

# Kentucky Power Company

2022 Third 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.
IRA	On August 16, 2022 President Biden signed into law legislation commonly referred to as the “Inflation Reduction Act” (IRA).
IRS	Internal Revenue Service.
ITC	Investment Tax Credit.
KPCo	Kentucky Power Company, an AEP electric utility subsidiary.
KPSC	Kentucky Public Service Commission.
KTCo	AEP Kentucky Transmission Company, Inc., an affiliate of KPCo and a wholly-owned subsidiary of AEP.
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.
PTC	Production Tax Credit.
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.

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**Term****Meaning**

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WPCo  
WVPSC

Wheeling Power Company, an AEP electric utility subsidiary.  
Public Service Commission of West Virginia.

**KENTUCKY POWER COMPANY**  
**CONDENSED STATEMENTS OF INCOME**  
For the Three and Nine Months Ended September 30, 2022 and 2021  
(in thousands)  
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2022	2021	2022	2021
<b>REVENUES</b>				
Electric Generation, Transmission and Distribution	\$ 191,639	\$ 163,133	\$ 544,489	\$ 469,081
Sales to AEP Affiliates	5,215	2,658	18,313	7,885
Other Revenues	310	252	1,325	754
<b>TOTAL REVENUES</b>	<u>197,164</u>	<u>166,043</u>	<u>564,127</u>	<u>477,720</u>
<b>EXPENSES</b>				
Purchased Electricity, Fuel and Other Consumables Used for Electric Generation	67,044	39,325	178,224	111,815
Purchased Electricity from AEP Affiliates	29,076	27,112	79,099	73,985
Other Operation	31,286	31,295	93,107	91,585
Maintenance	13,269	15,905	44,120	51,207
Depreciation and Amortization	31,458	28,502	92,116	85,154
Taxes Other Than Income Taxes	6,865	6,984	20,215	20,999
<b>TOTAL EXPENSES</b>	<u>178,998</u>	<u>149,123</u>	<u>506,881</u>	<u>434,745</u>
<b>OPERATING INCOME</b>	18,166	16,920	57,246	42,975
<b>Other Income (Expense):</b>				
Other Income	363	535	764	1,218
Non-Service Cost Components of Net Periodic Benefit Cost	1,622	1,035	4,867	3,106
Interest Expense	(11,713)	(8,845)	(31,728)	(26,701)
<b>INCOME BEFORE INCOME TAX BENEFIT</b>	8,438	9,645	31,149	20,598
Income Tax Benefit	(3,157)	(11,038)	(19,534)	(24,233)
<b>NET INCOME</b>	<u>\$ 11,595</u>	<u>\$ 20,683</u>	<u>\$ 50,683</u>	<u>\$ 44,831</u>

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

*See Condensed Notes to Condensed Financial Statements beginning on page 9.*

**KENTUCKY POWER COMPANY**  
**CONDENSED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**  
**For the Three and Nine Months Ended September 30, 2022 and 2021**  
**(in thousands)**  
**(Unaudited)**

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2022</b>	<b>2021</b>	<b>2022</b>	<b>2021</b>
Net Income	\$ 11,595	\$ 20,683	\$ 50,683	\$ 44,831
<b>OTHER COMPREHENSIVE LOSS, NET OF TAXES</b>				
Amortization of Pension and OPEB Deferred Costs, Net of Tax of \$(444) and \$(9) for the Three Months Ended September 30, 2022 and 2021, Respectively, and \$(465) and \$(27) for the Nine Months Ended September 30, 2022 and 2021, Respectively	(1,670)	(34)	(1,749)	(102)
<b>TOTAL COMPREHENSIVE INCOME</b>	<b>\$ 9,925</b>	<b>\$ 20,649</b>	<b>\$ 48,934</b>	<b>\$ 44,729</b>

See Condensed Notes to Condensed Financial Statements beginning on page 9.

**KENTUCKY POWER COMPANY**  
**CONDENSED STATEMENTS OF CHANGES IN**  
**COMMON SHAREHOLDER'S EQUITY**  
For the Nine Months Ended September 30, 2022 and 2021  
(in thousands)  
(Unaudited)

