

# Kentucky Power Company

2022 First Quarter Report

Financial Statements



An **AEP** Company

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BOUNDLESS ENERGY<sup>SM</sup>

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## GLOSSARY OF TERMS

When the following terms and abbreviations appear in the text of this report, they have the meanings indicated below.

| Term                      | Meaning  |
|---------------------------|--|
| AEP                       | American Electric Power Company, Inc., an investor-owned electric public utility holding company which includes American Electric Power Company, Inc. (Parent) and majority owned consolidated subsidiaries and consolidated affiliates.   |
| AEP Credit                | AEP Credit, Inc., a consolidated variable interest entity of AEP which securitizes accounts receivable and accrued utility revenues for affiliated electric utility companies.   |
| AEP System                | American Electric Power System, an electric system, owned and operated by AEP subsidiaries.  |
| AEPSC                     | American Electric Power Service Corporation, an AEP service subsidiary providing management and professional services to AEP and its subsidiaries.   |
| AFUDC                     | Allowance for Equity Funds Used During Construction.   |
| AOCI                      | Accumulated Other Comprehensive Income.  |
| APCo                      | Appalachian Power Company, an AEP electric utility subsidiary.   |
| CCR                       | Coal Combustion Residual.  |
| CWIP                      | Construction Work in Progress.   |
| ELG                       | Effluent Limitation Guidelines.  |
| Excess ADIT               | Excess accumulated deferred income taxes.  |
| FASB                      | Financial Accounting Standards Board.  |
| FERC                      | Federal Energy Regulatory Commission.  |
| FTR                       | Financial Transmission Right, a financial instrument that entitles the holder to receive compensation for certain congestion-related transmission charges that arise when the power grid is congested resulting in differences in locational prices.   |
| GAAP                      | Accounting Principles Generally Accepted in the United States of America.  |
| I&M                       | Indiana Michigan Power Company, an AEP electric utility subsidiary.  |
| IRS                       | Internal Revenue Service.  |
| KPCo                      | Kentucky Power Company, an AEP electric utility subsidiary.  |
| KPSC                      | Kentucky Public Service Commission.  |
| KTCo                      | AEP Kentucky Transmission Company, Inc., a wholly-owned AEPTCo transmission subsidiary.  |
| MTM                       | Mark-to-Market.  |
| MWh                       | Megawatt-hour.   |
| OPEB                      | Other Postretirement Benefits.   |
| OTC                       | Over-the-counter.  |
| Parent                    | American Electric Power Company, Inc., the equity owner of AEP subsidiaries within the AEP consolidation.  |
| PJM                       | Pennsylvania – New Jersey – Maryland regional transmission organization.   |
| Risk Management Contracts | Trading and non-trading derivatives, including those derivatives designated as cash flow and fair value hedges.  |
| Tax Reform                | On December 22, 2017, President Trump signed into law legislation referred to as the “Tax Cuts and Jobs Act” (the TCJA). The TCJA includes significant changes to the Internal Revenue Code of 1986, including a reduction in the corporate federal income tax rate from 35% to 21% effective January 1, 2018. |
| Utility Money Pool        | Centralized funding mechanism AEP uses to meet the short-term cash requirements of certain utility subsidiaries.   |
| WPCo                      | Wheeling Power Company, an AEP electric utility subsidiary.  |
| WVPSC                     | Public Service Commission of West Virginia.  |

**KENTUCKY POWER COMPANY**  
**CONDENSED STATEMENTS OF INCOME**  
**For the Three Months Ended March 31, 2022 and 2021**  
**(in thousands)**  
**(Unaudited)**

|  | <b>Three Months Ended<br/>March 31,</b> |                  |
|--|---|------------------|
|  | <b>2022</b>                             | <b>2021</b>      |
| <b>REVENUES</b>  |   |                  |
| Electric Generation, Transmission and Distribution       | \$ 176,497                              | \$ 159,123       |
| Sales to AEP Affiliates                                  | 5,118                                   | 2,597            |
| Other Revenues   | 822                                     | 223              |
| <b>TOTAL REVENUES</b>                                    | <b>182,437</b>                          | <b>161,943</b>   |
| <b>EXPENSES</b>  |   |                  |
| Fuel and Other Consumables Used for Electric Generation  | 15,719                                  | 17,750           |
| Purchased Electricity for Resale                         | 36,057                                  | 21,114           |
| Purchased Electricity from AEP Affiliates                | 24,450                                  | 22,101           |
| Other Operation  | 32,155                                  | 32,986           |
| Maintenance  | 14,430                                  | 19,377           |
| Depreciation and Amortization                            | 30,528                                  | 29,520           |
| Taxes Other Than Income Taxes                            | 6,759                                   | 7,021            |
| <b>TOTAL EXPENSES</b>                                    | <b>160,098</b>                          | <b>149,869</b>   |
| <b>OPERATING INCOME</b>                                  | <b>22,339</b>                           | <b>12,074</b>    |
| <b>Other Income (Expense):</b>                           |   |                  |
| Interest Income  | 4                                       | 4                |
| Allowance for Equity Funds Used During Construction      | 377                                     | 276              |
| Non-Service Cost Components of Net Periodic Benefit Cost | 1,622                                   | 1,035            |
| Interest Expense   | (9,165)                                 | (8,953)          |
| <b>INCOME BEFORE INCOME TAX BENEFIT</b>                  | <b>15,177</b>                           | <b>4,436</b>     |
| Income Tax Benefit                                       | (10,744)                                | (9,415)          |
| <b>NET INCOME</b>  | <b>\$ 25,921</b>                        | <b>\$ 13,851</b> |

*The common stock of KPCo is wholly-owned by Parent.*

*See Condensed Notes to Condensed Financial Statements beginning on page 8.*

**KENTUCKY POWER COMPANY**  
**CONDENSED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**  
**For the Three Months Ended March 31, 2022 and 2021**  
**(in thousands)**  
**(Unaudited)**

|  | <b>Three Months Ended<br/>March 31,</b> |                  |
|--|---|------------------|
|  | <b>2022</b>                             | <b>2021</b>      |
| Net Income   | \$ 25,921                               | \$ 13,851        |
| <b>OTHER COMPREHENSIVE LOSS, NET OF TAXES</b>  |   |                  |
| Amortization of Pension and OPEB Deferred Costs, Net of Tax of \$(10) and \$(9) in 2022 and 2021, Respectively | (39)                                    | (34)             |
| <b>TOTAL COMPREHENSIVE INCOME</b>  | <b>\$ 25,882</b>                        | <b>\$ 13,817</b> |

See Condensed Notes to Condensed Financial Statements beginning on page 8.

**KENTUCKY POWER COMPANY**  
**CONDENSED STATEMENTS OF CHANGES IN**  
**COMMON SHAREHOLDER'S EQUITY**  
**For the Three Months Ended March 31, 2022 and 2021**  
**(in thousands)**  
**(Unaudited)**

|  | <u>Common<br/>Stock</u> | <u>Paid-in<br/>Capital</u> | <u>Retained<br/>Earnings</u> | <u>Accumulated<br/>Other<br/>Comprehensive<br/>Income (Loss)</u> | <u>Total</u>      |
|--|-------------------------|----------------------------|------------------------------|--|-------------------|
| <b>TOTAL COMMON SHAREHOLDER'S<br/>EQUITY - DECEMBER 31, 2020</b> | \$ 50,450               | \$ 526,135                 | \$ 245,871                   | \$ 878   | \$ 823,334        |
| Net Income   |                         |                            | 13,851                       |  | 13,851            |
| Other Comprehensive Loss   |                         |                            |                              | (34)   | (34)              |
| <b>TOTAL COMMON SHAREHOLDER'S<br/>EQUITY - MARCH 31, 2021</b>    | <u>\$ 50,450</u>        | <u>\$ 526,135</u>          | <u>\$ 259,722</u>            | <u>\$ 844</u>  | <u>\$ 837,151</u> |
| <b>TOTAL COMMON SHAREHOLDER'S<br/>EQUITY - DECEMBER 31, 2021</b> | \$ 50,450               | \$ 526,135                 | \$ 296,021                   | \$ 1,749   | \$ 874,355        |
| Net Income   |                         |                            | 25,921                       |  | 25,921            |
| Other Comprehensive Loss   |                         |                            |                              | (39)   | (39)              |
| <b>TOTAL COMMON SHAREHOLDER'S<br/>EQUITY - MARCH 31, 2022</b>    | <u>\$ 50,450</u>        | <u>\$ 526,135</u>          | <u>\$ 321,942</u>            | <u>\$ 1,710</u>  | <u>\$ 900,237</u> |

