

# **KGEN POWER CORPORATION**

## **ANNUAL REPORT**

**For the Fiscal Year Ended June 30, 2012**

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## CAUTIONARY STATEMENT CONCERNING FORWARD LOOKING STATEMENTS

The discussion in this report contains certain forward looking statements that involve risks and uncertainties. We have based these forward looking statements on our current expectations and assumptions about future events. In some cases, you can identify forward looking statements by terminology, such as “may,” “should,” “could,” “predict,” “potential,” “continue,” “expect,” “anticipate,” “future,” “intend,” “plan,” “believe,” “estimate,” “forecast” and similar expressions (or the negative of such expressions). Forward looking statements include statements concerning known and unknown risks, uncertainties and other important factors that could cause actual results, performance or achievements of KGen Power Corporation and its subsidiaries to differ materially from any future results, performance or achievements expressed or implied by such forward looking statements. Forward looking statements are based on our beliefs as well as assumptions based on information currently available to us, including financial and operational information, current competitive conditions, and anticipated demand for electricity. As a result, these statements are subject to various risks and uncertainties. For a discussion of material risks and uncertainties that the Company faces, see “Number 1A. Risk Factors” in this Annual Report. Important factors that could cause actual results to differ materially include, but are not limited to, the following:

- the occurrence of any event, change, or other circumstance that could give rise to the termination of the agreements for the sale of our facilities;
- our inability to complete the sale transactions due to the failure to satisfy conditions to completion of the transactions, including receipt of required regulatory approvals;
- the failure of the sale transactions to close for any other reason;
- in connection with the sale of our facilities, the possibility that we may be required to make indemnification payments out of, or in excess of, the purchase price that has been placed into escrow to secure post-closing indemnification obligations;
- as a result of the transactions to sell our facilities, the potential difficulties in the retention of executive management and other key employees;
- limitations on our ability to utilize our net operating loss carryforwards to offset taxable gains from the sales transactions;
- the expenses related to the winding down of the Company may be greater than anticipated, as well as other risks related to our plan of liquidation and dissolution as more fully described herein;
- our remaining power generation plants are expected to be free cash flow negative for the foreseeable future and, if only one or both of the transactions for the sale of our facilities fails to close, we may not generate sufficient cash or otherwise have sufficient liquidity to operate those plants.
- the timing and extent of changes in commodity prices, particularly natural gas;
- the liquidity and competitiveness of wholesale markets for electricity;
- economic slowdowns and cooler-than-expected weather during our peak operating months that can adversely affect consumption of electricity by businesses and consumers;
- uncertainties that actual costs may be higher than estimated;
- uncertainties that our actual cash generation may be lower and our actual need for cash may be higher than estimated;
- refusal by or inability of our current or potential counterparties or vendors to enter into transactions with us or fulfill their obligations to us;

- effectiveness of our risk management policies and procedures;
- present and possible future claims, litigation, and enforcement actions;
- effects of the application of regulations, including changes in regulations or the interpretation thereof;
- disruptions in the transmission and distribution of power;
- availability of fuel and fuel transportation; and
- catastrophic events such as fires, hurricanes, explosions, floods, lightning strikes, terrorist attacks, or other similar occurrences to our facilities or to facilities upon which we depend.

We undertake no duty or obligation to revise or update these forward-looking statements.

## **Part I**

### **Number 1. Business**

#### **Overview**

We own and operate electric power generation plants and sell electricity and electrical generation capacity in the United States. We sell power and related products to wholesale purchasers such as retail electric providers, power trading organizations, municipal utilities, electric power cooperatives, and other power generation companies. Our portfolio of facilities consists of two operational and fully permitted combined-cycle power plants (Hot Spring and Hinds), or the Plants, located in the southeastern United States with General Electric 7FA gas turbines. Our plants have an aggregate capacity of 1,140 megawatts, or MW, and currently operate as merchant power providers. On April 28, 2011, we executed separate definitive sales agreements with subsidiaries of Entergy Corporation for the sale of our Hinds and Hot Spring power plants. The terms of these agreements are described below and in our proxy statement, dated May 16, 2011, relating to our special meeting of stockholders held on June 13, 2011, or the 2011 Special Meeting Proxy Statement. A copy of our 2011 Special Meeting Proxy Statement is available on our website at [www.kgenpower.com](http://www.kgenpower.com).

Under the terms of our definitive agreement for the sale of our Hinds power generation facility, we agreed to sell this facility to Entergy Mississippi, Inc. for a cash purchase price of \$206.0 million, subject to certain adjustments. The Company received approval from holders of a majority of the Company's outstanding shares for the sale of this facility. The transaction is conditioned on the satisfaction of various regulatory approvals and other conditions described in the 2011 Special Meeting Proxy Statement. Substantially all of the regulatory conditions to closing have been satisfied or waived. Although the mandatory waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, or the HSR Act, applicable to the transaction has expired, at the request of the Antitrust Division of the U.S. Department of Justice, or DOJ, made in connection with the DOJ's ongoing review of the Hinds and Hot Spring transactions, we and Entergy agreed to delay closing of the transaction. We are currently in discussions with the DOJ and Entergy regarding the DOJ's concerns and the potential timing for closing of the transaction. The transaction also remains subject to customary contractual closing conditions. Under the terms of the transaction agreement, \$30.0 million of the purchase price will be held in escrow to secure customary post-closing indemnification obligations. An escrow amount of \$10.0 million is subject to release 12 months after closing, an additional \$10.0 million is subject to release 18 months after closing, and the remaining balance will be subject to release 42 months after closing.

Under the terms of our definitive agreement for the sale of our Hot Spring power generation facility, we agreed to sell this facility to Entergy Arkansas, Inc. for a cash purchase price of \$253.0 million, subject to certain adjustments. The Company received approval from holders of a majority of the Company's outstanding shares for the sale of this facility. The transaction is conditioned on the satisfaction of various

regulatory approvals and other conditions described in the 2011 Special Meeting Proxy Statement. Substantially all of the regulatory conditions to closing have been satisfied or waived. Although the mandatory waiting period under the HSR Act applicable to the transaction has expired, at the request of the DOJ, made in connection with the DOJ's ongoing review of the Hinds and Hot Spring transactions, we and Entergy agreed to delay closing of the transaction. We are currently in discussions with the DOJ and Entergy regarding the DOJ's concerns and the potential timing for closing of the transaction. The transaction also remains subject to customary contractual closing conditions. Under the terms of the transaction agreement, \$38.0 million of the purchase price will be held in escrow to secure customary post-closing indemnification obligations. An escrow amount of \$12.0 million is subject to release 12 months after closing, an additional \$13.8 million is subject to release 18 months after closing, and the remaining balance will be subject to release 42 months after closing.

On April 27, 2011, the Board of Directors of the Company, or the Board, unanimously approved and adopted a plan of complete liquidation of the Company for federal income tax purposes, or the Plan of Liquidation. The Plan of Liquidation provides that the Company will distribute to the stockholders of the Company (on a pro rata basis), in a series of distributions in complete liquidation of the Company, the net proceeds of the Company's sale transactions. The Board expects that, after completion of our Hinds and Hot Spring divestitures, it will approve the dissolution of the Company, or the Dissolution, subject to stockholder approval. Risks related to the Plan of Liquidation and Dissolution are disclosed below under "Risk Factors—Risks Related to Our Plan of Liquidation and Dissolution."

## **Our Strategy**

Our strategy includes the following elements:

- ***Focus on completion of Hinds and Hot Spring divestitures and maximizing cash available for distribution.*** As indicated above, on April 28, 2011, we executed separate definitive sales agreements with subsidiaries of Entergy Corporation for the divestiture of our Hinds and Hot Spring power plants, our last remaining power plant assets. We are focused on working with Entergy to satisfy the conditions to complete these transactions as soon as possible. Our objective is to maximize the cash available for distribution to our stockholders. Accordingly, we are committed to controlling the costs and expenses at our corporate and plant levels.
- ***Disciplined and opportunistic commercial strategy.*** Until we complete the sale of our Hinds and Hot Spring facilities, we will seek to sell energy and capacity from those facilities into markets when pricing is most attractive. We currently sell and deliver our merchant energy primarily in the short-term, day-ahead, month ahead, or real-time markets to maintain our flexibility.
- ***Focus on operational efficiency and excellence.*** Until we complete the sale of our Hinds and Hot Spring facilities, we will focus on maintaining and enhancing our plant availability and operational reliability to take advantage of market opportunities. We are committed to operating our Hinds and Hot Spring plants in a safe, reliable, and environmentally-compliant manner. We maintain lean staffing at our corporate and plant levels and employ strategic outsource partners to enhance our energy marketing, gas supply, plant operations and maintenance functions, and to increase the economic efficiency of our operations.

## Our Remaining Power Plants

<u>Plant</u>	<u>Location</u>	<u>Turbines</u>	<u>Heat Rate(1)</u>	<u>Total Capacity (MW)(2)</u>	<u>Commercial Operation Date</u>
Hot Spring . . . . .	Hot Spring County, Arkansas	7FA	7,150	620	June 2002
Hinds . . . . .	Hinds County, Mississippi	7FA	7,000	520	May 2001
<b>Total . . . . .</b>				<u>1,140</u>	

(1) Approximate heat rate at full-load summer operation without supplemental firing.

