



# **Form 10-Q**

**Quarterly Report to the  
Securities and Exchange Commission**

**For the Quarter Ended  
September 30, 2003**

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**PPL Corporation  
PPL Energy Supply, LLC  
PPL Electric Utilities Corporation  
PPL Montana, LLC**

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549**

**Form 10-Q**

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 for the quarterly period ended September 30, 2003  
OR
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 for the transition period from \_\_\_\_\_ to \_\_\_\_\_

<u>Commission File Number</u>	<u>Registrant; State of Incorporation; Address and Telephone Number</u>	<u>IRS Employer Identification No.</u>
1-11459	<b>PPL Corporation</b> (Exact name of Registrant as specified in its charter) (Pennsylvania) Two North Ninth Street Allentown, PA 18101-1179 (610) 774-5151	23-2758192
333-74794	<b>PPL Energy Supply, LLC</b> (Exact name of Registrant as specified in its charter) (Delaware) Two North Ninth Street Allentown, PA 18101-1179 (610) 774-5151	23-3074920
1-905	<b>PPL Electric Utilities Corporation</b> (Exact name of Registrant as specified in its charter) (Pennsylvania) Two North Ninth Street Allentown, PA 18101-1179 (610) 774-5151	23-0959590
333-50350	<b>PPL Montana, LLC</b> (Exact name of Registrant as specified in its charter) (Delaware) 303 North Broadway - Suite 400 Billings, MT 59101 (406) 237-6900	54-1928759

Indicate by check mark whether the Registrants (1) have filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrants were required to file such reports), and (2) have been subject to such filing requirements for the past 90 days.

PPL Corporation	Yes <input checked="" type="checkbox"/>	No <input type="checkbox"/>
PPL Energy Supply, LLC	Yes <input checked="" type="checkbox"/>	No <input type="checkbox"/>
PPL Electric Utilities Corporation	Yes <input checked="" type="checkbox"/>	No <input type="checkbox"/>
PPL Montana, LLC	Yes <input checked="" type="checkbox"/>	No <input type="checkbox"/>

Indicate by check mark whether the Registrants are accelerated filers (as defined in Rule 12b-2 of the Act).

PPL Corporation	Yes <input checked="" type="checkbox"/>	No <input type="checkbox"/>
PPL Energy Supply, LLC	Yes <input type="checkbox"/>	No <input checked="" type="checkbox"/>
PPL Electric Utilities Corporation	Yes <input type="checkbox"/>	No <input checked="" type="checkbox"/>
PPL Montana, LLC	Yes <input type="checkbox"/>	No <input checked="" type="checkbox"/>

Indicate the number of shares outstanding of each of the issuer's classes of common stock; as of the latest practicable date:

PPL Corporation	Common stock, \$.01 par value, 177,326,521 shares outstanding at October 31, 2003, excluding 31,019,352 shares held as treasury stock
PPL Energy Supply, LLC	PPL Corporation indirectly holds all of the member interests in PPL Energy Supply, LLC.
PPL Electric Utilities Corporation	Common stock, no par value, 78,029,863 shares outstanding and all held by PPL Corporation at October 31, 2003, excluding 79,270,519 shares held as treasury stock
PPL Montana, LLC	PPL Corporation indirectly holds all of the member interests in PPL Montana, LLC.

**PPL Montana, LLC meets the conditions set forth in General Instruction (H)(1)(a) and (b) of Form 10-Q and is therefore filing this form with the reduced disclosure format.**

**This document is available free of charge at the Investor Center on PPL's website at [www.pplweb.com](http://www.pplweb.com). However, information on this website does not constitute a part of this Form 10-Q.**

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**PPL CORPORATION  
PPL ENERGY SUPPLY, LLC  
PPL ELECTRIC UTILITIES CORPORATION  
PPL MONTANA, LLC**

FORM 10-Q  
FOR THE QUARTER ENDED SEPTEMBER 30, 2003

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## GLOSSARY OF TERMS AND ABBREVIATIONS

£ - British pounds sterling.

**1945 First Mortgage Bond Indenture** - PPL Electric's Mortgage and Deed of Trust, dated as of October 1, 1945, to Deutsche Bank Trust Company Americas, as trustee, as supplemented.

**2001 Senior Secured Bond Indenture** - PPL Electric's Indenture, dated as of August 1, 2001, to JPMorgan Chase Bank, as trustee, as supplemented.

**ANEEL** - National Electric Energy Agency, Brazil's agency that regulates the transmission and distribution of electricity.

**APA** - Asset Purchase Agreement.

**APB** - Accounting Principles Board.

**ARB** - Accounting Research Bulletin.

**ARO** - asset retirement obligation.

**Bcf** - billion cubic feet.

**CEMAR** - Companhia Energética do Maranhão, a Brazilian electric distribution company in which PPL Global has a majority ownership interest.

**Clean Air Act** - federal legislation enacted to address certain environmental issues related to air emissions including acid rain, ozone and toxic air emissions.

**CTC** - competitive transition charge on customer bills to recover allowable transition costs under the Customer Choice Act.

**Customer Choice Act** - the Pennsylvania Electricity Generation Customer Choice and Competition Act, legislation enacted to restructure the state's electric utility industry to create retail access to a competitive market for generation of electricity.

**DEP** - Department of Environmental Protection, a state government agency.

**Derivative** - a financial instrument or other contract with all three of the following characteristics:

- a. It has (1) one or more underlyings and (2) one or more notional amounts or payment provisions or both. Those terms determine the amount of the settlement or settlements, and, in some cases, whether or not a settlement is required.
- b. It requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors.

- c. Its terms require or permit net settlement, it can readily be settled net by a means outside the contract, or it provides for delivery of an asset that puts the recipient in a position not substantially different from net settlement.

**DIG** - Derivatives Implementation Group.

**EITF** - Emerging Issues Task Force, an organization that assists the FASB in improving financial reporting through the identification, discussion and resolution of financial issues within the framework of existing authoritative literature.

**Emel** - Empresas Emel S.A., a Chilean electric distribution holding company of which PPL Global has majority ownership.

**EMF** - electric and magnetic fields.

**EPA** - Environmental Protection Agency, a U.S. government agency.

**EPS** - earnings per share.

**FASB** - Financial Accounting Standards Board, a rulemaking organization that establishes financial accounting and reporting standards.

**FERC** - Federal Energy Regulatory Commission, the federal agency that regulates interstate transmission and wholesale sales of electricity and related matters.

**FIN** - FASB Interpretation, intended to clarify accounting pronouncements previously issued by the FASB.

**GAAP** - generally accepted accounting principles.

**GWh** - gigawatt-hour, one million kilowatt-hours.

**Hyder** - Hyder Limited, which was acquired by WPDL and was the previous owner of South Wales Electricity plc. In March 2001, South Wales Electricity plc was acquired by WPDH Limited and renamed WPD (South Wales).

**IRS** - Internal Revenue Service, a U.S. government agency.

**ISO** - Independent System Operator.

**ITC** - intangible transition charge on customer bills to recover intangible transition costs associated with securitizing stranded costs under the Customer Choice Act.

**kWh** - kilowatt-hour, basic unit of electrical energy.

**LIBOR** - London Interbank Offered Rate.

**Mirant** - Mirant Corporation, a diversified energy company based in Atlanta. PPL Global and Mirant jointly owned WPD until September 6, 2002.

**Montana Power** - The Montana Power Company, a Montana-based company that sold its generating assets to PPL Montana in December 1999. Through a series of transactions consummated during the first quarter of 2002, Montana Power sold its electricity delivery business to NorthWestern.

**MW** - megawatt, one thousand kilowatts.

**MWh** - megawatt-hour, one thousand kilowatt-hours.

**NorthWestern** - NorthWestern Corporation, a Delaware corporation and successor in interest to Montana Power's electricity delivery business, including Montana Power's rights and obligations under contracts with PPL Montana.

**NPDES** - National Pollutant Discharge Elimination System.

**NUGs** (Non-Utility Generators) - generating plants not owned by public utilities, whose electrical output must be purchased by utilities under the PURPA if the plant meets certain criteria.

**PCB** - polychlorinated biphenyl, an additive to oil used in certain electrical equipment up to the late 1970s. Now classified as a hazardous chemical.

**PEPS Units** (Premium Equity Participating Security Units, or PEPS<sup>SM</sup> Units) - securities issued by PPL Capital Funding Trust I, consisting of a Preferred Security and a forward contract to purchase PPL common stock.

**PEPS Units, Series B** (Premium Equity Participating Security Units, or PEPS<sup>SM</sup> Units, Series B) - securities expected to be issued by PPL and PPL Capital Funding in connection with the proposed PEPS Units exchange offer which will consist of (i) an undivided interest in a debt security to be issued by PPL Capital Funding and guaranteed by PPL, and (ii) a forward contract to purchase PPL common stock.

**PJM** (PJM Interconnection, LLC) - operates the electric transmission network and electric energy market in the mid-Atlantic region of the U.S.

**PLR** (Provider of Last Resort) - PPL Electric providing electricity to retail customers within its delivery territory who have chosen not to shop for electricity under the Customer Choice Act.

**PPL** - PPL Corporation, the parent holding company of PPL Electric, PPL Energy Funding and other subsidiaries.

**PPL Capital Funding** - PPL Capital Funding, Inc., a PPL financing subsidiary.

**PPL Capital Funding Trust I** - a Delaware statutory business trust created to issue PEPS Units, whose common securities are held by PPL.

**PPL Electric** - PPL Electric Utilities Corporation, a regulated utility subsidiary of PPL that transmits and distributes electricity in its service territory and provides electric supply to retail customers in this territory as a PLR.

**PPL Energy Funding** - PPL Energy Funding Corporation, a subsidiary of PPL and the parent company of PPL Energy Supply.

**PPL EnergyPlus** - PPL EnergyPlus, LLC, a subsidiary of PPL Energy Supply, which markets wholesale and retail electricity, and supplies energy and energy services in newly deregulated markets.

**PPL Energy Supply** - PPL Energy Supply, LLC, the parent company of PPL Generation, PPL EnergyPlus, PPL Global and other subsidiaries. Formed in November 2000, PPL Energy Supply is a subsidiary of PPL Energy Funding.

**PPL Gas Utilities** - PPL Gas Utilities Corporation, a regulated utility subsidiary of PPL specializing in natural gas distribution, transmission and storage services, and the competitive sale of propane.

**PPL Generation** - PPL Generation, LLC, a subsidiary of PPL Energy Supply, which owns and operates U.S. generating facilities through various subsidiaries.

**PPL Global** - PPL Global, LLC, a subsidiary of PPL Energy Supply, which acquires and develops domestic generation projects and acquires and holds international energy projects that are primarily focused on the distribution of electricity.

**PPL Martins Creek** - PPL Martins Creek, LLC, a fossil generating subsidiary of PPL Generation.

**PPL Montana** - PPL Montana, LLC, an indirect subsidiary of PPL Generation, which generates electricity for wholesale sales in Montana and the Pacific Northwest.

**PPL Services** - PPL Services Corporation, a subsidiary of PPL, which provides shared services for PPL and its subsidiaries.

**PPL Susquehanna** - PPL Susquehanna, LLC, the nuclear generating subsidiary of PPL Generation.

**PPL Telcom** - PPL Telcom, LLC, an indirect subsidiary of PPL Energy Funding, which delivers high band-width telecommunication services in the Northeast corridor from Washington, D.C. to New York City and to six metropolitan areas in Central and Eastern Pennsylvania.

**PPL Transition Bond Company** - PPL Transition Bond Company, LLC, a wholly-owned subsidiary of PPL Electric

that was formed to issue transition bonds under the Customer Choice Act.

**Preferred Securities** - company-obligated mandatorily redeemable preferred securities issued by PPL Capital Funding Trust I, holding solely debentures of PPL Capital Funding, and by SIUK Capital Trust I, holding solely debentures of WPD LLP.

**PUC** - Pennsylvania Public Utility Commission, the state agency that regulates certain ratemaking, services, accounting and operations of Pennsylvania utilities.

**PURPA** - Public Utility Regulatory Policies Act of 1978, legislation passed by the U.S. Congress to encourage energy conservation, efficient use of resources and equitable rates.

**PURTA** - the Pennsylvania Public Utility Realty Tax Act.

**SCR** - selective catalytic reduction, a pollution control process.

**SEC** - Securities and Exchange Commission, a U.S. government agency.

**SFAS** - Statement of Financial Accounting Standards, the accounting and financial reporting rules issued by the FASB.

**SIUK Capital Trust I** - a business trust created to issue preferred securities, whose common securities are held by WPD LLP.

**Superfund** - federal environmental legislation that addresses remediation of contaminated sites; states also have similar statutes.

**Tolling agreement** - agreement whereby the owner of an electric generating facility agrees to use that facility to convert fuel provided by a third party into electric energy for delivery back to the third party.

**WPD** - refers collectively to WPDH Limited and WPD. PPL Global purchased Mirant's 49% ownership interest in these entities on September 6, 2002, thereby achieving 100% ownership and operational control.

**WPD LLP** - Western Power Distribution LLP, a wholly-owned subsidiary of WPDH Limited.

**WPD (South Wales)** - Western Power Distribution (South Wales) plc, a British regional electric utility company.

**WPD (South West)** - Western Power Distribution (South West) plc, a British regional electric utility company.

**WPDH Limited** - Western Power Distribution Holdings Limited, an indirect, wholly-owned subsidiary of PPL Global. WPDH Limited owns WPD LLP, which owns WPD (South West) and WPD (South Wales).

**WPDL** - WPD Investment Holdings Limited, an indirect wholly-owned subsidiary of PPL Global. WPDL owns 100% of the common shares of Hyder.

## FORWARD-LOOKING INFORMATION

Certain statements contained in this Form 10-Q concerning expectations, beliefs, plans, objectives, goals, strategies, future events or performance and underlying assumptions and other statements which are other than statements of historical facts are "forward-looking statements" within the meaning of the federal securities laws. Although PPL, PPL Energy Supply, PPL Electric and PPL Montana believe that the expectations and assumptions reflected in these statements are reasonable, there can be no assurance that these expectations will prove to be correct. These forward-looking statements involve a number of risks and uncertainties, and actual results may differ materially from the results discussed in the forward-looking statements. In addition to the specific factors discussed in the Management's Discussion and Analysis of the Financial Condition and Results of Operations sections herein, the following are among the important factors that could cause actual results to differ materially from the forward-looking statements:

- market demand and prices for energy, capacity and fuel;
- weather variations affecting customer energy usage;
- competition in retail and wholesale power markets;
- the effect of any business or industry restructuring;
- the profitability and liquidity of PPL and its subsidiaries;
- new accounting requirements or new interpretations or applications of existing requirements;
- operation of existing facilities and operating costs; environmental conditions and requirements; transmission and distribution system conditions and operating costs;
- development of new projects, markets and technologies;
- performance of new ventures;
- political, regulatory or economic conditions in states, regions or countries where PPL or its subsidiaries conduct business;

- receipt of necessary governmental permits, approvals and rate relief;
- impact of state or federal investigations applicable to PPL and its subsidiaries and the energy industry;
- the outcome of litigation against PPL and its subsidiaries;
- capital market conditions and decisions regarding capital structure;
- stock price performance;
- the market prices of equity securities and resultant cash funding requirements for defined benefit pension plans;
- securities and credit ratings;
- state and federal regulatory developments;
- foreign exchange rates;
- new state or federal legislation;
- national or regional economic conditions, including any potential effects arising from the September 11, 2001 terrorist attacks in the U.S., the situation in Iraq and any consequential hostilities or other hostilities; and
- the commitments and liabilities of PPL and its subsidiaries.

Any such forward-looking statements should be considered in light of such important factors and in conjunction with other documents of PPL, PPL Energy Supply, PPL Electric and PPL Montana on file with the SEC.

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

**Part I. FINANCIAL INFORMATION**  
**Item 1. Financial Statements**

**CONDENSED CONSOLIDATED STATEMENT OF INCOME**  
**PPL Corporation and Subsidiaries**

(Unaudited)

(Millions of Dollars, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
<b>Operating Revenues</b>				
Utility .....	\$ 897	\$ 935	\$ 2,778	\$ 2,774
Unregulated retail electric and gas .....	32	45	117	136
Wholesale energy marketing .....	406	378	1,007	792
Net energy trading margins .....	2	(3)	9	13
Energy related businesses.....	119	137	370	430
Total .....	<u>1,456</u>	<u>1,492</u>	<u>4,281</u>	<u>4,145</u>
<b>Operating Expenses</b>				
Operation				
Fuel .....	142	161	476	435
Energy purchases .....	308	298	861	710
Other .....	208	220	645	608
Amortization of recoverable transition costs.....	66	62	193	165
Maintenance .....	79	73	240	223
Depreciation .....	99	92	287	269
Taxes, other than income.....	64	54	189	172
Energy related businesses.....	119	137	375	416
Other charges				
Write-down of international energy projects.....				100
Workforce reduction .....	9	1	9	75
Total .....	<u>1,094</u>	<u>1,098</u>	<u>3,275</u>	<u>3,173</u>
<b>Operating Income</b> .....	<b>362</b>	<b>394</b>	<b>1,006</b>	<b>972</b>
Other Income - net.....	15	11	46	22
Interest Expense.....	119	168	355	430
<b>Income Before Income Taxes and Minority Interest</b> .....	<b>258</b>	<b>237</b>	<b>697</b>	<b>564</b>
Income Taxes.....	82	79	200	194
Minority Interest .....	3	20	5	76
<b>Income Before Cumulative Effect of a Change in Accounting Principle</b> .....	<b>173</b>	<b>138</b>	<b>492</b>	<b>294</b>
Cumulative Effect of a Change in Accounting Principle (net of income taxes) .....			63	(150)
<b>Income Before Dividends and Distributions on Preferred Securities</b> .....	<b>173</b>	<b>138</b>	<b>555</b>	<b>144</b>
Dividends and Distributions - Preferred Securities.....	2	16	29	52
<b>Net Income</b> .....	<b>\$ 171</b>	<b>\$ 122</b>	<b>\$ 526</b>	<b>\$ 92</b>
<b>Earnings Per Share of Common Stock</b>				
Net income - before cumulative effect of change in accounting principle:				
Basic .....	\$ 0.97	\$ 0.81	\$ 2.71	\$ 1.63
Diluted .....	0.97	0.80	2.70	1.63
Net income:				
Basic .....	\$ 0.97	\$ 0.81	\$ 3.07	\$ 0.62
Diluted .....	0.97	0.80	3.06	0.62
<b>Dividends Declared per Share of Common Stock</b> .....	<b>\$ 0.385</b>	<b>\$ 0.36</b>	<b>\$ 1.16</b>	<b>\$ 1.08</b>

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

**CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS**  
**PPL Corporation and Subsidiaries**

(Unaudited)

(Millions of Dollars)

	Nine Months Ended September 30,	
	2003	2002
<b>Net Cash Provided by Operating Activities</b> .....	\$ 1,016	\$ 427
<b>Cash Flows From Investing Activities</b>		
Expenditures for property, plant and equipment .....	(517)	(360)
Investment in generating assets and electric energy projects .....		(261)
Acquisition of controlling interest in WPD, net of cash acquired .....		(211)
Other investing activities - net .....	32	(26)
Net cash used in investing activities .....	(485)	(858)
<b>Cash Flows From Financing Activities</b>		
Issuance of long-term debt .....	989	
Issuance of common stock .....	424	539
Retirement of long-term debt .....	(467)	(449)
Retirement of company-obligated mandatorily redeemable preferred securities .....		(250)
Retirement of preferred stock .....	(14)	
Payment of common and preferred dividends .....	(217)	(197)
Net increase (decrease) in short-term debt .....	(873)	213
Other financing activities - net .....	(31)	(19)
Net cash used in financing activities .....	(189)	(163)
<b>Net Increase (Decrease) In Cash and Cash Equivalents</b> .....	342	(594)
Cash and Cash Equivalents at Beginning of Period .....	245	933
Cash and Cash Equivalents at End of Period .....	\$ 587	\$ 339

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

**CONDENSED CONSOLIDATED BALANCE SHEET**  
**PPL Corporation and Subsidiaries**

(Unaudited)

(Millions of Dollars)

	September 30, 2003	December 31, 2002
<b>Assets</b>		
<b>Current Assets</b>		
Cash and cash equivalents.....	\$ 587	\$ 245
Accounts receivable (less reserve: 2003, \$111; 2002, \$112).....	519	610
Unbilled revenues .....	275	281
Fuel, materials and supplies - at average cost .....	255	242
Prepayments .....	130	122
Deferred income taxes .....	99	99
Price risk management assets .....	70	103
Other .....	134	135
	2,069	1,837
<b>Investments</b>		
Investment in unconsolidated affiliates - at equity .....	221	234
Investment in unconsolidated affiliates - at cost.....	108	107
Nuclear plant decommissioning trust fund .....	330	287
Other .....	29	28
	688	656
<b>Property, Plant and Equipment - net</b>		
Electric plant in service		
Transmission and distribution .....	5,832	5,603
Generation .....	2,802	2,679
General .....	492	479
	9,126	8,761
Construction work in progress .....	147	223
Nuclear fuel.....	117	129
	9,390	9,113
Electric plant .....	9,390	9,113
Gas and oil plant .....	204	201
Other property .....	261	252
	9,855	9,566
<b>Regulatory and Other Noncurrent Assets</b>		
Recoverable transition costs.....	1,754	1,946
Goodwill and other intangibles .....	646	663
Other .....	922	879
	3,322	3,488
	\$ 15,934	\$ 15,547

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

**CONDENSED CONSOLIDATED BALANCE SHEET**  
**PPL Corporation and Subsidiaries**

(Unaudited)  
 (Millions of Dollars)

	September 30, 2003	December 31, 2002
<b>Liabilities and Equity</b>		
<b>Current Liabilities</b>		
Short-term debt .....	\$ 79	\$ 943
Long-term debt.....	333	366
Accounts payable .....	404	452
Above market NUG contracts .....	74	75
Taxes .....	324	193
Interest .....	109	101
Dividends .....	69	66
Price risk management liabilities .....	66	110
Other .....	314	307
	<u>1,772</u>	<u>2,613</u>
<b>Long-term Debt</b> .....	<u>7,130</u>	<u>5,901</u>
<b>Deferred Credits and Other Noncurrent Liabilities</b>		
Deferred income taxes and investment tax credits .....	2,400	2,371
Above market NUG contracts .....	297	352
Other .....	1,277	1,307
	<u>3,974</u>	<u>4,030</u>
<b>Commitments and Contingent Liabilities</b> .....		
<b>Minority Interest</b> .....	<u>35</u>	<u>36</u>
<b>Company-obligated Mandatorily Redeemable Preferred Securities of Subsidiary Trusts Holding Solely Company Debentures (Note 15)</b> .....		<u>661</u>
<b>Preferred Stock</b>		
With sinking fund requirements (Note 15).....		31
Without sinking fund requirements .....	51	51
	<u>51</u>	<u>82</u>
<b>Shareowners' Common Equity</b>		
Common stock .....	2	2
Capital in excess of par value.....	2,968	2,539
Treasury stock .....	(837)	(836)
Earnings reinvested .....	1,339	1,013
Accumulated other comprehensive loss .....	(438)	(446)
Capital stock expense and other .....	(62)	(48)
	<u>2,972</u>	<u>2,224</u>
	<u>\$ 15,934</u>	<u>\$ 15,547</u>

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

**CONDENSED CONSOLIDATED STATEMENT OF INCOME**  
**PPL Energy Supply, LLC and Subsidiaries**

(Unaudited)  
(Millions of Dollars)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
<b>Operating Revenues</b>				
Wholesale energy marketing .....	\$ 406	\$ 378	\$ 1,007	\$ 792
Wholesale energy marketing to affiliates .....	374	373	1,090	1,081
Utility .....	218	251	695	755
Unregulated retail electric and gas .....	32	45	117	136
Net energy trading margins .....	2	(3)	9	13
Energy related businesses.....	115	134	361	424
<b>Total .....</b>	<b>1,147</b>	<b>1,178</b>	<b>3,279</b>	<b>3,201</b>
<b>Operating Expenses</b>				
Operation				
Fuel .....	143	155	417	376
Energy purchases .....	255	244	703	552
Energy purchases from affiliates.....	39	43	122	129
Other operation and maintenance.....	191	209	638	597
Depreciation .....	70	67	203	194
Taxes, other than income.....	22	20	65	59
Energy related businesses.....	111	129	358	402
Other charges				
Write-down of international energy projects.....				100
Workforce reduction .....		1		41
<b>Total .....</b>	<b>831</b>	<b>868</b>	<b>2,506</b>	<b>2,450</b>
<b>Operating Income .....</b>	<b>316</b>	<b>310</b>	<b>773</b>	<b>751</b>
Other Income - net.....	17	11	59	32
Interest Expense.....	46	68	148	170
<b>Income Before Income Taxes and Minority Interest .....</b>	<b>287</b>	<b>253</b>	<b>684</b>	<b>613</b>
Income Taxes.....	93	90	199	236
Minority Interest .....	3	20	5	76
<b>Income Before Cumulative Effect of a Change in Accounting Principle .....</b>	<b>191</b>	<b>143</b>	<b>480</b>	<b>301</b>
Cumulative Effect of a Change in Accounting Principle (net of income taxes) .....			63	(150)
<b>Income Before Distributions on Preferred Securities.....</b>	<b>191</b>	<b>143</b>	<b>543</b>	<b>151</b>
Distributions - Preferred Securities.....	1	2	5	6
<b>Net Income .....</b>	<b>\$ 190</b>	<b>\$ 141</b>	<b>\$ 538</b>	<b>\$ 145</b>

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

**CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS**  
**PPL Energy Supply, LLC and Subsidiaries**

(Unaudited)  
 (Millions of Dollars)

	Nine Months Ended September 30,	
	2003	2002
<b>Net Cash Provided by Operating Activities</b> .....	<b>\$ 644</b>	<b>\$ 330</b>
<b>Cash Flows From Investing Activities</b>		
Expenditures for property, plant and equipment.....	(322)	(206)
Investment in generating assets and electric energy projects .....		(261)
Acquisition of controlling interest in WPD, net of cash acquired.....		(211)
Net decrease in notes receivable from affiliates.....	597	76
Other investing activities - net .....	45	(21)
Net cash provided by (used in) investing activities.....	<u>320</u>	<u>(623)</u>
<b>Cash Flows From Financing Activities</b>		
Issuance of long-term debt.....	799	1
Contributions from Member .....	261	158
Retirement of long-term debt.....	(56)	(11)
Distributions to Member.....	(909)	(667)
Net increase (decrease) in short-term debt.....	(858)	208
Other financing activities - net.....	(11)	(3)
Net cash used in financing activities.....	<u>(774)</u>	<u>(314)</u>
<b>Net Increase (Decrease) In Cash and Cash Equivalents</b> .....	<b>190</b>	<b>(607)</b>
Cash and Cash Equivalents at Beginning of Period .....	<u>149</u>	<u>815</u>
Cash and Cash Equivalents at End of Period .....	<u><u>\$ 339</u></u>	<u><u>\$ 208</u></u>

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

**CONDENSED CONSOLIDATED BALANCE SHEET**  
**PPL Energy Supply, LLC and Subsidiaries**

(Unaudited)

(Millions of Dollars)

	September 30, 2003	December 31, 2002
<b>Assets</b>		
<b>Current Assets</b>		
Cash and cash equivalents.....	\$ 339	\$ 149
Accounts receivable (less reserve: 2003, \$85; 2002, \$88).....	310	375
Unbilled revenues .....	175	165
Accounts receivable from affiliates.....	185	11
Notes receivable from affiliates .....	58	655
Fuel, materials and supplies - at average cost .....	199	200
Price risk management assets.....	63	93
Other .....	140	177
	1,469	1,825
<b>Investments</b>		
Investment in unconsolidated affiliates - at equity .....	221	234
Investment in unconsolidated affiliates - at cost.....	108	107
Nuclear plant decommissioning trust fund.....	330	287
Other .....	5	10
	664	638
<b>Property, Plant and Equipment - net</b>		
Electric plant in service		
Transmission and distribution .....	3,535	3,390
Generation .....	2,802	2,679
General .....	266	279
	6,603	6,348
Construction work in progress .....	113	176
Nuclear fuel.....	117	129
	6,833	6,653
Electric plant .....	6,833	6,653
Gas and oil plant .....	22	23
Other property.....	207	213
	7,062	6,889
<b>Other Noncurrent Assets</b>		
Goodwill and other intangibles .....	458	489
Other .....	549	495
	1,007	984
	\$ 10,202	\$ 10,336

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

**CONDENSED CONSOLIDATED BALANCE SHEET**  
**PPL Energy Supply, LLC and Subsidiaries**

(Unaudited)  
 (in Billions of Dollars)

	<u>September 30,</u> <u>2003</u>	<u>December 31,</u> <u>2002</u>
<b>Liabilities and Equity</b>		
<b>Current Liabilities</b>		
Short-term debt .....	\$ 79	\$ 928
Long-term debt .....	5	6
Accounts payable .....	341	382
Accounts payable to affiliates .....	39	76
Above market NUG contracts .....	74	75
Taxes .....	271	114
Interest .....	66	55
Collateral on PLR energy supply to affiliate .....	45	
Deferred revenue on PLR energy supply to affiliate .....	12	12
Price risk management liabilities .....	56	96
Other .....	203	216
	<u>1,191</u>	<u>1,960</u>
<b>Long-term Debt</b> .....	<u>3,046</u>	<u>2,225</u>
<b>Deferred Credits and Other Noncurrent Liabilities</b>		
Deferred income taxes and investment tax credits .....	1,107	1,028
Above market NUG contracts .....	297	352
Deferred revenue on PLR energy supply to affiliate .....	60	69
Other .....	1,054	1,073
	<u>2,518</u>	<u>2,522</u>
<b>Commitments and Contingent Liabilities</b> .....		
<b>Minority Interest</b> .....	<u>35</u>	<u>36</u>
<b>Company-obligated Mandatorily Redeemable Preferred Securities</b> <b>of Subsidiary Trusts Holding Solely Company Debentures (Note 15)</b> .....		<u>86</u>
<b>Member's Equity</b> .....	<u>3,412</u>	<u>3,507</u>
	<u>\$ 10,202</u>	<u>\$ 10,336</u>

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

**CONDENSED CONSOLIDATED STATEMENT OF INCOME**  
**PPL Electric Utilities Corporation and Subsidiaries**

(Unaudited)

(Millions of Dollars)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
<b>Operating Revenues</b>				
Retail electric .....	\$ 658	\$ 665	\$ 1,957	\$ 1,914
Wholesale electric .....	7	7	22	21
Wholesale electric to affiliate .....	39	40	115	122
Energy related businesses .....		3		6
<b>Total</b> .....	<b>704</b>	<b>715</b>	<b>2,094</b>	<b>2,063</b>
<b>Operating Expenses</b>				
Operation				
Energy purchases .....	54	54	158	158
Energy purchases from affiliate .....	368	371	1,082	1,078
Other .....	70	68	199	184
Amortization of recoverable transition costs .....	66	62	193	165
Maintenance .....	29	16	61	43
Depreciation .....	26	23	76	69
Taxes, other than income .....	41	32	122	111
Energy related businesses .....		2		6
Workforce reduction .....	9		9	33
<b>Total</b> .....	<b>663</b>	<b>628</b>	<b>1,900</b>	<b>1,847</b>
<b>Operating Income</b> .....	<b>41</b>	<b>87</b>	<b>194</b>	<b>216</b>
Other Income - net .....	1	6	5	15
Interest Expense .....	52	52	161	161
<b>Income (Loss) Before Income Taxes</b> .....	<b>(10)</b>	<b>41</b>	<b>38</b>	<b>68</b>
Income Taxes (Benefit) .....	(5)	13	12	17
<b>Income (Loss) Before Dividends and Distributions on Preferred Securities</b> .....				
	(5)	28	26	51
Dividends and Distributions - Preferred Securities .....	1	4	3	15
<b>Net Income (Loss)</b> .....	<b>\$ (6)</b>	<b>\$ 24</b>	<b>\$ 23</b>	<b>\$ 36</b>

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

**CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS**  
**PPL Electric Utilities Corporation and Subsidiaries**

(Unaudited)  
 (Millions of Dollars)

	Nine Months Ended September 30,	
	2003	2002
<b>Net Cash Provided by Operating Activities</b> .....	<b>\$ 415</b>	<b>\$ 180</b>
<b>Cash Flows From Investing Activities</b>		
Expenditures for property, plant and equipment .....	(174)	(148)
Net decrease in notes receivable from affiliates .....	90	260
Other investing activities - net .....	3	12
Net cash provided by (used in) investing activities .....	(81)	124
<b>Cash Flows From Financing Activities</b>		
Issuance of long-term debt .....	190	
Contribution from parent .....	75	240
Retirement of long-term debt .....	(351)	(228)
Retirement of company-obligated mandatorily redeemable preferred securities .....		(250)
Retirement of preferred stock .....	(14)	
Payment of common and preferred dividends .....	(32)	(67)
Net decrease in short-term debt .....	(15)	
Other financing activities - net .....	(8)	
Net cash used in financing activities .....	(155)	(305)
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b> .....	<b>179</b>	<b>(1)</b>
Cash and Cash Equivalents at Beginning of Period .....	29	79
Cash and Cash Equivalents at End of Period .....	<b>\$ 208</b>	<b>\$ 78</b>

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

**CONDENSED CONSOLIDATED BALANCE SHEET**  
**PPL Electric Utilities Corporation and Subsidiaries**

(Unaudited)

(Millions of Dollars)

	<u>September 30,</u> <u>2003</u>	<u>December 31,</u> <u>2002</u>
<b>Assets</b>		
<b>Current Assets</b>		
Cash and cash equivalents.....	\$ 208	\$ 29
Accounts receivable (less reserve: 2003, \$24; 2002, \$23).....	190	216
Unbilled revenues .....	98	113
Accounts receivable from affiliates.....	37	44
Notes receivable from affiliates .....		90
Income tax receivable .....	35	35
Prepayments.....	82	51
Prepayment on PLR energy supply from affiliate .....	12	12
Deferred income taxes .....	45	43
Collateral on PLR energy supply from affiliate .....	45	
Other .....	50	36
	<u>802</u>	<u>669</u>
<b>Property, Plant and Equipment - net</b>		
Electric plant in service		
Transmission and distribution .....	2,297	2,214
General .....	220	192
	<u>2,517</u>	<u>2,406</u>
Construction work in progress .....	32	46
Electric plant .....	2,549	2,452
Other property .....	4	4
	<u>2,553</u>	<u>2,456</u>
<b>Regulatory and Other Noncurrent Assets</b>		
Recoverable transition costs.....	1,754	1,946
Intangibles.....	117	118
Prepayment on PLR energy supply from affiliate .....	60	69
Other .....	325	325
	<u>2,256</u>	<u>2,458</u>
	<u>\$ 5,611</u>	<u>\$ 5,583</u>

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

**CONDENSED CONSOLIDATED BALANCE SHEET**  
**PPL Electric Utilities Corporation and Subsidiaries**

(Unaudited)

(Millions of Dollars)

	<u>September 30,</u> <u>2003</u>	<u>December 31,</u> <u>2002</u>
<b>Liabilities and Equity</b>		
<b>Current Liabilities</b>		
Short-term debt .....		\$ 15
Long-term debt.....	\$ 303	274
Accounts payable .....	38	42
Accounts payable to affiliates .....	171	24
Taxes.....	77	96
Interest .....	18	34
Other .....	83	63
	<u>690</u>	<u>548</u>
<b>Long-term Debt</b> .....	<u>2,729</u>	<u>2,901</u>
<b>Deferred Credits and Other Noncurrent Liabilities</b>		
Deferred income taxes and investment tax credits .....	791	780
Other .....	134	125
	<u>925</u>	<u>905</u>
<b>Commitments and Contingent Liabilities</b> .....		
<b>Preferred Stock</b>		
With sinking fund requirements (Note 15).....		31
Without sinking fund requirements .....	51	51
	<u>51</u>	<u>82</u>
<b>Shareowner's Common Equity</b>		
Common stock .....	1,476	1,476
Additional paid-in capital.....	357	282
Treasury stock.....	(912)	(912)
Earnings reinvested .....	302	308
Capital stock expense and other .....	(7)	(7)
	<u>1,216</u>	<u>1,147</u>
	<u>\$ 5,611</u>	<u>\$ 5,583</u>

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

**CONDENSED CONSOLIDATED STATEMENT OF INCOME**  
**PPL Montana, LLC and Subsidiaries**

(Unaudited)  
(Millions of Dollars)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
<b>Operating Revenues</b>				
Wholesale energy marketing .....	\$ 66	\$ 58	\$ 212	\$ 164
Wholesale energy marketing to affiliate.....	16	21	47	51
Net energy trading margins .....				(1)
Other .....	2	1	3	2
<b>Total</b> .....	<b>84</b>	<b>80</b>	<b>262</b>	<b>216</b>
<b>Operating Expenses</b>				
Operation				
Fuel .....	10	10	26	24
Energy purchases .....	15	11	52	33
Other operation and maintenance.....	22	23	70	77
Transmission.....	2	2	8	5
Depreciation.....	2	3	8	8
Taxes, other than income.....	5	4	13	12
<b>Total</b> .....	<b>56</b>	<b>53</b>	<b>177</b>	<b>159</b>
<b>Operating Income</b> .....	<b>28</b>	<b>27</b>	<b>85</b>	<b>57</b>
Other Income - net.....		(1)		
Interest Expense.....	2	2	4	
<b>Income Before Income Taxes</b> .....	<b>26</b>	<b>24</b>	<b>81</b>	<b>52</b>
Income Taxes.....	10	10	32	21
<b>Net Income</b> .....	<b>\$ 16</b>	<b>\$ 14</b>	<b>\$ 49</b>	<b>\$ 31</b>

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

**CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS**  
**PPL Montana, LLC and Subsidiaries**

(Unaudited)  
 (Millions of Dollars)

	Nine Months Ended September 30,	
	2003	2002
<b>Net Cash Provided by Operating Activities</b> .....	\$ 48	\$ 9
<b>Cash Flows From Investing Activities</b>		
Expenditures for property, plant and equipment .....	(16)	(12)
Net cash used in investing activities .....	(16)	(12)
<b>Cash Flows From Financing Activities</b>		
Net repayments under revolving line of credit .....	(26)	(9)
Distribution to Member .....	(5)	
Net cash used in financing activities .....	(31)	(9)
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b> .....	1	(12)
Cash and Cash Equivalents at Beginning of Period .....	1	24
Cash and Cash Equivalents at End of Period .....	<u>\$ 2</u>	<u>\$ 12</u>

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

**CONDENSED CONSOLIDATED BALANCE SHEET**  
**PPL Montana, LLC and Subsidiaries**

(Unaudited)

(Millions of Dollars)

	September 30, 2003	December 31, 2002
<b>Assets</b>		
<b>Current Assets</b>		
Cash and cash equivalents.....	\$ 2	\$ 1
Accounts receivable (less reserve: 2003, \$47; 2002, \$47).....	11	26
Accounts receivable from joint owners.....	5	8
Accounts receivable from Member.....		2
Fuel, materials and supplies - at average cost.....	6	6
Price risk management assets.....	14	12
Deferred income taxes.....	18	17
Prepayments and other.....	6	4
	<u>62</u>	<u>76</u>
<b>Noncurrent Assets</b>		
Property, plant and equipment - net.....	441	433
Deferred income taxes.....	2	12
Other.....	143	122
	<u>586</u>	<u>567</u>
	<u>\$ 648</u>	<u>\$ 643</u>
<b>Liabilities and Equity</b>		
<b>Current Liabilities</b>		
Accounts payable.....	\$ 19	\$ 31
Accounts payable to affiliates.....	8	1
Accounts payable to Member.....	2	
Revolving line of credit with affiliate.....		26
Accrued expenses.....	18	17
Price risk management liabilities.....	7	12
Wholesale energy commitments.....	3	2
	<u>57</u>	<u>89</u>
<b>Noncurrent Liabilities</b>		
Employee benefit obligations.....	21	27
Wholesale energy commitments.....	60	62
Other.....	31	31
	<u>112</u>	<u>120</u>
<b>Commitments and Contingent Liabilities</b> .....		
<b>Member's Equity</b> .....	<u>479</u>	<u>434</u>
	<u>\$ 648</u>	<u>\$ 643</u>

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

## Combined Notes to Condensed Consolidated Financial Statements

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

### **1. Interim Financial Statements**

*(PPL, PPL Energy Supply, PPL Electric and PPL Montana)*

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the U.S. for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X and, therefore, do not include all of the information and footnotes required by accounting principles generally accepted in the U.S. for complete financial statements. In the opinion of management, all adjustments (including normal, recurring accruals) considered necessary for a fair presentation in accordance with accounting principles generally accepted in the U.S. are reflected in the condensed consolidated financial statements. The Balance Sheet as of December 31, 2002 is derived from each Registrant's 2002 audited Balance Sheet. The financial statements and notes thereto should be read in conjunction with the financial statements and notes contained in each Registrant's Annual Report to the SEC on Form 10-K for the year ended December 31, 2002. The results of operations for the three and nine months ended September 30, 2003 are not necessarily indicative of the results to be expected for the full year ending December 31, 2003 or other future periods, because results for interim periods can be disproportionately influenced by various factors and developments and seasonal variations.

Certain amounts in the September 30, 2002 and December 31, 2002 financial statements have been reclassified to conform to the presentation in the September 30, 2003 financial statements.

### **2. Summary of Significant Accounting Policies**

The following accounting policy disclosures represent updates to the "Summary of Significant Accounting Policies" Note in each Registrant's Annual Report to the SEC on Form 10-K for the year ended December 31, 2002.

#### **Stock-Based Compensation**

*(PPL, PPL Energy Supply, PPL Electric and PPL Montana)*

PPL grants stock options, restricted stock, restricted stock units and stock units to employees and directors under several stock-based compensation plans. SFAS 123, "Accounting for Stock-Based Compensation," encourages entities to record compensation expense for stock-based compensation plans at fair value but provides the option of measuring compensation expense using the intrinsic value method prescribed by APB

Opinion No. 25, "Accounting for Stock Issued to Employees." The fair value method under SFAS 123 is indicated therein as the preferable method of accounting for stock-based compensation, as it provides a consistent basis of accounting for all stock-based awards, thereby facilitating a better measure of compensation cost and improved financial reporting.

Prior to 2003, PPL accounted for stock-based compensation in accordance with APB Opinion No. 25, as permitted by SFAS 123. Effective January 1, 2003, PPL and its subsidiaries adopted the fair value method of accounting for stock-based compensation, as prescribed by SFAS 123, using the prospective method of transition permitted by SFAS 148, "Accounting for Stock-Based Compensation - Transition and Disclosure, an Amendment of FASB Statement No. 123." See Note 15 for further discussion of SFAS 148. The prospective method of transition requires PPL and its subsidiaries to use the fair value method under SFAS 123 for all stock-based compensation awards granted, modified or settled on or after January 1, 2003. Thus, all awards granted prior to January 1, 2003 continue to be accounted for under the intrinsic value method of APB Opinion No. 25, to the extent such awards are not modified or settled. Stock-based compensation is included in "Other operation" expense on PPL's Statement of Income.

Use of the fair value method prescribed by SFAS 123 requires PPL and its subsidiaries to recognize compensation expense for stock options issued. Fair value for the stock options is determined using the Black-Scholes options pricing model.

Prior to January 1, 2003, PPL and its subsidiaries were not required to recognize compensation expense for stock options issued under the intrinsic value method of APB Opinion No. 25, since PPL grants stock options with an exercise price that is not less than the fair market value of PPL's common stock on the date of grant. For stock options granted on or after January 1, 2003, stock option expense for PPL was approximately \$1 million and \$2 million for the three and nine months ended September 30, 2003. As currently structured, awards of restricted stock, restricted stock units and stock units result in the same amount of compensation expense under the fair value method of SFAS 123 as they would under the intrinsic value method of APB Opinion No. 25.

*(PPL and PPL Energy Supply)*

The following tables illustrate the pro forma effect on net income and EPS as if the fair value method had been used to account for all outstanding stock-based compensation awards in the periods shown:

PPL	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
<b>Income</b>				
Net Income - as reported	\$ 171	\$ 122	\$ 526	\$ 92
Add: Stock-based employee compensation expense included in reported net income, net of tax	1	1	4	3
Deduct: Total stock-based compensation expense determined under the fair value method for all awards, net of tax	2	2	6	6
Pro forma Net Income	<u>\$ 170</u>	<u>\$ 121</u>	<u>\$ 524</u>	<u>\$ 89</u>

<b>EPS</b>				
Basic - as reported	\$ 0.97	\$ 0.81	\$ 3.07	\$ 0.62
Basic - pro forma	\$ 0.97	\$ 0.80	\$ 3.05	\$ 0.60
Diluted - as reported	\$ 0.97	\$ 0.80	\$ 3.06	\$ 0.62
Diluted - pro forma	\$ 0.96	\$ 0.80	\$ 3.04	\$ 0.60

PPL Energy Supply	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
<b>Income</b>				
Net Income - as reported	\$ 190	\$ 141	\$ 538	\$ 145
Add: Stock-based employee compensation expense included in reported net income, net of tax	1		2	2
Deduct: Total stock-based compensation expense determined under the fair value method for all awards, net of tax	1	1	4	4
Pro forma Net Income	<u>\$ 190</u>	<u>\$ 140</u>	<u>\$ 536</u>	<u>\$ 143</u>

*(PPL Electric and PPL Montana)*

Stock-based compensation expense, including awards granted to employees and an allocation of costs of awards granted to employees of PPL Services, was insignificant under both the intrinsic value and fair value methods for the three and nine months ended September 30, 2003.

**Other**

*(PPL, PPL Energy Supply, PPL Electric and PPL Montana)*

See Note 13 for a discussion of the accounting for asset retirement obligations, and Note 15 for a discussion of other new accounting standards.

**3. Segment and Related Information**

*(PPL and PPL Energy Supply)*

See the "Segment and Related Information" Note in each Registrant's Annual Report to the SEC on Form 10-K for the year ended December 31, 2002 for a discussion of reportable segments.

Financial data for the segments are as follows:

*(PPL)*

Income Statement Data	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
<b>Revenues from external customers</b>				
Supply	\$ 538	\$ 530	\$ 1,436	\$ 1,283
International	239	275	761	836
Delivery	<u>679</u>	<u>687</u>	<u>2,084</u>	<u>2,026</u>
	1,456	1,492	4,281	4,145
<b>Intersegment revenues</b>				
Supply	374	373	1,090	1,081
Delivery	39	40	115	122
<b>Net Income</b>				
Supply (a)	160	112	401	286
International (b)	19	(12)	96	(234)
Delivery	<u>(8)</u>	<u>22</u>	<u>29</u>	<u>40</u>
	\$ 171	\$ 122	\$ 526	\$

- (a) The nine months ended September 30, 2003 includes the "Cumulative Effect of a Change in Accounting Principle" recorded in January 2003. See Note 13 for additional information.
- (b) The nine months ended September 30, 2002 includes the "Cumulative Effect of a Change in Accounting Principle" recorded in March 2002. See Note 12 for additional information. The International segment also includes the write-downs of the CEMAR investment recorded in March and June 2002 described in Note 7.

Balance Sheet Data	September 30,	December 31,
	2003	2002
<b>Total assets</b>		
Supply	\$ 5,303	\$ 4,907
International	4,877	4,773
Delivery	<u>5,754</u>	<u>5,867</u>
	<u>\$ 15,934</u>	<u>\$ 15,547</u>

(PPL Energy Supply)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
<b>Income Statement Data</b>				
Revenues from external customers				
Supply	\$ 908	\$ 903	\$ 2,518	\$ 2,365
International	239	275	761	836
	<u>1,147</u>	<u>1,178</u>	<u>3,279</u>	<u>3,201</u>
Net Income				
Supply (a)	171	153	442	379
International (b)	19	(12)	96	(234)
	<u>\$ 190</u>	<u>\$ 141</u>	<u>\$ 538</u>	<u>\$ 145</u>

- (a) The nine months ended September 30, 2003 includes the "Cumulative Effect of a Change in Accounting Principle" recorded in January 2003. See Note 13 for additional information.
- (b) The nine months ended September 30, 2002 includes the "Cumulative Effect of a Change in Accounting Principle" recorded in March 2002. See Note 12 for additional information. The International segment also includes the write-downs of the CEMAR investment recorded in March and June 2002 described in Note 7.

	September 30, 2003	December 31, 2002
<b>Balance Sheet Data</b>		
Total assets		
Supply	\$ 5,325	\$ 5,563
International	4,877	4,773
	<u>\$ 10,202</u>	<u>\$ 10,336</u>

**4. Earnings Per Share**

(PPL)

Basic EPS is calculated by dividing "Net Income" on the Statement of Income by the weighted-average number of common shares outstanding during the period. Diluted EPS is calculated similarly, except that weighted average shares outstanding are increased for additional shares that would be outstanding if potentially dilutive securities were converted to common stock. Potentially dilutive securities consist of:

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
<b>Income (Numerator)</b>				
Net Income - before cumulative effect of a change in accounting principle (a)	\$ 171	\$ 122	\$ 463	\$ 242
Cumulative effect of a change in accounting principle (net of tax)			63	(150)
Net Income	\$ 171	\$ 122	\$ 526	\$ 92
<b>Shares (Denominator)</b>				
Shares for Basic EPS	176,397	151,565	171,577	148,758
Add: Incremental shares:				
Stock options and other share-based awards	654	282	604	326
Shares for Diluted EPS	177,051	151,847	172,181	149,084
<b>Basic EPS</b>				
Net Income - before cumulative effect of a change in accounting principle	\$ 0.97	\$ 0.81	\$ 2.71	\$ 1.63
Cumulative effect of a change in accounting principle (net of tax)			0.36	(1.01)
Net Income	\$ 0.97	\$ 0.81	\$ 3.07	\$ 0.62
<b>Diluted EPS</b>				
Net Income - before cumulative effect of a change in accounting principle	\$ 0.97	\$ 0.80	\$ 2.70	\$ 1.63
Cumulative effect of a change in accounting principle (net of tax)			0.36	(1.01)
Net Income	\$ 0.97	\$ 0.80	\$ 3.06	\$ 0.62

(a) Represents income before cumulative effect of a change in accounting principle less dividends and distributions on preferred securities.

In May 2001, PPL issued 23 million PEPS Units that contain a purchase contract component for PPL's common stock. The purchase contracts will only be dilutive if the average price of PPL's common stock exceeds a threshold appreciation price, which is adjusted for cash distributions on PPL common stock. The appreciation price was initially set at \$65.03 and has subsequently been adjusted to \$63.94 as of September 30, 2003 based on dividends paid on PPL's common stock since issuance. Since the average price has not exceeded the threshold appreciation price, the purchase contracts were excluded from the diluted EPS calculations.

In May 2003, PPL Energy Supply issued \$400 million of 2.625% Convertible Senior Notes due 2023. The notes can be converted into shares of PPL common stock, at an initial conversion rate of 20.1106 shares per \$1,000 principal amount of notes, subject to adjustment if:

- during any fiscal quarter starting after June 30, 2003, the market price of PPL's common stock trades at or above \$59.67 per share over a certain period during the preceding fiscal quarter;
- PPL calls the debt for redemption;
- the holder exercises its right to put the debt on any five-year anniversary of the offering;
- the long-term credit rating assigned to the notes by Moody's and Standard & Poor's falls below Ba2 and BB or the notes are not rated; or
- certain specified corporate transactions occur, e.g., change in control and certain distributions to the holders of PPL common stock.

As none of these events has occurred, the convertible senior notes were excluded from the diluted EPS calculations.

The following number of stock options to purchase PPL common shares were excluded in the periods' computations of diluted EPS, because the exercise price of the options was greater than the average market price of the common shares. Therefore, the effect would have been antidilutive.

(Thousands of Shares)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
Antidilutive stock options	1,673	1,716	1,687	1,158

## 5. Comprehensive Income

(PPL, PPL Energy Supply and PPL Montana)

The following tables show the after-tax components of comprehensive income:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
<b>PPL</b>				
Net Income	\$ 171	\$ 122	\$ 526	\$ 92
Other comprehensive income:				
Foreign currency translation adjustments	(5)	(11)	12	133
Unrealized gain (loss) on available-for-sale securities	(2)	(1)	7	(3)
Unrealized gain (loss) on qualifying derivatives	(25)	5	(11)	(6)
Total other comprehensive income (loss)	(32)	(7)	8	124
Comprehensive Income	<u>\$ 139</u>	<u>\$ 115</u>	<u>\$ 534</u>	<u>\$ 216</u>

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002

### PPL Energy Supply

Net Income	\$ 190	\$ 141	\$ 538	\$
Other comprehensive income:				
Foreign currency translation adjustments	(5)	(11)	12	133
Unrealized gain (loss) on available-for-sale securities	(3)		5	
Unrealized gain (loss) on qualifying derivatives	(29)	10	(5)	(4)
Total other comprehensive income (loss)	(37)	(1)	12	129
Comprehensive Income	<u>\$ 153</u>	<u>\$ 140</u>	<u>\$ 550</u>	<u>\$ 274</u>

### PPL Montana

Net Income	\$ 16	\$ 14	\$ 49	\$ 31
Other comprehensive income:				
Unrealized gain (loss) on qualifying derivatives	8	(5)	1	(18)
Comprehensive Income	<u>\$ 24</u>	<u>\$ 9</u>	<u>\$ 50</u>	<u>\$ 13</u>

(PPL Electric)

PPL Electric's net income approximates comprehensive income.

## 6. Credit Arrangements and Financing Activities

### Credit Arrangements

(PPL, PPL Energy Supply and PPL Electric)

In June 2003, PPL Energy Supply's \$300 million, 364-day credit facility and PPL Electric's \$400 million, 364-day credit facility expired. PPL Energy Supply replaced its facility with a \$300 million, three-year credit facility maturing in June 2006. PPL Electric replaced its facility with a \$200 million, 364-day facility maturing in June 2004 and a \$100 million three-year credit facility maturing in June 2006. At September 30, 2003, no cash borrowings were outstanding under any credit facilities of PPL Electric or PPL Energy Supply. Both PPL Electric and PPL Energy Supply have the ability to cause the lenders to issue letters of credit under their respective facilities. At September 30, 2003, PPL Electric had \$42 million of letters of credit outstanding under its \$100 million, three-year facility, and PPL Energy Supply had \$78 million of letters of credit outstanding under its existing \$500 million, three-year facility.

(PPL and PPL Energy Supply)

At September 30, 2003, WPD (South West) had no outstanding borrowings under either its £100 million 364-day credit facility maturing in October 2003 or its £150 million five-year credit facility maturing in October 2007. In October 2003, WPD (South West) replaced its expiring facility with a new £100 million 364-day credit facility maturing in October

2004 and extended its £150 million five-year credit facility to October 2008. At September 30, 2003, WPD (South West) had uncommitted credit line borrowings of £9 million (\$15 million based on current exchange rates) in separate agreements with lender banks.

WPD (South West) maintained a £250 million bridge facility, that expired in April 2003, to meet short-term liquidity. This bridge facility was paid down with the proceeds from the issuance of long-term bonds and borrowings under another credit facility. The long-term bond issuance is discussed in more detail under "Financing Activities."

*(PPL Montana)*

At September 30, 2003, PPL Montana had no outstanding borrowings under its credit facility with another PPL Energy Supply subsidiary.

*(PPL, PPL Energy Supply, PPL Electric and PPL Montana)*

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

Similarly, the subsidiaries of PPL Energy Supply, PPL Electric and PPL Montana are separate legal entities. These subsidiaries are not liable for the debts of PPL Energy Supply, PPL Electric and PPL Montana. Accordingly, creditors of PPL Energy Supply, PPL Electric and PPL Montana may not satisfy their debts from the assets of their subsidiaries absent a specific contractual undertaking by a subsidiary to pay the creditors or as required by applicable law or regulation. In addition, absent a specific contractual undertaking or as required by applicable law or regulation, PPL Energy Supply, PPL Electric and PPL Montana are not liable for the debts of their subsidiaries. Accordingly, creditors of these subsidiaries may not satisfy their debts from the assets of PPL Energy Supply, PPL Electric or PPL Montana absent a specific contractual undertaking by that parent to pay the creditors of its subsidiaries or as required by applicable law or regulation.

## **Financing Activities**

*(PPL)*

March 2003, PPL Capital Funding retired all \$60 million of its medium-term notes, 6.375% Series due March 2003, at par value.

In September 2003, PPL filed a Form S-4 registration statement with the SEC relating to an offer to exchange up to \$573 million aggregate stated amount of its currently outstanding PEPS Units for up to \$573 million aggregate stated amount of its PEPS Units, Series B, plus a cash payment of \$0.375 for each validly tendered and accepted outstanding PEPS Unit. PPL is seeking to conduct the exchange offer to reduce its future interest expense. The registration statement is not yet effective and the exchange offer has not been commenced.

During the nine months ended September 30, 2003, PPL issued \$424 million of common stock, including \$109 million through its Structured Equity Shelf Program and \$270 million through a public offering in May 2003. In this public offering, PPL issued 7.1 million shares of common stock for \$38.25 per share. PPL received net proceeds of approximately \$261 million, which were used to repurchase commercial paper of PPL Energy Supply and for general corporate purposes.

*(PPL and PPL Energy Supply)*

In March 2003, WPD (South West) issued £200 million of 5.875% bonds due 2027. The proceeds from this issuance were used to repay £200 million of borrowings under its bridge facility. Additionally, in May 2003, WPD (South West) issued an additional £50 million of 5.875% bonds due 2027. WPD (South West) used the proceeds from this issuance to pay down short-term borrowings. The issuance of this long-term debt resulted in an \$11 million write-off of unamortized swap restructuring costs in the second quarter of 2003.

In May 2003, PPL Energy Supply issued \$400 million of 2.625% Convertible Senior Notes due 2023, which are guaranteed by PPL and convertible into PPL common stock. The convertible notes were sold in a Rule 144A private offering to qualified institutional buyers, and PPL Energy Supply and PPL subsequently registered the resale of the notes with the SEC for the benefit of the holders. See Note 4 for additional information on the convertibility features of the notes. PPL Energy Supply used the proceeds from the private offering of the convertible notes to repurchase commercial paper and for general corporate purposes.

During the nine months ended September 30, 2003, WPD retired \$53 million of 7.375% unsecured bonds due 2028, of which \$3 million was retired in the third quarter of 2003.

At September 30, 2003, PPL Energy Supply had no commercial paper outstanding.

During the nine months ended September 30, 2003, PPL Energy Supply distributed \$909 million to its parent company, PPL Energy Funding, and received capital contributions of \$261 million.

*(PPL and PPL Electric)*

In February 2003, the Lehigh County Industrial Development Authority (LCIDA) issued \$90 million of 3.125% Pollution Control Revenue Refunding Bonds due November 2008 on behalf of PPL Electric. The proceeds of the bonds were used to refund the LCIDA's \$90 million, 6.40% Pollution Control Revenue Refunding Bonds due 2021. In order to secure its obligations to repay the LCIDA, PPL Electric issued \$90 million aggregate principal amount of its Senior Secured Bonds under its 2001 Senior Secured Bond Indenture, having terms corresponding to the terms of the LCIDA bonds.

In February 2003, PPL Electric retired \$19 million of its outstanding First Mortgage Bonds, 6-7/8% Series due February 2003, at par value.

In April 2003, as permitted by the 1945 First Mortgage Bond Indenture, PPL Electric retired approximately \$46 million aggregate principal amount of its First Mortgage Bonds, 7-7/8% Series due 2023, at par value, plus accrued interest, through the application of cash deposited with the trustee to release certain transmission lines and other equipment from the lien of the 1945 First Mortgage Bond Indenture.

In April 2003, PPL Electric redeemed all outstanding shares of its 6.15% Series Preferred Stock. This redemption, which totaled \$10 million, was made at par value of \$100 per share plus accumulated and unpaid dividends, in accordance with the mandatory sinking fund requirements of this series.

In May 2003, PPL Electric issued \$100 million of 4.30% Senior Secured Bonds due 2013. The proceeds were used for general corporate purposes including the refunding of higher-cost securities.

In July 2003, PPL Electric redeemed all outstanding shares of the 6.33% Series Preferred Stock. This redemption, which totaled \$5 million, was made at par value of \$100 per share plus accumulated and unpaid dividends, in accordance with the mandatory sinking fund requirements of this series.

In October 2003, PPL Electric redeemed all of its outstanding shares of the 6.125% Series Preferred Stock. This redemption, totaling \$17 million, was made at par value of \$100 per share plus accumulated and unpaid dividends, in accordance with the optional redemption provisions of this series.

During the nine months ended September 30, 2003, PPL Transition Bond Company made principal payments on transition bonds totaling \$196 million.

During the nine months ended September 30, 2003, PPL Electric received a capital contribution of \$75 million from PPL.

At September 30, 2003, PPL Electric had no commercial paper outstanding.

*(PPL Montana)*

During the nine months ended September 30, 2003, PPL Montana repaid \$26 million under its revolving line of credit with an affiliate. Also during this period, PPL Montana distributed \$5 million to its parent company, PPL Montana Holdings, LLC.

#### **Dividends and Dividend Restrictions (PPL)**

In February 2003, PPL announced an increase of its quarterly common stock dividend, effective April 1, 2003, from 36 cents per share to 38.5 cents per share (equivalent to \$1.54 per annum). Future dividends, declared at the discretion of the Board of Directors, will be dependent upon future earnings, cash flows, financial requirements and other factors.

#### **7. Acquisitions, Development and Divestitures**

##### **Domestic Generation Projects (PPL and PPL Energy Supply)**

In January 2003, PPL announced that it had decided not to proceed with development of the 300 MW Kings Park project. In March, PPL Global sold its interest in Kings Park Energy, LLC.

In April 2003, PPL Susquehanna completed the replacement of the Unit 2 steam turbine at the Susquehanna station. This project provides a nominal power increase of 50 MW of generation capacity, of which PPL Susquehanna has a 90% undivided interest. An additional turbine upgrade is in progress for Unit 1 and is expected to be completed in 2004. Through September 30, 2003, a total of approximately \$84 million has been incurred on these projects.

In October 2003, PPL Maine, LLC, a subsidiary of PPL Generation, entered into an agreement in principle with a coalition of government agencies and private groups to sell three of its nine hydroelectric dams in Maine. If the agreement is finalized, a non-profit organization designated by the coalition would have a five-year option to purchase the dams for approximately \$25 million, and PPL Maine would receive rights to increase energy output at its other hydroelectric dams in Maine. The coalition has indicated that it plans to remove or bypass the dams subject to the agreement in order to restore runs of Atlantic salmon and other migratory fish to the Penobscot River. Any final agreement will require several approvals by the FERC.

See Notes 8 and 15 for a discussion of the Lower Mt. Bethel facility.

## International Energy Projects (PPL and PPL Energy Supply)

### Acquisitions

WPD

On September 6, 2002, PPL Global acquired the remaining 49% equity interest in WPDH Limited and WPDL from Mirant for approximately \$236 million, including acquisition costs. The acquisition of Mirant's 49% interest provides PPL Global with complete control of WPD.

Prior to the acquisition, PPL Global held 51% of the equity interest in WPD but shared control with Mirant pursuant to a shareholders' agreement. The shareholders' agreement was terminated in connection with the closing of the acquisition. No regulatory approvals were required for this transaction.

The purchase of Mirant's interest in WPD was accounted for as a step-acquisition and resulted in the consolidation of WPD's accounts by PPL and PPL Energy Supply.

The assets acquired and liabilities assumed were recorded at estimated fair value as determined by management based on information currently available, including an independent appraisal of the fair value of acquired property, plant and equipment and intangible assets. Management is also completing its review and determination of fair value of other assets acquired and liabilities assumed, including pre-acquisition contingencies. Accordingly, the allocation of purchase price is preliminary and may be revised as additional information becomes available. The following table summarizes the preliminary allocation of purchase price based on estimated fair values of the assets acquired and liabilities assumed at the date of acquisition, plus the book value of assets and liabilities underlying PPL Global's previous 51% equity ownership:

Current assets	\$	228
Investments (a)		(438)
Property, plant and equipment		3,437
Goodwill		197
Other		244
Total assets acquired		<u>3,668</u>
Current liabilities		787
Long-term debt		1,581
Other		1,064
Total liabilities assumed		<u>3,432</u>
Net assets acquired	\$	<u>236</u>

(a) Includes the reversal of PPL Global's equity investment.

The goodwill reflected above includes the remaining value of PPL Global's 51% share of the goodwill recognized by WPD on its acquisition of Hyder.

The PPL income statements for the nine months ended September 30, 2003 and 2002 include consolidated WPD results for the nine-month periods ended August 31, 2003 and 2002. This reflects PPL Global's policy of recording the results of foreign controlled subsidiaries on a one-month lag. The portion of earnings attributable to Mirant, \$19 million and \$72 million for the three and nine months ended September 30, 2002, is reported on the Statement of Income in "Minority Interest."

### TransEmel

Emel acquired the remaining 40% interest in a joint venture (TransEmel, a provider of transmission service to northern Chile) in July 2003 at a net cost of \$3 million, bringing its total ownership interest in TransEmel to 100%. As a result of this acquisition, the operating results of TransEmel have been consolidated from the beginning of the year. The portion of earnings attributable to the minority shareholder is reported on the Statement of Income in "Minority Interest."

### Write-down of International Energy Projects - CEMAR

At December 31, 2001, PPL Global estimated that the long-term viability of its CEMAR investment was jeopardized and that there was minimal probability of positive future cash flows. At that time, PPL Global recorded an impairment loss of \$217 million in the carrying value of its net assets in CEMAR. At March 31, 2002, PPL Global recorded a further impairment loss of \$6 million, which was charged to "Write-down of international energy projects" on the Statement of Income. In June 2002, PPL made a decision to exit the investment. PPL Global's remaining portion of its CEMAR investment, \$94 million, which related to foreign currency translation adjustments (CTA), was written-off as of June 30, 2002. Accounting guidance prohibited the inclusion of CTA in impairment calculations prior to designating such assets as held for disposal.

On August 21, 2002, ANEEL authorized an administrative intervention in CEMAR and fully assumed operational and financial control of the company. In its public announcement relating to the intervention, ANEEL said that its intervention and control of CEMAR would last for an initial term of 180 days and that it could be extended.

The intervenor appointed by ANEEL issued a public statement and schedule for the transfer of the ownership interest in CEMAR to a new owner. Although the schedule announced by the intervenor reflected a closing for the transfer of control of CEMAR to a third party on December 20, 2002, the closing did not occur. The deadline for the sale process was extended to February 17, 2003, the same day the initial term of the intervention was scheduled to end. No conforming bids were submitted to ANEEL by the February 17 deadline due to three outstanding injunctions preventing the sale process from continuing. ANEEL publicly announced a 180-day extension of the initial intervention on February 14, citing the continuing unresolved financial crisis of CEMAR as the primary reason

for the extension. As of February 11, 2003, due to the inability to discharge their obligations under the continuing intervention, PPL-related officers and directors of CEMAR resigned from their respective positions.

In April 2003, PPL learned that the Brazilian Federal Appellate Court hearing the appeal of one of the above-mentioned injunctions accepted ANEEL's arguments and cancelled the injunction. In June, ANEEL's officials indicated to PPL that the other two injunctions outstanding against the sale process had been lifted as well. The intervenor appointed by ANEEL issued a public statement and revised schedule for the transfer of the ownership interest in CEMAR to a new owner. In July, ANEEL pre-qualified a Brazilian private equity fund, GP Investimentos (GP), as the sole qualified bidder. However, on August 12, ANEEL announced that it could not proceed with GP's offer because, among other reasons, it was unacceptable to CEMAR's creditors. On August 16, ANEEL extended the intervention for up to an additional 180 days. On September 4, ANEEL published a revised schedule for the sale of CEMAR to a third party by the end of the year. PPL Global cannot predict the outcome of the current sale process sponsored by ANEEL.

Based on these and other events described more fully in each Registrant's Annual Report to the SEC on Form 10-K for the year ended December 31, 2002, PPL Global no longer controls or manages CEMAR and PPL Global has deconsolidated the financial assets and liabilities of CEMAR from its financial statements. Consistent with the cost method of accounting, PPL Global is no longer recording CEMAR's operating results.

At September 30, 2003, the negative investment in CEMAR of \$18 million was included in "Deferred Credits and Other Noncurrent Liabilities - Other." Any negative carrying value will be reversed upon the final sale or other disposition of the company.

### Sales

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

### Other (PPL)

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

## **8. Commitments and Contingent Liabilities**

### **Energy Purchases and Sales Commitments**

#### Liability for Above Market NUG Contracts (PPL, PPL Energy Supply and PPL Electric)

In 1998, PPL Electric recorded a loss accrual for above market contracts with NUGs of \$854 million, due to its generation business being deregulated. Effective January 1999, PPL Electric began reducing this liability as an offset to "Energy purchases" on the Statement of Income. This reduction is based on the estimated timing of the purchases from the NUGs and projected market prices for this generation. The final existing NUG contract expires in 2014. In connection with the corporate realignment, effective July 1, 2000, the remaining balance of this liability was transferred to PPL EnergyPlus. At September 30, 2003, the remaining liability associated with the above market NUG contracts was \$371 million.

#### Wholesale Energy Commitments

##### *(PPL, PPL Energy Supply and PPL Montana)*

As part of the purchase of generation assets from Montana Power, PPL Montana assumed a power purchase agreement and a power sales agreement, which were still in effect at September 30, 2003. In accordance with purchase accounting guidelines, PPL Montana recorded liabilities of \$66 million as the estimated fair value of these agreements at the acquisition date. These liabilities are being reduced over the terms of the agreements, through 2010, as adjustments to "Wholesale energy marketing" revenues and "Energy purchases" on the Statement of Income. The unamortized balance of these liabilities at September 30, 2003 was \$63 million.

On July 1, 2002, PPL EnergyPlus began to sell to NorthWestern an aggregate of 450 MW of energy to be supplied by PPL Montana. Under two five-year agreements, PPL EnergyPlus is supplying 300 MW of around-the-clock electricity and 150 MW of unit-contingent on-peak electricity. PPL Montana also makes short-term energy sales to NorthWestern. Following NorthWestern's credit downgrades to below investment grade in late 2002, PPL Montana and NorthWestern agreed to modify the payment provisions of the energy contracts such that NorthWestern would pay PPL Montana on a weekly basis, in arrears.

In September 2003, NorthWestern filed a voluntary petition for relief seeking to reorganize under Chapter 11 of the U.S. Bankruptcy Code. NorthWestern made its filing in federal bankruptcy court in Delaware. Between the time of NorthWestern's last weekly payment and the bankruptcy filing date, PPL Montana made approximately \$1.6 million of energy sales to NorthWestern.

Following the date that NorthWestern filed for bankruptcy, PPL Montana and NorthWestern agreed to amend the power supply agreements to, among other things, eliminate the

weekly payment arrangements and resume more typical monthly invoicing and payment arrangements. The amendments were contingent on NorthWestern's assumption of the power supply agreements in its bankruptcy proceeding.

On September 26, 2003, NorthWestern filed a motion with the bankruptcy court seeking, among other things, to assume the two five-year power supply agreements (as amended) and to pay PPL Montana for the approximately \$1.6 million of energy sales made immediately prior to the time of the bankruptcy filing. On October 13, 2003, the bankruptcy court entered an order granting NorthWestern's motion.

NorthWestern has, in accordance with the terms of the judge's order, paid PPL Montana for the pre-filing energy sales, and the parties have resumed monthly invoicing and payment arrangements.

*(PPL and PPL Energy Supply)*

As a result of New Jersey's Electric Discount and Energy Competition Act, its Board of Public Utilities authorized and made available to power suppliers, on a competitive basis, the opportunity to provide Basic Generation Service (BGS) to all non-shopping New Jersey customers. In February 2003, PPL EnergyPlus was awarded 34-month fixed-price BGS and 10-month hourly energy price BGS for a fixed percentage of customer load (approximately 1,000 MW) for Atlantic City Electric Company, Jersey Central Power & Light Company and Public Service Electric & Gas Company. These contracts commenced in August 2003.

In April 2003, PPL EnergyPlus entered into an agreement with Arizona Public Service Company to provide 112 MW of capacity and associated electricity from July through September of 2003 and 150 MW from June through September of 2004 and 2005.

In May 2003, PPL EnergyPlus entered into agreements with Tucson Electric Power Company to provide 37 MW of capacity and associated electricity from June through December of 2003 and 75 MW from January 2004 through December 2006.

In May 2003, PPL EnergyPlus entered into a 20-year agreement with Community Energy, Inc. to purchase energy from its Bear Creek wind power project in northeastern Pennsylvania. The project is expected to produce up to 20 MW and to be completed in 2004.

## **Legal Matters**

*(PPL, PPL Energy Supply, PPL Electric and PPL Montana)*

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

## **Tax Assessment Appeals**

*(PPL and PPL Energy Supply)*

Pursuant to changes in PURTA enacted in 1999, PPL subsidiaries have filed a number of tax assessment appeals in various Pennsylvania counties where PPL facilities are located. These appeals challenge existing local tax assessments, which now comprise the basis for payment of the PURTA tax on PPL's properties. Also, as of January 1, 2000, generation facilities are no longer taxed under PURTA, and these local assessments will be used directly to determine local real estate tax liability for PPL's power plants. In July 1999, PPL filed retroactive appeals for tax years 1998 and 1999, as permitted by the new law. In addition, PPL has filed appeals for 2000 and beyond, as permitted under normal assessment procedures. It is anticipated that assessment appeals may now be an annual occurrence.

Hearings on the pending appeals were held by the boards of assessment appeals in each county, and decisions have now been rendered by all counties. To the extent the appeals were denied or PPL was not otherwise satisfied with the results, PPL filed further appeals from the board decisions with the appropriate county Courts of Common Pleas.

Of the three pending proceedings in Pennsylvania, only the appeal concerning the assessed value of the Susquehanna nuclear station will result in annual local taxes exceeding \$1 million. PPL's appeal of the Susquehanna station assessment was decided in its favor by the Luzerne County Court of Common Pleas, and PPL subsequently settled with the local taxing authorities, resulting in annual local tax liability of approximately \$3 million for tax years 2000 and beyond and no additional PURTA tax liability for tax years 1998 and 1999. However, the settlement of the tax liability for tax years 1998 and 1999 is subject to the outcome of claims asserted by certain intervenors which are described below.

In August 2000, over PPL's objections, the Luzerne County Court of Common Pleas permitted Philadelphia City and County, the Philadelphia School District and the Southeastern Pennsylvania Transportation Authority (SEPTA) (collectively, the "Philadelphia parties") to intervene in the case because a change in the assessment of the plant affected the amount they collected under PURTA for the tax years 1998 and 1999. Based on the appraisal obtained by the Philadelphia parties, PPL would be required to pay up to an extra \$213 million in PURTA taxes for 1998 and 1999. The court ruled in PPL's favor concerning the assessed value of the plant, and this determination was affirmed by the Commonwealth Court in October 2003.

*(PPL, PPL Energy Supply and PPL Montana)*

PPL Montana is currently protesting certain property tax assessments by the Montana Department of Revenue (MDOR) on its generation facilities. The tax liabilities in dispute are approximately \$2 million for 2000 and 2001 and \$9 million

for 2002. PPL Montana's dispute with respect to most of the 2002 tax liability is based on the assessed value used by the MDOR for PPL Montana's hydroelectric facilities versus the assessed value used for the facilities of another hydroelectric generator in the state. The state tax appeals board is scheduled to hear the 2000 and 2001 disputes in January 2004, while the hearing for the 2002 dispute is scheduled for April 2004.

#### Montana Power Shareholders' Litigation (PPL, PPL Energy Supply and PPL Montana)

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

#### Energy West Litigation (PPL, PPL Energy Supply and PPL Montana)

In July 2001, PPL Montana filed an action in state court and a responsive pleading in the U.S. District Court of Montana, Great Falls Division, both related to a breach of contract by Energy West Resources, Inc. (Energy West), a Great Falls, Montana-based energy aggregator. PPL Montana was seeking a judgment that Energy West violated the terms of the contract under which it supplied energy to Energy West during the period July 1, 2000 through June 30, 2002. All litigation in this matter was consolidated in the U.S. District Court of Montana, Great Falls Division. In June 2003, PPL Montana and Energy West agreed to settle the litigation. Under the terms of the settlement, Energy West agreed to pay PPL Montana \$3 million, of which \$1 million was paid in June and the remaining \$2 million was paid in September 2003. The litigation has now been dismissed by the federal court.

#### NorthWestern Corporation Litigation (PPL, PPL Energy Supply and PPL Montana)

In connection with the acquisition of the Montana generation assets, the Montana Power APA, which was previously assigned to PPL Montana by PPL Global, includes a provision concerning the proposed purchase by PPL Montana of a portion of NorthWestern's interest in the 500-kilovolt Colstrip Transmission System (CTS) for \$97 million. During 2002, PPL Montana had been in discussions with NorthWestern regarding the proposed purchase of the CTS and the claims that PPL Montana believes it has against NorthWestern arising from the Montana Power APA and related agreements. Notwithstanding such discussions, in September 2002, NorthWestern filed a lawsuit against PPL Montana in Montana state court seeking specific performance of PPL Montana's purchase of the CTS or, alternatively, damages for breach of contract. Pursuant to PPL Montana's application, the matter was removed to the U.S. District Court of Montana, Butte Division. Following removal, NorthWestern asserted additional claims for damages against PPL Montana, and PPL Montana filed defenses denying liability for NorthWestern's claims as well as counterclaims against NorthWestern seeking damages PPL Montana believes it has suffered under the Montana Power APA and related agreements. This matter is currently scheduled for trial in mid-2005. In September 2003, NorthWestern filed a petition in Delaware for reorganization under the U.S. Bankruptcy Code, which has resulted in an automatic stay of PPL Montana's counterclaims against NorthWestern. PPL Montana has applied to the bankruptcy court for relief from the automatic stay. PPL, PPL Energy Supply and PPL Montana cannot predict the outcome of this litigation.

#### Montana Hydroelectric Litigation (PPL, PPL Energy Supply and PPL Montana)

In October 2003, a lawsuit was filed against PPL Montana, PPL Services, Avista Corporation, PacifiCorp and nine John Doe defendants in the U.S. District Court of Montana, Missoula Division, by two residents allegedly acting in a representative capacity on behalf of the State of Montana. The action seeks a declaratory judgment, compensatory damages for unjust enrichment, trespass and negligence, and attorneys fees on a "private attorney general" theory for use of state "school trust" lands without the compensation required by law and to require defendants to adequately compensate the State School Trust fund for full market value of lands occupied. Generally, the suit is founded on allegations that the bed of navigable rivers is state-owned property following admission to statehood, and that the use thereof for placement of dam structures, affiliated structures and reservoirs should trigger lease payments for use of "school trust" land underneath. The plaintiffs allege that the State Land Board and Department of Natural Resources and Conservation failed to exercise their duty to administer riverbeds for the maximum benefit of public education. No specific amount of damages has been claimed. PPL Montana and PPL Services deny the allegations in the complaint and intend to defend the lawsuit. PPL Montana and

PPL Services cannot predict the outcome of this litigation at this time.

## Regulatory Issues

### California ISO and Pacific Northwest (PPL, PPL Energy Supply and PPL Montana)

Through its subsidiaries, PPL has made approximately \$18 million of sales to the California ISO, of which \$17 million has not been paid to PPL subsidiaries. Given the myriad of electricity supply problems presently faced by the California electric utilities and the California ISO, PPL cannot predict whether or when it will receive payment. As of September 30, 2003, PPL has fully reserved for possible underrecoveries of payments for these sales.

Regulatory proceedings arising out of the California electricity supply situation have been filed at the FERC. The FERC has determined that all sellers of energy into markets operated by the California ISO and the California Power Exchange, including PPL Montana, should be subject to refund liability for the period beginning October 2, 2000 through June 20, 2001 and initiated an evidentiary hearing concerning refund amounts. In April 2003, the FERC changed the manner in which this refund liability is to be computed and ordered further proceedings to determine the exact amounts that the sellers, including PPL Montana, would be required to refund.

In June 2003, the FERC took several actions as a result of a number of related investigations. The FERC terminated proceedings pursuant to which it had been considering whether to order refunds for spot market bilateral sales made in the Pacific Northwest, including sales made by PPL Montana, during the period December 2000 through June 2001. The FERC explained that the totality of the circumstances made refunds unfeasible and inequitable, and that it had provided adequate relief by adopting a price cap throughout the western U.S. The FERC also denied pending complaints against long-term contracts in the western U.S. In these complaints, various power buyers challenged selected long-term contracts that they entered into during 2000 and 2001, complaining that the power prices were too high and reflected manipulation of those energy markets. The FERC found that the complainants had not met their burden of showing that changing or canceling the contracts was "in the public interest" and that the dysfunction in the California markets did not justify changing these long-term contracts. In two separate orders, the FERC also ordered 65 different companies, agencies or municipalities to show cause why they should not be ordered to disgorge profits for "gaming" or anomalous market behavior during 2000 and 2001. These orders to show cause address both unilateral and joint conduct identified as the "Enron trading strategies." Neither PPL EnergyPlus nor PPL Montana was included in these orders to show cause, and they previously have explained their responses to data requests from the FERC that they have not engaged in such trading strategies. Finally, the FERC issued a new investigation order directing its staff to investigate any bids made into the California markets in excess of \$250/MWh

during the period from May 2000 to October 2000, a period of time prior to the period examined in connection with most of the proceedings described above. To their knowledge, neither PPL EnergyPlus nor PPL Montana is being investigated by the FERC under this new order.

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

In May 2003, the Port of Seattle filed a lawsuit in the U.S. District Court for the Western District of Washington against eighteen defendants, including PPL Montana. The lawsuit asserts claims against all defendants under the federal and state antitrust laws, the federal Racketeer Influenced and Corrupt Organizations Act and for common law fraud. The complaint centers on many of the same alleged activities that are the basis for the litigation arising out of the California electricity supply situation described above. The Port of Seattle is seeking actual, trebled and punitive damages, as well as attorneys' fees.

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

### PJM Capacity Transactions (PPL, PPL Energy Supply and PPL Electric)

In November 2001, the PJM Market Monitor publicly released a report prepared for the PUC entitled "Capacity Market Questions" relating to the pricing of installed capacity in the PJM daily market during the first quarter of 2001. The report concluded that PPL EnergyPlus (identified in the report as "Entity 1") was able to exercise market power to raise the market-clearing price above the competitive level during that period. PPL EnergyPlus does not agree with the Market Monitor's conclusions that it exercised market power, and the

Market Monitor acknowledged in his report that PJM's standards and rules did not prohibit PPL EnergyPlus' conduct. In November 2001, the PUC issued an Investigation Order directing its Law Bureau to conduct an investigation into the PJM capacity market and the allegations in the Market Monitor's report. In June 2002, the PUC issued an investigation report alleging, among other things, that PPL had unfairly manipulated electricity markets in early 2001. The PUC stated that it was not authorized to, and was not attempting to, adjudicate the merits of PPL's defenses to its allegations, but referred the matter to the U.S. Department of Justice - Antitrust Division (DOJ), the FERC and the Pennsylvania Attorney General.

In June 2003, the DOJ notified PPL that it had closed its investigation in this matter. Also in June, the Pennsylvania Attorney General's office completed its investigation and notified the PUC that PPL did not violate antitrust or other laws in its capacity market activities. The FERC already has completed two investigations related to these capacity market questions and has found no reason to take action against PPL. PPL continues to believe that the PUC's report is inaccurate, that its conclusions are groundless, and that PPL acted ethically and legally, in compliance with all applicable laws and regulations.

In September 2002, PPL was served with a complaint filed by Utilimax.com, Inc., which was a member of PJM, in the U.S. District Court for the Eastern District of Pennsylvania against PPL and PPL EnergyPlus alleging, among other things, violations of the federal antitrust laws in connection with the capacity transactions described in the Market Monitor's report. The court dismissed the complaint with prejudice in July 2003, and Utilimax has appealed the court's dismissal to the U.S. Court of Appeals for the Third Circuit.

In December 2002, PPL was served with a complaint against PPL, PPL EnergyPlus and PPL Electric filed in the U.S. District Court for the Eastern District of Pennsylvania by a group of 14 Pennsylvania boroughs that apparently alleges, in broad terms, similar violations of the federal antitrust laws. These boroughs are wholesale customers of PPL Electric. In addition, in November 2003, PPL and PPL EnergyPlus were served with a complaint which was filed in the same court by Joseph Martorano, III (d/b/a ENERCO), that also alleges violations of the federal antitrust laws. The complaint indicates that ENERCO provides consulting and energy procurement services to clients in Pennsylvania and New Jersey. Although PPL, PPL EnergyPlus and PPL Electric believe the claims in these complaints are without merit, they cannot predict the outcome of these matters.

#### FERC Market-Based Rate Authority (PPL and PPL Energy Supply)

In December 1998, the FERC issued an order authorizing PPL EnergyPlus to make wholesale sales of electric power and related products at market-based rates. In that order, the FERC directed PPL EnergyPlus to file an updated market

analysis within three years of the date of the order, and every three years thereafter. PPL EnergyPlus filed its initial updated market analysis in December 2001. Several parties thereafter filed interventions and protests requesting that, in light of the PJM Market Monitor's report described above, PPL EnergyPlus be required to provide additional information demonstrating that it has met the FERC's market power tests necessary for PPL EnergyPlus to continue its market-based rate authority. PPL EnergyPlus has responded that the FERC does not require the economic test suggested by the intervenors and that, in any event, it would meet such economic test if required by the FERC. PPL EnergyPlus cannot predict the outcome of this matter.

#### FERC Proposed Rules (PPL, PPL Energy Supply, PPL Electric and PPL Montana)

In July 2002, the FERC issued a Notice of Proposed Rulemaking entitled "Remedying Undue Discrimination through Open Access Transmission Service and Standard Electricity Market Design." The proposed rule is currently available for public comment and contains a proposed implementation date of July 31, 2003. However, since the issuance of the proposed rule, the FERC has delayed the implementation date. This far-reaching proposed rule, in its current form, purports to establish uniform transmission rules and establish a standard market design by, among other things:

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

In April 2003, the FERC issued a white paper describing certain modifications to the proposed rule. The FERC has requested comments and is holding numerous public comment sessions concerning the white paper.

In an order issued in June 2003, the FERC requested comments on a proposal to condition all new and existing electric market-based tariffs and authorizations to include provisions prohibiting the seller from engaging in anticompetitive behavior or the exercise of market power. The FERC order proposes a list of market behavior rules that, if adopted, would apply to all electric market-based rate tariffs and authorizations, including those of PPL EnergyPlus and any other PPL subsidiaries that hold market-based rate authority.

If adopted, these proposed rules may have a significant impact on PPL and its subsidiaries, which cannot be predicted at this time.

### Montana Hydroelectric License Contingencies (PPL Montana)

PPL Montana has 11 hydroelectric facilities and one storage reservoir licensed by the FERC pursuant to the Federal Power Act under long-term licenses which expire on varying dates from 2009 through 2040. Pursuant to Section 8(e) of the Federal Power Act, the FERC approved the transfer from Montana Power to PPL Montana of all pertinent licenses and any amendments in connection with the Montana APA.

The Kerr Dam Project license was jointly issued by the FERC to Montana Power and the Confederated Salish and Kootenai Tribes of the Flathead Reservation in 1985, and required Montana Power to hold and operate the project for 30 years. The license required Montana Power, and subsequently PPL Montana as a result of the purchase of the Kerr Dam from Montana Power, to continue to implement a plan to mitigate the impact of the Kerr Dam on fish, wildlife and the habitat. Such implementation will require remaining payments totaling approximately \$22 million between 2004 and 2015.

PPL Montana entered into a Memorandum of Understanding (MOU) with state, federal and private entities related to the issuance in 2000 of the FERC renewal license for the nine dams for the Missouri-Madison project. The MOU requires PPL Montana to implement plans to mitigate the impact of its projects on fish, wildlife, habitat and to increase recreational opportunities. The MOU was created to maximize collaboration between the parties and possibilities for matching funds. Such implementation will require remaining payments by PPL Montana totaling \$17 million between 2003 and 2010.

### Wallingford Deactivation (PPL and PPL Energy Supply)

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

### IRS Synthetic Fuels Tax Credits (PPL and PPL Energy Supply)

Through one of its subsidiaries, PPL operates a synfuel facility in Somerset, Pennsylvania and receives tax credits pursuant to Section 29 of the Internal Revenue Code based on its sale of synfuel to unaffiliated third-party purchasers. Section 29 of the Internal Revenue Code provides tax credits for the production and sale of solid synthetic fuels produced from coal. To qualify for the Section 29 tax credits, the synthetic fuel must meet three primary conditions: (i) there must be a significant chemical change in the coal feedstock, (ii) the product must be sold to an unaffiliated entity, and (iii) the production facility must have been placed in service before July 1, 1998. Section 29 tax credits are currently scheduled to expire at the end of 2007.

PPL received a private letter ruling from the IRS in November 2001 pursuant to which, among other things, the IRS concluded that the synthetic fuel produced at the Somerset facility qualifies for Section 29 tax credits. PPL uses the Covol technology to produce synfuel at the Somerset facility, and the IRS issued the private letter ruling after its review and approval of that technology. In reliance on this private letter ruling, PPL has sold synfuel produced at the Somerset facility resulting in an aggregate of approximately \$133 million of tax credits as of September 30, 2003. PPL has projected that the Somerset facility will contribute approximately \$0.15 to its EPS in each year from 2003 through 2007. PPL also purchases synfuel from unaffiliated third parties, at prices below the market price of coal, for use at its coal-fired power plants.

In June 2003, the IRS announced that it had reason to question the scientific validity of certain test procedures and results that have been presented to it by taxpayers with interests in synfuel operations as evidence that the required significant chemical change has occurred, and that it was reviewing information regarding these test procedures and practices. In conjunction with such review, the IRS suspended the issuance of private letter rulings concerning whether a significant chemical change has occurred for requests relying on the procedures and results being reviewed. In addition, the IRS indicated that it might revoke existing private letter rulings that relied on the procedures and results under review if it determined that those test procedures and results do not demonstrate that a significant chemical change has occurred.