	<u>Common Stock</u>	<u>Paid-in Capital</u>	<u>Retained Earnings</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Total</u>
<b>TOTAL COMMON SHAREHOLDER'S 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 EQUITY - MARCH 31, 2021</b>	50,450	526,135	259,722	844	837,151
Net Income			10,297		10,297
Other Comprehensive Loss				(34)	(34)
<b>TOTAL COMMON SHAREHOLDER'S EQUITY - JUNE 30, 2021</b>	50,450	526,135	270,019	810	847,414
Net Income			20,683		20,683
Other Comprehensive Loss				(34)	(34)
<b>TOTAL COMMON SHAREHOLDER'S EQUITY - SEPTEMBER 30, 2021</b>	<u>\$ 50,450</u>	<u>\$ 526,135</u>	<u>\$ 290,702</u>	<u>\$ 776</u>	<u>\$ 868,063</u>
<b>TOTAL COMMON SHAREHOLDER'S 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 EQUITY - MARCH 31, 2022</b>	50,450	526,135	321,942	1,710	900,237
Net Income			13,167		13,167
Other Comprehensive Loss				(40)	(40)
<b>TOTAL COMMON SHAREHOLDER'S EQUITY - JUNE 30, 2022</b>	50,450	526,135	335,109	1,670	913,364
Net Income			11,595		11,595
Other Comprehensive Loss				(1,670)	(1,670)
<b>TOTAL COMMON SHAREHOLDER'S EQUITY - SEPTEMBER 30, 2022</b>	<u>\$ 50,450</u>	<u>\$ 526,135</u>	<u>\$ 346,704</u>	<u>\$ —</u>	<u>\$ 923,289</u>

See Condensed Notes to Condensed Financial Statements beginning on page 9.

**KENTUCKY POWER COMPANY**  
**CONDENSED BALANCE SHEETS**  
**ASSETS**  
**September 30, 2022 and December 31, 2021**  
**(in thousands)**  
**(Unaudited)**

	<b>September 30, 2022</b>	<b>December 31, 2021</b>
<b>CURRENT ASSETS</b>		
Cash and Cash Equivalents	\$ 4,350	\$ 763
Accounts Receivable:		
Customers	56,331	16,281
Affiliated Companies	29,285	25,578
Accrued Unbilled Revenues	21,934	16,647
Miscellaneous	157	57
Allowance for Uncollectible Accounts	(883)	(3)
Total Accounts Receivable	<u>106,824</u>	<u>58,560</u>
Fuel	12,323	10,090
Materials and Supplies	24,361	20,515
Risk Management Assets	14,364	5,986
Accrued Tax Benefits	3,123	892
Regulatory Asset for Under-Recovered Fuel Costs	24,425	8,216
Margin Deposits	124	14,229
Prepayments and Other Current Assets	2,484	2,598
<b>TOTAL CURRENT ASSETS</b>	<u>192,378</u>	<u>121,849</u>
<b>PROPERTY, PLANT AND EQUIPMENT</b>		
Electric:		
Generation	1,233,986	1,231,494
Transmission	782,291	760,359
Distribution	1,050,860	1,017,406
Other Property, Plant and Equipment	162,308	137,554
Construction Work in Progress	135,601	95,093
<b>Total Property, Plant and Equipment</b>	<u>3,365,046</u>	<u>3,241,906</u>
Accumulated Depreciation and Amortization	1,144,610	1,104,492
<b>TOTAL PROPERTY, PLANT AND EQUIPMENT – NET</b>	<u>2,220,436</u>	<u>2,137,414</u>
<b>OTHER NONCURRENT ASSETS</b>		
Regulatory Assets	495,939	476,457
Employee Benefits and Pension Assets	31,042	60,333
Operating Lease Assets	557	10,748
Deferred Charges and Other Noncurrent Assets	20,395	33,848
<b>TOTAL OTHER NONCURRENT ASSETS</b>	<u>547,933</u>	<u>581,386</u>
<b>TOTAL ASSETS</b>	<u>\$ 2,960,747</u>	<u>\$ 2,840,649</u>

*See Condensed Notes to Condensed Financial Statements beginning on page 9.*



**KENTUCKY POWER COMPANY**  
**CONDENSED BALANCE SHEETS**  
**LIABILITIES AND COMMON SHAREHOLDER'S EQUITY**  
**September 30, 2022 and December 31, 2021**  
**(Unaudited)**

	<b>September 30, 2022</b>	<b>December 31, 2021</b>
	<b>(in thousands)</b>	
<b>CURRENT LIABILITIES</b>		
Advances from Affiliates	\$ 48,494	\$ 47,895
Accounts Payable:		
General	62,094	52,837
Affiliated Companies	38,609	42,223
Long-term Debt Due Within One Year – Nonaffiliated	215,000	200,000
Customer Deposits	38,002	32,432
Accrued Taxes	24,937	45,243
Accrued Interest	7,977	5,685
Obligations Under Operating Leases	136	2,173
Other Current Liabilities	19,803	21,435
<b>TOTAL CURRENT LIABILITIES</b>	<b>455,052</b>	<b>449,923</b>
<b>NONCURRENT LIABILITIES</b>		
Long-term Debt – Nonaffiliated	963,355	903,105
Deferred Income Taxes	457,146	437,152
Regulatory Liabilities and Deferred Investment Tax Credits	130,020	140,506
Asset Retirement Obligations	17,101	16,399
Employee Benefits and Pension Obligations	10,012	8,064
Obligations Under Operating Leases	471	8,614
Deferred Credits and Other Noncurrent Liabilities	4,301	2,531
<b>TOTAL NONCURRENT LIABILITIES</b>	<b>1,582,406</b>	<b>1,516,371</b>
<b>TOTAL LIABILITIES</b>	<b>2,037,458</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	346,704	296,021
Accumulated Other Comprehensive Income (Loss)	—	1,749
<b>TOTAL COMMON SHAREHOLDER'S EQUITY</b>	<b>923,289</b>	<b>874,355</b>
<b>TOTAL LIABILITIES AND COMMON SHAREHOLDER'S EQUITY</b>	<b>\$ 2,960,747</b>	<b>\$ 2,840,649</b>

See Condensed Notes to Condensed Financial Statements beginning on page 9.