(2) Nominal operating capacity.

## Our Operations

Our management includes a core group of industry veterans. We have leveraged the capabilities of this core team by using third-party outsource providers to manage and maintain our facilities.

Our Hot Spring and Hinds Plants are operated pursuant to operation and maintenance agreements with NAES Corporation, or NAES. NAES provides operations, certain accounting, human resources, engineering, environmental, health and safety compliance, and other services to the Plants. NAES utilizes their own personnel, supplemented by outside contractors on an as-needed basis, to perform such services. NAES also provides, when requested, technical and commercial services, health and safety services, and human resources support for plant employees.

The energy management services for the power and capacity of our Plants are provided by Twin Eagle Resource Management, LLC, or Twin Eagle. The services include seeking purchasers for our merchant power sales and handling our natural gas purchases to meet operating needs for electricity placed through Twin Eagle and providing administrative services for the tracking of power sales and gas purchases. Under our energy management arrangements, we use Twin Eagle's balance sheet to transact with other counterparties which streamlines our sales process and allowed us to enter into transactions that we might not otherwise have been able to enter. Twin Eagle does not have an investment grade rating. Accordingly, under the Company's agreements with Twin Eagle, Twin Eagle is required to post collateral in the form of letters of credit or cash in the event our exposure to Twin Eagle exceeds certain specified thresholds. Prior to October 1, 2011, our energy management services for the power and capacity of our Plants were provided by BNP Paribas Energy Trading GP, or BNP.

Our Hinds Plant began operations in May 2001 and our Hot Spring Plant began operations in June 2002. Since inception, our Plants have been maintained pursuant to long-term service agreements, or LTSA's, with General Electric International, or GEI. Average availability at the Plants was 68.2% for the year ended June 30, 2012, or 93.5% excluding major maintenance. Our Plants are fully operational with all required permits, transmission interconnections, and gas transportation access. In addition, the use of standardized equipment in the Plants creates economies of scale with respect to operations and maintenance, spare parts, and capital equipment inventory.

## Effects of Seasonality

The electric power industry is highly seasonal. In the summer months, especially in the southeastern United States, demand for electricity is usually much higher than in other months as a result of increased use of air conditioning. Our results of operations are subject to seasonal variations since demand for electricity and production capacity varies with weather conditions. Our Plants currently operate on a merchant basis without long-term purchase agreements, and therefore are exposed to significant volatility in prices and generation demand. We earn the majority of our annual revenues in the five summer months, May through September. The shoulder periods, months other than the peak summer months, historically

have not been profitable for us and are typically the months during which we seek to perform scheduled maintenance-related activities.

### **Principal Customers**

Our sales are merchant sales that we have made through Twin Eagle, and previously BNP, who simultaneously sell the power to other counterparties under identical sale arrangements, i.e., on a “back-to-back basis”, which are approved by us.

### **Power Transmission**

Our Hinds facility is interconnected to Entergy Services’ transmission system at the 230 kV Lakeover substation pursuant to a long-term interconnection agreement with Entergy Mississippi.

Our Hot Spring facility is interconnected to Entergy Services’ transmission system at the 500 kV Etta substation pursuant to a long-term interconnection agreement with Entergy Arkansas.

### **Gas Supply**

Our source of fuel to generate electricity is natural gas and we purchase gas generally on a short-term basis. When we enter into longer-term electricity transactions, we enter into gas purchase agreements that are consistent with our electricity pricing exposure. Natural gas is delivered to our Hinds facility through a 2.5-mile pipeline interconnected to Texas Eastern Transmission, LP, or TETCO. The firm transport contract provides firm capacity of 80,000 decatherms per day, or Dth/day, in our summer peak period and lesser amounts in the other parts of the year.

At our Hot Spring facility, natural gas is delivered through either of two pipeline systems to which the plant is interconnected. We have long-term pipeline transport contracts with CenterPoint Inc., or Centerpoint, that provide firm capacity of 98,000 Dth/day in our summer peak period and 50,000 Dth/day in the other parts of the year.

The Hot Spring facility is also served by TETCO, a subsidiary of Spectra Energy Transmission Services, LLC, through an 8.5 mile pipeline lateral (112,000 Dth/day of firm capacity) which connects to TETCO’s 24-inch line on which Hot Spring has 100,000 Dth/day of firm transportation services.

### **Competition**

Our Plants currently operate on a merchant basis. As a result, we face competition from the power generation plants operated by Entergy Services, other utilities, and from other merchant generators within the SERC region and outside the SERC region for electricity orders. Furthermore, competitive conditions may be substantially affected by various forms of energy legislation and/or regulation considered from time to time by the government of the United States or the states in which our Plants reside. At this time, it is not possible to predict the nature of any such legislation or regulation that may ultimately be adopted or its effects upon our future operations.

### **Employees**

As of June 30, 2012, we employed 17 people all of whom are located at our corporate office in Houston, Texas.

## **Regulatory Matters**

### *Overview*

We are subject to U.S. federal, state, and local energy and environmental laws and regulations applicable to the development, ownership and operation of our Plants. Federal laws and regulations govern, among other things, types of fuel used, the type of energy produced, power plant ownership, the rates, terms and conditions of wholesale electricity sales, and corporate transactions involving entities that engage in wholesale sales and interstate transmission of electricity. State energy laws govern, among other things, retail utility rates, terms of retail sales, determinations of need for new facilities, land use, and local permitting. Power projects also are subject to laws and regulations governing environmental emissions and other substances produced by a plant, along with the geographical location, zoning, land use, and operation of a plant. Applicable federal environmental laws typically have state and local enforcement and implementation provisions. These environmental laws and regulations generally require that a wide variety of permits and other approvals be obtained before construction or operation of a power plant commences and that the facility operate in compliance therewith.

### *Federal Regulation and the Federal Energy Regulatory Commission*

The FERC is an independent regulatory commission within the Department of Energy that, among other things, regulates the transmission and wholesale sale of electricity in interstate commerce under the authority of the Federal Power Act, or FPA. Each of our subsidiary generating companies makes wholesale sales of electricity and is a “public utility” under the FPA, subject to regulation by the FERC. In addition, FERC determines whether a company that owns or operates a generation facility qualifies for Exempt Wholesale Generator, or EWG, status under the Public Utility Holding Company Act of 2005, or PUHCA of 2005. Each of our Plants is owned through subsidiaries that have been determined to be EWGs. This permits us to be exempt from most regulation as a holding company under PUHCA of 2005.

*Federal Power Act.* The FPA gives FERC exclusive rate-making jurisdiction over wholesale sales of electricity and transmission of electricity in interstate commerce. Under the FPA, FERC, with certain exceptions, regulates entities that engage in wholesale sales of electricity and transmission of electricity in interstate commerce as “public utilities.” Public utilities under the FPA are required to obtain FERC’s acceptance, pursuant to Section 205 of the FPA, of their rate schedules and tariffs under which they sell electricity at wholesale. FERC has granted each of our generating companies the authority to sell electricity at market-based rates. FERC’s orders that grant our generating companies market-based rate authority reserve the right to revoke or revise that authority if FERC subsequently determines that we can exercise undue market power in transmission or generation, create barriers to entry or engage in abusive affiliate transactions. As a condition to the orders granting our generating companies market-based rate authority, we are required every three years to file a market power update to show that our generating companies and other generating assets that are considered to be under common control with us continue to meet FERC’s standards with respect to generation market power and other criteria used to evaluate whether entities qualify for market-based rates. Our generating companies will be filing their next market power update with FERC in December 2014. We are also required to report to FERC any material change in status that would reflect a departure from the characteristics that FERC relied upon when it granted our various generating companies’ market-based rates. When determining whether market power issues exist, FERC aggregates our generating assets with other generating assets owned or controlled by any of our stockholders that own ten percent or more of the Company’s voting securities. Thus, to the extent one of our existing ten percent stockholders directly or indirectly owns or acquires ten percent or more of the voting securities of new generating assets, or an existing or new stockholder that acquires ten percent or more of our stock also owns or acquires ten percent or more of the voting securities of other generating assets, either directly or indirectly, our generating companies may be required to make a change of status filing with FERC, and the aggregation of such additional generating assets with ours could cause market



power issues that could cause the generating companies to lose or restrict their market-based rate authority.

The market-based rate sales made by our generating companies are subject to certain market manipulation prohibitions that make it unlawful for any entity involved directly or indirectly in a FERC jurisdictional transaction to intentionally defraud, make untrue statements or omit material facts. If any of our generating companies were deemed to have violated one of those rules or any other FPA provision or rules or orders issued thereunder, they could be subject to potential civil or criminal penalties, disgorgement of profits associated with the violation and/or suspension or revocation of their market-based rate authority.

If our generating companies were to lose their market-based rate authority, such companies would be required to obtain FERC's acceptance to sell power at cost-based rates. Our company then would become subject to the accounting, record-keeping and reporting requirements that are imposed on utilities with cost-based rate schedules.

