Kentucky Power Company

2020 Second Quarter Report

Financial Statements

An AEP Company

BOUNDLESS ENERGY℠

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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 Funds Used During Construction.
AOCI	Accumulated Other Comprehensive Income.
APCo	Appalachian Power Company, an AEP electric utility subsidiary.
ASU	Accounting Standards Update.
COVID-19	Coronavirus 2019, a highly infectious respiratory disease. In March 2020, the World Health Organization declared COVID-19 a worldwide pandemic.
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.
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.
Reference Rate Reform	The global transition away from referencing the London Interbank Offered Rate and other interbank offered rates, and toward new reference rates that are more reliable and robust.
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.

KENTUCKY POWER COMPANY
CONDENSED STATEMENTS OF OPERATIONS
For Three and Six Months Ended June 30, 2020 and 2019
(in thousands)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2020	**2019**	**2020**	**2019**
REVENUES				
Electric Generation, Transmission and Distribution	$ 119,520	$ 137,135	$ 263,479	$ 302,671
Sales to AEP Affiliates	3,088	3,760	6,518	7,537
Other Revenues	168	198	412	479
TOTAL REVENUES	122,776	141,093	270,409	310,687
EXPENSES				
Fuel and Other Consumables Used for Electric Generation	16,525	21,653	40,505	51,347
Purchased Electricity for Resale	3,798	6,822	17,065	16,457
Purchased Electricity from AEP Affiliates	18,754	22,021	34,241	47,616
Other Operation	20,253	27,828	43,261	54,507
Maintenance	25,063	17,268	40,016	33,167
Depreciation and Amortization	25,032	21,742	49,452	45,981
Taxes Other Than Income Taxes	7,094	7,513	14,021	14,592
TOTAL EXPENSES	116,519	124,847	238,561	263,667
OPERATING INCOME	6,257	16,246	31,848	47,020
Other Income (Expense):				
Other Income	598	595	629	872
Non-Service Cost Components of Net Periodic Benefit Cost	1,014	954	2,028	1,908
Interest Expense	(9,522)	(9,739)	(19,438)	(18,605)
INCOME (LOSS) BEFORE INCOME TAX EXPENSE (BENEFIT)	(1,653)	8,056	15,067	31,195
Income Tax Expense (Benefit)	(718)	555	(2,833)	2,933
NET INCOME (LOSS)	$ (935)	$ 7,501	$ 17,900	$ 28,262

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 and Six Months Ended June 30, 2020 and 2019
(in thousands)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2020	**2019**	**2020**	**2019**
Net Income (Loss)	$ (935)	$ 7,501	$ 17,900	$ 28,262
OTHER COMPREHENSIVE LOSS, NET OF TAXES				
Amortization of Pension and OPEB Deferred Costs, Net of Tax of $(7) and $(3) for the Three Months Ended June 30, 2020 and 2019, Respectively, and $(14) and $(5) for the Six Months Ended June 30, 2020 and 2019, Respectively	(26)	(9)	(53)	(18)
TOTAL COMPREHENSIVE INCOME (LOSS)	$ (961)	$ 7,492	$ 17,847	$ 28,244

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 Six Months Ended June 30, 2020 and 2019
(in thousands)
(Unaudited)

	Common Stock	Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
TOTAL COMMON SHAREHOLDER'S EQUITY - DECEMBER 31, 2018	$ 50,450	$ 526,135	$ 156,506	$ (212)	$ 732,879
Net Income			20,761		20,761
Other Comprehensive Loss				(9)	(9)
TOTAL COMMON SHAREHOLDER'S EQUITY - MARCH 31, 2019	50,450	526,135	177,267	(221)	753,631
Common Stock Dividends			(5,000)		(5,000)
Net Income			7,501		7,501
Other Comprehensive Loss				(9)	(9)
TOTAL COMMON SHAREHOLDER'S EQUITY - JUNE 30, 2019	$ 50,450	$ 526,135	$ 179,768	$ (230)	$ 756,123
TOTAL COMMON SHAREHOLDER'S EQUITY - DECEMBER 31, 2019	$ 50,450	$ 526,135	$ 204,806	$ 790	$ 782,181
ASU 2016-13 Adoption			48		48
Net Income			18,835		18,835
Other Comprehensive Loss				(27)	(27)
TOTAL COMMON SHAREHOLDER'S EQUITY - MARCH 31, 2020	50,450	526,135	223,689	763	801,037
Net Loss			(935)		(935)
Other Comprehensive Loss				(26)	(26)
TOTAL COMMON SHAREHOLDER'S EQUITY - JUNE 30, 2020	$ 50,450	$ 526,135	$ 222,754	$ 737	$ 800,076

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

KENTUCKY POWER COMPANY
CONDENSED BALANCE SHEETS
ASSETS
June 30, 2020 and December 31, 2019
(in thousands)
(Unaudited)