**KENTUCKY POWER COMPANY**  
**CONDENSED STATEMENTS OF CASH FLOWS**  
**For the Nine Months Ended September 30, 2022 and 2021**  
**(in thousands)**  
**(Unaudited)**

	<b>Nine Months Ended September 30,</b>	
	<b>2022</b>	<b>2021</b>
<b>OPERATING ACTIVITIES</b>		
<b>Net Income</b>	\$ 50,683	\$ 44,831
<b>Adjustments to Reconcile Net Income to Net Cash Flows from Operating Activities:</b>		
Depreciation and Amortization	92,116	85,154
Deferred Income Taxes	(12,650)	(13,538)
Allowance for Equity Funds Used During Construction	(646)	(1,202)
Mark-to-Market of Risk Management Contracts	(8,425)	(2,547)
Pension and Postemployment Benefit Reserves	32,042	(1,004)
Property Taxes	14,654	14,486
Deferred Fuel Over/Under-Recovery, Net	(16,209)	(6,053)
Change in Regulatory Assets	(28,525)	(53,243)
Change in Other Noncurrent Assets	1,827	(10,264)
Change in Other Noncurrent Liabilities	9,190	1,521
<b>Changes in Certain Components of Working Capital:</b>		
Accounts Receivable, Net	(47,805)	5,414
Fuel, Materials and Supplies	(6,031)	15,895
Margin Deposits	14,106	(202)
Accounts Payable	3,143	2,363
Accrued Taxes, Net	(22,537)	(23,914)
Other Current Assets	40	(2,500)
Other Current Liabilities	(3,530)	1,461
<b>Net Cash Flows from Operating Activities</b>	<b>71,443</b>	<b>56,658</b>
<b>INVESTING ACTIVITIES</b>		
Construction Expenditures	(149,041)	(117,816)
Proceeds from Sales of Assets	7,995	993
Other Investing Activities	417	2,180
<b>Net Cash Flows Used for Investing Activities</b>	<b>(140,629)</b>	<b>(114,643)</b>
<b>FINANCING ACTIVITIES</b>		
Issuance of Long-term Debt – Nonaffiliated	149,873	149,974
Change in Advances from Affiliates, Net	599	(51,836)
Retirement of Long-term Debt – Nonaffiliated	(75,000)	(40,000)
Principal Payments for Finance Lease Obligations	(2,705)	(693)
Other Financing Activities	6	162
<b>Net Cash Flows from Financing Activities</b>	<b>72,773</b>	<b>57,607</b>
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	<b>3,587</b>	<b>(378)</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>\$ 4,350</b>	<b>\$ 1,155</b>
<b>SUPPLEMENTARY INFORMATION</b>		
Cash Paid for Interest, Net of Capitalized Amounts	\$ 28,635	\$ 28,181
Net Cash Paid (Received) for Income Taxes	(2,234)	1,991
Noncash Acquisitions Under Finance Leases	126	288
Construction Expenditures Included in Current Liabilities as of September 30,	31,514	21,049

*See Condensed Notes to Condensed Financial Statements beginning on page 9.*

## 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 and nine months ended September 30, 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 the first quarter of 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 was immaterial to KPCo's financial statements.

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

In October 2021, AEP entered into a Stock Purchase Agreement (SPA) 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. In May 2022, the KPSC approved the transfer of KPCo to Liberty subject to certain conditions contingent upon the closing of the sale. AEP has received clearance under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 and the Committee on Foreign Investment in the United States. The sale remains subject to FERC approval under Section 203 of the Federal Power Act.

In September 2022, AEP, AEPTCo and Liberty entered into an amendment (Amendment) to the SPA which reduced the purchase price to approximately \$2.646 billion and Liberty agreed to waive, upon FERC approval of the sale, the SPA condition precedent to closing requiring the issuance of regulatory orders approving a new proposed Mitchell Plant Operations and Maintenance Agreement and Mitchell Plant Ownership Agreement between KPCo and WPCo. The Amendment also provided that the closing shall not occur prior to January 4, 2023, unless mutually agreed to by AEP and Liberty.

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

KPCo and WPCo each own a 50% undivided interest in the 1,560 MW coal-fired Mitchell Plant. As of September 30, 2022, the net book value of KPCo's share of the Mitchell Plant, before cost of removal including CWIP and inventory, was \$576 million.