In addition, Section 204 of the FPA gives FERC jurisdiction over a public utility's issuance of securities or assumption of liabilities. However, FERC typically grants blanket approval for future securities issuances or assumptions of liabilities to entities with market-based rate authority. FERC granted such blanket authority to our generating companies. In the event that one of our public utility generating companies were to lose its market-based rate authority, such company's future securities issuances or assumptions of liabilities could require prior approval of the FERC.

The FPA also gives FERC jurisdiction to review certain corporate transactions and numerous other activities of public utilities, including mergers or consolidations involving public utilities, certain transfers of public utility and electric generation facilities, certain purchases by a public utility of the securities of another public utility, and certain public utility holding company purchases of securities and direct or indirect mergers and consolidations. FERC will grant approval under FPA Section 203 if it finds that the proposed transaction will be consistent with the public interest and does not raise concerns with respect to cross-subsidization involving a traditional public utility that has captive customers which receive services at cost-based rates.

In compliance with Section 215 of the EPA Act, FERC has approved the North American Electric Reliability Corporation, or NERC, as the national Electric Reliability Organization, or ERO. As the ERO, NERC is responsible for the development and enforcement of mandatory electric reliability standards for the wholesale electric power system. Our subsidiary generating companies are responsible for complying with the standards applicable to Generator Owners. The ERO can assess civil penalties for non-compliance with the standards.

*Public Utility Holding Company Act of 2005.* The PUHCA of 2005 gives FERC access to the books and records of holding companies if necessary for determining jurisdictional rates. FERC has also implemented the PUHCA of 2005 rules governing accounting, record retention and reporting, as required by EPA Act. Because we are a holding company under the PUHCA of 2005 solely as the result of owning one or more EWGs, we and our subsidiary generating companies are exempt from FERC access to books and records under the PUHCA of 2005. However, FERC has asserted independent authority under the FPA granting it access to the books and records of public utilities and holding companies. Moreover, the PUHCA of 2005 also gives state regulatory authorities access to books and records of holding companies if necessary for determining jurisdictional rates. Our subsidiary companies' EWG status does not exempt them or us from such state authority.

*The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.* On July 21, 2010 the President signed into law H.R. 4173, the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Dodd-Frank Act, or the Act, the most comprehensive restructuring of the banking and financial sectors in many decades. The Dodd-Frank Act authorizes the Commodity Futures Trading Commission, or CFTC,

to regulate trading in derivatives in energy and energy-related commodities, including electricity, natural gas, oil, renewable energy credits, and greenhouse gas allowances and offset credits. Prior to enactment of the Act, derivatives and other financial transactions in energy and energy-related commodities, which are widely used by energy companies to manage and hedge commercial risks, had largely been exempt from CFTC regulation. The Act repeals this exemption.

Under the Dodd-Frank Act, trading of certain energy and energy-related derivatives, commonly referred to as “swaps”, will be subject to clearing requirements, under which trading in swaps that had heretofore been conducted in bilateral, over-the-counter transactions must be traded on or processed by a registered clearing house organization, such as NYMEX. Mandatory clearing will be accompanied by capital and margin requirements, collateral posting requirements, position limits and reporting requirements, and the use of standardized contracts. The capital and margin requirements, in particular, could impose substantial new costs on energy companies trading derivatives, i.e., swaps, for risk-management purposes.

The Dodd-Frank Act includes an exemption from the general clearing requirements for swaps in which at least one party is not a defined financial entity, known as a “major swap participant”, and whose purpose is to hedge that entity’s commercial risks. The CFTC issued final regulations on the scope of this “end-user’s” exemption on July 19, 2012. The CFTC regulations establish criteria for determining whether a swap is used to hedge commercial risk. Basically, hedges meet this definition if they are appropriate to the reduction of risks in the conduct of a commercial enterprise, and such risks arise from the potential change in value of assets, liabilities, services, inputs or outputs used in the ordinary course of business of the enterprise. In order to be exempt from the clearing requirements applicable to swaps, an entity using swaps to hedge commercial risk must report each exempt swap, or cause its counterparty to report such exempt swap to a special swaps data repository and explain how the electing entity generally expects to meet its financial obligations associated with the non-cleared swap, e.g. through the use of credit support, third party guarantees, or available financial resources. The CFTC will monitor reports to ensure that entities do not abuse the end-user exception.

The CFTC also clarified that certain non-futures forward contracts that normally involve physical delivery are excluded from the definition of swaps. Fuel delivery and physical energy exchanges were clarified to be exempt. The CFTC clarified that “book-outs” of such forward contracts resulting from a separately negotiated agreement are not swaps. Oral agreements to engage in book-outs must be confirmed in a subsequent written agreement. The CFTC also clarified that forward contracts retain their exclusion from the definition of swaps even if they involve volumetric optionality or contain liquidated damages or evergreen renewal provisions. Forward contracts that include other optionality features might be deemed futures contracts or swaps.

The CFTC also clarified that environmental commodities, such as renewable energy credits, emission allowances and offsets would be deemed exempt from the swap rules. Further, the CFTC stated that it would consider further categorical exceptions of specific types of energy contracts on a case-by-case basis. At present, the CFTC has pending a request from the major ISOs to exempt categorically from swap treatment contracts and transactions conducted pursuant to ISO tariffs, including financial transmission rights, other congestion rights, and capacity contracts.

The CFTC regulations described above should lessen regulatory uncertainty and enable non-financial power companies to continue to engage in a range of customary commercial hedging practices, without thereby becoming subject to clearing requirements or associated capital and margin requirements. However, individual hedging transactions may raise interpretive issues under the regulations, for which there may be no or uncertain guidance under the Dodd-Frank Act or CFTC precedent. Given this uncertainty and the considerable discretion given to the CFTC under the Dodd-Frank Act, the future regulatory burdens to be imposed on non-financial power companies under the Act are subject to change.

### *Environmental Regulation*

The construction and operation of power projects are subject to extensive environmental protection and land use laws and regulations in the United States. Environmental laws and regulations that apply to us primarily involve emissions into the air, discharges to surface waters and the use of water, but often also include wetlands preservation, endangered species preservation, waste disposal and noise abatement. These laws and regulations often require us to follow lengthy and complex procedures to obtain licenses, permits and approvals for the Plants and their operations from federal, state and local agencies.

Since the Clean Air Act of 1970 was enacted, the air emissions of power plants such as our Plants have been comprehensively regulated by the United States Environmental Protection Agency, or EPA, and/or EPA-authorized States. New power plants are required to include either Best Available Control Technology, or BACT, for the control of various regulated emissions, including nitrogen oxides, or NO<sub>x</sub>, sulfur dioxide, or SO<sub>2</sub>, volatile organic compounds, or VOCs, and particulate matter. If located in a nonattainment area for a specific pollutant, the plant must achieve the Lowest Achievable Emission Rate, or LAER for that pollutant. In addition, operating power plants can become subject to new BACT and LAER provisions if they undergo “major modification,” thereby rendering them subject to current BACT/LAER requirements rather than the BACT/LAER requirements in effect when the Plant was originally built. Finally, operating plants generally are not exempt or otherwise grandfathered from subsequent changes in environmental law, either federal or state. For this reason, for example, the greenhouse gas, or GHG, emissions of our Plants could become subject to federal and/or state regulation, and the current regulatory requirements governing the Plant’s NO<sub>x</sub>, SO<sub>2</sub>, VOC, and particulate matter emissions could be increased.

Based on current trends, we expect that environmental and land use laws and regulations will continue to change and indeed to become more stringent with time. If such laws and regulations or the terms of our licenses, permits or approvals are changed and our facilities are not grandfathered or excluded from these changes, we may need to make significant capital expenditures for modifications to project technologies and facilities to maintain compliance in order to continue operation. We do not anticipate incurring material capital expenditures related to environmental compliance in the near term.

*Clean Air Act.* There are three parts of the Clean Air Act that are particularly relevant to electricity generation facilities: Title I—National Ambient Air Quality Standards; Title IV—Acid Deposition Control; and Title V—The Clean Air Act Permit Program. Most of the permit and regulatory requirements that apply to the Plants arise under Titles IV and V. Title IV affects all fossil fuel-fired generation facilities and requires covered sources to generate or obtain annual credits for SO<sub>2</sub> emissions. Title V affects all emission sources, including gas-fired electricity generation facilities. Title V requires that we obtain comprehensive air emission control permits for the Plants that are classified as major sources under the Clean Air Act. All of our Plants are major sources, and we have applied for and obtained the required Title V permits.

Under Title I of the federal Clean Air Act, if National Ambient Air Quality Standards, or NAAQS, are violated in a region, that area is designated as a non-attainment area by the EPA, and is given a deadline for reaching compliance. The relevant state is required to submit a state implementation plan, or SIP, detailing how regional attainment will be achieved within the prescribed time limit, including a requirement for new and modified stationary sources to obtain emissions offsets for their NO<sub>x</sub>, VOC, and particulate matter emissions where certain emission thresholds are triggered. All of the Plants are located in areas presently in attainment of NAAQS.

*Proposed and Recently Adopted Air Quality Regulations.* During 2005, the EPA adopted the Clean Air Interstate Rule, or CAIR, which expands the NO<sub>x</sub> and SO<sub>2</sub> “cap and trade” programs established for states in the eastern and southeastern United States, including Arkansas and Mississippi.