	June 30, 2020	December 31, 2019
CURRENT ASSETS		
Cash and Cash Equivalents	$ 550	$ 849
Accounts Receivable:		
Customers	11,935	14,749
Affiliated Companies	26,861	20,663
Accrued Unbilled Revenues	13,274	13,550
Miscellaneous	43	145
Allowance for Uncollectible Accounts	(92)	(346)
Total Accounts Receivable	52,021	48,761
Fuel	24,849	29,855
Materials and Supplies	19,104	18,011
Risk Management Assets	6,515	6,878
Accrued Tax Benefits	4,099	2,205
Margin Deposits	504	600
Prepayments and Other Current Assets	1,564	2,892
TOTAL CURRENT ASSETS	109,206	110,051
PROPERTY, PLANT AND EQUIPMENT		
Electric:		
Generation	1,223,568	1,219,454
Transmission	665,400	651,091
Distribution	934,364	897,247
Other Property, Plant and Equipment	120,504	112,529
Construction Work in Progress	98,599	98,671
Total Property, Plant and Equipment	3,042,435	2,978,992
Accumulated Depreciation and Amortization	1,030,277	1,005,546
TOTAL PROPERTY, PLANT AND EQUIPMENT – NET	2,012,158	1,973,446
OTHER NONCURRENT ASSETS		
Regulatory Assets	438,735	421,621
Long-term Risk Management Assets	75	25
Employee Benefits and Pension Assets	24,381	23,421
Operating Lease Assets	11,371	10,120
Deferred Charges and Other Noncurrent Assets	25,119	33,815
TOTAL OTHER NONCURRENT ASSETS	499,681	489,002
TOTAL ASSETS	$ 2,621,045	$ 2,572,499

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

KENTUCKY POWER COMPANY
CONDENSED BALANCE SHEETS
LIABILITIES AND COMMON SHAREHOLDER'S EQUITY
June 30, 2020 and December 31, 2019
(Unaudited)

	June 30, 2020	December 31, 2019
	(in thousands)	
CURRENT LIABILITIES		
Advances from Affiliates	$ 40,734	$ 113,175
Accounts Payable:		
General	49,720	63,350
Affiliated Companies	22,908	23,449
Long-term Debt Due Within One Year – Nonaffiliated	40,000	65,000
Risk Management Liabilities	339	1,480
Customer Deposits	31,649	30,954
Accrued Taxes	21,196	33,108
Accrued Interest	5,775	6,365
Obligations Under Operating Leases	2,154	2,005
Regulatory Liability for Over-Recovered Fuel Costs	4,559	223
Asset Retirement Obligations	15,480	15,480
Other Current Liabilities	22,409	25,080
TOTAL CURRENT LIABILITIES	256,923	379,669
NONCURRENT LIABILITIES		
Long-term Debt – Nonaffiliated	952,403	802,553
Long-term Risk Management Liabilities	32	1
Deferred Income Taxes	431,185	421,858
Regulatory Liabilities and Deferred Investment Tax Credits	135,452	135,686
Asset Retirement Obligations	21,723	28,108
Employee Benefits and Pension Obligations	7,080	7,496
Obligations Under Operating Leases	9,250	8,154
Deferred Credits and Other Noncurrent Liabilities	6,921	6,793
TOTAL NONCURRENT LIABILITIES	1,564,046	1,410,649
TOTAL LIABILITIES	1,820,969	1,790,318
Rate Matters (Note 4)		
Commitments and Contingencies (Note 5)		
COMMON SHAREHOLDER'S EQUITY		
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	222,754	204,806
Accumulated Other Comprehensive Income (Loss)	737	790
TOTAL COMMON SHAREHOLDER'S EQUITY	800,076	782,181
TOTAL LIABILITIES AND COMMON SHAREHOLDER'S EQUITY	$ 2,621,045	$ 2,572,499

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

KENTUCKY POWER COMPANY
CONDENSED STATEMENTS OF CASH FLOWS
For the Six Months Ended June 30, 2020 and 2019
(in thousands)
(Unaudited)

	Six Months Ended June 30, 2020	Six Months Ended June 30, 2019
OPERATING ACTIVITIES		
Net Income	$ 17,900	$ 28,262
Adjustments to Reconcile Net Income to Net Cash Flows from Operating Activities:		
Depreciation and Amortization	49,452	45,981
Deferred Income Taxes	2,339	2,791
Allowance for Equity Funds Used During Construction	(570)	(847)
Mark-to-Market of Risk Management Contracts	(797)	(7,504)
Property Taxes	9,906	9,932
Deferred Fuel Over/Under-Recovery, Net	4,336	2,708
Deferred Rockport Capacity Costs	(5,510)	(7,783)
Change in Other Noncurrent Assets	(20,470)	(16,338)
Change in Other Noncurrent Liabilities	(5,757)	(11,014)
Changes in Certain Components of Working Capital:		
Accounts Receivable, Net	(2,934)	9,304
Fuel, Materials and Supplies	3,765	(10,987)
Accounts Payable	(2,440)	7,227
Accrued Taxes, Net	(13,806)	(15,842)
Accrued Interest	(590)	1,701
Other Current Assets	1,590	(691)
Other Current Liabilities	(1,628)	(3,520)
Net Cash Flows from Operating Activities	34,786	33,380
INVESTING ACTIVITIES		
Construction Expenditures	(87,445)	(72,578)
Other Investing Activities	460	304
Net Cash Flows Used for Investing Activities	(86,985)	(72,274)
FINANCING ACTIVITIES		
Issuance of Long-term Debt – Nonaffiliated	124,624	—
Change in Advances from Affiliates, Net	(72,441)	43,568
Principal Payments for Finance Lease Obligations	(400)	(327)
Dividends Paid on Common Stock	—	(5,000)
Other Financing Activities	117	76
Net Cash Flows from Financing Activities	51,900	38,317
Net Decrease in Cash and Cash Equivalents	(299)	(577)
Cash and Cash Equivalents at Beginning of Period	849	1,168
Cash and Cash Equivalents at End of Period	$ 550	$ 591
SUPPLEMENTARY INFORMATION		
Cash Paid for Interest, Net of Capitalized Amounts	$ 20,174	$ 16,541
Net Cash Paid (Received) for Income Taxes	(3,657)	7,049
Noncash Acquisitions Under Finance Leases	463	475
Construction Expenditures Included in Current Liabilities as of June 30,	18,710	26,896