In October 2003, the IRS announced that it had completed its review of the scientific validity of test procedures and results presented by taxpayers as evidence of significant chemical change and determined that the test procedures and results used by taxpayers are scientifically valid, if the procedures are applied in a consistent and unbiased manner. Further, the IRS announced that it will continue to issue rulings on significant chemical change under applicable IRS guidelines, despite some question by the IRS as to whether those processes result in the level of significant chemical change required by Section 29 of the Internal Revenue Code and IRS revenue rulings.

Finally, the IRS indicated that it would require taxpayers to comply with certain sampling and data/record retention practices to obtain or maintain a ruling on significant chemical change.

PPL believes that the October IRS announcement confirms that PPL is justified in its reliance on the private letter ruling for the Somerset facility, that the test results that PPL presented to the IRS in connection with its private letter ruling are scientifically valid and that PPL has operated the Somerset facility in compliance with the private letter ruling and Section 29 of the Internal Revenue Code.

In October 2003, following the IRS announcement, PPL became aware of reports indicating that the U.S. Senate Permanent Subcommittee on Investigations, of the Committee on Governmental Affairs, had begun an investigation of the synthetic fuel industry and its producers. PPL has no further knowledge of the investigation, when the investigation will be completed or the potential results of the investigation.

#### U.K. Electricity Regulation (*PPL and PPL Energy Supply*)

The principal legislation governing the structure of the electricity industry in Great Britain is the Electricity Act 1989 (the "Electricity Act"), as amended by the Utilities Act 2000 (the "Utilities Act").

The provisions in the Utilities Act include the replacement of individual gas and electricity regulators with the Gas and Electricity Markets Authority (the "Regulator"). The principal objective of the Regulator is to protect the interests of consumers, wherever appropriate, by promoting effective competition in electricity generation and supply. There currently is no competition in electricity distribution.

Each distribution business constitutes a natural regional monopoly and is subject to control on the prices it can charge and the quality of supply it must provide. The operations of WPD are regulated under its distribution licenses, pursuant to which income generated is subject to an allowed revenue regulatory framework that provides economic incentives to minimize operating, capital and financing costs. Under the Electricity Act, WPD is under a statutory duty to offer terms to connect any customer requiring electricity within their area and to maintain that connection. The allowed revenue that is recovered from electricity supply businesses through charges by the Distribution Network Operator (DNO) made for the use of the distribution network is regulated on the basis of the Retail Price Index (RPI) minus X formula. The allowed revenue is increased by RPI minus X during the tenure of each price control period. (RPI is a measure of inflation and equals the percentage change in the U.K. RPI between the six-month period of July to December in the previous year. The X factor is established by the Regulator following review and represents an annual efficiency factor.) The Regulator currently sets the Distribution Price Control Formula for five-year periods.

The current Distribution Price Control Formula permits DNOs, within a review period, to partially retain additional revenues due to increased distribution of units and to retain all increases in operating profit due to efficient operations and the reduction of expenses (including financing costs). The Regulator may reduce this increase in operating profit through a one-off price reduction in the first year of the new pricing regime, if the Regulator determines that it is not a function of efficiency savings, or, if genuine efficiency savings have been made, and the Regulator determines that customers should benefit through lower prices.

In December 1999, the Regulator published final price proposals for distribution price control for the 12 DNOs in England and Wales. These proposals represented a reduction to distribution prices of 20% for WPD (South West) and 26% for WPD (South Wales) effective April 2000, followed by a reduction in real terms (i.e., before inflation is taken into account) of 3% each year from April 2001. This price control is scheduled to operate until March 2005.

Improvements in quality of supply form an important part of the final proposals. Revised targets for system performance, in terms of the security and availability of supply, were proposed with new targets for reductions in minutes lost and interruptions.

The Regulator has introduced a quality of service incentive plan for the period from April 2002 to March 2005. Companies will be penalized annually up to 2% of revenue for failing to meet their quality of supply targets for the incentive plan. The plan includes a mechanism for rewarding companies which exceed their targets based on their rate of improvement of performance during the period and a process for rewarding exceptional performance by specifying how the targets will be reset.

Distribution businesses must also meet the Guaranteed and Overall Standards of Performance, which are set by the Regulator to ensure an appropriate level of quality of supply. If a company fails to provide the level of service specified, it must make a fixed payment to the retail customer affected.

In June 2003, the Regulator published a report on the quality of supply from April 2001 through March 2002. The report confirms that WPD (South West) and WPD (South Wales) met or exceeded such standards and that no payments were required to be made by either company.

#### **Environmental Matters - Domestic**

*(PPL, PPL Energy Supply, PPL Electric and PPL Montana)*

Due to the environmental issues discussed below or other environmental matters, PPL subsidiaries may be required to modify, replace or cease operating certain facilities to comply with statutes, regulations and actions by regulatory bodies or courts. In this regard, PPL subsidiaries also may incur capital

expenditures or operating expenses in amounts which are not now determinable, but which could be significant.

#### *Air (PPL, PPL Energy Supply and PPL Montana)*

The Clean Air Act deals, in part, with acid rain, attainment of federal ambient ozone standards and toxic air emissions in the U.S. PPL's subsidiaries are in substantial compliance with the Clean Air Act. The Bush administration and certain members of Congress have made proposals regarding possible amendments to the Clean Air Act. These amendments could require significant further reductions in nitrogen oxide, sulfur dioxide and mercury and could possibly require measures to limit carbon dioxide. In addition, several states have taken their own actions requiring mandatory carbon dioxide emission reductions. Pennsylvania and Montana have not, at this time, established any formal programs to address carbon dioxide and other greenhouse gases.

The Pennsylvania DEP has finalized regulations requiring further seasonal (May-June) nitrogen oxide reductions to 80% from 1990 levels starting in 2003. These regulations are pursuant to EPA's 1998 State Implementation Plan (SIP) call to 22 eastern states, including Pennsylvania, to revise their state implementation plans. PPL will achieve the 2003 nitrogen oxide reductions with the recent installation of SCR technology on the Montour units, and may install SCR or other additional nitrogen oxide reduction technology on one or more Brunner Island units at a later date.

The EPA has also developed new standards for ambient levels of ozone and fine particulates in the U.S. These standards have been upheld following court challenges. The new particulates standard may require further reductions in sulfur dioxide and year-round nitrogen oxide reductions commencing in 2010-2012 at SIP-call levels in Pennsylvania for certain PPL subsidiaries, and at slightly less stringent levels in Montana. The revised ozone standard is not expected to have a material effect on facilities of PPL subsidiaries.

Under the Clean Air Act, the EPA has been studying the health effects of hazardous air emissions from power plants and other sources in order to determine what emissions should be regulated, and has determined that mercury and nickel emissions must be regulated. The EPA may determine that other hazardous air emissions from power plants should be regulated. In this regard, the EPA is expected to develop mercury and nickel regulations by 2004.

In 1999, the EPA initiated enforcement actions against several utilities, asserting that older, coal-fired power plants operated by those utilities have, over the years, been modified in ways that subject them to more stringent "New Source" requirements under the Clean Air Act. The EPA has since issued notices of violation and commenced enforcement activities against other utilities. The future direction of the EPA's enforcement initiative is presently unclear. Therefore, at this time, PPL is unable to predict whether such EPA enforcement actions will be brought with respect to any of its

affiliates' plants. However, the EPA regional offices that regulate plants in Pennsylvania (Region III) and Montana (Region VIII) have indicated an intention to issue information requests to all utilities in their jurisdiction. The Region VIII office issued such a request to PPL Montana's Corette plant in 2000, and the Region III office issued such a request to PPL Generation's Martins Creek plant in 2002. PPL and its subsidiaries have responded to both of these information requests. The EPA has taken no further action following these submittals. PPL cannot presently predict what, if any, action the EPA might take in this regard. Should the EPA or any state initiate one or more enforcement actions against PPL or its subsidiaries, compliance with any such enforcement actions could result in additional capital and operating expenses in amounts which are not now determinable, but which could be significant.

The EPA has issued further changes to its "New Source" regulations that clarify what projects are exempt from "New Source" requirements as routine maintenance and repair. These clarifications substantially reduce the uncertainties under the prior "New Source" regulations. Under the new rules, any project to replace existing equipment with functionally equivalent equipment is considered routine maintenance and excluded from "New Source" review if the cost of the replaced equipment does not exceed 20% of the replacement cost of the entire process unit, the basic design is not changed and no permit limit is exceeded.

The New Jersey DEP and some New Jersey residents raised environmental concerns with respect to the Martins Creek plant, particularly with respect to sulfur dioxide emissions and the opacity of the plant's plume. These issues were raised in the context of an appeal by the New Jersey DEP of the Air Quality Plan Approval issued by the Pennsylvania DEP to the adjacent Lower Mt. Bethel facility, which is currently under construction. In October 2003, PPL finalized an agreement with the New Jersey DEP and the Pennsylvania DEP pursuant to which it will reduce sulfur dioxide emissions from its Martins Creek power plant. Under the agreement, PPL Martins Creek will shut down the plant's two coal-fired generating units by September 2007 and may repower them any time after shutting them down so long as it follows all applicable state and federal requirements, including installing the best available pollution control technology. PPL Martins Creek also will reduce the fuel sulfur content for those units as well as the plant's two oil-fired units beginning in 2004. In addition, PPL will donate to a non-profit organization 70% of the excess emission allowances and emission reduction credits that result from shutting down or repowering the coal units. As a result of the agreement, the New Jersey DEP will withdraw its challenge to the Air Quality Plan Approval for the Lower Mt. Bethel facility. The agreement will not result in material costs to PPL. The agreement does not address the opacity issues. If it is determined that opacity must be addressed, the cost is not now determinable, but could be significant.

## Water/Waste (PPL, PPL Energy Supply and PPL Montana)

A final NPDES permit has been issued to the Brunner Island generating plant. The permit contains a provision requiring further studies on the thermal impact of the cooling water discharge from the plant. These studies are underway and are expected to be completed in 2006. Depending on the outcome of these studies, the plant could be subject to capital and operating costs that are not now determinable, but which could be significant.

The Pennsylvania DEP has issued a water quality certification to PPL Holtwood, LLC in the FERC license renewal proceeding for its Lake Wallenpaupack hydroelectric facility. PPL has appealed the certification and is discussing the matter with the Pennsylvania DEP. Depending on the outcome of this appeal, the certification could impose additional costs on PPL, which are not now determinable, but which could be significant.

The EPA has significantly tightened the water quality standard for arsenic. The revised standard may require several PPL subsidiaries to either further treat wastewater or take abatement action at their power plants, or both. The cost of complying with the revised standard is not now determinable, but could be significant.

The EPA recently finalized requirements for new or modified water intake structures. These requirements will affect where generating facilities are built, will establish intake design standards, and could lead to requirements for cooling towers at new and modified power plants. If the source of water for the plants is surface water, these rules could impose significant capital and operating costs on PPL subsidiaries. Another new rule, expected to be finalized in 2004, will address existing structures. PPL has begun preliminary studies to evaluate options to comply with the expected rule. Each of these rules could impose additional costs on PPL subsidiaries, which are not now determinable, but which could be significant.

## Superfund and Other Remediation

### *(PPL and PPL Electric)*

In 1995, PPL Electric entered into a consent order with the Pennsylvania DEP to address a number of sites where it may be liable for remediation. This may include potential PCB contamination at certain PPL Electric substations and pole sites; potential contamination at a number of coal gas manufacturing facilities formerly owned or operated by PPL Electric; and oil or other contamination which may exist at some of PPL Electric's former generating facilities. Remedial actions at the site in Sunbury, Pennsylvania are now substantially completed. As of September 30, 2003, work has been completed on over 90% of the sites included in the consent order. Additional sites formerly owned or operated by PPL Electric are added to the consent order on a case-by-case basis.

In 1996, PPL Gas Utilities entered into a similar consent order with the Pennsylvania DEP to address a number of sites where subsidiaries of PPL Gas Utilities may be liable for remediation. The sites primarily include former coal gas manufacturing facilities. Subsidiaries of PPL Gas Utilities are also investigating the potential for any mercury contamination from gas meters and regulators. Accordingly, PPL Gas Utilities and the Pennsylvania DEP have agreed to add 72 meter/regulation sites to the consent order. As of September 30, 2003, PPL Gas Utilities had addressed 15% of the sites under its consent order.

At September 30, 2003, PPL Electric and PPL Gas Utilities had accrued approximately \$4 million and \$9 million, representing the estimated amounts they will have to spend for site remediation, including those sites covered by each company's consent orders mentioned above. Depending on the outcome of investigations at sites where investigations have not begun or have not been completed, the costs of remediation and other liabilities could be substantial. PPL also could face other non-remediation liabilities at sites included in the consent order or other contaminated sites, the costs of which are not now determinable, but which could be significant.

### *(PPL, PPL Energy Supply and PPL Montana)*

In conjunction with its 1999 sale of generating assets to PPL Montana, Montana Power prepared a Phase I and Phase II Environmental Site Assessment. The assessment identified various groundwater remediation issues. Based upon subsequent assessments and actions taken by PPL Montana, the costs to PPL Montana of the groundwater remediation measures identified in those assessments are expected to be approximately \$3 million. However, additional expenditures could be required in amounts which are not now determinable, but which could be significant.

In May 2003, approximately 40 plaintiffs brought an action in the Montana Second Judicial District Court, Butte-Silver Bow County, against PPL Montana and the other owners of the Colstrip plant alleging property damage from freshwater pond seepage and contamination from wastewater ponds at the plant. This action has been moved to the Montana Sixteenth Judicial District Court, Rosebud County. This action could result in PPL Montana and the other Colstrip owners being required to take additional remedial measures, the costs of which are not now determinable, but which could be significant.

In 1999, the Montana Supreme Court held in favor of several citizens' groups that the right to a clean and healthful environment is a fundamental right guaranteed by the Montana Constitution. The court's ruling could result in significantly more stringent environmental laws and regulations, as well as an increase in citizens' suits under Montana's environmental laws. The effect on PPL Montana of any such changes in law or regulations or any such increase in legal actions is not currently determinable, but it could be significant.

Future cleanup or remediation work at sites currently under review, or at sites not currently identified, may result in material additional operating costs for PPL subsidiaries that cannot be estimated at this time.

#### Asbestos (PPL and PPL Energy Supply)

There have been increasing litigation claims throughout the U.S. based on exposure to asbestos against companies that manufacture or distribute asbestos products or that have these products on their premises. Certain of PPL's generation subsidiaries and certain of its energy services subsidiaries, such as those that have supplied, may have supplied or installed asbestos material in connection with the repair or installation of process piping and heating, ventilating and air conditioning systems, have been named as defendants in asbestos-related lawsuits. PPL cannot predict the outcome of these lawsuits or whether additional claims may be asserted against its subsidiaries in the future. PPL does not expect that the ultimate resolution of the current lawsuits will have a material adverse effect on its financial condition.

#### Electric and Magnetic Fields (PPL, PPL Energy Supply and PPL Electric)

Concerns have been expressed by some members of the public regarding the potential health effects of EMFs. These fields are emitted by all devices carrying electricity, including electric transmission and distribution lines and substation equipment. Government officials in the U.S. and the U.K. have focused attention on this issue. PPL and its subsidiaries support the current efforts to determine whether EMFs cause any human health problems and are taking steps to reduce EMFs, where practical, in the design of new transmission and distribution facilities. PPL is unable to predict what effect, if any, the EMF issue might have on its operations and facilities either in the U.S. or abroad, and the associated cost, or what, if any, liabilities it might incur related to the EMF issue.

#### Lower Mt. Bethel (PPL and PPL Energy Supply)

The Air Quality Plan Approval issued by the Pennsylvania DEP for construction of the Lower Mt. Bethel facility was appealed by the New Jersey DEP to the Pennsylvania DEP Environmental Hearing Board. In October 2003, PPL Generation finalized an agreement with the New Jersey DEP and the Pennsylvania DEP pursuant to which PPL will, among other things, reduce the sulfur dioxide emissions from its Martins Creek power plant and the New Jersey DEP will withdraw its challenge to the Air Quality Plan Approval for the Lower Mt. Bethel facility. PPL's costs to comply with this agreement will not be material.

In addition, in August 2002, the Northampton County Court of Common Pleas issued a decision concerning the permissible noise levels from the Lower Mt. Bethel facility when it becomes operational. Specifically, the court's decision addressed the noise measurement criteria and the point at which the noise levels are to be measured. PPL appealed the

court's decision to the Commonwealth Court, and an intervenor in the lawsuit cross-appealed the court's decision. In May 2003, the Commonwealth Court remanded the case to the Court of Common Pleas for further findings of fact concerning the zoning application relating to the construction of the facility. The Court of Common Pleas ruled in PPL's favor in September 2003, and the intervenor has appealed this ruling to the Commonwealth Court. The Lower Mt. Bethel facility is expected to enter into its final construction phase, including initial startup, in the fourth quarter of 2003 and be operational in early 2004. However, PPL and PPL Energy Supply cannot predict the outcome of the ongoing litigation concerning the facility or its ultimate impact on the Lower Mt. Bethel facility, but such impact may be material.

#### **Environmental Matters - International** (PPL and PPL Energy Supply)

##### U.K.

WPD's distribution businesses are subject to numerous regulatory and statutory requirements with respect to environmental matters. PPL believes that WPD has taken and continues to take measures to comply with the applicable laws and governmental regulations for the protection of the environment. There are no material legal or administrative proceedings pending against WPD with respect to environmental matters. See "Environmental Matters - Domestic - Electric and Magnetic Fields" for a discussion of EMFs.

##### Latin America

Certain of PPL's affiliates have electric distribution operations in Latin America. PPL believes that these affiliates have taken and continue to take measures to comply with the applicable laws and governmental regulations for the protection of the environment. There are no material legal or administrative proceedings pending against PPL's affiliates in Latin America with respect to environmental matters.

##### **Other**

#### Commitments - Acquisitions, Development and Lease Activities (PPL and PPL Energy Supply)

At September 30, 2003, a lessor had \$22 million of purchase commitments for domestic construction projects for which a PPL subsidiary is the construction agent. PPL's exposure is limited to the guarantees under the operating lease. See Note 15 for additional information on guarantees under operating lease arrangements.

#### Nuclear Insurance (PPL and PPL Energy Supply)

PPL Susquehanna is a member of certain insurance programs which provide coverage for property damage to members' nuclear generating stations. Facilities at the Susquehanna station are insured against property damage losses up to \$2.75

billion under these programs. PPL Susquehanna is also a member of an insurance program which provides insurance coverage for the cost of replacement power during prolonged outages of nuclear units caused by certain specified conditions. Under the property and replacement power insurance programs, PPL Susquehanna could be assessed retroactive premiums in the event of the insurers' adverse loss experience. At September 30, 2003, this maximum assessment was about \$40 million.

PPL Susquehanna's public liability for claims resulting from a nuclear incident at the Susquehanna station is limited to about \$10.9 billion under provisions of The Price Anderson Amendments Act of 1988. PPL Susquehanna is protected against this liability by a combination of commercial insurance and an industry assessment program. In the event of a nuclear incident at any of the reactors covered by The Price Anderson Amendments Act of 1988, PPL Susquehanna could be assessed up to \$201 million per incident, payable at \$20 million per year.

### Guarantees and Other Assurances

*(PPL, PPL Energy Supply and PPL Electric)*

In the normal course of business, PPL, PPL Energy Supply and PPL Electric enter into agreements that provide financial performance assurance to third parties on behalf of certain subsidiaries. Such agreements include, for example, guarantees, stand-by letters of credit issued by financial institutions and surety bonds issued by insurance companies. These agreements are entered into primarily to support or enhance the creditworthiness attributed to a subsidiary on a stand-alone basis, thereby facilitating the extension of credit to accomplish the subsidiaries' intended commercial purposes.

*(PPL)*

PPL fully and unconditionally guarantees the medium-term notes of PPL Capital Funding, a wholly owned financing subsidiary of PPL. PPL also fully and unconditionally guarantees all of the obligations of PPL Capital Funding Trust I, a wholly owned financing subsidiary of PPL, under the trust preferred securities that are a component of the PEPS Units.

*(PPL, PPL Energy Supply, PPL Electric and PPL Montana)*

PPL, PPL Energy Supply, PPL Electric and PPL Montana provide certain guarantees that are required to be disclosed in accordance with FIN 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, an Interpretation of FASB Statements No. 5, 57, and 107 and Rescission of FASB Interpretation No. 34." See Note 15 for a discussion of FIN 45. The guarantees provided as of September 30, 2003 are discussed below. In accordance with the provisions of FIN 45, the fair values of guarantees related to arrangements entered into prior to January 1, 2003, as well as guarantees excluded

from the initial recognition and measurement provisions of FIN 45, are not recorded in the financial statements.

*(PPL Energy Supply)*

PPL Energy Supply has entered into several standby letter of credit arrangements under its \$500 million three-year credit facility for the purposes of protecting various third parties against nonperformance by PPL and PPL Gas Utilities. As of September 30, 2003, the aggregate maximum exposure related to these standby letters of credit was \$13 million. These letters of credit expire in 2004.

*(PPL and PPL Energy Supply)*

PPL Generation has entered into certain partnership arrangements for the sale of coal to third parties. PPL Generation has also executed support agreements, which expire in 2007, for the benefit of these third-party purchasers pursuant to which it guarantees the partnerships' obligations in an amount up to its pro rata ownership interest in the partnerships. PPL Generation's maximum aggregate exposure under these support arrangements was approximately \$9 million as of September 30, 2003.

Certain PPL Generation subsidiaries provide residual value guarantees under the operating leases for the Sundance, University Park and Lower Mt. Bethel generation facilities. See Note 15 for further discussion of these residual value guarantees.

PPL Susquehanna is contingently obligated to pay \$40 million related to potential retroactive premiums that could be assessed under its nuclear insurance programs. Additionally, under the Price Anderson Amendments Act of 1988, PPL Susquehanna could be assessed up to \$201 million for each incident at any of the nuclear reactors covered by this Act. See "Nuclear Insurance" for additional information.

PPL EnergyPlus is party to numerous energy trading or purchase and sale agreements pursuant to which the parties indemnify each other for any damages arising from events that occur while the indemnifying party has title to the electricity or natural gas. For example, in the case of the party that is delivering the product, such party would be responsible for damages arising from events occurring prior to delivery. The overall maximum amount of the obligation under such indemnifications cannot be reasonably estimated. Historically, PPL EnergyPlus has not made any significant payments with respect to this type of indemnification. As of September 30, 2003, the aggregate fair value of these indemnifications related to arrangements entered into subsequent to December 31, 2002 was insignificant.

PPL EnergyPlus enters into written put option contracts under which, in exchange for a premium received, it agrees to purchase a specified quantity of a commodity for a specified price if the counterparty exercises the option. The aggregate carrying value of such contracts that were outstanding as of

September 30, 2003 was a net liability of \$3 million, which is included in price risk management assets and liabilities on the Balance Sheet. These option contracts expire from October 2003 through August 2004. The aggregate maximum amount of payments that PPL EnergyPlus could be required to make if the options are exercised by the counterparties under these contracts is \$17 million.

In connection with their sales of various businesses, WPD and its affiliates have provided the purchasers with indemnifications that are standard for such transactions, including indemnifications for certain pre-existing liabilities and environmental and tax matters. In addition, in connection with certain of these sales, WPD and its affiliates have agreed to continue their obligations under existing third-party guarantees, either for a set period of time following the transactions or upon the condition that the purchasers make reasonable efforts to terminate the guarantees. They also have guaranteed the payment of up to £19 million, or \$32 million at current exchange rates, under a contract, which expires in 2005, assigned as part of one of these sales. Finally, WPD and its affiliates remain secondarily responsible for lease payments under certain leases that they have assigned to third parties. These various guarantees vary in duration and in the maximum potential payment, which, except as otherwise noted above, cannot be estimated but which in the aggregate could be material. To date, neither WPD nor any of its affiliates have made any significant payments with respect to these guarantees.

Certain acquisition agreements relating to the acquisition of mechanical contractors contain provisions that require a PPL Energy Supply subsidiary to make contingent payments to the former owners based upon the profitability of the business unit. The maximum amount of potential payments is not explicitly stated in the acquisition agreements. Such arrangements expire in 2005. Based on current expectations, PPL Energy Supply estimates that an aggregate of approximately \$7 million could be paid under these arrangements.

Certain agreements relating to the purchase of ownership interests in synfuel projects contain provisions that require certain PPL Energy Supply subsidiaries to make contingent purchase price payments to the former owners. These payments are non-recourse to PPL, PPL Energy Supply and their other subsidiaries and are based primarily upon production levels of the synfuel projects. The maximum amounts of potential payments are not explicitly stated in the agreements. Such arrangements expire in 2007. Based on current expectations, PPL Energy Supply estimates that the subsidiaries could pay up to an aggregate of approximately \$66 million under these arrangements.

*(PPL and PPL Electric)*

PPL Electric provides a guarantee in the amount of approximately \$7 million, as of September 30, 2003, related to

debt of an unconsolidated entity. The guarantee expires in June 2008.

PPL Electric leases vehicles and other equipment under four master operating lease agreements. The term for each piece of equipment leased under three of the master agreements is one year, after which time the lease term is extended from month to month until terminated. Under the fourth master agreement, the term for each piece of equipment ranges from one year to three years, after which time the lease term may be extended for certain equipment for up to two additional years. Under these lease arrangements, PPL Electric provides residual value guarantees to the lessors. PPL Electric generally could be required to pay a residual value guarantee if the proceeds received from the sale of a piece of equipment, upon termination of the lease, are less than the expected residual value of the equipment. As of September 30, 2003, the maximum aggregate amount of future payments that PPL Electric could be required to make as a result of these residual value guarantees was approximately \$90 million. The aggregate carrying value of PPL Electric's residual value guarantees issued subsequent to December 31, 2002 was \$15 million at September 30, 2003 and is included in "Current Liabilities - Other" on the Balance Sheet. These guarantees generally expire within one year, unless the lease terms are extended.

*(PPL, PPL Energy Supply and PPL Montana)*

PPL Montana leases certain equipment under a master operating lease agreement. The term for each piece of equipment leased under the master agreement is one year, after which time the lease term is extended from month to month until terminated. Under this lease arrangement, PPL Montana provides residual value guarantees to the lessor. PPL Montana generally would be required to pay a residual value guarantee if the proceeds received from the sale of a piece of equipment, upon termination of the lease, are less than the expected residual value of the equipment. As of September 30, 2003, the maximum aggregate amount of future payments that PPL Montana could be required to make as a result of these residual value guarantees was approximately \$4 million. The aggregate carrying value of PPL Montana's residual value guarantees issued subsequent to December 31, 2002 was insignificant at September 30, 2003. These guarantees generally expire within one year, unless the lease terms are extended.

*(PPL, PPL Energy Supply, PPL Electric and PPL Montana)*

The operating lease arrangements described above and the companies' or their subsidiaries' other lease arrangements include certain indemnifications in favor of the lessors (e.g., tax and environmental matters) with terms that range in duration and scope and that are not explicitly defined. Because the obligated amounts of these types of indemnifications often are not explicitly stated, the overall maximum amount of the obligation under such indemnifications cannot be reasonably estimated. Historically,

no significant payments have been made with respect to these indemnifications. As of September 30, 2003, the aggregate fair value of these indemnifications related to arrangements entered into subsequent to December 31, 2002 was insignificant.

In connection with their issuances of securities, PPL, PPL Energy Supply, PPL Electric and PPL Montana and their subsidiaries engage underwriters, purchasers and purchasing agents to whom they provide indemnification for damages incurred by such parties arising from the companies' material misstatements or omissions in the related offering documents. In addition, in connection with these securities offerings and other financing transactions, the companies also engage trustees or custodial, escrow or other agents to act for the benefit of the investors or to provide other agency services. PPL, PPL Energy Supply, PPL Electric, PPL Montana and their subsidiaries typically provide indemnification to these agents for any liability or expenses incurred by them in performing their obligations. Because the obligated amounts of these types of indemnifications often are not explicitly stated, the overall maximum amount of the obligation under such indemnifications cannot be reasonably estimated. Historically, no significant payments have been made with respect to these indemnifications. As of September 30, 2003, the fair value of these indemnifications related to arrangements entered into subsequent to December 31, 2002 was insignificant.

PPL, PPL Energy Supply, PPL Electric, PPL Montana and their subsidiaries also have various guarantees in contracts that they enter into in the normal course of business. These guarantees are primarily in the form of various indemnifications as well as warranties, related to services or equipment, that range in duration and coverage and that do not explicitly state the amount of the indemnification obligation. Historically, no significant payments have been made for these guarantees. As of September 30, 2003, the aggregate fair value of these guarantees related to arrangements entered into subsequent to December 31, 2002 was insignificant.

PPL, on behalf of itself and its subsidiaries, maintains insurance that covers liability assumed under contract for bodily injury and property damage. The coverage requires a \$4 million deductible per occurrence and provides maximum aggregate coverage of approximately \$175 million. This insurance may be applicable to certain obligations under the contractual arrangements discussed above.

## 9. Related Party Transactions

### **PLR Contract** (*PPL Energy Supply and PPL Electric*)

PPL Electric has power sales agreements with PPL EnergyPlus, effective January 1, 2002, to supply all of PPL Electric's PLR load through 2009. Under these contracts, PPL EnergyPlus will provide electricity at the pre-determined capped prices that PPL Electric is authorized to charge its PLR customers. For the three months ended September 30, 2003

and 2002, these purchases were \$368 million and \$371 million. For the nine months ended September 30, 2003 and 2002, these purchases were \$1.1 billion in each period. These purchases include nuclear decommissioning recovery and amortization of an up-front contract payment and are included in the Statement of Income as "Energy purchases from affiliate" by PPL Electric and as revenues from "Wholesale energy marketing to affiliates" by PPL Energy Supply.

Under the PLR contracts, PPL Electric is required to make performance assurance deposits with PPL EnergyPlus when the market price of electricity is less than the contract price by more than its contract collateral threshold. Conversely, PPL EnergyPlus is required to make performance assurance deposits with PPL Electric when the market price of electricity is greater than the contract price by more than its contract collateral threshold. PPL Electric's deposit with PPL EnergyPlus was \$45 million at September 30, 2003. This deposit is shown on the Balance Sheet as "Collateral on PLR energy supply to/from affiliate," a current asset of PPL Electric and a current liability of PPL Energy Supply. PPL Energy Supply pays interest equal to the three-month LIBOR plus 3% on this deposit.

In 2001, PPL Electric made a \$90 million payment to PPL EnergyPlus in connection with the PLR contracts. The upfront payment is being amortized by both parties over the term of the PLR contracts. The unamortized balance of this payment, and other payments under the contract, were \$72 million at September 30, 2003 and \$81 million at December 31, 2002.

### **NUG Purchases** (*PPL Energy Supply and PPL Electric*)

PPL Electric has a reciprocal contract with PPL EnergyPlus to sell electricity purchased under contracts with NUGs. PPL Electric purchases electricity from the NUGs at contractual rates and then sells the electricity at the same price to PPL EnergyPlus. For the three months ended September 30, 2003 and 2002, these NUG purchases totaled \$39 million and \$40 million and for the nine months ended September 30, 2003 and 2002 were \$115 million and \$122 million. These amounts are included in the Statement of Income as revenues from "Wholesale electric to affiliate" by PPL Electric, and as "Energy purchases from affiliates" by PPL Energy Supply.

### **Montana Retail Supply** (*PPL Montana*)

PPL Montana has a memorandum of understanding (MOU) with PPL EnergyPlus regarding the supply of energy to satisfy PPL EnergyPlus' obligations under its retail contracts. This MOU will remain in effect until terminated by mutual consent of the parties, or upon 90 days written notice of termination given by either party to the other party. Under the MOU, energy sales to PPL EnergyPlus for the three months ended September 30, 2003 and 2002 were \$16 million and \$21 million and for the nine months ended September 30, 2003 and 2002 were \$47 million and \$51 million. These amounts are included in revenues from "Wholesale energy marketing to affiliate" on the Statement of Income.

**Brokering and Contract Management Agreement**  
(PPL Montana)

Under a brokering and contract management agreement between PPL Montana and PPL EnergyPlus, PPL Montana paid PPL EnergyPlus \$1 million and \$2 million for the three months ended September 30, 2003 and 2002. For the nine months ended September 30, 2003 and 2002, the payments were \$3 million and \$5 million. These amounts are included in "Other operation and maintenance" on the Statement of Income.

**Allocations of Corporate Service Costs** (PPL Energy Supply, PPL Electric and PPL Montana)

PPL Services provides corporate functions such as financial, legal, human resources and information services. PPL Services bills the respective PPL subsidiaries for the cost of such services when they can be specifically identified. The cost of these services that is not directly charged to PPL subsidiaries is allocated to certain of the subsidiaries using a three-factor method based on an average of the subsidiaries' relative invested capital, operation and maintenance expenses, and number of employees. PPL Services allocated the following charges to PPL Energy Supply, PPL Electric and PPL Montana:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
<b>Direct expenses</b>				
PPL Energy Supply	\$ 24	\$ 22	\$ 68	\$ 65
PPL Electric	15	13	45	41
PPL Montana	2	4	4	8
<b>Overhead costs</b>				
PPL Energy Supply	12	8	40	26
PPL Electric	6	7	19	21
PPL Montana	1	2	3	6

**Intercompany Borrowings**

(PPL Energy Supply)

PPL Energy Supply, primarily through its financing subsidiary PPL Investment Corporation, had notes receivable from affiliates of PPL totaling \$58 million and \$655 million at September 30, 2003 and December 31, 2002. Interest earned on loans to affiliates, included in "Other Income - net" on the Statement of Income, was \$2 million and \$4 million for the three months ended September 30, 2003 and 2002 and was \$14 million and \$16 million for the nine months ended September 30, 2003 and 2002.

(PPL Electric)

In 2001, PPL Electric made a \$150 million demand loan from excess cash to PPL Energy Funding. Interest on the loan is due monthly at an annual interest rate of 4.0%. There was no outstanding balance at September 30, 2003. The outstanding

balance at December 31, 2002 was \$90 million. Intercompany interest income was \$1 million for the three months ended September 30, 2003 and 2002, and was \$3 million and \$7 million for the nine months ended September 30, 2003 and 2002.

(PPL Montana)

In 2002, PPL Montana entered into a \$100 million three-year credit facility with PPL Investment Corporation on market terms to meet its liquidity needs. PPL Montana had outstanding borrowings under this facility of \$26 million at December 31, 2002, which is shown as "Revolving line of credit with affiliate" on the Balance Sheet. There was no outstanding balance at September 30, 2003.

**Trademark Royalties** (PPL Energy Supply)

In the fourth quarter of 2002, a PPL subsidiary that owns PPL trademarks began billing certain affiliates who use these trademarks. PPL Energy Supply was allocated \$10 million and \$30 million of this license fee for the three and nine months ended September 30, 2003, which is primarily included in "Other operation and maintenance" on the Statement of Income.

**10. Other Income - Net**

The breakdown of "Other Income - net" was as follows:

PPL	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
<b>Other Income</b>				
Interest income	\$ 3	\$ 14	\$ 9	\$ 27
Realized earnings on nuclear decommissioning trust (a)	10		18	
Hyder-related activity	2		6	
Gain on property sales		4	3	5
Rental income	2		5	
Legal claim settlements			3	
Equity earnings (loss)	(1)	(4)	(1)	1
Miscellaneous	1		15	4
<b>Total</b>	<b>17</b>	<b>14</b>	<b>58</b>	<b>37</b>
<b>Other Deductions</b>				
Non-operating taxes other than income		2	1	3
Miscellaneous	2	1	11	12
<b>Other Income - net</b>	<b>\$ 15</b>	<b>\$ 11</b>	<b>\$ 46</b>	<b>\$ 22</b>

(a) Effective with the adoption of SFAS 143 on January 1, 2003 (as described in Note 13), realized earnings on the nuclear decommissioning trust are recorded in "Other Income - net." Prior to January 1, 2003, such realized earnings were recorded as an increase to the nuclear decommissioning liability.

<b>PPL Energy Supply</b>	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2003</b>	<b>2002</b>	<b>2003</b>	<b>2002</b>
<b>Other Income</b>				
Affiliated interest income	\$ 2	\$ 4	\$ 14	\$ 16
Realized earnings on nuclear decommissioning trust (a)	10		18	
Hyder-related activity	2		6	
Interest income	2	9	6	18
Gain on property sales		4	3	5
Rental income	2		5	
Legal claim settlements			3	
Equity earnings			2	2
Miscellaneous	1	(4)	10	1
<b>Total</b>	<b>19</b>	<b>13</b>	<b>67</b>	<b>42</b>
<b>Other Deductions</b>				
Non-operating taxes other than income	1		1	1
Miscellaneous	1	2	7	9
<b>Other Income - net</b>	<b>\$ 17</b>	<b>\$ 11</b>	<b>\$ 59</b>	<b>\$ 32</b>

(a) Effective with the adoption of SFAS 143 on January 1, 2003 (as described in Note 13), realized earnings on the nuclear decommissioning trust are recorded in "Other Income - net." Prior to January 1, 2003, such realized earnings were recorded as an increase to the nuclear decommissioning liability.

<b>PPL Electric</b>	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2003</b>	<b>2002</b>	<b>2003</b>	<b>2002</b>
<b>Other Income</b>				
Affiliated interest income	\$ 1	\$ 1	\$ 3	\$ 7
Interest income		5	3	7
Miscellaneous				1
<b>Total</b>	<b>1</b>	<b>6</b>	<b>6</b>	<b>15</b>
<b>Other Deductions</b>				
Miscellaneous			1	2
<b>Other Income - net</b>	<b>\$ 1</b>	<b>\$ 6</b>	<b>\$ 5</b>	<b>\$ 13</b>

## 11. Derivative Instruments and Hedging Activities

(PPL, PPL Energy Supply and PPL Montana)

### Fair Value Hedges

PPL Energy Supply and PPL Montana enter into financial or physical contracts to hedge a portion of the fair value of firm commitments of forward electricity sales. These contracts range in maturity through 2006. Additionally, PPL and PPL Energy Supply enter into financial contracts to hedge fluctuations in market value of existing debt issuances. These contracts range in maturity through 2029.

As a result of settling certain transactions with a counterparty that exited its energy marketing function, PPL and PPL Energy Supply recognized a \$1 million net gain for the nine months ended September 30, 2003. PPL Montana recognized a \$1 million net loss for the nine months ended September 30, 2003. No gains or losses were recognized for these

transactions for the three months ended September 30, 2003. These gains and losses resulted from firm commitments that no longer qualified as fair value hedges and were reported in "Energy purchases" on the Statement of Income. PPL, PPL Energy Supply and PPL Montana did not recognize any net gains or losses for similar activity for the three and nine months ended September 30, 2002.

PPL, PPL Energy Supply and PPL Montana did not recognize any gains or losses resulting from the ineffective portion of fair value hedges for the three and nine months ended September 30, 2003 or 2002.

### Cash Flow Hedges

PPL Energy Supply and PPL Montana enter into financial and physical contracts, including forwards, futures and swaps, to hedge the price risk associated with electric, gas and oil commodities. These contracts range in maturity through 2007. Additionally, PPL and PPL Energy Supply enter into financial interest rate forward and swap contracts to hedge interest expense associated with both existing and anticipated debt issuances. These contracts range in maturity through 2014. PPL and PPL Energy Supply also enter into foreign currency forward and swap contracts to hedge exchange rates associated with firm commitments and anticipated debt financings denominated in foreign currencies, and to hedge the net investment of foreign operations. These forward contracts range in maturity through 2028.

Cash flow hedges may be discontinued if it becomes probable that the original forecasted transaction will not occur by the end of the originally specified time period. PPL and PPL Energy Supply discontinued certain cash flow hedges which resulted in a net loss of \$11 million being reclassified from other comprehensive income into earnings for the nine months ended September 30, 2003 (reported in "Interest Expense" on the Statement of Income). There was no such reclassification for the three months ended September 30, 2003. Reclassifications for the three and nine months ended September 30, 2002 were insignificant.

Due to hedge ineffectiveness, PPL and PPL Energy Supply reclassified a net loss of \$1 million into earnings for the three and nine months ended September 30, 2003, and a net loss of \$2 million for the three and nine months ended September 30, 2002.

As of September 30, 2003, the deferred net gain, after tax, on derivative instruments in accumulated other comprehensive income expected to be reclassified into earnings during the next twelve months was \$2 million, \$5 million and \$4 million for PPL, PPL Energy Supply and PPL Montana.

The following table shows the change in accumulated unrealized gains or losses on qualifying derivatives in other comprehensive income (see also Note 5):

	Three Months Ended		Nine Months Ended	
	September 30, 2003	2002	September 30, 2003	2002
<b>PPL</b>				
Beginning accumulated derivative gain	\$ 21	\$ 12	\$ 7	\$ 23
Net change associated with current period hedging activities and other	(51)	6	17	(2)
Net change associated with net investment hedge	(2)	(1)	(5)	(1)
Net change from reclassification into earnings	28		(23)	(3)
Ending accumulated derivative gain (loss)	<u>\$ (4)</u>	<u>\$ 17</u>	<u>\$ (4)</u>	<u>\$ 17</u>

#### **PPL Energy Supply**

Beginning accumulated derivative gain	\$ 47	\$ 33	\$ 23	\$ 47
Net change associated with current period hedging activities and other	(54)	11	21	1
Net change associated with net investment hedge	(2)	(1)	(5)	(1)
Net change from reclassification into earnings	27		(21)	(4)
Ending accumulated derivative gain	<u>\$ 18</u>	<u>\$ 43</u>	<u>\$ 18</u>	<u>\$ 43</u>

#### **PPL Montana**

Beginning accumulated derivative gain (loss)	\$ (3)	\$ 20	\$ 4	\$ 33
Net change associated with current period hedging activities and other	7	(1)	1	(14)
Net change from reclassification into earnings	1	(4)		(4)
Ending accumulated derivative gain	<u>\$ 5</u>	<u>\$ 15</u>	<u>\$ 5</u>	<u>\$ 15</u>

The changes associated with current period activity and reclassifications into earnings were significantly higher in 2003 than 2002 due to foreign currency hedges at WPD that were not reported on a consolidated basis during the first half of 2002. The transaction gains and losses arising from the remeasurement of its foreign-currency denominated debt are offset by a related amount reclassified each period from other comprehensive income to earnings.

See Note 15 regarding the adoption of SFAS 149.

#### **Energy Trading Activities**

PPL adopted the final provisions of EITF 02-3, "Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities," during the fourth quarter of 2002. As such, PPL now reflects its net realized and unrealized gains and losses associated with all derivatives that are held for trading purposes in the "Net energy trading margins" line on the Statement of Income. Non-derivative

contracts that meet the definition of energy trading activities as defined by EITF 98-10, "Accounting for Energy Trading and Risk Management Activities," are reflected in the financial statements using the accrual method of accounting. Under the accrual method of accounting, unrealized gains and losses are not reflected in the financial statements. Prior periods have been reclassified. PPL did not need to record a cumulative effect of this change in accounting principle because all non-derivative energy-related trading contracts had been shown in the financial statements at their amortized cost. This amortized cost reflected modeling reserves that incorporated the lack of independence in valuing contracts for which there were no external market prices.

The financial statement impact of netting energy trading activities is as follows:

	Three Months Ended		Nine Months Ended	
	September 30, 2003	2002	September 30, 2003	2002
<b>PPL and PPL Energy Supply</b>				
Prior classification				
Wholesale energy marketing	\$ 203	\$ 188	\$ 716	\$ 394
Energy purchases	201	191	707	381
Net energy trading margins	<u>\$ 2</u>	<u>\$ (3)</u>	<u>\$ 9</u>	<u>\$ 13</u>

#### **PPL Montana**

Prior classification				
Wholesale energy marketing	\$ 7		\$ 20	
Energy purchases	7		20	1
Net energy trading margins	<u>\$</u>	<u></u>	<u>\$</u>	<u>\$ (1)</u>

#### **Credit Concentration**

PPL, PPL Energy Supply and PPL Montana enter into contracts with many entities for the purchase and sale of energy. Most of these contracts are considered a normal part of doing business and, as such, the mark-to-market value of these contracts is not reflected in the financial statements. However, the mark-to-market value of these contracts is considered when committing to new business from a credit perspective.

PPL, PPL Energy Supply and PPL Montana have credit exposures to energy trading partners. The majority of these exposures were the mark-to-market value of multi-year contracts for energy sales. Therefore, if these counterparties fail to perform their obligations under such contracts, the companies would not experience an immediate financial loss, but would experience lower revenues in future years to the extent that replacement sales could not be made at the same prices as sales under the defaulted contracts.

At September 30, 2003, PPL had a credit exposure of \$188 million to energy trading partners. Ten counterparties accounted for 62% of this exposure. No other individual counterparty accounted for more than 3% of the exposure. With two exceptions, each of the ten primary counterparties

had an investment grade credit rating from Standard & Poor's. PPL entered into a multi-year contract with one non-investment grade counterparty through a bidding process sponsored by a state regulatory commission. The other non-investment grade counterparty, NorthWestern, has filed for Chapter 11 bankruptcy protection. NorthWestern has assumed the power supply agreements in its bankruptcy proceeding. NorthWestern has remained current on all post-bankruptcy obligations with PPL Montana. Payment on all pre-bankruptcy obligations was received in October 2003. See Note 8 under "Wholesale Energy Commitments," for additional information regarding the NorthWestern bankruptcy proceeding.

At September 30, 2003, PPL Energy Supply had a credit exposure of \$482 million to energy trading partners. Eleven counterparties accounted for 85% of this exposure. No other individual counterparty accounted for more than 1% of the exposure. The largest exposure, \$294 million, was to PPL Electric, under the long-term contract to provide PPL Electric's PLR load. With two exceptions, the other ten counterparties have an investment grade credit rating from Standard & Poor's. PPL Energy Supply entered into a multi-year contract with one non-investment grade counterparty through a bidding process sponsored by a state regulatory commission. The other non-investment grade counterparty, NorthWestern, has filed for Chapter 11 bankruptcy protection, as discussed above.

At September 30, 2003, PPL Montana had a credit exposure of \$50 million to energy trading partners. Four counterparties accounted for 83% of this exposure. No other individual counterparty accounted for more than 4% of the exposure. Three of the four counterparties have an investment grade credit rating from Standard & Poor's. The non-investment grade counterparty, NorthWestern, has filed for Chapter 11 bankruptcy protection, as discussed above.

PPL, PPL Energy Supply and PPL Montana have the right to request collateral from each of these counterparties, except for one government agency, in the event their credit ratings fall below investment grade or, in one case, below current levels. PPL Montana and NorthWestern have mutually agreed not to request collateral from each other while NorthWestern's Chapter 11 bankruptcy proceeding is pending. It is also the policy of PPL, PPL Energy Supply and PPL Montana to enter into netting agreements with all of their counterparties to minimize credit exposure.

## 12. Goodwill

*(PPL and PPL Energy Supply)*

The changes in the carrying amounts of goodwill by segment were as follows:

	PPL Energy Supply			Delivery(a)	PPL
	Supply	International	Total		Total
Balance at December 31, 2002	\$ 85	\$ 334	\$ 419	\$ 55	\$ 474
Effect of foreign currency exchange rates		4	4		
Purchase accounting adjustments	1	(27) (b)	(26)		(26)
Balance at September 30, 2003	<u>\$ 86</u>	<u>\$ 311</u>	<u>\$ 397</u>	<u>\$ 55</u>	<u>\$ 452</u>

(a) The Delivery segment is not part of PPL Energy Supply.  
(b) See Note 7 for additional information.

The reporting units of the Supply, Delivery and International segments completed the transition impairment test in the first quarter of 2002 in accordance with SFAS 142, "Goodwill and Other Intangible Assets." A transition goodwill impairment loss of \$150 million was recognized in the Latin American reporting unit within the International segment, and is reported as a "Cumulative Effect of a Change in Accounting Principle" on the Statement of Income. The fair value of the reporting unit was estimated using the expected present value of future cash flows.

## 13. Asset Retirement Obligations

*(PPL, PPL Energy Supply, PPL Electric and PPL Montana)*

In 2001, the FASB issued SFAS 143, "Accounting for Asset Retirement Obligations," which addresses the accounting for obligations associated with the retirement of tangible long-lived assets. SFAS 143 requires legal obligations associated with the retirement of long-lived assets to be recognized as a liability in the financial statements. The initial obligation should be measured at the estimated fair value. An equivalent amount should be recorded as an increase in the value of the capitalized asset and allocated to expense over the useful life of the asset. Until the obligation is settled, the liability should be increased, through the recognition of accretion expense in the income statement, for changes in the obligation due to the passage of time. SFAS 143 is effective for fiscal years beginning after June 15, 2002.

*(PPL and PPL Energy Supply)*

PPL and PPL Energy Supply adopted SFAS 143 effective January 1, 2003. Initial adoption of the new rules resulted in an increase in net property, plant and equipment of \$32 million, reversal of previously recorded liabilities of \$304 million, recognition of asset retirement obligations of \$229 million, recognition of a deferred tax liability of \$44 million and a cumulative effect of adoption that increased net income by \$63 million. For the three and nine months ended September 30, 2003, PPL and PPL Energy Supply recognized \$5 million and \$14 million of accretion expense and an

insignificant amount of depreciation expense as a result of applying SFAS 143.

PPL and PPL Energy Supply identified various legal obligations to retire long-lived assets, the largest of which relates to the decommissioning of the Susquehanna station. PPL and PPL Energy Supply identified and recorded other asset retirement obligations related to significant interim retirements at the Susquehanna station and various environmental requirements for coal piles, ash basins and other waste basin retirements.

PPL and PPL Energy Supply also identified legal retirement obligations that were not measurable at the time of adoption. These items included the retirement of certain transmission assets and a reservoir. These retirement obligations were not measurable due to indeterminable dates of retirement.

Amounts collected from PPL Electric's customers for decommissioning, less applicable taxes, are deposited in external trust funds for investment and can only be used for future decommissioning costs. The fair value of the nuclear decommissioning trust was \$330 million and \$287 million as of September 30, 2003 and December 31, 2002.

Asset retirement obligations are included in "Deferred Credits and Other Noncurrent Liabilities - Other" on the Balance Sheet. The changes in the carrying amounts of asset retirement obligations were as follows:

Asset retirement obligation at January 1, 2003	\$ 229
Add: Accretion expense	14
Less: Settlement	<u>(4)</u>
Asset retirement obligation at September 30, 2003	<u>\$ 239</u>

The pro forma asset retirement obligation liability balances, calculated as if SFAS 143 had been adopted on January 1, 2002 (rather than January 1, 2003), were \$239 million, \$229 million and \$211 million as of September 30, 2003, December 31, 2002 and January 1, 2002.

The pro forma income statement effects of the application of SFAS 143, calculated as if it had been adopted on January 1, 2002 (rather than January 1, 2003), are presented below:

(PPL)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
Reported net income - before cumulative effect of a change in accounting principle (a)	\$ 171	\$ 122	\$ 463	\$ 242
Pro forma net income - before cumulative effect of a change in accounting principle	\$ 171	\$ 114	\$ 463	\$ 227
Reported net income	\$ 171	\$ 122	\$ 526	\$ 92
Pro forma net income	\$ 171	\$ 114	\$ 463	\$ 77
<b>Basic EPS:</b>				
Reported net income - before cumulative effect of a change in accounting principle	\$ 0.97	\$ 0.81	\$ 2.71	\$ 1.63
Pro forma net income - before cumulative effect of a change in accounting principle	\$ 0.97	\$ 0.76	\$ 2.71	\$ 1.53
Reported net income	\$ 0.97	\$ 0.81	\$ 3.07	\$ 0.62
Pro forma net income	\$ 0.97	\$ 0.76	\$ 2.71	\$ 0.52
<b>Diluted EPS:</b>				
Reported net income - before cumulative effect of a change in accounting principle	\$ 0.97	\$ 0.80	\$ 2.70	\$ 1.63
Pro forma net income - before cumulative effect of a change in accounting principle	\$ 0.97	\$ 0.75	\$ 2.70	\$ 1.52
Reported net income	\$ 0.97	\$ 0.80	\$ 3.06	\$ 0.62
Pro forma net income	\$ 0.97	\$ 0.75	\$ 2.70	\$ 0.52

(a) Represents income before cumulative effect of a change in accounting principle less dividends and distributions on preferred securities.

(PPL Energy Supply)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
Reported net income - before cumulative effect of a change in accounting principle (a)	\$ 190	\$ 141	\$ 475	\$ 295
Pro forma net income - before cumulative effect of a change in accounting principle	\$ 190	\$ 133	\$ 475	\$ 280
Reported net income	\$ 190	\$ 141	\$ 538	\$ 145
Pro forma net income	\$ 190	\$ 133	\$ 475	\$ 130

(a) Represents income before cumulative effect of a change in accounting principle less dividends and distributions on preferred securities.

(PPL Electric)

PPL Electric adopted SFAS 143 effective January 1, 2003 and did not record any asset retirement obligations upon adoption. PPL Electric identified legal retirement obligations for the retirement of certain transmission assets that were not

measurable at this time due to indeterminable dates of retirement.

*(PPL Montana)*

PPL Montana adopted SFAS 143 effective January 1, 2003. PPL Montana recorded asset retirement obligations associated with various environmental requirements for coal piles, ash basins and other waste basin retirements. The impact of these asset retirement obligations was insignificant.

**Reconciliation of Prior Annual Periods (PPL and PPL Energy Supply)**

The pro forma asset retirement obligation liability balances, calculated as if SFAS 143 had been adopted on January 1, 2000 (rather than January 1, 2003), were \$211 million, \$196 million and \$181 million as of December 31, 2001, December 31, 2000 and January 1, 2000.

The pro forma income statement effects of the application of SFAS 143, calculated as if it had been adopted on January 1, 2000 (rather than January 1, 2003), are presented below:

	<b>PPL</b>		
	<b>For the Years Ended</b>		
	<b>December 31,</b>		
	<b>2002</b>	<b>2001</b>	<b>2000</b>
Reported net income - before extraordinary item and cumulative effect of a change in accounting principle (a)	\$ 358	\$ 169	\$ 487
Pro forma net income - before extraordinary item and cumulative effect of a change in accounting principle	\$ 349	\$ 167	\$ 489
Reported net income	\$ 208	\$ 179	\$ 498
Pro forma net income	\$ 199	\$ 177	\$ 500
<b>Basic EPS:</b>			
Reported net income - before extraordinary item and cumulative effect of a change in accounting principle	\$ 2.35	\$ 1.16	\$ 3.38
Pro forma net income - before extraordinary item and cumulative effect of a change in accounting principle	\$ 2.29	\$ 1.15	\$ 3.39
Reported net income	\$ 1.37	\$ 1.23	\$ 3.45
Pro forma net income	\$ 1.31	\$ 1.21	\$ 3.46
<b>Diluted EPS:</b>			
Reported net income - before extraordinary item and cumulative effect of a change in accounting principle	\$ 2.35	\$ 1.15	\$ 3.37
Pro forma net income - before extraordinary item and cumulative effect of a change in accounting principle	\$ 2.29	\$ 1.14	\$ 3.38
Reported net income	\$ 1.36	\$ 1.22	\$ 3.44
Pro forma net income	\$ 1.31	\$ 1.21	\$ 3.45

(a) Represents income before extraordinary item and cumulative effect of a change in accounting principle, less dividends and distributions on preferred securities.

	<b>PPL Energy Supply</b>		
	<b>For the Years Ended</b>		
	<b>December 31,</b>		
	<b>2002</b>	<b>2001</b>	<b>2000</b>
Reported net income - before cumulative effect of a change in accounting principle (a)	\$ 429	\$ 171	\$ 244
Pro forma net income - before cumulative effect of a change in accounting principle	\$ 420	\$ 169	\$ 244
Reported net income	\$ 279	\$ 174	\$ 242
Pro forma net income	\$ 270	\$ 172	\$ 244

(a) Represents income before cumulative effect of a change in accounting principle less dividends and distributions on preferred securities.

**14. Workforce Reduction**

*(PPL, PPL Energy Supply, PPL Electric and PPL Montana)*

In an effort to improve operational efficiency and reduce costs, PPL and its subsidiaries commenced a workforce reduction assessment in June 2002 that was expected to eliminate up to 598 employees, or about 7% of PPL's U.S. workforce, at an estimated cost of \$74 million. The program was broad-based and impacted all employee groups except certain positions that are key to providing high-quality service to PPL's electricity delivery customers. Linemen, electricians and line foremen, for example, were not affected by the reductions. An additional \$1 million workforce reduction charge was recorded in September 2002, when plans specific to PPL Global and PPL Montana subsidiaries were finalized which were expected to impact 26 employees. These additional reductions increased PPL's total charge for workforce reductions to \$75 million for the elimination of up to 624 positions.

PPL recorded the charges in the Statement of Income as "Workforce reduction" for the year ended December 31, 2002. These charges reduced net income by \$44 million after taxes. The program provides primarily for enhanced early retirement benefits and/or one-time special pension separation allowances based on an employee's age and years of service. These features of the program will be paid from the PPL Retirement Plan pension trust and increased PPL's pension and postretirement benefit liabilities by \$65 million. The remaining \$10 million of costs related primarily to non-pension benefits, such as severance payments and outplacement costs, which will be paid by PPL.

PPL Energy Supply expected to ultimately eliminate up to 221 employees and recorded charges of \$40 million in June 2002 and \$1 million in September 2002. These charges reduced net income by \$24 million for the year ended December 31, 2002. Included in these charges was a \$10 million allocation of costs associated with the elimination of employees of PPL Services.

PPL Electric expected to ultimately eliminate up to 260 employees and recorded a charge of \$33 million, which reduced net income by \$19 million for the year ended December 31, 2002. Included in the charge was a \$6 million

allocation of costs associated with the elimination of employees of PPL Services.

PPL Montana expected to ultimately eliminate up to ten employees and recorded an insignificant charge for the year ended December 31, 2002.

In the third quarter of 2003, PPL Electric recorded an additional \$9 million charge as a completion of the program that commenced in 2002. This additional charge covers the final 94 employees anticipated to be separated as part of the automated meter reader implementation project. The charge was related to pension enhancements, which will be paid from the PPL Retirement Plan pension trust.

As of September 30, 2003, 478 employees of PPL subsidiaries were terminated. Approximately 143 positions, which are primarily bargaining unit, will be evaluated for termination over the next twelve months, due to the timing of the automated meter reader implementation and the displacement process under the bargaining unit contract. Substantially all of the accrued non-pension benefits have been paid.

## 15. New Accounting Standards

### **SFAS 143** (*PPL, PPL Energy Supply, PPL Electric and PPL Montana*)

See Note 13 for a discussion of SFAS 143, "Accounting for Asset Retirement Obligations," and the impact of its adoption.

### **SFAS 146** (*PPL, PPL Energy Supply, PPL Electric and PPL Montana*)

In 2002, the FASB issued SFAS 146, "Accounting for Costs Associated with Exit or Disposal Activities." SFAS 146 addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies EITF Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." SFAS 146 requires the recognition of a liability for costs associated with exit or disposal activities when the liability is incurred rather than at the date of a commitment to an exit or disposal plan. SFAS 146 also establishes that the initial liability should be measured at its estimated fair value. The provisions of SFAS 146 are effective for exit or disposal activities initiated after December 31, 2002, with earlier application encouraged. PPL and its subsidiaries adopted SFAS 146 effective January 1, 2003. The initial adoption did not have an impact on PPL or its subsidiaries. However, SFAS 146 may impact the accounting treatment of future disposal or exit activities.

### **SFAS 148** (*PPL, PPL Energy Supply, PPL Electric and PPL Montana*)

In 2002, the FASB issued SFAS 148, "Accounting for Stock-Based Compensation - Transition and Disclosure, an Amendment of FASB Statement No. 123." SFAS 148 provides three transition methods for adopting the fair value method of accounting for stock-based compensation prescribed under SFAS 123 and enhances the required disclosures regarding stock-based compensation effective for fiscal years ending after December 15, 2002. SFAS 148 also requires certain disclosures in financial reports issued for interim periods beginning after December 15, 2002.

PPL and its subsidiaries elected to adopt the fair value method of accounting for stock-based compensation as of January 1, 2003 using the prospective method of transition, as permitted by SFAS 148. The prospective method provides that PPL and its subsidiaries will recognize expense for all stock-based compensation awards granted, modified or settled on or after January 1, 2003. See Note 2 for a discussion of the change in accounting for stock-based compensation and the interim disclosures required by SFAS 148.

### **SFAS 149** (*PPL, PPL Energy Supply and PPL Montana*)

In April 2003, the FASB issued SFAS 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." SFAS 149 amends and clarifies SFAS 133 to improve financial accounting and reporting for derivative instruments and hedging activities. To ensure that contracts with comparable characteristics are accounted for similarly, SFAS 149 clarifies the circumstances under which a contract with an initial net investment meets the characteristics of a derivative, clarifies when a derivative contains a financing component, amends the definition of an "underlying" and amends certain other existing pronouncements. SFAS 149 is effective for contracts entered into or modified and for hedging relationships designated after June 30, 2003, except certain provisions relating to forward purchases or sales of when-issued securities or other securities that do not yet exist should be applied to both existing contracts and new contracts entered into after June 30, 2003.

PPL, PPL Energy Supply and PPL Montana adopted SFAS 149 effective July 1, 2003. The adoption of SFAS 149 did not have a significant impact on any of PPL, PPL Energy Supply or PPL Montana for the quarter ended September 30, 2003. Each company has changed the accounting for certain transactions on a prospective basis to conform with SFAS 149. This change could result in increased volatility in other comprehensive income and earnings in future periods.

## SFAS 150

*(PPL, PPL Energy Supply, PPL Electric and PPL Montana)*

In May 2003, the FASB issued SFAS 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity." SFAS 150 establishes standards for classifying and measuring certain financial instruments that have characteristics of both liabilities and equity. The standards established by it require certain financial instruments that, under previous guidance, could be classified as equity or "mezzanine" equity to now be classified as liabilities on the Balance Sheet. SFAS 150 requires the following freestanding financial instruments to be classified as liabilities (or assets in some circumstances):

- mandatorily redeemable financial instruments,
- financial instruments that embody obligations to repurchase equity shares in exchange for cash or other assets, including written put options and forward purchase contracts, and
- certain financial instruments that embody obligations to issue a variable number of shares.

SFAS 150 also requires disclosure regarding the nature and terms of those instruments and settlement alternatives. Except as discussed below, SFAS 150 is effective for all financial instruments entered into or modified after May 31, 2003 and is otherwise effective at the beginning of the first interim period beginning after June 15, 2003. In November 2003, the FASB issued Staff Position No. FAS 150-3, "Effective Date, Disclosures, and Transition for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests under FASB Statement No. 150, 'Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity,'" which, as it relates to public entities, defers indefinitely certain provisions of SFAS 150 related to certain mandatorily redeemable noncontrolling interests. SFAS 150 prohibits the restatement of financial statements for periods prior to its adoption.

*(PPL, PPL Energy Supply and PPL Electric)*

In accordance with SFAS 150, effective July 1, 2003, PPL changed its classification of the trust preferred securities of PPL Capital Funding Trust I, which were issued as a component of the PEPS Units, PPL Energy Supply changed its classification of the trust preferred securities issued by SIUK Capital Trust I and PPL Electric changed its classification of its preferred stock with sinking fund requirements. These securities are mandatorily redeemable financial instruments, as they require the issuer to redeem the securities for cash on a specified date. Thus, they have been classified as liabilities, as a component of long-term debt, instead of "mezzanine" equity, on the Balance Sheet as of September 30, 2003. The amounts included in long-term debt as of September 30, 2003 are as follows: \$575 million of trust preferred securities of PPL Capital Funding Trust I (for PPL), \$86 million of trust

preferred securities of SIUK Capital Trust I (for PPL and PPL Energy Supply) and \$17 million of preferred stock with sinking fund requirements (for PPL and PPL Electric). Additionally, the distributions on these securities are required to be included as a component of "Interest Expense" instead of "Dividends and Distributions - Preferred Securities" in the Statement of Income effective July 1, 2003. "Interest Expense" for the three and nine months ended September 30, 2003 includes distributions on these mandatorily redeemable securities totaling \$15 million for PPL, \$4 million for PPL Energy Supply and an insignificant amount for PPL Electric. Periods ending prior to July 1, 2003 have not been restated to conform to these presentations since SFAS 150 specifically prohibits the restatement of financial statements for periods prior to its adoption.

See the "Consolidated Statement of Company-Obligated Mandatorily Redeemable Securities" contained in PPL's Annual Report to the SEC on Form 10-K for the year ended December 31, 2002 for a discussion of the terms of the trust preferred securities of PPL Capital Funding Trust I and SIUK Capital Trust I. In addition, SIUK Capital Trust I may, at the discretion of WPD LLP, redeem its preferred securities, in whole or in part, at 104.115% of par beginning February 2007 and thereafter at an annually declining premium over par through January 2017, after which time they are redeemable at par. The preferred stock with sinking fund requirements of PPL Electric that was outstanding at September 30, 2003 was redeemed in full in October 2003.

**FIN 45** *(PPL, PPL Energy Supply, PPL Electric and PPL Montana)*

In 2002, the FASB issued Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, an Interpretation of FASB Statements No. 5, 57, and 107 and Rescission of FASB Interpretation No. 34." FIN 45 clarifies that upon issuance of certain types of guarantees, the guarantor must recognize an initial liability for the fair value of the obligation it assumes under the guarantee. The offsetting entry will be dependent upon the circumstances under which the guarantee is issued, and the initial liability should typically be reduced as the guarantor is released from risk under the guarantee. FIN 45 also requires a guarantor to make significant new disclosures for guarantees even if the likelihood of the guarantor's having to make payments is remote. The provisions relating to the initial recognition and measurement of guarantee obligations must be applied on a prospective basis to guarantees issued or modified after December 31, 2002. PPL and its subsidiaries adopted FIN 45 effective January 1, 2003. FIN 45 did not have a significant impact on earnings for the three or nine months ended September 30, 2003. See Note 8 for disclosure of guarantees and other assurances existing as of September 30, 2003.

**FIN 46** (*PPL, PPL Energy Supply, PPL Electric and PPL Montana*)

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51." FIN 46 clarifies that variable interest entities, as defined therein, that do not disperse risks among the parties involved should be consolidated by the entity that is determined to be the primary beneficiary. FIN 46 also requires certain disclosures to be made by the primary beneficiary and by an enterprise that holds a significant variable interest in a variable interest entity but is not the primary beneficiary. FIN 46 applies immediately to variable interest entities created after January 31, 2003 and to variable interest entities in which an enterprise obtains an interest after January 31, 2003. For variable interest entities in which an enterprise holds a variable interest that was acquired before February 1, 2003, FIN 46 was originally required to be adopted no later than the first fiscal year or interim period beginning after June 15, 2003. However, in October 2003, the FASB issued Staff Position No. FIN 46-6, "Effective Date of FASB Interpretation No. 46, Consolidation of Variable Interest Entities," which delays the effective date for applying the provisions of FIN 46 to interests held by public entities in variable interest entities or potential variable interest entities created before February 1, 2003 until the end of the first interim period ending after December 15, 2003.

FIN 46 did not have an impact on PPL or its subsidiaries during the three or nine months ended September 30, 2003. PPL and its subsidiaries are in the process of evaluating entities in which they hold a variable interest that was acquired before February 1, 2003. Except as discussed below, PPL and its subsidiaries are currently not aware of any variable interest entities that are not consolidated as of September 30, 2003 but which they will be required to consolidate in accordance with FIN 46 effective December 31, 2003. As they continue to evaluate the impact of applying FIN 46, PPL and its subsidiaries may identify additional entities that they would need to consolidate.

*(PPL and PPL Energy Supply)*

The lessors under the operating leases for the Sundance, University Park and Lower Mt. Bethel generation facilities are variable interest entities in which PPL Energy Supply is the primary beneficiary. Consequently, under FIN 46, PPL Energy Supply will be required to consolidate the financial statements of the lessors effective December 31, 2003. The principal impact from consolidating the lessors under these leases will be the inclusion of the generation facilities as assets and the lease financing as liabilities in the consolidated balance sheet of PPL Energy Supply. Additionally, PPL Energy Supply will be required to recognize a cumulative effect of a change in accounting principle in connection with the initial consolidation of these variable interest entities. PPL Energy Supply estimates that, upon applying FIN 46 to these entities effective December 31, 2003, it will recognize approximately \$1.0 billion of additional assets and liabilities on

its balance sheet and a charge of \$27 million, after-tax, as a cumulative effect of a change in accounting principle. See below for a discussion of the leases.

In May 2001, a subsidiary of PPL Energy Supply entered into a lease arrangement, as lessee, for the development, construction and operation of commercial power generation facilities. The lessor is a variable interest entity that was created for the sole purpose of owning the facilities and incurring the related financing costs. The \$660 million operating lease arrangement covers the 450 MW gas-powered Sundance project near Coolidge, Arizona and the 540 MW gas-powered University Park project near University Park, Illinois. These facilities were substantially complete in July 2002, at which time the initial lease term commenced. At the end of the lease term, which is June 2008, the lessee has the option to extend the lease or purchase the facilities. If the lessee does not choose either of these options, then it must sell the assets on behalf of the lessor and guarantee a residual value of up to \$544 million based on a total lessor's investment of \$656 million for both projects combined. If the financing is terminated early as a result of significant environmental damage, or an event of default, the lessee could be obligated to pay up to 100% of the lessor's investment in the facilities.

In December 2001, another subsidiary of PPL Energy Supply entered into a \$455 million operating lease arrangement, as lessee, for the development, construction and operation of a 600 MW gas-fired combined-cycle generation facility located in Lower Mt. Bethel Township, Northampton County, Pennsylvania. The lessor is a variable interest entity that was created for the sole purpose of owning the facilities and incurring the related financing costs. The initial lease term commences on the date of commercial operation, which is expected to occur in early 2004, and ends in December 2013. At the end of the lease term, the lessee has the option to extend the lease or purchase the facilities. If the lessee does not choose either of these options, then it must sell the assets on behalf of the lessor and guarantee a residual value estimated to be up to \$321 million based on an estimated total lessor's investment of \$455 million. The lessee could be obligated to pay up to 100% of the lessor's investment and other obligations in the facilities if the financing is terminated early as a result of a loss, destruction or condemnation of the project, or upon an event of default. Based on current market conditions, the total exposure as a result of such a termination is estimated to be up to \$558 million as of September 30, 2003 and is estimated to be up to \$570 million as of the commencement of the lease.

**EITF 03-11** (*PPL, PPL Energy Supply and PPL Montana*)

In August 2003, the FASB ratified EITF 03-11, "Reporting Realized Gains and Losses on Derivative Instruments That Are Subject to FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities, and Not 'Held for Trading Purposes' as Defined in EITF Issue No. 02-3, 'Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy

Trading and Risk Management Activities.' " EITF 03-11 addresses whether realized gains and losses on physically settled derivative contracts not "held for trading purposes" should be reported in the income statement on a gross or net basis. It requires that each entity make this determination for itself based on the relevant facts and circumstances in the context of the various activities of the entity rather than based solely on the terms of the individual contracts. EITF 03-11 is effective for transactions entered into on or after October 1, 2003. PPL, PPL Energy Supply and PPL Montana are in the process of evaluating the impact of the adoption of EITF 03-11. Although this new accounting guidance could have a material impact on the presentation of certain line items in the financial statements, it will not impact the financial position or earnings of PPL, PPL Energy Supply or PPL Montana.

**PPL CORPORATION AND SUBSIDIARIES**

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

This discussion should be read in conjunction with the Financial Statements and Combined Notes to Condensed Consolidated Financial Statements included in Item 1 above, and with the section entitled "Review of the Financial Condition and Results of Operations" in PPL's Annual Report to the SEC on Form 10-K for the year ended December 31, 2002. Terms and abbreviations appearing here are explained in the glossary. Dollars are in millions, except per share data, unless otherwise noted.

**Results of Operations**

The following discussion, which explains significant changes in principal items on the Statement of Income, compares the three and nine months ended September 30, 2003 to the comparable periods in 2002.

Prior to September 6, 2002, PPL Global held 51% of the equity interest in WPD, but shared joint control with Mirant. On September 6, 2002, PPL Global acquired the remaining 49% equity interest in WPD and gained complete control. The purchase of Mirant's interest was accounted for as a step-acquisition and resulted in the consolidation of WPD's results of operations as of January 1, 2002. Therefore, PPL's Statement of Income for the three and nine months ended September 30, 2002 has been reclassified to reflect the consolidation of WPD's results. Mirant's \$19 million and \$72 million share of earnings for the three and nine months ended September 30, 2002 is reflected in "Minority Interest."

WPD's results, as consolidated in PPL's Statement of Income, are impacted by changes in foreign currency exchange rates. For the three and nine months ended September 30, 2003, as compared to the same periods in 2002, changes in foreign exchange rates increased WPD's portion of revenue and expense line items by about 6% and 10%.

The Statement of Income reflects the results of past operations and is not intended as any indication of future operating results. Future operating results will necessarily be affected by various and diverse factors and developments. Furthermore, because results for interim periods can be disproportionately influenced by various factors and developments and by seasonal variations, the results of operations for interim periods do not necessarily indicate results or trends for the year.

**Earnings**

The changes in net income from period to period were, in part, attributable to several non-core items with significant earnings impacts as shown below. Income from core operations, which excludes the impact of non-core items, should not be considered as an alternative to net income, which is an indicator of operating performance determined in accordance

with GAAP. PPL believes that income from core operations, although a non-GAAP measure, is also useful and meaningful to investors because it provides them with PPL's underlying earnings performance as another criterion in making their investment decisions. PPL's management also uses income from core operations in measuring certain corporate performance goals. Other companies may use different measures to present financial performance. The tables below reconcile income from core operations to net income in dollars and EPS, by eliminating the impact of non-core items.

	Net Income			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
Income from core operations	\$ 176	\$ 145	\$ 468	\$ 407
Non-core items (net of tax):				
Accounting changes:				
Asset retirement obligations (Note 13)			63	
Goodwill impairment (Note 12)				(150)
Unusual items:				
Workforce reduction (Note 14)	(5)		(5)	(44)
CEMAR operating losses (Note 7)		(23)		(23)
CEMAR impairment (Note 7)				(98)
Net Income - actual	<u>\$ 171</u>	<u>\$ 122</u>	<u>\$ 526</u>	<u>\$ 92</u>

	EPS - Diluted			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
Income from core operations	\$ 1.00	\$ 0.95	\$ 2.73	\$ 2.72
Non-core items (net of tax):				
Accounting changes:				
Asset retirement obligations (Note 13)			0.36	
Goodwill impairment (Note 12)				(1.01)
Unusual items:				
Workforce reduction (Note 14)	(0.03)		(0.03)	(0.29)
CEMAR operating losses (Note 7)		(0.15)		(0.15)
CEMAR impairment (Note 7)				(0.65)
Net Income - actual	<u>\$ 0.97</u>	<u>\$ 0.80</u>	<u>\$ 3.06</u>	<u>\$ 0.62</u>

The after-tax changes in core earnings were primarily due to:

	September 30, 2003 vs. September 30, 2002	
	Three Months Ended	Nine Months Ended
<b>Domestic:</b>		
Higher wholesale energy margins	\$ 9	\$ 38
Net energy trading margins	3	(2)
Lower unregulated retail energy margins	(5)	(4)
Lower regulated retail energy margins		(37)
Delivery revenues (net of CTC/ITC amortization and interest expense on transition bonds)	(2)	15
Higher ancillary expenses	(1)	(8)
Higher operating and maintenance expenses	(2)	(30)
Settlement of capital stock tax in 2002	(7)	(7)
Realized earnings on decommissioning trust fund	6	10
Lower dividends and distributions on preferred securities	8	13
Lower interest expense	13	23
Other	2	(4)
<b>International:</b>		
Higher earnings from U.K. operations	6	58
Other	1	(4)
	<u>\$ 31</u>	<u>\$ 61</u>

The period to period changes in earnings components, including margins by activity and income statement line items, are discussed in the balance of the discussion in "Results of Operations." The increase in earnings from U.K. operations was primarily due to obtaining complete ownership of WPD in September 2002. (See Note 7 to the Financial Statements for additional information.)

PPL's future earnings could be impacted by a number of factors, including the following:

- PPL expects that the low level of wholesale energy prices will continue to put pressure on margins in 2003 and beyond. Based upon current energy price levels, there is a risk that PPL may be unable to recover its investment in new gas-fired generation facilities. Under GAAP, PPL does not believe that there is an impairment charge to be recorded at this time. PPL is unable to predict the ultimate earnings impact of this issue, based upon energy price levels, applicable accounting rules and other factors, but such impact may be material. See "Application of Critical Accounting Policies - Asset Impairment" in PPL's Annual Report to the SEC on Form 10-K for the year ended December 31, 2002 for additional information.
- Earnings in the fourth quarter of 2003 and beyond will be impacted by the consolidation of variable interest entities (as discussed in Note 15 to the Financial Statements).

- In May 2003, PPL Electric announced that it expects to file a request for a delivery rate increase with the PUC in the spring of 2004. If approved, the new rates will go into effect January 2005, when PPL Electric's distribution rate cap expires. PPL Electric has not yet determined the amount of the rate increase it will request, and cannot predict the amount of such increase that will ultimately be approved by the PUC.
- Earnings in 2005 and beyond may be impacted by a rate review of the delivery business of WPD (South West) and WPD (South Wales). WPD cannot predict the ultimate outcome of the rate review.
- PPL operates a synfuel facility and receives tax credits pursuant to Section 29 of the Internal Revenue Code based on its sale of synfuel to unaffiliated third-party purchasers. See Note 8 to the Financial Statements for a discussion of the IRS review of synfuel production procedures, and the projected annual earnings attributable to PPL's synfuel operations.
- PPL expects to record the benefit of a tax loss associated with the CEMAR investment in the fourth quarter of 2003. This is expected to increase 2003 reported earnings by \$0.50 to \$0.65 per share. Future earnings may also be impacted by the ultimate exiting of this investment.

### Domestic Energy Margins

The following table provides changes in income statement line items that comprise domestic gross energy margins for the three and nine months ended September 30, 2003, compared with the same periods in 2002:

	September 30, 2003 vs. September 30, 2002	
	Three Months Ended	Nine Months Ended
Utility revenues	\$ (38)	\$ 4
Unregulated retail electric and gas revenues	(13)	(19)
Wholesale energy marketing revenues	28	215
Net energy trading margins	5	(4)
Other revenue adjustments (a)	45	21
Total revenues	<u>27</u>	<u>217</u>
Fuel	(19)	41
Energy purchases	10	151
Other cost adjustments (a)	24	34
Total cost of sales	<u>15</u>	<u>226</u>
Domestic gross energy margins	<u>\$ 12</u>	<u>\$ (9)</u>

- (a) Adjusted to exclude the impact of any revenues and costs not associated with domestic energy margins, in particular, revenues and costs related to the international operations of PPL Global and the domestic delivery operations of PPL Electric and PPL Gas Utilities. Also adjusted to include gains on sales of emission allowances, which are included in other operation expenses on the Statement of Income.

## Changes in Gross Domestic Energy Margins By Activity

Gross margin calculations are dependent on the allocation of fuel and purchased power costs to the activities listed in the following table. That allocation is based on monthly MWh consumption levels compared to monthly MWh supply costs. Any costs specific to an activity are charged to that activity.

	<u>September 30, 2003 vs. September 30, 2002</u>	
	<u>Three Months Ended</u>	<u>Nine Months Ended</u>
Wholesale - Eastern U.S.	\$ 4	\$ 35
Wholesale - Western U.S.	11	30
Net energy trading	5	(4)
Unregulated retail	(8)	(7)
Regulated retail		(63)
Domestic gross energy margins	<u>\$ 12</u>	<u>\$ (9)</u>

### Wholesale - Eastern U.S.

Eastern wholesale margins were higher for the three and nine months ended September 30, 2003, compared to the same periods in 2002, primarily due to higher volumes, which increased by 11% and 39% over the same periods in 2002. The higher volumes were primarily driven by market opportunities to optimize the value of generating assets, and for the nine months ended September 30, 2003, by higher spot prices that allowed PPL to increase the utilization of its higher-cost generating units and by 699 MW of new generation which began commercial operations in mid-2002. Average PJM spot market real time prices rose 43% for the nine months ended September 30, 2003, compared to the same period in 2002. Partially offsetting the increase in wholesale energy margins for the nine months ended September 30, 2003, compared to the same period in 2002, was the buyout of a NUG contract in February 2002, which reduced power purchases by \$25 million.

### Wholesale - Western U.S.

Western wholesale margins consist of margins in the Northwest and in the Southwest.

In the Northwest, margins were \$5 million and \$28 million higher for the three and nine months ended September 30, 2003, compared to the same periods in 2002, primarily due to higher wholesale prices. Average wholesale prices for the three and nine months ended September 30, 2003 were \$6/MWh higher than those realized in the same periods in 2002. Also, the nine months ended September 30, 2003 includes a \$3 million favorable settlement with Energy West Resources, Inc. in June 2003.

In the Southwest, margins were \$6 million higher for the three months ended September 30, 2003, compared to the same period in 2002, primarily due to the inception of new tolling agreements in Arizona in mid-2003. Margins in the Southwest were \$2 million higher for the nine months ended September 30, 2003, compared to the same period in 2002, due to the new tolling agreements in Arizona, partially offset by lower margins earlier in the year due to lower sales volumes.

### Net Energy Trading

PPL enters into certain energy contracts that meet the criteria of trading derivatives as defined by EITF 02-3. These physical and financial contracts cover trading activity associated with electricity, gas and oil. Margins include both realized and unrealized gains and losses. The \$5 million increase for the three months ended September 30, 2003, compared to the same period in 2002, was primarily due to realized gains associated with electricity positions. The \$4 million decrease for the nine months ended September 30, 2003, compared to the same period in 2002, was primarily due to realized electric swap losses in 2003. The physical volumes associated with energy trading for the three months ended September 30, 2003 were 2,760 GWh and 3.8 Bcf, compared to 3,088 GWh and 3.6 Bcf for the three months ended September 30, 2002. Energy trading physical volumes for the nine months ended September 30, 2003 were 7,616 GWh and 11.0 Bcf, compared to 7,824 GWh and 8.7 Bcf for the nine months ended September 30, 2002.

### Unregulated Retail

Unregulated retail margins were lower for the three and nine months ended September 30, 2003, compared to the same periods in 2002, primarily due to significantly lower electric retail prices in the West. West retail contract prices decreased by approximately 22% for both the three and nine months ended September 30, 2003, compared to the same periods in 2002.

### Regulated Retail

Regulated retail margins in the East were flat for the three months ended September 30, 2003, compared to the same period in 2002, as sales and supply costs were unchanged between the periods. For the nine months ended September 30, 2003, regulated retail margins decreased by 10%, compared to the same period in 2002, due to higher supply costs resulting from higher purchased power prices during the first half of 2003. Purchase power prices were higher because of increased gas and oil prices and the abnormally cold winter.

### Utility Revenues

The increase (decrease) in utility revenues was attributable to the following:

## Energy Related Businesses

Energy-related businesses contributed \$19 million less to operating income for the nine months ended September 30, 2003, compared to the same period in 2002. The decrease resulted primarily from:

- \$8 million due to credits recorded on development projects in 2002, due largely to a favorable settlement on the cancellation of a generation project in Washington state;
- a \$6 million operating loss on some Hyder properties in 2003, which were subsequently sold in April 2003;
- a \$4 million decrease in Latin America revenues from lower material and construction project sales. In 2002, PPL Global's Bolivian subsidiary participated in the construction of a 1,500 kilometer transmission line in rural areas of Bolivia; and
- a \$4 million decrease in margins from telecommunications, due to the acquisition of a fiber optic network and start-up activities for new products.

## Other Operation Expenses

The increase (decrease) in other operation expenses was primarily due to:

	September 30, 2003 vs. September 30, 2002	
	Three Months Ended	Nine Months Ended
Decrease in domestic and international pension income	\$ 11	\$ 42
Increased operating expenses in domestic business lines	23	
Increase in WPD expenses due to increases in foreign currency exchange rates, regulatory accounting adjustments, and resolution of purchase accounting contingencies in the second quarter of 2002 related to the Hyder acquisition	15	32
Additional expenses of new generating facilities that became operational in mid-2002	3	20
Accretion expense as a result of applying SFAS 143, "Accounting for Asset Retirement Obligations." See Note 13.	5	14
Incremental storm restoration costs associated with Hurricane Isabel	6	6
Change to account for CEMAR on the cost method	(23)	(38)
Reduction in salaries and benefits as a result of the workforce reduction initiated in 2002	(10)	(29)
Insurance settlements - property damage and environmental	(23)	(27)
Estimated 2002 vacation liability adjustment in conjunction with the workforce reduction	(15)	(15)
Other decreases - net	(4)	(5)
	<u>\$ (12)</u>	<u>\$ 37</u>

The decreases in pension income for the three and nine months ended September 30, 2003 were attributable to PPL's primary

## September 30, 2003 vs. September 30, 2002

	September 30, 2003 vs. September 30, 2002	
	Three Months Ended	Nine Months Ended
<b>Domestic:</b>		
Retail electric revenue (PPL Electric)		
Electric delivery	\$ 1	\$ 48
PLR electric generation supply	(2)	11
Other		(4)
Wholesale electric revenue (PPL Electric)	(1)	1
Gas revenue (PPL Gas Utilities)	(3)	8
<b>International:</b>		
Retail electric delivery (PPL Global)		
U.K.	2	31
El Salvador	3	12
Bolivia		1
Chile	10	9
Brazil	(48)	(113)
	<u>\$ (38)</u>	<u>\$ 4</u>

The decrease in utility revenues for the three months ended September 30, 2003, compared with the same period in 2002, was primarily due to:

- lower revenues in Brazil attributable to the deconsolidation of CEMAR in August 2002. PPL Global stopped recording operating results of CEMAR upon relinquishing control to ANEEL. (See Note 7 to the Financial Statements for additional information); offset by
- higher revenues in Chile primarily due to higher volumes and the consolidation of certain transmission revenues. (See Note 7 to the Financial Statements for additional information.)

The increase in utility revenues for the nine months ended September 30, 2003, compared with the same period in 2002, was primarily due to:

- higher PPL Electric delivery revenues resulting from a 1.5% increase in delivery sales, in part due to the colder winter weather in the first quarter of 2003;
- higher PPL Electric PLR supply revenues due to higher energy and capacity rates in 2003 compared with 2002;
- higher PPL Gas Utilities revenues primarily due to higher sales volumes of 19%, which were also attributable to the colder winter weather in the first quarter of 2003;
- higher WPD revenues in the U.K. due to the change in foreign currency exchange rates from period to period;
- higher revenues in El Salvador due to higher volumes and higher pass-through energy costs, partially offset by a 6% tariff reduction effective January 1, 2003; and
- higher revenues in Chile primarily due to higher volumes and the consolidation of certain transmission revenues; offset by
- lower revenues in Brazil due to the deconsolidation of CEMAR, as noted above.

domestic pension plan and the U.K. pension plans of WPD. As a result of weak capital markets during 2002, PPL's domestic and U.K. pension plans experienced significant asset losses. The weakened market performance decreased economic forecasts, which resulted in PPL reducing its assumed expected return on assets for its pension plans for 2003. In addition, declining fixed-income security yield rates resulted in PPL decreasing its discount rate assumption for its pension plans as of December 31, 2002. These events and assumption changes reduced the amount of pension income PPL will record in 2003. Through September 30, 2003, PPL recorded approximately \$32 million of pension income and will record approximately \$10 million of additional pension income in the fourth quarter of 2003. Future levels of pension income or expense depend on ongoing market conditions and results.

### Maintenance Expenses

Maintenance expenses increased by \$6 million for the three months ended September 30, 2003, compared with the same period in 2002. This was primarily due to \$7 million of incremental storm restoration costs due to Hurricane Isabel, \$2 million from summer electrical storms, \$5 million from outage work at two fossil plants and \$5 million of increased maintenance expenses in domestic business lines. These increases were offset by a \$9 million decline in WPD expenses associated with timing of network and substation maintenance, tree trimming accruals and cost transfers.

Maintenance expenses increased by \$17 million for the nine months ended September 30, 2003, compared with the same period in 2002. This was primarily due to \$3 million of additional outage costs associated with the turbine replacement at the PPL Susquehanna station, \$9 million of storm restoration costs, \$2 million of additional tree trimming costs and \$12 million of increased maintenance expenses in domestic business lines. These increases were offset by a \$3 million decrease in WPD expenses primarily due to adjustment of tree trimming accruals and cost transfers, partially offset by higher foreign currency exchange rates in 2003.

### Depreciation

Impacts on depreciation were as follows:

	September 30, 2003 vs. September 30, 2002	
	Three Months Ended	Nine Months Ended
Normal plant additions	\$ 11	\$ 25
Additional depreciation due to write-up to fair value of acquired WPD assets	3	10
Foreign currency exchange rates	2	7
Lower depreciation due to deconsolidation of CEMAR	(3)	(7)
Decommissioning expense 2003 due to application of SFAS 143 (a)	(6)	(17)
	<u>\$ 7</u>	<u>\$ 18</u>

- (a) There was a corresponding recording of accretion expense for PPL Susquehanna in 2003, which is part of other operation expense.

### Taxes, Other Than Income

Taxes, other than income, increased by \$10 million during the three months ended September 30, 2003, compared with the same period in 2002. This increase was primarily due to the settlement of prior years' capital stock tax refund claims of \$8 million in 2002, and higher taxes related to an increase in the basis on which capital stock tax is calculated for 2003.

Taxes, other than income, increased by \$17 million during the nine months ended September 30, 2003, compared with the same period in 2002. This increase was affected by the same items that impacted the three-month period, as well as a \$5 million increase in property taxes.

### Write-down of International Energy Projects

See Note 7 to the Financial Statements for additional information on the write-down of PPL Global's investment in CEMAR.

### Workforce Reduction

See Note 14 to the Financial Statements for information regarding the \$9 million charge recorded in September 2003 and the \$75 million of charges recorded in 2002.

### Other Income - net

See Note 10 to the Financial Statements for details of other income.

