (a) | **(78)** | (34) |
| Total cost of sales | **97** | (4) |
| Domestic gross energy margins | **$ (73)** | $ 61 |

(a) Adjusted to exclude the impact of any revenues and costs not associated with domestic gross energy margins, in particular, revenues and energy costs related to the international operations of PPL Global, the domestic delivery operations of PPL Electric and PPL Gas Utilities and an accrual for the loss contingency related to the PJM billing dispute in 2005 (see Note 14 to the Financial Statements for additional information). Also adjusted to include the margins of PPL's Sundance plant, which are included in "Loss from Discontinued Operations," and gains or losses on sales of emission allowances, which are included in "Other operation and maintenance" expenses, on the Statement of Income. Also, 2003 includes a reduction of the reserve for Enron receivables.

*Changes in Domestic Gross Energy Margins By Region*

Domestic gross energy margins are generated through PPL's normal hedging (non-trading) activities, as well as trading activities. PPL manages its non-trading energy business on a geographic basis that is aligned with its generation assets. In the second quarter of 2005, PPL also began participating in the Midwest ISO (MISO), an independent transmission system operator that serves the electric transmission needs of much of the Midwest. PPL records its business activities within MISO consistent with its accounting for activities in other RTOs.

| | 2005 vs. 2004 | 2004 vs. 2003 |
|---|---|---|
| Eastern U.S. | $(77) | $58 |
| Northwestern U.S. | (1) | (2) |
| Southwestern U.S. | (8) | (8) |
| Net energy trading | 13 | 13 |
| Domestic gross energy margins | $(73) | $61 |

*Eastern U.S.*

Eastern U.S. non-trading margins were lower in 2005 compared with 2004, primarily due to higher fuel costs. Average coal prices increased by 12% over last year, while average gas and oil prices increased by 24%. Despite record high generation in 2005, the increased use of higher-cost oil and gas units to cover retail volumes, which were up 5% over 2004, and generation output lost during coal and nuclear plant outages contributed to lower margins. Due to market price increases and changes in fuel mix, average fuel prices increased 22% over 2004. Partially offsetting the effects of higher supply costs was a 2% increase in retail energy prices, in accordance with the schedule established by the PUC Final Order.

Eastern U.S. non-trading margins were higher in 2004 compared with 2003, primarily due to 3% higher generation, as well as higher prices and slightly higher sales volumes. In PJM, where the majority of PPL's Eastern wholesale activity occurs, average spot prices rose 15% in 2004 over 2003. PPL also benefited from favorable transmission congestion positions. In addition, retail energy prices increased by approximately 1% in 2004 in accordance with the schedule established by the PUC. The higher sales volumes reflect the return of customers who had previously shopped for electricity, as well as new load obligations in Connecticut and New Jersey, partially offset by lower wholesale sales. Partially offsetting these improvements were increased supply costs driven by increased fossil fuel and purchased power prices.

*Southwestern U.S.*

Southwestern U.S. non-trading margins were lower in 2005 compared with 2004, primarily due to the sale of PPL's Sundance plant in May 2005 and the cost to terminate a tolling arrangement on the Griffith plant during the second quarter of 2005.

Southwestern U.S. non-trading margins were lower in 2004 compared with 2003, primarily due to a 17% decrease in wholesale volumes. Also contributing to the decrease in margins was a $3 million positive impact to 2003 margins related to a partial reversal of a reserve against Enron receivables.

*Net Energy Trading*

PPL enters into certain energy contracts that meet the criteria of trading derivatives as defined by EITF Issue 02-3, "Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities." These physical and financial contracts cover trading activity associated with electricity, gas and oil.

Net energy trading margins increased by $13 million in 2005 compared with 2004, primarily due to the inclusion of FTRs. As of July 1, 2005, FTRs were deemed to meet the definition of a derivative and were accounted for as such prospectively. Therefore, the forward and realized value for FTRs entered into for speculative purposes is accounted for as part of "Net energy trading margins" on the Statement of Income. From July 1 through December 31, 2005, gains on speculative FTRs totaled $10 million.

The $13 million increase in net energy trading margins in 2004 compared with 2003 was due to a $6 million increase in electricity positions and a $6 million increase in gas and oil positions.

The physical volumes for electricity and gas associated with energy trading were 5,800 GWh and 13.4 Bcf in 2005; 5,700 GWh and 11.7 Bcf in 2004; and 5,200 GWh and 12.6 Bcf in 2003. The amount of energy trading margins from unrealized mark-to-market transactions was a $5 million loss in 2005, a $13 million gain in 2004 and not significant in 2003.

**Utility Revenues**

The increases in utility revenues were attributable to:

| | 2005 vs. 2004 | 2004 vs. 2003 |
|---|---|---|
| Domestic: | | |
| Retail electric revenue (PPL Electric) | | |
| PLR electric generation supply | $122 | $ 94 |
| Electric delivery | 201 | (7) |
| Wholesale electric revenue (PPL Electric) | (2) | (23) |
| Gas revenue (PPL Gas Utilities) | 9 | 22 |
| Other | 1 | (1) |
| International: | | |
| Retail electric delivery (PPL Global) | | |
| U.K. | 34 | 70 |
| Chile | 52 | 27 |
| El Salvador | 10 | |
| Bolivia | 2 | 1 |
| | $429 | $183 |

The increase in utility revenues for 2005 compared with 2004 was attributable to:

- higher domestic delivery revenues resulting from higher transmission and distribution customer rates effective January 1, 2005, and a 4.3% increase in volume;
- higher PLR revenues due to higher energy and capacity rates and a 6% increase in volume, in part due to the return of customers previously served by alternate suppliers;
- higher revenues in Chile, primarily due to a 7% increase in sales volumes, higher average prices overall and a favorable change in foreign currency exchange rates;

- higher U.K. revenues, primarily due to favorable customer mix, an incentive revenue award for outstanding customer service and a favorable change in foreign currency exchange rates; and
- higher revenues in El Salvador, primarily due to a 6% increase in sales volumes and higher average prices overall.

The increase in utility revenues for 2004 compared with 2003 was attributable to:

- higher PLR revenues due to higher energy and capacity rates and a 3.6% increase in volume, in part due to the return of customers previously served by alternate suppliers;
- higher gas revenues, primarily due to sales of storage gas in the fourth quarter of 2004, and the increase in natural gas prices, which are a pass-through to customer rates, partially offset by a decrease in volume;
- higher U.K. revenues, primarily due to a favorable change in foreign currency exchange rates;
- higher revenues in Chile, due to higher energy prices, which are a pass-through to customer rates, a favorable change in foreign currency exchange rates, and a 7% increase in sales volumes; partially offset by
- lower electric delivery revenues, due to a decrease in ITC and CTC revenue as a result of lower ITC rates, and several rate groups reaching their rate cap; and
- lower wholesale electric revenues, due to the expiration of all PPL Electric municipal purchase power agreements at the end of January 2004.

**Energy-related Businesses**

Energy-related businesses contributed $9 million more to operating income in 2005, compared with 2004. The increase was attributable to:

- a $15 million pre-tax loss in 2004, related to the sale of CGE (see Note 9 to the Financial Statements);
- an aggregate increase of $4 million from various international subsidiary businesses; and
- a $6 million increase from PPL Telcom due to an increase in transport-related sales, as well as reduced spending on a product line; partially offset by
- additional pre-tax losses in 2005 of $16 million on synfuel projects. This reflects $26 million of additional expenses due to higher production levels, offset by a $10 million net unrealized gain on options purchased to hedge a portion of the risk associated with the phase-out of the synthetic fuel tax credits for 2006 and 2007.

Energy-related businesses contributed $39 million less to operating income in 2004 compared with 2003. The decrease was primarily attributable to:

- a $17 million higher pre-tax operating loss from synfuel projects;
- a $15 million pre-tax loss on the sale of CGE in 2004;
- an aggregate decrease of $3 million from various domestic subsidiary businesses; and
- a $3 million pre-tax decrease from Latin American subsidiaries due primarily to lower dividends received and lower construction sales.

**Other Operation and Maintenance**

The increases in other operation and maintenance expenses were due to:

| | 2005 vs. 2004 | 2004 vs. 2003 |
|---|---|---|
| Martins Creek ash basin remediation (Note 14) | $ 48 | |
| Costs associated with severe ice storms in January 2005 | 16 | |
| Subsequent deferral of a portion of costs associated with January 2005 ice storms (Note 1) | (12) | |
| Accelerated amortization of stock-based compensation (Note 1) | 18 | |
| NorthWestern litigation payment (Note 14) | 9 | |
| Outage costs at Eastern U.S. fossil/hydro stations | 14 | $ 1 |
| Outage costs at Susquehanna nuclear station | 6 | 2 |
| Outage costs at Western U.S. fossil/hydro stations | 4 | |
| Change in foreign currency exchange rates | 1 | 15 |
| Reduction in WPD costs that are a pass-through to customers | (7) | (10) |
| Property damage and environmental insurance settlements which were recorded in 2003 | | 27 |
| Increase in domestic system reliability work and tree trimming | 10 | |
| Increase in domestic and international pension costs | 49 | 18 |
| Additional expenses of new generating facilities | | 5 |
| Increase in WPD tree trimming costs | | 8 |
| Decrease in the Clean Air Act contingency relating to generating facilities recorded in 2005 and 2003 | (3) | 8 |
| Consulting and independent auditor costs to meet the requirements of Sarbanes-Oxley 404 | (2) | 6 |
| Write-off of Hurricane Isabel costs not approved for recovery by the PUC | | 4 |
| Decrease in lease expense due to consolidation of the lessor of the University Park generation facility | | (13) |
| WPD capitalization | 4 | (13) |
| Decrease in other postretirement benefit expense | (5) | (12) |
| Other | 14 | 14 |
| | $164 | $ 60 |

The increase in net pension costs for both periods was primarily attributable to reductions in the discount rate assumption for PPL's domestic and international pension plans at December 31, 2004 and 2003. Increased WPD pension obligations as a result of the most recent actuarial valuation as of March 31, 2004, also served to increase the 2005 and ongoing net pension costs.

Although financial markets have improved and equity returns for PPL's domestic and international plans have been strong, interest rates on longer-duration, fixed-income obligations have continued to fall, requiring further reductions to the discount rates at December 31, 2005. In addition, PPL adopted the most current mortality tables and other demographic assumptions for its pension plans as of December 31, 2005. These assumptions are expected to increase PPL's pension costs for 2006 by approximately $20 million. See Note 12 to the financial statements for details on the funded status of PPL's pension plans.

### Depreciation

Increases in depreciation expense were due to:

| | 2005 vs. 2004 | 2004 vs. 2003 |
|---|---|---|
| Lower Mt. Bethel generation facility, which began commercial operation in May 2004 | $ 6 | $ 10 |
| Other additions to PP&E | 14 | 18 |
| University Park generation facility – FIN 46 (a) | | 9 |
| Reduction of useful lives of certain assets (Note 1) | 7 | |
| Foreign currency exchange rates | 1 | 13 |
| 2003 purchase accounting adjustments related to the 2002 acquisition of WPD assets | | (22) |
| Extension of useful lives of certain generation assets (Note 1) | (12) | |
| | $ 16 | $ 28 |

(a) The lessor of this facility was consolidated under FIN 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51," effective December 31, 2003. In June 2004, a subsidiary of PPL Energy Supply purchased the University Park generation facility from the lessor that was consolidated by PPL Energy Supply under FIN 46. See Note 22 to the Financial Statements for additional information.

### Taxes, Other Than Income

In 2004, PPL Electric reversed a $14 million accrued liability for 1998 and 1999 PURTA taxes that had been accrued based on potential exposure in the proceedings regarding the Susquehanna nuclear station tax assessment. The rights of third-party intervenors to further appeal expired in 2004. The reversal and a $19 million increase in domestic gross receipts tax expense, offset by an $8 million decrease in domestic capital stock expense in 2005, are the primary reasons for the $30 million increase in taxes, other than income, compared with 2004.

Taxes, other than income, decreased by $7 million in 2004 compared with 2003. The decrease was primarily due to the reversal of the PURTA tax liability and a $5 million decrease in domestic capital stock expense, partially offset by an $8 million increase in WPD's property tax, primarily from the impact of changes in foreign currency exchange rates, adjustments recorded in 2003 and an increase in property tax rates.

### Workforce Reduction

See Note 20 to the Financial Statements for information on the $9 million charge recorded in 2003.

### Other Income – net

See Note 16 to the Financial Statements for details of other income and deductions.

### Financing Costs

The increase (decrease) in interest expense, which includes "Interest Expense" and "Distributions on Preferred Securities," was due to:

| | 2005 vs. 2004 | 2004 vs. 2003 |
|---|---|---|
| Interest expense related to the Lower Mt. Bethel generation facility, which began commercial operation in May 2004 (a) | $14 | $23 |
| Increase (decrease) in interest expense related to the University Park generation facility (b) | (13) | 13 |
| Interest accrued for PJM billing dispute | 8 | |
| Write-off of financing costs associated with PPL Energy Supply's 2.625% Convertible Senior Notes (Note 8) | 6 | |
| Increase in foreign currency exchange rates | 1 | 15 |
| Increase (decrease) in interest expense due to hedging activities accounted for under SFAS 133, "Accounting for Derivative Instruments and Hedging Activities" | 26 | (11) |
| Increase (decrease) in amortization expense | 9 | (6) |
| Increase (decrease) in short-term debt interest expense | 4 | (10) |
| Decrease in long-term debt interest expense | (55) | (1) |
| (Increase) decrease in capitalized interest | (3) | 1 |
| Write-off of unamortized swap costs on WPD debt restructuring in 2003 | | (11) |
| Other | (2) | |
| | $(5) | $13 |

(a) Prior to commercial operation, interest related to the Lower Mt. Bethel financing was capitalized as part of the cost of the facility.

(b) In June 2004, a subsidiary of PPL Energy Supply purchased the University Park generation facility from the lessor that was consolidated by PPL Energy Supply under FIN 46 (revised December 2003), "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51." In connection with the purchase, the related financing was repaid and the deferred financing costs were written off. See Note 22 to the Financial Statements for further information.

### Income Taxes

Income tax expense decreased by $82 million in 2005 compared with 2004. This decrease was primarily attributable to:

- a $22 million reduction in income taxes related to lower pre-tax book income;
- a $33 million tax benefit recognized in 2005 related to additional nonconventional fuel tax credits in excess of credits recognized in 2004;
- a $19 million decrease in tax expense on foreign earnings in 2005;
- a $12 million reduction in income tax expense related to the filing of PPL's income tax returns; offset by
- a $3 million reduction in tax benefits in 2005 related to federal and state income tax reserves that included a $15 million decrease in tax benefits associated with stranded costs securitization, offset by a $12 million increase in tax benefits associated with other income tax reserves, predicated upon management's reassessment of its best estimate of probable tax exposure relative to 2004.

Income tax expense increased by $24 million in 2004 compared with 2003. This increase was primarily attributable to:

- an $84 million tax benefit recognized in 2003 related to foreign investment losses not recurring in 2004; and
- a $9 million tax benefit recognized in 2003 related to a charitable contribution of property not recurring in 2004; offset by
- a $22 million tax benefit recognized in 2004 related to a reduction in tax reserves associated with stranded costs securitization predicated upon management's reassessment of its best estimate of probable tax exposure relative to 2003;
- a $25 million decrease in tax expense on foreign earnings in 2004; and
- a $22 million tax benefit recognized in 2004 related to additional nonconventional fuel tax credits in excess of credits recognized in 2003.

Annual tax provisions include amounts considered sufficient to pay assessments that may result from examination of prior year tax returns by taxing authorities. However, the amount ultimately paid upon resolution of any issues raised by such authorities may differ materially from the amount accrued. In evaluating the exposure associated with various filing positions, PPL accounts for changes in probable exposures based on management's best estimate of the amount that should be recognized. An allowance is maintained for the tax contingencies, the balance of which management believes to be adequate. During 2004, PPL reached partial settlement with the IRS with respect to the tax years 1991 through 1995 and received a cash refund in the amount of $52 million. As a result of this settlement, the net tax impact recorded in 2004 was not significant.

See Note 5 to the Financial Statements for details on effective income tax rates and for information on the American Jobs Creation Act of 2004.

### Discontinued Operations

In 2003, PPL reported a loss of $20 million in connection with the approval of a plan of sale of PPL Global's investment in a Latin American telecommunications company. In 2005, PPL recorded a $47 million loss, net of a tax benefit of $26 million, on the sale of its Sundance power plant.

See Note 9 to the Financial Statements for information on the sales, along with information regarding operating losses recorded in 2003, 2004 and 2005 for the Sundance plant prior to the sale and for operating losses recorded in 2004 related to the sale of PPL Global's investment in the Latin American telecommunications company.

### Cumulative Effects of Changes in Accounting Principles

In 2003, PPL recorded a charge of $27 million, after-tax, as a cumulative effect of a change in accounting principle in connection with the adoption of FIN 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51," for certain entities. See Note 22 to the Financial Statements for additional information.

PPL adopted SFAS 143, "Accounting for Asset Retirement Obligations," in 2003 and adopted FIN 47, "Accounting for Conditional Asset Retirement Obligations, an Interpretation of FASB Statement No. 143," in 2005. Both pronouncements address the accounting for obligations associated with the retirement of tangible long-lived assets. They require legal obligations associated with the retirement of long-lived assets to be recognized as a liability in the financial statements. Application of the new rules resulted in cumulative effects of changes in accounting principles that increased net income by $63 million in 2003 and decreased net income by $8 million in 2005. See Note 21 to the Financial Statements for additional information.

## Financial Condition

### Liquidity and Capital Resources

PPL is focused on maintaining an appropriate liquidity position and strengthening its balance sheet, thereby continuing to improve its credit profile. PPL believes that its cash on hand, short-term investments, operating cash flows, access to debt and equity capital markets and borrowing capacity, taken as a whole, provide sufficient resources to fund its ongoing operating requirements, future security maturities and estimated future capital expenditures. PPL currently expects cash, cash equivalents and short-term investments at the end of 2006 to be approximately $400 million, while maintaining approximately $3.3 billion in credit facilities. However, PPL's cash flows from operations and its access to cost effective bank and capital markets are subject to risks and uncertainties, including but not limited to:

- changes in market prices for electricity;
- changes in commodity prices that may increase the cost of producing power or decrease the amount PPL receives from selling power;
- price and credit risks associated with selling and marketing products in the wholesale power markets;
- significant switching by customers to or from alternative suppliers that would impact the level of sales under the PLR contracts;
- ineffectiveness of the trading, marketing and risk management policy and programs used to mitigate PPL's risk exposure to adverse energy and fuel prices, interest rates, foreign currency exchange rates and counterparty credit;
- unusual or extreme weather that may damage PPL's transmission and distribution facilities or affect energy sales to customers;
- reliance on transmission and distribution facilities that PPL does not own or control to deliver its electricity and natural gas;
- unavailability of generating units (due to unscheduled or longer-than-anticipated generation outages) and the resulting loss of revenues and additional costs of replacement electricity;
- ability to recover and the timeliness and adequacy of recovery of costs associated with regulated utility businesses;
- costs of compliance with existing and new environmental laws and with new safety requirements for nuclear facilities;
- any adverse outcome of legal proceedings and investigations currently being conducted with respect to PPL's current and past business activities;
- a phase-out of the significant tax credits that PPL receives based on the sale of synthetic fuel; and
- a downgrade in PPL's or its subsidiaries' credit ratings that could negatively affect their ability to access capital and increase the cost of maintaining credit facilities and any new debt.

At December 31, 2005, PPL had $618 million of cash, cash equivalents and short-term investments and $214 million of short-term debt, compared with $682 million in cash, cash equivalents and short-term investments and $42 million of short-term debt at December 31, 2004, and $476 million in cash, cash equivalents and short-term investments and $56 million of short-term debt at December 31, 2003. The changes in PPL's cash and cash equivalents position resulted from:

| | 2005 | 2004[a] | 2003[a] |
|---|---|---|---|
| Net Cash Provided by Operating Activities | **$1,388** | $1,497 | $1,355 |
| Net Cash Used in Investing Activities | **(779)** | (778) | (754) |
| Net Cash Used in Financing Activities | **(676)** | (578) | (387) |
| Effect of Exchange Rates on Cash and Cash Equivalents | **6** | 9 | 7 |
| Net Increase (Decrease) in Cash and Cash Equivalents | **$ (61)** | $ 150 | $ 221 |

[a] See Note 1 to the Financial Statements for an explanation of prior year reclassifications.

*Operating Activities*

Net cash from operating activities decreased by 7%, or $109 million, in 2005 compared with 2004, primarily as a result of increased income tax payments and fuel expenditures, partially offset by favorable margin impacts attributable to the 7.1% increase in distribution rates and transmission cost recoveries effective January 1, 2005. Income tax payments increased primarily due to favorable impacts of tax credits and refunds realized in 2004. Fuel expenditures increased $115 million due to increased prices and inventory build-up in anticipation of price increases in 2006. Net cash from operating activities increased by 10%, or $142 million, in 2004 compared with 2003, reflecting higher energy margins and other improvements in cash-adjusted net income.

PPL expects to continue to maintain stable cash provided by operating activities as a result of its long-term and intermediate-term power sales commitments from wholesale and retail customers and long-term fuel purchase contracts. PPL estimates that, on average, approximately 84% of its expected annual generation output for the period 2006 through 2009 is committed under long-term and intermediate-term power sales contracts. PPL currently estimates that approximately 5% of its expected generation output for 2010 is committed under power sales contracts, due to the expiration of the PLR contracts at the end of 2009. Consistent with its business strategy, PPL expects that the capacity and energy currently committed to long-term power sales contracts will be contracted in the wholesale markets during the next few years. Based on the way in which the wholesale markets have developed to this point, new contracts may be of a shorter duration than the PLR supply contracts with PPL Electric, which at inception had terms of approximately nine years.

PPL's contracts for the sale and purchase of electricity and fuel often require cash collateral or other credit enhancement, or reductions or terminations of a portion of the entire contract through cash settlement, in the event of a downgrade of PPL's or its subsidiaries' credit ratings or adverse changes in market prices. For example, in addition to limiting its trading ability, if PPL's or its subsidiaries' ratings were lowered to below "investment grade" and energy prices increased by 10%, PPL estimates that, based on its December 31, 2005 positions, it would have had to post additional collateral of approximately $611 million, compared with $280 million at December 31, 2004. PPL has in place risk management programs that are designed to monitor and manage its exposure to volatility of cash flows related to changes in energy prices, interest rates, foreign currency exchange rates, counterparty credit quality and the operational performance of its generating units.

*Investing Activities*

Although net cash used in investing activities remained stable in 2005 compared with 2004, and in 2004 compared with 2003, there were significant changes in certain components. PPL received $190 million in proceeds from the sale of the Sundance power plant in 2005, compared with $123 million of proceeds from the sale of PPL's minority interest in CGE in 2004. For 2005 compared with 2004, there was an increase of $58 million in net proceeds from the sales of auction rate securities, an increase of $77 million in capital expenditures and an increase of $63 million in net purchases of emission allowances, in anticipation of future generation. For 2004 compared with 2003, PPL received $123 million of proceeds from the sale of PPL's minority interest in CGE in 2004, which was partially offset by a net increase of $60 million in restricted cash, an increase of $46 million in net purchases of auction rate securities and an increase of $46 million in net purchases of emission allowances. The primary use of cash in investing activities is capital expenditures. See "Forecasted Uses of Cash" for detail regarding capital expenditures in 2005 and projected expenditures for the years 2006 through 2010.

*Financing Activities*

Net cash used in financing activities was $676 million in 2005, compared with $578 million in 2004 and $387 million in 2003. The increase from 2004 to 2005 primarily reflects the continued retirement of long-term debt and increased dividends to shareowners. In 2005, cash used in financing activities primarily consisted of net debt retirements of $340 million and common and preferred distributions paid of $349 million, partially offset by common stock sale proceeds of $37 million.

In 2004, cash used in financing activities primarily consisted of net debt retirements of $863 million and common and preferred distributions paid of $299 million, partially offset by common stock sale proceeds of $596 million, of which $575 million related to the settlement of the common stock purchase contracts that were a component of the PEPS Units and the PEPS Units, Series B.

In 2003, cash used in financing activities primarily consisted of net debt retirements of $460 million, preferred stock retirements of $31 million and common and preferred distributions paid of $287 million, partially offset by common stock sale proceeds of approximately $426 million. See "Forecasted Sources of Cash" for a discussion of PPL's plans to issue debt and equity securities, as well as a discussion of credit facility capacity available to PPL. Also see "Forecasted Uses of Cash" for a discussion of PPL's plans to pay dividends on its common and preferred securities and repurchase common stock in the future, as well as maturities of PPL's long-term debt.

PPL's debt financing activity in 2005 was:

| | Issuances | Retirements |
|---|---|---|
| PPL Energy Supply Senior Unsecured Notes (a) | $313 | |
| PPL Capital Funding Medium-Term Notes | | $(350) |
| PPL Transition Bond Company Transition Bonds | | (266) |
| PPL Electric First Mortgage Bonds | | (69) |
| PPL Electric First Mortgage Pollution Control Bonds | 224 | (224) |
| PPL Electric Senior Secured Bonds | 200 | |
| PPL Capital Funding Subordinated Notes | | (142) |
| WPD Unsecured Bonds (b) | | (208) |
| WPD short-term debt (net change) | 84 | |
| PPL Energy Supply Commercial Paper (net change) | 100 | |
| Latin American companies long-term debt | | (2) |
| Total | $921 | $(1,261) |
| Net reduction | | $(340) |

(a) Includes a premium of approximately $13 million associated with the remarketing feature of the 5.70% REset Put Securities due 2035.

(b) Repayment includes $30 million that was used to settle a related cross-currency swap.

Debt issued during 2005 had stated interest rates ranging from 2.25% to 9.0% and maturities from 2005 through 2035. See Note 8 to the Financial Statements for more detailed information regarding PPL's financing activities.

*Forecasted Sources of Cash*

PPL expects to continue to have significant sources of cash available in the near term, including various credit facilities, commercial paper programs, an asset-backed commercial paper program and operating leases. PPL also expects to continue to have access to debt and equity capital markets, as necessary, for its long-term financing needs.

Credit Facilities

At December 31, 2005, PPL's total committed borrowing capacity under credit facilities and the use of this borrowing capacity were:

| | Committed Capacity | Borrowed | Letters of Credit Issued and Commercial Paper Backstop (d) | Available Capacity |
|---|---|---|---|---|
| PPL Electric Credit Facilities (a) | $ 300 | | | $ 300 |
| PPL Energy Supply Credit Facilities (b) | 2,400 | | $757 | 1,643 |
| WPD (South West) Bank Facilities (c) | 697 | $55 | 2 | 640 |
| Total | $3,397 | $55 | $759 | $2,583 |

(a) Borrowings under PPL Electric's credit facilities bear interest at LIBOR-based rates plus a spread, depending upon the company's public debt rating. PPL Electric also has the capability to cause the lenders to issue up to $300 million of letters of credit under these facilities, which issuances reduce available borrowing capacity.

The credit facilities contain a financial covenant requiring debt to total capitalization to not exceed 70%. At December 31, 2005 and 2004, PPL Electric's consolidated debt to total capitalization percentages, as calculated in accordance with its credit facilities, were 55% and 54%. The credit facilities also contain standard representations and warranties that must be made for PPL Electric to borrow under them.

(b) Borrowings under PPL Energy Supply's credit facilities bear interest at LIBOR-based rates plus a spread, depending upon the company's public debt rating. PPL Energy Supply also has the capability to cause the lenders to issue up to $2.4 billion of letters of credit under these facilities, which issuances reduce available borrowing capacity.

These credit facilities contain a financial covenant requiring debt to total capitalization to not exceed 65%. At December 31, 2005 and 2004, PPL Energy Supply's consolidated debt to total capitalization percentages, as calculated in accordance with its credit facilities were 35% and 34%. The credit facilities also contain standard representations and warranties that must be made for PPL Energy Supply to borrow under them.

(c) Borrowings under WPD (South West)'s credit facilities bear interest at LIBOR-based rates plus a spread, depending upon the company's public debt rating. WPD (South West) also has the capability to cause the lenders to issue up to approximately $4 million of letters of credit under one of its facilities, which can only be used for letters of credit.

These credit facilities contain financial covenants that require WPD (South West) to maintain an interest coverage ratio of not less than 3.0 times consolidated earnings before income taxes, depreciation and amortization and a regulatory asset base (RAB) at £150 million greater than total gross debt, in each case as calculated in accordance with the credit facilities. At December 31, 2005 and 2004, WPD (South West)'s interest coverage ratios, as calculated in accordance with its credit lines, were 6.0 and 6.8. At December 31, 2005 and 2004, WPD (South West)'s RAB, as calculated in accordance with the credit facilities, exceeded its total gross debt by £407 million and £534 million.

(d) The Borrower under each of these facilities has a reimbursement obligation to the extent any letters of credit are drawn upon. The letters of credit issued as of December 31, 2005, expire as follows: $641 million in 2006 and $18 million in 2007.

As of December 31, 2005, $100 million of PPL Energy Supply's credit facility capacity served as commercial paper backstop.

In addition to the financial covenants noted in the table above, these credit agreements contain various other covenants. Failure to meet the covenants beyond applicable grace periods could result in acceleration of due dates of borrowings and/or termination of the agreements. PPL monitors the covenants on a regular basis. At December 31, 2005, PPL was in material compliance with those covenants. At this time, PPL believes that these covenants and other borrowing conditions will not limit access to these funding sources. PPL intends to renew and extend $2.5 billion of its credit facility capacity in 2006. See Note 8 to the Financial Statements for further discussion of PPL's credit facilities.

Commercial Paper

PPL Energy Supply and PPL Electric maintain commercial paper programs for up to $500 million for PPL Energy Supply and for up to $200 million for PPL Electric to provide them each with an additional financing source to fund their short-term liquidity needs, if and when necessary. Commercial paper issuances are supported by certain credit agreements of each company. PPL Energy Supply had $100 million of commercial paper outstanding at December 31, 2005, and no commercial paper outstanding at December 31, 2004. PPL Electric had no commercial paper outstanding at December 31, 2005 and 2004. During 2006, PPL Energy Supply and PPL Electric may issue commercial paper from time-to-time to facilitate short-term cash flow needs.

Asset-Backed Commercial Paper Program

PPL Electric participates in an asset-backed commercial paper program through which PPL Electric obtains financing by selling and contributing its eligible accounts receivable and unbilled revenue to a special purpose, wholly owned subsidiary on an ongoing basis. The subsidiary pledges these assets to secure loans of up to an aggregate of $150 million from a commercial paper conduit sponsored by a financial institution. PPL Electric uses the proceeds from the program for general corporate purposes and to cash collateralize letters of credit. At December 31, 2005 and 2004, the loan balance outstanding was $42 million, all of which was being used to cash collateralize letters of credit. See Note 8 to the Financial Statements for further discussion of the asset-backed commercial paper program.

Operating Leases

PPL and its subsidiaries also have available funding sources that are provided through operating leases. PPL's subsidiaries lease vehicles, office space, land, buildings, personal computers and other equipment. These leasing structures provide PPL with additional operating and financing flexibility. The operating leases contain covenants that are typical for these agreements, such as maintaining insurance, maintaining corporate existence and timely payment of rent and other fees. Failure to meet these covenants could limit or restrict access to these funds or require early payment of obligations. At this time, PPL believes that these covenants will not limit access to these funding sources or cause acceleration or termination of the leases.

PPL, through its subsidiary PPL Montana, leases a 50% interest in Colstrip Units 1 and 2 and a 30% interest in Unit 3, under four 36-year, non-cancelable operating leases. These operating leases are not recorded on PPL's Balance Sheet, which is in accordance with applicable accounting guidance. The leases place certain restrictions on PPL Montana's ability to incur additional debt, sell assets and declare dividends. At this time, PPL believes that these restrictions will not limit access to these funding sources or cause acceleration or termination of the leases. See Note 8 to the Financial Statements for a discussion of other dividend restrictions related to PPL subsidiaries.

See Note 10 to the Financial Statements for further discussion of the operating leases.

Long-Term Debt and Equity Securities

Subject to market conditions in 2006, PPL and its subsidiaries currently plan to issue approximately $1.1 billion in long-term debt securities and $250 million in preferred securities. PPL expects to use the proceeds primarily to fund capital expenditures, to fund maturities of existing debt and for general corporate purposes. PPL currently does not plan to issue any significant amounts of common stock in 2006.

*Forecasted Uses of Cash*

In addition to expenditures required for normal operating activities, such as purchased power, payroll, fuel and taxes, PPL currently expects to incur future cash outflows for capital expenditures, various contractual obligations, payment of dividends on its common and preferred securities and possibly the repurchase of a portion of its common stock, beginning in 2009.

Capital Expenditures

The table below shows PPL's actual spending for the year 2005 and current capital expenditure projections for the years 2006 through 2010.

| | Actual | Projected | | | | |
|---|---|---|---|---|---|---|
| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
| Construction expenditures [(a)] [(b)] | | | | | | |
| Generating facilities | $180 | $256 | $216 | $167 | $200 | $174 |
| Transmission and distribution facilities | 460 | 511 | 526 | 511 | 552 | 615 |
| Environmental | 48 | 370 | 567 | 296 | 64 | 67 |
| Other | 59 | 82 | 76 | 37 | 29 | 29 |
| Total Construction Expenditures | 747 | 1,219 | 1,385 | 1,011 | 845 | 885 |
| Nuclear fuel | 64 | 81 | 92 | 97 | 97 | 99 |
| Total Capital Expenditures | $811 | $1,300 | $1,477 | $1,108 | $942 | $984 |

[(a)] *Construction expenditures include AFUDC and capitalized interest, which are expected to be approximately $151 million for the 2006-2010 period.*

[(b)] This information excludes any potential investments by PPL Global and PPL Development Company for new projects.

PPL's capital expenditure projections for the years 2006-2010 total approximately $5.8 billion. Capital expenditure plans are revised periodically to reflect changes in market and regulatory conditions. See Note 14 to the Financial Statements for additional information regarding the installation costs of sulfur dioxide scrubbers and other pollution control equipment, which comprise most of the "Environmental" expenditures noted above.

PPL plans to fund all of its capital expenditures in 2006 with cash on hand, cash from operations, and, when necessary, the issuance of debt securities.

Contractual Obligations

PPL has assumed various financial obligations and commitments in the ordinary course of conducting its business. At December 31, 2005, the estimated contractual cash obligations of PPL were:

| Contractual Cash Obligations | Total | Less Than 1 Year | 1-3 Years | 4-5 Years | After 5 Years |
|---|---|---|---|---|---|
| Long-term Debt[a] | $ 7,189 | $1,126 | $1,647 | $ 702 | $3,714 |
| Capital Lease Obligations | 17 | 1 | 2 | 2 | 12 |
| Operating Leases | 758 | 77 | 134 | 124 | 423 |
| Purchase Obligations[b] | 4,224 | 1,414 | 1,786 | 429 | 595 |
| Other Long-term Liabilities Reflected on the Balance Sheet under GAAP[c] | 65 | 27 | 38 | | |
| Total Contractual Cash Obligations | $12,253 | $2,645 | $3,607 | $1,257 | $4,744 |

[a] Reflects principal maturities only, including maturities of consolidated lease debt. See Note 4 to the Financial Statements for a discussion of conversion triggers related to PPL Energy Supply's 2.625% Convertible Senior Notes. Also, see Note 8 for a discussion of the remarketing feature related to PPL Energy Supply's 5.70% REset Put Securities.

[b] The payments reflected herein are subject to change, as certain purchase obligations included are estimates based on projected obligated quantities and/or projected pricing under the contracts. Purchase orders made in the ordinary course of business are excluded from the amounts presented. Includes obligations related to nuclear fuel and the installation of the scrubbers, which are also reflected in the Capital Expenditures table presented above.

[c] The amounts reflected represent estimated deficit pension funding requirements arising from an actuarial valuation performed in March 2004 and do not include pension funding requirements for future service.

Dividends

In December 2004, PPL's Board of Directors adopted a dividend policy that provides for growing the common stock dividend in the future at a rate exceeding the projected rate of growth in earnings per share from ongoing operations until the dividend payout ratio reaches the 50 percent level, which PPL expects to occur in 2006. Earnings from ongoing operations exclude items that management considers unusual. In February 2006, PPL announced its expectation that the growth rate of its dividends over the next few years will continue to exceed the growth rate in the company's earnings per share and, therefore, result in a dividend payout ratio above 50 percent after 2006. Any future dividends are subject to the Board of Directors' quarterly dividend declarations, based on the company's financial position and other relevant considerations at the time.

PPL Electric expects to continue to pay quarterly dividends on its outstanding preferred stock, and to pay quarterly dividends on the preferred securities expected to be issued in 2006, in each case if and as declared by its Board of Directors.

Common Stock Repurchase

Given the continued improvement in its credit profile, PPL expects to be in a position to repurchase a portion of its common stock beginning in 2009.

*Credit Ratings*

Moody's, S&P and Fitch periodically review the credit ratings on the debt and preferred securities of PPL and its subsidiaries. Based on their respective reviews, the rating agencies may make certain ratings revisions.

A credit rating reflects an assessment by the rating agency of the credit worthiness associated with particular securities issued by PPL and its subsidiaries based on information provided by PPL and other sources. The ratings of Moody's, S&P and Fitch are not a recommendation to buy, sell or hold any securities of PPL or its subsidiaries. Such ratings may be subject to revisions or withdrawal by the agencies at any time and should be evaluated independently of each other and any other rating that may be assigned to their securities. A downgrade in PPL's or PPL's subsidiaries' credit ratings could result in higher borrowing costs and reduced access to capital markets.

The following table summarizes the credit ratings of PPL and its key subsidiaries at December 31, 2005.

| | Moody's | S&P | Fitch[b] |
|---|---|---|---|
| **PPL** | | | |
| Issuer Rating | | BBB | BBB |
| Senior Unsecured Debt | Baa3 | BBB– | BBB |
| Outlook | STABLE | STABLE | STABLE |
| **PPL Energy Supply** | | | |
| Issuer Rating | | BBB | BBB |
| Senior Unsecured Notes | Baa2 | BBB | BBB+ |
| Commercial Paper | P-2 | A-2 | F2 |
| Outlook | STABLE | STABLE | STABLE |
| **PPL Capital Funding** | | | |
| Issuer Rating | | | BBB |
| Senior Unsecured Debt | Baa3 | BBB– | BBB |
| Subordinated Debt | Ba1 | BBB– | BBB– |
| Medium-Term Notes | Baa3 | BBB– | BBB |
| Outlook | STABLE | STABLE | STABLE |
| **PPL Electric** | | | |
| Senior Unsecured/Issuer Rating | Baa2 | A– | BBB |
| First Mortgage Bonds | Baa1 | A– | A– |
| Pollution Control Bonds[a] | Aaa | AAA | |
| Senior Secured Bonds | Baa1 | A– | A– |
| Commercial Paper | P-2 | A-2 | F2 |
| Preferred Stock | Ba1 | BBB | BBB+ |
| Outlook | STABLE | STABLE | STABLE |
| **PPL Transition Bond Company** | | | |
| Transition Bonds | Aaa | AAA | AAA |
| **PPL Montana** | | | |
| Pass-Through Certificates | Baa3 | BBB– | BBB |
| Outlook | STABLE | STABLE | |
| **WPDH Limited** | | | |
| Issuer Rating | Baa3 | BBB– | |
| Senior Unsecured Debt | Baa3 | BBB– | BBB– |
| Short-term Debt | | A-3 | |
| Outlook | STABLE | STABLE | STABLE |
| **WPD LLP** | | | |
| Issuer Rating | | BBB– | |
| Senior Unsecured Debt | Baa2 | BBB– | BBB |
| Short-term Debt | | A-3 | |
| Preferred Stock | Baa3 | BB | BBB– |
| Outlook | STABLE | STABLE | STABLE |
| **WPD (South Wales)** | | | |
| Issuer Rating | | BBB+ | |
| Senior Unsecured Debt | Baa1 | BBB+ | BBB+ |
| Short-term Debt | | A-2 | F2 |
| Outlook | STABLE | STABLE | STABLE |
| **WPD (South West)** | | | |
| Issuer Rating | Baa1 | BBB+ | |
| Senior Unsecured Debt | Baa1 | BBB+ | BBB+ |
| Short-term Debt | P-2 | A-2 | F2 |
| Outlook | STABLE | STABLE | STABLE |

[a] Insured as to payment of principal and interest.

[b] All Issuer Ratings for Fitch are "Issuer Default Ratings."

The rating agencies took the following actions on the debt and preferred securities of PPL and its subsidiaries in 2005 and through February 2006:

Moody's

In June 2005, Moody's revised its outlooks to stable from negative on the senior unsecured debt and issuer ratings of WPDH Limited, the senior unsecured debt ratings of WPD LLP and the subordinated unsecured debt ratings of WPD LLP's unconsolidated subsidiary SIUK Capital Trust I. Moody's indicated that this positive change to the financial profiles resulted from a reduction in consolidated adjusted leverage at the WPD companies as a result of the redeployment to WPD of surplus cash from Latin American subsidiaries of PPL and from PPL's commitment to suspend its dividend from WPDH Limited in 2005. At the same time, Moody's affirmed the WPD companies' long-term and short-term credit rating. The outlook on the debt ratings of WPD (South Wales) and WPD (South West) was already stable.

S&P

In January 2005, S&P affirmed PPL Electric's A-/A-2 corporate credit ratings and favorably revised its outlook on the company to stable from negative following the authorization of a $194 million rate increase by the PUC. S&P indicated that the outlook revision reflects its expectations that the rate increase, effective January 1, 2005, will allow for material improvement in PPL Electric's financial profile, which had lagged S&P's expectations in recent years. S&P indicated that the stable outlook reflects its expectations that PPL Electric "will rapidly improve and then maintain financial metrics more consistent with its ratings." S&P indicated that it expects PPL Electric's operations to remain stable through the expiration of the PLR agreement.

Additionally, in January 2005, S&P revised its outlooks on the WPD companies to stable from negative. S&P attributed this positive change to financial profile improvements resulting from the final regulatory outcome published by Ofgem in November 2004. At the same time, S&P affirmed the WPD companies' long-term and short-term credit ratings.

In October 2005, S&P affirmed its BBB corporate credit rating of PPL and also affirmed its ratings of PPL Energy Supply, PPL Electric and PPL Montana. The ratings affirmation is the result of S&P's annual review of PPL, including its business and financial risk profiles.

Fitch

In January 2005, Fitch announced that it downgraded the WPD companies' senior unsecured credit ratings by one notch:

- WPDH Limited to BBB- from BBB;
- WPD LLP to BBB from BBB+; and
- WPD (South Wales) and WPD (South West) to BBB+/F2 from A-/F1.

Fitch stated that its downgrade was prompted by the high level of pension-adjusted leverage at WPD. Fitch acknowledged that WPD's funding plan should reduce its pension deficit over time, and it expects WPD to proceed with its de-leveraging program. However, Fitch indicated that it is not certain enough, due to the unpredictability in future pension valuations, that pension-adjusted leverage will support a BBB rating at WPDH Limited. Fitch indicated that WPD (South Wales) and WPD (South West) have been downgraded to maintain a two-notch differential with WPDH Limited because Fitch does not believe that WPD's financial ring-fencing is restrictive enough to support a three-notch differential.

In December 2005, Fitch affirmed PPL Montana's amortizing Pass-Through Certificates, the last of which are due 2020, at BBB. Fitch Indicated that the rating reflects PPL Montana's credit quality on a stand-alone basis.

In December 2005, Fitch assigned issuer default ratings (IDRs) for its North American global power portfolio of issuers with ratings of BB- or higher. The IDR reflects Fitch's assessment of an issuer's ability to meet all of its financial commitments on a timely basis, effectively becoming its benchmark probability of default. Fitch rates securities in an issuer's capital structure higher, lower or the same as the IDR based on Fitch's assessment of a particular security's relative recovery prospects. There were no changes in Fitch's securities ratings at PPL, PPL Capital Funding, PPL Energy Supply or PPL Electric as a result of Fitch's assignment of an IDR.

In February 2006, Fitch's Europe, Middle East and Africa group implemented IDRs based on its new IDR methodology. This implementation led to Fitch's assignment of the following IDRs and Fitch's revision of its ratings on the following securities currently outstanding at WPD and its affiliates.

- WPDH Limited IDR of BBB- and senior unsecured rating to BBB from BBB-;
- WPD LLP IDR of BBB, senior unsecured rating to BBB+ from BBB and preferred stock rating to BBB from BBB-; and
- WPD (South Wales) and WPD (South West) IDR of BBB+ and senior unsecured debt rating to A- from BBB+.

Fitch's outlook for WPD and its affiliates remains stable.

*Ratings Triggers*

PPL Energy Supply's $400 million of 2.625% Convertible Senior Notes due 2023 are convertible upon the occurrence of certain events, including if the long-term credit ratings assigned to the notes by Moody's and S&P are lower than BB and Ba2, or either Moody's or S&P no longer rates the notes. The terms of the notes require cash settlement of the principal amount upon conversion of the notes. See Note 4 to the Financial Statements for more information concerning the Convertible Senior Notes.

PPL and its subsidiaries do not have additional material liquidity exposures caused by a ratings downgrade below "investment grade" that would accelerate the due dates of borrowings. However, if PPL's and PPL Energy Supply's debt ratings had been below investment grade at December 31, 2005, PPL and PPL Energy Supply would have had to post an additional $128 million of collateral to counterparties.

**Off-Balance Sheet Arrangements**

PPL provides guarantees for certain consolidated affiliate financing arrangements that enable certain transactions. Some of the guarantees contain financial and other covenants that, if not met, would limit or restrict the consolidated affiliates' access to funds under these financing arrangements, require early maturity of such arrangements or limit the consolidated affiliates' ability to enter into certain transactions. At this time, PPL believes that these covenants will not limit access to the relevant funding sources.

PPL has entered into certain guarantee agreements that are within the scope of FIN 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, an Interpretation of FASB Statements No. 5, 57, and 107 and Rescission of FASB Interpretation No. 34." See Note 14 to the Financial Statements for a discussion on guarantees.

**Risk Management – Energy Marketing & Trading and Other**

*Market Risk*

Background

Market risk is the potential loss PPL may incur as a result of price changes associated with a particular financial or commodity instrument. PPL is exposed to market risk from:

- commodity price risk associated with the sale and purchase of energy and energy-related products, and the purchase of fuel for the generating assets and energy trading activities;
- interest rate risk associated with variable-rate debt and the fair value of fixed-rate debt used to finance operations, as well as the fair value of debt securities invested in by PPL's nuclear decommissioning trust funds;
- foreign currency exchange rate risk associated with investments in affiliates in Latin America and Europe, as well as purchases of equipment in currencies other than U.S. dollars; and
- equity securities price risk associated with the fair value of equity securities invested in by PPL's nuclear decommissioning trust funds.

PPL has a risk management policy approved by its Board of Directors to manage market risk and counterparty credit risk. (Credit risk is discussed below.) The RMC, comprised of senior management and chaired by the Vice President-Risk Management, oversees the risk management function. Key risk control activities designed to monitor compliance with the risk policy and detailed programs include, but are not limited to, credit review and approval, validation of transactions and market prices, verification of risk and transaction limits, sensitivity analyses, daily portfolio reporting, including open positions, mark-to-market valuations and other risk measurement metrics.

The forward-looking information presented below provides estimates of what may occur in the future, assuming certain adverse market conditions, due to reliance on model assumptions. Actual future results may differ materially from those presented. These disclosures are not precise indicators of expected future losses, but only indicators of reasonably possible losses.

Contract Valuation

PPL utilizes forward contracts, futures contracts, options, swaps and tolling agreements as part of its risk management strategy to minimize unanticipated fluctuations in earnings caused by commodity price, interest rate and foreign currency volatility. When available, quoted market prices are used to determine the fair value of a commodity or financial instrument. This may include exchange prices, the average mid-point bid/ask spreads obtained from brokers, or an independent valuation by an external source, such as a bank. However, market prices for energy or energy-related contracts may not be readily determinable because of market illiquidity. If no active trading market exists, contracts are valued using internally developed models, which are then reviewed by an independent, internal group. Although PPL believes that its valuation methods are reasonable, changes in the underlying assumptions could result in significantly different values and realization in future periods.

To record energy derivatives at their fair value, PPL discounts the forward values using the U.S. Utility BBB+ Curve. Additionally, PPL adjusts derivative carrying values to recognize differences in counterparty credit quality and potential illiquidity in the market:

- The credit adjustment takes into account the probability of default, as calculated by an independent service, for each counterparty that has an out-of-the money position with PPL.
- The liquidity adjustment takes into account the fact that it may not be appropriate to value contracts at the midpoint of the bid/ask spread. PPL might have to accept the "bid" price if PPL wants to close an open sales position or PPL might have to accept the "ask" price if PPL wants to close an open purchase position.
- The modeling adjustment takes into account market value for certain contracts when there is no external market to value the contract or when PPL is unable to find independent confirmation of the true market value of the contract.

Accounting and Reporting

To account for and report on contracts entered into to manage market risk, PPL follows the provisions of SFAS 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities," and SFAS 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities," and interpreted by DIG issues (together, "SFAS 133"), EITF 02-3, "Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities," and EITF 03-11, "Reporting Realized Gains and Losses on Derivative Instruments That Are Subject to FASB Statement No. 133 and Not 'Held for Trading Purposes' as Defined in Issue No. 02-3." SFAS 133 requires that all derivative instruments be recorded at fair value on the balance sheet as an asset or liability (unless they meet SFAS 133's criteria for exclusion) and that changes in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met.

In April 2003, the FASB issued SFAS 149, which amends and clarifies SFAS 133 to improve financial accounting and reporting for derivative instruments and hedging activities. To ensure that contracts with comparable characteristics are accounted for similarly, SFAS 149 clarified the circumstances under which a contract with an initial net investment meets the characteristics of a derivative, clarified when a derivative contains a financing component, amended the definition of an "underlying" and amended certain other existing pronouncements. Additionally, SFAS 149 placed additional limitations on the use of the normal purchase or normal sale exception. SFAS 149 was effective for contracts entered into or modified and for hedging relationships designated after June 30, 2003, except certain provisions relating to forward purchases or sales of when-issued securities or other securities that did not yet exist. PPL adopted SFAS 149 as of July 1, 2003. The adoption of SFAS 149 did not have a significant impact on PPL.

In accordance with EITF 02-3, PPL reflects its net realized and unrealized gains and losses associated with all derivatives that are held for trading purposes in the "Net energy trading margins" line on the Statement of Income. Non-derivative contracts that met the definition of energy trading activities as defined by EITF 98-10, "Accounting for Contracts Involved in Energy Trading and Risk Management Activities" are reflected in the financial statements using the accrual method of accounting. Under the accrual method of accounting, unrealized gains and losses are not reflected in the financial statements.

PPL adopted the final provisions of EITF 03-11 prospectively as of October 1, 2003. As a result of this adoption, non-trading bilateral sales of electricity at major market delivery points are netted with purchases that offset the sales at those same delivery points. A major market delivery point is any delivery point with liquid pricing available. See Note 17 to the Financial Statements for the impact of the adoption of EITF 03-11.

PPL's short-term derivative contracts are recorded as "Price risk management assets" and "Price risk management liabilities" on the Balance Sheet. Long-term derivative contracts are included in "Regulatory and Other Noncurrent Assets – Other" and "Deferred Credits and Other Noncurrent Liabilities – Other."

*Accounting Designation*

Energy contracts that do not qualify as derivatives receive accrual accounting treatment. For energy contracts that meet the definition of a derivative, the circumstances and intent existing at the time that energy transactions are entered into determine their accounting designation. In addition to energy-related transactions, PPL enters into financial interest rate and foreign currency swap contracts to hedge interest expense associated with both existing and anticipated debt issuances. PPL also enters into foreign currency swap contracts to hedge the fair value of firm commitments denominated in foreign currency and net investments in foreign operations. As with energy transactions, the circumstances and intent existing at the time of the transaction determine a contract's accounting designation. These designations are verified by a separate internal group on a daily basis. See Note 17 to the Financial Statements for a summary of the guidelines that have been provided to the traders who are responsible for the designation of derivative energy contracts.

Commodity Price Risk (Non-trading)

Commodity price risk is one of PPL's most significant risks due to the level of investment that PPL maintains in its generation assets, coupled with the volatility of prices for energy and energy-related products. Several factors influence price levels and volatilities. These factors include, but are not limited to, seasonal changes in demand, weather conditions, available generating assets within regions, transportation availability and reliability within and between regions, market liquidity, and the nature and extent of current and potential federal and state regulations. To hedge the impact of market price fluctuations on PPL's energy-related assets, liabilities and other contractual arrangements, PPL EnergyPlus sells and purchases physical energy at the wholesale level under FERC market-based tariffs throughout the U.S. and enters into financial exchange-traded and over-the-counter contracts. Because PPL owns or controls generating assets, the majority of PPL's energy transactions qualify for accrual or hedge accounting. Additionally, the non-trading portfolio includes the fair value of options that are economic hedges of PPL's synthetic fuel tax credits. Although they do not receive hedge accounting treatment, these options are considered non-trading.

Within PPL's non-trading portfolio, the decision to enter into energy contracts hinges on the expected value of PPL's generation. To address this risk, PPL takes a conservative approach in determining the number of MWhs that are available to be sold forward. In this regard, PPL reduces the maximum potential output that a plant may produce by three factors – planned maintenance, unplanned outages and economic conditions. The potential output of a plant is first reduced by the amount of unavailable generation due to planned maintenance on a particular unit. Another reduction, representing the unplanned outage rate, is the amount of MWhs that historically is not produced by a plant due to such factors as equipment breakage. Finally, the potential output of certain plants (such as peaking units) is reduced because their higher cost of production will not allow them to economically run during all hours.

PPL's non-trading portfolio also includes full requirements energy contracts. The net obligation to serve these contracts changes minute by minute. PPL analyzes historical on-peak and off-peak usage patterns, as well as spot prices and weather patterns, to determine a monthly level of a block of electricity that best fits the usage patterns in order to minimize earnings volatility. On a forward basis, PPL reserves a block amount of generation for full requirements energy contracts that is expected to be the best match with their anticipated usage patterns and energy peaks. Anticipated usage patterns and energy peaks are affected by expected load changes, regional economic drivers and seasonality.