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

INDEX OF CONDENSED NOTES TO CONDENSED FINANCIAL STATEMENTS

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 and six months ended June 30, 2020 is not necessarily indicative of results that may be expected for the year ending December 31, 2020. The condensed financial statements are unaudited and should be read in conjunction with the audited 2019 financial statements and notes thereto, which are included in KPCo's 2019 Annual Report.

COVID-19

In March 2020, COVID-19 was declared a pandemic by the World Health Organization and the Centers for Disease Control and Prevention. Its rapid spread around the world and throughout the United States prompted many countries, including the United States, to institute restrictions on travel, public gatherings and certain business operations. These restrictions continue to significantly disrupt economic activity in AEP's service territory and could reduce future demand for energy, particularly from commercial and industrial customers. KPCo is taking steps to mitigate the potential risks to customers, suppliers and employees posed by the spread of COVID-19.

As of June 30, 2020 and through the date of this report, KPCo assessed certain accounting matters that require consideration of forecasted financial information, including, but not limited to, the allowance for credit losses and the carrying value of long-lived assets. While there were not any impairments or significant increases in credit allowances resulting from these assessments for the three and six months ended June 30, 2020, the ultimate impact of COVID-19 also depends on factors beyond management's knowledge or control, including the duration and severity of this outbreak as well as third-party actions taken to contain its spread and mitigate its public health effects. Therefore, management cannot estimate the potential future impact to financial position, results of operations and cash flows, but the impacts could be material.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Allowance for Uncollectible Accounts

Generally, AEP Credit records bad debt expense related to receivables purchased from KPCo under a sale of receivables agreement. The assessment is performed separately by each participating AEP subsidiary, which inherently contemplates any differences in geographical risk characteristics for the allowance. For customer accounts receivables relating to risk management activities, accounts receivables are reviewed for bad debt reserves at a specific counterparty level basis. For miscellaneous accounts receivable, bad debt expense is recorded based upon a 12-month rolling average of bad debt write-offs in proportion to gross accounts receivable, unless specifically identified. In addition to these processes, management contemplates available current information, as well as any reasonable and supportable forecast information, to determine if allowances for uncollectible accounts should be further adjusted in accordance with the accounting guidance for "Credit Losses." Management's assessments contemplate expected losses over the life of the accounts receivable.

Subsequent Events

Management reviewed subsequent events through August 6, 2020, the date that the second quarter 2020 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. The following standards will impact the financial statements.

ASU 2016-13 "Measurement of Credit Losses on Financial Instruments" (ASU 2016-13)

In June 2016, the FASB issued ASU 2016-13 requiring the recognition of an allowance for expected credit losses for financial instruments within its scope. Examples of financial instruments that are in scope include trade receivables, certain financial guarantees and held-to-maturity debt securities. The allowance for expected credit losses should be based on historical information, current conditions and reasonable and supportable forecasts. Entities are required to evaluate, and if necessary, recognize expected credit losses at the inception or initial acquisition of a financial instrument (or pool of financial instruments that share similar risk characteristics) subject to ASU 2016-13, and subsequently as of each reporting date. The new standard also revises the other-than-temporary impairment model for available-for-sale debt securities.

New standard implementation activities included: (a) the identification and evaluation of the population of financial instruments within the AEP system that are subject to the new standard, (b) the development of supporting valuation models to also contemplate appropriate metrics for current and supportable forecasted information and (c) the development of disclosures to comply with the requirements of ASU 2016-13. As required by ASU 2016-13, the financial instruments subject to the new standard were evaluated on a pool-basis to the extent such financial instruments shared similar risk characteristics.

Management adopted ASU 2016-13 and its related implementation guidance effective January 1, 2020, by means of an immaterial cumulative-effect adjustment to Retained Earnings on the balance sheets. The adoption of the new standard did not have a material impact to financial position and had no impact on the results of operations or cash flows. Additionally, the adoption of the new standard did not result in any changes to current accounting systems.