### Financing Costs

The decreases in interest expense were due to:

	September 30, 2003 vs. September 30, 2002	
	Three Months Ended	Nine Months Ended
Decrease in long-term debt interest due to debt retirements	\$ (23)	\$ (55)
Decrease in long-term debt interest from the deconsolidation of CEMAR	(17)	(34)
Write-off unamortized swap costs on WPD debt restructuring		11
Decrease in short-term debt interest	(6)	
Interest on preferred securities due to applying SFAS 150	14	14
2002 charge to cancel a remarketing agreement	(24)	(24)
Capitalized interest and other	7	13
	<u>\$ (49)</u>	<u>\$ (75)</u>

## Financial Condition

Dividends and distributions on preferred securities decreased by \$14 million and \$23 million during the three and nine months ended September 30, 2003, compared with the same periods in 2002. The three-month decrease is due to the implementation of SFAS 150 on July 1, 2003, which requires the classification of dividends and distributions on certain preferred securities to be recorded as a component of interest expense. See Note 15 to the Financial Statements for additional information. The remaining decrease for the nine-month period was due to the retirement of preferred securities in 2002.

### **Income Taxes**

Income taxes increased by \$3 million and \$6 million for the three and nine months ended September 30, 2003, compared to the same periods in 2002. The increases were primarily due to:

- higher pre-tax book income, resulting in \$10 million and \$58 million increases in income taxes for the three and nine months ended September 30, 2003; offset by
- a reduction related to an impairment charge on PPL's investment in CEMAR resulting in a \$33 million deferred income tax valuation allowance recorded in the second quarter of 2002; and
- differences in income recognition for tax purposes related to foreign affiliates, resulting in \$9 million and \$20 million reductions in income taxes for the three and nine months ended September 30, 2003.

### **Cumulative Effect of a Change in Accounting Principle**

PPL adopted SFAS 143, "Accounting for Asset Retirement Obligations," effective January 1, 2003. SFAS 143 addresses the accounting for obligations associated with the retirement of tangible long-lived assets. It requires legal obligations associated with the retirement of long-lived assets to be recognized as a liability in the financial statements.

Application of the new rules resulted in a cumulative effect of adoption that increased net income by \$63 million in 2003. See Note 13 to the Financial Statements for additional information.

PPL adopted SFAS 142, "Goodwill and Other Intangible Assets," on January 1, 2002. SFAS 142 requires an annual impairment test of goodwill and other intangible assets that are not subject to amortization. PPL conducted a transition impairment analysis in the first quarter of 2002 and recorded a transition goodwill impairment charge of \$150 million. See Note 12 to the Financial Statements for additional information.

### **Liquidity**

At September 30, 2003, PPL had \$587 million of cash and cash equivalents and \$412 million of short-term debt (including long-term debt due within one year). At December 31, 2002, PPL had \$245 million of cash and cash equivalents and \$1.3 billion of short-term debt (including long-term debt due within one year).

The increase in PPL's cash position was primarily the net result of:

- cash provided by operating activities of \$1 billion,
- the issuance of \$989 million of long-term debt, and
- the issuance of \$424 million of common stock; offset by
- the net decrease of \$873 million of short-term debt,
- the retirement of \$467 million of long-term debt,
- payment of \$217 million of common and preferred dividends, and
- capital expenditures of \$517 million.

In July 2003, PPL Energy Supply and PPL Electric each determined that, based on their strong current cash positions and anticipated cash flows, they will not need to access the commercial paper markets through at least the end of 2003. Neither company currently has any commercial paper outstanding. As a result, PPL Energy Supply and PPL Electric each requested Standard & Poor's Ratings Services (S&P), Moody's Investors Service, Inc. (Moody's) and Fitch Ratings (Fitch) to withdraw their ratings for these currently inactive commercial paper programs, which they did effective as of July 9, 2003. Based on current cash positions and availabilities under their respective revolving credit facilities, PPL Energy Supply and PPL Electric do not expect this decision to limit their ability to fund their short-term liquidity needs.

### Rating Agency Decisions - PPL

S&P, Moody's and Fitch recently reviewed the credit ratings on the debt and preferred securities of PPL and its subsidiaries. Based on their respective reviews, the rating agencies made certain ratings revisions which are described below.

Management does not expect these ratings decisions to impact PPL and its subsidiaries' ability to raise new long-term debt. These ratings decisions will have an insignificant impact on PPL and its subsidiaries' cost of maintaining their credit facilities and the cost of any new long-term debt.

The ratings of S&P, Moody's and Fitch are not a recommendation to buy, sell or hold any securities of PPL or its subsidiaries. Such ratings may be subject to revisions or withdrawal by the agencies at any time and should be evaluated independently of each other and any other rating that may be assigned to their securities.

## S&P

In April 2003, S&P notified PPL, PPL Energy Supply and PPL Electric that it:

- affirmed both the 'A-' ratings on PPL Electric's first mortgage bonds and senior secured bonds and the 'BBB' corporate credit ratings for PPL and PPL Energy Supply;
- lowered the rating on PPL Capital Funding's senior unsecured debt to 'BBB-' from 'BBB';
- placed PPL Electric on negative outlook. S&P indicated that PPL and PPL Energy Supply remain on negative outlook; and
- affirmed the 'A-2' commercial paper ratings of PPL Energy Supply and PPL Electric.

S&P indicated that the rating revision on PPL Capital Funding's senior unsecured debt is based on its structural subordination, which it noted will increase as new debt is financed at PPL Energy Supply. S&P also indicated that the negative outlook for PPL and its subsidiaries reflects its view of weak debt-protection measures due to low wholesale energy prices.

## Moody's

In May 2003, Moody's downgraded the credit ratings on the debt and preferred securities of PPL, PPL Electric and PPL Energy Supply. The ratings downgraded include:

- PPL Electric's first mortgage bonds and senior secured bonds, to 'Baa1' from 'A3';
- PPL Energy Supply's senior unsecured notes, to 'Baa2' from 'Baa1';
- PPL Capital Funding's senior unsecured debt, to 'Baa3' from 'Baa2'; and
- PPL's senior unsecured debt that is not currently outstanding but that may be issued under PPL's shelf registration statement on file with the SEC, to 'Baa3' from 'Baa2'.

The Moody's ratings outlook was stable for each of PPL, PPL Electric, PPL Energy Supply and PPL Capital Funding.

Neither PPL Electric's nor PPL Energy Supply's short-term debt ratings was impacted by Moody's long-term debt review.

Moody's stated that the downgrades reflect its concerns about PPL's high debt levels, PPL Energy Supply's modest exposure to merchant generation risk, the continued weakness in the wholesale power market and the associated financial impact on PPL Energy Supply, and concerns regarding the amount of cash flow to be generated from PPL Energy Supply's non-regulated domestic operations and the free cash flow available from its regulated international assets. However, Moody's also indicated that the full requirements contract between PPL Electric and PPL EnergyPlus, which previously was approved by the PUC and which extends through December 2009, mitigates PPL Electric's supply and price risk and provides a

predictable stream of cash flows to PPL Energy Supply during such time period. Moody's also noted that PPL's management has already implemented a number of initiatives to strengthen its current credit quality and reduce its debt levels, such as the issuance of over \$1 billion of common stock and mandatory convertible securities over the last few years, a sizeable reduction in planned capital expenditures, the cancellation of projects under development, workforce reductions and write-downs of certain investments.

In September 2003, Moody's announced that it was placing PPL Montana's 8.903% Pass-Through Certificates due 2020 under review for possible downgrade. These securities currently are rated 'Baa3' by Moody's. Moody's stated that its review is prompted by its concerns about the credit profile of PPL Montana's largest customer, NorthWestern, and lower cash flow generation than was forecasted at the time the securities were issued in 2000. See Note 8 to the Financial Statements for additional information on NorthWestern's current situation. Management does not expect any action by Moody's based on this review to limit PPL Montana's ability to fund its short-term liquidity needs. PPL Montana has no plans to raise new long-term debt. Any ratings downgrade by Moody's would have an insignificant impact on PPL Montana's cost of maintaining the credit facility that it has in place with its affiliate. In addition, management does not expect any ratings downgrade by Moody's based on this review to have any adverse impact on the credit ratings of PPL or PPL Energy Supply.

## Fitch

In May 2003, Fitch notified PPL, PPL Energy Supply and PPL Capital Funding that it:

- downgraded PPL Capital Funding's senior unsecured debt to 'BBB' from 'BBB+';
- downgraded PPL's senior unsecured debt that is not currently outstanding but that may be issued under PPL's shelf registration statement on file with the SEC, to 'BBB' from 'BBB+';
- affirmed both the 'BBB+' rating of PPL Energy Supply's senior unsecured debt, and the 'F2' rating of its commercial paper; and
- placed each of PPL, PPL Capital Funding and PPL Energy Supply on negative outlook.

Fitch indicated that the revised ratings for PPL and PPL Capital Funding reflect the structural subordination of PPL to that of its subsidiaries and Fitch's expectations of lower cash flow from PPL Electric until early 2005. Fitch indicated that the change in outlook for these companies results from the increase during 2002 in PPL's generation asset portfolio that is dependent on merchant generation, continued weakness in U.S. merchant energy markets and exposure to international distribution assets primarily in Latin America and the U.K. However, Fitch noted that PPL Energy Supply derives significant earnings and cash flow from long-term supply contracts, including the full requirements contract between

PPL Electric and PPL EnergyPlus, that on average account for about 70% of PPL Energy Supply's gross margin over the next five years.

### Rating Agency Decisions - WPD

In February 2003, Moody's confirmed the ratings of WPDH Limited and WPD (South Wales) at 'Baa2' and 'Baa1', and downgraded WPD LLP from 'Baa1' to 'Baa2' and SIUK Capital Trust I from 'Baa2' to 'Baa3'. The outlook on all ratings was stable. In March 2003, S&P assigned its 'BBB+' senior unsecured debt rating to the £200 million bonds issued by WPD (South West). At the same time, the 'BBB+' and 'A-2' corporate credit ratings on SIUK PLC were withdrawn as a result of the acquisition of its debt by WPD LLP. S&P assigned its 'BBB' long-term and 'A-2' short-term corporate credit ratings to WPD LLP in line with the ratings on the rest of the WPD group.

Following a review of holding companies of U.K. regulated utilities, in July 2003 S&P downgraded the long-term ratings from 'BBB' to 'BBB-' and short-term ratings from 'A-2' to 'A-3' for both WPDH Limited and WPD LLP, and retained a negative outlook. At the same time, S&P reaffirmed the credit ratings for WPD (South West) and WPD (South Wales) at 'BBB+'. This is in line with S&P U.K.'s recently announced implementation of a new methodology related to U.K. electric distribution holding companies wherein electric distribution operating companies rated in the 'BBB' category will have the parent holding company (WPDH Limited) notched down by two categories from the operating company rating level. WPD's management does not expect the placement of WPD on negative outlook to limit its ability to fund its short-term liquidity needs or access new long-term debt or to impact the cost of any new long-term debt.

### **Risk Management - Energy Marketing & Trading and Other**

#### Market Risk

##### *Accounting and Reporting*

PPL follows the provisions of SFAS 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities," and SFAS 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities," and interpreted by DIG issues (together, "SFAS 133") and EITF 02-3, "Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities," to account for contracts entered into to manage market risk. SFAS 133 requires that all derivative instruments be recorded at fair value on the balance sheet as an asset or liability (unless they meet SFAS 133's criteria for exclusion) and that changes in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. PPL is in the process of evaluating the impact of adopting

EITF 03-11, "Reporting Realized Gains and Losses on Derivative Instruments That Are Subject to FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities, and Not 'Held for Trading Purposes' as Defined in EITF Issue No. 02-3, 'Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities,'" which requires prospective application as of October 1, 2003.

In April 2003, the FASB issued SFAS 149, which amends and clarifies SFAS 133 to improve financial accounting and reporting for derivative instruments and hedging activities. To ensure that contracts with comparable characteristics are accounted for similarly, SFAS 149 clarifies the circumstances under which a contract with an initial net investment meets the characteristics of a derivative, clarifies when a derivative contains a financing component, amends the definition of an "underlying" and amends certain other existing pronouncements. SFAS 149 is effective for contracts entered into or modified and for hedging relationships designated after June 30, 2003, except certain provisions relating to forward purchases or sales of when-issued securities or other securities that do not yet exist should be applied to both existing contracts and new contracts entered into after June 30, 2003.

PPL adopted SFAS 149 effective July 1, 2003. The adoption of SFAS 149 did not have a significant impact on PPL for the quarter ended September 30, 2003. PPL has changed the accounting for certain transactions on a prospective basis to conform with SFAS 149. This change could result in increased volatility in other comprehensive income and earnings in future periods.

For energy contracts that meet the definition of a derivative, the circumstances and intent existing at the time that energy transactions are entered into determine their accounting designation. The following summarizes the changes to the electricity guidelines that have been provided to the traders who are responsible for contract designation for derivative energy contracts due to the adoption of SFAS 149:

- Any wholesale and retail contracts to sell electricity and the related capacity that are expected to be delivered from PPL's generation are considered "normal." These transactions are not recorded in the financial statements and have no earnings impact until delivery.
- Physical electricity-only transactions can receive cash flow hedge treatment if all of the qualifications under SFAS 133 are met. Any unrealized gains or losses on transactions receiving cash flow hedge treatment are recorded in other comprehensive income.
- Physical electricity purchases that increase PPL's long position and any energy sale or purchase considered a "market call" are speculative, with unrealized gains or losses recorded immediately through earnings.
- Financial electricity transactions, which can be settled in cash, cannot be considered "normal" because they do not require physical delivery. These transactions receive cash

flow hedge treatment if they lock in the price PPL will receive or pay for energy expected to be generated or purchased in the spot market. Any unrealized gains or losses on transactions that receive cash flow hedge treatment are recorded in other comprehensive income.

Transactions which do not qualify for hedge accounting treatment are marked to market through earnings.

#### Commodity Price Risk

As of September 30, 2003, PPL estimated that a 10% adverse movement in market prices across all geographic areas and time periods would have decreased the value of the commodity contracts in its non-trading portfolio by approximately \$174 million. However, the change in the value of the non-trading portfolio would have been substantially offset by an increase in the value of the underlying commodity, the electricity generated, because these contracts serve to reduce the market risk inherent in the generation of electricity. Additionally, the value of PPL's unsold generation would be improved. Because PPL's electricity portfolio is generally in a net sales position, the adverse movement in prices is usually an increase in prices. Conversely, because PPL's commodity fuels portfolio is generally in a net purchase position, the adverse movement in prices is usually a decrease in prices. If both of these scenarios happened, the implied margins for the unsold generation would increase.

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

PPL's trading contracts mature at various times through 2005. The following chart sets forth PPL's net fair market value of trading contracts:

	Three Months Ended		Nine Months Ended	
	September 30, 2003	2002	September 30, 2003	2002
Fair value of contracts outstanding at the beginning of the period	\$ (7)	\$ 1	\$ (6)	
Contracts realized or otherwise settled during the period	7	(1)	16	(2)
Fair value of new contracts at inception		(5)	(2)	(12)
Other changes in fair values	(3)	1	(11)	10
Fair value of contracts outstanding at the end of the period	<u>\$ (3)</u>	<u>\$ (4)</u>	<u>\$ (3)</u>	<u>\$ (4)</u>

During the three and nine months ended September 30, 2003, PPL reversed net losses of approximately \$7 million and \$16 million, and during the three and nine months ended

September 30, 2002, PPL reversed net gains of approximately \$1 million and \$2 million. These amounts do not reflect intra-period contracts that were entered into and settled during the period.

"Other changes in fair values" represents changes in the market value of contracts outstanding at the end of the period.

As of September 30, 2003, the net unrealized loss on PPL's trading activities expected to be realized in earnings during the next three months is approximately \$9 million.

The following chart segregates estimated fair values of PPL's trading portfolio at September 30, 2003 based on whether the fair values are determined by quoted market prices or other more subjective means.

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

The "Prices actively quoted" category includes the fair value of exchange-traded natural gas futures contracts quoted on the New York Mercantile Exchange.

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

The "Prices based on models and other valuation methods" category includes the value of transactions for which an internally developed price curve was constructed as a result of the long-dated nature of the transaction or the illiquidity of the market point, or the value of options not quoted by an exchange or OTC broker. Additionally, this category includes "strip" transactions whose prices are obtained from external sources and then modeled to monthly prices as appropriate. This level of modeling has been increasingly required due to the illiquidity of the energy markets.

As of September 30, 2003, PPL estimated that a 10% adverse movement in market prices across all geographic areas and

time periods would have decreased the value of the commodity contracts in its trading portfolio by \$3 million.

#### *Interest Rate Risk*

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

At September 30, 2003, PPL's potential annual exposure to increased interest expense, based on a 10% increase in interest rates, was estimated at \$1 million.

PPL is also exposed to changes in the fair value of its U.S. and international debt portfolios. At September 30, 2003, PPL estimated that its potential exposure to a change in the fair value of its debt portfolios, through a 10% adverse movement in interest rates, was \$141 million.

PPL utilizes various risk management instruments to reduce its exposure to adverse interest rate movements for future anticipated financing. While PPL is exposed to changes in the fair value of these instruments, they are designed such that an economic loss in value should generally be offset by interest rate savings at the time the future anticipated financing is completed. At September 30, 2003, PPL estimated that its potential exposure to a change in the fair value of these instruments, through a 10% adverse movement in interest rates, was approximately \$5 million.

#### *Foreign Currency Risk*

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

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

PPL holds contracts for the forward purchase of 26 million euros and £1 million to pay for certain equipment of a PPL Energy Supply subsidiary in 2003 and 2004. The estimated value of these forward purchases as of September 30, 2003, being the amount PPL would receive to terminate them, was approximately \$6 million.

To protect expected income in British pounds sterling, PPL entered into average rate options for £26 million and average rate forward sale agreements for £20 million. To protect

expected income in Chilean pesos, PPL entered into average rate options for 4 billion Chilean pesos. At September 30, 2003, the market value of these positions, representing the amount PPL would pay to terminate them, was \$1 million.

WPDH Limited executed cross-currency swaps totaling \$1.3 billion to hedge the value of its U.S. dollar-denominated bonds. The estimated value of this position on September 30, 2003, being the amount PPL would pay to terminate them, was \$31 million.

#### *Nuclear Decommissioning Fund - Securities Price Risk*

In connection with certain Nuclear Regulatory Commission requirements, PPL Susquehanna maintains trust funds to fund certain costs of decommissioning the Susquehanna station. As of September 30, 2003, these funds were invested primarily in domestic equity securities and fixed-rate, fixed-income securities and are reflected at fair value on PPL's Balance Sheet. The mix of securities is designed to provide returns to be used to fund Susquehanna's decommissioning and to compensate for inflationary increases in decommissioning costs. However, the equity securities included in the trusts are exposed to price fluctuation in equity markets, and the values of fixed-rate, fixed-income securities are exposed to changes in interest rates. PPL Susquehanna actively monitors the investment performance and periodically reviews asset allocation in accordance with its nuclear decommissioning trust policy statement. At September 30, 2003, a hypothetical 10% adverse movement in interest rates and a 10% decrease in equity prices would have resulted in an estimated \$21 million reduction in the fair value of the trust assets.

PPL Electric's 1998 restructuring settlement agreement provides for the collection of authorized nuclear decommissioning costs through the CTC. Additionally, PPL Electric is permitted to seek recovery from customers of up to 96% of certain increases in these costs. Under the power supply agreements between PPL Electric and PPL EnergyPlus, these revenues are passed on to PPL EnergyPlus. Similarly, these revenues are passed on to PPL Susquehanna under a power supply agreement between PPL EnergyPlus and PPL Susquehanna. These revenues are used to fund the trusts.

#### **Related Party Transactions**

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

#### **Acquisitions and Development**

From time-to-time, PPL and its subsidiaries are involved in negotiations with third parties regarding acquisitions, joint ventures and other arrangements which may or may not result in definitive agreements. See Note 7 to the Financial

Statements for information regarding recent acquisitions and development activities.

At September 30, 2003, PPL had domestic generation projects under development which will provide 645 MW of additional generation.

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

### **Environmental Matters**

See Note 8 to the Financial Statements for a discussion of environmental matters.

### **New Accounting Standards**

#### **FIN 46**

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51." FIN 46 clarifies that variable interest entities, as defined therein, that do not disperse risks among the parties involved should be consolidated by the entity that is determined to be the primary beneficiary. FIN 46 also requires certain disclosures to be made by the primary beneficiary and by an enterprise that holds a significant variable interest in a variable interest entity but is not the primary beneficiary. FIN 46 applies immediately to variable interest entities created after January 31, 2003 and to variable interest entities in which an enterprise obtains an interest after January 31, 2003. For variable interest entities in which an enterprise holds a variable interest that was acquired before February 1, 2003, FIN 46 was originally required to be adopted no later than the first fiscal year or interim period beginning after June 15, 2003. However, in October 2003, the FASB issued Staff Position No. FIN 46-6, "Effective Date of FASB Interpretation No. 46, Consolidation of Variable Interest Entities," which delays the effective date for applying the provisions of FIN 46 to interests held by public entities in variable interest entities or potential variable interest entities created before February 1, 2003 until the end of the first interim period ending after December 15, 2003.

FIN 46 did not have an impact on PPL during the three or nine months ended September 30, 2003. PPL is in the process of evaluating entities in which it holds a variable interest that was acquired before February 1, 2003. Except as discussed below, PPL is currently not aware of any variable interest entities that are not consolidated as of September 30, 2003 but which it will be required to consolidate in accordance with FIN 46 effective December 31, 2003. As it continues to evaluate the impact of applying FIN 46, PPL may identify additional entities that it would need to consolidate.

The lessors under the operating leases for the Sundance, University Park and Lower Mt. Bethel generation facilities are variable interest entities in which PPL is the primary beneficiary. Consequently, under FIN 46, PPL will be required to consolidate the financial statements of the lessors effective December 31, 2003. The principal impact from consolidating the lessors under these leases will be the inclusion of the generation facilities as assets and the lease financing as liabilities in the consolidated balance sheet of PPL. Additionally, PPL will be required to recognize a cumulative effect of a change in accounting principle in connection with the initial consolidation of these variable interest entities. PPL estimates that, upon applying FIN 46 to these entities effective December 31, 2003, it will recognize approximately \$1.0 billion of additional assets and liabilities on its balance sheet and a charge of \$27 million, after-tax, as a cumulative effect of a change in accounting principle. See Note 15 to the Financial Statements for a discussion of the leases.

#### **Other**

See Note 15 to the Financial Statements for information on other new accounting standards adopted in 2003 or pending adoption.

### **Application of Critical Accounting Policies**

PPL's financial condition and results of operations are impacted by the methods, assumptions and estimates used in the application of critical accounting policies. The following accounting policies are particularly important to the financial condition or results of operations of PPL, and require estimates or other judgments of matters inherently uncertain: price risk management, pension and other postretirement benefits, asset impairment, leasing, loss accruals, and asset retirement obligations.

See Item 7, "Review of the Financial Condition and Results of Operations," in PPL's Annual Report to the SEC on Form 10-K for the year ended December 31, 2002 for a discussion of each critical accounting policy, except for asset retirement obligations which is discussed below. For an additional discussion on the impact of SFAS 149 on price risk management, see "Risk Management - Energy Marketing & Trading and Other" in Financial Condition. PPL's senior management has reviewed these critical accounting policies, and the estimates and assumptions regarding them, with its Audit Committee. In addition, PPL's senior management reviewed the Form 10-K disclosures regarding the application of these critical accounting policies with the Audit Committee.

#### **Asset Retirement Obligations**

In 2001, the FASB issued SFAS 143, "Accounting for Asset Retirement Obligations," which addresses the accounting for obligations associated with the retirement of tangible long-lived assets. SFAS 143 requires legal obligations associated with the retirement of long-lived assets to be recognized as a liability in the financial statements. The initial obligation

should be measured at the estimated fair value. An equivalent amount should be recorded as an increase in the value of the capitalized asset and allocated to expense over the useful life of the asset. Until the obligation is settled, the liability should be increased, through the recognition of accretion expense in the income statement, for changes in the obligation due to the passage of time. SFAS 143 is effective for fiscal years beginning after June 15, 2002.

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

PPL adopted SFAS 143 effective January 1, 2003. Initial adoption of the new rules resulted in an increase in net property, plant and equipment of \$32 million, reversal of previously recorded liabilities of \$304 million, recognition of asset retirement obligations of \$229 million, recognition of a deferred tax liability of \$44 million and a cumulative effect adoption that increased net income by \$63 million. PPL's most significant assumptions surrounding asset retirement obligations are the forecasted retirement cost, discount rate and inflation rate. A variance in the forecasted retirement cost, discount rate or inflation rate could have a significant impact on the ARO liability and the cumulative effect gain.

The following chart reflects the sensitivities associated with a change in these assumptions upon initial adoption. Each sensitivity below reflects an evaluation of the change based solely on a change in that assumption only.

	<u>Change in Assumption</u>	<u>Impact on Cumulative Effect</u>	<u>Impact on ARO Liability</u>
<b>Retirement Cost</b>	10/(10)%	\$(10)/\$10	\$21/\$(21)
<b>Discount Rate</b>	0.25/(0.25)%	\$10/\$(11)	\$(22)/\$25
<b>Inflation Rate</b>	0.25/(0.25)%	\$(12)/\$11	\$25/\$(22)

## PPL ENERGY SUPPLY, LLC AND SUBSIDIARIES

### Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

This discussion should be read in conjunction with the Financial Statements and Combined Notes to Condensed Consolidated Financial Statements included in Item 1 above, and with the section entitled "Review of the Financial Condition and Results of Operations" in PPL Energy Supply's Annual Report to the SEC on Form 10-K for the year ended December 31, 2002. Terms and abbreviations appearing here are explained in the glossary. Dollars are in millions, unless otherwise noted.

#### Results of Operations

The following discussion, which explains significant changes in principal items on the Statement of Income, compares the three and nine months ended September 30, 2003 to the comparable periods in 2002.

Prior to September 6, 2002, PPL Global held 51% of the equity interest in WPD, but shared joint control with Mirant. On September 6, 2002, PPL Global acquired the remaining 49% equity interest in WPD and gained complete control. The purchase of Mirant's interest was accounted for as a step-acquisition and resulted in the consolidation of WPD's results of operations as of January 1, 2002. Therefore, PPL Energy Supply's Statement of Income for the three and nine months ended September 30, 2002 has been reclassified to reflect the consolidation of WPD's results. Mirant's \$19 million and \$72 million share of earnings for the three and nine months ended September 30, 2002 is reflected in "Minority Interest."

WPD's results, as consolidated in PPL Energy Supply's Statement of Income, are impacted by changes in foreign currency exchange rates. For the three and nine months ended September 30, 2003, as compared to the same periods in 2002, changes in foreign exchange rates increased WPD's portion of revenue and expense line items by about 6% and 10%.

The Statement of Income reflects the results of past operations and is not intended as any indication of future operating results. Future operating results will necessarily be affected by various and diverse factors and developments. Furthermore, because results for interim periods can be disproportionately influenced by various factors and developments and by seasonal variations, the results of operations for interim periods do not necessarily indicate results or trends for the year.

#### **Earnings**

The changes in net income from period to period were, in part, attributable to several non-core items with significant earnings impacts as shown below. Income from core operations, which includes the impact of non-core items, should not be considered as an alternative to net income, which is an indicator of operating performance determined in accordance with GAAP. PPL Energy Supply believes that income from

core operations, although a non-GAAP measure, is also useful and meaningful to investors because it provides them with PPL Energy Supply's underlying earnings performance as another criterion in making their investment decisions. PPL Energy Supply's management also uses income from core operations in measuring certain corporate performance goals. Other companies may use different measures to present financial performance. The table below reconciles income from core operations to net income, by eliminating the impact of non-core items.

	<u>Three Months Ended</u>		<u>Nine Months Ended</u>	
	<u>September 30,</u>		<u>September 30,</u>	
	<u>2003</u>	<u>2002</u>	<u>2003</u>	<u>2002</u>
Income from core operations	\$ 190	\$ 164	\$ 475	\$ 440
Non-core items (net of tax):				
Accounting changes:				
Asset retirement obligations (Note 13)			63	
Goodwill impairment (Note 12)				(150)
Unusual items:				
Workforce reduction (Note 14)				(24)
CEMAR operating losses (Note 7)		(23)		(23)
CEMAR impairment (Note 7)				(98)
Net Income - actual	<u>\$ 190</u>	<u>\$ 141</u>	<u>\$ 538</u>	<u>\$ 145</u>

The after-tax changes in core earnings were primarily due to:

	<u>September 30, 2003 vs. September 30, 2002</u>	
	<u>Three Months Ended</u>	<u>Nine Months Ended</u>
Domestic:		
Higher wholesale energy margins	\$ 9	\$ 38
Net energy trading margins	3	(2)
Lower unregulated retail energy margins	(5)	(4)
Lower regulated retail energy margins		(37)
Realized earnings on decommissioning trust fund	6	10
Trademark royalties to affiliates	(6)	(17)
Operating and maintenance expenses	7	(8)
Other	5	1
International:		
Higher earnings from U.K. operations	6	58
Other	1	(4)
	<u>\$ 26</u>	<u>\$ 35</u>

The period to period changes in earnings components, including margins by activity and income statement line items,

are discussed in the balance of the discussion in "Results of Operations." The increase in earnings from U.K. operations was primarily due to obtaining complete ownership of WPD in September 2002. (See Note 7 to the Financial Statements for additional information.)

PPL Energy Supply's future earnings could be impacted by a number of factors, including the following:

- PPL Energy Supply expects that the low level of wholesale energy prices will continue to put pressure on margins in 2003 and beyond. Based upon current energy price levels, there is a risk that PPL Energy Supply may be unable to recover its investment in new gas-fired generation facilities. Under GAAP, PPL Energy Supply does not believe that there is an impairment charge to be recorded at this time. PPL Energy Supply is unable to predict the ultimate earnings impact of this issue, based upon energy price levels, applicable accounting rules and other factors, but such impact may be material. See "Application of Critical Accounting Policies - Asset Impairment" in PPL Energy Supply's Annual Report to the SEC on Form 10-K for the year ended December 31, 2002 for additional information.
- Earnings in the fourth quarter of 2003 and beyond will be impacted by the consolidation of variable interest entities (as discussed in Note 15 to the Financial Statements).
- Earnings in 2005 and beyond may be impacted by a rate review of the delivery business of WPD (South West) and WPD (South Wales). WPD cannot predict the ultimate outcome of the rate review.
- PPL Energy Supply operates a synfuel facility and receives tax credits pursuant to Section 29 of the Internal Revenue Code based on its sale of synfuel to unaffiliated third-party purchasers. See Note 8 to the Financial Statements for a discussion of the IRS review of synfuel production procedures, and the projected annual earnings attributable to PPL Energy Supply's synfuel operations.
- PPL Energy Supply expects to record the benefit of a tax loss associated with the CEMAR investment in the fourth quarter of 2003. This is expected to increase 2003 reported earnings by \$85 million to \$112 million. Future earnings may also be impacted by the ultimate exiting of this investment.

### Domestic Energy Margins

The following table provides changes in income statement line items that comprise domestic gross energy margins for the three and nine months ended September 30, 2003, compared with the same periods in 2002:

	September 30, 2003 vs. September 30, 2002	
	Three Months Ended	Nine Months Ended
Wholesale energy marketing revenues	\$ 28	\$ 21
Wholesale energy marketing to affiliates	1	
Unregulated retail electric and gas revenues	(13)	(19)
Net energy trading margins	5	(4)
Other revenue adjustments (a)	6	16
<b>Total revenues</b>	<b>27</b>	<b>217</b>
Fuel	(12)	41
Energy purchases	11	151
Energy purchases from affiliates	(4)	(7)
Other cost adjustments (a)	20	41
<b>Total cost of sales</b>	<b>15</b>	<b>226</b>
<b>Domestic gross energy margins</b>	<b>\$ 12</b>	<b>\$ (9)</b>

(a) Adjusted to exclude the impact of any costs and revenues not associated with domestic energy margins, in particular, costs related to the international operations of PPL Global. Also adjusted to include gains on sales of emission allowances, which are included in other operation and maintenance expenses on the Statement of Income.

### Changes in Gross Domestic Energy Margins By Activity

Gross margin calculations are dependent on the allocation of fuel and purchased power costs to the activities listed in the following table. That allocation is based on monthly MWh consumption levels compared to monthly MWh supply costs. Any costs specific to an activity are charged to that activity.

	September 30, 2003 vs. September 30, 2002	
	Three Months Ended	Nine Months Ended
Wholesale - Eastern U.S.	\$ 4	\$ 35
Wholesale - Western U.S.	11	30
Net energy trading	5	(4)
Unregulated retail	(8)	(7)
Regulated retail		(63)
<b>Domestic gross energy margins</b>	<b>\$ 12</b>	<b>\$ (9)</b>

### Wholesale - Eastern U.S.

East wholesale margins were higher for the three and nine months ended September 30, 2003, compared to the same periods in 2002, primarily due to higher volumes, which increased by 11% and 39% over the same periods in 2002. The higher volumes were primarily driven by market opportunities to optimize the value of generating assets, and for the nine months ended September 30, 2003, by higher spot prices that allowed PPL Energy Supply to increase the utilization of its higher-cost generating units and by 699 MW of new generation which began commercial operations in mid 2002. Average PJM spot market real time prices rose 43% for the nine months ended September 30, 2003, compared to the same period in 2002. Partially offsetting the increase in

wholesale energy margins for the nine months ended September 30, 2003, compared to the same period in 2002, was the buyout of a NUG contract in February 2002, which reduced power purchases by \$25 million.

### Wholesale - Western U.S.

Western wholesale margins consist of margins in the Northwest and in the Southwest.

In the Northwest, margins were \$5 million and \$28 million higher for the three and nine months ended September 30, 2003, compared to the same periods in 2002, primarily due to higher wholesale prices. Average wholesale prices for the three and nine months ended September 30, 2003 were \$6/MWh higher than those realized in the same periods in 2002. Also, the nine months ended September 30, 2003 includes a \$3 million favorable settlement with Energy West Resources, Inc. in June 2003.

In the Southwest, margins were \$6 million higher for the three months ended September 30, 2003, compared to the same period in 2002, primarily due to the inception of new tolling agreements in Arizona in mid-2003. Margins in the Southwest were \$2 million higher for the nine months ended September 30, 2003, compared to the same period in 2002, due to the new tolling agreements in Arizona, partially offset by lower margins earlier in the year due to lower sales volumes.

### Spot Energy Trading

PPL Energy Supply enters into certain energy contracts that meet the criteria of trading derivatives as defined by EITF 02-3. These physical and financial contracts cover trading activity associated with electricity, gas and oil. Margins include both realized and unrealized gains and losses. The \$5 million increase for the three months ended September 30, 2003, compared to the same period in 2002, was primarily due to realized gains associated with electricity positions. The \$4 million decrease for the nine months ended September 30, 2003, compared to the same period in 2002, was primarily due to realized electric swap losses in 2003. The physical volumes associated with energy trading for the three months ended September 30, 2003 were 2,760 GWh and 3.8 Bcf, compared to 3,088 GWh and 3.6 Bcf for the three months ended September 30, 2002. Energy trading physical volumes for the nine months ended September 30, 2003 were 7,616 GWh and 11.0 Bcf, compared to 7,824 GWh and 8.7 Bcf for the nine months ended September 30, 2002.

### Unregulated Retail

Unregulated retail margins were lower for the three and nine months ended September 30, 2003, compared to the same periods in 2002, primarily due to significantly lower electric retail prices in the West. West retail contract prices decreased by approximately 22% for both the three and nine months ended September 30, 2003, compared to the same periods in 2002.

### Regulated Retail

Regulated retail margins in the East were flat for the three months ended September 30, 2003, compared to the same period in 2002, as sales and supply costs were unchanged between the periods. For the nine months ended September 30, 2003, regulated retail margins decreased by 10%, compared to the same period in 2002, due to higher supply costs resulting from higher purchased power prices during the first half of 2003. Purchase power prices were higher because of increased gas and oil prices and the abnormally cold winter.

### Utility Revenues

The decreases in utility revenues were attributable to the following:

	<u>September 30, 2003 vs. September 30, 2002</u>	
	<u>Three Months Ended</u>	<u>Nine Months Ended</u>
International:		
Retail electric delivery (PPL Global)		
U.K.	\$ 2	\$ 31
El Salvador	3	12
Bolivia		1
Chile	10	9
Brazil	(48)	(113)
	<u>\$ (33)</u>	<u>\$ (60)</u>

The decrease for both periods was primarily due to the deconsolidation of CEMAR in August 2002. PPL Global stopped recording operating results of CEMAR upon relinquishing control to ANEEL. (See Note 7 to the Financial Statements for additional information.)

The decreases for the three and nine month periods were partially offset by:

- higher WPD revenues in the U.K. primarily due to the change in foreign currency exchange rates from period to period;
- higher revenues in El Salvador primarily due to higher volumes and higher pass-through energy costs, partially offset by a 6% tariff reduction effective January 1, 2003; and
- higher revenues in Chile primarily due to higher volumes and the consolidation of certain transmission revenues. (See Note 7 to the Financial Statements for additional information.)

### Energy Related Businesses

Energy related businesses contributed \$19 million less to operating income for the nine months ended September 30, 2003, compared to the same period in 2002. The decrease resulted primarily from:

- \$8 million due to credits recorded on development projects in 2002, due largely to a favorable settlement on the cancellation of a generation project in Washington state;
- a \$6 million operating loss on some Hyder properties in 2003, which were subsequently sold in April 2003; and
- a \$4 million decrease in Latin America revenues from lower material and construction project sales. In 2002, PPL Global's Bolivian subsidiary participated in the construction of a 1,500 kilometer transmission line in rural areas of Bolivia.

### Other Operation and Maintenance

The increase (decrease) in other operation and maintenance expenses was primarily due to:

	September 30, 2003 vs. September 30, 2002	
	Three Months Ended	Nine Months Ended
Increase in WPD expenses due to increases in foreign currency exchange rates, regulatory accounting adjustments, and resolution of purchase accounting contingencies in the second quarter of 2002 related to the Hyder acquisition	\$ 6	\$ 29
Decrease in domestic and international pension income	9	28
Allocated trademark license fees from a PPL subsidiary	10	22
Additional expenses of new generating facilities that became operational in mid-2002	4	21
Accretion expense as a result of applying SFAS 143, "Accounting for Asset Retirement Obligations." See Note 13.	5	14
Outage costs associated with the turbine replacement at the Susquehanna station		7
Impairment charge on transmission rights		4
Increased expenses in domestic business lines and other-net	7	19
Change to account for CEMAR on the cost-method	(23)	(38)
Insurance settlements - property damage and environmental	(22)	(26)
Reduction in salaries and benefits as a result of the workforce reduction initiated in 2002	(6)	(16)
Gains on sales of emission allowances	(2)	(9)
Decrease in the Clean Air Act contingency relating to generating facilities		(8)
Estimated 2002 vacation liability adjustment in conjunction with the workforce reduction	(6)	(6)
	<u>\$ (18)</u>	<u>\$ 41</u>

The decreases in pension income for the three and nine months ended September 30, 2003 were attributable to PPL Energy

Supply's participation in PPL's primary domestic pension plan and the U.K. pension plans of WPD. As a result of weak capital markets during 2002, PPL's domestic and U.K. pension plans experienced significant asset losses. The weakened market performance decreased economic forecasts, which resulted in PPL reducing its expected return on assets assumption for its pension plans for 2003. In addition, declining fixed-income security yield rates resulted in PPL decreasing its discount rate assumption for its pension plans as of December 31, 2002. These events and assumption changes reduced the amount of pension income PPL Energy Supply will record in 2003. Through September 30, 2003, PPL Energy Supply recorded approximately \$30 million of pension income and will record approximately \$10 million of additional pension income in the fourth quarter of 2003. Future levels of income or expense will depend on ongoing market conditions and results.

### Depreciation

Depreciation expense increased by \$9 million for the nine months ended September 30, 2003, compared with the same period in 2002. Normal plant additions accounted for a \$16 million increase. Other impacts on depreciation were as follows:

- WPD depreciation increased by \$10 million due to depreciation on the write-up to fair value of assets acquired in the acquisition, and by \$7 million from increased foreign currency exchange rates.
- PPL Global's deconsolidation of CEMAR in 2002 resulted in a \$7 million decrease in depreciation on those assets in 2003.
- Due to the application of SFAS 143 on January 1, 2003, PPL Susquehanna depreciation expense (which previously included nuclear decommissioning expense) decreased by \$17 million for the nine months ended September 30, 2003, compared with the same period in 2002. There was a corresponding recording of accretion expense in 2003, which is part of other operation expense.

### Write-down of International Energy Projects

See Note 7 to the Financial Statements for additional information on the write-down of PPL Global's investment in CEMAR.

### Workforce Reduction

See Note 14 to the Financial Statements for information regarding the \$41 million charge recorded in 2002.

## Other Income - net

See Note 10 to the Financial Statements for details of other income.

## Interest Expense

The decreases in interest expense were due to:

	<u>September 30, 2003 vs. September 30, 2002</u>	
	<u>Three Months Ended</u>	<u>Nine Months Ended</u>
Decrease in long-term debt interest due to debt retirements	\$ (12)	\$ (20)
Decrease in long-term debt interest from the deconsolidation of CEMAR	(17)	(34)
Write-off unamortized swap costs on WPD debt restructuring		11
Decrease in short-term debt interest	(7)	(1)
Interest on Preferred Securities due to applying SFAS 150	3	3
Capitalized interest and other	11	19
	<u>\$ (22)</u>	<u>\$ (22)</u>

## Income Taxes

Income taxes increased by \$3 million and decreased by \$37 million for the three and nine months ended September 30, 2003, compared to the same periods in 2002. The changes were primarily due to:

- higher pre-tax book income, resulting in \$11 million and \$18 million increases in income taxes for the three and nine months ended September 30, 2003; offset by
- a reduction related to an impairment charge on PPL Energy Supply's investment in CEMAR resulting in a \$33 million deferred income tax valuation allowance recorded in the second quarter of 2002; and
- differences in income recognition for tax purposes related to foreign affiliates resulting in \$9 million and \$20 million reductions in income taxes for the three and nine months ended September 30, 2003.

## Cumulative Effect of a Change in Accounting Principle

PPL Energy Supply adopted SFAS 143, "Accounting for Asset Retirement Obligations," effective January 1, 2003. SFAS 143 addresses the accounting for obligations associated with the retirement of tangible long-lived assets. It requires legal obligations associated with the retirement of long-lived assets to be recognized as a liability in the financial statements. Application of the new rules resulted in a cumulative effect of adoption that increased net income by \$63 million. See Note 3 to the Financial Statements for additional information.

PPL Energy Supply adopted SFAS 142, "Goodwill and Other Intangible Assets," on January 1, 2002. SFAS 142 requires an

annual impairment test of goodwill and other intangible assets that are not subject to amortization. PPL Energy Supply conducted a transition impairment analysis in the first quarter of 2002 and recorded a transition goodwill impairment charge of \$150 million. See Note 12 to the Financial Statements for additional information.

## Financial Condition

### Liquidity

At September 30, 2003, PPL Energy Supply had \$339 million of cash and cash equivalents and \$84 million of short-term debt (including long-term debt due within one year). At December 31, 2002, PPL Energy Supply had \$149 million of cash and cash equivalents and \$934 million of short-term debt (including long-term debt due within one year).

The increase in PPL Energy Supply's cash position was primarily the net result of:

- cash provided by operating activities of \$645 million,
- the net decrease of \$597 million of notes receivables from affiliates,
- the issuance of \$799 million of long-term debt, and
- \$261 million of contributions from Member; offset by
- the net decrease of \$858 million of short-term debt,
- the retirement of \$56 million of long-term debt,
- \$909 million of distributions to Member, and
- capital expenditures of \$322 million.

In July 2003, PPL Energy Supply determined that, based on its strong current cash position and anticipated cash flows, it would not need to access the commercial paper markets through at least the end of 2003. PPL Energy Supply currently has no commercial paper outstanding. As a result, PPL Energy Supply requested Standard & Poor's Ratings Services (S&P), Moody's Investors Service, Inc. (Moody's) and Fitch Ratings (Fitch) to withdraw their ratings for the currently inactive commercial paper program, which they did effective as of July 9, 2003. Based on current cash position and credit availabilities under its respective revolving credit facilities, PPL Energy Supply does not expect this decision to limit its ability to fund its short-term liquidity needs.

### Rating Agency Decisions - PPL Energy Supply

S&P, Moody's and Fitch recently reviewed the credit ratings on the debt of PPL Energy Supply. Based on their respective reviews, the rating agencies made certain ratings revisions which are described below.

Management does not expect these ratings decisions to impact PPL Energy Supply's ability to raise new long-term debt. These ratings decisions will have an insignificant impact on PPL Energy Supply's cost of maintaining its credit facilities and the cost of any new long-term debt.

The ratings of S&P, Moody's and Fitch are not a recommendation to buy, sell or hold any securities of PPL Energy Supply. Such ratings may be subject to revisions or withdrawal by the agencies at any time and should be evaluated independently of each other and any other rating that may be assigned to its securities.

#### *S&P*

In April 2003, S&P notified PPL Energy Supply that it affirmed the 'BBB' corporate credit rating for PPL Energy Supply. S&P indicated that PPL Energy Supply remains on negative outlook. S&P indicated that the negative outlook for PPL Energy Supply reflects its view of weak debt-protection measures due to low wholesale energy prices. S&P also affirmed the 'A-2' commercial paper rating of PPL Energy Supply.

#### *Moody's*

In May 2003, Moody's downgraded the credit ratings on PPL Energy Supply's senior unsecured notes to 'Baa2' from 'Baa1'. The Moody's ratings outlook was stable for PPL Energy Supply.

Moody's stated that its downgrade reflects its concerns about PPL Energy Supply's modest exposure to merchant generation risk, the continued weakness in the wholesale power market and the associated financial impact on PPL Energy Supply, and concerns regarding the amount of cash flow to be generated from PPL Energy Supply's non-regulated domestic operations and the free cash flow available from its regulated international assets. However, Moody's also indicated that the full requirements contract between PPL Electric and PPL EnergyPlus, which previously was approved by the PUC and which extends through December 2009, provides a predictable stream of cash flows to PPL Energy Supply during such time period. Moody's also noted that PPL Energy Supply's management has already implemented a number of initiatives to strengthen its current credit quality and reduce its debt levels, such as a sizeable reduction in planned capital expenditures, the cancellation of projects under development, workforce reductions and write-downs of certain investments.

PPL Energy Supply's short-term debt rating was not impacted by Moody's long-term debt review.

In September 2003, Moody's announced that it was placing PPL Montana's 8.903% Pass-Through Certificates due 2020 under review for possible downgrade. These securities currently are rated 'Baa3' by Moody's. Moody's stated that its review is prompted by its concerns about the credit profile of PPL Montana's largest customer, NorthWestern, and lower

cash flow generation than was forecasted at the time the securities were issued in 2000. See Note 8 to the Financial Statements for additional information on NorthWestern's current situation. Management does not expect any action by Moody's based on this review to limit PPL Montana's ability to fund its short-term liquidity needs. PPL Montana has no plan to raise new long-term debt. Any ratings downgrade by Moody's would have an insignificant impact on PPL Montana's cost of maintaining the credit facility that it has in place with its affiliate. In addition, management does not expect any ratings downgrade by Moody's based on this review to have any adverse impact on the credit ratings of PPL Energy Supply.

#### *Fitch*

In May 2003, Fitch notified PPL Energy Supply that it:

- affirmed both the 'BBB+' rating of PPL Energy Supply's senior unsecured debt, and the 'F2' rating of its commercial paper; and
- placed PPL Energy Supply on negative outlook.

Fitch indicated that the change in outlook for PPL Energy Supply results from the increase during 2002 in its generation asset portfolio that is dependent on merchant generation, continued weakness in U.S. merchant energy markets and exposure to international distribution assets primarily in Latin America and the U.K. However, Fitch noted that PPL Energy Supply derives significant earnings and cash flow from long-term supply contracts, including the full requirements contract between PPL Electric and PPL EnergyPlus, that on average account for about 70% of PPL Energy Supply's gross margin over the next five years.

#### Rating Agency Decisions - WPD

In February 2003, Moody's confirmed the ratings of WPDH Limited and WPD (South Wales) at 'Baa2' and 'Baa1', and downgraded WPD LLP from 'Baa1' to 'Baa2' and SIUK Capital Trust I from 'Baa2' to 'Baa3'. The outlook on all ratings was stable. In March 2003, S&P assigned its 'BBB+' senior unsecured debt rating to the £200 million bonds issued by WPD (South West). At the same time, the 'BBB+' and 'A-2' corporate credit ratings on SIUK PLC were withdrawn as a result of the acquisition of its debt by WPD LLP. S&P assigned its 'BBB' long-term and 'A-2' short-term corporate credit ratings to WPD LLP in line with the ratings on the rest of the WPD group.

Following a review of holding companies of U.K. regulated utilities, in July 2003 S&P downgraded the long-term ratings from 'BBB' to 'BBB-' and short-term ratings from 'A-2' to 'A-3' for both WPDH Limited and WPD LLP, and retained a negative outlook. At the same time, S&P reaffirmed the credit ratings for WPD (South West) and WPD (South Wales) at 'BBB+'. This is in line with S&P U.K.'s recently announced implementation of a new methodology related to U.K. electric distribution holding companies wherein electric distribution

operating companies rated in the 'BBB' category will have the parent holding company (WPDH Limited) notched down by two categories from the operating company rating level. WPD's management does not expect the placement of WPD on a negative outlook to limit its ability to fund its short-term liquidity needs or access new long-term debt or to impact the cost of any new long-term debt.

## **Risk Management - Energy Marketing & Trading and Other**

### Market Risk

#### *Accounting and Reporting*

PPL Energy Supply follows the provisions of SFAS 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities," and SFAS 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities," and interpreted by DIG issues (together, "SFAS 133") and EITF 02-3, "Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities," to account for contracts entered into to manage market risk. SFAS 133 requires that all derivative instruments be recorded at fair value on the balance sheet as an asset or liability (unless they meet SFAS 133's criteria for exclusion) and that changes in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. PPL Energy Supply is in the process of evaluating the impact of adopting EITF 03-11, "Reporting Realized Gains and Losses on Derivative Instruments That Are Subject to FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities, and Not 'Held for Trading Purposes' as Defined in EITF Issue No. 02-3, 'Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities,'" which requires prospective application as of October 1, 2003.

In April 2003, the FASB issued SFAS 149, which amends and clarifies SFAS 133 to improve financial accounting and reporting for derivative instruments and hedging activities. To ensure that contracts with comparable characteristics are accounted for similarly, SFAS 149 clarifies the circumstances under which a contract with an initial net investment meets the characteristics of a derivative, clarifies when a derivative contains a financing component, amends the definition of an "underlying" and amends certain other existing pronouncements. SFAS 149 is effective for contracts entered into or modified and for hedging relationships designated after June 30, 2003, except certain provisions relating to forward purchases or sales of when-issued securities or other securities that do not yet exist should be applied to both existing contracts and new contracts entered into after June 30, 2003.

PPL Energy Supply adopted SFAS 149 effective July 1, 2003. The adoption of SFAS 149 did not have a significant impact

on PPL Energy Supply for the quarter ended September 30, 2003. PPL Energy Supply has changed the accounting for certain transactions on a prospective basis to conform with SFAS 149. This change could result in increased volatility in other comprehensive income and earnings in future periods.

For energy contracts that meet the definition of a derivative, the circumstances and intent existing at the time that energy transactions are entered into determine their accounting designation. The following summarizes the changes to the electricity guidelines that have been provided to the traders who are responsible for contract designation for derivative energy contracts due to the adoption of SFAS 149:

- Any wholesale and retail contracts to sell electricity and the related capacity that are expected to be delivered from PPL Energy Supply's generation are considered "normal." These transactions are not recorded in the financial statements and have no earnings impact until delivery.
- Physical electricity-only transactions can receive cash flow hedge treatment if all of the qualifications under SFAS 133 are met. Any unrealized gains or losses on transactions receiving cash flow hedge treatment are recorded in other comprehensive income.
- Physical electricity purchases that increase PPL Energy Supply's long position and any energy sale or purchase considered a "market call" are speculative, with unrealized gains or losses recorded immediately through earnings.
- Financial electricity transactions, which can be settled in cash, cannot be considered "normal" because they do not require physical delivery. These transactions receive cash flow hedge treatment if they lock in the price PPL Energy Supply will receive or pay for energy expected to be generated or purchased in the spot market. Any unrealized gains or losses on transactions that receive cash flow hedge treatment are recorded in other comprehensive income.

Transactions which do not qualify for hedge accounting treatment are marked to market through earnings.

#### *Commodity Price Risk*

As of September 30, 2003, PPL Energy Supply estimated that a 10% adverse movement in market prices across all geographic areas and time periods would have decreased the value of the commodity contracts in its non-trading portfolio by approximately \$174 million. However, the change in the value of the non-trading portfolio would have been substantially offset by an increase in the value of the underlying commodity, the electricity generated, because these contracts serve to reduce the market risk inherent in the generation of electricity. Additionally, the value of PPL Energy Supply's unsold generation would be improved. Because PPL Energy Supply's electricity portfolio is generally in a net sales position, the adverse movement in prices is usually an increase in prices. Conversely, because PPL Energy Supply's commodity fuels portfolio is generally in a net

purchase position, the adverse movement in prices is usually a decrease in prices. If both of these scenarios happened, the implied margins for the unsold generation would increase.

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

PPL Energy Supply's trading contracts mature at various times through 2005. The following chart sets forth PPL Energy Supply's net fair market value of trading contracts:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
Fair value of contracts outstanding at the beginning of the period	\$ (7)	\$ 1	\$ (6)	
Contracts realized or otherwise settled during the period	7	(1)	16	(2)
Fair value of new contracts at inception		(5)	(2)	(12)
Other changes in fair values	(3)	1	(11)	10
Fair value of contracts outstanding at the end of the period	<u>\$ (3)</u>	<u>\$ (4)</u>	<u>\$ (3)</u>	<u>\$ (4)</u>

During the three and nine months ended September 30, 2003, PPL Energy Supply reversed net losses of approximately \$7 million and \$16 million, and during the three and nine months ended September 30, 2002, PPL Energy Supply reversed net gains of approximately \$1 million and \$2 million. These amounts do not reflect intra-period contracts that were entered into and settled during the period.

"Other changes in fair values" represents changes in the market value of contracts outstanding at the end of the period.

As of September 30, 2003, the net unrealized loss on PPL Energy Supply's trading activities expected to be realized in earnings during the next three months is approximately \$9 million.

The following chart segregates estimated fair values of PPL Energy Supply's trading portfolio at September 30, 2003 based on whether the fair values are determined by quoted market prices or other more subjective means.

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

The "Prices actively quoted" category includes the fair value of exchange-traded natural gas futures contracts quoted on the New York Mercantile Exchange.

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

The "Prices based on models and other valuation methods" category includes the value of transactions for which an internally developed price curve was constructed as a result of the long-dated nature of the transaction or the illiquidity of the market point, or the value of options not quoted by an exchange or OTC broker. Additionally, this category includes "strip" transactions whose prices are obtained from external sources and then modeled to monthly prices as appropriate. This level of modeling has been increasingly required due to the illiquidity of the energy markets.

As of September 30, 2003, PPL Energy Supply estimated that a 10% adverse movement in market prices across all geographic areas and time periods would have decreased the value of the commodity contracts in its trading portfolio by \$3 million.

#### Interest Rate Risk

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

debt portfolio due to changes in the absolute level of interest rates.

At September 30, 2003, PPL Energy Supply's potential annual exposure to increased interest expense, based on a 10% increase in interest rates, was estimated at \$1 million.

PPL Energy Supply is also exposed to changes in the fair value of its debt portfolio. At September 30, 2003, PPL Energy Supply estimated that its potential exposure to a change in the fair value of its debt portfolio, through a 10% adverse movement in interest rates, was \$127 million.

PPL and PPL Energy Supply utilize various risk management instruments to reduce PPL Energy Supply's exposure to adverse interest rate movements for future anticipated financings. While PPL Energy Supply is exposed to changes in the fair value of these instruments, they are designed such that any economic loss in value should be offset by interest rate savings at the time the future anticipated financing is completed. At September 30, 2003, PPL Energy Supply estimated that its potential exposure to a change in the fair value of these instruments, through a 10% adverse movement in interest rates, was insignificant.

#### *Foreign Currency Risk*

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

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

PPL holds contracts for the forward purchase of 26 million euros and £1 million to pay for certain equipment of a PPL Energy Supply subsidiary in 2003 and 2004. The estimated value of these forward purchases as of September 30, 2003, being the amount PPL would receive to terminate them, was approximately \$6 million.

To protect expected income in British pounds sterling, PPL entered into average rate options for £26 million and average rate forward sale agreements for £20 million. To protect expected income in Chilean pesos, PPL entered into average rate options for 4 billion Chilean pesos. At September 30, 2003, the market value of these positions, representing the amount PPL would pay to terminate them, was \$1 million.

WPDH Limited executed cross-currency swaps totaling \$1.3 billion to hedge the value of its U.S. dollar-denominated bonds. The estimated value of this position on September 30, 2003, being the amount PPL would pay to terminate them, was \$31 million.

#### *Nuclear Decommissioning Fund - Securities Price Risk*

In connection with certain Nuclear Regulatory Commission requirements, PPL Susquehanna maintains trust funds to fund certain costs of decommissioning the Susquehanna station. As of September 30, 2003, these funds were invested primarily in domestic equity securities and fixed-rate, fixed-income securities and are reflected at fair value on PPL Energy Supply's Balance Sheet. The mix of securities is designed to provide returns to be used to fund Susquehanna's decommissioning and to compensate for inflationary increases in decommissioning costs. However, the equity securities included in the trusts are exposed to price fluctuation in equity markets, and the values of fixed-rate, fixed-income securities are exposed to changes in interest rates. PPL Susquehanna actively monitors the investment performance and periodically reviews asset allocation in accordance with its nuclear decommissioning trust policy statement. At September 30, 2003, a hypothetical 10% adverse movement in interest rates and a 10% decrease in equity prices would have resulted in an estimated \$21 million reduction in the fair value of the trust assets.

PPL Electric's 1998 restructuring settlement agreement provides for the collection of authorized nuclear decommissioning costs through the CTC. Additionally, PPL Electric is permitted to seek recovery from customers of up to 96% of certain increases in these costs. Under the power supply agreements between PPL Electric and PPL EnergyPlus, these revenues are passed on to PPL EnergyPlus. Similarly, these revenues are passed on to PPL Susquehanna under a power supply agreement between PPL EnergyPlus and PPL Susquehanna. These revenues are used to fund the trusts.

#### **Related Party Transactions**

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

For information on related party accounting transactions, see Note 9 to the Financial Statements.

#### **Acquisitions and Development**

From time-to-time, PPL Energy Supply and its subsidiaries are involved in negotiations with third parties regarding acquisitions, joint ventures and other arrangements which may or may not result in definitive agreements. See Note 7 to the Financial Statements for information regarding recent acquisitions and development activities.

At September 30, 2003, PPL Energy Supply had domestic generation projects under development which will provide 645 MW of additional generation.

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

## **Environmental Matters**

See Note 8 to the Financial Statements for a discussion of environmental matters.

## **New Accounting Standards**

### **FIN 46**

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51." FIN 46 clarifies that variable interest entities, as defined therein, that do not disperse risks among the parties involved should be consolidated by the entity that is determined to be the primary beneficiary. FIN 46 also requires certain disclosures to be made by the primary beneficiary and by an enterprise that holds a significant variable interest in a variable interest entity but is not the primary beneficiary. FIN 46 applies immediately to variable interest entities created after January 31, 2003 and to variable interest entities in which an enterprise obtains an interest after January 31, 2003. For variable interest entities in which an enterprise holds a variable interest that was acquired before February 1, 2003, FIN 46 was originally required to be adopted no later than the first fiscal year or interim period beginning after June 15, 2003. However, in October 2003, the FASB issued Staff Position No. FIN 46-6, "Effective Date of FASB Interpretation No. 46, Consolidation of Variable Interest Entities," which delays the effective date for applying the provisions of FIN 46 to interests held by public entities in variable interest entities or potential variable interest entities created before February 1, 2003 until the end of the first interim period ending after December 15, 2003.

FIN 46 did not have an impact on PPL Energy Supply during the three or nine months ended September 30, 2003. PPL Energy Supply is in the process of evaluating entities in which it holds a variable interest that was acquired before February 1, 2003. Except as discussed below, PPL Energy Supply is currently not aware of any variable interest entities that are not consolidated as of September 30, 2003 but which it will be required to consolidate in accordance with FIN 46 effective December 31, 2003. As it continues to evaluate the impact of applying FIN 46, PPL Energy Supply may identify additional entities that it would need to consolidate.

The lessors under the operating leases for the Sundance, University Park and Lower Mt. Bethel generation facilities are variable interest entities in which PPL Energy Supply is the primary beneficiary. Consequently, under FIN 46, PPL Energy Supply will be required to consolidate the financial statements of the lessors effective December 31, 2003. The principal impact from consolidating the lessors under these

leases will be the inclusion of the generation facilities as assets and the lease financing as liabilities in the consolidated balance sheet of PPL Energy Supply. Additionally, PPL Energy Supply will be required to recognize a cumulative effect of a change in accounting principle in connection with the initial consolidation of these variable interest entities. PPL Energy Supply estimates that, upon applying the provisions of FIN 46 to these entities effective December 31, 2003, it will recognize approximately \$1.0 billion of additional assets and liabilities on its balance sheet and a charge of \$27 million, after-tax, as a cumulative effect of a change in accounting principle. See Note 15 to the Financial Statements for a discussion of the leases.

### **Other**

See Note 15 to the Financial Statements for information on other new accounting standards adopted in 2003 or pending adoption.

## **Application of Critical Accounting Policies**

PPL Energy Supply's financial condition and results of operations are impacted by the methods, assumptions and estimates used in the application of critical accounting policies. The following accounting policies are particularly important to the financial condition or results of operations of PPL Energy Supply, and require estimates or other judgments of matters inherently uncertain: price risk management, pension and other postretirement benefits, asset impairment, leasing, loss accruals and asset retirement obligations.

See Item 7, "Review of the Financial Condition and Results of Operations," in PPL Energy Supply's Annual Report to the SEC on Form 10-K for the year ended December 31, 2002 for a discussion of each critical accounting policy, except for asset retirement obligations which is discussed below. For an additional discussion on the impact of SFAS 149 on price risk management, see "Risk Management - Energy Marketing & Trading and Other" in Financial Condition. PPL's senior management has reviewed these critical accounting policies, and the estimates and assumptions regarding them, with its Audit Committee. In addition, PPL's senior management reviewed the Form 10-K disclosures regarding the application of these critical accounting policies with the Audit Committee.

### **Asset Retirement Obligations**

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

the income statement, for changes in the obligation due to the passage of time. SFAS 143 is effective for fiscal years beginning after June 15, 2002.

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

PPL Energy Supply adopted SFAS 143 effective January 1, 2003. Initial adoption of the new rules resulted in an increase in net property, plant and equipment of \$32 million, reversal of previously recorded liabilities of \$304 million, recognition of asset retirement obligations of \$229 million, recognition of a deferred tax liability of \$44 million and a cumulative effect of adoption that increased net income by \$63 million. PPL Energy Supply's most significant assumptions surrounding asset retirement obligations are the forecasted retirement cost, discount rate and inflation rate. A variance in the forecasted retirement cost, discount rate or inflation rate could have a significant impact on the ARO liability and the cumulative effect gain.

The following chart reflects the sensitivities associated with a change in these assumptions upon initial adoption. Each sensitivity below reflects an evaluation of the change based solely on a change in that assumption only.

	<u>Change in Assumption</u>	<u>Impact on Cumulative Effect</u>	<u>Impact on ARO Liability</u>
<b>Retirement Cost</b>	10/(10)%	\$(10)/\$10	\$21/\$(21)
<b>Discount Rate</b>	0.25/(0.25)%	\$10/\$(11)	\$(22)/\$25
<b>Inflation Rate</b>	0.25/(0.25)%	\$(12)/\$11	\$25/\$(22)

# PPL ELECTRIC UTILITIES CORPORATION AND SUBSIDIARIES

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

This discussion should be read in conjunction with the Financial Statements and Combined Notes to Condensed Consolidated Financial Statements included in Item 1 above, and with the section entitled "Review of the Financial Condition and Results of Operations" in PPL Electric's Annual Report to the SEC on Form 10-K for the year ended December 31, 2002. Terms and abbreviations appearing here are explained in the glossary. Dollars are in millions, unless otherwise noted.

### Results of Operations

The following discussion, which explains significant changes in principal items on the Statement of Income, compares the three and nine months ended September 30, 2003 to the comparable periods in 2002.

The Statement of Income reflects the results of past operations and is not intended as any indication of future operating results. Future operating results will necessarily be affected by various and diverse factors and developments. Furthermore, because results for interim periods can be disproportionately influenced by various factors and developments and by seasonal variations, the results of operations for interim periods do not necessarily indicate results or trends for the year.

### **Earnings**

The changes in net income from period to period were, in part, attributable to an unusual item with unfavorable earnings impacts as show below. Income from core operations, which excludes the impact of unusual items, should not be considered as an alternative to net income, which is an indicator of operating performance determined in accordance with GAAP. PPL Electric believes that income from core operations, although a non-GAAP measure, is also useful and meaningful to investors because it provides them with PPL Electric's underlying earnings performance as another criterion in making their investment decisions. PPL Electric's management also uses income from core operations in measuring certain corporate performance goals. Other companies may use different measures to present financial performance. The table below reconciles income from core operations to net income, by eliminating the impact of unusual items.

	<u>Three Months Ended</u>		<u>Nine Months Ended</u>	
	<u>September 30,</u>	<u>September 30,</u>	<u>September 30,</u>	<u>September 30,</u>
	<u>2003</u>	<u>2002</u>	<u>2003</u>	<u>2002</u>
Income (loss) from core operations	\$ (1)	\$ 24	\$ 28	\$ 55
Unusual item (net of tax):				
Workforce reduction (Note 14)	(5)		(5)	(19)
Net Income (loss) - actual	<u>\$ (6)</u>	<u>\$ 24</u>	<u>\$ 23</u>	<u>\$ 36</u>

The after-tax changes in core earnings were primarily due to:

	<u>September 30, 2003 vs. September 30, 2002</u>	
	<u>Three Months Ended</u>	<u>Nine Months Ended</u>
Delivery revenues (net of CTC/ITC amortization and interest expense on transition bonds)	\$ (2)	\$ 15
Higher ancillary expenses		(4)
Higher operating and maintenance expenses	(9)	(19)
Lower dividends and distributions on preferred securities	2	7
Lower interest income	(3)	(5)
Higher interest expense (excluding transition bonds)	(2)	(7)
Settlement of capital stock tax in 2002	(7)	(7)
Lower affiliated revenues	(2)	(6)
Higher depreciation expense	(2)	(4)
Other - net		3
	<u>\$ (25)</u>	<u>\$ (27)</u>

The period to period changes in earnings components are discussed in the balance of "Results of Operations."

In May 2003, PPL Electric announced that it expects to file a request for a delivery rate increase with the PUC in the spring of 2004. If approved, the new rates will go into effect in January 2005, when PPL Electric's distribution rate cap expires. PPL Electric has not yet determined the amount of the rate increase it will request, and cannot predict the amount of such increase that will ultimately be approved by the PUC.

### **Operating Revenues**

#### Retail Electric

The increase (decrease) in revenues from retail electric operations was attributable to the following:

	<u>September 30, 2003 vs. September 30, 2002</u>	
	<u>Three Months Ended</u>	<u>Nine Months Ended</u>
Electric delivery	\$ 1	\$ 48
PLR electric generation supply	(2)	11
Delivery and PLR supply to PPL Generation	(6)	(12)
Other		(4)
	<u>\$ (7)</u>	<u>\$ 43</u>

The decrease in operating revenue from retail electric operations for the three months ended September 30, 2003, compared with the same period in 2002, was primarily due to

lower sales to PPL Generation beginning in April 2003. PPL Generation's power plants began self-supplying their station use at that date, rather than taking delivery from PPL Electric.

The increase in operating revenues from retail electric operations for the nine months ended September 30, 2003, compared with the same period in 2002, was primarily due to:

- higher delivery revenues resulting from a 1.5% increase in delivery sales. The increase in sales volume was due in part to colder winter weather in the first quarter of 2003;
- higher net unbilled revenues;
- higher PLR revenues due to increased energy and capacity rates in 2003 compared with 2002; and
- lower sales to PPL Generation's power plants, as described above.

### Wholesale Electric to Affiliate

PPL Electric has a contract to sell to PPL EnergyPlus the electricity that PPL Electric purchases under contracts with NUGs. With the termination in February 2002 of a NUG contract, PPL Electric purchased less NUG energy in 2003 and therefore had less electricity to sell to PPL EnergyPlus.

### Other Operation Expenses

The increases in other operation expenses were due to:

	<u>September 30, 2003 vs. September 30, 2002</u>	
	<u>Three Months Ended</u>	<u>Nine Months Ended</u>
Decrease in pension income	\$ 2	\$ 11
Incremental storm restoration costs associated with Hurricane Isabel	6	6
Increases in expenses in responding to customers' service calls	2	4
Environmental accrual for a former manufactured gas plant		2
Increased electric contractor/additional material costs	1	2
Increased residential weatherization program expenses	1	2
Increase to property damage provision, based on an aging of those accounts receivable		1
Other increases - net	1	4
Reduction in salaries and benefits as a result of the workforce reduction initiated in 2002	(4)	(10)
Estimated 2002 vacation liability adjustment in conjunction with the workforce reduction	(7)	(7)
	<u>\$ 2</u>	<u>\$ 15</u>

The decreases in pension income for the three and nine months ended September 30, 2003 were attributable to PPL Electric's participation in PPL's primary domestic pension plan. As a

result of weak capital markets during 2002, PPL's domestic pension plans experienced significant asset losses. The weakened market performance decreased economic forecasts, which resulted in PPL reducing its expected return on assets assumption for 2003. In addition, declining fixed-income security yield rates resulted in PPL's decreasing its discount rate assumption for its pension plans as of December 31, 2002. These events and assumption changes reduced the amount of pension income PPL will record in 2003. PPL Electric participates in PPL's primary domestic pension plan and is allocated approximately 46% of the obligations and costs of that plan. Through September 30, 2003, PPL Electric was allocated approximately \$3 million of pension income and expects to be allocated an additional \$1 million of pension income in the fourth quarter of 2003. Future levels of pension income or expense depend on ongoing market conditions and plan results.

### Maintenance Expenses

Maintenance expenses increased by \$13 million for the three months ended September 30, 2003, compared with the same period in 2002. The increase was primarily due to \$7 million of incremental storm restoration costs due to Hurricane Isabel, \$2 million associated with summer storms and a \$2 million increase in tree trimming costs.

Maintenance expenses increased by \$18 million for the nine months ended September 30, 2003, compared with the same period in 2002. The increase was primarily due to the \$9 million of storm restoration costs mentioned above, as well as \$2 million of work performed to assure reliability of the transmission and distribution system and \$4 million in lower rent allocations to other PPL affiliates in 2003.

### Depreciation

Depreciation increased by \$3 million and \$7 million for the three and nine months ended September 30, 2003, compared with the same periods in 2002, primarily due to plant and software additions, including the automated meter reading project.

### Taxes, Other Than Income

Taxes, other than income, increased by \$9 million and \$11 million during the three and nine months ended September 30, 2003, compared with the same periods in 2002. These increases were primarily due to the settlement of prior years' capital stock tax refund claims of \$8 million in 2002, and higher taxes related to an increase in the basis on which capital stock tax is calculated for 2003.

### Workforce Reduction

See Note 14 to the Financial Statements for information regarding the \$33 million charge recorded in June 2002 and the \$9 million charge recorded in September 2003.

## Income Taxes

Income taxes decreased by \$18 million and \$5 million for the three and nine months ended September 30, 2003, compared to the same periods in 2002, as a result of lower pre-tax book income.

## Dividends and Distributions - Preferred Securities

Dividends and distributions on preferred securities decreased by \$3 million and \$12 million during the three and nine months ended September 30, 2003, compared with the same periods in 2002, due to the retirement of preferred securities in 2002.

## Financial Condition

### Liquidity

At September 30, 2003, PPL Electric had \$208 million of cash and cash equivalents and \$303 million of long-term debt due within one year. At December 31, 2002, PPL Electric had \$29 million of cash and cash equivalents and \$289 million of short-term debt (including long-term debt due within one year).

The increase in PPL Electric's cash position was primarily the net result of:

- cash provided by operating activities of \$415 million,
- the issuance of \$190 million of long-term debt,
- a \$90 million net decrease in notes receivable from affiliates, and
- a \$75 million capital contribution from PPL; offset by
- the retirement of \$351 million of long-term debt,
- payment of \$32 million of common and preferred dividends,
- retirement of preferred stock of \$14 million,
- repayment of commercial paper of \$15 million, and
- capital expenditures of \$174 million.

In July 2003, PPL Electric determined that, based on its strong current cash position and anticipated cash flows, it would not need to access the commercial paper markets through at least the end of 2003. PPL Electric currently has no commercial paper outstanding. As a result, PPL Electric requested Standard & Poor's Ratings Services (S&P), Moody's Investors Service, Inc. (Moody's) and Fitch Ratings (Fitch) to withdraw their ratings for the currently inactive commercial paper program, which they did effective as of July 9, 2003. Based on current cash position and credit availabilities under its respective revolving credit facilities, PPL Electric does not expect this decision to limit its ability to fund its short-term liquidity needs.

### Rating Agency Decisions

S&P and Moody's recently reviewed the credit ratings on the debt and preferred securities of PPL Electric. Based on their

respective reviews, the rating agencies made certain ratings revisions which are described below.

Management does not expect these ratings decisions to impact PPL Electric's ability to raise new long-term debt. These ratings decisions will have an insignificant impact on PPL Electric's cost of maintaining its credit facilities and the cost of any new long-term debt.

The ratings of S&P and Moody's are not a recommendation to buy, sell or hold any securities of PPL Electric. Such ratings may be subject to revisions or withdrawal by the agencies at any time and should be evaluated independently of each other and any other rating that may be assigned to its securities.

### *S&P*

In April 2003, S&P notified PPL Electric that it affirmed 'A-' ratings on PPL Electric's first mortgage bonds and senior secured bonds, and placed PPL Electric on negative outlook. S&P also affirmed the 'A-2' commercial paper rating of PPL Electric.

### *Moody's*

In May 2003, Moody's downgraded the credit ratings on PPL Electric's first mortgage bonds and senior secured bonds to 'Baa1' from 'A3'. The ratings outlook was stable for PPL Electric. PPL Electric's short-term debt rating was not impacted by Moody's long-term debt review.

For additional information on PPL Electric's liquidity, see Item 7, "Review of the Financial Condition and Results of Operations," in PPL Electric's Annual Report to the SEC on Form 10-K for the year ended December 31, 2002.

## Risk Management

### Market Risk

#### *Commodity Price Risk - PLR Contracts*

PPL Electric and PPL EnergyPlus have power supply agreements under which PPL EnergyPlus sells to PPL Electric (under a predetermined pricing arrangement) energy and capacity to fulfill PPL Electric's PLR obligation through 2009. As a result, PPL Electric has shifted any electric price risk relating to its PLR obligation to PPL EnergyPlus for 2002 through 2009. See Note 9 to the Financial Statements for information on the PLR contracts.

#### *Interest Rate Risk*

PPL Electric has issued debt to finance its operations, which increases its interest rate risk. At September 30, 2003, PPL Electric's potential annual exposure to increased interest expense, based on a 10% increase in interest rates, was insignificant.

PPL Electric is also exposed to changes in the fair value of its debt portfolio. At September 30, 2003, PPL Electric estimated that its potential exposure to a change in the fair value of its debt portfolio, through a 10% adverse movement in interest rates, was approximately \$60 million.

### **Related Party Transactions**

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

For information on related party accounting transactions, see Note 9 to the Financial Statements.

### **Environmental Matters**

See Note 8 to the Financial Statements for a discussion of environmental matters.

### **New Accounting Standards**

See Note 15 to the Financial Statements for information on new accounting standards adopted in 2003 or pending adoption.

### **Application of Critical Accounting Policies**

PPL Electric's financial condition and results of operations are impacted by the methods, assumptions and estimates used in the application of critical accounting policies. The following accounting policies are particularly important to the financial condition or results of operations of PPL Electric, and require estimates or other judgments of matters inherently uncertain: pension and other postretirement benefits, and loss accruals. See Item 7, "Review of the Financial Condition and Results of Operations," in PPL Electric's Annual Report to the SEC on Form 10-K for the year ended December 31, 2002 for a discussion of each critical accounting policy. PPL's senior management has reviewed these critical accounting policies, and the estimates and assumptions regarding them, with its Audit Committee. In addition, PPL's senior management reviewed the Form 10-K disclosures regarding the application of these critical accounting policies with the Audit Committee.

**Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following analysis of the results of operations and financial condition of PPL Montana is abbreviated as PPL Montana meets the conditions set forth in General Instruction (H)(1)(a) and (b) of Form 10-Q. This discussion should be read in conjunction with the Financial Statements and Combined Notes to Condensed Consolidated Financial Statements included in Item 1 above, and with the section entitled "Review of the Financial Condition and Results of Operations" in PPL Montana's Annual Report to the SEC on Form 10-K for the year ended December 31, 2002. Terms and abbreviations appearing here are explained in the glossary.

**Results of Operations**

The following discussion explains significant changes in principal items on the Statement of Income, comparing the nine months ended September 30, 2003 to the comparable period in 2002.

The Statement of Income reflects the results of past operations and is not intended as any indication of future operating results. Future operating results will necessarily be affected by various and diverse factors and developments. Furthermore, because results for interim periods can be disproportionately influenced by various factors and developments and by seasonal variations, the results of operations for interim periods are not necessarily indicative of results or trends for the year.

**Earnings**

Net income increased by \$18 million for the nine months ended September 30, 2003, compared with the same period in 2002. The increase was primarily due to higher wholesale prices in the western U.S.

**Operating Revenues**

Operating revenues increased by \$46 million for the nine months ended September 30, 2003, compared with the same period in 2002. Higher wholesale energy prices in 2003, compared with 2002, accounted for \$35 million of this increase. Higher sales volumes accounted for an additional \$11 million increase.

**Operating Expense**

Operating expenses increased by \$18 million during the nine months ended September 30, 2003, compared with the same period in 2002. Operating expenses consist mainly of expenses for fuel, energy purchases, transmission tariffs, plant operations and maintenance, lease rental payments, and general and administrative expenses. The increase was primarily due to a \$19 million increase in energy purchases. Higher power prices resulted in an \$18 million increase in

energy purchases, while an increase in volumes purchased resulted in an increase of \$1 million.

Generation increased by 306 million kWh during the nine months ended September 30, 2003, compared with the same period in 2002. This increase was due to improved operational performance from coal-fired generation units.

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

**Market Risk**

*Accounting and Reporting*

PPL Montana follows the provisions of SFAS 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities," and SFAS 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities," and interpreted by DIG issues (together, "SFAS 133") and EITF 02-3, "Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities," to account for contracts entered into to manage market risk. SFAS 133 requires that all derivative instruments be recorded at fair value on the balance sheet as an asset or liability (unless they meet SFAS 133's criteria for exclusion) and that changes in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. PPL Montana is in the process of evaluating the impact of adopting EITF 03-11, "Reporting Realized Gains and Losses on Derivative Instruments That Are Subject to FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities, and Not "Held for Trading Purposes" as Defined in EITF Issue No. 02-3, "Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities," which requires prospective application as of October 1, 2003.

In April 2003, the FASB issued SFAS 149, which amends and clarifies SFAS 133 to improve financial accounting and reporting for derivative instruments and hedging activities. To ensure that contracts with comparable characteristics are accounted for similarly, SFAS 149 clarifies the circumstances under which a contract with an initial net investment meets the characteristics of a derivative, clarifies when a derivative contains a financing component, amends the definition of an "underlying" and amends certain other existing pronouncements. SFAS 149 is effective for contracts entered into or modified and for hedging relationships designated after June 30, 2003, except certain provisions relating to forward purchases or sales of when-issued securities or other securities

that do not yet exist should be applied to both existing contracts and new contracts entered into after June 30, 2003.

PPL Montana adopted SFAS 149 effective July 1, 2003. The adoption of SFAS 149 did not have a significant impact on PPL Montana for the quarter ended September 30, 2003. PPL Montana has changed the accounting for certain transactions on a prospective basis to conform with SFAS 149. This change could result in increased volatility in other comprehensive income and earnings in future periods.

For energy contracts that meet the definition of a derivative, the circumstances and intent existing at the time that energy transactions are entered into determine their accounting designation. The following summarizes the changes to the electricity guidelines that have been provided to the traders who are responsible for contract designation for derivative energy contracts due to the adoption of SFAS 149:

- Any wholesale and retail contracts to sell electricity and the related capacity that are expected to be delivered from PPL Montana's generation are considered "normal." These transactions are not recorded in the financial statements and have no earnings impact until delivery.
- Physical electricity-only transactions can receive cash flow hedge treatment if all of the qualifications under SFAS 133 are met. Any unrealized gains or losses on transactions receiving cash flow hedge treatment are recorded in other comprehensive income.
- Physical electricity purchases that increase PPL Montana's long position and any energy sale or purchase considered a "market call" are speculative, with unrealized gains or losses recorded immediately through earnings.
- Financial electricity transactions, which can be settled in cash, cannot be considered "normal" because they do not require physical delivery. These transactions receive cash flow hedge treatment if they lock in the price PPL Montana will receive or pay for energy expected to be generated or purchased in the spot market. Any unrealized gains or losses on transactions that receive cash flow hedge treatment are recorded in other comprehensive income.

Transactions which do not qualify for hedge accounting treatment are marked to market through earnings.

#### *Commodity Price Risk*

As of September 30, 2003, PPL Montana estimated that a 10% adverse movement in market prices across all geographic areas and time periods would have decreased the value of the commodity contracts in its non-trading portfolio by approximately \$85 million. However, the change in the value of the non-trading portfolio would have been substantially offset by an increase in the value of the underlying commodity, the electricity generated, because these contracts serve to reduce the market risk inherent in the generation of electricity. Additionally, the value of PPL Montana's unsold generation would be improved. Because PPL Montana's electricity

portfolio is generally in a net sales position, the adverse movement in prices is usually an increase in prices.

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

PPL Montana's trading contracts mature at various times through 2003. PPL Montana's net fair market value of trading contracts as of September 30, 2003 was insignificant.

As of September 30, 2003, the net unrealized gain on PPL Montana's trading activities expected to be realized in earnings during the next three months is insignificant.

PPL Montana estimated that a 10% adverse movement in market prices across all geographic areas and time periods would have decreased the value of the commodity contracts in its trading portfolio by an insignificant amount at September 30, 2003.

#### *Interest Rate Risk*

PPL Montana may use borrowings to provide funds for its operations. PPL and PPL Energy Supply may utilize various financial derivative products and risk management techniques on behalf of PPL Montana to adjust the mix of fixed and floating interest rates in PPL Montana's debt portfolio and thereby reduce its exposure to adverse interest rate movements. PPL Montana had no exposure to increased interest expense based on a 10% increase in interest rates.

#### **New Accounting Standards**

See Note 15 to the Financial Statements for information on new accounting standards adopted in 2003 or pending adoption.

#### **Application of Critical Accounting Policies**

PPL Montana's financial condition and results of operations are impacted by the methods, assumptions and estimates used in the application of critical accounting policies. The following accounting policies are particularly important to the financial condition or results of operations of PPL Montana, and require estimates or other judgments of matters inherently uncertain: price risk management, pension and other postretirement benefits, leasing, and loss accruals.

See Item 7, "Review of the Financial Condition and Results of Operations," in PPL Montana's Annual Report to the SEC on Form 10-K for the year ended December 31, 2002 for a discussion of each critical accounting policy. For an additional discussion on the impact of SFAS 149 on price risk management, see "Risk Management - Energy Marketing &

Trading and Other" in Financial Condition. PPL's senior management has reviewed these critical accounting policies, and the estimates and assumptions regarding them, with its Audit Committee. In addition, PPL's senior management reviewed the Form 10-K disclosures regarding the application of these critical accounting policies with the Audit Committee.

**PPL CORPORATION  
PPL ENERGY SUPPLY, LLC  
PPL ELECTRIC UTILITIES CORPORATION  
PPL MONTANA, LLC AND SUBSIDIARIES**

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

Reference is made to "Risk Management - Energy Marketing & Trading and Other" in Management's Discussion and Analysis of Financial Condition and Results of Operations.

**Item 4. Controls and Procedures**

- (a) Evaluation of disclosure controls and procedures.

The registrants' principal executive officers and principal financial officers, based on their evaluation of the registrants' disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934), have concluded that, as of September 30, 2003, the registrants' disclosure controls and procedures are adequate and effective to ensure that material information relating to the registrants and their consolidated subsidiaries is recorded, processed, summarized and reported within the time periods specified by the SEC's rules and forms, particularly during the period for which this quarterly report has been prepared.

- (b) Change in internal control over financial reporting.

The registrants' principal executive officers and principal financial officers have concluded that there were no changes in the registrants' internal control over financial reporting during the registrants' third fiscal quarter that have materially affected, or are reasonably likely to materially affect, the registrants' internal control over financial reporting.

**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

For additional information regarding various pending administrative and judicial proceedings involving regulatory, environmental and other matters, which information is incorporated by reference into this Part II, see:

- Item 3 "Legal Proceedings" in PPL's, PPL Energy Supply's, PPL Electric's and PPL Montana's Annual Report to the SEC on Form 10-K for the year ended December 31, 2002; and
- Note 8 of the registrants' "Combined Notes to Condensed Consolidated Financial Statements" in Part I of this report.

**Item 6. Exhibits and Reports on Form 8-K**

(a) Exhibits

Computation of Ratio of Earnings to Fixed Charges for the following Company:

12(a) - PPL Energy Supply, LLC and Subsidiaries

Certifications pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, for the quarterly period ended September 30, 2003, filed by the following officers for the following companies:

- 31(a) - William F. Hecht for PPL Corporation
- 31(b) - John R. Biggar for PPL Corporation
- 31(c) - William F. Hecht for PPL Energy Supply, LLC
- 31(d) - James E. Abel for PPL Energy Supply, LLC
- 31(e) - John F. Sipics for PPL Electric Utilities Corporation
- 31(f) - James E. Abel for PPL Electric Utilities Corporation
- 31(g) - James H. Miller for PPL Montana, LLC
- 31(h) - James E. Abel for PPL Montana, LLC

Certifications pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, for the quarterly period ended September 30, 2003, furnished by the following officers for the following companies:

- 32(a) - William F. Hecht for PPL Corporation
- 32(b) - John R. Biggar for PPL Corporation
- 32(c) - William F. Hecht for PPL Energy Supply, LLC
- 32(d) - James E. Abel for PPL Energy Supply, LLC
- 32(e) - John F. Sipics for PPL Electric Utilities Corporation
- 32(f) - James E. Abel for PPL Electric Utilities Corporation
- 32(g) - James H. Miller for PPL Montana, LLC
- 32(h) - James E. Abel for PPL Montana, LLC

(b) Reports on Form 8-K

Report dated July 9, 2003 - PPL, PPL Energy Supply and PPL Electric

Item 5. Other Events

Announced that based on their strong current cash positions and anticipated cash flows, they will not need to access the commercial paper markets through at least the end of 2003. As a result of this announcement, requested Standard & Poor's Ratings Services, Moody's Investor Service, Inc. and Fitch Ratings to withdraw their ratings for these currently inactive commercial paper programs, effective July 9, 2003.

Report dated July 29, 2003 - PPL

Item 12. Disclosure of Results of Operations and Financial Condition

Press release regarding PPL's results for the quarter ended June 30, 2003.

Item 7. Financial Statements and Exhibits

Press release announcing PPL's results for the quarter ended June 30, 2003.

Report dated September 11, 2003 - PPL Montana

Item 9. Rating Agency Announcement

Moody's Investors Service, Inc. announced that it was placing PPL Montana's 8.903% Pass-Through Certificates due 2020 under review for possible downgrade due to the credit profile of PPL Montana's largest customer, NorthWestern, and lower cash generation than was forecasted at the time the securities were issued in 2000.

Item 7. Financial Statements and Exhibits

Press Release by Moody's Investors Service, Inc.

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrants have duly caused this report to be signed on their behalf by the undersigned thereunto duly authorized. The signature for each undersigned company shall be deemed to relate only to matters having reference to such company or its subsidiaries.

**PPL Corporation**

(Registrant)

**PPL Energy Supply, LLC**

(Registrant)

**PPL Electric Utilities Corporation**

(Registrant)

**PPL Montana, LLC**

(Registrant)

Date: November 10, 2003

/s/ John R. Biggar

John R. Biggar  
Executive Vice President and  
Chief Financial Officer  
(PPL Corporation)  
(principal financial officer)

/s/ James E. Abel

James E. Abel  
Treasurer  
(PPL Energy Supply, LLC)  
(principal financial officer)

/s/ Joseph J. McCabe

Joseph J. McCabe  
Vice President and Controller  
(PPL Electric Utilities Corporation)  
(principal accounting officer)

/s/ Charles S. Baker

Charles S. Baker  
Controller  
(PPL Montana, LLC)  
(principal accounting officer)

## PPL ENERGY SUPPLY, LLC AND SUBSIDIARIES

## COMPUTATION OF RATIO OF EARNINGS TO FIXED CHARGES

(Millions of Dollars)

	12 Months Ended September 30,			12 Months Ended December 31,		
	2003	2002	2001	2000	1999 (c)	1998 (c)
Fixed charges, as defined:						
Interest on long-term debt (a) .....	\$ 132	\$ 169	\$ 36	\$ 54	\$ 20	\$ 11
Interest on short-term debt and other interest .....	46	52	33	75	32	14
Amortization of debt discount, expense and premium - net .....	37	9	2	11	1	
Estimated interest component of operating rentals .....	42	23	19	9		
Preferred securities distributions of subsidiaries on a pre-tax basis .....	10	12				
<b>Total fixed charges .....</b>	<b>\$ 267</b>	<b>\$ 265</b>	<b>\$ 90</b>	<b>\$ 149</b>	<b>\$ 53</b>	<b>\$ 25</b>
Earnings, as defined:						
Net income (loss) (b) .....	\$ 616	\$ 507	\$ 168	\$ 246	\$ (20)	\$ 12
Preferred security dividend requirement..	8	9				
Less undistributed income (loss) of equity method investments .....	(21)	(22)	20	74	56	3
	645	538	148	172	(76)	9
Add:						
Income taxes (benefit) .....	230	266	274	125	(29)	(6)
Total fixed charges as above (excluding capitalized interest and preferred stock dividends of subsidiaries on a pre-tax basis) .....	249	234	66	135	52	24
<b>Total earnings .....</b>	<b>\$ 1,124</b>	<b>\$ 1,038</b>	<b>\$ 488</b>	<b>\$ 432</b>	<b>\$ (53)</b>	<b>\$ 27</b>
<b>Ratio of earnings to fixed charges .....</b>	<b>4.2</b>	<b>3.9</b>	<b>5.4</b>	<b>2.9</b>	<b>(1.0)</b>	<b>1.1</b>
Deficiency .....					\$ 106	

(a) The 2003 and 2002 periods were impacted by the acquisition of a controlling interest in WPD. See Note 7 to the Financial Statements for additional information.