*See Condensed Notes to Condensed Financial Statements beginning on page 8.*

**KENTUCKY POWER COMPANY**  
**CONDENSED BALANCE SHEETS**  
**ASSETS**  
**March 31, 2022 and December 31, 2021**  
**(in thousands)**  
**(Unaudited)**

|  | <b>March 31,<br/>2022</b> | <b>December 31,<br/>2021</b> |
|--|---------------------------|------------------------------|
| <b>CURRENT ASSETS</b>                            |                           |                              |
| Cash and Cash Equivalents                        | \$ 2,973                  | \$ 763                       |
| Accounts Receivable:                             |                           |                              |
| Customers  | 55,084                    | 16,281                       |
| Affiliated Companies                             | 23,152                    | 25,578                       |
| Accrued Unbilled Revenues                        | 20,735                    | 16,647                       |
| Miscellaneous                                    | 112                       | 57                           |
| Allowance for Uncollectible Accounts             | (871)                     | (3)                          |
| Total Accounts Receivable                        | <u>98,212</u>             | <u>58,560</u>                |
| Fuel   | 16,679                    | 10,090                       |
| Materials and Supplies                           | 20,727                    | 20,515                       |
| Risk Management Assets                           | 1,456                     | 5,986                        |
| Regulatory Asset for Under-Recovered Fuel Costs  | 15,552                    | 8,216                        |
| Margin Deposits                                  | 1,448                     | 14,229                       |
| Prepayments and Other Current Assets             | 2,055                     | 3,490                        |
| <b>TOTAL CURRENT ASSETS</b>                      | <u>159,102</u>            | <u>121,849</u>               |
| <b>PROPERTY, PLANT AND EQUIPMENT</b>             |                           |                              |
| Electric:  |                           |                              |
| Generation                                       | 1,232,391                 | 1,231,494                    |
| Transmission                                     | 772,026                   | 760,359                      |
| Distribution                                     | 1,030,201                 | 1,017,406                    |
| Other Property, Plant and Equipment              | 137,560                   | 137,554                      |
| Construction Work in Progress                    | 102,565                   | 95,093                       |
| <b>Total Property, Plant and Equipment</b>       | <u>3,274,743</u>          | <u>3,241,906</u>             |
| Accumulated Depreciation and Amortization        | 1,117,433                 | 1,104,492                    |
| <b>TOTAL PROPERTY, PLANT AND EQUIPMENT – NET</b> | <u>2,157,310</u>          | <u>2,137,414</u>             |
| <b>OTHER NONCURRENT ASSETS</b>                   |                           |                              |
| Regulatory Assets                                | 477,173                   | 476,457                      |
| Employee Benefits and Pension Assets             | 61,403                    | 60,333                       |
| Operating Lease Assets                           | 10,147                    | 10,748                       |
| Deferred Charges and Other Noncurrent Assets     | 28,509                    | 33,848                       |
| <b>TOTAL OTHER NONCURRENT ASSETS</b>             | <u>577,232</u>            | <u>581,386</u>               |
| <b>TOTAL ASSETS</b>                              | <u>\$ 2,893,644</u>       | <u>\$ 2,840,649</u>          |

*See Condensed Notes to Condensed Financial Statements beginning on page 8.*

**KENTUCKY POWER COMPANY**  
**CONDENSED BALANCE SHEETS**  
**LIABILITIES AND COMMON SHAREHOLDER'S EQUITY**  
**March 31, 2022 and December 31, 2021**  
**(Unaudited)**

|  | <b>March 31,<br/>2022</b> | <b>December 31,<br/>2021</b> |
|--|---------------------------|------------------------------|
|  | <b>(in thousands)</b>     |                              |
| <b>CURRENT LIABILITIES</b>                                 |                           |                              |
| Advances from Affiliates                                   | \$ 93,939                 | \$ 47,895                    |
| Accounts Payable:  |                           |                              |
| General  | 56,989                    | 52,837                       |
| Affiliated Companies                                       | 31,806                    | 42,223                       |
| Long-term Debt Due Within One Year – Nonaffiliated         | 200,000                   | 200,000                      |
| Risk Management Liabilities                                | 30                        | 51                           |
| Customer Deposits  | 34,186                    | 32,432                       |
| Accrued Taxes  | 32,239                    | 45,243                       |
| Accrued Interest   | 6,256                     | 5,685                        |
| Obligations Under Operating Leases                         | 2,072                     | 2,173                        |
| Other Current Liabilities                                  | 26,816                    | 21,384                       |
| <b>TOTAL CURRENT LIABILITIES</b>                           | <b>484,333</b>            | <b>449,923</b>               |
| <b>NONCURRENT LIABILITIES</b>                              |                           |                              |
| Long-term Debt – Nonaffiliated                             | 903,190                   | 903,105                      |
| Deferred Income Taxes                                      | 436,166                   | 437,152                      |
| Regulatory Liabilities and Deferred Investment Tax Credits | 132,412                   | 140,506                      |
| Asset Retirement Obligations                               | 17,276                    | 16,399                       |
| Employee Benefits and Pension Obligations                  | 8,546                     | 8,064                        |
| Obligations Under Operating Leases                         | 8,105                     | 8,614                        |
| Deferred Credits and Other Noncurrent Liabilities          | 3,379                     | 2,531                        |
| <b>TOTAL NONCURRENT LIABILITIES</b>                        | <b>1,509,074</b>          | <b>1,516,371</b>             |
| <b>TOTAL LIABILITIES</b>                                   | <b>1,993,407</b>          | <b>1,966,294</b>             |
| Rate Matters (Note 4)                                      |                           |                              |
| Commitments and Contingencies (Note 5)                     |                           |                              |
| <b>COMMON SHAREHOLDER'S EQUITY</b>                         |                           |                              |
| Common Stock – Par Value – \$50 Per Share:                 |                           |                              |
| Authorized – 2,000,000 Shares                              |                           |                              |
| Outstanding – 1,009,000 Shares                             | 50,450                    | 50,450                       |
| Paid-in Capital  | 526,135                   | 526,135                      |
| Retained Earnings  | 321,942                   | 296,021                      |
| Accumulated Other Comprehensive Income (Loss)              | 1,710                     | 1,749                        |
| <b>TOTAL COMMON SHAREHOLDER'S EQUITY</b>                   | <b>900,237</b>            | <b>874,355</b>               |
| <b>TOTAL LIABILITIES AND COMMON SHAREHOLDER'S EQUITY</b>   | <b>\$ 2,893,644</b>       | <b>\$ 2,840,649</b>          |

See Condensed Notes to Condensed Financial Statements beginning on page 8.



**KENTUCKY POWER COMPANY**  
**CONDENSED STATEMENTS OF CASH FLOWS**  
**For the Three Months Ended March 31, 2022 and 2021**  
**(in thousands)**  
**(Unaudited)**

|  | <b>Three Months Ended March 31,</b> |                 |
|--|-------------------------------------|-----------------|
|  | <b>2022</b>                         | <b>2021</b>     |
| <b>OPERATING ACTIVITIES</b>  |                                     |                 |
| <b>Net Income</b>  | \$ 25,921                           | \$ 13,851       |
| <b>Adjustments to Reconcile Net Income to Net Cash Flows from (Used for) Operating Activities:</b> |                                     |                 |
| Depreciation and Amortization  | 30,528                              | 29,520          |
| Deferred Income Taxes  | (10,224)                            | (4,323)         |
| Allowance for Equity Funds Used During Construction  | (377)                               | (276)           |
| Mark-to-Market of Risk Management Contracts  | 4,509                               | 1,873           |
| Property Taxes   | 5,391                               | 5,279           |
| Deferred Fuel Over/Under-Recovery, Net   | (7,336)                             | (2,779)         |
| Change in Regulatory Assets  | (3,502)                             | (44,779)        |
| Change in Other Noncurrent Assets  | (3,372)                             | (4,799)         |
| Change in Other Noncurrent Liabilities   | (2,404)                             | 2,475           |
| <b>Changes in Certain Components of Working Capital:</b>   |                                     |                 |
| Accounts Receivable, Net   | (39,499)                            | 2,611           |
| Fuel, Materials and Supplies   | (6,776)                             | (527)           |
| Margin Deposits  | 12,782                              | (20)            |
| Accounts Payable   | (4,251)                             | 44,306          |
| Accrued Taxes, Net   | (12,238)                            | (13,742)        |
| Other Current Assets   | 685                                 | 546             |
| Other Current Liabilities  | 7,528                               | (1,618)         |
| <b>Net Cash Flows from (Used for) Operating Activities</b>   | <b>(2,635)</b>                      | <b>27,598</b>   |
| <b>INVESTING ACTIVITIES</b>  |                                     |                 |
| Construction Expenditures  | (41,950)                            | (37,010)        |
| Other Investing Activities   | 1,015                               | 279             |
| <b>Net Cash Flows Used for Investing Activities</b>  | <b>(40,935)</b>                     | <b>(36,731)</b> |
| <b>FINANCING ACTIVITIES</b>  |                                     |                 |
| Change in Advances from Affiliates, Net  | 46,044                              | 8,752           |
| Principal Payments for Finance Lease Obligations   | (230)                               | (218)           |
| Other Financing Activities   | (34)                                | 117             |
| <b>Net Cash Flows from Financing Activities</b>  | <b>45,780</b>                       | <b>8,651</b>    |
| <b>Net Increase (Decrease) in Cash and Cash Equivalents</b>  | <b>2,210</b>                        | <b>(482)</b>    |
| <b>Cash and Cash Equivalents at Beginning of Period</b>  | <b>763</b>                          | <b>1,533</b>    |
| <b>Cash and Cash Equivalents at End of Period</b>  | <b>\$ 2,973</b>                     | <b>\$ 1,051</b> |
| <b>SUPPLEMENTARY INFORMATION</b>   |                                     |                 |
| Cash Paid for Interest, Net of Capitalized Amounts   | \$ 8,594                            | \$ 8,829        |
| Net Cash Paid for Income Taxes   | —                                   | 156             |
| Noncash Acquisitions Under Finance Leases  | 77                                  | 46              |
| Construction Expenditures Included in Current Liabilities as of March 31,                          | 25,246                              | 32,351          |

*See Condensed Notes to Condensed Financial Statements beginning on page 8.*

## INDEX OF CONDENSED NOTES TO CONDENSED FINANCIAL STATEMENTS

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## **1. SIGNIFICANT ACCOUNTING MATTERS**

### ***General***

The unaudited condensed financial statements and footnotes were prepared in accordance with GAAP for interim financial information. Accordingly, they do not include all of the information and footnotes required by GAAP for complete annual financial statements.