ASU 2020-04 "Reference Rate Reform: Facilitation of the Effects of Reference Rate Reform on Financial Reporting" (ASU 2020-04)

In March 2020, the FASB issued ASU 2020-04 providing guidance to ease the potential burden in accounting for Reference Rate Reform on financial reporting. The new standard is elective and applies to all entities, subject to meeting certain criteria, that have contracts, hedging relationships, and other transactions that reference the London Interbank Offered Rate (LIBOR) or another reference rate expected to be discontinued because of Reference Rate Reform. The new standard establishes a general contract modification principle that entities can apply in other areas that may be affected by Reference Rate Reform and certain elective hedge accounting expedients. Under the new standard, an entity may make a one-time election to sell or to transfer to the available-for-sale or trading classifications (or both sell and transfer), debt securities that both reference an affected rate, and were classified as held to maturity before January 1, 2020.

The new accounting guidance is effective for all entities as of March 12, 2020 through December 31, 2022. The amendments may be applied to contract modifications as of any date from the beginning of an interim period that includes or is subsequent to March 12, 2020, or prospectively from a date within an interim period that includes or is subsequent to March 12, 2020, up to the date that the financial statements are available to be issued. The amendments may be applied to eligible hedging relationships existing as of the beginning of the interim period that includes March 12, 2020 and to new eligible hedging relationships entered into after the beginning of the interim period that includes March 12, 2020. The one-time election to sell, transfer, or both sell and transfer debt securities classified as held to maturity may be made at any time after March 12, 2020 but no later than December 31, 2022. Management has yet to apply the amendments in the new standard to any contract modifications, hedging relationships, or debt securities. Management is analyzing the impact of this new standard and at this time, cannot estimate the impact of adoption on results of operations, financial position or cash flows.

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 details.

Three Months Ended June 30, 2020	Pension and OPEB
	(in thousands)
Balance in AOCI as of March 31, 2020	$ 763
Change in Fair Value Recognized in AOCI	—
Amount of (Gain) Loss Reclassified from AOCI	
Amortization of Prior Service Cost (Credit)	(57)
Amortization of Actuarial (Gains) Losses	24
Reclassifications from AOCI, before Income Tax (Expense) Benefit	(33)
Income Tax (Expense) Benefit	(7)
Reclassifications from AOCI, Net of Income Tax (Expense) Benefit	(26)
Net Current Period Other Comprehensive Income (Loss)	(26)
Balance in AOCI as of June 30, 2020	$ 737

Three Months Ended June 30, 2019	Pension and OPEB
	(in thousands)
Balance in AOCI as of March 31, 2019	$ (221)
Change in Fair Value Recognized in AOCI	—
Amount of (Gain) Loss Reclassified from AOCI	
Amortization of Prior Service Cost (Credit)	(56)
Amortization of Actuarial (Gains) Losses	44
Reclassifications from AOCI, before Income Tax (Expense) Benefit	(12)
Income Tax (Expense) Benefit	(3)
Reclassifications from AOCI, Net of Income Tax (Expense) Benefit	(9)
Net Current Period Other Comprehensive Income (Loss)	(9)
Balance in AOCI as of June 30, 2019	$ (230)

Six Months Ended June 30, 2020	Pension and OPEB
	(in thousands)
Balance in AOCI as of December 31, 2019	$ 790
Change in Fair Value Recognized in AOCI	—
Amount of (Gain) Loss Reclassified from AOCI	
Amortization of Prior Service Cost (Credit)	(114)
Amortization of Actuarial (Gains) Losses	47
Reclassifications from AOCI, before Income Tax (Expense) Benefit	(67)
Income Tax (Expense) Benefit	(14)
Reclassifications from AOCI, Net of Income Tax (Expense) Benefit	(53)
Net Current Period Other Comprehensive Income (Loss)	(53)
Balance in AOCI as of June 30, 2020	$ 737

Six Months Ended June 30, 2019	Pension and OPEB
	(in thousands)
Balance in AOCI as of December 31, 2018	$ (212)
Change in Fair Value Recognized in AOCI	—
Amount of (Gain) Loss Reclassified from AOCI	
Amortization of Prior Service Cost (Credit)	(112)
Amortization of Actuarial (Gains) Losses	89
Reclassifications from AOCI, before Income Tax (Expense) Benefit	(23)
Income Tax (Expense) Benefit	(5)
Reclassifications from AOCI, Net of Income Tax (Expense) Benefit	(18)
Net Current Period Other Comprehensive Income (Loss)	(18)
Balance in AOCI as of June 30, 2019	$ (230)

4. RATE MATTERS

As discussed in KPCo's 2019 Annual Report, KPCo is involved in rate and regulatory proceedings at the FERC and the KPSC. The Rate Matters note within KPCo's 2019 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 2020 and updates KPCo's 2019 Annual Report.