(b) Net income (loss) excludes minority interest and the cumulative effect of a change in accounting principle.

(c) Due to the corporate realignment on July 1, 2000, data in 2000 and subsequent years are not comparable to prior years. See Note 19 in PPL Energy Supply's Form 10-K for the year ended December 31, 2002 for additional information.

CERTIFICATION

I, WILLIAM F. HECHT, the principal executive officer of PPL Corporation (the "registrant"), certify that:

1. I have reviewed this quarterly report on Form 10-Q of the registrant for the quarter ended September 30, 2003;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c. disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 10, 2003

/s/ William F. Hecht  
William F. Hecht  
Chairman, President and Chief Executive Officer  
PPL Corporation

CERTIFICATION

JOHN R. BIGGAR, the principal financial officer of PPL Corporation (the "registrant"), certify that:

1. I have reviewed this quarterly report on Form 10-Q of the registrant for the quarter ended September 30, 2003;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made; in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c. disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 10, 2003

/s/ John R. Biggar  
John R. Biggar  
Executive Vice President and Chief Financial Officer  
PPL Corporation

CERTIFICATION

I, WILLIAM F. HECHT, the principal executive officer of PPL Energy Supply, LLC (the "registrant"), certify that:

1. I have reviewed this quarterly report on Form 10-Q of the registrant for the quarter ended September 30, 2003;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c. disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 10, 2003

/s/ William F. Hecht

William F. Hecht

President

PPL Energy Supply, LLC

CERTIFICATION

JAMES E. ABEL, the principal financial officer of PPL Energy Supply, LLC (the "registrant"), certify that:

1. I have reviewed this quarterly report on Form 10-Q of the registrant for the quarter ended September 30, 2003;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c. disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 10, 2003

/s/ James E. Abel  
James E. Abel  
Treasurer  
PPL Energy Supply, LLC

CERTIFICATION

I, JOHN F. SIPICS, the principal executive officer of PPL Electric Utilities Corporation (the "registrant"), certify that:

1. I have reviewed this quarterly report on Form 10-Q of the registrant for the quarter ended September 30, 2003;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c. disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 10, 2003

/s/ John F. Sipics

John F. Sipics

President

PPL Electric Utilities Corporation

CERTIFICATION

JAMES E. ABEL, the principal financial officer of PPL Electric Utilities Corporation (the "registrant"), certify that:

1. I have reviewed this quarterly report on Form 10-Q of the registrant for the quarter ended September 30, 2003;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c. disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 10, 2003

/s/ James E. Abel  
James E. Abel  
Treasurer  
PPL Electric Utilities Corporation

CERTIFICATION

I, JAMES H. MILLER, the principal executive officer of PPL Montana, LLC (the "registrant"), certify that:

1. I have reviewed this quarterly report on Form 10-Q of the registrant for the quarter ended September 30, 2003;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c. disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 10, 2003

/s/ James H. Miller

James H. Miller  
 President  
 PPL Montana, LLC

CERTIFICATION

JAMES E. ABEL, the principal financial officer of PPL Montana, LLC (the "registrant"), certify that:

1. I have reviewed this quarterly report on Form 10-Q of the registrant for the quarter ended September 30, 2003;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c. disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 10, 2003

/s/ James E. Abel

James E. Abel  
Treasurer  
PPL Montana, LLC

CERTIFICATE PURSUANT TO 18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002 -  
FOR PPL CORPORATION'S 10-Q FOR THE QUARTER ENDED SEPTEMBER 30, 2003

In connection with the quarterly report on Form 10-Q of PPL Corporation (the "Company") for the quarter ended September 30, 2003, as filed with the Securities and Exchange Commission on the date hereof (the "Covered Report"), I, the principal executive officer of the Company, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, hereby certify that:

- The Covered Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- The information contained in the Covered Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 10, 2003

/s/ William F. Hecht

William F. Hecht  
Chairman, President and  
Chief Executive Officer  
PPL Corporation

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

CERTIFICATE PURSUANT TO 18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002  
FOR PPL CORPORATION'S 10-Q FOR THE QUARTER ENDED SEPTEMBER 30, 2003

In connection with the quarterly report on Form 10-Q of PPL Corporation (the "Company") for the quarter ended September 30, 2003, as filed with the Securities and Exchange Commission on the date hereof (the "Covered Report"), I, the principal financial officer of the Company, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, hereby certify that:

- The Covered Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- The information contained in the Covered Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 10, 2003

/s/ John R. Biggar

John R. Biggar  
Executive Vice President and  
Chief Financial Officer  
PPL Corporation

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

CERTIFICATE PURSUANT TO 18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002  
FOR PPL ENERGY SUPPLY, LLC'S 10-Q FOR THE QUARTER ENDED SEPTEMBER 30, 2003

In connection with the quarterly report on Form 10-Q of PPL Energy Supply, LLC (the "Company") for the quarter ended September 30, 2003, as filed with the Securities and Exchange Commission on the date hereof (the "Covered Report"), I, the principal executive officer of the Company, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, hereby certify that:

- The Covered Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- The information contained in the Covered Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 10, 2003

/s/ William F. Hecht  
William F. Hecht  
President  
PPL Energy Supply, LLC

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

CERTIFICATE PURSUANT TO 18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002  
FOR PPL ENERGY SUPPLY, LLC'S 10-Q FOR THE QUARTER ENDED SEPTEMBER 30, 2003

In connection with the quarterly report on Form 10-Q of PPL Energy Supply, LLC (the "Company") for the quarter ended September 30, 2003, as filed with the Securities and Exchange Commission on the date hereof (the "Covered Report"), I, the principal financial officer of the Company, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, hereby certify that:

- The Covered Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- The information contained in the Covered Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 10, 2003

/s/ James E. Abel

James E. Abel  
Treasurer  
PPL Energy Supply, LLC

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

CERTIFICATE PURSUANT TO 18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002  
FOR PPL ELECTRIC UTILITIES CORPORATION'S 10-Q FOR THE QUARTER ENDED SEPTEMBER 30, 2003

In connection with the quarterly report on Form 10-Q of PPL Electric Utilities Corporation (the "Company") for the quarter ended September 30, 2003, as filed with the Securities and Exchange Commission on the date hereof (the "Covered Report"), I, the principal executive officer of the Company, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, hereby certify that:

- The Covered Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- The information contained in the Covered Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 10, 2003

/s/ John F. Sipics

John F. Sipics

President

PPL Electric Utilities Corporation

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

CERTIFICATE PURSUANT TO 18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002  
FOR PPL ELECTRIC UTILITIES CORPORATION'S 10-Q FOR THE QUARTER ENDED SEPTEMBER 30, 2003

In connection with the quarterly report on Form 10-Q of PPL Electric Utilities Corporation (the "Company") for the quarter ended September 30, 2003, as filed with the Securities and Exchange Commission on the date hereof (the "Covered Report"), I, the principal financial officer of the Company, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, hereby certify that:

- The Covered Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- The information contained in the Covered Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 10, 2003

/s/ James E. Abel  
James E. Abel  
Treasurer  
PPL Electric Utilities Corporation

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

CERTIFICATE PURSUANT TO 18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002  
FOR PPL MONTANA, LLC'S 10-Q FOR THE QUARTER ENDED SEPTEMBER 30, 2003

In connection with the quarterly report on Form 10-Q of PPL Montana, LLC (the "Company") for the quarter ended September 30, 2003, as filed with the Securities and Exchange Commission on the date hereof (the "Covered Report"), I, the principal executive officer of the Company, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, hereby certify that:

- The Covered Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- The information contained in the Covered Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 10, 2003

/s/ James H. Miller

James H. Miller  
President  
PPL Montana, LLC

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

CERTIFICATE PURSUANT TO 18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002  
FOR PPL MONTANA, LLC'S 10-Q FOR THE QUARTER ENDED SEPTEMBER 30, 2003

In connection with the quarterly report on Form 10-Q of PPL Montana, LLC (the "Company") for the quarter ended September 30, 2003, as filed with the Securities and Exchange Commission on the date hereof (the "Covered Report"), I, the principal financial officer of the Company, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, hereby certify that:

- The Covered Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- The information contained in the Covered Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 10, 2003

/s/ James E. Abel  
James E. Abel  
Treasurer  
PPL Montana, LLC

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

**PROSPECTUS SUPPLEMENT**  
(To Prospectus dated July 16, 2001)

**\$100,000,000**



**PPL Electric Utilities**

# **PPL Electric Utilities Corporation**

## **4.30% Senior Secured Bonds Due 2013**

### **Interest payable June 1 and December 1**

Our Senior Secured Bonds, 4.30% Series due 2013 (the "Offered Bonds"), constitute a series of our Debt Securities described in the accompanying prospectus. Interest on the Offered Bonds will be payable on June 1 and December 1, commencing December 1, 2003. The Offered Bonds will mature on June 1, 2013, unless redeemed on an earlier date. The Offered Bonds are redeemable at our option, in whole at any time or in part from time to time, as described herein. See "Description of the Offered Bonds—Redemption".

The Offered Bonds will initially be secured as described in this prospectus supplement and in the accompanying prospectus. The lien of the indenture under which the Offered Bonds will be issued may be released in certain circumstances and subject to certain conditions, including a condition that we provide confirmations from certain nationally recognized statistical rating organizations that, at the time of release, the release will not cause a reduction in the credit ratings on the Offered Bonds below specified ratings described in the accompanying prospectus. Upon any such release, the Offered Bonds will cease to be secured and will become our unsecured general obligations. At such time, we will be subject to certain restrictions on our ability to issue secured debt. See "Description of the Offered Bonds—Security; Release and Discharge of Lien" herein and "Description of the Debt Securities—Security—Discharge of Lien; Release Date" in the accompanying prospectus.

**Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon the adequacy or accuracy of this prospectus supplement, the accompanying prospectus or any pricing supplement. Any representation to the contrary is a criminal offense.**

	Price to Public <sup>(1)</sup>	Underwriting Discount	Proceeds, Before Expenses, to Us <sup>(1)</sup>
Per Offered Bond . . . . .	99.452%	0.650%	98.802%
Total . . . . .	\$99,452,000	\$650,000	\$98,802,000

(1) Plus accrued interest, if any, from the date of issuance.

The underwriters expect to deliver the Offered Bonds to the purchasers in book-entry form through the facilities of The Depository Trust Company on or about May 23, 2003.

*Sole Book-Running Manager*

**Banc One Capital Markets, Inc.**

*Joint Lead Manager*

**Barclays Capital**

**Morgan Stanley**

**Wachovia Securities**

The date of this prospectus supplement is May 20, 2003

You should rely on the information contained in or incorporated by reference in this prospectus supplement and the accompanying prospectus. We have not authorized anyone to provide you with different information. We are not making an offer of these securities in any state where the offer is not permitted. You should not assume that the information contained in or incorporated by reference in this prospectus supplement and the accompanying prospectus is accurate as of any date after the date of this prospectus supplement.

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PPL Electric Utilities Corporation (“PPL Electric”) is a Pennsylvania corporation. Our principal executive offices are located at Two Ninth Street, Allentown, Pennsylvania 18101-1179 and our telephone number at that address is (610) 774-5151. Information about PPL Electric is available on the website of our parent company, PPL Corporation. PPL Corporation’s website is located at [www.pplweb.com](http://www.pplweb.com). The information on PPL Corporation’s website is not part of this prospectus supplement. In this prospectus supplement, “we”, “us” and “our” refer to PPL Electric; and “underwriters” refers to the firms listed on the cover of this prospectus supplement.

## RECENT DEVELOPMENTS

### Strategic Initiative; PLR Obligation

As described in the accompanying prospectus, PPL Electric is required, under the Pennsylvania Customer Choice Act (as defined in the accompanying prospectus), to act as a “provider of last resort,” or PLR, and provide electricity to retail customers who do not select an alternate electric energy supplier. As part of a 1998 settlement order by the Pennsylvania Public Utility Commission (“PUC”) in connection with the restructuring plan we filed under the Customer Choice Act, we agreed to provide this electricity at predetermined capped rates through 2009. As part of a strategic initiative in 2001, which was designed, among other things, to substantially reduce our exposure to volatility in energy prices through 2009, we entered into a generation supply agreement with PPL EnergyPlus, LLC. This 2001 generation supply agreement, together with a previously existing supply agreement with PPL EnergyPlus, LLC (together, the “PLR Agreements”), provides us with electricity and capacity in amounts sufficient for us to meet our PLR obligation to deliver electricity at the predetermined capped rates we may charge to our PLR customers. See “PPL Electric—Strategic Initiative” and “—The New POLR Agreement” in the accompanying prospectus. The PLR Agreements were approved by the PUC and accepted for filing by the Federal Energy Regulatory Commission (“FERC”). PPL Energy Supply, LLC has guaranteed the obligations of PPL EnergyPlus, LLC under the PLR Agreements. PPL Corporation owns all of the common stock of PPL Electric. PPL Energy Supply, LLC and PPL EnergyPlus, LLC are indirect wholly-owned subsidiaries of PPL Corporation.

In addition, as part of our 2001 strategic initiative, we adopted a plan of division and certain amendments to our Articles of Incorporation and Bylaws designed to reinforce our legal separateness from PPL Corporation and its other affiliates. In 2001, the plan of division and these amendments were approved at a special meeting of our shareholders and became effective. See “PPL Electric—Strategic Initiative” in the accompanying prospectus.

### Distribution Rate Case

Pursuant to the 1998 PUC settlement order in connection with our restructuring plan under the Customer Choice Act, we agreed to a cap on our average electricity transmission and distribution rates totaling 1.74 cents per kWh through December 31, 2004. We currently plan to file a request with the PUC in 2004 to increase our electricity distribution rates upon the expiration of the rate cap. We have not determined the size of any rate increase request at this time. We expect that any request for an electricity distribution rate increase would be subject to extensive review by the PUC, and we cannot predict whether or the extent to which any such rate increase will be granted by the PUC.

### Recent Ratings Information

In April and May 2003, Standard & Poor’s Ratings Services, a division of The McGraw-Hill Companies, Inc. (“S&P”), and Fitch Ratings (“Fitch”) each affirmed their outstanding ratings on our senior secured bonds and first mortgage bonds at “A-.” In May 2003, Moody’s Investor Services, Inc. (“Moody’s”) downgraded the ratings on our senior secured bonds and first mortgage bonds to “Baa1” from “A3.” Management does not expect the action by Moody’s to limit our ability to raise new long-term debt, but such a downgrade could increase the cost to us of any new long-term debt.

The ratings of S&P, Fitch and Moody’s are not a recommendation to buy, sell or hold any of our securities. Such ratings may be subject to revisions or withdrawal by these agencies at any time and should be evaluated independently of each other and any other rating that may be assigned to our securities.

## Amendments to 1945 Mortgage

The 1945 Mortgage (as described in the accompanying prospectus) was amended, as of January 1, 2002, to delete the provisions described in the accompanying prospectus under "Description of the 1945 Bonds—Issuance of Additional Bonds under the 1945 Mortgage" that required a net earnings test or net earnings certificate as a condition precedent to the issuance or authentication of 1945 Mortgage Bonds, and to delete the dividend covenant described in the accompanying prospectus under "Description of the 1945 Mortgage Bonds—Dividend Covenant." (See 1945 Mortgage, Articles V, VI, and VI, Sec. 39, and the Sixty-ninth Supplemental Indenture, Secs. 3 and 6.)

## USE OF PROCEEDS

We will use the net proceeds from the sale of the Offered Bonds for general corporate purposes, including the future refunding of higher-cost securities.

## SUMMARY FINANCIAL INFORMATION

Set forth below is certain summary unaudited consolidated financial information for the three months ended March 31, 2003 and 2002 and audited consolidated financial information for the years ended December 31, 2002 and 2001. This financial information has been derived from the consolidated financial statements of PPL Electric, which are incorporated herein by reference. The following material should be read in conjunction with the consolidated financial statements of PPL Electric and related notes, which are incorporated by reference herein.

	3 Months Ended March 31,		Year Ended December 31,	
	2003	2002	2002	2001
	(in millions of dollars, except ratios)			
Operating Revenues	\$753	\$697	\$2,748	\$2,694
Operating Income	99	89	275	419
Income Before Dividends and Distributions on Preferred Securities	30	26	55	145
Dividends and Distributions—Preferred Securities	1	6	16	26
Net Income	29	20	39	119
Ratios of Earnings to Fixed Charges <sup>(1)</sup>	1.3 <sup>(2)</sup>	1.6 <sup>(2)</sup>	1.2	1.7

(1) The ratios for the years 2000 and 1999 were 2.5 and 3.2, respectively. The ratios are computed using earnings and fixed charges of PPL Electric and its subsidiaries. Earnings consist of net income (excluding extraordinary items and the cumulative effect of a change in accounting principle); plus preferred security dividend requirements; income taxes; amortization of capitalized interest on capitalized leases; and fixed charges (excluding capitalized interest, capitalized interest on capital lease obligations and preferred security distributions of subsidiaries on a pre-tax basis). Fixed charges consist of interest on short- and long-term debt; other interest charges; amortization of debt discount, expense and premium; interest on capital lease obligations; the estimated interest component of operating rentals; and preferred security distributions of subsidiaries on a pre-tax basis. In addition, due to our corporate realignment on July 1, 2000, in which PPL Electric transferred its electric generation and related assets to PPL Corporation and its subsidiaries and affiliates, data in 2000 and subsequent years are not comparable to prior years.

(2) Calculated for the twelve months ended March 31, 2002 and 2003.

## CAPITALIZATION

The following table sets forth PPL Electric's historical unaudited consolidated capitalization as of March 31, 2003:

- on an actual basis;
- on an as adjusted basis to give effect to (a) the estimated net proceeds of \$99 million from the sale by us of the Offered Bonds in this offering; (b) the deposit of approximately \$47 million in cash with the 1945 Mortgage Trustee to release certain transmission property as described under "Description of the Offered Bonds—Security; Release and Discharge of Lien" and the application of such cash to retire approximately \$46 million aggregate principal amount of our first mortgage bonds 7 $\frac{7}{8}$ % Series due 2023, at par plus accrued interest in April 2003; and (c) the sinking fund redemption of our 6.15% Series Preferred Stock in April 2003.

This table should be read in conjunction with our consolidated financial statements, the notes related thereto and the other financial and operating data incorporated by reference into this prospectus supplement and the accompanying prospectus.

	<u>As of March 31, 2003</u>	
	<u>Actual</u>	<u>As Adjusted</u>
	(in millions)	
Cash and cash equivalents .....	\$ 213	\$ 255
Short-term debt .....	\$ 136	\$ 136 <sup>(1)</sup>
Long-term debt (including current portion), excluding transition bonds <sup>(2)</sup> .....	\$1,480	\$1,534
Transition bonds (including current portion) .....	1,608	1,608
Preferred stock, including sinking fund obligations .....	82	72
Common equity .....	1,249	1,249
Total .....	<u>\$4,419</u>	<u>\$4,463</u>

(1) As of May 20, 2003, the short-term debt balance was \$0.

(2) In 1999, PPL Transition Bond Company, LLC, which is a wholly-owned subsidiary of PPL Electric, completed an offering of \$2.4 billion of transition bonds, of which \$1.608 billion were outstanding at March 31, 2003. These transition bonds were used to securitize a portion of recoveries associated with PPL Electric's stranded costs. This debt is non-recourse to PPL Electric.

## DESCRIPTION OF THE OFFERED BONDS

The following description of the particular terms of the Offered Bonds supplements, and to the extent inconsistent, replaces the description of the general terms and provisions of the Debt Securities set forth under “Description of the Debt Securities” in the accompanying prospectus, to which general description reference is made. Capitalized terms used but not defined herein shall have the meanings given to them in the accompanying prospectus, the Offered Bonds or the Indenture, as the case may be.

### General

The Offered Bonds will be issued as one series of Debt Securities under our Indenture, which is more fully described in the accompanying prospectus. The Offered Bonds will be issued upon the basis of an equal principal amount of first mortgage bonds issued under the 1945 Mortgage, and delivered to the Trustee under the Indenture. At March 31, 2003, we could have issued approximately \$530 million of first mortgage bonds against the retirement or cancellation of previously outstanding first mortgage bonds under our 1945 Mortgage.

The Offered Bonds will be issued in fully registered form only, without coupons. The Offered Bonds will be initially represented by one or more fully registered global securities (the “Global Securities”) deposited with or on behalf of The Depository Trust Company (“DTC”), as depository, and registered in the name of DTC or DTC’s nominee. A beneficial interest in a Global Security will be shown on, and transfers or exchanges thereof will be effected only through, records maintained by DTC and its participants, as described below under “—Book-Entry Only Issuance—The Depository Trust Company.” The authorized denominations of the Offered Bonds will be \$1,000 and any larger amount that is an integral multiple of \$1,000. Except in limited circumstances described below, the Offered Bonds will not be exchangeable for Offered Bonds in definitive certificated form.

### Maturity; Interest

The Offered Bonds will mature on June 1, 2013, and will bear interest from the date of issuance at a rate of 4.30% per annum until the principal amount thereof is paid or made available for payment. Interest on the Offered Bonds will be payable on each June 1 and December 1, commencing December 1, 2003 (each such date, an “Interest Payment Date”), and at maturity. The regular record dates with respect to any Interest Payment Date will be the May 15 or November 15, as the case may be, immediately preceding such Interest Payment Date (whether or not any such regular record date is also a Business Day).

Interest on the Offered Bonds will be computed on the basis of a 360-day year of twelve 30-day months.

If any Interest Payment Date, redemption date or the maturity falls on a day that is not a Business Day, the required payment of principal, premium, if any, and/or interest will be made on the next succeeding Business Day as if made on the date such payment was due, and no interest will accrue on such payment for the period from and after such Interest Payment Date, redemption date or maturity, as the case may be, to the date of such payment on the next succeeding Business Day.

“Business Day” with respect to any Offered Bond means any day, other than Saturday or Sunday, which is not a day on which banking institutions or trust companies in The City of New York, New York or other city in which a paying agent for such Offered Bond is located, are authorized or required by law, regulation or executive order to remain closed.

### Redemption

The Offered Bonds of each series will be redeemable at our election, in whole at any time or in part from time to time, at a redemption price equal to the greater of:

- (a) 100% of the principal amount of the Offered Bonds to be so redeemed; or

(b) as determined by an Independent Investment Banker, the sum of the present values of the remaining scheduled payments of principal and interest on the Offered Bonds to be so redeemed (not including any portion of such payments of interest accrued to the date of redemption) discounted to the redemption date on a semiannual basis (assuming a 360-day year consisting of twelve 30-day months) at the Adjusted Treasury Rate, plus 15 basis points,

plus accrued and unpaid interest to the date of redemption.

“Adjusted Treasury Rate” means, with respect to any redemption date:

(a) the yield, under the heading which represents the average for the immediately preceding week, appearing in the most recently published statistical release designated “H.15(519)” or any successor publication which is published weekly by the Board of Governors of the Federal Reserve System and which establishes yields on actively traded United States Treasury securities adjusted to constant maturity under the caption “Treasury Constant Maturities,” for the maturity corresponding to the Comparable Treasury Issue (if no maturity is within three months before or after the Remaining Life (as defined below), yields for the two published maturities most closely corresponding to the Comparable Treasury Issue shall be determined and the Adjusted Treasury Rate shall be interpolated or extrapolated from such yields on a straight line basis, rounding to the nearest month); or

(b) if such release (or any successor release) is not published during the week preceding the calculation date or does not contain such yields, the rate per annum equal to the semi-annual equivalent yield to maturity of the Comparable Treasury Issue, calculated using a price for the Comparable Treasury Issue (expressed as a percentage of its principal amount) equal to the Comparable Treasury Price for such redemption date.

The Adjusted Treasury Rate shall be calculated on the third Business Day preceding the redemption date.

“Comparable Treasury Issue” means the United States Treasury security selected by an Independent Investment Banker as having a maturity comparable to the remaining term to the stated maturity date of the Offered Bonds to be redeemed that would be utilized, at the time of selection and in accordance with customary financial practice, in pricing new issues of corporate debt securities of comparable maturity to the remaining term of the Offered Bonds (the “Remaining Life”).

“Comparable Treasury Price” means (1) the average of four Reference Treasury Dealer Quotations for such redemption date, after excluding the highest and lowest Reference Treasury Dealer Quotations, or (2) if the Independent Investment Banker obtains fewer than four Reference Treasury Dealer Quotations, the average of all such quotations.

“Independent Investment Banker” means one of the Reference Treasury Dealers appointed by us.

“Reference Treasury Dealer” means:

(a) each of Banc One Capital Markets, Inc., Barclays Capital Inc., Morgan Stanley & Co. Incorporated and Wachovia Securities, Inc., and their respective successors; *provided, however*, that if any of the foregoing shall cease to be a primary U.S. Government securities dealer in New York, New York (a “Primary Treasury Dealer”), we will substitute another Primary Treasury Dealer; and

(b) any other Primary Treasury Dealer selected by us.

“Reference Treasury Dealer Quotations” means, with respect to each Reference Treasury Dealer and any redemption date, the average, as determined by the Independent Investment Banker, of the bid and asked prices for the Comparable Treasury Issue (expressed in each case as a percentage of its principal amount) quoted

in writing to the Independent Investment Banker at 5:00 p.m., New York, New York time, on the third Business Day preceding such redemption date.

Additional information concerning redemption is contained under “Description of the Debt Securities—Redemption” in the accompanying prospectus.

The Offered Bonds will not be subject to a sinking fund or other mandatory redemption provisions, and will not be repayable at the option of the Holder prior to the stated maturity date.

### **Security; Release and Discharge of Lien**

Except as described herein and in the accompanying prospectus, all Indenture Securities, including the Offered Bonds, will be initially secured, equally and ratably, by:

- an equal principal amount of first mortgage bonds issued under the 1945 Mortgage, and delivered to the Trustee under the Indenture, and other Class A Bonds as described in the accompanying prospectus; subject to certain exceptions, the 1945 Mortgage constitutes a first mortgage lien on substantially all of our electric transmission and distribution properties; and
- the lien of the Indenture on substantially all of our tangible electric transmission and distribution property located in Pennsylvania, which lien is junior to the lien of the 1945 Mortgage.

Each of the Indenture and the 1945 Mortgage creates a lien on substantially all tangible properties of PPL Electric in Pennsylvania used in the transmission and distribution of electric energy, other than property duly released from the liens thereof in accordance with the provisions of the Indenture and the 1945 Mortgage, as the case may be, and certain other excepted property, and subject to certain permitted liens and excepted encumbrances, in each case as described in the accompanying prospectus.

We may obtain the release of property from the liens of the Indenture and the 1945 Mortgage from time to time in connection with the sale or other disposition of such property, or in certain circumstances, without any such disposition, upon the bases provided for such release in the Indenture and the 1945 Mortgage. See “Description of the Debt Securities—Security—Release of Property” and “Description of the 1945 Mortgage Bonds—Security” and “—Release Provisions” in the accompanying prospectus.

Recent federal regulatory initiatives, if adopted, may encourage independent ownership of transmission assets and provide economic incentives for divestiture of transmission assets. While we cannot predict whether such proposals will be adopted, and while we have no current intention of selling our transmission properties, we believe that it is prudent to take steps to release transmission property from the liens of our mortgage indentures so that we can act expeditiously in the event that attractive sale opportunities arise. As a result, we may release certain portions of our transmission properties from such liens from time to time upon the deposit of cash, the certification of property additions or retired bonds, or other permitted bases as provided in the Indenture and the 1945 Mortgage. In March 2003, we applied for the release of certain transmission lines and other equipment having a fair value of approximately \$47 million upon the basis of approximately \$47 million of cash to be deposited with the trustee under the 1945 Mortgage. Such cash deposits were used to retire outstanding first mortgage bonds on April 30, 2003. In addition, in April 2003, we applied for the release of transmission property having a fair value of approximately \$35 million upon the basis of property additions.

At any time after all Class A Mortgages, including the 1945 Mortgage, have been satisfied and discharged, the lien of the Indenture may be released and discharged, without the consent of the holders of the Offered Bonds, if we deliver to the Trustee Rating Agency Confirmations from each applicable Rating Agency, to the effect that such release will not result in the reduction or withdrawal of the ratings on the Offered Bonds below the lower of (x) such Rating Agency’s rating then in effect, and (y) such Rating Agency’s Threshold

Rating. Upon any such release, the Offered Bonds will cease to be secured and will become our unsecured general obligations. At such time, we will be subject to certain restrictions on our ability to issue secured debt.

See “Description of the Debt Securities—Security—Discharge of Lien; Release Date” and “—Limitation on Secured Debt” in the accompanying prospectus.

#### **Book-Entry Only Issuance—The Depository Trust Company**

DTC will act as securities depository for the Offered Bonds. The Offered Bonds will be issued only as fully-registered securities registered in the name of Cede & Co. (DTC’s nominee). One or more fully-registered global certificates for each series of Offered Bonds, representing the aggregate principal amount of such series of Offered Bonds, will be issued and deposited with DTC.

The following is based upon information furnished by DTC:

DTC is a limited-purpose trust company organized under the New York Banking Law, a “banking organization” within the meaning of the New York Banking Law, a member of the Federal Reserve System, a “clearing corporation” within the meaning of the New York Uniform Commercial Code and a “clearing agency” registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934, as amended. DTC holds securities that its participants (“Participants”) deposit with DTC. DTC also facilitates the settlement among Participants of securities transaction, such as transfers and pledges, in deposited securities through electronic computerized book-entry changes in Participants’ accounts, thereby eliminating the need for physical movement of securities certificates. “Direct Participants” in DTC include securities brokers and dealers, banks, trust companies, clearing corporations and certain other organizations. DTC is owned by a number of its Direct Participants and by The New York Stock Exchange, the American Stock Exchange, Inc., and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others, such as securities brokers and dealers, banks and trust companies that clear transactions through or maintain a custodial relationship with a Direct Participant either directly or indirectly (“Indirect Participants”). The rules applicable to DTC and its Participants are on file with the Securities and Exchange Commission.

Purchases of Offered Bonds within the DTC system must be made by or through Direct Participants, which will receive a credit for the Offered Bonds on DTC’s records. The ownership interest of each actual purchaser of each Offered Bond (“Beneficial Owner”) is in turn to be recorded on the Direct and Indirect Participants’ records. Beneficial Owners will not receive written confirmation from DTC of their purchase, but Beneficial Owners are expected to receive written confirmation providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participants through which the Beneficial Owners entered into the transaction. Transfers of ownership interests in the Offered Bonds are to be accomplished by entries made on the books of Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in the Offered Bonds, except in the event that use of the book-entry system for the Offered Bonds is discontinued, as discussed below.

To facilitate subsequent transfers, all Offered Bonds deposited by Participants with DTC are registered in the name of DTC’s partnership nominee, Cede & Co. The deposit of Offered Bonds with DTC and their registration in the name of Cede & Co. effect no change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Offered Bonds; DTC’s records reflect only the identity of the Direct Participants to whose accounts such Offered Bonds are credited, which may or may not be the Beneficial Owners. The Participants will remain responsible for keeping account of their holdings on behalf of their customers.

The delivery of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time.

Redemption notices will be sent to Cede & Co., as registered Holder of the Offered Bonds. If less than all of the Offered Bonds are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant to be redeemed.

Neither DTC nor Cede & Co. will itself consent or vote with respect to Offered Bonds. Under its usual procedures, DTC will mail an omnibus proxy to PPL Electric as soon as possible after the record date. The omnibus proxy will assign Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the Offered Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Payments on the Offered Bonds will be made to DTC. DTC's practice is to credit Direct Participants' accounts on the relevant payment date in accordance with their respective holdings shown on DTC's records unless DTC has reason to believe that it will not receive payment on such payment date. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name", and will be the responsibility of such Participants and not of DTC or PPL Electric, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment to DTC will be the responsibility of PPL Electric, disbursement of payments to Direct Participants will be the responsibility of DTC, and further disbursement of payments to the Beneficial Owners will be the responsibility of Direct Participants and Indirect Participants.

DTC may discontinue providing its services as securities depository for the Offered Bonds at any time by giving notice to us. Under such circumstances, in the event that a successor securities depository is not obtained, certificates for the Offered Bonds will be delivered to the Beneficial Owners. Additionally, we may decide to discontinue use of the system of book-entry transfers through DTC (or a successor depository). In that event, certificates for the Offered Bonds will be delivered.

The information in this section concerning DTC and DTC's book-entry system and procedures has been obtained from sources that we believe to be reliable, but we take no responsibility for the accuracy thereof. Neither we, the Trustee nor the underwriters will have any responsibility or liability for any aspect of the records relating to or payments made on account of beneficial ownership interests in the Offered Bonds or for maintaining, supervising or reviewing any records relating thereto.

Except as provided herein, a Beneficial Owner of an interest in a global Offered Bond certificate may not receive physical delivery of the Offered Bonds. Accordingly, each Beneficial Owner must rely on the procedures of DTC to exercise any rights under the Offered Bonds.

## UNDERWRITING

Under the terms and subject to the conditions contained in an underwriting agreement dated the date hereof, the underwriters named below have severally agreed to purchase, and we have agreed to sell to them, the respective principal amounts of Offered Bonds set forth opposite their respective names below:

<u>Underwriters</u>	<u>Principal Amount of Offered Bonds</u>
Banc One Capital Markets, Inc. ....	\$ 55,000,000
Barclays Capital Inc. ....	30,000,000
Morgan Stanley & Co. Incorporated ....	7,500,000
Wachovia Securities, Inc. ....	7,500,000
Total .....	<u>\$100,000,000</u>

The underwriting agreement provides that the obligation of the several underwriters to pay for and accept delivery of the Offered Bonds is subject to the approval of certain legal matters by their counsel and to certain other conditions. The underwriters are obligated to take and pay for the Offered Bonds if any are taken.

The underwriters of the Offered Bonds propose to offer the Offered Bonds directly to the public at the public offering price set forth on the cover page hereof and to certain dealers at a price that represents a concession not in excess of 0.40% of the principal amount of the Offered Bonds. In addition, the underwriters may allow, and those selected dealers may reallow, a concession of up to 0.25% of the principal amount to certain other dealers. After the initial offering of the Offered Bonds, the offering price and other selling terms may from time to time be varied.

We have agreed to indemnify the several underwriters against certain liabilities, including liabilities under the Securities Act of 1933, as amended.

PPL Electric's expenses in connection with the offering of the Offered Bonds, net of the underwriting discount, are currently estimated to be \$150,000.

We do not intend to apply for listing of the Offered Bonds on a national securities exchange, but have been advised by the underwriters that they presently intend to make a market in the Offered Bonds as permitted by applicable laws and regulations. The underwriters are not obligated, however, to make a market in the Offered Bonds and any such market making may be discontinued at any time at the sole discretion of the underwriters. Accordingly, no assurance can be given as to the liquidity of, or trading markets for, the Offered Bonds.

In order to facilitate the offering of the Offered Bonds, the underwriters may engage in transactions that stabilize, maintain or otherwise affect the price of the Offered Bonds. Specifically, the underwriters may overallocate in connection with the offering, creating a short position in the Offered Bonds for their own account. In addition, to cover overallocations or to stabilize the price of the Offered Bonds, the underwriters may bid for, and purchase, the Offered Bonds in the open market. Finally, the underwriting syndicate may reclaim selling concessions allowed to an underwriter or a dealer for distributing the Offered Bonds in the offering, if the syndicate repurchases previously distributed Offered Bonds in transactions to cover syndicate short positions, in stabilization transactions or otherwise. Any of these activities may stabilize or maintain the market price of the Offered Bonds above independent market levels. The underwriters are not required to engage in these activities and may end these activities at any time.

In the ordinary course of their business, certain of the underwriters and their affiliates have engaged and may in the future engage in investment and commercial banking transactions with us and certain of our affiliates.

## **VALIDITY OF THE OFFERED BONDS AND THE 1945 MORTGAGE BONDS**

Thomas D. Salus, Esq., Senior Counsel of PPL Services Corporation, and Dewey Ballantine LLP, New York, New York, counsel to PPL Electric, will pass upon the validity of the Offered Bonds and the 1945 Mortgage Bonds for PPL Electric. Sullivan & Cromwell LLP, New York, New York, will pass upon the validity of the Offered Bonds and the 1945 Mortgage Bonds for the underwriters. However, all matters pertaining to the organization of PPL Electric and PPL Electric's title to its property and the liens of the Indenture and the 1945 Mortgage upon PPL Electric's properties will be passed upon only by Mr. Salus. As to matters involving the law of the Commonwealth of Pennsylvania, Dewey Ballantine LLP and Sullivan & Cromwell LLP will rely on the opinion of Mr. Salus. As to matters involving the law of the State of New York, Mr. Salus will rely on the opinion of Dewey Ballantine LLP.

**\$900,000,000**

**PPL Electric Utilities Corporation**  
**Debt Securities**

We expect to offer from time to time up to \$900,000,000 aggregate principal amount of our Debt Securities at prices and on terms to be determined at the time of each sale. Until the Release Date described in this prospectus, the Debt Securities will be secured primarily by

- first mortgage bonds issued under our 1945 first mortgage indenture, which, subject to certain exceptions described in this prospectus, constitutes a first mortgage lien on substantially all of our electric transmission and distribution properties, and
- the lien of the Debt Securities indenture on our electric transmission and distribution properties (other than certain excepted property referred to in this prospectus), which lien is junior to the lien of the 1945 first mortgage indenture.

Under certain circumstances described in this prospectus, the 1945 first mortgage bonds and lien of the 1945 first mortgage indenture may be discharged. Upon such a discharge and subject to certain exceptions described in this prospectus, the lien of the Debt Securities indenture will become a direct first mortgage lien on our electric transmission and distribution properties. Upon the Release Date described in this prospectus, the lien of the Debt Securities indenture may be released and discharged, subject to certain conditions, including the condition that we provide confirmations from certain nationally recognized statistical rating organizations that the release will not cause a reduction in the credit ratings on the Debt Securities at the time of release below specified ratings described in this prospectus. Upon the Release Date, the Debt Securities will cease to be secured and will become our unsecured general obligations. Upon the Release Date, we will be subject to certain restrictions on our ability to issue secured debt as described in this prospectus.

For each series of Debt Securities for which this prospectus is delivered we will deliver an accompanying prospectus supplement that will set forth the aggregate principal amount, interest rate or rates and payment dates, maturity date or dates, initial public offering price, the net proceeds to us, redemption provisions, provisions for repayment or redemption at the option of the holder and any other specific provisions for and terms of such series of Debt Securities. This prospectus may not be used to sell securities unless accompanied by a prospectus supplement.

We may offer the securities directly or through underwriters or agents. The applicable prospectus supplement will describe the terms of any particular plan of distribution.

**These securities have not been approved or disapproved by the Securities and Exchange Commission or any state securities commission, nor has the Securities and Exchange Commission or any state securities commission determined that this prospectus is accurate or complete. Any representation to the contrary is a criminal offense.**

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### FORWARD-LOOKING STATEMENTS

Certain statements contained in this prospectus concerning expectations, beliefs, plans, objectives, goals, strategies, future events or performance and underlying assumptions and other statements which are other than statements of historical facts are “forward-looking statements” within the meaning of the federal securities laws. Although we believe that the expectations and assumptions reflected in these statements are reasonable, we cannot make any assurance that these expectations will prove to be correct. These forward-looking statements involve a number of risks and uncertainties, and actual results may differ materially from the results discussed in the forward-looking statements. In addition to the specific factors discussed in this prospectus, the following are among the important factors that could cause actual results to differ materially from the forward-looking statements:

- market demand and prices for energy, capacity and fuel;
- the effect of any business or industry restructuring;
- our profitability and liquidity;
- new accounting requirements or new interpretations or applications of existing requirements;
- environmental conditions and requirements;
- markets and technologies;
- receipt of necessary governmental approvals;
- capital market conditions; and
- our commitments and liabilities.

You should consider any forward-looking statements in light of such important factors and in conjunction with our other documents on file with the SEC.

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

## ABOUT THIS PROSPECTUS

This prospectus is part of a registration statement that we filed with the Securities and Exchange Commission, or SEC, using a "shelf" registration process. Under this shelf process, we may, from time to time, sell up to \$900 million aggregate principal amount of our debt securities, consisting of notes or bonds ("Debt Securities"), in one or more offerings. The Debt Securities offered by this prospectus will be issued pursuant to our Indenture (such Indenture, as it may be supplemented, the "Indenture"), to The Chase Manhattan Bank, as trustee (the "Trustee"). This prospectus provides a general description of the Debt Securities we may offer and of our first mortgage bonds ("1945 Mortgage Bonds") issued under our Mortgage and Deed of Trust dated as of October 1, 1945, as supplemented (the "1945 Mortgage") to Bankers Trust Company, as trustee (the "1945 Mortgage Trustee") which, under the circumstances described in this prospectus, will secure Debt Securities. Each time we sell Debt Securities, we will provide a prospectus supplement that will contain specific information about the terms of that offering. The prospectus supplement may also add, update or change information contained in this prospectus. You should read both this prospectus and any prospectus supplement together with additional information described under "Where You Can Find More Information."

For more detailed information about the Debt Securities and the 1945 Mortgage Bonds, you can read the exhibits to the registration statement. Those exhibits have been either filed with the registration statement or incorporated by reference to earlier SEC filings listed in the registration statement.

## WHERE YOU CAN FIND MORE INFORMATION

### Available Information

We file reports and other information with the SEC. Information we file with the SEC can be inspected and copied at the Public Reference Room maintained by the SEC and at the following Regional Offices of the SEC:

Public Reference Room  
450 Fifth Street, N.W.  
Room 1024  
Washington, D.C. 20549

New York Regional Office  
7 World Trade Center  
Suite 1300  
New York, New York 10048

Chicago Regional Office  
Citicorp Center  
500 West Madison Street  
Suite 1400  
Chicago, Illinois 60661-2551

You may also obtain copies of this information by mail from the Public Reference Section of the SEC, 450 Fifth Street, N.W., Room 1024, Washington, D.C. 20549, at prescribed rates. You may obtain further information on the operation of the SEC's Public Reference Room in Washington, D.C. by calling the SEC at 1-800-SEC-0330.

The SEC also maintains an Internet world wide web site that contains reports and other information about issuers, like us, who file electronically with the SEC. The address of that site is <http://www.sec.gov>.

Certain of our securities are listed on the New York Stock Exchange ("NYSE") and the Philadelphia Stock Exchange, and reports and other information concerning us can also be inspected at the offices of the NYSE at 20 Broad Street, New York, New York 10005 and the Philadelphia Stock Exchange, 1900 Market Street, Philadelphia, Pennsylvania 19103. In addition, reports and other information concerning us can be inspected at our offices at Two North Ninth Street, Allentown, Pennsylvania 18101-1179.

### **Incorporation by Reference**

The rules of the SEC allow us to "incorporate by reference" information into this prospectus, which means that we can disclose important information to you by referring you to another document filed separately with the SEC. The information incorporated by reference is deemed to be part of this prospectus, and later information that we file with the SEC will automatically update and supersede that information. This prospectus incorporates by reference the documents set forth below that have been previously filed with the SEC. These documents contain important information about us.

<b><u>SEC Filings (File No. 1-905)</u></b>	<b><u>Period/Date(s)</u></b>
Annual Report on Form 10-K	Year ended December 31, 2000
Quarterly Reports on Form 10-Q	Quarter ended March 31, 2001
Information Statement regarding Special Meeting of Shareowners to be held on July 17, 2001	June 15, 2001
Current Reports on Form 8-K	June 22, 2001

We are also incorporating by reference additional documents that we file with the SEC pursuant to Sections 13(a), 13(c), 14 or 15(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), between the date of this prospectus and the termination of the offering of the Securities.

We will provide without charge to each person, including any beneficial owner, to whom a copy of this prospectus has been delivered, a copy of any and all of these filings. You may request a copy of these filings by writing or telephoning us at:

PPL Electric Utilities Corporation  
Two North Ninth Street  
Allentown, Pennsylvania 18101-1179  
Attention: Investor Services Department  
Telephone: 1-800-345-3085

## **PPL ELECTRIC**

PPL Electric Utilities Corporation (“PPL Electric”), was incorporated under the laws of the Commonwealth of Pennsylvania in 1920, and provides electricity delivery service in eastern and central Pennsylvania. Prior to July 1, 2000, we had been an integrated public utility which engaged in the generation, transmission and distribution of electricity in our franchised territory in eastern and central Pennsylvania, and which also engaged in wholesale energy marketing in the United States and Canada. We also engaged in retail energy marketing in newly deregulated markets through PPL EnergyPlus, LLC (“PPL EnergyPlus”), which had been our wholly-owned subsidiary.

In 1996, the Pennsylvania Electricity Generation Customer Choice and Competition Act (the “Customer Choice Act”), was enacted to restructure Pennsylvania’s electric utility industry in order to create retail access to a competitive market for generation of electricity. The Customer Choice Act required each Pennsylvania electric utility to file a restructuring plan to “unbundle” its rates into separate generation, transmission and distribution components and to permit its customers to directly access alternate suppliers of electricity. On July 1, 2000, PPL Electric and our parent, PPL Corporation, completed a corporate realignment in order to effectively separate our regulated transmission and distribution operations from our recently deregulated generation operations and better position our companies and affiliates in the new competitive marketplace. As part of the corporate realignment, we transferred our generating assets to PPL Generation, LLC. We also transferred our wholesale energy marketing operations to PPL EnergyPlus, and subsequently transferred our interest in PPL EnergyPlus to PPL Energy Funding Corporation, another subsidiary of PPL Corporation. We retained our electric transmission and distribution operations. The corporate realignment followed receipt of various regulatory approvals, including approvals of the Pennsylvania Public Utility Commission (the “PUC”), the Federal Energy Regulatory Commission (the “FERC”), and the Nuclear Regulatory Commission.

### **POLR Obligation**

As a result of the corporate realignment in 2000, we divested ourselves of our electric generation and wholesale energy marketing operations and became engaged primarily in the transmission and distribution of electricity. Under the Customer Choice Act, we are required to act as a “provider of last resort,” or POLR, and provide electricity to our retail customers who do not select an alternate electric energy supplier. As part of a settlement order by the PUC in connection with the restructuring plan we filed under the Customer Choice Act, we agreed to provide this electricity at predetermined “capped” rates through 2009. Our POLR obligation after 2009, if any, will be determined by the PUC pursuant to regulations that have not yet been promulgated. The Customer Choice Act allows for limited rate relief during the “capped” rate period for instances of unforeseen and significant operating or market events, or changes in law. However, as a result of the settlement order and POLR obligation, through the year 2009, we generally bear the risk that we will not be able to obtain adequate energy supply at the “capped” rates we may charge to our retail customers who do not select an alternate electric energy supplier. We currently have in effect a full requirements energy supply agreement with PPL EnergyPlus that is designed to satisfy our POLR obligation through the end of 2001.

### **Strategic Initiative**

In April 2001, we announced a strategic initiative (the “Initiative”), designed to substantially reduce our exposure to volatility in energy prices through 2009 and to reduce our business and financial risk profile by, among other things, limiting our business activities to the transmission and distribution of electricity and businesses related to or arising out of the electric transmission and distribution businesses.

Under the Initiative, we are taking the following steps:

- Obtaining a long-term electric supply contract, at prices generally equal to the pre-determined “capped” rates under the PUC settlement order, to satisfy our POLR obligations to retail customers from 2002 through 2009;
- Limiting our businesses to electric transmission and distribution and activities relating to or arising out of those businesses;
- Adopting amendments to our Articles of Incorporation and Bylaws containing corporate governance and operating provisions designed to reinforce our corporate separateness from affiliated companies, including:
  - Requiring that our assets and our books and records of account be kept separate from those of our affiliates;
  - Requiring that we conduct our business so as to make clear our separateness from our affiliates, and to make clear that we are not liable for their obligations and that they are not liable for ours;
  - Requiring that we maintain arm’s-length relationships with our affiliates;
  - Appointing an independent director to our Board of Directors and requiring the unanimous consent of the Board of Directors, including the consent of the independent director, to amendments to these corporate governance and operating provisions or to the commencement by us of any insolvency proceeding, including any filing by us of a voluntary petition in bankruptcy or other similar actions;
  - Appointing an independent compliance administrator (the “Independent Administrator”) to review, on a semi-annual basis, our compliance with the new corporate governance and operating requirements contained in our amended Articles of Incorporation and Bylaws.
- Providing, with respect to the Debt Securities, certain covenants that are designed to limit certain financial risks, including:
  - a covenant restricting our ability to issue additional debt securities under the Indenture or to merge or make substantial acquisitions if certain conditions, including receipt of specified rating agency confirmations that the transaction will not cause a reduction of the rating on the Debt Securities to below the lower of the then existing ratings or certain specified threshold ratings;
  - a covenant to suspend declarations of dividends on our common stock if the Independent Administrator has delivered a notice of our noncompliance with the new corporate governance and operating requirements or if we fail to meet certain financial tests; and
  - a covenant to initiate a filing for rate relief with the PUC under certain circumstances if we fail to meet certain financial covenants. See “Certain Agreements of PPL Electric.”
- Adopting a plan of division pursuant to the Pennsylvania Business Corporation Law. The plan of division will result in two separate corporations. We will be the surviving corporation

and a new Pennsylvania corporation will be created. Under the plan of division, \$5 million of cash and certain of our potential liabilities will be allocated to the new corporation. PPL Corporation will guarantee the obligations of the new corporation with respect to such liabilities. These liabilities include:

- any liabilities under contracts that, prior to the division, we had assigned to an affiliate, and any other contracts under which we have joint liability with any other affiliate, for which releases from the other contracting party or parties have not been obtained;
- any liabilities of PPL Electric under any employee benefit arrangements for payments to employees of any other affiliate, other than liabilities for which we are liable under applicable law or regulation notwithstanding the division;
- any liabilities for damages with respect to claims that may be made in the future based on occurrences arising prior to the effective date of the division for which we may be jointly liable with any other affiliate, other than tax liabilities and liabilities for which we are liable under applicable law or regulation notwithstanding the division; and
- any liabilities for damages with respect to claims that may be made in the future based on occurrences arising, prior to the effective date of the division, which do not relate to or arise out of (1) our transmission and distribution businesses, or (2) those business activities that are related to or arise out of our electric transmission and distribution businesses, other than tax liabilities and liabilities for which we are liable under applicable law or regulation notwithstanding the division.

The enhancements to our legal separation from our affiliates are intended to minimize the risk that a court would order our assets and liabilities to be substantively consolidated with those of PPL Corporation or another affiliate of PPL Corporation in the event that PPL Corporation or another PPL Corporation affiliate were to become a debtor in a bankruptcy case. The requirement of an independent director is intended to ensure that if PPL Corporation or a PPL Corporation affiliate files a voluntary bankruptcy or reorganization petition, our Board of Directors will make an independent decision regarding whether PPL Electric should file a voluntary bankruptcy or reorganization petition based upon the best interests of PPL Electric and the groups whose interests the directors may properly consider, rather than make a decision dictated by PPL Corporation. Taken collectively with the other steps in the Initiative to reduce our business and financial risk profile, we anticipate that we can increase the leverage in our capital structure by issuing the Debt Securities. This, in turn, is expected to enable us to replace higher-cost equity with lower-cost debt, and, thus, lower our total cost of capital. Nevertheless, there can be no assurance that a bankruptcy court would enforce the provision in our Articles of Incorporation that requires the consent of the independent director as a condition to the authorization to file a voluntary bankruptcy petition. In addition, if PPL Corporation or another PPL Corporation affiliate were to become a debtor in a bankruptcy case, there can be no assurance that a court would not order our assets and liabilities to be consolidated with those of PPL Corporation or such other PPL Corporation affiliate. Any such substantive consolidation could result in delays or reductions in payments on the Debt Securities.

### **The New POLR Agreement**

We currently have a full requirements energy supply agreement with PPL EnergyPlus that is designed to satisfy our POLR obligation, as described above, through the end of 2001. Under the existing POLR agreement, PPL EnergyPlus will provide energy and capacity sufficient for us to meet our POLR obligation through the end of 2001 at the pre-determined "capped" rates we may charge our POLR customers during this period. In May 2001, we solicited bids from energy suppliers, including PPL

EnergyPlus, to enter into one or more additional generation supply agreements to provide us with electric energy and capacity in amounts sufficient for us to meet our POLR obligation to deliver electric energy, beginning in 2002 through 2009, at the pre-determined "capped" rates we may charge to our POLR customers. PPL EnergyPlus was the low bidder and was selected to provide us with energy and capacity sufficient to meet our POLR obligations from 2002 through 2009. Under the new supply contract, PPL EnergyPlus will provide the energy and capacity at the pre-determined "capped" rates. We will also pay PPL EnergyPlus \$90 million by January 1, 2002, to offset the difference between the revenues expected under the pre-determined "capped" rates and projected market prices through the life of the supply agreement (as projected by PPL EnergyPlus when it submitted its bid). The purpose of obtaining the generation supply agreement is to reduce the supply and price risk we would otherwise bear through 2009 in connection with our POLR obligation.

The new POLR agreement contains certain credit and security provisions designed to mitigate each party's risk in the event of a failure by the other party to perform its obligations. Among other things, each of the parties is required, upon the request of the other party, to provide performance assurance to the other party in the form of cash, letters of credit or other security to the extent that, as of any date of determination, the difference between the assumed ongoing POLR revenue and the market value of energy and capacity exceeds certain specified thresholds, or if the other party has reasonable grounds to believe that the first party's creditworthiness or performance will become unsatisfactory. The current thresholds requiring a party to post collateral as performance assurance are, in the case of PPL EnergyPlus' obligations, \$100 million, and in the case of our obligations, \$150 million. For example, if, as of any determination date, the market value of energy and capacity required to meet the POLR obligations exceeded the then assumed future POLR revenues by more than \$100 million, PPL EnergyPlus would be required by the agreement to post performance assurance in the form of cash, letters of credit or other security, but only to the extent of such excess over \$100 million. If the excess were less than \$100 million, no performance assurance would generally be required. In addition, based on current performance assurance limits, no party is required to provide collateral in excess of \$300 million. While these security provisions are designed to mitigate our risk in the event of a failure by PPL EnergyPlus to perform its obligations under the POLR contract, in such event, we would remain obligated to provide POLR services through 2009, absent any rate relief, at the pre-determined "capped" rates. In this case, we would probably need to secure electricity to meet our POLR obligation through purchases in the wholesale electric market at prices which could be substantially higher or lower than the pre-determined "capped" rates, depending on market conditions at that time.

The POLR contract has been filed with the PUC and the FERC, and we have requested approvals by the end of July.

#### **Amendments to Articles of Incorporation and Bylaws**

A special meeting of our shareowners is to be held on July 17, 2001 for the purpose of approving the plan of division and the amendments to our Articles of Incorporation and Bylaws referred to above. PPL Corporation holds all of the shares of our common stock, which represents 99% of the voting shares in PPL Electric. Thus, PPL Corporation's approval will assure approval of the plan of division, including the amendments to the Articles of Incorporation and the Bylaws, at the special meeting. The plan of division and the amendments to the Articles of Incorporation and Bylaws will become effective upon filing of articles of division and the plan of division with the Secretary of State of the Commonwealth of Pennsylvania.

As compared with our current Articles of Incorporation, the amended Articles of Incorporation will:

- Require that our Board of Directors include at all times at least one individual who is not, and within the previous five years was not, a shareholder, director, officer, employee, customer, supplier or major creditor of us or any affiliated entity (an "Independent Director"); and
- Require the Independent Director's consent to any action by us (1) to amend the specified corporate governance and operating provisions of the amended Articles of Incorporation and Bylaws that are designed to reinforce our corporate separateness from affiliated companies, or (2) to file a petition commencing a voluntary bankruptcy case, or take similar specified actions.

The amended Bylaws are designed to reinforce our legal separateness from our affiliates, and among other things, will require us to:

- Engage, whether directly or indirectly through subsidiaries, only (except to the extent mandated by or necessary to comply with obligations imposed by applicable law or regulation) in (1) the electric transmission and distribution businesses and (2) those business activities that are related to or arise out of its electric transmission and distribution businesses (including, by way of example, activities associated with our POLR obligations);
- Remain separate from PPL Corporation and its other affiliates in a number of specific ways:
  - Our funds and other assets may not be commingled with the funds and assets of other PPL entities and we must pay our own liabilities out of our own funds;
  - We may not hold ourselves out as liable for the debts of any of the other PPL entities;
  - We must hold ourselves out as a separate entity, conduct our business in our own name, act solely in our own corporate name and conduct our business so as not to mislead others as to our identity;
  - We must maintain separate accounts and separate books and records of accounts and financial statements;
  - We must observe all formalities required by our Articles of Incorporation and Bylaws and the Pennsylvania Business Corporation Law;
  - Our capitalization must be adequate in light of our business and purpose;
  - We may not guarantee or become obligated for the debts of PPL Corporation or any of our other affiliates or make our credit available to satisfy the obligations of, or pledge our assets for the benefit of, PPL Corporation or any other affiliate, with specified exceptions for existing guarantees and guarantees of subsidiary obligations;
  - We must maintain an arms-length relationship with PPL Corporation and its other affiliates;

- Our officers and directors must make all decisions with respect to our businesses and daily operations independent of, and not dictated by, PPL Corporation or any of its other affiliates, in accordance with applicable law; and
- To operate in such manner as our Board of Directors deems reasonable and necessary or appropriate to preserve our separateness from PPL Corporation or any of its other affiliates.

We have agreed in the Indenture, that for so long as the Debt Securities remain outstanding, we will comply in all material respects with the separateness provisions in our Articles of Incorporation and Bylaws, as such provisions may be amended from time to time in accordance with the provisions of the Articles of Incorporation and Bylaws.

The amended Articles of Incorporation and Bylaws will permit our Board of Directors to adopt additional amendments to the Bylaws, including amendments that revise or eliminate provisions that are designed to reinforce our legal separateness from our affiliates. However, any such amendment must be approved unanimously by our Board of Directors, including the Independent Director.

The requirement of an independent director is intended to ensure that the provisions in the amended Articles of Incorporation and Bylaws that are designed to reinforce our corporate separateness from our affiliates will not be eliminated or revised without an independent decision based upon the best interests of PPL Electric and the groups whose interests the directors may properly consider, including Holders of the Debt Securities.

In discharging their duties as directors, including with regard to any action contemplated by the foregoing or with regard to any action taken or determination made at any time when we are insolvent, the amended Articles of Incorporation will permit the directors, in considering the best interests of PPL Electric, to consider the effects of any action upon any groups affected by such action, including holders of the Debt Securities and our other creditors. In considering the best interests of PPL Electric or the effects of any action, the directors will not be required to regard the interests of our shareowners as a dominant or controlling interest or factor.

### **Independent Administrator**

Our board of directors will appoint the Independent Administrator to monitor specified formalities and activities that support our legal separateness from PPL Corporation and the other affiliates of PPL Corporation. We will enter into a Compliance Administration Agreement with the Independent Administrator that requires the Independent Administrator to review, on a semi-annual basis, certain information relating to our activities. In addition, the Compliance Administration Agreement will require our officers to certify, semi-annually, our compliance with particular formalities intended to reinforce this legal separateness. The Independent Administrator will also make semi-annual compliance reports to us, and in the event of continuation of noncompliance beyond specified grace periods, will send a notice directing us to cease payment of dividends on our common stock. Further, continuance of such noncompliance could give rise to an event of default with respect to the Debt Securities. See "Description of the Debt Securities – Events of Default" and "–Certain Additional Agreements of PPL Electric" below.

The Compliance Administration Agreement can be terminated if we receive Rating Agency Confirmations from each applicable Rating Agency (in each case as defined below), each to the effect that the termination of the Compliance Administration Agreement will not result in the reduction or withdrawal of the ratings on the Debt Securities below the lower of (x) such Rating Agency's rating then in effect or (y) such Rating Agency's Threshold Rating. We may also agree with the Independent

Administrator to amend the Compliance Administration Agreement (x) if the amendments are necessary to comply with applicable law or regulation and if our Board of Directors unanimously approves of such amendment or (y) if we deliver an opinion of nationally recognized bankruptcy counsel to the effect that the proposed amendment will not adversely affect the likelihood that our assets and liabilities would be substantively consolidated with those of PPL Corporation or another affiliate of PPL Corporation in the event that PPL Corporation or another PPL Corporation affiliate were to become a debtor in a bankruptcy case.

**The information above concerning PPL Electric is only a summary and does not purport to be comprehensive. For additional information concerning PPL Electric, including certain assumptions, risks and uncertainties involved in the forward-looking statements contained or incorporated by reference in this prospectus, you should refer to the information described in "Where You Can Find More Information."**

Our offices are located at Two Ninth Street, Allentown, Pennsylvania 18101-1179 and our telephone number is (610) 774-5151.

### USE OF PROCEEDS

Unless we indicate differently in the applicable prospectus supplement, we will use the net proceeds from the sale of the Debt Securities to make payments to PPL EnergyPlus to obtain the energy supply contract described above, to repurchase a portion of our common stock from PPL Corporation, to fund construction expenditures, and for other general corporate purposes, including the reduction of short-term debt currently outstanding having a weighted average interest rate of 4.15%.

### RATIOS OF EARNINGS TO FIXED CHARGES

The following table sets forth our ratios of earnings to fixed charges for the periods indicated:

	<b>Twelve Months Ended</b>	<b>Year Ended December 31,</b>				
	<u>March 31, 2001</u>	<u>2000</u>	<u>1999</u>	<u>1998</u>	<u>1997</u>	<u>1996</u>
Ratio of earnings to fixed charges (a) (b).....	2.15(c)	2.72(c)	3.54	3.94	3.48	3.51

(a) The ratios presented for 2001, 2000, 1999 and 1998 are based on net income excluding extraordinary items.

(b) Excluding non-recurring items, the ratio of earnings to fixed charges are as follows: March 31, 2001, 1.99; 2000, 2.56; 1999, 3.35; and 1998, 3.53.

(c) Prior to July 1, 2000 the ratios reflect our generation and marketing operations. Due to the corporate realignment on July 1, 2000, prior years are not comparable to 2001 and 2000.

## DESCRIPTION OF THE DEBT SECURITIES

The following description sets forth certain general terms and provisions of the Debt Securities that we may offer by this prospectus. We will describe the particular terms of Debt Securities, and provisions that vary from those described below, in one or more prospectus supplements.

We may issue the Debt Securities from time to time in the future in one or more series. We will issue the Debt Securities under the Indenture.

A form of the Indenture is filed as an exhibit to the registration statement. The Indenture and its associated documents contain the full legal text of the matters described in this section. Because this section is a summary, it does not describe every aspect of the Debt Securities or the Indenture. This summary is subject to and qualified in its entirety by reference to all the provisions of the Indenture, including definitions of certain terms used in the Indenture. We also include references in parentheses to certain sections of the Indenture. Whenever we refer to particular sections or defined terms of the Indenture in this prospectus or in a prospectus supplement, such sections or defined terms are incorporated by reference herein or in the prospectus supplement. This summary also is subject to and qualified by reference to the description of the particular terms of your securities described in the applicable prospectus supplement or supplements. The Indenture has been qualified under the Trust Indenture Act, and you should also refer to the Trust Indenture Act for provisions that apply to the Debt Securities.

There is no requirement under the Indenture that PPL Electric issue future issuances of debt securities exclusively under the Indenture, and PPL Electric will be free to employ other indentures or agreements containing provisions different from those included in the Indenture or applicable to one or more issues of Debt Securities, in connection with future issues of such other debt securities.

### General

We may issue an unlimited amount of Debt Securities or other securities under the Indenture, subject to certain conditions. See “Issuance of Additional Indenture Securities.” The Debt Securities and all other debt securities issued under the Indenture are collectively referred to herein as the “Indenture Securities.”

Until the Release Date described below, the Debt Securities will be issued on the basis of, and primarily secured by, one or more series of 1945 Mortgage Bonds issued and delivered by PPL Electric to the Trustee, and the other collateral described below. See “—Security” and “Issuance of Additional Indenture Securities” below. **On the Release Date, and subject to receiving the necessary Rating Agency Confirmations described below, the Indenture Securities will cease to be secured and will become our unsecured general obligations, ranking on a parity with our other senior unsecured indebtedness.**

Prior to the issuance of each series, certain terms of the particular Debt Securities have to be specified in or pursuant to a supplemental indenture, a board resolution, or one or more officer’s certificates. We refer you to the applicable prospectus supplement(s) for a description of the following terms of the series of Debt Securities:

- (a) the title of such Debt Securities;
- (b) any limit upon the principal amount of such Debt Securities;

- (c) the date or dates on which principal will be payable or how to determine such dates;
- (d) the rate or rates or method of determination of interest; the date from which interest will accrue; the dates on which interest will be payable (“Interest Payment Dates”); and any record dates for the interest payable on such Interest Payment Dates;
- (e) any obligation or option of PPL Electric to redeem, purchase or repay Debt Securities, including any obligations pursuant to any sinking fund or similar redemption provisions, or any option of the Holder to require PPL Electric to redeem or repurchase Debt Securities, and the terms and conditions upon which such Debt Securities will be redeemed, purchased or repaid;
- (f) the denominations in which such Debt Securities will be issuable (if other than denominations of \$1,000 and any integral multiple thereof);
- (g) whether such Debt Securities are to be issued in whole or in part in the form of one or more global Debt Securities and, if so, the identity of the depositary for such global Debt Securities;
- (h) any additional events of default or additional covenants for the benefit of the holders of Debt Securities; and
- (i) any other terms of such Debt Securities.

## **Payment of Debt Securities**

### **Interest**

Unless we indicate differently in a prospectus supplement, we will pay interest on each Debt Security on each Interest Payment Date by check mailed to the person in whose name such Debt Security is registered (the registered holder of any Indenture Security being called a “Holder” in this prospectus) as of the close of business on the regular record date relating to such Interest Payment Date, *except* that interest payable at maturity (whether at stated maturity, upon redemption or otherwise, “Maturity”) will be paid to the person to whom principal is paid.

However, if we default in paying interest on a Debt Security, we will pay defaulted interest in either of the two following ways:

- (a) We will first propose to the Trustee a payment date for such defaulted interest. Next, the Trustee will choose a special record date for determining which Holders are entitled to the payment. The special record date will be between 10 and 15 days before the payment date we propose. Finally, we will pay such defaulted interest on the payment date to the Holder of the Debt Security as of the close of business on the Special Record Date.
- (b) Alternatively, we can propose to the Trustee any other lawful manner of payment that is consistent with the requirements of any securities exchange on which such Debt Securities are listed for trading. If the Trustee thinks the proposal is practicable, payment will be made as proposed.

(See Section 307.)

## **Principal**

Unless we indicate differently in a prospectus supplement, we will pay principal of and any interest and premium on the Debt Securities at Maturity upon presentation of the Debt Securities at the office of The Chase Manhattan Bank in New York, New York, as our paying agent. Any other paying agent initially designated for the Debt Securities of a particular series will be named in the applicable prospectus supplement.

In our discretion, we may change the place of payment on the Debt Securities, and may remove any Paying Agent and may appoint one or more additional paying agents (including us or any affiliate). (See Section 702.)

## **Form; Transfers; Exchanges**

Unless otherwise indicated in a prospectus supplement, the Debt Securities will be issued:

- (a) only in fully registered form;
- (b) without interest coupons; and
- (c) in denominations that are integral multiples of \$1,000. (See Sections 201 and 302.)

You may have your Debt Securities divided into Debt Securities of smaller denominations (of at least \$1,000) or combined into Debt Securities of larger denominations, as long as the total principal amount is not changed. This is called an "exchange." (See Section 305.)

You may exchange or transfer Debt Securities at the office of the Trustee. The Trustee acts as our agent for registering Debt Securities in the names of holders and transferring debt securities. We may appoint another agent (including one of our affiliates) or act as our own agent for this purpose. The entity performing the role of maintaining the list of registered holders is called the "Security Registrar." It will also perform transfers. (See Section 305.)

In our discretion, we may change the place for registration of transfer of the Debt Securities and may change the Security Registrar. (See Sections 305 and 702.)

Except as otherwise provided in a prospectus supplement, there will be no service charge for any transfer or exchange of the Debt Securities, but you may be required to pay a sum sufficient to cover any tax or other governmental charge payable in connection with the transfer or exchange. We may block the transfer or exchange of (a) Debt Securities during a period of 15 days prior to giving any notice of redemption or (b) any Debt Security selected for redemption in whole or in part, except the unredeemed portion of any Debt Security being redeemed in part. (See Section 305.)

## **Redemption**

We will set forth any terms for the redemption of Debt Securities in a prospectus supplement. Unless we indicate differently in a prospectus supplement, and except with respect to Debt Securities redeemable at the option of the Holder, Debt Securities will be redeemable upon notice by mail between 30 and 60 days prior to the redemption date. If less than all of the Debt Securities of any series or any tranche thereof are to be redeemed, the Trustee will select the Debt Securities to be redeemed. In the absence of any provision for selection, the Trustee will choose a method of random selection as it deems fair and appropriate. (See Sections 503 and 504.)

Debt Securities will cease to bear interest on the redemption date. PPL Electric will pay the redemption price and any accrued interest to the redemption date once you surrender the Debt Security for redemption. (See Section 505.) If only part of a Debt Security is redeemed, the Trustee will deliver to you a new Debt Security of the same series for the remaining portion without charge. (See Section 506.)

We may make any redemption at our option conditional upon the receipt by the Paying Agent, on or prior to the date fixed for redemption, of money sufficient to pay the redemption price. If the Paying Agent has not received such money by the date fixed for redemption, we will not be required to redeem such Debt Securities. (See Section 504.)

## **Security**

Except as described below under this heading and under "Issuance of Additional Indenture Securities," and subject to the exceptions we discuss under "Discharge of Lien; Release Date" and under "Satisfaction and Discharge," all Indenture Securities will be secured, equally and ratably, by:

- (a) an equal principal amount of first mortgage bonds issued under the 1945 Mortgage, and delivered to the Trustee under the Indenture, and other Class A Bonds as described below; as discussed under "Description of the 1945 Mortgage Bonds – Security," the 1945 Mortgage constitutes, subject to certain exceptions, a first mortgage lien on substantially all of our electric transmission and distribution properties; and
- (b) the lien of the Indenture on substantially all of our tangible electric transmission and distribution property located in Pennsylvania, which lien is junior to the lien of the 1945 Mortgage. We sometimes refer to our property that is subject to the lien of the Indenture as "Mortgaged Property."

See "Discharge of Lien; Release Date" for a discussion of provisions of the Indenture pursuant to which, subject to the satisfaction of the specified conditions, the lien of the Indenture would be discharged and the Indenture Securities would become our unsecured obligations.

## **Class A Bonds**

As discussed below under "Certain Additional Agreements of PPL Electric – Consolidation, Merger and Conveyance of Assets as an Entirety," we will be permitted to merge or consolidate with another company upon meeting specified requirements, including, under certain circumstances, a requirement that we deliver written evidence to the Trustee to the effect that the merger or consolidation will not result in the withdrawal or reduction of the ratings on the outstanding Debt Securities by three Rating Agencies (as defined below) below the lower of the ratings then in effect or certain specified threshold ratings described below. See "Certain Additional Agreements of PPL Electric – Ratings" below. Following a merger or consolidation of another company into us, we could deliver to the Trustee bonds issued under an existing mortgage on the properties of such other company in lieu of or in addition to bonds issued under the 1945 Mortgage. In such event, the Indenture Securities would be secured, additionally, by such bonds and by the lien of the Indenture on the properties of such other company, which would be junior to the liens of such existing mortgage and the 1945 Mortgage. The 1945 Mortgage and all such other mortgages are hereinafter collectively referred to as the "Class A Mortgages," and all bonds issued under the Class A Mortgages and delivered to the Trustee are hereinafter collectively referred to as the "Class A Bonds." (See Section 1706.)

Class A Bonds, including 1945 Mortgage Bonds, that are the basis for the authentication and delivery of Indenture Securities (a) will be delivered to, and registered in the name of, the Trustee or its

nominee and will be owned and held by the Trustee, subject to the provisions of the Indenture, for the benefit of the Holders of all Indenture Securities outstanding from time to time; (b) will mature or be subject to mandatory redemption on the same dates, and in the same principal amounts, as such Indenture Securities; and (c)(i) may, but need not, bear interest and (ii) may, but need not, contain provisions for the redemption at our option, any such redemption to be made at a redemption price or prices not less than the principal amount of such Class A Bonds. (See Sections 1602 and 1701). To the extent that Class A Bonds do not bear interest, holders of Indenture Securities will not have the benefit of the lien of a Class A Mortgage in respect of an amount equal to accrued interest, if any, on the Indenture Securities; however, such holders will nevertheless have the benefit of the lien of the Indenture in respect of the amount of accrued interest.

Any payment by us of principal of or premium or interest on the Class A Bonds delivered to and held by the Trustee will be applied by the Trustee to the payment of any principal, premium or interest, as the case may be, in respect of the Indenture Securities which is then due. Our obligation under the Indenture to make such payment in respect of the Indenture Securities will be deemed satisfied and discharged to the extent of such payment. If, at the time of any such payment of principal of Class A Bonds, there is no principal then due in respect of the Indenture Securities, the proceeds of the payment will constitute Funded Cash and will be held by the Trustee as part of the Mortgaged Property, to be withdrawn, used or applied as provided in the Indenture. If, at the time of any such payment of premium or interest on Class A Bonds, there is no premium or interest then due on the Indenture Securities, the payment will be remitted to us at our request; except that, if any Event of Default, as described below, has occurred and is continuing, the payment will be held as part of the Mortgaged Property until the Event of Default has been cured or waived. (See Section 1702 and "Withdrawal of Cash" below.)

Any payment by us on Indenture Securities authenticated and delivered on the basis of the delivery to the Trustee of Class A Bonds (other than by application of the proceeds of a payment in respect of such Class A Bonds) will, to the extent thereof, be deemed to satisfy and discharge our obligations, if any, to make a corresponding payment, in respect of such Class A Bonds which is then due. (See Section 1702).

The Trustee may not sell, assign or otherwise transfer any Class A Bonds except to a successor trustee under the Indenture. (See Section 1704.) At the time any Indenture Securities which have been authenticated and delivered upon the basis of Class A Bonds, cease to be outstanding (other than as a result of the application of the proceeds of the payment or redemption of such Class A Bonds), the Trustee will surrender to us, or upon our order, an equal principal amount of such Class A Bonds. (See Section 1703.)

When no Class A Bonds are outstanding under a Class A Mortgage except for Class A Bonds delivered to and held by the Trustee, then, at our request and subject to satisfaction of certain conditions, the Trustee will surrender such Class A Bonds for cancellation, the related Class A Mortgage will be satisfied and discharged, the lien of such Class A Mortgage on our property subject thereto will cease to exist and the priority of the lien of the Indenture, as to such property, will be increased accordingly. (See Section 1703.) If and when no Class A Mortgages are in effect, the Indenture will constitute a direct, first mortgage lien on our electric utility property, subject to certain Permitted Liens and certain other exceptions described below (see "Lien of the Indenture" below).

At the date of this prospectus, the only Class A Mortgage is the 1945 Mortgage, and the only Class A Bonds issuable at this time are 1945 Mortgage Bonds issuable under the 1945 Mortgage. Upon discharge of the 1945 Mortgage and assuming no other Class A Mortgage exists at the time, the lien of the Indenture would become a first mortgage lien, subject to certain Permitted Liens as referred to below.

## **Lien of the Indenture**

The Indenture creates a lien on substantially all tangible properties of PPL Electric in Pennsylvania used in the transmission and distribution of electric energy, other than certain excepted property and subject to certain permitted liens, in each case as described below. We sometimes refer to PPL Electric's transmission and distribution properties of the type subject to the lien of the Indenture, regardless of whether the Release Date has occurred, but exclusive of Excepted Property described below, as "Electric Utility Property." At the date of this prospectus, substantially all of such property, while subject to the lien of the Indenture, is also subject to the prior lien of the 1945 Mortgage. For so long as the 1945 Mortgage is in effect, the Indenture Securities will have the benefit of the first mortgage lien of the 1945 Mortgage on such property, and the benefit of the prior lien of any additional Class A Mortgage on any property subject thereto, to the extent of the aggregate principal amount of Class A Bonds, issued under the respective Class A Mortgages, held by the Trustee.

**Permitted Liens.** The lien of the Indenture is subject to permitted liens described in the Indenture. Such permitted liens include liens existing at the execution date of the Indenture, liens on property at the time we acquire such property, tax liens and other governmental charges which are not delinquent or which are being contested in good faith, mechanics', construction and materialmen's liens, certain judgment liens, easements, reservations and rights of others (including governmental entities) in, and defects of title in, our property, certain leases and leasehold interests, liens to secure public obligations, rights of others to take minerals, timber, electric energy or capacity, gas, water, steam or other products produced by us or by others on our property, rights and interests of Persons other than us arising out of agreements relating to the common ownership or joint use of property, and liens on the interests of such Persons in such property, liens which have been bonded or for which other security arrangements have been made, liens created in connection with the issuance of tax-exempt debt securities, purchase money liens and liens related to the construction or acquisition of property, or the development or expansion of property, liens which secure specified Indenture Securities equally and ratably with other obligations, and additional liens on any of our property (other than Excepted Property, as described below) to secure debt for borrowed money in an aggregate principal amount not exceeding 10% of the total assets of PPL Electric and its consolidated subsidiaries, as shown on the latest audited balance sheet of PPL Electric and such subsidiaries. (See Granting Clauses and Section 101 and Section 707.)

The Indenture provides that the Trustee will have a lien, prior to the lien on behalf of the holders of Indenture Securities, upon the Mortgaged Property for the payment of its reasonable compensation and expenses and for indemnity against certain liabilities. (See Section 1007.) Any such lien would be a Permitted Lien under the Indenture.

**Excepted Property.** The lien of the Indenture does not cover, among other things, the following types of property: property located outside of Pennsylvania; property not used in the electric transmission and distribution business; cash and securities not paid, deposited or held under the Indenture; contracts, leases and other agreements of all kinds, contract rights, bills, notes and other instruments, accounts receivable, claims, demands and judgments; governmental and other licenses, permits, franchises, consents and allowances; intellectual property rights and other general intangibles; vehicles, movable equipment, aircraft and vessels; all goods, stock in trade, wares, merchandise and inventory held for sale or lease in the ordinary course of business; materials, supplies, inventory and other personal property consumable in the operation of our business; fuel; tools and equipment; furniture and furnishings; computers and data processing, telecommunications and other facilities used primarily for administrative or clerical purposes or otherwise not used in connection with the operation or maintenance of electric transmission and distribution facilities; coal, ore, gas, oil and other minerals and timber rights; electric energy, gas, steam, water and other products generated, produced, manufactured, purchased or otherwise acquired; real property and facilities used primarily for the production or gathering of natural gas; and

leasehold interests. We sometimes refer to property of PPL Electric not covered by the lien of the Indenture as "Excepted Property." (See Granting Clauses.)

We may enter into supplemental indentures with the Trustee, without the consent of the Holders, in order to subject additional property (including property that would otherwise be excepted from such lien) to the lien of the Indenture. (See Section 1301.) This property would constitute Property Additions and would be available as a basis for the issuance of Indenture Securities. See "Issuance of Additional Indenture Securities."

The Indenture provides that after-acquired Electric Utility Property (other than Excepted Property) will be subject to the lien of the Indenture. (See Granting Clause Second.) However, in the case of consolidation or merger (whether or not we are the surviving company) or transfer of the Mortgaged Property as or substantially as an entirety, the Indenture will not be required to be a lien upon any of the properties either owned or subsequently acquired by the successor company except properties acquired from us in or as a result of such transfer, as well as improvements, extensions and additions (as defined in the Indenture) to such properties and renewals, replacements and substitutions of or for any part or parts thereof. (See Section 1203 and "Consolidation, Merger and Conveyance of Assets as an Entirety" below.)

See "Discharge of Lien; Release Date" for a discussion of provisions of the Indenture pursuant to which, subject to the satisfaction of specified conditions, all the Mortgaged Property would be released from the lien of the Indenture and Indenture Securities would become our unsecured obligations.

#### **Issuance of Additional Indenture Securities**

Subject to the issuance restrictions described below, the maximum principal amount of Indenture Securities that may be authenticated and delivered under the Indenture is unlimited. (See Section 301.) Indenture Securities of any series may be issued from time to time on the basis of, and in an aggregate principal amount not exceeding:

- (a) the aggregate principal amount of Class A Bonds delivered to the Trustee;
- (b) the Cost or Fair Value to PPL Electric (whichever is less) of Property Additions (as described below) which do not constitute Funded Property (generally, Property Additions which have been made the basis of the authentication and delivery of Indenture Securities, the release of Mortgaged Property or the withdrawal of cash, which have been substituted for retired Funded Property or which have been used for other specified purposes) after certain deductions and additions, primarily including adjustments to offset property retirements;
- (c) the aggregate principal amount of Retired Securities, but if Class A Bonds had been made the basis for the authentication and delivery of such Retired Securities, only after the discharge of the related Class A Mortgage; or
- (d) an amount of cash deposited with the Trustee. (See Article Sixteen.)

Property Additions generally include any property which is owned by PPL Electric and is subject to the lien of the Indenture. (See Section 104.)

We expect that, until the 1945 Mortgage has been discharged, we will issue Indenture Securities primarily on the basis of Class A Bonds issued under our 1945 Mortgage. However, we have reserved

the right to issue additional Indenture Securities on the basis of property additions, retired Indenture Securities and cash deposits, and not on the basis of Class A Bonds issued under our 1945 Mortgage.

### **Limitation on Issuance of Additional Securities**

We have agreed that for so long as the Debt Securities are outstanding, we will not issue additional Indenture Securities (other than Indenture Securities issued to refund outstanding Indenture Securities, outstanding bonds issued under the 1945 Mortgage or other Class A Bonds, and other than Indenture Securities issuable upon permitted transfers and exchanges, or for lost or mutilated Indenture Securities) unless we have received Rating Agency Confirmations from each applicable Rating Agency (in each case as defined below), each to the effect that the issuance of such additional Indenture Securities will not result in the reduction or withdrawal of the ratings on the Debt Securities below the lower of (x) such Rating Agency's rating then in effect or (y) such Rating Agency's Threshold Rating. (See Supplemental Indenture, Section 102.)

### **Release of Property**

Unless an Event of Default has occurred and is continuing, we may obtain the release from the lien of the Indenture of any Mortgaged Property, except for cash held by the Trustee, upon delivery to the Trustee of an amount in cash equal to the amount, if any, by which the Cost of the property to be released (or, if less, the Fair Value to us of such property at the time it became Funded Property) exceeds the aggregate of:

- (a) an amount equal to the aggregate principal amount of obligations secured by Purchase Money Liens upon the property to be released and delivered to the Trustee;
- (b) an amount equal to the Cost or Fair Value to us (whichever is less) of certified Property Additions not constituting Funded Property after certain deductions and additions, primarily including adjustments to offset property retirements (except that such adjustments need not be made if such Property Additions were acquired or made within the 90-day period preceding the release);
- (c) the aggregate principal amount of Indenture Securities we would be entitled to issue on the basis of Retired Securities (with such entitlement being waived by operation of such release);
- (d) the aggregate principal amount of Indenture Securities delivered to the Trustee (with such Indenture Securities to be canceled by the Trustee);
- (e) any amount of cash and/or an amount equal to the aggregate principal amount of obligations secured by Purchase Money Liens upon the property released delivered to the trustee or other holder of a lien prior to the lien of the Indenture, subject to certain limitations described below; and
- (f) any taxes and expenses incidental to any sale, exchange, dedication or other disposition of the property to be released.

(See Section 1803.)

Property which is not Funded Property may generally be released from the lien of the Indenture without depositing any cash or property with the Trustee as long as (a) the aggregate amount of Cost or

Fair Value to us (whichever is less) of all Property Additions which do not constitute Funded Property (excluding the property to be released) after certain deductions and additions, primarily including adjustments to offset property retirements, is not less than zero or (b) the Cost or Fair Value (whichever is less) of property to be released does not exceed the aggregate amount of the Cost or Fair Value to us (whichever is less) of Property Additions acquired or made within the 90-day period preceding the release. (See Section 1804.)

The Indenture provides simplified procedures for the release of property which has been released from the lien of a Class A Mortgage, minor properties and property taken by eminent domain, and provides for dispositions of certain obsolete property and grants or surrender of certain rights without any release or consent by the Trustee. (See Sections 1802, 1805 and 1807.)

If we retain any interest in any property released from the lien of the Indenture, the Indenture will not become a lien on such property or such interest therein or any improvements, extensions or additions to such property or renewals, replacements or substitutions of or for such property or any part or parts thereof. (See Section 1810.)

### **Withdrawal of Cash**

Unless an Event of Default has occurred and is continuing, and subject to certain limitations, cash held by the Trustee may, generally, (1) be withdrawn by us (a) to the extent of the Cost or Fair Value to us (whichever is less) of Property Additions not constituting Funded Property, after certain deductions and additions, primarily including adjustments to offset retirements (except that such adjustments need not be made if such Property Additions were acquired or made within the 90-day period preceding the withdrawal) or (b) in an amount equal to the aggregate principal amount of Indenture Securities that we would be entitled to issue on the basis of Retired Securities (with the entitlement to such issuance being waived by operation of such withdrawal) or (c) in an amount equal to the aggregate principal amount of any outstanding Indenture Securities delivered to the Trustee, or (2) upon our request, be applied to (a) the purchase of Indenture Securities or (b) the payment (or provision for payment) at stated maturity of any Indenture Securities or the redemption (or provision for payment) of any Indenture Securities which are redeemable (see Section 1806); except that cash deposited with the Trustee as the basis for the authentication and delivery of Indenture Securities, as well as cash representing a payment of principal of Class A Bonds, may, in addition, be withdrawn in an amount equal to the aggregate principal amount of Class A Bonds delivered to the Trustee. (See Sections 1605 and 1702.)

### **Discharge of Lien; Release Date**

At any time after all Class A Mortgages have been satisfied and discharged, as discussed in "Security," the Indenture may be amended and supplemented, without the consent of the holders of Debt Securities or any other Indenture Securities, to eliminate all terms and conditions relating to security for the Indenture Securities, with the result that our obligations under the Indenture and the Indenture Securities (including the Debt Securities) would be entirely unsecured. We refer to the date on which the elimination of security occurs as the "Release Date."

The occurrence of the Release Date is subject to our delivery of the following documents to the Trustee:

- (a) an officer's certificate stating that
  - (1) to his knowledge, no Event of Default has occurred and is continuing; and

- (2) all Class A Mortgages have been discharged;
- (b) Rating Agency Confirmations from each applicable Rating Agency, each to the effect that such amendment and supplement will not result in the reduction or withdrawal of the ratings on the Debt Securities below the lower of (x) such Rating Agency's rating then in effect, and (y) such Rating Agency's Threshold Rating; and
- (c) an opinion of counsel to the effect that none of our Electric Utility Property, other than Excepted Property, is subject to any lien other than the lien of the Indenture and Permitted Liens.

Upon the execution and delivery of the amendment of the Indenture as contemplated above, the lien of the Indenture will be deemed to have been satisfied and discharged and the Trustee will release the Mortgaged Property from the lien of the Indenture. (See Section 1811.)

### **Limitation on Secured Debt**

Unless we specify differently in a prospectus supplement for the Debt Securities, after the Release Date, so long as any of the Debt Securities remain outstanding, we will not issue any Secured Debt other than Permitted Secured Debt (in each case as defined below) without the consent of the Holders of a majority in principal amount of the outstanding Indenture Securities of all series with respect to which this covenant is made, considered as one class; provided, however, that this covenant will not prohibit the creation, issuance, incurrence or assumption of any Secured Debt if either:

- (a) we make effective provision whereby all Debt Securities and other affected Indenture Securities then outstanding will be secured equally and ratably with such Secured Debt; or
- (b) we deliver to the Trustee bonds, notes or other evidences of indebtedness secured by the lien which secures such Secured Debt in an aggregate principal amount equal to the aggregate principal amount of the Debt Securities and other affected Indenture Securities then outstanding and meeting certain other requirements set forth in the Indenture.

*"Secured Debt"* means Debt created, issued, incurred or assumed by us which is secured by a lien upon any of our property (other than Excepted Property).

*"Debt"* means:

- (a) our indebtedness for borrowed money evidenced by a bond, debenture, note or other written instrument or agreement by which we are obligated to repay such borrowed money; and
- (b) any guaranty by us of any such indebtedness of another person.

*"Debt"* does not include, among other things:

- (w) indebtedness under any installment sale or conditional sale agreement or any other agreement relating to indebtedness for the deferred purchase price of property or services;

- (x) any trade obligations (including any obligations under power or other commodity purchase agreements and any associated hedges or derivatives) or other obligations in the ordinary course of business; or
- (y) obligations under any lease agreement (including any lease intended as security), whether or not such obligations are required to be capitalized on our balance under generally accepted accounting principles;
- (z) liabilities secured by any lien on our property if and to the extent we have not assumed or otherwise become liable for the payment thereof.