In the opinion of management, the unaudited condensed interim financial statements reflect all normal and recurring accruals and adjustments necessary for a fair statement of the net income, financial position and cash flows for the interim periods. Net income for the three months ended March 31, 2022 is not necessarily indicative of results that may be expected for the year ending December 31, 2022. The condensed financial statements are unaudited and should be read in conjunction with the audited 2021 financial statements and notes thereto, which are included in KPCo's 2021 Annual Report.

### ***AEP System Tax Allocation***

KPCo joins in the filing of a consolidated tax return. Historically, the allocation of the AEP System's current consolidated federal income tax to the AEP System companies allocated the benefit of current tax loss of the parent company (Parent Company Loss Benefit) to the AEP System subsidiaries through a reduction of current tax expense. In 2022, AEP and subsidiaries changed accounting for the Parent Company Loss Benefit from a reduction of current tax expense to an allocation through equity. The impact of this change is immaterial to KPCo's financial statements.

### ***Disposition of KPCo and KTCo***

In October 2021, AEP entered into a Stock Purchase Agreement to sell KPCo and KTCo to Liberty Utilities Co., a subsidiary of Algonquin Power & Utilities Corp. (Liberty), for approximately a \$2.85 billion enterprise value. The sale is subject to regulatory approvals from the FERC and KPSC. Clearance under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 and clearance from the Committee on Foreign Investment in the United States has been received.

### ***Proposed Operations and Maintenance Agreement and Plant Ownership Agreement***

KPCo currently operates and owns a 50% undivided interest in the 1,560 MW coal-fired Mitchell Plant with the remaining 50% owned by WPCo. The Stock Purchase Agreement is further contingent upon the issuance by the KPSC, WVPSC and FERC of orders regarding a new proposed Mitchell Plant Operations and Maintenance Agreement and Mitchell Plant Ownership Agreement between KPCo and WPCo.

In November 2021, AEP made filings with the KPSC, WVPSC and FERC seeking approval of a proposed Mitchell Plant Operations and Maintenance Agreement and Mitchell Plant Ownership Agreement, pursuant to which WPCo would replace KPCo as the operator of the Mitchell Plant and KPCo employees at the Mitchell Plant would become employees of WPCo. Under this originally proposed Ownership Agreement, WPCo is obligated to purchase KPCo's 50% undivided interest in the Mitchell Plant on December 31, 2028 unless KPCo and WPCo have agreed to retire the Mitchell Plant earlier or, absent such agreement, if WPCo elects prior to December 31, 2027 to retire the Mitchell Plant on December 31, 2028. The Ownership Agreement provides that the purchase price for KPCo's 50% ownership interest in the Mitchell Plant will be determined through the mutual agreement of WPCo and KPCo (subject to approval from the KPSC and WVPSC) or through a fair market valuation determination conducted by independent appraisals, with offsets for estimated decommissioning costs and the cost of ELG investments made by WPCo, if KPCo and WPCo are unable to reach agreement as to the purchase price.

In January 2022, intervenor testimony was filed with the KPSC, recommending the KPSC either reject the new proposed Mitchell Plant Ownership Agreement or approve the agreement with certain modifications including a revision to the buyout provision that would set WPCo's Mitchell Plant purchase price at the greater of fair market value or net book value. The intervenor testimony also recommends the KPSC reject the proposed Mitchell Plant

Operations and Maintenance Agreement, which the testimony stated should be modified to remove references to the Mitchell Plant Ownership Agreement. In February 2022, AEP filed rebuttal testimony with the KPSC opposing the intervenor testimony filed in January 2022. AEP's rebuttal testimony also discusses an alternative proposal to the fair market value provision included in the proposed Mitchell Plant Ownership Agreement. Under the alternative proposal, KPCo's and WPCo's interest in the Mitchell Plant would be divided by unit if the plant is not retired before the end of 2028 and a mutual agreement cannot be reached on a buyout price. Under the alternative proposal, mutual agreement on the buyout price or unit disposition would need to be finalized by May 2025, with a division of plant ownership by unit effective January 1, 2029, unless otherwise agreed. In March 2022, a hearing was held on the agreements with the KPSC. Following the hearing, KPCo amended its November 2021 filing with a new version of the Mitchell Plant Ownership Agreement that provided further details about the alternative proposal. As amended, the proposed Mitchell Plant Ownership Agreement creates procedures, subject to all required regulatory approvals, that provide the option for WPCo and KPCo to negotiate a sale of KPCo's interest in the Mitchell Plant to WPCo, split the Mitchell Plant units with additional agreements for KPCo to utilize WPCo's ELG assets, if necessary, or to agree on the procedures and timetable to retire one or both units. As amended, the proposed Mitchell Plant Ownership Agreement replaced certain aspects of the originally proposed agreement including the buyout provision at fair market value. A hearing on the amended filing was held on March 30, 2022. A decision from the KPSC is expected in the second quarter of 2022.

For the filing at the WVPSC, intervenor testimony filed in March 2022 and briefs filed in April 2022 recommended various clarifying modifications to the Mitchell Ownership Agreement and the Mitchell Operations and Maintenance Agreement. A decision from the WVPSC is expected in the second quarter of 2022.

The KPSC and WVPSC intervened in the FERC proceeding and have recommended that FERC dismiss or reject AEP's request, or defer ruling on AEP's request until both the retail commissions have rendered decisions. In February 2022, AEP filed a motion to withdraw its filing with the FERC, noting that AEP intends to re-file its request after the KPSC and WVPSC have reviewed the agreements.

### *Transfer of Ownership*

In December 2021, Liberty, KPCo and KTCo sought approval from the FERC under Section 203 of the Federal Power Act for the sale. In February 2022, several intervenors in the case filed protests related to whether the sale will negatively impact the wholesale transmission and generation rates of applicants. In April 2022, the FERC issued a deficiency letter stating that the Section 203 application is deficient and that additional information is required to process it. Liberty, KPCo and KTCo plan to respond to provide additional information in response to the letter. An order from the FERC is expected on the matter in the second quarter of 2022.

In January 2022, KPCo and Liberty filed a joint application requesting the KPSC authorize the transfer of ownership of KPCo to Liberty. In February 2022, certain intervenors filed testimony recommending that the KPSC not approve the transfer of ownership. If, however, the KPSC does approve the transfer, these intervenors recommend that the KPSC require AEP to compensate KPCo customers \$578 million for alleged future increased costs and higher rates that the intervenors claim will exist under Liberty's ownership. AEP disagrees with the recommendation and filed rebuttal testimony in March 2022. AEP has committed to fund, through a reduction in Liberty's purchase price, \$20 million of Liberty's commitment to provide \$40 million of benefits to KPCo customers in bill reductions to help offset fuel costs. Intervenors also recommended imposing certain conditions on Liberty, including conditions related to recovering certain costs, inter-company agreement filing requirements, KPCo's capital structure and future generation resource planning processes and analyses. In addition, certain intervenors argue that the commission should not approve the new proposed Mitchell Plant Ownership Agreement and Mitchell Plant Operations and Maintenance Agreement, and that deciding the request to transfer ownership of KPCo should be separated from approval of the Mitchell agreements even though such approval is a condition to the transaction closing. AEP also disagrees with this argument. A hearing was held with the KPSC in March 2022. In April 2022, certain intervenors filed briefs with the KPSC in support of their original recommendations, including both recommendations for and against approval of the transfer of KPCo to Liberty. A final order is expected in the second quarter of 2022.

Subject to receipt of regulatory approval and resolution of the Mitchell ownership and operating issues disclosed above, the sale is expected to close in the second quarter of 2022 with Liberty acquiring the assets and assuming the

liabilities of KPCo and KTCo, excluding pension and other post-retirement benefit plan assets and liabilities. AEP expects to provide customary transition services to Liberty for a period of time after closing of the transaction.

***Subsequent Events***

Management reviewed subsequent events through April 28, 2022, the date that the first quarter 2022 report was available to be issued.

## **2. NEW ACCOUNTING STANDARDS**

During the FASB's standard-setting process and upon issuance of final standards, management reviews the new accounting literature to determine its relevance, if any, to KPCo's business. There are no new standards expected to have a material impact on KPCo's financial statements.