On July 6, 2011, the EPA issued a Final Cross-State Air Pollution Rule, or CSAPR, which replaced CAIR. Under the CSAPR Rule, the EPA adopted federal implementation plans, or FIPs, for each of the states covered by the rule. The FIP is only operative until individual states submit revised SIPs implementing the CSAPR to the EPA for approval. Like CAIR, the CSAPR is a two phase program with declining compliance caps for SO<sub>2</sub> and NO<sub>x</sub> by January 1, 2012 with a second phase of SO<sub>2</sub> reductions by January 1, 2014. Additionally, twenty states, including Arkansas and Mississippi, are required to reduce NO<sub>x</sub> emissions during the ozone season (May through September) by May 1, 2012 in order to decrease the emissions transported to downwind states. Under the CSAPR, plants in Mississippi and Arkansas are only subject to the ozone season NO<sub>x</sub> reduction requirements and not the general SO<sub>2</sub> and NO<sub>x</sub> phased reductions. The CSAPR allows emission allowance trading among covered sources, utilizing an allowance market infrastructure based on existing, successful allowance trading programs. Sources can trade emissions allowances with other sources within the ozone season NO<sub>x</sub> program in the same or different states. Several power companies and fifteen states petitioned for review of the CSAPR in the U.S. Court of Appeals for the D.C. Circuit. Nineteen parties filed motions for stay. On August 21, 2012, the D.C. Circuit vacated the CSAPR, ordering the EPA to enforce CAIR until a viable replacement to the CSAPR is made.

Legislative efforts are underway to delay implementation of the CSAPR. In September 2011, the U.S. House of Representatives voted to approve an amendment to the Transparency in Regulatory Analysis of Impacts on the Nation Act of 2011, or the TRAIN Act (H.R. 2401), that would delay implementation of the CSAPR. The TRAIN Act has not been acted upon by the Senate and the White House has threatened to veto the legislation were it enacted in this Congress.

As the allowable caps on ozone season NO<sub>x</sub> emissions decreases, we anticipate that the cost to acquire emission credits will increase. If we are unable to satisfy some or all of our environmental commitments with emissions allowances, either because of regulatory changes or an inability to obtain emissions allowances, we could be required to take alternative actions, which may include reduced plant operation or shutdown or additional capital expenditures to comply with the Clean Air Act.

*Proposed Climate Change Legislation and Regulations.* There is a growing popular consensus in the U.S. and globally that GHG emissions are linked to global climate change; this consensus may lead to more stringent regulation of GHG emissions in the future. Increased public concern and mounting political pressure may result in state, regional, and/or federal requirements to reduce or mitigate the effects of GHG emissions, in particular from power plants.

In *Massachusetts v EPA*, 549 U.S. 497 (2007), the United States Supreme Court determined that the EPA has authority under existing law to regulate GHG emissions pursuant to its authority to set emission standards for “any air pollutant” which in the EPA Administrator’s judgment “cause[s], or contribute[s] to, air pollution which may reasonably be anticipated to endanger public health or welfare.” In a related action, on April 24, 2009, the EPA issued a proposed finding that carbon dioxide, or CO<sub>2</sub>, and other GHGs endanger public health and welfare, which could require the EPA to issue emissions limits for GHG emissions from motor vehicles. This so-called “endangerment finding,” if affirmed in court, would establish the EPA’s authority to set GHG emission standards. In reliance on its “endangerment finding,” on May 13, 2010, the EPA issued a final rule (Prevention of Significant Deterioration and Title V Greenhouse Gas Tailoring Rule, or Tailoring Rule) adopting a phased-in approach to address six GHG emissions from stationary sources, including power plants, which began in January 2011. A number of industry groups, environmental organizations and states challenged the endangerment finding and the Tailoring Rule in the courts. On June 26, 2012, the United States Court of Appeals for the District of Columbia Circuit issued an opinion upholding the endangerment finding and the EPA’s authority to apply the Clean Air Act to GHG sources. The Court of Appeals also dismissed challenges of the Tailoring Rule on the ground that petitioners lacked standing. The Court of Appeals decision may be subject to rehearing by the Court or an appeal to the United States Supreme Court.

On March 27, 2012, EPA proposed a Carbon Pollution Standard for new or modified power plants under its New Source Performance Standards authority. The proposed GHG standards were set at the expected level of GHG emissions of a combined-cycle gas-fired facility and have been widely interpreted to preclude development of new coal-fired power plants, unless accompanied by carbon sequestration technology. The proposed GHG standards for new or modified power plants are now subject to public comment and EPA may reconsider, modify, or finalize the standards. A Final Rule is not expected before the November 2012 elections. While the Tailoring Rule and the proposed Carbon Pollution Standard would only apply to new and modified facilities, the EPA has previously entered into two proposed court-supervised settlement agreements, under which it will issue rules that will address GHG emissions from existing fossil fuel-fired power plants, as well as new and modified sources. Nonetheless, upon issuance of the proposed Carbon Pollution Standard, the EPA Administrator stated publicly that EPA has no current plans to address GHG emissions from existing power plants. It is unclear at this time whether or when environmental organizations that are parties to the settlement agreements might seek to force EPA to issue GHG standards for existing power plants. Such standards could involve the states in making individual determinations of GHG requirements under federal NAAQS guidelines. The degree of flexibility in federal guidelines and the degree of discretion that states would be given to regulate GHG emissions of existing power plants remain highly uncertain.

While a comprehensive energy and environmental bill establishing a “cap and trade” system for targeted reductions of GHG emissions passed the U.S. House of Representatives two years ago, further action was not taken on this bill and additional climate change bills have not been passed by the House or Senate. With the 112th Congress now in its last few months, it is highly unlikely that a climate change bill, or even a pared-down energy bill, will reach the President’s desk this year.

EPA rulemakings to regulate GHG emissions are expected to continue despite the absence of a new, comprehensive federal statutory scheme to address the issue, but since the mid-term elections the EPA has been reconsidering and delaying its efforts. While new GHG rules, once finalized, are expected to be challenged in the courts and by Congress through attempts to delay, defund, or deauthorize the EPA’s regulation of GHG emissions, it is likely that the current Administration will continue this regulatory exercise in the near term, or at least until a consensus emerges on possible GHG legislation. In addition, states and regions seeking to control the GHG emissions of their power plants are expected to continue. Regulation of CO<sub>2</sub> emissions at the federal level or in the states or regions where we operate could impact our operations by requiring us to obtain allowances for each ton of CO<sub>2</sub> produced. It is uncertain whether existing emitters will be awarded allowances or be required to purchase allowances under federal regulatory framework. Our power generation operations primarily use natural gas and therefore emit less CO<sub>2</sub> than coal-fired generation facilities. Natural-gas fired combined cycle facilities emit 50% to 60% less CO<sub>2</sub> per kW-hr compared to conventional coal-fired generation facilities.

*Site Remediation Liability.* Certain federal and state environmental laws impose joint and several liability without regard to fault for costs required to clean up and restore sites where hazardous substances have been or could be released. We could be responsible under these laws for liabilities associated with the environmental condition of power generation plants that we own or operate or locations where we have arranged for the disposal of hazardous substances. We are also subject to environmental laws and regulations that require us to report and respond to spills and releases that may occur as a result of our operations. We are not currently subject to material liabilities or obligations to investigate, clean-up, or monitor on-site or off-site environmental contamination under these environmental laws.

## **Insurance**

We carry insurance coverage consistent with companies engaged in similar commercial operations with similar properties, including business interruption insurance for our facilities. However, our insurance policies are subject to certain limits and deductibles as well as policy exclusions. Adequate insurance coverage in the future may be more expensive or may not be available on commercially reasonable terms. Also, the insurance proceeds received for any loss of or any damage to any of our generation facilities may not be sufficient to restore the loss or damage without negative impact on our financial condition, results of operations, or cash flows.

## **Available Information**

Our principal offices are at Four Oaks Place, 1330 Post Oak Blvd., Suite 1500, Houston, TX 77056. Our phone number is (713) 979-1900. Our investor relations department will provide without charge, upon the written request of a holder of our common stock or a prospective investor, our annual reports, quarterly reports, and any amendments to these reports. Certain of these reports and other communication are also available on our website at *www.kgenpower.com*. We are not an SEC registrant and therefore none of these reports have been filed with the Securities and Exchange Commission.

### **Number 1A. Risk Factors**

#### **Risks Related to Our Business**

*The Company has entered into agreements for the sale of its remaining facilities, and upon consummation of those sales, the Company will have no remaining operations and will be wound down and, subject to approval of the Board and stockholders, dissolved.*

Upon the consummation of the Hinds and Hot Spring transactions, the Company will have sold all of its remaining operating assets. As the Company will cease to own any operating assets upon the consummation of the Hinds and Hot Spring transactions, the Board expects to distribute to our stockholders substantially all of the net after-tax proceeds of these sales as they are received after taking into account the anticipated expenses of winding down the Company. If expenses related to the winding down of the Company are greater than anticipated, there will be less net after-tax proceeds from the sales available for distribution to our stockholders. For further discussion of risks related to the dissolution of the Company, see “Risks Related to Our Plan of Liquidation and Dissolution” below.