“*Permitted Secured Debt*” means, as of any particular time:

- (a) Secured Debt which matures less than one year from the date of the issuance or incurrence and is not extendible at the option of the issuer; and any refundings, refinancings and/or replacements of any such Secured Debt by or with similar Secured Debt;
- (b) Secured Debt secured by Purchase Money Liens or any other liens existing or placed upon property at the time of, or within one hundred eighty (180) days after, the acquisition thereof by us, and any refundings, refinancings and/or replacements of any such Secured Debt; provided, however, that no such Purchase Money Lien or other Lien shall extend to or cover any of our property other than (1) the property so acquired and improvements, extensions and additions to such property and renewals, replacements and substitutions of or for the property or any part or parts of the property and (2) with respect to Purchase Money Liens, other property subsequently acquired by us;
- (c) Secured Debt relating to governmental obligations the interest on which is not included in gross income for purposes of federal income taxation pursuant to Section 103 of the Internal Revenue Code of 1986, as amended (or any successor provision of law), for the purpose of financing or refinancing, in whole or in part, costs of acquisition or construction of property to be used by us, to the extent that the lien which secures the Secured Debt is required either by applicable law or by the issuer of such governmental obligations or is otherwise necessary in order to establish or maintain the exclusion from gross income; and any refundings, refinancings and/or replacements of any Secured Debt by or with similar Secured Debt;
- (d) Secured Debt (i) which is related to the construction or acquisition of property not previously owned by us or (ii) which is related to the financing of a project involving the development or expansion of our property and (iii) in either case, the obligee in respect of which has no recourse to us or any of our property other than the property constructed or acquired with the proceeds of such transaction or the project financed with the proceeds of such transaction (or the proceeds of such property or such project); and any refundings, refinancings and/or replacements of any such Secured Debt by or with Secured Debt described in clause (iii) above;
- (e) Secured Debt permitted as described in the first paragraph under “Limitation on Secured Debt” above; and
- (f) in addition to the Permitted Secured Debt described in clauses (a) through (e) above, Secured Debt not otherwise so permitted in an aggregate principal amount not exceeding

10% of the total assets of PPL Electric and our consolidated subsidiaries, as shown on our latest consolidated balance sheet, audited by independent certified public accountants.

(See Section 707.)

### Events of Default

An "Event of Default" occurs under the Indenture if

- (a) we do not pay any interest on any Indenture Securities within 30 days of the due date;
- (b) we do not pay principal or premium on any Indenture Securities on its due date;
- (c) the Independent Administrator delivers a notice to the Trustee of our material, continuing noncompliance under the Compliance Administration Agreement, which noncompliance has continued for a period of 90 business days without correction as provided in such agreement;
- (d) we remain in breach of any other covenant (excluding covenants specifically dealt with elsewhere in this section) in respect of any Indenture Securities for 90 days after we receive a written notice of default stating we are in breach and requiring remedy of the breach; the notice must be sent by either the Trustee or Holders of 25% of the principal amount of Indenture Securities; the Trustee or such Holders can agree to extend the 90-day period and such an agreement to extend will be automatically deemed to occur if we are diligently pursuing action to correct the default;
- (e) we file for bankruptcy or certain other events in bankruptcy, insolvency, receivership or reorganization occur;
- (f) for so long as the Trustee holds any outstanding Class A Bonds which were delivered as the basis for the authentication and delivery of outstanding Indenture Securities, the occurrence of a matured event of default under the related Class A Mortgage (other than any such matured event of default which (i) is not a failure to make payments on Class A Bonds and is not of similar kind or character to the Event of Default described in clause (e) above and (ii) has not resulted in the acceleration of the outstanding Class A Bonds under such Class A Mortgage); provided, however, that the waiver or cure of such event of default under a Class A Mortgage will constitute a waiver and cure of the corresponding Event of Default under the Indenture, and the rescission and annulment of the consequences thereof will constitute a rescission and annulment of the corresponding consequences under the Indenture; or
- (g) any other Event of Default specified in the prospectus supplement occurs.

(See Section 901.)

## **Remedies**

### **Acceleration**

If an Event of Default occurs and is continuing, then either the Trustee or the Holders of 25% in principal amount of the outstanding Indenture Securities may declare the principal amount of all of the Indenture Securities to be due and payable immediately. (See Section 902.)

### **Rescission of Acceleration**

After the declaration of acceleration has been made and before the Trustee has obtained a judgment or decree for payment of the money due, such declaration and its consequences will be rescinded and annulled, if

- (a) we pay or deposit with the Trustee a sum sufficient to pay:
  - (1) all overdue interest;
  - (2) the principal of and any premium which have become due otherwise than by such declaration of acceleration and overdue interest thereon;
  - (3) interest on overdue interest to the extent lawful; and
  - (4) all amounts due to the Trustee under the Indenture; and
- (b) all Events of Default, other than the nonpayment of the principal which has become due solely by such declaration of acceleration, have been cured or waived as provided in the Indenture.

(See Section 902.) For more information as to waiver of defaults, see “—Waiver of Default and of Compliance” below.

### **Appointment of Receiver and Other Remedies**

Subject to the Indenture, under certain circumstances and to the extent permitted by law, if an Event of Default occurs and is continuing prior to the Release Date, the Trustee has the power to appoint a receiver of the Mortgaged Property, and is entitled to all other remedies available to mortgagees and secured parties under the Uniform Commercial Code or any other applicable law. (See Section 917.)

Upon the occurrence and continuance of an Event of Default after the Release Date, the remedies of the Trustee and the Holders under the Indenture would be limited to the rights of unsecured creditors.

In addition to every other right and remedy provided in the Indenture, the Trustee may exercise any right or remedy available to the Trustee in its capacity as owner and holder of Class A Bonds which arises as a result of a default or matured event of default under any Class A Mortgage, whether or not an Event of Default under the Indenture has occurred and is continuing. (See Section 916.)

### **Control by Holders; Limitations**

Subject to the Indenture, if an Event of Default occurs and is continuing, the Holders of a majority in principal amount of the outstanding Indenture Securities will have the right to

- (a) direct the time, method and place of conducting any proceeding for any remedy available to the Trustee, or
- (b) exercise any trust or power conferred on the Trustee with respect to the Indenture Securities.

The rights of Holders to make direction are subject to the following limitations:

- (a) the Holders' directions may not conflict with any law or the Indenture; and
- (b) the Holders' directions may not involve the Trustee in personal liability where the Trustee believes indemnity is not adequate.

The Trustee may also take any other action it deems proper which is not inconsistent with the Holders' direction. (See Sections 912 and 1003.)

In addition, the Indenture provides that no Holder of any Indenture Securities will have any right to institute any proceeding, judicial or otherwise, with respect to the Indenture for the appointment of a receiver or for any other remedy thereunder unless

- (a) that Holder has previously given the Trustee written notice of a continuing Event of Default;
- (b) the Holders of 25% in aggregate principal amount of the outstanding Indenture Securities have made written request to the Trustee to institute proceedings in respect of that Event of Default and have offered the Trustee reasonable indemnity against costs and liabilities incurred in complying with such request; and
- (c) for 60 days after receipt of such notice, the Trustee has failed to institute any such proceeding and no direction inconsistent with such request has been given to the Trustee during such 60-day period by the Holders of a majority in aggregate principal amount of outstanding Indenture Securities.

Furthermore, no Holder will be entitled to institute any such action if and to the extent that such action would disturb or prejudice the rights of other Holders. (See Sections 907 and 1003.)

However, each Holder has an absolute and unconditional right to receive payment when due and to bring a suit to enforce that right. (See Section 908.)

### **Notice of Default**

The Trustee is required to give the Holders of the Indenture Securities notice of any default under the Indenture to the extent required by the Trust Indenture Act, unless such default has been cured or waived; except that in the case of an Event of Default of the character specified above in clause (d) under "Events of Default," no such notice shall be given to such Holders until at least 60 days after the occurrence thereof. (See Section 1002.) The Trust Indenture Act currently permits the Trustee to withhold notices of default (except for certain payment defaults) if the Trustee in good faith determines the withholding of such notice to be in the interests of the Holders.

We will furnish the Trustee with an annual statement as to our compliance with the conditions and covenants in the Indenture. (See Section 705.)

## **Waiver of Default and of Compliance**

The Holders of a majority in aggregate principal amount of the outstanding Indenture Securities may waive, on behalf of the Holders of all Indenture Securities, any past default under the Indenture, except a default in the payment of principal, premium or interest, or with respect to compliance with certain provisions of the Indenture that cannot be amended without the consent of the Holder of each outstanding Indenture Security affected. (See Section 913.)

Compliance with certain covenants in the Indenture or otherwise provided with respect to Indenture Securities may be waived by the Holders of a majority in aggregate principal amount of the affected Indenture Securities, considered as one class. (See Section 706.)

## **Certain Additional Agreements of PPL Electric**

### **Limitation on Dividends; Restricted Payments**

**Failure to Meet Target Coverage Ratio.** We have agreed that, for so long as the Debt Securities remain outstanding, we will not declare any dividends or commit to make any other distribution on shares of our common stock (other than dividends and distributions payable in shares of our common stock) or purchase or redeem any shares of common stock other than with proceeds of an additional common stock financing (each such payment, distribution, purchase or redemption, a "Restricted Payment"), if, and for so long as, the average of our Interest Coverage Ratios for the immediate four fiscal quarters preceding the date of declaration of any such Restricted Payment falls below 1.5. We have also agreed that we will not declare any cash dividend on shares of our common stock, or otherwise commit to make any other Restricted Payment, unless such cash dividend or other Restricted Payment is payable within 120 days of the date of declaration or other commitment. (See Supplemental Indenture, Section 102.)

**Failure to Comply with Specified Separateness Formalities.** We have also agreed that, for so long as the Debt Securities remain outstanding, if we have received a notice from the Independent Administrator of continuing noncompliance under the Compliance Administration Agreement that we have not corrected within 30 business days as provided in such agreement, we will cease to declare or commit to any Restricted Payments until that noncompliance is so corrected. (See Supplemental Indenture, Section 102.)

### **Limitation on Activities**

We have agreed that for so long as the Debt Securities remain outstanding, we will not, subject to the requirements of applicable law, regulation or policies of applicable regulatory bodies, engage in any business, either directly or through subsidiaries, other than our electric transmission and distribution businesses and businesses related to or arising out of the electric transmission and distribution businesses. (See Supplemental Indenture, Section 102.)

### **Limitation on Acquisitions**

We have also agreed that for so long as the Debt Securities remain outstanding, we will not acquire tangible electric transmission and distribution assets of any other electric transmission and distribution company having a value in excess of 20% of our total consolidated assets as shown on our most recent audited consolidated balance sheet unless we have received Rating Agency Confirmations from each applicable Rating Agency, each to the effect that such acquisition will not result in the reduction or withdrawal of the ratings on the outstanding Debt Securities below the lower of (x) such

Rating Agency's rating then in effect or (y) such Rating Agency's Threshold Rating. See "Ratings" below. (See Supplemental Indenture, Section 102.)

### **Rate Relief**

We have agreed in the Indenture that for so long as the Debt Securities remain outstanding, if, and for so long as, the average of our Interest Coverage Ratios for the immediate four fiscal quarters preceding any date of determination falls below 1.5, we will initiate a filing for rate relief with the PUC within 90 days, unless we are not eligible for such rate relief under applicable law, regulation or orders or policies of the PUC then in effect. (See Supplemental Indenture, Section 102.)

### **Consolidation, Merger and Conveyance of Assets as an Entirety**

Subject to the provisions described in the next paragraph, we have agreed to preserve our corporate existence. (See Section 704.)

We have agreed not to consolidate with or merge with or into any other entity or convey, transfer or lease our Electric Utility Property as or substantially as an entirety to any entity unless

- (a) the entity formed by such consolidation or into which we merge, or the entity which acquires or which leases our Electric Utility Property substantially as an entirety, is an entity organized and existing under the laws of the United States of America or any State thereof or the District of Columbia, and
  - (1) expressly assumes, by supplemental indenture, the due and punctual payment of the principal, and any premium and interest on all the outstanding Indenture Securities and the performance of all of our covenants under the Indenture, and
  - (2) if such consolidation, merger, conveyance, sale, disposition or other transfer occurs prior to the Release Date, confirms the lien of the Indenture on the Mortgaged Property;
- (b) in the case of a lease, such lease is made expressly subject to termination by us or by the Trustee at any time during the continuance of an Event of Default;
- (c) we have received Rating Agency Confirmations from each applicable Rating Agency, each to the effect that such merger, consolidation, or other transfer will not result in the reduction or withdrawal of the ratings on the outstanding Debt Securities below the lower of (x) such Rating Agency's rating then in effect or (y) such Rating Agency's Threshold Rating;
- (d) immediately after giving effect to such transaction, our Consolidated Net Worth, or the Consolidated Net Worth of our successor as the case may be, is not less than our Consolidated Net Worth immediately prior to the transaction; and
- (e) immediately after giving effect to such transaction, no Event of Default, and no event which after notice or lapse of time or both would become an Event of Default, will have occurred and be continuing.

(See Section 1201.) In the case of the conveyance or other transfer of the Electric Utility Property as or substantially as an entirety to any other person, upon the satisfaction of all the conditions described above

we would be released and discharged from all obligations under the Indenture and on the Indenture Securities then outstanding unless we elect to waive such release and discharge. (See Section 1204.)

The Indenture does not prevent or restrict:

- (a) any conveyance or other transfer, or lease, of any part of our properties which does not constitute the entirety, or substantially the entirety, thereof; or
- (b) any conveyance or transfer of any of our properties where we retain Electric Utility Property with a fair value in excess of the aggregate principal amount of all outstanding Indenture Securities. This fair value will be determined within 90 days of the conveyance or transfer by an independent expert that we select and that is approved by the Trustee.

(See Sections 1205 and 1206.)

**Certain Definitions.** As used herein,

**“Consolidated Net Worth”** means, with respect to any person, the excess of such person’s consolidated assets over our consolidated liabilities, determined in accordance with generally accepted accounting principles.

**“Funds from Operation”** means for any period with respect to us and our consolidated subsidiaries, the aggregate amount of our consolidated net income (x) *plus* deferred income taxes, depreciation and amortization expense, preferred dividends, extraordinary expenses, any non-recurring or non-cash charges to net income (whether or not an extraordinary item) and any expense associated with intangible transition charges, and (y) *minus* any deferred investment tax credit, any extraordinary revenues and any income associated with intangible transition charges, all computed in accordance with generally accepted accounting principles in effect on the date of original issue of the Debt Securities;

**“Gross Interest Expense”** means for any period, the interest expense on our consolidated indebtedness minus any interest expense associated with intangible transition debt.

**“Interest Coverage Ratio”** means the ratio of (i) the sum of Funds from Operation plus Gross Interest Expense to (ii) Gross Interest Expense.

**“Rating Agency”** means each of Fitch, Inc. (“Fitch”), Moody’s Investors Service, Inc. (“Moody’s”), and Standard and Poor’s, a division of the McGraw-Hill Companies (“S&P”), and, in each case, its respective successors and assigns, or absent a successor to any such Rating Agency, or if such entity ceases to rate the Debt Securities, such other nationally recognized statistical rating organization as we may designate to be a Rating Agency. If any Rating Agency ceases to rate the Debt Securities, we may, but are not required to, so designate another nationally recognized statistical rating organization as a “Rating Agency.”

**“Rating Agency Confirmations”** means written evidence of the ratings on the Debt Securities of the three Rating Agencies, provided that if any Rating Agency ceases to exist or to rate the Debt Securities, “Rating Agency Confirmations” will mean the written evidence of the ratings on the Debt Securities of any remaining Rating Agency or Rating Agencies.

**“Threshold Rating”** shall mean, with respect to the Debt Securities, A- in the case of Fitch, A3 in the case of Moody’s, and A- in the case of S&P, or, in each case, the equivalent rating if any such Rating Agency shall change its rating designations.

## **Ratings**

Certain of our agreements in the Indenture restrict our actions in the event that such action would cause a Rating Agency to reduce its rating on the Debt Securities. Ratings are not recommendations to buy, sell or hold the Debt Securities, and any Rating Agency may revise or withdraw its rating on the Debt Securities at any time. Any downward revision or withdrawal of a rating by any Rating Agency would probably have an adverse effect on the market price of the Debt Securities.

Each Rating Agency’s ratings should be evaluated independently of each other Rating Agency’s ratings of the Debt Securities. The ratings reflect the respective Rating Agency’s current assessment of our creditworthiness and our ability to make payments on the Debt Securities. Any further explanation as to the significance of any Rating Agency’s rating may be obtained only from the applicable Rating Agency.

## **Modification of Indenture**

**Without Holder Consent.** Without the consent of any Holders of Indenture Securities, we may enter into one or more supplemental indentures with the Trustee for any of the following purposes:

- (a) to evidence the succession of another entity to us; or
- (b) to add one or more covenants or other provisions for the benefit of the Holders of all or any series or tranche of Indenture Securities, or to surrender any right or power conferred upon us; or
- (c) to add any additional Events of Default for all or any series of Indenture Securities; or
- (d) to change or eliminate any provision of the Indenture or to add any new provision to the Indenture that does not adversely affect the interests of the Holders in any material respect; or
- (e) to provide additional security for any Indenture Securities; or
- (f) to establish the form or terms of any Indenture Securities; or
- (g) to provide for the issuance of bearer securities; or
- (h) to evidence and provide for the acceptance of appointment of a separate or successor Trustee; or
- (i) to provide for the procedures required to permit the utilization of a noncertificated system of registration for any series or tranche of Indenture Securities; or
- (j) to change any place or places where
  - (1) we may pay principal, premium and interest,
  - (2) Indenture Securities may be surrendered for transfer or exchange, and

- (3) notices and demands to or upon us may be served; or
- (k) after the Release Date, to amend the Indenture to eliminate any provisions related to the Lien of the Indenture and Mortgaged Property which are no longer applicable;
- (l) to amend and restate the Indenture as originally executed, and as amended from time to time, with such additions, deletions and other changes that do not adversely affect the interest of the Holders in any material respect; or
- (m) to cure any ambiguity, defect or inconsistency or to make any other changes that do not materially adversely affect the interests of the Holders in any material respect.

In addition, if the Trust Indenture Act is amended after the date of the Indenture so as to require changes to the Indenture or so as to permit changes to, or the elimination of, provisions which, at the date of the Indenture or at any time thereafter, were required by the Trust Indenture Act to be contained in the Indenture, the Indenture will be deemed to have been amended so as to conform to such amendment or to effect such changes or elimination, and we may, without the consent of any Holders, enter into one or more supplemental indentures with the Trustee to effect or evidence such amendment.

(See Section 1301.)

**With Holder Consent.** Except as provided above, the consent of the Holders of at least a majority in aggregate principal amount of the Indenture Securities of all outstanding series, considered as one class, is generally required for the purpose of adding to, or changing or eliminating any of the provisions of, the Indenture pursuant to a supplemental indenture. However, if less than all of the series of outstanding Indenture Securities are directly affected by a proposed supplemental indenture, then such proposal only requires the consent of the Holders of a majority in aggregate principal amount of the outstanding Indenture Securities of all directly affected series, considered as one class. Moreover, if the Indenture Securities of any series have been issued in more than one tranche and if the proposed supplemental indenture directly affects the rights of the Holders of Indenture Securities of one or more, but less than all, of such tranches, then such proposal only requires the consent of the Holders of a majority in aggregate principal amount of the outstanding Indenture Securities of all directly affected tranches, considered as one class.

However, no amendment or modification may, without the consent of the Holder of each outstanding Indenture Security directly affected thereby,

- (a) change the stated maturity of the principal or interest on any Indenture Security (other than pursuant to the terms thereof), or reduce the principal amount, interest or premium payable or change the currency in which any Indenture Security is payable, or impair the right to bring suit to enforce any payment;
- (b) create any Lien ranking prior to the lien of the Indenture with respect to all or substantially all of the Mortgaged Property, or unless in connection with the Release Date, terminate the lien of the Indenture on all or substantially all of the Mortgaged Property, or deprive any Holder of the benefits of the security of the lien of the Indenture; or
- (c) reduce the percentages of Holders whose consent is required for any supplemental indenture or waiver of compliance with any covenant or of any default and its consequences or reduce the requirements for quorum and voting under the Indenture.

A supplemental indenture which changes, modifies or eliminates any provision of the Indenture expressly included solely for the benefit of Holders of Indenture Securities of one or more particular series or tranches will be deemed not to affect the rights under the Indenture of the Holders of Indenture Securities of any other series or tranche.

(See Section 1302.)

### **Miscellaneous Provisions**

The Indenture provides that certain Indenture Securities, including those for which payment or redemption money has been deposited or set aside in trust as described under “—Satisfaction and Discharge” below, will not be deemed to be “outstanding” in determining whether the Holders of the requisite principal amount of the outstanding Indenture Securities have given or taken any demand, direction, consent or other action under the Indenture as of any date, or are present at a meeting of Holders for quorum purposes. (See Section 101.)

We will be entitled to set any day as a record date for the purpose of determining the Holders of outstanding Indenture Securities of any series entitled to give or take any demand, direction, consent or other action under the Indenture, in the manner and subject to the limitations provided in the Indenture. In certain circumstances, the Trustee also will be entitled to set a record date for action by Holders. If such a record date is set for any action to be taken by Holders of particular Indenture Securities, such action may be taken only by persons who are Holders of such Indenture Securities on the record date. (See Section 107.)

### **Satisfaction and Discharge**

Any Indenture Securities or any portion thereof will be deemed to have been paid and no longer outstanding for purposes of the Indenture, and at our election, our entire indebtedness with respect to those securities will be satisfied and discharged, if there shall have been irrevocably deposited with the Trustee or any Paying Agent (other than PPL Electric), in trust:

- (a) money sufficient, or
- (b) in the case of a deposit made prior to the maturity of such Indenture Securities, non-redeemable Government Obligations (as defined in the Indenture) sufficient, or
- (c) a combination of (a) and (b), which in total are sufficient,

to pay when due the principal of, and any premium, and interest due and to become due on such Indenture Securities or portions of such Indenture Securities on and prior to their maturity.

(See Section 801.)

The Indenture will be deemed satisfied and discharged when no Indenture Securities remain outstanding and when we have paid all other sums payable by us under the Indenture. (See Section 802.)

All moneys we pay to the Trustee or any Paying Agent on Debt Securities that remain unclaimed at the end of two years after payments have become due may be paid to or upon our order. Thereafter, the Holder of such Debt Security may look only to us for payment. (See Section 703.)

## Voting of Class A Bonds

**Voting of Class A Bonds.** The Indenture provides that the Trustee will, as holder of Class A Bonds delivered as the basis for the issuance of Debt Securities, attend such meetings of bondholders under the related Class A Mortgage, or deliver its proxy in connection therewith, as relate to matters with respect to which it, as such holder, is entitled to vote or consent. The Indenture provides that, so long as no Event of Default as defined in the Indenture has occurred and is continuing, the Trustee will, as holder of such Class A Bonds, vote or consent (without any consent or other action by the holders of the Debt Securities, except as described in the proviso of paragraph (h) below) in favor of any amendments or modifications to the Class A Mortgage of substantially the same tenor and effect as follows:

- (a) to delete any provisions in any Class A Mortgage limiting the payment of dividends or distributions on the common stock or purchases of common stock;
- (b) to delete any provisions in any Class A Mortgage that require a sale, exchange or other disposition, or an agreement to sell, exchange or dispose of property to be released from the lien of a Class A Mortgage;
- (c) to modify any provisions in any Class A Mortgage that require insurance proceeds or other payments to be paid to the trustee under such Class A Mortgage in case of any loss so that such proceeds or payments need not be paid to such trustee with respect to any loss less than the greater of (A) Ten Million Dollars (\$10,000,000) and (B) three percent (3%) of the sum of (1) the principal amount of Indenture Securities outstanding on the date of such particular loss and (2) the principal amount of the Class A Bonds outstanding on the date of such particular loss, other than Class A Bonds delivered to and held by the Trustee under the Indenture;
- (d) to modify certain net earnings test requirements of any Class A Mortgage to facilitate issuances of variable rate debt by providing for calculations of annual interest requirements to be based on average annual rates or the initial interest rate;
- (e) to modify any Class A Mortgage to delete any requirement of a net earnings test or certificate as a condition precedent to the issuance or authentication of Class A Bonds;
- (f) to modify any Class A Mortgage to provide that the term "corporation" as used in such Class A Mortgage shall mean "corporation, limited liability company, partnership, or trust or other legal entity" and to provide that any provision requiring us to maintain our "corporate existence" shall not be interpreted to prevent us from changing from a corporation, limited liability company, partnership, trust or other legal entity to a corporation, limited liability company, a partnership, a trust or any other legal entity;
- (g) to conform any provision of a Class A Mortgage to the correlative provision of the Indenture, to add to a Class A Mortgage any provision not otherwise contained therein which conforms to a provision contained in the Indenture, to delete from a Class A Mortgage any provision to which the Indenture contains no correlative provision, and any combination of the foregoing; and/or
- (h) with respect to any amendments or modifications to any Class A Mortgage other than those amendments or modifications referred to in clauses (a) through (g) above, vote all such Class A Bonds delivered under such Class A Mortgage, or consent with respect thereto, proportionately with the vote or consent of holders of all other Class A Bonds

outstanding under such Class A Mortgage the holders of which are eligible to vote or consent, as evidenced by a certificate delivered by the trustee under such Class A Mortgage; provided, however, that the Trustee will not vote in favor of, or consent to, any amendment or modification of a Class A Mortgage which, if it were an amendment or modification of the Indenture, would require the consent of Holders of Indenture Securities as described under "Modification of the Indenture — With Holder Consent," without the prior consent of Holders of Indenture Securities which would be required for such an amendment or modification of the Indenture. (See Section 1705.)

If we issue the Debt Securities, and corresponding 1945 Mortgage Bonds, in an aggregate principal amount of \$900,000,000, the Trustee will hold a majority of the outstanding bonds issued under the 1945 Mortgage. As described more fully in "Description of the 1945 Mortgage Bonds – Modification of Mortgage" below, we may make amendments to, or eliminate certain covenants in, the 1945 Mortgage with the consent of the holders of a majority of the outstanding bonds issued under the 1945 Mortgage. A Holder of Debt Securities would no longer benefit from such covenants contained in the 1945 Mortgage should the Trustee vote these 1945 Mortgage Bonds to amend or eliminate the covenants as described above.

### **Resignation and Removal of the Trustee; Deemed Resignation**

The Trustee may resign at any time by giving written notice thereof to us.

The Trustee may also be removed by act of the Holders of a majority in principal amount of the then outstanding Indenture Securities.

No resignation or removal of the Trustee and no appointment of a successor trustee will become effective until the acceptance of appointment by a successor trustee in accordance with the requirements of the Indenture.

Under certain circumstances, we may appoint a successor trustee and if the successor accepts, the Trustee will be deemed to have resigned.

(See Section 1010.)

### **Governing Law**

The Indenture and the Debt Securities provide that they are to be governed by and construed in accordance with the laws of the State of New York except where otherwise required by law. (See Section 115.) Under existing law, the effectiveness of the lien of the Indenture on our properties, and the perfection and priority thereof, will be governed by Pennsylvania law.

## **DESCRIPTION OF THE 1945 MORTGAGE BONDS**

### **General**

We will issue the 1945 Mortgage Bonds in an aggregate principal amount equal to the aggregate principal amount of the Debt Securities, in one or more series, under the 1945 Mortgage, in fully registered form. The 1945 Mortgage Bonds will rank on a parity with our other first mortgage bonds issued under the 1945 Mortgage.

The 1945 Mortgage is filed as an exhibit to the registration statement. The 1945 Mortgage and its associated documents contain the full legal text of the matters described in this section. Because this section is a summary, it does not describe every aspect of the 1945 Mortgage Bonds or the 1945 Mortgage. This summary is subject to and qualified in its entirety by reference to all the provisions of the 1945 Mortgage, including definitions of certain terms used in the 1945 Mortgage. We also include references in parentheses to certain sections of the 1945 Mortgage. Whenever we refer to particular sections or defined terms of the 1945 Mortgage in this prospectus or in a prospectus supplement, such sections or defined terms are incorporated by reference herein or in the prospectus supplement. This summary also is subject to and qualified by reference to the description of the particular terms of the 1945 Mortgage Bonds described in the applicable prospectus supplement or supplements. The 1945 Mortgage has been qualified under the Trust Indenture Act, and you should refer to the Trust Indenture Act for provisions that apply to the 1945 Mortgage Bonds.

### **Security**

The 1945 Mortgage Bonds now or hereafter issued will be secured by the 1945 Mortgage, which, in the opinion of our counsel, constitutes a first mortgage lien on substantially all of our electric transmission and distribution properties (except those referred to below), subject to:

- (a) minor defects, irregularities and deficiencies in titles of properties and rights-of-way, which do not materially impair the use of such property and rights-of-way for PPL Electric's purposes; and
- (b) other excepted encumbrances.

In general, there are excepted from the lien of the 1945 Mortgage

- (a) all cash and securities;
- (b) equipment, apparatus, materials or supplies held for sale or other disposition;
- (c) aircraft, automobiles and other vehicles;
- (d) timber, minerals, mineral rights and royalties; and
- (e) receivables, contracts, leases and operating agreements.

The 1945 Mortgage will generally also create a lien on electric transmission and distribution property that we acquire after the date of this prospectus, subject to any pre-existing liens and to certain limitations in the case of consolidation, merger or sale of substantially all of our assets.

### **Issuance of Additional Bonds under the 1945 Mortgage**

We may issue 1945 Mortgage Bonds, from time to time, on the basis of:

- (a) 60% of property additions to electric, gas, steam or hot water property, acquired after June 30, 1945, but not including natural gas production property, and after adjustments for retirements of funded property other than property for supplying water;
- (b) retirement or cancellation of 1945 Mortgage Bonds or prior lien indebtedness; or
- (c) deposit of cash.

With certain exceptions in the case of (b) above, the issuance of 1945 Mortgage Bonds is subject to an earnings coverage test which requires adjusted net earnings before income taxes for twelve out of the preceding fifteen months of at least twice the annual interest requirements on all 1945 Mortgage Bonds at the time outstanding, including those being issued, and on all indebtedness of prior rank. In computing adjusted net earnings, an amount equal to 15½% of the adjusted gross operating revenues (calculated as provided in the 1945 Mortgage) must be used in lieu of actual expenditures for maintenance and repairs and provisions for property retirement. It is expected that the 1945 Mortgage Bonds issued to the Trustee as the basis for issuance of Debt Securities will be issued against the retirement or cancellation of 1945 Mortgage Bonds, which were in excess of \$1.1 billion at March 31, 2001 and that such issuance will not be subject to the earnings coverage test. (See Articles V, VI and VII.)

The amount of any obligations secured by a prior lien on mortgaged property may be increased, provided that, if any property subject to such prior lien shall have been made the basis of a credit under the 1945 Mortgage, all the additional obligations are deposited with the 1945 Mortgage Trustee or the trustee or other holder of the prior lien. (See Section 46.)

### **Release Provisions**

We may release property from the lien of the 1945 Mortgage upon the bases of

- (a) the deposit of cash, or, to a limited extent, purchase money mortgages;
- (b) property additions, after adjustments in certain cases to offset retirements and after making adjustments for any prior lien indebtedness on mortgaged property; and
- (c) waiver of our right to issue a principal amount of 1945 Mortgage Bonds.

We may withdraw cash upon the bases stated in (b) and (c) above. We have reserved the right (without any consent or other action by holders of any series of 1945 Mortgage Bonds created after September 30, 1989, including the 1945 Mortgage Bonds delivered to the Trustee as the basis for the issuance of Debt Securities) to amend the release provisions of the 1945 Mortgage to permit releases of funded property at the lower of cost or fair value at the time of funding and to permit release of unfunded property on the basis of an engineer's certificate stating that we have at least one dollar (\$1.00) of unfunded property after deducting the cost of the property then being released. (See Article XI.)

### **Maintenance and Replacement Fund**

The 1945 Mortgage currently provides for an annual Maintenance and Replacement Fund requirement equal to 15½% of adjusted gross operating revenues (calculated in accordance with the 1945 Mortgage). We may meet this requirement by depositing cash with the 1945 Mortgage Trustee; certifying expenditures for maintenance and repairs of mortgaged property, for gross property additions, and for certain automotive equipment; or by taking credit for bonds and qualified prior lien bonds retired. Such cash may be withdrawn on similar bases. We have the right (without any consent or other action by the holders of any series of 1945 Mortgage Bonds) to make such amendments to the 1945 Mortgage as shall be necessary to delete the Maintenance and Replacement Fund requirement. (See Section 39.)

### **Dividend Covenant**

The 1945 Mortgage currently provides that we may not pay cash dividends on our common stock, or repurchase our common stock, unless, after such dividends or repurchases, the amount remaining in earned surplus plus the provisions made subsequent to September 30, 1945 for depreciation and

retirement of property will equal the Maintenance and Replacement Fund requirements of the 1945 Mortgage for such period, less maintenance expenditures. (See Section 39.) Upon issuance of the Debt Securities, the Trustee, as holder of 1945 Mortgage Bonds, is required to consent to the elimination of the 1945 Mortgage dividend covenant. See "Description of Debt Securities — Voting of Class A Bonds."

### **Modification of Mortgage**

We have the right to modify the 1945 Mortgage generally with the consent of the holders of a majority of the 1945 Mortgage Bonds affected by the modification. In general, no modification of the terms of payment of principal or interest and no modification affecting the lien or reducing the percentage required for modification is effective against any bondholder without its consent. (See Article XIX.) If we issue the Debt Securities, and corresponding 1945 Mortgage Bonds, in an aggregate principal amount of \$900,000,000, the Trustee will hold a majority of outstanding bonds issued under the 1945 Mortgage.

### **Voting of 1945 Mortgage Bonds Held by the Trustee**

The Trustee will, as holder of the 1945 Mortgage Bonds, attend such meetings of bondholders under the 1945 Mortgage, or deliver its proxy in connection therewith, as to matters with respect to which it is entitled to vote or consent. See "Description of Debt Securities — Voting of Class A Bonds."

### **Events of Default; Notice of Default; Remedies**

The following are defaults under the 1945 Mortgage:

- (a) default in payment of principal;
- (b) default for 60 days in payment of interest or of installments of funds for retirement of 1945 Mortgage Bonds;
- (c) certain defaults with respect to qualified lien bonds;
- (d) certain events of bankruptcy, insolvency or reorganization; and
- (e) default for 90 days after notice by the 1945 Mortgage Trustee in other covenants.

The 1945 Mortgage Trustee may withhold notice of default (except in payment of principal, interest or any fund for retirement of 1945 Mortgage Bonds), if it thinks it is in the interests of the holders of the 1945 Mortgage Bonds.

Holders of 25% of the 1945 Mortgage Bonds may declare the principal and interest due on default, but a majority may annul such declaration if such default has been cured. No holder of 1945 Mortgage Bonds may enforce the lien of the 1945 Mortgage unless:

- (a) such holder has given the 1945 Mortgage Trustee written notice of a default;
- (b) holders of 25% of the 1945 Mortgage Bonds have requested the 1945 Mortgage Trustee to act and offered it reasonable opportunity to act and indemnity satisfactory to the 1945 Mortgage Trustee against the costs, expenses and liabilities to be incurred thereby; and
- (c) the 1945 Mortgage Trustee has failed to act.

The 1945 Mortgage Trustee is not required to risk its funds or incur personal liability if there is reasonable ground for believing that the repayment is not reasonably assured. The holders of a majority of the 1945 Mortgage Bonds may direct the time, method and place of conducting any proceedings for any remedy available to the 1945 Mortgage Trustee, or exercising any trust or power conferred upon the First Mortgage Trustee. (See Article XIII.)

#### **Limitation on Issuance of Additional 1945 Mortgage Bonds**

We have agreed that, so long as the Debt Securities are outstanding, we will not issue additional 1945 Mortgage Bonds, except for 1945 Mortgage Bonds issued and delivered to the Trustee under the Indenture, to refund or refinance outstanding Class A Bonds and for other limited purposes.

#### **Evidence to be Furnished to the 1945 Mortgage Trustee**

We will furnish the 1945 Mortgage Trustee with an annual statement as to our compliance with the 1945 Mortgage.

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#### **Certain Pennsylvania Tax Matters**

Debt Securities owned by individuals residing in Pennsylvania are subject to the 4 mills (\$4.00 on each \$1,000 of principal amount) Pennsylvania corporate loans tax.

### **INFORMATION CONCERNING THE TRUSTEES**

The Chase Manhattan Bank and Bankers Trust Company have at various times in the ordinary course of business made loans to us and to our affiliates. The Chase Manhattan Bank also acts as *guarantee trustee and property trustee for the trust originated preferred securities and common securities* of our subsidiaries, PPL Capital Trust and PPL Capital Trust I and acts as trustee with respect to our junior subordinated deferrable interest debentures. Chase Manhattan Bank USA, National Association, an affiliate of the Trustee, also acts as Delaware trustee for the trust originated preferred securities and common securities of PPL Capital Trust and PPL Capital Trust I.

### **EXPERTS**

Our consolidated financial statements incorporated in this prospectus by reference to our Annual Report on Form 10-K for the year ended December 31, 2000, have been so incorporated in reliance on the report of PricewaterhouseCoopers LLP, independent accountants, given on the authority of said firm as experts in auditing and accounting.

### **VALIDITY OF THE DEBT SECURITIES AND THE 1945 MORTGAGE BONDS**

Michael A. McGrail, Esq., Senior Counsel of PPL Services Corporation, and Thelen Reid & Priest LLP, New York, New York, counsel to PPL Electric, will pass upon the validity of the Debt Securities and the 1945 Mortgage Bonds for PPL Electric. Orrick, Herrington & Sutcliffe LLP, San Francisco, California, will pass upon certain legal matters in connection with the Debt Securities for any underwriters or agents. However, all matters pertaining to the organization of PPL Electric and PPL

Electric's title to its property and the liens of the Indenture and the 1945 Mortgage upon PPL Electric's properties will be passed upon only by Mr. McGrail. As to matters involving the law of the Commonwealth of Pennsylvania, Thelen Reid & Priest LLP and Orrick Herrington & Sutcliffe LLP will rely on the opinion of Mr. McGrail. As to matters involving the law of the State of New York, Mr. McGrail will rely on the opinion of Thelen Reid & Priest LLP.

## **PLAN OF DISTRIBUTION**

We may sell Debt Securities (a) to purchasers directly; (b) to underwriters for public offering and sale by them; or (c) through agents or dealers. We may determine the price or other terms of the Debt Securities offered under this prospectus by use of an electronic auction. We will describe how any auction will be used to determine the price or any other terms, how potential investors may participate in the auction, and the nature of the underwriters' obligations in connection with an auction in a supplement to this prospectus.

### **Direct Sales**

We may sell the Debt Securities directly to institutional investors or others who may be deemed to be underwriters within the meaning of the Securities Act with respect to any resale of the Debt Securities. A prospectus supplement will describe the terms of any such sale.

### **To Underwriters**

The applicable prospectus supplement will name any underwriter involved in a sale of Debt Securities. Underwriters may offer and sell Debt Securities at a fixed price or prices, which may be changed, or from time to time at market prices or at negotiated prices. Underwriters may be deemed to have received compensation from us from sales of Debt Securities in the form of underwriting discounts or commissions and may also receive commissions from purchasers of Debt Securities for whom they may act as agent.

Underwriters may sell Debt Securities to or through dealers, and such dealers may receive compensation in the form of discounts, concessions or commissions from the underwriters and/or commissions (which may be changed from time to time) from the purchasers for whom they may act as agent.

Unless otherwise provided in a prospectus supplement, the obligations of any underwriters to purchase particular Debt Securities will be subject to certain conditions precedent, and the underwriters will be obligated to purchase all such Debt Securities if any are purchased.

### **Through Agents**

We will name any agent involved in a sale of Debt Securities, as well as any commissions payable by us to such agent, in a prospectus supplement. Unless we indicate differently in the prospectus supplement, any such agent will be acting on a reasonable efforts basis for the period of its appointment.

### **General Information**

Underwriters, dealers and agents participating in a sale of Debt Securities may be deemed to be underwriters as defined in the Securities Act, and any discounts and commissions received by them and any profit realized by them on resale of the Debt Securities may be deemed to be underwriting discounts

and commissions, under the Securities Act. We may have agreements with underwriters, dealers and agents to indemnify them against certain civil liabilities, including liabilities under the Securities Act, and to reimburse them for certain expenses.

Underwriters or agents and their associates may be customers of, engage in transactions with or perform services for us or our affiliates in the ordinary course of business.

Each series of Debt Securities will be a new issue and will have no established trading market. We may elect to list any series of new Debt Securities on an exchange, but unless we advise you differently in the prospectus supplement, we have no obligation to cause any Debt Securities to be so listed. Any underwriters that purchase Debt Securities for public offering and sale may make a market in the Debt Securities, but such underwriters will not be obligated to do so and may discontinue any market making at any time without notice. We make no assurance as to the liquidity of, or the trading markets for, any Debt Securities.



**PPL Electric Utilities**

**PPL Electric Utilities Corporation**

**\$100,000,000**

**4.30% Senior Secured Bonds Due 2013**

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**PROSPECTUS SUPPLEMENT**

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**Banc One Capital Markets, Inc.**

**Barclays Capital**

**Morgan Stanley**

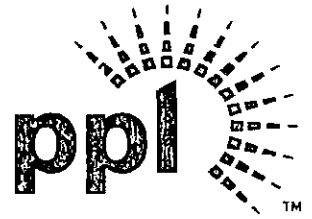
**Wachovia Securities**

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**May 20, 2003**

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# **Form 10-K**

**Annual Report to the  
Securities and Exchange Commission**

**For the Year Ended  
December 31, 2003**

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**PPL Corporation  
PPL Energy Supply, LLC  
PPL Electric Utilities Corporation  
PPL Montana, LLC**

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**FORM 10-K**

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 for the fiscal year ended December 31, 2003

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 for the transition period from \_\_\_\_\_ to \_\_\_\_\_

<u>Commission File Number</u>	<u>Registrant; State of Incorporation; Address and Telephone Number</u>	<u>IRS Employer Identification No.</u>
1-11459	<b>PPL Corporation</b> (Exact name of Registrant as specified in its charter) (Pennsylvania) Two North Ninth Street Allentown, PA 18101-1179 (610) 774-5151	23-2758192
333-74794	<b>PPL Energy Supply, LLC</b> (Exact name of Registrant as specified in its charter) (Delaware) Two North Ninth Street Allentown, PA 18101-1179 (610) 774-5151	23-3074920
1-905	<b>PPL Electric Utilities Corporation</b> (Exact name of Registrant as specified in its charter) (Pennsylvania) Two North Ninth Street Allentown, PA 18101-1179 (610) 774-5151	23-0959590
333-50350	<b>PPL Montana, LLC</b> (Exact name of Registrant as specified in its charter) (Delaware) 303 North Broadway - Suite 400 Billings, MT 59101 (406) 869-5100	54-1928759

Securities registered pursuant to Section 12(b) of the Act:

<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
Common Stock of PPL Corporation	New York & Philadelphia Stock Exchanges
Preferred Stock of PPL Electric Utilities Corporation	
4-1/2%	New York Stock Exchange
4.40% Series	New York Stock Exchange
7-3/4% PEPS <sup>SM</sup> Units (\$25 stated value) of PPL Corporation and PPL Capital Funding Trust I (a)	New York Stock Exchange
7-3/4% PEPS <sup>SM</sup> Units, Series B (\$25 stated value) of PPL Corporation and PPL Capital Funding (a)(b)	New York Stock Exchange

(a) Guaranteed by PPL Corporation

(b) Issued January 21, 2004

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrants' knowledge, in definitive proxy or information statements incorporated by reference in Part III of Form 10-K or any amendment to this Form 10-K.

PPL Corporation	[ X ]
PPL Energy Supply, LLC	[ X ]
PPL Electric Utilities Corporation	[ X ]
PPL Montana, LLC	[ X ]

Indicate by check mark whether the Registrants (1) have filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrants were required to file such reports), and (2) have been subject to such filing requirements for the past 90 days.

PPL Corporation	Yes <u>X</u>	No ___
PPL Energy Supply, LLC	Yes <u>X</u>	No ___
PPL Electric Utilities Corporation	Yes <u>X</u>	No ___
PPL Montana, LLC	Yes <u>X</u>	No ___

Indicate by check mark whether the Registrants are accelerated filers (as defined in Rule 12b-2 of the Act).

PPL Corporation	Yes <u>X</u>	No ___
PPL Energy Supply, LLC	Yes ___	No <u>X</u>
PPL Electric Utilities Corporation	Yes ___	No <u>X</u>
PPL Montana, LLC	Yes ___	No <u>X</u>

As of June 30, 2003, PPL Corporation had 176,688,958 shares of its \$.01 par value Common Stock outstanding, excluding 31,016,424 shares held as treasury stock. The aggregate market value of these common shares (based upon the closing price of these shares on the New York Stock Exchange on that date) held by non-affiliates was \$7,597,625,194. As of January 31, 2004, PPL Corporation had 177,506,989 shares of its \$.01 par value Common Stock outstanding, excluding 31,019,352 shares held as treasury stock.

As of June 30, 2003, PPL Corporation held all 78,029,863 outstanding common shares, no par value, of PPL Electric Utilities Corporation, excluding 79,270,519 shares held as treasury stock. The aggregate market value of the voting preferred stock held by non-affiliates of PPL Electric Utilities Corporation at June 30, 2003 was \$63,108,094.

PPL Corporation indirectly holds all of the member interests in PPL Energy Supply, LLC and PPL Montana, LLC.

**PPL Energy Supply, LLC and PPL Montana, LLC meet the conditions set forth in General Instructions (I)(1)(a) and (b) of Form 10-K and are therefore filing this form with the reduced disclosure format.**

Documents incorporated by reference:

PPL Corporation and PPL Electric Utilities Corporation have incorporated herein by reference certain sections of PPL Corporation's 2004 Notice of Annual Meeting and Proxy Statement, and PPL Electric Utilities Corporation's 2004 Notice of Annual Meeting and Information Statement, which will be filed with the Securities and Exchange Commission not later than 120 days after December 31, 2003. Such Statements will provide the information required by Part III of this Report.

**PPL CORPORATION  
PPL ENERGY SUPPLY, LLC  
PPL ELECTRIC UTILITIES CORPORATION  
PPL MONTANA, LLC**

**FORM 10-K ANNUAL REPORT TO  
THE SECURITIES AND EXCHANGE COMMISSION  
FOR THE YEAR ENDED DECEMBER 31, 2003**

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This combined Form 10-K is separately filed by PPL Corporation, PPL Energy Supply, LLC, PPL Electric Utilities Corporation and PPL Montana, LLC. Information contained herein relating to PPL Energy Supply, LLC, PPL Electric Utilities Corporation and PPL Montana, LLC is filed by PPL Corporation and separately by PPL Energy Supply, LLC, PPL Electric Utilities Corporation and PPL Montana, LLC on their own behalf. No registrant makes any representation as to information relating to any other registrant, except that information relating to the three PPL Corporation subsidiaries is also attributed to PPL Corporation.

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## GLOSSARY OF TERMS AND ABBREVIATIONS

**£** - British pounds sterling.

**1945 First Mortgage Bond Indenture** - PPL Electric's Mortgage and Deed of Trust, dated as of October 1, 1945, to Deutsche Bank Trust Company Americas, as trustee, as supplemented.

**2001 Senior Secured Bond Indenture** - PPL Electric's Indenture, dated as of August 1, 2001, to JPMorgan Chase Bank, as trustee, as supplemented.

**AFUDC** (Allowance for Funds Used During Construction) - the cost of equity and debt funds used to finance construction projects of regulated businesses that is capitalized as part of construction cost.

**ANEEL** - National Electric Energy Agency, Brazil's agency that regulates the transmission and distribution of electricity.

**APA** - Asset Purchase Agreement.

**APB** - Accounting Principles Board.

**ARB** - Accounting Research Bulletin.

**ARO** - asset retirement obligation.

**Bangor Hydro** - Bangor Hydro-Electric Company.

**Bcf** - billion cubic feet.

**CEMAR** - Companhia Energética do Maranhão, a Brazilian electric distribution company in which PPL Global has a majority ownership interest.

**CGE** - Compañía General de Electricidad, S.A., a distributor of electricity and natural gas with other industrial segments in Chile and Argentina in which PPL Global has an 8.7% direct and indirect minority ownership interest.

**Clean Air Act** - federal legislation enacted to address certain environmental issues related to air emissions including acid rain, ozone and toxic air emissions.

**CTC** - competitive transition charge on customer bills to recover allowable transition costs under the Customer Choice Act.

**Customer Choice Act** - the Pennsylvania Electricity Generation Customer Choice and Competition Act, legislation enacted to restructure the state's electric utility industry to create retail access to a competitive market for generation of electricity.

**DelSur** - Distribuidora de Electricidad DelSur, S.A. de C.V., an electric distribution company in El Salvador, a majority of which is owned by EC.

**DEP** - Department of Environmental Protection, a state government agency.

**Derivative** - a financial instrument or other contract with all three of the following characteristics:

- a. It has (1) one or more underlyings and (2) one or more notional amounts or payment provisions or both. Those terms determine the amount of the settlement or settlements, and, in some cases, whether or not a settlement is required.
- b. It requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors.
- c. Its terms require or permit net settlement, it can readily be settled net by a means outside the contract, or it provides for delivery of an asset that puts the recipient in a position not substantially different from net settlement.

**DIG** - Derivatives Implementation Group.

**DOE** - Department of Energy, a U.S. government agency.

**DRIP** - Dividend Reinvestment Plan.

**EC** - Electricidad de Centroamerica, S.A. de C.V., an El Salvadoran holding company and the majority owner of DelSur and El Salvador Telecom, S.A. de C.V. PPL Global has 100% ownership of EC.

**EGS** - electric generation supplier.

**EITF** - Emerging Issues Task Force, an organization that assists the FASB in improving financial reporting through the identification, discussion and resolution of financial issues within the framework of existing authoritative literature.

**Efec** - Empresa de Luz y Fuerza Electrica Cochabamba S.A. a Bolivian electric distribution company in which PPL Global has a majority ownership interest.

**Emel** - Empresas Emel S.A., a Chilean electric distribution holding company in which PPL Global has majority ownership.

**EMF** - electric and magnetic fields.

**Enrichment** - the concentration of fissionable isotopes to produce a fuel suitable for use in a nuclear reactor.

**EPA** - Environmental Protection Agency, a U.S. government agency.

**EPS** - earnings per share.

**ESOP** - Employee Stock Ownership Plan.

**EWG** - exempt wholesale generator.

**Fabrication** - the process which manufactures nuclear fuel assemblies for insertion into the reactor.

**FASB** - Financial Accounting Standards Board, a rulemaking organization that establishes financial accounting and reporting standards.

**FERC** - Federal Energy Regulatory Commission, the federal agency that regulates interstate transmission and wholesale sales of electricity and related matters.

**FIN** - FASB Interpretation.

**FSP** - FASB Staff Position.

**GAAP** - generally accepted accounting principles.

**Griffith Energy** - Griffith Energy LLC, which owns and operates a 600 MW gas-fired station in Kingman, Arizona, and which is jointly owned by subsidiaries of PPL Generation and Duke Energy Corporation.

**GWh** - gigawatt-hour, one million kilowatt-hours.

**Hyder** - Hyder Limited, a subsidiary of WPDL that was the previous owner of South Wales Electricity plc. In March 2001, South Wales Electricity plc was acquired by WPDH Limited and renamed WPD (South Wales).

**Integra** - Empresa de Ingenieria y Servicios Integrales Cochabamba S.A., a Bolivian company providing construction and engineering services, in which PPL Global has a majority ownership interest.

**IBEW** - International Brotherhood of Electrical Workers.

**ICP** - Incentive Compensation Plan.

**ICPKE** - Incentive Compensation Plan for Key Employees.

**IRS** - Internal Revenue Service, a U.S. government agency.

**ISO** - Independent System Operator.

**ITC** - intangible transition charge on customer bills to recover intangible transition costs associated with securitizing stranded costs under the Customer Choice Act.

**kWh** - kilowatt-hour, basic unit of electrical energy.

**kVA** - kilovolt-ampere.

**LIBOR** - London Interbank Offered Rate.

**Mirant** - Mirant Corporation, a diversified energy company based in Atlanta. PPL Global and Mirant jointly owned WPD from 1996 until September 6, 2002.

**Montana Power** - The Montana Power Company, a Montana-based company that sold its generating assets to PPL Montana in December 1999. Through a series of transactions consummated during the first quarter of 2002, Montana Power sold its electricity delivery business to NorthWestern.

**MW** - megawatt, one thousand kilowatts.

**MWh** - megawatt-hour, one thousand kilowatt-hours.

**NorthWestern** - NorthWestern Energy Division, a Delaware corporation and a division of NorthWestern Corporation and successor in interest to Montana Power's electricity delivery business, including Montana Power's rights and obligations under contracts with PPL Montana.

**NPDES** - National Pollutant Discharge Elimination System.

**NRC** - Nuclear Regulatory Commission, the federal agency that regulates operation of nuclear power facilities.

**NUGs (Non-Utility Generators)** - generating plants not owned by public utilities, whose electrical output must be purchased by utilities under the PURPA if the plant meets certain criteria.

**OSM** - Office of Surface Mining, a U.S. government agency.

**PCB** - polychlorinated biphenyl, an additive to oil used in certain electrical equipment up to the late-1970s. Now classified as a hazardous chemical.

**PEPS Units (Premium Equity Participating Security Units, or PEPS<sup>SM</sup> Units)** - securities issued by PPL and PPL Capital Funding Trust I, consisting of a Preferred Security and a forward contract to purchase PPL common stock.

**PEPS Units, Series B (Premium Equity Participating Security Units, or PEPS<sup>SM</sup> Units, Series B)** - securities issued by PPL and PPL Capital Funding, consisting of an undivided interest in a debt security issued by PPL Capital Funding and guaranteed by PPL, and a forward contract to purchase PPL common stock.

**PJM (PJM Interconnection, L.L.C.)** - operates the electric transmission network and electric energy market in the mid-Atlantic region of the U.S.

**PLR (Provider of Last Resort)** - PPL Electric providing electricity to retail customers within its delivery territory who have chosen not to shop for electricity under the Customer Choice Act.

**PP&E** - property, plant and equipment.

**PPL** - PPL Corporation, the parent holding company of PPL Electric, PPL Energy Funding and other subsidiaries.

**PPL Capital Funding** - PPL Capital Funding, Inc., a PPL financing subsidiary.

**PPL Capital Funding Trust I** - a Delaware statutory business trust created to issue PEPS Units, whose common securities are held by PPL.

**PPL Coal Supply** - PPL Coal Supply, LLC, a limited liability company owned by PPL Coal Holdings Corporation (a subsidiary of PPL Generation) and Iris Energy LLC. PPL Coal Supply procures coal, which it sells to PPL Generation for power plants and to Iris Energy for synfuel production.

**PPL Electric** - PPL Electric Utilities Corporation, a regulated utility subsidiary of PPL that transmits and distributes electricity in its service territory and provides electric supply to retail customers in this territory as a PLR.

**PPL Energy Funding** - PPL Energy Funding Corporation, a subsidiary of PPL and the parent company of PPL Energy Supply.

**PPL EnergyPlus** - PPL EnergyPlus, LLC, a subsidiary of PPL Energy Supply, which markets wholesale and retail electricity, and supplies energy and energy services in deregulated markets.

**PPL Energy Supply** - PPL Energy Supply, LLC, the parent company of PPL Generation, PPL EnergyPlus, PPL Global and other subsidiaries. Formed in November 2000, PPL Energy Supply is a subsidiary of PPL Energy Funding.

**PPL Gas Utilities** - PPL Gas Utilities Corporation, a regulated utility subsidiary of PPL specializing in natural gas distribution, transmission and storage services, and the competitive sale of propane.

**PPL Generation** - PPL Generation, LLC, a subsidiary of PPL Energy Supply, which owns and operates U.S. generating facilities through various subsidiaries.

**PPL Global** - PPL Global, LLC, a subsidiary of PPL Energy Supply, which acquires and develops domestic generation projects and acquires and holds international energy projects that are primarily focused on the distribution of electricity.

**PPL Holtwood** - PPL Holtwood, LLC, a subsidiary of PPL Generation, which owns PPL's hydroelectric generating operations in Pennsylvania.

**PPL Maine** - PPL Maine, LLC, a subsidiary of PPL Generation, which owns generating operations in Maine.

**PPL Martins Creek** - PPL Martins Creek, LLC, a generating subsidiary of PPL Generation.

**PPL Montana** - PPL Montana, LLC, an indirect subsidiary of PPL Generation, which generates electricity for wholesale in Montana and the Pacific Northwest.

**PPL Services** - PPL Services Corporation, a subsidiary of PPL, which provides shared services for PPL and its subsidiaries.

**PPL Susquehanna** - PPL Susquehanna, LLC, the nuclear generating subsidiary of PPL Generation.

**PPL Telcom** - PPL Telcom, LLC, an indirect subsidiary of PPL Energy Funding, which delivers high bandwidth telecommunication services in the Northeast corridor from Washington, D.C., to New York City and to six metropolitan areas in central and eastern Pennsylvania.

**PPL Transition Bond Company** - PPL Transition Bond Company, LLC, a wholly-owned subsidiary of PPL Electric that was formed to issue transition bonds under the Customer Choice Act.

**Preferred Securities** - company-obligated mandatorily redeemable preferred securities issued by PPL Capital Funding Trust I, holding solely debentures of PPL Capital Funding, and by SIUK Capital Trust I, holding solely debentures of WPD LLP.

**PUC** - Pennsylvania Public Utility Commission, the state agency that regulates certain ratemaking, services, accounting and operations of Pennsylvania utilities.

**PUC Final Order** - final order issued by the PUC on August 27, 1998, approving the settlement of PPL Electric Utilities' restructuring proceeding.

**PUHCA** - Public Utility Holding Company Act of 1935, legislation passed by the U.S. Congress.

**PURPA** - Public Utility Regulatory Policies Act of 1978, legislation passed by the U.S. Congress to encourage energy conservation, efficient use of resources and equitable rates.

**PURTA** - the Pennsylvania Public Utility Realty Tax Act.

**RMC** - Risk Management Committee.

**SCR** - selective catalytic reduction, a pollution control process.

**SEC** - Securities and Exchange Commission, a U.S. government agency.

**SFAS** - Statement of Financial Accounting Standards, the accounting and financial reporting rules issued by the FASB.

**SIUK Capital Trust I** - a business trust created to issue preferred securities, whose common securities are held by WPD LLP.

**SIUK Limited** - was an intermediate holding company within the WPDH Limited group. In January 2003, SIUK Limited transferred its assets and liabilities to WPD LLP.

**SPE** - special purpose entity.

**Superfund** - federal environmental legislation that addresses remediation of contaminated sites; states also have similar statutes.

**Synfuel projects** - production facilities that manufacture synthetic fuel from coal or coal byproducts. Favorable federal tax credits are available on qualified synfuel products.

**Tolling agreement** - agreement whereby the owner of an electric generating facility agrees to use that facility to convert fuel provided by a third party into electric energy for delivery back to the third party.

**UF** - inflation-indexed peso-denominated unit.

**VEBA** - Voluntary Employee Benefit Association Trust, trust accounts for health and welfare plans for future benefit payments for employees, retirees or their beneficiaries.

**WPD** - refers collectively to WPDH Limited and WPDLL. PPL Global purchased Mirant's 49% ownership interest in these entities on September 6, 2002, thereby achieving 100% ownership and operational control.

**WPD LLP** - Western Power Distribution LLP, a wholly-owned subsidiary of WPDH Limited, which owns WPD (South West) and WPD (South Wales).

**WPD (South Wales)** - Western Power Distribution (South Wales) plc, a British regional electric utility company.

**WPD (South West)** - Western Power Distribution (South West) plc, a British regional electric utility company.

**WPDH Limited** - Western Power Distribution Holdings Limited, an indirect, wholly-owned subsidiary of PPL Global. WPDH Limited owns WPD LLP.

**WPDLL** - WPD Investment Holdings Limited, an indirect wholly-owned subsidiary of PPL Global. WPDLL owns 100% of the common shares of Hyder.

## FORWARD-LOOKING INFORMATION

Certain statements contained in this Form 10-K concerning expectations, beliefs, plans, objectives, goals, strategies, future events or performance and underlying assumptions and other statements which are other than statements of historical facts are "forward-looking statements" within the meaning of the federal securities laws. Although PPL, PPL Energy Supply, PPL Electric and PPL Montana believe that the expectations and assumptions reflected in these statements are reasonable, there can be no assurance that these expectations will prove to be correct. These forward-looking statements involve a number of risks and uncertainties, and actual results may differ materially from the results discussed in the forward-looking statements. In addition to the specific factors discussed in the Management's Discussion and Analysis of Financial Condition and Results of Operations sections herein, the following are among the important factors that could cause actual results to differ materially from the forward-looking statements:

- market demand and prices for energy, capacity and fuel;
- weather variations affecting customer energy usage;
- competition in retail and wholesale power markets;
- the effect of any business or industry restructuring;
- the profitability and liquidity of PPL and its subsidiaries;
- new accounting requirements or new interpretations or applications of existing requirements;
- operation of existing facilities and operating costs;
- environmental conditions and requirements;
- transmission and distribution system conditions and operating costs;
- development of new projects, markets and technologies;
- performance of new ventures;
- asset acquisitions and dispositions;
- political, regulatory or economic conditions in states, regions or countries where PPL or its subsidiaries conduct business;
- receipt of necessary governmental permits, approvals and rate relief;
- impact of state or federal investigations applicable to PPL and its subsidiaries and the energy industry;
- the outcome of litigation against PPL and its subsidiaries;
- capital market conditions and decisions regarding capital structure;
- stock price performance;
- the market prices of equity securities and resultant cash funding requirements for defined benefit pension plans;
- securities and credit ratings;
- state and federal regulatory developments;
- foreign exchange rates;
- new state or federal legislation, including new tax legislation;
- national or regional economic conditions, including any potential effects arising from the September 11, 2001 terrorist attacks in the U.S., the situation in Iraq and any consequential hostilities or other hostilities; and
- the commitments and liabilities of PPL and its subsidiaries.

Any such forward-looking statements should be considered in light of such important factors and in conjunction with other documents of PPL, PPL Energy Supply, PPL Electric and PPL Montana on file with the SEC.

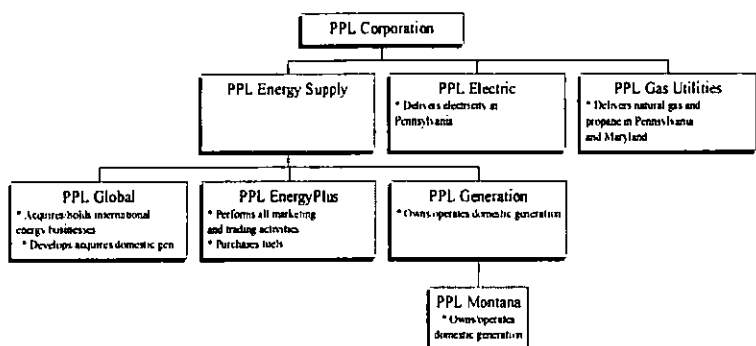
New factors that could cause actual results to differ materially from those described in forward-looking statements emerge from time to time, and it is not possible for PPL, PPL Energy Supply, PPL Electric or PPL Montana to predict all of such factors, or the extent to which any such factor or combination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

## PART I

### ITEM 1. BUSINESS

#### BACKGROUND

PPL Corporation is an energy and utility holding company that was incorporated in 1994. Through its subsidiaries, PPL generates electricity in power plants in the northeastern and western U.S.; markets wholesale or retail energy primarily in the northeastern and western portions of the U.S.; delivers electricity to nearly five million customers in Pennsylvania, the U.K. and Latin America; and provides energy services for businesses in the mid-Atlantic and northeastern U.S. PPL's significant subsidiaries are shown below:



See Exhibit 99 in Item 15 for additional information on the current corporate organization. In addition to PPL Corporation, the other SEC registrants included in this filing are:

*PPL Energy Supply, LLC*, an indirect wholly-owned subsidiary of PPL formed in 2000, is an energy company engaged through its subsidiaries in the generation and marketing of power primarily in the northeastern and western power markets of the U.S. and in the delivery of electricity in the U.K. and Latin America. PPL Energy Supply's major operating subsidiaries are PPL Generation, PPL EnergyPlus and PPL Global. PPL Energy Supply owns or controls 11,527 MW of electric power generation capacity, and is constructing new electric generation projects in Pennsylvania, which will add 663 MW of electric generation capacity.

*PPL Electric Utilities Corporation*, incorporated in 1920, is a direct subsidiary of PPL and a regulated public utility. PPL Electric provides electricity delivery service in its service territory in Pennsylvania, and provides electricity supply to retail customers in that territory as a PLR under the Customer Choice Act.

*PPL Montana, LLC*, an indirect wholly-owned subsidiary of PPL Energy Supply formed in 1998, acquired the Montana generating assets in 1999. PPL Montana operates interests in 13 electric generating facilities, which it owns or leases, with an aggregate capacity of 1,157 MW. PPL Montana's primary regional market for wholesale customers is the northwest U.S. (Montana, Oregon, Washington and Idaho).

#### Segment Information

PPL is organized into segments consisting of Supply, Delivery and International. PPL Energy Supply's segments consist of Supply and International. In addition, certain corporate service functions reside in PPL Services. PPL Electric and PPL Montana do not have segments. See Note 2 to the Financial Statements for financial information about the segments and geographic financial data.

##### • Supply Segment -

*Owns and operates power plants to generate electricity; markets this electricity and other power purchases to deregulated wholesale and retail markets; and acquires and develops domestic generation projects.*

*Consists of the activities of PPL Generation, PPL EnergyPlus and the domestic activities of PPL Global.*

PPL has generation assets that are focused on the eastern and western markets. The eastern generation assets are focused on the Northeast/Mid-Atlantic energy markets - including the PJM, the New York ISO, the New England Power Pool and the Mid-American Interconnection Network. PPL's western generating capacity is focused on the markets within the Western Systems Coordinating Council.

##### PPL Generation

PPL Generation had a total generating capacity of 11,527 MW at December 31, 2003. Through subsidiaries, PPL Generation owns and operates power plants in Pennsylvania, Montana, Maine, Connecticut, Arizona, Illinois and New York.

The Pennsylvania generation plants had a total capacity of 8,582 MW at December 31, 2003. These plants are fueled by nuclear reaction, coal, gas, oil and hydro power. The electricity from these plants is sold to PPL EnergyPlus under FERC-jurisdictional power purchase agreements.

PPL's U.S. generation subsidiaries are EWGs, which sell electricity into the wholesale market. PPL's EWGs are subject to regulation by the FERC but not subject to regulation under PUHCA. The FERC has authorized these EWGs to sell generation from their facilities at market-based prices.

PPL Susquehanna, a subsidiary of PPL Generation, owns a 90% undivided interest in each of the two nuclear-fueled generating units at its Susquehanna station and Allegheny Electric Cooperative, Inc. owns the remaining 10% undivided interest in each of those units. PPL's 90% share of Susquehanna's capacity was 2,072 MW at December 31, 2003. In 2003, PPL Susquehanna completed the installation of a more efficient steam turbine to Unit 2 that increased the capacity of the

Susquehanna plant by 50 MW. PPL Susquehanna's share of this new capacity is 45 MW. PPL Susquehanna is currently installing a similar steam turbine for Unit 1 and the project is expected to be completed in 2004.

PPL Generation operates its Pennsylvania power plants in conjunction with PJM. PPL Generation's Pennsylvania power plants and PPL EnergyPlus are parties to the Mid-Atlantic Area Coordination Agreement. Refer to "Delivery Segment" for information regarding PJM's operations and functions and the Mid-Atlantic Area Coordination Agreement.

The Montana generating stations are fueled by coal and hydro power, and have a net capacity of 1,157 MW. PPL EnergyPlus, as agent for PPL Montana, supplies 300 MW of around-the-clock electricity and 150 MW of unit-contingent on-peak electricity to NorthWestern under two five-year agreements that began in July 2002. These contracts accounted for 33% of PPL Montana's operating revenue in 2003. PPL Montana also purchases 98 MW of firm energy and capacity during the months of November through April from Basin Electric Cooperative.

The Maine generating assets were acquired from Bangor Hydro in 1998. The oil- and hydro-powered stations have a total capacity of 96 MW.

The Wallingford, Connecticut generating station was constructed by PPL and began commercial operations in 2001. This natural gas-powered station has a total capacity of 243 MW.

During 2002, PPL began commercial operations in Arizona of two natural gas-powered stations. The Griffith project is located in Kingman, and PPL's ownership interest is 300 MW. The Sundance project near Coolidge has a total capacity of 450 MW.

In 2002, PPL also began commercial operations in Illinois with a 540 MW natural gas-powered station located in University Park, and in New York with a natural gas-powered station in Edgewood and an oil-powered station in Shoreham, both on Long Island. These plants have a combined capacity of 159 MW.

At December 31, 2003, PPL Generation was in the process of developing approximately 670 MW of electric generating capacity in Pennsylvania, consisting of 600 MW at the Lower Mt. Bethel gas-fired facility and 70 MW at the Susquehanna station. PPL's share of the additional Susquehanna capacity is approximately 63 MW. See Item 2, "Properties," for additional information.

PPL Generation subsidiaries are subject to the jurisdiction of certain federal, regional, state and local regulatory agencies with respect to air and water quality, land use and other environmental matters. PPL Susquehanna is subject to the jurisdiction of the NRC in connection with the operation of the Susquehanna units. Certain of PPL Generation's other subsidiaries, including PPL Montana, are subject to the

jurisdiction of the NRC in connection with the operation of the fossil plants with respect to certain level and density monitoring devices.

Certain operations of PPL Generation's subsidiaries are subject to the Occupational Safety and Health Act of 1970 and comparable state statutes.

Refer to the "Power Supply" section for additional information regarding the various power plants operated by PPL Generation. Also refer to "Fuel Supply" for a discussion of fuel requirements and contractual arrangements.

### PPL EnergyPlus

PPL EnergyPlus markets or brokers the electricity produced by PPL Generation subsidiaries, along with purchased power, natural gas and oil, in competitive wholesale and deregulated retail markets in order to take advantage of opportunities in the competitive energy marketplace.

PPL EnergyPlus buys and sells energy at competitive prices. PPL EnergyPlus purchases electric capacity and energy at the wholesale level, and also sells electric capacity and energy at the wholesale level under FERC market-based tariffs. PPL EnergyPlus enters into these agreements to market available energy and capacity from PPL Generation's assets and to profit from market price fluctuations. PPL EnergyPlus is actively managing its portfolios to maximize the value of PPL's generating assets and to limit exposure to price fluctuations. PPL EnergyPlus also purchases and sells energy forward and futures contracts as well as other commodity-based financial instruments in accordance with PPL's risk management policies, objectives and strategies.

PPL EnergyPlus has executed contracts to provide electricity to PPL Electric sufficient for it to meet its PLR obligation from 2003 through 2009, at the predetermined capped rates PPL Electric is entitled to charge its customers during this period. This arrangement with PPL Electric accounted for 34% of PPL Energy Supply's consolidated revenues in 2003. See Note 15 to the Financial Statements for more information concerning these contracts.

PPL EnergyPlus has a PUC license to act as an EGS in Pennsylvania. This license permits PPL EnergyPlus to offer retail electric supply to customers throughout Pennsylvania. In 2003, PPL EnergyPlus was licensed, and supplied energy to industrial and commercial customers in Pennsylvania, New Jersey and Montana. PPL EnergyPlus also is licensed to provide energy in Delaware, Maryland, Maine and Massachusetts. At this time, PPL EnergyPlus has decided not to pursue residential customers in the competitive marketplace based on economic considerations.

PPL EnergyPlus also provides distributed generation and energy-related products and services to commercial and industrial customers, through its mechanical contracting and engineering subsidiaries operating primarily in Pennsylvania,

Massachusetts, Connecticut, New York and New Jersey. The distributed generation business brings customers closer to distributed energy generating technologies, such as fuel cells, small turbines, microturbines and reciprocating engines. Through these various technologies, the distributed generation business currently owns approximately 500 kilowatts of installed capacity to serve commercial customers and has installed approximately 2 MW of capacity which is owned by the customer.

PPL Synfuel Investments, LLC, a subsidiary of PPL EnergyPlus, indirectly owns, through its subsidiaries, two production facilities. These facilities manufacture synthetic fuel from coal or coal byproducts. PPL receives federal tax credits for these qualified manufactured synfuel products.

#### PPL Global (domestic operations)

PPL Global acquires and develops domestic generation projects for PPL Generation as opportunities arise.

#### PPL Telcom

PPL Telcom, an unregulated subsidiary of PPL Energy Funding, has a fiber optic network and markets available capacity on PPL Electric's fiber optic cables in eastern and central Pennsylvania. The fiber optic services include point-to-point data transport, high-speed connections among multiple sites and access to national and global fiber networks. PPL Telcom markets its services to customers such as other telecommunications companies, internet service providers and large enterprises that need high-speed data connections between multiple locations. Additionally, PPL Telcom provides engineering, construction and site leasing services to wireless carriers.

In April 2003, a subsidiary of PPL Telcom acquired the fiber optic network of a Fairfax, Virginia-based company. The 1,330-route-mile metropolitan area fiber network connects New York, northern New Jersey, Philadelphia, Baltimore and Washington, D.C.

#### • Delivery Segment -

*Includes the regulated electric and gas delivery operations of PPL Electric and PPL Gas Utilities.*

PPL Electric provides electricity delivery service to approximately 1.3 million customers in a 10,000-square mile territory in 29 counties of eastern and central Pennsylvania. The largest cities in this territory are Allentown, Bethlehem, Harrisburg, Hazleton, Lancaster, Scranton, Wilkes-Barre and Williamsport. Pursuant to the PUC Final Order, PPL Electric agreed in 1998 to a cap on the electricity transmission and distribution rates that it collects from retail customers in its service territory. This cap expires on December 31, 2004. PPL Electric expects to file a request for a distribution rate increase with the PUC in March 2004. If approved, the new distribution rates will go into effect in January 2005, when the distribution

rate cap expires. PPL Electric cannot predict the amount of the rate increase that will ultimately be approved by the PUC.

In addition to providing electricity delivery service in its service territory in Pennsylvania, PPL Electric also provides electricity supply to retail customers in that territory as a PLR under the Customer Choice Act. As part of the PUC Final Order, PPL Electric agreed to provide this electricity supply at predetermined capped rates through 2009. PPL Electric has executed two contracts to purchase electricity from PPL EnergyPlus sufficient for PPL Electric to meet its PLR obligation from 2003 through 2009, at the pre-determined capped rates. PPL Electric's PLR obligation after 2009 will be determined by the PUC pursuant to rules that have not yet been promulgated.

During 2003, about 93% of PPL Electric's operating revenues were derived from regulated electricity deliveries and supply as a PLR. About 7% of 2003 operating revenues were from wholesale sales, including the sale to PPL EnergyPlus of power purchased from NUGs. During 2003, about 44% of electricity delivery and PLR revenues were from residential customers, 35% from commercial customers, 20% from industrial customers and 1% from other customer classes.

PPL Electric is subject to regulation as a public utility by the PUC, and certain of its activities are subject to the jurisdiction of the FERC under the Federal Power Act. PPL Electric is not a holding company under PUHCA, and PPL has been exempted by the SEC from the provisions of PUHCA applicable to it as a holding company.

PPL Electric also is subject to the jurisdiction of certain federal, regional, state and local regulatory agencies with respect to land use and other environmental matters. Certain operations of PPL Electric are subject to the Occupational Safety and Health Act of 1970 and comparable state statutes.

PPL Electric operates its transmission facilities as part of PJM. PJM operates the electric transmission network and electric energy market in the mid-Atlantic region of the U.S. Bulk electricity is transmitted to wholesale users throughout a geographic area including all or part of Pennsylvania, New Jersey, Maryland, Delaware, Virginia, Ohio, West Virginia and the District of Columbia. PPL Electric is also a party to the Mid-Atlantic Area Coordination Agreement, which provides for the coordinated planning of generation and transmission facilities by the companies included in PJM.

PJM serves as an ISO in order to accommodate greater competition and broader participation in the power pool. The purpose of the ISO is to separate operation of, and access to, the transmission grid from PJM electric utilities' generation interests. The electric utilities continue to own the transmission assets, but the ISO directs the control and operation of the transmission facilities. In March 2004, PPL Electric expects to notify the PUC and retail customers that, beginning January 1, 2005, it will begin to fully recover from retail customers the charges that it pays to PJM for transmission-related services.

PJM imposes these charges pursuant to its FERC-approved Open Access Transmission Tariff. PPL Electric's retail electric tariff authorizes it to recover such charges from its retail customers, but pursuant to the transmission and distribution rate cap described above, full recovery is precluded through December 31, 2004.

PPL Gas Utilities provides natural gas and propane delivery to approximately 105,000 customers in Pennsylvania and Maryland.

- **International Segment -**

*Includes PPL Global's acquiring and holding of international energy projects that are primarily focused on the distribution of energy.*

In September 2002, PPL Global acquired the remaining 49% equity interest in WPDH Limited and WPDL from Mirant, for approximately \$236 million. The acquisition of Mirant's 49% interest provides PPL Global with complete ownership of WPD. WPD, through indirect wholly-owned subsidiaries, operates two electric distribution companies in the U.K., which together serve approximately 2.5 million end-users. WPD delivered 28,137 million kWh of electricity in 2003. See Note 9 to the Financial Statements for additional information on this acquisition.

PPL Global also has controlling interests in electricity transmission and distribution companies serving customers in Chile, El Salvador and Bolivia. Emel, of which PPL Global owns 95.4%, serves approximately 529,000 customers with its distribution companies in northern Chile and just south of its headquarters in Santiago, Chile. DelSur, of which PPL Global owns 80.5%, is an electric distribution company headquartered in San Salvador, which serves approximately 261,000 customers in the central and southern regions of El Salvador, including a portion of the city of San Salvador. Elfec, of which PPL Global owns 92.1%, is the second largest electric distribution company in Bolivia, and serves approximately 251,000 customers in Cochabamba.

PPL Global also has minority investments in generating facilities in Peru and Spain and has a majority ownership interest in a telecommunications company in El Salvador with approximately 7,000 customers. In 2003, PPL Global's Board of Managers authorized PPL Global to sell its investment in the telecommunications company, and approved a plan of sale. See Note 9 to the Financial Statements for additional information on this divestiture.

In August 2002, PPL Global deconsolidated its 90% equity interest in its Brazilian investment, CEMAR, when ANEEL authorized an administrative intervention and fully assumed operational and financial control of the company. See Note 9 to the Financial Statements for additional information on the deconsolidation and status of the CEMAR investment.

## PPL Services

Various corporate service functions reside in PPL Services, an unregulated subsidiary of PPL. PPL Services provides shared services for PPL and its subsidiaries. These services include financial, legal, human resources and information services. These services are directly charged or allocated, as appropriate, to the Supply, Delivery and International segments.

## Seasonality

In some parts of the country, demand for, and market prices of, electricity are higher during the hot summer months, while in other parts of the country such peaks may occur in the cold winter months. As a result, PPL's overall operating results in the future may fluctuate substantially on a seasonal basis, especially when more severe weather conditions such as heat waves or winter storms make such fluctuations more pronounced. The pattern of this fluctuation may change depending on the nature and location of the facilities PPL acquires and the terms of the contracts to sell electricity.

## **FINANCIAL CONDITION**

See PPL's, PPL Energy Supply's and PPL Electric's Management's Discussion and Analysis of Financial Condition and Results of Operations for this information.

## **CAPITAL EXPENDITURE REQUIREMENTS**

See "Financial Condition - Capital Expenditure Requirements" in PPL's, PPL Energy Supply's and PPL Electric's Management's Discussion and Analysis of Financial Condition and Results of Operations for information concerning estimated capital expenditure requirements for the years 2004-2008. See Note 14 to the Financial Statements for information concerning estimates of the costs to comply with various environmental regulations.

## **COMPETITION**

The unregulated businesses and markets that PPL and its subsidiaries participate in are highly competitive. The electric industry has experienced an increase in the level of competition in the energy markets over the last several years due to federal and state deregulation initiatives.

In 1992, the Energy Act amended the PUHCA to create a new class of independent power producers, and amended the Federal Power Act to provide open access to electric transmission systems for wholesale transactions. In 1996, the Customer Choice Act was enacted in Pennsylvania to restructure the state's electric utility industry in order to create retail access to a competitive market for the generation of electricity. Certain other states in which PPL's subsidiaries operate have also adopted a "customer choice" plan to allow customers to choose their electricity supplier. Competitive factors affecting PPL's results of operations include energy and fuel prices, new market entrants, construction by others of generating assets, the actions

of regulatory authorities and other factors. PPL cannot predict the impact of these and other competitive factors on its future results of operations or financial condition.

PPL and its subsidiaries believe that competition in deregulated energy markets will continue to be intense. In addition to deregulation, competitive pressures have resulted from technological advances in power generation and electronic communications and the greater efficiency of energy markets.

The wholesale power markets in which PPL Generation subsidiaries and PPL EnergyPlus operate are highly competitive. Competitors include regulated utilities, industrial companies, non-utility generators and unregulated subsidiaries of regulated utilities. Although PPL EnergyPlus has long-term supply agreements (see "Background - Supply Segment"), a substantial portion of PPL's future sales will be made into the competitive wholesale markets. Competition will occur principally on the basis of the price of products and, to a lesser extent, on the basis of reliability and availability.

PPL EnergyPlus also faces competition in the wholesale markets for energy capacity and ancillary services. As pricing information becomes increasingly available in the energy trading and marketing business and assuming deregulation in the electricity markets continues, PPL EnergyPlus anticipates that trading, marketing and risk management operations will experience greater competition. PPL EnergyPlus primarily competes with other energy merchants based on the ability to aggregate supplies at competitive prices from different sources and locations and to efficiently utilize transportation from third-party pipelines and transmission from electric utilities. Competitors may employ widely differing strategies in their fuel supply and power sales contracts with respect to pricing and other terms and conditions. PPL EnergyPlus also competes against other energy marketers on the basis of relative financial condition and access to credit sources.

Some restructured markets have recently experienced supply problems and price volatility. In a number of these markets, government agencies and other interested parties have made proposals to delay market restructuring or even re-regulate certain areas of these markets that have previously been deregulated. In California, legislation has been passed placing a moratorium on the sale of generation plants by public utilities regulated by the California Public Utilities Commission. In June 2001, the FERC instituted a series of price controls designed to mitigate (or cap) prices in the entire western U.S. to address the extreme volatility in the California energy markets. These price controls have contributed to the lowering of spot and forward energy prices in the western market. In addition, ISOs that oversee the transmission systems in certain wholesale power markets have from time to time been authorized to address volatility in power markets. These types of price limitations and other mechanisms may adversely impact the profitability of PPL's wholesale power marketing and trading business. Other proposals to institute price controls or to re-regulate the energy industry may be made, and legislative or other actions may cause the electric power restructuring process

to be delayed, discontinued or reversed in the states in which PPL currently, or may in the future, operate. If the competitive restructuring of the wholesale and retail power markets is delayed, discontinued or reversed, PPL's business prospects and financial condition could be materially adversely affected.

See Note 14 to the Financial Statements for information on the FERC Proposed Rules entitled "Remedying Undue Discrimination through Open Access Transmission Service and Standard Electricity Market Design."

Pursuant to PPL Electric's authorizations from the Commonwealth of Pennsylvania and the PUC, PPL Electric operates a regulated distribution monopoly in its service area. Accordingly, PPL Electric does not face competition in its distribution business. Although the majority of PPL Global's international electricity transmission and distribution companies operate in non-exclusive concession areas in their respective countries, these companies currently face little or no competition. See "Franchises and Licenses" for more information.

## POWER SUPPLY

PPL Generation's system capacity (winter rating) at December 31, 2003 was as follows:

<u>Plant</u>	<u>Net MW Capacity</u>
<u>Pennsylvania</u>	
Nuclear-fueled steam station Susquehanna	2,072 (a)
Coal-fired steam stations	
Montour	1,540
Brunner Island	1,473
Martins Creek	300
Keystone	211 (b)
Conemaugh	278 (c)
Total coal-fired	3,802
Gas- and oil-fired steam station Martins Creek	1,670
Combustion turbines and diesels	451
Hydroelectric	153
Total generating capacity	8,148
Firm purchases	
Hydroelectric	140 (d)
Qualifying facilities	294
Total firm purchases	434
Total system capacity - Pennsylvania	8,582
<u>Arizona</u>	
Natural gas-powered stations	
Griffith	300 (e)
Sundance	450
Total system capacity - Arizona	750
<u>Connecticut</u>	
Natural gas-powered station	
Wallingford	243
<u>Illinois</u>	
Natural gas-powered station	
University Park	540
<u>New York</u>	
Natural gas- and oil-powered stations	
Edgewood and Shoreham	159
<u>Montana</u>	
Coal-fired stations	
Colstrip Units 1 & 2	307 (f)
Colstrip Unit 3	222 (g)
Corette	154
Total coal-fired	683
Hydroelectric	474
Total system capacity - Montana	1,157
<u>Maine</u>	
Oil-fired generating station	
Wyman Unit 4	52 (h)
Hydroelectric	44 (i)
Total system capacity - Maine	96
Total system capacity - PPL Generation	11,527

- (a) PPL's 90% undivided interest.  
(b) PPL's 12.34% undivided interest.  
(c) PPL's 16.25% aggregate interest.  
(d) From Safe Harbor Water Power Corporation.  
(e) PPL's 50% equity investment.  
(f) PPL's 50% undivided leasehold interest.  
(g) PPL's 30% undivided leasehold interest.  
(h) PPL's 8.33% undivided interest.  
(i) Includes PPL's 50% interest in the West Enfield Station.

The capacity of generating units is based upon a number of factors, including the operating experience and physical condition of the units, and may be revised periodically to reflect changed circumstances.

During 2003, PPL Generation's plants generated the following amounts of electricity:

<u>State</u>	<u>Millions of kWh</u>
Pennsylvania	42,952
Montana	8,151
Arizona	672
Maine	378
New York	142
Connecticut	97
Illinois	59
Total	52,451

Of this generation, 55% of the energy was generated by coal-fired stations, 31% from nuclear operations at the Susquehanna station, 8% from hydroelectric stations and 6% from oil/gas-fired stations.

On average, approximately 80% of PPL's expected annual generation output for the period 2004 through 2008 is committed to meet:

- PPL EnergyPlus' obligation under two contracts to provide electricity for PPL Electric to satisfy its PLR obligation under the Customer Choice Act;
- PPL EnergyPlus' obligation under two contracts to provide electricity to NorthWestern through June 2007; and
- Other contractual sales to other counterparties for terms of various lengths.

See Note 14 to the Financial Statements for more information regarding PPL's wholesale energy commitments and Note 15 for more information regarding the PLR contracts. These contractual arrangements are consistent with and are an integral part of PPL's overall business strategy, which includes the matching of PPL's anticipated energy supply with load, or customer demand, under long-term and intermediate-term contracts with creditworthy counterparties to capture profits while reducing PPL's exposure to movements in energy and fuel prices and counterparty credit risk.

## **FUEL SUPPLY**

### Coal

#### *Pennsylvania*

In 2001, a subsidiary of PPL Generation entered into a partnership with Iris Energy, LLC, an unrelated third party, to procure coal and facilitate the production of synthetic fuel. PPL Coal Supply began operations in mid-2001 and provides coal to PPL Generation power plants and to Iris Energy for the production of synthetic fuel. In 2003, synthetic fuel from Iris Energy provided 59% of the fuel requirements of PPL Generation's Pennsylvania stations. The balance of the requirements was met by coal provided by PPL Coal Supply. PPL Coal Supply actively manages its supply base principally in central Appalachia and western and central Pennsylvania.

During 2003, about 92% of the coal delivered to PPL Generation's Pennsylvania stations was purchased under long-term contracts and 8% was obtained through open market purchases. These contracts provided PPL Generation with about 8 million tons of coal. Contracts currently in place are expected to provide approximately 7.4 million tons in 2004. At December 31, 2003, Pennsylvania plants had sufficient supply for about 33 days of operations. The amount of coal in inventory varies from time-to-time depending on market conditions and plant operations.

At December 31, 2003, a PPL Generation subsidiary owned a 12.34% undivided interest in the Keystone station and a 16.25% aggregate interest in the Conemaugh station. The owners of the Keystone station have a long-term contract with a synthetic fuel supplier to provide a minimum of 3.0 million tons in 2004. In addition, the Keystone station contracts with Keystone Fuels, LLC for the balance of its requirements. The owners of the Conemaugh station have a long-term contract with a synthetic fuel supplier to provide a minimum of 2.4 million tons in 2004. The balance of the Conemaugh station requirements is purchased under contract from Conemaugh Fuels, LLC.

#### *Montana*

PPL Montana has a 50% leasehold interest in Colstrip Units 1 and 2, and a 30% leasehold interest in Unit 3. PPL Montana is party to contracts to purchase coal from a neighboring mine with defined quality characteristics and specifications. The coal purchase contract for Units 1 and 2 is in effect through December 31, 2009. The coal purchase contract for Unit 3 is in effect through December 31, 2019.

PPL Montana owns the Corette power plant. The plant has coal purchase contracts to purchase low sulfur coal with defined quality characteristics and specifications. The contracts supplied 100% of the plant coal requirements and expired at the end of 2003. Similar contracts are currently in place to supply 100% of the expected coal requirements for 2004.

#### Oil and Natural Gas

PPL Generation's Martins Creek Units 3 and 4 burn both oil and natural gas. PPL EnergyPlus, the marketing and trading subsidiary of PPL, is responsible for procuring the oil and natural gas supply for all PPL Generation operations. During 2003, 100% of the oil requirements for the Martins Creek units were purchased on the spot market. As of December 31, 2003, PPL EnergyPlus had no long-term agreements for these requirements.

PPL EnergyPlus has a long-term pipeline capacity contract for delivery of gas supply representing approximately 10% of the maximum requirements of the Sundance facility, but has no long-term supply agreement to purchase natural gas. As of December 31, 2003, there were no long-term delivery or supply agreements to purchase natural gas for University Park.

PPL EnergyPlus has a long-term contract for approximately 40% of the expected pipeline transportation requirements of the Wallingford facility, but has no long-term supply agreement to purchase natural gas. Likewise, PPL EnergyPlus has long-term pipeline transportation contracts in place for the Griffith Energy facility equaling 100% of the expected requirements.

In 2003, PPL EnergyPlus began supplying natural gas for the testing process for the Lower Mt. Bethel project. PPL EnergyPlus has two gas transportation contracts in place for approximately 30% of the maximum daily requirements of the plant. These contracts expire in September 2008 and 2013.

PPL EnergyPlus employs a strategy of procuring natural gas in conjunction with electricity sales commitments.