### 3. COMPREHENSIVE INCOME

#### *Presentation of Comprehensive Income*

The following tables provide the components of changes in AOCI and details of reclassifications from AOCI. The amortization of pension and OPEB AOCI components are included in the computation of net periodic pension and OPEB costs. See Note 6 - Benefit Plans for additional information.

| <b>Three Months Ended March 31, 2022</b>                         | <b>Pension<br/>and OPEB<br/>(in thousands)</b> |
|--|--|
| <b>Balance in AOCI as of December 31, 2021</b>                   | \$ 1,749                                       |
| Change in Fair Value Recognized in AOCI                          | —  |
| Amount of (Gain) Loss Reclassified from AOCI                     |  |
| Amortization of Prior Service Cost (Credit)                      | (59)   |
| Amortization of Actuarial (Gains) Losses                         | 10   |
| Reclassifications from AOCI, before Income Tax (Expense) Benefit | (49)   |
| Income Tax (Expense) Benefit                                     | (10)   |
| Reclassifications from AOCI, Net of Income Tax (Expense) Benefit | (39)   |
| Net Current Period Other Comprehensive Income (Loss)             | (39)   |
| <b>Balance in AOCI as of March 31, 2022</b>                      | <b>\$ 1,710</b>                                |

| <b>Three Months Ended March 31, 2021</b>                         | <b>Pension<br/>and OPEB<br/>(in thousands)</b> |
|--|--|
| <b>Balance in AOCI as of December 31, 2020</b>                   | \$ 878   |
| Change in Fair Value Recognized in AOCI                          | —  |
| Amount of (Gain) Loss Reclassified from AOCI                     |  |
| Amortization of Prior Service Cost (Credit)                      | (59)   |
| Amortization of Actuarial (Gains) Losses                         | 16   |
| Reclassifications from AOCI, before Income Tax (Expense) Benefit | (43)   |
| Income Tax (Expense) Benefit                                     | (9)  |
| Reclassifications from AOCI, Net of Income Tax (Expense) Benefit | (34)   |
| Net Current Period Other Comprehensive Income (Loss)             | (34)   |
| <b>Balance in AOCI as of March 31, 2021</b>                      | <b>\$ 844</b>                                  |

#### 4. RATE MATTERS

As discussed in KPCo's 2021 Annual Report, KPCo is involved in rate and regulatory proceedings at the FERC and the KPSC. The Rate Matters note within KPCo's 2021 Annual Report should be read in conjunction with this report to gain a complete understanding of material rate matters still pending that could impact net income, cash flows and possibly financial condition. The following discusses ratemaking developments in 2022 and updates KPCo's 2021 Annual Report.

##### *Regulatory Assets Pending Final Regulatory Approval*

| <u>Noncurrent Regulatory Assets</u>                              | <u>March 31,<br/>2022</u> | <u>December 31,<br/>2021</u> |
|--|---------------------------|------------------------------|
|  | (in thousands)            |                              |
| <u>Regulatory Assets Currently Earning a Return</u>              |                           |                              |
| Kentucky Deferred Purchased Power Expenses                       | \$ 49,116                 | \$ 47,528                    |
| <u>Regulatory Assets Currently Not Earning a Return</u>          |                           |                              |
| Storm-Related Costs  | 56,506                    | 56,506                       |
| Other Regulatory Assets Pending Final Regulatory Approval        | 1,085                     | 893                          |
| <b>Total Regulatory Assets Pending Final Regulatory Approval</b> | <u>\$ 106,707</u>         | <u>\$ 104,927</u>            |

If these costs are ultimately determined not to be recoverable, it could reduce future net income and cash flows and impact financial condition.

##### *Mitchell Plant*

KPCo and WPCo each own a 50% interest in the 1,560 MW coal-fired the Mitchell Plant. In December 2020 and February 2021, WPCo and KPCo filed requests with the WVPSC and KPSC, respectively, to obtain the regulatory approvals necessary to implement CCR and ELG compliance plans and seek recovery of the estimated \$132 million investment for the Mitchell Plant that would allow the plant to continue operating beyond 2028. Within those requests, WPCo and KPCo also filed a \$25 million alternative to implement only the CCR-related investments with the WVPSC and KPSC, respectively, which would allow the Mitchell Plant to continue operating only through 2028.

In July 2021, the KPSC issued an order approving the CCR only alternative and rejecting the full CCR and ELG compliance plan. In August 2021, the WVPSC approved the full CCR and ELG compliance plan for the WPCo share of the Mitchell Plant. In September 2021, WPCo submitted a filing with the WVPSC to reopen the CCR/ELG case that was approved by the WVPSC in August 2021. Due to the rejection by the KPSC of the KPCo share of the ELG investments, WPCo requested the WVPSC consider approving the construction and recovery of all ELG costs at the plant. In October 2021, the WVPSC affirmed its August 2021 order approving the construction of CCR/ELG investments and directed WPCo to proceed with CCR/ELG compliance plans that would allow the plant to continue operating beyond 2028. The WVPSC's order further states WPCo will not share capacity and energy from the plant with KPCo customers if those customers are not paying for ELG compliance costs, or for any new capital investment or continuing operations costs incurred, to allow the plant to operate beyond 2028 or prevent downgrades prior to 2028. The WVPSC also ordered that WPCo will be given the opportunity to recover, from its customers, the new capital and operating costs arising solely from the WVPSC's directive to operate the plant beyond 2028 if the WVPSC finds that the costs are reasonably and prudently incurred. In October and November 2021, intervenors filed petitions for reconsideration at the WVPSC requesting clarification on certain aspects of the order, primarily the jurisdictional allocation of future operating expenses and plant costs.



In November 2021, AEP made filings with the KPSC, WVPSC and FERC seeking approval of a proposed Mitchell Plant Operations and Maintenance Agreement and Mitchell Plant Ownership Agreement between KPCo and WPCo pursuant to which WPCo would replace KPCo as the operator of the Mitchell Plant. In February 2022, AEP filed a motion to withdraw its filing with the FERC, noting that AEP intends to re-file its request after the KPSC and WVPSC have reviewed the agreements. See “Disposition of KPCo and KTCo” section of Note 1 for additional information.

As of March 31, 2022, KPCo’s share of the Mitchell Plant’s ELG investment balance in CWIP was \$4.1 million. As of March 31, 2022, the net book value of KPCo’s share of the Mitchell Plant, before cost of removal including CWIP and inventory, was \$584.9 million.

If any of the ELG costs are not approved for recovery and/or the retirement date of the Mitchell Plant is accelerated to 2028 without commensurate cost recovery, it would reduce future net income and cash flows and impact financial condition.

## **5. COMMITMENTS, GUARANTEES AND CONTINGENCIES**

KPCo is subject to certain claims and legal actions arising in its ordinary course of business. In addition, KPCo's business activities are subject to extensive governmental regulation related to public health and the environment. The ultimate outcome of such pending or potential litigation against KPCo cannot be predicted. Management accrues contingent liabilities only when management concludes that it is both probable that a liability has been incurred at the date of the financial statements and the amount of loss can be reasonably estimated. When management determines that it is not probable, but rather reasonably possible that a liability has been incurred at the date of the financial statements, management discloses such contingencies and the possible loss or range of loss if such estimate can be made. Any estimated range is based on currently available information and involves elements of judgment and significant uncertainties. Any estimated range of possible loss may not represent the maximum possible loss exposure. Circumstances change over time and actual results may vary significantly from estimates.

For current proceedings not specifically discussed below, management does not anticipate that the liabilities, if any, arising from such proceedings would have a material effect on the financial statements. The Commitments, Guarantees and Contingencies note within KPCo's 2021 Annual Report should be read in conjunction with this report.

### **GUARANTEES**

Liabilities for guarantees are recorded in accordance with the accounting guidance for "Guarantees." There is no collateral held in relation to any guarantees. In the event any guarantee is drawn, there is no recourse to third-parties unless specified below.

#### ***Indemnifications and Other Guarantees***

##### ***Contracts***

KPCo enters into certain types of contracts which require indemnifications. Typically these contracts include, but are not limited to, sale agreements, lease agreements, purchase agreements and financing agreements. Generally, these agreements may include, but are not limited to, indemnifications around certain tax, contractual and environmental matters. With respect to sale agreements, exposure generally does not exceed the sale price. As of March 31, 2022, there were no material liabilities recorded for any indemnifications.

AEPSC conducts power purchase and sale activity on behalf of APCo, I&M, KPCo and WPCo, who are jointly and severally liable for activity conducted on their behalf.

##### ***Master Lease Agreements***

KPCo leases certain equipment under master lease agreements. Under the lease agreements, the lessor is guaranteed a residual value up to a stated percentage of the equipment cost at the end of the lease term. If the actual fair value of the leased equipment is below the guaranteed residual value at the end of the lease term, KPCo is committed to pay the difference between the actual fair value and the residual value guarantee. Historically, at the end of the lease term the fair value has been in excess of the amount guaranteed. As of March 31, 2022, the maximum potential loss for these lease agreements was \$1.6 million assuming the fair value of the equipment is zero at the end of the lease term.

## CONTINGENCIES

### *Claims Challenging Transition of American Electric Power System Retirement Plan to Cash Balance Formula*

Four participants in The American Electric Power System Retirement Plan (the Plan) filed a class action complaint in December 2021 in the U.S. District Court for the Southern District of Ohio against AEPSC and the Plan. When the Plan's benefit formula was changed in the year 2000, AEP provided a special provision for employees hired before January 1, 2001, allowing them to continue benefit accruals under the then benefit formula for a full 10 years alongside of the new cash balance benefit formula then being implemented. Employees who were hired on or after January 1, 2001 accrued benefits only under the new cash balance benefit formula. The Plaintiffs assert a number of claims on behalf of themselves and the purported class, including that: (a) the Plan violates the requirements under the Employee Retirement Income Security Act (ERISA) intended to preclude back-loading the accrual of benefits to the end of a participant's career, (b) the Plan violates the age discrimination prohibitions of ERISA and the Age Discrimination in Employment Act and (c) AEP failed to provide required notice regarding the changes to the Plan. Among other relief, the Complaint seeks reformation of the Plan to provide additional benefits and the recovery of plan benefits for former employees under such reformed plan. The Plaintiffs previously had submitted claims for additional plan benefits to AEP, which were denied. On February 15, 2022, AEPSC and the Plan filed a motion to dismiss the complaint for failure to state a claim. AEP will continue to defend against the claims. Management is unable to determine a range of potential losses that is reasonably possible of occurring.