*The sales of the Company’s remaining facilities are subject to satisfaction of various customary contractual closing conditions and will not be able to be closed until completion of an ongoing review by the DOJ. In addition, at the request of the DOJ, we and Entergy agreed to delay closing of the transaction. If as a result of the failure to satisfy any of the conditions, or as a result of the DOJ review, we are prevented from closing one or both of the sales, there would be no distribution of the expected net after-tax sale proceeds from such sale or sales to our stockholders.*

The Hinds and Hot Spring transactions are each conditioned upon certain customary closing conditions and also will not be able to be closed until the ongoing DOJ review is completed. In addition, at the request of the DOJ, made in connection with the DOJ’s ongoing review of the Hinds and Hot Spring transactions, we and Entergy agreed to delay closing of the transaction. We are currently in discussions with the DOJ and Entergy regarding the DOJ’s concerns and the potential timing for closing of the transaction which could result in a significant further delay to closing. In addition, the transactions may not close at all as a result of our failure to satisfy one or more of the customary closing conditions or because we are prevented by the DOJ from closing. Neither the Hinds transaction nor the Hot Spring transaction is conditioned on the closing of the other, thus the transactions may close at different times and one transaction may be completed and not the other.

In addition, the occurrence of certain events, changes, or other circumstances that are beyond our control could give rise to the termination of one or both of the agreements for the sale of our facilities.

If either or both of the Hinds or Hot Spring transactions fail to close, the net after-tax sale proceeds from such sale or sales would not be available for distribution to our stockholders.

***The Company has certain indemnity obligations under the agreements for the sale of the Hinds and Hot Spring facilities as well as under the agreements for the sale of the Company's legacy facilities which have already been consummated. Any indemnification payments required to be made by the Company under those agreements would reduce the net after-tax sale proceeds available for distribution to our stockholders.***

In order to secure the Company's post-closing indemnification obligations under the agreements for the sale of the Hinds and Hot Spring facilities as well as under the agreements for the sale of the Company's Murray facilities which have already been consummated, a portion of the purchase price for the Murray transaction has been, and in the case of the Hinds and Hot Spring facilities, will be, placed into escrow. It is possible that the Company may be required to make indemnification payments out of, or in excess of, the portion of the amounts that have been, and will be, placed into escrow. To the extent indemnification payments are required to be made by the Company under those agreements, whether out of or in excess of the respective escrowed amounts, those payments would reduce the available net after-tax sale proceeds available for distribution to our stockholders.

***Until the consummation of the sale of our facilities, the failure to achieve favorable operating results could have an effect on our financial condition.***

Our inability to operate the Plants efficiently, manage capital expenditures and costs, and generate earnings and cash flow from our asset-based businesses in relation to our obligations could have a material adverse effect on our results of operations, financial condition, or cash flows.

We expect both our Hinds and Hot Spring facilities to be free cash flow negative for the foreseeable future and, if only one or both of the sales fails to close, we may not generate sufficient cash or otherwise have sufficient liquidity to continue to operate our facilities.

***Both of our Plants currently operate without long-term power purchase agreements and if we are unable to find purchasers for our power or capacity or to find purchasers at attractive pricing, it would have a material adverse effect on our financial condition and cash flows.***

Our Plants currently operate as merchant facilities without long-term power purchase agreements, and therefore are exposed to significant price volatility from the supply and demand imbalances in the day-ahead and spot markets. Without the benefit of long-term power purchase agreements for these assets, we cannot be sure that we will be able to sell any or all of the capacity available or power generated by these facilities at commercially attractive rates or that these facilities will be able to generate revenues or operate profitably.

***We rely on a power transmission facility that we do not own or control and are subject to transmission constraints within our core region. If this facility fails to provide us with adequate transmission capacity, we may be restricted in our ability to deliver wholesale electric power to our customers and we may either incur additional costs or forego revenues.***

We depend on a transmission facility owned and operated by others to deliver the wholesale power we sell from the Plants to our customers. Entergy Services controls the transmission infrastructure in our primary region of operations within SERC.

Additionally, if transmission is unavailable or disrupted, or if the transmission capacity infrastructure is inadequate, our ability to sell and deliver wholesale power may be adversely impacted. If a region's power transmission infrastructure is inadequate, our recovery of costs and wholesale profits may be limited.

***Until the consummation of the sale of our facilities, our costs, results of operations, financial condition, and cash flows could be adversely impacted by disruption of our fuel supplies.***

We rely on natural gas to fuel our Plants. Delivery of fuel to our Plants is dependent upon the continuing financial viability of contractual counterparties as well as upon the infrastructure (particularly natural gas pipelines) available to serve each plant. As a result, we are subject to the risks of disruptions or curtailments in the production of power at the Plants if a counter party fails to perform or if there is a disruption in the fuel delivery infrastructure. We buy significant amounts of fuel on a short-term or spot market basis. Prices for our fuel fluctuate, sometimes rising or falling significantly over a short period. The price we can obtain for the sale of electric energy may not rise at the same rate, or may not rise at all, to match a rise in fuel or fuel delivery costs. This may have a material adverse effect on our financial performance. Changes in market prices for natural gas may result from the following:

- weather conditions;
- seasonality;
- demand for energy commodities and general economic conditions;
- disruption of gas transportation, infrastructure, or other constraints or inefficiencies;
- changes in FERC-approved gas transport tariff rates;
- additional generation capacity;
- outages resulting from maintenance;
- availability of competitively priced alternative energy sources;
- availability and levels of storage and inventory for fuel stocks;
- natural gas production levels;
- the creditworthiness or bankruptcy or other financial distress of market participants;
- changes in market liquidity;
- natural disasters, wars, embargoes, acts of terrorism, and other catastrophic events; and
- federal, state, and foreign governmental regulation and legislation.

We obtain supplies of natural gas through firm and interruptible pipeline transport agreements. The transport prices we pay are regulated under tariffs approved by FERC. Certain tariffs apply to gas supplies taken over a fixed period of time. As the Plants are generally dispatched intermittently, we do not need gas at a steady rate over a long period of time but in compressed periods. Unless the gas transporter has flexible operations or cooperates with us, a requirement to take a minimum amount of gas over an extended period or face penalties related to the pressure in the pipeline and other contract requirements can make it uneconomical to operate a plant under certain conditions.

***As a result of the transactions to sell our facilities, we face potential difficulties in the retention of executive management and other employees.***

Our ability to successfully consummate the sale of our facilities will depend in part on the skills, experience and efforts of our senior management and certain key personnel with critical skills. While our Chief Executive Officer and certain other members of our management are subject to employment agreements, these employment agreements may be terminated at will by the employees and the loss of the services of any such individual or other key personnel could have a material adverse impact upon our business and results of operations. The Company's entry into agreements for the sale of its remaining



facilities may negatively impact our ability to retain our senior management team and certain other key personnel.

***We have only one significant customer with which we have a direct contractual relationship for our power so our credit risk is concentrated. This customer does not have an investment grade credit rating. If our customer was to experience financial difficulties, we could be subject to a material and adverse effect on our financial condition and results of operations.***

Since October 1, 2011, our only significant customer with which we have a direct contractual relationship with is Twin Eagle. We benefit from credit sleeving with Twin Eagle through back-to-back sales of merchant power and capacity to our ultimate customers. Changes in economic, regulatory, or other factors could have a significant effect on these customers or our contractual relationships. Twin Eagle does not have an investment grade credit rating. If Twin Eagle failed to pay us or was delayed in their payments under our contracts, we would be adversely affected to the extent that we were unable to find other customers at the same level of contract profitability.

### **Risks Related to Our Plan of Liquidation and Dissolution**

On April 27, 2011, the Board unanimously approved and adopted a Plan of Liquidation of the Company for federal income tax purposes. The Plan of Liquidation provides that the Company will distribute to the stockholders of the Company (on a pro rata basis), in a series of distributions in complete liquidation of the Company, the net proceeds of the Company's sale transactions. The Board expects that, after completion of our Hinds and Hot Spring divestitures, it will approve the Dissolution of the Company, subject to stockholder approval. Risks related to the Plan of Liquidation and Dissolution may include, among others, those set out below.

***If the pending Hinds and Hot Spring divestitures are not completed or the Dissolution is not approved by stockholders, we may not be able to make the final liquidating distribution in the time required under the Plan of Liquidation, in which case prior distributions could be subject to recharacterization for U.S. federal income tax purposes, resulting in adverse tax consequences to stockholders.***

The Plan of Liquidation provides that the Company will make the final liquidating distribution under the Plan of Liquidation to its stockholders no later than three years after the date of adoption of the Plan of Liquidation. If the pending Hinds and Hot Spring divestitures are completed and the Dissolution is approved by the stockholders, we expect that the Dissolution would be effected around April 2014, approximately three years after the adoption of the Plan of Liquidation. However, if the pending Hinds and Hot Spring divestitures are not completed or the Dissolution is not approved by stockholders, we may not be able to make the final liquidating distribution under the Plan of Liquidation within approximately three years of its adoption. If the Company is unable to complete the Plan of Liquidation within this time frame, prior distributions under the Plan of Liquidation could be recharacterized as taxable dividends.