Regulatory Assets Pending Final Regulatory Approval

Noncurrent Regulatory Assets	June 30, 2020	December 31, 2019
	(in thousands)	
Regulatory Assets Currently Earning a Return		
Kentucky Deferred Purchased Power Expenses	$ 35,675	$ 30,165
Regulatory Assets Currently Not Earning a Return		
Other Regulatory Assets Pending Final Regulatory Approval	1,549	1,333
Total Regulatory Assets Pending Final Regulatory Approval	$ 37,224	$ 31,498

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

Storm-Related Costs

In April 2020, major storms impacted KPCo's service territory resulting in customer outages for approximately 62,000 customers and damages to KPCo utility assets. Management currently estimates that KPCo will incur incremental other operation and maintenance expenses, split approximately evenly between the second and third quarters of 2020, related to the April 2020 storms ranging from $3.7 million to $5.8 million. Consistent with prior guidance from the KPSC, KPCo will file with the KPSC seeking recovery of these prudently incurred costs in addition to $502 thousand of previously incurred incremental operation and maintenance expenses related to a major storm in January 2020. Until KPCo receives deferral authority for these incremental storm costs from the KPSC, it will reduce future net income and cash flows and impact financial condition.

COVID-19 Pandemic

AEP's electric utility operating companies have informed retail customers and state regulators that disconnections for non-payment have been temporarily suspended. These uncertain economic conditions may result in the inability of customers to pay for electric service, which could affect the collectability of revenues and adversely affect financial results. KPCo is working with the KPSC on potential rate recovery for increased costs as a result of the impacts of COVID-19. In May 2020, KPCo filed a request with the KPSC to issue a one-time refund of Excess ADIT that is not subject to normalization requirements to customers of approximately $10.8 million to eliminate certain customer delinquencies attributable to the COVID-19 pandemic. If any costs related to COVID-19 are not recoverable, it could reduce future net income and cash flows and impact financial condition.

2020 Kentucky Base Rate Case

In June 2020, KPCo filed a request with the KPSC for a $65 million net annual increase in base rates based upon a proposed 10% ROE with the increase to be implemented no earlier than January 2021. The filing proposes that KPCo would offset the first year of rate increases by refunding Excess ADIT that is not subject to normalization requirements to customers. Additionally, KPCo requested recovery of the previously authorized deferral of $50 million of Rockport Plant Unit Power Agreement expenses and related carrying charges over a 5-year period beginning in December 2022, through an existing purchased power rider. If any of these costs are not recoverable, it could 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 2019 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 June 30, 2020, 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 June 30, 2020, the maximum potential loss for these lease agreements was $1.9 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

The American Electric Power System Retirement Plan (the Plan) has received a letter written on behalf of four participants (the Claimants) making a claim for additional plan benefits and purporting to advance such claims on behalf of a class. 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 Claimants have asserted claims 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 (ADEA); and (c) the company failed to provide required notice regarding the changes to the Plan. AEP has responded to the Claimants providing a reasoned explanation for why each of their claims have been denied. The denial of those claims was appealed to the AEP System Retirement Plan Appeal Committee and the Committee upheld the denial of claims. Management will continue to defend against the claims. Management is unable to determine a range of potential losses that are 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 tables provide the components of KPCo's net periodic benefit cost (credit) for the plans:

	Pension Plans		OPEB	
	Three Months Ended June 30,		Three Months Ended June 30,	
	2020	2019	2020	2019
	(in thousands)			
Service Cost	$ 779	$ 711	$ 74	$ 66
Interest Cost	1,492	1,823	374	464
Expected Return on Plan Assets	(2,472)	(2,728)	(940)	(910)
Amortization of Prior Service Credit	—	—	(613)	(606)
Amortization of Net Actuarial Loss	823	505	59	212
Net Periodic Benefit Cost (Credit)	$ 622	$ 311	$ (1,046)	$ (774)

	Pension Plans		OPEB	
	Six Months Ended June 30,		Six Months Ended June 30,	
	2020	2019	2020	2019
	(in thousands)			
Service Cost	$ 1,559	$ 1,422	$ 149	$ 131
Interest Cost	2,985	3,646	747	928
Expected Return on Plan Assets	(4,945)	(5,455)	(1,881)	(1,820)
Amortization of Prior Service Credit	—	—	(1,226)	(1,212)
Amortization of Net Actuarial Loss	1,646	1,010	119	426
Net Periodic Benefit Cost (Credit)	$ 1,245	$ 623	$ (2,092)	$ (1,547)

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:

Notional Volume of Derivative Instruments

	Volume		
Primary Risk Exposure	**June 30, 2020**	**December 31, 2019**	**Unit of Measure**
	(in thousands)		
Commodity:			
Power	17,193	11,383	MWhs
Heating Oil and Gasoline	401	273	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, supply and demand market data 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 June 30, 2020 and December 31, 2019 balance sheets, KPCo netted $0 and $129 thousand, respectively, of cash collateral received from third-parties against short-term and long-term risk management assets and $118 thousand and $150 thousand, 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
June 30, 2020

Balance Sheet Location	Risk Management Contracts – Commodity (a)	Gross Amounts Offset in the Statement of Financial Position (b)	Net Amounts of Assets/Liabilities Presented in the Statement of Financial Position (c)
		(in thousands)	
Current Risk Management Assets	$ 12,950	$ (6,435)	$ 6,515
Long-term Risk Management Assets	686	(611)	75
Total Assets	13,636	(7,046)	6,590
Current Risk Management Liabilities	6,892	(6,553)	339
Long-term Risk Management Liabilities	644	(612)	32
Total Liabilities	7,536	(7,165)	371
Total MTM Derivative Contract Net Assets	$ 6,100	$ 119	$ 6,219