## 6. BENEFIT PLANS

KPCo participates in an AEP sponsored qualified pension plan and two unfunded nonqualified pension plans. Substantially all of KPCo's employees are covered by the qualified plan or both the qualified and nonqualified pension plans. KPCo also participates in OPEB plans sponsored by AEP to provide health and life insurance benefits for retired employees.

### *Components of Net Periodic Benefit Cost*

The following table provides the components of KPCo's net periodic benefit cost (credit) for the plans:

|   | <b>Pension Plans</b>                         |               | <b>OPEB</b>                                  |                   |
|---|--|---------------|--|-------------------|
|   | <b>Three Months Ended March 31,<br/>2022</b> | <b>2021</b>   | <b>Three Months Ended March 31,<br/>2022</b> | <b>2021</b>       |
|   | <b>(in thousands)</b>                        |               |  |                   |
| Service Cost                              | \$ 791                                       | \$ 869        | \$ 52  | \$ 71             |
| Interest Cost                             | 1,288  | 1,210         | 261  | 274               |
| Expected Return on Plan Assets            | (2,400)                                      | (2,146)       | (1,060)                                      | (870)             |
| Amortization of Prior Service Credit      | —  | —             | (630)  | (625)             |
| Amortization of Net Actuarial Loss        | 536  | 881           | —  | —                 |
| <b>Net Periodic Benefit Cost (Credit)</b> | <b>\$ 215</b>                                | <b>\$ 814</b> | <b>\$ (1,377)</b>                            | <b>\$ (1,150)</b> |

## 7. DERIVATIVES AND HEDGING

### OBJECTIVES FOR UTILIZATION OF DERIVATIVE INSTRUMENTS

AEPSC is agent for and transacts on behalf of KPCo.

KPCo is exposed to certain market risks as a major power producer and participant in the electricity, natural gas, coal and emission allowance markets. These risks include commodity price risk, interest rate risk and credit risk. These risks represent the risk of loss that may impact KPCo due to changes in the underlying market prices or rates. Management utilizes derivative instruments to manage these risks.

### STRATEGIES FOR UTILIZATION OF DERIVATIVE INSTRUMENTS TO ACHIEVE OBJECTIVES

#### *Risk Management Strategies*

The strategy surrounding the use of derivative instruments primarily focuses on managing risk exposures, future cash flows and creating value utilizing both economic and formal hedging strategies. The risk management strategies also include the use of derivative instruments for trading purposes which focus on seizing market opportunities to create value driven by expected changes in the market prices of the commodities. To accomplish these objectives, KPCo primarily employs risk management contracts including physical and financial forward purchase-and-sale contracts and, to a lesser extent, OTC swaps and options. Not all risk management contracts meet the definition of a derivative under the accounting guidance for “Derivatives and Hedging.” Derivative risk management contracts elected normal under the normal purchases and normal sales scope exception are not subject to the requirements of this accounting guidance.

KPCo utilizes power, capacity, coal, natural gas, interest rate and, to a lesser extent, heating oil, gasoline and other commodity contracts to manage the risk associated with the energy business. KPCo utilizes interest rate derivative contracts in order to manage the interest rate exposure associated with its commodity portfolio. For disclosure purposes, such risks are grouped as “Commodity,” as these risks are related to energy risk management activities. KPCo may also utilize derivative contracts to manage interest rate risk associated with debt financing. For disclosure purposes, these risks are grouped as “Interest Rate.” The amount of risk taken is determined by the Commercial Operations and Finance groups in accordance with the established risk management policies as approved by the Finance Committee of the Board of Directors.

The following table represents the gross notional volume of KPCo’s outstanding derivative contracts:

| <u>Primary Risk Exposure</u> | <u>March 31,<br/>2022</u> | <u>December 31,<br/>2021</u> | <u>Unit of<br/>Measure</u> |
|------------------------------|---------------------------|------------------------------|----------------------------|
|                              | <u>(in thousands)</u>     |                              |                            |
| Commodity:                   |                           |                              |                            |
| Power                        | 2,795                     | 6,927                        | MWhs                       |
| Heating Oil and Gasoline     | 222                       | 305                          | Gallons                    |

### ***Cash Flow Hedging Strategies***

KPCo utilizes cash flow hedges on certain derivative transactions for the purchase and sale of power (“Commodity”) in order to manage the variable price risk related to forecasted purchases and sales. Management monitors the potential impacts of commodity price changes and, where appropriate, enters into derivative transactions to protect profit margins for a portion of future electricity sales and purchases. KPCo does not hedge all commodity price risk.

KPCo may utilize a variety of interest rate derivative transactions in order to manage interest rate risk exposure. KPCo may also utilize interest rate derivative contracts to manage interest rate exposure related to future borrowings of fixed-rate debt. KPCo does not hedge all interest rate exposure.

### **ACCOUNTING FOR DERIVATIVE INSTRUMENTS AND THE IMPACT ON KPCo’s FINANCIAL STATEMENTS**

The accounting guidance for “Derivatives and Hedging” requires recognition of all qualifying derivative instruments as either assets or liabilities on the balance sheets at fair value. The fair values of derivative instruments accounted for using MTM accounting or hedge accounting are based on exchange prices and broker quotes. If a quoted market price is not available, the estimate of fair value is based on the best information available including valuation models that estimate future energy prices based on existing market and broker quotes and assumptions. In order to determine the relevant fair values of the derivative instruments, KPCo applies valuation adjustments for discounting, liquidity and credit quality.

Credit risk is the risk that a counterparty will fail to perform on the contract or fail to pay amounts due. Liquidity risk represents the risk that imperfections in the market will cause the price to vary from estimated fair value based upon prevailing market supply and demand conditions. Since energy markets are imperfect and volatile, there are inherent risks related to the underlying assumptions in models used to fair value risk management contracts. Unforeseen events may cause reasonable price curves to differ from actual price curves throughout a contract’s term and at the time a contract settles. Consequently, there could be significant adverse or favorable effects on future net income and cash flows if market prices are not consistent with management’s estimates of current market consensus for forward prices in the current period. This is particularly true for longer term contracts. Cash flows may vary based on market conditions, margin requirements and the timing of settlement of risk management contracts.

According to the accounting guidance for “Derivatives and Hedging,” KPCo reflects the fair values of derivative instruments subject to netting agreements with the same counterparty net of related cash collateral. For certain risk management contracts, KPCo is required to post or receive cash collateral based on third-party contractual agreements and risk profiles. For the March 31, 2022 and December 31, 2021 balance sheets, KPCo netted \$226 thousand and \$95 thousand, respectively, of cash collateral received from third-parties against short-term and long-term risk management assets and \$0 and \$0, respectively, of cash collateral paid to third-parties against short-term and long-term risk management liabilities.

The following tables represent the gross fair value of KPCo's derivative activity on the balance sheets:

**Fair Value of Derivative Instruments  
March 31, 2022**

| Balance Sheet Location  | Risk Management<br>Contracts –<br>Commodity (a) | Gross Amounts Offset<br>in the Statement of<br>Financial Position (b) | Net Amounts of Assets/Liabilities<br>Presented in the Statement<br>of Financial Position (c) |
|---|---|---|--|
|   |   | (in thousands)  |  |
| Current Risk Management Assets                                | \$ 2,349  | \$ (893)  | \$ 1,456   |
| Long-term Risk Management Assets                              | 87  | (87)  | —  |
| <b>Total Assets</b>   | <u>2,436</u>                                    | <u>(980)</u>  | <u>1,456</u>   |
| Current Risk Management Liabilities                           | 697   | (667)   | 30   |
| Long-term Risk Management Liabilities                         | 87  | (87)  | —  |
| <b>Total Liabilities</b>                                      | <u>784</u>                                      | <u>(754)</u>  | <u>30</u>  |
| <b>Total MTM Derivative Contract Net Assets (Liabilities)</b> | <u>\$ 1,652</u>                                 | <u>\$ (226)</u>   | <u>\$ 1,426</u>  |

**December 31, 2021**

| Balance Sheet Location  | Risk Management<br>Contracts –<br>Commodity (a) | Gross Amounts Offset<br>in the Statement of<br>Financial Position (b) | Net Amounts of Assets/Liabilities<br>Presented in the Statement<br>of Financial Position (c) |
|---|---|---|--|
|   |   | (in thousands)  |  |
| Current Risk Management Assets                                | \$ 7,488  | \$ (1,502)  | \$ 5,986   |
| Long-term Risk Management Assets                              | 46  | (46)  | —  |
| <b>Total Assets</b>   | <u>7,534</u>                                    | <u>(1,548)</u>  | <u>5,986</u>   |
| Current Risk Management Liabilities                           | 1,458   | (1,407)   | 51   |
| Long-term Risk Management Liabilities                         | 46  | (46)  | —  |
| <b>Total Liabilities</b>                                      | <u>1,504</u>                                    | <u>(1,453)</u>  | <u>51</u>  |
| <b>Total MTM Derivative Contract Net Assets (Liabilities)</b> | <u>\$ 6,030</u>                                 | <u>\$ (95)</u>  | <u>\$ 5,935</u>  |

- (a) Derivative instruments within this category are disclosed as gross. These instruments are subject to master netting agreements and are presented on the balance sheets on a net basis in accordance with the accounting guidance for "Derivatives and Hedging."
- (b) Amounts include counterparty netting of risk management and hedging contracts and associated cash collateral in accordance with the accounting guidance for "Derivatives and Hedging."
- (c) All derivative contracts subject to a master netting arrangement or similar agreement are offset in the statement of financial position.