PPL's non-trading commodity derivative contracts mature at various times through 2010. The following chart sets forth PPL's net fair market value of these contracts as of December 31.

| | Gains (Losses) | |
|---|---|---|
| | **2005** | 2004 |
| Fair value of contracts outstanding at the beginning of the period | **$ (11)** | $ 86 |
| Contracts realized or otherwise settled during the period | **(21)** | (66) |
| Fair value of new contracts at inception | **27** | |
| Other changes in fair values | **(279)** | (31) |
| Fair value of contracts outstanding at the end of the period | **$(284)** | $(11) |

The following chart segregates estimated fair values of PPL's non-trading commodity derivative contracts at December 31, 2005, based on whether the fair values are determined by quoted market prices or other more subjective means.

| **Fair Value of Contracts at Period-End Gains (Losses)** | Maturity Less Than 1 Year | Maturity 1-3 Years | Maturity 4-5 Years | Maturity in Excess of 5 Years | Total Fair Value |
|---|---|---|---|---|---|
| **Source of Fair Value** | | | | | |
| Prices actively quoted | $ 21 | $ 7 | $ 3 | | $ 31 |
| Prices provided by other external sources | (82) | (235) | (36) | | (353) |
| Prices based on models and other valuation methods | 21 | 17 | | | 38 |
| Fair value of contracts outstanding at the end of the period | $(40) | $(211) | $(33) | | $(284) |

The "Prices actively quoted" category includes the fair value of exchange-traded natural gas futures contracts quoted on the NYMEX, which has currently quoted prices through 2011.

The "Prices provided by other external sources" category includes PPL's forward positions and options in natural gas and power and natural gas basis swaps at points for which over-the-counter (OTC) broker quotes are available. The fair value of electricity positions recorded above use the midpoint of the bid/ask spreads obtained through OTC brokers. On average, OTC quotes for forwards and swaps of natural gas and power extend one and two years into the future.

The "Prices based on models and other valuation methods" category includes the value of transactions for which an internally developed price curve was constructed as a result of the long-dated nature of the transaction or the illiquidity of the market point, or the value of options not quoted by an exchange or OTC broker.

Because of PPL's efforts to hedge the value of the energy from its generation assets, PPL sells electricity and buys fuel on a forward basis, resulting in open contractual positions. If PPL were unable to deliver firm capacity and energy or to accept the delivery of fuel under its agreements, under certain circumstances it could be required to pay damages. These damages would be based on the difference between the market price and the contract price of the commodity. Depending on price volatility in the wholesale energy markets, such damages could be significant. Extreme weather conditions, unplanned power plant outages, transmission disruptions, non-performance by counterparties (or their own counterparties) with which it has energy contracts and other factors could affect PPL's ability to meet its obligations, or cause significant increases in the market price of replacement energy. Although PPL attempts to mitigate these risks, there can be no assurance that it will be able to fully meet its firm obligations, that it will not be required to pay damages for failure to perform, or that it will not experience counterparty non-performance in the future.

As of December 31, 2005, PPL estimated that a 10% adverse movement in market prices across all geographic areas and time periods would have decreased the value of the commodity contracts in its non-trading portfolio by approximately $275 million, compared with a decrease of $165 million at December 31, 2004. For purposes of this calculation, an increase in the market price for electricity is considered an adverse movement because PPL's electricity portfolio is generally in a net sales position, and the decrease in the market price for fuel is considered an adverse movement because PPL's commodity fuels portfolio is generally in a net purchase position. PPL enters into those commodity contracts to reduce the market risk inherent in the generation of electricity.

In accordance with its marketing strategy, PPL does not completely hedge its generation output or fuel requirements. PPL estimates that for its entire portfolio, including all generation, emissions and physical and financial energy positions, a 10% adverse change in power prices across all geographic zones

and time periods would decrease expected 2006 gross margins by $18 million. Similarly, a 10% adverse movement in all fossil fuel prices would decrease 2006 gross margins by $10 million.

Commodity Price Risk (Trading)

PPL also executes energy contracts to take advantage of market opportunities. As a result, PPL may at times create a net open position in its portfolio that could result in significant losses if prices do not move in the manner or direction anticipated. The margins from these trading activities are shown in the Statement of Income as "Net energy trading margins."

PPL's trading contracts mature at various times through 2009. The following chart sets forth PPL's net fair market value of trading contracts as of December 31.

| | Gains (Losses) | |
|---|---|---|
| | **2005** | 2004 |
| Fair value of contracts outstanding at the beginning of the period | **$10** | $3 |
| Contracts realized or otherwise settled during the period | **(30)** | (12) |
| Fair value of new contracts at inception | **3** | 1 |
| Other changes in fair values | **22** | 18 |
| *Fair value of contracts outstanding at the end of the period* | ***$5*** | *$10* |

PPL will reverse approximately $1 million of the $5 million unrealized trading gains over the first three months of 2006 as the transactions are realized.

The following chart segregates estimated fair values of PPL's trading portfolio at December 31, 2005, based on whether the fair values are determined by quoted market prices or other more subjective means.

| **Fair Value of Contracts at Period-End Gains (Losses)** | Maturity Less Than 1 Year | Maturity 1–3 Years | Maturity 4–5 Years | Maturity in Excess of 5 Years | Total Fair Value |
|---|---|---|---|---|---|
| **Source of Fair Value** | | | | | |
| Prices actively quoted | $ 8 | $(2) | | | $ 6 |
| Prices provided by other external sources | (1) | | $2 | | 1 |
| Prices based on models and other valuation methods | (1) | (1) | | | (2) |
| Fair value of contracts outstanding at the end of the period | $ 6 | $(3) | $2 | | $ 5 |

See "Commodity Price Risk (Non-trading)" for information on the various sources of fair value.

As of December 31, 2005, PPL estimated that a 10% adverse movement in market prices across all geographic areas and time periods would have decreased the value of the commodity contracts in its trading portfolio by $23 million, compared with a decrease of $5 million at December 31, 2004.

Interest Rate Risk

PPL and its subsidiaries have issued debt to finance their operations. PPL utilizes various financial derivative products to adjust the mix of fixed and floating interest rates in its debt portfolio, adjust the duration of its debt portfolio and lock in U.S. Treasury rates (and interest rate spreads over treasuries) in anticipation of future financing, when appropriate. Risk limits under the risk management program are designed to balance risk exposure to volatility in interest expense and changes in the fair value of PPL's debt portfolio due to changes in the absolute level of interest rates.

At December 31, 2005, PPL's potential annual exposure to increased interest expense, based on a 10% increase in interest rates, was estimated at $7 million, compared with a $4 million exposure at December 31, 2004.

PPL is also exposed to changes in the fair value of its domestic and international debt portfolios. At December 31, 2005, PPL estimated that its potential exposure to a change in the fair value of its debt portfolio, through a 10% adverse movement in interest rates, was approximately $200 million, compared with $216 million at December 31, 2004.

PPL utilizes various risk management instruments to reduce its exposure to the expected future cash flow variability of its debt instruments. These risks include exposure to adverse interest rate movements for outstanding variable rate debt and for future anticipated financing. While PPL is exposed to changes in the fair value of these instruments, any changes in the fair value of these instruments are recorded in equity and then reclassified into earnings in the same period during which the item being hedged affects earnings. At December 31, 2005, the market value of these instruments, representing the amount PPL would receive upon their termination, was approximately $6 million. At December 31, 2005, PPL estimated that its potential exposure to a change in the fair value of these instruments, through a 10% adverse movement in the hedged exposure, was approximately $7 million, compared with a $2 million exposure at December 31, 2004.

PPL also utilizes various risk management instruments to adjust the mix of fixed and floating interest rates in its debt portfolio. While PPL is exposed to changes in the fair value of these instruments, any change in market value is recorded with an equal and offsetting change in the value of the debt being hedged. At December 31, 2005, PPL estimated that its potential exposure to a change in the fair value of these instruments, through a 10% adverse movement in interest rates, was approximately $12 million, compared with a $19 million exposure at December 31, 2004.

Foreign Currency Risk

PPL is exposed to foreign currency risk, primarily through investments in affiliates in the U.K. and Latin America. In addition, PPL may make purchases of equipment in currencies other than U.S. dollars.

PPL has adopted a foreign currency risk management program designed to hedge certain foreign currency exposures, including firm commitments, recognized assets or liabilities and net investments. In addition, PPL enters into financial instruments to protect against foreign currency translation risk.

To protect expected income in Chilean pesos, PPL entered into an average rate forward for 8 billion Chilean pesos. The settlement date of this forward is November 2006. At December 31, 2005, the market value of this position, representing the amount PPL would pay upon its termination, was insignificant. PPL estimated that its potential exposure to a change in the market value of these instruments, through a 10% adverse movement in foreign exchange rates, was insignificant at December 31, 2005.

WPDH Limited holds a net position in cross-currency swaps totaling $1.1 billion to hedge the interest payments and value of its U.S. dollar-denominated bonds with maturity dates ranging from December 2006 to December 2028. The estimated value of this position at December 31, 2005, being the amount PPL would pay to terminate it, including accrued interest, was approximately $164 million. PPL estimated that its potential exposure to a change in the market value of these instruments, through a 10% adverse movement in foreign exchange rates, was approximately $140 million at December 31, 2005.

On the Statement of Income, gains and losses associated with hedges of interest payments denominated in foreign currencies are reflected in "Interest Expense." Gains and losses associated with the purchase of equipment are reflected in "Depreciation." Gains and losses associated with net investment hedges remain in "Accumulated other comprehensive loss" on the Balance Sheet until the investment is disposed.

Nuclear Decommissioning Trust Funds – Securities Price Risk

In connection with certain NRC requirements, PPL Susquehanna maintains trust funds to fund certain costs of decommissioning the Susquehanna station. As of December 31, 2005, these funds were invested primarily in domestic equity securities and fixed-rate, fixed-income securities and are reflected at fair value on PPL's Balance Sheet. The mix of securities is designed to provide returns to be used to fund Susquehanna's decommissioning and to compensate for inflationary increases in decommissioning costs. However, the equity securities included in the trusts are exposed to price fluctuation in equity markets, and the values of fixed-rate, fixed-income securities are exposed to changes in interest rates. PPL Susquehanna actively monitors the investment performance and periodically reviews asset allocation in accordance with its nuclear decommissioning trust policy statement. At December 31, 2005, a hypothetical 10% increase in interest rates and a 10% decrease in equity prices would have resulted in an estimated $33 million reduction in the fair value of the trust assets, compared with a $30 million reduction at December 31, 2004. See Note 21 to the Financial Statements for more information regarding the nuclear decommissioning trust funds.

Synthetic Fuel Tax Credit Risk

Recent increases in and the volatility of crude oil prices threaten to reduce the amount of synthetic fuel tax credits that PPL expects to receive through its synthetic fuel production. The tax credits are reduced if the annual average wellhead price of domestic crude oil falls within a phase-out range. The tax credits are eliminated if this reference price exceeds the phase-out range. See "Regulatory Issues – IRS Synthetic Fuels Tax Credits" in Note 14 to the Financial Statements for more information regarding the phase-out of the tax credits.

PPL implemented a risk management objective to hedge a portion of the variability of cash flows associated with its 2006 and 2007 synthetic fuel tax credits by hedging the risk that the 2006 and 2007 annual average wellhead price for domestic crude oil will be within the phase-out range.

PPL purchased options in 2005 to mitigate some of the reductions in synthetic fuel tax credits if the annual average wellhead price for 2006 and 2007 falls within the applicable phase-out range. These positions did not qualify for hedge accounting treatment. The mark-to-market value of these positions as of December 31, 2005, was a gain of $10 million, and is reflected in "Energy-related businesses" revenues on the Statement of Income.

As of December 31, 2005, PPL estimated that a 10% adverse movement in market prices of crude oil would have decreased the value of the synthetic fuel hedges by $24 million. For purposes of this calculation, a decrease in the market price for crude oil is considered an adverse movement.

*Credit Risk*

Credit risk relates to the risk of loss that PPL would incur as a result of nonperformance by counterparties of their contractual obligations. PPL maintains credit policies and procedures with respect to counterparties (including requirements that counterparties maintain certain credit ratings criteria) and requires other assurances in the form of credit support or collateral in certain circumstances in order to limit counterparty credit risk. However, PPL has concentrations of suppliers and customers among electric utilities, natural gas distribution companies and other energy marketing and trading companies. These concentrations of counterparties may impact PPL's overall exposure to credit risk, either positively or negatively, in that counterparties may be similarly affected by changes in economic, regulatory or other conditions. As discussed above in "Contract Valuation," PPL records certain non-performance reserves to reflect the probability that a counterparty with contracts that are out of the money (from the counterparty's standpoint) will default in its performance. In this case, PPL would have to sell into a lower-priced market or purchase from a higher-priced market. These reserves are reflected in the fair value of assets recorded in "Price risk management assets" on the Balance Sheet. PPL also records reserves to reflect the probability that a counterparty will not make payments for deliveries PPL has made but not yet billed. These reserves are reflected in "Unbilled revenues" on the Balance Sheet. PPL also has established a reserve with respect to certain sales to the California ISO for which PPL has not yet been paid, as well as a reserve related to PPL's exposure as a result of the Enron bankruptcy, which are reflected in "Accounts receivable" on the Balance Sheet. See Notes 1 and 14 to the Financial Statements.

**Related Party Transactions**

PPL is not aware of any material ownership interests or operating responsibility by senior management of PPL in outside partnerships, including leasing transactions with variable interest entities, or other entities doing business with PPL.

For additional information on related party transactions, see Note 15 to the Financial Statements.

**Acquisitions, Development and Divestitures**

From time to time, PPL and its subsidiaries are involved in negotiations with third parties regarding acquisitions and dispositions of businesses and assets, joint ventures and development projects, which may or may not result in definitive agreements. Any such transactions may impact future financial results. See Note 9 to the Financial Statements for information regarding recent acquisitions and development activities.

At December 31, 2005, PPL Global had investments in foreign facilities, including consolidated investments in WPD, Emel, EC and others. See Note 3 to the Financial Statements for information on unconsolidated investments accounted for under the equity method.

In connection with the ongoing review of its non-core international minority ownership investments, PPL Global sold certain minority interests in 2005 and 2004. See Note 9 to the Financial Statements for additional information.

PPL is currently planning incremental capacity increases of 258 MW at several existing domestic generating facilities.

PPL is continuously reexamining development projects based on market conditions and other factors to determine whether to proceed with these projects, sell them, cancel them, expand them, execute tolling agreements or pursue other opportunities.

**Environmental Matters**

See Note 14 to the Financial Statements for a discussion of environmental matters.

## New Accounting Standards

See Note 23 to the Financial Statements for a discussion of new accounting standards recently adopted or pending adoption.

## Application of Critical Accounting Policies

PPL's financial condition and results of operations are impacted by the methods, assumptions and estimates used in the application of critical accounting policies. The following accounting policies are particularly important to the financial condition or results of operations of PPL, and require estimates or other judgments of matters inherently uncertain. Changes in the estimates or other judgments included within these accounting policies could result in a significant change to the information presented in the financial statements. (These accounting policies are also discussed in Note 1 to the Financial Statements.) PPL's senior management has reviewed these critical accounting policies, and the estimates and assumptions regarding them, with its Audit Committee. In addition, PPL's senior management has reviewed the following disclosures regarding the application of these critical accounting policies with the Audit Committee.

**1) Price Risk Management**

See "Risk Management – Energy Marketing & Trading and Other" in Financial Condition.

**2) Pension and Other Postretirement Benefits**

PPL follows the guidance of SFAS 87, "Employers' Accounting for Pensions," and SFAS 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," when accounting for these pension and other postretirement benefits. Under these accounting standards, assumptions are made regarding the valuation of benefit obligations and the performance of plan assets. Delayed recognition of differences between actual results and expected or estimated results is a guiding principle of these standards. This delayed recognition of actual results allows for a smoothed recognition of changes in benefit obligations and plan performance over the working lives of the employees who benefit under the plans. The primary assumptions are:

- Discount Rate – The discount rate is used in calculating the present value of benefits, which is based on projections of benefit payments to be made in the future. The objective in selecting the discount rate is to measure the single amount that, if invested at the measurement date in a portfolio of high-quality debt instruments, would provide the necessary future cash flows to pay the accumulated benefits when due.
- Expected Return on Plan Assets – Management projects the future return on plan assets considering prior performance, but primarily based upon the plans' mix of assets and expectations for the long-term returns on those asset classes. These projected returns reduce the net benefit costs PPL records currently.
- Rate of Compensation Increase – Management projects employees' annual pay increases, which are used to project employees' pension benefits at retirement.
- Health Care Cost Trend Rate – Management projects the expected increases in the cost of health care.

In selecting a discount rate for its domestic pension and other postretirement plans, PPL starts with an analysis of the expected benefit payment stream for its plans. This information is first matched against a spot rate yield curve. A portfolio of nearly 600 Moody's Aa-graded non-callable corporate bonds, with a total outstanding float in excess of $300 billion, serves as the base from which those with the lowest and highest yields are eliminated to develop the ultimate yield curve. The results of this analysis are considered in conjunction with other economic data and consideration of movements in the Moody's Aa bond index to determine the discount rate assumption. At December 31, 2005, PPL decreased the discount rate for its domestic plans from 5.75% to 5.70% as a result of this assessment.

The selection of a discount rate for the international pension plans of WPD again starts with an analysis of the expected benefit payment streams. This information is analyzed against yields on long-term high-quality corporate bonds within the iBoxx index. Due to the flatness of U.K. yield curves, the duration-weighted discount rate is approximately the same. At December 31, 2005, PPL decreased the discount rate for its international pension plans from 5.50% to 4.75% as a result of this assessment.

In selecting an expected return on plan assets, PPL considers tax implications, past performance and economic forecasts for the types of investments held by the plans. At December 31, 2005, PPL's expected return on plan assets was decreased from 8.75% to 8.50% for its domestic pension plans and increased to 8.00% from 7.90% for its other postretirement benefit plans. For

its international plans, PPL's expected return on plan assets was reduced from 8.30% to 8.09% at December 31, 2005. Both PPL's domestic and international pension plans have significantly exceeded the expected return on plan assets for 2004 and 2005. However, the expected return on plan assets assumption was decreased to reflect a long-term view of equity markets and an expected increase in long-term bond yields.

In selecting a rate of compensation increase, PPL considers past experience in light of movements in inflation rates. At December 31, 2005, PPL's rate of compensation increase was changed to 4.75% from 4.00% for its domestic plans. For its international plans, PPL's rate of compensation increase remained at 3.75% at December 31, 2005.

In selecting health care cost trend rates, PPL considers past performance and forecasts of health care costs. At December 31, 2005, PPL's health care cost trend rates were 10.0% for 2006, gradually declining to 5.5% for 2011.

A variance in the assumptions listed above could have a significant impact on projected benefit obligations, accrued pension and other postretirement benefit liabilities, reported annual net periodic pension and other postretirement benefit cost and other comprehensive income (OCI). The following chart reflects the sensitivities in the 2005 financial statements associated with a change in certain assumptions. While the chart below reflects either an increase or decrease in each assumption, the inverse of this change would impact the projected benefit obligation, accrued pension and other postretirement benefit liabilities, reported annual net periodic pension and other postretirement benefit cost and OCI by a similar amount in the opposite direction. Each sensitivity below reflects an evaluation of the change based solely on a change in that assumption.

| | | Increase (Decrease) | | | |
|---|---|---|---|---|---|
| **Actuarial Assumption** | Change in Assumption | Impact on Obligation | Impact on Liabilities[(a)] | Impact on Cost | Impact on OCI |
| Discount Rate | (0.25)% | $165 | $2 | $2 | $80 |
| Expected Return on Plan Assets | (0.25)% | N/A | 11 | 11 | (6) |
| Rate of Compensation Increase | 0.25 % | 28 | 3 | 3 | (1) |
| Health Care Cost Trend Rate[(b)] | 1.0 % | 13 | 1 | 1 | N/A |

(a) Excludes the impact of additional minimum liability.
(b) Only impacts other postretirement benefits.

PPL's total net pension and other postretirement benefit obligation as of December 31, 2005, was $853 million. PPL recognized an aggregate net accrued pension and other postretirement benefit liability of $429 million on its Balance Sheet as of December 31, 2005. The total obligation is not fully reflected in the current financial statements due to the delayed recognition criteria of the accounting standards for these obligations.

In 2005, PPL recognized net periodic pension and other postretirement costs charged to operating expenses of $51 million. This amount represents a $44 million increase from 2004. This increase in expense was primarily attributable to PPL's international plans and was the result of the decrease in the discount rate at December 31, 2004 and recognition of prior losses.

The pension plans of WPD have accumulated deferred losses of $721 million as of December 31, 2005, as a result of changes in the discount rate assumption, expected compared with actual asset returns and changes in demographic assumptions and experience. The losses, to the extent not offset by future gains, will be amortized in accordance with PPL's policy regarding recognition of gains and losses as detailed in Note 1 to the Financial Statements.

Strong asset returns and falling foreign currency conversion rates offset the impact of the decrease in the discount rate, allowing PPL to reduce its additional minimum pension liability for its international pension plans, offset by a modest increase for PPL's domestic pension plans. Recording the change in the additional minimum liability resulted in a $19 million decrease to the pension-related charge to OCI, net of taxes, translation adjustment and unrecognized prior service costs, with no effect on net income. The pension-related balance in OCI, which is a reduction to shareowners' equity, was reduced from $368 million at December 31, 2004 to $349 million at December 31, 2005. The charges to OCI will reverse in future periods if the fair value of trust assets exceeds the accumulated benefit obligation.

Refer to Note 12 to the Financial Statements for additional information regarding pension and other postretirement benefits.

### 3) Asset Impairment

PPL performs impairment analyses for long-lived assets, including intangibles, that are subject to depreciation or amortization in accordance with SFAS 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." PPL tests for impairment whenever events or changes in circumstances indicate that a long-lived asset's carrying value may not be recoverable. Examples of such events or changes in circumstances are:

- a significant decrease in the market price of an asset;
- a significant adverse change in the manner in which an asset is being used or in its physical condition;
- a significant adverse change in legal factors or in the business climate;
- an accumulation of costs significantly in excess of the amount originally expected for the acquisition or construction of an asset;
- a current-period operating or cash flow loss combined with a history of losses or a forecast that demonstrates continuing losses; or
- a current expectation that, more likely than not, an asset will be sold or otherwise disposed of before the end of its previously estimated useful life.

For a long-lived asset, an impairment exists when the carrying value exceeds the sum of the estimated undiscounted cash flows expected to result from the use and eventual disposition of the asset. If the asset is impaired, an impairment loss is recorded to adjust the asset's carrying value to its estimated fair value.

In determining asset impairments, management must make significant judgments to estimate future cash flows, the useful lives of long-lived assets, the fair value of the assets and management's intent to use the assets. Changes in assumptions and estimates included within the impairment reviews could result in significantly different results than those identified and recorded in the financial statements. For determining fair value, the FASB has indicated that quoted market prices in active markets are the best evidence of fair value. However, when market prices are unavailable, other valuation techniques may be used. PPL has generally used a present value technique (i.e., discounted cash flow). Discounted cash flow is calculated by estimating future cash flow streams and applying appropriate discount rates to determine the present value of the cash flow streams.

PPL has determined that, when alternative courses of action to recover the carrying value of a long-lived asset are being considered, it uses estimated cash flows from the most likely approach to assess impairment whenever one scenario is clearly the most likely outcome. If no scenario is clearly most likely, then a probability-weighted approach is used taking into consideration estimated cash flows from the alternative scenarios. For assets tested for impairment as of the balance sheet date, the estimates of future cash flows used in that test consider the likelihood of possible outcomes that existed at the balance sheet date, including the assessment of the likelihood of the future sale of the assets. That assessment made as of the balance sheet date is not revised based on events that occur after the balance sheet date.

During 2005, PPL and its subsidiaries evaluated certain gas-fired generation assets for impairment, as events and circumstances indicated that the carrying value of these assets may not be recoverable. PPL did not record an impairment of these gas-fired generation assets in 2005. For these impairment analyses, the most significant assumption was the estimate of future cash flows. PPL estimates future cash flows using information from its corporate business plan adjusted for any recent sale or purchase commitments. Key factors that impact cash flows include projected prices for electricity and gas as well as firm sale and purchase commitments. A 10% decrease in estimated future cash flows for the gas-fired generation assets would not have resulted in an impairment charge.

PPL performs impairment analyses for goodwill in accordance with SFAS 142, "Goodwill and Other Intangible Assets." PPL performs an annual impairment test for goodwill, or more frequently if events or changes in circumstances indicate that the asset might be impaired.

SFAS 142 requires goodwill to be tested for impairment at the reporting unit level. PPL has determined its reporting units to be one level below its operating segments.

Goodwill is tested for impairment using a two-step approach. The first step of the goodwill impairment test compares the estimated fair value of a reporting unit with its carrying value, including goodwill. If the estimated fair value of a reporting unit exceeds its carrying value, goodwill of the reporting unit is considered not impaired. If the carrying value exceeds the estimated fair value of the reporting unit, the second step is performed to measure the amount of impairment loss, if any.

The second step requires a calculation of the implied fair value of goodwill. The implied fair value of goodwill is determined in the same manner as the amount of goodwill in a business combination. That is, the estimated fair value of a reporting unit is allocated to all of the assets and liabilities of that unit as if the reporting unit had been acquired in a business combination and the estimated fair value of the reporting unit was the price paid to acquire the reporting unit. The excess of the estimated fair value of a reporting unit over the amounts assigned to its assets and liabilities is the implied fair value of goodwill. The implied fair value of the reporting unit goodwill is then compared with the carrying value of that goodwill. If the carrying value exceeds the implied fair value, an impairment loss is recognized in an amount equal to that excess. The loss recognized cannot exceed the carrying value of the reporting unit's goodwill.

PPL completed its annual goodwill impairment test in the fourth quarter of 2005. This test did not require any second-step assessments and did not result in any impairments. PPL's most significant assumptions surrounding the goodwill impairment test relate to the estimates of reporting unit fair values. PPL estimated fair values primarily based upon discounted cash flows. Although a full two-step evaluation was not completed, a decrease in the forecasted cash flows of 10% or an increase of the discount rates by 50 basis points would have resulted in the carrying value of certain reporting units exceeding their estimated fair values, indicating a potential impairment of goodwill.

**4) Leasing**

PPL applies the provisions of SFAS 13, "Accounting for Leases," to all leasing transactions. In addition, PPL applies the provisions of numerous other accounting pronouncements issued by the FASB and the EITF that provide specific guidance and additional requirements related to accounting for various leasing arrangements. In general, there are two types of leases from a lessee's perspective: operating leases – leases accounted for off-balance sheet; and capital leases – leases capitalized on the balance sheet.

In accounting for leases, management makes various assumptions, including the discount rate, the fair market value of the leased assets and the estimated useful life, in determining whether a lease should be classified as operating or capital. Changes in these assumptions could result in the difference between whether a lease is determined to be an operating lease or a capital lease, thus significantly impacting the amounts to be recognized in the financial statements.

In addition to uncertainty inherent in management's assumptions, leasing transactions and the related accounting rules become increasingly complex when they involve: real estate and/or related integral equipment; sale/leaseback accounting (leasing transactions where the lessee previously owned the leased assets); synthetic leases (leases that qualify for operating lease treatment for book accounting purposes and financing treatment for tax accounting purposes); and lessee involvement in the construction of leased assets.

At December 31, 2005, PPL continued to participate in a significant sale/leaseback transaction. In July 2000, PPL Montana sold its interest in the Colstrip generating plant to owner lessors who are leasing the assets back to PPL Montana under four 36-year operating leases. This transaction is accounted for as an operating lease in accordance with current rules related to sale/leaseback arrangements. If for any reason this transaction did not meet the requirements for off-balance sheet operating lease treatment as a sale/leaseback, PPL would have recorded approximately $270 million of additional assets and approximately $318 million of additional liabilities on its balance sheet at December 31, 2005, and would have recorded additional expenses currently estimated at $7 million, after-tax, in 2005.

See Note 10 to the Financial Statements for additional information related to operating leases.

**5) Loss Accruals**

PPL periodically accrues losses for the estimated impacts of various conditions, situations or circumstances involving uncertain outcomes. These events are called "contingencies," and PPL's accounting for such events is prescribed by SFAS 5, "Accounting for Contingencies," and other related accounting guidance. SFAS 5 defines a contingency as "an existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss to an enterprise that will ultimately be resolved when one or more future events occur or fail to occur."

For loss contingencies, the loss must be accrued if (1) information is available that indicates it is "probable" that the loss has been incurred, given the likelihood of the uncertain future events and (2) the amount of the loss can be reasonably estimated. FASB defines "probable" as cases in which "the future event or events are likely to occur." SFAS 5 does not permit the accrual of contingencies that might result in gains. PPL continuously assesses potential loss contingencies for environmental remediation, litigation claims, income taxes, regulatory penalties and other events.

PPL also has accrued estimated losses on long-term purchase commitments when significant events have occurred. For example, estimated losses were accrued when long-term purchase commitments were assumed under asset acquisition agreements and when PPL Electric's generation business was deregulated. Under regulatory accounting, PPL Electric recorded the above-market cost of energy purchases from NUGs as part of its purchased power costs on an as-incurred basis, since these costs were recovered in regulated rates. When the generation business was deregulated, the estimated loss associated with these long-term purchase commitments to make above-market NUG purchases was recorded because PPL Electric was committed to purchase electricity at above market prices but it could no longer recover these costs in regulated rates.

The accounting aspects of estimated loss accruals include: (1) the initial identification and recording of the loss; (2) the determination of triggering events for reducing a recorded loss accrual; and (3) the ongoing assessment as to whether a recorded loss accrual is sufficient. All three of these aspects of accounting for loss accruals require significant judgment by PPL's management.

*Initial Identification and Recording of the Loss Accrual*

PPL uses its internal expertise and outside experts (such as lawyers, tax specialists and engineers), as necessary, to help estimate the probability that a loss has been incurred and the amount (or range) of the loss.

Two significant loss accruals were recorded in 2005. The first was the loss accrual related to the PJM billing dispute. The second involved the accrual of remediation expenses in connection with the ash basin leak at the Martins Creek generating station. Significant judgment was required by PPL's management to perform the initial assessment of these contingencies.

- In December 2004, Exelon Corporation, on behalf of its subsidiary, PECO Energy, Inc. (PECO), filed a complaint against PJM and PPL Electric with the FERC, alleging that PJM had overcharged PECO from April 1998 through May 2003 as a result of an error by PJM. The complaint requested the FERC, among other things, to direct PPL Electric to refund to PJM $39 million, plus interest of approximately $8 million, and for PJM to refund these same amounts to PECO. In April 2005, the FERC issued an Order Establishing Hearing and Settlement Judge Proceedings (the Order). In the Order, the FERC determined that PECO was entitled to reimbursement for the transmission congestion charges that PECO asserted PJM erroneously billed. The FERC ordered settlement discussions, before a judge, to determine the amount of the overcharge to PECO and the parties responsible for reimbursement to PECO.

  Based on an evaluation of FERC's Order, PPL's management concluded that it was probable that a loss had been incurred in connection with the PJM billing dispute. PPL Electric recorded a loss accrual of $47 million, the amount of PECO's claim, in the first quarter of 2005.
- In August 2005, a leak from a disposal basin containing fly ash and water at the Martins Creek generating station caused a discharge from the basin onto adjacent roadways and fields, and into a nearby creek and the Delaware River. PPL immediately began to work with the Pennsylvania DEP and appropriate agencies and consultants to assess the extent of environmental damage caused by the discharge and to remediate the damage. At that time, PPL had, and still has, no reason to believe that the Martins Creek leak has caused any danger to human health or any adverse biological impact on the river aquatic life. However, at that time, PPL expected that it would be subject to an enforcement action by the Pennsylvania DEP and that claims may be brought against it by several state agencies and private litigants.

PPL's management assessed the contingency in the third quarter of 2005. The ultimate cost of the remediation effort was difficult to estimate due to a number of uncertainties, such as the scope of the project, the impact of weather conditions on the ash recovery effort, and the ultimate outcome of enforcement actions and private litigation. PPL's management concluded, at the time, that $33 million was the best estimate of the cost of the remediation effort. PPL recorded this loss accrual in the third quarter of 2005.

See Note 14 to the Financial Statements for additional information on both of these contingencies and see "Ongoing Assessment of Recorded Loss Accruals" for a discussion of the year-end 2005 assessments of these contingencies.

PPL has identified certain other events that could give rise to a loss, but that do not meet the conditions for accrual under SFAS 5. SFAS 5 requires disclosure, but not a recording, of potential losses when it is "reasonably possible" that a loss has been incurred. The FASB defines "reasonably possible" as cases in which "the chance of the future event or events occurring is more than remote but less than likely." See Note 14 to the Financial Statements for disclosure of other potential loss contingencies that have not met the criteria for accrual under SFAS 5.

*Reducing Recorded Loss Accruals*

When an estimated loss is accrued, PPL identifies, where applicable, the triggering events for subsequently reducing the loss accrual. The triggering events generally occur when the contingency has been resolved and the actual loss is incurred, or when the risk of loss has diminished or been eliminated. The following are some of the triggering events that provide for the reduction of certain recorded loss accruals:

- Certain loss accruals are systematically reduced based on the expiration of contract terms. An example of this is the loss accrual for above-market NUG purchase commitments, which is described below. This loss accrual is being reduced over the lives of the NUG purchase contracts.
- Allowances for excess or obsolete inventory are reduced as the inventory items are pulled from the warehouse shelves and sold as scrap or otherwise disposed.
- Allowances for uncollectible accounts are reduced when accounts are written off after prescribed collection procedures have been exhausted or when underlying amounts are ultimately collected.
- Environmental and other litigation contingencies are reduced when the contingency is resolved and PPL makes actual payments or the loss is no longer considered probable.

The largest loss accrual on PPL's balance sheet, and the loss accrual that changed most significantly in 2005, was for an impairment of above-market NUG purchase commitments. This loss accrual reflects the estimated difference between the above-market contract terms, under the purchase commitments, and the fair value of the electricity to be purchased. This loss accrual was originally recorded at $854 million in 1998, when PPL Electric's generation business was deregulated.

When the loss accrual related to NUG purchases was recorded in 1998, PPL Electric established the triggering events for when the loss accrual would be reduced. A schedule was established to reduce the liability based on projected purchases over the lives of the NUG contracts. This loss accrual was transferred to PPL EnergyPlus in the July 1, 2000, corporate realignment. PPL EnergyPlus continues to reduce the above-market NUG liability based on the aforementioned schedule. As PPL EnergyPlus reduces the liability for the above-market NUG purchases, it offsets the actual cost of NUG purchases, thereby bringing the net power purchase expense more in line with expected market prices. The above-market loss accrual was $206 million at December 31, 2005. This loss accrual will be significantly reduced by 2009, when all but one of the NUG contracts expires. The then-remaining NUG contract will expire in 2014.

*Ongoing Assessment of Recorded Loss Accruals*

PPL reviews its loss accruals on a regular basis to assure that the recorded potential loss exposures are sufficient. This involves ongoing communication and analyses with internal and external legal counsel, engineers, tax specialists, operation management and other parties.

Significant management judgment is required in developing PPL's contingencies, or reserves, for income taxes and valuation allowances for deferred tax assets. The ongoing assessment of tax contingencies is intended to result in management's best estimate of the ultimate settled tax position for each tax year. Annual tax provisions include amounts considered sufficient to pay assessments that may result from examination of prior year tax returns by taxing authorities. However, the amount ultimately paid upon resolution of any issues raised by such authorities may differ from the amount accrued. In evaluating the exposure associated with various filing positions, PPL accounts for changes in probable exposures based on management's best estimate of the amount that should be recognized. An allowance is maintained for the tax contingencies, the balance of which management believes to be adequate. The ongoing assessment of valuation allowances is based on an assessment of whether deferred tax assets will ultimately be realized. Management considers a number of factors in assessing the ultimate realization of deferred tax assets, including forecasts of taxable income in future periods.

As part of the year-end preparation of its financial statements, PPL's management re-assessed the loss accruals recorded earlier in the year for the two contingencies described above under "Initial Identification and Recording of the Loss Accrual." See Note 14 to the Financial Statements for additional information.

- In re-assessing the PJM billing dispute, PPL's management considered the proposed settlement agreement that was filed with FERC in September 2005. Under the settlement agreement, PPL Electric would pay $33 million plus interest over a four-year period to PJM through a new transmission charge that, under applicable law, is recoverable from PPL Electric's retail customers. Also, all PJM market participants would pay approximately $8 million plus interest over a four-year period to PJM through a new market adjustment charge. PJM would forward amounts collected under the two new charges to PECO. Numerous parties filed comments with the FERC opposing the settlement agreement, and the FERC has not yet acted on the proposed settlement agreement. Accordingly, PPL's management had no basis to revise the loss accrual that was recorded in the first quarter of 2005. PPL's management will continue to assess the loss accrual for this contingency in future periods.

- PPL also re-assessed the contingency for the Martins Creek ash basin remediation. Based on the ongoing remediation efforts and communications with the Pennsylvania DEP and other appropriate agencies, PPL's management concluded that $48 million was currently the best estimate of the cost of the remediation effort. Therefore, PPL revised the loss accrual in the fourth quarter of 2005. PPL cannot predict the final cost of assessment and remediation of the leak, the outcome of the action initiated by the Pennsylvania DEP or the action initiated by the Delaware Riverside Conservancy and several citizens, the outcome of the natural resource damage assessment, the exact nature of any other regulatory or other legal actions that may be initiated against PPL as a result of the disposal basin leak, the extent of the fines or damages that may be sought in connection with any such actions or the ultimate financial impact on PPL. PPL's management will continue to assess the loss accrual for this contingency in future periods.

**6) Asset Retirement Obligations**

SFAS 143, "Accounting for Asset Retirement Obligations," requires legal obligations associated with the retirement of long-lived assets to be recognized as a liability in the financial statements. The initial obligation should be measured at the estimated fair value. An equivalent amount should be recorded as an increase in the value of the capitalized asset and allocated to expense over the useful life of the asset. Until the obligation is settled, the liability should be increased, through the recognition of accretion expense in the income statement, for changes in the obligation due to the passage of time.

FIN 47, "Accounting for Conditional Asset Retirement Obligations, an interpretation of FASB Statement No. 143," which was issued in March 2005, and adopted by PPL effective December 31, 2005, clarified the term conditional ARO as used in SFAS 143. FIN 47 specified that a conditional ARO must be recognized when incurred if the fair value of the ARO can be reasonably estimated. See Note 21 for further discussion of the impact of FIN 47 on PPL.

In determining AROs, management must make significant judgments and estimates to calculate fair value. Fair value is developed through consideration of estimated retirement costs in today's dollars, inflated to the anticipated retirement date and then discounted back to the date the ARO was incurred. Changes in assumptions and estimates included within the calculations of the fair value of AROs could result in significantly different results than those identified and recorded in the financial statements.

At December 31, 2005, PPL had AROs totaling $298 million recorded on the Balance Sheet. PPL's most significant assumptions surrounding AROs are the forecasted retirement costs, the discount rates and the inflation rates. A variance in the forecasted retirement costs, the discount rates or the inflation rates could have a significant impact on the ARO liabilities.

The following chart reflects the sensitivities related to the ARO liabilities as of December 31, 2005, associated with a change in these assumptions at the time of initial recognition. There is no significant change to the ARO asset values, depreciation expense of the ARO assets or accretion expense of the ARO liabilities as a result of changing the assumptions. Each sensitivity below reflects an evaluation of the change based solely on a change in that assumption.

| | Change in Assumption | Impact on ARO Liability |
|---|---|---|
| Retirement Cost | 10%/(10)% | $27/$(27) |
| Discount Rate | 0.25%/(0.25)% | $(26)/$29 |
| Inflation Rate | 0.25%/(0.25)% | $31/$(28) |

## Other Information

PPL's Audit Committee has approved the independent auditor to provide audit and audit-related services and other services permitted by the Sarbanes-Oxley Act of 2002 and SEC rules. The audit and audit-related services include services in connection with statutory and regulatory filings, reviews of offering documents and registration statements, employee benefit plan audits and internal control reviews.

# REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

**To the Board of Directors and Shareowners of PPL Corporation:**

We have completed integrated audits of PPL Corporation's 2005 and 2004 consolidated financial statements and of its internal control over financial reporting as of December 31, 2005, and an audit of its 2003 consolidated financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

*Consolidated financial statements*

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, of long-term debt, of shareowners' common equity and comprehensive income, and of cash flows present fairly, in all material respects, the financial position of PPL Corporation and its subsidiaries (the "Company") at December 31, 2005 and 2004, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2005 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1 to the consolidated financial statements, the Company adopted Emerging Issues Task Force Issue No. 03-11, *Reporting Realized Gains and Losses on Derivative Instruments That Are Subject to FASB Statement No. 133 and Not "Held for Trading Purposes" as Defined in Issue No. 02-3,* in 2003. As discussed in Note 8 to the consolidated financial statements, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity,* in 2003. As discussed in Note 21 to the consolidated financial statements, the Company adopted SFAS No. 143, *Accounting for Asset Retirement Obligations,* in 2003. As discussed in Note 22 to the consolidated financial statements, the Company adopted FASB Interpretation ("FIN") No. 46, *Consolidation of Variable Interest Entities – an interpretation of ARB 51,* as amended by FIN No. 46(R), in 2003. As discussed in Note 21 to the consolidated financial statements, the Company adopted FIN No. 47, *Accounting for Conditional Asset Retirement Obligations,* in 2005.

*Internal control over financial reporting*

Also, in our opinion, management's assessment, included in the accompanying "Management's Report on Internal Control Over Financial Reporting," that the Company maintained effective internal control over financial reporting as of December 31, 2005 based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on criteria established in *Internal Control – Integrated Framework* issued by the COSO. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management's assessment and on the effectiveness of the Company's internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

PricewaterhouseCoopers LLP

Philadelphia, Pennsylvania
February 24, 2006

# MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

PPL's management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). PPL's internal control over financial reporting is a process designed to provide reasonable assurance to PPL's management and Board of Directors regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements.

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in "Internal Control – Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework in "Internal Control – Integrated Framework," our management concluded that our internal control over financial reporting was effective as of December 31, 2005. Our management's assessment of the effectiveness of our internal control over financial reporting as of December 31, 2005, has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report, contained herein.

# CONSOLIDATED STATEMENT OF INCOME

| *(Millions of dollars, except per share data)* *For the years ended December 31,* | **2005** | 2004 | 2003 |
|---|---|---|---|
| **Operating Revenues** | | | |
| Utility | **$4,329** | $3,900 | $3,717 |
| Unregulated retail electric and gas | **101** | 114 | 148 |
| Wholesale energy marketing | **1,128** | 1,224 | 1,214 |
| Net energy trading margins | **35** | 22 | 9 |
| Energy related businesses | **626** | 534 | 497 |
| Total | **6,219** | 5,794 | 5,585 |
| **Operating Expenses** | | | |
| Operation | | | |
| Fuel | **933** | 771 | 649 |
| Energy purchases | **923** | 910 | 1,002 |
| Other operation and maintenance | **1,401** | 1,237 | 1,177 |
| Amortization of recoverable transition costs | **268** | 257 | 260 |
| Depreciation (Note 1) | **420** | 404 | 376 |
| Taxes, other than income (Note 5) | **279** | 249 | 256 |
| Energy-related businesses | **649** | 566 | 490 |
| Workforce reduction (Note 20) | | | 9 |
| Total | **4,873** | 4,394 | 4,219 |
| **Operating Income** | **1,346** | 1,400 | 1,366 |
| Other income – net (Note 16) | **29** | 39 | 55 |
| Interest expense | **508** | 513 | 473 |
| ***Income from Continuing Operations Before Income Taxes, Minority Interest and Distributions on Preferred Securities*** | **867** | 926 | 948 |
| Income taxes (Note 5) | **121** | 203 | 179 |
| Minority interest | **7** | 8 | 7 |
| Distributions on preferred securities (Note 8) | **2** | 2 | 29 |
| **Income from Continuing Operations** | **737** | 713 | 733 |
| Loss from discontinued operations (net of income taxes) (Note 9) | **51** | 15 | 34 |
| **Income Before Cumulative Effects of Changes in Accounting Principles** | **686** | 698 | 699 |
| Cumulative effects of changes in accounting principles (net of income taxes) (Notes 21 and 22) | **(8)** | | 35 |
| **Net Income** | **$ 678** | $ 698 | $ 734 |
| **Earnings per Share of Common Stock** (Note 4)[a] | | | |
| ***Income from Continuing Operations:*** | | | |
| Basic | **$ 1.94** | $ 1.93 | $ 2.12 |
| Diluted | **$ 1.92** | $ 1.93 | $ 2.12 |
| **Net Income:** | | | |
| Basic | **$ 1.79** | $ 1.89 | $ 2.13 |
| Diluted | **$ 1.77** | $ 1.89 | $ 2.12 |
| **Dividends Declared Per Share of Common Stock** [a] | **$ 0.96** | $ 0.82 | $ 0.77 |

[a] Prior periods have been adjusted to reflect PPL's 2-for-1 common stock split completed in August 2005. See Note 4 to the Financial Statements for additional information.

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

# CONSOLIDATED STATEMENT OF CASH FLOWS

| *(Millions of dollars)* *For the years ended December 31,* | **2005** | 2004 | 2003 |
|---|---|---|---|
| **Cash Flows from Operating Activities** | | | |
| Net income | **$ 678** | $ 698 | $ 734 |
| Adjustments to reconcile net income to net cash provided by operating activities | | | |
| Cumulative effects of changes in accounting principles | **8** | | (35) |
| Pre-tax loss from the sale of the Sundance plant | **72** | | |
| Depreciation | **423** | 412 | 380 |
| Stock compensation expense | **32** | 12 | 11 |
| Amortizations – recoverable transition costs and other | **298** | 279 | 256 |
| Pension expense (income) – net | **26** | (24) | (41) |
| Pension funding | **(67)** | (10) | (18) |
| Deferred income taxes (benefits) and investment tax credits | **(66)** | 155 | 96 |
| Accrual for PJM billing dispute | **47** | | |
| Accrual for remediation of ash basin leak – net of cash paid | **32** | | |
| Unrealized gain on derivatives and other hedging activities | **(1)** | (15) | (38) |
| Write-off (deferral) of storm-related costs | **(12)** | 4 | (15) |
| Interest accretion on asset retirement obligation and other | **24** | 23 | 22 |
| Other | **2** | 14 | 33 |
| Change in current assets and current liabilities | | | |
| Accounts receivable | **(93)** | 109 | 11 |
| Accounts payable | **141** | (49) | 7 |
| Fuel, materials and supplies | **(38)** | (52) | (13) |
| Other | **(101)** | 3 | (10) |
| Other operating activities | | | |
| Other assets | **18** | (4) | 51 |
| Other liabilities | **(35)** | (58) | (76) |
| Net cash provided by operating activities | **1,388** | 1,497 | 1,355 |
| **Cash Flows from Investing Activities** | | | |
| Expenditures for property, plant and equipment | **(811)** | (734) | (767) |
| Proceeds from the sale of the Sundance plant | **190** | | |
| Proceeds from the sale of minority interest in CGE | | 123 | |
| Purchases of emission allowances | **(169)** | (109) | (68) |
| Proceeds from the sale of emission allowances | **64** | 67 | 72 |
| Purchases of nuclear decommissioning trust investments | **(239)** | (134) | (161) |
| Proceeds from the sale of nuclear decommissioning trust investments | **223** | 113 | 140 |
| Purchases of auction rate securities | **(116)** | (130) | (15) |
| Proceeds from the sale of auction rate securities | **118** | 74 | 5 |
| Net (increase) decrease in restricted cash | **(34)** | (48) | 12 |
| Other investing activities | **(5)** | | 28 |
| Net cash used in investing activities | **(779)** | (778) | (754) |
| **Cash Flows from Financing Activities** | | | |
| Issuance of long-term debt | **737** | 322 | 992 |
| Retirement of long-term debt | **(1,261)** | (1,171) | (575) |
| Issuance of common stock | **37** | 596 | 426 |
| Payment of common dividends | **(347)** | (297) | (260) |
| Payment of preferred distributions | **(2)** | (2) | (27) |
| Net increase (decrease) in short-term debt | **184** | (14) | (877) |
| Other financing activities | **(24)** | (12) | (66) |
| Net cash used in financing activities | **(676)** | (578) | (387) |
| **Effect of Exchange Rates on Cash and Cash Equivalents** | **6** | 9 | 7 |
| **Net Increase (Decrease) in Cash and Cash Equivalents** | **(61)** | 150 | 221 |
| Cash and Cash Equivalents at Beginning of Period | **616** | 466 | 245 |
| Cash and Cash Equivalents at End of Period | **$ 555** | $ 616 | $ 466 |
| **Supplemental Disclosures of Cash Flow Information** | | | |
| Cash paid (received) during the period for: | | | |
| Interest | **$ 466** | $ 488 | $ 456 |
| Income taxes – net | **$ 149** | $ 14 | $ (23) |

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

## CONSOLIDATED BALANCE SHEET

| *(Millions of dollars)* At December 31, | 2005 | 2004 |
|---|---|---|
| **ASSETS** | | |
| **Current Assets** | | |
| Cash and cash equivalents | **$ 555** | $ 616 |
| Restricted cash (Note 18) | **93** | 50 |
| Accounts receivable (less reserve: 2005, $87; 2004, $88) | **544** | 459 |
| Unbilled revenues | **479** | 407 |
| Fuel, materials and supplies (Note 1) | **346** | 309 |
| Prepayments | **53** | 56 |
| Deferred income taxes (Note 5) | **192** | 134 |
| Price risk management assets (Note 17) | **488** | 115 |
| Other | **160** | 130 |
| Total Current Assets | **2,910** | 2,276 |
| **Investments** | | |
| Investment in unconsolidated affiliates – at equity (Note 3) | **56** | 51 |
| Nuclear plant decommissioning trust fund (Note 21) | **444** | 409 |
| Other | **8** | 12 |
| Total Investments | **508** | 472 |
| **Property, Plant and Equipment** (Note 1) | | |
| Electric plant in service | | |
| Transmission and distribution | **7,984** | 7,936 |
| Generation | **8,761** | 8,946 |
| General | **646** | 666 |
| | **17,391** | 17,548 |
| Construction work in progress | **259** | 148 |
| Nuclear fuel | **327** | 314 |
| Electric plant | **17,977** | 18,010 |
| Gas and oil plant | **349** | 336 |
| Other property | **289** | 285 |
| | **18,615** | 18,631 |
| Less: accumulated depreciation | **7,699** | 7,482 |
| Total Property, Plant and Equipment | **10,916** | 11,149 |
| **Regulatory and Other Noncurrent Assets** (Note 1) | | |
| Recoverable transition costs | **1,165** | 1,431 |
| Goodwill (Note 19) | **1,070** | 1,127 |
| Other acquired intangibles (Note 19) | **412** | 336 |
| Other | **945** | 942 |
| Total Regulatory and Other Noncurrent Assets | **3,592** | 3,836 |
| Total Assets | **$17,926** | $17,733 |

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

# CONSOLIDATED BALANCE SHEET

| *(Millions of dollars)* At December 31, | 2005 | 2004 |
|---|---|---|
| **LIABILITIES AND EQUITY** | | |
| **Current Liabilities** | | |
| Short-term debt (Note 8) | **$ 214** | $ 42 |
| Long-term debt | **1,126** | 866 |
| Accounts payable | **542** | 407 |
| Above market NUG contracts (Note 14) | **70** | 73 |
| Taxes | **168** | 164 |
| Interest | **112** | 129 |
| Dividends | **96** | 79 |
| Price risk management liabilities (Note 17) | **533** | 167 |
| Other | **479** | 368 |
| Total Current Liabilities | **3,340** | 2,295 |
| **Long-term Debt** | **5,955** | 6,792 |
| **Long-term Debt with Affiliate Trust** (Notes 15 and 22) | **89** | 89 |
| **Deferred Credits and Other Noncurrent Liabilities** | | |
| Deferred income taxes and investment tax credits (Note 5) | **2,197** | 2,398 |
| Accrued pension obligations (Note 12) | **374** | 476 |
| Asset retirement obligations (Note 21) | **298** | 257 |
| Above market NUG contracts (Note 14) | **136** | 206 |
| Other (Note 12) | **1,012** | 874 |
| Total Deferred Credits and Other Noncurrent Liabilities | **4,017** | 4,211 |
| **Commitments and Contingent Liabilities** (Note 14) | | |
| **Minority Interest** | **56** | 56 |
| **Preferred Stock** (Note 7) | **51** | 51 |
| **Shareowners' Common Equity** | | |
| Common stock – $0.01 par value[a] | **4** | 2 |
| Capital in excess of par value | **3,623** | 3,577 |
| Treasury stock | **(838)** | (838) |
| Earnings reinvested | **2,182** | 1,870 |
| Accumulated other comprehensive loss (Note 1) | **(532)** | (323) |
| Capital stock expense and other | **(21)** | (49) |
| Total Shareowners' Common Equity | **4,418** | 4,239 |
| Total Liabilities and Equity | **$17,926** | $17,733 |

[a] 780 million shares authorized; 380 million shares outstanding at December 31, 2005, and 378 million shares outstanding at December 31, 2004.

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

# CONSOLIDATED STATEMENT OF SHAREOWNERS' COMMON EQUITY AND COMPREHENSIVE INCOME

| *(Millions of dollars, except per share amounts)* *For the years ended December 31,* | **2005** | 2004 | 2003 |
|---|---|---|---|
| Common stock at beginning of year | **$ 2** | $ 2 | $ 2 |
| Common stock split | **2** | | |
| Common stock at end of year | **4** | 2 | 2 |
| Capital in excess of par value at beginning of year | **3,577** | 2,977 | 2,543 |
| Common stock split | **(2)** | | |
| Common stock issued | **42** | 596 | 426 |
| Other | **6** | 4 | 8 |
| Capital in excess of par value at end of year | **3,623** | 3,577 | 2,977 |
| Treasury stock at beginning of year | **(838)** | (837) | (836) |
| Treasury stock purchased | | (1) | (1) |
| Treasury stock at end of year | **(838)** | (838) | (837) |
| Earnings reinvested at beginning of year | **1,870** | 1,478 | 1,013 |
| Net income[(b)] | **678** | 698 | 734 |
| Dividends declared on common stock and restricted stock units | **(366)** | (306) | (269) |
| Earnings reinvested at end of year | **2,182** | 1,870 | 1,478 |
| Accumulated other comprehensive loss at beginning of year[(c)] | **(323)** | (297) | (446) |
| Other comprehensive income (loss)[(b)] | **(209)** | (26) | 149 |
| Accumulated other comprehensive loss at end of year | **(532)** | (323) | (297) |
| Capital stock expense and other at beginning of year | **(49)** | (64) | (52) |
| Issuance costs and other charges to issue common stock | | | (9) |
| Other | **28** | 15 | (3) |
| Capital stock expense and other at end of year | **(21)** | (49) | (64) |
| Total Shareowners' Common Equity | **$4,418** | $4,239 | $3,259 |
| Common stock shares at beginning of year[(a)] | **378,143** | 354,723 | 331,472 |
| Common stock issued through the DRIP, ICP, ICPKE, PEPS Units conversion, directors retirement plan, structured equity program and public offering | **2,024** | 23,473 | 23,303 |
| Treasury stock purchased | **(22)** | (53) | (52) |
| Common stock shares at end of year | **380,145** | 378,143 | 354,723 |

(a) Shares in thousands. Each share entitles the holder to one vote on any question presented to any shareowners' meeting. Prior periods have been adjusted to reflect PPL's 2-for-1 common stock split completed in August 2005. See Note 4 to the Financial Statements for additional information.