December 31, 2019

Balance Sheet Location	Risk Management Contracts – Commodity (a)	Gross Amounts Offset in the Statement of Financial Position (b)	Net Amounts of Assets/Liabilities Presented in the Statement of Financial Position (c)
		(in thousands)	
Current Risk Management Assets	$ 21,653	$ (14,775)	$ 6,878
Long-term Risk Management Assets	160	(135)	25
Total Assets	21,813	(14,910)	6,903
Current Risk Management Liabilities	16,285	(14,805)	1,480
Long-term Risk Management Liabilities	128	(127)	1
Total Liabilities	16,413	(14,932)	1,481
Total MTM Derivative Contract Net Assets	$ 5,400	$ 22	$ 5,422

(a) Derivative instruments within this category are reported 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 June 30, 2020	Three Months Ended June 30, 2019	Six Months Ended June 30, 2020	Six Months Ended June 30, 2019
	(in thousands)			
Electric Generation, Transmission and Distribution Revenues	$ (110)	$ 37	$ 22	$ 44
Purchased Electricity for Resale	43	23	44	60
Other Operation	(20)	—	(28)	(15)
Maintenance	(44)	(4)	(51)	(18)
Regulatory Assets (a)	1,674	(224)	280	(102)
Regulatory Liabilities (a)	2,909	2,268	3,333	554
Total Gain on Risk Management Contracts	$ 4,452	$ 2,100	$ 3,600	$ 523

(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 expense line item on the statements of income as that of the associated risk. 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 and six months ended June 30, 2020 and 2019, 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 and six months ended June 30, 2020 and 2019, 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 June 30, 2020 and December 31, 2019.

The actual amounts that KPCo reclassifies from Accumulated Other Comprehensive Income (Loss) to Net Income can differ due to market price changes. As of June 30, 2020, 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 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 June 30, 2020 and December 31, 2019, KPCo did not have derivative contracts with collateral triggering events in a net liability position.

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. The following table represents: (a) the fair value of these derivative liabilities subject to cross-default provisions prior to consideration of contractual netting arrangements, (b) the amount this exposure has been reduced by cash collateral posted and (c) if a cross-default provision would have been triggered, the settlement amount that would be required after considering contractual netting arrangements:

	June 30, 2020	December 31, 2019
	(in thousands)	
Liabilities for Contracts with Cross-Default Provisions Prior to Contractual Netting Arrangements	$ 99	$ 419
Additional Settlement Liability if Cross-Default Provision is Triggered	9	65

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:

	June 30, 2020		December 31, 2019	
	Book Value	Fair Value	Book Value	Fair Value
	(in thousands)			
Long-term Debt	$ 992,403	$ 1,139,337	$ 867,553	$ 970,437

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
June 30, 2020

	Level 1	Level 2	Level 3	Other	Total
Assets:			(in thousands)		
Risk Management Assets					
Risk Management Commodity Contracts (a) (b)	$ —	$ 6,741	$ 6,622	$ (6,773)	$ 6,590
Liabilities:					
Risk Management Liabilities					
Risk Management Commodity Contracts (a) (b)	$ —	$ 6,941	$ 321	$ (6,891)	$ 371

December 31, 2019

	Level 1	Level 2	Level 3	Other	Total
Assets:			(in thousands)		
Risk Management Assets					
Risk Management Commodity Contracts (a) (b)	$ —	$ 14,758	$ 7,054	$ (14,909)	$ 6,903
Liabilities:					
Risk Management Liabilities					
Risk Management Commodity Contracts (a) (b)	$ —	$ 15,059	$ 1,352	$ (14,930)	$ 1,481

(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:

Three Months Ended June 30, 2020	Net Risk Management Assets (Liabilities) (in thousands)
Balance as of March 31, 2020	$ 1,250
Realized Gain (Loss) Included in Net Income (or Changes in Net Assets) (a) (b)	4,646
Settlements	(5,664)
Changes in Fair Value Allocated to Regulated Jurisdictions (d)	6,069
Balance as of June 30, 2020	$ 6,301

Three Months Ended June 30, 2019	Net Risk Management Assets (Liabilities) (in thousands)
Balance as of March 31, 2019	$ 1,367
Realized Gain (Loss) Included in Net Income (or Changes in Net Assets) (a) (b)	2,689
Settlements	(3,651)
Changes in Fair Value Allocated to Regulated Jurisdictions (d)	12,876
Balance as of June 30, 2019	$ 13,281

Six Months Ended June 30, 2020	Net Risk Management Assets (Liabilities) (in thousands)
Balance as of December 31, 2019	$ 5,702
Realized Gain (Loss) Included in Net Income (or Changes in Net Assets) (a) (b)	4,035
Settlements	(9,744)
Transfers out of Level 3 (c)	130
Changes in Fair Value Allocated to Regulated Jurisdictions (d)	6,178
Balance as of June 30, 2020	$ 6,301

Six Months Ended June 30, 2019	Net Risk Management Assets (Liabilities) (in thousands)
Balance as of December 31, 2018	$ 5,804
Realized Gain (Loss) Included in Net Income (or Changes in Net Assets) (a) (b)	1,399
Settlements	(6,600)
Transfers out of Level 3 (c)	(120)
Changes in Fair Value Allocated to Regulated Jurisdictions (d)	12,798
Balance as of June 30, 2019	$ 13,281

(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) Transfers are recognized based on their value at the beginning of the reporting period that the transfer occurred.
(d) Relates to the net gains (losses) of those contracts that are not reflected on KPCo's statements of income. These net gains (losses) are recorded as regulatory assets/liabilities or accounts payable.