The table below presents KPCo's activity of derivative risk management contracts:

**Amount of Gain (Loss) Recognized on  
Risk Management Contracts**

| Location of Gain (Loss)                                     | Three Months Ended<br>March 31, |               |
|---|---------------------------------|---------------|
|   | 2022                            | 2021          |
|   | (in thousands)                  |               |
| Electric Generation, Transmission and Distribution Revenues | \$ 2                            | \$ (1)        |
| Purchased Electricity for Resale                            | 59                              | 15            |
| Other Operation   | 16                              | 8             |
| Maintenance   | 21                              | 21            |
| Regulatory Assets (a)                                       | (46)                            | (87)          |
| Regulatory Liabilities (a)                                  | 1,566                           | 818           |
| <b>Total Gain on Risk Management Contracts</b>              | <u>\$ 1,618</u>                 | <u>\$ 774</u> |

- (a) Represents realized and unrealized gains and losses subject to regulatory accounting treatment recorded as either current or noncurrent on the balance sheets.

Certain qualifying derivative instruments have been designated as normal purchase or normal sale contracts, as provided in the accounting guidance for “Derivatives and Hedging.” Derivative contracts that have been designated as normal purchases or normal sales under that accounting guidance are not subject to MTM accounting treatment and are recognized on the statements of income on an accrual basis.

The accounting for the changes in the fair value of a derivative instrument depends on whether it qualifies for and has been designated as part of a hedging relationship and further, on the type of hedging relationship. Depending on the exposure, management designates a hedging instrument as a fair value hedge or a cash flow hedge.

For contracts that have not been designated as part of a hedging relationship, the accounting for changes in fair value depends on whether the derivative instrument is held for trading purposes. Unrealized and realized gains and losses on derivative instruments held for trading purposes are included in revenues on a net basis on KPCo’s statements of income. Unrealized and realized gains and losses on derivative instruments not held for trading purposes are included in revenues or expenses on KPCo’s statements of income depending on the relevant facts and circumstances. Certain derivatives that economically hedge future commodity risk are recorded in the same line item on the statements of income as that of the associated risk being hedged. However, unrealized and some realized gains and losses for both trading and non-trading derivative instruments are recorded as regulatory assets (for losses) or regulatory liabilities (for gains), in accordance with the accounting guidance for “Regulated Operations.”

### ***Accounting for Cash Flow Hedging Strategies***

For cash flow hedges (i.e. hedging the exposure to variability in expected future cash flows that is attributable to a particular risk), KPCo initially reports the gain or loss on the derivative instrument as a component of Accumulated Other Comprehensive Income (Loss) on the balance sheets until the period the hedged item affects Net Income.

Realized gains and losses on derivative contracts for the purchase and sale of power designated as cash flow hedges are included in Total Revenues or Purchased Electricity for Resale on KPCo’s statements of income, or in Regulatory Assets or Regulatory Liabilities on KPCo’s balance sheets, depending on the specific nature of the risk being hedged. During the three months ended March 31, 2022 and 2021, KPCo did not apply cash flow hedging to outstanding power derivatives.

KPCo reclassifies gains and losses on interest rate derivative hedges related to debt financings from Accumulated Other Comprehensive Income (Loss) on its balance sheets into Interest Expense on its statements of income in those periods in which hedged interest payments occur. During the three months ended March 31, 2022 and 2021, KPCo did not apply cash flow hedging to outstanding interest rate derivatives.

There was no impact of cash flow hedges included in Accumulated Other Comprehensive Income (Loss) on KPCo’s balance sheets as of March 31, 2022 and December 31, 2021.

The actual amounts that KPCo reclassifies from Accumulated Other Comprehensive Income (Loss) to Net Income can differ due to market price changes. As of March 31, 2022, KPCo is not hedging (with contracts subject to the accounting guidance for “Derivatives and Hedging”) its exposure to variability in future cash flows related to forecasted transactions.



## ***Credit Risk***

Management mitigates credit risk in KPCo's wholesale marketing and trading activities by assessing the creditworthiness of potential counterparties before entering into transactions with them and continuing to evaluate their creditworthiness on an ongoing basis. Management uses credit agency ratings and current market-based qualitative and quantitative data as well as financial statements to assess the financial health of counterparties on an ongoing basis.

Master agreements are typically used to facilitate the netting of cash flows associated with a single counterparty and may include collateral requirements. Collateral requirements in the form of cash, letters of credit, surety bonds and parental/affiliate guarantees may be obtained as security from counterparties in order to mitigate credit risk. Some master agreements include margining, which requires a counterparty to post cash or letters of credit in the event exposure exceeds the established threshold. The threshold represents an unsecured credit limit which may be supported by a parental/affiliate guaranty, as determined in accordance with AEP's credit policy. In addition, master agreements allow for termination and liquidation of all positions in the event of a default including failure or inability to post collateral when required.

## ***Collateral Triggering Events***

### *Credit Downgrade Triggers*

A limited number of derivative contracts include collateral triggering events, which include a requirement to maintain certain credit ratings. On an ongoing basis, AEP's risk management organization assesses the appropriateness of these collateral triggering events in contracts. KPCo has not experienced a downgrade below a specified credit rating threshold that would require the posting of additional collateral. As of March 31, 2022 and December 31, 2021, KPCo did not have derivative contracts with collateral triggering events in a net liability position.

### *Cross-Acceleration Triggers*

Certain interest rate derivative contracts contain cross-acceleration provisions that, if triggered, would permit the counterparty to declare a default and require settlement of the outstanding payable. These cross-acceleration provisions could be triggered if there was a non-performance event by KPCo under any of their outstanding debt of at least \$50 million and the lender on that debt has accelerated the entire repayment obligation. On an ongoing basis, AEP's risk management organization assesses the appropriateness of these cross-acceleration provisions in contracts. KPCo had no derivative contracts with cross-acceleration provisions in a net liability position as of March 31, 2022 and December 31, 2021, respectively. There was no cash collateral posted as of March 31, 2022 and December 31, 2021. If a cross-acceleration provision would have been triggered, settlement at fair value would have been required. KPCo had no derivative contracts with cross-acceleration provisions outstanding as of March 31, 2022 and December 31, 2021.

### *Cross-Default Triggers*

In addition, a majority of KPCo's non-exchange-traded commodity contracts contain cross-default provisions that, if triggered, would permit the counterparty to declare a default and require settlement of the outstanding payable. These cross-default provisions could be triggered if there was a non-performance event by Parent or the obligor under outstanding debt or a third-party obligation that is \$50 million or greater. On an ongoing basis, AEP's risk management organization assesses the appropriateness of these cross-default provisions in the contracts. KPCo had derivative liabilities subject to cross-default provisions in a net liability position of \$30 thousand and \$51 thousand and no cash collateral posted as of March 31, 2022 and December 31, 2021, respectively, after considering contractual netting arrangements. If a cross-default provision would have been triggered, settlement at fair value would have been required.

## 8. FAIR VALUE MEASUREMENTS

### *Fair Value Hierarchy and Valuation Techniques*

The accounting guidance for “Fair Value Measurements and Disclosures” establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement). Where observable inputs are available for substantially the full term of the asset or liability, the instrument is categorized in Level 2. When quoted market prices are not available, pricing may be completed using comparable securities, dealer values, operating data and general market conditions to determine fair value. Valuation models utilize various inputs such as commodity, interest rate and, to a lesser degree, volatility and credit that include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in inactive markets, market corroborated inputs (i.e. inputs derived principally from, or correlated to, observable market data) and other observable inputs for the asset or liability.

For commercial activities, exchange-traded derivatives, namely futures contracts, are generally fair valued based on unadjusted quoted prices in active markets and are classified as Level 1. Level 2 inputs primarily consist of OTC broker quotes in moderately active or less active markets, as well as exchange-traded derivatives where there is insufficient market liquidity to warrant inclusion in Level 1. Management verifies price curves using these broker quotes and classifies these fair values within Level 2 when substantially all of the fair value can be corroborated. Management typically obtains multiple broker quotes, which are nonbinding in nature but are based on recent trades in the marketplace. When multiple broker quotes are obtained, the quoted bid and ask prices are averaged. In certain circumstances, a broker quote may be discarded if it is a clear outlier. Management uses a historical correlation analysis between the broker quoted location and the illiquid locations. If the points are highly correlated, these locations are included within Level 2 as well. Certain OTC and bilaterally executed derivative instruments are executed in less active markets with a lower availability of pricing information. Illiquid transactions, complex structured transactions, FTRs and counterparty credit risk may require nonmarket-based inputs. Some of these inputs may be internally developed or extrapolated and utilized to estimate fair value. When such inputs have a significant impact on the measurement of fair value, the instrument is categorized as Level 3. The main driver of contracts being classified as Level 3 is the inability to substantiate energy price curves in the market. A portion of the Level 3 instruments have been economically hedged which limits potential earnings volatility.