If the pending Hinds and Hot Spring divestitures are not completed, the Board will evaluate whether to seek to sell those facilities to other buyers or whether there is any other prudent course of action in order to allow it to make the final liquidating distribution within approximately three years of the adoption of the Plan of Liquidation. There can be no assurance that Board will be able to sell the facilities or implement an alternative course of action that would allow it to make the final liquidating distribution within approximately three years of the adoption of the Plan of Liquidation.

***The amount and timing of future distributions is uncertain.***

The amount of cash ultimately distributed by the Company to the stockholders, and the timing of those distributions, will depend on the extent, if any, to which the Company becomes subject to claims for indemnification under its transaction agreements (or any indemnification arrangements for directors and

officers and trustees of the liquidating trust) and the amount of escrowed funds ultimately released to the Company under its transaction agreements. In addition, the amount of cash ultimately distributed will be reduced by, and the timing of such distributions may be delayed on the account of, any liabilities, obligations, taxes, expenses, and claims against us or the liquidating trust (including, but not limited to, any litigation arising in connection with our decision to liquidate and dissolve), and contingency reserves that may be established by the Board or the trustees of the liquidating trust.

***We will continue to incur claims, liabilities and expenses which may reduce the amount available for distribution to stockholders.***

We will continue to incur claims, liabilities and expenses (such as salaries and benefits, directors' and officers' insurance, payroll and taxes, legal and accounting expenses, and miscellaneous office expenses) as we wind down. Such expenses may reduce the amount ultimately available for distribution to our stockholders

***Interests in liquidating trust that we expect to establish around April 2014 for the benefit of our stockholders will generally not be transferable and will have limited rights.***

If the Dissolution is approved by stockholders of the Company, we expect to affect the Dissolution on or around April 2014. Promptly after the effective date of the Dissolution, the Company expects to transfer to a liquidating trust established for the benefit of our stockholders, all remaining cash and other assets of the Company (including the right to receive all sale proceeds paid to the Company out of the escrows established pursuant to the Company's transaction agreements). The Company's stockholders will receive one unit of beneficial interests in the liquidating trust for each share of stock of the Company they own. The holders of these beneficial interests will be entitled to receive distributions of any cash or sale proceeds received by the liquidating trust, subject to wind down expenses and reserves for liabilities of the Company and the liquidating trust, including contingent liabilities. The beneficial interests in the liquidating trust will, however, generally not be transferable. Therefore, the recipients of units of beneficial interests in the liquidating trust will not realize any value from these interests unless and until the liquidating trust makes distributions to them.

***There may be material United States federal income tax consequences to stockholders as a result of distributions as well as transfers to, and the ongoing activities of, the liquidating trust.***

The U.S. federal income tax consequences to each stockholder will depend on such stockholder's particular facts and circumstances. In that regard, any distributions to our stockholders pursuant to the Plan of Liquidation or the Dissolution may be taxable to our U.S. stockholders for U.S. federal income tax purposes depending upon certain factors, including the adjusted tax basis a stockholder has in its shares of the Company, and U.S. stockholders may recognize taxable gain on any such distributions.

When the Company transfers assets to the liquidating trust, stockholders will generally be treated for tax purposes as having received their pro rata share of the property transferred to the liquidating trust (including the right to receive all sale proceeds paid to the Company out of the escrows established pursuant to the Company's transaction agreements), reduced by the amount of known liabilities assumed by the liquidating trust or to which the property transferred is subject. Under the Plan of Liquidation, the liquidating trust itself will not be subject to federal income tax. After the transfer of assets to the liquidating trust, the holders of beneficial interests in the liquidating trust will be required to recognize, for federal income tax purposes, their allocable portion of any income, gain, deduction or loss recognized by the liquidating trust. As a result of the transfer of property to the liquidating trust and the ongoing activities of the liquidating trust, holders of beneficial interests in the liquidating trust may be subject to tax, whether or not they have received any actual distributions from the liquidating trust with which to pay such tax.

If the Company is unable to make the final liquidating distribution to the stockholders within three years of the adoption of the plan of liquidation, prior distributions could be recharacterized as dividends subject to U.S. federal income taxes (including withholding taxes) at ordinary income tax rates.

Pursuant to U.S. Treasury Department Circular 230, our stockholders are hereby notified that: (i) any discussion of U.S. federal income tax matters set forth in this document is not intended and was not written to be used, and cannot be used, for the purpose of avoiding penalties that may be imposed under the U.S. Internal Revenue Code of 1986, as amended, or the Code; (ii) such discussion was written to support the promotion or marketing (within the meaning of Circular 230) of the transactions or matters addressed herein; and (iii) stockholders of the Company should seek advice based on their particular circumstances from their own independent tax advisors.

### **Risks Related to Our Industry**

*Until the consummation of the sale of our facilities, the operation of power generation plants involves significant risks that could result in unplanned power outages or reduced output, which would adversely affect our results of operations, financial condition or cash flows.*

We are subject to significant risks associated with operating power generation plants, any of which could adversely affect our revenues, costs, results of operations, financial condition or cash flows. These risks include:

- operating performance below expected levels of output or efficiency;
- failure of equipment or processes, operator or maintenance errors, or other events resulting in power outages or reduced output;
- availability of fuel and fuel transportation;
- disruptions in the transmission or distribution of power; and
- catastrophic events such as fires, hurricanes, explosions, floods, lightning strikes, terrorist attacks, or other similar occurrences to our facilities or to facilities upon which we depend.

Unplanned outages of generation units, including extensions of scheduled outages due to mechanical failures or other problems occur from time to time and are an inherent risk of our business. Unplanned outages typically increase our operating and maintenance expenses. In addition, an unplanned outage may reduce our revenues as a result of selling fewer megawatt hours, or MWh, or require us to incur significant additional costs as a result of obtaining replacement power from third parties in the open market to satisfy our power sales obligations. As a result, if any one unit were to experience an unexpected failure or unplanned outage, especially during our peak summer season, it may have a material adverse effect on our revenues from operations or our costs of operations.

The cost of repairing damage to our Plants due to storms, lightning strikes, natural disasters, and other catastrophic events may adversely affect our results of operations, financial condition, or cash flows. These events and future events of this kind could damage our Plants and disrupt our fuel supply and transmission capability. Such events could also result in adverse changes in the insurance markets or other operating costs and disruptions of power and fuel markets. In addition, our power generation plants, fuel supply, fuel transport, and transmission capability could be directly or indirectly harmed by future terrorist activity or acts of war. Strategic targets, such as energy-related facilities, may be at greater risk of future terrorist activities than other domestic targets. The occurrence or risk of occurrence of future terrorist attacks or related acts of war could result in increased securities and insurance costs, adversely affect the U.S. economy or otherwise impact our results of operations and financial condition in unpredictable ways.

***Our operations are subject to hazards customary to the power generation industry. We may not have adequate insurance to cover all of these hazards.***

Power generation involves hazardous activities, including acquiring, transporting and unloading fuel, operating large pieces of rotating equipment, and delivering electricity to transmission and distribution systems. In addition to natural risks such as earthquake, flood, lightning strikes, hurricane and wind, other hazards, such as fire, explosion, structural collapse, and machinery failure are inherent risks in our operations. These and other hazards can cause significant personal injury or loss of life, severe damage to and destruction of property, plant and equipment, contamination of, or damage to, the environment, and suspension of operations. The occurrence of any one of these events may result in our being named as a defendant in lawsuits asserting claims for substantial damages, including for environmental cleanup costs, personal injury and property damage, and fines and/or penalties. We maintain an amount of insurance protection that we consider adequate, but we cannot make assurances that our insurance will be sufficient or effective under all circumstances and against all hazards or liabilities to which we may be subject. A successful claim for which we are not fully insured could hurt our financial results and materially harm our financial condition. Further, due to rising insurance costs and changes in the insurance markets, we cannot make assurances that insurance coverage will continue to be available at all or at rates or on terms similar to those presently available to us. Any losses not covered by insurance could have a material adverse effect on our financial condition, results of operations, or cash flows.

***Until the consummation of the sale of our facilities, our revenues and results of operations from the sale of electric power and generation capacity may be adversely impacted by market risks that are beyond our control.***

We have not sought FERC approval to sell electric energy and capacity from our generation facilities at cost-based rates. Rather, we sell electric generation capacity and energy on a merchant basis to wholesale purchasers at prices determined by the market. As a result, we are not guaranteed any rate of return on our capital investments through mandated rates, and our revenues and results of operations depend upon current and forward market prices for power. Unlike most other commodities, large quantities of electricity cannot be economically stored and therefore must be produced concurrently with its use. As a result, wholesale power markets are subject to significant price volatility from supply and demand imbalances, especially in the day-ahead and spot markets. Long-term and short-term power prices may also fluctuate substantially due to other factors outside of our control, including:

- oversupply or undersupply of generation capacity;
- changes in power transmission or fuel transportation capacity constraints or inefficiencies;
- electric supply disruptions, including plant outages and transmission disruptions;
- seasonality;
- demand changes due to changes in the macro-economic environment;
- weather conditions;
- availability and market prices for natural gas;
- changes in demand for power or patterns of power usage;
- additional supplies of power from existing competitors or new market entrants as a result of the development of new generation plants, expansion of existing plants, the revitalization of non-operating plants, or additional transmission capacity;
- development of new fuels and new technologies for the production of power;
- availability of competitively priced alternative power sources;
- changes in the relationship between the prices of natural gas and coal;

- natural disasters, wars, embargoes, terrorist attacks, and other catastrophic events;
- regulations and actions of regulatory bodies; and
- federal and state power market and environmental regulation and legislation.