(b) Statement of Comprehensive Income (Note 1):

| | | | |
|---|---|---|---|
| Net income | **$ 678** | $ 698 | $ 734 |
| Other comprehensive income (loss): | | | |
| *Foreign currency translation adjustments* | **(53)** | 110 | 104 |
| Net unrealized gains on available-for-sale securities, net of tax expense of $5, $18, $14 | **8** | 20 | 24 |
| Additional minimum pension liability adjustments, net of tax expense (benefit) of $8, $(24), $(4) | **19** | (52) | (10) |
| Net unrealized gains (losses) on qualifying derivatives, net of tax expense (benefit) of $(115), $(60), $15 | **(183)** | (104) | 31 |
| Total other comprehensive income (loss) | **(209)** | (26) | 149 |
| Comprehensive Income | **$ 469** | $ 672 | $ 883 |

(c) See Note 1 for disclosure of balances for each component of Accumulated Other Comprehensive Loss.

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

# CONSOLIDATED STATEMENT OF LONG-TERM DEBT

| *(Millions of dollars)* | *At December 31,* | Outstanding 2005 | 2004 | Maturity (a) |
|---|---|---|---|---|
| **Bonds:** | | | | |
| 6-1/2% – 7.7% First Mortgage Bonds (b) | | **$ 156** | $ 225 | 2005-2014 |
| 3.125% – 6.40% First Mortgage Pollution Control Bonds (b) | | **314** | 314 | 2008-2029 |
| 4.30% – 6-1/4% Senior Secured Bonds (b) | | **1,041** | 841 | 2007-2020 |
| 6.83% – 7.15% Series 1999-1 Transition Bonds | | **892** | 1,159 | 2005-2008 |
| 5.875% – 9.25% Unsecured Bonds | | **1,784 (g)** | 2,051 | 2004-2028 |
| 6.107% – 6.40% Inflation-linked Bonds | | **190 (g)** | 161 | 2006-2022 |
| Floating Rate Pollution Control Revenue Bonds (c) | | **9** | 9 | 2027 |
| 6.8% – 9.0% Bolivian Bonds | | **23 (h)** | 22 | 2005-2010 |
| **Notes:** | | | | |
| 6.17% – 8.375% Medium-term Notes | | **283** | 632 | 2005-2007 |
| 4.33% – 6.40% Senior Unsecured Notes | | **1,301** | 1,001 | 2009-2035 |
| 8.05% – 8.30% Senior Secured Notes (d) | | **437** | 437 | 2013 |
| 2.625% Convertible Senior Notes | | **400** | 400 | 2023 |
| 7.29% Subordinated Notes | | **148** | 290 | 2006 |
| 8.70% Unsecured Promissory Notes | | **10** | 10 | 2022 |
| Senior Floating Rate Notes (e) | | **99** | 99 | 2006 |
| Other Long-term Debt | | **13** | 15 | 2011–2013 |
| | | **7,100** | 7,666 | |
| Fair value adjustments from hedging activities | | **(15)** | 17 | |
| Unamortized premium | | **13** | | |
| Unamortized discount | | **(17)** | (25) | |
| | | **7,081** | 7,658 | |
| Less amount due within one year | | **(1,126)** | (866) | |
| Total Long-term Debt | | **$ 5,955** | $6,792 | |
| **Long-term Debt with Affiliate Trusts:** | | | | |
| 8.23% Subordinated Debentures (f) | | **$ 89** | $ 89 | 2027 |

See Note 8 for information on debt issuances, debt retirements and other changes in long-term debt.

(a) Aggregate maturities of long-term debt through 2010 are (millions of dollars): 2006, $1,126; 2007, $1,020; 2008, $627; 2009, $692; and 2010, $10.

(b) The First Mortgage Bonds and the First Mortgage Pollution Control Bonds were issued under, and are secured by, the lien of the 1945 First Mortgage Bond Indenture. The lien of the 1945 First Mortgage Bond Indenture covers substantially all electric distribution plant and certain transmission plant owned by PPL Electric. The Senior Secured Bonds were issued under the 2001 Senior Secured Bond Indenture. The Senior Secured Bonds are secured by (i) an equal principal amount of First Mortgage Bonds issued under the 1945 First Mortgage Bond Indenture and (ii) the lien of the 2001 Senior Secured Bond Indenture, which covers substantially all electric distribution plant and certain transmission plant owned by PPL Electric and which is junior to the lien of the 1945 First Mortgage Bond Indenture.

(c) Rate at December 31, 2005, was 3.58% and at December 31, 2004, was 2.0%.

(d) Represents lease financing consolidated through a variable interest entity. See Note 22 for additional information.

(e) Rate at December 31, 2005, was 5.42% and at December 31, 2004, was 3.36%.

(f) Represents debt with a wholly owned trust that was deconsolidated effective December 31, 2003, as a result of the adoption of FIN 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51," for certain entities. See Notes 8 and 22 for further discussion.

(g) Increase is due to or partially due to an increase in foreign currency exchange rates.

(h) A portion of the bonds have interest rates that are inflation-linked.

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

Terms and abbreviations appearing in Notes to Consolidated Financial Statements are explained in the glossary. Dollars are in millions, except per share data, unless otherwise noted.

# 1. Summary of Significant Accounting Policies

**General**

*Business and Consolidation*

PPL is an energy and utility holding company that, through its subsidiaries, is primarily engaged in the generation and marketing of electricity in the northeastern and western U.S. and in the delivery of electricity in Pennsylvania, the U.K. and Latin America. Based in Allentown, PA, PPL's principal direct subsidiaries are PPL Energy Funding, PPL Electric, PPL Gas Utilities, PPL Services and PPL Capital Funding.

PPL Energy Funding is the parent of PPL Energy Supply, which serves as the holding company for PPL's principal unregulated subsidiaries. PPL Energy Supply is the parent of PPL Generation, PPL EnergyPlus and PPL Global.

PPL Generation owns and operates a portfolio of domestic power generating assets. These power plants are located in Pennsylvania, Montana, Arizona, Illinois, Connecticut, New York and Maine and use well-diversified fuel sources including coal, uranium, natural gas, oil and water. PPL EnergyPlus markets or brokers electricity produced by PPL Generation, along with purchased power, natural gas and oil, in competitive wholesale and deregulated retail markets, primarily in the northeastern and western portions of the U.S. PPL Global owns and operates international energy businesses that are primarily focused on the distribution of electricity.

PPL Electric is a rate-regulated subsidiary of PPL. PPL Electric's principal businesses are the transmission and distribution of electricity to serve retail customers in its franchised territory in eastern and central Pennsylvania, and the supply of electricity to retail customers in that territory as a PLR.

The consolidated financial statements of PPL include its own accounts as well as the accounts of all entities in which the company has a controlling financial interest. Investments in entities in which the company has the ability to exercise significant influence but does not have a controlling financial interest are accounted for under the equity method. See Note 3 for further discussion. All other investments are carried at cost or fair value. All significant intercompany transactions have been eliminated. Any minority interests are reflected in the consolidated financial statements.

It is the policy of PPL to consolidate or record equity in earnings of foreign entities on a lag, based on the availability of financial data on a U.S. GAAP basis:

- PPL and its subsidiaries consolidate the results of foreign entities in which they have a controlling financial interest (WPD, Emel, EC, the Bolivian subsidiaries and other investments) on a one-month lag.
- Earnings from foreign equity method investments are recorded on a three-month lag.

Effective December 31, 2003, PPL's consolidated financial statements include the accounts of the lessors under the operating leases for the Sundance, University Park and Lower Mt. Bethel generation facilities. In June 2004, PPL Energy Supply subsidiaries purchased the Sundance and University Park generation assets from the lessor. See Note 22 for further discussion. In May 2005, a subsidiary of PPL Generation completed the sale of its Sundance generation assets to Arizona Public Service Company. See Note 9 for further discussion.

Effective December 31, 2003, PPL deconsolidated PPL Capital Funding Trust I and SIUK Capital Trust I, both of which are wholly owned trusts. See Note 22 for further discussion.

The consolidated financial statements of PPL include its share of undivided interests in jointly-owned facilities, as well as its share of the related operating costs of those facilities. See Note 13 for additional information.

*Regulation*

PPL Electric and PPL Gas Utilities account for regulated operations in accordance with the provisions of SFAS 71, "Accounting for the Effects of Certain Types of Regulation," which requires rate-regulated entities to reflect the effects of regulatory decisions in their financial statements.

The following regulatory assets were included in the "Regulatory and Other Noncurrent Assets" section of the Balance Sheet at December 31.

| | 2005 | 2004 |
|---|---|---|
| Recoverable transition costs | **$1,165** | $1,431 |
| Taxes recoverable through future rates | **250** | 276 |
| Other | **29** | 20 |
| | **$1,444** | $1,727 |

Based on the PUC Final Order, PPL Electric began amortizing its competitive transition (or stranded) costs, $2.97 billion, over an 11-year transition period effective January 1, 1999. In August 1999, competitive transition costs of $2.4 billion were converted to intangible transition costs when they were securitized by the issuance of transition bonds. The intangible transition costs are being amortized over the life of the transition bonds, through December 2008, in accordance with an amortization schedule filed with the PUC. The assets of PPL Transition Bond Company, including the intangible transition property, are not available to creditors of PPL or PPL Electric. The transition bonds are obligations of PPL Transition Bond Company and are non-recourse to PPL and PPL Electric. The remaining competitive transition costs are also being amortized based on an amortization schedule previously filed with the PUC, adjusted for those competitive transition costs that were converted to intangible transition costs. As a result of the conversion of a significant portion of the competitive transition costs into intangible transition costs, amortization of substantially all of the remaining competitive transition costs will occur in 2009.

Included in "Other" above as of December 31, 2005 and 2004, were approximately $10 million and $11 million of storm restoration costs associated with the September 2003 Hurricane Isabel. PPL Electric deferred these costs based on assessment of the PUC declaratory order of January 2004. The costs are being recovered through customer transmission and distribution rates, and are being amortized over ten years effective January 1, 2005.

Also included in "Other" at December 31, 2005, were approximately $12 million of costs associated with severe ice storms in PPL Electric's service territory in January 2005. These costs have been deferred based on an assessment of an order issued by the PUC on August 26, 2005. The ratemaking treatment of these costs will be addressed in PPL Electric's next distribution base rate case. PPL believes there is a reasonable basis for recovery of all regulatory assets.

Elfec accounts for regulated operations in accordance with the provisions of SFAS 71. Regulatory assets as of December 31, 2005 and 2004 were insignificant.

*Accounting Records*

The system of accounts for PPL Electric and PPL Gas Utilities are maintained in accordance with the Uniform System of Accounts prescribed by the FERC and adopted by the PUC.

*Use of Estimates*

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

*Loss Accruals*

Loss accruals are recorded in accordance with SFAS 5, "Accounting for Contingencies," and other related accounting guidance. Potential losses are accrued when (1) information is available that indicates it is "probable" that the loss has been incurred, given the likelihood of the uncertain future events and (2) the amount of the loss can be reasonably estimated. FASB defines "probable" as cases in which "the future event or events are likely to occur." SFAS 5 does not permit the accrual of contingencies that might result in gains. PPL continuously assesses potential loss contingencies for environmental remediation, litigation claims, income taxes, regulatory penalties and other events.

PPL also has accrued estimated losses on long-term purchase commitments when significant events have occurred. For example, estimated losses were accrued when long-term purchase commitments were assumed under asset acquisition agreements and when PPL Electric's generation business was deregulated.

*Changes in Classification*

The classification of certain amounts in the 2004 and 2003 financial statements has been changed to conform to the current presentation. The changes in classification did not affect net income or total equity.

In addition, based on recent clarifications of accounting guidance, the Statement of Cash Flows has been revised to reflect the purchases and sales of emission allowances, and the purchases and sales of investments in the nuclear decommissioning trust, on a gross basis within "Cash Flows from Investing Activities." Previously, these cash flows were presented on a net basis within "Cash Flows from Operating Activities." The net impact of this revised presentation was to increase "Cash Flows from Operating Activities" and to decrease "Cash Flows from Investing Activities" by $63 million in 2004 and $17 million in 2003. This revision had no impact on "Cash and Cash Equivalents" for the periods reported. This revision is not considered by management as material to the Financial Statements.

See Note 19 for additional information regarding emission allowances and Note 21 for additional information regarding investments in the nuclear decommissioning trust.

*Comprehensive Income*

Comprehensive income consists of net income and other comprehensive income, defined as changes in common equity from transactions not related to shareowners. Comprehensive income is shown on PPL's Statement of Shareowners' Common Equity and Comprehensive Income.

Accumulated other comprehensive loss, which is presented on the Balance Sheet, consisted of these after-tax amounts at December 31.

| | **2005** | 2004 |
|---|---|---|
| Foreign currency translation adjustments | **$ 15** | $ 68 |
| Net unrealized gains on available-for-sale securities | **48** | 40 |
| Additional minimum pension liability | **(349)** | (368) |
| Net unrealized losses on qualifying derivatives | **(246)** | (63) |
| | **$(532)** | $(323) |

**Price Risk Management**

PPL enters into energy and energy-related contracts to hedge the variability of expected cash flows associated with its generating units and marketing activities, as well as for trading purposes. PPL enters into interest rate derivative contracts to hedge its exposure to changes in the fair value of its debt instruments and to hedge its exposure to variability in expected cash flows associated with existing debt instruments or forecasted transactions. PPL also enters into foreign currency derivative contracts to hedge foreign currency exposures, including firm commitments, recognized assets or liabilities, forecasted transactions, net investments, or foreign earnings translation.

Contracts that meet the definition of a derivative are accounted for under SFAS 133, "Accounting for Derivative Instruments and Hedging Activities," as amended and interpreted. Certain energy contracts have been excluded from the requirements of SFAS 133 because they meet the definition of a "normal purchase or normal sale." These contracts are reflected in the financial statements using the accrual method of accounting.

Additionally, PPL adopted SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities," as of July 1, 2003. The requirements of SFAS 149, which required prospective application, placed additional limitations on the use of the normal purchase or normal sale exception.

All derivative contracts that are subject to the requirements of SFAS 133 and its amendments are reflected on the balance sheet at their fair value. On the date the derivative contract is executed, PPL may designate the derivative as a hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment ("fair value" hedge), a hedge of a forecasted transaction or of the variability of cash flows to be received or paid related to a recognized asset or liability ("cash flow" hedge), a foreign currency fair value or cash flow hedge ("foreign currency" hedge), or a hedge of a net investment in a foreign operation ("net investment" hedge). Changes in the fair value of derivatives are recorded in either other comprehensive income or in current-period earnings in accordance with SFAS 133.

Unrealized gains and losses from changes in market prices of energy contracts accounted for as fair value hedges are reflected in "Energy purchases" on the Statement of Income, as are changes in the underlying positions. Realized gains and losses from energy contracts accounted for as fair value hedges or cash flow hedges, when recognized on the Statement of Income, are reflected in "Fuel" or "Energy purchases," consistent with the hedged item. Changes in the fair value of derivatives that are not designated as hedging instruments are

reflected in "Net energy trading margins" revenues. However, unrealized gains and losses on FTRs and options to hedge synthetic fuel tax credits, which are not designated as hedging instruments, are reflected in "Energy purchases" and "Energy-related business" revenues, respectively. Gains and losses from interest rate and foreign currency derivative contracts that hedge interest payments, when recognized on the Statement of Income, are accounted for in "Interest Expense." Gains and losses from foreign currency derivative contracts that economically hedge foreign earnings translation are recognized in "Other Income – net." Gains and losses from foreign currency derivative contracts that hedge foreign currency payments for equipment, when recognized on the Statement of Income, are accounted for in "Depreciation."

Under EITF 02-3, "Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities," PPL reflects its net realized and unrealized gains and losses associated with all derivatives that are held for trading purposes in "Net energy trading margins" revenues on the Statement of Income. The physical volumes for electricity and gas associated with energy trading were 5,800 GWh and 13.4 Bcf in 2005; 5,700 GWh and 11.7 Bcf in 2004; and 5,200 GWh and 12.6 Bcf in 2003.

PPL adopted the final provisions of EITF 03-11, "Reporting Realized Gains and Losses on Derivative Instruments That Are Subject to FASB Statement No. 133 and Not 'Held for Trading Purposes' as Defined in Issue No. 02-3," prospectively as of October 1, 2003. As a result of the adoption, non-trading bilateral sales of electricity at major market delivery points are netted with purchases that offset the sales at those same delivery points. A major market delivery point is any delivery point with liquid pricing available.

See Note 17 for additional information on SFAS 133, its amendments and related accounting guidance.

**Revenue**

*Utility Revenue*

The Statement of Income "Utility" line item contains revenues from domestic and international rate-regulated delivery operations.

WPD revenues are stated net of value-added tax.

*Revenue Recognition*

Operating revenues, except for "Energy-related businesses," are recorded based on energy deliveries through the end of the calendar month. Unbilled retail revenues result because customers' meters are read and bills are rendered throughout the month, rather than all being read at the end of the month. Unbilled revenues for a month are calculated by multiplying an estimate of unbilled kWh by the estimated average cents per kWh. Unbilled wholesale energy revenues are recorded at month-end to reflect estimated amounts until actual dollars and MWhs are confirmed and invoiced. At that time, unbilled revenue is reversed and actual revenue is recorded.

PPL records energy marketing activity in the period when the energy is delivered. The wholesale sales and purchases that meet the criteria in EITF 03-11 are reported net on the Statement of Income within "Wholesale energy marketing." Additionally, the bilateral sales and purchases that are designated as trading activities are also reported net, in accordance with EITF 02-3 and are reported on the Statement of Income within "Net energy trading margins." Spot market activity that balances PPL's physical trading positions is included on the Statement of Income in "Net energy trading margins."

Certain PPL subsidiaries participate in RTOs, primarily in PJM, but also in the surrounding regions of New York (NYISO), New England (ISO-NE) and the Midwest (MISO). In PJM, PPL EnergyPlus is a marketer, a load-serving entity to its customers who have selected it as a supplier and a seller for PPL's generation subsidiaries. PPL Electric is a transmission owner and PLR in PJM. In ISO-NE, PPL EnergyPlus is a marketer, a load-serving entity, and a seller for PPL's New England generating assets. In the NYISO and MISO regions, PPL EnergyPlus acts as a marketer. PPL Electric does not participate in ISO-NE, NYISO or MISO. A function of interchange accounting is to match participants' MWh entitlements (generation plus scheduled bilateral purchases) against their MWh obligations (load plus scheduled bilateral sales) during every hour of every day. If the net result during any given hour is an entitlement, the participant is credited with a spot-market sale to the ISO at the respective market price for that hour; if the net result is an obligation, the participant is charged with a spot-market purchase from the ISO at the respective market price for that hour. ISO purchases and sales are not allocated to individual customers. PPL records the hourly net sales and purchases in its financial statements as sales to and purchases from the respective ISOs.

"Energy-related businesses" revenue includes revenues from the mechanical contracting and engineering subsidiaries, WPD's telecommunications and property subsidiaries and PPL Global's proportionate share of affiliate earnings under the equity or cost method of accounting, as described in the "Business and Consolidation" section of Note 1. The mechanical contracting and engineering subsidiaries record profits from construction contracts on the percentage-of-completion method of accounting. Income from time and material contracts is recognized currently as the work is performed.

*Allowance for Doubtful Accounts*

Accounts receivable collectibility is evaluated using a combination of factors. Reserve balances are analyzed to assess the reasonableness of the balances in comparison to the actual accounts receivable balances and write-offs. Adjustments are made to reserve balances based on the results of analysis, the aging of receivables, and historical and industry trends.

Additional specific reserves for uncollectible accounts receivable, such as bankruptcies, are recorded on a case-by-case basis after having been researched and reviewed by management. Unusual items, trends in write-offs, the age of the receivable, counterparty creditworthiness and economic conditions are considered as a basis for determining the adequacy of the reserve for uncollectible account balances.

PPL's significant specific reserves relate to receivables from Enron, which filed for bankruptcy in 2001, and from the California ISO, which has withheld payment pending the outcome of regulatory proceedings arising from the California electricity supply situation that began in 2000. At December 31, 2005 and 2004, these two reserves accounted for 60% and 59% of PPL's total allowance for doubtful accounts.

**Cash and Investments**

*Cash Equivalents*

All highly liquid debt instruments purchased with original maturities of three months or less are considered to be cash equivalents.

PPL invests in auction rate and similar securities which provide for periodic reset of interest rates and are highly liquid. Even though PPL considers these debt securities as part of its liquid portfolio, it does not include these securities in cash and cash equivalents due to the stated maturity of the securities. These securities are included in "Current Assets – Other" on the Balance Sheet.

*Restricted Cash*
Bank deposits that are restricted by agreement or that have been designated for a specific purpose are classified as restricted cash. The change in restricted cash is reported as an investing activity in the Statement of Cash Flows. On the Balance Sheet, the current portion of restricted cash is shown as "Restricted cash" within current assets, while the noncurrent portion is included in "Other" within other noncurrent assets. See Note 18 for the components of restricted cash.

*Investments in Debt and Marketable Equity Securities*
Investments in debt securities are classified as held-to-maturity, and measured at amortized cost, when there is an intent and ability to hold the securities to maturity. Debt securities and marketable equity securities that are acquired and held principally for the purpose of selling them in the near-term are classified as trading. All other investments in debt and marketable equity securities are classified as available-for-sale. Both trading and available-for-sale securities are carried at fair value. Any unrealized gains and losses for trading securities are included in earnings. Unrealized gains and losses for available-for-sale securities are reported, net of tax, in other comprehensive income or are recognized currently in earnings when a decline in fair value is determined to be other than temporary. The specific identification method is used to calculate realized gains and losses on debt and marketable equity securities. See Note 21 for additional information on securities held in the nuclear decommissioning trusts.

**Long-Lived and Intangible Assets**

*Property, Plant and Equipment*
PP&E is recorded at original cost, unless impaired. If impaired, the asset is written down to fair value at that time, which becomes the asset's new cost basis. Original cost includes material, labor, contractor costs, construction overheads and financing costs, where applicable. The cost of repairs and minor replacements are charged to expense as incurred. PPL records costs associated with planned major maintenance projects in the period in which the costs are incurred. No costs are accrued in advance of the period in which the work is performed.

AFUDC is capitalized as part of the construction costs for regulated projects. Interest is capitalized as part of construction costs for non-regulated projects.

Included in PP&E on the balance sheet are capitalized costs of software projects that were developed or obtained for internal use. At December 31, 2005 and 2004, capitalized software costs were $92 million and $83 million, and there was $57 million and $46 million of accumulated amortization. Such capitalized amounts are amortized ratably over the expected lives of the projects when they become operational, generally not to exceed 10 years. During 2005, 2004 and 2003, PPL amortized capitalized software costs of $13 million, $11 million and $14 million.

*Depreciation*
Depreciation is computed over the estimated useful lives of property using various methods including the straight-line, composite and group methods. When a component of PP&E is retired that was depreciated under the composite or group method, the original cost is charged to accumulated depreciation. When all or a significant portion of an operating unit that was depreciated under the composite or group method is retired or sold, the property and the related accumulated depreciation account is reduced and any gain or loss is included in income, unless otherwise required by regulators.

PPL and its subsidiaries periodically review the useful lives of their fixed assets. In light of significant planned environmental capital expenditures, PPL Generation conducted studies of the useful lives of Montour Units 1 and 2 and Brunner Island Unit 3 during the first quarter of 2005. Based on these studies, the useful lives of these units were extended from 2025 to 2035, effective January 1, 2005. In the second quarter of 2005, PPL Generation conducted additional studies of the useful lives of certain Eastern fossil-fuel and hydroelectric generation plants. The most significant change related to the useful lives of Brunner Island Units 1 and 2 and Martins Creek Units 3 and 4, which were extended from 2025 to 2035, effective July 1, 2005. The effect of these changes in useful lives for 2005 was to increase net income, as a result of lower depreciation, by approximately $7 million.

As a result of the final regulatory outcome published by Ofgem of the most recent price control review and an assessment of the economic life of meters, WPD reduced the remaining depreciable lives of its existing meter stock to approximately nine years. The lives of new meters were reduced from 40 years to 19 years. The effect for 2005 was to decrease net income, as a result of higher depreciation, by approximately $5 million.

Following are the weighted-average rates of depreciation at December 31.

| | 2005 | 2004 |
|---|---|---|
| Generation | **2.01%** | 2.11% |
| Transmission and distribution | **3.03%** | 2.86% |
| General | **3.78%** | 3.41% |

The annual provisions for depreciation have been computed principally in accordance with the following ranges, in years, of assets lives: generation, 2–50 years; transmission and distribution, 5–70 years; and general, 3–80 years.

*Goodwill and Other Acquired Intangible Assets*
Goodwill represents the excess of the purchase price paid over the estimated fair value of the assets acquired and liabilities assumed in the acquisition of a business. In accordance with SFAS 142, "Goodwill and Other Intangible Assets," PPL and its subsidiaries do not amortize goodwill.

Other acquired intangible assets that have finite useful lives are valued at cost and amortized over their useful lives based upon the pattern in which the economic benefits of the intangible assets are consumed or otherwise used up.

*Asset Impairment*
PPL and its subsidiaries review long-lived assets, including intangibles, that are subject to depreciation or amortization for impairment when events or circumstances indicate carrying amounts may not be recoverable. An impairment loss is recognized if the carrying amount of long-lived assets is not recoverable from undiscounted future cash flow. The impairment charge is measured by the difference between the carrying amount of the asset and its fair value. See Note 9 for a discussion of asset impairment charges recorded.

Goodwill is reviewed for impairment, at the reporting unit level, annually or more frequently when events or circumstances indicate that the carrying value may be greater than the implied fair value. PPL's reporting units are one level below its operating segments. If the carrying value of the reporting unit exceeds its fair value, the implied fair value of goodwill must be calculated. If the implied fair value of goodwill is less than its carrying value, the difference represents the amount of impairment.

*Asset Retirement Obligations*

In 2001, the FASB issued SFAS 143, "Accounting for Asset Retirement Obligations," which addresses the accounting for obligations associated with the retirement of tangible long-lived assets. SFAS 143 requires legal obligations associated with the retirement of long-lived assets to be recognized as a liability in the financial statements. The initial obligation is measured at the estimated fair value. An equivalent amount is recorded as an increase in the value of the capitalized asset and allocated to expense over the useful life of the asset. Until the obligation is settled, the liability is increased, through the recognition of accretion expense in the income statement, for changes in the obligation due to the passage of time.

In 2005, the FASB issued FIN No. 47, "Accounting for Conditional Asset Retirement Obligations, an interpretation of FASB Statement No. 143" that clarifies certain aspects of SFAS 143 related to conditional AROs.

See Note 21 for a discussion of accounting for AROs.

**Compensation and Benefits**

*Pension and Other Postretirement Benefits*

PPL and certain of its subsidiaries sponsor various pension and other postretirement and postemployment benefit plans. PPL follows the guidance of SFAS 87, "Employers' Accounting for Pensions," and SFAS 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," when accounting for these benefits.

PPL uses a market-related value of plan assets in accounting for its pension plans. The market-related value of assets is calculated by rolling forward the prior year market-related value with contributions, disbursements and expected return on investments. One-fifth of the difference between the actual value and the expected value is added (or subtracted if negative) to the expected value to determine the new market-related value.

PPL uses an accelerated amortization method for the recognition of gains and losses for its pension plans. Under the accelerated method, gains and losses in excess of 10% but less than 30% of the greater of the plan's projected benefit obligation or the market-related value of plan assets are amortized on a straight-line basis over the estimated average future service period of plan participants. Gains and losses in excess of 30% of the plan's projected benefit obligation are amortized on a straight-line basis over a period equal to one-half of the average future service period of the plan participants.

See Note 12 for a discussion of pension and other postretirement benefits.

*Stock-Based Compensation*

PPL grants stock options, restricted stock, restricted stock units and stock units to employees and directors under several stock-based compensation plans. SFAS 123, "Accounting for Stock-Based Compensation," encourages entities to record compensation expense for stock-based compensation plans at fair value but provides the option of measuring compensation expense using the intrinsic value method prescribed by APB Opinion No. 25, "Accounting for Stock Issued to Employees." The fair value method under SFAS 123 is the preferable method of accounting for stock-based compensation, as it provides a consistent basis of accounting for all stock-based awards, thereby facilitating a better measure of compensation cost and improved financial reporting.

Prior to 2003, PPL and its subsidiaries accounted for stock-based compensation in accordance with APB Opinion No. 25, as permitted by SFAS 123. Effective January 1, 2003, PPL and its subsidiaries adopted the fair value method of accounting for stock-based compensation, as prescribed by SFAS 123, using the prospective method of transition permitted by SFAS 148, "Accounting for Stock-Based Compensation – Transition and Disclosure, an Amendment of FASB Statement No. 123." The prospective method of transition requires PPL and its subsidiaries to use the fair value method under SFAS 123 for all stock-based compensation awards granted, modified or settled on or after January 1, 2003. Thus, all awards granted prior to January 1, 2003, were accounted for under the intrinsic value method of APB Opinion No. 25, to the extent such awards are not modified or settled.

Use of the fair value method prescribed by SFAS 123 requires PPL and its subsidiaries to recognize compensation expense for stock options issued. Fair value for the stock options is determined using the Black-Scholes options pricing model. Stock options with graded vesting (i.e., that vest in installments) are valued as a single award.

PPL and its subsidiaries were not required to recognize compensation expense for stock options issued and accounted for under the intrinsic value method of APB Opinion No. 25, since PPL grants stock options with an exercise price that is not less than the fair market value of PPL's common stock on the date of grant. As currently structured, awards of restricted stock, restricted stock units and stock units result in the same amount of compensation expense under the fair value method of SFAS 123 as they would under the intrinsic value method of APB Opinion No. 25. See Note 11 for a discussion of stock-based compensation. Stock-based compensation is included in "Other operation and maintenance" expense on the Statement of Income.

The table below illustrates the pro forma effect on net income and EPS as if the fair value method had been used to account for all outstanding stock-based compensation awards in 2004 and 2003. For 2005, the difference between the pro forma and reported amounts would have been insignificant.

| | 2005 | 2004 |
|---|---|---|
| **Net Income** | | |
| Net Income – as reported | **$ 698** | $ 734 |
| Add: Stock-based employee compensation expense included in reported net income, net of tax | **8** | 5 |
| Deduct: Total stock-based compensation expense determined under the fair value method for all awards, net of tax | **10** | 9 |
| Pro forma Net Income | **$ 696** | $ 730 |
| **EPS** | | |
| Basic – as reported | **$1.89** | $2.13 |
| Basic – pro forma | **$1.89** | $2.12 |
| Diluted – as reported | **$1.89** | $2.12 |
| Diluted – pro forma | **$1.88** | $2.11 |

In December 2004, the FASB issued SFAS 123 (revised 2004), "Share-Based Payment," which is known as SFAS 123(R) and replaces SFAS 123, "Accounting for Stock-Based Compensation," as amended by SFAS 148, "Accounting for Stock-Based Compensation-Transition and Disclosure." PPL and its subsidiaries adopted SFAS 123(R) effective January 1, 2006. See Note 23 for a discussion of SFAS 123(R).

In SFAS 123(R), the FASB provided additional guidance on the requirement to accelerate expense recognition for employees who are at or near retirement age and who are under a plan that allows for accelerated vesting upon an employee's retirement. Such guidance is relevant to prior accounting for stock-based compensation under other accounting guidance. PPL's stock-based compensation plans allow for accelerated vesting upon an employee's retirement. Thus, for employees who are retirement eligible when stock-based awards are granted, PPL will recognize the expense immediately. For employees who are not retirement eligible when stock-based awards are granted, PPL will amortize the awards on a straight-line basis over the shorter of the vesting period or the period up to the employee's attainment of retirement age. Retirement eligible has been defined by PPL as the early retirement age of 55. The adjustments below related to retirement-eligible employees were recorded based on the aforementioned clarification of existing guidance and are not related to the adoption of SFAS 123(R).

In 2005, PPL recorded a charge of approximately $10 million after tax, or $0.03 per share, to accelerate stock-based compensation expense for retirement-eligible employees. Approximately $5 million of the after-tax total, or $0.01 per share, was related to periods prior to 2005. The prior period amounts were not material to previously issued financial statements.

**Other**

*Income Taxes*

The income tax provision for PPL and its subsidiaries is calculated in accordance with SFAS 109, "Accounting for Income Taxes." PPL and its domestic subsidiaries file a consolidated U.S. federal income tax return.

Significant management judgment is required in developing PPL's provision for income taxes, including the determination of deferred tax assets and liabilities and any valuation allowances that might be required against the deferred tax assets, as well as estimating the phase-out range for synthetic fuel tax credits that is not published by the IRS until April of the following year. PPL and its subsidiaries record valuation allowances to reduce deferred tax assets to the amounts that are more likely than not to be realized. PPL and its subsidiaries have considered future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for valuation allowances. If PPL and its subsidiaries determined that they would be able to realize deferred tax assets in the future in excess of net deferred tax assets, adjustments to the deferred tax assets would increase income by reducing tax expense in the period that such determination was made. Likewise, if PPL and its subsidiaries determined that they would not be able to realize all or part of net deferred tax assets in the future, adjustments to the deferred tax assets would decrease income by increasing tax expense in the period that such determination was made.

Annual tax provisions include amounts considered sufficient to pay assessments that may result from examination by taxing authorities of prior year tax returns; the amount ultimately paid upon resolution of issues raised by such authorities may differ materially from the amount accrued and may materially impact PPL's financial statements. In evaluating the exposure associated with various tax filing positions, PPL and its subsidiaries accrue charges for probable exposures based on management's best estimate of the amount that should be recognized. PPL and its subsidiaries maintain an allowance for tax contingencies, the balance of which management believes to be adequate.

PPL Energy Supply and PPL Electric deferred investment tax credits when they were utilized and are amortizing the deferrals over the average lives of the related assets. See Note 5 for additional discussion regarding income taxes.

The provision for PPL Electric's deferred income taxes for regulated assets is based upon the ratemaking principles reflected in rates established by the PUC and the FERC. The difference in the provision for deferred income taxes for regulated assets and the amount that otherwise would be recorded under U.S. GAAP is deferred and included in taxes recoverable through future rates in "Regulatory and Other Noncurrent Assets – Other" on the Balance Sheet. See Note 5 for additional information.

*Leases*

PPL and its subsidiaries apply the provisions of SFAS 13, "Accounting for Leases," as amended and interpreted, to all transactions that qualify for lease accounting. See Note 10 for a discussion of accounting for leases under which PPL and its subsidiaries are lessees.

In 2002, PPL began commercial operation of its 79.9 MW oil-powered station in Shoreham, New York. The Long Island Power Authority has contracted to purchase all of the plant's capacity and ancillary services as part of a 15-year power purchase agreement with PPL EnergyPlus. The capacity payments in the power purchase agreement result in the plant being classified as a direct-financing lease, under which PPL EnergyPlus is the lessor.

In December 2004, PPL recorded a sales-type lease related to an 8 MW on-site electrical generation plant, under which a subsidiary of PPL Energy Supply is the lessor.

As of December 31, 2005 and 2004, PPL had receivable balances of $256 million and $273 million (included in "Current Assets – Other" and "Regulatory and Other Noncurrent Assets – Other") and unearned revenue balances of $143 million and $158 million (included in "Deferred Credits and Other Noncurrent Liabilities – Other"). The receivable balances include $65 million of an unguaranteed residual value. Rental income received during 2005, 2004 and 2003 was $15 million, $14 million and $15 million. Total future minimum lease payments expected to be received on both leases are estimated at $16 million for each of the years from 2006 through 2010.

*Fuel, Materials and Supplies*

PPL and its subsidiaries value inventory at the lower of cost or market, primarily using the average-cost method. At December 31, 2005, PPL Gas Utilities valued all of its natural gas inventory using the last-in, first-out method (LIFO). The carrying value of that inventory was $16 million and $5 million at December 31, 2005 and 2004, and the excess of replacement cost over carrying value was $15 million and $7 million at December 31, 2005 and 2004.

*Guarantees*

In accordance with the provisions of FIN 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, an Interpretation of FASB Statements No. 5, 57, and 107 and Rescission of FASB Interpretation No. 34," the fair values of guarantees related to arrangements entered into prior to January 1, 2003, as well as guarantees excluded from the initial recognition and measurement provisions of FIN 45, are not recorded in the financial statements. See Note 14 for further discussion of recorded and unrecorded guarantees.

*Treasury Stock*

Treasury shares are reflected on the balance sheet as an offset to common equity under the cost method of accounting. Management has no definitive plans for the future use of these shares. Treasury shares are not considered outstanding in calculating EPS.

At December 31, 2005 and 2004, PPL held 62,113,489 and 62,091,706 shares of treasury stock.

*Foreign Currency Translation and Transactions*

Assets and liabilities of international operations, where the local currency is the functional currency, are translated at year-end exchange rates, and related revenues and expenses are translated at average exchange rates prevailing during the year. Adjustments resulting from translation are recorded in accumulated other comprehensive loss.

Gains or losses relating to foreign currency transactions are recognized currently in income. The aggregate transaction losses were insignificant in 2005, 2004 and 2003.

**New Accounting Standards**

See Note 23 for a discussion of new accounting standards recently adopted or pending adoption.

# 2. Segment and Related Information

PPL's reportable segments are Supply, International Delivery (formerly International) and Pennsylvania Delivery (formerly Delivery). In 2005, there were no changes to the reportable segments except that the segments were renamed to more specifically describe their businesses. The Supply segment primarily consists of the domestic energy marketing, domestic generation and domestic development operations of PPL Energy Supply. The International Delivery segment includes operations of the international energy businesses of PPL Global that are primarily focused on the distribution of electricity. The majority of PPL Global's international businesses are located in the U.K., Chile, El Salvador and Bolivia. The Pennsylvania Delivery segment includes the regulated electric and gas delivery operations of PPL Electric and PPL Gas Utilities.

Segments include direct charges, as well as an allocation of indirect corporate costs, for services provided by PPL Services. These service costs include functions such as financial, legal, human resources and information services.

Financial data for the segments are:

| | 2005 | 2004 | 2003 |
|---|---|---|---|
| ***Income Statement Data*** | | | |
| Revenues from external customers | | | |
| Supply | **$1,814** | $1,823 | $1,788 |
| International Delivery | **1,206** | 1,102 | 1,013 |
| Pennsylvania Delivery | **3,199** | 2,869 | 2,784 |
| | **6,219** | 5,794 | 5,585 |
| Intersegment revenues [a] | | | |
| Supply | **1,590** | 1,500 | 1,444 |
| Pennsylvania Delivery | **152** | 156 | 161 |
| Equity in earnings of unconsolidated affiliates | | | |
| Supply | **(12)** | (10) | (14) |
| International Delivery | **3** | 2 | 3 |
| | **(9)** | (8) | (11) |
| Depreciation | | | |
| Supply | **144** | 144 | 120 |
| International Delivery | **157** | 146 | 147 |
| Pennsylvania Delivery | **119** | 114 | 109 |
| | **420** | 404 | 376 |
| Amortizations – recoverable transition costs and other | | | |
| Supply | **33** | 14 | (15) |
| International Delivery | **(13)** | (2) | |
| Pennsylvania Delivery | **278** | 267 | 271 |
| | **298** | 279 | 256 |
| Interest income | | | |
| Supply | **(6)** | 15 | (2) |
| International Delivery | **8** | 8 | 7 |
| Pennsylvania Delivery | **21** | 16 | 7 |
| | **23** | 39 | 12 |
| Interest expense | | | |
| Supply | **116** | 114 | 38 |
| International Delivery | **203** | 203 | 218 |
| Pennsylvania Delivery | **189** | 196 | 217 |
| | **508** | 513 | 473 |
| Income tax expense | | | |
| Supply | **20** | 127 | 186 |
| International Delivery | **34** | 59 | (30) |
| Pennsylvania Delivery | **67** | 17 | 23 |
| | **121** | 203 | 179 |
| Deferred income taxes and investment tax credits | | | |
| Supply | **(92)** | 18 | 13 |
| International Delivery | **18** | 50 | 55 |
| Pennsylvania Delivery | **10** | 87 | 22 |
| | **(64)** | 155 | 90 |
| Net Income | | | |
| Supply [b] [c] | **311** | 421 | 502 |
| International Delivery [d] | **215** | 197 | 196 |
| Pennsylvania Delivery | **152** | 80 | 36 |
| | **$678** | $698 | $734 |

| | 2005 | 2004 | 2003 |
|---|---|---|---|
| **Cash Flow Data** | | | |
| Expenditures for property, plant and equipment | | | |
| Supply | **$332** | $259 | $270 |
| International Delivery | **289** | 279 | 246 |
| Pennsylvania Delivery | **190** | 196 | 251 |
| | **$811** | $734 | $767 |

| *As of December 31,* | 2005 | 2004 |
|---|---|---|
| **Balance Sheet Data** | | |
| Net investment in unconsolidated affiliates – at equity | | |
| Supply | **$ 41** | $ 36 |
| International Delivery | **15** | 15 |
| | **56** | 51 |
| Total assets | | |
| Supply | **7,118** | 6,645 |
| International Delivery | **5,089** | 5,390 |
| Pennsylvania Delivery | **5,719** | 5,698 |
| | **$17,926** | $17,733 |

| | 2005 | 2004 | 2003 |
|---|---|---|---|
| **Geographic Data** | | | |
| Revenues from external customers | | | |
| U.S. | **$5,013** | $4,692 | $4,572 |
| Foreign: | | | |
| U.K. | **750** | 715 | 651 |
| Latin America | **456** | 387 | 362 |
| | **1,206** | 1,102 | 1,013 |
| | **$6,219** | $5,794 | $5,585 |

| *As of December 31,* | 2005 | 2004 |
|---|---|---|
| Property, Plant and Equipment | | |
| U.S. | **$ 7,292** | $ 7,359 |
| Foreign: | | |
| U.K. | **3,162** | 3,373 |
| Latin America | **462** | 417 |
| | **3,624** | 3,790 |
| | **$10,916** | $11,149 |

(a) See "PLR Contracts" and "NUG Purchases" in Note 15 for the basis of accounting between reportable segments.

(b) 2005 and 2003 include cumulative effects of changes in accounting principles. See Notes 21 and 22 for additional information.

(c) 2005, 2004 and 2003 include the operating results of the Sundance plant recorded in "Loss from Discontinued Operations." 2005 also includes the loss on the sale of the Sundance plant that is recorded in "Loss from Discontinued Operations." See Note 9 for additional information.

(d) 2004 includes the operating results of a Latin American telecommunications company, as well as an insignificant write-down of its net assets, recorded in "Loss from Discontinued Operations." See Note 9 for additional information.

## 3. Investment in Unconsolidated Affiliates – at Equity

Investment in unconsolidated affiliates accounted for under the equity method at December 31 (equity ownership percentages as of December 31, 2005) was:

| | 2005 | 2004 |
|---|---|---|
| Aguaytia Energy, LLC – 11.4% | **$10** | $9 |
| Bangor-Pacific Hydro Associates – 50.0% | **17** | 15 |
| Safe Harbor Water Power Corporation – 33.3% | **15** | 15 |
| Other | **14** | 12 |
| | **$56** | $51 |

In January 2006, PPL Global entered into an agreement to sell its minority interest in Aguaytia Energy, LLC.

A PPL subsidiary has a 50% interest in a partnership that owns the Griffith gas-fired generation station. The partnership arrangement is essentially a cost-sharing arrangement, in that each of the partners has rights to one-half of the plant capacity and energy, and an obligation to cover one-half of the operating costs of the station. Accordingly, the equity investment is not reflected in the table above and is classified as "Electric plant in service – Generation" on the Balance Sheet.

## 4. Earnings Per Share

In August 2005, PPL completed a 2-for-1 split of its common stock. The record date for the stock split was August 17, 2005, and the distribution date was August 24, 2005. As a result of the stock split, approximately 190 million shares were issued to shareholders, and approximately 31 million shares were issued as treasury shares as of the record date. The par value of the stock remains at $0.01 per share and, accordingly, $2 million was transferred from "Capital in excess of par value" to "Common stock" on the Balance Sheet. The number of shares, the market price, and earnings and dividends per share amounts, as well as PPL's stock-based compensation awards, the conversion rate and market price trigger of PPL Energy Supply's 2.625% Convertible Senior Notes due 2023 and the threshold appreciation price and shares issued under the PEPS Units transaction, included in these financial statements have been adjusted for all periods presented to reflect the stock split.

Basic EPS is calculated using the weighted-average number of common shares outstanding during the period. Diluted EPS is calculated using weighted average shares outstanding that are increased for additional shares that would be outstanding if potentially dilutive securities were converted to common stock. Potentially dilutive securities consist of:

- stock options, restricted stock and restricted stock units granted under the incentive compensation plans;
- stock units representing common stock granted under the directors compensation programs;
- common stock purchase contracts that were a component of the PEPS Units and PEPS Units, Series B; and
- convertible senior notes.

The basic and diluted EPS calculations, and the reconciliation of the shares (in thousands) used in the calculations, are:

| | 2005 | 2004 | 2003 |
|---|---|---|---|
| **Income (Numerator)** | | | |
| Income from continuing operations | **$ 737** | $ 713 | $ 733 |
| Loss from discontinued operations (net of tax) | **51** | 15 | 34 |
| Cumulative effects of changes in accounting principles (net of tax) | **(8)** | | 35 |
| Net Income | **$ 678** | $ 698 | $ 734 |
| **Shares (Denominator)** | | | |
| Shares for Basic EPS | **379,132** | 368,456 | 345,589 |
| Add incremental shares | | | |
| Convertible Senior Notes | **2,263** | 134 | |
| Restricted stock, stock options and other share-based awards | **2,342** | 1,396 | 1,194 |
| Shares for Diluted EPS | **383,737** | 369,986 | 346,783 |
| **Basic EPS** | | | |
| Income from continuing operations | **$ 1.94** | $ 1.93 | $ 2.12 |
| Loss from discontinued operations (net of tax) | **0.13** | 0.04 | 0.09 |
| Cumulative effects of changes in accounting principles (net of tax) | **(0.02)** | | 0.10 |
| Net Income | **$ 1.79** | $ 1.89 | $ 2.13 |
| **Diluted EPS** | | | |
| Income from continuing operations | **$ 1.92** | $ 1.93 | $ 2.12 |
| Loss from discontinued operations (net of tax) | **0.13** | 0.04 | 0.10 |
| Cumulative effects of changes in accounting principles (net of tax) | **(0.02)** | | 0.10 |
| Net Income | **$ 1.77** | $ 1.89 | $ 2.12 |

In May 2001, PPL and PPL Capital Funding Trust I issued 23 million PEPS Units that contained a purchase contract component for PPL's common stock. The purchase contracts were only dilutive if the average price of PPL's common stock exceeded a threshold appreciation price, which was adjusted for cash distributions on PPL common stock. The threshold appreciation price was initially set at $32.52 and was adjusted to $31.69 as of April 1, 2004, based on dividends paid on PPL's common stock since issuance. The purchase contracts were settled in May 2004. Since the average price did not exceed the threshold appreciation price, the purchase contracts were excluded from the diluted EPS calculations for 2004 and 2003.

In January 2004, PPL completed an exchange offer resulting in the exchange of approximately four million PEPS Units for PEPS Units, Series B. The primary difference in the units related to the debt component. The purchase contract components of both units, which were potentially dilutive, were identical. The threshold appreciation price for the purchase contract component of the PEPS Units, Series B was adjusted in the same manner as that of the PEPS Units and was $31.69 as a result of the adjustment as of April 1, 2004. These purchase contracts were settled in May 2004. Since the average price did not exceed the threshold appreciation price, the purchase contracts were excluded from the diluted EPS calculations for 2004.

In May 2003, PPL Energy Supply issued $400 million of 2.625% Convertible Senior Notes due 2023. The notes are guaranteed by PPL and, as originally issued, could be converted into shares of PPL common stock if:

- during any fiscal quarter starting after June 30, 2003, the market price of PPL's common stock trades at or above $29.84 per share over a certain period during the preceding fiscal quarter;
- PPL calls the debt for redemption;
- the holder exercises its right to put the debt on any five-year anniversary of the offering;
- the long-term credit rating assigned to the notes by Moody's Investors Service, Inc. and Standard & Poor's Ratings Services falls below Ba2 and BB or the notes are not rated; or
- certain specified corporate transactions occur, e.g., change in control and certain distributions to the holders of PPL common stock.

The conversion rate is 40.2212 shares per $1,000 principal amount of notes. It will be adjusted if certain specified distributions, whether in the form of cash, stock, other equity interests, evidence of indebtedness or assets, are made to holders of PPL common stock. Additionally, the conversion rate can be increased by PPL if its Board of Directors has made a determination that to do so would be in the best interests of either PPL or holders of PPL common stock.

Depending upon which of the conversion events identified above occurs, the Convertible Senior Notes, as originally issued, could have been settled in cash or shares. However, the notes were modified in November 2004 to require cash settlement of the principal amount, permit settlement of any conversion premium in cash or stock and eliminate a provision that required settlement in stock in the event of default. These modifications were made in response to the FASB's ratification of EITF Issue 04-8, "The Effect of Contingently Convertible Instruments on Diluted Earnings per Share," as well as other anticipated rules relating to EPS. EITF Issue 04-8 requires contingently convertible instruments to be included in diluted EPS. It also requires restatement of prior-period diluted EPS, in certain circumstances, based upon the terms of the contingently convertible instruments as of the date of adoption, which was December 31, 2004, for PPL.

The Convertible Senior Notes have a dilutive impact when the average market price of PPL common stock exceeds the conversion price of $24.87. The Convertible Senior Notes did not have a dilutive impact on EPS for 2003.

The maximum number of shares that could potentially be issued to settle the conversion premium, based upon the current conversion rate, is 16,088,480 shares. Based on PPL's common stock price at December 31, 2005, the conversion premium equated to 2,483,038 shares, or approximately $73 million.

See Note 8 for discussion of attainment of the market price trigger related to the Convertible Senior Notes in the third quarter of 2005 and the related conversion requests that PPL received in the fourth quarter.

The following number of stock options to purchase PPL common shares were excluded in the periods' computations of diluted EPS because the effect would have been antidilutive.

| *(Thousands of Shares)* | 2005 | 2004 | 2003 |
|---|---|---|---|
| Antidilutive stock options | **402** | 2,266 | 3,366 |

# 5. Income and Other Taxes

For 2005, 2004 and 2003, the statutory U.S. corporate federal income tax rate was 35%. The statutory corporate net income tax rate for Pennsylvania was 9.99%.

"Income from Continuing Operations Before Income Taxes, Minority Interest and Distributions on Preferred Securities" included the following components for the years ended December 31.

| | 2005 | 2004 | 2003 |
|---|---|---|---|
| Domestic income | **$613** | $662 | $750 |
| Foreign income | **254** | 264 | 198 |
| | **$867** | $926 | $948 |

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for accounting purposes and their basis for income tax purposes and the tax effects of net operating loss and tax credit carryforwards.

Net deferred tax assets have been recognized based on management's estimates of future taxable income for U.S. and certain foreign jurisdictions in which PPL's operations have historically been profitable.

Significant components of PPL's deferred income tax assets and liabilities from continuing operations were:

| | 2005 | 2004 |
|---|---|---|
| **Deferred Tax Assets** | | |
| Deferred investment tax credits | **$ 36** | $ 42 |
| NUG contracts and buybacks | **102** | 135 |
| Unrealized loss on qualifying derivatives | **139** | 30 |
| Accrued pension costs | **80** | 86 |
| Federal tax credit carryforwards | **112** | 58 |
| Foreign loss carryforwards | **140** | 152 |
| Foreign – pensions | **53** | 51 |
| Foreign – other | **36** | 26 |
| Contribution in aid of construction | **78** | 65 |
| Other | **195** | 189 |
| Valuation allowance | **(148)** | (164) |
| | **823** | 670 |
| **Deferred Tax Liabilities** | | |
| Plant – net | **1,316** | 1,291 |
| Restructuring – CTC | **434** | 526 |
| Taxes recoverable through future rates | **106** | 115 |
| Reacquired debt costs | **16** | 14 |
| Foreign – plant | **692** | 770 |
| Foreign – other | **98** | 55 |
| Other domestic | **78** | 62 |
| | **2,740** | 2,833 |
| **Net deferred tax liability** | **$1,917** | $2,163 |

Details of the components of income tax expense, a reconciliation of federal income taxes derived from statutory tax rates applied to income from continuing operations for accounting purposes, and details of taxes other than income are:

| | 2005 | 2004 | 2003 |
|---|---|---|---|
| **Income Tax Expense** | | | |
| Current – Federal | **$122** | $52 | $39 |
| Current – State | **(1)** | (31) | 15 |
| Current – Foreign | **64** | 27 | 35 |
| | **185** | 48 | 89 |
| Deferred – Federal | **(83)** | 102 | 34 |
| Deferred – State | **17** | 17 | 23 |
| Deferred – Foreign | **17** | 51 | 48 |
| | **(49)** | 170 | 105 |
| Investment tax credit, net – federal | **(15)** | (15) | (15) |
| Total income tax expense from continuing operations [a] | **$121** | $203 | $179 |
| Total income tax expense – Federal | **$ 24** | $139 | $ 58 |
| Total income tax expense – State | **16** | (14) | 38 |
| Total income tax expense – Foreign | **81** | 78 | 83 |
| Total income tax expense from continuing operations [a] | **$121** | $203 | $179 |

[a] Excludes $6 million of deferred federal, state and foreign tax benefit in 2005 and $26 million of current and deferred federal and state tax expense in 2003 related to the cumulative effect of changes in accounting principles, recorded net of tax. Excludes current and deferred federal and state tax benefits of $28 million in 2005, $8 million in 2004 and $10 million in 2003 related to loss from discontinued operations, recorded net of tax.