### *Fair Value Measurements of Long-term Debt*

The fair values of Long-term Debt are based on quoted market prices, without credit enhancements, for the same or similar issues and the current interest rates offered for instruments with similar maturities classified as Level 2 measurement inputs. These instruments are not marked-to-market. The estimates presented are not necessarily indicative of the amounts that could be realized in a current market exchange.

The book values and fair values of KPCo’s Long-term Debt are summarized in the following table:

|                | <u>March 31, 2022</u> |                   | <u>December 31, 2021</u> |                   |
|----------------|-----------------------|-------------------|--------------------------|-------------------|
|                | <u>Book Value</u>     | <u>Fair Value</u> | <u>Book Value</u>        | <u>Fair Value</u> |
| Long-term Debt | \$ 1,103,190          | \$ 1,146,301      | \$ 1,103,105             | \$ 1,224,664      |

## ***Fair Value Measurements of Financial Assets and Liabilities***

The following tables set forth, by level within the fair value hierarchy, KPCo's financial assets and liabilities that were accounted for at fair value on a recurring basis. As required by the accounting guidance for "Fair Value Measurements and Disclosures," financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. Management's assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels. There have not been any significant changes in management's valuation techniques.

### **Assets and Liabilities Measured at Fair Value on a Recurring Basis March 31, 2022**

| <b>Assets:</b>                              | <u>Level 1</u> | <u>Level 2</u> | <u>Level 3</u>  | <u>Other</u>    | <u>Total</u>    |
|---|----------------|----------------|-----------------|-----------------|-----------------|
|   | (in thousands) |                |                 |                 |                 |
| <b>Risk Management Assets</b>               |                |                |                 |                 |                 |
| Risk Management Commodity Contracts (a) (b) | <u>\$ —</u>    | <u>\$ 902</u>  | <u>\$ 1,534</u> | <u>\$ (980)</u> | <u>\$ 1,456</u> |
| <b>Liabilities:</b>                         |                |                |                 |                 |                 |
| <b>Risk Management Liabilities</b>          |                |                |                 |                 |                 |
| Risk Management Commodity Contracts (a) (b) | <u>\$ —</u>    | <u>\$ 631</u>  | <u>\$ 153</u>   | <u>\$ (754)</u> | <u>\$ 30</u>    |

### **December 31, 2021**

| <b>Assets:</b>                              | <u>Level 1</u> | <u>Level 2</u>  | <u>Level 3</u>  | <u>Other</u>      | <u>Total</u>    |
|---|----------------|-----------------|-----------------|-------------------|-----------------|
|   | (in thousands) |                 |                 |                   |                 |
| <b>Risk Management Assets</b>               |                |                 |                 |                   |                 |
| Risk Management Commodity Contracts (a) (b) | <u>\$ —</u>    | <u>\$ 1,096</u> | <u>\$ 6,439</u> | <u>\$ (1,549)</u> | <u>\$ 5,986</u> |
| <b>Liabilities:</b>                         |                |                 |                 |                   |                 |
| <b>Risk Management Liabilities</b>          |                |                 |                 |                   |                 |
| Risk Management Commodity Contracts (a) (b) | <u>\$ —</u>    | <u>\$ 937</u>   | <u>\$ 568</u>   | <u>\$ (1,454)</u> | <u>\$ 51</u>    |

- (a) Amounts in "Other" column primarily represent counterparty netting of risk management and hedging contracts and associated cash collateral under the accounting guidance for "Derivatives and Hedging."
- (b) Substantially comprised of power contracts.

The following tables set forth a reconciliation of changes in the fair value of net trading derivatives classified as Level 3 in the fair value hierarchy:

| <b>Three Months Ended March 31, 2022</b>                                       | <b>Net Risk Management<br/>Assets (Liabilities)<br/>(in thousands)</b> |
|--|--|
| <b>Balance as of December 31, 2021</b>   | \$ 5,871   |
| Realized Gain (Loss) Included in Net Income (or Changes in Net Assets) (a) (b) | 1,021  |
| Settlements  | (5,960)  |
| Changes in Fair Value Allocated to Regulated Jurisdictions (c)                 | 449  |
| <b>Balance as of March 31, 2022</b>  | <u>\$ 1,381</u>  |

| <b>Three Months Ended March 31, 2021</b>                                       | <b>Net Risk Management<br/>Assets (Liabilities)<br/>(in thousands)</b> |
|--|--|
| <b>Balance as of December 31, 2020</b>   | \$ 3,025   |
| Realized Gain (Loss) Included in Net Income (or Changes in Net Assets) (a) (b) | 887  |
| Settlements  | (2,738)  |
| Changes in Fair Value Allocated to Regulated Jurisdictions (c)                 | (131)  |
| <b>Balance as of March 31, 2021</b>  | <u>\$ 1,043</u>  |

- (a) Included in revenues on KPCo's statements of income.
- (b) Represents the change in fair value between the beginning of the reporting period and the settlement of the risk management commodity contract.
- (c) Relates to the net gains (losses) of those contracts that are not reflected on KPCo's statements of income. These changes in fair value are recorded as regulatory liabilities for net gains and as regulatory assets for net losses.

The following tables quantify the significant unobservable inputs used in developing the fair value of Level 3 positions:

**Significant Unobservable Inputs  
March 31, 2022**

|                  | Fair Value      |               | Valuation<br>Technique | Significant<br>Unobservable<br>Input (a) | Input/Range |          |                         |
|------------------|-----------------|---------------|------------------------|--|-------------|----------|-------------------------|
|                  | Assets          | Liabilities   |                        |  | Low         | High     | Weighted<br>Average (b) |
|                  | (in thousands)  |               |                        |  |             |          |                         |
| Energy Contracts | \$ —            | \$ 30         | Discounted Cash Flow   | Forward Market Price                     | \$ 44.99    | \$ 66.21 | \$ 55.42                |
| FTRs             | 1,534           | 123           | Discounted Cash Flow   | Forward Market Price                     | (0.04)      | 10.51    | 1.03                    |
| <b>Total</b>     | <u>\$ 1,534</u> | <u>\$ 153</u> |                        |  |             |          |                         |

**December 31, 2021**

|                  | Fair Value      |               | Valuation<br>Technique | Significant<br>Unobservable<br>Input (a) | Input/Range |          |                         |
|------------------|-----------------|---------------|------------------------|--|-------------|----------|-------------------------|
|                  | Assets          | Liabilities   |                        |  | Low         | High     | Weighted<br>Average (b) |
|                  | (in thousands)  |               |                        |  |             |          |                         |
| Energy Contracts | \$ —            | \$ 51         | Discounted Cash Flow   | Forward Market Price                     | \$ 32.20    | \$ 56.54 | \$ 44.77                |
| FTRs             | 6,439           | 517           | Discounted Cash Flow   | Forward Market Price                     | (1.44)      | 22.19    | 1.74                    |
| <b>Total</b>     | <u>\$ 6,439</u> | <u>\$ 568</u> |                        |  |             |          |                         |

(a) Represents market prices in dollars per MWh.

(b) The weighted average is the product of the forward market price of the underlying commodity and volume weighted by term.

The following table provides the measurement uncertainty of fair value measurements to increases (decreases) in significant unobservable inputs related to Energy Contracts and FTRs as of March 31, 2022 and December 31, 2021:

**Uncertainty of Fair Value Measurements**

| Significant Unobservable Input | Position | Change in Input     | Impact on Fair Value<br>Measurement |
|--------------------------------|----------|---------------------|-------------------------------------|
| Forward Market Price           | Buy      | Increase (Decrease) | Higher (Lower)                      |
| Forward Market Price           | Sell     | Increase (Decrease) | Lower (Higher)                      |

## 9. INCOME TAXES

### *Effective Tax Rates (ETR)*

KPCo's interim ETR reflects the estimated annual ETR for 2022 and 2021, adjusted for tax expense associated with certain discrete items.

KPCo includes the amortization of Excess ADIT not subject to normalization requirements in the annual estimated ETR when regulatory proceedings instruct KPCo to provide the benefits of Tax Reform to customers over multiple interim periods. Certain regulatory proceedings instruct KPCo to provide the benefits of Tax Reform to customers in a single period (e.g. by applying the Excess ADIT not subject to normalization requirements against an existing regulatory asset balance) and in these circumstances, KPCo recognizes the tax benefit discretely in the period recorded. The annual amount of Excess ADIT approved by KPCo's regulatory commissions may not impact the ETR ratably during each interim period due to the variability of pretax book income between interim periods and the application of an annual estimated ETR.