***Until the consummation of the sale of our facilities, our business will be subject to substantial governmental regulation and may be adversely affected by liability under, or any future inability to comply with, existing or future regulations or requirements.***

Our business is subject to extensive federal, state, and local laws and regulation. Compliance with the requirements under these various regulatory regimes may cause us to incur significant additional costs and failure to comply with such requirements could result in the shutdown of the non-complying facility, the imposition of liens, fines, and/or civil or criminal liability. We are also affected by changes to market rules, tariffs, changes in market structures, changes in administrative fee allocations, and changes in market bidding rules.

***Until the consummation of the sale of our facilities, we will be subject to environmental laws and regulations that impose extensive and increasingly stringent requirements and liabilities on our operations that could adversely impact our results of operations, financial condition, and cash flows.***

Our business is subject to the environmental laws and regulations of federal, state, and local authorities. We must comply with these laws and regulations and obtain numerous governmental permits and approvals to operate our power projects. If we fail to comply with environmental requirements applicable to our operations, we could be subject to administrative, civil and/or criminal liability and fines, and regulatory agencies could take other actions to limit or curtail our operations. We are also subject to liability for environmental contamination at our operating facilities or third-party locations where our operations have sent wastes. In addition, new environmental requirements that take effect or changes to or reinterpretation of existing environmental requirements or enforcement policies could adversely affect our business, results of operations, financial condition, and cash flows. See “Number 1. *Business—Regulatory Matters—Environmental Regulation.*”

***Until the consummation of the sale of our facilities, competition in wholesale power markets may have a material adverse effect on our results of operations, cash flows, and the market value of our assets.***

We have numerous competitors in all aspects of our business, and additional competitors may enter the industry. Other companies with which we compete may have greater liquidity, access to credit and other financial resources, lower cost structures, more effective risk management policies and procedures, greater ability to incur losses, longer standing relationships with customers, greater potential for profitability from ancillary services, or greater flexibility in the timing of their sale of generation capacity and ancillary services than we do.

## **Other Risks**

***We rely extensively on third party service providers for the operation and maintenance of our Plants and for certain marketing of our electricity, and if such service providers cease to perform such services or fail to perform such services adequately or on the same terms, it could adversely affect our business results of operations and cash flows.***

We currently rely on contractual arrangements with third parties for the operation and maintenance of our Plants and for the marketing of our Plants’ output. Our Hinds and Hot Spring plants are operated by NAES, under operating and maintenance agreements. Since October 1, 2011, Twin Eagle provides energy management services. In addition, GEI provides maintenance services to our plants under LTSAs. While we believe that such contractual arrangements allow us to leverage our management team and have allowed us to operate more effectively and efficiently, in the event we have a significant disagreement with

our third party service providers that interrupts one of their services or one of these providers experiences financial difficulties that adversely affect their ability to provide services, our results of operations, financial condition, and cash flows may be adversely affected. In this regard, NAES and Twin Eagle have the right to terminate their agreements with us at their convenience. In addition, although we seek to align our interests contractually, there may be conflicts of interest and one of these parties may take actions that are not in our best interests. We do not have the internal operating capability to perform the services that we outsource, and to develop such capabilities would be time consuming and expensive. However, based upon discussions with potential alternative providers, we believe that multiple options for a replacement operations and maintenance service provider and a replacement energy management provider are available to KGen. However, we cannot be certain that such replacement providers will deliver their services to us on the same terms as our current providers.

*There has been only limited trading in our common stock, so our stockholders may find it difficult to dispose of their investment.*

Our common stock is not traded on any established trading market. Although institutional investors do occasionally trade our common stock, this trading activity is limited and may not occur on a regular basis. As such, investors who own or purchase our common stock will find that the liquidity or transferability of the common stock is limited. Accordingly, stockholders may find it difficult to dispose of, or obtain accurate quotations as to the market value, of our common stock.

**Number 2. Properties**

Our corporate headquarters are located in Houston, Texas. As of June 30, 2012, we leased approximately 20,200 square feet of office space of which approximately 6,318 square feet of corporate office space is currently subleased. The commencement date of the sublease was December 17, 2009. Sublease payments began on February 17, 2010.

In addition, we own and lease various real property and facilities relating to our power generation business. We believe we have satisfactory title to our Plants and our facilities in accordance with standards generally accepted in the electric power industry, subject to exceptions that, in our opinion, should not have a material adverse effect on the use or value of our portfolio. Our properties are as follows:

<u>Site Name</u>	<u>Location</u>	<u>Owned/Leased</u>
Corporate Office . . . . .	Houston, TX	Leased
Hinds . . . . .	Jackson, MS	Owned
Hot Spring . . . . .	Malvern, AR	Leased(1)

(1) Generation assets and real property are leased in relation to the Industrial Revenue Bonds mentioned in Note 5 to our audited financial statements. There is a bargain purchase option whereby we can acquire the asset at the end of the lease for a nominal price.

**Number 3. Legal Proceedings**

The Company could be party to various legal and regulatory actions arising in the normal course of business. Matters that are probable of unfavorable outcome to the Company and which can be reasonably estimated are accrued.

## Part II

### Number 4. Market for the Company's Common Equity, Related Stockholder Matters and Company Purchases of Equity Securities

Our common stock shares are not traded on any securities exchange.

### Number 5. Selected Financial Data

	Year Ended June 30, 2012	Year Ended June 30, 2011	Year Ended June 30, 2010	Year Ended June 30, 2009	Year Ended June 30, 2008
	(in thousands)	(in thousands) (1)	(in thousands) (1)	(in thousands)	(in thousands)
<b>Operating Results Data:</b>					
Revenues:					
Energy sales . . . . .	\$ 52,752	\$ 97,422	\$ 66,263	\$206,674	\$ 308,605
Capacity sales . . . . .	6,837	4,999	1,932	54,666	51,416
Other revenue . . . . .	900	—	—	—	—
Total revenues . . . . .	<u>60,489</u>	<u>102,421</u>	<u>68,195</u>	<u>261,340</u>	<u>360,021</u>
Operating expenses:					
Cost of fuel . . . . .	42,957	80,843	55,403	174,392	268,978
Operating and maintenance . . . . .	11,859	19,478	28,369	40,733	52,065
Gas transportation . . . . .	10,693	5,926	3,333	16,438	16,382
Selling, general, and administrative . . . . .	10,208	12,322	10,613	15,422	29,418
Acquisition contract termination loss . . . . .	—	—	—	—	37,190
Depreciation . . . . .	438	8,629	10,242	24,272	24,068
Auxiliary power . . . . .	2,781	2,953	2,696	8,784	8,437
Insurance . . . . .	1,838	1,575	1,791	3,605	3,177
Total operating expenses . . . . .	<u>80,774</u>	<u>131,726</u>	<u>112,447</u>	<u>283,646</u>	<u>439,715</u>
Operating loss . . . . .	<u>(20,285)</u>	<u>(29,305)</u>	<u>(44,252)</u>	<u>(22,306)</u>	<u>(79,694)</u>
Other income (expenses):					
Interest expense . . . . .	—	(9,782)	(12,226)	(11,770)	(16,513)
Taxes, other than income taxes . . . . .	(4,412)	(3,813)	(2,101)	(4,355)	(3,457)
Interest income . . . . .	—	—	—	147	2,796
Other . . . . .	(233)	(375)	(230)	(7,206)	(7,065)
Total other expenses . . . . .	<u>(4,645)</u>	<u>(13,970)</u>	<u>(14,557)</u>	<u>(23,184)</u>	<u>(24,239)</u>
Net loss from continuing operations before income taxes . . . . .	(24,930)	(43,275)	(58,809)	(45,490)	(103,933)
Income tax benefit . . . . .	9,729	16,489	—	—	—
Net loss from continuing operations after taxes . . . . .	<u>\$(15,201)</u>	<u>\$(26,786)</u>	<u>\$(58,809)</u>	<u>\$(45,490)</u>	<u>\$(103,933)</u>
Net income from discontinued operations, net of tax . . . . .	—	234,386	13,873	—	—
Net (loss) income . . . . .	<u>\$(15,201)</u>	<u>\$207,600</u>	<u>\$(44,936)</u>	<u>\$(45,490)</u>	<u>\$(103,933)</u>
Net (loss) income per share—basic and diluted					
Continuing operations . . . . .	\$ (0.27)	\$ (0.48)	\$ (1.05)	\$ (0.81)	\$ (1.86)
Discontinued operations . . . . .	—	4.18	0.25	—	—
Total . . . . .	<u>\$(0.27)</u>	<u>\$ 3.70</u>	<u>\$(0.80)</u>	<u>\$(0.81)</u>	<u>\$(1.86)</u>
Weighted average shares					
outstanding—basic . . . . .	56,124	56,027	55,969	55,968	55,949
Weighted average shares outstanding—diluted . . . . .	56,124	56,118	55,969	55,968	55,949
<b>Balance Sheet Data:</b>					
Total property, plant, and equipment, net . . . . .	\$ 552	\$ 990	\$563,525	\$648,210	\$ 671,114
Total assets . . . . .	463,699	480,823	772,254	818,463	870,722
Total current liabilities . . . . .	20,657	22,750	23,767	21,078	39,457
Long-term debt . . . . .	—	—	201,000	203,000	195,000
Stockholders' equity . . . . .	\$443,036	\$458,060	\$529,641	\$573,702	\$ 615,805

(1) These columns reflect discontinued operations due to the sale of the Murray and Sandersville facilities.