In November 2021, AEP made filings with the KPSC, WVPSC and FERC seeking approval of a new proposed Mitchell Plant Operations and Maintenance Agreement and Mitchell Plant Ownership Agreement. In February 2022, AEP filed a motion to withdraw its filing with the FERC. The KPSC and WVPSC issued orders addressing AEP's filings in May 2022 and July 2022. Those orders proposed materially different modifications to the Mitchell Plant agreements filed by AEP such that the new agreements could not be executed by the parties. In lieu of new agreements, in July 2022, KPCo and WPCo confirmed with the KPSC and WVPSC, respectively, that they will continue operating under the existing Mitchell Agreement, utilizing the Mitchell Agreement Operating Committee's

authority under that agreement to issue appropriate resolutions so the parties can operate in accordance with each state commission's directives related to CCR and ELG investment.

In September 2022, pursuant to resolutions under the existing Mitchell Plant agreement, WPCo replaced KPCo as the Operator of Mitchell Plant and 467 Mitchell Plant employees and retirees became employees and retirees of WPCo. This arrangement resulted in a \$29 million reduction in Employee Benefits and Pension Assets, a \$3 million net increase in Employee Benefits and Pension Obligations due to funding status of the Pension and OPEB plans as it relates to the Mitchell employees and retirees. As of September 30, 2022 KPCo has received \$2 million from WPCo and \$24 million remains in Accounts Receivable – Affiliated Companies on the balance sheet related to this arrangement.

### *Transfer of Ownership*

#### FERC Proceedings

In December 2021, Liberty, KPCo and KTCo requested FERC approval of the sale under Section 203 of the Federal Power Act. In February 2022, several intervenors in the case filed protests related to whether the sale will negatively impact the wholesale transmission 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. In May 2022, Liberty, KPCo and KTCo supplemented the application and in June 2022, the FERC issued an order formally notifying AEP that it was exercising its ability to take up to an additional 180 days to act on the application. An order from the FERC is expected in the fourth quarter of 2022.

#### KPSC Proceedings

In May 2022, the KPSC approved the transfer of KPCo to Liberty subject to conditions contingent upon the closing of the sale, including establishment of regulatory liabilities to subsidize retail customer transmission and distribution expenses, a fuel adjustment clause bill credit, and a three-year Big Sandy decommissioning rider rate holiday during which KPCo's carrying charge is reduced by 50%. The accounting implications for these items will be evaluated by KPCo upon closing of the transaction.

Subject to receipt of FERC authorization under Section 203 of the Federal Power Act, the sale is expected to close in January 2023 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.

In June 2022, KPCo entered into agreements to purchase assets under lease, terminating remaining lease obligations prior to the original maturity date. As a result of the early terminations, current obligations under operating and finance leases of \$1.9 million and \$583 thousand, respectively, and noncurrent obligations under operating and finance leases of \$7.2 million and \$1.4 million, respectively, were relieved from KPCo's balance sheet in the second quarter of 2022.

### *Subsequent Events*

Management reviewed subsequent events through October 27, 2022, the date that the third 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 September 30, 2022</b>	<b>Pension and OPEB (in thousands)</b>
<b>Balance in AOCI as of June 30, 2022</b>	\$ 1,670
Change in Fair Value Recognized in AOCI	—
Pension and OPEB Adjustment Related to Plant Transfers	(2,114)
Income Tax (Expense) Benefit	(444)
Pension and OPEB Adjustment Related to Plant Transfers, Net of Income Tax (Expense) Benefit	(1,670)
Net Current Period Other Comprehensive Income (Loss)	(1,670)
<b>Balance in AOCI as of September 30, 2022</b>	<b>\$ —</b>
<b>Three Months Ended September 30, 2021</b>	<b>Pension and OPEB (in thousands)</b>
<b>Balance in AOCI as of June 30, 2021</b>	\$ 810
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 September 30, 2021</b>	<b>\$ 776</b>

<b>Nine Months Ended September 30, 2022</b>	<b>Pension and OPEB</b>
	<b>(in thousands)</b>
<b>Balance in AOCI as of December 31, 2021</b>	<b>\$ 1,749</b>
Change in Fair Value Recognized in AOCI	—
Amount of (Gain) Loss Reclassified from AOCI	
Amortization of Prior Service Cost (Credit)	(119)
Amortization of Actuarial (Gains) Losses	19
Reclassifications from AOCI, before Income Tax (Expense) Benefit	(100)
Income Tax (Expense) Benefit	(21)
Reclassifications from AOCI, Net of Income Tax (Expense) Benefit	(79)
Pension and OPEB Adjustment Related to Plant Transfers	(2,114)
Income Tax (Expense) Benefit	(444)
Pension and OPEB Adjustment Related to Plant Transfers, Net of Income Tax (Expense) Benefit	(1,670)
Net Current Period Other Comprehensive Income (Loss)	(1,749)
<b>Balance in AOCI as of September 30, 2022</b>	<b>\$ —</b>