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

Significant Unobservable Inputs
June 30, 2020

	Fair Value		Valuation	Significant Unobservable	Input/Range		
	Assets	Liabilities	Technique	Input (a)	Low	High	Weighted Average (b)
	(in thousands)						
Energy Contracts	$ 352	$ 128	Discounted Cash Flow	Forward Market Price	$ 8.53	$ 40.35	$ 25.34
FTRs	6,270	193	Discounted Cash Flow	Forward Market Price	0.03	5.57	0.96
Total	$ 6,622	$ 321					

December 31, 2019

	Fair Value		Valuation	Significant Unobservable	Input/Range		
	Assets	Liabilities	Technique	Input (a)	Low	High	Weighted Average (b)
	(in thousands)						
Energy Contracts	$ 1,049	$ 475	Discounted Cash Flow	Forward Market Price	$ 12.70	$ 41.20	$ 25.92
FTRs	6,005	877	Discounted Cash Flow	Forward Market Price	(0.47)	4.07	1.30
Total	$ 7,054	$ 1,352					

(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 June 30, 2020 and December 31, 2019:

Uncertainty of Fair Value Measurements

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

9. INCOME TAXES

Federal Legislation

In March 2020, the "Coronavirus Aid, Relief, and Economic Security Act" (CARES Act) was signed into law. The CARES Act includes several significant changes to the Internal Revenue Code that will have an impact on KPCo. The CARES Act includes certain tax relief provisions applicable to KPCo including a) the immediate refund of the corporate Alternative Minimum Tax credit, b) the ability to carryback net operating losses five years for tax years 2018 through 2020 and c) delayed payment of employer payroll taxes. KPCo and other AEP subsidiaries were most recently a tax payer in 2014 and management is currently evaluating the ability to recover cash taxes paid in 2014 under the 5-year net operating loss carryback provision.

Effective Tax Rates (ETR)

KPCo's interim ETR reflects the estimated annual ETR for 2020 and 2019, 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:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2020	2019	2020	2019
U.S. Federal Statutory Rate	21.0 %	21.0 %	21.0 %	21.0 %
Increase (decrease) due to:				
State Income Tax, net of Federal benefit	7.7 %	2.2 %	(5.0)%	2.2 %
Tax Reform Excess ADIT Reversal	13.6 %	(11.7)%	(30.2)%	(11.7)%
Flow Through	(0.4)%	(3.3)%	0.3 %	(3.3)%
AFUDC Equity	0.9 %	(0.9)%	(2.0)%	(0.9)%
Parent Company Loss Benefit	— %	(1.2)%	— %	(1.2)%
Discrete Tax Adjustments	— %	0.6 %	(3.0)%	3.1 %
Other	0.6 %	0.2 %	0.1 %	0.2 %
Effective Income Tax Rate	43.4 %	6.9 %	(18.8)%	9.4 %

Federal and State Income Tax Audit Status

KPCo and other AEP subsidiaries are no longer subject to U.S. federal examination by the IRS for all years through 2015. During the third quarter of 2019, AEP and subsidiaries elected to amend the 2014 and 2015 federal returns. In the first quarter of 2020, the IRS notified AEP that it was beginning an examination of these amended returns, including the net operating loss carryback to 2015 that originated in the 2017 return. The IRS may examine only the amended items on the 2014 and 2015 federal returns.

10. FINANCING ACTIVITIES

Long-term Debt

Long-term debt issued during the first six months of 2020 are shown in the following table:

Type of Issuance		Principal Amount (a)	Interest Rate	Due Date
		(in thousands)	(%)	
Other Long-term Debt	$	125,000	Variable	2022

(a) Amounts indicated on the statements of cash flows are net of issuance costs and premium or discount and will not tie to the issuance amounts.

KPCo did not have any long-term debt retirements during the first six months of 2020.

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 June 30, 2020, 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 June 30, 2020 and December 31, 2019 are included in Advances from Affiliates on KPCo's balance sheets. KPCo's Utility Money Pool activity and corresponding authorized borrowing limit for the six months ended June 30, 2020 are described in the following table:

Maximum Borrowings from the Utility Money Pool	Maximum Loans to the Utility Money Pool	Average Borrowings from the Utility Money Pool	Average Loans to the Utility Money Pool	Borrowings from the Utility Money Pool as of June 30, 2020	Authorized Short-Term Borrowing Limit
		(in thousands)			
$ 126,742	$ 6,572	$ 53,221	$ 5,020	$ 40,734	$ 180,000