In 2005, 2004 and 2003, PPL realized tax benefits related to stock-based compensation, recorded as an increase to capital in excess of par value of approximately $7 million, $3 million and $5 million.

| | 2005 | 2004 | 2003 |
|---|---|---|---|
| **Reconciliation of Income Tax Expense** | | | |
| Indicated federal income tax on Income from Continuing Operations Before Income Taxes, Minority Interest and Distributions on Preferred Securities at statutory tax rate – 35% | **$ 303** | $ 324 | $ 332 |
| Increase (decrease) due to: | | | |
| State income taxes | **21** | 12 | 26 |
| Amortization of investment tax credit | **(10)** | (10) | (10) |
| Write-down of international energy projects | | | (83) |
| Difference related to income recognition of foreign affiliates (net of foreign income taxes) | **(55)** | (36) | (11) |
| Stranded cost securitization | **(7)** | (22) | |
| Federal income tax credits | **(107)** | (74) | (52) |
| Contribution of property | | (2) | (9) |
| Federal income tax return adjustments | **(16)** | (1) | (11) |
| Other | **(8)** | 12 | (3) |
| | **(182)** | (121) | (153) |
| **Total income tax expense from continuing operations** | **$ 121** | $ 203 | $ 179 |
| **Effective income tax rate** | **14.0%** | 21.9% | 18.9% |

During 2005, PPL recorded a $13 million benefit from the reduction of state and federal income taxes from filing the 2004 income tax returns. The $13 million benefit included in the Reconciliation of Income Tax Expense

consisted of a $16 million federal benefit reflected in "Federal income tax return adjustments," offset by a $3 million state expense reflected in "State income taxes."

During 2005, PPL recorded a $12 million benefit related to federal and state income tax reserve changes. The $12 million benefit included in the Reconciliation of Income Tax Expense consisted of a $7 million benefit reflected in "Stranded cost securitization," a $2 million state benefit reflected in "State income taxes" and a $3 million federal benefit reflected in "Other."

During 2004, PPL recorded a $1 million benefit from the reduction of state and federal income taxes from filing the 2003 income tax returns. The $1 million benefit included in the Reconciliation of Income Tax Expense consisted of a $2 million federal benefit reflected in "Contribution of property" and a $1 million federal benefit reflected in "Federal income tax return adjustments," offset by a $2 million state expense reflected in "State income taxes."

During 2004, PPL recorded a $15 million benefit related to federal and state income tax reserve changes. The $15 million benefit included in the Reconciliation of Income Tax Expense consisted of a $22 million benefit reflected in "Stranded cost securitization" and a $2 million state benefit reflected in "State income taxes," offset by a $9 million federal expense reflected in "Other."

| | **2005** | 2004 | 2003 |
|---|---|---|---|
| **Taxes, Other than Income** | | | |
| State gross receipts | **$175** | $156 | $155 |
| State utility realty | **6** | (10) | 3 |
| State capital stock | **14** | 22 | 27 |
| Property – foreign | **57** | 55 | 47 |
| Other – foreign | **1** | 1 | |
| Domestic property and other | **26** | 25 | 24 |
| | **$279** | $249 | $256 |

PPL had federal alternative minimum tax credit carryforwards with an indefinite carryforward period of $111 million and $58 million at December 31, 2005 and 2004. PPL also had state net operating loss carryforwards that expire between 2006 and 2024 of approximately $97 million and $77 million at December 31, 2005 and 2004. Valuation allowances have been established for the amount that, more likely than not, will not be realized.

PPL Global had foreign net operating loss carryforwards of approximately $50 million and $27 million at December 31, 2005 and 2004. PPL Global also had foreign capital loss carryforwards of $439 million and $486 million at December 31, 2005 and 2004. All of these losses have an unlimited carryforward period. However, it is more likely than not that these losses will not be utilized and, as such, a full valuation allowance has been provided against the related deferred tax asset.

PPL Global does not pay or record U.S. income taxes on the undistributed earnings of its foreign subsidiaries where management has determined that the earnings are permanently reinvested. The cumulative undistributed earnings are included in "Earnings reinvested" on the Balance Sheet. The amounts considered permanently reinvested at December 31, 2005 and 2004, were $650 million and $406 million. If the earnings were remitted as dividends, PPL Global may be subject to additional U.S. taxes, net of allowable foreign tax credits. It is not practical to estimate the amount of additional taxes that might be payable on these foreign earnings.

In October 2004, President Bush signed the American Jobs Creation Act of 2004 (the Act). The Act creates a temporary incentive for U.S. corporations to repatriate accumulated income earned abroad by providing an 85% dividends received deduction for certain dividends from controlled foreign corporations. During 2005, PPL did not repatriate any foreign earned income subject to the Act.

The Act also provides, beginning in 2005, a tax deduction from income for certain qualified domestic production activities. FSP FAS 109-1, "Application of FASB Statement No. 109, 'Accounting for Income Taxes,' to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004," specifies that this tax deduction will be treated as a special deduction and not as a tax rate reduction. For 2005, PPL recognized a $3 million tax benefit related to this new deduction.

## 6. Financial Instruments

At December 31, 2005 and 2004, the carrying value of cash and cash equivalents, investments in the nuclear decommissioning trust funds, other investments and short-term debt approximated fair value due to the short-term nature of the instruments, variable interest rates associated with the financial instruments or the carrying value of the instruments being based on established market prices. Price risk management assets and liabilities are recorded at fair value using exchange-traded market quotes, prices obtained through third-party brokers or internally developed price curves. Financial instruments where the carrying amount on the Balance Sheet and the estimated fair value (based on quoted market prices for the securities where available and estimates based on current rates where quoted market prices are not available) are different, are set forth below:

| | **December 31, 2005** | | December 31, 2004 | |
|---|---|---|---|---|
| | **Carrying Amount** | **Fair Value** | Carrying Amount | Fair Value |
| Long-term debt | **$7,081** | **$7,585** | $7,658 | $8,242 |
| Long-term debt with affiliate trusts | **89** | **84** | 89 | 84 |

## 7. Preferred Stock

Presented below are the details of PPL Electric's $100 par value cumulative preferred stock, without sinking fund requirements, that were outstanding as of December 31, 2005 and 2004.

| Dividend | Outstanding | Issued and Outstanding Shares | Shares Authorized | Optional Redemption Price Per Share at 12/31/2005 |
|---|---|---|---|---|
| 4-1/2% | $25 | 247,524 | 629,936 | $110.00 |
| Series Preferred | | | | |
| 3.35% | 2 | 20,605 | | 103.50 |
| 4.40% | 12 | 117,676 | | 102.00 |
| 4.60% | 3 | 28,614 | | 103.00 |
| 6.75% | 9 | 90,770 | | 102.70 |
| Total Series Preferred | 26 | 257,665 | 10,000,000 | |
| Total Preferred Stock | $51 | 505,189 | | |

The involuntary liquidation price of the preferred stock is $100 per share. The optional voluntary liquidation price is the optional redemption price per share in effect, except for the 4-1/2% Preferred Stock and the 6.75% Series Preferred Stock for which such price is $100 per share (plus, in each case, any unpaid dividends in arrears).

Holders of the outstanding preferred stock are entitled to one vote per share on matters on which PPL Electric's shareowners are entitled to vote.

The following are decreases in preferred stock due to the redemption of previously outstanding preferred stock with sinking fund requirements.

| | 2005 | | 2004 | | 2003 | |
|---|---|---|---|---|---|---|
| | **Shares** | **Amount** | Shares | Amount | Shares | Amount |
| Series Preferred | | | | | | |
| 6.125% | | | | | (167,500) | $(17) |
| 6.15% | | | | | (97,500) | (10) |
| 6.33% | | | | | (46,000) | (4) |

PPL Electric is authorized to issue 5 million shares of preference stock. No preference stock had been issued or was outstanding at December 31, 2005.

PPL is authorized to issue up to 10 million shares of preferred stock. No preferred stock had been issued or was outstanding at December 31, 2005.

# 8. Credit Arrangements and Financing Activities

### Credit Arrangements

PPL Electric maintains credit facilities in order to enhance liquidity and provide credit support, and as a backstop to its commercial paper program. At December 31, 2005, no cash borrowings were outstanding under any PPL Electric credit facilities.

In June 2005, PPL Electric extended to June 2010 its $200 million five-year facility originally set to expire in 2009. PPL Electric also maintains a $100 million three-year credit facility maturing in June 2006. PPL Electric has the ability to cause the lenders under its facilities to issue letters of credit. At December 31, 2005, PPL Electric had less than $1 million of letters of credit outstanding under its credit facilities.

PPL Electric maintains a commercial paper program for up to $200 million, to provide it with an additional financing source to fund its short-term liquidity needs, if and when necessary. Commercial paper issuances are supported by certain credit agreements of PPL Electric. PPL Electric had no commercial paper outstanding at December 31, 2005 and 2004.

PPL Electric participates in an asset-backed commercial paper program through which PPL Electric obtains financing by selling and contributing its eligible accounts receivable and unbilled revenue to a special purpose, wholly owned subsidiary on an ongoing basis. The subsidiary has pledged these assets to secure loans from a commercial paper conduit sponsored by a financial institution. PPL Electric uses the proceeds from the credit agreement for general corporate purposes and to cash collateralize letters of credit. The subsidiary's borrowing limit under this credit agreement is $150 million, and interest under the credit agreement varies based on the commercial paper conduit's actual cost to issue commercial paper that supports the debt. At December 31, 2005 and 2004, $131 million and $96 million of accounts receivable and $142 million and $128 million of unbilled revenue were pledged under the credit agreement. At December 31, 2005 and 2004, there was $42 million of short-term debt outstanding under the credit agreement at an interest rate of 4.3% for 2005 and 2.33% for 2004, all of which was being used to cash collateralize letters of credit issued on PPL Electric's behalf. At December 31, 2005, based on the accounts receivable and unbilled revenue pledged, an additional $108 million was available for borrowing. The funds used to cash collateralize the letters of credit are reported in "Restricted cash" on the Balance Sheet. PPL Electric's sale to its subsidiary of the accounts receivable and unbilled revenue is an absolute sale of the assets, and PPL Electric does not retain an interest in these assets. However, for financial reporting purposes, the subsidiary's financial results are consolidated in PPL Electric's financial statements. PPL Electric performs certain record-keeping and cash collection functions with respect to the assets in return for a servicing fee from the subsidiary. PPL Electric currently expects the subsidiary to renew the credit agreement on an annual basis.

PPL Energy Supply maintains credit facilities in order to enhance liquidity and provide credit support, and as a backstop to its commercial paper program. PPL Energy Supply increased its facility capacity in 2005 in order to provide more liquidity capacity.

In March 2005, PPL Energy Supply entered into a 364-day reimbursement agreement with a bank for the purpose of issuing letters of credit. Under the agreement, PPL Energy Supply can cause the bank to issue up to $200 million of letters of credit. At December 31, 2005, there were $199 million of letters of credit and no cash borrowings outstanding under this agreement.

In June 2005, PPL Energy Supply extended to June 2010 its $800 million five-year facility originally set to expire in 2009 and entered into a new $600 million five-year credit facility expiring in June 2010, which replaced its $300 million three-year facility due to expire in 2006. PPL Energy Supply has the ability to cause the lenders under these facilities to issue letters of credit. At December 31, 2005, PPL Energy Supply had $172 million of letters of credit and no cash borrowings outstanding under these credit facilities.

In December 2005, PPL Energy Supply entered into a new $500 million five-year credit facility expiring in December 2010. The credit agreement allows for cash borrowings and issuances of letters of credit. PPL Energy Supply expects that this facility will be used primarily as a commercial paper backstop and for issuing letters of credit to satisfy collateral requirements of PPL Energy Supply's affiliates. At December 31, 2005, no cash borrowings or letters of credit were outstanding under this facility.

Also, in December 2005, PPL Energy Supply entered into a new $300 million five-year letter of credit and revolving credit facility expiring in March 2011. The credit agreement allows for cash borrowings and issuances of letters of credit. PPL Energy Supply expects that this facility will be used primarily for issuing letters of credit to satisfy collateral requirements of PPL Energy Supply's affiliates. At December 31, 2005, there were no cash borrowings and $286 million of letters of credit outstanding under this facility. PPL Energy Supply's obligations under this facility are supported by a $300 million letter of credit issued on PPL Energy Supply's behalf under a separate $300 million five-year letter of credit and reimbursement agreement also expiring in March 2011.

PPL Energy Supply maintains a commercial paper program for up to $500 million to provide it with an additional financing source to fund its short-term liquidity needs, if and when necessary. Commercial paper issuances are supported by certain credit arrangements of PPL Energy Supply. PPL Energy Supply had $100 million of commercial paper outstanding at December 31, 2005 with a weighted-average interest rate of 4.51% and no commercial paper outstanding at December 31, 2004.

WPD (South West) maintains three committed credit facilities: a £100 million 364-day facility, a £150 million three-year facility and a £150 million five-year facility. In October 2005, WPD (South West) extended the £100 million 364-day facility until October 2006 and the £150 million three-year facility until October 2008. The £150 million five-year facility expires in October 2009. At December 31, 2005, WPD (South West) also has uncommitted credit facilities of £65 million. The balance outstanding under the WPD (South West) credit facilities at December 31, 2005, was £41 million (approximately $71 million at current exchange rates) with a weighted-average interest rate of 4.98%.

In 2001, PPL Electric completed a strategic initiative to confirm its legal separation from PPL and PPL's other affiliated companies. This initiative was designed to enable PPL Electric to substantially reduce its exposure to volatility in energy prices through 2009 and to reduce its business and financial risk profile by, among other things, limiting its business activities to the transmission and distribution of electricity and businesses related to or arising out of the electric transmission and distribution businesses. In connection with this initiative, PPL Electric:

- obtained long-term electric supply contracts to meet its PLR obligations (with its affiliate PPL Energy Plus) through 2009, as further described in Note 15 under "PLR Contracts";
- agreed to limit its businesses to electric transmission and distribution and related activities;
- adopted amendments to its Articles of Incorporation and Bylaws containing corporate governance and operating provisions designed to clarify and reinforce its legal and corporate separateness from PPL and its other affiliated companies;
- appointed an independent director to its board of directors and required the unanimous approval of the board of directors, including the consent of the independent director, to amendments to these corporate governance and operating provisions or to the commencement of any insolvency proceedings, including any filing of a voluntary petition in bankruptcy or other similar actions; and
- appointed an independent compliance administrator to review, on a semi-annual basis, its compliance with the corporate governance and operating requirements contained in its Articles of Incorporation and Bylaws.

The enhancements to PPL Electric's legal separation from its affiliates are intended to minimize the risk that a court would order PPL Electric's assets and liabilities to be substantively consolidated with those of PPL or another affiliate of PPL in the event that PPL or another PPL affiliate were to become a debtor in a bankruptcy case. Based on these various measures, PPL Electric was able to issue and maintain a higher level of debt and use it to replace higher cost equity, thereby maintaining a lower total cost of capital. Nevertheless, if PPL or another PPL affiliate were to become a debtor in a bankruptcy case, there can be no assurance that a court would not order PPL Electric's assets and liabilities to be consolidated with those of PPL or such other PPL affiliate.

The subsidiaries of PPL are separate legal entities. PPL's subsidiaries are not liable for the debts of PPL. Accordingly, creditors of PPL may not satisfy their debts from the assets of the subsidiaries absent a specific contractual undertaking by a subsidiary to pay PPL's creditors or as required by applicable law or regulation. Similarly, absent a specific contractual undertaking or as required by applicable law or regulation, PPL is not liable for the debts of its subsidiaries. Accordingly, creditors of PPL's subsidiaries may not satisfy their debts from the assets of PPL absent a specific contractual undertaking by PPL to pay the creditors of its subsidiaries or as required by applicable law or regulation.

**Financing Activities**

In April 2005, PPL Capital Funding retired all $320 million of its 7-3/4% Medium-term Notes due April 2005 upon maturity. The funds for the retirement were primarily obtained from PPL Energy Supply's August 2004 issuance of $300 million of 5.40% Senior Notes maturing in August 2014.

In July 2005, PPL Capital Funding retired $142 million of its 7.29% Subordinated Notes due May 2006 at a market value of $145 million. PPL recorded a loss of $3 million related to this transaction in 2005.

PPL Capital Funding retired all $10 million of its 6.17% Medium-term Notes due September 2005 and retired all $20 million of its 6.39% Medium-term Notes due October 2005 upon maturity.

In December 2004, WPD borrowed £108 million (approximately $208 million at December 2004 exchange rates) under its credit facilities to retire $178 million of 6.75% Unsecured Bonds due December 2004 and settle the related $30 million cross-currency swap. The total amount is included on the Statement of Cash Flows as "Retirement of long-term debt." This bond retirement was recorded in 2005, due to the one-month reporting lag.

In October 2005, PPL Energy Supply issued $300 million aggregate principal amount of 5.70% REset Put Securities due 2035 (REPS℠). The REPS bear interest at a rate of 5.70% per annum to, but excluding, October 15, 2015 (Remarketing Date). The REPS are required to be put by existing holders on the Remarketing Date either for (a) purchase and remarketing by a designated remarketing dealer, or (b) repurchase by PPL Energy Supply. If the remarketing dealer elects to purchase the REPS for remarketing, it will purchase the REPS at 100% of the principal amount, and the REPS will bear interest on and after the Remarketing Date at a new fixed rate per annum determined in the remarketing. PPL Energy Supply has the right to terminate the remarketing process. If the remarketing is terminated at the option of PPL Energy Supply, or under certain other circumstances, including the occurrence of an event of default by PPL Energy Supply under the related indenture or a failed remarketing for certain specified reasons, PPL Energy Supply will be required to pay the remarketing dealer a settlement amount. The settlement amount will be the present value of an annuity equal to the positive difference, if any, between (a) a stream of interest payments that would have been due on the REPS after the Remarketing Date, assuming the REPS were to bear interest at a rate based on the 20-year swap rate in effect on October 20, 2005, and (b) a stream of

interest payments that would have been due on the REPS after the Remarketing Date, assuming the REPS were to bear interest at a rate based on the 20-year swap rate in effect on the date of calculation of the settlement amount. Also, if the remarketing is terminated for any reason, PPL Energy Supply must repurchase the entire principal amount of the REPS on the Remarketing Date at 100% of the principal amount. PPL Energy Supply received net proceeds of approximately $311 million from the issuance of the REPS, which includes a premium of approximately $13 million associated with the remarketing feature. These proceeds will be used by PPL Energy Supply's affiliates to repay indebtedness and by PPL Energy Supply for capital expenditures and/or general corporate purposes.

In November 2005, Emel entered into a contract that established the fixed terms under which Emel will borrow UF 2,535,000 (approximately $73 million at current exchange rates) in July 2006 to partially finance the UF 3 million bond maturity due August 1, 2006. Any borrowing will be recorded when drawn.

The terms of PPL Energy Supply's 2.625% Convertible Senior Notes due 2023 include a market price trigger that permits holders to convert the notes during any fiscal quarter if the closing sale price of PPL's common stock exceeds $29.83 for at least 20 trading days in the 30 consecutive trading days ending on the last trading day of the preceding fiscal quarter. This market price trigger was met in the third quarter of 2005. Therefore, holders of the Convertible Senior Notes were entitled to convert their notes at any time during the fourth quarter of 2005. As discussed in Note 4, when holders elect to convert the Convertible Senior Notes, PPL Energy Supply is required to settle the principal amount in cash and any conversion premium in cash or PPL common stock. In December 2005, an insignificant amount of bonds was presented for conversion and settled in January 2006 with the issuance of PPL common stock and the payment by PPL Energy Supply of an insignificant amount of cash. As a result of the market price trigger being met in the third quarter, PPL Energy Supply wrote-off $6 million of unamortized debt issuance costs during 2005, which is included in "Interest Expense" on the Statement of Income. The market price trigger was not met in the fourth quarter of 2005.

In February 2005, the Lehigh County Industrial Development Authority (LCIDA) issued $116 million of 4.70% Pollution Control Revenue Refunding Bonds due 2029 on behalf of PPL Electric. The proceeds of the LCIDA bonds were used in March 2005 to refund the LCIDA's $116 million of 6.40% Pollution Control Revenue Refunding Bonds due 2029, previously issued on behalf of PPL Electric. A $2 million premium was paid to redeem these bonds.

In May 2005, the LCIDA issued $108 million of 4.75% Pollution Control Revenue Refunding Bonds due 2027 on behalf of PPL Electric. The proceeds of these LCIDA bonds were used in June 2005 to refund the LCIDA's $53 million of 5.50% Pollution Control Revenue Refunding Bonds due 2027 and in August 2005 to refund the LCIDA's $55 million of 6.15% Pollution Control Revenue Refunding Bonds due 2029, previously issued on behalf of PPL Electric. A $1 million premium was paid as part of each bond redemption.

In connection with the issuance of each of these new series of LCIDA bonds, PPL Electric entered into a loan agreement with the LCIDA pursuant to which the LCIDA has loaned to PPL Electric the proceeds of the LCIDA bonds on payment terms that correspond to the LCIDA bonds. The scheduled principal and interest payments on the LCIDA bonds are insured. In order to secure its obligations to the insurance provider, PPL Electric issued $224 million aggregate principal amount of its Senior Secured Bonds (under its 2001 Senior Secured Bond Indenture), which also have payment terms that correspond to the LCIDA bonds.

In April 2005, PPL Electric retired all $69 million of its 6-1/2% First Mortgage Bonds due April 2005 upon maturity.

In December 2005, PPL Electric sold $200 million of Senior Secured Bonds to certain institutional buyers in a private placement. The bonds were issued in two tranches: $100 million of bonds maturing in December 2015 with a coupon of 4.95%, and $100 million of bonds maturing in December 2020 with a coupon of 5.15%. PPL Electric will use the proceeds from the bonds to refund maturing First Mortgage Bonds.

During 2005, PPL Transition Bond Company made principal payments on transition bonds of $266 million.

**Dividends and Dividend Restrictions**

There were two common stock dividend increases in 2005. In February 2005, PPL announced an increase to its quarterly common stock dividend to 23 cents per share (equivalent to $0.92 per annum) and in August 2005, PPL announced an increase, effective October 1, 2005, to 25 cents per share (equivalent to $1.00 per annum). In February 2006, PPL announced an increase to its quarterly common stock dividend, payable April 1, 2006, to 27.5 cents per share (equivalent to $1.10 per annum). Future dividends, declared at the discretion of the Board of Directors, will be dependent upon future earnings, cash flows, financial requirements and other factors.

The PPL Montana Colstrip lease places certain restrictions on PPL Montana's ability to declare dividends. At this time, PPL believes that these covenants will not limit PPL's ability to operate as desired and will not affect its ability to meet any of its cash obligations. Certain of PPL Global's international subsidiaries also have financing arrangements which limit their ability to pay dividends. However, PPL does not, at this time, expect that any of such limitations would significantly impact PPL's ability to meet its cash obligations.

PPL Electric's 2001 Senior Secured Bond Indenture restricts dividend payments in the event that PPL Electric fails to meet interest coverage ratios or fails to comply with certain requirements included in its Articles of Incorporation and Bylaws to maintain its separateness from PPL and PPL's other subsidiaries. PPL Electric does not, at this time, expect that any of such limitations would significantly impact its ability to declare dividends.

**Mandatorily Redeemable Securities**

On July 1, 2003, PPL adopted the provisions of SFAS 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity." As a result, PPL changed its classification of the trust preferred securities of PPL Capital Funding Trust I, which were issued as a component of the PEPS Units, PPL Energy Supply changed its classification of the trust preferred securities issued by SIUK Capital Trust I and PPL Electric changed its classification of its preferred stock with sinking fund requirements. Under SFAS 150, these securities were required to be classified as liabilities instead of "mezzanine" equity on the balance sheet because they were considered mandatorily

redeemable securities. As of December 31, 2005 and 2004, no amounts were included in long-term debt for any of these securities because of the following: PPL deconsolidated PPL Capital Funding Trust I in accordance with FASB Interpretation No. 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51," effective December 31, 2003, and terminated the trust in 2004; PPL Energy Supply deconsolidated SIUK Capital Trust I in accordance with FIN 46, effective December 31, 2003; and there was no preferred stock with sinking fund requirements of PPL Electric outstanding (due to preferred stock redemptions). See Note 22 for a discussion of the deconsolidation of the trusts. As a result of the deconsolidation and continued existence of SIUK Capital Trust I, the subordinated debt securities that support the SIUK Capital Trust I preferred securities, rather than the trust preferred securities themselves, are reflected in long-term debt as of December 31, 2005 and 2004.

SFAS 150 also required the distributions on these mandatorily redeemable securities to be included as a component of "Interest Expense" instead of "Distributions on Preferred Securities" in the Statement of Income, effective July 1, 2003. "Interest Expense" for 2003 includes distributions on these securities totaling $27 million and "Distributions on Preferred Securities" for 2003 includes distributions on these securities totaling $27 million. As a result of the adoption of FIN 46 by PPL and the redemption of the preferred stock with sinking fund requirements, no amounts are reflected in "Interest Expense" for these mandatorily redeemable securities in 2005 and 2004.

# 9. Acquisitions, Development and Divestitures

From time to time, PPL and its subsidiaries are involved in negotiations with third parties regarding acquisitions and dispositions of businesses and assets, joint ventures and development projects. Any such transactions may impact future financial results.

### Domestic Generation Projects

In January 2003, PPL announced that it had decided not to proceed with development of a 300 MW project at the Kings Park site on Long Island, New York. In March 2003, PPL Global sold its interest in Kings Park Energy, LLC. At that time, six unassigned gas combustion turbine generators and other related equipment to be used at the Kings Park site were transferred to PPL Generation and retained as spare parts.

In November 2003, PPL Generation sold four of the six spare gas combustion turbine generators and related equipment for approximately $33 million. The pre-tax loss on the sale of approximately $3 million is included in "Other Income – net" on the Statement of Income in 2003. In 2004, a subsidiary of PPL Generation sold the remaining two spare gas combustion turbine generators and related equipment for approximately $18 million. The net loss from these two sales was insignificant.

In 2004, PPL Maine entered into an agreement with a coalition of government agencies and private groups to sell three of its nine hydroelectric dams in Maine. Under the agreement, a non-profit organization designated by the coalition would have a five-year option to purchase the dams for approximately $25 million, and PPL Maine would receive rights to increase energy output at its other hydroelectric dams in Maine. The coalition has announced plans to remove or bypass the dams subject to the agreement in order to restore runs of Atlantic salmon and other migratory fish to the Penobscot River. The agreement requires several approvals by the FERC. Certain of these regulatory approvals have been obtained, but PPL cannot predict whether or when all of them will be obtained.

### International Energy Projects

*Sale of CEMAR*

In June 2002, PPL made a decision to exit its CEMAR investment after a series of impairment losses were recorded. At that time, PPL Global's remaining portion of its CEMAR investment was written-off.

In April 2004, PPL Global transferred its interest in CEMAR to two companies controlled by a private equity fund managed by GP Investimentos, a Brazilian private equity firm. The sale resulted in a credit of approximately $23 million as a result of the reversal of the negative carrying value and the associated cumulative translation adjustment, which is included in "Other Income – net" on the Statement of Income.

*Sale of CGE*

In March 2004, PPL Global completed the sale of its minority interest in shares of CGE for approximately $123 million. The sale resulted in a pre-tax charge of approximately $15 million ($7 million after tax), which is included in operating expenses as "Energy-related businesses" on the Statement of Income. This charge was due to the write-off of the associated cumulative translation adjustment, primarily as a result of the devaluation of the Chilean peso since the original acquisition in 2000.

*Other Sales*

In 2003, a subsidiary of WPD sold certain Hyder properties. PPL Global received approximately $17 million from the sales, and recorded a pre-tax gain of approximately $2 million. This gain is included in "Other Income – net" on the Statement of Income.

In January 2006, PPL Global executed an agreement for the sale of its minority interest in Aguaytia Energy, LLC, a combined generating and natural gas facility in Peru.

### Discontinued Operations

*Sale of Sundance Plant*

In May 2005, a subsidiary of PPL Generation completed the sale of its 450 MW Sundance power plant located in Pinal County, Arizona, to Arizona Public Service Company for approximately $190 million in cash. Proceeds from the sale were used to reduce PPL's outstanding debt and improve liquidity. The book value of the plant was approximately $260 million on the sale date. PPL recorded a loss on the sale in May 2005 of approximately $47 million, or $0.12 per share, net of a tax benefit of $26 million. The loss on the sale is reflected as "Loss from Discontinued Operations," along with operating losses of the Sundance plant of $4 million, $13 million, and $14 million in 2005, 2004 and 2003. The 2003 operating loss excludes a charge of $9 million due to a cumulative effect of a change in accounting principle discussed in Note 22. At December 31, 2004,

the Sundance plant had a book value of $263 million, which was recorded in "Electric plant in service – Generation" on the Balance Sheet. The plant had been included in the total assets of the Supply segment prior to the sale.

*Sale of Latin American Telecommunications Company*

In December 2003, PPL Global's Board of Managers authorized PPL Global to sell its investment in a Latin American telecommunications company, and approved a plan of sale. It was determined that the viability of this non-strategic business was not economical. As a result, PPL Global recorded an $18 million write-down in the carrying value of the company's net assets to their estimated fair value of approximately $1 million as of December 31, 2003.

In June 2004, PPL Global sold this investment to local management for a nominal amount. The operating results of the Latin American telecommunications company, which was a loss of approximately $2 million in 2004 and 2003, as well as the write-down of its net assets, which was an insignificant amount in 2004 and approximately $18 million in 2003, are reflected as "Loss from Discontinued Operations" on the Statement of Income.

**Other**

In 2003, a subsidiary of PPL Telcom acquired the fiber optic network of a Fairfax, Virginia-based company for approximately $21 million, consisting of $9 million in cash and a $12 million capital lease obligation for the right to use portions of a fiber optic network. The 1,330-route-mile metropolitan area fiber network connects New York, northern New Jersey, Philadelphia, Baltimore and Washington, D.C. The acquisition required certain regulatory approvals and authorizations in the area served by the network.

In June 2004, a PPL subsidiary evaluated its investment in a technology supplier for impairment. As a result of the evaluation, the subsidiary recorded a pre-tax impairment charge of approximately $10 million ($6 million after tax), which is included in "Other Income – net" on the Statement of Income.

# 10. Leases

**Colstrip Generating Plant**

PPL Montana leases a 50% interest in Colstrip Units 1 and 2 and a 30% interest in Unit 3, under four 36-year non-cancelable operating leases. These leases provide two renewal options based on the economic useful life of the generation assets. PPL Montana is required to pay all expenses associated with the operations of the generation units. The leases place certain restrictions on PPL Montana's ability to incur additional debt, sell assets and declare dividends and require PPL Montana to maintain certain financial ratios related to cash flow and net worth. There are no residual value guarantees in these leases. However, upon an event of default or an event of loss, the lessee could be required to pay a termination value of amounts sufficient to allow the lessor to repay amounts owing on the lessor notes and make the lessor whole for its equity investment and anticipated return on investment. The events of default include payment defaults, breaches of representations or covenants, acceleration of other indebtedness of PPL Montana, change in control of PPL Montana and certain bankruptcy events. The termination value was estimated to be $637 million at December 31, 2005.

**Other Leases**

PPL and its subsidiaries have leases for vehicles, office space, land, buildings, personal computers and other equipment. Rental expense for all operating leases, including the Colstrip generating plant, was $68 million in 2005, $65 million in 2004 and $85 million in 2003, and was primarily included in "Operation and maintenance" on the Statement of Income.

Total future minimum rental payments for all operating leases, including those with cancelable terms but covered by residual value guarantees, are estimated to be:

| | |
|---|---|
| 2006 | $ 77 |
| 2007 | 68 |
| 2008 | 66 |
| 2009 | 63 |
| 2010 | 61 |
| Thereafter | 423 |
| | $758 |

In connection with the acquisition of the fiber optic network discussed in Note 9, a subsidiary of PPL Telcom assumed a capital lease obligation through 2020 for the right to use portions of the fiber optic network. The balance outstanding at December 31, 2005 and 2004 was $11 million. Total future minimum rental payments for this capital lease are estimated at $1 million for each of the years from 2006 through 2010, and $12 million thereafter.

# 11. Stock-Based Compensation

Under the PPL Incentive Compensation Plan (ICP) and the Incentive Compensation Plan for Key Employees (ICPKE) (together, the Plans), restricted shares of PPL common stock, restricted stock units and stock options may be granted to officers and other key employees of PPL and other affiliated companies. Awards under the Plans are made by the Compensation and Corporate Governance Committee (CCGC) of the PPL Board of Directors, in the case of the ICP, and by the PPL Corporate Leadership Council (CLC), in the case of the ICPKE. The ICP limits the total number of awards that may be granted under it after April 23, 1999, to 15,769,430 awards, or 5% of the total shares of common stock that were outstanding at April 23, 1999. The ICPKE limits the total number of awards that may be granted under it after April 25, 2003, to 16,573,608 awards, or 5% of the total shares of common stock that were outstanding at January 1, 2003, reduced by outstanding awards for which common stock was not yet issued as of April 25, 2003. In addition, each Plan limits the number of shares available for awards in any calendar year to 2% of the outstanding common stock of PPL on the first day of such calendar year. The maximum number of options that can be awarded under each Plan to any single eligible employee in any calendar year is three million shares. Any portion of these options that has not been granted may be carried over and used in any subsequent year. If any award lapses, is forfeited or the rights of the participant terminate, the shares of common stock underlying such an award are again available for grant. Shares delivered under the Plans may be in the form of authorized and unissued common stock, common stock held in treasury by PPL or common stock purchased on the open market (including private purchases) in accordance with applicable securities laws.

**Restricted Stock**

Restricted shares of PPL common stock are outstanding shares with full voting and dividend rights. Restricted stock awards are subject to a restriction or vesting period as determined by the CCGC in the case of the ICP, and the CLC in the case of the ICPKE. In addition, the shares are subject to forfeiture or accelerated payout under Plan provisions for termination, retirement, disability and death of employees. Restricted shares vest fully if control of PPL changes, as defined by the plans.

**Restricted Stock Units**

The Plans allow for the grant of restricted stock units. Restricted stock units are awards based on the fair market value of PPL common stock. Actual PPL common shares will be issued upon completion of a restriction or vesting period as determined by the CCGC in the case of the ICP, and the CLC in the case of the ICPKE. Recipients of restricted stock units may also be granted the right to receive dividend equivalents through the end of the restriction period or until the award is forfeited. Restricted stock units are subject to forfeiture or accelerated payout under the Plan provisions for termination, retirement, disability and death of employees. Restricted stock units vest fully if control of PPL changes, as defined by the Plans.

A summary of restricted stock/unit grants follows.

| | *Restricted Shares Granted* | *Weighted Average Fair Value* | *Restricted Units Granted* | *Weighted Average Fair Value* |
|---|---|---|---|---|
| **2005** | | | **509,105** | **$27.08** |
| 2004 | | | 466,110 | $23.03 |
| 2003 | 84,180 | $18.12 | 279,464 | $17.55 |

At December 31, 2005, PPL had 417,740 restricted shares and 1,139,383 restricted units outstanding. These awards currently vest from three to 25 years from the date of grant.

Compensation expense related to restricted stock and restricted stock unit awards was $18 million, $6 million and $5 million for PPL for 2005, 2004 and 2003. Compensation expense for 2005 included an adjustment to record accelerated recognition of expense for employees at or near retirement age. See Note 1 for additional details.

**Stock Options**

Under the Plans, stock options may also be granted with an option exercise price per share not less than the fair market value of PPL's common stock on the date of grant. The options are exercisable beginning one year after the date of grant, assuming the individual is still employed by PPL or a subsidiary, in installments as determined by the CCGC in the case of the ICP, and the CLC in the case of the ICPKE. Options outstanding at December 31, 2005, become exercisable over a three-year period from the date of grant in equal installments. The CCGC and CLC have discretion to accelerate the exercisability of the options, except that the exercisability of an option issued under the ICP may not be accelerated unless the individual remains employed by PPL or a subsidiary for one year from the date of grant. All options expire no later than ten years from the grant date. The options become exercisable immediately if control of PPL changes, as defined by the Plans.

PPL recorded compensation expense related to stock options of $12 million, $6 million and $3 million for 2005, 2004 and 2003. Compensation expense for 2005 included an adjustment to record accelerated recognition of expense for employees at or near retirement age. See Note 1 for additional details.

A summary of stock option activity follows.

| | **2005** | | 2004 | | 2003 | |
|---|---|---|---|---|---|---|
| | **Number of Options** | **Weighted Average Exercise Price** | Number of Options | Weighted Average Exercise Price | Number of Options | Weighted Average Exercise Price |
| Outstanding at beginning of year | **5,961,950** | **$19.42** | 5,824,516 | $17.78 | 6,017,370 | $16.05 |
| Granted | **1,607,140** | **26.66** | 1,520,880 | 22.59 | 1,632,220 | 18.12 |
| Exercised | **(1,983,018)** | **18.56** | (1,307,306) | 15.70 | (1,721,830) | 12.05 |
| Forfeited | | | (76,140) | 21.37 | (103,244) | 17.66 |
| Outstanding at end of year | **5,586,072** | **21.81** | 5,961,950 | 19.42 | 5,824,516 | 17.78 |
| Options exercisable at end of year | **2,741,033** | **19.36** | 3,100,674 | 18.77 | 2,708,150 | 17.32 |
| Weighted-average fair value of options granted | **$3.99** | | $6.16 | | $5.96 | |

The estimated fair value of each option granted was calculated using a Black-Scholes option-pricing model. The weighted average assumptions used in the model were:

| | **2005** | 2004 | 2003 |
|---|---|---|---|
| Risk-free interest rate | **4.09%** | 3.79% | 3.81% |
| Expected option life | **7.00 yrs.** | 7.47 yrs. | 7.75 yrs. |
| Expected stock volatility | **18.09%** | 32.79% | 39.94% |
| Dividend yield | **3.88%** | 3.51% | 3.48% |

The following table summarizes information about stock options at December 31, 2005.

| | Options Outstanding | | | Options Exercisable | |
|---|---|---|---|---|---|
| Range of Exercise Prices | Number Outstanding | Weighted-Average Remaining Contractual Life | Weighted-Average Exercise Prices | Number Exercisable | Weighted-Average Exercise Price |
| $ 9.00–$14.99 | 99,600 | 3.7 | $12.25 | 99,600 | $12.25 |
| $15.00–$19.99 | 1,719,420 | 6.6 | 17.54 | 1,286,568 | 17.35 |
| $20.00–$24.99 | 2,194,612 | 6.6 | 22.10 | 1,354,865 | 21.80 |
| $25.00–$29.99 | 1,572,440 | 9.1 | 26.66 | | |

Total options outstanding had a weighted-average remaining life of 7.2 years at December 31, 2005.

### Directors Stock Units

Under the Directors Deferred Compensation Plan, stock units are used to compensate members of PPL's Board of Directors who are not employees of PPL. Such stock units represent shares of PPL's common stock to which board members are entitled after they cease serving as a member of the Board of Directors. Board members are also entitled to defer any or all of their cash compensation into stock units. The stock unit accounts of each board member are increased based on dividends paid or other distributions on PPL's common stock. There were 273,775 stock units outstanding at December 31, 2005. Compensation expense was $2 million for 2005 and insignificant for 2004 and 2003.

### Stock Appreciation Rights

WPD uses stock appreciation rights to compensate senior management employees. Stock appreciation rights are granted with a reference price to PPL's common stock at the date of grant. These awards vest over a three-year period and have a 10-year term, during which time employees are entitled to receive a cash payment of any appreciation in the price of PPL's common stock over the grant date value. At December 31, 2005, there were 294,060 stock appreciation rights outstanding. Compensation expense for all periods reported was insignificant.

## 12. Retirement and Postemployment Benefits

### Pension and Other Postretirement Benefits

PPL and certain of its subsidiaries sponsor various pension and other post-retirement and postemployment benefit plans. PPL follows the guidance of SFAS 87, "Employers' Accounting for Pensions," and SFAS 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," and SFAS 112, "Employers Accounting for Postemployment Benefits," when accounting for these benefits.

The majority of PPL's domestic employees are eligible for pension benefits under non-contributory defined benefit pension plans with benefits based on length of service and final average pay, as defined by the plans. Employees of PPL Montana are eligible for pension benefits under a cash balance pension plan and employees of certain of PPL's mechanical contracting companies are eligible for benefits under multi-employer plans sponsored by various unions. The employees of PPL's U.K. subsidiary, WPD, are eligible for benefits from one pension scheme with benefits based on length of service and final average pay. Retirees of PPL's Latin American subsidiaries may be eligible for coverage under government-sponsored and administered programs.

PPL and certain of its subsidiaries also provide supplemental retirement benefits to directors, executives and other key management employees through unfunded nonqualified retirement plans.

The majority of employees of PPL's domestic subsidiaries will become eligible for certain health care and life insurance benefits upon retirement through contributory plans. Postretirement benefits under the PPL Retiree Health Plan and PPL Gas Retiree Health Plan are paid from funded VEBA trusts sponsored by the respective companies. Postretirement benefits under the PPL Montana Retiree Health Plan are paid from company assets.

The following disclosures distinguish between PPL's domestic and international pension plans.

PPL uses a December 31 measurement date for its domestic pension and other postretirement benefit plans and its international pension plans.

Net periodic pension and other postretirement benefit costs (credits) were:

| | Pension Benefits | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Domestic | | | International | | | Other Postretirement Benefits | | |
| | **2005** | 2004 | 2003 | **2005** | 2004 | 2003 | **2005** | 2004 | 2003 |
| Service cost | **$ 56** | $ 49 | $ 42 | **$ 17** | $ 15 | $ 14 | **$ 7** | $ 6 | $ 7 |
| Interest cost | **114** | 112 | 105 | **150** | 139 | 124 | **26** | 29 | 31 |
| Expected return on plan assets | **(158)** | (151) | (143) | **(202)** | (205) | (188) | **(19)** | (17) | (13) |
| Net amortization and deferral | **13** | 4 | (6) | **34** | 11 | 4 | **16** | 19 | 25 |
| Net periodic pension and postretirement costs (credits) prior to special termination benefits | **25** | 14 | (2) | **(1)** | (40) | (46) | **30** | 37 | 50 |
| Special termination benefits [a] | | | 9 | **5** | | | | | |
| Net periodic pension and postretirement benefit costs (credits) | **$ 25** | $ 14 | $ 7 | **$ 4** | $ (40) | $ (46) | **$ 30** | $ 37 | $ 50 |

[a] The $9 million cost of special termination benefits for 2003 was the final cost recorded to complete PPL's 2002 workforce reduction program. See Note 20 for additional information.

The $5 million cost of special termination benefits for 2005 was related to the WPD approved staff reduction plan as a result of the merger of its two control rooms, metering reorganization and other staff efficiencies. Additional pension costs were recognized due to early retirement and pension enhancement provisions granted to the employees.

Net periodic pension and other postretirement benefits costs charged (credited) to operating expense, excluding amounts charged to construction and other non-expense accounts, were:

| | Pension Benefits | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Domestic | | | International | | | Other Postretirement Benefits | | |
| | **2005** | 2004 | 2003 | **2005** | 2004 | 2003 | **2005** | 2004 | 2003 |
| Operating Expense[a] | **$21** | $12 | $(2) | **$4** | $(36) | $(40) | **$26** | $31 | $43 |

[a] The domestic amount for 2003 excludes the $9 million cost of special termination benefits, which are included separately on the Statement of Income, within the "Workforce reduction" charge for that year.

The following assumptions were used in the valuation of the benefit obligations at December 31 and determination of net periodic benefit cost for the years ended December 31.

| | Pension Benefits | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Domestic | | | International | | | Other Postretirement Benefits | | |
| | **2005** | 2004 | 2003 | **2005** | 2004 | 2003 | **2005** | 2004 | 2003 |
| Discount rate | | | | | | | | | |
| – obligations | **5.70%** | 5.75% | 6.25% | **4.75%** | 5.50% | 5.50% | **5.70%** | 5.75% | 6.25% |
| – cost | **5.75%** | 6.25% | 6.75% | **5.50%** | 5.50% | 5.75% | **5.75%** | 6.25% | 6.75% |
| Rate of compensation increase | | | | | | | | | |
| – obligations | **4.75%** | 4.00% | 4.00% | **3.75%** | 3.75% | 3.75% | **4.75%** | 4.00% | 4.00% |
| – cost | **4.00%** | 4.00% | 4.00% | **3.75%** | 3.75% | 3.75% | **4.00%** | 4.00% | 4.00% |
| Expected return on plan assets [a] | | | | | | | | | |
| – obligations | **8.50%** | 8.75% | 8.75% | **8.09%** | 8.30% | 8.30% | **8.00%** | 7.90% | 7.80% |
| – cost | **8.75%** | 8.75% | 8.75% | **8.30%** | 8.30% | 8.31% | **7.90%** | 7.80% | 7.80% |

[a] The expected return on plan assets for PPL's Domestic Pension Plans includes a 25 basis point reduction for management fees.

| *Assumed Health Care Cost Trend Rates at December 31,* | **2005** | 2004 | 2003 |
|---|---|---|---|
| Health care cost trend rate assumed for next year | | | |
| – obligations | **10.0%** | 10.0% | 11.0% |
| – cost | **10.0%** | 11.0% | 12.0% |
| Rate to which the cost trend rate is assumed to decline (the ultimate trend rate) | | | |
| – obligations | **5.5%** | 5.0% | 5.0% |
| – cost | **5.0%** | 5.0% | 5.0% |
| Year that the rate reaches the ultimate trend rate | | | |
| – obligations | **2011** | 2010 | 2010 |
| – cost | **2010** | 2010 | 2010 |

A one-percentage point change in the assumed health care costs trend rate assumption would have the following effects in 2005.

| | One Percentage Point | |
|---|---|---|
| | Increase | Decrease |
| Effect on service cost and interest cost components | $ 1 | $ (1) |
| Effect on postretirement benefit obligation | 14 | (12) |

The expected long-term rate of return for PPL's domestic pension plans considers the plans' historical experience, but is primarily based on the plans' mix of assets and expectations for long-term returns of those asset classes.

The expected long-term rate of return for PPL's other postretirement benefit plans is based on the VEBA trusts' mix of assets and expectations for long-term returns of those asset classes considering that a portion of those assets are taxable.

The expected rate of return for PPL's international pension plans considers that a portfolio largely invested in equities would be expected to achieve an average rate of return in excess of a portfolio largely invested in long-term bonds. The historical experience has been an excess return of 2% to 4% per annum on average over the return on long-term bonds.

The funded status of the PPL plans was as follows.

| | Pension Benefits | | | | | |
|---|---|---|---|---|---|---|
| | Domestic | | International | | Other Postretirement Benefits | |
| | **2005** | 2004 | **2005** | 2004 | **2005** | 2004 |
| **Change in Benefit Obligation** | | | | | | |
| Benefit Obligation, January 1 | **$1,969** | $1,772 | **$2,931** | $2,474 | **$ 485** | $ 512 |
| Service cost | **56** | 49 | **17** | 15 | **7** | 6 |
| Interest cost | **114** | 112 | **150** | 139 | **26** | 29 |
| Participant contributions | | | **6** | 5 | **7** | 4 |
| Plan amendments | **1** | | **5** | | **16** | (47) |
| Actuarial loss | **87** | 115 | **233** | 180 | **11** | 17 |
| Special termination benefits | | | **5** | | | |
| Actual expense paid | | (1) | | | | |
| Net benefits paid | **(80)** | (78) | **(165)** | (160) | **(34)** | (36) |
| Currency conversion | | | **(291)** | 278 | | |
| Benefit Obligation, December 31 | **2,147** | 1,969 | **2,891** | 2,931 | **518** | 485 |
| **Change in Plan Assets** | | | | | | |
| Plan assets at fair value, January 1 | **1,767** | 1,653 | **2,483** | 2,164 | **249** | 219 |
| Actual return on plan assets | **191** | 184 | **427** | 232 | **11** | 20 |
| Employer contributions | **27** | 9 | **41** | 3 | **25** | 42 |
| Participant contributions | | | **6** | 5 | **7** | 4 |
| Actual expense paid | | (1) | | | | |
| Net benefits paid | **(80)** | (78) | **(165)** | (160) | **(34)** | (36) |
| Currency conversion | | | **(252)** | 239 | | |
| Plan assets at fair value, December 31 | **1,905** | 1,767 | **2,540** | 2,483 | **258** | 249 |
| **Funded Status** | | | | | | |
| Funded Status of Plan | **(242)** | (202) | **(351)** | (448) | **(260)** | (236) |
| Unrecognized actuarial (gain) loss | **(49)** | (100) | **721** | 676 | **156** | 141 |
| Unrecognized prior service cost | **139** | 154 | **36** | 32 | **35** | 23 |
| Unrecognized transition assets | **(18)** | (23) | | | **61** | 69 |
| Currency conversion | | | **(72)** | 69 | | |
| Net amount recognized at end of year | **$ (170)** | $ (171) | **$ 334** | $ 329 | **$ (8)** | $ (3) |
| **Amounts recognized in the Balance Sheet consist of:** | | | | | | |
| Prepaid benefit cost | **$ 12** | $ 7 | **$ 334** | $ 329 | **$ 4** | $ 8 |
| Accrued benefit liability | **(182)** | (178) | | | **(12)** | (11) |
| Additional minimum liability | **(40)** | (37) | **(545)** | (635) | | |
| Intangible asset | **9** | 9 | **33** | 36 | | |
| Accumulated other comprehensive income (pre-tax) | **31** | 28 | **472** | 503 | | |
| Cumulative translation adjustment | | | **40** | 96 | | |
| Net amount recognized at end of year | **$ (170)** | $ (171) | **$ 334** | $ 329 | **$ (8)** | $ (3) |
| **Total accumulated benefit obligation for defined benefit pension plans** | **$1,883** | $1,710 | **$2,751** | $2,789 | | |

Information for pension plans with projected and accumulated benefit obligations in excess of plan assets follows.

| | Plans With Projected Benefit Obligations in Excess of Plan Assets | | | | Plans With Accumulated Benefit Obligations in Excess of Plan Assets | | | |
|---|---|---|---|---|---|---|---|---|
| | Domestic | | International | | Domestic | | International | |
| | **2005** | 2004 | **2005** | 2004 | **2005** | 2004 | **2005** | 2004 |
| Projected benefit obligation | **$2,147** | $1,969 | **$2,891** | $2,931 | **$199** | $174 | **$2,891** | $2,931 |
| Accumulated benefit obligation | **1,883** | 1,710 | **2,751** | 2,789 | **178** | 159 | **2,751** | 2,789 |
| Fair value of assets | **1,905** | 1,767 | **2,540** | 2,483 | **111** | 95 | **2,540** | 2,483 |

Other postretirement benefit plans with accumulated postretirement benefit obligations in excess of plan assets had accumulated postretirement benefit obligations and fair value of assets of $518 million and $258 million at December 31, 2005, and $485 million and $249 million at December 31, 2004.

**Plan Assets – Domestic Pension Plans**

The asset allocation for the PPL Retirement Plan Master Trust and the target allocation, by asset category, is detailed below.

| | Percentage of plan assets at December 31, | | Target asset allocation |
|---|---|---|---|
| Asset Category | **2005** | 2004 | |
| Equity securities | **74%** | 73% | 70% |
| Debt securities | **21%** | 22% | 25% |
| Real estate and other | **5%** | 5% | 5% |
| Total | **100%** | 100% | 100% |

The domestic pension plan assets are managed by outside investment managers and are rebalanced as necessary to maintain the target asset allocation ranges. PPL's investment strategy with respect to the domestic pension assets is to achieve a satisfactory risk-adjusted return on assets that, in combination with PPL's funding policy and tolerance for return volatility, will ensure that sufficient dollars are available to provide benefit payments.

**Plan Assets – Domestic Other Postretirement Benefit Plans**

The asset allocation for the PPL other postretirement benefit plans by asset category is detailed below.

| | Percentage of plan assets at December 31, | |
|---|---|---|
| Asset Category | **2005** | 2004 |
| Equity securities | **62%** | 60% |
| Debt securities | **38%** | 40% |
| Total | **100%** | 100% |

PPL's investment strategy with respect to its other postretirement benefit obligations is to fund the VEBA trusts with voluntary contributions and to invest in a tax efficient manner utilizing a prudent mix of assets. Based on the current VEBA and postretirement plan structure, a targeted asset allocation range of 50% to 60% equity and 40% to 50% debt is maintained.

**Plan Assets – International Pension Plans**

WPD operates three defined benefit plans, the WPD Group segment of the Electricity Supply Pension Scheme (ESPS), the Western Power Utilities Pension Scheme and the Infralec 1992 Scheme. The assets of all three schemes are held separately from those of WPD in trustee-administered funds.

PPL's international pension plan asset allocation and target allocation is detailed below.

| | Percentage of plan assets at December 31, | | Target asset allocation |
|---|---|---|---|
| Asset Category | **2005** | 2004 | |
| Equity securities | **76%** | 74% | 75% |
| Debt securities | **21%** | 22% | 23% |
| Real estate and other | **3%** | 4% | 2% |
| Total | **100%** | 100% | 100% |

In consultation with its investment advisor and with WPD, the group trustees of the WPD Group of the ESPS have drawn up a Statement of Investment Principles to comply with the requirements of U.K. legislation.

The group trustees' primary investment objective is to maximize investment returns within the constraint of avoiding excessive volatility in the funding position.

**Expected Cash Flows – Domestic Pension and Other Postretirement Benefit Plans**

There are no contributions required for PPL's primary domestic pension plan or any of PPL's other domestic subsidiary pension plans. However, PPL's domestic subsidiaries expect to contribute approximately $37 million to their pension plans in 2006 to ensure future compliance with minimum funding requirements.

PPL sponsors various non-qualified supplemental pension plans for which no assets are segregated from corporate assets. PPL expects to make approximately $2 million of benefit payments under these plans in 2006.

PPL is not required to make contributions to its other postretirement benefit plans but has historically funded these plans in amounts equal to the postretirement benefit costs recognized. Continuation of this past practice would provide for PPL to contribute $39 million to its other postretirement benefit plans in 2006.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid and the following federal subsidy payments are expected to be received by the separate plan trusts.

| | | Other Postretirement | |
|---|---|---|---|
| | Pension | Benefit Payment | Expected Federal Subsidy |
| 2006 | $ 83 | $ 40 | $ 2 |
| 2007 | 88 | 45 | 2 |
| 2008 | 95 | 50 | 2 |
| 2009 | 101 | 56 | 2 |
| 2010 | 109 | 61 | 3 |
| 2011–2015 | 699 | 389 | 18 |

### Expected Cash Flows – International Pension Plans

The pension plans of WPD are subject to formal actuarial valuations every three years, which are used to determine funding requirements. Future contributions were evaluated in accordance with the latest valuation performed as of March 31, 2004, in respect of WPD's principal pension scheme, the ESPS, to determine contribution requirements for 2005 and forward. WPD expects to make contributions of approximately $47 million in 2006.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid by the separate plan trusts.

| | Pension |
|---|---|
| 2006 | $159 |
| 2007 | 163 |
| 2008 | 167 |
| 2009 | 171 |
| 2010 | 176 |
| 2011–2015 | 945 |

### Savings Plans

Substantially all employees of PPL's domestic subsidiaries are eligible to participate in deferred savings plans (401(k)s). Contributions to the plans charged to operating expense approximated $13 million in 2005 and 2004 and $11 million in 2003.