<b>Nine Months Ended September 30, 2021</b>	<b>Pension and OPEB</b>
	<b>(in thousands)</b>
<b>Balance in AOCI as of December 31, 2020</b>	<b>\$ 878</b>
Change in Fair Value Recognized in AOCI	—
Amount of (Gain) Loss Reclassified from AOCI	
Amortization of Prior Service Cost (Credit)	(176)
Amortization of Actuarial (Gains) Losses	47
Reclassifications from AOCI, before Income Tax (Expense) Benefit	(129)
Income Tax (Expense) Benefit	(27)
Reclassifications from AOCI, Net of Income Tax (Expense) Benefit	(102)
Net Current Period Other Comprehensive Income (Loss)	(102)
<b>Balance in AOCI as of September 30, 2021</b>	<b>\$ 776</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>September 30,</u> <u>2022</u>	<u>December 31,</u> <u>2021</u>
<b>Noncurrent Regulatory Assets</b>	<b>(in thousands)</b>	
<u>Regulatory Assets Currently Earning a Return</u>		
Kentucky Deferred Purchased Power Expenses	\$ 52,320	\$ 47,528
<u>Regulatory Assets Currently Not Earning a Return</u>		
Storm-Related Costs	74,061	56,506
Other Regulatory Assets Pending Final Regulatory Approval	1,489	893
<b>Total Regulatory Assets Pending Final Regulatory Approval</b>	<b><u>\$ 127,870</u></b>	<b><u>\$ 104,927</u></b>

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

##### *CCR/ELG Compliance Plan Filings*

KPCo and WPCo each own a 50% interest in the Mitchell Plant. As of September 30, 2022, the net book value of KPCo's share of the Mitchell Plant, before cost of removal including CWIP and inventory, was \$575.6 million. 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 May 2022, the KPSC approved recovery of the Kentucky jurisdictional share of ELG costs incurred at the Mitchell Plant prior to July 15, 2021.

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 also ordered that WPCo will be given the opportunity to recover, from its customers, the ELG and 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. The WVPSC's order further states that unless KPCo pays for its share of costs for ELG improvements and costs necessary to continue operations beyond 2028, the benefit of the capacity and energy made possible by those improvements and operating Mitchell Plant beyond 2028 should benefit only West Virginia jurisdictional customers who have shared in paying for those costs.

### ***Storm-Related Costs***

In June 2022, KPCo's service territory was impacted by strong winds from severe storms resulting in system damages and power outages. In July 2022, KPCo's service territory was impacted again by severe storms, which caused flash flooding, resulting in additional system damages and power outages. In August 2022, KPCo filed an application with the KPSC requesting deferral authority for \$18 million of incremental operation and maintenance costs related to these storms. In September 2022, the KPSC issued an order granting deferral authority. KPCo intends to seek recovery of the deferral in a future base rate case. If any of these incremental storm costs are not recoverable, it could reduce future net income and cash flows and impact financial condition.

### ***Deferred Purchased Power Expenses***

In September 2022, the KPSC initiated a proceeding to investigate the appropriate amortization period and recovery mechanism for the deferral of Kentucky Deferred Purchased Power Expenses related to the Rockport Plant Unit Power Agreement, as well as KPCo's ability to use the level of non-fuel, non-environmental Rockport UPA expense included in base rates to earn its authorized ROE in 2023 since the KPCo UPA ends in December 2022. KPCo has requested the KPSC approve the terms related to each of the foregoing items as reflected in the settlement agreement in the 2017 Kentucky Base Rate Case, including recovery of the Kentucky Deferred Purchased Power Expenses over five years through a rider beginning in December 2022. KPCo expects a decision from the KPSC in the fourth quarter of 2022. If any of these amounts 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 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 September 30, 2022, there were no material liabilities recorded for any indemnifications.

AEPSA 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.

## 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. On August 16, 2022, the district court granted the motion to dismiss the complaint without prejudice. The plaintiffs have filed a motion for leave to file an amended complaint. 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 tables provide the components of KPCo's net periodic benefit cost (credit) for the plans:

	<b>Pension Plans</b>		<b>OPEB</b>	
	<b>Three Months Ended September 30, 2022</b>	<b>2021</b>	<b>Three Months Ended September 30, 2022</b>	<b>2021</b>
	<b>(in thousands)</b>			
Service Cost	\$ 791	\$ 869	\$ 52	\$ 71
Interest Cost	1,289	1,210	260	274
Expected Return on Plan Assets	(2,401)	(2,145)	(1,060)	(869)
Amortization of Prior Service Credit	—	—	(629)	(625)
Amortization of Net Actuarial Loss	536	880	—	—
<b>Net Periodic Benefit Cost (Credit)</b>	<b>\$ 215</b>	<b>\$ 814</b>	<b>\$ (1,377)</b>	<b>\$ (1,149)</b>

  