The ETR for KPCo is included in the following table:

|  | <b>Three Months Ended March 31,</b> |                 |
|--|-------------------------------------|-----------------|
|  | <b>2022</b>                         | <b>2021</b>     |
| U.S. Federal Statutory Rate              | 21.0 %                              | 21.0 %          |
| Increase (decrease) due to:              |                                     |                 |
| State Income Tax, net of Federal Benefit | (0.9)%                              | 0.4 %           |
| Tax Reform Excess ADIT Reversal          | (89.7)%                             | (231.0)%        |
| Flow Through                             | 0.1 %                               | (1.7)%          |
| AFUDC Equity                             | (1.4)%                              | (0.9)%          |
| Other                                    | 0.1 %                               | — %             |
| Effective Income Tax Rate                | <u>(70.8)%</u>                      | <u>(212.2)%</u> |

### *Federal Income Tax Audit Status*

In the third quarter of 2019, KPCo and other AEP subsidiaries elected to amend the 2014 through 2017 federal returns. In the first quarter of 2020, the IRS notified KPCo and other AEP subsidiaries that it was beginning an examination of these amended returns, including the net operating loss carryback to 2015 that originated in the 2017 return. As of March 31, 2022, the IRS has not issued any proposed adjustment and has accepted the 2014 amended return as filed. KPCo and other AEP subsidiaries has agreed to extend the statute of limitations on the 2017 tax return to December 31, 2022 to allow time for the audit to be completed and the Congressional Joint Committee on Taxation to approve the associated refund claim.

## 10. FINANCING ACTIVITIES

### *Long-term Debt*

KPCo did not have any long-term debt issuances or retirements during the first three months of 2022.

### *Dividend Restrictions*

KPCo pays dividends to Parent provided funds are legally available. Various financing arrangements and regulatory requirements may impose certain restrictions on the ability of KPCo to transfer funds to Parent in the form of dividends.

All of the dividends declared by KPCo are subject to a Federal Power Act restriction that prohibits the payment of dividends out of capital accounts without regulatory approval; payment of dividends is allowed out of retained earnings only.

KPCo has credit agreements that contain a covenant that limit its debt to capitalization ratio to 67.5%. As of March 31, 2022, KPCo did not exceed its debt to capitalization limit. The method for calculating outstanding debt and capitalization is contractually-defined in the credit agreements.

The Federal Power Act restriction does not limit the ability of KPCo to pay dividends out of retained earnings.

### *Corporate Borrowing Program – AEP System*

The AEP System uses a corporate borrowing program to meet the short-term borrowing needs of AEP's subsidiaries. The corporate borrowing program includes a Utility Money Pool, which funds AEP's utility subsidiaries. The AEP System Utility Money Pool operates in accordance with the terms and conditions of its agreement filed with the FERC. The amounts of outstanding borrowings from the Utility Money Pool as of March 31, 2022 and December 31, 2021 are included in Advances from Affiliates on KPCo's balance sheets. KPCo's Utility Money Pool activity and corresponding authorized borrowing limit for the three months ended March 31, 2022 are described in the following table:

| <b>Maximum Borrowings from the Utility Money Pool</b> | <b>Average Borrowings from the Utility Money Pool</b> | <b>Borrowings from the Utility Money Pool as of March 31, 2022</b> | <b>Authorized Short-Term Borrowing Limit</b> |
|---|---|--|--|
| (in thousands)  |   |  |  |
| \$ 97,366   | \$ 61,135   | \$ 93,939  | \$ 180,000                                   |

Maximum, minimum and average interest rates for funds borrowed from the Utility Money Pool are summarized in the following table:

| <b>Three Months Ended March 31,</b> | <b>Maximum Interest Rate for Funds Borrowed from the Utility Money Pool</b> | <b>Minimum Interest Rate for Funds Borrowed from the Utility Money Pool</b> | <b>Average Interest Rate for Funds Borrowed from the Utility Money Pool</b> |
|-------------------------------------|---|---|---|
| 2022                                | 1.00 %  | 0.10 %  | 0.67 %  |
| 2021                                | 0.40 %  | 0.25 %  | 0.31 %  |

### ***Securitized Accounts Receivables – AEP Credit***

Under an affiliated receivables sales arrangement, KPCo sold, without recourse, certain of its customer accounts receivable and accrued unbilled revenue balances to AEP Credit. KPCo was charged a fee for each sale that is based on AEP Credit's financing costs, administrative costs and uncollectible accounts experience from previous purchases of KPCo's customer accounts receivable. The costs of customer accounts receivable sold are reported in Other Operation expense on KPCo's statements of income. In January 2022, due to the pending sale to Liberty, KPCo terminated selling accounts receivable to AEP Credit. As result of the termination, in the first quarter of 2022, KPCo began recording an allowance for uncollectible accounts on its balance sheet for those receivables no longer sold to AEP Credit.

KPCo's amounts of accounts receivable and accrued unbilled revenues sold under the sale of receivables agreement were \$423 thousand and \$53.3 million as of March 31, 2022 and December 31, 2021, respectively.

The fees paid by KPCo to AEP Credit for customer accounts receivable sold for the three months ended March 31, 2022 and 2021 were \$295 thousand and \$169 thousand, respectively.

KPCo's proceeds on the sale of receivables to AEP Credit for the three months ended March 31, 2022 and 2021 were \$65.6 million and \$153.7 million, respectively.



## 11. REVENUE FROM CONTRACTS WITH CUSTOMERS

### *Disaggregated Revenues from Contracts with Customers*

The table below represents KPCo's revenues from contracts with customers, net of respective provisions for refund, by type of revenue:

|   | <b>Three Months Ended</b> |                   |
|---|---------------------------|-------------------|
|   | <b>March 31,</b>          |                   |
|   | <b>2022</b>               | <b>2021</b>       |
|   | <b>(in thousands)</b>     |                   |
| <b>Retail Revenues:</b>                             |                           |                   |
| Residential Revenues                                | \$ 81,690                 | \$ 77,317         |
| Commercial Revenues                                 | 44,071                    | 38,192            |
| Industrial Revenues                                 | 39,650                    | 32,217            |
| Other Retail Revenues                               | 538                       | 507               |
| <b>Total Retail Revenues</b>                        | <b>165,949</b>            | <b>148,233</b>    |
| <b>Wholesale Revenues:</b>                          |                           |                   |
| Generation Revenues (a)                             | 4,618                     | 7,289             |
| Transmission Revenues (b)                           | 7,851                     | 5,462             |
| <b>Total Wholesale Revenues</b>                     | <b>12,469</b>             | <b>12,751</b>     |
| Other Revenues from Contracts with Customers (a)    | 3,819                     | 2,796             |
| <b>Total Revenues from Contracts with Customers</b> | <b>182,237</b>            | <b>163,780</b>    |
| <b>Other Revenues:</b>                              |                           |                   |
| Alternative Revenues                                | 198                       | (1,837)           |
| Other Revenues                                      | 2                         | —                 |
| <b>Total Other Revenues</b>                         | <b>200</b>                | <b>(1,837)</b>    |
| <b>Total Revenues</b>                               | <b>\$ 182,437</b>         | <b>\$ 161,943</b> |

(a) Amounts include affiliated and nonaffiliated revenues.

(b) Amounts include affiliated and nonaffiliated revenues. The affiliated revenues were \$4.7 million and \$2.2 million for the three months ended March 31, 2022 and 2021, respectively.

### *Fixed Performance Obligations*

The following table represents KPCo's remaining fixed performance obligations satisfied over time as of March 31, 2022. Fixed performance obligations primarily include wholesale transmission services, electricity sales for fixed amounts of energy and stand ready services into PJM's Reliability Pricing Model market. The amounts shown in the table below include affiliated and nonaffiliated revenues.

| <b>2022</b>           | <b>2023-2024</b> | <b>2025-2026</b> | <b>After 2026</b> | <b>Total</b> |
|-----------------------|------------------|------------------|-------------------|--------------|
| <b>(in thousands)</b> |                  |                  |                   |              |
| \$ 23,247             | \$ 2,870         | \$ 2,870         | \$ 1,435          | \$ 30,422    |

### ***Contract Assets and Liabilities***

Contract assets are recognized when KPCo has a right to consideration that is conditional upon the occurrence of an event other than the passage of time, such as future performance under a contract. KPCo did not have material contract assets as of March 31, 2022 and December 31, 2021, respectively.

When KPCo receives consideration, or such consideration is unconditionally due from a customer prior to transferring goods or services to the customer under the terms of a sales contract, they recognize a contract liability on the balance sheet in the amount of that consideration. Revenue for such consideration is subsequently recognized in the period or periods in which the remaining performance obligations in the contract are satisfied. KPCo's contract liabilities typically arise from advanced payments of services provided primarily with respect to joint use agreements for utility poles. KPCo did not have material contract liabilities as of March 31, 2022 and December 31, 2021, respectively.

### ***Accounts Receivable from Contracts with Customers***

Accounts receivable from contracts with customers are presented on KPCo's balance sheets within the Accounts Receivable - Customers line item. KPCo's balances for receivables from contracts that are not recognized in accordance with the accounting guidance for "Revenue from Contracts with Customers" included in Accounts Receivable - Customers were not material as of March 31, 2022 and December 31, 2021. See "Securitized Accounts Receivable - AEP Credit" section of Note 10 for additional information related to AEP Credit's securitized accounts receivable.

The amount of affiliated accounts receivable from contracts with customers included in Accounts Receivable - Affiliated Companies on KPCo's balance sheets were \$9.5 million and \$9.1 million, respectively, as of March 31, 2022 and December 31, 2021.