### Employee Stock Ownership Plan

PPL sponsors a non-leveraged ESOP, in which substantially all employees, excluding those of PPL Global, PPL Montana, PPL Gas Utilities and the mechanical contractors, are enrolled after one year of credited service. Dividends paid on ESOP shares are treated as ordinary dividends by PPL. Under existing income tax laws, PPL is permitted to deduct the amount of those dividends for income tax purposes and to contribute the resulting tax savings (dividend-based contribution) to the ESOP.

The dividend-based contribution is used to buy shares of PPL's common stock and is expressly conditioned upon the deductibility of the contribution for federal income tax purposes. Contributions to the ESOP are allocated to eligible participants' accounts as of the end of each year, based 75% on shares held in existing participants' accounts and 25% on the eligible participants' compensation.

Amounts charged as compensation expense for ESOP contributions approximated $6 million in 2005 and $5 million in each of 2004 and 2003. These amounts were offset by the dividend-based contribution tax savings and had no impact on PPL's earnings.

ESOP shares outstanding at December 31, 2005, were 8,836,536, or 2% of total common shares outstanding, and are included in all EPS calculations.

### Postemployment Benefits

Certain PPL subsidiaries provide health and life insurance benefits to disabled employees and income benefits to eligible spouses of deceased employees. Postemployment benefits charged to operating expenses for 2005 were $8 million, primarily due to an updated valuation for Long Term Disability benefits completed in 2005, and were not significant in 2004 and 2003.

Certain of PPL Global subsidiaries, including Emel, EC, Elfec and Integra, provide limited non-pension benefits to all current employees. All active employees are entitled to benefits in the event of termination or retirement in accordance with government-sponsored programs. These plans generally obligate a company to pay one month's salary per year of service to employees in the event of involuntary termination. Under certain plans, employees with five or more years of service are entitled to this payment in the event of voluntary or involuntary termination.

The liabilities for these plans are accounted for under the guidance of EITF 88-1, "Determination of Vested Benefit Obligation for a Defined Benefit Pension Plan," using what is commonly referred to as the "shut down" method, where a company records the undiscounted obligation as if it were payable at each balance sheet date. The combined liabilities for these plans at December 31, 2005 and 2004, were $10 million and $9 million, and are recorded in "Deferred Credits and Noncurrent Liabilities – Other" on the Balance Sheet.

## 13. Jointly-Owned Facilities

At December 31, 2005, subsidiaries of PPL owned interests in the facilities listed below. The Balance Sheet includes the amounts noted in the following table.

| | Ownership Interest | Electric Plant in Service | Other Property | Accumulated Depreciation | Construction Work in Progress |
|---|---|---|---|---|---|
| **PPL Generation** | | | | | |
| Generating Stations | | | | | |
| Susquehanna | 90.00% | $4,308 | | $3,447 | $57 |
| Griffith[(a)] | 50.00% | 151 | | | |
| Conemaugh | 16.25% | 199 | | 83 | 3 |
| Keystone | 12.34% | 100 | | 54 | 3 |
| Wyman Unit 4 | 8.33% | 15 | | 5 | |
| Merrill Creek Reservoir | 8.37% | | $22 | 14 | |

(a) A PPL subsidiary has a 50% interest in a partnership that owns the Griffith gas-fired generating station. The partnership arrangement is essentially a cost-sharing arrangement, in that each of the partners has rights to one-half of the plant capacity and energy, and an obligation to cover one-half of the operating costs of the station. Accordingly, the equity investment is classified as "Electric Plant in Service – Generation" on the Balance Sheet.

Each PPL Generation subsidiary provided its own funding for its share of the facility. Each receives a portion of the total output of the generating stations equal to its percentage ownership. The share of fuel and other operating costs associated with the stations is reflected on the Statement of Income.

In addition to the interests mentioned above, PPL Montana is the operator of the jointly-owned, coal-fired generating units comprising the Colstrip steam generation facility. At December 31, 2005 and 2004, PPL Montana had a 50% leasehold interest in Colstrip Units 1 and 2 and a 30% leasehold interest in Colstrip Unit 3 under operating leases. See Note 10 for additional information.

PPL Montana's share of direct expenses associated with the operation and maintenance of these facilities is included in the corresponding operating expenses on the Statement of Income. Each joint-owner in these facilities provides its own financing. As operator of all Colstrip Units, PPL Montana invoices each joint-owner for their respective portion of the direct expenses. The amount due from joint-owners was approximately $7 million and $6 million at December 31, 2005 and 2004.

At December 31, 2005, NorthWestern owned a 30% leasehold interest in Colstrip Unit 4. PPL Montana and NorthWestern have a sharing agreement to govern each party's responsibilities regarding the operation of Colstrip Units 3 and 4, and each party is responsible for 15% of the respective operating and construction costs, regardless of whether a particular cost is specified to Colstrip Unit 3 or 4. However, each party is responsible for its own fuel-related costs.

# 14. Commitments and Contingent Liabilities

### Energy Purchases, Energy Sales and Other Commitments

*Energy Purchase Commitments*

PPL enters into long-term purchase contracts to supply the fuel requirements for generation facilities. These include contracts to purchase coal, emission allowances, natural gas, oil and nuclear fuel. These contracts extend for terms through 2019. PPL also enters into long-term contracts for the storage and transport of natural gas. These contracts extend through 2014 and 2032, respectively. Additionally, PPL enters into long-term contracts to purchase power to meet load requirements. These contracts extend for terms through April 2010.

PPL entered into long-term power purchase agreements with two wind project developers to purchase the full output of their facilities when they begin commercial operation. One of the power purchase agreements is for 50–100 MW and extends for a term of 15 years. The in-service date for this project is under evaluation. The other agreement is for 24 MW and extends for a term of 20 years, and the project is expected to be in service in early 2006.

As part of the purchase of generation assets from Montana Power, PPL Montana assumed a power purchase agreement, which was still in effect at December 31, 2005. In accordance with purchase accounting guidelines, PPL Montana recorded a liability of $58 million as the estimated fair value of the agreement at the acquisition date. The liability is being reduced over the term of the agreement, through 2010, as an adjustment to "Energy purchases" on the Statement of Income. The unamortized balance of the liability related to the agreement at December 31, 2005, was $49 million and is included in "Deferred Credits and Other Noncurrent Liabilities – Other" on the Balance Sheet.

In 1998, PPL Electric recorded a loss accrual for above-market contracts with NUGs of $854 million, due to its generation business being deregulated. Effective January 1999, PPL Electric began reducing this liability as an offset to "Energy purchases" on the Statement of Income. This reduction is based on the estimated timing of the purchases from the NUGs and projected market prices for this generation. The final existing NUG contract expires in 2014. In connection with the corporate realignment in 2000, the remaining balance of this liability was transferred to PPL EnergyPlus. At December 31, 2005, the remaining liability associated with the above market NUG contracts was $206 million.

*Energy Sales Commitments*

PPL Energy Supply enters into long-term power sales contracts in connection with its load-serving activities or associated with certain of its power plants. These power sales contracts extend for terms through 2017. All long-term contracts were executed at pricing that approximated market rates, including profit margin, at the time of execution.

As part of the purchase of generation assets from Montana Power, PPL Montana assumed a power sales agreement, which was still in effect at December 31, 2005. In accordance with purchase accounting guidelines, PPL Montana recorded a liability of $7 million as the estimated fair value of the agreement at the acquisition date. The agreement was re-evaluated under DIG Issue C20, "Scope Exceptions: Interpretation of the Meaning of Not Clearly and Closely Related in Paragraph 10(b) Regarding Contracts with a Price Adjustment Feature," which changed its fair value and reclassified it as a derivative instrument in 2003. At December 31, 2005, $5 million was recorded as a component of accumulated other comprehensive loss.

On July 1, 2002, PPL Montana began to sell to NorthWestern an aggregate of 450 MW of energy supplied by PPL Montana. Under two five-year agreements, PPL Montana is supplying 300 MW of around-the-clock electricity and 150 MW of unit-contingent on-peak electricity. PPL Montana also makes short-term energy sales to NorthWestern.

In 2002, PPL began commercial operations in New York of its Edgewood natural gas-fired generating station and its Shoreham oil-fired generating station. Each of these New York plants has a capacity of 79.9 MW. Initially, the Long Island Power Authority contracted to purchase all of Edgewood's capacity and ancillary services as part of a 3-year power purchase agreement with PPL EnergyPlus beginning at commercial operation, and all of Shoreham's capacity and ancillary services as part of a 15-year power purchase agreement with PPL EnergyPlus beginning at commercial operation. In 2005, PPL EnergyPlus extended the Edgewood power purchase agreement for an additional term that runs through October 2008. The Shoreham power purchase agreement remains in effect until 2017.

As a result of New Jersey's Electric Discount and Energy Competition Act, the New Jersey Board of Public Utilities authorized and made available to power suppliers, on a competitive basis, the opportunity to provide Basic Generation Service (BGS) to all non-shopping New Jersey customers. In February 2003, PPL EnergyPlus was awarded a 34-month fixed-price BGS contract for a fixed percentage of customer load (approximately 1,000 MW) for Atlantic City Electric Company (ACE), Jersey Central Power & Light Company (JCPL) and Public Service Electric & Gas Company (PSEG). This contract commenced in August 2003. In February 2004, PPL EnergyPlus was awarded a 12-month hourly energy price supply BGS contract for a fixed percentage of customer load (approximately 450 MW) for ACE, JCPL and PSEG. These contracts commenced in June 2004 and expired in May 2005. In the first quarter of 2005, PPL EnergyPlus was awarded a portion of the Commercial Industrial Energy Pricing tranche, which amounts to approximately 85 MW after expected shopping. These 12-month contracts commenced in June 2005. In February 2006, PPL EnergyPlus was awarded 36-month fixed-price BGS contracts for fixed percentages of customer load (an aggregate of approximately 600 MW) for ACE, JCPL and PSEG. These contracts commence in June 2006.

In January 2004, PPL EnergyPlus began supplying 12.5% of Connecticut Light & Power Company's (CL&P) Transitional Standard Offer load under a three-year fixed-price contract. During peak hours, PPL EnergyPlus' obligation to supply the Transitional Standard Offer load may reach 625 MW. Additionally, in January 2006, PPL EnergyPlus will begin to supply an additional 6.25% of

CL&P's Transitional Standard Offer load under a one-year fixed-price contract. During peak hours, PPL EnergyPlus' obligation to supply the Transitional Standard Offer load may reach 313 MW.

In December 2005 and January 2006, PPL EnergyPlus entered into agreements with Delmarva Power and Light Company to provide a portion of its full requirements service from May 2006 through May 2008.

*PPL Montana Hydroelectric License Commitments*

PPL Montana has 11 hydroelectric facilities and one storage reservoir licensed by the FERC pursuant to the Federal Power Act under long-term licenses. Pursuant to Section 8(e) of the Federal Power Act, the FERC approved the transfer from Montana Power to PPL Montana of all pertinent licenses and any amendments in connection with the Montana APA.

The Kerr Dam Project license was jointly issued by the FERC to Montana Power and the Confederated Salish and Kootenai Tribes of the Flathead Reservation in 1985, and required Montana Power to hold and operate the project for 30 years. The license required Montana Power, and subsequently PPL Montana as a result of the purchase of the Kerr Dam from Montana Power, to continue to implement a plan to mitigate the impact of the Kerr Dam on fish, wildlife and the habitat. Under this arrangement, PPL Montana has a remaining commitment to spend approximately $19 million between 2006 and 2015, at which point the tribes have the option to purchase, hold and operate the project.

PPL Montana entered into two Memorandums of Understanding (MOUs) with state, federal and private entities related to the issuance in 2000 of the FERC renewal license for the nine dams for the Missouri-Madison project. The MOUs require PPL Montana to implement plans to mitigate the impact of its projects on fish, wildlife and the habitat, and to increase recreational opportunities. The MOUs were created to maximize collaboration between the parties and enhance the possibility for matching funds from relevant federal agencies. Under this arrangement, PPL Montana has a remaining commitment to spend approximately $35 million between 2006 and 2040.

**Legal Matters**

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

*Montana Power Shareholders' Litigation*

In August 2001, a purported class-action lawsuit was filed by a group of shareholders of Montana Power against Montana Power, the directors of Montana Power, certain advisors and consultants of Montana Power and PPL Montana. The plaintiffs allege, among other things, that Montana Power was required to, and did not, obtain shareholder approval of the sale of Montana Power's generation assets to PPL Montana in 1999. Although most of the claims in the complaint are against Montana Power, its board of directors, and its consultants and advisors, two claims are asserted against PPL Montana. In the first claim, plaintiffs seek a declaration that because Montana Power shareholders did not vote on the 1999 sale of generating assets to PPL Montana, that sale "was null and void ab initio." The second claim alleges that PPL Montana was privy to and participated in a strategy whereby Montana Power would sell its generation assets to PPL Montana without first obtaining Montana Power shareholder approval, and that PPL Montana has made net profits in excess of $100 million as the result of this alleged illegal sale. In the second claim, plaintiffs request that the court impose a "resulting and/or constructive trust" on both the generation assets themselves and all profits, plus interest on the amounts subject to the trust. This lawsuit has been pending in the U.S. District Court of Montana, Butte Division and the judge has placed this proceeding on hold pending the outcome of certain motions currently before the U.S. Bankruptcy Court for the District of Delaware, the resolution of which may impact this proceeding. PPL cannot predict the outcome of this matter.

*NorthWestern Corporation Litigation*

In September 2002, NorthWestern filed a lawsuit against PPL Montana in Montana state court seeking specific performance of a provision in the Montana Power APA concerning the proposed purchase by PPL Montana of a portion of NorthWestern's interest in the 500-kilovolt Colstrip Transmission System (CTS) for $97 million. In 2005, PPL Montana and NorthWestern settled the litigation, and PPL Energy Supply recorded a charge of $9 million ($6 million after tax, or $0.02 per share) in the first quarter of 2005 related to the settlement agreement. Pursuant to the settlement agreement, all claims of the parties in the litigation were dismissed with prejudice, NorthWestern retained its interest in the CTS, and PPL Montana paid NorthWestern $9 million in October 2005.

*Montana Hydroelectric Litigation*

In October 2003, a lawsuit was filed against PPL Montana, PPL Services, Avista Corporation, PacifiCorp and nine John Doe defendants in the U.S. District Court of Montana, Missoula Division, by two residents allegedly acting in a representative capacity on behalf of the State of Montana. In January 2004, the complaint was amended to, among other things, include the Great Falls school districts as additional plaintiffs. In May 2004, the Montana Attorney General filed a motion to allow the State of Montana to intervene as an additional plaintiff in the litigation. This motion was granted without objection. The individual plaintiffs, the school districts and the State sought declaratory judgment, compensatory damages and attorneys fees and costs for use of state and/or "school trust" lands by hydropower facilities and to require the defendants to adequately compensate the State and/or the State School Trust fund for full market value of lands occupied. Generally, the suit is founded on allegations that the bed of navigable rivers became state-owned property upon Montana's admission to statehood, and that the use thereof for placement of dam structures, affiliated structures and reservoirs should, under an existing regulatory scheme, trigger lease payments for use of land underneath. The plaintiffs also sought relief on theories of unjust enrichment, trespass and negligence. No specific amount of damages or future rental value has been claimed by the plaintiffs. The defendants filed separate motions to dismiss the individual plaintiffs' and school districts' complaint, as well as the complaint of the State of Montana. In September 2004, the federal court granted the motions to dismiss the individual plaintiffs' and school districts' complaint but denied the similar motions as to the State of Montana's complaint. Following the federal court's September decision, PPL Montana and the other defendants

filed a motion to dismiss the State of Montana's complaint for lack of diversity jurisdiction and also filed a motion to vacate certain portions of the decision. The federal court granted both of these motions in September 2005.

In November 2004, PPL Montana, Avista Corporation and PacifiCorp commenced an action for declaratory judgment in Montana First Judicial District Court seeking a determination that no lease payments or other compensation for the hydropower facilities' use and occupancy of streambeds can be collected by the State of Montana. The State subsequently filed counterclaims and a motion for summary judgment. In February 2005, the individual plaintiffs and school districts who were dismissed from the federal court proceeding, along with a state teachers' union, filed a motion to intervene as additional defendants in this state court proceeding, and also filed a proposed answer and counterclaims to be used if their motion to intervene is granted. The state court denied this motion to intervene, but has not yet ruled on any of the other above-described motions. PPL cannot predict the outcome of the state court proceeding.

### Regulatory Issues

*California ISO and Western Markets*

Through its subsidiaries, PPL made approximately $18 million of sales to the California ISO during the period from October 2000 through June 2001, of which $17 million has not been paid to PPL subsidiaries. Given the myriad of electricity supply problems presently faced by the California electric utilities and the California ISO, PPL cannot predict whether or when it will receive payment. At December 31, 2005, PPL has fully reserved for possible under-recoveries of payments for these sales.

Regulatory proceedings arising out of the California electricity supply situation have been filed at the FERC. The FERC has determined that all sellers of energy into markets operated by the California ISO and the California Power Exchange, including PPL Montana, should be subject to refund liability for the period beginning October 2, 2000, through June 20, 2001, and initiated an evidentiary hearing concerning refund amounts. In April 2003, the FERC changed the manner in which this refund liability is to be computed and ordered further proceedings to determine the exact amounts that the sellers, including PPL Montana, would be required to refund. In September 2004, the U.S. Court of Appeals for the Ninth Circuit held that the FERC had the additional legal authority to order refunds for periods prior to October 2, 2000, and ordered the FERC to determine whether or not it would be appropriate to grant such additional refunds.

In June 2003, the FERC took several actions as a result of a number of related investigations. The FERC terminated proceedings pursuant to which it had been considering whether to order refunds for spot market bilateral sales made in the Pacific Northwest, including sales made by PPL Montana, during the period December 2000 through June 2001. The FERC also commenced additional investigations relating to "gaming" and bidding practices during 2000 and 2001, but, to their knowledge, neither PPL EnergyPlus nor PPL Montana is a subject of these investigations.

Litigation arising out of the California electricity supply situation has been filed in California courts against sellers of energy to the California ISO. The plaintiffs and intervenors in these legal proceedings allege, among other things, abuse of market power, manipulation of market prices, unfair trade practices and violations of state antitrust laws, and seek other relief, including treble damages and attorneys' fees. While PPL's subsidiaries have not been named by the plaintiffs in these legal proceedings, PPL Montana was named by a defendant in its cross-complaint in a consolidated court proceeding, which combined into one master proceeding several of the lawsuits alleging antitrust violations and unfair trade practices. This generator denies that any unlawful, unfair or fraudulent conduct occurred but asserts that, if it is found liable, the other generators and power marketers, including PPL Montana, caused, contributed to and/or participated in the plaintiffs' alleged losses.

In February 2004, the Montana Public Service Commission initiated a limited investigation of the Montana retail electricity market for the years 2000 and 2001, focusing on how that market was affected by transactions involving the possible manipulation of the electricity grid in the western U.S. The investigation includes all public utilities and licensed electricity suppliers in Montana, as well as other entities that may possess relevant information. Through its subsidiaries, PPL is a licensed electricity supplier in Montana and a wholesale supplier in the western U.S. In June 2004, the Montana Attorney General served PPL Montana and more than 20 other companies with subpoenas requesting documents, and PPL Montana has provided responsive documents to the Montana Attorney General. As with the other investigations taking place as a result of the issues arising out of the electricity supply situation in California and other western states, PPL and its subsidiaries believe that they have not engaged in any improper trading or marketing practices affecting the Montana retail electricity market.

PPL and its subsidiaries believe that they have not engaged in any improper trading practices. However, they cannot predict whether, or the extent to which, any PPL subsidiaries will be the target of any additional governmental investigations or named in other lawsuits or refund proceedings. PPL also cannot predict the outcome of any such lawsuits or proceedings or whether the ultimate impact on them of the electricity supply situation in California and other western states will be material.

*PJM Capacity Litigation*

In December 2002, PPL was served with a complaint against PPL, PPL EnergyPlus and PPL Electric filed in the U.S. District Court for the Eastern District of Pennsylvania by a group of 14 Pennsylvania boroughs that apparently alleges, among other things, violations of the federal antitrust laws in connection with the pricing of installed capacity in the PJM daily market during the first quarter of 2001. These boroughs were wholesale customers of PPL Electric. In addition, in November 2003, PPL and PPL EnergyPlus were served with a complaint which was filed in the same court by Joseph Martorano, III (d/b/a ENERCO), that also alleges violations of the federal antitrust laws in early 2001. The complaint indicates that ENERCO provides consulting and energy procurement services to clients in Pennsylvania and New Jersey. In September 2004, this complaint was dismissed by the District Court, and in June 2005 the U.S. Court of Appeals for the Third Circuit denied the plaintiff's appeal.

Each of the U.S. Department of Justice – Antitrust Division, the FERC and the Pennsylvania Attorney General conducted investigations regarding PPL's PJM capacity market transactions in early 2001 and did not find any reason to take action against PPL.

*New England Investigation*

In January 2004, PPL became aware of an investigation by the Connecticut Attorney General and the FERC's Office of Market Oversight and Investigation (OMOI) regarding allegations that natural gas-fired generators located in New England illegally sold natural gas instead of generating electricity during the week of January 12, 2004. Subsequently, PPL and other generators were served with a data request by OMOI. The data request indicated that PPL was not under suspicion of a regulatory violation, but that OMOI was conducting an initial investigation. PPL has responded to this data request. PPL also has responded to data requests of ISO New England and data requests served by subpoena from the Connecticut Attorney General. Both OMOI and ISO New England have issued preliminary reports finding no regulatory or other violations concerning these matters. While PPL does not believe that it committed any regulatory or other violations concerning the subject matter of these investigations, PPL cannot predict the outcome of these investigations.

*PJM Billing*

In December 2004, Exelon Corporation, on behalf of its subsidiary, PECO Energy, Inc. (PECO), filed a complaint against PJM and PPL Electric with the FERC alleging that PJM had overcharged PECO from April 1998 through May 2003 as a result of an error by PJM in the State Estimator Model used in connection with billing all PJM customers for certain transmission, spot market energy and ancillary services charges. Specifically, the complaint alleges that PJM mistakenly identified PPL Electric's Elroy substation transformer as belonging to PECO and that, as a consequence, during times of congestion, PECO's bills for transmission congestion from PJM erroneously reflected energy that PPL Electric took from the Elroy substation and used to serve PPL Electric's load. The complaint requests the FERC, among other things, to direct PPL Electric to refund to PJM $39 million, plus interest of approximately $8 million, and for PJM to refund these same amounts to PECO. In February 2005, PPL Electric filed its response with the FERC stating that neither PPL Electric nor any of its affiliates should be held financially responsible or liable to PJM or PECO as a result of PJM's error.

In April 2005, the FERC issued an Order Establishing Hearing and Settlement Judge Proceedings (the Order). In the Order, the FERC determined that PECO is entitled to reimbursement for the transmission congestion charges that PECO asserts PJM erroneously billed to it at the Elroy substation. The FERC set for additional proceedings before a judge the determination of the amount of the overcharge to PECO and which PJM market participants were undercharged and therefore are responsible for reimbursement to PECO. The FERC also ordered procedures before a judge to attempt to reach a settlement of the dispute.

PPL recognized an after-tax charge of approximately $27 million (or $0.07 per share) in the first quarter of 2005 for a loss contingency related to this matter. The pre-tax accrual was approximately $47 million, with $39 million included in "Energy purchases" on the Statement of Income, and $8 million in "Interest Expense."

In September 2005, PPL Electric and Exelon Corporation filed a proposed settlement agreement regarding this matter with the FERC. Under the settlement agreement, PPL Electric would pay $33 million plus interest over a four-year period to PJM through a new transmission charge that, under applicable law, is recoverable from PPL Electric's retail customers. Also, all PJM market participants would pay approximately $8 million plus interest over a four-year period to PJM through a new market adjustment charge. PJM would forward amounts collected under the two new charges to PECO. PJM filed comments with the FERC neither supporting nor opposing the settlement agreement, and the FERC Trial Staff filed comments with the FERC supporting the settlement agreement. Numerous other parties, including PJM market participants, filed comments with the FERC opposing the settlement agreement. The FERC has not yet acted on the proposed settlement agreement.

PPL cannot be certain of the outcome of this matter or the impact on PPL and its subsidiaries. Some or all of the first quarter 2005 charges for this matter may be reversed in a future period depending on the outcome of this matter, the potential for recovery of any amounts paid as a result of the additional FERC proceedings, the application of the relevant provisions of the energy supply agreements between PPL Electric and PPL EnergyPlus and other factors. Depending on these factors, PPL Energy Supply, the parent company of PPL EnergyPlus, may incur some or all of the costs associated with this matter in a future period.

*FERC Market-Based Rate Authority*

In December 1998, the FERC issued an order authorizing PPL EnergyPlus to make wholesale sales of electric power and related products at market-based rates. In that order, the FERC directed PPL EnergyPlus to file an updated market analysis within three years of the date of the order, and every three years thereafter. PPL EnergyPlus filed its initial updated market analysis in December 2001. Several parties thereafter filed interventions and protests requesting that PPL EnergyPlus be required to provide additional information demonstrating that it has met the FERC's market power tests necessary for PPL EnergyPlus to continue its market-based rate authority. PPL EnergyPlus has responded that the FERC does not require the economic test suggested by the intervenors and that, in any event, it would meet such economic test if required by the FERC.

In June 2004, FERC approved certain changes to its standards for granting market-based rate authority. As a result of the schedule adopted by the FERC, PPL EnergyPlus, PPL Electric, PPL Montana and most of PPL Generation's subsidiaries were required to file, in November 2004, updated analyses demonstrating that they should continue to maintain market-based rate authority under the new standards. PPL made two filings, a Western market-based rate filing for PPL Montana and an Eastern market-based rate filing for most of the other PPL subsidiaries in the PJM region.

In September 2005, the FERC issued an order conditionally approving the Eastern market-based rate filing. The FERC expressly rejected the concerns raised by various consumer advocates and industrial customers regarding generation market power of PPL's generation subsidiaries in the PJM region. The FERC's order required the subsidiaries to make a compliance filing providing

further support that they cannot erect other non-transmission barriers to entry into the generation market, and the PPL subsidiaries made this compliance filing in October 2005.

Also in September 2005, in an order on PPL's western market-based rate filing, the FERC found that PPL Montana did not pass one of the FERC's initial screening tests for market power in the Northwestern Energy Control Area, namely the wholesale market share screen. As a result, PPL Montana was required to make a more detailed filing with the FERC demonstrating that it meets the market power tests. Also, the FERC has established a refund effective date of November 8, 2005 (for sales made in the Northwestern Energy Control Area pursuant to contracts entered into on and after that date), in the event that PPL Montana does not pass the FERC's market power tests. The FERC's order is not a definitive determination that PPL Montana has market power but rather the FERC's mechanism for analyzing market-based rate authority applications that require further scrutiny. In October 2005, PPL Montana made the more detailed filing with the FERC, which PPL Montana believes demonstrates that it cannot exercise generation market power in the Northwestern Energy Control Area and should be granted market-based rate authority in that area. The FERC has not yet acted on this more detailed filing. While PPL Montana continues to believe that it does not have market power in the Northwestern Energy Control Area, it cannot predict the outcome of this proceeding.

*FERC Proposed Rules*

In July 2002, the FERC issued a Notice of Proposed Rulemaking entitled "Remedying Undue Discrimination through Open Access Transmission Service and Standard Electricity Market Design." The proposed rule contained a proposed implementation date of July 31, 2003. This far-reaching proposed rule purported to establish uniform transmission rules and a standard market design by, among other things:

- enacting standard transmission tariffs and uniform market mechanisms;
- monitoring and mitigating "market power";
- managing transmission congestion through pricing and tradable financial rights;
- requiring independent operational control over transmission facilities;
- forming state advisory committees on regional transmission organizations and resource adequacy; and
- exercising FERC jurisdiction over all transmission service.

In April 2003, the FERC issued a white paper describing certain modifications to the proposed rule. The FERC requested comments and held numerous public comment sessions concerning the white paper. In July 2005, the FERC terminated the proposed rule based on its conclusion that the objectives of the proposed rule had been overtaken by other events in the industry, such as the continuing development of voluntary ISOs and RTOs.

In November 2003, the FERC adopted a proposed rule to require all existing and new electric market-based tariffs and authorizations to include provisions prohibiting the seller from engaging in anticompetitive behavior or the exercise of market power. The FERC order adopts a list of market behavior rules that apply to all electric market-based rate tariffs and authorizations, including those of PPL EnergyPlus and any other PPL subsidiaries that hold market-based rate authority. PPL does not expect this rule to have a significant impact on its subsidiaries.

*Wallingford Cost-Based Rates*

In January 2003, PPL negotiated an agreement with ISO New England that would declare that four of the five units at PPL's Wallingford, Connecticut facility are "reliability must run" units and put those units under cost-based rates. This agreement and the cost-based rates are subject to the FERC's approval. PPL filed a request with the FERC for such approval. PPL requested authority for cost-based rates because the current and anticipated wholesale prices in New England are insufficient to cover the costs of keeping these units available for operation. In March 2003, PPL filed an application with the New England Power Pool to temporarily deactivate these four units. In May 2003, the FERC denied PPL's request for cost-based rates in light of the FERC's changes to the market and bid mitigation rules of ISO New England made in a similar case involving generating units owned by NRG Energy, Inc. PPL subsequently has explained to the FERC that its changes to the market and bid mitigation rules of ISO New England will not provide sufficient revenues to PPL, and PPL continues to seek approval of its cost-based rates. However, PPL has informed the New England Power Pool that it will not pursue its request to temporarily deactivate certain Wallingford units. In August 2005, the U.S. Court of Appeals for the District of Columbia Circuit reversed the FERC's denial of PPL's request for cost-based rates and remanded the case to the FERC for further consideration. PPL cannot predict the outcome of this matter.

*IRS Synthetic Fuels Tax Credits*

PPL, through its subsidiaries, has interests in two synthetic fuel production facilities: the Somerset facility located in Pennsylvania and the Tyrone facility located in Kentucky. PPL receives tax credits pursuant to Section 29 of the Internal Revenue Code based on the sale of synthetic fuel from these facilities to unaffiliated third-party purchasers. Section 29 of the Internal Revenue Code provides tax credits for the production and sale of solid synthetic fuels produced from coal. Section 29 tax credits are currently scheduled to expire at the end of 2007.

To qualify for the Section 29 tax credits, the synthetic fuel must meet three primary conditions: (i) there must be a significant chemical change in the coal feedstock, (ii) the product must be sold to an unaffiliated entity, and (iii) the production facility must have been placed in service before July 1, 1998.

In addition, Section 29 provides for the synthetic fuel tax credit to begin to phase-out when the relevant annual reference price for crude oil, which is the domestic first purchase price (DFPP), falls within a designated range and to be eliminated when the DFPP exceeds the range. The phase-out range is adjusted annually for inflation. The DFPP is published by the IRS annually in April for the prior year and is calculated based on the annual average wellhead price per barrel for all unregulated domestic crude oil. Accounting for inflation, PPL estimates that the 2005 tax credit phase-out would start at a DFPP for the year of about $52 per barrel and the tax credit would be totally eliminated at about $65 per barrel. PPL currently does not expect any phase-out of the synthetic fuel tax credit for 2005. Based on current market conditions and given the recent increases in and volatility of crude oil prices, PPL cannot predict the final DFPP for crude oil for 2006 and 2007 or inflation for those years that affects the determination of the phase-out range of the tax credit.

PPL has entered into economic hedge transactions that serve to mitigate some of the earnings and cash flow impact of increases in crude oil prices for 2006 and 2007, with the mark-to-market value of these hedges reflected in "Energy-related businesses" revenues on the Statement of Income. Nonetheless, if the price of crude oil remains at, or increases above, current price levels in 2006 or 2007, PPL's expected synthetic fuel tax credits for either or both of those years could be significantly reduced. Based on forecasted oil prices and other market factors for 2006 and 2007, PPL will evaluate its synthetic fuel production levels and operations.

A PPL subsidiary owns and operates the Somerset facility. In November 2001, PPL received a private letter ruling from the IRS pursuant to which, among other things, the IRS concluded that the synthetic fuel produced at the Somerset facility qualifies for Section 29 tax credits. The Somerset facility uses the Covol technology to produce synthetic fuel, and the IRS issued the private letter ruling after its review and approval of that technology. In reliance on this private letter ruling, PPL has sold synthetic fuel produced at the Somerset facility resulting in an aggregate of approximately $267 million of tax credits as of December 31, 2005.

PPL owns a limited partnership interest in the entity that owns and operates the Tyrone facility. In April 2004, this entity received a private letter ruling from the IRS. Similar to its conclusions relating to the Somerset facility, the IRS concluded that the synthetic fuel to be produced at the Tyrone facility qualifies for Section 29 tax credits. In reliance on this private letter ruling, this entity has sold synthetic fuel produced at the Tyrone facility resulting in an aggregate of approximately $60 million of tax credits as of December 31, 2005. The Tyrone facility began commercial operation in the third quarter of 2004, after being relocated to Kentucky from Pennsylvania.

PPL also purchases synthetic fuel from unaffiliated third parties, at prices below the market price of coal, for use at its coal-fired power plants.

In October 2003, it was reported that the U.S. Senate Permanent Subcommittee on Investigations, of the Committee on Governmental Affairs, had begun an investigation of the synthetic fuel industry and its producers. That investigation is ongoing. PPL cannot predict when the investigation will be completed or the potential results of the investigation.

*Energy Policy Act of 2005*

In August 2005, President Bush signed into law the Energy Policy Act of 2005 (the "2005 Energy Act"). The 2005 Energy Act is comprehensive legislation that will substantially affect the regulation of energy companies. The Act amends federal energy laws and provides the FERC with new oversight responsibilities. Among the important changes to be implemented as a result of this legislation are:

- The Public Utility Holding Company Act of 1935, or PUHCA, will be repealed effective six months after the 2005 Energy Act is enacted. PUHCA significantly restricted mergers and acquisitions in the electric utility sector.
- The FERC will appoint and oversee an electric reliability organization to establish and enforce mandatory reliability rules regarding the bulk power system.
- The FERC will establish incentives for transmission companies, such as performance-based rates, recovery of the costs to comply with reliability rules and accelerated depreciation for investments in transmission infrastructure.
- The Price Anderson Amendments Act of 1988, which provides the framework for nuclear liability protection, will be extended by twenty years to 2025.
- Federal support will be available for certain clean coal power initiatives, nuclear power projects and renewable energy technologies.

The implementation of the 2005 Energy Act requires proceedings at the state level and the development of regulations by the FERC, the DOE and other federal agencies, some of which have been finalized. PPL cannot predict when all of these proceedings and regulations will be finalized.

PPL cannot predict with certainty the impact of the 2005 Energy Act and any related regulations on PPL and its subsidiaries.

**Environmental Matters – Domestic**

Due to the environmental issues discussed below or other environmental matters, PPL subsidiaries may be required to modify, replace or cease operating certain facilities to comply with statutes, regulations and actions by regulatory bodies or courts. In this regard, PPL subsidiaries also may incur capital expenditures or operating expenses in amounts which are not now determinable, but could be significant.

*Air*

The Clean Air Act deals, in part, with acid rain, attainment of federal ambient ozone standards, fine particulate matter standards and toxic air emissions and visibility in the U.S. Amendments to the Clean Air Act, although not presently under consideration, are likely to continue to be brought up for consideration in the U.S. Congress. Past proposed amendments would have required significant further reductions in emissions of nitrogen oxide and sulfur dioxide and reductions in emissions of mercury beyond the reductions discussed below.

Citing its authority under the Clean Air Act, the EPA has developed new standards for ambient levels of ozone and fine particulates in the U.S. These standards have been upheld following court challenges. To facilitate attainment of these standards, the EPA has promulgated the Clean Air Interstate Rule (CAIR) for 28 midwestern and eastern states, including Pennsylvania, to reduce national sulfur dioxide emissions by about 50% by 2010 and to extend the current seasonal program for nitrogen oxide emission reductions to a year-round program starting in 2009. The CAIR requires further reductions, starting in 2015, in sulfur dioxide and nitrogen oxide of 30% and 20%, respectively, from 2010 levels. The CAIR allows these reductions to be achieved through cap-and-trade programs. Pennsylvania and Montana have not challenged the CAIR, but the rule has been challenged by several states and environmental groups as not being sufficiently strict, and by industry petitioners as being too strict. In addition, several Canadian environmental groups have petitioned the EPA under the Clean Air Act to revise the CAIR to require deeper reductions in sulfur dioxide and mercury emissions.

In order to continue meeting existing sulfur dioxide reduction requirements of the Clean Air Act, PPL is proceeding with the installation of sulfur dioxide scrubbers at its Montour Units 1 and 2 and Brunner Island Unit 3 by 2008, and also plans to install a scrubber at Brunner Island Units 1 and 2 by 2009. Based on expected levels of generation, emission allowance shortfalls that would otherwise occur without significant additional purchases of allowances and projected emission allowance prices, PPL has determined that it is more economic to install these scrubbers than to purchase significant additional emission allowances. PPL's current installation plan for the scrubbers and other pollution control equipment (primarily aimed at sulfur dioxide and nitrogen oxide emissions reduction) from 2005 to 2010 reflects a cost of approximately $1.5 billion.

Also citing its authority under the Clean Air Act, the EPA has finalized mercury regulations that affect coal-fired plants. These regulations establish an emission trading program to take effect beginning January 2010, with a second phase to take effect in 2018. At the same time that it finalized these mercury regulations, the EPA determined that it currently does not need to regulate nickel emissions from oil-fired units. PPL is still assessing what measures it will need to take to comply with the mercury regulations. PPL expects that the scrubbers to be installed at Montour and Brunner Island will provide mercury removal co-benefits. However, PPL believes that it may need to take additional measures to comply with the 2010 requirements of the EPA's mercury regulations and that it will need to take additional measures to comply with the 2018 requirements. The capital costs to PPL of complying with these new mercury regulations are not now determinable, but could be significant. Based on preliminary industry estimates, the costs are expected to exceed $150 million.

Pennsylvania and ten other states have challenged the new EPA mercury regulations in the D.C. Circuit Court of Appeals as not being sufficiently strict. The Pennsylvania Environmental Quality Board (PaEQB) has accepted a petition filed by PennFuture, an environmental citizens organization, requesting the PaEQB to develop mercury rules that would require by 2008 a level of mercury reduction that would be more stringent than the level required by 2018 under the EPA's mercury regulations. In addition, the Ozone Transport Commission (consisting of Pennsylvania and 11 other states and the District of Columbia) has passed a resolution calling for reductions in sulfur dioxide, nitrogen oxide and mercury emissions that are more stringent than those under CAIR and the EPA's mercury regulations. The Pennsylvania DEP (which works with the PaEQB to develop Pennsylvania environmental regulations) has initiated a process to develop mercury regulations that are expected to be more stringent than the EPA's regulations but different from those requested by PennFuture, and it also has indicated support for developing more stringent regulations for reductions in sulfur dioxide and nitrogen oxide. A proposed rule is expected by mid-2006.

As a result of a petition to initiate state-specific rulemaking for mercury emissions that was filed by a coalition of environmental and other public interest groups with the Montana Board of Environmental Review (BER) in September 2005, the Montana Department of Environmental Quality (DEQ) is developing a rule to recommend to the BER. The DEQ has circulated to certain parties, including PPL Montana, a preliminary proposed rule that PPL Montana is evaluating. The rule presently is expected to be formally proposed to the BER in March 2006.

PPL and other energy companies and industry groups oppose state-specific regulations that are more stringent than the current federal rules and regulations regarding nitrogen oxide, sulfur dioxide and mercury emissions. PPL cannot predict whether more stringent regulations will ultimately be adopted in Pennsylvania or Montana. The additional costs to comply with any such regulations are not now determinable, but could be significant.

In addition to the above rules, the Clean Air Visibility Rule was issued by the EPA on June 15, 2005, to address regional haze or regionally-impaired visibility caused by multiple sources over a wide area. The rule defines Best Available Retrofit Technology requirements for electric generating units, including presumptive limits for sulfur dioxide and nitrogen oxide controls for large units. The EPA has stated that this rule will not require reductions in sulfur dioxide or nitrogen oxide beyond those required by CAIR. At this time, PPL cannot predict whether the Pennsylvania DEP will require additional reductions beyond the visibility requirements established through CAIR. If the Pennsylvania DEP establishes regulations to require additional reductions, the additional costs to comply with such regulations, which are not now determinable, could be significant. In states like Montana that are not within the CAIR region, the need for and costs of additional controls as a result of this new rule are not now determinable, but could be significant.

In 1999, the EPA initiated enforcement actions against several utilities, asserting that older, coal-fired power plants operated by those utilities have, over the years, been modified in ways that subject them to more stringent "New Source" requirements under the Clean Air Act. The EPA subsequently issued notices of violation and commenced enforcement activities against other utilities. However, in the past several years, the EPA has shifted its position on New Source Review. In 2003, the EPA issued changes to its regulations that clarified what projects are exempt from "New Source" requirements as routine maintenance and repair. However, these regulations have been stayed by the U.S. Court of Appeals for the District of Columbia Circuit. PPL is therefore continuing to operate under the "New Source" regulations as they existed prior to the EPA's 2003 clarifications.

In October 2005, the EPA proposed changing its rules on how to determine whether a project results in an emissions increase and is therefore subject to review under the "New Source" regulations. The EPA's proposed tests are consistent with the position of energy companies and industry groups and, if adopted, would substantially reduce the uncertainties under the current regulations. PPL cannot predict whether these proposed new tests will be adopted. In addition to proposing these new tests, the EPA also announced in October 2005 that it will not bring new enforcement actions with respect to projects that would satisfy the proposed new tests or the EPA's 2003 clarifications referenced above. Accordingly, PPL believes that it is unlikely that the EPA will follow up on the information requests that had been issued to PPL Montana's Corette and Colstrip plants by EPA Region VIII in 2000 and 2003, respectively, and to PPL Generation's Martins Creek plant by EPA Region III in 2002. However, states and environmental groups also have been bringing enforcement actions alleging violations of "New Source" requirements by coal-fired plants, and PPL is unable to predict whether such state or citizens enforcement actions will be brought with respect to any of its affiliates' plants.

The New Jersey DEP and some New Jersey residents raised environmental concerns with respect to the Martins Creek plant, particularly with respect to sulfur dioxide emissions and the opacity of the plant's plume. These issues were raised in the context of an appeal by the New Jersey DEP of the Air Quality Plan Approval issued by the Pennsylvania DEP to PPL's Lower Mt. Bethel generating plant. In October 2003, PPL finalized an agreement with the New Jersey DEP and the Pennsylvania DEP pursuant to which PPL will reduce sulfur dioxide emissions from its Martins Creek power plant. Under the agreement, PPL Martins Creek will shut down the plant's two coal-fired generating units by September 2007 and may repower them any time after shutting them down so long as it follows all applicable state and federal requirements, including installing the best available pollution control technology. Pursuant to the agreement, PPL Martins Creek began reducing the fuel sulfur content for the coal units as well as the plant's two oil-fired units in June 2004. The agreement also calls for PPL to donate to a non-profit organization 70% of the excess emission allowances and emission reduction credits that result from shutting down or repowering the coal units. Some of these donations have already been made to the Pennsylvania Environmental Council. As a result of the agreement, the New Jersey DEP withdrew its challenge to the Air Quality Plan Approval for the Lower Mt. Bethel facility. The agreement will not result in material costs to PPL. The agreement does not address the issues raised by the New Jersey DEP regarding the visible opacity of emissions from the oil-fired units at the Martins Creek plant. Similar issues also are being raised by the Pennsylvania DEP. PPL is currently negotiating the matter with the Pennsylvania DEP. If it is determined that actions must be taken to address the visible opacity of these emissions, such actions could result in costs that are not now determinable, but could be significant.

In addition to the opacity concerns raised by the New Jersey DEP, PPL and the Pennsylvania DEP were engaged in litigation relating to the opacity of emissions from the Montour plant. That litigation now has been resolved. The settlement does not impose any material costs.

In December 2003, PPL Montana, as operator of the Colstrip facility, received an Administrative Compliance Order (ACO) from the EPA pursuant to the Clean Air Act. The ACO alleges that Units 3 and 4 of the facility have been in violation of the Clean Air Act permit at Colstrip since 1980. The permit required Colstrip to submit for review and approval by the EPA an analysis and proposal for reducing emissions of nitrogen oxide to address visibility concerns upon the occurrence of certain triggering events. The EPA is asserting that regulations it promulgated in 1980 triggered this requirement. PPL believes that the ACO is unfounded. PPL is engaged in settlement negotiations on these matters with the EPA, the Montana DEQ and the Northern Cheyenne Tribe.

In addition to the requirements related to emissions of sulfur dioxide, nitrogen oxide and mercury noted above, there is a growing concern nationally and internationally about carbon dioxide emissions. In June 2005, the U.S. Senate adopted a resolution declaring that mandatory reductions in carbon dioxide are needed. Various legislative proposals are being considered in Congress, and several states already have passed legislation capping carbon dioxide emissions. The Bush administration is promoting a voluntary carbon dioxide reduction program, called the Climate VISION program. In support of this program, the electric power industry has committed to reducing its greenhouse gas emission intensity levels (measured as tons of carbon dioxide equivalent against electric power production in MWh) by 3% to 5% by the 2010 to 2012 period. Furthermore, in December 2005, seven northeastern states (New York, Connecticut, Delaware, Maine, New Hampshire, New Jersey and Vermont) signed an MOU establishing a cap and trade program commencing in January 2009 for stabilization of carbon dioxide emissions, at base levels established in 2005, from electric power plants larger than 25 MW in capacity. This MOU also provides for a 10% reduction in carbon dioxide emissions from the base levels by the end of 2018. Increased pressure for carbon dioxide emissions reduction also is coming from investor organizations and the international community.

Pennsylvania and Montana have not, at this time, established any formal programs to address carbon dioxide and other greenhouse gases. PPL has conducted an inventory of its carbon dioxide emissions and is continuing to evaluate various options for reducing, avoiding, off-setting or sequestering its emissions. If Pennsylvania or Montana develop regulations imposing mandatory reductions of carbon dioxide and other greenhouse gases on generation facilities, the cost to PPL of such reductions could be significant.

In June 2005, PPL Montour, along with 20 other companies with coal-fired generating plants, was named as a defendant in a toxic-tort, purported class-action lawsuit filed in the Ontario Superior Court of Justice. The complaint alleged damages in the approximate amount of Canadian $49 billion (approximately $42 billion at current exchange rates), along with continuing damages in the amount of Canadian $4.1 billion (approximately $3.5 billion at current exchange rates) per year and punitive damages of Canadian $1 billion (approximately $858 million at current exchange rates), along with such other relief as the court deems just. However, the deadline for serving the complaint on PPL Montour now has expired. PPL does not believe that the complaint was served on any of the defendants, and it is not clear whether the plaintiffs intend to pursue this action.

*Water/Waste*

In August 2005, a leak from a disposal basin containing fly ash and water used in connection with the operation of the two 150-MW coal-fired generating units at the Martins Creek generating facility caused the discharge of approximately 100 million gallons of water containing ash from the basin onto adjacent roadways and fields, and into a nearby creek and the Delaware River. The leak was stopped, and PPL has determined that the problem was caused by a failure in the disposal basin's discharge structure. PPL is continuing to work with the Pennsylvania DEP and other appropriate agencies and consultants to assess the extent of the environmental damage caused by the ash in the discharged water and to remediate the damage. PPL shut down the two coal-fired generating units in August 2005 and placed the units back in service in December 2005 after completing the repairs and upgrades to the basin and obtaining the Pennsylvania DEP's approval.

On September 20, 2005, PPL Martins Creek and the Pennsylvania DEP were served with notice by the Delaware Riverside Conservancy and several citizens of their intention to file a citizens' suit on the basis that the leak from the disposal basin at Martins Creek allegedly violated various state and federal laws. The Pennsylvania DEP subsequently filed a complaint in Commonwealth court against PPL Martins Creek and PPL Generation, alleging violations of various state laws and regulations and seeking penalties and injunctive relief. The Delaware Riverside Conservancy and several citizens have filed a motion to intervene in the Pennsylvania DEP's action, which motion includes a class action complaint alleging that the fly ash spill caused damages to property along a 40-mile stretch of the Delaware River. PPL has objected to the intervention by certain of the intervenors and both PPL and the Pennsylvania DEP have objected to the purported class action suit. PPL intends to engage in settlement discussions to resolve the Pennsylvania DEP action.

At this time, PPL has no reason to believe that the Martins Creek leak has caused any danger to human health or any adverse biological impact on the river aquatic life. However, a group of natural resource trustees, along with the Delaware River Basin Commission, has been conducting an assessment of any natural resource damages that could have been caused by the Martins Creek leak. PPL expects the trustees and the Delaware River Basin Commission to seek to recover their costs as well as any damages they determine were caused by the leak. PPL cannot predict when the assessment will be completed but does not expect it to be completed before the end of 2006.

PPL recognized a $33 million charge in the third quarter of 2005 and an additional $15 million charge in the fourth quarter of 2005 (or a total of $31 million after tax, or $0.08 per share) in connection with the current expected on-site and off-site costs relating to the leak. Approximately $41 million of the total charge, or $27 million after tax, relates to the off-site costs, and the balance of the total charge, $7 million, or $4 million after tax, relates to the on-site costs. The pre-tax accrual of $48 million was included in "Other operation and maintenance" on the Statement of Income. PPL cannot predict the final cost of assessment and remediation of the leak, the outcome of the action initiated by the Pennsylvania DEP, the outcome of the natural resource damage assessment, and the exact nature of any other regulatory or other legal actions that may be initiated against PPL or its subsidiaries as a result of the disposal basin leak. PPL also cannot predict the extent of the fines or damages that may be sought in connection with any such actions or the ultimate financial impact on PPL or its subsidiaries.

Seepages have been detected at active and retired wastewater basins at various PPL plants, including the Montour, Brunner Island and Martins Creek generating facilities. PPL has completed an assessment of some of the seepages at the Montour and Brunner Island facilities and is working with the Pennsylvania DEP to implement abatement measures for those seepages. PPL is continuing to conduct assessments of other seepages at the Montour and Brunner Island facilities as well as seepages at the Martins Creek facility to determine the appropriate abatement actions. PPL plans to comprehensively address issues related to wastewater basins at all of its Pennsylvania plants, as part of the process to renew the residual waste permits for these basins that expire within the next three years. The cost of addressing seepages at PPL's Pennsylvania plants is not now determinable, but could be significant.

In May 2003, approximately 50 plaintiffs brought an action now pending at the Montana Sixteenth Judicial District Court, Rosebud County, against PPL Montana and the other owners of the Colstrip plant alleging property damage from seepage from the freshwater and wastewater ponds at Colstrip. PPL Montana has undertaken certain groundwater investigation and remediation measures at the Colstrip plant to address groundwater contamination alleged by the plaintiffs as well as other groundwater contamination at the plant. These measures include offering to extend city water to certain residents who live near the plant, some of whom are plaintiffs in the litigation. Beyond the original estimated reserve of $1 million recorded by PPL Montana in 2004 (of which only an insignificant amount remains at December 31, 2005) for a proposed settlement of the property damage claims raised in the litigation, for extending city water and for a portion of the remedial investigation costs, PPL Montana may incur further costs based on its additional groundwater investigations and any related remedial measures, which costs are not now determinable, but could be significant.

The Pennsylvania DEP has stated that the temperature of the cooling water discharge at the Brunner Island plant must be lowered. The Pennsylvania DEP has also stated that it believes the plant is in violation of a permit condition prohibiting the discharge from changing the river temperature by more than two degrees per hour. PPL is discussing these matters with the agency. Depending on the outcome of these discussions, the plant could be subject to additional capital and operating costs that are not now determinable, but could be significant. In early January, PPL received notice from PennFuture (an environmental citizens organization) that they intended to sue PPL for alleged violations of the permit condition that prohibits the discharge from changing the river temperature by more than two degrees per hour. PPL cannot predict the outcome of this potential citizens' suit.

The EPA has significantly tightened the water quality standard for arsenic. The revised standard becomes effective in 2006. The revised standard may result in action by individual states that could require several PPL subsidiaries to either further treat wastewater or take abatement action at their power plants, or both. The cost of complying with any such requirements is not now determinable, but could be significant.

The EPA finalized requirements in 2004 for new or modified water intake structures. These requirements affect where generating facilities are built, establish intake design standards, and could lead to requirements for cooling towers at new and modified power plants. Another new rule that was finalized in 2004 addresses existing structures. PPL does not believe that either of these rules will impose material costs on PPL subsidiaries. However, six northeastern states have challenged the new rules for existing structures as being inadequate. If this challenge is successful, it could result in the EPA establishing stricter standards for existing structures that could impose significant costs on PPL subsidiaries.

*Superfund and Other Remediation*

In 1995, PPL Electric and PPL Generation and, in 1996, PPL Gas Utilities entered into consent orders with the Pennsylvania DEP to address a number of sites that were not being addressed under another regulatory program such as Superfund, but for which PPL Electric, PPL Generation or PPL Gas Utilities may be liable for remediation. This may include potential PCB contamination at certain PPL Electric substations and pole sites; potential contamination at a number of coal gas manufacturing facilities formerly owned or operated by PPL Electric; oil or other contamination that may exist at some of PPL Electric's former generating facilities; and potential contamination at abandoned power plant sites owned by PPL Generation. This may also include former coal gas manufacturing facilities and potential mercury contamination from gas meters and regulators at PPL Gas Utilities' sites.

Since the PPL Electric Consent Order expired on January 31, 2005, and since only four sites remained, PPL has negotiated a new consent order and agreement (COA) with the Pennsylvania DEP that combines both PPL Electric's and PPL Gas Utilities' consent orders into one single agreement. As of December 31, 2005, PPL Electric and PPL Gas Utilities have 144 sites to address under the new combined COA. Additional sites formerly owned or operated by PPL Electric, PPL Generation or PPL Gas Utilities are added to the consent orders on a case-by-case basis.

At December 31, 2005, PPL Electric and PPL Gas Utilities had accrued approximately $2 million and $6 million, respectively, representing the estimated amounts each will have to spend for site remediation, including those sites covered by each company's consent orders mentioned above. Depending on the outcome of investigations at sites where investigations have not begun or have not been completed, the costs of remediation and other liabilities could be substantial. PPL and its subsidiaries also could incur other non-remediation costs at sites included in the consent orders or other contaminated sites, the costs of which are not now determinable, but could be significant.

The Pennsylvania DEP has raised concerns regarding potential leakage of natural gas from the Tioga gas storage field owned by PPL Gas Utilities. The Pennsylvania DEP believes gas is leaking from the storage field and causing methane impacts to nearby residential wells. While PPL Gas has no evidence to confirm or deny the Pennsylvania DEP's position, PPL Gas Utilities has initiated a plan to identify and address potential sources of gas leakage from the field. PPL Gas Utilities is discussing the matter with the operator of the field and with the Pennsylvania DEP.