#### Nuclear

PPL Susquehanna has in effect uranium supply and conversion agreements that satisfied 100% of its uranium requirements in 2003 and, including options, will satisfy approximately 25% of its requirements for the period 2004-2007. Deliveries under these agreements are expected to provide sufficient uranium to permit Unit 1 to operate into the first quarter of 2006 and Unit 2 to operate into the first quarter of 2005.

PPL Susquehanna has executed an agreement that satisfies all of its enrichment requirements through 2008. Assuming that the other uranium components of the nuclear fuel cycle are satisfied, deliveries under this agreement are expected to provide sufficient enrichment to permit Unit 1 to operate into the first quarter of 2010 and Unit 2 to operate into the first quarter of 2011.

PPL Susquehanna has entered into an agreement that, including options, satisfies all of its fabrication requirements through 2006. Assuming that the uranium and other components of the nuclear fuel cycle are satisfied, deliveries under this agreement can provide sufficient fabrication to permit Unit 1 to operate into the first quarter of 2008 and Unit 2 to operate into the first quarter of 2007.

Federal law requires the federal government to provide for the permanent disposal of commercial spent nuclear fuel. Under the Nuclear Waste Policy Act (NWPA), the DOE initiated an analysis of a site in Nevada for a permanent nuclear waste repository. DOE does not expect the repository to be operational before 2010. As a result, it was necessary to expand Susquehanna's on-site spent fuel storage capacity. To support this expansion, PPL Susquehanna contracted for the design and construction of a spent fuel storage facility employing dry cask fuel storage technology. The facility is modular, so that additional storage capacity can be added as needed. The facility began receiving spent nuclear fuel in 1999. PPL Susquehanna estimates that there is sufficient storage capacity in the spent nuclear fuel pools and the on-site spent fuel storage facility at Susquehanna to accommodate spent fuel discharged through approximately 2017, under current operating conditions. If necessary, the on-site spent fuel storage facility can be

expanded, assuming appropriate regulatory approvals are obtained, such that, together, the spent fuel pools and the expanded dry fuel storage facility will accommodate all of the spent fuel expected to be discharged through the current life of the plant.

In 2002, President Bush approved the Congressional override of a veto by the State of Nevada, designating Yucca Mountain, Nevada as the site for development of a long-term repository for high-level radioactive waste. The next step is for the DOE to submit a license application to the NRC to build and then operate the Yucca Mountain repository.

In 1996, the U.S. Court of Appeals for the District of Columbia Circuit ruled that the NWPA imposed on DOE an unconditional obligation to begin accepting spent nuclear fuel on or before January 31, 1998. In 1997, the Court ruled that the contracts between the utilities and the DOE provide a potentially adequate remedy if the DOE failed to begin disposal of spent nuclear fuel by January 31, 1998. The DOE did not, in fact, begin to dispose of spent nuclear fuel on that date. The DOE continues to contest claims that its failures resulted in recoverable damages. On January 22, 2004, PPL Susquehanna filed suit in the U.S. Court of Federal Claims for unspecified damages suffered as a result of the DOE's breach of its contract to accept and dispose of spent nuclear fuel. PPL cannot predict the outcome of this dispute.

## ENVIRONMENTAL MATTERS

Certain PPL subsidiaries, including PPL Electric and PPL Generation subsidiaries, are subject to certain present and developing federal, regional, state and local laws and regulations with respect to air and water quality, land use and other environmental matters. See PPL's and PPL Energy Supply's "Financial Condition - Capital Expenditure Requirements" in Management's Discussion and Analysis of Financial Condition and Results of Operations for information concerning environmental expenditures during 2003 and their estimate of those expenditures during the years 2004-2008. PPL believes that its subsidiaries are in substantial compliance with applicable environmental laws and regulations.

See "Environmental Matters" in Note 14 to the Financial Statements for information concerning federal clean air legislation, groundwater degradation and waste water control at facilities owned by PPL's subsidiaries and PPL Electric's and PPL Gas Utilities' agreements with the Pennsylvania DEP concerning remediation at certain sites. Other environmental laws, regulations and developments that may have a substantial impact on PPL's subsidiaries are discussed below.

### Air

The Clean Air Act includes, among other things, provisions that: (a) restrict the construction of, and revise the performance standards for, new and substantially modified coal-fired and oil-fired generating stations; and (b) authorize the EPA to impose substantial noncompliance penalties of up to \$27,500 per day of

violation for each facility found to be in violation of the requirements of an applicable state implementation plan. The state agencies administer the EPA's air quality regulations through the state implementation plans and have concurrent authority to impose penalties for non-compliance.

In 1997, international negotiators reached agreement in Kyoto, Japan to strengthen the 1992 United Nations Global Climate Change Treaty by adding legally-binding greenhouse gas emission limits. This agreement, the Kyoto Protocol, would require the U.S. to reduce its greenhouse gas emissions to 7% below 1990 levels by 2008 through 2012. Although the Kyoto Protocol is unlikely to be ratified by the U.S., the electricity generating industry has committed to certain voluntary reductions in carbon dioxide. Some form of carbon dioxide reductions will likely be required in the future. Such requirements could result in increased capital and operating expenses which are not now determinable, but which could be significant.

### Water

To implement the requirements of the Federal Water Pollution Control Act of 1972, as amended by the Clean Water Act of 1977 and the Water Quality Act of 1987, the EPA has adopted regulations on effluent standards for steam electric stations. The states administer the EPA's effluent standards through state laws and regulations relating to, among other things, effluent discharges and water quality. The standards adopted by the EPA pursuant to the Clean Water Act may have a significant impact on existing facilities of certain PPL subsidiaries, depending on the states' interpretation and future amendments to regulations.

Pursuant to the Surface Mining and Reclamation Act of 1977, the Office of Surface Mining (OSM) has adopted effluent guidelines which are applicable to PPL subsidiaries as a result of their past coal mining and coal processing activities. The EPA and the OSM limitations, guidelines and standards also are enforced through the issuance of NPDES permits. In accordance with the provisions of the Clean Water Act and the Reclamation Act of 1977, the EPA and the OSM have authorized the states to implement the NPDES program. Compliance with applicable water quality standards is assured by state imposition of NPDES permit conditions and requirements to address acid mine drainage.

### Solid and Hazardous Waste

The provisions of Superfund authorize the EPA to require past and present owners of contaminated sites and generators of any hazardous substance found at a site to clean-up the site or pay the EPA or the state for the costs of clean-up. The generators and past owners can be liable even if the generator contributed only a minute portion of the hazardous substances at the site. Present owners can be liable even if they contributed no hazardous substances to the site.

State laws such as the Pennsylvania and Montana Superfund statutes also give state agencies broad authority to identify hazardous or contaminated sites and to order owners or responsible parties to clean-up the sites. If responsible parties cannot or will not perform the clean-up, the agency can hire contractors to clean-up the sites and then require reimbursement from the responsible parties after the clean-up is completed. Another Pennsylvania statute, the Industrial Sites Recycling Act, encourages voluntary clean-ups by allowing responsible parties to choose from a menu of clean-up standards and providing liability protection commensurate with the clean-up standard chosen.

Certain federal and state statutes, including federal and state Superfund statutes, also impose liability on the responsible parties for the lost value of damaged natural resources.

#### Low-Level Radioactive Waste

Under federal law, each state is responsible for the disposal of low-level radioactive waste generated in that state. States may join in regional compacts to jointly fulfill their responsibilities. The states of Pennsylvania, Maryland, Delaware and West Virginia are members of the Appalachian States Low-Level Radioactive Waste Compact. Efforts to develop a regional disposal facility in Pennsylvania were suspended by the Pennsylvania DEP in 1998. The Commonwealth retains the legal authority and may be required to resume the siting process should it be necessary. Low-level radioactive waste resulting from the operation of the Susquehanna facility is currently being sent to Barnwell, South Carolina and Clive, Utah for disposal. In the event this or other emergent disposal options become unavailable or no longer cost-effective, the low-level radioactive waste will be stored on-site at Susquehanna. PPL Susquehanna cannot predict the future availability of low-level waste disposal facilities or the cost of such disposal.

#### Asbestos

There have been increasing litigation claims throughout the U.S. based on exposure to asbestos against companies that manufacture or distribute asbestos products or that have these products on their premises. Certain of PPL's generation subsidiaries and certain of its energy services subsidiaries, such as those that have supplied, may have supplied or installed asbestos material in connection with the repair or installation of heating, ventilating and air conditioning systems, have been named as defendants in asbestos-related lawsuits. PPL cannot predict the outcome of these lawsuits or whether additional claims may be asserted against its subsidiaries in the future. PPL does not expect that the ultimate resolution of the current lawsuits will have a material adverse effect on its financial condition.

#### Electric and Magnetic Fields

Concerns have been expressed by some members of the public regarding the potential health effects of EMFs. These fields are emitted by all devices carrying electricity, including electric

transmission and distribution lines and substation equipment. Government officials in the U.S. and the U.K. have focused attention on this issue. PPL and its subsidiaries support the current efforts to determine whether EMFs cause any human health problems and are taking steps to reduce EMFs, where practical, in the design of new transmission and distribution facilities. PPL is unable to predict what effect, if any, the EMF issue might have on its operations and facilities either in the U.S. or abroad, and the associated cost, or what, if any, liabilities it might incur related to the EMF issue.

#### General

PPL and its subsidiaries are unable to predict the ultimate effect of evolving environmental laws and regulations upon their existing and proposed facilities and operations. In complying with statutes, regulations and actions by regulatory bodies involving environmental matters, including the areas of water and air quality, hazardous and solid waste handling and disposal and toxic substances, PPL's subsidiaries may be required to modify, replace or cease operating certain of their facilities. PPL's subsidiaries may also incur significant capital expenditures and operating expenses in amounts which are not now determinable, but which could be significant.

#### **FRANCHISES AND LICENSES**

PPL Electric is authorized to provide electric public utility service throughout its service area as a result of grants by the Commonwealth of Pennsylvania in corporate charters to PPL Electric and companies to which it has succeeded and as a result of certification by the PUC. PPL Electric is granted the right to enter the streets and highways by the Commonwealth subject to certain conditions. In general, such conditions have been met by ordinance, resolution, permit, acquiescence or other action by an appropriate local political subdivision or agency of the Commonwealth.

See "Background - Supply Segment" for a discussion of PPL EnergyPlus' licenses in various states. PPL EnergyPlus also has an export license from the DOE to sell capacity and/or energy to electric utilities in Canada.

PPL Susquehanna operates Units 1 and 2 pursuant to NRC operating licenses which expire in 2022 and 2024, respectively. In November 2001, PPL Susquehanna notified the NRC that it intends to seek extensions of its operating licenses. The application for this extension will most likely be made in 2006 or 2007, in accordance with NRC guidelines. If the NRC approves PPL Susquehanna's application, the operating licenses for Units 1 and 2 would each be extended for an additional 20 years, to 2042 and 2044, respectively.

PPL Holtwood operates the Wallenpaupack and Holtwood hydroelectric projects pursuant to licenses renewed by the FERC in 1980. The Wallenpaupack license expires in 2004 and the Holtwood license expires in 2014. PPL Holtwood also owns one-third of the capital stock of Safe Harbor Water Power Corporation (Safe Harbor), which holds a project license which extends the

operation of its hydroelectric plant until 2030. The total capacity of the Safe Harbor plant is 418 MW, and PPL Holtwood is entitled by contract to one-third of the total capacity.

The 11 hydroelectric facilities and one storage reservoir purchased from Montana Power in 1999 are licensed by the FERC. These licenses expire periodically, and the generating facilities must be relicensed at such times. The FERC license for the Mystic facility expires in 2009; the Thompson Falls and Kerr licenses expire in 2025 and 2035, respectively, and the licenses for the nine Missouri-Madison facilities expire in 2040.

PPL Holtwood is working to have the Wallenpaupack facility relicensed, and PPL Montana is working to have the Mystic facility relicensed. Under applicable law, FERC may relicense the original licensee or may license a new licensee, or the U.S. government may take over the project. If the original licensee is not relicensed, it is compensated for its net investment in the project, not to exceed the fair value of the property taken, plus reasonable damages to other property affected by the lack of relicensing.

PPL Global's international electricity transmission and distribution companies are authorized by the governments of their respective countries to provide electric distribution services within their concession areas and service territories, subject to certain conditions and obligations. For instance, each of these companies is subject to governmental regulation on the prices that it can charge and the quality of supply it must provide, and the companies can be fined if they do not meet the mandated quality of supply.

WPD operates under distribution licenses granted, and price controls set, by Great Britain's Gas and Electricity Markets Authority. The price control formula that governs WPD's allowed revenue is normally determined every five years with the next review to be completed by the end of 2004, and effective April 1, 2005. Absent WPD's breach or default under its distribution licenses, the regulator must provide 25-years notice before the licenses may be revoked. See Note 14 for more information regarding certain U.K. electricity regulations.

Emel is subject to regulated maximum tariffs set by Chile's National Energy Commission. The components of the distribution tariffs are an energy price, a transmission surcharge and the value added on account of distribution costs (VAD). The VAD includes a targeted return on invested capital of 10% per year. The energy price is a direct pass-through to regulated customers of the energy charge that Emel pays to the generation companies. The tariffs are calculated every four years, with the next tariff review to be completed by the end of 2004 and effective beginning 2005. Absent Emel's breach or default of its regulated obligations, Emel's distribution rights within its concession area are perpetual.

DelSur is subject to regulated maximum tariffs set by El Salvador's Superintendencia General de Electricidad y Telecomunicaciones. The three components of the distribution tariff are an energy price, a commercialization charge and a

distribution charge. DelSur's tariff specifies the energy price as a trailing six-month average of the spot market price. The tariffs are calculated every 5 years and are adjusted for inflation on January 1 of each year. The next comprehensive tariff review will take place in 2007 and be effective in 2008. Absent DelSur's breach or default of its regulated obligations, DelSur's distribution rights within its service territory are perpetual.

Elfec is subject to regulated maximum tariffs set by Bolivia's Superintendent of Electricity. Tariffs are calculated every four years based on the trailing three-year average of the equity returns from companies listed in the Dow Jones Utility Index. Tariffs are adjusted on a monthly basis for local inflation and every six months to reflect any changes in the energy node prices, which is a pass-through to regulated customers of the energy charge that Elfec pays to generation companies. The tariffs are calculated every four years. The latest tariff review was completed in January 2004 and is effective beginning 2004. Absent Elfec's breach or default of its regulated obligations, Elfec's distribution rights within its concession area are perpetual.

## EMPLOYEE RELATIONS

As of December 31, 2003, PPL and its subsidiaries had the following full-time employees:

PPL Energy Supply		
PPL Generation	2,237	(a)
PPL EnergyPlus	1,663	(b)
PPL Global		
Domestic	19	
International	<u>3,939</u>	(c)
Total PPL Energy Supply	7,858	
PPL Electric	2,842	
PPL Gas Utilities	386	
PPL Services & Other	<u>1,170</u>	
Total PPL	<u><u>12,256</u></u>	

- (a) Includes 458 PPL Montana employees.
- (b) Includes union employees of mechanical contracting subsidiaries, which tend to fluctuate due to the nature of their business.
- (c) Includes employees of WPD and PPL Global's consolidated subsidiaries in Latin America.

Approximately 60%, or 4,958, of PPL's domestic workforce are members of labor unions, with four IBEW locals representing 3,425 employees. The other unions primarily represent employees of the mechanical contractors and gas utility employees in Pennsylvania. The bargaining agreement with the largest union was negotiated in May 2002 and expires in May 2006. Eight four-year contracts with smaller gas utility locals in Pennsylvania were negotiated in 2003. Also in 2001, three- and four-year contracts were concluded with two IBEW locals in Montana that represent 300 and 48 employees, respectively. The three-year contract expires in April 2004, and PPL Montana currently is negotiating with the IBEW Local regarding a new contract. The other IBEW contract expires in April 2005. PPL Montana negotiated a five-year agreement with the Teams Union in 2002 that expires in September 2006.

Approximately 79%, or 3,115, of PPL's international workforce are members of labor unions. WPD represents the majority of the international workforce. WPD recognizes five unions, the largest of which represents 38% of union members. WPD has two employment agreements which are negotiated with the unions. The Electricity Business Agreement covers 2,392 employees; it may be amended by agreement between WPD and the unions and is terminable with 12 months notice by either side. The other employment agreement, called the Meter Reading Services Handbook of Agreements, covers 54 employees; it may be amended by agreement between WPD and the unions and is terminable by written notice by either side.

PPL's Latin American subsidiaries have 941 union employees that are represented by 12 unions in 14 companies located in three countries. Several employees of Emel and its five distribution companies belong to ten unions, one of which negotiated a new, three-year agreement during 2003 and the remaining nine unions have agreements in place until May 2006. DelSur is currently negotiating with its one union and is expected to reach an agreement in early 2004 that will remain in force for three years. Union employees of Elfec and Integra are not covered by a collective bargaining agreement, but instead informally negotiate adjustments to their benefits with management each year. The agreement covering 2004 is expected to be settled during March 2004.

## AVAILABLE INFORMATION

PPL's Internet Web site is [www.pplweb.com](http://www.pplweb.com). On the Investor Center page of that Web site, PPL provides access to all SEC filings of PPL registrants free of charge, as soon as reasonably practicable after filing with the SEC. Additionally, PPL registrants' filings are available at the SEC's Web site ([www.sec.gov](http://www.sec.gov)) and at the SEC's Public Reference Room at 450 Fifth Street, NW, Washington, DC 20549, or by calling 1-800-SEC-0330.

## ITEM 2. PROPERTIES

### Domestic Generation

For a description of PPL's domestic generation portfolio, see Item 1, "Business - Power Supply."

### Domestic Generation Under Development

PPL Generation had the following domestic generation development projects in progress at December 31, 2003:

<u>Project</u>	<u>Type</u>	<u>Total MW Capacity (a)</u>	<u>PPL Ownership or Lease Interest in MW</u>	<u>Expected In-Service Date (b)</u>
<b>Pennsylvania</b>				
Lower Mt. Bethel (c) .....	Gas-fired	600	600 (100%)	2004
Susquehanna (d) .....	Nuclear	50	45 (90%)	2004
Susquehanna (e) .....	Nuclear	20	18 (90%)	2005 - 2006
<b>Total</b>		<b>670</b>	<b>663</b>	

- (a) The capacity of generation units is based on a number of factors, including the operating experience and physical condition of the units, and may be revised periodically to reflect changed circumstances.
- (b) The expected in-service dates are subject to receipt of required approvals and permits and to other contingencies.
- (c) This project is a gas-fired combined cycle combustion turbine facility.
- (d) This project involves the installation of more efficient steam turbines to increase capacity on Unit 1.
- (e) This project involves the installation of more efficient internals for the high pressure turbine moisture separators on Units 1 and 2.

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

### Domestic Delivery

#### *Electric*

For a description of PPL Electric's service territory, see Item 1, "Business - Background." At December 31, 2003, PPL Electric had electric transmission and distribution lines in public streets and highways pursuant to franchises and rights-of-way secured from property owners. PPL Electric's system included 379 substations with a total capacity of 25.6 million kVA, 32,797 circuit miles of overhead lines and 6,334 cable miles of

underground conductors. All of PPL Electric's facilities are located in Pennsylvania. Substantially all of PPL Electric's transmission and distribution properties are subject to the lien of PPL Electric's 1945 First Mortgage Bond Indenture and its 2001 Senior Secured Bond Indenture.

#### *Gas*

PPL Gas Utilities has two natural gas distribution subsidiaries, PFG Gas, Inc., which distributes gas to customers in southeastern and central Pennsylvania and parts of Maryland, and North Penn Gas Company, which serves customers in the northern part of Pennsylvania. North Penn Gas Company also has natural gas storage facilities in Pennsylvania. As of December 31, 2003, PFG Gas, Inc. had approximately 40,500 customers and 1,173 miles of pipeline mains, with 14 miles in Maryland and the remainder in Pennsylvania. North Penn Gas Company had approximately 35,500 customers and 2,714 miles of pipeline mains in Pennsylvania.

### International Delivery

PPL Global has consolidated investments in electricity distribution companies, serving approximately 3.5 million customers in Latin America and the U.K., as follows:

<u>Company (a)</u>	<u>Location</u>	<u>PPL Ownership Interest</u>	<u>2003 Electricity Sales GWh (b)</u>
<b>Latin America</b>			
Empresas Emel S.A. (Emel) .....	Santiago, Chile	95.4%	2,286
Empresa de Luz y Fuerza Electrica Cochabamba S.A. (Elfec) .....	Cochabamba, Bolivia	92.1%	595
Distribuidora de Electricidad DelSur S.A.de C.V. (DelSur) .....	San Salvador, El Salvador	80.5%	934
<b>United Kingdom</b>			
Western Power Distribution Holdings Limited (WPDH Limited) .....	Bristol, England	100%	28,137
<b>Total</b>			<b>31,952</b>

- (a) PPL Global no longer controls CEMAR and has deconsolidated this investment in its financial statements. PPL Global stopped recording operating results of CEMAR after August 21, 2002, the day ANEEL assumed control. CEMAR's customers have not been included in the year-end customer count above. See Note 9 to the Financial Statements for additional information.
- (b) Corresponds to revenues recorded by PPL Global in 2003.

### ITEM 3. LEGAL PROCEEDINGS

See Item 1, "Business - Fuel Supply," for information concerning a lawsuit against the DOE for failure of that agency to perform certain contractual obligations. See "Environmental Matters" in Note 14 to the Financial Statements for information concerning certain environmental matters.

#### **Tax Assessment Appeals**

Pursuant to changes in PURTA enacted in 1999, PPL subsidiaries have filed a number of tax assessment appeals in various Pennsylvania counties where PPL facilities are located. These appeals challenge existing local tax assessments, which now comprise the basis for payment of the PURTA tax on PPL's properties. Also, as of January 1, 2000, generation facilities are no longer taxed under PURTA, and these local assessments will be used directly to determine local real estate tax liability for PPL's power plants. In July 1999, PPL filed retroactive appeals for tax years 1998 and 1999, as permitted by the new law. In addition, PPL has filed appeals for 2000 and beyond, as permitted under normal assessment procedures. It is anticipated that assessment appeals may now be an annual occurrence.

Hearings on the pending appeals were held by the boards of assessment appeals in each county, and decisions have now been rendered by all counties. To the extent the appeals were denied or PPL was not otherwise satisfied with the results, PPL filed further appeals from the board decisions with the appropriate county Courts of Common Pleas.

Of the two pending proceedings in Pennsylvania, only the appeal concerning the assessed value of the Susquehanna nuclear station will result in annual local taxes exceeding \$1 million. PPL's appeal of the Susquehanna station assessment was decided in its favor by the Luzerne County Court of Common Pleas, and PPL subsequently settled with the local taxing authorities, resulting in annual local tax liability of approximately \$3 million for tax years 2000 and beyond and no additional PURTA tax liability for tax years 1998 and 1999. However, the settlement of the tax liability for tax years 1998 and 1999 was subject to the outcome of claims asserted by certain intervenors which are described below.

In August 2000, over PPL's objections, the Luzerne County Court of Common Pleas permitted Philadelphia City and County, the Philadelphia School District and the Southeastern Pennsylvania Transportation Authority (SEPTA) (collectively, the "Philadelphia parties") to intervene in the case because a change in the assessment of the plant affected the amount they collected under PURTA for the tax years 1998 and 1999. Based on the appraisal obtained by the Philadelphia parties, PPL would have been required to pay up to an extra \$213 million in PURTA taxes for 1998 and 1999. The court ruled in PPL's favor concerning the assessed value of the plant, and this determination was affirmed by the Commonwealth Court in October 2003. The Philadelphia parties subsequently petitioned the Commonwealth Court for reargument, and this request was

denied. The Philadelphia parties did not seek further appellate review of this matter.

PPL Montana is currently protesting certain property tax assessments by the Montana Department of Revenue (MDOR) on its generation facilities. The tax liabilities in dispute are approximately \$2 million for 2000 and 2001, \$9 million for 2002 and \$6 million for 2003. PPL Montana's dispute with respect to most of the 2002 and 2003 tax liability is based on the assessed value used by the MDOR for PPL Montana's hydroelectric facilities versus the assessed value used for the facilities of another hydroelectric generator in the state. The state tax appeals board is scheduled to hear the 2000 and 2001 disputes in April 2004, while the hearing for the 2002 dispute is scheduled for May 2004. A hearing for the 2003 dispute has not yet been scheduled.

#### **NorthWestern Corporation Litigation**

In connection with the acquisition of the Montana generation assets, the Montana Power APA, which was previously assigned to PPL Montana by PPL Global, includes a provision concerning the proposed purchase by PPL Montana of a portion of NorthWestern's interest in the 500-kilovolt Colstrip Transmission System (CTS) for \$97 million. During 2002, PPL Montana had been in discussions with NorthWestern regarding the proposed purchase of the CTS and the claims that PPL Montana believes it has against NorthWestern arising from the Montana Power APA and related agreements. Notwithstanding such discussions, in September 2002, NorthWestern filed a lawsuit against PPL Montana in Montana state court seeking specific performance of PPL Montana's purchase of the CTS or, alternatively, damages for breach of contract. Pursuant to PPL Montana's application, the matter was removed to the U.S. District Court of Montana, Butte Division. Following removal, NorthWestern asserted additional claims for damages against PPL Montana, and PPL Montana filed defenses denying liability for NorthWestern's claims as well as counterclaims against NorthWestern seeking damages PPL Montana believes it has suffered under the Montana Power APA and related agreements. This matter currently is scheduled for trial in the Montana federal district court in mid-2005.

In September 2003, NorthWestern filed a petition in Delaware for reorganization under the U.S. Bankruptcy Code, which has resulted in an automatic stay of PPL Montana's counterclaims against NorthWestern. PPL Montana has applied to the bankruptcy court for relief from the automatic stay. In December 2003, NorthWestern filed a motion to transfer this litigation from the Montana federal district court to the federal district court in Delaware where NorthWestern's bankruptcy proceeding is pending. PPL Montana has opposed the motion for transfer, which will be decided by the Montana federal district court. NorthWestern and PPL Montana also have stipulated in NorthWestern's bankruptcy proceeding that the automatic stay of PPL Montana's counterclaims will be lifted ten days after the Montana federal district court rules on the

transfer motion. PPL, PPL Energy Supply and PPL Montana cannot predict the outcome of this litigation.

### **Montana Hydroelectric Litigation**

In October 2003, a lawsuit was filed against PPL Montana, PPL Services, Avista Corporation, PacifiCorp and nine John Doe defendants in the U.S. District Court of Montana, Missoula Division, by two residents allegedly acting in a representative capacity on behalf of the State of Montana. In January 2004, the complaint was amended to, among other things, include the Great Falls school district as additional plaintiffs. The action seeks a declaratory judgment, compensatory damages for unjust enrichment, trespass and negligence, and attorneys fees on a "private attorney general" theory for use of state and/or "school trust" lands without the compensation required by law and to require defendants to adequately compensate the state and/or the State School Trust fund for full market value of lands occupied. Generally, the suit is founded on allegations that the bed of navigable rivers is state-owned property following admission to statehood, and that the use thereof for placement of dam structures, affiliated structures and reservoirs should trigger lease payments for use of land underneath. The plaintiffs allege that the State Land Board and Department of Natural Resources and Conservation failed to exercise their duty to administer riverbeds for the maximum benefit of public education and/or the state. No specific amount of damages has been claimed. PPL Montana and PPL Services cannot predict the outcome of this litigation.

### **California ISO and Western Markets**

Through its subsidiaries, PPL has made approximately \$18 million of sales to the California ISO, of which \$17 million has not been paid to PPL subsidiaries. Given the myriad of electricity supply problems faced by the California electric utilities and the California ISO, PPL cannot predict whether or when it will receive payment. As of December 31, 2003, PPL has fully reserved for possible underrecoveries of payments for these sales.

Regulatory proceedings arising out of the California electricity supply situation have been filed at the FERC. The FERC has determined that all sellers of energy into markets operated by the California ISO and the California Power Exchange, including PPL Montana, should be subject to refund liability for the period beginning October 2, 2000 through June 20, 2001 and initiated an evidentiary hearing concerning refund amounts. In April 2003, the FERC changed the manner in which this refund liability is to be computed and ordered further proceedings to determine the exact amounts that the sellers, including PPL Montana, would be required to refund.

In June 2003, the FERC took several actions as a result of a number of related investigations. The FERC terminated proceedings pursuant to which it had been considering whether to order refunds for spot market bilateral sales made in the Pacific Northwest, including sales made by PPL Montana, during the period December 2000 through June 2001. The

FERC explained that the totality of the circumstances made refunds unfeasible and inequitable, and that it had provided adequate relief by adopting a price cap throughout the western U.S. The FERC also denied pending complaints against long-term contracts in the western U.S. In these complaints, power buyers challenged selected long-term contracts that entered into during 2000 and 2001, complaining that the power prices were too high and reflected manipulation of those energy markets. The FERC found that the complainants had not met their burden of showing that changing or canceling the contract was "in the public interest" and that the dysfunction in the California markets did not justify changing these long-term contracts. In two separate orders, the FERC also ordered 65 different companies, agencies or municipalities to show cause why they should not be ordered to disgorge profits for "gaming or anomalous market behavior during 2000 and 2001. These orders to show cause address both unilateral and joint conduct identified as the "Enron trading strategies." Neither PPL EnergyPlus nor PPL Montana was included in these orders to show cause, and they previously have explained in responses to data requests from the FERC that they have not engaged in such trading strategies. Finally, the FERC issued a new investigation order directing its staff to investigate any bids made into the California markets in excess of \$250/MWh during the period from May 2000 to October 2000, a period of time prior to the period examined in connection with most of the proceedings described above. To their knowledge, neither PPL EnergyPlus nor PPL Montana is being investigated by the FERC under this new order.

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

In May 2003, the Port of Seattle filed a lawsuit in the U.S. District Court for the Western District of Washington against eighteen defendants, including PPL Montana. The lawsuit asserts claims against all defendants under the federal and state antitrust laws, the federal Racketeer Influenced and Corrupt Organizations Act and for common law fraud. The complaint centers on many of the same alleged activities that are the basis for the litigation arising out of the California electricity supply situation described above. The Port of Seattle is seeking actual,

trebled and punitive damages, as well as attorneys' fees. PPL Montana and several other defendants have filed a motion to dismiss this complaint that has not been ruled on by the court. In December 2003, this matter was transferred to the U.S. District Court for the Southern District of California for inclusion with proceedings already centralized and pending in that court.

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

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

### **New England Investigation**

In January 2004, PPL became aware of an investigation by the Connecticut Attorney General and the FERC's Office of Market Oversight and Investigation (OMOI) regarding allegations that natural gas-fired generators located in New England illegally sold natural gas instead of generating electricity during the week of January 12, 2004. Subsequently, PPL and other generators were served with a data request by OMOI. The data request indicated that PPL was not under suspicion of a regulatory violation but that OMOI was conducting an initial investigation. PPL has responded to this data request. While PPL does not believe that it committed any regulatory or other violations concerning the subject matter of the investigation, PPL cannot predict the outcome of the investigation.

### **Montana Power Shareholders' Litigation**

In August 2001, a purported class-action lawsuit was filed by a group of shareholders of Montana Power against Montana Power, the directors of Montana Power, certain advisors and consultants of Montana Power and PPL Montana. The plaintiffs allege, among other things, that Montana Power was required to, and did not, obtain shareholder approval of the sale of Montana Power's generation assets to PPL Montana in 1999. Although most of the claims in the complaint are against Montana Power,

its board of directors, and its consultants and advisors, two claims are asserted against PPL Montana. In the first claim, plaintiffs seek a declaration that because Montana Power shareholders did not vote on the 1999 sale of generating assets to PPL Montana, that sale "was null and void ab initio." The second claim alleges that PPL Montana was privy to and participated in a strategy whereby Montana Power would sell its generation assets to PPL Montana without first obtaining Montana Power shareholder approval, and that PPL Montana has made net profits in excess of \$100 million as the result of this alleged illegal sale. In the second claim, plaintiffs request that the court impose a "resulting and/or constructive trust" on both the generation assets themselves and all profits, plus interest on the amounts subject to the trust. This lawsuit is currently pending in the U.S. District Court of Montana, Butte Division. PPL, PPL Energy Supply and PPL Montana cannot predict the outcome of this matter.

### **PJM Capacity Transactions**

In November 2001, the PJM Market Monitor publicly released a report prepared for the PUC entitled "Capacity Market Questions" relating to the pricing of installed capacity in the PJM daily market during the first quarter of 2001. The report concluded that PPL EnergyPlus (identified in the report as "Entity 1") was able to exercise market power to raise the market-clearing price above the competitive level during that period. PPL EnergyPlus does not agree with the Market Monitor's conclusions that it exercised market power, and the Market Monitor acknowledged in his report that PJM's standards and rules did not prohibit PPL EnergyPlus' conduct. In November 2001, the PUC issued an Investigation Order directing its Law Bureau to conduct an investigation into the PJM capacity market and the allegations in the Market Monitor's report. In June 2002, the PUC issued an investigation report alleging, among other things, that PPL had unfairly manipulated electricity markets in early 2001. The PUC stated that it was not authorized to, and was not attempting to, adjudicate the merits of PPL's defenses to its allegations, but referred the matter to the U.S. Department of Justice - Antitrust Division (DOJ), the FERC and the Pennsylvania Attorney General.

In June 2003, the DOJ notified PPL that it had closed its investigation in this matter. Also in June, the Pennsylvania Attorney General's office completed its investigation and notified the PUC that PPL did not violate antitrust or other laws in its capacity market activities. The FERC already has completed two investigations related to these capacity market questions and has found no reason to take action against PPL. PPL continues to believe that the PUC's report is inaccurate, that its conclusions are groundless, and that PPL acted ethically and legally, in compliance with all applicable laws and regulations.

In September 2002, PPL was served with a complaint filed by Utilimax.com, Inc., which was a member of PJM, in the U.S. District Court for the Eastern District of Pennsylvania against PPL and PPL EnergyPlus alleging, among other things, violations of the federal antitrust laws in connection with the

capacity transactions described in the Market Monitor's report. The court dismissed the complaint with prejudice in July 2003, and Utilimax has appealed the court's dismissal to the U.S. Court of Appeals for the Third Circuit.

In December 2002, PPL was served with a complaint against PPL, PPL EnergyPlus and PPL Electric filed in the U.S. District Court for the Eastern District of Pennsylvania by a group of 14 Pennsylvania boroughs that apparently alleges, in broad terms, similar violations of the federal antitrust laws. These boroughs were wholesale customers of PPL Electric. In addition, in November 2003, PPL and PPL EnergyPlus were served with a complaint which was filed in the same court by Joseph Martorano, III (d/b/a ENERCO), that also alleges violations of the federal antitrust laws. The complaint indicates that ENERCO provides consulting and energy procurement services to clients in Pennsylvania and New Jersey. Although PPL, PPL EnergyPlus and PPL Electric believe the claims in these complaints are without merit, they cannot predict the outcome of these matters.

#### **FERC Market-Based Rate Authority**

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

#### **Lower Mt. Bethel**

In August 2002, the Northampton County Court of Common Pleas issued a decision concerning the permissible noise levels from the Lower Mt. Bethel facility when it becomes operational. Specifically, the court's decision sets certain permissible noise levels required for plant operation. PPL appealed the court's decision to the Commonwealth Court, and an intervenor in the lawsuit cross-appealed the court's decision. In May 2003, the Commonwealth Court remanded the case to the Court of Common Pleas for further findings of fact concerning the zoning application relating to the construction of the facility. In September 2003, the Court of Common Pleas ruled in PPL's favor while also reaffirming its decision on the noise levels, and the intervenor has appealed this ruling to the Commonwealth Court. The Lower Mt. Bethel facility is expected to be operational in 2004. However, PPL and PPL Energy Supply cannot predict the outcome of the ongoing litigation concerning the facility or its ultimate impact on the Lower Mt. Bethel facility, but such impact may be material.

#### **ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

There were no matters submitted to a vote of security holders, through the solicitation of proxies or otherwise, during the fourth quarter of 2003.

## EXECUTIVE OFFICERS OF THE REGISTRANTS

Officers of PPL, PPL Energy Supply, PPL Electric and PPL Montana are elected annually by their Boards of Directors (or Boards of Managers, as applicable) to serve at the pleasure of the respective Boards. There are no family relationships among any of the executive officers, nor is there any arrangement or understanding between any executive officer and any other person pursuant to which the officer was selected.

There have been no events under any bankruptcy act, no criminal proceedings and no judgments or injunctions material to the evaluation of the ability and integrity of any executive officer during the past five years.

Listed below are the executive officers:

### **PPL Corporation**

<u>Name</u>	<u>Age</u>	<u>Positions Held During the Past Five Years</u>	<u>Dates</u>
William F. Hecht	60	Chairman, President and Chief Executive Officer	February 1995 - present
John R. Biggar	59	Executive Vice President and Chief Financial Officer Senior Vice President and Chief Financial Officer	January 2001 - present November 1998 - January 2001
Lawrence E. De Simone	56	Executive Vice President Executive Vice President - Supply President - PPL EnergyPlus	January 2004 - present October 2001 - January 2004 November 1998 - October 2001
James H. Miller	55	Executive Vice President President - PPL Generation Executive Vice President - USEC, Inc. Vice President, Production - USEC, Inc.	January 2004 - present February 2001 - present January 1999 - February 2001 September 1995 - January 1999
Robert J. Grey	53	Senior Vice President, General Counsel and Secretary	March 1996 - present
Paul T. Champagne*	45	President - PPL EnergyPlus President - PPL Global Vice President and Senior Business Development Officer - PPL Global	October 2001 - present May 1999 - October 2001 October 1998 - May 1999
Paul A. Farr*	36	Senior Vice President - PPL Global Vice President - International Operations - PPL Global Vice President - PPL Global Vice President and Chief Financial Officer - PPL Montana Director of International Tax - PPL Global	January 2004 - present June 2002 - January 2004 October 2001 - June 2002 June 1999 - October 2001 June 1998 - June 1999
Roger L. Petersen*	52	President - PPL Global President and Chief Executive Officer - PPL Montana President - PPL Montana	October 2001 - present May 1999 - October 2001 January 1999 - May 1999
John F. Sipics*	55	President - PPL Electric Vice President - Asset Management Vice President - Regulatory Support Vice President - Delivery Services & Economic Development	October 2003 - present August 2001 - October 2003 August 2000 - August 2001 October 1998 - August 2000
James E. Abel	52	Vice President - Finance and Treasurer Treasurer	June 1999 - present August 1996 - June 1999
Mark D. Woods	45	Controller Manager - Financial Reporting and Consolidation - PPL Services Supervisor - Financial Accounting - PPL Services	February 2004 - present March 1999 - February 2004 March 1997 - March 1999

Messrs. Champagne, Farr, Petersen and Sipics have been designated executive officers of PPL by virtue of their respective positions at PPL subsidiaries.

**PPL Electric Utilities Corporation**

<u>Name</u>	<u>Age</u>	<u>Positions Held During the Past Five Years</u>	<u>Dates</u>
John F. Sipics	55	President Vice President - Asset Management Vice President - Regulatory Support Vice President - Delivery Services & Economic Development	October 2003 - present August 2001 - October 2003 August 2000 - August 2001 October 1998 - August 2000
James E. Abel	52	Treasurer Vice President - Finance and Treasurer Treasurer	July 2000 - present June 1999 - July 2000 August 1996 - June 1999
Mark D. Woods	45	Controller Manager - Financial Reporting and Consolidation - PPL Services Supervisor - Financial Accounting - PPL Services	February 2004 - present March 1999 - February 2004 March 1997 - March 1999

**PPL Energy Supply, LLC**

Item 4 is omitted as PPL Energy Supply meets the conditions set forth in General Instruction (I)(1)(a) and (b) of Form 10-K.

**PPL Montana, LLC**

Item 4 is omitted as PPL Montana meets the conditions set forth in General Instruction (I)(1)(a) and (b) of Form 10-K.

## PART II

### **ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS**

#### **PPL Corporation**

Additional information for this item is set forth in the sections entitled "Quarterly Financial, Common Stock Price and Dividend Data," "Item 12 - Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters" and "Shareowner and Investor Information" of this report. The number of common shareowners is set forth in "Item 6 - Selected Financial and Operating Data."

#### **PPL Energy Supply, LLC**

There is no established public trading market for PPL Energy Supply's membership interests. PPL Energy Funding, a direct wholly-owned subsidiary of PPL, owns all of PPL Energy Supply's outstanding membership interests. Distributions on the membership interests will be paid as determined by PPL Energy Supply's Board of Managers. PPL Energy Supply made cash distributions to PPL Energy Funding of approximately \$1.2 billion in 2003 and \$710 million in 2002.

#### **PPL Electric Utilities Corporation**

Additional information for this item is set forth in the sections entitled "Quarterly Financial Data" and "Shareowner and Investor Information" of this report.

#### **PPL Montana, LLC**

There is no established public trading market for PPL Montana's membership interests. PPL indirectly owns all of PPL Montana's outstanding membership interests. Distributions on the membership interests will be paid as determined by PPL Montana's Board of Managers. PPL Montana made a cash distribution indirectly to PPL of \$5 million in 2003. There were no such distributions in 2002.

### **ITEM 6. SELECTED FINANCIAL AND OPERATING DATA**

#### **PPL Energy Supply, LLC**

Item 6 is omitted as PPL Energy Supply meets the conditions set forth in General Instructions (I)(1)(a) and (b) of Form 10-K.

#### **PPL Montana, LLC**

Item 6 is omitted as PPL Montana meets the conditions set forth in General Instructions (I)(1)(a) and (b) of Form 10-K.

## ITEM 6. SELECTED FINANCIAL AND OPERATING DATA

PPL Corporation (a)	2003	2002	2001	2000	1999
<b>Income Items - millions</b>					
Operating revenues (b).....	\$ 5,587	\$ 5,481	\$ 5,115	\$ 4,545	\$ 4,111
Operating income (b).....	1,340	1,246	850	1,194	821
Income from continuing operations.....	719	360	169	487	478
Net income.....	734	208	179	498	432
<b>Balance Sheet Items - millions (c)</b>					
Property, plant and equipment - net.....	10,446	9,566	5,947	5,948	5,624
Recoverable transition costs.....	1,687	1,946	2,172	2,425	2,647
Total assets.....	17,123	15,552	12,562	12,360	11,174
Long-term debt.....	7,859	6,267	5,579	4,784	4,157
Long-term debt with affiliate trusts (d).....	681				
Company-obligated mandatorily redeemable preferred securities of subsidiary trusts holding solely company debentures (d).....		661	825	250	250
<b>Preferred stock</b>					
With sinking fund requirements.....		31	31	46	46
Without sinking fund requirements.....	51	51	51	51	51
Common equity.....	3,259	2,224	1,857	2,012	1,613
Short-term debt.....	56	943	118	1,037	857
Total capital provided by investors.....	11,906	10,177	8,461	8,180	6,974
Capital lease obligations.....	12				125
<b>Financial Ratios</b>					
Return on average common equity - %.....	26.56	10.27	8.41	27.49	24.70
<b>Embedded cost rates (c)</b>					
Long-term debt - %.....	6.56	7.04	6.84	6.98	6.95
Preferred stock - %.....	5.14	5.81	5.81	5.87	5.87
Preferred securities - % (d).....		8.02	8.13	8.44	8.44
Times interest earned before income taxes.....	2.92	1.97	2.19	3.05	3.37
Ratio of earnings to fixed charges - total enterprise basis (e).....	2.5	1.9	1.7	2.5	
<b>Common Stock Data</b>					
<b>Number of shares outstanding - thousands</b>					
Year-end.....	177,362	165,736	146,580	145,041	143,697
Average.....	172,795	152,492	145,974	144,350	152,287
Number of record shareowners (c).....	83,783	85,002	87,796	91,777	91,553
Income from continuing operations - Basic EPS.....	\$ 4.16	\$ 2.36	\$ 1.16	\$ 3.38	\$ 3.14
Income from continuing operations - Diluted EPS.....	\$ 4.15	\$ 2.36	\$ 1.15	\$ 3.37	\$ 3.14
Net income - Basic EPS.....	\$ 4.25	\$ 1.37	\$ 1.23	\$ 3.45	\$ 2.84
Net income - Diluted EPS.....	\$ 4.24	\$ 1.36	\$ 1.22	\$ 3.44	\$ 2.84
Dividends declared per share.....	\$ 1.54	\$ 1.44	\$ 1.06	\$ 1.06	\$ 1.00
Book value per share (c).....	\$ 18.37	\$ 13.42	\$ 12.67	\$ 13.87	\$ 11.23
Market price per share (c).....	\$ 43.75	\$ 34.68	\$ 34.85	\$ 45.188	\$ 22.875
Dividend payout rate - % (f).....	36	106	87	31	35
Dividend yield - % (g).....	3.52	4.15	3.04	2.35	4.37
Price earnings ratio (f) (g).....	10.32	25.50	28.57	13.14	8.05
<b>Sales Data - millions of kWh</b>					
Domestic - Electric energy supplied - retail.....	36,774	36,746	37,395	37,758	33,695
Domestic - Electric energy supplied - wholesale.....	41,709	36,849	27,683	40,925	32,045
Domestic - Electric energy delivered.....	36,083	35,712	35,534	34,731	33,874
International - Electric energy delivered (h).....	31,952	33,313	5,919	3,735	2,942

(a) The earnings each year were affected by unusual items, which affected net income. See "Earnings" in Management's Discussion and Analysis of Financial Condition and Results of Operations for a description of unusual items in 2003, 2002 and 2001.

(b) Operating revenues and operating income of certain years are restated to conform to the current presentation.

(c) At year-end.

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

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

(f) Based on diluted EPS.

(g) Based on year-end market prices.

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

**ITEM 6. SELECTED FINANCIAL AND OPERATING DATA**

PPL Electric Utilities Corporation (a)	2003	2002	2001	2000	1999 (e)
<b>Income Items - millions</b>					
Operating revenues .....	\$ 2,788	\$ 2,748	\$ 2,694	\$ 3,336	\$ 3,059
Operating income .....	251	275	419	669	749
Income available to PPL Corporation.....	25	39	119	261	398
<b>Balance Sheet Items - millions (b)</b>					
Property, plant and equipment - net.....	2,589	2,456	2,319	2,401	4,345
Recoverable transition costs .....	1,687	1,946	2,172	2,425	2,647
Total assets .....	5,469	5,583	5,921	6,023	9,092
Long-term debt .....	2,937	3,175	3,459	3,126	3,505
Company-obligated mandatorily redeemable preferred securities of subsidiary trusts holding solely company debentures .....			250	250	250
<b>Preferred stock</b>					
With sinking fund requirements .....		31	31	46	46
Without sinking fund requirements .....	51	51	51	51	51
Common equity .....	1,222	1,147	931	1,160	1,296
Short-term debt .....		15		59	183
Total capital provided by investors.....	4,210	4,419	4,722	4,692	5,331
Capital lease obligations .....					125
<b>Financial Ratios</b>					
Return on average common equity - %.....	2.08	3.87	11.09	19.40	25.59
<b>Embedded cost rates (b)</b>					
Long-term debt - %.....	6.61	6.83	6.81	6.88	6.97
Preferred stock - % .....	5.14	5.81	5.81	5.87	5.87
Preferred securities - %.....			8.44	8.44	8.44
Times interest earned before income taxes.....	1.22	1.33	1.92	2.81	3.75
Ratio of earnings to fixed charges (c).....	1.2	1.2	1.7	2.5	3.2
<b>Sales Data</b>					
Customers (thousands) (b).....	1,330	1,308	1,298	1,270	1,270
<b>Electric energy delivered - millions of kWh</b>					
Residential .....	13,266	12,640	12,269	11,924	11,704
Commercial .....	12,388	12,371	12,130	11,565	11,002
Industrial.....	9,599	9,853	10,000	10,224	10,179
Other.....	154	169	211	194	160
Retail electric sales .....	35,407	35,033	34,610	33,907	33,045
Wholesale electric sales (d).....	676	679	924	17,548	31,715
Total electric energy sales delivered.....	36,083	35,712	35,534	51,455	64,760
Electric energy supplied as a PLR .....	33,627	33,747	31,653	32,260	33,695

- (a) Earnings each year were affected by unusual items which affected net income. See "Earnings" in Management's Discussion and Analysis of Financial Condition and Results of Operations for a description of unusual items in 2003, 2002 and 2001.
- (b) At year-end.
- (c) Computed using earnings and fixed charges of PPL Electric and its subsidiaries. Fixed charges consist of interest on short- and long-term debt, other interest charges, interest on capital lease obligations and the estimated interest component of other rentals.
- (d) After the July 1, 2000 corporate realignment, PPL Electric had only wholesale sales to municipalities and NUG purchases that are resold to PPL EnergyPlus.
- (e) Comparability of Selected Financial and Operating Data for 1999 to subsequent years is affected by the corporate realignment on July 1, 2000, in which PPL Electric transferred its electric generation and related assets to certain PPL affiliates.

**ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS****Overview**

PPL is an energy and utility holding company with headquarters in Allentown, PA. See Item 1, "Business - Background," for descriptions of PPL's major segments. See Exhibit 99 in Item 15 for the current corporate organization structure. Through its subsidiaries, PPL is primarily engaged in the generation and marketing of electricity in two key markets - the northeastern and western U.S. - and in the delivery of electricity in Pennsylvania, the U.K. and Latin America. PPL's strategy for its electricity generation and marketing business is to match energy supply with load, or customer demand, under long-term and intermediate-term contracts with creditworthy counterparties. PPL's strategy for its electricity delivery businesses is to own and operate these businesses at the highest level of quality and reliability and at the most efficient cost.

PPL faces several risks in its generation business. The principal risks are electricity wholesale price risk, fuel supply and price risk, power plant performance and counterparty credit risk. PPL attempts to manage these risks through various means. For instance, PPL operates a portfolio of generation assets that is diversified as to geography, fuel source, cost structure and operating characteristics. PPL is focused on the operating efficiency and maintaining availability of these power plants. In addition, PPL has in place and continues to pursue long-term and intermediate-term contracts for energy sales and fuel supply, and other means, to mitigate the risks associated with adverse changes in the difference, or margin, between the cost to produce electricity and the price at which PPL sells it. PPL's contractual commitments for energy sales are primarily satisfied through its own generation assets - i.e., PPL primarily markets and trades around its physical portfolio of generating assets through integrated generation, marketing and trading functions. Finally, PPL attempts to reduce its exposure to the various risks it faces through its risk management program, which, among other things, includes an evaluation of market risks and the creditworthiness of all counterparties.

PPL's electricity delivery businesses are rate-regulated.

Accordingly, these businesses are subject to regulatory risk in terms of the costs that they may recover and the investment returns that they may collect in customer rates. The principal challenge that PPL faces in its electricity delivery businesses is to maintain high standards of customer service and reliability in a cost-effective manner. PPL seeks to apply its experience in operating and managing its Pennsylvania delivery business to its international businesses. In turn, PPL has also gained valuable experience by operating and managing these international businesses. PPL faces certain financial risks by conducting international operations, such as fluctuations in currency exchange rates. PPL attempts to manage these financial risks through its risk management program.

A key challenge for PPL's business as a whole is to maintain a strong credit profile. In the past few years, investors, analysts and rating agencies that follow companies in the energy industry

have been particularly focused on the credit quality and liquidity position of energy companies. PPL is focused on strengthening its balance sheet and improving its liquidity position, thereby improving its credit profile.

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

- "Results of Operations" provides an overview of PPL's operating results in 2003, 2002 and 2001, starting with a review of earnings. The earnings review includes a listing of certain unusual items that had significant impacts in these years, and it also includes a description of key factors that management expects may impact future earnings. "Results of Operations" also includes an explanation of changes during this three-year period in significant income statement components, such as energy margins, utility revenues, operation and maintenance expenses, financing costs, income taxes and cumulative effects of accounting changes.
- "Financial Condition - Liquidity" provides an analysis of PPL's liquidity position and credit profile, including its sources of cash (including bank credit facilities and sources of operating cash flow) and uses of cash (including contractual commitments and capital expenditure requirements) and the key risks and uncertainties that impact PPL's past and future liquidity position and financial condition. This subsection also includes an explanation of recent rating agency decisions affecting PPL, as well as a listing of PPL's current credit ratings.
- "Financial Condition - Risk Management - Energy Marketing & Trading and Other" includes an explanation of PPL's risk management program relating to market risk (i.e., commodity price, interest rate and foreign currency exchange risk) and credit risk (i.e., counterparty credit risk).
- "New Accounting Standards" provides a description of accounting standards that impact PPL's Financial Statements and that were implemented in 2003 or are pending adoption.
- "Application of Critical Accounting Policies" provides an overview of the accounting policies that are particularly important to the results of operations and financial condition of PPL and that require PPL's management to make significant estimates, assumptions and other judgments. Although PPL's management believes that these estimates, assumptions and other judgments are appropriate, they relate to matters that are inherently uncertain. Accordingly, changes in the estimates, assumptions and other judgments applied to these accounting policies could have a significant impact on PPL's results of operations and financial condition, as reflected in PPL's Financial Statements.

The information provided in "Management's Discussion and Analysis of Financial Condition and Results of Operations" should be read in conjunction with PPL's Financial Statements and the Notes thereto.

Terms and abbreviations appearing herein are explained in the glossary. Dollars are in millions, except per share data, unless otherwise noted.

### Results of Operations

Earnings in 2003 and 2002 were impacted by the acquisition of a controlling interest in WPD on September 6, 2002, and the resulting consolidation, as described in Note 9 to the Financial Statements. Therefore, the comparison of reported income statement line items between 2002 and 2001 is not meaningful without eliminating the impact of the WPD consolidation. The following table shows the 2002 Statement of Income as reported, the adjustments to eliminate the impact of the WPD consolidation (by reflecting WPD on the equity method), and as adjusted to exclude the WPD consolidation. The following discussion, that explains significant annual changes in principal items on the Statement of Income, compares 2003 to 2002, unadjusted, and compares 2002, as adjusted, to 2001.

**PPL Corporation and Subsidiaries  
Consolidated Statement of Income  
Adjusted to Eliminate WPD Consolidation**

	2002		
	As Reported	Adjustment	As Adjusted
<b>Operating Revenues</b>			
Utility	\$ 3,676	\$ 579	\$ 3,097
Unregulated retail electric and gas	182		182
Wholesale energy marketing	1,036		1,036
Net energy trading margins	19		19
Energy related businesses	<u>568</u>	<u>(60)</u>	<u>628</u>
Total	<u>5,481</u>	<u>519</u>	<u>4,962</u>
<b>Operating Expenses</b>			
<b>Operation</b>			
Fuel	584		584
Energy purchases	916		916
Other operation and maintenance	1,136	42	1,094
Amortization of recoverable transition costs	226		226
Depreciation	367	112	255
Taxes, other than income	231	42	189
Energy related businesses	543	29	514
<b>Other charges</b>			
Write-down of international energy projects	113		113
Workforce reduction	75		75
Write-down of generation assets	<u>44</u>		<u>44</u>
Total	<u>4,235</u>	<u>225</u>	<u>4,010</u>

	As Reported	Adjustment	As Adjusted
Operating Income	1,246	294	952
Other Income - net	30	20	10
Interest Expense	561	127	434
Income Taxes	210	105	105
Minority Interest	78	73	5
Distributions on Preferred Securities	67	9	58
Loss from Discontinued Operations	2		2
Cumulative Effect of a Change in Accounting Principle	<u>(150)</u>		<u>(150)</u>
Net Income	<u>\$ 208</u>	<u>\$</u>	<u>\$ 208</u>

The comparability of certain items on the Statement of Income has also been impacted by PPL Global's investment in CEMAR. The consolidated results of CEMAR are included for periods during which PPL had a controlling interest, from January 1, 2001 to August 2002. See Note 9 to the Financial Statements for more information.

WPD's results, as consolidated in PPL's Statement of Income, are impacted by changes in foreign currency exchange rates. For the twelve months ended December 31, 2003, as compared to the same period in 2002, changes in foreign exchange rates increased WPD's portion of revenue and expense line items by about 9%.

### Earnings

Net income, and the related EPS, were as follows:

	2003	2002	2001
Net income	\$ 734	\$ 208	\$ 179
EPS - basic	\$ 4.25	\$ 1.37	\$ 1.23
EPS - diluted	\$ 4.24	\$ 1.36	\$ 1.22

The after-tax changes in net income were primarily due to:

	2003 vs. 2002	2002 vs. 2001
<b>Domestic:</b>		
Wholesale energy margins	\$ 68	\$ (81)
Net energy trading margins	(4)	(11)
Unregulated retail energy margins	(6)	(33)
Regulated retail energy margins	(43)	59
Delivery revenues (net of CTC/ITC amortization and interest expense on transition bonds)	11	(10)
Operation and maintenance expenses	(41)	(34)
Realized earnings on decommissioning trust fund	12	
Depreciation		4
Contribution of property	12	
Taxes other than income (excluding gross receipts tax)	(14)	5
Synfuel tax credits	2	10

	<u>2003 vs. 2002</u>	<u>2002 vs. 2001</u>
Mechanical contractors earnings		(4)
Interest expense and preferred dividends	51	(29)
Other	<u>(12)</u>	<u>(5)</u>
Total Domestic	36	(129)
International:		
U.K. operations:		
Benefit of complete ownership of WPD (see Note 9)	29	11
Impact of changes in foreign currency exchange rates	14	1
Other	1	1
Latin America	18	(24)
Other	<u>3</u>	<u>61</u>
Total International	65	50
Unusual items	<u>425</u>	<u>108</u>
	<u>\$ 526</u>	<u>\$ 29</u>

The changes in net income from year to year were, in part, attributable to several unusual items with significant earnings impacts, including accounting changes, discontinued operations and infrequently occurring items. The after-tax impacts of these unusual items are shown below.

	<u>Impact on Net Income</u>		
	<u>2003</u>	<u>2002</u>	<u>2001</u>
Accounting changes:			
Asset retirement obligation (Note 21)	\$ 63		
Consolidation of variable interest entities (Note 22)	(27)		
Goodwill impairment (Note 18)		\$ (150)	
Pensions (Note 12)			\$ 10
Discontinued operations (Note 9)	(20)		
CEMAR-related net tax benefit (Note 5)	81		
Workforce reduction (Note 20)	(5)	(44)	
Write-down of generation assets (Note 9)		(26)	
CEMAR operating losses (Note 9)		(23)	
CEMAR impairment (Note 9)		(98)	(217)
Cancellation of generation projects (Note 9)			(88)
WPD impairment (Note 9)			(117)
Tax benefit - Teesside (Note 9)		8	
Enron impact on trading (Note 17)			(8)
Enron impact - write-down investment in Teesside (Note 9)			(21)
Total	<u>\$ 92</u>	<u>\$ (333)</u>	<u>\$ (441)</u>

The year to year changes in earnings components, including margins by activity and income statement line items, are discussed in the balance of the discussion in "Results of Operations."

PPL's future earnings could be, or will be, impacted by a number of key factors, including the following:

- Based upon current electricity and natural gas price levels, there is a risk that PPL may be unable to recover its investment in new gas-fired generation facilities. Under GAAP, PPL does not believe that there is an impairment charge to be recorded for these facilities at this time. PPL is unable to predict the ultimate earnings impact of this issue, based upon future energy price levels, applicable accounting rules and other factors, but such impact may be material. (See "Application of Critical Accounting Policies - Asset Impairment" for additional information.)
- PPL is unable to predict whether future impairments of goodwill may be required for its domestic and international investments. While no goodwill impairments were required based on the annual review performed in the fourth quarter of 2003, future impairments may occur due to determinations of fair value exceeding the carrying value of these investments. (See "Application of Critical Accounting Policies - Asset Impairment" for additional information.)
- Earnings in 2004 and beyond will be impacted by the consolidation of variable interest entities (as discussed in Note 22 to the Financial Statements).
- PPL Electric expects to file a request for a distribution rate increase with the PUC in March 2004. If approved, the new rates will go into effect in January 2005, when PPL Electric's distribution rate cap expires. In addition, beginning January 1, 2005, PPL Electric expects to fully recover from its retail customers the charges that it pays to PJM for transmission-related services. See "Item 1. Business-Background-Delivery Segment" for more information regarding PPL Electric's transmission and distribution rate cap.
- Earnings in 2005 and beyond may be impacted by a rate review of the delivery business of WPD (South West) and WPD (South Wales). PPL cannot predict the ultimate outcome of the rate review.
- PPL operates a synfuel facility and receives tax credits pursuant to Section 29 of the Internal Revenue Code based on its sale of synfuel to unaffiliated third-party purchasers. See Note 14 to the Financial Statements for a discussion of the IRS review of synfuel production procedures, and the projected annual earnings attributable to PPL's synfuel operations.
- Future earnings may also be impacted by the ultimate exiting of the CEMAR investment (see Note 9 to the Financial Statements for additional information) or other investments.

### Domestic Gross Energy Margins

The following table provides changes in income statement line items that comprise domestic gross energy margins:

	<u>2003 vs. 2002</u>	<u>2002 vs. 2001</u>
Utility revenues	\$ 34	\$ 63
Unregulated retail electric and gas revenues	(30)	(174)
Wholesale energy marketing revenues	178	9
Net energy trading margins	(7)	(18)
Other revenue adjustments (a)	<u>6</u>	<u>41</u>
Total revenues	<u>181</u>	<u>(79)</u>
Fuel	33	(18)
Energy purchases	114	5
Other cost adjustments (a)	<u>9</u>	<u>31</u>
Total cost of sales	<u>156</u>	<u>18</u>
Domestic gross energy margins	<u>\$ 25</u>	<u>\$ (97)</u>

(a) Adjusted to exclude the impact of any revenues and costs not associated with domestic energy margins, in particular, revenues and energy costs related to the international operations of PPL Global and the domestic delivery operations of PPL Electric and PPL Gas Utilities. Also adjusted to include gains on sales of emission allowances, which are reflected in "Other operation and maintenance" expenses on the Statement of Income, and the reduction of the reserve for Enron receivables, as described in Note 17 to the Financial Statements.

### Changes in Domestic Gross Energy Margins By Activity

Gross margin calculations are dependent on the allocation of fuel and purchased power costs to the activities listed below. That allocation is based on monthly MWh consumption levels compared to monthly MWh supply costs. Any costs specific to an activity are charged to that activity.

	<u>2003 vs. 2002</u>	<u>2002 vs. 2001</u>
Wholesale - Eastern U.S.	\$ 67	\$ (64)
Wholesale - Western U.S.	49	(71)
Net energy trading	(7)	(18)
Unregulated retail	(10)	(55)
Regulated retail	<u>(74)</u>	<u>111</u>
Domestic gross energy margins	<u>\$ 25</u>	<u>\$ (97)</u>

### Wholesale - Eastern U.S.

Eastern U.S. wholesale margins were higher in 2003 compared to 2002 primarily due to higher volumes, which increased by 47%. The higher volumes were primarily driven by market opportunities to optimize the value of generating assets and by higher spot prices that allowed PPL to increase the utilization of its higher cost generating units including 699 MW of new generation that began commercial operation in mid-2002. In PJM, where the majority of PPL's Eastern wholesale activity occurs, average on-peak spot market real time prices rose 34% in 2003 compared to 2002. Partially offsetting the increase in wholesale energy margins in 2003 compared to 2002, was the buyout of a NUG contract in February 2002, which reduced power purchases by \$25 million.

Eastern wholesale margins were lower in 2002 compared to 2001, despite a buyout of a NUG contract in February 2002 that reduced purchased power costs by \$25 million. The decline in margins was primarily attributable to the decline in wholesale prices for energy and capacity. PJM on-peak prices averaged

\$6/MWh less, a decline of 14%, for 2002 compared to 2001. Additionally, because new generating capability came on-line within PJM in 2002, the prices for the PJM monthly auctions for unforced capacity credits fell from an average of \$100/MW-month in 2001 to an average of \$38/MW-month in 2002. However, higher volumes of energy sales partially offset the decline in prices, as wholesale transactions in 2002 increased by about 33% over 2001 due to better generating unit availability.

### Wholesale - Western U.S.

Western U.S. wholesale margins consist of margins in the Northwest and in the Southwest.

In the Northwest, margins were \$31 million higher in 2003 compared to 2002, primarily due to higher wholesale prices. Average wholesale prices for 2003 were \$6/MWh higher than prices in 2002. A favorable settlement of \$3 million with Energy West Resources Inc. in June 2003 also positively impacted margins in 2003. Margins were \$74 million lower in 2002 compared to 2001, primarily due to a decrease in average realized wholesale prices by \$15/MWh, partially offset by a 7% increase in volumes.

In the Southwest, margins were \$9 million higher in 2003 compared to 2002, primarily due to the inception of new tolling agreements in Arizona and due to an increase of average wholesale prices in 2003 by \$16/MWh compared to 2002. Margins were \$9 million lower in 2002 compared to 2001, primarily due to a decrease in average wholesale prices by \$40/MWh. These lower prices were offset by increased sales, which were three times higher than the prior period, as a result of the Griffith Energy and Sundance facilities coming on-line in 2002.

The above explanation is exclusive of \$9 million related to the 2003 partial reversal of a reserve against Enron receivables, and a 2001 charge of \$12 million for the Enron bankruptcy, both of which affected gross margins. These items are discussed in further detail in Note 17 to the Financial Statements.

### Net Energy Trading

PPL enters into certain contractual arrangements that meet the criteria of energy trading derivatives as defined by EITF 02-3, "Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities." These physical and financial contracts cover trading activity associated with electricity, gas and oil. The \$7 million decrease in 2003 compared to 2002 was primarily due to realized electric swap losses in 2003. The \$18 million decrease in 2002 compared to 2001 was primarily due to unrealized, mark-to-market gains in 2001 and lower energy margins in 2002. The physical volumes associated with energy trading were 9,100 GWh and 12.6 Bcf in 2003; 10,700 GWh and 12.4 Bcf in 2002; and 7,700 GWh and 22.4 Bcf in 2001. The amount of energy trading margins from unrealized mark-to-market transactions was not significant in 2003, 2002 and 2001.

## Unregulated Retail

Unregulated retail margins declined in 2003 compared to 2002 primarily due to significantly lower electric retail prices in the Western U.S. Western U.S. retail contract prices decreased about 19% in 2003 compared to 2002. The decline in 2002 compared to 2001 was primarily due to lower revenues resulting from the expiration of contracts which were not renewed in the Eastern U.S. and due to significantly lower retail prices in the Western U.S., somewhat offset by an increase in the number of customers in the Western U.S.

## Regulated Retail

Regulated retail margins in the Eastern U.S. for 2003 decreased by 9% compared to 2002, due to higher supply costs resulting from higher purchased power prices. Purchased power prices were higher because of increased gas and oil prices and an abnormally cold winter. Regulated retail margins for 2002 were 17% higher than in 2001. Higher sales volumes and higher average prices, caused by changes in usage among customer classes, provided the improved margins. In addition, lower supply costs in 2002, due to lower fuel costs and increased generating unit availability, further improved margins.

## Utility Revenues

The increase (decrease) in utility revenues was attributable to the following:

	<u>2003 vs. 2002</u>	<u>2002 vs. 2001</u>
Domestic:		
Retail electric revenue (PPL Electric)		
Electric delivery	\$ 48	\$ (1)
PLR electric supply	22	102
Other		(11)
Wholesale electric revenue (PPL Electric)		(5)
Gas revenue (PPL Gas Utilities)	10	(15)
International:		
Retail electric delivery (PPL Global)		
U.K.	35	
El Salvador	13	4
Bolivia	1	2
Chile	18	4
Brazil	(113)	(17)
	<u>\$ 34</u>	<u>\$ 63</u>

The increase in utility revenues for 2003 compared with 2002 was attributable to:

- higher PPL Electric delivery revenues resulting from a 1.1% increase in delivery sales, in part due to colder winter weather in the first quarter of 2003;

- higher PPL Electric PLR supply revenues due to higher energy and capacity rates in 2003 compared with 2002;
- higher PPL Gas Utilities revenues primarily due to higher sales volumes of propane and natural gas;
- higher WPD revenues in the U.K. primarily due to the change in foreign currency exchange rates from period to period;
- higher revenues in El Salvador primarily due to higher volumes and higher pass-through energy costs, partially offset by a 6% tariff reduction effective January 1, 2003; and
- higher revenues in Chile primarily due to higher volumes and the consolidation of TransEmel (see Note 9 to the Financial Statements); partially offset by
- lower revenues in Brazil attributable to the deconsolidation of CEMAR in August 2002 (see Note 9).

The increase in utility revenues in 2002 compared with 2001 was primarily due to:

- higher PPL Electric PLR supply revenues, see "Regulated Retail" for additional information; partially offset by
- lower PPL Gas Utilities revenues primarily due to lower sales volumes (due in part to milder winter weather experienced in the first quarter of 2002) and a decrease in the fuel cost component of customer rates; and
- lower revenues in Brazil, as noted above.

## Energy Related Businesses

Energy related businesses contributed \$17 million less to operating income in 2003 compared with 2002. The decrease resulted primarily from:

- \$7 million of credits recorded on development projects in 2002, due largely to a favorable settlement on the cancellation of a generation project in Washington state;
- a \$5 million operating loss on some Hyder properties in the first quarter of 2003, which were subsequently sold in April 2003;
- an \$8 million decrease in Latin America revenues from lower material and construction project sales. (In 2002, a Bolivian subsidiary participated in the construction of a 1,500 kilometer transmission line in rural areas); and
- a \$3 million decrease in margins from telecommunications, due to the acquisition of a fiber optic network and start-up activities for new products; partially offset by
- a \$3 million improvement in contributions from mechanical contracting subsidiaries due to enhanced project controls that were implemented to minimize project overruns, offset by a continuing decline in construction markets in 2003.

Energy related businesses (when adjusted to include WPD on an equity basis) contributed \$12 million less to operating income in 2002 compared with 2001. This was primarily due to:

- a \$14 million benefit recorded in 2001 from an equity interest in Griffith Energy related to margins on forward

electricity contracts executed prior to commercial operation;

- a \$9 million decline from the mechanical contracting and engineering subsidiaries, primarily due to cost overruns experienced at two major projects;
- a \$6 million operating loss on start-up telecommunications operations; and
- \$4 million of pre-tax operating losses from synfuel projects; partially offset by
- a \$23 million decrease in PPL Global's expenses due to lower spending on development projects in 2002, including a favorable settlement on the cancellation of a generation project in Washington state.

Although operating income from synfuel operations declined in 2002 compared to 2001, the synfuel projects contributed \$7 million more to net income after recording tax credits.

### Other Operation and Maintenance

The increase (decrease) in other operation and maintenance expenses was primarily due to:

	2003 vs. 2002	2002 vs. 2001
Decrease in domestic and international pension income	\$ 53	\$ 17
Increased operating expenses in domestic business lines and other	44	2
Additional expenses of new operating facilities	28	27
Increase in WPD expenses due to regulatory accounting adjustments, and resolution of purchase accounting contingencies in the second quarter of 2002 related to the Hyder acquisition	18	
Increase in foreign currency exchange rates	10	
Accretion expense as a result of applying SFAS 143 (see Note 21)	18	
Increase in other postretirement benefit expense	15	6
Outage costs associated with the turbine replacement at the Susquehanna station	7	
Change to account for CEMAR on the cost method	(38)	(9)
Estimated reduction in salaries and benefits as a result of the workforce reduction initiated in 2002	(28)	(11)
Insurance settlements - property damage and environmental	(27)	
Decrease in PPL Global's administrative and general expenses		(10)
Gains on sales of emission allowances	(17)	(2)
Accretion liability adjustment in 2002 in conjunction with the workforce reduction	(15)	15
	<u>\$ 68</u>	<u>\$ 35</u>

The \$53 million decrease in net pension income was attributable to decreased asset values at the end of 2002 and reductions in the discount rate assumptions for PPL's domestic and international pension plans, which were the result of weakness in the financial markets during 2002. The 2002 year-end asset values and discount rates were used to measure net pension income for 2003. Through December 31, 2003, PPL recorded \$42 million of net pension income.

Although financial markets have improved and PPL's domestic and international pension plans have experienced significant asset gains in 2003, interest rates on fixed-income obligations have continued to fall, requiring a further reduction in the discount rate assumption as of December 31, 2003. The reduction in the discount rate assumption has a significant impact on the measurement of plan obligations and net pension cost, which will result in PPL's recognition of lower levels of net pension income in 2004. See Note 12 to the Financial Statements for details of the funded status of PPL's pension plans.

### Depreciation

Impacts on depreciation were as follows:

	2003 vs. 2002	2002 vs. 2001
Additions to PP&E	\$ 32	\$ 20
Foreign currency exchange rates	10	
Lower depreciation due to deconsolidation of CEMAR in 2002	(7)	(7)
Discontinuation of recording goodwill amortization in 2002 due to adoption of SFAS 142 (see Note 18)		(10)
Extension of Susquehanna station's depreciable life		(14)
No decommissioning expense in 2003 due to application of SFAS 143 (a)	(22)	
	<u>\$ 13</u>	<u>\$ (11)</u>

(a) There was a corresponding recording of accretion expense for PPL Susquehanna in 2003, which is part of "Other operation and maintenance" expense.

Depreciation expense increased in 2003 by \$13 million. An additional \$32 million of depreciation was recorded related to several projects, the largest of which were the Susquehanna Unit 2 turbine replacement and the Automated Meter Reading and Power Management System projects. The additional depreciation was partially offset by the removal of decommissioning expense from depreciation expense as required by SFAS 143, "Accounting for Asset Retirement Obligations." See Note 21 to the Financial Statements for additional information.

### Taxes, Other Than Income

Taxes, other than income, increased by \$25 million in 2003 compared with 2002 due to the settlement of prior years' capital stock tax refund claims of \$8 million in 2002, higher taxes related to an increase in the basis on which capital stock tax is calculated in 2003 and higher real estate taxes.

Taxes, other than income, increased by \$34 million in 2002 compared with 2001, primarily due to a \$42 million increase in gross receipts tax, partially offset by a \$12 million decrease in capital stock tax.

The gross receipts tax increase in 2002 was due to an increase in the revenue-neutral reconciliation (RNR) tax component of the effective Pennsylvania gross receipts tax rate in January 2002. The RNR, which adjusts the base gross receipts tax rate of 4.4%, was enacted as part of the Customer Choice Act as a tax revenue replacement component to recoup losses to the Commonwealth of Pennsylvania or return benefits to customers that may result from the restructuring of the electric industry. This increase was partially offset by the settlement of prior years' capital stock tax refund claims and a lower capital stock tax rate in 2002.

### Other Charges

Other charges of \$9 million in 2003 consisted of a charge for a workforce reduction program (see Note 20 to the Financial Statements).

Other charges of \$232 million in 2002 consisted of the write-down of PPL Global's investment in CEMAR and several smaller impairment charges on other international investments (see Note 9), the write-down of generation assets (see Note 9) and a charge for a workforce reduction program (see Note 20).

Other charges of \$486 million in 2001 consisted of the write-down of international energy projects and the cancellation of generation projects (see Note 9).

### Other Income - net

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

### Financing Costs

Interest expense decreased by \$86 million in 2003 compared with 2002 primarily due to the net effect of:

- a \$55 million decrease in long-term debt interest due to debt retirements in 2003;
- a \$34 million decrease in long-term debt interest from the deconsolidation of CEMAR in August 2002;
- a \$24 million charge that occurred in 2002 to cancel a remarketing agreement;
- a \$20 million decrease in short-term debt interest expense;
- a \$15 million decrease due to a 2002 charge to expense related to the ineffectiveness and subsequent dedesignation of hedges on anticipated debt issuances that did not occur; and
- a \$7 million decrease due to changes in interest rates caused by economic hedges that did not qualify for hedge accounting treatment under SFAS 133, "Accounting for Derivative Instruments and Hedging Activities;" offset by

- \$27 million of interest on Preferred Securities and preferred stock with sinking fund requirements due to reclassifications from applying SFAS 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity." See Note 22 to the Financial Statements for additional information;
- a \$14 million increase in long-term debt interest expense due to issuances of \$100 million Senior Secured Bonds and \$400 million Convertible Senior Notes;
- a \$14 million decrease in capitalized interest; and
- an \$11 million write-off of unamortized swap costs on WPD debt restructuring in 2003.

Interest expense increased by \$48 million in 2002 compared with 2001 primarily due to:

- a \$24 million charge to cancel the remarketing agreement of the 7.7% Reset Put Securities;
- a \$19 million net increase in long-term debt interest related to a full year of interest in 2002 from the issuances in 2001 of \$800 million of senior secured bonds by PPL Electric, \$500 million of senior unsecured notes by PPL Energy Supply and debt by PPL Global's consolidated subsidiaries, partially offset by bond retirements;
- a \$15 million charge due to ineffectiveness and subsequent dedesignation of hedges on anticipated debt issuances that did not occur in 2002;
- a \$3 million charge due to market fluctuations for economic hedges that did not qualify for hedge accounting treatment under SFAS 133; and
- a \$7 million decrease in capitalized interest; offset by
- a \$24 million decrease in short-term debt interest as a portion of the proceeds from the issuance of long-term debt was used to pay down commercial paper.

Distributions on preferred securities decreased by \$38 million in 2003 compared with 2002. This decrease was due to:

- \$27 million of distributions on Preferred Securities and preferred stock with sinking fund requirements are categorized as interest expense due to the implementation of SFAS 150 on July 1, 2003 (see Note 22); and
- the retirement of preferred securities in 2002.

Distributions on preferred securities increased by \$6 million in 2002 compared with 2001. This increase was due to:

- a \$15 million increase in distributions on the PEPS Units, issued in the second quarter of 2001; offset by
- a \$10 million decrease in dividends and distributions due to the retirements and redemptions in 2002 of preferred securities.

### Income Taxes

Income tax expense decreased by \$40 million in 2003 compared with 2002. This decrease was due to:

- a \$31 million reduction related to deferred income tax valuation allowances recorded on impairment charges on PPL's investment in Brazil recorded during 2002;
- an \$84 million reduction in income taxes related to the tax benefit recognized in 2003 on foreign investment losses included in the 2002 federal income tax return;
- a \$9 million decrease related to a contribution of property; and
- a \$2 million decrease related to additional federal synfuel tax credits recognized; offset by
- higher pre-tax domestic book income, resulting in an \$84 million increase in income taxes.

Income tax expense decreased by \$156 million in 2002 compared with 2001. This decrease was due to:

- lower pre-tax domestic book income, resulting in a \$75 million reduction in income taxes;
- lower impairment charges on PPL's investment in Brazil resulting in a \$30 million decrease in the amount of deferred income tax valuation allowances recorded;
- a \$27 million reduction in income taxes due to losses recognized on foreign investments; and
- a \$10 million decrease related to additional federal synfuel tax credits recognized.

### **Discontinued Operations**

PPL reported a loss of \$20 million in connection with the approval of a plan of sale of PPL Global's investment in a Latin American telecommunications company. See "Discontinued Operations" in Note 9 to the Financial Statements for additional information.

### **Cumulative Effects of Changes in Accounting Principles**

In 2003, PPL recorded a charge of \$27 million, after-tax, as a cumulative effect of a change in accounting principle in connection with the adoption of FIN 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51," for certain entities. See "New Accounting Standards" for further discussion.

PPL adopted SFAS 143, "Accounting for Asset Retirement Obligations," effective January 1, 2003. SFAS 143 addresses the accounting for obligations associated with the retirement of tangible long-lived assets. It requires legal obligations associated with the retirement of long-lived assets to be recognized as a liability in the financial statements. Application of the new rules resulted in a cumulative effect of adoption that increased net income by \$63 million in 2003. See Note 21 to the Financial Statements for additional information.

PPL adopted SFAS 142, "Goodwill and Other Intangible Assets," on January 1, 2002. SFAS 142 requires an annual impairment test of goodwill and other intangible assets that are not subject to amortization. PPL conducted a transition impairment analysis in the first quarter of 2002 and recorded a

transition goodwill impairment charge of \$150 million. See Note 18 to the Financial Statements for additional information.

In 2001, PPL changed its method of amortizing unrecognized gains or losses in the annual pension expense or income determined under SFAS 87, "Employers' Accounting for Pensions." This change resulted in a cumulative-effect credit of \$10 million. See Note 12 to the Financial Statements for additional information.

## **Financial Condition**

### **Liquidity**

PPL is focused on maintaining a strong liquidity position and strengthening its balance sheet, thereby improving its credit profile. PPL believes that its cash on hand, operating cash flows, access to debt and equity capital markets and borrowing capacity, taken as a whole, provide sufficient resources to fund its ongoing operating requirements, future security maturities and estimated future capital expenditures. PPL currently expects cash on hand at the end of 2004 to be approximately \$400 million, with about \$1.5 billion in syndicated credit facilities. PPL also expects that cash from operations less payments for capital expenditures, dividends and transition bonds will be positive in 2004. However, PPL's cash flows from operations and its access to cost effective bank and capital markets are subject to risks and uncertainties, including but not limited to, the following:

- changes in market prices for electricity;
- changes in commodity prices that may increase the cost of producing power or decrease the amount PPL receives from selling power;
- price and credit risks associated with selling and marketing products in the wholesale power markets;
- ineffectiveness of trading, marketing and risk management policies and programs used to mitigate PPL's risk exposure to adverse energy and fuel prices, interest rates, foreign currency exchange rates and counterparty credit;
- unusual or extreme weather that may damage PPL's transmission and distribution facilities or effect energy sales to customers;
- reliance on transmission and distribution facilities that PPL does not own or control to deliver its electricity and natural gas;
- unavailability of generating units (due to unscheduled or longer-than-anticipated generation outages) and the resulting loss of revenues and additional costs of replacement electricity;
- ability to recover, and timeliness and adequacy of recovery of costs associated with regulated utility businesses; and
- a downgrade in PPL's or PPL's subsidiaries' credit ratings that could negatively affect their ability to access capital and increase the cost of maintaining credit facilities and any new debt.

At December 31, 2003, PPL had \$476 million in cash and cash equivalents and \$56 million of short-term debt as compared to

\$245 million in cash and cash equivalents and \$943 million of short-term debt at December 31, 2002, and \$933 million in cash and cash equivalents and \$118 million of short-term debt at December 31, 2001. The changes in cash and cash equivalents resulted from the following:

	<u>2003</u>	<u>2002</u>	<u>2001</u>
Net Cash Provided by Operating Activities	\$ 1,340	\$ 802	\$ 909
Net Cash Used in Investing Activities	(729)	(1,129)	(702)
Net Cash Provided by (Used in) Financing Activities	(387)	(363)	249
Effect of Exchange Rates on Cash & Cash Equivalents	<u>7</u>	<u>2</u>	<u>(3)</u>
Increase (Decrease) in Cash & Cash Equivalents	<u>\$ 231</u>	<u>\$ (688)</u>	<u>\$ 453</u>

### Net Cash Provided by Operating Activities

Net cash provided by operating activities increased by 67%, or \$538 million in 2003 versus 2002, reflecting higher net income adjusted for non-cash items, working capital improvements and lower cash income taxes. In addition, 2002 included cash outlays of \$152 million for the cancellation of generation projects and \$50 million for the termination of a NUG contract. The higher net income in 2003 was principally driven by complete ownership of WPD, higher wholesale energy margins, lower interest expense and savings from a workforce reduction program in the U.S. that commenced in 2002. The working capital improvements resulted from a decrease in accounts receivable and prepayments. These positive changes were partially offset by rising transmission and distribution operating costs at PPL Electric and other factors.

Important elements supporting the stability of PPL's cash provided by operating activities are the long-term and intermediate-term commitments from wholesale and retail customers and long-term fuel supply contracts PPL has in place. In 2003, PPL EnergyPlus entered into several new wholesale agreements to provide capacity and/or electricity to utilities in New Jersey, Arizona and Connecticut. These agreements supplement previously existing long-term contracts with PPL Electric, NorthWestern and the Long Island Power Authority (see Note 14 to the Financial Statements for additional information). PPL estimates that, on average, approximately 80% of its expected annual generation output for the period 2004 through 2008 is committed under long-term and intermediate-term energy supply contracts. PPL EnergyPlus also enters into contracts under which it agrees to sell and purchase electricity, natural gas, oil and coal. These contracts often require cash collateral or other credit enhancement, or reductions or terminations of a portion or the entire contract through cash settlement in the event of a downgrade of PPL or the respective subsidiary's credit ratings or adverse changes in market prices. For example, in addition to limiting its trading ability, if PPL or its respective subsidiary's ratings were lowered to below "investment grade" and energy prices increased by 10%, PPL estimates that, based on its December 31, 2003 position, it would have to post collateral of approximately \$190

million as compared to \$121 million at December 31, 2002. PPL has in place risk management programs that, among other things, are designed to monitor and manage its exposure to volatility of cash flows related to changes in energy prices, interest rates, foreign currency exchange rates, counterparty credit quality and the operational performance of its generation units.

Net cash provided by operating activities decreased by \$107 million in 2002 versus 2001. This decrease was primarily due to \$152 million of turbine cancellation payments made in 2002, a \$50 million payment to terminate a NUG contract also made in 2002 and an \$89 million decrease in dividends received from unconsolidated affiliates, partially offset by increases in net income adjusted for non-cash items.

### Net Cash Used in Investing Activities

Net cash used in investing activities decreased by 35%, or \$400 million, in 2003 versus 2002, primarily as a result of reduced investment in generation assets and electric energy projects and the acquisition of the controlling interest in WPD in September 2002. The primary use of cash for investing activities is capital and investment expenditures, which are summarized by category in the table in "Capital Expenditure Requirements." In 2004, PPL expects to be able to fund all of its capital expenditures with cash from operations.

Net cash used in investing activities in 2002 was \$1.1 billion, compared to \$702 million in 2001. The primary reasons for the \$427 million increase in cash used in investing activities were the acquisition of the controlling interest in WPD for \$211 million, net of cash acquired, and a repayment of the loan from a non-consolidated affiliate in 2001.

### Net Cash Provided by (Used in) Financing Activities

Net cash used in financing activities was \$387 million in 2003, compared to \$363 million in 2002, and primarily reflected the repayment of short-term debt, retirement of long-term debt and increased dividends to shareholders. In 2003, the \$387 million primarily consisted of net debt retirements of \$460 million, common stock sale proceeds of approximately \$426 million, preferred stock retirements of \$31 million and common and preferred dividends paid of \$287 million. In 2002, the \$363 million primarily consisted of net debt retirements of \$412 million, company-obligated mandatorily redeemable preferred securities retirements of \$250 million, common stock sale proceeds of \$587 million and common and preferred stock dividends paid of \$261 million. PPL currently has no plans to issue any additional common stock other than the shares associated with the May 2004 common stock conversion related to the \$575 million aggregate stated amount of PEPS Units and PEPS Units, Series B. See Note 8 to the Financial Statements for additional information on common stock sales in 2003.

PPL's debt financing activity in 2003 was as follows:

	Additions	Payments	Net
PPL Electric First Mortgage Bonds (FMB)	\$ 100	\$ (85)	\$ 15
PPL Electric FMB Pollution Control Bonds	90	(90)	
PPL Electric Commercial Paper (net change)		(15)	(15)
PPL Transition Bond Company		(255)	(255)
North Penn Gas, Inc. Notes		(1)	(1)
PPL Capital Funding Medium-Term Notes		(85)	(85)
PPL Energy Supply Convertible Notes	400		400
PPL Energy Supply Commercial Paper (net change)		(374)	(374)
WPD (South West) (USD equivalent)	402	(409)	(7)
WPDH Limited (USD equivalent)		(53)	(53)
Latin America Companies (USD equivalent)		(4)	(4)
Payments on amounts advanced from trustee in synthetic lease agreement and other		(81)	(81)
<b>Total</b>	<b>\$ 992</b>	<b>\$ (1,452)</b>	<b>\$ (460)</b>

Debt issued during 2003 had stated interest rates ranging from 2.62% to 5.87% and maturities from 2008 through 2027. See Note 8 to the Financial Statements for more detailed information regarding PPL's borrowings.

In July 2003, PPL Energy Supply and PPL Electric each determined that, based on their current cash positions and anticipated cash flows, they would not need to access the commercial paper markets through at least the end of 2003. As a result, PPL Energy Supply and PPL Electric each requested Standard & Poor's Ratings Services (S&P), Moody's Investors Service, Inc. (Moody's) and Fitch Ratings (Fitch) to withdraw their ratings for these currently inactive commercial paper programs, which the rating agencies did effective as of July 9, 2003. This decision has not limited the ability of either PPL Energy Supply or PPL Electric to fund its short-term liquidity needs. Neither company currently has any commercial paper outstanding. PPL Electric expects to renew its commercial paper program in early 2004. PPL Energy Supply currently does not anticipate a need to access the commercial paper market in 2004.

At December 31, 2003, PPL's total committed borrowing capacity and the use of this borrowing capacity were as follows:

	Committed Capacity	Borrowed	Letters of Credit Issued (d)	Available Capacity (d)
PPL Electric Credit Facilities (a)	\$ 300		\$ 42	\$ 258
PPL Energy Supply Credit Facilities (b)	1,100		87	1,013
WPD (South West) Bank Facilities (c)	435	\$ 48		387
<b>Total</b>	<b>\$ 1,835</b>	<b>\$ 48</b>	<b>\$ 129</b>	<b>\$ 1,658</b>

(a) PPL Electric's credit facilities allow for borrowings at LIBOR-based rates plus a spread, depending upon the company's public debt rating. PPL Electric also has the capability to issue up to \$250 million of letters of credit under these facilities, which issuance reduces available borrowing capacity.

These credit facilities contain a financial covenant requiring debt to total capitalization not greater than 70%. At December 31, 2003 and 2002, PPL Electric's consolidated debt to total capitalization percentages, as calculated in accordance with its credit facilities, were 57% and 58%. PPL Electric's 364-day credit facility also allows it to borrow up to the full amount of the credit facility on the day of expiration for up to a one-year period. The credit agreements also contain certain representations and warranties that must be made for PPL Electric to borrow under them, including, but not limited to, a material adverse change clause that relates to PPL Electric's ability to perform its obligations under the credit agreements and related loan documents.

(b) PPL Energy Supply's credit facilities allow for borrowings at LIBOR-based rates plus a spread, depending upon the company's public debt rating. PPL Energy Supply also has the capability to issue up to \$800 million of letters of credit under these facilities, which issuance reduces available borrowing capacity.