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

Six Months Ended June 30,	Maximum Interest Rate for Funds Borrowed from the Utility Money Pool	Minimum Interest Rate for Funds Borrowed from the Utility Money Pool	Maximum Interest Rate for Funds Loaned to the Utility Money Pool	Minimum Interest Rate for Funds Loaned to the Utility Money Pool	Average Interest Rate for Funds Borrowed from the Utility Money Pool	Average Interest Rate for Funds Loaned to the Utility Money Pool
2020	2.70 %	0.33 %	2.08 %	1.80 %	1.83 %	1.81 %
2019	3.02 %	2.68 %	— %	— %	2.78 %	— %

Securitized Accounts Receivables – AEP Credit

Under a sale of receivables arrangement, KPCo sells, without recourse, certain of its customer accounts receivable and accrued unbilled revenue balances to AEP Credit and is charged a fee based on AEP Credit's financing costs, administrative costs and uncollectible accounts experience for KPCo's receivables. The costs of customer accounts receivable sold are reported in Other Operation expense on KPCo's statements of income. KPCo manages and services its accounts receivable sold.

During the second quarter of 2020, AEP Credit breached the eligibility criteria on the receivables securitization agreement related to the accounts receivables acquired from KPCo and entered into waivers with the bank conduits in May and June 2020. In response to the COVID-19 pandemic and related deterioration in aging of KPCo's accounts receivables, KPCo filed a request with the KPSC in May 2020 to issue a one-time refund of Excess ADIT that is not subject to normalization requirements to customers of approximately $11 million to eliminate certain customer delinquencies. See Note 4 - Rate Matters for additional information. Also in May 2020, AEP Credit entered into an amendment on the receivables securitization agreement to increase the eligibility criteria related to aged receivable requirements for the participating affiliated utility subsidiaries as a response to the COVID-19 pandemic. To the extent that KPCo is deemed ineligible under the agreement, receivables would no longer be purchased by the bank conduits and KPCo would need to finance working capital through other funding mechanisms.

AEP Credit's receivables securitization agreement provides a commitment of $750 million from bank conduits to purchase receivables and expires in July 2021.

KPCo's amounts of accounts receivable and accrued unbilled revenues sold under the sale of receivables agreement were $39.7 million and $41.6 million as of June 30, 2020 and December 31, 2019, respectively.

The fees paid by KPCo to AEP Credit for customer accounts receivable sold for the three months ended June 30, 2020 and 2019 were $1 million and $1 million, respectively, and for the six months ended June 30, 2020 and 2019 were $2 million and $2.1 million, respectively.

KPCo's proceeds on the sale of receivables to AEP Credit for the three months ended June 30, 2020 and 2019 were $110 million and $125.8 million, respectively, and for the six months ended June 30, 2020 and 2019 were $252.5 million and $282.7 million, respectively.

11. PROPERTY, PLANT AND EQUIPMENT

Asset Retirement Obligations (ARO)

KPCo records ARO in accordance with the accounting guidance for "Asset Retirement and Environmental Obligations" for the retirement of ash disposal facilities and asbestos removal.

The following is a reconciliation of the aggregate carrying amounts of ARO for KPCo:

ARO as of December 31, 2019	Accretion Expense	Liabilities Incurred	Liabilities Settled	Revisions in Cash Flow Estimates	ARO as of June 30, 2020
		(in thousands)			
$ 43,588	$ 960	$ 77	$ (7,422)	$ —	$ 37,203

12. 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:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2020	2019	2020	2019
	(in thousands)			
Retail Revenues:				
Residential Revenues	$ 49,669	$ 50,001	$ 114,942	$ 124,233
Commercial Revenues	31,144	36,441	66,390	75,114
Industrial Revenues	29,211	38,476	61,994	77,699
Other Retail Revenues	459	480	957	991
Total Retail Revenues	110,483	125,398	244,283	278,037
Wholesale Revenues:				
Generation Revenues (a)	3,027	5,445	6,294	12,605
Transmission Revenues (b)	5,708	5,051	11,433	9,869
Total Wholesale Revenues	8,735	10,496	17,727	22,474
Other Revenues from Contracts with Customers (a)	2,745	4,069	8,009	8,120
Customers	121,963	139,963	270,019	308,631
Other Revenues:				
Alternative Revenues	813	1,130	390	2,056
Total Other Revenues	813	1,130	390	2,056
Total Revenues	$ 122,776	$ 141,093	$ 270,409	$ 310,687

(a) Amounts included affiliated and nonaffiliated revenues.
(b) Amounts included affiliated and nonaffiliated revenues. The affiliated revenues were $2.6 million and $2.5 million for the three months ended June 30, 2020 and 2019, respectively, and $5.3 million and $4.8 million for the six months ended June 30, 2020 and 2019, respectively.

Fixed Performance Obligations

The following table represents KPCo's remaining fixed performance obligations satisfied over time as of June 30, 2020. 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.

2020	2021-2022	2023-2024	After 2024	Total
(in thousands)				
$ 12,639	$ 3,843	$ 2,870	$ 1,435	$ 20,787

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 June 30, 2020 and December 31, 2019.

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 June 30, 2020 and December 31, 2019.

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 June 30, 2020 and December 31, 2019. 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 $8.6 million and $7 million, respectively, as of June 30, 2020 and December 31, 2019.