The EPA is evaluating the risks associated with naphthalene, a chemical by-product of coal gas manufacturing operations. As a result of the EPA's evaluation, individual states may establish stricter standards for water quality and soil clean-up. This could require several PPL subsidiaries to take more extensive assessment and remedial actions at former coal gas manufacturing facilities. The costs to PPL of complying with any such requirements are not now determinable, but could be significant.

Under the Pennsylvania Clean Streams Law, subsidiaries of PPL Generation are obligated to remediate acid mine drainage at former mine sites and may be required to take additional measures to prevent potential acid mine drainage at previously capped refuse piles. One PPL Generation subsidiary is pumping and treating mine water at two mine sites. Another PPL Generation subsidiary is installing passive wetlands treatment at a third site, and the Pennsylvania DEP has suggested that it may require that PPL Generation subsidiary to pump and treat the mine water at that third site. At December 31, 2005, a PPL Energy Supply subsidiary had accrued $28 million to cover the costs of pumping and treating groundwater at the two mine sites for 50 years and for operating and maintaining passive wetlands treatment at the third site.

In 1999, the Montana Supreme Court held in favor of several citizens' groups that the right to a clean and healthful environment is a fundamental right guaranteed by the Montana Constitution. The court's ruling could result in significantly more stringent environmental laws and regulations, as well as an increase in citizens' suits under Montana's environmental laws. The effect on PPL Montana of any such changes in laws or regulations or any such increase in legal actions is not currently determinable, but could be significant.

Future cleanup or remediation work at sites currently under review, or at sites not currently identified, may result in material additional operating costs for PPL subsidiaries that cannot be estimated at this time.

*Asbestos*

There have been increasing litigation claims throughout the U.S. based on exposure to asbestos against companies that manufacture or distribute asbestos products or that have these products on their premises. Certain of PPL's generation subsidiaries and certain of its energy services subsidiaries, such as those that have supplied, may have supplied or installed asbestos material in connection with the repair or installation of process piping and heating, ventilating and air conditioning systems, have been named as defendants in asbestos-related lawsuits. PPL cannot predict the outcome of these lawsuits or whether additional claims may be asserted against its subsidiaries in the future. PPL does not expect that the resolution of the current lawsuits will have a material adverse effect on its results of operations.

*Electric and Magnetic Fields*

Concerns have been expressed by some members of the public regarding potential health effects of power frequency EMFs, which are emitted by all devices carrying electricity, including electric transmission and distribution lines and substation equipment. Government officials in the U.S. and the U.K. have reviewed this issue. The U.S. National Institute of Environmental Health Sciences concluded in 2002 that, for most health outcomes, there is no evidence of EMFs causing adverse effects. The agency further noted that there is some epidemiological evidence of an association with childhood leukemia, but that this evidence is difficult to interpret without supporting laboratory evidence. The U.K. National Radiological Protection Board concluded in 2004

that, while the research on EMFs does not provide a basis to find that EMFs cause any illness, there is a basis to consider precautionary measures beyond existing exposure guidelines. PPL and its subsidiaries believe the current efforts to determine whether EMFs cause adverse health effects should continue and are taking steps to reduce EMFs, where practical, in the design of new transmission and distribution facilities. PPL and its subsidiaries are unable to predict what effect, if any, the EMF issue might have on their operations and facilities either in the U.S. or abroad, and the associated cost, or what, if any, liabilities they might incur related to the EMF issue.

*Lower Mt. Bethel*

In August 2002, the Northampton County Court of Common Pleas issued a decision setting the permissible noise levels for operation of the Lower Mt. Bethel facility. PPL appealed the court's decision to the Commonwealth Court, and an intervenor in the lawsuit cross-appealed the court's decision. In May 2003, the Commonwealth Court remanded the case to the Court of Common Pleas for further findings of fact concerning the zoning application relating to the construction of the facility. In September 2003, the Court of Common Pleas ruled in PPL's favor while also reaffirming its decision on the noise levels, and the intervenor appealed this ruling to the Commonwealth Court. In April 2004, the Commonwealth Court affirmed the decision of the Court of Common Pleas, and the Supreme Court of Pennsylvania has denied the intervenor's Petition for Allowance of Appeal. Accordingly, the September 2003 ruling by the Court of Common Pleas is final.

The certificate of occupancy for the Lower Mt. Bethel facility was issued by the local township zoning officer in April 2004, and the facility was placed in service in May 2004. In May 2004, the intervenor in the legal proceedings regarding the facility's permissible noise levels filed an appeal with the township zoning board regarding the issuance of the certificate of occupancy. The hearing on the appeal was held in December 2004, and the intervenor's appeal was denied. The intervenor appealed the zoning board's decision to the Northampton County Court of Common Pleas in February 2005, and the Court of Common Pleas denied this appeal in August 2005. The intervenor did not further appeal this matter. Accordingly, the zoning board's decision is final.

**Environmental Matters – International**

*U.K.*

WPD's distribution businesses are subject to numerous regulatory and statutory requirements with respect to environmental matters. PPL believes that WPD has taken and continues to take measures to comply with the applicable laws and governmental regulations for the protection of the environment. There are no material legal or administrative proceedings pending against WPD with respect to environmental matters. See "Environmental Matters – Domestic – Electric and Magnetic Fields" for a discussion of EMFs.

*Latin America*

Certain of PPL's affiliates have electric distribution operations in Latin America. PPL believes that these affiliates have taken and continue to take measures to comply with the applicable laws and governmental regulations for the protection of the environment. There are no material legal or administrative proceedings pending against PPL's affiliates in Latin America with respect to environmental matters.

**Other**

*Nuclear Insurance*

PPL Susquehanna is a member of certain insurance programs that provide coverage for property damage to members' nuclear generating stations. Facilities at the Susquehanna station are insured against property damage losses up to $2.75 billion under these programs. PPL Susquehanna is also a member of an insurance program that provides insurance coverage for the cost of replacement power during prolonged outages of nuclear units caused by certain specified conditions. Under the property and replacement power insurance programs, PPL Susquehanna could be assessed retroactive premiums in the event of the insurers' adverse loss experience. At December 31, 2005, this maximum assessment was about $38 million.

In the event of a nuclear incident at the Susquehanna station, PPL Susquehanna's public liability for claims resulting from such incident would be limited to about $10.8 billion under provisions of The Price Anderson Act Amendments under the Energy Policy Act of 2005. PPL Susquehanna is protected against this liability by a combination of commercial insurance and an industry assessment program. In the event of a nuclear incident at any of the reactors covered by The Price Anderson Act Amendments under the Energy Policy Act of 2005, PPL Susquehanna could be assessed up to $201 million per incident, payable at $30 million per year.

*Guarantees and Other Assurances*

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

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

PPL provides certain guarantees that are required to be disclosed in accordance with FIN 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, an Interpretation of FASB Statements No. 5, 57, and 107 and Rescission of FASB Interpretation No. 34." The table below details guarantees provided as of December 31, 2005.

| | Recorded Liability at December 31, | | Exposure at December 31, | | |
|---|---|---|---|---|---|
| | 2005 | 2004 | 2005[a] | Expiration Date | Description |
| Residual value guarantees of leased equipment | | $1 | $85 | 2006 | PPL Services, PPL Montana and PPL Electric lease certain equipment under master operating lease agreements. The term for each piece of equipment leased by PPL Services and PPL Montana is one year, after which time the lease may be extended from month-to-month until terminated. The term for each piece of equipment leased by PPL Electric ranges from one to three years, after which time the lease term may be extended for certain equipment either (i) from month-to-month until terminated or (ii) for up to two additional years. Under these lease arrangements, PPL Services, PPL Montana and PPL Electric provide residual value guarantees to the lessors. PPL Services, PPL Montana and PPL Electric generally could be required to pay the guaranteed residual value of the leased equipment if the proceeds received from the sale of a piece of equipment upon termination of the lease are less than the expected residual value of the equipment. These guarantees generally expire within one year, unless the lease terms are extended. The liability recorded is included in "Other current liabilities" on the Balance Sheet. Although the expiration date noted is 2006, equipment of similar value is generally leased and guaranteed on an ongoing basis. |
| WPD LLP guarantee of obligations under SIUK Capital Trust I preferred securities | | | 82 | 2027 | WPD LLP guarantees all of the obligations of SIUK Capital Trust I, an unconsolidated wholly owned financing subsidiary of WPD LLP, under its trust preferred securities. The exposure at December 31, 2005, reflects principal payments only. See Note 22 for further discussion. |
| Support agreements to guarantee partnerships' obligations for the sale of coal | | | 9 | 2007 | PPL Generation has entered into certain partnership arrangements for the sale of coal to third parties. PPL Generation also has executed support agreements for the benefit of these third-party purchasers pursuant to which it guarantees the partnerships' obligations in an amount up to its pro rata ownership interest in the partnerships. |
| Retroactive premiums under nuclear insurance programs | | | 38 | | PPL Susquehanna is contingently obligated to pay this amount related to potential retroactive premiums that could be assessed under its nuclear insurance programs. See "Nuclear Insurance" for additional information. |
| Nuclear claims under The Price-Anderson Act Amendments under The Energy Policy Act of 2005 | | | 201 | | This is the maximum amount PPL Susquehanna could be assessed for each incident at any of the nuclear reactors covered by this Act. See "Nuclear Insurance" for additional information. |
| Contingent purchase price payments to former owners of synfuel projects | | $11 | 33 | 2007 | Certain agreements relating to the purchase of ownership interests in synfuel projects contain provisions that require certain PPL Energy Supply subsidiaries to make contingent purchase price payments to the former owners. These payments are non-recourse to PPL, PPL Energy Supply and their other subsidiaries and are based primarily upon production levels of the synfuel projects. The maximum potential amount of future payments is not explicitly stated in the related agreements. |
| Indemnifications for entities in liquidation | | | 262 | 2008 to 2012 | In connection with the liquidation of wholly owned subsidiaries that have been deconsolidated upon turning the entities over to the liquidators, certain affiliates of PPL Global have agreed to indemnify the liquidators, directors and/or the entities themselves for any liabilities or expenses arising during the liquidation process, including liabilities and expenses of the entities placed into liquidation. In some cases, the indemnifications are limited to a maximum amount that is based on distributions made from the subsidiary to its parent either prior or subsequent to being placed into liquidation. In other cases, the maximum amount of the indemnifications is not explicitly stated in the agreements. The indemnifications generally expire two to seven years subsequent to the date of dissolution of the entities. The exposure noted is only for those cases in which the agreements provide for a specific limit on the amount of the indemnification, and the expiration date was based on an estimate of the dissolution date of the entities. |
| WPD guarantee of pension and other obligations of unconsolidated entities | $4 | | 41 | 2017 | As a result of the privatization of the utility industry in the U.K., certain electric associations' roles and responsibilities were discontinued or modified. As a result, certain obligations, primarily pension-related, associated with these organizations have been guaranteed by the participating members. Costs are allocated to the members based on predetermined percentages as outlined in specific agreements. However, if a member becomes insolvent, costs can be reallocated to and are guaranteed by the remaining members. At December 31, 2005, WPD has recorded an estimated discounted liability based on its current allocated percentage of the total expected costs. Neither the expiration date nor the maximum amount of potential payments for certain obligations is explicitly stated in the related agreements. Therefore, they have been estimated based on the types of obligations. |
| Tax indemnification related to unconsolidated WPD affiliates | | | 9 | 2012 | Two WPD unconsolidated affiliates were refinanced during the year. Under the terms of the refinancing, WPD has indemnified the lender against certain tax and other liabilities. At this time, WPD believes that the likelihood of such liabilities arising is remote. |
| WPD guarantee of an unconsolidated entity's lease obligations | | | 1 | 2008 | The maximum potential amount of future payments is not explicitly stated in the related agreements. |

| | Recorded Liability at December 31, 2005 | 2004 | Exposure at December 31, 2005[a] | Expiration Date | Description |
|---|---|---|---|---|---|
| Indemnifications related to the sale of the Sundance plant | 1 | | [b] | [b] | PPL Energy Supply has provided indemnifications to the purchaser for losses arising out of any breach of the representations, warranties and covenants under the related transaction documents and for losses arising with respect to liabilities not specifically assumed by the purchaser, including certain pre-closing environmental and tort liabilities. Certain of the indemnifications are triggered only if the purchaser's losses reach $1 million in the aggregate, are capped at 50% of the purchase price (or approximately $95 million), and survive for a period of only 24 months after the May 13, 2005, transaction closing. The indemnification provision for unknown environmental and tort liabilities related to periods prior to PPL Energy Supply's ownership of the real property on which the facility is located are capped at approximately $4 million in the aggregate and survive for a maximum period of five years after the transaction closing. |
| Guarantee of a portion of an unconsolidated entity's debt | | | 7 | 2008 | The exposure at December 31, 2005, reflects principal payments only. |

(a) Represents the estimated maximum potential amount of future payments that could be required to be made under the guarantee.

(b) PPL Energy Supply's maximum exposure with respect to these indemnifications and the expiration of the indemnifications cannot be estimated because, in the case of certain of the indemnification provisions, the maximum potential liability is not capped by the transaction documents, and the expiration date is based on the applicable statute of limitations.

PPL and its subsidiaries provide other miscellaneous guarantees through contracts entered into in the normal course of business. These guarantees are primarily in the form of various indemnifications or warranties related to services or equipment and vary in duration. The obligated amounts of these guarantees often are not explicitly stated, and the overall maximum amount of the obligation under such guarantees cannot be reasonably estimated. Historically, PPL and its subsidiaries have not made any significant payments with respect to these types of guarantees. As of December 31, 2005, the aggregate fair value of these indemnifications related to arrangements entered into subsequent to December 31, 2002, was insignificant. Among these guarantees are:

- The companies' or their subsidiaries' leasing arrangements, including those discussed above, contain certain indemnifications in favor of the lessors (e.g., tax and environmental matters).
- In connection with their issuances of securities, the companies and their subsidiaries engage underwriters, purchasers and purchasing agents to whom they provide indemnification for damages incurred by such parties arising from the companies' material misstatements or omissions in the related offering documents. In addition, in connection with these securities offerings and other financing transactions, the companies also engage trustees or custodial, escrow or other agents to act for the benefit of the investors or to provide other agency services. The companies and their subsidiaries typically provide indemnification to these agents for any liabilities or expenses incurred by them in performing their obligations.
- In connection with certain of their credit arrangements, the companies provide the creditors or credit arrangers with indemnification that is standard for each particular type of transaction. For instance, under the credit agreement for the asset-backed commercial paper program, PPL Electric and its special purpose subsidiary have agreed to indemnify the commercial paper conduit, the sponsoring financial institution and the liquidity banks for damages incurred by such parties arising from, among other things, a breach by PPL Electric or the subsidiary of their various representations, warranties and covenants in the credit agreement, PPL Electric's activities as servicer with respect to the pledged accounts receivable and any dispute by PPL Electric's customers with respect to payment of the accounts receivable.
- PPL EnergyPlus is party to numerous energy trading or purchase and sale agreements pursuant to which the parties indemnify each other for any damages arising from events that occur while the indemnifying party has title to the electricity or natural gas. For example, in the case of the party that is delivering the product, such party would be responsible for damages arising from events occurring prior to delivery.
- In connection with their sales of various businesses, WPD and its affiliates have provided the purchasers with indemnifications that are standard for such transactions, including indemnifications for certain pre-existing liabilities and environmental and tax matters. In addition, in connection with certain of these sales, WPD and its affiliates have agreed to continue their obligations under existing third-party guarantees, either for a set period of time following the transactions or upon the condition that the purchasers make reasonable efforts to terminate the guarantees. Finally, WPD and its affiliates remain secondarily responsible for lease payments under certain leases that they have assigned to third parties.

PPL, on behalf of itself and certain of its subsidiaries, maintains insurance that covers liability assumed under contract for bodily injury and property damage. The coverage requires a $4 million deductible per occurrence and provides maximum aggregate coverage of approximately $175 million. This insurance may be applicable to certain obligations under the contractual arrangements discussed above.

# 15. Related Party Transactions

At both December 31, 2005, and 2004, the Balance Sheet reflected $89 million of "Long-term Debt with Affiliate Trust." This debt represents obligations of PPL Energy Supply under 8.23% subordinated debentures maturing in February 2027 that are held by SIUK Capital Trust I, which is a variable interest entity whose common securities are owned by PPL Energy Supply but which is not consolidated by PPL Energy Supply. Interest expense on this obligation was $12 million in 2005, $11 million in 2004 and $5 million in 2003. See Note 22 for additional information.

## 16. Other Income – Net

The breakdown of "Other Income – net" was:

| | 2005 | 2004 | 2003 |
|---|---|---|---|
| **Other Income** | | | |
| Interest income – IRS settlement | | $23 | |
| Other interest income | **$23** | 16 | $12 |
| Sale of CEMAR (Note 9) | | 23 | |
| Equity earnings | **3** | 3 | |
| Realized earnings on nuclear decommissioning trust [a] | **5** | (7) | 20 |
| Hyder-related activity | | | 8 |
| Reduction of reserves for receivables from Enron | | | 10 |
| Miscellaneous – Domestic | **7** | 7 | 9 |
| Miscellaneous – International | **7** | 8 | 12 |
| Total | **45** | 73 | 71 |
| **Other Deductions** | | | |
| Impairment of investment in technology supplier (Note 9) | | 10 | |
| Asset valuation write-down | | | 3 |
| Charitable contributions | **4** | 2 | 3 |
| Realized loss on available-for-sale investment | | 6 | |
| Non-operating taxes, other than income | **1** | 2 | 1 |
| Miscellaneous – Domestic | **6** | 6 | 4 |
| Miscellaneous – International | **5** | 8 | 5 |
| **Other Income – net** | **$29** | $39 | $55 |

[a] 2004 includes a $(10) million and a $(2) million adjustment to the realized earnings on the nuclear decommissioning trust recorded in 2003 and 2004, respectively. The adjustment was recorded in the fourth quarter of 2004, as the adjustment was not material to the financial statements for any affected periods in 2003 or 2004, or as recorded in the fourth quarter of 2004.

## 17. Derivative Instruments and Hedging Activities

PPL adopted SFAS 133, "Accounting for Derivative Instruments and Hedging Activities," on January 1, 2001. In April 2003, the FASB issued SFAS 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities," which amended and clarified SFAS 133 to improve financial accounting and reporting for derivative instruments and hedging activities. To ensure that contracts with comparable characteristics are accounted for similarly, SFAS 149 clarified the circumstances under which a contract with an initial net investment meets the characteristics of a derivative, clarified when a derivative contains a financing component, amended the definition of an "underlying" and amended certain other existing pronouncements.

Additionally, SFAS 149 placed additional limitations on the use of the normal purchase or normal sale exception. SFAS 149 was effective for contracts entered into or modified and for hedging relationships designated after June 30, 2003, except certain provisions relating to forward purchases or sales of when-issued securities or other securities that did not yet exist. PPL adopted SFAS 149 as of July 1, 2003. The adoption of SFAS 149 did not have a significant impact on PPL or its subsidiaries.

### Management of Market Risk Exposures

Market risk is the potential loss PPL may incur as a result of price changes associated with a particular financial or commodity instrument. PPL is exposed to market risk from:

- commodity price risk for energy and energy-related products associated with the sale of electricity from its generating assets and other electricity marketing activities, the purchase of fuel for the generating assets and energy trading activities;
- interest rate risk associated with variable-rate debt and the fair value of fixed-rate debt used to finance operations, as well as the fair value of debt securities invested in by PPL's nuclear decommissioning trust funds;
- foreign currency exchange rate risk associated with investments in affiliates in Latin America and Europe, as well as purchases of equipment in currencies other than U.S. dollars; and
- equity securities price risk associated with the fair value of equity securities invested in by PPL's nuclear decommissioning trust funds.

PPL has a risk management policy approved by the Board of Directors to manage market risk and counterparty credit risk. The RMC, comprised of senior management and chaired by the Vice President-Risk Management, oversees the risk management function. Key risk control activities designed to ensure compliance with the risk policy and detailed programs include, but are not limited to, credit review and approval, validation of transactions and market prices, verification of risk and transaction limits, sensitivity analyses, and daily portfolio reporting, including open positions, mark-to-market valuations, and other risk measurement metrics.

PPL utilizes forward contracts, futures contracts, options, swaps and tolling agreements as part of its risk management strategy to minimize unanticipated fluctuations in earnings caused by commodity price, interest rate and foreign currency volatility. All derivatives are recognized on the balance sheet at their fair value, unless they meet SFAS 133 criteria for exclusion (see discussion in "Accounting Designations" below).

### Fair Value Hedges

PPL and its subsidiaries enter into financial or physical contracts to hedge a portion of the fair value of firm commitments of forward electricity sales and emission allowance positions. These contracts range in maturity through 2007. Additionally, PPL and its subsidiaries enter into financial contracts to hedge fluctuations in the market value of existing debt issuances. These contracts range in maturity through 2013. PPL and its subsidiaries also enter into foreign currency forward contracts to hedge the exchange rates associated with firm commitments denominated in foreign currencies. These forward contracts range in maturity through 2008.

PPL did not recognize significant gains or losses resulting from hedges of firm commitments that no longer qualified as fair value hedges for 2005, 2004 or 2003.

PPL also did not recognize any gains or losses resulting from the ineffective portion of fair value hedges for these years.

### Cash Flow Hedges

PPL and its subsidiaries enter into financial and physical contracts, including forwards, futures and swaps, to hedge the price risk associated with electric, gas and oil commodities. These contracts range in maturity through 2010.

Additionally, PPL and its subsidiaries enter into financial interest rate swap contracts to hedge interest expense associated with both existing and anticipated debt issuances. These interest rate swap contracts range in maturity through 2016. PPL and its subsidiaries also enter into foreign currency forward contracts to hedge the cash flows associated with foreign currency-denominated debt, the exchange rates associated with firm commitments denominated in foreign currencies and the net investment of foreign operations. These forward contracts range in maturity through 2028.

Net investment hedge activity is reported in the foreign currency translation adjustments component of other comprehensive income. PPL recorded net investment hedge losses, after tax, of $6 million and $7 million as of December 31, 2005 and 2004.

Cash flow hedges may be discontinued if it is probable that the original forecasted transaction will not occur by the end of the originally specified time period. There were no such events in 2005, and there was an insignificant impact from such an event in 2004. In 2003, PPL discontinued certain cash flow hedges, which resulted in the reclassification of $7 million of after-tax losses from other comprehensive income (reported in "Wholesale energy marketing" revenues, "Energy purchases" and "Interest Expense" on the Statement of Income).

Hedge ineffectiveness associated with energy derivatives did not have a significant impact in 2005, 2004 and 2003.

Ineffectiveness associated with interest rate and foreign currency derivatives also was not significant for 2005, 2004 and 2003.

As of December 31, 2005, the deferred net loss, after tax, on derivative instruments in "Accumulated other comprehensive income" expected to be reclassified into earnings during the next twelve months was $72 million. Amounts are reclassified as the energy contracts go to delivery and interest payments are made.

This table shows the change in accumulated unrealized gains or losses on derivatives, after tax, in accumulated other comprehensive income.

| | 2005 | 2004 |
|---|---|---|
| Beginning accumulated derivative gain (loss) | $ (63) | $ 41 |
| Net change associated with current period hedging activities and other | (160) | (209) |
| Net change from reclassification into earnings | (23) | 105 |
| Ending accumulated derivative loss | $(246) | $ (63) |

**Accounting Designations**

For energy contracts that meet the definition of a derivative, the circumstances and intent existing at the time that energy transactions are entered into determine their accounting designation, which is subsequently verified by an independent internal group on a daily basis. The following summarizes the electricity guidelines that have been provided to the marketers who are responsible for contract designation for derivative energy contracts in accordance with SFAS 133.

- Any wholesale and retail contracts to sell electricity and the related capacity that are expected to be delivered from PPL's generation or that do not meet the definition of a derivative are considered "normal." These transactions are not recorded in the financial statements and have no earnings impact until delivery.
- Physical electricity-only transactions can receive cash flow hedge treatment if all of the qualifications under SFAS 133 are met.
- Physical capacity-only transactions to sell excess capacity from PPL's generation are considered "normal." These transactions are not recorded in the financial statements and have no earnings impact until delivery.
- Any physical energy sale or purchase deemed to be a "market call" is considered speculative, with unrealized gains or losses recorded immediately through earnings.
- Financial transactions, which can be settled in cash, cannot be considered "normal" because they do not require physical delivery. These transactions receive cash flow hedge treatment if they lock in the price PPL will receive or pay for energy expected to be generated or purchased in the spot market. Certain financial transactions, specifically FTRs, do not currently qualify for hedge treatment. Unrealized and realized gains and losses from FTRs that were entered into to offset probable transmission congestion expenses are recorded in "Energy purchases" on the Statement of Income.
- Physical and financial transactions for gas and oil to meet fuel and retail requirements can receive cash flow hedge treatment if they lock-in the price PPL will pay in the spot market.
- Option contracts that do not meet the requirements of DIG Issue C15, "Scope Exceptions: Interpreting the Normal Purchases and Normal Sales Exception as an Election," do not receive hedge accounting treatment and are marked to market through earnings.

Any unrealized gains or losses on transactions receiving cash flow hedge treatment are recorded in other comprehensive income. These unrealized gains and losses become realized when the contracts settle and are recognized in income when the hedged transactions occur.

In addition to energy-related transactions, PPL enters into financial interest rate and foreign currency swap contracts to hedge interest expense associated with both existing and anticipated debt issuances. PPL and its subsidiaries also enter into foreign currency swap contracts to hedge the fair value of firm commitments denominated in foreign currency and net investments in foreign operations. As with energy transactions, the circumstances and intent existing at the time of the transaction determine a contract's accounting designation, which is subsequently verified by an independent internal group on a daily basis. The following is a summary of certain guidelines that have been provided to PPL's finance department, which is responsible for contract designation.

- Transactions to lock in an interest rate prior to a debt issuance can be designated as cash flow hedges. Any unrealized gains or losses on transactions receiving cash flow hedge treatment are recorded in other comprehensive income and are amortized as a component of interest expense over the life of the debt.
- Transactions entered into to hedge fluctuations in the value of existing debt can be designated as fair value hedges. To the extent that the change in the fair value of the derivative offsets the change in the fair value of the existing debt, there is no earnings impact, as both changes are reflected in interest expense. Realized gains and losses over the life of the hedge are reflected in interest expense.

- Transactions entered into to hedge the value of a net investment of foreign operations can be designated as net investment hedges. To the extent that the derivatives are highly effective at hedging the value of the net investment, gains and losses are recorded in other comprehensive income/loss and will not be recorded in earnings until the investment is disposed of.
- Derivative transactions that do not qualify for hedge accounting treatment are marked to market through earnings.

**Related Implementation Issues**

In November 2003, the FASB revised the guidance in DIG Issue C15, "Scope Exceptions: Normal Purchases and Normal Sales Exception for Certain Option-Type Contracts and Forward Contracts in Electricity," to clarify the application of derivative accounting rules for contracts that may involve capacity. The guidance was effective January 1, 2004, for PPL and did not have a significant impact on its financial statements.

In June 2003, the FASB issued DIG Issue C20, "Scope Exceptions: Interpretation of the Meaning of Not Clearly and Closely Related in Paragraph 10(b) Regarding Contracts with a Price Adjustment Feature," which became effective October 1, 2003. DIG Issue C20 addresses a requirement in SFAS 133 that contracts that qualify for normal treatment must feature pricing that is clearly and closely related to the asset being sold. Diversity in practice had developed among companies. DIG Issue C20 permits normal treatment if a price adjustment factor, such as a broad market index (e.g., Consumer Price Index), is not extraneous to both the cost and the fair value of the asset being sold and is not significantly disproportionate in terms of the magnitude and direction when compared with the asset being sold. However, DIG Issue C20 also stated that prior guidance did not permit the use of a broad market index to serve as a proxy for an ingredient or direct factor. Thus, DIG Issue C20 required that contracts that had been accounted for as normal, but were not eligible for normal treatment under prior guidance, be reflected on the balance sheet at their fair value, with an offsetting amount reflected in income as of the date of adoption. These contracts could then be evaluated under the provisions of DIG Issue C20 to determine whether they could qualify for normal treatment prospectively. PPL recorded a pre-tax charge to income of $2 million in the fourth quarter of 2003 to comply with the provisions of DIG Issue C20.

PPL and its subsidiaries adopted the final provisions of EITF 03-11, "Reporting Realized Gains and Losses on Derivative Instruments That Are Subject to FASB Statement No. 133 and Not 'Held for Trading Purposes' as Defined in Issue No. 02-3," prospectively as of October 1, 2003. As a result of this adoption, non-trading bilateral sales of electricity at major market delivery points are netted with purchases that offset the sales at those same delivery points. A major market delivery point is any delivery point with liquid pricing available. The impact of adopting EITF 03-11 was a reduction in both "Wholesale energy marketing" revenues and "Energy purchases" by $290 million on the Statement of Income for the year ended December 31, 2005, and a reduction of $277 million and $105 million for the years ended December 31, 2004 and December 31, 2003, respectively.

**Credit Concentration**

PPL and its subsidiaries enter into contracts with many entities for the purchase and sale of energy. Many of these contracts are considered a normal part of doing business and, as such, the mark-to-market value of these contracts is not reflected in the financial statements. However, the mark-to-market value of these contracts is considered when committing to new business from a credit perspective.

PPL and its subsidiaries have credit exposures to energy trading partners. The majority of these exposures are the mark-to-market value of multi-year contracts for energy sales and purchases. Therefore, if these counterparties fail to perform their obligations under such contracts, PPL and its subsidiaries would not experience an immediate financial loss but would experience lower revenues or higher costs in future years to the extent that replacement sales or purchases could not be made at the same prices as those under the defaulted contracts.

At December 31, 2005, PPL had a credit exposure of $559 million to energy trading partners. Ten counterparties accounted for 72% of this exposure. No other individual counterparty accounted for more than 2% of the exposure. Nine of the ten counterparties had an investment grade credit rating from S&P. One counterparty was not investment grade but was current on its obligations and has posted collateral in the form of a letter of credit equal to PPL's exposure.

PPL and its subsidiaries generally have the right to request collateral from their counterparties in the event that the counterparties' credit ratings fall below investment grade. It is also the policy of PPL and its subsidiaries to enter into netting agreements with all of their counterparties to minimize credit exposure.

## 18. Restricted Cash

The following table details the components of restricted cash by type.

| | 2005 | 2004 |
|---|---|---|
| **Current:** | | |
| Collateral for letters of credit [(a)] | $ 42 | $ 42 |
| Deposits for trading purposes with NYMEX broker | 29 | |
| Counterparty collateral | 9 | |
| Client deposits | 12 | 5 |
| Miscellaneous | 1 | 3 |
| Restricted cash – current | 93 | 50 |
| **Noncurrent:** | | |
| Required deposits of WPD [(b)] | 16 | 37 |
| PPL Transition Bond Company Indenture reserves [(c)] | 32 | 22 |
| Restricted cash – noncurrent | 48 | 59 |
| Total restricted cash | $141 | $109 |

(a) A deposit with a financial institution of funds from the asset-backed commercial paper program to fully collateralize $42 million of letters of credit. See Note 8 for further discussion on the asset-backed commercial paper program.

(b) Includes insurance reserves of $15 million and $37 million at December 31, 2005 and 2004.

(c) Credit enhancement for PPL Transition Bond Company's $2.4 billion Series 1999-1 Bonds to protect against losses or delays in scheduled payments.

# 19. Goodwill and Other Acquired Intangible Assets

**Goodwill**

Goodwill by segment at December 31 was:

| | 2005 | 2004 | 2003 |
|---|---|---|---|
| Supply | $ 94 | $ 94 | $ 93 |
| International Delivery | 921 | 978 | 920 |
| Pennsylvania Delivery | 55 | 55 | 55 |
| | $1,070 | $1,127 | $1,068 |

In 2005, the decrease of $57 million in the International Delivery segment was attributable to a decrease of $60 million due to the effect of changes in foreign currency exchange rates, offset by $3 million of adjustments pursuant to EITF Issue 93-7, "Uncertainties Related to Income Taxes in a Purchase Business Combination."

In 2004, the increase of $58 million in the International Delivery segment was attributable to an increase of $93 million due to the effect of changes in foreign currency exchange rates, offset by $35 million consisting primarily of adjustments pursuant to EITF Issue No. 93-7.

In December 2003, the PPL Global Board of Managers authorized the sale of its investment in a Latin American telecommunications company. As a result of this decision, PPL Global wrote off $6 million of goodwill in 2003.

**Other Acquired Intangible Assets**

The carrying amount and the accumulated amortization of acquired intangible assets were:

| | December 31, 2005 | | December 31, 2004 | |
|---|---|---|---|---|
| | Carrying Amount | Accumulated Amortization | Carrying Amount | Accumulated Amortization |
| Land and transmission rights | $279 | $104 | $284 | $99 |
| Emission allowances | 176 | | 78 | |
| Easements | 55 | | 56 | |
| Licenses and other | 83 | 27 | 67 | 11 |
| | $593 | $131 | $485 | $110 |

Current intangible assets are included in "Current Assets – Other," and long-term intangible assets are included in "Other acquired intangibles" on the Balance Sheet.

Amortization expense was approximately $8 million for 2005 and $6 million for 2004 and 2003. Amortization expense is estimated at $9 million per year for 2006 through 2010.

# 20. Workforce Reduction

In an effort to improve operational efficiency and reduce costs, PPL and its subsidiaries commenced a workforce reduction assessment in June 2002. The program was broad-based and impacted all employee groups, except certain positions that are key to providing high-quality service to PPL's electricity delivery customers.

PPL recorded a final charge of $9 million, or $5 million after tax, in 2003. This final charge included employee terminations associated with implementation of the Automated Meter Reading project.

The program provided primarily for enhanced early retirement benefits and/or one-time special pension separation allowances based on an employee's age and years of service. These features of the program were paid from the PPL Retirement Plan pension trust. All of the accrued non-pension benefits have been paid.

# 21. Asset Retirement Obligations and Nuclear Decommissioning

*Asset Retirement Obligations*

In connection with the adoption of SFAS 143, "Accounting for Asset Retirement Obligations," effective January 1, 2003, PPL recorded a cumulative effect of adoption that increased net income by $63 million (net of tax of $44 million), or $0.18 per share.

PPL identified various legal obligations to retire long-lived assets, the largest of which relates to the decommissioning of the Susquehanna plant. PPL identified and recorded other AROs related to significant interim retirements at the Susquehanna plant, and various environmental requirements for coal piles, ash basins and other waste basin retirements at Susquehanna and other facilities.

PPL also identified legal retirement obligations that could not be reasonably estimated at that time. These items included requirements associated with the retirement of a reservoir and certain transmission assets. These retirement obligations could not be reasonably estimated due to indeterminable settlement dates.

In March 2005, the FASB issued Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations, an Interpretation of FASB Statement No. 143." FIN 47 clarifies that an entity is required to recognize a liability for the fair value of a conditional ARO when incurred if the fair value of the ARO can be reasonably estimated. FIN 47 also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an ARO.

PPL adopted FIN 47 effective December 31, 2005. Adoption of the new guidance resulted in an increase in net PP&E of $4 million, recognition of AROs of $17 million, recognition of deferred tax assets of $5 million and a cumulative effect of adoption that decreased net income by $8 million (net of tax of $6 million), or $0.02 per share.

PPL identified several conditional AROs. The most significant of these related to the removal and disposal of asbestos-containing material at various generation plants. The fair value of the portion of these obligations that could be reasonably estimated was recorded at December 31, 2005, and resulted in AROs of $14 million and a cumulative effect of adoption that decreased net income by $8 million.

Also, PPL Global identified and recorded conditional AROs that related to treated wood poles and fluid-filled cable, which had an insignificant impact on the financial statements.

In addition to the AROs that were recorded for asbestos-containing material, PPL identified other asbestos-related obligations, but was unable to reasonably estimate their fair values. These retirement obligations could not be reasonably estimated due to their indeterminable settlement dates. The generation plants, where significant amounts of asbestos-containing material are located, have been well maintained, and large capital and environmental investments are being made at these plants. During the last five years, the useful lives of the plants have been reviewed and in most cases significantly extended. See Note 1 for further discussion related to the extension of the useful lives of these assets. Due to these circumstances, PPL management was unable to reasonably estimate a settlement date or range of settlement dates for the remediation of all of the asbestos-containing material at the generation plants. If economic events or other circumstances change that enable PPL to reasonably estimate the fair value of these retirement obligations, they will be recorded at that time.

The changes in the carrying amounts of AROs were:

| | **2005** | 2004 |
|---|---|---|
| ARO at beginning of year | **$257** | $242 |
| Accretion expense | **21** | 19 |
| Obligations incurred: | | |
| Adoption of FIN 47 | **17** | |
| Other | **3** | |
| Obligations settled | | (4) |
| ARO at end of year | **$298** | $257 |

The pro forma ARO liability balances calculated as if FIN 47 had been adopted on January 1, 2003, would not have been significantly different than those calculated at December 31, 2005.

The pro forma income statement effects, including the effects on income from continuing operations, net income, and basic and diluted EPS, from the application of FIN 47 calculated as if it had been adopted prior to January 1, 2003, also would have been insignificant for 2003, 2004 and 2005.

*Nuclear Decommissioning*

The expected cost to decommission the Susquehanna plant is based on a 2002 site-specific study that estimated the cost to dismantle and decommission each unit immediately following final shutdown. PPL Susquehanna's 90% share of the total estimated cost of decommissioning the Susquehanna plant was approximately $936 million measured in 2002 dollars. This estimate includes decommissioning the radiological portions of the station and the cost of removal of non-radiological structures and materials.

Beginning in January 1999, in accordance with the PUC Final Order, approximately $130 million of decommissioning costs are being recovered from PPL Electric's customers through the CTC over the 11-year life of the CTC rather than the remaining life of Susquehanna. The recovery includes a return on unamortized decommissioning costs. Under the power supply agreements between PPL Electric and PPL EnergyPlus, these revenues are passed on to PPL EnergyPlus. Similarly, these revenues are passed on to PPL Susquehanna under a power supply agreement between PPL EnergyPlus and PPL Susquehanna.

Accretion expense, as determined under the provisions of SFAS 143, was $19 million in 2005, $18 million in 2004 and $16 million in 2003, and is included in "Other operation and maintenance" on the Statement of Income. Accrued nuclear decommissioning expenses, as determined under the provisions of SFAS 143, were $255 million and $236 million at December 31, 2005 and 2004, and are included in "Asset Retirement Obligations" on the Balance Sheet.

Amounts collected from PPL Electric's customers for decommissioning, less applicable taxes, are deposited in external trust funds for investment and can only be used for future decommissioning costs. To the extent that the actual costs for decommissioning exceed the amounts in the nuclear decommissioning trust funds, PPL Susquehanna would be obligated to fund 90% of the shortfall.

Investments in the trust funds for decommissioning the nuclear plant are classified as available-for-sale. The following tables show the fair values and gross unrealized gains and gross unrealized losses for the securities held in the trust funds.

| | **December 31, 2005** | | |
|---|---|---|---|
| | **Gross Unrealized Gains** | **Gross Unrealized Losses** | **Fair Value** |
| Cash and cash equivalents | | | **$ 10** |
| Equity securities | **$85** | **$(2)** | **295** |
| Debt securities | | | |
| Government | **1** | **(2)** | **119** |
| Other | | | **20** |
| Total debt securities | **1** | **(2)** | **139** |
| Total | **$86** | **$(4)** | **$444** |

| | December 31, 2004 | | |
|---|---|---|---|
| | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| Cash and cash equivalents | | | $ 11 |
| Equity securities | $70 | | 279 |
| Debt securities | | | |
| Government | 1 | $(3) | 102 |
| Other | | | 17 |
| Total debt securities | 1 | (3) | 119 |
| Total | $71 | $(3) | $409 |

At December 31, 2005, PPL Susquehanna's nuclear decommissioning trust funds contained investments with an aggregate unrealized loss position of approximately $4 million, of which $2 million was attributable to investments with an aggregate fair value of approximately $69 million that have been in a continuous unrealized loss position for less than 12 months and $2 million was attributable to investments with an aggregate fair value of approximately $40 million that have been in a continuous unrealized loss position for 12 months or longer. The equity securities' unrealized loss position consists of 132 investments with an aggregate fair value of $20 million and an average unrealized loss of 7%. The largest unrealized loss for any individual investment was $387 thousand, which represents a decrease in value of only 15%.

The minor decline in the value of government securities is primarily due to the impact of interest rates as such securities are essentially free of credit risk. Currently, PPL Susquehanna believes it is reasonable to expect these securities to recover from this temporary decline in value.

At December 31, 2004, PPL Susquehanna's nuclear decommissioning trust funds contained investments with an aggregate unrealized loss position of approximately $3 million, of which $1 million was attributable to investments with an aggregate fair value of approximately $56 million that had been in a continuous unrealized loss position for less than 12 months, and $2 million was attributable to investments with an aggregate fair value of approximately $29 million that had been in a continuous unrealized loss position for 12 months or longer. The minor decline in the value of government securities is primarily due to the impact of interest rates, as such securities are essentially free of credit risk.

Of the $139 million of government obligations and other debt securities held at December 31, 2005, $3 million mature within one year, $45 million mature after one year through five years, $43 million mature after five years through ten years and $48 million mature after ten years.

The following table shows proceeds from and realized gains and losses on sales of securities held in the trust.

| | **2005** | 2004 | 2003 |
|---|---|---|---|
| Proceeds from sales | **$223** | $113 | $140 |
| Gross realized gains | **10** | 3 | 14 |
| Gross realized losses [a] | **(12)** | (17) | (3) |

[a] 2004 includes a $(10) million adjustment to the net realized gains recorded in 2003. The adjustment was included in gross realized losses in this table.

The proceeds from the sales of securities are reinvested in the trust. These funds, along with deposits of amounts collected from customers, are used to pay income taxes and fees related to managing the trust. Due to the restricted nature of these investments, they are not included in cash and cash equivalents.

Net unrealized gains associated with current year activities increased accumulated other comprehensive income by:

| | **2005** | 2004 | 2003 |
|---|---|---|---|
| Pre-tax | **$12** | $24 | $41 |
| After-tax | **7** | 15 | 23 |

Net gains (losses) reclassified from accumulated other comprehensive income and realized in "Other Income – net" on the Statement of Income were:

| | **2005** | 2004 | 2003 |
|---|---|---|---|
| Pre-tax | **$(2)** | $(14) | $11 |
| After-tax | **(1)** | (8) | 6 |

PPL Susquehanna intends to file with the NRC in 2006 for license renewals for each of the Susquehanna units to extend their expirations by 20 years, from 2022 to 2042 for Unit 1 and from 2024 to 2044 for Unit 2.

# 22. Variable Interest Entities

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51." FIN 46 clarified that variable interest entities, as defined therein, that do not disperse risks among the parties involved should be consolidated by the entity that is determined to be the primary beneficiary. In December 2003, the FASB revised FIN 46 by issuing Interpretation No. 46 (revised December 2003), "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51," which is known as FIN 46(R) and replaces FIN 46. FIN 46(R) does not change the general consolidation concepts of FIN 46. Among other things, FIN 46(R) clarifies certain provisions of FIN 46 and provides additional scope exceptions for certain types of businesses. FIN 46 applied immediately to variable interest entities created after January 31, 2003, and to variable interest entities in which an enterprise obtained an interest after January 31, 2003. FIN 46(R) provides that a public entity that is not a small business issuer (i) should apply FIN 46 or FIN 46(R) to entities that are considered to be SPEs no later than the end of the first reporting period that ends after December 15, 2003 and (ii) should apply the provisions of FIN 46(R) to all entities no later than the end of the first reporting period that ends after March 15, 2004.

As permitted by FIN 46(R), PPL and its subsidiaries adopted FIN 46 effective December 31, 2003, for entities created before February 1, 2003, that are considered to be SPEs. This adoption resulted in the consolidation of the lessors under the operating leases for the Sundance, University Park and Lower Mt. Bethel generation facilities, as well as the deconsolidation of two wholly owned trusts. See below for further discussion. Also, as permitted by FIN 46(R), PPL and its subsidiaries deferred the application of FIN 46 for other entities and adopted FIN 46(R) for all entities on March 31, 2004. The adoption of FIN 46(R) did not have a material impact on the results of PPL and its subsidiaries.

*Additional Entities Consolidated*

In May 2001, a subsidiary of PPL entered into a lease arrangement, as lessee, for the development, construction and operation of commercial power generation facilities. The lessor was created for the sole purpose of owning the facilities and incurring the related financing costs. The $660 million operating lease arrangement covered the 450 MW gas-fired Sundance project located in Pinal County, Arizona and the 540 MW gas-fired University Park project near University Park, Illinois. These facilities were substantially complete in July 2002, at which time the initial lease term commenced. In June 2004, PPL subsidiaries purchased the Sundance and University Park generation assets from the lessor. In May 2005, a subsidiary of PPL completed the sale of its Sundance generation assets to Arizona Public Service Company. See Note 9 for further discussion of the sale.

In December 2001, another subsidiary of PPL entered into a $455 million operating lease arrangement, as lessee, for the development, construction and operation of a 582 MW gas-fired combined-cycle generation facility located in Lower Mt. Bethel Township, Northampton County, Pennsylvania. The lessor was created for the sole purpose of owning the facilities and incurring the related financing costs. The initial lease term commenced on the date of commercial operation, which occurred in May 2004, and ends in December 2013. The lease financing, which is included in "Long-term Debt," is secured by,

among other things, the generation facility. At December 31, 2005 and 2004, the facility had a carrying value of $459 million and $470 million, net of accumulated depreciation and amortization of $25 million and $10 million, and was included in "Property, Plant and Equipment" and "Other acquired intangibles" on the Balance Sheet.

PPL was required to consolidate the financial statements of the lessors under the operating leases for the Sundance, University Park and Lower Mt. Bethel generation facilities effective December 31, 2003, since it was the primary beneficiary of these entities. Upon initial consolidation, PPL recognized a charge of $27 million (net of a tax benefit of $18 million) as a cumulative effect of a change in accounting principle.

*Entities Deconsolidated*

Effective December 31, 2003, PPL deconsolidated PPL Capital Funding Trust I and SIUK Capital Trust I. These trusts were deconsolidated because PPL was not the primary beneficiary of the trusts under interpretations of FIN 46. The deconsolidation of the trusts did not impact the earnings of PPL. See below for a discussion of PPL's interest in the trusts. See Note 15 for a discussion of the presentation of the related party debt.

In May 2001, PPL and PPL Capital Funding Trust I, a wholly owned financing subsidiary of PPL, issued $575 million of 7.75% PEPS Units. Each PEPS Unit consisted of (i) a contract to purchase shares of PPL common stock on or prior to May 2004 and (ii) a trust preferred security of PPL Capital Funding Trust I with a maturity date of May 2006. The trust's sole source of funds for distributions were from payments of interest on 7.29% subordinated notes of PPL Capital Funding, due May 18, 2006, that were issued to the trust. PPL guaranteed the payment of principal and interest on the subordinated notes issued to the trust by PPL Capital Funding. PPL also fully and unconditionally guaranteed all of the trust's obligations under the trust preferred securities. All of the preferred securities of PPL Capital Funding Trust I were cancelled in 2004, and the trust was terminated in June 2004.

SIUK Capital Trust I issued $82 million of 8.23% preferred securities maturing in February 2027 and invested the proceeds in 8.23% subordinated debentures maturing in February 2027 issued by SIUK Limited. Thus, the preferred securities are supported by a corresponding amount of subordinated debentures. SIUK Limited owned all of the common securities of SIUK Capital Trust I and guaranteed all of SIUK Capital Trust I's obligations under the preferred securities. In January 2003, SIUK Limited transferred its assets and liabilities, including the common securities of SIUK Capital Trust I and the obligations under the subordinated debentures, to WPD LLP. Therefore, WPD LLP currently guarantees all of SIUK Capital Trust I's obligations under the preferred securities. SIUK Capital Trust I may, at the discretion of WPD LLP, redeem the preferred securities, in whole or in part, at 104.115% of par beginning February 2007 and thereafter at an annually declining premium over par through January 2017, after which time they are redeemable at par.

# 23. New Accounting Standards

**SFAS 123(R)**

In December 2004, the FASB issued SFAS 123 (revised 2004), "Share-Based Payment," which is known as SFAS 123(R) and replaces SFAS 123, "Accounting for Stock-Based Compensation," as amended by SFAS 148, "Accounting for Stock-Based Compensation-Transition and Disclosure." Among other things, SFAS 123(R) eliminates the alternative to use the intrinsic value method of accounting for stock-based compensation. SFAS 123(R) requires public entities to recognize compensation expense for awards of equity instruments to employees based on the grant-date fair value of the awards. SFAS 123(R) was originally effective for public entities that do not file as small business issuers as of the beginning of the first interim or annual period that begins after June 15, 2005. However, in April 2005, the SEC issued a rule that amended Regulation S-X to change this effective date to the beginning of an entity's fiscal year that begins on or after June 15, 2005.

SFAS 123(R) requires public entities to apply the modified prospective application transition method of adoption. Under this application, entities must recognize compensation expense based on the grant-date fair value for new awards granted or modified after the effective date and for unvested awards outstanding on the effective date. Additionally, public entities may choose to apply modified retrospective application to periods before the effective date of SFAS 123(R). This application may be applied either to all prior years for which SFAS 123 was effective or only to prior interim periods in the year of initial adoption of SFAS 123(R). Under modified retrospective application, prior periods would be adjusted to recognize compensation expense as though stock-based awards granted, modified or settled in cash in fiscal years beginning after December 15, 1994, had been accounted for under SFAS 123.

PPL and its subsidiaries adopted SFAS 123(R) effective January 1, 2006. PPL and its subsidiaries will not apply modified retrospective application to any periods prior to the date of adoption. The adoption of SFAS 123(R) is not expected to have a significant impact on PPL and its subsidiaries, since PPL and its subsidiaries adopted the fair value method of accounting for stock-based compensation, as described by SFAS 123, effective January 1, 2003.

**SFAS 155**

In February 2006, the FASB issued SFAS 155, "Accounting for Certain Hybrid Financial Instruments, an amendment of FASB Statements No. 133 and 140." Among other items, SFAS 155 addresses certain accounting issues surrounding securitized financial assets and hybrid financial instruments with embedded derivatives that require bifurcation. PPL and its subsidiaries must adopt SFAS 155 no later than January 1, 2007. PPL and its subsidiaries are currently in the process of performing a complete assessment of SFAS 155. However, since PPL and its subsidiaries do not have any interests in securitized financial assets or hybrid financial instruments with embedded derivatives that require bifurcation, the impact from the adoption of SFAS 155 is not expected to be material.

**FIN 47**

See Note 21 for a discussion of FIN 47, "Accounting for Conditional Asset Retirement Obligations, an Interpretation of FASB Statement No. 143," and the impact of its adoption.

# RECONCILIATION OF FINANCIAL MEASURES (UNAUDITED)

Millions of dollars, except per share data

"Net Income" is a financial measure determined in accordance with generally accepted accounting principles (GAAP). "Earnings from Ongoing Operations" as referenced in this Annual Report, is a non-GAAP financial measure. However, PPL's management believes that it provides useful information to investors, as a supplement to the comparable GAAP financial measure. Following is additional information on this non-GAAP financial measure, including a reconciliation to Net Income.

"Earnings from Ongoing Operations" excludes the impact of unusual items. Earnings from ongoing operations should not be considered as an alternative to net income, which is an indicator of operating performance determined in accordance with GAAP. PPL believes that earnings from ongoing operations, although a non-GAAP measure, is also useful and meaningful to investors because it provides them with PPL's underlying earnings performance as another criterion in making their investment decisions. PPL's management also uses earnings from ongoing operations in measuring certain corporate performance goals. Other companies may use different measures to present financial performance.

### Reconciliation of Earnings from Ongoing Operations and Net Income*

| | *(Millions of Dollars)* | | *(Per Share – Diluted)* | |
|---|---|---|---|---|
| | **2005** | 2004 | **2005** | 2004 |
| **Earnings from Ongoing Operations** | **$ 798** | $690 | **$ 2.08** | $ 1.87 |
| Unusual Items (net of tax): | | | | |
| PJM billing dispute | **(27)** | | **(0.07)** | |
| NorthWestern litigation | **(6)** | | **(0.02)** | |
| Sale of Sundance plant | **(47)** | | **(0.12)** | |
| Stock-based compensation adjustment | **(5)** | | **(0.01)** | |
| Off-site remediation of ash basin leak | **(27)** | | **(0.07)** | |
| Conditional asset retirement obligation | **(8)** | | **(0.02)** | |
| Impairment of investment in technology supplier | | (6) | | (0.02) |
| Sale of CGE | | (7) | | (0.02) |
| Sale of CEMAR | | 23 | | 0.06 |
| Discontinued operations | | (2) | | |
| *Total Unusual Items* | **(120)** | 8 | **(0.31)** | 0.02 |
| **Net Income** | **$ 678** | $698 | **$ 1.77** | $ 1.89 |

### Reconciliation of Business Segment Earnings from Ongoing Operations and Net Income*

| *For the year ended December 31, 2005* | Supply | International Delivery | Pennsylvania Delivery | Total |
|---|---|---|---|---|
| **Earnings from Ongoing Operations** | $ 402 | $ 215 | $ 181 | $ 798 |
| Unusual Items | (91) | | (29) | (120) |
| **Net Income** | **$311** | **$215** | **$152** | **$ 678** |

*See pages 25, 26 and 27 in Management's Discussion and Analysis for financial statement note references for each of these unusual items for 2005 and 2004.

### Key Earnings Forecast Assumptions

For 2006 forecast:

- Increased generation prices under the Pennsylvania PLR contract.
- Higher generation output.
- Expiring wholesale energy contracts replaced by new contracts at current forward prices.
- Lower purchased power costs.
- Increased fuel and fuel transportation costs.
- Higher operation and maintenance expenses.
- Reduced synfuel earnings due to oil prices.
- Flat Pennsylvania delivery revenues.
- Higher U.S. taxes on foreign earnings.
- *Unfavorable foreign currency effects.*

For 2010 CAGR forecast:

- Expiring wholesale energy contracts replaced by new contracts at current forward prices, most importantly the Pennsylvania PLR contract expiring at the end of 2009.
- Current projections of fuel and emission allowance prices, fuel transportation costs and other costs of operating the business.
- Annual increases in the generation prices under the Pennsylvania PLR contract.
- Incremental capacity increases of about 260 megawatts at several existing generating facilities
- Net economic benefits from the installation of scrubbers at the Montour and Brunner Island generating plants.
- Reduced synfuel earnings due to oil prices and the expiration of synfuel tax credits after 2007.
- Higher fuel costs and operation and maintenance expenses.