	<b>Pension Plans</b>		<b>OPEB</b>	
	<b>Nine Months Ended September 30, 2022</b>	<b>2021</b>	<b>Nine Months Ended September 30, 2022</b>	<b>2021</b>
	<b>(in thousands)</b>			
Service Cost	\$ 2,373	\$ 2,608	\$ 157	\$ 212
Interest Cost	3,865	3,630	781	822
Expected Return on Plan Assets	(7,202)	(6,436)	(3,180)	(2,609)
Amortization of Prior Service Credit	—	—	(1,889)	(1,874)
Amortization of Net Actuarial Loss	1,608	2,641	—	—
<b>Net Periodic Benefit Cost (Credit)</b>	<b>\$ 644</b>	<b>\$ 2,443</b>	<b>\$ (4,131)</b>	<b>\$ (3,449)</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>September 30, 2022</u>	<u>December 31, 2021</u>	<u>Unit of Measure</u>
	<u>(in thousands)</u>		
Commodity:			
Power	5,547	6,927	MWhs
Heating Oil and Gasoline	262	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. The netted cash collateral from third-parties against short-term and long-term risk management assets and netted cash collateral paid to third-parties against short-term and long-term risk management liabilities were immaterial for KPCo as of September 30, 2022 and December 31, 2021.

The following tables represent the gross fair value of KPCo's derivative activity on the balance sheets. Unless shown as a separate line on the balance sheets due to materiality, Current Risk Management Assets are included in Prepayments and Other Current Assets, Long-term Risk Management Assets are included in Deferred Charges and Other Noncurrent Assets, Current Risk Management Liabilities are included in Other Current Liabilities and Long-term Risk Management Liabilities are included in Deferred Credits and Other Noncurrent Liabilities on the balance sheets.

**Fair Value of Derivative Instruments  
September 30, 2022**

<b>Balance Sheet Location</b>	<b>Risk Management Contracts – Commodity (a)</b>	<b>Gross Amounts Offset in the Statement of Financial Position (b)</b>	<b>Net Amounts of Assets/Liabilities Presented in the Statement of Financial Position (c)</b>
		(in thousands)	
Current Risk Management Assets	\$ 14,351	\$ 13	\$ 14,364
Long-term Risk Management Assets	—	19	19
<b>Total Assets</b>	<b>14,351</b>	<b>32</b>	<b>14,383</b>
Current Risk Management Liabilities	9	—	9
Long-term Risk Management Liabilities	14	—	14
<b>Total Liabilities</b>	<b>23</b>	<b>—</b>	<b>23</b>
<b>Total MTM Derivative Contract Net Assets (d)</b>	<b>\$ 14,328</b>	<b>\$ 32</b>	<b>\$ 14,360</b>

**December 31, 2021**

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

- (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.
- (d) Increase in amounts as of September 30, 2022 are primarily due to increases in commodity prices for power and natural gas and an increase in value of FTRs.



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

Location of Gain (Loss)	Amount of Gain (Loss) Recognized on Risk Management Contracts			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2022	2021	2022	2021
	(in thousands)			
Electric Generation, Transmission and Distribution Revenues	\$ 3	\$ (12)	\$ 7	\$ (12)
Purchased Electricity for Resale	34	35	144	72
Other Operation	36	28	107	59
Maintenance	102	35	198	82
Regulatory Assets (a)	1	(1,955)	(25)	(3,226)
Regulatory Liabilities (a)	5,813	2,555	14,308	4,944
<b>Total Gain on Risk Management Contracts</b>	<u>\$ 5,989</u>	<u>\$ 686</u>	<u>\$ 14,739</u>	<u>\$ 1,919</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 and nine months ended September 30, 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 and nine months ended September 30, 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 September 30, 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 September 30, 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 September 30, 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 September 30, 2022 and December 31, 2021, respectively. There was no cash collateral posted as of September 30, 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 September 30, 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 \$0 thousand and \$51 thousand and no cash collateral posted as of September 30, 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>September 30, 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	\$ 1,178,355	\$ 1,139,434	\$ 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 September 30, 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>\$ 160</u>	<u>\$ 14,430</u>	<u>\$ (207)</u>	<u>\$ 14,383</u>
<b>Liabilities:</b>					
<b>Risk Management Liabilities</b>					
Risk Management Commodity Contracts (a) (b)	<u>\$ —</u>	<u>\$ 160</u>	<u>\$ 102</u>	<u>\$ (239)</u>	<u>\$ 23</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 September 30, 2022</b>	<b>Net Risk Management Assets (Liabilities) (in thousands)</b>
<b>Balance as of June 30, 2022</b>	\$ 13,549
Realized Gain (Loss) Included in Net Income (or Changes in Net Assets) (a) (b)	1,120
Settlements	(5,307)
Changes in Fair Value Allocated to Regulated Jurisdictions (c)	4,966
<b>Balance as of September 30, 2022</b>	<b>\$ 14,328</b>

  