These credit facilities contain financial covenants requiring debt to total capitalization not greater than 65% and an interest coverage ratio of not less than 2.0 times consolidated earnings before income taxes, depreciation and amortization. At December 31, 2003 and 2002, PPL Energy Supply's consolidated debt to total capitalization percentages, as calculated in accordance with its credit facilities, were 36% and 35%. At December 31, 2003 and 2002, PPL Energy Supply's interest coverage ratios, as calculated in accordance with its credit facilities, were 6.3 and 7.4. The credit agreements also contain certain representations and warranties that must be made for PPL Energy Supply to borrow under them, including, but not limited to a material adverse change clause that relates solely to PPL Energy Supply's ability to perform its obligations under the credit agreements and related loan documents.

(c) WPD (South West)'s credit facilities allow for borrowings at LIBOR-based rates plus a spread, depending upon the company's public debt rating.

These credit facilities contain financial covenants that require it to maintain an interest coverage ratio of not less than 3.0 times consolidated earnings before income taxes, depreciation and amortization, and the regulatory asset base must be £150 million greater than total gross debt, in each case as calculated in accordance with the credit facilities. At December 31, 2003 and 2002, WPD (South West)'s interest coverage ratio, as calculated in accordance with its credit lines, was 6.7 and 10.3. At December 31, 2003 and 2002, WPD (South West)'s regulatory asset base exceeded its total gross debt by £457 million and £491 million.

(d) The Borrower under each of these facilities has a reimbursement obligation to the extent any letters of credit are drawn upon. The letters of credit issued as of December 31, 2003 expire in 2004.

These credit agreements contain various other covenants. Failure to meet those covenants beyond applicable grace periods could result in acceleration of due dates of borrowings and/or termination of the agreements. PPL monitors the covenants on a regular basis. At December 31, 2003, PPL was in compliance with those covenants. At this time PPL believes that these covenants and other borrowing conditions will not limit access to these funding sources. PPL Electric intends to reduce its total syndicated credit facilities to \$200 million in the first quarter of 2004. In early 2004, PPL Electric also intends to participate in an Asset-Backed Commercial Paper (ABCP) Program for up to

\$150 million that would be secured by a portion of its accounts receivable. The ABCP Program would provide a more reliable and stable source of liquidity than an unsecured commercial paper program. PPL Energy Supply intends to reduce its syndicated credit facilities to \$800 million in the first quarter of 2004 because of lower development and acquisition requirements related to its supply business. WPD (South West) intends to renew and extend all of its syndicated credit facilities in 2004.

Net cash used in financing activities was \$363 million in 2002, compared to net cash provided by financing activities of \$249 million in 2001. In 2001, PPL had net issuances of \$544 million of debt, preferred securities and equity, compared to net retirements of \$75 million in 2002.

### Operating Leases

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

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

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

### Contractual Obligations

At December 31, 2003, the estimated contractual cash obligations of PPL were as follows:

<u>Contractual Cash Obligations</u>	<u>Total</u>	<u>Less Than 1 Year</u>	<u>1-3 Years</u>	<u>3-5 Years</u>	<u>After 5 Years</u>
Long-term Debt (a)	\$ 8,525	\$ 395	\$ 2,365	\$ 2,350	\$ 3,415
Capital Lease Obligations	20	1	2	2	15
Operating Leases (b)	827	79	131	112	515
Purchase Obligations (c)	3,251	628	1,189	588	946
Other Long-term Liabilities Reflected on the Balance Sheet under GAAP					
<b>Total Contractual Cash Obligations</b>	<b>\$ 12,623</b>	<b>\$ 1,103</b>	<b>\$ 3,687</b>	<b>\$ 3,052</b>	<b>\$ 4,781</b>

- (a) Reflects principal maturities only, including maturities of consolidated lease debt.  
 (b) Excludes amounts for the leases of the Sundance, University Park and Lov Mt. Bethel generation facilities as the lessors were consolidated effective December 31, 2003 as a result of the adoption of FIN 46 for certain entities. See "New Accounting Standards" for further discussion.  
 (c) The payments reflected herein are subject to change as certain purchase obligations included are estimates based on projected obligated quantities and/or projected pricing under the contracts.

### Credit Ratings

The following table summarizes the credit ratings of PPL and its key financing subsidiaries at December 31, 2003:

	<u>Moody's</u>	<u>Standard &amp; Poor's</u>	<u>Fitch</u>
<b>PPL</b>			
Issuer Rating		BBB	BBB
Subordinated Debt	Baa3	BBB-	BBB-
Senior Unsecured Debt		BBB	BBB
Short-term Debt			
Outlook	STABLE	NEGATIVE	NEGATIVE
<b>PPL Energy Supply</b>			
Issuer Rating		BBB	BBB+
Senior Unsecured Notes	Baa2	BBB	BBB+
Outlook	STABLE	NEGATIVE	NEGATIVE
<b>PPL Capital Funding</b>			
Senior Unsecured Debt	Baa3	BBB-	BBB
Subordinated Debt	Ba1	BBB-	BBB
Medium -Term Notes	Baa3	BBB-	BBB
Outlook	STABLE	NEGATIVE	NEGATIVE
<b>PPL Capital Funding Trust I</b>			
PEPS Units*	Ba1	BB+	BBB-
<b>PPL Electric</b>			
Senior Unsecured/Issuer Rating	Baa1	A-	A-
First Mortgage Bonds	Baa1	A-	A-
Pollution Control Bonds**	Aaa	AAA	
Senior Secured Bonds	Baa1	A-	A-
Preferred Stock	Ba1	BBB	BBB+
Outlook	STABLE	NEGATIVE	STABLE
<b>PPL Transition Bond Company</b>			
Transition Bonds	Aaa	AAA	AAA
<b>PPL Montana</b>			
Pass -Through Certificates	Baa3	BBB-	BBB
Outlook	Poss. Downgrade	NEGATIVE	
<b>WPDH Limited</b>			
Issuer Rating	Baa2	BBB-	BBB-
Senior Unsecured Debt	Baa2	BBB-	BBB-
Outlook	STABLE	NEGATIVE	STABLE

	Moody's	Standard & Poor's	Fitch
<b>WPD LLP</b>			
Issuer Rating		BBB-	
Senior Unsecured Debt	Baa2	BBB-	BBB
Capital Trust Securities*	Baa3	BB	
Outlook	STABLE	NEGATIVE	STABLE
<b>WPD (South Wales)</b>			
Issuer Rating		BBB+	
Senior Unsecured Debt	Baa1	BBB+	A-
Commercial Paper		A-2	F2
Outlook	STABLE	NEGATIVE	STABLE
<b>WPD (South West)</b>			
Issuer Rating	Baa1	BBB+	
Senior Unsecured Debt		BBB+	A-
Commercial Paper	P-2	A-2	F2
Outlook	STABLE	NEGATIVE	STABLE

\* These trust preferred securities were deconsolidated effective December 31, 2003 from the Balance Sheet. See Note 22 to the Financial Statements for additional information.

\*\* Insured as to payment of principal and interest.

### Rating Agency Actions in 2003

In 2003, S&P, Moody's and Fitch reviewed the credit ratings on the debt and preferred securities of PPL and its subsidiaries. Based on their respective reviews, the rating agencies made certain ratings revisions that are described below. Management does not expect these ratings decisions to impact PPL and its subsidiaries' ability to raise new debt or equity capital or to have a significant impact on the cost of any new capital or the cost of maintaining their credit facilities.

The ratings of S&P, Moody's and Fitch are not a recommendation to buy, sell or hold any securities of PPL or its subsidiaries. Such ratings may be subject to revisions or withdrawal by the agencies at any time and should be evaluated independently of each other and any other rating that may be assigned to their securities.

#### *PPL and Domestic Subsidiaries*

#### S&P

In April 2003, S&P notified PPL, PPL Energy Supply and PPL Electric that it:

- affirmed both the 'A-' ratings on PPL Electric's first mortgage bonds and senior secured bonds and the 'BBB' corporate credit ratings for PPL and PPL Energy Supply;
- lowered the rating on PPL Capital Funding's senior unsecured debt to 'BBB-' from 'BBB';
- placed PPL Electric on negative outlook. S&P indicated that PPL and PPL Energy Supply remain on negative outlook; and
- affirmed the 'A-2' commercial paper ratings of PPL Energy Supply and PPL Electric.

S&P indicated that the rating revision on PPL Capital Funding's senior unsecured debt is based on the addition of debt at PPL Energy Supply, which it noted is expected to increase further in the future. PPL Energy Supply provides significant cash flows

to PPL Capital Funding to support PPL Capital Funding's cash requirements. S&P also indicated that the negative outlook for PPL and its subsidiaries reflects its view of weak credit metrics due to low wholesale energy prices.

In December 2003, S&P downgraded PPL Montana's 8.903% Pass Through Certificates due 2020 to BBB- from BBB. S&P indicated that its outlook for these securities remains negative.

S&P indicated that its downgrade reflects certain risks that it believes PPL Montana faces, including counterparty credit risk resulting from the Chapter 11 bankruptcy filing of NorthWestern, which is PPL Montana's largest customer. S&P noted, however, that the bankruptcy court has approved NorthWestern's request to affirm the power sales agreements with PPL Montana and that NorthWestern has strong incentives to maintain this status. See Note 14 for more detailed information regarding NorthWestern's bankruptcy filing.

#### Moody's

In May 2003, Moody's downgraded the credit ratings on the debt and preferred securities of PPL, PPL Electric and PPL Energy Supply. The ratings downgraded include:

- PPL Electric's first mortgage bonds and senior secured bonds, to 'Baa1' from 'A3';
- PPL Energy Supply's senior unsecured notes, to 'Baa2' from 'Baa1';
- PPL Capital Funding's senior unsecured debt, to 'Baa3' from 'Baa2'; and
- PPL's senior unsecured debt that is not currently outstanding but that may be issued under PPL's shelf registration statement on file with the SEC, to 'Baa3' from 'Baa2'.

The Moody's ratings outlook is stable for each of PPL, PPL Electric, PPL Energy Supply and PPL Capital Funding. Neither PPL Electric's nor PPL Energy Supply's short-term debt ratings was impacted by Moody's long-term debt review.

Moody's stated that the downgrades reflect its concerns about PPL's high debt levels, PPL Energy Supply's modest exposure to merchant generation risk, the continued weakness in the wholesale power market and the associated financial impact on PPL Energy Supply, and concerns regarding the amount of cash flow to be generated from PPL Energy Supply's non-regulated domestic operations and the free cash flow available from its regulated international assets. However, Moody's also indicated that the full requirements contract between PPL Electric and PPL EnergyPlus, which previously was approved by the PUC and which extends through December 2009, mitigates PPL Electric's supply and price risk and provides a predictable stream of cash flows to PPL Energy Supply during such time period. Moody's also noted that PPL's management had implemented a number of initiatives to strengthen its current credit quality and reduce its debt levels, such as the issuance of over \$1 billion of common stock and mandatorily convertible securities over the last few years, a sizeable reduction in planned

capital expenditures, the cancellation of projects under development, workforce reductions and write-downs of certain investments.

In September 2003, Moody's announced that it was placing PPL Montana's 8.903% Pass-Through Certificates due 2020 under review for possible downgrade. These securities currently are rated 'Baa3' by Moody's. Moody's stated that its review is prompted by its concerns about the credit profile of PPL Montana's largest customer, NorthWestern, and lower cash flow generation than was forecasted at the time the securities were issued in 2000. See Note 14 to the Financial Statements for additional information on NorthWestern's current situation. Management does not expect any action by Moody's based on this review to limit PPL Montana's ability to fund its short-term liquidity needs. PPL Montana has no plans to raise new long-term debt. Any ratings downgrade by Moody's would have an insignificant impact on PPL Montana's cost of maintaining the credit facility that it has in place with its affiliate. In addition, management does not expect any ratings downgrade by Moody's based on this review to have any adverse impact on the credit ratings of PPL or PPL Energy Supply.

#### Fitch

In May 2003, Fitch notified PPL, PPL Energy Supply and PPL Capital Funding that it:

- downgraded PPL Capital Funding's senior unsecured debt to 'BBB' from 'BBB+';
- downgraded PPL's senior unsecured debt that is not currently outstanding but that may be issued under PPL's shelf registration statement on file with the SEC, to 'BBB' from 'BBB+';
- affirmed both the 'BBB+' rating of PPL Energy Supply's senior unsecured debt, and the 'F2' rating of its commercial paper; and
- placed each of PPL, PPL Capital Funding and PPL Energy Supply on negative outlook.

Fitch indicated that the revised ratings for PPL and PPL Capital Funding reflect the structural subordination of the obligations of PPL to those of its subsidiaries and Fitch's expectations of lower cash flow from PPL Electric until early 2005. Fitch indicated that the change in outlook for these companies results from the increase during 2002 in PPL's generation asset portfolio that is dependent on merchant generation, continued weakness in U.S. merchant energy markets and exposure to international distribution assets primarily in Latin America and the U.K. However, Fitch noted that PPL Energy Supply derives significant earnings and cash flow from long-term supply contracts, including the full requirements contract between PPL Electric and PPL EnergyPlus, that on average account for about 70% of PPL Energy Supply's gross margin over the next five years.

#### *WPD and Subsidiaries*

In February 2003, Moody's confirmed the ratings of WPDH Limited at 'Baa2' and WPD (South West) and WPD (South Wales) at 'Baa1', and downgraded WPD LLP from 'Baa1' to 'Baa2' and SIUK Capital Trust I from 'Baa2' to 'Baa3'. The outlook on all ratings was stable. In March 2003, S&P assigned its 'BBB+' senior unsecured debt rating to the £200 million bonds issued by WPD (South West). At the same time, the 'BBB+' and 'A-2' corporate credit ratings on SIUK Limited were withdrawn as a result of the acquisition of its debt by WPD LLP. S&P assigned its 'BBB' long-term and 'A-2' short-term corporate credit ratings to WPD LLP, in line with the ratings on the rest of the WPD group.

Following a review of holding companies of U.K. regulated utilities, in July 2003 S&P downgraded the long-term ratings from 'BBB' to 'BBB-' and short-term ratings from 'A-2' to 'A-3' for both WPDH Limited and WPD LLP, and retained a negative outlook. At the same time, S&P reaffirmed the credit ratings for WPD (South West) and WPD (South Wales) at 'BBB+'. S&P stated that this is in line with S&P U.K.'s recently announced implementation of a new methodology related to U.K. electric distribution holding companies, whereby electric distribution operating companies rated in the 'BBB' category will have the parent holding company (WPDH Limited) notched down by two categories from the operating company rating level. WPD's management does not expect the placement of WPD on negative outlook to limit its ability to fund its short-term liquidity needs or access to new long-term debt or to impact materially the availability of any new long-term debt.

#### Subsequent Events

In February 2004, PPL successfully remarketed an aggregate liquidation amount of \$257 million of the PPL Capital Funding Trust I trust preferred securities that were a component of the PEPS Units. The trust preferred securities were remarketed at a price of 107.284% of their aggregate stated liquidation amount, resulting in a yield to maturity of 3.912% based on the reset distribution rate of 7.29% per annum. Under the terms of the PEPS Units, holders were entitled to surrender their trust preferred securities for remarketing in order to settle the purchase contract component of the PEPS Units. Holders of an aggregate liquidation amount of \$218 million of the trust preferred securities elected not to participate in the remarketing. Those holders will retain their trust preferred securities at a distribution rate of 7.29% per annum. Both the trust preferred securities that were remarketed and those that were not remarketed will mature in May 2006.

Additionally in February 2004, PPL Capital Funding issued \$201 million of senior unsecured notes guaranteed by PPL. The senior notes bear interest at a rate of 4.33% per year that is payable semiannually on March 1 and September 1 of each year, from September 1, 2004 through the maturity date of March 1, 2009. The senior notes are not redeemable by PPL or PPL Capital Funding, and the holders will not be entitled to require PPL or PPL Capital Funding to repurchase the senior notes

before maturity. The senior notes were sold in an SEC Rule 144A private offering to qualified institutional buyers in exchange for \$185 million aggregate liquidation amount of the trust preferred securities of PPL Capital Funding Trust I, which were surrendered for cancellation, and for a payment of \$400,000 in cash. Except for the receipt of \$400,000 in cash, neither PPL nor PPL Capital Funding received any cash proceeds from the sale of the senior notes. Pursuant to a registration rights agreement with the initial purchasers, PPL and PPL Capital Funding intend to consummate an exchange offer for the notes to register them with the SEC for resale.

Also in February 2004, notice was provided to the holders of the trust preferred securities that PPL has elected to liquidate PPL Capital Funding Trust I and cause the distribution of the underlying PPL Capital Funding 7.29% subordinated notes due 2006 to the holders of the trust preferred securities. The liquidation date is expected to occur on or about March 23, 2004. From and after the liquidation date, the trust preferred securities will no longer be deemed to be outstanding and the underlying PPL Capital Funding 7.29% subordinated notes will be held by the former holders of the trust preferred securities.

Finally, in February 2004, PPL announced an increase to its quarterly common stock dividend, payable April 1, 2004, to 41 cents per share (equivalent to \$1.64 per annum). Future dividends, declared at the discretion of the Board of Directors, will be dependent upon future earnings, cash flows, financial requirements and other factors.

## Off-Balance Sheet Arrangements

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

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

## Risk Management - Energy Marketing & Trading and Other

### Market Risk

#### *Background*

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

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

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

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

#### *Contract Valuation*

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

To record derivatives at their fair value, PPL discounts the forward values using LIBOR. Additionally, PPL reduces derivative assets' carrying values to recognize differences in counterparty credit quality and potential illiquidity in the market:

- The credit adjustment takes into account the probability of default, as calculated by an independent service, for each counterparty that has an out-of-the money position with PPL.
- The liquidity adjustment takes into account the fact that it may not be appropriate to value contracts at the midpoint of the bid/ask spread. PPL might have to accept the "bid" price if PPL wanted to close an open sales position or PPL might have to accept the "ask" price if PPL wanted to close an open purchase position.

### *Accounting and Reporting*

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

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

PPL adopted the final provisions of EITF 02-3 during the fourth quarter of 2002. As such, PPL now reflects its net realized and unrealized gains and losses associated with all derivatives that are held for trading purposes in the "Net energy trading margins" line on the Statement of Income. Non-derivative contracts that met the definition of energy trading activities defined by EITF 98-10, "Accounting for Energy Trading and Risk Management Activities" are reflected in the financial statements using the accrual method of accounting. Under the accrual method of accounting, unrealized gains and losses are not reflected in the financial statements. Prior periods were reclassified. No cumulative effect adjustment was required upon adoption.

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

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

### *Accounting Designation*

Energy contracts that do not qualify as derivatives receive accrual accounting. For energy contracts that meet the definition of a derivative, the circumstances and intent existing at the time that energy transactions are entered into determine their accounting designation. These designations are verified by PPL's risk control group on a daily basis. The following is a summary of the guidelines that have been provided to the traders who are responsible for contract designation for derivative energy contracts due to the adoption of SFAS 149:

- Any wholesale and retail contracts to sell or buy electricity and the related capacity that are expected to be delivered from PPL's generation or that are approved by the RMC to fulfill a strategic element of PPL's overall marketing strategy are considered "normal." These transactions are not recorded in the financial statements and have no earnings impact until delivery.
- Physical electricity-only transactions can receive cash flow hedge treatment if all of the qualifications under SFAS 133 are met. Any unrealized gains or losses on transactions receiving cash flow hedge treatment are recorded in other comprehensive income. These unrealized gains and losses become realized when the contracts settle and are recognized in income when the hedged transactions occur.
- Physical electricity purchases that increase PPL's long position and any energy sale or purchase judged a "market

call" are considered speculative, with unrealized gains or losses recorded immediately through earnings.

Financial transactions, which can be settled in cash, cannot be considered "normal" because they do not require physical delivery. These transactions receive cash flow hedge treatment if they lock-in the price PPL will receive or pay for energy expected to be generated or purchased in the spot market. Any unrealized gains or losses on transactions that receive cash flow hedge treatment are recorded in other comprehensive income. These unrealized gains and losses become realized when the contracts settle and are recognized in income when the hedged transactions occur.

- Physical and financial transactions for gas and oil to meet fuel and retail requirements can receive cash flow hedge treatment if they lock-in the price PPL will pay in the spot market. Any unrealized gains or losses on transactions receiving cash flow hedge treatment are recorded in other comprehensive income. These unrealized gains and losses become realized when the contracts settle and are recognized in income when the hedged transactions occur.
- Option contracts that do not meet the requirements of DIG Issue C15, "Scope Exceptions: Interpreting the Normal Purchases and Normal Sales Exception as an Election," do not receive hedge accounting treatment and are marked to market through earnings.

In addition to energy-related transactions, PPL enters into financial interest rate and foreign currency swap contracts to hedge interest expense associated with both existing and anticipated debt issuances. PPL also enters into foreign currency swap contracts to hedge the fair value of firm commitments denominated in foreign currency and net investments in foreign operations. As with energy transactions, the circumstances and intent existing at the time of the transaction determine a contract's accounting designation, which is subsequently verified by PPL's risk control group on a daily basis. The following is a summary of certain guidelines that have been provided to the Treasury Department, which is responsible for contract designation:

- Transactions to lock-in an interest rate prior to a debt issuance are considered cash flow hedges. Any unrealized gains or losses on transactions receiving cash flow hedge treatment are recorded in other comprehensive income and are amortized as a component of interest expense over the life of the debt.
- Transactions entered into to hedge fluctuations in the value of existing debt are considered fair value hedges with no earnings impact until the debt is terminated because the hedged debt is also marked to market.

Transactions entered into to hedge the value of a net investment of foreign operations are considered net investment hedges. To the extent that the derivatives are highly effective at hedging the value of the net investment,

gains and losses are recorded in other comprehensive income/loss and will not be recorded in earnings until the investment is disposed of.

- Transactions which do not qualify for hedge accounting treatment are marked to market through earnings.

#### *Commodity Price Risk*

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

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

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

PPL's commodity derivative contracts that qualify for hedge accounting treatment mature at various times through 2010.

The following chart sets forth PPL's net fair market value of these contracts as of December 31, 2003:

	<u>Gains/(Losses)</u>
Fair value of contracts outstanding at the beginning of the year	\$ 63
Contracts realized or otherwise settled during the year	(67)
Fair value of new contracts at inception	
Other changes in fair values	<u>90</u>
Fair value of contracts outstanding at the end of the year	<u>\$ 86</u>

During 2003, PPL realized or otherwise settled net gains of approximately \$67 million related to contracts entered into prior to January 1, 2003. This amount does not reflect intra-quarter contracts that were entered into and settled during the period.

"Other changes in fair values," a gain of approximately \$90 million, represents changes in the market value that occurred during 2003 for contracts that were outstanding at the end of 2003.

The following chart segregates estimated fair values of PPL's commodity derivative contracts that qualify for hedge accounting treatment at December 31, 2003 based on whether the fair values are determined by quoted market prices or other more subjective means.

	<u>Fair Value of Contracts at Period-End</u>				
	<u>Gains/(Losses)</u>				
<u>Source of Fair Value</u>	<u>Maturity</u> <u>Less Than</u> <u>1 Year</u>	<u>Maturity</u> <u>1-3 Years</u>	<u>Maturity</u> <u>3-5 Years</u>	<u>Maturity</u> <u>in Excess</u> <u>of 5 Years</u>	<u>Total Fair</u> <u>Value</u>
Prices actively quoted	\$ 7	\$ 1			\$ 8
Prices provided by other external sources	47	32	\$ (1)		78
Prices based on models and other valuation methods					
Fair value of contracts outstanding at the end of the period	<u>\$ 54</u>	<u>\$ 33</u>	<u>\$ (1)</u>		<u>\$ 86</u>

The "Prices actively quoted" category includes the fair value of exchange-traded natural gas futures contracts quoted on the New York Mercantile Exchange (NYMEX). The NYMEX has currently quoted prices through 2010.

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

The "Prices based on models and other valuation methods" category includes the value of transactions for which an internally developed price curve was constructed as a result of

the long-dated nature of the transaction or the illiquidity of the market point, or the value of options not quoted by an exchange or OTC broker. Additionally, this category includes "strip" transactions whose prices are obtained from external sources and then modeled to monthly prices as appropriate.

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

As of December 31, 2003, PPL estimated that a 10% adverse movement in market prices across all geographic areas and time periods would have decreased the value of the commodity contracts in its non-trading portfolio by approximately \$14 million, which is equal to the estimated decrease at December 31, 2002. However, the change in the value of the non-trading portfolio would have been substantially offset by an increase in the value of the underlying commodity, the electricity generated, because these contracts serve to reduce the market risk inherent in the generation of electricity. Additionally, the value of PPL's unsold generation would be improved. Because PPL's electricity portfolio is generally in a net sales position, the adverse movement in prices is usually an increase in prices. Conversely, because PPL's commodity fuels portfolio is generally in a net purchase position, the adverse movement in prices is usually a decrease in prices. If both of these scenarios happened, the implied margins for the unsold generation would increase.

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

PPL's trading contracts mature at various times through 2005. The following chart sets forth PPL's net fair market value of trading contracts as of December 31, 2003.

	<u>Gains/(Losses)</u>
Fair value of contracts outstanding at the beginning of the year	\$ (6)
Contracts realized or otherwise settled during the year	21
Fair value of new contracts at inception	1
Other changes in fair values	<u>(13)</u>
Fair value of contracts outstanding at the end of the year	<u>\$ 3</u>

During 2003, PPL realized or otherwise settled net losses of approximately \$21 million related to contracts entered into prior to January 1, 2003. This amount does not reflect intra-year contracts that were entered into and settled during the period.

The fair value of new contracts at inception is usually zero, because they are entered into at current market prices. However, when PPL enters into an option contract, a premium is paid or received. PPL paid \$1 million, net, during 2003 for these option contracts.

"Other changes in fair values," a loss of approximately \$13 million, represent changes in the market value of contracts outstanding at the end of 2003.

As of December 31, 2003, the net loss on PPL's trading activities expected to be recognized in earnings during the next three months is approximately \$2 million.

The following chart segregates estimated fair values of PPL's trading portfolio at December 31, 2003 based on whether the fair values are determined by quoted market prices or other more subjective means.

Source of Fair Value	<u>Fair Value of Contracts at Period-End</u>				Total Fair Value
	<u>Gains/(Losses)</u>				
	<u>Maturity Less Than 1 Year</u>	<u>Maturity 1-3 Years</u>	<u>Maturity 3-5 Years</u>	<u>Maturity in Excess of 5 Years</u>	
Prices actively quoted					
Prices provided by other external sources					
Prices based on models and other valuation methods	\$ 3				\$ 3
Fair value of contracts outstanding at the end of the period	<u>\$ 3</u>				<u>\$ 3</u>

The "Prices actively quoted" category includes the fair value of exchange-traded natural gas futures contracts quoted on the NYMEX. The NYMEX has currently quoted prices through 2010.

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

forwards and swaps of natural gas and power extend one and two years into the future.

The "Prices based on models and other valuation methods" category includes the value of transactions for which an internally developed price curve was constructed as a result of the long-dated nature of the transaction or the illiquidity of the market point, or the value of options not quoted by an exchange or OTC broker. Additionally, this category includes "strip" transactions whose prices are obtained from external sources and then modeled to monthly prices as appropriate.

As of December 31, 2003, PPL estimated that a 10% adverse movement in market prices across all geographic areas and time periods would have decreased the value of the commodity contracts in its trading portfolio by \$3 million compared to a decrease of \$7 million at December 31, 2002.

In accordance with its marketing strategy, PPL does not completely hedge its generation output or fuel requirements. PPL estimates that for its entire portfolio, including all generation and physical and financial energy positions, a 10% adverse change in power prices across all geographic zones and time periods will decrease expected 2004 gross margins by about \$3 million. Similarly, a 10% adverse movement in all fossil fuel prices will decrease 2004 gross margins by \$15 million.

#### *Interest Rate Risk*

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

At December 31, 2003, PPL's potential annual exposure to increased interest expense, based on a 10% increase in interest rates, was estimated at \$2 million, compared to a \$3 million increase at December 31, 2002.

PPL is also exposed to changes in the fair value of its U.S. and international debt portfolios. At December 31, 2003, PPL estimated that its potential exposure to a change in the fair value of its debt portfolio, through a 10% adverse movement in interest rates, was \$168 million, compared to \$219 million at December 31, 2002.

PPL utilizes various risk management instruments to reduce its exposure to adverse interest rate movements for future anticipated financing. While PPL is exposed to changes in the fair value of these instruments, they are designed such that an economic loss in value should generally be offset by interest rate savings at the time the future anticipated financing is

completed. At December 31, 2003, PPL estimated that its potential exposure to a change in the fair value of these instruments, through a 10% adverse movement in interest rates, was approximately \$6 million, compared to an \$18 million exposure at December 31, 2002.

#### *Foreign Currency Risk*

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

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

PPL holds contracts for the forward purchase of 26 million euros to pay for certain equipment of PPL Susquehanna in 2004. The estimated value of these forward purchases as of December 31, 2003, being the amount PPL would receive to terminate them, was \$1 million.

PPL executed forward sale transactions for £25 million to hedge a portion of its net investment in WPDH Limited. The estimated value of these agreements as of December 31, 2003 was \$4 million, being the amount PPL would pay to terminate the transactions.

PPL executed forward sale transactions for 3.1 billion Chilean pesos to hedge a portion of its net investment in its subsidiary that owns CGE. The estimated value of these agreements as of December 31, 2003 was \$1 million, being the amount PPL would pay to terminate the transactions.

To protect expected income in Chilean pesos, PPL entered into average rate options for 2.4 billion Chilean pesos. At December 31, 2003, the market value of these positions, representing the amount PPL would pay to terminate them, was insignificant.

WPDH Limited executed cross-currency swaps totaling \$1.5 billion to hedge the interest payments and value of its U.S. dollar-denominated bonds. The estimated value of this position on December 31, 2003, being the amount PPL would pay to terminate them, including accrued interest, was \$84 million.

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

#### *Nuclear Decommissioning Fund - Securities Price Risk*

In connection with certain NRC requirements, PPL Susquehanna maintains trust funds to fund certain costs of

decommissioning the Susquehanna station. As of December 31, 2003, these funds were invested primarily in domestic equity securities and fixed-rate, fixed-income securities and are reflected at fair value on PPL's Balance Sheet. The mix of securities is designed to provide returns to be used to fund Susquehanna's decommissioning and to compensate for inflationary increases in decommissioning costs. However, the equity securities included in the trusts are exposed to price fluctuation in equity markets, and the values of fixed-rate, fixed income securities are exposed to changes in interest rates. PPL Susquehanna actively monitors the investment performance and periodically reviews asset allocation in accordance with its nuclear decommissioning trust policy statement. At December 31, 2003, a hypothetical 10% increase in interest rates and a 10% decrease in equity prices would have resulted in an estimated \$24 million reduction in the fair value of the trust assets, as compared to a \$16 million reduction at December 31, 2002.

PPL Electric's 1998 restructuring settlement agreement provides for the collection of authorized nuclear decommissioning costs through the CTC. Additionally, PPL Electric is permitted to seek recovery from customers of up to 96% of certain increases in these costs. Under the power supply agreements between PPL Electric and PPL EnergyPlus, these revenues are passed on to PPL EnergyPlus. Similarly, these revenues are passed on to PPL Susquehanna under a power supply agreement between PPL EnergyPlus and PPL Susquehanna. These revenues are used to fund the trusts.

#### Credit Risk

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

been paid, as well as a reserve related to PPL's exposure as a result of the Enron bankruptcy, which are reflected in "Accounts receivable" on the Balance Sheet. See Notes 14 and 17 to the Financial Statements.

### Related Party Transactions

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

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

### Capital Expenditure Requirements

The schedule below shows PPL's current capital expenditure projections for the years 2004-2008 and actual spending for the year 2003:

	Actual		Projected			
	2003	2004	2005	2006	2007	2008
Construction expenditures (a) (b)						
Generating facilities (c)	\$ 300	\$ 167	\$ 193	\$ 161	\$ 194	\$ 180
Transmission and distribution facilities	467	427	416	436	473	476
Environmental	21	5	12	32	74	102
Other	47	39	28	23	16	16
Total Construction Expenditures	835	638	649	652	757	774
Nuclear fuel	53	56	59	62	63	64
Total Capital Expenditures	<u>\$ 888</u>	<u>\$ 694</u>	<u>\$ 708</u>	<u>\$ 714</u>	<u>\$ 820</u>	<u>\$ 838</u>

- (a) Construction expenditures include AFUDC and capitalized interest, which are expected to be less than \$12 million in each of the years 2004-2008.
- (b) This information excludes any investments by PPL Global for new projects.
- (c) Expenditures for generating facilities in 2003 include \$116 million for facilities under synthetic lease agreements that had been reflected off-balance sheet prior to December 31, 2003. Projected capital expenditures on these facilities are also included for the years 2004 through 2008.

PPL's capital expenditure projections for the years 2004-2008 total about \$3.8 billion. Capital expenditure plans are revised periodically to reflect changes in market, and asset regulatory conditions. PPL also leases vehicles, personal computers and other equipment, as described in Note 10 to the Financial Statements. See Note 14 for additional information regarding potential capital expenditures for environmental projects.

### Acquisitions, Development and Divestitures

From time-to-time, PPL and its subsidiaries are involved in negotiations with third parties regarding acquisitions, joint ventures and other arrangements which may or may not result in definitive agreements. See Note 9 to the Financial Statements for information regarding recent acquisitions and development activities.

At December 31, 2003, PPL Global had investments in foreign facilities, including consolidated investments in WPD, Emel, EC and others. See Note 3 to the Financial Statements for information on unconsolidated investments accounted for under the equity method.

PPL Global is exploring potential sale opportunities for its interest in CGE, within the context of an on-going review of its international minority ownership investments.

At December 31, 2003, PPL had domestic generation projects under development which will provide 663 MW of additional generation.

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

### Environmental Matters

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

### Competition

See Item 1, "Business - Competition," for additional information.

### New Accounting Standards

#### FIN 46 and FIN 46(R)

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51." FIN 46 clarifies that variable interest entities, as defined therein, that do not disperse risks among the parties involved should be consolidated by the entity that is determined to be the primary beneficiary. FIN 46 also requires certain disclosures to be made by the primary beneficiary and by an enterprise that holds a significant variable interest in a variable interest entity but is not the primary beneficiary. FIN 46 applies immediately to variable interest entities created after January 31, 2003 and to variable interest entities in which an enterprise obtains an interest after January 31, 2003. For variable interest entities in which an enterprise holds a variable interest that was acquired before February 1, 2003, FIN 46 was originally required to be adopted no later than the first fiscal year or interim period beginning after June 15, 2003. However, in October 2003, the FASB issued FSP FIN 46-6, "Effective Date of FASB Interpretation No. 46, Consolidation of Variable Interest Entities," which delayed the effective date for applying the provisions of FIN 46 to interests held by public entities in variable interest entities or potential variable interest entities created before February 1, 2003 until the end of the first interim period ending after December 15, 2003.

In December 2003, the FASB revised FIN 46 by issuing Interpretation No. 46 (revised December 2003), which is known

as FIN 46(R) and replaces FIN 46. FIN 46(R) does not change the general consolidation concepts of FIN 46. Among other things, FIN 46(R) again changes the effective date for applying the provisions of FIN 46 to certain entities, clarifies certain provisions of FIN 46 and provides additional scope exceptions for certain types of businesses. For entities to which the provisions of FIN 46 have not been applied as of December 24, 2003, FIN 46(R) provides that a public entity that is not a small business issuer should apply the provisions of FIN 46 or FIN 46(R) as follows: (i) FIN 46(R) shall be applied to all entities no later than the end of the first reporting period that ends after March 15, 2004 and (ii) FIN 46 or FIN 46(R) should be applied to entities that are considered to be SPEs no later than the end of the first reporting period that ends after December 15, 2003.

As permitted by FIN 46(R), PPL adopted FIN 46 effective December 31, 2003 for entities created before February 1, 2003 that are considered to be SPEs. This adoption resulted in the consolidation of the lessors under the operating leases for the Sundance, University Park and Lower Mt. Bethel generation facilities, as well as the deconsolidation of two wholly-owned trusts. See below for further discussion. Also, as permitted by FIN 46(R), PPL deferred the application of FIN 46 for other entities and plans to adopt FIN 46(R) for all entities on March 31, 2004.

PPL is in the process of evaluating entities in which it holds a variable interest in accordance with FIN 46(R). PPL is currently not aware of any variable interest entities that are not consolidated as of December 31, 2003 but which it will be required to consolidate in accordance with FIN 46(R) effective March 31, 2004. As it continues to evaluate the impact of applying FIN 46(R), PPL may identify additional entities that it would need to consolidate.

#### Additional Entities Consolidated

The lessors under the operating leases for the Sundance, University Park and Lower Mt. Bethel generation facilities are variable interest entities that are considered to be SPEs. PPL is the primary beneficiary of these entities. Consequently, PPL was required to consolidate the financial statements of the lessors effective December 31, 2003. Upon initial consolidation, PPL recognized \$1.1 billion of additional assets and liabilities on its balance sheet and a charge of \$27 million, after-tax, as a cumulative effect of a change in accounting principle. The additional assets consist principally of the generation facilities, and the additional liabilities consist principally of the lease financing. See Note 22 to the Financial Statements for a discussion of the leases.

#### Entities Deconsolidated

Effective December 31, 2003, PPL deconsolidated PPL Capital Funding Trust I and SIUK Capital Trust I. These trusts are considered to be SPEs and were deconsolidated because PPL is not the primary beneficiary of the trusts under current interpretations of FIN 46. Therefore, the "Company-obligated Mandatorily Redeemable Preferred Securities of Subsidiary

Trusts Holding Solely Company Debentures" amounting to \$661 million, which would have been recorded as a component of long-term debt in 2003 in accordance with SFAS 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity," if the trusts consolidated, are not reflected in PPL's Balance Sheet at December 31, 2003. Instead, the subordinated debt securities that support the trust preferred securities are reflected in "Long-term Debt with Affiliate Trusts" as of December 31, 2003. See below for further discussion.

The trusts hold subordinated debt securities of PPL Capital Funding, in the case of PPL Capital Funding Trust I, and WPD LLP, in the case of SIUK Capital Trust I. As a result of deconsolidating the trusts, the subordinated debt securities are no longer eliminated in the consolidated financial statements. As of December 31, 2003, \$681 million is reflected as "Long-term Debt with Affiliate Trusts" in PPL's Balance Sheet.

The effect on the Balance Sheet as a result of deconsolidating the trusts was an increase in both total assets and total liabilities of \$21 million. The increase in assets relates to the investments in the common securities of the trusts, which are no longer eliminated in the consolidated financial statements. The increase in liabilities consists primarily of the difference between the carrying value of the preferred securities issued by the trusts compared to the carrying value of the subordinated debt securities of PPL Capital Funding and WPD LLP. The deconsolidation of the trusts did not impact the earnings of PPL.

See the Statement of Company-obligated Mandatorily Redeemable Securities contained in the Financial Statements for a discussion of the trusts and their preferred securities, as well as the subordinated debt securities issued to the trusts.

#### **Other**

See Note 22 to the Financial Statements for information on other new accounting standards adopted in 2003 or pending adoption.

#### **Application of Critical Accounting Policies**

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

## 1) Price Risk Management

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

## 2) Pension and Other Postretirement Benefits

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

- **Discount Rate** - The discount rate is used in calculating the present value of benefits, which is based on projections of benefit payments to be made in the future.
- **Expected Return on Plan Assets** - Management projects the future return on plan assets considering prior performance, but primarily based upon the plans' mix of assets and expectations for the long-term returns on those asset classes. These projected returns reduce the net benefit costs the company will record currently.
- **Rate of Compensation Increase** - Management projects employees' annual pay increases, which are used to project employees' pension benefits at retirement.
- **Health Care Cost Trend Rate** - Management projects the expected increases in the cost of health care.

In selecting discount rates, PPL considers fixed-income security yield rates. At December 31, 2003, PPL decreased the discount rate for its domestic plans from 6.75% to 6.25% as a result of decreased fixed-income security returns. For its international plans, PPL decreased the discount rate for its international plans from 5.75% to 5.50% at December 31, 2003.

In selecting an expected return on plan assets, PPL considers tax implications, past performance and economic forecasts for the types of investments held by the plan. At December 31, 2003, PPL's expected return on plan assets remained at 9.0% for its domestic pension plans and 7.8% for its other postretirement plans. For its international plans, PPL maintained a weighted average of 8.30% as the expected return on plan assets at December 31, 2003.

In selecting a rate of compensation increase, PPL considers past experience in light of movements in inflation rates. At December 31, 2003, PPL's rate of compensation increase remained at 4.0% for its domestic plans. For its international

plans, PPL's rate of compensation increase remained at 3.75% at December 31, 2003.

In selecting health care cost trend rates, PPL considers past performance and forecasts of health care costs. At December 31, 2003, PPL's health care cost trend rates were 11% for 2004, gradually declining to 5.0% for 2010.

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

Actuarial Assumption	Change in Assumption	Increase/(Decrease)			
		Impact on Obligation	Impact on Liabilities (a)	Impact on Cost	Impact on OCI
Discount Rate	(0.25)%	\$ 160	\$ 6	\$ 6	\$ 89
Expected Return on Plan Assets	(0.25)%	N/A	10	10	
Rate of Compensation Increase	0.25%	20	4	4	
Health Care Cost Trend Rate (b)	1.0%	33	5	5	N/A

(a) Excludes the impact of additional minimum liability.

(b) Only impacts other postretirement benefits.

At December 31, 2003, PPL had recognized accrued pension and other postretirement benefit liabilities totaling \$463 million, included in "Deferred Credits and Other Noncurrent Liabilities - Other" on the Balance Sheet. At December 31, 2003, PPL had recognized \$4 million of prepaid postretirement benefit costs included in "Prepayments" on the Balance Sheet. PPL's total projected obligation for these benefits was approximately \$4.8 billion, which was offset by \$4.0 billion of assets held in various trusts. However, these amounts are not fully reflected in the current financial statements due to the delayed recognition criteria of the accounting standards for these obligations.

In 2003, PPL recognized net periodic pension and other postretirement costs charged to operating expenses of \$1 million. This amount represents a \$62 million decrease from the credit recognized during 2002. This decrease was primarily due to the decrease in the discount rate at December 31, 2002.

As a result of the decrease in the assumed discount rate at December 31, 2003, PPL was required to increase its recognized

additional minimum pension liability. Recording the change in the additional minimum liability resulted in a \$10 million increase to the pension related charge to OCI, net of taxes, translation adjustment and unrecognized prior service costs, with no effect on net income. This charge increased the pension-related balance in OCI, which is a reduction to shareowners equity, to \$316 million at December 31, 2003. The charges to OCI will reverse in future periods if the fair value of trust assets exceeds the accumulated benefit obligation.

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

### 3) Asset Impairment

PPL and its subsidiaries review long-lived assets for impairment when events or circumstances indicate carrying amounts may not be recoverable. Assets subject to this review, for which impairments have been recorded in 2003 or prior years, include international equity investments, new generation assets, consolidated international energy projects and goodwill.

PPL performs impairment analyses for tangible long-lived assets in accordance with SFAS 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." For long-lived assets to be held and used, SFAS 144 requires companies to (a) recognize an impairment loss only if the carrying amount is not recoverable from undiscounted cash flows and (b) measure an impairment loss as the difference between the carrying amount and fair value of the asset.

In determining asset impairments, management must make significant judgments and estimates to calculate the fair value of an investment. Fair value is developed through consideration of several valuation methods including comparison to market multiples, comparison to similar recent sales transactions, comparison to replacement cost and discounted cash flow. Discounted cash flow is calculated by estimating future cash flow streams, applying appropriate discount rates to determine the present value of the cash flow streams, and then assessing the probability of the various cash flow scenarios. The impairment is then recorded based on the excess of the carrying value of the investment over fair value. Changes in assumptions and estimates included within the impairment reviews could result in significantly different results than those identified and recorded in the financial statements.

During 2003, PPL and its subsidiaries evaluated certain gas-fired generation assets for impairment, as events and circumstances indicated that the carrying value of these investments may not be recoverable. PPL did not record an impairment of its new gas-fired generation assets in 2003. For these impairment analyses, the most significant assumption was the estimate of future cash flows. PPL estimates future cash flow using information from its corporate business plan adjusted for any recent sales or purchase commitments. Key factors that impact cash flows include projected prices for electricity and gas as well as firm sales and purchase commitments. A 10% decrease in estimated future cash flows for certain in-service

gas-fired generation assets would have resulted in an impairment charge.

PPL performs impairment analyses of goodwill in accordance with SFAS 142, "Goodwill and Other Intangible Assets." SFAS 142 requires an annual impairment test of goodwill and other intangible assets that are not subject to amortization.

PPL completed its annual goodwill impairment test in the fourth quarter of 2003. This test did not result in an impairment. PPL's most significant assumptions surrounding the goodwill impairment test relate to the determination of fair value. PPL determined fair value based upon discounted cash flows. A decrease in the forecasted cash flows of 10% or an increase of the discount rates by 25 basis points would have resulted in impairment.

### 4) Leasing

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

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

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

At December 31, 2003, PPL subsidiaries participated in one significant sale/leaseback transaction which has been accounted for as an operating lease. As discussed in Note 22 to the Financial Statements, the lessors under certain synthetic operating leases previously accounted for off-balance sheet were consolidated effective December 31, 2003 as a result of the adoption of FIN 46, "Consolidation of Variable Interest Entities," an Interpretation of ARB No. 51," for certain entities.

## Sale/Leaseback

In July 2000, PPL Montana sold its interest in the Colstrip generating plant to owner lessors who are leasing the assets back to PPL Montana under four 36-year operating leases. This transaction is accounted for as an operating lease in accordance with current rules related to sale/leaseback arrangements. If for any reason this transaction did not meet the requirements for off-balance sheet operating lease treatment as a sale/leaseback, PPL would have approximately \$315 million of additional assets and liabilities recorded on its balance sheet at December 31, 2003 and would have recorded additional expenses currently estimated at \$9 million, after-tax, in 2003.

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

## **5) Loss Contingencies**

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

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

The accrual of a loss contingency involves considerable judgment on the part of management. The accounting aspects of loss contingencies include: (1) the initial identification and recording of the loss contingency; (2) the determination of a triggering event for reducing a recorded loss contingency; and (3) the on-going assessment as to whether a recorded loss contingency is reasonable.

### Initial Identification and Recording of the Loss Contingency

PPL uses its internal expertise and outside experts (such as lawyers, tax specialists and engineers), as necessary, to help estimate the probability that a loss has been incurred and the amount (or range) of the loss. PPL continuously assesses potential loss contingencies for environmental remediation, litigation claims, regulatory penalties and other events.

PPL has identified certain events which could give rise to a loss, but which do not meet the conditions for accrual under SFAS 5. SFAS 5 requires disclosure, but not a recording, of potential losses when it is "reasonably possible" that a loss has been

incurred. FASB defines "reasonably possible" as cases in which "the chance of the future event or events occurring is more than remote but less than likely." See Note 14 to the Financial Statements for disclosure of potential loss contingencies, most of which have not met the criteria for accrual under SFAS 5.

### Reducing Recorded Loss Contingencies

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

- Certain loss contingencies are systematically reduced based on the expiration of contract terms. An example of this is the recorded liability for above-market NUG purchase commitments, which is described below. This loss contingency is being reduced over the lives of the NUG purchase contracts.
- Allowances for excess or obsolete inventory are reduced as the inventory items are pulled from the warehouse shelves and sold as scrap or otherwise disposed.
- Allowances for uncollectible accounts are reduced when accounts are written off after prescribed collection procedures have been exhausted.
- Environmental loss contingencies are reduced when PPL makes payments for environmental remediation.

### On-Going Assessment of Recorded Loss Contingencies

PPL reviews its loss contingencies on a regular basis to assure that the recorded potential loss exposures are reasonable. This involves on-going communication and analyses with internal and external legal counsel, engineers, tax specialists, managers in various operational areas and other parties.

All three aspects of accounting for loss contingencies - the initial identification and recording of a probable loss, the identification of triggering events to reduce the loss contingency, and the ongoing assessment of the reasonableness of a recorded loss contingency - require significant judgment by PPL's management.

The largest loss contingency on PPL's balance sheet, and the loss contingency that changed most significantly in 2003, was for above-market NUG purchase commitments. This loss contingency reflects the estimated difference between the above-market contract terms under the purchase commitments, and the fair value of electricity. This loss contingency was originally recorded at \$854 million in 1998, when PPL Electric's generation business was deregulated. Under regulatory accounting, PPL Electric recorded the above-market cost of the purchases from NUGs as part of its purchased power costs on an as-incurred basis, since these costs were

recovered in regulated rates. When the generation business was deregulated, the loss contingency associated with the commitment to make above-market NUG purchases was recorded. This loss contingency for the above-market portion of NUG purchase commitments was recorded because it was probable that the loss had been incurred and the estimate of future energy prices could be reasonably determined, using the then forward prices of electricity and capacity. This loss contingency was transferred to PPL EnergyPlus in the July 1, 2000 corporate realignment. The above-market loss contingency was \$352 million at December 31, 2003.

When the loss contingency related to NUG purchases was recorded in 1998, PPL Electric established the triggering events for when the loss contingency would be reduced. A schedule was established to reduce the liability based on projected purchases over the lives of the NUG contracts. All but one of the NUG contracts expire by 2009, with the last one ending in 2014. PPL EnergyPlus reduces the above-market NUG liability based on the aforementioned schedule. As PPL EnergyPlus reduces the liability for the above-market NUG purchases, it offsets the actual cost of NUG purchases, thereby bringing the net power purchase expense more in line with market prices.

PPL EnergyPlus assessed the remaining \$352 million above-market liability at December 31, 2003, comparing the projected electricity purchases under the terms of the NUG contracts, with the purchases assuming projected market prices for the energy. This assessment was based on projected PJM market prices, including capacity, through 2014. The assessment also used sensitivities around the market prices, adjusting such prices upwards and downwards by 10%.

The assessment is dependent on the market prices of energy and the estimated output levels of the NUGs. Market prices of energy are dependent on many variables, including growth in electricity demand in PJM, available generation, and changes in regulatory and economic conditions. Accordingly, market price sensitivities were used in the assessment. If estimated market prices were adjusted upwards by 10% in each of the years from 2004 through 2014, the contingency for the above-market NUG purchase commitments would be approximately \$296 million. Conversely, if estimated market prices were adjusted downwards by 10% during the remaining term of the NUG contracts, the contingency for the above-market NUG purchase commitments would be approximately \$386 million. The recorded above-market liability of \$352 million at December 31, 2003 falls within the range calculated in the year-end assessment. As noted above, it is very difficult to estimate future electricity prices, which are dependent on many variables and subject to significant volatility. However, PPL's management believes that the current recorded NUG above-market liability was fairly stated at December 31, 2003.

## 6) Asset Retirement Obligations

In 2001, the FASB issued SFAS 143, "Accounting for Asset Retirement Obligations," which addresses the accounting for obligations associated with the retirement of tangible long-lived assets. SFAS 143 requires legal obligations associated with the retirement of long-lived assets to be recognized as a liability in the financial statements. The initial obligation should be

measured at the estimated fair value. An equivalent amount should be recorded as an increase in the value of the capitalized asset and allocated to expense over the useful life of the asset. Until the obligation is settled, the liability should be increased through the recognition of accretion expense in the income statement, for changes in the obligation due to the passage of time. SFAS 143 is effective for fiscal years beginning after June 15, 2002.

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

PPL adopted SFAS 143 effective January 1, 2003. Initial adoption of the new rules resulted in an increase in net PP&E of \$32 million, reversal of previously recorded liabilities of \$304 million, recognition of asset retirement obligations of \$229 million, recognition of a deferred tax liability of \$44 million and a cumulative effect of adoption that increased net income by \$63 million. At December 31, 2003, PPL had asset retirement obligations totaling \$242 million recorded on the Balance Sheet. PPL's most significant assumptions surrounding asset retirement obligations are the forecasted retirement cost, discount rate and inflation rate. A variance in the forecasted retirement cost, discount rate or inflation rate could have a significant impact on the ARO liability and the cumulative effect gain.

The following chart reflects the sensitivities associated with a change in these assumptions upon initial adoption. Each sensitivity below reflects an evaluation of the change based solely on a change in that assumption only.

	Change in Assumption	Impact on Cumulative Effect	Impact on ARO Liability
Retirement Cost	10%/(10)%	\$(10)/\$10	\$22/\$(22)
Discount Rate	0.25%/(0.25)%	\$10/\$(11)	\$(23)/\$26
Inflation Rate	0.25%/(0.25)%	\$(12)/\$11	\$27/\$(24)

### Other Information

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

## PPL ENERGY SUPPLY, LLC

### ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

#### Overview

PPL Energy Supply is an energy company with headquarters in Allentown, PA. See Item 1, "Business - Background," for a description of PPL Energy Supply's domestic and international businesses. See Exhibit 99 in Item 15 for a listing of its principal subsidiaries. Through its subsidiaries, PPL Energy Supply is primarily engaged in the generation and marketing of electricity in two key markets - the northeastern and western U.S. - and in the delivery of electricity in the U.K. and Latin America. PPL Energy Supply's strategy for its electricity generation and marketing business is to match energy supply with load, or customer demand, under long-term and intermediate-term contracts with creditworthy counterparties. PPL Energy Supply's strategy for its international electricity delivery businesses is to own and operate these businesses at the highest level of quality and reliability and at the most efficient cost.

PPL Energy Supply faces several risks in its generation business. The principal risks are electricity wholesale price risk, fuel supply and price risk, power plant performance and counterparty credit risk. PPL Energy Supply attempts to manage these risks through various means. For instance, PPL Energy Supply operates a portfolio of generation assets that is diversified as to geography, fuel source, cost structure and operating characteristics. PPL Energy Supply is focused on the operating efficiency and maintaining the availability of these power plants. In addition, PPL Energy Supply has in place and continues to pursue long-term and intermediate-term contracts for energy sales and fuel supply, and other means, to mitigate the risks associated with adverse changes in the difference, or margin, between the cost to produce electricity and the price at which PPL Energy Supply sells it. PPL Energy Supply's contractual commitments for energy sales are primarily satisfied through its own generation assets - i.e., PPL Energy Supply primarily markets and trades around its physical portfolio of generating assets through integrated generation, marketing and trading functions. Finally, PPL Energy Supply attempts to reduce its exposure to the various risks it faces through its risk management program, which, among other things, includes an evaluation of market risks and the creditworthiness of all counterparties.

PPL Energy Supply's international electricity delivery businesses are rate-regulated. Accordingly, these businesses are subject to regulatory risks in terms of the costs that they may recover and the investment returns that they may collect in customer rates. The principal challenge that PPL Energy Supply faces in its international electricity delivery businesses is to maintain high standards of customer service and reliability in a cost-effective manner. PPL Energy Supply faces certain financial risks by conducting international operations, such as fluctuations in currency exchange rates. PPL Energy Supply

attempts to manage these financial risks through its risk management program.

A key challenge for PPL Energy Supply's business as a whole is to maintain a strong credit profile. In the past few years, investors, analysts and rating agencies that follow companies in the energy industry have been particularly focused on the credit quality and liquidity position of energy companies. PPL Energy Supply is focused on strengthening its balance sheet and improving its liquidity position, thereby improving its credit profile.

The purpose of "Management's Discussion and Analysis of Financial Condition and Results of Operations" is to provide information concerning PPL Energy Supply's past and expected future performance in implementing the strategies and managing the risks and challenges outlined above. Specifically:

- "Results of Operations" provides an overview of PPL Energy Supply's operating results in 2003, 2002 and 2001, starting with a review of earnings. The earnings review includes a listing of certain unusual items that had significant impacts in these years, and it also includes a description of key factors that management expects may impact future earnings. "Results of Operations" also includes an explanation of changes during this three-year period in significant income statement components, such as energy margins, utility revenues, operation and maintenance expenses, interest expense, income taxes and cumulative effects of accounting changes.
- "Financial Condition - Liquidity" provides an analysis of PPL Energy Supply's liquidity position and credit profile, including its sources of cash (including bank credit facilities and sources of operating cash flow) and uses of cash (including contractual commitments and capital expenditure requirements) and the key risks and uncertainties that impact PPL Energy Supply's past and future liquidity position and financial condition. This subsection also includes an explanation of recent rating agency decisions affecting PPL Energy Supply, as well as a listing of PPL Energy Supply's current credit ratings.
- "Financial Condition - Risk Management - Energy Marketing & Trading and Other" includes an explanation of PPL Energy Supply's risk management program relating to market risk (i.e., commodity price, interest rate and foreign currency exchange risk) and credit risk (i.e., counterparty credit risk).
- "New Accounting Standards" provides a description of accounting standards that impact PPL Energy Supply's Financial Statements and that were implemented in 2003 or are pending adoption.

- "Application of Critical Accounting Policies" provides an overview of the accounting policies that are particularly important to the results of operations and financial condition of PPL Energy Supply and that require PPL Energy Supply's management to make significant estimates, assumptions and other judgments. Although PPL Energy Supply's management believes that these estimates, assumptions and other judgments are appropriate, they relate to matters that are inherently uncertain. Accordingly, changes in the estimates, assumptions and other judgments applied to these accounting policies could have a significant impact on PPL Energy Supply's results of operations and financial condition, as reflected in PPL Energy Supply's Financial Statements.

The information provided in "Management's Discussion and Analysis of Financial Condition and Results of Operations" should be read in conjunction with PPL Energy Supply's Financial Statements and the Notes thereto.

Terms and abbreviations appearing herein are explained in the glossary. Dollars are in millions, except per share data, unless otherwise noted.

### Results of Operations

Earnings in 2003 and 2002 were impacted by the acquisition of a controlling interest in WPD on September 6, 2002, and the resulting consolidation, as described in Note 9 to the Financial Statements. Therefore, the comparison of reported income statement line items between 2002 and 2001 is not meaningful without eliminating the impact of the WPD consolidation. The following table shows the 2002 Statement of Income as reported, the adjustments to eliminate the impact of the WPD consolidation (by reflecting WPD on the equity method), and as adjusted to exclude the WPD consolidation. The following discussion, that explains significant annual changes in principal items on the Statement of Income compares 2003 to 2002, unadjusted, and compares 2002, as adjusted, to 2001.

#### **PPL Energy Supply, LLC and Subsidiaries Consolidated Statement of Income Adjusted to Eliminate WPD Consolidation**

	2002		
	As Reported	Adjustment	As Adjusted
<b>Operating Revenues</b>			
Wholesale energy marketing	\$ 1,036		\$ 1,036
Wholesale energy marketing to affiliates	1,434		1,434
Utility	980	\$ 579	401
Unregulated retail electric and gas	182		182
Net energy trading margins	19		19
Energy related businesses	555	(60)	615
<b>Total</b>	<b>4,206</b>	<b>519</b>	<b>3,687</b>

	2002		
	As Reported	Adjustment	As Adjusted
<b>Operating Expenses</b>			
Operation			
Fuel	502		502
Energy purchases	708		708
Energy purchases from affiliates	171		171
Other operation and maintenance	812	42	770
Depreciation	265	112	153
Taxes, other than income	78	42	36
Energy related businesses	522	29	493
Other charges			
Write-down of international energy projects	113		113
Workforce reduction	41		41
Write-down of generation assets	44		44
<b>Total</b>	<b>3,256</b>	<b>225</b>	<b>3,031</b>
<b>Operating Income</b>	<b>950</b>	<b>294</b>	<b>656</b>
Other Income - net	44	20	24
Interest Expense	207	127	80
Interest Expense with Affiliate	3		3
Income Taxes	266	105	161
Minority Interest	78	73	5
Distributions on Preferred Securities	9	9	
Loss from Discontinued Operations	2		2
Cumulative Effect of a Change in Accounting Principle	(150)		(150)
<b>Net Income</b>	<b>\$ 279</b>	<b>\$</b>	<b>\$ 279</b>

The comparability of certain items on the Statement of Income has also been impacted by PPL Global's investment in CEMAR. The consolidated results of CEMAR are included for periods during which PPL had a controlling interest, from January 1, 2001 to August 2002. See Note 9 to the Financial Statements for more information.

WPD's results, as consolidated in PPL Energy Supply's Statement of Income, are impacted by changes in foreign currency exchange rates. For the twelve months ended December 31, 2003, as compared to the same period in 2002, changes in foreign exchange rates increased WPD's portion of revenue and expense line items by about 9%.

## Earnings

Net income was as follows:

	2003	2002	2001
	\$ 727	\$ 279	\$ 174

The after-tax changes in net income were primarily due to:

	2003 vs. 2002	2002 vs. 2001
<b>Domestic:</b>		
Wholesale energy margins	\$ 68	\$ (81)
Net energy trading margins	(4)	(11)
Unregulated retail energy margins	(6)	(33)
Regulated retail energy margins	(43)	59
Realized earnings on decommissioning trust fund	12	
Trademark license fees from affiliate	(18)	(5)
Operation and maintenance expenses	(28)	(20)
Synfuel tax credit	2	10
Mechanical contractor earnings		(4)
Other	(10)	5
Total Domestic	(27)	(80)
<b>International:</b>		
U.K. operations:		
Benefit of complete ownership of WPD (see Note 9)	29	11
Impact of changes in foreign currency exchange rates	14	1
Other	1	1
Latin America	18	(24)
Other	3	61
Total International	65	50
Unusual items	410	135
	<u>\$ 448</u>	<u>\$ 105</u>

The changes in net income from year to year were, in part, attributable to several unusual items with significant earnings impacts, including accounting changes, discontinued operations and infrequently occurring items. The after-tax impacts of these unusual items are shown below.

	Impact on Net Income		
	2003	2002	2001
<b>Accounting changes:</b>			
Asset retirement obligation (Note 21)	\$ 63		
Consolidation of variable interest entities (Note 22)	(27)		
Goodwill impairment (Note 18)		\$ (150)	
Pensions (Note 12)			\$ 3
Discontinued operations (Note 9)	(20)		
CEMAR-related net tax benefit (Note 5)	81		
Workforce reduction (Note 20)		(24)	
Write-down of generation assets (Note 9)		(26)	
CEMAR operating losses (Note 9)		(23)	
CEMAR impairment (Note 9)		(98)	(217)
Cancellation of generation projects (Note 9)			(88)

	Impact on Net Income		
	2003	2002	2001
WPD impairment (Note 9)			(117)
Tax benefit - Teesside (Note 9)		8	
Enron impact on trading (Note 17)			(8)
Enron impact - write-down investment in Teesside (Note 9)			(21)
Total	<u>\$ 97</u>	<u>\$ (313)</u>	<u>\$ (448)</u>

The year to year changes in earnings components, including margins by activity and income statement line items, are discussed in the balance of the discussion in "Results of Operations."

PPL Energy Supply's future earnings could be, or will be, impacted by a number of key factors, including the following:

- Based upon current electricity and natural gas price levels, there is a risk that PPL Energy Supply may be unable to recover its investment in new gas-fired generation facilities. Under GAAP, PPL Energy Supply does not believe that there is an impairment charge to be recorded for these facilities at this time. PPL Energy Supply is unable to predict the ultimate earnings impact of this issue, based upon future energy price levels, applicable accounting rules and other factors, but such impact may be material. (See "Application of Critical Accounting Policies - Asset Impairment" for additional information.)
- PPL Energy Supply is unable to predict whether future impairments of goodwill may be required for its domestic and international investments. While no goodwill impairments were required based on the annual review performed in the fourth quarter of 2003, future impairments may occur due to determinations of fair value exceeding the carrying value of these investments. See "Application of Critical Accounting Policies - Asset Impairment" for additional information.
- Earnings in 2004 and beyond will be impacted by the consolidation of variable interest entities (as discussed in Note 22 to the Financial Statements).
- Earnings in 2005 and beyond may be impacted by a rate review of the delivery business of WPD (South West) and WPD (South Wales). WPD cannot predict the ultimate outcome of the rate review.
- PPL Energy Supply operates a synfuel facility and receives tax credits pursuant to Section 29 of the Internal Revenue Code based on its sale of synfuel to unaffiliated third-party purchasers. See Note 14 to the Financial Statements for a discussion of the IRS review of synfuel production procedures, and the projected annual earnings attributable to PPL Energy Supply's synfuel operations.
- Future earnings may also be impacted by the ultimate exiting of the CEMAR investment (see Note 9 to the Financial Statements for additional information) or other investments.

## Domestic Gross Energy Margins

The following table provides changes in income statement line items that comprise domestic gross energy margins:

	<u>2003 vs. 2002</u>	<u>2002 vs. 2001</u>
Wholesale energy marketing revenues	\$ 178	\$ 9
Wholesale energy marketing to affiliates	17	103
Unregulated retail electric and gas revenues	(30)	(174)
Net energy trading margins	(7)	(18)
Other revenue adjustments (a)	<u>23</u>	<u>1</u>
Total revenues	<u>181</u>	<u>(79)</u>
Fuel	35	2
Energy purchases	110	(26)
Energy purchases from affiliates	(11)	(23)
Other cost adjustments (a)	<u>22</u>	<u>65</u>
Total cost of sales	<u>156</u>	<u>18</u>
Domestic gross energy margins	<u>\$ 25</u>	<u>\$ (97)</u>

- (a) Adjusted to exclude the impact of any revenues and costs not associated with domestic energy margins, in particular, revenues and energy costs related to the international operations of PPL Global. Also adjusted to include gains on sales of emission allowances, which are reflected in "Other operation and maintenance" expenses on the Statement of Income, and the reduction of the reserve for Enron receivables, as described in Note 17 to the Financial Statements.

### Changes in Domestic Gross Energy Margins By Activity

Gross margin calculations are dependent on the allocation of fuel and purchased power costs to the activities listed below. That allocation is based on monthly MWh consumption levels compared to monthly MWh supply costs. Any costs specific to an activity are charged to that activity.

	<u>2003 vs. 2002</u>	<u>2002 vs. 2001</u>
Wholesale - Eastern U.S.	\$ 67	\$ (64)
Wholesale - Western U.S.	49	(71)
Net energy trading	(7)	(18)
Unregulated retail	(10)	(55)
Regulated retail	<u>(74)</u>	<u>111</u>
Domestic gross energy margins	<u>\$ 25</u>	<u>\$ (97)</u>

### Wholesale - Eastern U.S.

Eastern U.S. wholesale margins were higher in 2003 compared to 2002 primarily due to higher volumes, which increased by 47%. The higher volumes were primarily driven by market opportunities to optimize the value of generating assets and by higher spot prices that allowed PPL Energy Supply to increase the utilization of its higher cost generating units including 699 MW of new generation that began commercial operation in mid-2002. In PJM, where the majority of PPL Energy Supply's Eastern wholesale activity occurs, average on-peak spot market real time prices rose 34% in 2003 compared to 2002. Partially offsetting the increase in wholesale energy margins in 2003 compared to 2002, was the buyout of a NUG contract in February 2002, which reduced power purchases by \$25 million.

Eastern wholesale margins were lower in 2002 compared to 2001, despite a buyout of a NUG contract in February 2002 that reduced purchased power costs by \$25 million. The decline in margins was primarily attributable to the decline in wholesale prices for energy and capacity. PJM on-peak prices averaged \$6/MWh less, a decline of 14%, for 2002 compared to 2001. Additionally, because new generating capability came on-line within PJM in 2002, the prices for the PJM monthly auctions for unforced capacity credits fell from an average of \$100/MW-month in 2001 to an average of \$38/MW-month in 2002. However, higher volumes of energy sales partially offset the decline in prices, as wholesale transactions in 2002 increased by about 33% over 2001 due to better generating unit availability.

### Wholesale - Western U.S.

Western U.S. wholesale margins consist of margins in the Northwest and in the Southwest.

In the Northwest, margins were \$31 million higher in 2003 compared to 2002, primarily due to higher wholesale prices. Average wholesale prices for 2003 were \$6/MWh higher than prices in 2002. A favorable settlement of \$3 million with Energy West Resources Inc. in June 2003 also positively impacted margins in 2003. Margins were \$74 million lower in 2002 compared to 2001, primarily due to a decrease in average realized wholesale prices by \$15/MWh, partially offset by a 7% increase in volumes.

In the Southwest, margins were \$9 million higher in 2003 compared to 2002, primarily due to the inception of new agreements in Arizona and due to an increase of average wholesale prices in 2003 by \$16/MWh compared to 2002. Margins were \$9 million lower in 2002 compared to 2001, primarily due to a decrease in average wholesale prices by \$40/MWh. These lower prices were offset by increased sales, which were three times higher than the prior period, as a result of the Griffith Energy and Sundance facilities coming on-line in 2002.

The above explanation is exclusive of \$9 million related to the 2003 partial reversal of a reserve against Enron receivables, and a 2001 charge of \$12 million for the Enron bankruptcy, both of which affected gross margins. These items are discussed in further detail in Note 17 to the Financial Statements.

### Net Energy Trading

PPL Energy Supply enters into certain contractual arrangements that meet the criteria of energy trading derivatives as defined by EITF 02-3, "Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities." These physical and financial contracts cover trading activity associated with electricity, gas and oil. The \$7 million decrease in 2003 compared to 2002 was primarily due to realized electric sales losses in 2003. The \$18 million decrease in 2002 compared to 2001 was primarily due to unrealized, mark-to-market gains in 2001 and lower energy margins in 2002. The physical volumes

associated with energy trading were 9,100 GWh and 12.6 Bcf in 2003; 10,700 GWh and 12.4 Bcf in 2002; and 7,700 GWh and 22.4 Bcf in 2001. The amount of energy trading margins from realized mark-to-market transactions was not significant in 2003, 2002 and 2001.

### Unregulated Retail

Unregulated retail margins declined in 2003 compared to 2002 primarily due to significantly lower electric retail prices in the Western U.S. Western U.S. retail contract prices decreased about 19% in 2003 compared to 2002. The decline in 2002 compared to 2001 was primarily due to lower revenues resulting from the expiration of contracts which were not renewed in the Eastern U.S. and due to significantly lower retail prices in the Western U.S., somewhat offset by an increase in the number of customers in the Western U.S.

### Regulated Retail

Regulated retail margins in the Eastern U.S. for 2003 decreased by 9% compared to 2002, due to higher supply costs resulting from higher purchased power prices. Purchased power prices were higher because of increased gas and oil prices and an abnormally cold winter. Regulated retail margins for 2002 were 17% higher than in 2001. Higher sales volumes and higher average prices, caused by changes in usage among customer classes, provided the improved margins. In addition, lower supply costs in 2002, due to lower fuel costs and increased generating unit availability, further improved margins.

### Utility Revenues

The increase (decrease) in utility revenues was attributable to the following:

	<u>2003 vs. 2002</u>	<u>2002 vs. 2001</u>
International:		
Retail electric delivery (PPL Global)		
U.K.	\$ 35	
El Salvador	13	\$ 4
Bolivia	1	2
Chile	18	4
Brazil	(113)	(17)
	<u>\$ (46)</u>	<u>\$ (7)</u>

The decrease for both periods was primarily due to the deconsolidation of CEMAR. (See Note 9 to the Financial Statements for additional information.)

The decrease for 2003 compared with 2002 was partially offset by:

- higher WPD revenues in the U.K. primarily due to the change in foreign currency exchange rates from period to period;
- higher revenues in El Salvador primarily due to higher volumes and higher pass-through energy costs, partially

offset by a 6% tariff reduction effective January 1, 2003; and

- higher revenues in Chile primarily due to higher volumes and the consolidation of TransEmel. (See Note 9 to the Financial Statements for additional information.)

The decrease for 2002 compared with 2001 was partially offset by higher sales volumes in Chile and El Salvador.

### Energy Related Businesses

Energy related businesses contributed \$16 million less to operating income in 2003 compared with 2002. The decrease resulted primarily from:

- \$7 million of credits recorded on development projects in 2002, due largely to a favorable settlement on the cancellation of a generation project in Washington state;
- a \$5 million operating loss on some Hyder properties in the first quarter of 2003, which were subsequently sold in April 2003; and
- an \$8 million decrease in Latin America revenues from lower material and construction project sales (In 2002, a Bolivian subsidiary participated in the construction of a 1,500 kilometer transmission line in rural areas.); partially offset by
- a \$3 million improvement in contributions from mechanical contracting subsidiaries due to enhanced project controls that were implemented to minimize project overruns, offset by a continuing decline in construction markets in 2003.

Energy related businesses (when adjusted to include WPD on an equity basis) contributed \$3 million less to operating income in 2002 compared with 2001. This was primarily due to:

- a \$14 million benefit recorded in 2001 from an equity interest in Griffith Energy related to margins on forward electricity contracts, executed prior to commercial operation;
- a \$9 million decline from the mechanical contracting and engineering subsidiaries, primarily due to cost overruns experienced at two major projects; and
- \$4 million of pre-tax operating losses from synfuel projects; partially offset by
- a \$23 million decrease in PPL Global's expenses due to lower spending on development projects, including a favorable settlement on the cancellation of a generation project in Washington state.

Although operating income from synfuel operations declined in 2002 compared to 2001, the synfuel projects contributed \$7 million more to net income after the recording of tax credits.

### Other Operation and Maintenance

The increase (decrease) in other operation and maintenance expenses was primarily due to:

	<u>2003 vs. 2002</u>	<u>2002 vs. 2001</u>
Decrease in domestic and international pension income	\$ 37	\$ 7
Higher trademark license fees from a PPL subsidiary (see Note 15)	30	8
Additional expenses of new generating facilities	28	27
Increase in WPD expenses due to increases in regulatory accounting adjustments, and resolution of purchase accounting contingencies in the second quarter of 2002 related to the Hyder acquisition	18	
Increase in foreign currency exchange rates	10	
Accretion expense as a result of applying SFAS 143 (see Note 21)	18	
Increased operating expenses in domestic business lines and other	20	1
Outage costs associated with the turbine replacement at the Susquehanna station	7	
Increase in other postretirement benefit expense	5	2
Change to account for CEMAR on the cost-method	(38)	(9)
Insurance settlements - property damage and environmental	(26)	
Estimated reduction in salaries and benefits as a result of the workforce reduction initiated in 2002	(15)	(6)
Gains on sales of emission allowances	(17)	(2)
Decrease in PPL Global's administrative and general expenses		(10)
Decrease in the Clean Air Act contingency relating to generating facilities	(8)	
Vacation liability adjustment in 2002 in conjunction with the workforce reduction	(6)	6
	<u>\$ 63</u>	<u>\$ 24</u>

The \$37 million decrease in net pension income was attributable to decreased asset values at the end of 2002 and reductions in the discount rate assumptions for PPL and PPL Energy Supply domestic and international pension plans, which were the result of weakness in the financial markets during 2002. The 2002 year-end asset values and discount rates were used to measure net pension income for 2003. Through December 31, 2003, PPL Energy Supply recorded and was allocated \$39 million of net pension income.

Although financial markets have improved and PPL and PPL Energy Supply domestic and international pension plans have experienced significant asset gains in 2003, interest rates on fixed-income obligations have continued to fall, requiring a further reduction in the discount rate assumption as of December 31, 2003. The reduction in the discount rate assumption has a significant impact on the measurement of plan obligations and net pension cost, which will result in PPL and PPL Energy Supply recognizing lower levels of net pension income in 2004. See Note 12 to the Financial Statements for details of the funded status of PPL's pension plans.

## Depreciation

Depreciation expense decreased by \$16 million in 2002 compared with 2001. Depreciation on plant additions accounted for a \$15 million increase. Other impacts on depreciation are as follows:

- \$14 million decrease due to extension of the Susquehanna station's depreciable life, in conjunction with the announcement to seek an extension of its NRC operating licenses;
- \$10 million decrease due to no longer recording goodwill amortization due to adoption of SFAS 142 (see Note 18); and
- \$7 million decrease due to PPL Global's write-down of CEMAR assets in 2001, resulting in no depreciation being recorded on these assets in 2002.

## Taxes, Other Than Income

Taxes, other than income, increased by \$11 million in 2003 compared with 2002, due to higher taxes related to increases in the basis on which capital stock is calculated and higher real estate taxes in 2003.

## Other Charges

Other charges of \$198 million in 2002 consisted of the write-down of PPL Global's investment in CEMAR and several smaller impairment charges on other international investments (see Note 9 to the Financial Statements), the write-down of generation assets (see Note 9) and a charge for a workforce reduction program (see Note 20).

Other charges of \$486 million in 2001 consisted of the write-down of international energy projects and the cancellation of generation projects (See Note 9).

## Other Income - net

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

## Interest Expense

Interest expense decreased by \$11 million in 2003 compared to 2002 primarily due to:

- a \$34 million decrease in long-term debt interest from the deconsolidation of CEMAR in August 2002; and
- a \$20 million decrease in short-term debt interest expense; offset by
- an \$11 million write-off of unamortized swap costs on WPD debt restructuring in 2003;
- a \$7 million increase in long-term debt interest due to the issuance of \$400 million 2.625% Convertible Senior Notes

- \$5 million of interest on preferred securities of SIUK Capital Trust I due to reclassifications from adopting SFAS 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity" (see Note 22 to the Financial Statements for additional information);
- a \$13 million decrease in capitalized interest; and
- a \$7 million increase in amortization expense and other.

Interest expense increased by \$36 million in 2002 compared with 2001 primarily due to:

- a \$52 million increase in long-term debt interest due to a full year of interest in 2002 from the issuances of \$500 million of senior unsecured notes in 2001 and debt issued by PPL Global's consolidated subsidiaries; and
- a \$7 million decrease in capitalized interest; offset by
- a \$23 million decrease in short-term debt interest from a decrease in short-term borrowings from affiliates.

### Income Taxes

Income tax expense decreased by \$81 million in 2003 compared with 2002. This decrease was due to:

- a \$31 million reduction related to deferred income tax valuation allowances recorded on impairment charges on PPL Energy Supply's investment in Brazil recorded during 2002;
- an \$84 million reduction in income taxes related to the tax benefit recognized in 2003 on foreign investment losses included in the 2002 federal income tax return; and
- a \$2 million decrease related to additional federal synfuel tax credits recognized; offset by
- higher pre-tax domestic book income, resulting in a \$39 million increase in income taxes.

Income tax expense decreased by \$113 million in 2002 compared with 2001. This decrease was due to:

- lower pre-tax domestic book income, resulting in a \$35 million reduction in income taxes;
- lower impairment charges on PPL Energy Supply's investment in Brazil resulting in a \$30 million decrease in the amount of deferred income tax valuation allowances recorded;
- a \$27 million reduction in income taxes due to losses recognized on foreign investments; and
- a \$10 million decrease related to additional federal synfuel tax credits recognized.

### Discontinued Operations

PPL Energy Supply reported a loss of \$20 million in connection with the approval of a plan of sale of PPL Global's investment in a Latin American telecommunications company. See "Discontinued Operations" in Note 9 to the Financial Statements for additional information.

### Cumulative Effects of Changes in Accounting Principles

In 2003, PPL Energy Supply recorded a charge of \$27 million, after-tax, as a cumulative effect of a change in accounting principle in connection with the adoption of FIN 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51," for certain entities. See "New Accounting Standards" for further discussion.

PPL Energy Supply adopted SFAS 143, "Accounting for Asset Retirement Obligations," effective January 1, 2003. SFAS 143 addresses the accounting for obligations associated with the retirement of tangible long-lived assets. It requires legal obligations associated with the retirement of long-lived assets to be recognized as a liability in the financial statements. Application of the new rules resulted in a cumulative effect of adoption that increased net income by \$63 million in 2003. See Note 21 to the Financial Statements for additional information.

PPL Energy Supply adopted SFAS 142, "Goodwill and Other Intangible Assets," on January 1, 2002. SFAS 142 requires an annual impairment test of goodwill and other intangible assets that are not subject to amortization. PPL Energy Supply conducted a transition impairment analysis in the first quarter of 2002 and recorded a transition goodwill impairment charge of \$150 million. See Note 18 to the Financial Statements for additional information.

In 2001, PPL changed its method of amortizing unrecognized gains or losses in the annual pension expense or income determined under SFAS 87, "Employers' Accounting for Pensions." This change resulted in an allocation to PPL Energy Supply of a cumulative-effect credit of \$3 million. See Note 12 to the Financial Statements for additional information.

### Financial Condition

#### Liquidity

PPL Energy Supply is focused on maintaining a strong liquidity position and strengthening its balance sheet, thereby improving its credit profile. PPL Energy Supply believes that its cash on hand, operating cash flows, access to debt capital markets and borrowing capacity, taken as a whole, provide sufficient resources to fund its ongoing operating requirements, future security maturities and estimated future capital expenditures. PPL Energy Supply currently expects cash on hand at the end of 2004 to be approximately \$200 million, with about \$1.2 billion in syndicated credit facilities. However, PPL Energy Supply's cash flows from operations and its access to cost effective bank and capital markets are subject to risks and uncertainties, including but not limited to, the following:

- changes in market prices for electricity;
- changes in commodity prices that may increase the cost of producing power or decrease the amount PPL Energy Supply receives from selling power;

- price and credit risks associated with selling and marketing products in the wholesale power markets;
- ineffectiveness of trading, marketing and risk management policies and programs used to mitigate PPL Energy Supply's risk exposure to adverse energy and fuel prices, interest rates, foreign currency exchange rates and counterparty credit;
- unusual or extreme weather that may damage its international transmission and distribution facilities or effect energy sales to customers;
- reliance on transmission and distribution facilities that PPL Energy Supply does not own or control to deliver its electricity;
- unavailability of generating units (due to unscheduled or longer-than-anticipated generation outages) and the resulting loss of revenues and additional costs of replacement electricity;
- ability to recover, and timeliness and adequacy of recovery of, costs associated with international electricity delivery businesses; and
- a downgrade in PPL Energy Supply's or its rated subsidiaries' credit ratings that could negatively affect their ability to access capital and increase the cost of maintaining credit facilities and any new debt.

At December 31, 2003, PPL Energy Supply had \$227 million in cash and cash equivalents and \$56 million of short-term debt, as compared to \$149 million in cash and cash equivalents and \$928 million of short-term debt at December 31, 2002, and \$815 million in cash and cash equivalents and \$118 million of short-term debt at December 31, 2001. The changes in cash and cash equivalents resulted from the following:

	2003	2002	2001
Net Cash Provided by Operating Activities	\$ 910	\$ 651	\$ 619
Net Cash Provided by (Used in) Investing Activities	204	(1,144)	278
Net Cash Used in Financing Activities	(1,043)	(175)	(209)
Effect of Exchange Rates on Cash & Cash Equivalents	7	2	(3)
Increase (Decrease) in Cash & Cash Equivalents	<u>\$ 78</u>	<u>\$ (666)</u>	<u>\$ 685</u>

#### Net Cash Provided by Operating Activities

Net cash provided by operating activities increased by 40%, or \$259 million, in 2003 versus 2002, reflecting higher net income adjusted for non-cash items and lower cash income taxes. In addition, 2002 included cash outlays of \$152 million for the cancellation of generation projects and \$50 million for the termination of a NUG contract. The higher net income in 2003 was principally driven by complete ownership in WPD, higher wholesale energy margins, lower interest expense and savings from a workforce reduction program in the U.S. that commenced in 2002.

Important elements supporting the stability of PPL Energy Supply's cash provided by operating activities are the long-term

and intermediate-term commitments from wholesale and retail customers and long-term fuel supply contracts PPL Energy Supply has in place. In 2003, PPL EnergyPlus entered into several new wholesale agreements to provide capacity and/or electricity to utilities in New Jersey, Arizona and Connecticut. These agreements supplement previously existing long-term contracts with PPL Electric, NorthWestern and the Long Island Power Authority (see Note 14 to the Financial Statements for additional information). PPL Energy Supply estimates that, on average, approximately 80% of its expected annual generation output for the period 2004 through 2008 is committed under long-term and intermediate-term energy supply contracts. PPL EnergyPlus also enters into contracts under which it agrees to sell and purchase electricity, natural gas, oil and coal. These contracts often require cash collateral or other credit enhancement, or reductions or terminations of a portion or the entire contract through cash settlement in the event of a downgrade of PPL Energy Supply or the respective subsidiary's credit ratings or adverse changes in market prices. For example in addition to limiting its trading ability, if PPL Energy Supply or its respective subsidiary's ratings were lowered to below "investment grade" and energy prices increased by 10%, PPL Energy Supply estimates that, based on its December 31, 2003 position, it would have to post collateral of approximately \$490 million as compared to \$421 million at December 31, 2002. PPL Energy Supply has in place risk management programs that, among other things, are designed to monitor and manage its exposure to volatility of cash flows related to changes in energy prices, interest rates, foreign currency exchange rates, counterparty credit quality and the operational performance of its generating units.

Net cash provided by operating activities in 2002 was \$651 million, compared to \$619 million in 2001. The \$32 million increase in cash provided by operations was due to the net effect of increases in net income adjusted to a cash basis (i.e., adding back non-cash items such as depreciation, write-downs of projects and assets, change in accounting principle, etc.), partially offset by \$152 million of turbine cancellation payments made in 2002, a \$50 million payment to terminate a NUG contract also made in 2002, and an \$89 million decrease in dividends received from unconsolidated affiliates.

#### Net Cash Provided by (Used in) Investing Activities

Net cash provided by investing activities in 2003 was \$204 million, compared to net cash used in investing activities of \$1.1 billion in 2002. The primary reasons for the \$1.3 billion increase in net cash provided by investing activities was reduced investment in generation assets and electric energy projects, the acquisition of controlling interest in WPD in 2002, and a repayment of a loan from an affiliate. The primary use of cash for investing activities is capital and investment expenditures, which are summarized by category in the table in "Capital Expenditure Requirements." In 2004, PPL Energy Supply expects to be able to fund all of its capital expenditures with cash provided by operating activities.

Net cash used in investing activities in 2002 was \$1.1 billion, compared to net cash provided of \$278 million in 2001. The primary reasons for the \$1.4 billion increase in cash used in investing activities was due to the acquisition of the controlling interest in WPD in 2002 and a repayment of the loan from a non-consolidated affiliate in 2001.

### Net Cash Used in Financing Activities

Net cash used in financing activities was \$1.0 billion in 2003, compared to \$175 million in 2002. The increase primarily reflected the repayment of short-term debt, retirement of long-term debt, distributions to PPL to support dividends to PPL's shareholders, and maturities and interest payments on PPL Capital Funding's debt. In 2003, PPL Energy Supply had net retirements of debt of \$120 million compared with net issuances of \$378 million in 2002. Net distributions to Member were \$907 million in 2003 compared with \$550 million in 2002.

PPL Energy Supply's debt financing activity in 2003 was as follows:

	<u>Additions</u>	<u>Payments</u>	<u>Net</u>
PPL Energy Supply Convertible Notes	\$ 400		\$ 400
PPL Energy Supply Commercial Paper (net change)		\$ (374)	(374)
WPD (South West) (USD equivalent)	402	(409)	(7)
WPDH Limited (USD equivalent)		(53)	(53)
Latin America Companies (USD equivalent)		(4)	(4)
Payments on amounts advanced from trustee in synthetic lease agreement and other		(82)	(82)
<b>Total</b>	<u>\$ 802</u>	<u>\$ (922)</u>	<u>\$ (120)</u>

Debt issued during 2003 had stated interest rates ranging from 2.62% to 5.87% and maturities from 2023 through 2027. See Note 8 to the Financial Statements for more detailed information regarding PPL Energy Supply's borrowings.

In July 2003, PPL Energy Supply determined that, based on its current cash position and anticipated cash flows, it would not need to access the commercial paper markets through at least the end of 2003. As a result, PPL Energy Supply requested Standard & Poor's Ratings Services (S&P), Moody's Investors Service, Inc. (Moody's) and Fitch Ratings (Fitch) to withdraw their ratings for its currently inactive commercial paper program, which the rating agencies did effective as of July 9, 2003. This decision has not limited the ability of PPL Energy Supply to fund its short-term liquidity needs. PPL Energy Supply currently does not have any commercial paper outstanding, and it does not anticipate a need to access the commercial paper market in 2004.

At December 31, 2003, PPL Energy Supply's total committed borrowing capacity and the use of this borrowing capacity were as follows:

	<u>Committed Capacity</u>	<u>Borrowed</u>	<u>Letters of Credit Issued (c)</u>	<u>Available Capacity (c)</u>
PPL Energy Supply Credit Facilities (a)	\$ 1,100		\$ 87	\$ 1,013
WPD (South West) Bank Facilities (b)	435	\$ 48		387
<b>Total</b>	<u>\$ 1,535</u>	<u>\$ 48</u>	<u>\$ 87</u>	<u>\$ 1,400</u>

- (a) PPL Energy Supply's credit facilities allow for borrowings at LIBOR-based rates plus a spread, depending upon the company's public debt rating. PPL Energy Supply also has the capability to issue up to \$800 million of letters of credit under its facilities, which issuance reduces available borrowing capacity.

These credit facilities contain financial covenants requiring debt to total capitalization not greater than 65% and an interest coverage ratio of not less than 2.0 times consolidated earnings before income taxes, depreciation and amortization. At December 31, 2003 and 2002, PPL Energy Supply's consolidated debt to total capitalization percentages, as calculated in accordance with its credit facilities, were 36% and 35%. At December 31, 2003 and 2002, PPL Energy Supply's interest coverage ratios, as calculated in accordance with its credit facilities, were 6.3 and 7.4. The credit agreements also contain certain representations and warranties that must be made for PPL Energy Supply to borrow under them, including, but not limited to, a material adverse change clause that relates to PPL Energy Supply's ability to perform its obligations under the credit agreements and related loan documents.

- (b) WPD (South West)'s credit facilities allow for borrowings at LIBOR-based rates plus a spread, depending upon the company's public debt rating.

These credit facilities contain financial covenants that require it to maintain an interest coverage ratio of not less than 3.0 times consolidated earnings before income taxes, depreciation and amortization, and the regulatory asset base must be £150 million greater than total gross debt, in each case as calculated in accordance with the credit facilities. At December 31, 2003 and 2002, WPD (South West)'s interest coverage ratio, as calculated in accordance with its credit lines, was 6.7 and 10.3. At December 31, 2003 and 2002, WPD (South West)'s regulatory asset base exceeded its total gross debt by £457 million and £491 million.

- (c) PPL Energy Supply and WPD (South West) have a reimbursement obligation to the extent any letters of credit are drawn upon. The letters of credit issued as of December 31, 2003 expire in 2004.