## Glossary of Terms and Abbreviations

### PPL Corporation and its current and former subsidiaries

**CEMAR** – Companhia Energética do Maranhão, a Brazilian electric distribution company in which PPL Global had a majority ownership interest until the transfer of this interest in April 2004.

**CGE** – Compañia General de Electricidad, S.A., a distributor of electricity and natural gas with other industrial segments in Chile and Argentina in which PPL Global had an 8.7% direct and indirect minority ownership interest until the sale of this interest in March 2004.

**DelSur** – Distribuidora de Electricidad Del Sur, S.A. de C.V., an electric distribution company in El Salvador, a majority of which is owned by EC.

**EC** – Electricidad de Centroamerica, S.A. de C.V., an El Salvadoran holding company and the majority owner of DelSur. EC was also the majority owner of El Salvador Telecom, S.A. de C.V. until the sale of this company in June 2004. PPL Global has 100% ownership of EC.

**Elfec** – Empresa de Luz y Fuerza Electrica Cochabamba S.A., a Bolivian electric distribution company in which PPL Global has a majority ownership interest.

**Emel** – Empresas Emel S.A., a Chilean electric distribution holding company in which PPL Global has a majority ownership interest.

**Griffith** – a 600 MW gas-fired station in Kingman, Arizona, that is jointly owned by indirect subsidiaries of PPL Generation and Duke Energy Corporation.

**Hyder** – Hyder Limited, a subsidiary of WPDL that was the previous owner of South Wales Electricity plc. In March 2001, South Wales Electricity plc was acquired by WPDH Limited and renamed WPD (South Wales).

**Integra** – Empresa de Ingenieria y Servicios Integrales Cochabamba S.A., a Bolivian construction and engineering services company in which PPL Global has a majority ownership interest.

**PPL** – PPL Corporation, the parent holding company of PPL Electric, PPL Energy Funding and other subsidiaries.

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

**PPL Capital Funding Trust I** – a Delaware statutory business trust created to issue the Preferred Security component of the PEPS Units. This trust was terminated in June 2004.

**PPL Development Company** – PPL Development Company, LLC, a subsidiary of PPL Services that has responsibility for PPL's acquisition, divestiture and development activities.

**PPL Electric** – PPL Electric Utilities Corporation, a regulated utility subsidiary of PPL that transmits and distributes electricity in its service territory and provides electric supply to retail customers in this territory as a PLR.

**PPL Energy Funding** – PPL Energy Funding Corporation, a subsidiary of PPL and the parent company of PPL Energy Supply.

**PPL EnergyPlus** – PPL EnergyPlus, LLC, a subsidiary of PPL Energy Supply that markets wholesale and retail electricity, and supplies energy and energy services in deregulated markets.

**PPL Energy Supply** – PPL Energy Supply, LLC, a subsidiary of PPL Energy Funding and the parent company of PPL Generation, PPL EnergyPlus, PPL Global and other subsidiaries.

**PPL Gas Utilities** – PPL Gas Utilities Corporation, a regulated utility subsidiary of PPL that specializes in natural gas distribution, transmission and storage services, and the competitive sale of propane.

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

**PPL Global** – PPL Global, LLC, a subsidiary of PPL Energy Supply that owns and operates international energy businesses that are focused on the regulated distribution of electricity.

**PPL Maine** – PPL Maine, LLC, a subsidiary of PPL Generation that owns generating operations in Maine.

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

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

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

**PPL Services** – PPL Services Corporation, a subsidiary of PPL that provides shared services for PPL and its subsidiaries.

**PPL Susquehanna** – PPL Susquehanna, LLC, the nuclear generating subsidiary of PPL Generation.

**PPL Telcom** – PPL Telcom, LLC, an indirect subsidiary of PPL Energy Funding that delivers high bandwidth telecommunication services in the Northeast corridor from Washington, D.C., to New York City and to six metropolitan areas in central and eastern Pennsylvania.

**PPL Transition Bond Company** – PPL Transition Bond Company, LLC, a subsidiary of PPL Electric that was formed to issue transition bonds under the Customer Choice Act.

**SIUK Capital Trust I** – a business trust created to issue preferred securities and whose common securities are held by WPD LLP.

**SIUK Limited** – was an intermediate holding company within the WPDH Limited group. In January 2005, SIUK Limited transferred its assets and liabilities to WPD LLP.

**WPD** – refers collectively to WPDH Limited and WPDL.

**WPD LLP** – Western Power Distribution LLP, a wholly owned subsidiary of WPDH Limited, which owns WPD (South West) and WPD (South Wales).

**WPD (South Wales)** – Western Power Distribution (South Wales) plc, a British regional electric utility company.

**WPD (South West)** – Western Power Distribution (South West) plc, a British regional electric utility company.

**WPDH Limited** – Western Power Distribution Holdings Limited, an indirect, wholly owned subsidiary of PPL Global. WPDH Limited owns WPD LLP.

**WPDL** – WPD Investment Holdings Limited, an indirect wholly owned subsidiary of PPL Global. WPDL owns 100% of the common shares of Hyder.

## Other terms and abbreviations

**£** – British pounds sterling.

**1945 First Mortgage Bond Indenture** – PPL Electric's Mortgage and Deed of Trust, dated as of October 1, 1945, to Deutsche Bank Trust Company Americas, as trustee, as supplemented.

**2001 Senior Secured Bond Indenture** – PPL Electric's Indenture, dated as of August 1, 2001, to JPMorgan Chase Bank, as trustee, as supplemented.

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

**APA** – Asset Purchase Agreement.

**APB** – Accounting Principles Board.

**ARB** – Accounting Research Bulletin.

**ARO** – asset retirement obligation.

**Bcf** – billion cubic feet.

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

**CTC** – competitive transition charge on customer bills to recover allowable transition costs under the Customer Choice Act.

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

**DEP** – Department of Environmental Protection, a state government agency.

**Derivative** – a financial instrument or other contract with all three of the following characteristics:

**a.** It has (1) one or more underlyings and (2) one or more notional amounts or payment provisions or both. Those terms determine the amount of the settlement or settlements, and, in some cases, whether or not a settlement is required.

**b.** It requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors.

**c.** Its terms require or permit net settlement, it can readily be settled net by a means outside the contract, or it provides for delivery of an asset that puts the recipient in a position not substantially different from net settlement.

**DIG** – Derivatives Implementation Group.

**DOE** – Department of Energy, a U.S. government agency.

**DRIP** – Dividend Reinvestment Plan.

**EITF** – Emerging Issues Task Force, an organization that assists the FASB in improving financial reporting through the identification, discussion and resolution of financial accounting issues within the framework of existing authoritative literature.

**EMF** – electric and magnetic fields.

**Enrichment** – the concentration of fissionable isotopes to produce a fuel suitable for use in a nuclear reactor.

**EPA** – Environmental Protection Agency, a U.S. government agency.

**EPS** – earnings per share.

**ESOP** – Employee Stock Ownership Plan.

**Fabrication** – the process that manufactures nuclear fuel assemblies for insertion into the reactor.

**FASB** – Financial Accounting Standards Board, a rulemaking organization that establishes financial accounting and reporting standards.

**FERC** – Federal Energy Regulatory Commission, the federal agency that regulates interstate transmission and wholesale sales of electricity and related matters.

**FIN** – FASB Interpretation.

**Fitch** – Fitch, Inc.

**FSP** – FASB Staff Position.

**FTR** – financial transmission rights, which are financial instruments established to manage price risk related to electricity transmission congestion. They entitle the holder to receive compensation or remit payment for certain congestion-related transmission charges that arise when the transmission grid is congested.

**GAAP** – generally accepted accounting principles.

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

**ICP** - Incentive Compensation Plan.

**ICPKE** – Incentive Compensation Plan for Key Employees.

**IRS** – Internal Revenue Service, a U.S. government agency.

**ISO** – Independent System Operator.

**ITC** – intangible transition charge on customer bills to recover intangible transition costs associated with securitizing stranded costs under the Customer Choice Act.

**kWh** – kilowatt-hour, basic unit of electrical energy.

**LIBOR** – London Interbank Offered Rate.

**Montana Power** – The Montana Power Company, a Montana-based company that sold its generating assets to PPL Montana in December 1999. Through a series of transactions consummated during the first quarter of 2002, Montana Power sold its electricity delivery business to NorthWestern.

**Moody's** – Moody's Investors Service, Inc.

**MW** – megawatt, one thousand kilowatts.

**MWh** – megawatt-hour, one thousand kilowatt-hours.

**NorthWestern** – NorthWestern Energy Division, a Delaware corporation and a subsidiary of NorthWestern Corporation and successor in interest to Montana Power's electricity delivery business, including Montana Power's rights and obligations under contracts with PPL Montana.

**NPDES** – National Pollutant Discharge Elimination System.

**NRC** – Nuclear Regulatory Commission, the federal agency that regulates the operation of nuclear power facilities.

**NUGs (Non-Utility Generators)** – generating plants not owned by public utilities, whose electrical output must be purchased by utilities under the PURPA if the plant meets certain criteria.

**NYMEX** – New York Mercantile Exchange.

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

**PCB** – polychlorinated biphenyl, an oil additive used in certain electrical equipment up to the late 1970s. It is now classified as a hazardous chemical.

**PEPS Units (Premium Equity Participating Security Units, or PEPS℠ Units)** – securities issued by PPL and PPL Capital Funding Trust I that consisted of a Preferred Security and a forward contract to purchase PPL common stock, which settled in May 2004.

**PEPS Units, Series B (Premium Equity Participating Security Units, or PEPS℠ Units, Series B)** – securities issued by PPL and PPL Capital Funding that consisted of an undivided interest in a debt security issued by PPL Capital Funding and guaranteed by PPL, and a forward contract to purchase PPL common stock, which settled in May 2004.

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

**PLR (Provider of Last Resort)** – The role of PPL Electric in providing electricity to retail customers within its delivery territory who have not chosen to select an alternative electricity supplier under the Customer Choice Act.

**PP&E** – property, plant and equipment.

**Preferred Securities** – company-obligated mandatorily redeemable preferred securities issued by PPL Capital Funding Trust I, which solely held debentures of PPL Capital Funding, and by SIUK Capital Trust I, which solely holds debentures of WPD LLP.

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

**PUC Final Order** – final order issued by the PUC on August 27, 1998, approving the settlement of PPL Electric's restructuring proceeding.

**PUHCA** – Public Utility Holding Company Act of 1935, legislation passed by the U.S. Congress. Repealed effective February 2006 by the Energy Policy Act of 2005.

**PURPA** – Public Utility Regulatory Policies Act of 1978, legislation passed by the U.S. Congress to encourage energy conservation, efficient use of resources and equitable rates.

**PURTA** – the Pennsylvania Public Utility Realty Tax Act.

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

**RMC** – Risk Management Committee.

**RTO** – Regional Transmission Organization.

**Sarbanes-Oxley 404** – Section 404 of the Sarbanes-Oxley Act of 2002, which sets requirements for management assessment of internal controls for financial reporting. It also requires an independent auditor to attest to and report on management's assessment and make its own assessment.

**SCR** – selective catalytic reduction, a pollution control process.

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

**SFAS** – Statement of Financial Accounting Standards, the accounting and financial reporting rules issued by the FASB.

**S&P** – Standard & Poor's Ratings Services.

**SPE** – special purpose entity.

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

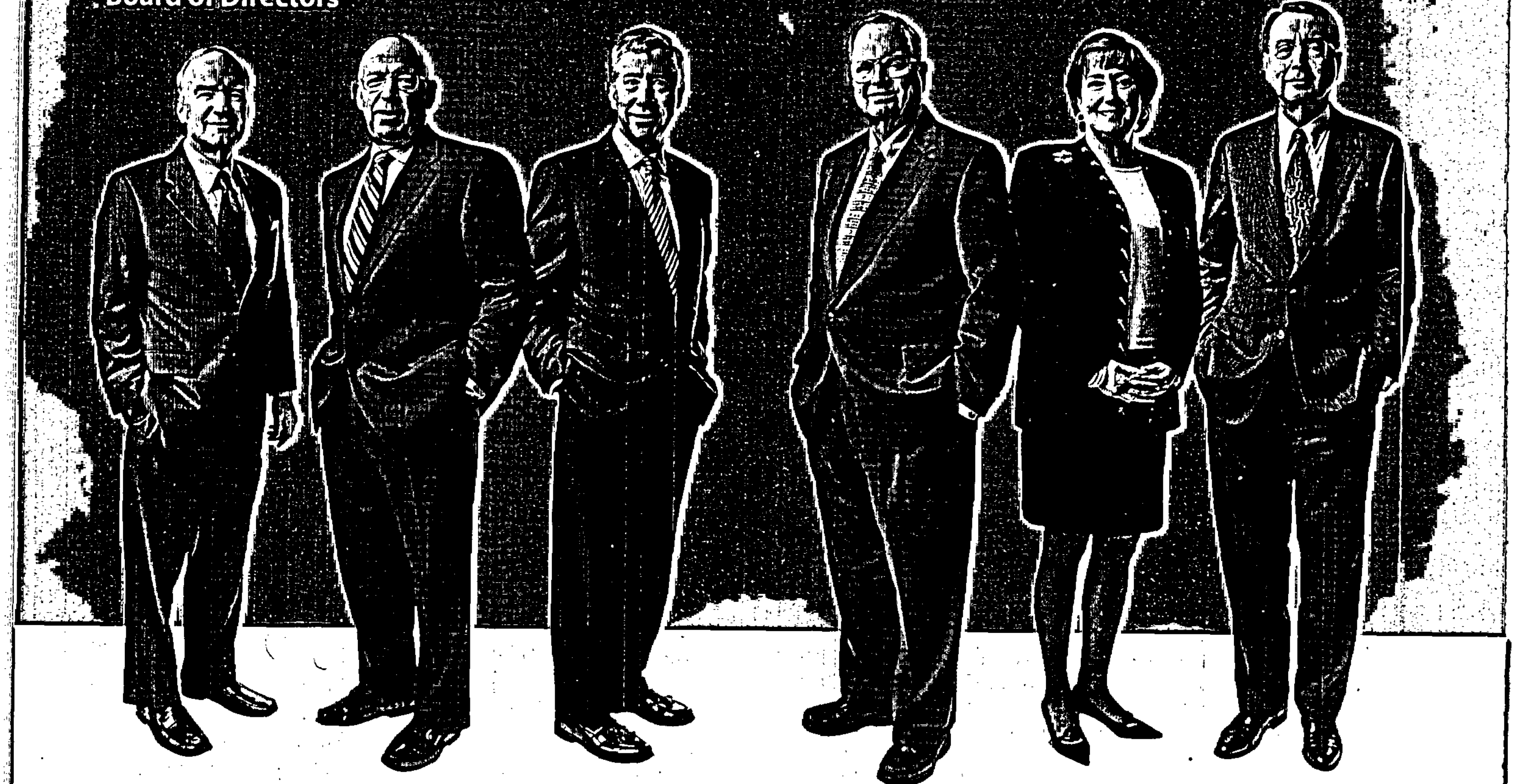
**Synfuel projects** – production facilities that manufacture synthetic fuel from coal or coal byproducts. Favorable federal tax credits are available on qualified synthetic fuel products.

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

**UF** – inflation-indexed Chilean peso-denominated unit.

**VEBA** – Voluntary Employee Benefit Association Trust, trust accounts for health and welfare plans for future benefit payments for employees, retirees or their beneficiaries.

## Board of Directors



**Frederick M. Bernthal**
*Washington, D.C.*

*President*
*Universities Research Association*
*A consortium of 90 universities engaged in the construction and operation of major research facilities*
*Age 63*
*Director since 1997*

Dr. Bernthal has served as president of URA since 1994. Prior to joining that organization, he was deputy director of the National Science Foundation. He also has served as a member of the U.S. Nuclear Regulatory Commission and as assistant secretary of state for Oceans, Environment and Science. Dr. Bernthal earned a Bachelor of Science degree in chemistry from Valparaiso University and a Ph.D. in nuclear chemistry from the University of California at Berkeley.

**John R. Biggar**
*Allentown, Pa.*

*Executive Vice President and Chief Financial Officer*
*PPL Corporation*
*Age 61*
*Director since 2001*

Mr. Biggar has served as executive vice president and chief financial officer of PPL Corporation since 2001. He also serves as a director of PPL Electric Utilities Corporation, a manager of PPL Energy Supply, LLC and PPL Transition Bond Company, LLC, and as a trustee of Lycoming College. He began his career with PPL in 1969. Prior to being named to his current position, Mr. Biggar served as senior vice president and chief financial officer as well as vice president-Finance. Mr. Biggar earned a bachelor's degree in political science from Lycoming College and a Juris Doctor degree from Syracuse University.

**John W. Conway**
*Philadelphia, Pa.*

*Chairman of the Board, President and Chief Executive Officer*
*Crown Holdings, Inc.*
*A leading international manufacturer of packaging products for consumer goods*
*Age 60*
*Director since 2000*

Mr. Conway has served as Crown's top executive since 2001. Prior to that, he had been president and chief operating officer of the company. Mr. Conway joined Crown, Cork & Seal in 1991 as a result of its acquisition of Continental Can International Corporation, where he served as president and in various management positions. He earned a Bachelor of Arts degree in economics from the University of Virginia and a law degree from Columbia Law School.

**E. Allen Deaver**
*Lancaster, Pa.*

*Former Executive Vice President and Director*
*Armstrong World Industries, Inc.*
*Manufacturer of interior furnishings and specialty products*
*Age 70*
*Director since 1991*

Mr. Deaver retired from Armstrong in 1998, after a career of 37 years, spanning a number of key management positions. He also serves as a director of the Geisinger Health System. He earned a Bachelor of Science degree in mechanical engineering from the University of Tennessee.

**Louise K. Goeser**
*Mexico City, Mexico*

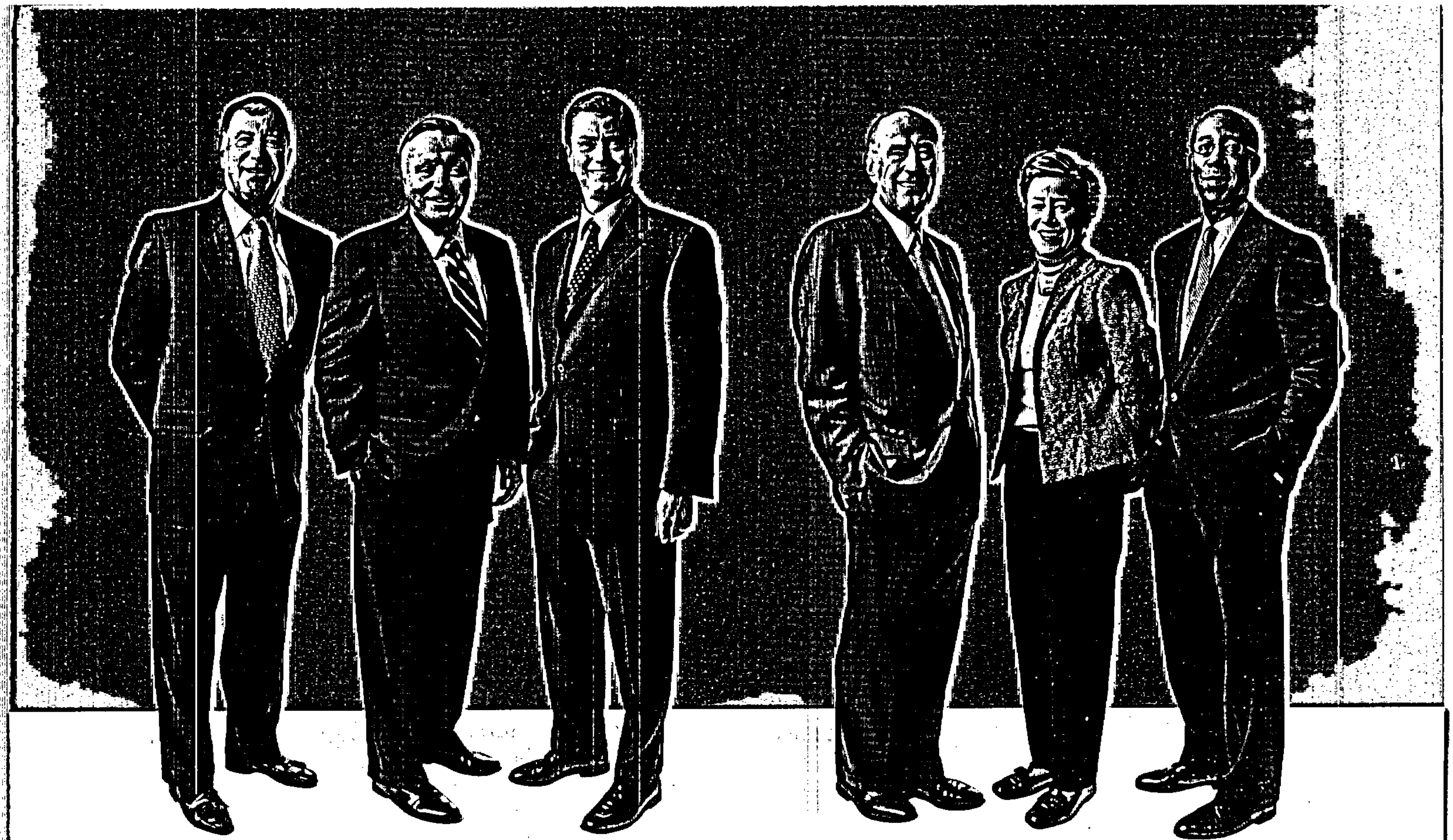
*President and Chief Executive Officer*
*Ford of Mexico*
*Manufacturer of cars, trucks and related parts and accessories*
*Age 52*
*Director since 2003*

Ms. Goeser served as vice president, Global Quality, at Ford Motor Company for five years before being named to her present position with Ford's Mexican subsidiary in 2005. Previously, she headed Whirlpool Corporation's quality and refrigeration units. Ms. Goeser started her career with Westinghouse Electric Corporation, where – over a 20-year period – she held a variety of key positions in the Energy Systems and Environmental businesses. She earned a bachelor's degree in mathematics from Pennsylvania State University and a Master of Business Administration degree from the University of Pittsburgh.

**William F. Hecht**
*Allentown, Pa.*

*Chairman and Chief Executive Officer*
*PPL Corporation*
*Age 63*
*Director since 1990*

Mr. Hecht has served as PPL's top executive since 1993. Prior to that, he served as president and chief operating officer for two years. He also serves as a director of PPL Electric Utilities Corporation, DENTSPLY International Inc., the Federal Reserve Bank of Philadelphia and RenaissanceRe Holdings Ltd. Mr. Hecht, who earned bachelor's and master's degrees in electrical engineering from Lehigh University, joined PPL in 1964.



**Stuart Heydt**
*Hershey, Pa.*

*Former Chief Executive Officer*
*Geisinger Health System*
*A nonprofit health care provider*
*Age 66*
*Director since 1991*

Dr. Heydt retired in 2000 as chief executive officer of the Geisinger Health System, an institution that he directed for eight years. He is past president and a Distinguished Fellow of the American College of Physician Executives. Dr. Heydt attended Dartmouth College and received an M.D. from the University of Nebraska.

**James H. Miller**
*Allentown, Pa.*

*President and Chief Operating Officer*
*PPL Corporation*
*Age 57*
*Director since 2005*

Mr. Miller served as executive vice president and chief operating officer before being named to his current position in August 2005. He also serves as a director of PPL Electric Utilities Corporation and as a manager of PPL Energy Supply, LLC. Mr. Miller joined PPL in February 2001 as president of PPL Generation and was named executive vice president of PPL Corporation in January 2004 and chief operating officer in August 2004. He earned a bachelor's degree in electrical engineering from the University of Delaware and served in the U.S. Navy nuclear submarine program.

**Craig A. Rogerson**
*Wilmington, Del.*

*President and Chief Executive Officer*
*Hercules Incorporated*
*Manufacturer and marketer of specialty chemicals and related services*
*Age 49*
*Director since 2005*

Mr. Rogerson has served as the top executive at Hercules since 2003. He joined Hercules in 1979 and served in a number of management positions, including president of several Hercules subsidiaries, before being named to his current position. From 1997 to 2000, he served as president and chief executive officer of Wacker Silicones Corporation. He also serves as a director of Hercules, and serves on the board of the American Chemistry Council. Mr. Rogerson earned a chemical engineering degree from Michigan State University.

**W. Keith Smith**
*Pittsburgh, Pa.*

*Former Vice Chairman*
*Mellon Financial Corporation*
*Major financial services company*
*Age 71*
*Director since 2000*

Mr. Smith served as vice chairman of Mellon Financial Corporation and senior vice chairman of Mellon Bank, N.A., before his retirement in 1998. He also is a director of DENTSPLY International Inc., West Penn Allegheny Health System, Invesmart, Inc., Baytree Bancorp, Inc., Baytree National Bank and Trust Co. and Robert Morris University, and serves as the Chairman of the Board of Allegheny General Hospital. Mr. Smith earned a Bachelor of Commerce degree from the University of Saskatchewan and a Master of Business Administration degree from the University of Western Ontario, and is a Chartered Accountant.

**Susan M. Stalnecker**
*Wilmington, Del.*

*Vice President*
*Risk Management*
*E.I. du Pont de Nemours and Company*
*Manufacturer of pharmaceuticals, specialty chemicals, biotechnology and high-performance materials*
*Age 53*
*Director since 2001*

Ms. Stalnecker served as vice president–Government and Consumer Markets, DuPont Safety & Protection for over two years, and as vice president–Finance and treasurer for over four years before being named to her current position in June 2005. She also serves on the board of Duke University and is president of the Board of Trustees of the Delaware Art Museum. Ms. Stalnecker earned a bachelor's degree from Duke University and a Master of Business Administration degree from the Wharton School of Graduate Business at the University of Pennsylvania.

**Keith H. Williamson**
*Stamford, Conn.*

*President*
*Capital Services Division*
*Pitney Bowes Inc.*
*Global provider of integrated mail, messaging and document management solutions*
*Age 53*
*Director since 2005*

Mr. Williamson has served as president of the Capital Services Division of Pitney Bowes Inc., since 1999. He joined Pitney Bowes in 1988 and held a series of positions in the company's tax, finance and legal operations, including oversight of the treasury function and rating agency activity. Mr. Williamson earned a Bachelor of Arts degree from Brown University, Juris Doctor and Master of Business Administration degrees from Harvard University, and a Master of Law degree in taxation from New York University Law School.

## Board Committees

**Executive Committee**

William F. Hecht, Chair
Frederick M. Bernthal
E. Allen Deaver
Stuart Heydt

**Audit Committee**

Stuart Heydt, Chair
Frederick M. Bernthal
W. Keith Smith
Susan M. Stalnecker

**Compensation and Corporate Governance Committee**

E. Allen Deaver, Chair
John W. Conway
Louise K. Goeser
Stuart Heydt

**Finance Committee**

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John W. Conway
E. Allen Deaver
Susan M. Stalnecker
Keith H. Williamson

**Nuclear Oversight Committee**

Frederick M. Bernthal, Chair
E. Allen Deaver
Stuart Heydt
Craig A. Rogerson

## Management and Officers

### CORPORATE LEADERSHIP COUNCIL

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Chairman and CEO
PPL Corporation

**James H. Miller**
President and COO
PPL Corporation

**John R. Biggar**
Executive VP and CFO
PPL Corporation

**Robert J. Grey**
Senior VP, General Counsel
and Secretary
PPL Corporation

### MAJOR SUBSIDIARY PRESIDENTS

**Paul T. Champagne**
PPL EnergyPlus

**Rick L. Klingensmith**
PPL Global

**Roger L. Petersen**
PPL Development Company

**Bryce L. Shriver**
PPL Generation

**John F. Sipics**
PPL Electric Utilities

### OFFICERS

**James E. Abel**
VP-Finance and Treasurer
PPL Corporation

**Robert W. Burke, Jr.**
VP and Chief Counsel
PPL Global

**Ivan Diaz-Molina**
VP-Latin America
PPL Global

**Paul A. Farr**
Senior VP-Financial
PPL Corporation

**Robert M. Geneczko**
VP-Customer Services
PPL Electric Utilities

President
PPL Gas Utilities

**C. Joseph Hopf, Jr.**
Senior VP-Energy Marketing
PPL EnergyPlus

**George T. Jones**
VP-Special Projects
PPL Susquehanna

**David H. Kelley**
President
PPL Telcom

**Michael E. Kroboth**
VP-Energy Services
PPL EnergyPlus

**Britt T. McKinney**
Senior VP and CNO
PPL Generation

**Dennis J. Murphy**
VP and COO-Eastern Fossil
and Hydro
PPL Generation

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VP-Corporate Information Officer
PPL Services

**Joanne H. Raphael**
VP-External Affairs
PPL Services

**Robert A. Saccone**
VP-Nuclear Operations
PPL Susquehanna

**Ronald Schwarz**
VP-Human Resources
PPL Services

**Matt Simmons**
VP and Controller
PPL Corporation

**Vijay Singh**
VP-Risk Management
PPL Services

**Bradley E. Spencer**
VP and COO-Western Fossil
and Hydro
PPL Generation

**Robert A. Symons**
Chief Executive
Western Power Distribution

VP-United Kingdom
PPL Global

# Shareowner Information

## Annual Meeting
Shareowners are invited to attend the annual meeting to be held on Friday, April 28, 2006, at the Holiday Inn in Fogelsville, Pennsylvania, in Lehigh County. The meeting will begin at 10 a.m. (EDT).

## Stock Exchange Listings
PPL Corporation common stock is listed on the New York and Philadelphia stock exchanges. The symbol is PPL.

The company has filed with the SEC, as exhibits to its 2005 Annual Report on Form 10-K, the certifications of the company's Chief Executive Officer and its Chief Financial Officer required under Sections 302 and 906 of the Sarbanes-Oxley Act of 2002. In addition, in 2005 the company submitted to the New York Stock Exchange (NYSE) and the Philadelphia Stock Exchange (PHLX) the required annual certifications of the company's Chief Executive Officer that he was not aware of any violation by the company of the NYSE's or PHLX's corporate governance listing standards.

## Common Stock Prices

| 2005 | High* | Low* | Dividends* Declared |
|---|---|---|---|
| 1st quarter | $27.95 | $25.52 | $.23 |
| 2nd quarter | 29.99 | 26.13 | .23 |
| 3rd quarter | 33.51 | 29.75 | .25 |
| 4th quarter | 33.68 | 28.25 | .25 |

| 2004 | High* | Low* | Dividends* Declared |
|---|---|---|---|
| 1st quarter | $23.62 | $21.37 | $.205 |
| 2nd quarter | 23.49 | 19.92 | .205 |
| 3rd quarter | 24.20 | 22.35 | .205 |
| 4th quarter | 27.08 | 23.57 | .205 |

The company has paid quarterly cash dividends on its common stock in every year since 1946. The dividends declared per share in 2005 and 2004 were $0.96* and $0.82*, respectively. The most recent regular quarterly dividend paid by the company was 25 cents per share, paid Jan. 1, 2006. On Feb. 24, 2006, the company increased its quarterly dividend to $0.275 per share (equivalent to $1.10 per year), effective with the quarterly dividend payable April 1, 2006, to holders of record on March 10, 2006.

* Stock prices and dividends declared for 2004 and for 2005 have been adjusted for the 2-for-1 stock split, effective Aug. 24, 2005.

## Dividends
The planned dates for consideration of the declaration of dividends by the board of directors or its Executive Committee for the balance of 2006 are May 26, Aug. 25 and Nov. 17. Subject to the declaration, dividends are paid on the first day of April, July, October and January. Dividend checks are mailed in advance of those dates with the intention that they arrive as close as possible to the payment dates. The record dates for dividends for the balance of 2006 are expected to be June 9, Sept. 8 and Dec. 8.

## Duplicate Mailings
If you have more than one account, or if there is more than one investor in your household, you may contact PPL Investor Services to request that only one annual report be delivered to your address. Please provide account numbers for all duplicate mailings.

## Form 10-K
PPL Corporation's annual report on Form 10-K, filed with the Securities and Exchange Commission, is available about mid-March. Investors may obtain a copy, at no cost, by calling the PPL Shareowner Information Line or by accessing the report via the company's Web site.

## PPL Shareowner Information Line (1-800-345-3085)
Shareowners can get detailed corporate and financial information 24 hours a day using the PPL Shareowner Information Line. They can hear timely recorded messages about earnings, dividends and other company news releases; request information by fax; and request printed materials in the mail. Other PPL publications, such as the annual and quarterly reports to the Securities and Exchange Commission (Forms 10-K and 10-Q) will be mailed upon request.

## PPL's Web Site (www.pplweb.com)
Shareowners can access PPL Securities and Exchange Commission filings, corporate governance materials, news releases, stock quotes and historical performance. Visitors to our Web site can provide their e-mail address and indicate their desire to receive future earnings or news releases automatically.

## Online Account Access
Registered shareowners can access account information by visiting www.shareowneronline.com.

## Dividend Disbursing Agent
**PPL Investor Services**
For any questions about PPL subsidiaries or information concerning:

- Lost Dividend Checks
- Bond Interest Checks
- Direct Deposit of Dividends
- Bondholder Information

Please contact:
Manager-PPL Investor Services
Two North Ninth Street (GENTW8)
Allentown, PA 18101

Toll-free: 1-800-345-3085
Fax: 610-774-5106
Via e-mail: invserv@pplweb.com

## Lost Dividend Checks
Dividend checks lost by investors, or those that may be lost in the mail, will be replaced if the check has not been located by the 10th business day following the payment date.

## Direct Deposit of Dividends
Shareowners may choose to have their dividend checks deposited directly into their checking or savings account.

## Stock Transfer Agent and Registrar; Dividend Reinvestment Plan Agent
**Wells Fargo Shareowner Services**
For information concerning:

- PPL's Dividend Reinvestment Plan
- Stock Transfers
- Lost Stock Certificates
- Certificate Safekeeping

Please contact:
Wells Fargo Bank, N.A.
Shareowner Services
161 North Concord Exchange
South St. Paul, MN 55075-1139

Toll-free: 1-866-280-0245
Outside U.S.: 651-453-2129

## Dividend Reinvestment Plan
Shareowners may choose to have dividends on their PPL Corporation common stock or PPL Electric Utilities preferred stock reinvested in PPL Corporation common stock instead of receiving the dividend by check.

## Certificate Safekeeping
PPL Corporation participates in the Direct Registration System (DRS). Shareowners may choose to have their common stock certificates deposited into DRS. Participants in PPL's Dividend Reinvestment Plan may choose to have their common stock certificates deposited into their Plan account.



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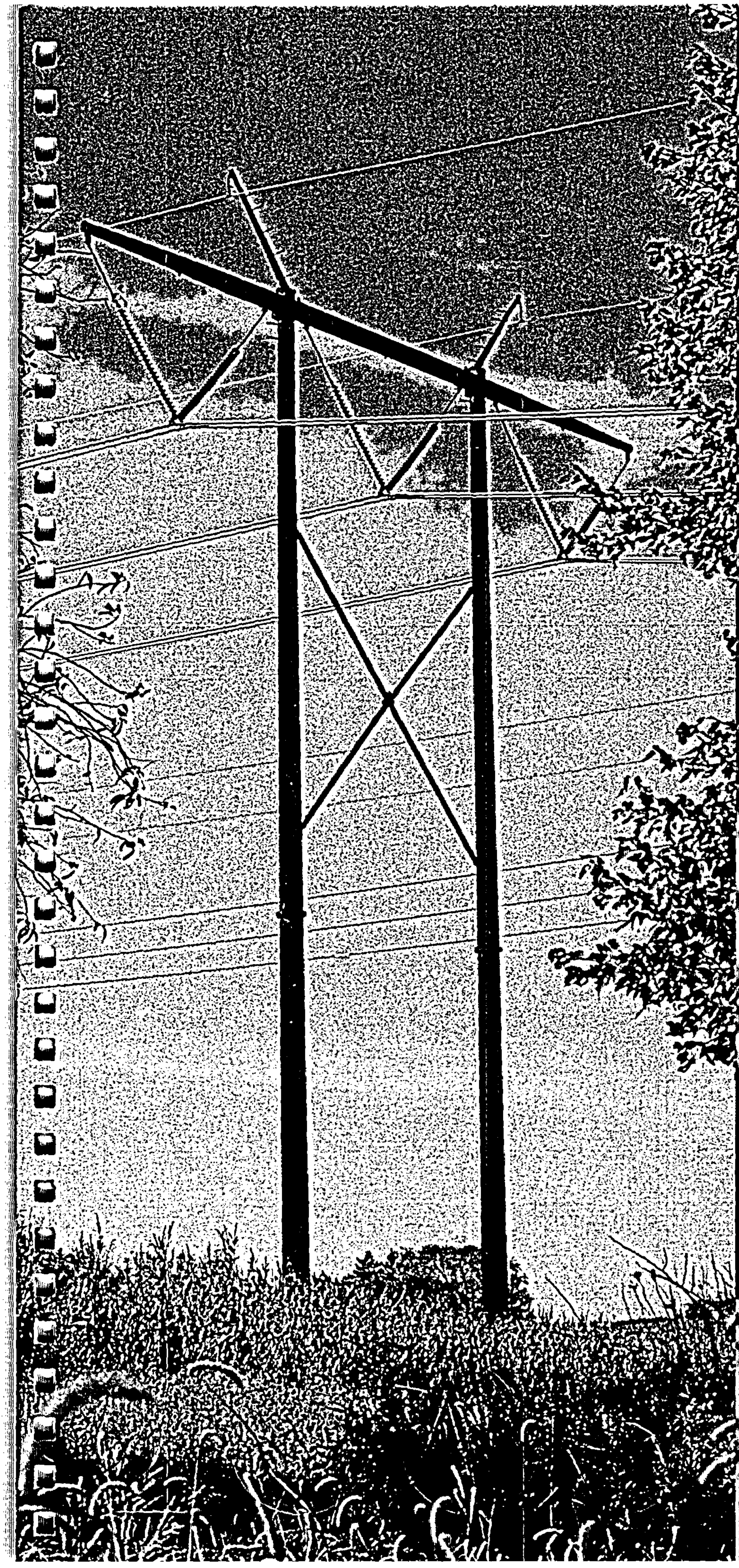
PPL Corporation
Two North Ninth Street
Allentown, PA 18101-1179
1-800-345-3085
www.pplweb.com



# ALLEGHENY ELECTRIC COOPERATIVE, INC.

*annual report*

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# TABLE OF CONTENTS

# A Message From the

# A MESSAGE FROM THE BOARD CHAIRMAN AND PRESIDENT & CEO

While pressures from high fossil fuel prices, environmental regulation, and electric competition are forcing most electric utilities to forecast an uninterrupted stream of rate increases for years to come, Allegheny Electric Cooperative, Inc. (Allegheny) and its 14 member electric distribution cooperatives in Pennsylvania and New Jersey remain "significantly protected" from market volatility.

Decisions made by Allegheny leaders more than a quarter-century ago to invest in nuclear and hydropower plants continue to bear fruit. In 2005, 70 percent of Allegheny's energy supply came from low-cost nuclear and hydropower resources that are either owned or under long-term contract. Because of this, Allegheny and its members remain largely shielded from price shocks facing utilities that receive most of their power from fossil fuel-burning facilities, or that buy large amounts off the wholesale market. And since nuclear and hydropower generating sources do not pollute the air, we are not impacted by federal clean air requirements in the same way as utilities that substantially depend on coal-fired power plants.

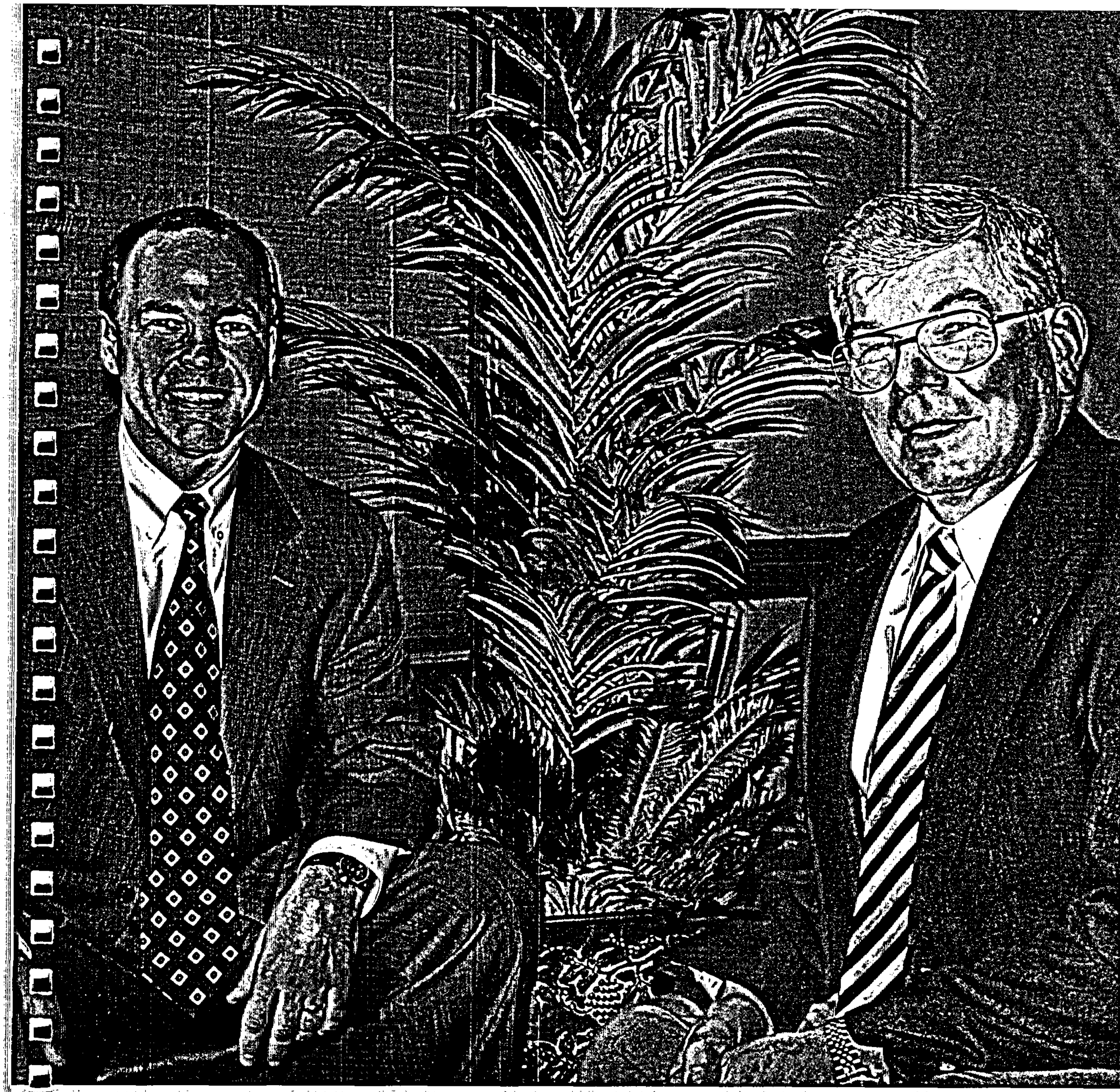
As 2006 dawned, Allegheny continued to evaluate options to secure its power supply future. Thanks to our existing favorable power purchase contracts, we will not need capacity until 2009 — giving us sufficient time to fully study and analyze market trends.

Our Coordinated Load Management System (CLMS) — which essentially works like a power plant in reverse — once again provided both economic and political benefits. Recognizing that the cheapest and cleanest kilowatt-hour is the one not produced at all, Pennsylvania legislators, in adopting Act 213 — a law that forces private power companies and competitive electric generation suppliers to include increasing amounts of clean energy in their generation mix, up to 18 percent by 2020 — required Allegheny and its member electric cooperatives to comply by offering a voluntary program of energy efficiency and demand-side management. We are accomplishing this legislative mandate through use of the CLMS network.

On a related note, Allegheny created a Renewable Energy Assistance Program (REAP) during 2005 to support efforts by Pennsylvania and New Jersey electric cooperative residential consumers — especially farmers — to develop clean energy projects. REAP will provide grants to cover some electric distribution cooperative costs associated with the installation and operation of alternative energy generation systems connected to their lines. The program provides another way for Allegheny to promote environmentally friendly power sources and wise energy use.

We also expect to see continuing improvements in the reliability of transmission service provided by private power companies to Allegheny, which in turn benefits our member electric distribution cooperatives. During 2005, companies affiliated with FirstEnergy Corporation agreed to adopt more aggressive pole inspection and replacement schedules and tighten the standard for outage frequency related to electric cooperative delivery points. Through all of this, our 1998 reliability settlement that obligates FirstEnergy to spend $4 million per year through 2009 to upgrade lines and equipment that feed electric cooperative delivery points remains in place.

On a bittersweet note, the board ended 2005 by analyzing approaches to constructively dissolve the five-year-old Continental Cooperative Services (CCS) alliance. The move follows discussion that took place during various strategic planning meetings. The Allegheny board — much like the board of its CCS partner, Illinois' Soyland Power Cooperative, Inc. (Soyland) — has concluded that CCS no longer provides the structure needed to achieve long-term objectives. While most of the original goals behind the creation of CCS have been met, changes in the electric utility environment, notably the demise of retail choice, suggest that the two generation and transmission cooperatives will better serve their member cooperatives as separate entities. While it's always a sad day when any joint effort comes to an end, Allegheny learned a great deal from working with Soyland.



ALLEGHENY ELECTRIC COOPERATIVE, INC. BOARD CHAIRMAN LOWELL FRIEDLINE, RIGHT, AND PRESIDENT & CEO FRANK BETLEY.

Overall, Allegheny's financial outlook remains positive. Our wholesale rates are lower than they have been at any point since 1987 and our stranded costs will be paid off at the end of 2007. Over coming years, rate stability should continue and debt will likely be reduced even further. All of this should leave the organization with substantial flexibility to meet the challenges of the deregulated utility environment.

In the end, we feel Allegheny stands very well positioned to meet its primary goal — providing electric cooperative consumers in Pennsylvania and New Jersey with an adequate and reliable supply of energy at a competitive price.

# *Year in Review*

# YEAR IN REVIEW

A diverse mix of self-owned generation coupled with demand-side management capabilities provide the cornerstone for Allegheny to fulfill its core mission — achieving stable and affordable wholesale power rates for member electric distribution cooperatives in Pennsylvania and New Jersey.

"Fuel diversity" affords Allegheny better balance and increased leverage in a competitive energy market easily shaped by national and global events. Crude oil prices, natural gas supplies, drought, even market jitters over regional power crises all affect how electricity markets operate and significantly impact power prices.

Allegheny's diversified generation portfolio played a key role in helping the organization negotiate, in 2001, an attractive wholesale power supply contract with Williams Power Company. The agreement runs through the end of 2008.

Following is a rundown on how Allegheny power supply resources performed in 2005:

**Raystown Hydroelectric Project:** Allegheny's Raystown Hydroelectric Project, William F. Matson Generating Station (Raystown) is a two-unit, 21-megawatt, run-of-river hydropower facility located at Raystown Lake and Dam in Huntingdon County, Pa. In 2005, Raystown provided 66.8 million kilowatt-hours at delivery.

Allegheny staff operates the hydro project in close cooperation with the Baltimore District of the U.S. Army Corps of Engineers. The Corps controls water releases from Raystown Lake, the largest man-made body of water in Pennsylvania.

**Susquehanna Steam Electric Station:** Allegheny owns 10 percent of the Susquehanna Steam Electric Station (SSES), a 2,360-megawatt, two-unit nuclear power plant located in Luzerne County, Pa. PPL Susquehanna, a division of Allentown, Pa.-based PPL Corporation, owns the remaining 90 percent and operates the boiling water reactor facility.

In 2005, this 10 percent share of SSES provided a record 1.83 billion kilowatt-hours of electricity at delivery to Pennsylvania and New Jersey electric cooperatives. The capacity factor of SSES Unit 1 was 91.7 percent; Unit 2 was 85.9 percent. This works out to an average annual composite capacity factor for the facility of 88.8 percent.

Both Unit 1 and Unit 2 run on a 24-month refueling cycle. During 2005, Unit 2 underwent its 12th planned refueling and inspection outage. The 26-day outage (shortest in SSES history) ended a record 677 consecutive days of operation, the first time in the unit's 20-year history that it ran non-stop between refueling outages.

**New York Power Authority:** Since 1966, Allegheny has purchased power generated at two hydroelectric projects located along the Niagara and St. Lawrence rivers in upstate New York. The New York Power Authority (NYPA) operates both facilities.

In 2005, Allegheny received an allocation of approximately 31 megawatts (MW) from the 2,280-MW Niagara Power Project (Niagara) and 0.5 MW from the 912-MW St. Lawrence Power Project. An additional 2 MW from both projects was allocated to Sussex Rural Electric Cooperative, an Allegheny member electric distribution cooperative in New Jersey.

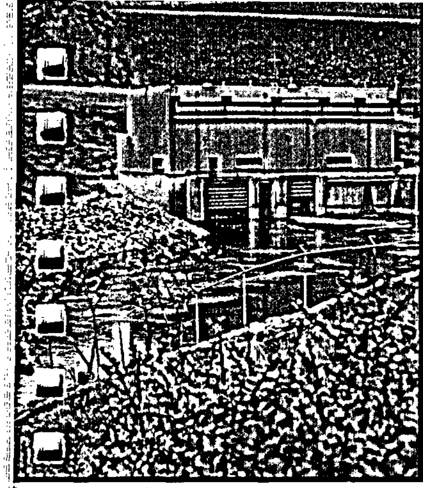
Also during the year, Allegheny signed a settlement agreement that will lead to a new 18-year contract with NYPA regarding allocations of low-cost electricity produced at Niagara. The revised allocations will take effect in September 2007 following approval of the settlement agreement and contracts by the Federal Energy Regulatory Commission and the Governor of New York. Overall, the new allocations should not significantly change Allegheny or Sussex REC's share of Niagara output.

Over the years, NYPA generation has saved Pennsylvania electric distribution cooperatives approximately $300 million compared to the cost of buying the same amount of power elsewhere.

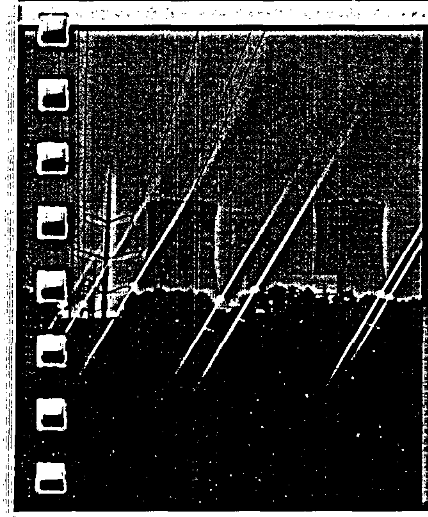
**Load Management:** In December 1986, Allegheny and its member electric distribution cooperatives in Pennsylvania and New Jersey launched the Coordinated Load Management System (CLMS) to reduce electricity consumption during peak demand periods.

By shifting use of residential electric water heaters, electric thermal storage units, dual fuel home heating systems, and other special equipment in the homes of volunteer cooperative consumers to off-peak hours, CLMS improves system efficiency, cuts costly demand charges cooperatives must pay for purchased power, and reduces the need for new generating capacity. CLMS is also used during summer peaks to reduce Allegheny capacity obligations under procedures established by Valley Forge, Pa.-based PJM Interconnection.

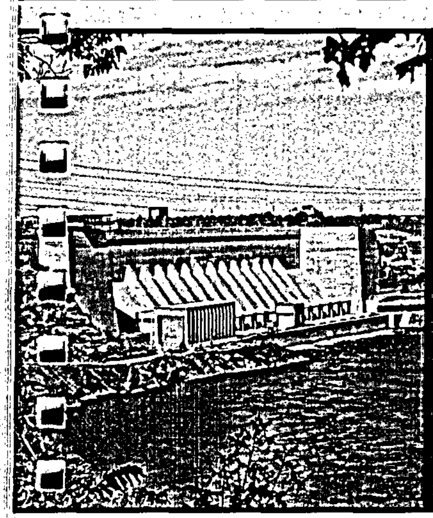
In 2005, CLMS reduced cooperative purchased power costs by $4.4 million, bringing total net power cost savings achieved over the past 19 years to more than $77.6 million. Currently, 198 substations are being utilized for load control with more than 46,700 load control receivers installed on appliances, mostly electric water heaters, in the homes of electric cooperative consumers. The network currently boasts demand-side reduction capabilities of 50 megawatts — roughly 8 percent of the cooperatives' peak load.



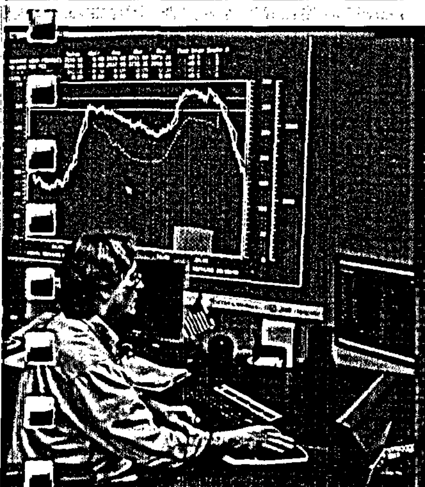
Raystown Hydroelectric Project,
William F. Matson Generating Station



Susquehanna Steam Electric Station



Niagara Power Project operated by
the New York Power Authority



Coordinated Load Management System

# Commitment to a Better Tomorrow

For four decades, Allegheny Electric Cooperative, Inc. (Allegheny) has remained a recognized leader in developing environmentally friendly power sources and promoting energy efficiency. Allegheny has long held that renewable energy generation and wise electricity use not only produce a cleaner environment for everyone, but better secure our nation's energy future.

Since 1966, Allegheny has purchased hydropower from the Niagara and St. Lawrence Power Projects located in upstate New York. This generation accounts for approximately 6 percent of Allegheny's energy needs annually.

Holding that the cheapest kilowatt-hour, and cleanest in terms of environmental impact, is the one never generated, Allegheny and its member electric cooperatives launched the Coordinated Load Management System (CLMS) in December 1986. CLMS works by controlling electric hot water heaters and other special equipment (in the homes and businesses of volunteer cooperative consumers) during times of peak electricity consumption. The load control network currently boasts demand-side reduction capabilities of 50 megawatts — roughly 8 percent of the cooperatives' peak load.

In June 1988, Allegheny placed the Raystown Hydroelectric Project (Raystown) into commercial operation. Located at the base of Raystown Dam in Huntingdon County, Pa., the 21-megawatt facility — in an average water year — supplies roughly 4 percent of the energy delivered by electric cooperatives, enough to power about 8,500 average rural homes.