<b>Three Months Ended September 30, 2021</b>	<b>Net Risk Management Assets (Liabilities) (in thousands)</b>
<b>Balance as of June 30, 2021</b>	\$ 6,355
Realized Gain (Loss) Included in Net Income (or Changes in Net Assets) (a) (b)	2,598
Settlements	(4,310)
Transfers out of Level 3 (c)	13
Changes in Fair Value Allocated to Regulated Jurisdictions (c)	896
<b>Balance as of September 30, 2021</b>	<b>\$ 5,552</b>

  

<b>Nine Months Ended September 30, 2022</b>	<b>Net Risk Management Assets (Liabilities) (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)	2,801
Settlements	(8,672)
Changes in Fair Value Allocated to Regulated Jurisdictions (c)	14,328
<b>Balance as of September 30, 2022</b>	<b>\$ 14,328</b>

  

<b>Nine Months Ended September 30, 2021</b>	<b>Net Risk Management Assets (Liabilities) (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)	1,981
Settlements	(5,039)
Transfers out of Level 3 (c)	8
Changes in Fair Value Allocated to Regulated Jurisdictions (c)	5,577
<b>Balance as of September 30, 2021</b>	<b>\$ 5,552</b>

- (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  
September 30, 2022**

	Fair Value		Valuation Technique	Significant Unobservable Input (a)	Input/Range		
	Assets	Liabilities			Low	High	Weighted Average (b)
	(in thousands)						
FTRs	\$ 14,430	\$ 102	Discounted Cash Flow	Forward Market Price	\$ (2.65)	\$ 18.87	\$ 2.62

**December 31, 2021**

	Fair Value		Valuation Technique	Significant Unobservable Input (a)	Input/Range		
	Assets	Liabilities			Low	High	Weighted 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>	<b>\$ 6,439</b>	<b>\$ 568</b>					

(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 September 30, 2022 and December 31, 2021:

**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

### *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:

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2022</u>	<u>2021</u>	<u>2022</u>	<u>2021</u>
U.S. Federal Statutory Rate	21.0 %	21.0 %	21.0 %	21.0 %
Increase (decrease) due to:				
State Income Tax, net of Federal Benefit	(8.8)%	(34.6)%	(2.5)%	(17.7)%
Tax Reform Excess ADIT Reversal	(44.1)%	(98.5)%	(77.0)%	(117.9)%
Flow Through	(1.6)%	(2.0)%	(0.2)%	(1.9)%
AFUDC Equity	(1.6)%	(0.7)%	(1.2)%	(1.1)%
Discrete Tax Adjustments	— %	— %	(2.8)%	— %
Other	(2.3)%	0.4 %	— %	— %
Effective Income Tax Rate	<u>(37.4)%</u>	<u>(114.4)%</u>	<u>(62.7)%</u>	<u>(117.6)%</u>

### *Federal and State Income Tax Audit Status*

The statute of limitations for the IRS to examine KPCo and other AEP subsidiaries originally filed federal return has expired for tax years 2016 and earlier. 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 September 30, 2022, the IRS has accepted the 2014-2016 amended tax returns as filed which completes the IRS audit of these tax years. Additionally, KPCo and other AEP subsidiaries have received and agreed to two proposed adjustments on the 2017 tax return, which were immaterial. KPCo and other AEP subsidiaries have agreed to extend the statute of limitations on the 2017 and 2018 tax return to December 31, 2023 to allow time for the audit to be completed and the Congressional Joint Committee on Taxation to approve the associated refund claim.

KPCo and other AEP subsidiaries file income tax returns in various state and local jurisdictions. These taxing authorities routinely examine the tax returns, and KPCo and other AEP subsidiaries are currently under examination in several state and local jurisdictions. Generally, the statutes of limitations have expired for tax years prior to 2017. In addition, management is monitoring and continues to evaluate the potential impact of federal legislation and corresponding state conformity.



### ***Federal Legislation***

On August 16, 2022, President Biden signed H.R. 5376 into law, commonly known as the Inflation Reduction Act of 2022 or IRA. Most notably this budget reconciliation legislation creates a 15% minimum tax on adjusted financial statement income (Corporate Alternative Minimum Tax or CAMT), extends and increases the value of PTCs and ITCs, adds a nuclear and clean hydrogen PTC, an energy storage ITC and allows the sale or transfer of tax credits to third parties for cash. With the exception of PTCs and ITCs, this legislation is prospective and has no material impact on the current period financial statements. As significant guidance from Treasury and the IRS is expected on the tax provisions in the IRA, KPCo and other AEP subsidiaries will continue to monitor any issued guidance and evaluate the impact on future net income, cash flows and financial condition.

## 10. FINANCING ACTIVITIES

### *Long-term Debt*

Long-term debt issued and retired during the first nine months of 2022 are shown in the tables below:

<b>Issuances:</b>	<b>Type of Debt</b>	<b>Principal Amount (a) (in millions)</b>	<b>Interest Rate (%)</b>	<b>Due Date</b>
	Other Long-term Debt	\$	150.0	Variable

(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.