These credit agreements contain various other covenants. Failure to meet those covenants beyond applicable grace periods could result in acceleration of due dates of borrowings and/or termination of the agreements. PPL Energy Supply monitors the covenants on a regular basis. At December 31, 2003, PPL Energy Supply was in compliance with those covenants. At this time, PPL Energy Supply believes that these covenants and other borrowing conditions will not limit access to these funding sources. PPL Energy Supply intends to reduce its syndicated credit facilities to \$800 million in the first quarter 2004 because of lower development and acquisition requirements related to its supply business. WPD (South West) intends to renew and extend all of its syndicated credit facilities in 2004.

Net cash used in financing activities was \$175 million in 2002 compared to \$209 million in 2001.

## Operating Leases

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

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

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

## Contractual Obligations

At December 31, 2003, the estimated contractual cash obligations of PPL Energy Supply were as follows:

<u>Contractual Cash Obligations</u>	<u>Total</u>	<u>Less Than 1 Year</u>	<u>1-3 Years</u>	<u>3-5 Years</u>	<u>After 5 Years</u>
Long-term Debt (a)	\$ 4,243	\$ 6	\$ 612	\$ 1,068	\$ 2,557
Capital Lease Obligations					
Operating Leases (b)	775	65	111	101	498
Purchase Obligations (c)	3,166	605	1,158	575	828
Other Long-term Liabilities Reflected on the Balance Sheet under GAAP					
<b>Total Contractual Cash Obligations</b>	<b>\$ 8,184</b>	<b>\$ 676</b>	<b>\$ 1,881</b>	<b>\$ 1,744</b>	<b>\$ 3,883</b>

- (a) Reflects principal maturities only, including maturities of consolidated lease debt.
- (b) Excludes amounts for the leases of the Sundance, University Park and Lower Mt. Bethel generation facilities as the lessors were consolidated effective December 31, 2003 as a result of the adoption of FIN 46 for certain entities. See "New Accounting Standards" for further discussion.
- (c) The payments reflected herein are subject to change as certain purchase obligations included are estimates based on projected obligated quantities and/or projected pricing under the contracts.

## Credit Ratings

The following table summarizes the credit ratings of PPL Energy Supply and its financing subsidiaries at December 31, 2003:

	<u>Moody's</u>	<u>Standard &amp; Poor's</u>	<u>Fitch</u>
<b>PPL Energy Supply</b>			
Issuer Rating		BBB	BBB+
Senior Unsecured Notes	Baa2	BBB	BBB+
Outlook	STABLE	NEGATIVE	NEGATIVE
<b>PPL Montana</b>			
Pass-Through Certificates	Baa3	BBB-	BBB
Outlook	Poss. Downgrade	NEGATIVE	
<b>WPDH Limited</b>			
Issuer Rating	Baa2	BBB-	
Senior Unsecured Debt	Baa2	BBB-	BBB
Outlook	STABLE	NEGATIVE	STABLE
<b>WPD LLP</b>			
Issuer Rating		BBB-	
Senior Unsecured Debt	Baa2	BBB-	BBB
Capital Trust Securities*	Baa3	BB	
Outlook	STABLE	NEGATIVE	STABLE
<b>WPD (South Wales)</b>			
Issuer Rating		BBB+	
Senior Unsecured Debt	Baa1	BBB+	A-
Commercial Paper		A-2	F2
Outlook	STABLE	NEGATIVE	STABLE
<b>WPD (South West)</b>			
Issuer Rating	Baa1	BBB+	
Senior Unsecured Debt		BBB+	A-
Commercial Paper	P-2	A-2	F2
Outlook	STABLE	NEGATIVE	STABLE

\* These trust preferred securities were deconsolidated effective December 31, 2003 from the Balance Sheet. See Note 22 to the Financial Statements for additional information.

## Rating Agency Actions in 2003

In 2003, S&P, Moody's and Fitch reviewed the credit ratings on the debt of PPL Energy Supply and its subsidiaries. Based on their respective reviews, the rating agencies made certain ratings revisions that are described below. Management does not expect these ratings decisions to impact PPL Energy Supply and its subsidiaries' ability to raise new debt or equity capital or to have a significant impact on the cost of any new capital or the cost of maintaining their credit facilities.

The ratings of S&P, Moody's and Fitch are not a recommendation to buy, sell or hold any securities of PPL Energy Supply or its subsidiaries. Such ratings may be subject to revisions or withdrawal by the agencies at any time and should be evaluated independently of each other and any other rating that may be assigned to their securities.

### *PPL Energy Supply*

#### S&P

In April 2003, S&P notified PPL Energy Supply that it affirmed the 'BBB' corporate credit rating for PPL Energy Supply and the 'A-2' commercial paper rating of PPL Energy Supply. S&P also indicated that PPL Energy Supply remains on negative outlook

based on S&P's view of weak debt-protection measures due to low wholesale energy prices.

In December 2003, S&P downgraded PPL Montana's 8.903% Pass-Through Certificates due 2020 to BBB- from BBB. S&P indicated that its outlook for these securities remains negative. S&P indicated that its downgrade reflects certain risks that it believes PPL Montana faces, including counterparty credit risk resulting from the Chapter 11 bankruptcy filing of NorthWestern, which is PPL Montana's largest customer. S&P noted, however, that the bankruptcy court has approved NorthWestern's request to affirm the power sales agreements with PPL Montana and that NorthWestern has strong incentives to maintain this status. See Note 14 to the Financial Statements for more detailed information regarding NorthWestern's bankruptcy filing.

#### Moody's

In May 2003, Moody's downgraded the credit ratings on PPL Energy Supply's senior unsecured notes, to 'Baa2' from 'Baa1'. The Moody's ratings outlook is stable for PPL Energy Supply. PPL Energy Supply's short-term debt rating was not impacted by Moody's long-term debt review.

Moody's stated that the downgrades reflect its concerns about PPL Energy Supply's modest exposure to merchant generation risk, the continued weakness in the wholesale power market and the associated financial impact on PPL Energy Supply, and concerns regarding the amount of cash flow to be generated from PPL Energy Supply's domestic operations and the free cash flow available from its regulated international assets. However, Moody's also indicated that the full requirements contract between PPL Electric and PPL EnergyPlus, which previously was approved by the PUC and which extends through December 2009, provides a predictable stream of cash flows to PPL Energy Supply during such time period. Moody's also viewed favorably certain actions taken by PPL Energy Supply, including a sizeable reduction in planned capital expenditures, the cancellation of projects under development, workforce reductions and write-downs of certain investments.

In September 2003, Moody's announced that it was placing PPL Montana's 8.903% Pass-Through Certificates due 2020 under review for possible downgrade. These securities currently are rated 'Baa3' by Moody's. Moody's stated that its review is prompted by its concerns about the credit profile of PPL Montana's largest customer, NorthWestern, and lower cash flow generation than was forecasted at the time the securities were issued in 2000. See Note 14 to the Financial Statements for additional information on NorthWestern's current situation. Management does not expect any action by Moody's based on this review to limit PPL Montana's ability to fund its short-term liquidity needs. PPL Montana has no plans to raise new long-term debt. Any ratings downgrade by Moody's would have an insignificant impact on PPL Montana's cost of maintaining the credit facility that it has in place with its affiliate. In addition, management does not expect any ratings downgrade by Moody's

based on this review to have any adverse impact on the credit ratings of PPL Energy Supply.

#### Fitch

In May 2003, Fitch notified PPL Energy Supply that it affirmed the 'BBB+' rating of PPL Energy Supply's senior unsecured debt and the 'F2' rating of its commercial paper, and that it placed PPL Energy Supply on negative outlook.

Fitch indicated that the change in outlook for PPL Energy Supply results from the increase during 2002 in PPL Energy Supply's generation asset portfolio that is dependent on merchant generation, continued weakness in U.S. merchant energy markets and exposure to international distribution assets primarily in Latin America and the U.K. However, Fitch noted that PPL Energy Supply derives significant earnings and cash flow from long-term supply contracts, including the full requirements contract between PPL Electric and PPL EnergyPlus, that on average account for about 70% of PPL Energy Supply's gross margin over the next five years.

#### WPD and Subsidiaries

In February 2003, Moody's confirmed the ratings of WPDH Limited at 'Baa2' and WPD (South West) and WPD (South Wales) at 'Baa1', and downgraded WPD LLP from 'Baa1' to 'Baa2' and SIUK Capital Trust I from 'Baa2' to 'Baa3'. The outlook on all ratings was stable. In March 2003, S&P assigned its 'BBB+' senior unsecured debt rating to the £200 million bonds issued by WPD (South West). At the same time, the 'BBB+' and 'A-2' corporate credit ratings on SIUK Limited were withdrawn as a result of the acquisition of its debt by WPD LLP. S&P assigned its 'BBB' long-term and 'A-2' short-term corporate credit ratings to WPD LLP, in line with the ratings on the rest of the WPD group.

Following a review of holding companies of U.K., regulated utilities, in July 2003 S&P downgraded the long-term ratings from 'BBB' to 'BBB-' and short-term ratings from 'A-2' to 'A-3' for both WPDH Limited and WPD LLP, and retained a negative outlook. At the same time, S&P reaffirmed the credit ratings for WPD (South West) and WPD (South Wales) at 'BBB+'. S&P stated that this is in line with S&P U.K.'s recently announced implementation of a new methodology related to U.K. electric distribution holding companies, whereby electric distribution operating companies rated in the 'BBB' category will have the parent holding company (WPDH Limited) notched down by two categories from the operating company rating level. WPD's management does not expect the placement of WPD on negative outlook to limit its ability to fund its short-term liquidity needs or access to new long-term debt or to impact the cost of any new long-term debt.

#### **Off-Balance Sheet Arrangements**

PPL Energy Supply provides guarantees for certain affiliate financing arrangements that enable certain transactions. Some of the guarantees contain financial and other covenants that, if

not met, would limit or restrict the affiliates' access to funds under these financing arrangements, require early maturity of such arrangements or limit PPL Energy Supply's ability to enter into certain transactions. At this time, PPL Energy Supply believes that these covenants will not limit access to the relevant funding sources.

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

## **Risk Management - Energy Marketing & Trading and Other**

### Market Risk

#### *Background*

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

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

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

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

#### *Contract Valuation*

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

To record derivatives at their fair value, PPL Energy Supply discounts the forward values using LIBOR. Additionally, PPL Energy Supply reduces derivative assets' carrying values to recognize differences in counterparty credit quality and potential illiquidity in the market:

- The credit adjustment takes into account the probability of default, as calculated by an independent service, for each counterparty that has an out-of-the money position with PPL Energy Supply.
- The liquidity adjustment takes into account the fact that it may not be appropriate to value contracts at the midpoint of the bid/ask spread. PPL Energy Supply might have to accept the "bid" price if PPL Energy Supply wanted to close an open sales position or PPL Energy Supply might have to accept the "ask" price if PPL Energy Supply wanted to close an open purchase position.

#### *Accounting and Reporting*

PPL Energy Supply follows the provisions of SFAS 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities," and SFAS 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities," and interpreted by DIG issues (together, "SFAS 133"), EITF 02-3, "Issues Involving Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities," and EITF 03-11, "Reporting Realized

Gains and Losses on Derivative Instruments That Are Subject to FASB Statement No. 133 and Not 'Held for Trading Purposes' as Defined in Issue No. 02-3," to account for and report on contracts entered into to manage market risk. SFAS 133 requires that all derivative instruments be recorded at fair value on the balance sheet as an asset or liability (unless they meet SFAS 133's criteria for exclusion) and that changes in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met.

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

PPL Energy Supply adopted the final provisions of EITF 02-3 during the fourth quarter of 2002. As such, PPL Energy Supply now reflects its net realized and unrealized gains and losses associated with all derivatives that are held for trading purposes in the "Net energy trading margins" line on the Statement of Income. Non-derivative contracts that met the definition of energy trading activities as defined by EITF 98-10, "Accounting for Energy Trading and Risk Management Activities" are reflected in the financial statements using the accrual method of accounting. Under the accrual method of accounting, unrealized gains and losses are not reflected in the financial statements. Prior periods were reclassified. No cumulative effect adjustment was required upon adoption.

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

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

### *Accounting Designation*

Energy contracts that do not qualify as derivatives receive accrual accounting. For energy contracts that meet the definition of a derivative, the circumstances and intent existing at the time that energy transactions are entered into determine their accounting designation. These designations are verified by PPL Energy Supply's risk control group on a daily basis. The following is a summary of the guidelines that have been provided to the traders who are responsible for contract designation for derivative energy contracts due to the adoption of SFAS 149:

- Any wholesale and retail contracts to sell or buy electricity and the related capacity that are expected to be delivered from PPL's generation or that are approved by the RMC to fulfill a strategic element of PPL's overall marketing strategy are considered "normal." These transactions are not recorded in the financial statements and have no earnings impact until delivery.
- Physical electricity-only transactions can receive cash flow hedge treatment if all of the qualifications under SFAS 133 are met. Any unrealized gains or losses on transactions receiving cash flow hedge treatment are recorded in other comprehensive income. These unrealized gains and losses become realized when the contracts settle and are recognized in income when the hedged transactions occur.
- Physical electricity purchases that increase PPL Energy Supply's long position and any energy sale or purchase judged a "market call" are considered speculative, with unrealized gains or losses recorded immediately through earnings.
- Financial transactions, which can be settled in cash, cannot be considered "normal" because they do not require physical delivery. These transactions receive cash flow hedge treatment if they lock-in the price PPL Energy Supply will receive or pay for energy expected to be generated or purchased in the spot market. Any unrealized gains or losses on transactions that receive cash flow hedge treatment are recorded in other comprehensive income. These unrealized gains and losses become realized when the contracts settle and are recognized in income when the hedged transactions occur.
- Physical and financial transactions for gas and oil to meet fuel and retail requirements can receive cash flow hedge treatment if they lock-in the price PPL Energy Supply will pay in the spot market. Any unrealized gains or losses on transactions receiving cash flow hedge treatment are recorded in other comprehensive income. These unrealized gains and losses become realized when the contracts settle and are recognized in income when the hedged transactions occur.
- Option contracts that do not meet the requirements of DIG Issue C15, "Scope Exceptions: Interpreting the Normal

Purchases and Normal Sales Exception as an Election," do not receive hedge accounting treatment and are marked to market through earnings.

In addition to energy-related transactions, PPL Energy Supply enters into foreign currency swap contracts to hedge the fair value of firm commitments denominated in foreign currency and net investments in foreign operations. As with energy transactions, the circumstances and intent existing at the time of the transaction determine a contract's accounting designation, which is subsequently verified by PPL Energy Supply's risk control group on a daily basis. The following is a summary of certain guidelines that have been provided to the Treasury Department, which is responsible for contract designation:

- Transactions to lock-in an interest rate prior to a debt issuance are considered cash flow hedges. Any unrealized gains or losses on transactions receiving cash flow hedge treatment are recorded in other comprehensive income and are amortized as a component of interest expense over the life of the debt.
- Transactions entered into to hedge fluctuations in the value of existing debt are considered fair value hedges with no earnings impact until the debt is terminated because the hedged debt is also marked to market.
- Transactions entered into to hedge the value of a net investment of foreign operations are considered net investment hedges. To the extent that the derivatives are highly effective at hedging the value of the net investment, gains and losses are recorded in other comprehensive income/loss and will not be recorded in earnings until the investment is disposed of.
- Transactions which do not qualify for hedge accounting treatment are marked to market through earnings.

#### Commodity Price Risk

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

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

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

PPL Energy Supply's commodity derivative contracts that qualify for hedge accounting treatment mature at various times through 2010. The following chart sets forth PPL Energy Supply's net fair market value of these contracts as of December 31, 2003.

	<u>Gains/(Losses)</u>
Fair value of contracts outstanding at the beginning of the year	\$ 58
Contracts realized or otherwise settled during the year	(64)
Fair value of new contracts at inception	
Other changes in fair values	<u>92</u>
Fair value of contracts outstanding at the end of the year	<u>\$ 86</u>

During 2003, PPL Energy Supply realized or otherwise settled net gains of approximately \$64 million related to contracts entered into prior to January 1, 2003. This amount does not reflect intra-quarter contracts that were entered into and settled during the period.

"Other changes in fair values," a gain of approximately \$92 million, represents changes in the market value that occurred during 2003 for contracts that were outstanding at the end of 2003.

The following chart segregates estimated fair values of PPL Energy Supply's commodity derivative contracts that qualify for hedge accounting treatment at December 31, 2003 based on

whether the fair values are determined by quoted market prices or other more subjective means.

Source of Fair Value	Fair Value of Contracts at Period-End Gains/(Losses)				Total Fair Value
	Maturity Less Than 1 Year	Maturity 1-3 Years	Maturity 3-5 Years	Maturity in Excess of 5 Years	
Prices actively quoted	\$ 7	\$ 1			\$ 8
Prices provided by other external sources	47	32	\$ (1)		78
Prices based on models and other valuation methods					
Fair value of contracts outstanding at the end of the period	<u>\$ 54</u>	<u>\$ 33</u>	<u>\$ (1)</u>		<u>\$ 86</u>

The "Prices actively quoted" category includes the fair value of exchange-traded natural gas futures contracts quoted on the New York Mercantile Exchange (NYMEX). The NYMEX has currently quoted prices through 2010.

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

The "Prices based on models and other valuation methods" category includes the value of transactions for which an internally developed price curve was constructed as a result of the long-dated nature of the transaction or the illiquidity of the market point, or the value of options not quoted by an exchange or OTC broker. Additionally, this category includes "strip" transactions whose prices are obtained from external sources and then modeled to monthly prices as appropriate.

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

required to pay damages for failure to perform, or that it will not experience counterparty non-performance in the future.

As of December 31, 2003, PPL Energy Supply estimated that a 10% adverse movement in market prices across all geographic areas and time periods would have decreased the value of the commodity contracts in its non-trading portfolio by approximately \$146 million, which is equal to the estimated decrease at December 31, 2002. However, the change in the value of the non-trading portfolio would have been substantially offset by an increase in the value of the underlying commodity, the electricity generated, because these contracts serve to reduce the market risk inherent in the generation of electricity. Additionally, the value of PPL Energy Supply's unsold generation would be improved. Because PPL Energy Supply's electricity portfolio is generally in a net sales position, the adverse movement in prices is usually an increase in prices. Conversely, because PPL Energy Supply's commodity fuels portfolio is generally in a net purchase position, the adverse movement in prices is usually a decrease in prices. If both of these scenarios happened, the implied margins for the unsold generation would increase.

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

PPL Energy Supply's trading contracts mature at various times through 2005. The following chart sets forth PPL Energy Supply's net fair market value of trading contracts as of December 31, 2003:

	Gains/(Losses)
Fair value of contracts outstanding at the beginning of the year	\$ (6)
Contracts realized or otherwise settled during the year	21
Fair value of new contracts at inception	1
Other changes in fair values	(13)
Fair value of contracts outstanding at the end of the year	<u>\$ 3</u>

During 2002, PPL Energy Supply realized or otherwise settled net losses of approximately \$21 million related to contracts entered into prior to January 1, 2003. This amount does not reflect intra-year contracts that were entered into and settled during the period.

The fair value of new contracts at inception is usually zero, because they are entered into at current market prices. However, when PPL Energy Supply enters into an option contract, a premium is paid or received. PPL Energy Supply paid \$1 million, net, during 2003 for these option contracts.

"Other changes in fair values," a loss of approximately \$13 million, represent changes in the market value of contracts outstanding at the end of 2003.

As of December 31, 2003, the net gain on PPL Energy Supply's trading activities expected to be recognized in earnings during the next three months is approximately \$2 million.

The following chart segregates estimated fair values of PPL Energy Supply's trading portfolio at December 31, 2003 based on whether the fair values are determined by quoted market prices or other more subjective means.

Source of Fair Value	Fair Value of Contracts at Period-End Gains/(Losses)				Total Fair Value
	Maturity Less Than 1 year	Maturity 1-3 years	Maturity 3-5 years	Maturity in Excess of 5 Years	
Prices actively quoted					
Prices provided by other external sources					
Prices based on models and other valuation methods	\$ 3				\$ 3
Fair value of contracts outstanding at the end of the period	\$ 3				\$ 3

The "Prices actively quoted" category includes the fair value of exchange-traded natural gas futures contracts quoted on the NYMEX. The NYMEX has currently quoted prices through 2010.

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

The "Prices based on models and other valuation methods" category includes the value of transactions for which an internally developed price curve was constructed as a result of the long-dated nature of the transaction or the illiquidity of the market point, or the value of options not quoted by an exchange or OTC broker. Additionally, this category includes "strip" transactions whose prices are obtained from external sources and then modeled to monthly prices as appropriate.

As of December 31, 2003, PPL Energy Supply estimated that a 10% adverse movement in market prices across all geographic areas and time periods would have decreased the value of the commodity contracts in its trading portfolio by \$3 million compared to a decrease of \$7 million at December 31, 2002.

In accordance with its marketing strategy, PPL Energy Supply does not completely hedge its generation output or fuel

requirements. PPL Energy Supply estimates that for its entire portfolio, including all generation and physical and financial energy positions, a 10% adverse change in power prices across all geographic zones and time periods will decrease expected 2004 gross margins by about \$3 million. Similarly, a 10% adverse movement in all fossil fuel prices will decrease 2004 gross margins by \$15 million.

#### Interest Rate Risk

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

At December 31, 2003, PPL Energy Supply's potential annual exposure to increased interest expense, based on a 10% increase in interest rates was insignificant, compared to \$1 million at December 31, 2002.

PPL Energy Supply is also exposed to changes in the fair value of its debt portfolio. At December 31, 2003, PPL Energy Supply estimated that its potential exposure to a change in fair value of its debt portfolio, through a 10% adverse movement in interest rates, was \$125 million, compared to \$79 million at December 31, 2002.

PPL and PPL Energy Supply utilize various risk management instruments to reduce PPL Energy Supply's exposure to adverse interest rate movements for future anticipated financings. While PPL Energy Supply is exposed to changes in the fair value of these instruments, they are designed such that any economic loss in value should be offset by interest rate savings at the time the future anticipated financing is completed. At December 31, 2003, PPL Energy Supply estimated that its potential exposure to a change in the fair value of these instruments, through a 10% adverse movement in interest rates, was \$1 million. At December 31, 2002, PPL Energy Supply had not entered into any such instruments.

#### Foreign Currency Risk

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

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

PPL holds contracts for the forward purchase of 26 million euros to pay for certain equipment of PPL Susquehanna in 2004. The estimated value of these forward purchases as of December 31, 2003, being the amount PPL would receive to terminate them, was \$1 million.

PPL executed forward sale transactions for £25 million to hedge a portion of its net investment in WPDH Limited. The estimated value of these agreements as of December 31, 2003 was \$4 million, being the amount PPL would pay to terminate the transactions.

PPL executed forward sale transactions for 3.1 billion Chilean pesos to hedge a portion of its net investment in its subsidiary that owns CGE. The estimated value of these agreements as of December 31, 2003 was \$1 million, being the amount PPL would pay to terminate the transactions.

To protect expected income in Chilean pesos, PPL entered into average rate options for 2.4 billion Chilean pesos. At December 31, 2003, the market value of these positions, representing the amount PPL would pay to terminate them, was insignificant.

WPDH Limited executed cross-currency swaps totaling \$1.5 billion to hedge the interest payments and value of its U.S. dollar-denominated bonds. The estimated value of this position on December 31, 2003, being the amount PPL Energy Supply would pay to terminate them, including accrued interest, was \$84 million.

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

#### *Nuclear Decommissioning Fund - Securities Price Risk*

In connection with certain NRC requirements, PPL Susquehanna maintains trust funds to fund certain costs of decommissioning the Susquehanna station. As of December 31, 2003, these funds were invested primarily in domestic equity securities and fixed-rate, fixed-income securities and are reflected at fair value on PPL Energy Supply's Balance Sheet. The mix of securities is designed to provide returns to be used to fund Susquehanna's decommissioning and to compensate for inflationary increases in decommissioning costs. However, the equity securities included in the trusts are exposed to price fluctuation in equity markets, and the values of fixed-rate, fixed-income securities are exposed to changes in interest rates. PPL Susquehanna actively monitors the investment performance and periodically reviews asset allocation in accordance with its nuclear decommissioning trust policy statement. At December 31, 2003, a hypothetical 10% increase in interest rates and a 10% decrease in equity prices would have resulted in an estimated \$24 million reduction in the fair value of the trust

assets, as compared to a \$16 million reduction at December 31, 2002.

PPL Electric's 1998 restructuring settlement agreement provides for the collection of authorized nuclear decommissioning costs through the CTC. Additionally, PPL Electric is permitted to seek recovery from customers of up to 96% of certain increases in these costs. Under the power supply agreements between PPL Electric and PPL EnergyPlus, these revenues are passed on to PPL EnergyPlus. Similarly, these revenues are passed on to PPL Susquehanna under a power supply agreement between PPL EnergyPlus and PPL Susquehanna. These revenues are used to fund the trusts.

#### Credit Risk

Credit risk relates to the risk of loss that PPL Energy Supply would incur as a result of non-performance by counterparties of their contractual obligations. PPL Energy Supply maintains credit policies and procedures with respect to counterparties (including requirements that counterparties maintain certain credit ratings criteria) and requires other assurances in the form of credit support or collateral in certain circumstances in order to limit counterparty credit risk. However, PPL Energy Supply has concentrations of suppliers and customers among electric utilities, natural gas distribution companies and other energy marketing and trading companies. These concentrations of counterparties may impact PPL Energy Supply's overall exposure to credit risk, either positively or negatively, in that counterparties may be similarly affected by changes in economic, regulatory or other conditions. As discussed above under "Contract Valuation," PPL Energy Supply records certain non-performance reserves to reflect the probability that a counterparty with contracts that are out of the money (from the counterparty's standpoint) will default in its performance, in which case PPL Energy Supply would have to sell into a lower-priced market or purchase from a higher-priced market. These reserves are reflected in the fair value of assets recorded in "Price risk management assets" on the Balance Sheet. PPL Energy Supply also records reserves to reflect the probability that a counterparty will not make payments for deliveries PPL Energy Supply has made but not yet billed. These reserves are reflected in "Unbilled revenues" on the Balance Sheet. PPL Energy Supply has also established a reserve with respect to certain sales to the California ISO for which PPL Energy Supply has not yet been paid, as well as a reserve related to PPL Energy Supply's exposure as a result of the Enron bankruptcy, which are reflected in "Accounts receivable" on the Balance Sheet. See Notes 14 and 17 to the Financial Statements.

#### **Related Party Transactions**

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

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

## Capital Expenditure Requirements

The schedule below shows PPL Energy Supply's current capital expenditure projections for the years 2004-2008 and actual spending for the year 2003:

	Actual	Projected				
	2003	2004	2005	2006	2007	2008
Construction expenditures (a) (b)						
Generating facilities (c)	\$ 300	\$ 167	\$ 193	\$ 161	\$ 194	\$ 180
Transmission and distribution facilities	226	249	221	220	244	253
Environmental	21	3	10	30	72	100
Other	12	20	2	2	2	2
Total Construction Expenditures	559	439	426	413	512	535
Nuclear fuel	53	56	59	62	63	64
Total Capital Expenditures	<u>\$ 612</u>	<u>\$ 495</u>	<u>\$ 485</u>	<u>\$ 475</u>	<u>\$ 575</u>	<u>\$ 599</u>

- (a) Construction expenditures include capitalized interest, which is expected to be less than \$10 million in each of the years 2004-2008.  
 (b) This information excludes any investments by PPL Global for new projects.  
 (c) Expenditures for generating facilities in 2003 include \$116 million for facilities under synthetic lease agreements that had been reflected off-balance sheet prior to December 31, 2003. Projected capital expenditures on these facilities are also included for the years 2004 through 2008.

PPL Energy Supply's capital expenditure projections for the years 2004-2008 total about \$2.6 billion. Capital expenditure plans are revised periodically to reflect changes in market, and asset regulatory conditions. PPL Energy Supply also leases vehicles, personal computers and other equipment, as described in Note 10 to the Financial Statements. See Note 14 for additional information regarding potential capital expenditures for environmental projects.

## Acquisitions, Development and Divestitures

From time-to-time, PPL Energy Supply and its subsidiaries are involved in negotiations with third parties regarding acquisitions, joint ventures and other arrangements which may or may not result in definitive agreements. See Note 9 to the Financial Statements for information regarding recent acquisitions and development activities.

At December 31, 2003, PPL Global had investments in foreign facilities, including consolidated investments in WPD, Emel, EC and others. See Note 3 to the Financial Statements for information on unconsolidated investments accounted for under the equity method.

PPL Global is exploring potential sale opportunities for its interest in CGE, within the context of an on-going review of its international minority ownership investments.

At December 31, 2003, PPL Energy Supply had domestic generation projects under development which will provide 663 MW of additional generation.

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

## Environmental Matters

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

## Competition

See Item 1, "Business - Competition," for additional information.

## New Accounting Standards

### FIN 46 and FIN 46(R)

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51." FIN 46 clarifies that variable interest entities, as defined therein, that do not disperse risks among the parties involved should be consolidated by the entity that is determined to be the primary beneficiary. FIN 46 also requires certain disclosures to be made by the primary beneficiary and by an enterprise that holds a significant variable interest in a variable interest entity but is not the primary beneficiary. FIN 46 applied immediately to variable interest entities created after January 31, 2003 and to variable interest entities in which an enterprise obtains an interest after January 31, 2003. For variable interest entities in which an enterprise holds a variable interest that was acquired before February 1, 2003, FIN 46 was originally required to be adopted no later than the first fiscal year or interim period beginning after June 15, 2003. However, in October 2003, the FASB issued FSP FIN 46-6, "Effective Date of FASB Interpretation No. 46, Consolidation of Variable Interest Entities," which delayed the effective date for applying the provisions of FIN 46 to interests held by public entities in variable interest entities or potential variable interest entities created before February 1, 2003 until the end of the first interim period ending after December 15, 2003.

In December 2003, the FASB revised FIN 46 by issuing Interpretation No. 46 (revised December 2003), which is known as FIN 46(R) and replaces FIN 46. FIN 46(R) does not change the general consolidation concepts of FIN 46. Among other things, FIN 46(R) again changes the effective date for applying the provisions of FIN 46 to certain entities, clarifies certain provisions of FIN 46 and provides additional scope exceptions for certain types of businesses. For entities to which the provisions of FIN 46 have not been applied as of December 24, 2003, FIN 46(R) provides that a public entity that is not a small business issuer should apply the provisions of FIN 46 or FIN 46(R) as follows: (i) FIN 46(R) shall be applied to all entities no later than the end of the first reporting period that ends March 15, 2004 and (ii) FIN 46 or FIN 46(R) should be applied

to entities that are considered to be SPEs no later than the end of the first reporting period that ends after December 15, 2003.

As permitted by FIN 46(R), PPL Energy Supply adopted FIN 46 effective December 31, 2003 for entities created before February 1, 2003 that are considered to be SPEs. This adoption resulted in the consolidation of the lessors under the operating leases for the Sundance, University Park and Lower Mt. Bethel generation facilities, as well as the deconsolidation of a wholly-owned trust. See below for further discussion. Also, as permitted by FIN 46(R), PPL Energy Supply deferred the application of FIN 46 for other entities and plans to adopt FIN 46(R) for all entities on March 31, 2004.

PPL Energy Supply is in the process of evaluating entities in which it holds a variable interest in accordance with FIN 46(R). PPL Energy Supply is currently not aware of any variable interest entities that are not consolidated as of December 31, 2003 but which it will be required to consolidate in accordance with FIN 46(R) effective March 31, 2004. As it continues to evaluate the impact of applying FIN 46(R), PPL Energy Supply may identify additional entities that it would need to consolidate.

#### Additional Entities Consolidated

The lessors under the operating leases for the Sundance, University Park and Lower Mt. Bethel generation facilities are variable interest entities that are considered to be SPEs. PPL Energy Supply is the primary beneficiary of these entities. Consequently, PPL Energy Supply was required to consolidate the financial statements of the lessors effective December 31, 2003. Upon initial consolidation, PPL Energy Supply recognized \$1.1 billion of additional assets and liabilities on its balance sheet and a charge of \$27 million, after-tax, as a cumulative effect of a change in accounting principle. The additional assets consist principally of the generation facilities, and the additional liabilities consist principally of the lease financing. See Note 10 to the Financial Statements for a discussion of the leases.

#### Entities Deconsolidated

Effective December 31, 2003, PPL Energy Supply deconsolidated SIUK Capital Trust I. This trust is considered to be an SPE and was deconsolidated because PPL Energy Supply is not the primary beneficiary of the trust under current interpretations of FIN 46. Therefore, the "Company-obligated Mandatorily Redeemable Preferred Securities of Subsidiary Trusts Holding Solely Company Debentures" amounting to \$86 million, which would have been recorded as a component of long-term debt in 2003 in accordance with SFAS 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity," if the trust was consolidated, are not reflected in PPL Energy Supply's Balance Sheet at December 31, 2003. Instead, the subordinated debt securities that support the trust preferred securities are reflected in "Long-term Debt with Affiliate Trust" as of December 31, 2003. See below for further discussion.

SIUK Capital Trust I holds subordinated debt securities of WPD LLP. As a result of deconsolidating the trust, the subordinated debt securities are no longer eliminated in the consolidated financial statements. As of December 31, 2003, \$89 million is reflected as "Long-term Debt with Affiliate Trust" in PPL Energy Supply's Balance Sheet.

The effect on the Balance Sheet as a result of deconsolidating the trust was an increase in both total assets and total liabilities of \$3 million. The increase in assets relates to the investment in the common securities of the trust, which is no longer eliminated in the consolidated financial statements. The increase in liabilities consists primarily of the difference between the carrying value of the preferred securities issued by the trust compared to the carrying value of the subordinated debt securities of WPD LLP. The deconsolidation of the trust did not impact the earnings of PPL Energy Supply.

See the Statement of Company-obligated Mandatorily Redeemable Securities contained in the Financial Statements for a discussion of the trust and its preferred securities, as well as the subordinated debt securities issued to the trust.

#### **Other**

See Note 22 to the Financial Statements for information on other new accounting standards adopted in 2003 or pending adoption.

#### **Application of Critical Accounting Policies**

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

#### **1) Price Risk Management**

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

## 2) Pension and Other Postretirement Benefits

As described in Note 12 to the Financial Statements, PPL Energy Supply subsidiaries sponsor various pension and other postretirement plans and participate in, and are allocated a significant portion of the liability and net periodic pension cost of the PPL Retirement Plan and the PPL Postretirement Benefit Plan. PPL and PPL Energy Supply follow the guidance of SFAS 87, "Employers' Accounting for Pensions," and SFAS 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," when accounting for these benefits. Under these accounting standards, assumptions are made regarding the valuation of benefit obligations and the performance of plan assets. Delayed recognition of differences between actual results and expected or estimated results is a guiding principle of these standards. This delayed recognition of actual results allows for a smoothed recognition of changes in benefit obligations and plan performance over the working lives of the employees who benefit under the plans. The primary assumptions are as follows:

- **Discount Rate** - The discount rate is used in calculating the present value of benefits, which are based on projections of benefit payments to be made in the future.
- **Expected Return on Plan Assets** - Management projects the future return on plan assets considering prior performance, but primarily based upon the plans' mix of assets and expectations for the long-term returns on those asset classes. These projected returns reduce the net benefit costs the company will record currently.
- **Rate of Compensation Increase** - Management projects employees' annual pay increases, which are used to project employees' pension benefits at retirement.
- **Health Care Cost Trend Rate** - Management projects the expected increases in the cost of health care.

In selecting discount rates, PPL and PPL Energy Supply consider fixed-income security yield rates. At December 31, 2003, PPL and PPL Energy Supply decreased the discount rate for their domestic plans from 6.75% to 6.25% as a result of decreased fixed-income security returns. For its international plans, PPL Energy Supply decreased the discount rate for its international plans from 5.75% to 5.50% at December 31, 2003.

In selecting an expected return on plan assets, PPL and PPL Energy Supply consider past performance and economic forecasts for the types of investments held by the plan. At December 31, 2003, PPL and PPL Energy Supply's expected return on plan assets for their domestic pension plans remained at 9.0%. For its international plans, PPL Energy Supply maintained a weighted average of 8.30% as the expected return on plan assets at December 31, 2003.

In selecting a rate of compensation increase, PPL and PPL Energy Supply consider tax implications, past experience in light of movements in inflation rates. At December 31, 2003, PPL and PPL Energy Supply's rates of compensation increase

remained at 4.0% for their domestic plans. For its international plans, PPL Energy Supply's rate of compensation increase remained at 3.75% at December 31, 2003.

In selecting health care cost trend rates, PPL and PPL Energy Supply consider past performance and forecasts of health care costs. At December 31, 2003, PPL and PPL Energy Supply's health care cost trend rates were 11% for 2004, gradually declining to 5.0% for 2010.

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

Actuarial Assumption	Change in Assumption	Increase/(Decrease)			
		Impact on Obligation	Impact on Liabilities (a)	Impact on Cost	Impact on OCI
Discount Rate	(0.25)%	\$ 114	\$ 2	\$ 2	\$ 1
Expected Return on Plan Assets	(0.25)%	N/A	7	7	
Rate of Compensation Increase	0.25%	10	2	2	
Health Care Cost Trend Rate (b)	1.0%	11	1	1	N/A

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

At December 31, 2003, PPL Energy Supply had been allocated and recognized accrued pension and other postretirement benefit liabilities totaling \$332 million, included in "Deferred Credits and Other Noncurrent Liabilities - Other" on the Balance Sheet. At December 31, 2003, PPL Energy Supply had been allocated \$1 million of prepaid postretirement benefit costs included in "Prepayments" on the Balance Sheet.

In 2003, PPL Energy Supply was allocated and recognized net periodic pension and other postretirement income credited to operating expenses of \$24 million. This amount represents a \$34 million decrease versus the credit recognized during 2002. This decrease was primarily due to the decrease in the discount rate at December 31, 2002.

As a result of the decrease in the assumed discount rate at December 31, 2003, PPL Energy Supply was required to include its recognized additional minimum pension liability. Recording the change in the additional minimum liability resulted in a \$12

million increase to the pension-related charge to OCI, net of taxes, translation adjustment and unrecognized prior service costs, with no effect on net income. This charge increased the pension-related balance in OCI, which is a reduction to Member's Equity, by \$309 million at December 31, 2003. The charges to OCI will reverse in future periods if the fair value of trust assets exceeds the accumulated benefit obligation.

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

### 3) Asset Impairment

PPL Energy Supply and its subsidiaries review long-lived assets for impairment when events or circumstances indicate carrying amounts may not be recoverable. Assets subject to this review, for which impairments have been recorded in 2003 or prior years, include international equity investments, new generation assets, consolidated international energy projects and goodwill.

PPL Energy Supply performs impairment analyses for tangible long-lived assets in accordance with SFAS 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." For long-lived assets to be held and used, SFAS 144 requires companies to (a) recognize an impairment loss only if the carrying amount is not recoverable from undiscounted cash flows and (b) measure an impairment loss as the difference between the carrying amount and fair value of the asset.

In determining asset impairments, management must make significant judgments and estimates to calculate the fair value of an investment. Fair value is developed through consideration of several valuation methods including comparison to market multiples, comparison to similar recent sales transactions, comparison to replacement cost and discounted cash flow. Discounted cash flow is calculated by estimating future cash flow streams, applying appropriate discount rates to determine the present values of the cash flow streams, and then assessing the probability of the various cash flow scenarios. The impairment is then recorded based on the excess of the carrying value of the investment over fair value. Changes in assumptions and estimates included within the impairment reviews could result in significantly different results than those identified and recorded in the financial statements.

During 2003, PPL Energy Supply and its subsidiaries evaluated gas-fired generation assets for impairment, as events and circumstances indicated that the carrying value of these investments may not be recoverable. PPL Energy Supply did not record an impairment of its new gas-fired generation assets in 2003. For these impairment analyses, the most significant assumption was the estimate of future cash flows. PPL Energy Supply estimates future cash flow using information from its corporate business plan adjusted for any recent sales or purchase commitments. Key factors that impact cash flows include projected prices for electricity and gas as well as firm sales and purchase commitments. A 10% decrease in estimated future cash flow for certain in-service gas-fired generation assets would have resulted in an impairment charge.

PPL Energy Supply performs impairment analyses of goodwill in accordance with SFAS 142, "Goodwill and Other Intangible Assets." SFAS 142 requires an annual impairment test of goodwill and other intangible assets that are not subject to amortization.

PPL Energy Supply completed its annual goodwill impairment test in the fourth quarter of 2003. This test did not result in an impairment. PPL Energy Supply's most significant assumptions surrounding the goodwill impairment test relate to the determination of fair value. PPL Energy Supply determined fair value based upon discounted cash flows. A decrease in the forecasted cash flows of 10% or an increase of the discount rate by 25 basis points would not have resulted in impairment.

### 4) Leasing

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

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

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

At December 31, 2003, PPL Energy Supply subsidiaries participated in one significant sale/leaseback transaction which has been accounted for as an operating lease. As discussed in Note 22 to the Financial Statements, the lessors under certain synthetic operating leases previously accounted for off-balance sheet were consolidated effective December 31, 2003 as a result of the adoption of FIN 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51," for certain entities.

#### Sale/Leaseback

In July 2000, PPL Montana sold its interest in the Colstrip generating plant to owner lessors who are leasing the assets back to PPL Montana under four 36-year operating leases. This

transaction is accounted for as an operating lease in accordance with current rules related to sale/leaseback arrangements. If for any reason this transaction did not meet the requirements for off-balance sheet operating lease treatment as a sale/leaseback, PPL Energy Supply would have approximately \$315 million of additional assets and liabilities recorded on its balance sheet at December 31, 2003 and would have recorded additional expenses currently estimated at \$9 million, after-tax, in 2003.

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

## 5) Loss Contingencies

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

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

The accrual of a loss contingency involves considerable judgment on the part of management. The accounting aspects of loss contingencies include: (1) the initial identification and recording of the loss contingency; (2) the determination of a triggering event for reducing a recorded loss contingency; and (3) the on-going assessment as to whether a recorded loss contingency is reasonable.

### Initial Identification and Recording of the Loss Contingency

PPL Energy Supply uses its internal expertise and outside experts (such as lawyers, tax specialists and engineers), as necessary, to help estimate the probability that a loss has been incurred and the amount (or range) of the loss. PPL Energy Supply continuously assesses potential loss contingencies for environmental remediation, litigation claims, regulatory penalties and other events.

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

loss contingencies, most of which have not met the criteria for accrual under SFAS 5.

### Reducing Recorded Loss Contingencies

When a loss contingency is recorded, PPL Energy Supply identifies, where applicable, the triggering events for subsequently reducing the loss contingency. The triggering events generally occur when the contingency has been resolved and the actual loss incurred, or when the risk of loss has diminished or been eliminated. The following are some of the triggering events which provide for the reduction of certain recorded loss contingencies:

- Certain loss contingencies are systematically reduced based on the expiration of contract terms. An example of this is the recorded liability for above-market NUG purchase commitments, which is described below. This loss contingency is being reduced over the lives of the NUG purchase contracts.
- Allowances for excess or obsolete inventory are reduced as the inventory items are pulled from the warehouse shelves and sold as scrap or otherwise disposed.
- Allowances for uncollectible accounts are reduced when accounts are written off after prescribed collection procedures have been exhausted.
- Environmental loss contingencies are reduced when PPL Energy Supply makes payments for environmental remediation.

### On-Going Assessment of Recorded Loss Contingencies

PPL Energy Supply reviews its loss contingencies on a regular basis to assure that the recorded potential loss exposures are reasonable. This involves on-going communication and analyses with internal and external legal counsel, engineers, tax specialists, managers in various operational areas and other parties.

All three aspects of accounting for loss contingencies - the initial identification and recording of a probable loss, the identification of triggering events to reduce the loss contingency, and the ongoing assessment of the reasonableness of a recorded loss contingency - require significant judgment by PPL Energy Supply's management.

The largest loss contingency on PPL Energy Supply's balance sheet, and the loss contingency that changed most significantly in 2003, was for above-market NUG purchase commitments. This loss contingency reflects the estimated difference between the above-market contract terms under the purchase commitments, and the fair value of electricity. This loss contingency was originally recorded at \$854 million in 1998, when PPL Electric's generation business was deregulated. Under regulatory accounting, PPL Electric recorded the above-market cost of the purchases from NUGs as part of its purchased power costs on an as-incurred basis, since these costs were

recovered in regulated rates. When the generation business was deregulated, the loss contingency associated with the commitment to make above-market NUG purchases was recorded. This loss contingency for the above-market portion of NUG purchase commitments was recorded because it was probable that the loss had been incurred and the estimate of future energy prices could be reasonably determined, using the then forward prices of electricity and capacity. This loss contingency was transferred to PPL EnergyPlus in the July 1, 2000 corporate realignment. The above-market loss contingency was \$352 million at December 31, 2003.

When the loss contingency related to NUG purchases was recorded in 1998, PPL Electric established the triggering events for when the loss contingency would be reduced. A schedule was established to reduce the liability based on projected purchases over the lives of the NUG contracts. All but one of the NUG contracts expire by 2009, with the last one ending in 2014. PPL EnergyPlus reduces the above-market NUG liability based on the aforementioned schedule. As PPL EnergyPlus reduces the liability for the above-market NUG purchases, it offsets the actual cost of NUG purchases, thereby bringing the net power purchase expense more in line with market prices.

PPL EnergyPlus assessed the remaining \$352 million above-market liability at December 31, 2003, comparing the projected electricity purchases under the terms of the NUG contracts, with the purchases assuming projected market prices for the energy. This assessment was based on projected PJM market prices, including capacity, through 2014. The assessment also used sensitivities around the market prices, adjusting such prices upwards and downwards by 10%.

The assessment is dependent on the market prices of energy and the estimated output levels of the NUGs. Market prices of energy are dependent on many variables, including growth in electricity demand in PJM, available generation, and changes in regulatory and economic conditions. Accordingly, market price sensitivities were used in the assessment. If estimated market prices were adjusted upwards by 10% in each of the years from 2004 through 2014, the contingency for the above-market NUG purchase commitments would be approximately \$296 million. Conversely, if estimated market prices were adjusted downwards by 10% during the remaining term of the NUG contracts, the contingency for the above-market NUG purchase commitments would be approximately \$386 million. The recorded above-market liability of \$352 million at December 31, 2003 falls within the range calculated in the year-end assessment. As noted above, it is very difficult to estimate future electricity prices, which are dependent on many variables and subject to significant volatility. However, PPL Energy Supply's management believes that the current recorded NUG above-market liability was fairly stated at December 31, 2003.

## 6) Asset Retirement Obligations

In 2001, the FASB issued SFAS 143, "Accounting for Asset Retirement Obligations," which addresses the accounting for obligations associated with the retirement of tangible long-lived

assets. SFAS 143 requires legal obligations associated with the retirement of long-lived assets to be recognized as a liability in the financial statements. The initial obligation should be measured at the estimated fair value. An equivalent amount should be recorded as an increase in the value of the capitalized asset and allocated to expense over the useful life of the asset. Until the obligation is settled, the liability should be increased, through the recognition of accretion expense in the income statement, for changes in the obligation due to the passage of time. SFAS 143 is effective for fiscal years beginning after June 15, 2002.

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

PPL Energy Supply adopted SFAS 143 effective January 1, 2003. Initial adoption of the new rules resulted in an increase in net PP&E of \$32 million, reversal of previously recorded liabilities of \$304 million, recognition of asset retirement obligations of \$229 million, recognition of a deferred tax liability of \$44 million and a cumulative effect of adoption that increased net income by \$63 million. At December 31, 2003, PPL Energy Supply had asset retirement obligations totaling \$242 million recorded on the Balance Sheet. PPL Energy Supply's most significant assumptions surrounding asset retirement obligations are the forecasted retirement cost, discount rate and inflation rate. A variance in the forecasted retirement cost, discount rate or inflation rate could have a significant impact on the ARO liability and the cumulative effect gain.

The following chart reflects the sensitivities associated with a change in these assumptions upon initial adoption. Each sensitivity below reflects an evaluation of the change based solely on a change in that assumption only.

	<u>Change in Assumption</u>	<u>Impact on Cumulative Effect</u>	<u>Impact on ARO Liability</u>
<b>Retirement Cost</b>	10%/(10)%	\$(10)/\$10	\$22/\$(22)
<b>Discount Rate</b>	0.25%/(0.25)%	\$10/\$(11)	\$(23)/\$26
<b>Inflation Rate</b>	0.25%/(0.25)%	\$(12)/\$11	\$27/\$(24)

### Other Information

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

**PPL ELECTRIC UTILITIES CORPORATION**

**ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**Overview**

PPL Electric provides electricity delivery service in eastern and central Pennsylvania. Its headquarters are in Allentown, Pennsylvania. See Item 1, "Business - Background," for a description of PPL Electric's business. PPL Electric's strategy and principal challenge is to own and operate its electricity delivery business at the highest level of quality and reliability and at the most efficient cost.

PPL Electric's electricity delivery business is rate-regulated. Accordingly, PPL Electric is subject to regulatory risks in terms of the costs that it may recover and the investment returns that it may collect in customers' rates.

An important challenge for PPL Electric is to maintain a strong credit profile. In the past few years, investors, analysts and rating agencies that follow companies in the energy industry have been particularly focused on the credit quality and liquidity position of these companies. PPL Electric is focused on strengthening its balance sheet and improving its liquidity position, thereby improving its credit profile.

The purpose of "Management's Discussion and Analysis of Financial Condition and Results of Operations" is to provide information concerning PPL Electric's past and expected future performance in implementing the strategy and challenges outlined above. Specifically:

- "Results of Operations" provides an overview of PPL Electric's operating results in 2003, 2002 and 2001, starting with a review of earnings. The earnings review identifies certain unusual items that had impacts in these years, and it also references the delivery rate increase that PPL Electric expects to file with the PUC in the spring of 2004. "Results of Operations" also includes an explanation of changes during this three-year period in significant income statement components, such as operating revenues, operation and maintenance expenses, financing costs, income taxes and cumulative effects of accounting changes.
- "Financial Condition - Liquidity" provides an analysis of PPL Electric's liquidity position and credit profile, including its sources of cash (including bank credit facilities and sources of operating cash flow) and uses of cash (including contractual commitments and capital expenditure requirements) and the key risks and uncertainties that impact PPL Electric's past and future liquidity position and financial condition. This subsection also includes an explanation of recent rating agency decisions affecting PPL Electric, as well as a listing of PPL Electric's current credit ratings.
- "Financial Condition - Risk Management" includes an explanation of PPL Electric's risk management activities regarding commodity price risk and interest rate risk.

- "Application of Critical Accounting Policies" provides an overview of the accounting policies that are particularly important to the results of operations and financial condition of PPL Electric and that require PPL Electric's management to make significant estimates, assumptions and other judgments. Although PPL Electric's management believes that these estimates, assumptions and other judgments are appropriate, they relate to matters that are inherently uncertain. Accordingly, changes in the estimates, assumptions and other judgments applied to these accounting policies could have a significant impact on PPL Electric's results of operations and financial condition, as reflected in PPL Electric's Financial Statements.

The information provided in "Management's Discussion and Analysis of Financial Condition and Results of Operations" should be read in conjunction with PPL Electric's Financial Statements and the Notes thereto.

Terms and abbreviations appearing herein are explained in the glossary. Dollars are in millions unless otherwise noted.

**Results of Operations**

The following discussion explains significant changes in principal items on the Statement of Income comparing 2003 to 2002, and 2002 to 2001.

**Earnings**

Income available to PPL was:

	<u>2003</u>		<u>2002</u>		<u>2001</u>
	\$ 25		\$ 39		\$ 119

The after-tax changes in income available to PPL were primarily due to:

	<u>2003 vs. 2002</u>		<u>2002 vs. 2001</u>
Delivery revenues (net of CTC/ITC amortization and interest expense on transition bonds)	\$ 17	\$	(10)
Operation and maintenance expenses	(15)		(18)
PJM ancillary expenses	(6)		(29)
Depreciation expense	(5)		(2)
Retail electric to affiliate revenues	(9)		2
Financing costs (excluding transition bond interest expense)	(6)		(2)
Other	(4)		3
Unusual items	14		(24)
	<u>\$ (14)</u>	<u>\$</u>	<u>(80)</u>

The changes in income available to PPL from year to year are, in part, attributable to several unusual items with significant earnings impacts, including an accounting change and an

infrequently occurring item. The after-tax impacts of these unusual items are shown below:

	2003	2002	2001
Workforce reduction (Note 20)	\$ (5)	\$ (19)	
Accounting method change - Pensions (Note 12)			\$ 5
<b>Total</b>	<u>\$ (5)</u>	<u>\$ (19)</u>	<u>\$ 5</u>

The year to year changes in earnings components are discussed in the balance of the discussion in "Results of Operations."

PPL Electric expects to file a request for a distribution rate increase with the PUC in March 2004. If approved, the new rates will go into effect in January 2005, when PPL Electric's distribution rate cap expires. In addition, beginning January 1, 2005, PPL Electric expects to fully recover from its retail customers the charges that it pays to PJM for transmission-related services. See "Item 1. Business-Background-Delivery Segment" for more information regarding PPL Electric's transmission and distribution rate cap.

## Operating Revenues

### Retail Electric (Including to Affiliate)

The increase (decrease) in revenues from retail electric operations was attributable to the following:

	2003 vs. 2002	2002 vs. 2001
Electric delivery	\$ 48	\$ (1)
PLR electric generation supply	22	102
Delivery and PLR supply to PPL Generation	(15)	3
Other		(11)
	<u>\$ 55</u>	<u>\$ 93</u>

The increase in operating revenues from retail electric operations for 2003, compared with the same period in 2002, was primarily due to:

- higher delivery revenues resulting from a 1.1% increase in delivery sales. The increase in sales volume was due in part to colder winter weather in the first quarter of 2003; and
- higher PLR revenues due to higher energy and capacity rates in 2003 compared with 2002; partially offset by
- lower sales to PPL Generation. PPL Generation's power plants began self-supplying their station use in April 2003, rather than taking supply from PPL Electric.

The increase in operating revenues from retail electric operations from 2002 compared with 2001 was primarily due to higher revenues from providing electric generation supply as a PLR. Since December 2001, about 50% to 60% of kWh load in PPL Electric's service territory that had been served by alternate suppliers under the Customer Choice Act had returned to PPL Electric as the supplier.

## Wholesale Electric

PPL Electric wholesale revenues are derived from sales to municipalities. The \$5 million decrease in wholesale electric revenues in 2002 compared with 2001 was due to the expiration of certain municipal contracts in February 2002.

### Wholesale Electric to Affiliate

PPL Electric has a contract to sell to PPL EnergyPlus the electricity that PPL Electric purchases under contracts with NUGs. The termination of one NUG contract in April 2003 and another in February 2002 caused PPL Electric to purchase \$8 million less NUG energy in 2003 compared to 2002 and \$16 million less in 2002 compared with 2001. PPL Electric therefore had less electricity to sell to PPL EnergyPlus.

## Energy Purchases

Effective January 1, 2002, PPL Electric began incurring the costs of certain ancillary services, such as area regulation and operating reserves, in connection with its power supply contract with PPL EnergyPlus. Energy purchases increased by \$31 million in 2002 compared with 2001, including \$48 million in ancillary service costs. These costs were primarily offset by a \$16 million decrease in NUG purchases due to the termination of an energy purchase contract with a NUG in February 2002.

### Energy Purchases from Affiliate

Energy purchases from affiliate increased by \$13 million in 2003 compared with 2002. This increase reflects higher prices for energy purchased under the power supply contracts with PPL EnergyPlus needed to support PLR load.

Energy purchases from affiliate increased by \$106 million in 2002 compared with 2001. This increase reflects higher purchases under power supply contracts with PPL EnergyPlus needed to support a higher PLR load, due to the return of customers to PPL Electric as their PLR. See Note 15 to the Financial Statements for a discussion of the power supply contracts.

### Other Operation and Maintenance

The increase (decrease) in other operation and maintenance expenses was primarily due to:

	<u>2003 vs. 2002</u>	<u>2002 vs. 2001</u>
Decrease in pension income	\$ 13	\$ 7
Lower net rent allocations to other PPL affiliates in 2003 and 2002	6	4
Increase in other postretirement benefit expense	7	3
Increases in expenses in responding to customers' service calls	2	5
Additional costs from winter storms		6
Work performed to assure reliability of the T&D system	2	3
Environmental accrual for a former manufactured gas plant	2	
Television advertising	2	
Increase in property damage provisions, based on an aging of those accounts receivable	1	
Estimated reduction in salaries and benefits as a result of the workforce reduction initiated in 2002	(8)	(4)
Vacation liability adjustment in 2002 in conjunction with the workforce reduction	(7)	7
Other - net	6	
	<u>\$ 26</u>	<u>\$ 31</u>

The \$13 million decrease in net pension income was attributable to decreased asset values at the end of 2002 and reductions in the discount rate assumptions for PPL's domestic pension plans, which was the result of weakness in the financial markets during 2002. The 2002 year-end asset values and discount rates were used to measure net pension income for 2003. Through December 31, 2003, PPL Electric was allocated \$4 million of net pension income, based on its participation in PPL's primary domestic pension plan.

Although financial markets have improved and PPL domestic pension plans have experienced significant asset gains in 2003, interest rates on fixed-income obligations have continued to fall requiring a further reduction in the discount rate assumption as of December 31, 2003. The reduction in the discount rate assumption has a significant impact on the measurement of plan obligations and net pension cost, which will result in the allocation of a pension charge to PPL Electric in 2004. See Note 12 to the Financial Statements for details of the funded status of PPL's pension plans.

### Depreciation

Depreciation increased by \$9 million in 2003 compared with 2002, primarily due to plant and software additions, including the Automated Meter Reading project.

### Taxes, Other Than Income

Taxes, other than income, increased by \$11 million in 2003 compared with 2002 due to the settlement of prior years' capital stock tax refund claims of \$8 million in 2002, and higher taxes related to an increase in the basis on which capital stock taxes were calculated in 2003.

Taxes, other than income, increased by \$37 million in 2002 compared with 2001, primarily due to a \$45 million increase in gross receipts tax, partially offset by a \$10 million decrease in capital stock tax.

The gross receipts tax increase in 2002 was due to an increase in the revenue-neutral reconciliation (RNR) tax component of the effective Pennsylvania gross receipts tax rate in January 2002. The RNR, which adjusts the base gross receipts tax rate of 4.4%, was enacted as part of the Customer Choice Act as a tax revenue replacement component to recoup losses to the Commonwealth of Pennsylvania or return benefits to customers that may result from the restructuring of the electric industry. This increase was partially offset by the settlement of prior years' capital stock tax refund claims and a lower capital stock tax rate in 2002.

### Workforce Reduction

See Note 20 to the Financial Statements for information on the charges recorded in 2003 and 2002.

### Other Income - net

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

### Financing Costs

Interest expense on long-term debt decreased by \$7 million in 2003 compared to 2002. This decrease was the net impact of retirements of mortgage bonds, Pollution Control Bonds and Transition Bonds, partially offset by the issuance of \$100 million of Senior Secured Bonds and \$90 million of Pollution Control Bonds.

Lower interest on long-term debt accounted for the \$12 million decrease in interest expense in 2002 compared with 2001. This decrease was the net impact of retirements of mortgage bonds and Transition Bonds, partially offset by the issuance of \$800 million of Senior Secured Bonds in August 2001.

Dividends on preferred securities decreased by \$13 million from 2002 to 2003 and by \$10 million from 2001 to 2002. These decreases were due to retirements and redemptions of preferred securities and preferred stock.

### Income Taxes

Income tax expense did not change for 2003 compared with 2002. This was due to lower pre-tax book income, resulting in a

\$5 million reduction in income taxes, offset by a \$3 million increase in income tax expense related to the filing of PPL Electric's income tax returns.

Income tax expense decreased by \$47 million in 2002 compared with 2001. This change was primarily due to a decrease in pre-tax book income.

### Cumulative Effect of a Change in Accounting Principle

In 2001, PPL changed its method of amortizing unrecognized gains or losses in the annual pension expense or income determined under SFAS 87, "Employers' Accounting for Pensions." This change resulted in an allocation to PPL Electric of a cumulative-effect credit of \$5 million. See Note 12 to the Financial Statements for additional information.

## Financial Condition

### Liquidity

PPL Electric is focused on maintaining a strong liquidity position and strengthening its balance sheet, thereby improving its credit profile. PPL Electric believes that its cash on hand, operating cash flows, access to debt capital markets and borrowing capacity, taken as a whole, provide sufficient resources to fund its ongoing operating requirements, future security maturities and estimated future capital expenditures. PPL Electric currently expects cash on hand at the end of 2004 to be approximately \$110 million, with about \$200 million in indicated credit facilities and up to \$150 million in short-term debt capacity related to an asset-backed commercial paper program in which it plans to participate starting in early 2004. However, PPL Electric's cash flows from operations and its access to cost effective bank and capital markets are subject to risks and uncertainties, including but not limited to, the following:

- unusual or extreme weather that may damage PPL Electric's transmission and distribution facilities or effect energy sales to customers;
- ability to recover, and timeliness and adequacy of recovery of costs associated with regulated utility businesses; and
- a downgrade in PPL Electric's credit ratings that could negatively affect its ability to access capital and increase the cost of maintaining credit facilities and any new debt.

At December 31, 2003, PPL Electric had \$162 million in cash and cash equivalents and no short-term debt as compared to \$29 million in cash and cash equivalents and \$15 million of short-term debt at December 31, 2002, and \$79 million in cash and cash equivalents and no short-term debt at December 31, 2001. The changes in short-term debt resulted primarily from the repayments described below under "Net Cash Provided by (Used in) Financing Activities" and in Note 8 to the Financial Statements. The changes in cash and cash equivalents resulted from the following:

	2003	2002	2001
Net Cash Provided by Operating Activities	\$ 528	\$ 274	\$ 392
Net Cash Provided by (Used in) Investing Activities	(145)	41	(432)
Net Cash Used in Financing Activities	(250)	(365)	(148)
Increase (Decrease) in Cash & Cash Equivalents	<u>\$ 133</u>	<u>\$ (50)</u>	<u>\$ (188)</u>

### Net Cash Provided by Operating Activities

Net cash provided by operating activities increased by 93%, or \$254 million, in 2003 versus 2002, reflecting working capital improvements resulting from a decrease in accounts receivable and an increase in accounts payable. The savings from a workforce reduction program that was commenced in 2002 was more than offset by rising transmission and distribution operating costs.

An important element supporting the stability of PPL Electric's cash from operations is its long-term energy purchase contracts with PPL EnergyPlus. These contracts provide sufficient energy for PPL Electric to meet its PLR obligation from 2003 through 2009, at the pre-determined capped rates it is entitled to charge its customers during this period. These contracts require cash collateral or other credit enhancement, or reductions or terminations of a portion or the entire contract through cash settlement in the event of a downgrade of PPL Electric or adverse changes in market prices. For example, if PPL Electric's ratings were lowered to below "investment grade" and energy prices decreased by 10%, PPL Electric estimates that, based on its December 31, 2003 and 2002 positions, it would have to post collateral of approximately \$300 million for both years. The maximum that PPL Electric would have to post under these contracts is \$300 million.

Net cash provided by operating activities in 2002 was \$274 million, compared to \$392 million in 2001. The decrease was primarily the result of lower earnings and an increase in accounts receivable. Cash provided by operating activities was lower in 2002, despite a \$90 million up-front payment on the PLR contract made in 2001.

### Net Cash Provided by (Used in) Investing Activities

Net cash used in investing activities in 2003 was \$145 million, as compared to net cash provided by investing activities in 2002 of \$41 million. The difference primarily was the result of a lower loan repayment by an affiliate. The primary use of cash for investing activities is capital and investment expenditures, which are summarized by category in the table in "Capital Expenditure Requirements." In 2004, PPL Electric expects to be able to fund all of its capital expenditures with cash from operations.

Net cash provided by investing activities in 2002 was \$41 million, as compared to net cash used in investing activities in 2001 of \$432 million. The difference primarily was the result of

a loan repayment by an affiliate in 2002, versus net lending to affiliates in 2001.

### Net Cash Used in Financing Activities

Net cash used in financing activities was \$250 million in 2003, compared to \$365 million in 2002, which reflects the repayment of long-term debt. In 2003, the \$250 million of cash used in financing activities primarily consisted of net debt retirements of \$255 million, preferred stock retirements of \$31 million, a contribution from parent of \$75 million and common and preferred dividends paid of \$32 million. In 2002, the \$365 million primarily consisted of net debt retirements of \$270 million, company-obligated mandatorily redeemable preferred securities retirements of \$250 million, a contribution from parent of \$240 million and common and preferred stock dividends paid of \$85 million.

PPL Electric's debt financing activity in 2003 was as follows:

	<u>Additions</u>	<u>Payments</u>	<u>Net</u>
PPL Electric First Mortgage Bonds (FMB)	\$ 100	\$ (85)	\$ 15
PPL Electric FMB Pollution Control Bonds	90	(90)	
PPL Electric Commercial Paper (net change)		(15)	(15)
PPL Transition Bond Company		(255)	(255)
Total	<u>\$ 190</u>	<u>\$ (445)</u>	<u>\$ (255)</u>

Debt issued during 2003 had stated interest rates ranging from 3.125% to 4.30% and maturities from 2008 through 2013. See Note 8 to the Financial Statements for more detailed information regarding PPL Electric's borrowings.

In July 2003, PPL Electric determined that, based on its current cash position and anticipated cash flows, it would not need to access the commercial paper markets through at least the end of 2003. As a result, PPL Electric requested Standard & Poor's Ratings Services (S&P), Moody's Investors Service, Inc. (Moody's) and Fitch Ratings (Fitch) to withdraw their ratings for its currently inactive commercial paper program, which the rating agencies did effective as of July 9, 2003. This decision has not limited the ability of PPL Electric to fund its short-term liquidity needs. PPL Electric currently does not have any commercial paper outstanding, but it expects to restart its commercial paper program in early 2004.

At December 31, 2003, PPL Electric's total committed borrowing capacity and the use of this borrowing capacity were as follows:

	<u>Committed Capacity</u>	<u>Borrowed</u>	<u>Letters of Credit Issued (b)</u>	<u>Available Capacity (b)</u>
PPL Electric Credit Facilities (a)	\$ 300		\$ 42	\$ 258

- (a) PPL Electric's credit facilities allow for borrowings at LIBOR-based rate plus a spread, depending upon the company's public debt rating. PPL Electric also has the capability to issue up to \$250 million of letters of credit under these facilities, which issuance reduces available borrowing capacity.

These credit facilities contain a financial covenant requiring debt to total capitalization not greater than 70%. At December 31, 2003 and 2002, PPL Electric's consolidated debt to total capitalization percentages, as calculated in accordance with its credit facilities, were 57% and 58%. PPL Electric's 364-day credit facility also allows it to borrow up to the full amount of the credit facility on the day of expiration for up to a one-year period. The credit agreements also contain certain representations and warranties that must be made for PPL Electric to borrow under them, including, but not limited to, a material adverse change clause that relates solely to PPL Electric's ability to perform its obligations under the credit agreements and related loan documents.

- (b) PPL Electric has a reimbursement obligation to the extent any letters of credit are drawn upon. The letters of credit issued as of December 31, 2003, expire in 2004.

These credit agreements contain various other covenants. Failure to meet those covenants beyond applicable grace period could result in acceleration of due dates of borrowings and/or termination of the agreements. PPL Electric monitors the covenants on a regular basis. At December 31, 2003, PPL Electric was in compliance with those covenants. At this time PPL Electric believes that these covenants and other borrowing conditions will not limit access to these funding sources. PPL Electric intends to reduce its total syndicated credit facilities to \$200 million in the first quarter of 2004. In early 2004, PPL Electric also intends to participate in an Asset-Backed Commercial Paper (ABCP) Program for up to \$150 million that would be secured by a portion of its accounts receivable. The ABCP Program would provide a more reliable and stable source of liquidity than an unsecured commercial paper program.

PPL Electric's 2001 Senior Secured Bond Indenture restricts dividend payments in the event that PPL Electric fails to meet interest coverage ratios or fails to comply with certain separateness formalities undertaken in connection with its strategic initiative (see Note 19 to the Financial Statements for additional information). PPL Electric does not, at this time, expect that any of such limitations would significantly impact its ability to declare dividends.

Net cash used in financing activities was \$365 million in 2002, compared to \$148 million in 2001. In 2002, the \$365 million primarily consisted of net debt retirements of \$270 million, company-obligated mandatorily redeemable preferred securities retirements of \$250 million, preferred and common dividend payments of \$85 million, offset by a contribution from PPL of \$240 million. In 2001, the \$148 million primarily consisted of net debt issuances of \$276 million, preferred stock redemptions of \$15 million, repurchase of common stock from PPL of \$280 million and preferred and common dividends of \$107 million.

### Operating Leases

PPL Electric has operating lease agreements to finance vehicles, personal computers and other equipment. These leasing structures provide PPL Electric with additional operating and financing flexibility. The operating leases contain covenants that are standard for these types of arrangements, such as maintaining insurance, maintaining corporate existence and the

timely payment of rent and other fees. Failure to meet these covenants could limit or restrict access to these leases or require early payment of obligations. At this time, PPL Electric believes that these covenants will not limit access to these leases because acceleration or termination of the leases.

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

### Contractual Obligations

At December 31, 2003, the estimated contractual cash obligations of PPL Electric were as follows:

Contractual Cash Obligations	Total	Less	1-3 Years	3-5 Years	After 5 Years
		Than 1 Year			
Long-term Debt (a)	\$ 2,943	\$ 289	\$ 810	\$ 995	\$ 849
Capital Lease Obligations					
Operating Leases	50	13	19	10	8
Purchase Obligations (b)	9,981	1,489	3,192	3,466	1,834
Other Long-term Liabilities Reflected on the Balance Sheet under GAAP					
<b>Total Contractual Cash Obligations</b>	<b>\$ 12,974</b>	<b>\$ 1,791</b>	<b>\$ 4,021</b>	<b>\$ 4,471</b>	<b>\$ 2,691</b>

- (a) Reflects maturities only. Includes \$1.4 billion of transition bonds issued by PPL Transition Bond Company in 1999 to securitize a portion of PPL Electric's stranded costs. This debt is non-recourse to PPL Electric.
- (b) The payments reflected herein are subject to change as the purchase obligation reflected is an estimate based on projected obligated quantities and projected pricing under the contract.

### Credit Ratings

The following table summarizes the credit ratings of PPL Electric and its subsidiary, PPL Transition Bond Company, LLC, at December 31, 2003:

	Moody's	Standard & Poor's	Fitch
<b>PPL Electric</b>			
Senior Unsecured/Issuer Rating	Baal	A-	
First Mortgage Bonds	Baal	A-	A-
Pollution Control Bonds*	Aaa	AAA	
Senior Secured Bonds	Baal	A-	A-
Preferred Stock	Bal	BBB	BBB+
Outlook	STABLE	NEGATIVE	STABLE
<b>PPL Transition Bond Company</b>			
Transition Bonds	Aaa	AAA	AAA

\* Insured as to payment of principal and interest.

### Rating Agency Actions in 2003

In 2003, S&P, Moody's and Fitch reviewed the credit ratings on the debt and preferred securities of PPL Electric. Based on their respective reviews, the rating agencies made certain ratings revisions that are described below. Management does not expect these ratings decisions to impact PPL Electric's ability to raise new debt or equity capital or to have a significant impact on its cost of any new capital or the cost of maintaining its credit facilities.

The ratings of S&P, Moody's and Fitch are not a recommendation to buy, sell or hold any securities of PPL Electric or its subsidiary, PPL Transition Bond Company, LLC. Such ratings may be subject to revisions or withdrawal by the agencies at any time and should be evaluated independently of each other and any other rating that may be assigned to their securities.

### S&P

In April 2003, S&P notified PPL Electric that it affirmed the 'A-' ratings on PPL Electric's first mortgage bonds and senior secured bonds and the 'A-2' commercial paper ratings of PPL Electric, and that it placed PPL Electric on negative outlook.

### Moody's

In May 2003, Moody's downgraded the credit ratings on PPL Electric's first mortgage bonds and senior secured bonds, to 'Baa1' from 'A3'. Moody's ratings outlook was stable for PPL Electric. PPL Electric's short-term debt rating was not impacted by Moody's long-term debt review. Moody's indicated that the full requirements contract between PPL Electric and PPL EnergyPlus, which previously was approved by the PUC and which extends through December 2009, mitigates PPL Electric's supply and price risk.

### Off-Balance Sheet Arrangements

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

### Risk Management

#### Market Risk

##### *Commodity Price Risk - PLR Contracts*

PPL Electric and PPL EnergyPlus have power supply agreements under which PPL EnergyPlus sells to PPL Electric (under a predetermined pricing arrangement) energy and capacity to fulfill PPL Electric's PLR obligation through 2009. As a result, PPL Electric has shifted any electric price risk relating to its PLR obligation to PPL EnergyPlus for 2003 through 2009. See Note 15 to the Financial Statements for information on the PLR contracts.

##### *Interest Rate Risk*

PPL Electric has issued debt to finance its operations, which increases its interest rate risk. At December 31, 2003, PPL Electric's potential annual exposure to increased interest expense, based on a 10% increase in interest rates, was insignificant.

PPL Electric is also exposed to changes in the fair value of its debt portfolio. At December 31, 2003, PPL Electric estimated that its potential exposure to a change in the fair value of its debt portfolio, through a 10% adverse movement in interest rates, was approximately \$51 million, compared to \$45 million at December 31, 2002.

### Related Party Transactions

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

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

### Capital Expenditure Requirements

The schedule below shows PPL Electric's current capital expenditure projections for the years 2004-2008 and actual spending for the year 2003:

	Actual	Projected				
	2003	2004	2005	2006	2007	2008
Construction expenditures						
Expenditures for PP&E	\$ 232	\$ 168	\$ 185	\$ 205	\$ 219	\$ 211

Construction expenditures include AFUDC which is expected to be less than \$2 million in each of the years 2004-2008.

PPL Electric's capital expenditure projections for the years 2004-2008 total \$988 million. Capital expenditure plans are revised periodically to reflect changes in market, and asset regulatory conditions. PPL Electric also leases vehicles, personal computers and other equipment, as described in Note 10 to the Financial Statements.

### Environmental Matters

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

### Competition

See Item 1, "Business - Competition," for additional information.

### New Accounting Standards

See Note 22 to the Financial Statements for information on new accounting standards adopted in 2003 or pending adoption.

## Application of Critical Accounting Policies

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

### 1) Pension and Other Postretirement Benefits

As described in Note 12 to the Financial Statements, PPL Electric participates in, and is allocated a significant portion of the liability and net periodic pension cost of the PPL Retirement Plan and the PPL Postretirement Benefit Plan. PPL follows the guidance of SFAS 87, "Employers' Accounting for Pensions," and SFAS 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," when accounting for these benefits. Under these accounting standards, assumptions are made regarding the valuation of benefit obligations and performance of plan assets. Delayed recognition of differences between actual results and expected or estimated results is a guiding principle of these standards. This delayed recognition of actual results allows for a smoothed recognition of changes in benefit obligations and plan performance over the working lives of the employees who benefit under the plans. The primary assumptions are as follows:

- **Discount Rate** - The discount rate is used in calculating the present value of benefits, which are based on projections of benefit payments to be made in the future.
- **Expected Return on Plan Assets** - Management projects the future return on plan assets considering prior performance, but primarily based upon the plans' mix of assets and expectations for the long-term returns on those asset classes. These projected returns reduce the net benefit cost the company will record currently.
- **Rate of Compensation Increase** - Management projects employees' annual pay increases, which are used to project employees' pension benefits at retirement.
- **Health Care Cost Trend Rate** - Management projects the expected increases in the cost of health care.

In selecting discount rates, PPL considers fixed-income security yield rates. At December 31, 2003, PPL decreased the discount

rate for its domestic plans from 6.75% to 6.25% as a result of decreased fixed-income security returns.

In selecting an expected return on plan assets, PPL considers performance and economic forecasts for the types of investments held by the plan. At December 31, 2003, PPL's expected return on plan assets for its domestic pension plans remained at 9.0%.

In selecting a rate of compensation increase, PPL considered past experience in light of movements in inflation rates. At December 31, 2003, PPL's rate of compensation increase remained at 4.0% for its domestic plans.

In selecting health care cost trend rates, PPL considers tax implications, past performance and forecasts of health care costs. At December 31, 2003, PPL's health care cost trend rates were 11% for 2004, gradually declining to 5.0% for 2010.

A variance in the assumptions listed above could have a significant impact on the accrued pension and other postretirement benefit liabilities and reported annual net periodic pension and other postretirement benefit cost allocated to PPL Electric. The following chart reflects the sensitivities associated with a change in certain assumptions. While the chart below reflects either an increase or decrease in each assumption, PPL and its actuaries expect that the inverse of this change would impact the accrued pension and other postretirement benefit liabilities and reported annual net periodic pension and other postretirement benefit cost by a similar amount in the opposite direction. Each sensitivity below reflects an evaluation of the change based solely on a change in that assumption.

Actuarial Assumption	Increase/(Decrease)		
	Change in Assumption	Impact on Liabilities	Impact on Cost
Discount Rate	(0.25)%	\$ 2	\$ 2
Expected Return on Plan Assets	(0.25)%	2	2
Rate of Compensation Increase	0.25%	1	1
Health Care Cost Trend Rate (a)	1.0%	2	2

(a) Only impacts other postretirement benefits.

At December 31, 2003, PPL Electric had been allocated accrued pension liabilities totaling \$74 million, included in "Deferred Credits and Other Noncurrent Liabilities - Other" on the Balance Sheet. At December 31, 2003, PPL Electric had been allocated prepaid postretirement benefit costs totaling \$2 million, included in "Prepayments" on the Balance Sheet.

In 2003, PPL Electric was allocated net periodic pension and other postretirement costs charged to operating expense of \$17 million. This amount represents a \$21 million reduction in the credit recognized during 2002. This reduction was primarily due to the decrease in the discount rate at December 31, 2002.

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

## 2) Loss Contingencies

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

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

The accrual of a loss contingency involves considerable judgment on the part of management. The accounting aspects of loss contingencies include: (1) the initial identification and recording of the loss contingency; (2) the determination of a triggering event for reducing a recorded loss contingency; and (3) the on-going assessment as to whether a recorded loss contingency is reasonable.

### Initial Identification and Recording of the Loss Contingency

PPL Electric uses its internal expertise and outside experts (such as lawyers, tax specialists and engineers), as necessary, to help estimate the probability that a loss has been incurred and the amount (or range) of the loss. PPL Electric continuously assesses potential loss contingencies for environmental remediation, litigation claims, regulatory penalties and other events.

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

### Reducing Recorded Loss Contingencies

When a loss contingency is recorded, PPL Electric identifies the triggering event for subsequently reducing the loss contingency. The triggering events generally occur when the contingency has been resolved and the actual loss is incurred, or when the risk of

loss has diminished or been eliminated. The following are some of the triggering events which provide for the reduction of certain recorded loss contingencies:

- Certain loss contingencies are systematically reduced based on the expiration of contract terms. An example of this is the recorded liability for above-market NUG purchase commitments, which is described below. This loss contingency was being reduced over the lives of the NUG purchase contracts, prior to the transfer of this loss contingency to PPL EnergyPlus.
- Allowances for excess or obsolete inventory are reduced as the inventory items are pulled from the warehouse shelves and sold as scrap or otherwise disposed.
- Allowances for uncollectible accounts are reduced when accounts are written off after prescribed collection procedures have been exhausted.
- Environmental loss contingencies are reduced when PPL Electric makes payments for environmental remediation.

#### On-Going Assessment of Recorded Loss Contingencies

PPL Electric reviews its loss contingencies on a regular basis to assure that the recorded potential loss exposures are reasonable. This involves ongoing communication and analyses with internal and external legal counsel, engineers, tax specialists, managers in various operational areas and other parties.

All three aspects of accounting for loss contingencies - the initial identification and recording of a probable loss, the identification of triggering events to reduce the loss contingency, and the ongoing assessment of the reasonableness of a recorded loss contingency - require significant judgment by PPL Electric's management.

The largest contingency currently on PPL's balance sheet is the loss contingency for above-market NUG purchase commitments, being the difference between the above-market contract terms and the fair value of electricity. This loss contingency was originally recorded at \$854 million in 1998, when PPL Electric's generation business was deregulated. Under regulatory accounting, PPL Electric recorded the above-market cost of the purchases from NUGs as part of its purchased power costs on an as-incurred basis, since these costs were recovered in regulated rates. When the generation business was deregulated, the loss contingency associated with the commitment to make above-market NUG purchases was recorded. This loss contingency for the above-market portion of NUG purchase commitments was recorded because it was probable that the loss had been incurred and the estimate of future energy prices could be reasonably determined, using the then forward prices of electricity and capacity information. This loss contingency was transferred to PPL EnergyPlus in the July 1, 2000 corporate realignment.

When the loss contingency related to NUG purchases was recorded in 1998, PPL Electric established the triggering events for when the loss contingency would be reduced. A schedule was established to reduce the liability based on projected purchases over the lives of the NUG contracts. All but one of the NUG contracts expired by 2009, with the last one ending in 2014.

Prior to the July 1, 2000 transfer, PPL Electric reduced the above-market NUG liability based on the aforementioned schedule. As PPL Electric reduced the liability for the above-market NUG purchases, it offset the actual cost of NUG purchases, thereby bringing the net power purchase expense more in line with market prices.

#### Other Information

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

**ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following analysis of the results of operations and financial condition of PPL Montana is abbreviated as PPL Montana meets the conditions set forth in General Instruction (I)(1)(a) and (b) of Form 10-K. Such analysis should be read in conjunction with the financial statements in Item 8. Terms and abbreviations appearing here are explained in the glossary.

### **Results of Operations**

The following discussion explains significant changes in principal items on the Statement of Income comparing 2003 to 2002. The Statement of Income reflects the results of past operations and is not intended as any indication of future operating results. Future operating results will necessarily be affected by various and diverse factors and developments.

#### **Earnings**

Net income increased by \$21 million in 2003 compared with 2002. The increase was primarily due to higher wholesale prices in the western U.S and an increase in generation.

#### **Operating Revenues**

Operating revenues increased by \$48 million in 2003 compared with 2002. The increase was primarily due to an increase in wholesale energy prices of \$27 million and an increase in volume sold of \$21 million.

#### **Operating Expenses**

Operating expenses increased by \$26 million in 2003 compared with 2002. Operating expenses consist mainly of expenses for fuel, energy purchases, transmission tariffs, plant operations and maintenance, lease rental payments, and general and administrative expenses. The increase was primarily due to higher energy purchases of \$11 million, related to the higher power costs in the western U.S. and higher volumes of \$9 million.

Generation increased by 345 million kWh during 2003 compared with 2002. This increase was primarily the result of improved operational performance from the coal-fired generation units.

#### **New Accounting Standards**

See Note 22 to the Financial Statements for information on new accounting standards adopted in 2003 or pending adoption.

### **Risk Management - Energy Marketing & Trading and Other**

#### **Market Risk**

##### *Background*

Market risk is the potential loss PPL Montana may incur as a result of price changes associated with a particular financial or commodity instrument. PPL Montana is exposed to market risk from commodity price risk for energy and energy-related products associated with the sale of electricity, the purchase of fuel for the generating assets, and energy trading activities.

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

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

##### *Contract Valuation*

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

To record derivatives at their fair value, PPL Montana discounts the forward values using LIBOR. Additionally, PPL Montana reduces derivative assets' carrying value to recognize differences in counterparty credit quality and potential illiquidity in the market.

- The credit adjustment takes into account the probability of default, as calculated by an independent service, for each counterparty that has an out-of-the money position with PPL Montana.
- The liquidity adjustment takes into account the fact that it may not be appropriate to value contracts at the midpoint of the bid/ask spread. PPL Montana might have to accept the "bid" price if PPL Montana wanted to close an open sales position or PPL Montana might have to accept the "ask" price if PPL Montana wanted to close an open purchase position.

#### *Accounting and Reporting*

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

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

PPL Montana adopted the final provisions of EITF 02-3 during the fourth quarter of 2002. As such, PPL Montana now reflects its net realized and unrealized gains and losses associated with all derivatives that are held for trading purposes in the "Net energy trading margins" line on the Statement of Income. Derivative contracts that met the definition of energy trading activities as defined by EITF 98-10, "Accounting for Energy Trading and Risk Management Activities" are reflected in the financial statements using the accrual method of accounting. Under the accrual method of accounting, unrealized gains and losses are not reflected in the financial statements. Prior periods were reclassified. No cumulative effect adjustment was required upon adoption.

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

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

#### *Accounting Designation*

Energy contracts that do not qualify as derivatives receive accrual accounting. For energy contracts that meet the definition of a derivative, the circumstances and intent existing at the time that energy transactions are entered into determine their accounting designation. These designations are verified by PPL Montana's risk control group on a daily basis. The following is a summary of the guidelines that have been provided to the traders who are responsible for contract designation for derivative energy contracts due to the adoption of SFAS 149:

- Any wholesale and retail contracts to sell or buy electricity and the related capacity that are expected to be delivered from PPL Montana's generation or that are approved by the RMC to fulfill a strategic element of PPL Montana's overall marketing strategy are considered "normal." These transactions are not recorded in the financial statements and have no earnings impact until delivery.
- Physical electricity-only transactions can receive cash flow hedge treatment if all of the qualifications under SFAS 133 are met. Any unrealized gains or losses on transactions receiving cash flow hedge treatment are recorded in other comprehensive income. These unrealized gains and losses become realized when the contracts settle and are recognized in income when the hedged transactions occur.

- Physical electricity purchases that increase PPL Montana's long position and any energy sale or purchase judged a "market call" are considered speculative, with unrealized gains or losses recorded immediately through earnings.
- Financial transactions, which can be settled in cash, cannot be considered "normal" because they do not require physical delivery. These transactions receive cash flow hedge treatment if they lock-in the price PPL Montana will receive or pay for energy expected to be generated or purchased in the spot market. Any unrealized gains or losses on transactions that receive cash flow hedge treatment are recorded in other comprehensive income. These unrealized gains and losses become realized when the contracts settle and are recognized in income when the hedged transactions occur.
- Option contracts that do not meet the requirements of DIG Issue C15, "Scope Exceptions: Interpreting the Normal Purchases and Normal Sales Exception as an Election," do not receive hedge accounting treatment and are marked to market through earnings.

### Commodity Price Risk

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

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

of production will not allow them to economically run during all hours.

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

PPL Montana's commodity derivative contracts that qualify for hedge accounting treatment mature at various times through 2010. The following chart sets forth PPL Montana's net fair market value of these contracts as of December 31, 2003:

	<u>Gains</u>
Fair value of contracts outstanding at the beginning of the year	\$ 11
Contracts realized or otherwise settled during the year	1
Fair value of new contracts at inception	
Other changes in fair values	<u>10</u>
Fair value of contracts outstanding at the end of the year	<u>\$ 22</u>

During 2003, PPL Montana realized or otherwise settled net losses of approximately \$1 million related to contracts entered into prior to January 1, 2003. This amount does not reflect intra-quarter contracts that were entered into and settled during the period.

"Other changes in fair values," a gain of approximately \$10 million, represent changes in the market value that occurred during 2003 for contracts that were outstanding at the end of 2003.

The following chart segregates estimated fair values of PPL Montana commodity derivative contracts that qualify for hedge accounting treatment at December 31, 2003 based on whether the fair values are determined by quoted market prices or other more subjective means.

**Fair Value of Contracts at Period-End  
Gains/(Losses)**

<b>Source of Fair Value</b>	<b>Maturity Less Than 1 Year</b>	<b>Maturity 1-3 Years</b>	<b>Maturity 3-5 Years</b>	<b>Maturity in Excess of 5 Years</b>	<b>Total Fair Value</b>
Prices actively quoted					
Prices provided by other external sources	\$ 11	\$ 12	\$ (1)		\$ 22
Prices based on models and other valuation methods					
Fair value of contracts outstanding at the end of the period	<u>\$ 11</u>	<u>\$ 12</u>	<u>\$ (1)</u>		<u>\$ 22</u>

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

The "Prices based on models and other valuation methods" category includes the value of transactions for which an internally developed price curve was constructed as a result of the long-dated nature of the transaction or the illiquidity of the market point, or the value of options not quoted by an exchange or OTC broker. Additionally, this category includes "strip" transactions whose prices are obtained from external sources and then modeled to monthly prices as appropriate.

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

As of December 31, 2003, PPL Montana estimated that a 10% adverse movement in market prices across all geographic areas and time periods would have decreased the value of the commodity contracts in its non-trading portfolio by

approximately \$80 million, as compared to a decrease of \$76 million at December 31, 2002. However, the change in the value of the non-trading portfolio would have been substantially offset by an increase in the value of the underlying commodity, the electricity generated, because these contracts serve to the market risk inherent in the generation of electricity. Additionally, the value of PPL Montana's unsold generation would be improved. Because PPL Montana's electricity portfolio is generally in a net sales position, the adverse movement in prices is usually an increase in prices.

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

PPL Montana's trading contracts mature at various times through 2004. PPL Montana's net fair market value of trading contracts as of December 31, 2003 and 2002 was insignificant.

As of December 31, 2003, the net loss on PPL Montana's trading activities expected to be recognized in earnings during the next three months is insignificant.

PPL Montana estimated that a 10% adverse movement in market prices across all geographic areas and time periods would have decreased the value of the commodity contracts in its trading portfolio by an insignificant amount at December 31, 2003 and 2002.

#### Interest Rate Risk

PPL Montana may use borrowings to provide funds for its operations. PPL and PPL Energy Supply may utilize various financial derivative products and risk management techniques on behalf of PPL Montana to adjust the mix of fixed and floating interest rates in PPL Montana's debt portfolio and thereby reduce its exposure to adverse interest rate movements. PPL Montana had no borrowings outstanding as of December 31, 2003.

#### Credit Risk

Credit risk relates to the risk of loss that PPL Montana would incur as a result of non-performance by counterparties of their contractual obligations. PPL Montana maintains credit policies and procedures with respect to counterparties (including requirements that counterparties maintain certain credit ratings criteria) and requires other assurances in the form of credit support or collateral in certain circumstances in order to limit counterparty credit risk. However, PPL Montana has concentrations of suppliers and customers among electric utilities and other energy marketing and trading companies. These concentrations of counterparties may impact PPL Montana's overall exposure to credit risk, either positively or negatively, in that counterparties may be similarly affected by