The Pennsylvania General Assembly recognized the renewable energy commitment shown by Allegheny and its electric cooperatives when it passed the Alternative Energy Portfolio Standards Act of 2004 (Act 213). Pennsylvania electric cooperatives comply with the law by offering voluntary energy efficiency and demand-side load management programs — a mandate met through CLMS.

**A New Way To Boost Clean Energy Sources — REAP**

Adding renewable generation to the electric cooperative power supply mix means a cleaner environment for everyone. Anaerobic digesters reduce the environmental impact of agricultural wastes, while small wind and solar systems do not produce emissions that pollute the air.

As a positive partner in the Commonwealth's alternative energy initiatives, Allegheny in 2005 created a program to assist cooperative consumer-members who want to install a clean energy generation system at their home or farm. The Renewable Energy Assistance Program (REAP) provides grants to electric distribution cooperatives to help cover various interconnection costs, such as metering equipment and distribution transformers. It also pays for certain transitional costs to help ensure that other electric cooperative consumer-members are not required to subsidize the operation or installation of a small renewable energy generation system — whether it is an anaerobic digester, windmill, or solar unit.

To qualify for REAP grants, a renewable energy system can be no larger than 200 kilowatts and must meet the definition of a "qualified facility" under the federal Public Utility Regulatory Policies Act of 1978 or as a "distributed resource" under Act 213.

Energy produced by REAP-assisted systems can offset a consumer-member's cost of electricity, with any excess sold to Allegheny, at its avoided cost. By purchasing this power, Allegheny receives title to renewable energy certificates credited to the generation project and will use any revenue from the certificates to make more grants available for other renewable energy projects.

In many ways, REAP reflects the electric cooperative tradition of members helping members and adds a new chapter to Allegheny's history of addressing environmental and energy challenges in a cost-effective and fair way.

# ALLEGHENY AT A GLANCE

## 2005 Fact Sheet

**Energy Sales** ............................... 2,975,112 MWh

**Total Operating Revenue** .......... $173,962,000

**Net Margins** ............................... $32,284,000

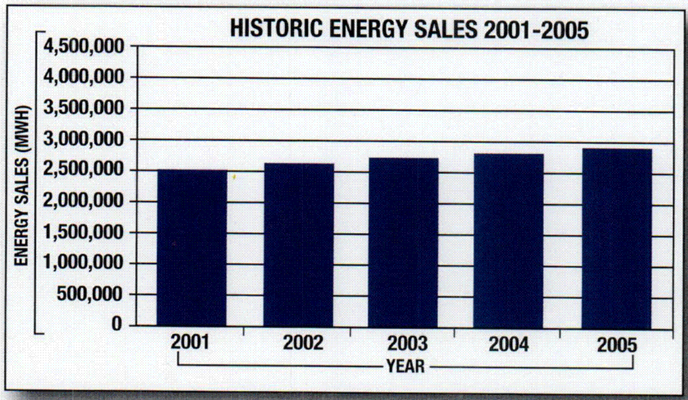
**Total Assets** ............................... $348,234,000

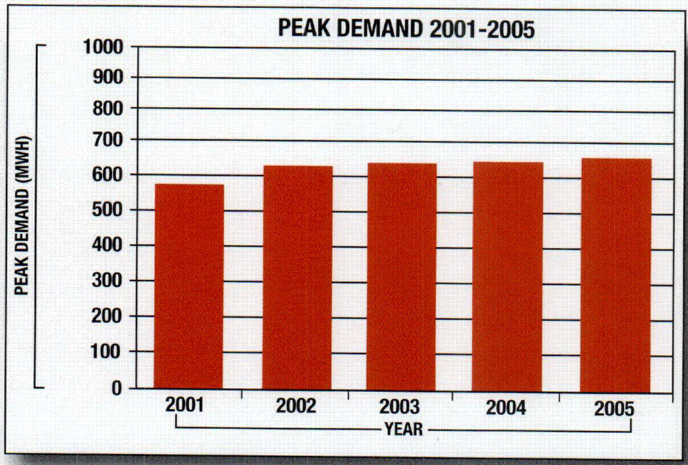
**Budgeted System Rate** ............... 57.4 mills per kWh

**Total Retail Consumers** ............. 222,104

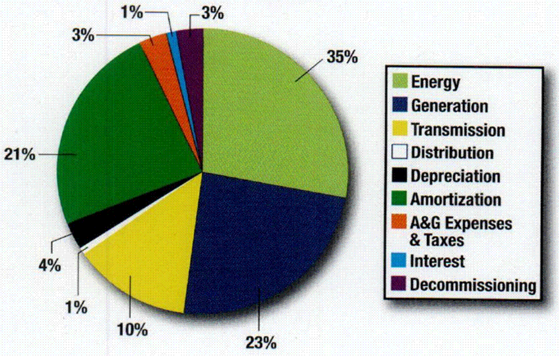
**2005 Peak Demand** ................. 655 MW

**Miles of Transmission Line** ........ 85

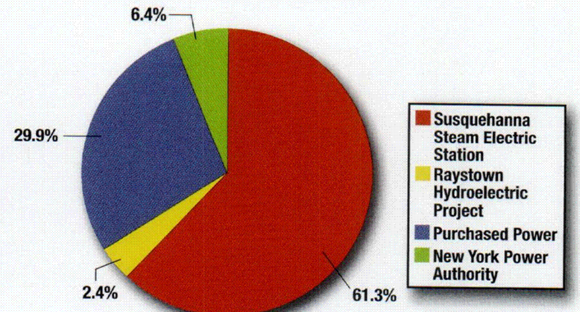



**ALLEGHENY 2005 OPERATING EXPENSES**




**ALLEGHENY SOURCES OF ENERGY 2005**



# ABOUT ALLEGHENY ELECTRIC COOPERATIVE, INC.

Electricity — powering our lives each day with heat, light, sound, and motion. At Allegheny Electric Cooperative, Inc. (Allegheny), a dedicated and experienced team of board members, management, and employees makes certain that wholesale electricity is provided round-the-clock to 14 member electric distribution cooperatives in Pennsylvania and New Jersey. In turn, those 14 member distribution cooperatives own and control Allegheny.

The cooperative electric systems comprising the Allegheny "family" maintain approximately 12.5 percent of all electric distribution lines in Pennsylvania, spanning one-third of the Commonwealth in 41 counties. New Jersey's lone electric cooperative maintains roughly 1 percent of the Garden State's total miles of line. Through these facilities, Allegheny member cooperatives deliver electricity to more than 220,000 homes, farms, small businesses, and industries with a combination of integrity, accountability, innovation, and commitment to community.


1. Adams Electric Cooperative, Inc.
2. Bedford Rural Electric Cooperative, Inc.
3. Central Electric Cooperative, Inc.
4. Claverack Rural Electric Cooperative, Inc.
5. New Enterprise Rural Electric Cooperative, Inc.
6. Northwestern Rural Electric Cooperative Association, Inc.
7. REA Energy Cooperative, Inc.
8. Somerset Rural Electric Cooperative, Inc.
9. Sullivan County Rural Electric Cooperative, Inc.
10. Sussex Rural Electric Cooperative, Inc.
11. Tri-County Rural Electric Cooperative, Inc.
12. United Electric Cooperative, Inc.
13. Valley Rural Electric Cooperative, Inc.
14. Warren Electric Cooperative, Inc.

# Board of Directors

# ALLEGHENY ELECTRIC COOPERATIVE, INC. BOARD OF DIRECTORS

**Lowell Friedline**
*Chairman*
Director
Somerset REC

**C. Robert Koontz**
Bedford REC
Director

**Curtin Rakestraw II**
Sullivan County REC
Director

**Kathryn Cooper-Winters**
*Vice Chairman*
Director
Northwestern REC

**Richard Weaver**
Central Electric
Director

**Thomas Webb**
Sussex REC
Director

**Robert Holmes**
*Secretary*
Director
Valley REC

**John McNamara**
Claverack REC
Director

**Dr. James Davis**
Tri-County
Rural Electric
Director

**Dave Turner**
*Treasurer*
Warren Electric
Director

**Robert Guyer**
New Enterprise REC
Director

**Stephen Marshall**
United Electric
Director

**David Cowan**
Adams Electric
Director

**Herman Blakley**
REA Energy
Director

2005

# *Financial Statements*

ALLEGHENY ELECTRIC COOPERATIVE, INC.

# ACCOUNTANTS' REPORT AND FINANCIAL STATEMENTS

DECEMBER 31, 2005 AND 2004

## *Contents*

## Independent Accountants' Report

Board of Directors
Allegheny Electric Cooperative, Inc.
Harrisburg, Pennsylvania

We have audited the accompanying balance sheets of Allegheny Electric Cooperative, Inc. (Cooperative) as of December 31, 2005 and 2004, and the related statements of margin, members' equities (deficits), and cash flows for the years then ended. These financial statements are the responsibility of the Cooperative's management. Our responsibility is to express an opinion on these 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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Allegheny Electric Cooperative, Inc. as of December 31, 2005 and 2004, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

BKD, LLP

March 3, 2006

225 North Water Street, Suite 400 P.O. Box 1580 Decatur, IL 62525-1580 217 429-2411 Fax 217 429-6109

# Balance Sheets

ALLEGHENY ELECTRIC COOPERATIVE, INC.

## BALANCE SHEETS

DECEMBER 31, 2005 AND 2004 (IN THOUSANDS)

### Assets

| | 2005 | 2004 |
|---|---|---|
| **Electric Utility Plant, at cost** | | |
| In service (see Note 2) | $ 780,221 | $ 781,139 |
| Less accumulated depreciation | (674,581) | (673,172) |
| | 105,640 | 107,967 |
| Construction work in progress | 7,087 | 2,862 |
| Nuclear fuel in process (see Note 1 and 3) | 15,841 | 15,334 |
| Net electric utility plant (see Note 1, 2 and 3) | 128,568 | 126,163 |
| **Investments and Other Assets** | | |
| Investments in associated organizations (see Note 4) | 764 | 739 |
| Other investments (see Note 1 and 6) | 50,873 | 47,828 |
| Notes receivable, members, less current portion (see Note 5) | 46 | 68 |
| Non-utility property, at cost (net of accumulated depreciation of $5,025 in 2005 and $4,754 in 2004) | 3,845 | 4,150 |
| Other noncurrent assets | 343 | 126 |
| | 55,871 | 52,911 |
| **Current Assets** | | |
| Cash and cash equivalents | 38,169 | 35,781 |
| Derivative investment (see Note 7) | 283 | — |
| Accounts receivable, members (see Note 1) | 16,395 | 14,030 |
| Accounts receivable, affiliated organizations | 148 | 58 |
| Other receivables | 20,388 | 2,882 |
| Inventories (see Note 1) | 6,748 | 6,350 |
| Other current assets | 1,280 | 1,397 |
| Total current assets | 83,411 | 60,498 |
| **Restricted Investments (see Note 1)** | 16,219 | 15,837 |
| **Deferred Charges** | | |
| Capital retirement asset | 63,529 | 98,953 |
| Other | 636 | 963 |
| | 64,165 | 99,916 |
| | $ 348,234 | $ 355,325 |

*See Notes to Financial Statements*

## Members' Equities (Deficits) and Liabilities

| | 2005 | 2004 |
|---|---|---|
| **Members' Equities (Deficits) (see Note 1)** | | |
| Membership fees | $ 3 | $ 3 |
| Patronage capital | 34,122 | 34,122 |
| Donated capital | 38 | 38 |
| Retained deficits | (20,627) | (52,911) |
| Members' equities (deficits) | 13,536 | (18,748) |
| Accumulated other comprehensive income | 3,370 | 2,905 |
| Total equities (deficits) | 16,906 | (15,843) |
| **Asset Retirement Obligation (see Note 9)** | 117,006 | 112,505 |
| **Long-Term Debt (see Note 10)** | 159,973 | 196,904 |
| **Current Liabilities** | | |
| Current installments of long-term debt | 37,023 | 38,833 |
| Accounts payable and accrued expenses | 12,074 | 17,307 |
| Total current liabilities | 49,097 | 56,140 |
| **Other Liabilities and Deferred Revenue** | | |
| Accrued decontamination and decommissioning of nuclear fuel | — | 308 |
| Deferred income tax obligation from safe harbor lease (see Note 14) | 2,160 | 2,423 |
| Financial transmission rights (see Note 7) | 283 | — |
| Other deferred revenue (see Note 15) | 2,809 | 2,888 |
| | 5,252 | 5,619 |
| | $ 348,234 | $ 355,325 |

# Statements of Margin

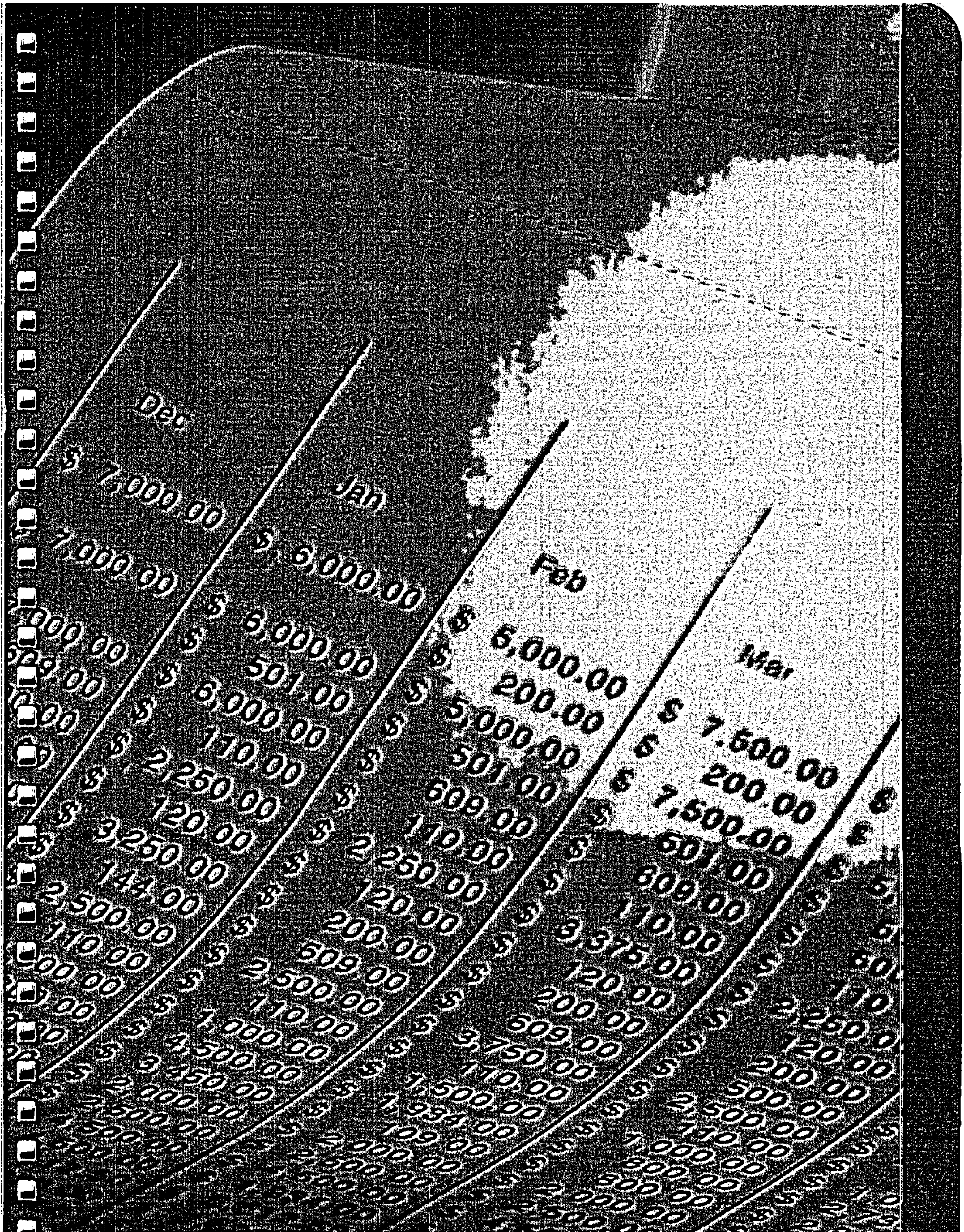
ALLEGHENY ELECTRIC COOPERATIVE, INC.

## STATEMENTS OF MARGIN

YEARS ENDED DECEMBER 31, 2005 AND 2004 (IN THOUSANDS)

| | 2005 | 2004 |
|---|---|---|
| **Operating Revenues** | $ 173,962 | $ 166,197 |
| **Operating Expenses** | | |
| Operations | | |
| Purchased capacity and energy costs | 57,119 | 44,128 |
| Transmission | | |
| Operation | 16,720 | 19,427 |
| Maintenance | 134 | 126 |
| Production | | |
| Operation | 19,500 | 21,050 |
| Maintenance | 9,644 | 8,837 |
| Fuel | 7,870 | 7,584 |
| | 110,987 | 101,152 |
| Depreciation | 6,245 | 5,066 |
| Accretion of asset retirement obligation | 4,501 | 4,327 |
| Amortization of capital retirement asset | 35,424 | 36,469 |
| Administrative and general | 5,663 | 5,286 |
| Property and other taxes | 505 | 457 |
| | 163,325 | 152,757 |
| **Operating Margin Before Interest and Other Expenses** | 10,637 | 13,440 |
| **Other Revenues and (Expenses)** | | |
| PURTA refund (see Note 12) | 16,001 | — |
| Interest expense | (1,485) | (966) |
| Other deductions, net | (1,368) | (1,265) |
| | 13,148 | (2,231) |
| **Operating Margin** | 23,785 | 11,209 |
| **Non-operating Margins** | | |
| Net non-operating rental income | 1,333 | 1,275 |
| Interest income | 8,299 | 2,294 |
| Other income (expense) | (1,133) | 99 |
| | 8,499 | 3,668 |
| **Net Margin** | 32,284 | 14,877 |
| **Other Comprehensive Margin** | | |
| Unrealized appreciation in investments | 465 | 500 |
| **Comprehensive Margin** | $ 32,749 | $ 15,377 |

*See Notes to Financial Statements*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ALLEGHENY ELECTRIC COOPERATIVE, INC.

# STATEMENTS OF MEMBERS' EQUITIES (DEFICITS)

YEARS ENDED DECEMBER 31, 2005 AND 2004 (IN THOUSANDS)

| | Membership Fees | Donated Capital | Patronage Capital |
|---|---|---|---|
| **Balance, January 1, 2004** | $ 3 | $ 38 | $ 34,122 |
| Comprehensive margin | | | |
| Net margin | — | — | — |
| Change in unrealized appreciation on investments | — | — | — |
| **Balance, December 31, 2004** | 3 | 38 | 34,122 |
| Comprehensive margin | | | |
| Net margin | — | — | — |
| Change in unrealized appreciation on investments | — | — | — |
| **Balance, December 31, 2005** | $ 3 | $ 38 | $ 34,122 |

*See Notes to Financial Statements*

| Retained Deficits | Total Members' Equities (Deficits) | Accumulated Other Comprehensive Margin | Total Equities (Deficits) |
|---|---|---|---|
| $ (67,788) | $ (33,625) | $ 2,405 | $ (31,220) |
| 14,877 | 14,877 | — | 14,877 |
| — | — | 500 | 500 |
| (52,911) | (18,748) | 2,905 | (15,843) |
| 32,284 | 32,284 | — | 32,284 |
| — | — | 465 | 465 |
| $ (20,627) | $ 13,536 | $ 3,370 | $ 16,906 |

# Statements of Cash

ALLEGHENY ELECTRIC COOPERATIVE, INC.

## STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31, 2005 AND 2004 (IN THOUSANDS)

| | 2005 | 2004 |
|---|---|---|
| **Operating Activities** | | |
| Net margin | $ 32,284 | $ 14,877 |
| Items not requiring cash | | |
| Depreciation and fuel amortization | 11,376 | 9,840 |
| Amortization of capital asset retirement | 35,424 | 36,469 |
| Accretion of asset retirement obligation | 4,501 | 4,327 |
| Change in | | |
| Accounts receivable, members | (2,365) | (591) |
| Other receivables | (17,506) | (2,524) |
| Inventories | (398) | (485) |
| Derivative investment | (283) | — |
| Other current and non-current assets | (121) | 1,336 |
| Accounts payable and accrued expenses | (5,233) | (3,790) |
| Accounts (receivable) payable, affiliated organizations | (90) | (368) |
| Other liabilities and deferred credits | (40) | 1,031 |
| Net cash provided by operating activities | 57,549 | 60,122 |
| **Investing Activities** | | |
| Additions to electric utility plant and non-utility property, net | (13,476) | (12,362) |
| Payments received on notes receivable, members | 18 | 15 |
| Purchase of restricted investments | (382) | (60) |
| Purchase of other investments | (2,580) | (3,263) |
| Net cash used in investing activities | (16,420) | (15,670) |
| **Financing Activity** | | |
| Principal payments on long-term debt | (38,741) | (26,560) |
| Net cash used in financing activity | (38,741) | (26,560) |
| **Net Increase in Cash and Cash Equivalents** | 2,388 | 17,892 |
| **Cash and Cash Equivalents, Beginning of Year** | 35,781 | 17,889 |
| **Cash and Cash Equivalents, End of Year** | $ 38,169 | $ 35,781 |
| **Supplemental Cash Flows Information** | | |
| Interest paid | $ 1,241 | $ 941 |
| Income tax paid | 225 | 354 |

*See Notes to Financial Statements*

ALLEGHENY ELECTRIC COOPERATIVE, INC.

# NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2005 AND 2004

## Note 1: Nature of Operations and Summary of Significant Accounting Policies

### *Nature of Operations*

Allegheny Electric Cooperative, Inc. (Cooperative) is a rural electric cooperative corporation established under the laws of the Commonwealth of Pennsylvania. Financing assistance has been provided by the U.S. Department of Agriculture, Rural Utilities Service (RUS) formerly known as the Rural Electrification Administration (REA) and, therefore, the Cooperative is subject to certain rules and regulations promulgated for rural electric borrowers by RUS. The Cooperative is a generation and transmission cooperative. The member cooperatives' primary service areas are rural areas throughout much of rural Pennsylvania and a portion of New Jersey. The Cooperative extends unsecured credit to its members. The Cooperative's primary operating asset is its 10% undivided interest in the Susquehanna Steam Electric Station (SSES), a 2,250-megawatt, two-unit nuclear power plant, co-owned by a subsidiary of PPL Corporation (PPL).

The Board of Directors of the Cooperative, appointed by its members, has full authority to establish electric rates subject to approval by RUS. Rates are established on a cost of service basis.

### *Basis of Accounting*

The Cooperative maintains its accounting records in accordance with the Federal Energy Regulatory Commission's (FERC) uniform system of accounts as modified and adopted by RUS.

In accordance with FERC guidelines, the Cooperative also maintains its accounts in accordance with Statement of Financial Accounting Standards Board (FASB) No. 71, *Accounting for the Effects of Certain Types of Regulations.*

### *Deregulation*

Pennsylvania retail electric customers have the choice of selecting the power supplier, or generator, from which they buy electricity. The ability to choose alternative energy suppliers has not significantly affected the Cooperative's operations or ability to recover its costs through future rates charged to members.

On a regular basis, the Cooperative reevaluates its application of FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation,* and No. 101, *Regulated Enterprises – Accounting for the Discontinuation of Application of FASB Statement No. 71.* The Cooperative has determined that regulatory assets and liabilities should continue to be accounted for under the provisions of FASB No. 71 because it is reasonable to assume that the Cooperative will continue to be able to charge and collect its cost of service-based rates.

ALLEGHENY ELECTRIC COOPERATIVE, INC.

# NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2005 AND 2004

### Use of Estimates

The preparation of 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 financial report and the reported amounts of revenues and expenses during the years then ended. Actual results could differ from those estimates.

### Electric Utility Plant

Electric utility plant is carried at cost. Depreciation of electric utility plant is provided over the estimated useful lives of the respective assets on the straight-line basis, except for nuclear fuel, as follows:

| | |
|---|---|
| Nuclear Utility Plant | |
| Production | 39 years |
| Transmission | 2.75% |
| General plant | 3% - 12.5% |
| Nuclear fuel | Units of heat production |
| Non-Nuclear Utility Plant | 3% - 33% |

Maintenance and repairs of property and replacements and renewals of items determined to be less than units of property are charged to expense. Replacements and renewals of items considered to be units of property are charged to the property accounts. At the time properties are disposed of, the original cost, plus cost of removal less salvage of such property, is charged to accumulated depreciation.

### Nuclear Fuel

Nuclear fuel is charged to fuel expense based on the quantity of heat produced for electric generation. Under the Nuclear Waste Policy Act of 1982, the U.S. Department of Energy (DOE) is responsible for the permanent storage and disposal of spent nuclear fuel removed from nuclear reactors. The Cooperative currently pays to PPL its portion of DOE fees for such future disposal services.

### Other Investments

Debt and equity securities for which the Cooperative has no immediate plan to sell but that may be sold in the future are classified as available for sale and carried at fair value. Unrealized gains and losses are recorded in members' equities (deficits).

Realized gains and losses, based on the specifically identified cost of the security, are included in net income.

### *Cash Equivalents*

Cash and cash equivalents consist of bank deposits in federally insured accounts and temporary investments.

The Cooperative places its cash and temporary investments with high quality financial institutions. Such cash and temporary investments may be in excess of FDIC insurance limits. For purposes of the statements of cash flows, the Cooperative considers all highly liquid investments with an original maturity of three months or less when purchased to be cash equivalents. Cash equivalents are carried at cost.

The Cooperative's cash and investments are in a variety of financial instruments. The related values as presented in the financial statements are subject to various market fluctuations, which include changes in the equity markets, interest rate environment and the general economic conditions. The Cooperative's credit losses have historically been minimal and within management's expectations.

### *Accounts Receivable and Notes Receivable*

Accounts receivable are stated at the amount billed to members. Accounts receivable are due in accordance with approved policies. An allowance for doubtful accounts has not been recorded because all accounts receivable are considered fully collectible.

Notes receivable are stated at their outstanding principal amount. An allowance for uncollectible notes has not been recorded because all notes receivable are considered fully collectible.

### *Inventories*

The Cooperative accounts for certain power plant spare parts using a deferred inventory method. Under this method, purchases of spare parts under inventory control are included in an inventory account and then charged to the appropriate capital or expense accounts when the parts are used or consumed. Inventories are carried at cost, with cost determined on the average cost method.

### *Restricted Investments*

The Cooperative was required by RUS to establish a trust account for the proceeds from the settlement of litigation with a former power supply provider. RUS is a named beneficiary of the trust fund and RUS requires that the Cooperative seek prior approval to utilize any of the amounts from this account. Such uses to date have consisted of providing collateral for financial obligations and for capital expenditures. Restricted investments consist of interest bearing sweep accounts and are stated at market.

ALLEGHENY ELECTRIC COOPERATIVE, INC.

# NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2005 AND 2004

### *Patronage Capital and Other Margins and Equities (Deficiencies)*

The Cooperative has established an unallocated equity account, Retained Deficits, as a result of charges against income. These charges against income were recorded as deficits in an unallocated equity account because the amount is not allocable to the Cooperative's members. RUS requires that subsequent net income recognized by the Cooperative must be used to reduce the deficits.

### *Income Taxes*

Deferred tax assets and liabilities are recognized for the tax effects of differences between the financial statement and tax bases of assets and liabilities. A valuation allowance is established to reduce deferred tax assets if it is more likely than not that a deferred tax asset will not be realized.

### *Revenue Recognition*

Revenue from the sale of electricity to members is recorded based on contracted power usage.

### *Impairment of Long-Lived Assets*

The Cooperative reviews the carrying amount of an asset for possible impairment whenever events or changes in circumstances indicate that such amount may not be recoverable. For the years ended 2005 and 2004, no such circumstances were noted.

## Note 2: Electric Utility Plant in Service

| | 2005 | 2004 |
|---|---|---|
| | (In thousands) | |
| Nuclear Utility Plant | | |
| Production | $ 567,720 | $ 577,381 |
| Transmission | 41,232 | 41,589 |
| General plant | 3,139 | 580 |
| Nuclear fuel | 155,115 | 148,636 |
| | 767,206 | 768,186 |
| Non-Nuclear Utility Plant | 13,015 | 12,953 |
| Total | $ 780,221 | $ 781,139 |

## Note 3: Susquehanna Steam Electric Station

The Cooperative owns a 10% undivided interest in SSES. PPL owns the remaining 90%. Both participants provide their own financing. The Cooperative's portion of SSES's gross assets, which includes electric utility plant in service, construction and nuclear fuel in progress, totaled $590 million and $592 million as of December 31, 2005 and 2004, respectively. The Cooperative's share of anticipated costs for ongoing construction and nuclear fuel for SSES is estimated to be approximately $85.3 million over the next five years. The Cooperative receives a portion of the total SSES output equal to its percentage ownership. SSES accounted for approximately 61% and 62% of the total kilowatt hours sold by the Cooperative during the years ended December 31, 2005 and 2004, respectively. The balance sheets and statements of income reflect the Cooperative's respective share of assets, liabilities and operations associated with SSES.

## Note 4: Investments in Associated Organizations

| | 2005 (In thousands) | 2004 |
|---|---|---|
| National Rural Utilities Cooperative Finance Corporation (CFC) Subordinated Term Certificates, bearing interest from 0% to 5%, maturing January 1, 2014 | $ 386 | $ 427 |
| Other | 378 | 312 |
| | $ 764 | $ 739 |

The Cooperative is required to maintain these investments pursuant to certain loan and guarantee agreements. Such investments are carried at cost.

## Note 5: Notes Receivable from Members

Notes receivable from members arise from the lease of load management equipment to the member cooperatives. Such notes bear interest at a variable rate (4.35% and 2.60% as of December 31, 2005 and 2004, respectively) and mature on March 31, 2009. Notes receivable from members were $72,000 and $90,000 as of December 31, 2005 and 2004, respectively.

ALLEGHENY ELECTRIC COOPERATIVE, INC.

# NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2005 AND 2004

## Note 6: Other Investments

Other investments consist of the following as of December 31, 2005 and 2004:

| | December 31, 2005 | | | |
|---|---|---|---|---|
| | Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| | (In thousands) | | | |
| Decommissioning Trust Fund A: | | | | |
| Cash | $ 264 | $ — | $ — | $ 264 |
| U.S. Government securities | 10,014 | 11 | (181) | 9,844 |
| Corporate bonds | 5,397 | 95 | (56) | 5,436 |
| Other obligations | 1,002 | — | (36) | 966 |
| Corporate stocks | 2,938 | 1,215 | (66) | 4,087 |
| | 19,615 | 1,321 | (339) | 20,597 |
| NRC mandated Decommissioning Trust Fund B: | | | | |
| Cash | 359 | — | — | 359 |
| U.S. Government securities | 13,396 | 16 | (168) | 13,244 |
| Corporate bonds | 5,764 | 29 | (87) | 5,706 |
| Other obligations | 625 | — | (14) | 611 |
| Common stocks | 5,909 | 2,782 | (170) | 8,521 |
| | 26,053 | 2,827 | (439) | 28,441 |
| Debt Service Reserve Fund — U.S. Government securities | 1,835 | — | — | 1,835 |
| | $ 47,503 | $ 4,148 | $ (778) | $ 50,873 |

| | December 31, 2004 | | | |
|---|---|---|---|---|
| | Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| | (In thousands) | | | |
| Decommissioning Trust Fund A: | | | | |
| Cash | $ 246 | $ — | $ — | $ 246 |
| U.S. Government securities | 9,229 | 19 | (114) | 9,134 |
| Corporate bonds | 5,974 | 149 | (42) | 6,081 |
| Other obligations | 740 | 2 | (4) | 738 |
| Corporate stocks | 3,145 | 1,002 | (275) | 3,872 |
| | 19,334 | 1,172 | (435) | 20,071 |
| NRC mandated Decommissioning Trust Fund B: | | | | |
| Cash | 380 | — | — | 380 |
| U.S. Government securities | 10,421 | 19 | (174) | 10,266 |
| Corporate bonds | 6,706 | 109 | (40) | 6,775 |
| Other obligations | 791 | 9 | (9) | 791 |
| Common stocks | 5,454 | 2,441 | (187) | 7,708 |
| | 23,752 | 2,578 | (410) | 25,920 |
| Debt Service Reserve Fund — U.S. Government securities | 1,837 | — | — | 1,837 |
| | $ 44,923 | $ 3,750 | $ (845) | $ 47,828 |

ALLEGHENY ELECTRIC COOPERATIVE, INC.

# NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2005 AND 2004

Certain investments in debt and equity securities are reported in the financial statements at an amount less than their historical cost. Total fair value of these investments at December 31, 2005 and 2004, was $25.4 million and $22.9 million, respectively. These declines primarily resulted from increases in market interest rates prior to the balance sheet date and the failure of certain investments to meet projected earnings targets, which management believes is temporary. The gross unrealized losses at December 31, 2005 for a period of less than 12 months was $332,000 and for a period greater than 12 months was $465,000. The gross unrealized losses at December 31, 2004 for a period of less than 12 months was $250,000 and for a period greater than 12 months was $595,000.

## Note 7: Financial Transmission Rights

In 1998, the FASB Issued Statement No. 133, *"Accounting for Derivative Instruments and Hedging Activities"*. Subsequent to the issuance of Statement No. 133, the Cooperative was issued Financial Transmission Rights (FTRs) by PJM Interconnection LLC, (PJM). These FTRs have been found to meet Statement No. 133 definition of a derivative, and therefore must have special derivative accounting procedures applied to them.

The Cooperative received an entitlement of FTRs. FTRs are defined from a "source" node to a "sink" node (path) for a specific amount of megawatts of electric power. The holder of an FTR is entitled to receive whole or partial offsets of transmission congestion charges that arise when that specific path is congested. The purpose of the FTR mechanism is to act as a hedge from volatile congestion charges.

Market values of FTRs are only observable based on the clearing prices of the FTRs in annual and monthly auctions. The expected value of FTRs fluctuates based on seasonal expectations of the supply and demand of energy for each specific path. Significant assumptions and modeling projections are necessary to value FTRs. The expected FTR values are considered in the rate-making process and therefore the fair value of FTRs are recognized on the balance sheet and recorded as deferred income under FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation.* The fair value of FTRs was $283,000 as of December 31, 2005 for the remainder of the current PJM planning period that ends May 31, 2006.

## Note 8: Deferred Charges

Deferred charges consist of the following regulatory assets as of December 31, 2005 and 2004.

| | 2005 | 2004 |
|---|---|---|
| | (In thousands) | |
| Capital retirement asset | $ 63,529 | $ 98,953 |
| Accrued decontamination and decommissioning of nuclear fuel | 551 | 867 |
| Safe harbor lease closing costs | 85 | 96 |
| | $ 64,165 | $ 99,916 |

Based on membership agreements signed by the 14 member distribution cooperatives on March 29, 1999, with an effective date of January 1, 1999, a portion of the SSES impairment writedown, which took place in 1998, has been recognized as a regulatory asset, referred to as the capital retirement asset. Under this agreement, the Cooperative will recover from members certain financing costs related primarily to the Cooperative's investment in SSES in the amount of $311 million over a nine-year period.

## Note 9: Asset Retirement Obligation

Amounts collected from the Cooperative's members for decommissioning, less applicable taxes, are deposited in external trust funds for investment and can only be used for future decommissioning costs. The fair value of the nuclear decommissioning trust was $49.0 million and $46.0 million for the years ended December 31, 2005 and 2004, respectively.

The changes in the carrying amounts of asset retirement obligations were as follows (in thousands):

| | 2005 | 2004 |
|---|---|---|
| | (In thousands) | |
| Beginning balance | $ 112,505 | $ 108,178 |
| Accretion expense | 4,501 | 4,327 |
| Ending balance | $ 117,006 | $ 112,505 |

The amount of actual obligation could differ materially from the estimates reflected in these financial statements.

ALLEGHENY ELECTRIC COOPERATIVE, INC.

# NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2005 AND 2004

## Note 10: Long-Term Debt

| | 2005 | 2004 |
|---|---|---|
| | (In thousands) | |
| Debt settlement note payable to RUS at an interest rate varying from 0.0% to 7.18%, due in varying amounts through 2008 | $ 174,665 | $ 211,663 |
| 6.00% replacement notes payable to RUS due in varying amounts through 2007 | 1,102 | 1,439 |
| Pollution Control Revenue Bonds, payable semiannually, including interest through 2014. Variable rates ranged from 1.48% to 3.10% in 2005 and 0.9% to 2.18% in 2004 | 16,800 | 18,000 |
| 5.00% mortgage notes payable to RUS due in varying amounts through 2019 | 4,429 | 4,635 |
| | 196,996 | 235,737 |
| Less current installments | 37,023 | 38,833 |
| | $ 159,973 | $ 196,904 |

Long-term debt consisted principally of advances under mortgage notes payable for electric utility plant to RUS and to the United States of America acting through the Federal Financing Bank (FFB) and guaranteed by RUS. Substantially all of the assets of the Cooperative are pledged as collateral.

Pursuant to the provisions set forth in 7 CFR Part 1717, *Settlement of Debt Owed by Electric Borrowers,* the Cooperative entered into a restructuring agreement with RUS on March 29, 1999, with an effective date of January 1, 1999. Under the restructuring, the original advances under the mortgage notes to FFB were replaced with a new RUS note in the amount of $406 million. The new note has a final maturity date on January 1, 2008, with an option for early termination on January 1, 2006 and January 1, 2007. Interest on the new note is 7.18%. The Cooperative, however, can receive an interest credit up to the amount of total interest expense based on the number of participating members. All of the Cooperative's members are currently participating.

Pollution Control Revenue Bonds (Bonds) were issued by an industrial development authority on the Cooperative's behalf. The Bonds are subject to purchase on demand of the holder and remarketing on a "best efforts" basis until the Bonds are converted to a fixed interest rate at the Cooperative's option. If a fixed interest rate is established for the Bonds, the Bonds will cease to be subject to purchase by the remarketing agent or the trustee. The indenture agreement contains various redemption provisions with redemption prices ranging from 100% to 103%. Included in other investments, at December 31, 2005 and 2004, respectively, are $1,835,000 and $1,837,000 of investments which relate to a debt service reserve fund required under the Bond Indenture.

In the event that the Bonds are called and cannot be remarketed, the Bonds are collateralized by irrevocable letters of credit from Rabobank Nederland (Rabobank). The trustee may draw on the letters of credit to make required payments to the bondholders. If Rabobank draws on such letters of credit and the Cooperative does not reimburse Rabobank for such draws under the terms of the agreements, the letters of credit are converted into a one-year term loan, with payments of principal and interest due quarterly.

The letters of credit and respective reimbursement agreements were amended as of July 21, 2003 and the stated termination date of each of the agreements is on October 31, 2006 or such later date as may be determined by Rabobank.

Future maturities of all long-term debt are as follows (in thousands):

| | | |
|---|---|---|
| 2006 | $ | 37,023 |
| 2007 | | 36,804 |
| 2008 | | 106,570 |
| 2009 | | 1,832 |
| 2010 | | 1,944 |
| Thereafter | | 12,823 |

The Cooperative is required by mortgage covenants to maintain certain levels of interest coverage and annual debt service coverage. The Cooperative represents that it was in compliance with the applicable mortgage covenants as of December 31, 2005 and 2004.

Certain of the Cooperative's long-term debt is at variable interest rates and is therefore subject to various market and interest rate fluctuations.

During 2005 and 2004, the Cooperative incurred interest costs of $1,485,000 and $966,000, respectively.

## Note 11: Income Taxes

There was no provision for federal income taxes at December 31, 2005 and 2004. The Cooperative is not subject to state income taxes.

At December 31, 2005, the Cooperative had available nonmember net operating loss carryforwards of approximately $62 million for tax reporting purposes expiring in 2006 through 2021, and alternative minimum tax credit carryforwards of approximately $1 million which carry forward indefinitely.

ALLEGHENY ELECTRIC COOPERATIVE, INC.

# NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2005 AND 2004

Temporary differences that give rise to deferred tax balances are principally attributable to fixed asset basis, safe harbor lease treatment, gain on installment sale, and financial statement accruals. Deferred tax assets also include the effect of net operating loss carryforwards. The temporary differences and the carryforward items produce a net deferred tax asset at year end. Realization of the net deferred tax asset is contingent upon the Cooperative's future earnings. A valuation allowance had been established against the asset since it has been determined that it is more likely than not that the net deferred tax asset will not be realized.

## Note 12: Pennsylvania Public Utility Realty Taxes

In December of 1998, the Pennsylvania Department of Revenue issued, pursuant to the Pennsylvania Public Utility Realty Tax Act (PURTA), additional assessments to PURTA taxpayers in order to cover the shortfall between PURTA tax revenues and the distributions. The Cooperative's additional assessment was $1,868,000, which was recorded as of October 1998. The Cooperative satisfied the 1997 reassessment by applying 1998 prepaid taxes against the assessment.

In 1999, approximately 20 utilities and the Cooperative filed suits against the Commonwealth of Pennsylvania challenging provisions of PURTA. The state later amended the PURTA statute and the way in which the tax is calculated retroactive to 1998. The Cooperative subsequently received and paid a 1998 PURTA tax bill of approximately $380,000.

In 2000, the Commonwealth removed electric generation assets from the PURTA tax base and effectively returned those assets to local real estate tax jurisdiction with liability calculations based on assessed values. During 2001, PPL settled the 2000 liability for county, municipality, and school district real estate taxes on the full value of the jointly owned SSES property. Also during 2001, the Cooperative's portion of these real estate taxes was billed by and paid to PPL.

In November 2005, the Pennsylvania Supreme Court, by way of order, affirmed that electric cooperatives are not subject to PURTA. As a result of this order, the Cooperative is due certain refunds, plus interest thereon, of PURTA taxes previously paid to the Commonwealth of Pennsylvania. The Cooperative has recorded income of $16,000,724 plus interest of $5,183,054 related to this matter.

## Note 13: Related Party Transactions

The Cooperative has arrangements with two affiliated organizations, the Pennsylvania Rural Electric Association (PREA) and Continental Cooperative Services (CCS). Both organizations have provided the Cooperative with certain management, general, and administrative services on a cost reimbursement basis. The costs for the services provided by PREA were $649,181 and $510,541 for the years ended December 31, 2005 and 2004, respectively. The costs for services provided by CCS were $5,437,000 and $5,408,307 for the same two comparative periods, respectively.

CCS was incorporated in March 2000, the result of a strategic alliance between the Cooperative, based in Harrisburg, Pennsylvania, and Soyland Power Cooperative, Inc. (Soyland), formerly based in Decatur, Illinois. CCS is organized as a Non-profit Electric Cooperative Corporation in the Commonwealth of Pennsylvania.

CCS is governed by a board of directors, composed of one representative from each affiliated distribution cooperative in Pennsylvania, New Jersey, and Illinois. Included in the Cooperative's investment in associated organizations is $100,000 for its membership in CCS.

The Cooperative has been officially notified through CCS, that Soyland will withdraw from the strategic alliance. The withdrawal will be completed by May 13, 2006 leaving the Cooperative as sole member of CCS.

## Note 14: Commitments and Contingencies

### *Power Supply and Transmission Agreements*

The Cooperative has entered into power supply and transmission agreements with approximately 45 service providers. A significant amount of these agreements are umbrella type agreements and do not bind the Cooperative to enter into any type of transaction. As of December 31, 2005, there were no significant transactions under these agreements.

The Cooperative has a number of power supply agreements under which it currently purchases capacity and power. These agreements contain no minimum purchase or take-or-pay provisions. Power supply agreements are as follows:

**New York Power Authority**

This contract meets a portion of the Cooperative's base load requirements and its delivered cost to the Cooperative's members is below market. The current contract terminates in August 2025 for the Niagara Project. The current contract for the St. Lawrence Project expires in 2017.

**Williams Energy Marketing & Trading, Inc.**

Effective on April 1, 2001, the Cooperative entered into an arrangement with Williams Energy Marketing & Trading, Inc. (Williams). The arrangement provides that Williams receives the output of all power from the Cooperatives' owned and controlled resources and in turn supplies all of the Cooperatives' load requirements in certain geographic areas. The agreement with Williams is scheduled to terminate on December 31, 2008.

The Williams agreement contains certain hourly and monthly energy caps. Energy provided above these thresholds is purchased at market prices. The Williams agreement also contains thresholds related to output from the Cooperative's resources. If the Cooperative fails to provide energy sufficient to meet the thresholds, the balance is purchased from Williams at market prices. Transmission service for this load is provided under the appropriate PJM Open Access Transmission Tariff (OATT) or the GPU WASP agreement as explained below.

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The Williams Agreement requires the Cooperative to provide credit support in the amount of $9 million. The National Rural Utilities Cooperative Finance Corporation (CFC) issued an irrevocable standby letter of credit on behalf of the Cooperative in the amount of $9 million in favor of Williams. The letter of credit is valid until June 1, 2006. In a related agreement to facilitate the transmission of power received from Williams, the Cooperative executed a Load Serving Entity Agreement with PJM LLC (PJM). The terms of the agreement required the Cooperative to provide $2 million of credit support for activities with PJM. To provide for the credit support, the Cooperative has an irrevocable standby letter of credit from CFC for $2 million in favor of PJM. This standby letter of credit is also valid until June 1, 2006.

**SSES Replacement Power Insurance Policy**

The Cooperative mitigated a portion of the economic risk of an outage by purchasing a Replacement Power Insurance Policy from XL Specialty Insurance Company. Under the terms of the policy, if SSES had a forced outage event, the Cooperative would have been reimbursed the cost of replacement power for the insured quantity of 230 MW. Replacement power cost is the total of the loss, in dollars, as calculated by subtracting the insured price of $50/MWh from the market price index (PJM Western Hub LMP) and multiplying that difference by the insured quantity. The policy stipulates that the outage limit for each such forced outage is 90 consecutive days, and the aggregate coverage limit is $25 million. For this coverage, the Cooperative paid XL a total premium of $926,400 and $861,000 for 2005 and 2004, respectively. Effective on January 1, 2006, the Cooperative entered into a similar insurance arrangement. Under the new policy, the Cooperative will pay a total premium of $889,000 for the policy period ending on December 31, 2006.

**Pennsylvania Electric Company**

The Cooperative terminated its supplemental generation portion of its Wheeling and Supplemental Power (WASP) agreement with Pennsylvania Electric Company (Penelec) on March 31, 2001. However, the Cooperative continues to purchase transmission service in the Penelec, Metropolitan Edison Company (Met-Ed), and Jersey Central Power & Light (JCP & L) zones from Penelec under the WASP agreement and the PJM OATT. Beginning April 1, 2001, the Cooperative became the sole Load Serving Entity (LSE) for the Cooperatives' load in the Penelec, Met-Ed, and JCP & L zones. Consequently, the Cooperative executed a LSE agreement with PJM, which outlines the responsibilities of each party with respect to the revised transmission and power supply arrangement. As part of its new LSE status, it was also necessary to take Network Integrated Transmission Service (NITS) under the PJM OATT. Penelec reimburses the Cooperative for most of the PJM NITS charges to prevent double billing for NITS.

### Insurance

PPL, as the 90% owner and sole operator of SSES, and the Cooperative, as owner of a 10% undivided interest in SSES, are members of certain insurance programs which provide coverage for property damage to the SSES nuclear generation plant. Under these programs, the plant, as a whole, has property damage coverage for up to $2.75 billion. Additionally, there is coverage for the cost of replacement power during prolonged outages of nuclear units caused by certain specified conditions. Under the property and replacement power insurance programs, PPL and the Cooperative could be assessed retrospective premiums in the event the insurers' losses exceed their reserves. At December 31, 2005, the maximum amount PPL and the Cooperative could jointly be assessed under these programs ranged from $20 million to $40 million annually.

PPL and the Cooperative's public liability for claims resulting from a nuclear incident is currently limited to $10.8 billion under provisions of the Price-Anderson Amendment Acts of 1988.

In the event of a nuclear incident at any of the reactors covered by the Act, PPL and the Cooperative could be assessed up to $100.6 million per reactor per incident, payable at $30 million per year.

### Safe Harbor Lease

The Cooperative previously sold certain investment and energy tax credits and depreciation deductions pursuant to a safe harbor lease. The proceeds from the sale, including interest earned thereon, have been deferred and are being recognized on the statements of operations over the 30-year term lease. The deferred gain was $2.2 million and $2.4 million as of December 31, 2005 and 2004, respectively. The net proceeds and related interest were required by RUS to be used to retire outstanding FFB debt.

Under the terms of the safe harbor lease, the Cooperative is contingently liable in varying amounts in the event the lessor's tax benefits are disallowed and in the event of certain other occurrences. The maximum amount for which the Cooperative was contingently liable as of December 31, 2005 was approximately $6.8 million. Payment of this contingent liability has been guaranteed by CFC.

### Purchased Power

For years preceding 2004, the Cooperative accrued amounts as a contingency for certain purchased power related costs. In accordance with Financial Accounting Standard 5 (FAS 5), the contingency was reversed during 2004 after the Cooperative received additional information suggesting the imposition of such costs unlikely. Accordingly, the reversal was treated as a credit against purchased capacity and energy costs in the amount of $7.7 million.

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### *Litigation*

The Cooperative may be subject to claims and lawsuits that arise primarily in the ordinary course of business. At December 31, 2005, no such claims or lawsuits existed.

## Note 15: Sale/Leaseback Arrangement

The Cooperative previously completed a sale and leaseback of its hydroelectric generation facility at the Raystown Dam (the Facility). The Facility was sold to a trustee bank representing Ford Motor Credit Company (Ford) for $32.0 million in cash. During 1996, Ford transferred its interest in the Facility to a third party. Under terms of the arrangement, the Cooperative is leasing the Facility for an initial term of 30 years. Payments under the lease are due in semi-annual installments which commenced January 10, 1989. At the end of the 30-year term, the Cooperative will have the option to purchase the Facility for an amount equal to the Facility's fair market value or for a certain amount fixed by the transaction documents.

The Cooperative also has the option to renew the lease for a five-year fixed rate renewal and three fair market renewal periods, each of which may not be for a term of less than two years. Payments during the fixed rate renewal period are 30% of the average semi-annual installments during the initial lease term. The Cooperative will retain co-licensee status for the Facility throughout the term of the lease. The gain of $1.9 million related to the sale is being recognized over the lease term. The unrecognized gain is recorded in other deferred revenue and was $1.03 and $1.11 million as of December 31, 2005 and 2004, respectively.

The payments by the Cooperative under this lease were determined in part on the assumption that Ford, or its successor, will be entitled to certain income tax benefits as a result of the sale and leaseback of the Facility. In the event that Ford, or its successor, were to lose all or any portion of such tax benefits, the Cooperative would be required to indemnify Ford, or its successor, for the amount of the additional federal income tax payable to Ford, or its successor, as a result of any such loss.

The leaseback of the Facility is accounted for as an operating lease by the Cooperative. As of December 31, 2005, future minimum lease payments under this lease, which can vary based on the interest paid on the debt used to finance the transaction, are estimated as follows (in thousands):

| | | |
|---|---|---|
| 2006 | $ | 1,932 |
| 2007 | | 1,932 |
| 2008 | | 1,932 |
| 2009 | | 2,361 |
| 2010 | | 2,361 |
| Thereafter | | 18,887 |
| Total minimum lease payments | $ | 29,405 |

The future minimum lease payments shown above are for the initial lease term and the five-year renewal period. These payments are based on an assumed interest rate of 8.8% and may fluctuate based on differences between the future interest rate and the assumed interest rate. Rental expense for this lease totaled $1.2 million and $1.4 million in years ended December 31, 2005 and 2004, respectively.

## Note 16: Government Regulations

The Energy Policy Act of 1992 established, among other things, a fund to pay for the decontamination and decommissioning of three nuclear enrichment facilities operated by DOE. A portion of the fund is to be collected from electric utilities that have purchased enrichment services from DOE and will be in the form of annual special assessments for a period not to exceed more than 15 years. The special assessments are based on a formula that takes into account the amount of enrichment services purchased by the utilities in past periods.

The Cooperative has previously recorded its share of the liability in connection with PPL's recognition of the liability in the accounts of SSES. The Cooperative's share of the liability is $4.4 million. The Cooperative recorded its share of the liability as a deferred charge which is being amortized to expense and paid over 15 years, consistent with the ratemaking treatment. The remaining liability to be amortized was $0.6 million and $0.9 million as of December 31, 2005 and 2004, respectively.

## Note 17: Fair Value of Financial Instruments

The estimated fair value amounts have been determined by the Cooperative using available market information and appropriate valuation methodologies. However, considerable judgment is required in interpreting market data to develop the estimates of fair value.

Accordingly, the estimates presented herein are not necessarily indicative of the amounts that the Cooperative could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments:

Assets

- *Cash and Restricted Investments* – The carrying amounts of these items are a reasonable estimate of their fair value due to the short-term nature of the instruments.

- *Other Investments and Investments in Associated Organizations* – The fair value of other investments are estimated based on quoted market prices. Fair values of investments in associated organizations approximate their carrying amount.

- *Notes Receivable from Members* – The carrying amount of the Cooperative's notes receivable from members, which primarily relate to sales-type leases, approximates fair value because the notes bear a variable rate of interest which is reset on a frequent basis.

Liabilities

- *Long-term debt* – The fair value of the Cooperative's fixed rate long-term debt is estimated using discounted cash flows based on current rates offered to the Cooperative for similar debt of the same remaining maturities.

The estimated fair values of the Cooperative's financial instruments at December 31, 2005 and 2004, are as follows (in thousands):

| | 2005 | | 2004 | |
|---|---|---|---|---|
| | Carrying Amount | Estimated Fair Value | Carrying Amount | Estimated Fair Value |
| Cash and cash equivalents | $ 38,169 | $ 38,169 | $ 35,781 | $ 35,781 |
| Restricted investments | 16,219 | 16,219 | 15,837 | 15,837 |
| Other investments | 50,873 | 50,873 | 47,828 | 47,828 |
| Investment in associated organizations | 764 | 764 | 739 | 739 |
| Notes receivable from members | 46 | 46 | 68 | 68 |
| Long-term debt | 196,996 | 177,231 | 235,737 | 201,334 |

## Note 18: Subsequent Event

Effective March 31, 2006, the Cooperative refinanced all of its debt and completed a buyout from Rural Utilities Services (RUS), eliminating all regulatory oversight from RUS. The new 100% lender, National Rural Utilities Cooperative Finance Corporation (CFC), extended nearly $300 million of financing including a $35 million unsecured line of credit. The CFC loan commitment also provided for $40 million of financing for capital additions the Cooperative will be making in future years. The CFC long-term debt has fixed interest rates ranging from 6.8% to 7.0% and maturities extending through December 31, 2025. The refinancing allowed for the Cooperative to restructure its debt for longer terms and provided a mechanism to fund ongoing SSES operating efficiency and life extension capital improvements.

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