<b>Retirements and Principal Payments:</b>	<b>Type of Debt</b>	<b>Principal Amount Paid (in millions)</b>	<b>Interest Rate (%)</b>	<b>Due Date</b>
	Other Long-term Debt	\$	75.0	Variable

### *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 requirement that prohibits the payment of dividends out of capital accounts in certain circumstances; payment of dividends is generally allowed out of retained earnings.

KPCo has credit agreements that contain a covenant that limit its debt to capitalization ratio to 67.5%. As of September 30, 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 September 30, 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 nine months ended September 30, 2022 are described in the following table:

<b>Maximum Borrowings from the Utility Money Pool</b>	<b>Maximum Loans to the Utility Money Pool</b>	<b>Average Borrowings from the Utility Money Pool</b>	<b>Average Loans to the Utility Money Pool</b>	<b>Borrowings from the Utility Money Pool as of September 30, 2022</b>	<b>Authorized Short-Term Borrowing Limit</b>
(in thousands)					
\$ 161,643	\$ 28,393	\$ 80,771	\$ 23,343	\$ 48,494	\$ 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:

Nine Months Ended September 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
2022	3.39 %	0.10 %	2.15 %	2.14 %	1.45 %	2.15 %
2021	0.40 %	0.02 %	0.34 %	0.03 %	0.32 %	0.33 %

#### ***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 ceased selling accounts receivable to AEP Credit. As a result, 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 \$0 and \$53.3 million as of September 30, 2022 and December 31, 2021, respectively.

The fees paid by KPCo to AEP Credit for customer accounts receivable sold for the three months ended September 30, 2022 and 2021 were \$0 thousand and \$1.2 million, respectively, and for the nine months ended September 30, 2022 and 2021 were \$63 thousand and \$868 thousand, respectively. In 2020, an increase in allowance for doubtful accounts was recognized in response to the anticipated impact of COVID-19 on the collectability of accounts receivable, which caused an increase in fees paid by KPCo. In 2021, due to higher than expected collections of accounts receivables, allowance for doubtful accounts was adjusted resulting in the issuance of credits to offset the higher fees previously paid. In 2022, as a result of KPCo’s discontinued sale of receivables with AEP Credit, KPCo was issued a net credit upon final settlement of the allowance for doubtful accounts balance as collections of accounts receivable were higher than originally estimated.

KPCo’s proceeds on the sale of receivables to AEP Credit for the three months ended September 30, 2022 and 2021 were \$0 and \$150.9 million, respectively, and for the nine months ended September 30, 2022 and 2021 were \$65.6 million and \$443.4 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:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2022	2021	2022	2021
	(in thousands)			
<b>Retail Revenues:</b>				
Residential Revenues	\$ 79,716	\$ 71,581	\$ 232,404	\$ 209,907
Commercial Revenues	51,351	40,806	141,930	117,032
Industrial Revenues	46,678	34,614	131,362	102,222
Other Retail Revenues	530	486	1,580	1,485
<b>Total Retail Revenues</b>	<b>178,275</b>	<b>147,487</b>	<b>507,276</b>	<b>430,646</b>
<b>Wholesale Revenues:</b>				
Generation Revenues (a)	11,017	11,007	27,776	25,630
Transmission Revenues (b)	7,925	5,602	23,581	16,522
<b>Total Wholesale Revenues</b>	<b>18,942</b>	<b>16,609</b>	<b>51,357</b>	<b>42,152</b>
Other Revenues from Contracts with Customers (a)	2,703	2,167	8,945	6,416
<b>Total Revenues from Contracts with Customers</b>	<b>199,920</b>	<b>166,263</b>	<b>567,578</b>	<b>479,214</b>
<b>Other Revenues:</b>				
Alternative Revenues	(2,759)	(220)	(3,458)	(1,494)
Other Revenues	3	—	7	—
<b>Total Other Revenues</b>	<b>(2,756)</b>	<b>(220)</b>	<b>(3,451)</b>	<b>(1,494)</b>
<b>Total Revenues</b>	<b>\$ 197,164</b>	<b>\$ 166,043</b>	<b>\$ 564,127</b>	<b>\$ 477,720</b>

(a) Amounts include affiliated and nonaffiliated revenues.

(b) Amounts include affiliated and nonaffiliated revenues. The affiliated revenues were \$4.8 million and \$2.2 million for the three months ended September 30, 2022 and 2021, respectively, and \$14.3 million and \$6.7 million for the nine months ended September 30, 2022 and 2021, respectively.

### *Fixed Performance Obligations*

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

2022	2023-2024	2025-2026	After 2026	Total
(in thousands)				
\$ 7,766	\$ 2,512	\$ 2,512	\$ 1,256	\$ 14,046

### ***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 September 30, 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 September 30, 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 September 30, 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 \$10.2 million and \$9.1 million, respectively, as of September 30, 2022 and December 31, 2021.