## **Number 6. *Management's Discussion and Analysis of Financial Condition and Results of Operations***

The following discussion is intended to assist you in understanding our business and the results of operations together with our present financial condition. This section should be read in conjunction with our Consolidated Financial Statements and the accompanying notes included in this Annual Report for the fiscal year ended June 30, 2012. Unless the context otherwise requires or indicates, references to "KGen," "Company," "we," "our," and "us" refer to KGen Power Corporation and its subsidiaries. Statements in our discussion may be forward-looking. These forward-looking statements involve risk and uncertainties. We caution that a number of factors could cause future results to differ materially from our expectations. Please see "Number 1A. *Risk Factors*" of Part I of our Annual Report for the fiscal year ended June 30, 2012 regarding certain risk factors related to the Company.

### **Business Overview**

We own and operate electric power generation plants and sell electricity and electrical generation capacity in the southeastern United States. We sell power and related products to wholesale purchasers such as retail electric providers, power trading organizations, municipal utilities, electric power cooperatives, and other power generation companies. Our portfolio of facilities consists of two operational and fully permitted combined-cycle power plants, (Hot Spring and Hinds), with General Electric (GE) 7FA gas turbines. Our Plants have an aggregate nominal capacity of 1,140 MW. On July 9, 2010, we completed the sale of our Sandersville power plant, a 640 MW simple-cycle plant, for which we received \$129.3 million in cash sales proceeds. On April 8, 2011, we completed the sale of our Murray I and Murray II combined-cycle power plants having an aggregate nominal capacity of 1,250 MW, for which we received \$530.3 million in cash sales proceeds. On April 28, 2011, we executed separate definitive sales agreements for the sale of our Hinds and Hot Spring power plants having an aggregate nominal capacity of 1,140 MW.

Our two Plants currently operate, and historically the Sandersville and Murray II power plants operated, as merchant power providers. Our Murray I plant, benefited from a fixed-price long-term power purchase agreement, or the GPC PPA, for all of its 630 MW of capacity with Georgia Power, a subsidiary of Southern Company. The GPC PPA provided for fixed capacity payments that provided stable cash flow. The Company recognized \$37.6 million related to capacity sales on the GPC PPA for the year ended June 30, 2011.

Under the terms of our definitive agreement for the sale of our Hinds power generation facility, we agreed to sell this facility to Entergy Mississippi, Inc. for a cash purchase price of \$206.0 million, subject to certain adjustments. The Company received approval from holders of a majority of the Company's outstanding shares for the sale of this facility. The transaction is conditioned on the satisfaction of various regulatory approvals and other conditions described in the 2011 Special Meeting Proxy Statement. Substantially all of the regulatory conditions to closing have been satisfied or waived. Although the mandatory waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, or the HSR Act, applicable to the transaction has expired, at the request of the Antitrust Division of the U.S. Department of Justice, or DOJ, made in connection with the DOJ's ongoing review of the Hinds and Hot Spring transactions, we and Entergy agreed to delay closing of the transaction. We are currently in discussions with the DOJ and Entergy regarding the DOJ's concerns and the potential timing for closing of the transaction. The transaction also remains subject to customary contractual closing conditions. Under the terms of the transaction agreement, \$30.0 million of the purchase price will be held in escrow to secure customary post-closing indemnification obligations. An escrow amount of \$10.0 million is subject to release 12 months after closing, an additional \$10.0 million is subject to release 18 months after closing, and the remaining balance will be subject to release 42 months after closing.



Under the terms of our definitive agreement for the sale of our Hot Spring power generation facility, we agreed to sell this facility to Entergy Arkansas, Inc. for a cash purchase price of \$253.0 million, subject to certain adjustments. The Company received approval from holders of a majority of the Company's outstanding shares for the sale of this facility. The transaction is conditioned on the satisfaction of various regulatory approvals and other conditions described in the 2011 Special Meeting Proxy Statement. Substantially all of the regulatory conditions to closing have been satisfied or waived. Although the mandatory waiting period under the HSR Act applicable to the transaction has expired, at the request of the DOJ, made in connection with the DOJ's ongoing review of the Hinds and Hot Spring transactions, we and Entergy agreed to delay closing of the transaction. We are currently in discussions with the DOJ and Entergy regarding the DOJ's concerns and the potential timing for closing of the transaction. The transaction also remains subject to customary contractual closing conditions. Under the terms of the transaction agreement, \$38.0 million of the purchase price will be held in escrow to secure customary post-closing indemnification obligations. An escrow amount of \$12.0 million is subject to release 12 months after closing, an additional \$13.8 million is subject to release 18 months after closing, and the remaining balance will be subject to release 42 months after closing.

On April 27, 2011, the Board unanimously approved and adopted a Plan of Liquidation of the Company for federal income tax purposes. The Plan of Liquidation provides that the Company will distribute to the stockholders of the Company (on a pro rata basis), in a series of distributions in complete liquidation of the Company, the net proceeds of the Company's sale transactions. The Board expects that, after completion of our Hinds and Hot Spring divestitures, it will approve the Dissolution of the Company, subject to stockholder approval. Promptly after the effective date of the Dissolution, which we expect to occur around April 2014, the Company will transfer to a liquidating trust that we expect to establish for the benefit of our stockholders, all remaining cash and other assets of the Company (including the right to receive all sale proceeds paid to the Company out of the escrows established pursuant to the Company's transaction agreements). In addition, the liquidating trust will assume, and become responsible for, all of the Company's unsatisfied liabilities and obligations, including any unknown or contingent liabilities of the Company. The Company's stockholders of record as of the close of business on the effective date of the Dissolution will receive one unit of beneficial interests in the liquidating trust for each share of stock of the Company. All cash transferred by the Company to the liquidating trust and the net proceeds to the liquidating trust of funds released from escrow after the Dissolution (and the proceeds received by the liquidating trust from the disposition of any non-cash assets it receives) will be distributed by the liquidating trust to the holders of beneficial interests in the liquidating trust, subject to wind down expenses and reserves for liabilities of the Company and the liquidating trust, including contingent liabilities. Risks related to the Plan of Liquidation and Dissolution are disclosed above under "Risk Factors—Risks Related to Our Plan of Liquidation and Dissolution."

## **Results of Operations**

Our results of operations are subject to seasonal variations since demand for electricity and production capacity varies with weather conditions. We earn the majority of our revenues in the months of May through September. Months other than the peak summer months are the months during which we typically seek to perform scheduled maintenance-related activities. The below information does not include the discontinued results of operations of Murray and Sandersville for the year ended June 30, 2011.

**Consolidated Results of Operations of KGen for the Year Ended June 30, 2012 compared to the Year Ended June 30, 2011.**

The following table sets forth our results of operations for the year ended June 30, 2012 and 2011, expressed in thousands of dollars.

	For the Year Ended June 30, 2012	For the Year Ended June 30, 2011	Favorable/ (Unfavorable)	
			Change	% Change
<b>Revenues:</b>				
Energy sales . . . . .	\$ 52,752	\$ 97,422	\$(44,670)	(46)%
Capacity sales . . . . .	6,837	4,999	1,838	37%
Other revenue . . . . .	900	—	900	100%
Total revenues . . . . .	60,489	102,421	(41,932)	(41)%
<b>Operating expenses:</b>				
Cost of fuel . . . . .	42,957	80,843	37,886	47%
Operating and maintenance . . . . .	11,859	19,478	7,619	39%
Gas transportation . . . . .	10,693	5,926	(4,767)	(80)%
Selling, general, and administrative . . . . .	10,208	12,322	2,114	17%
Depreciation . . . . .	438	8,629	8,191	95%
Auxiliary power . . . . .	2,781	2,953	172	6%
Insurance . . . . .	1,838	1,575	(263)	(17)%
Total operating expenses . . . . .	80,774	131,726	50,952	39%
<b>Operating loss . . . . .</b>	<b>(20,285)</b>	<b>(29,305)</b>	<b>9,020</b>	<b>31%</b>
<b>Other expenses:</b>				
Interest expense . . . . .	—	(9,782)	9,782	100%
Taxes, other than income taxes . . . . .	(4,412)	(3,813)	(599)	(16)%
Other . . . . .	(233)	(375)	142	38%
Total other expenses . . . . .	(4,645)	(13,970)	9,325	67%
<b>Net loss from continuing operations before taxes . . . .</b>	<b>\$(24,930)</b>	<b>\$(43,275)</b>	<b>\$ 18,345</b>	<b>42%</b>

**Operating and Business Metrics We Use to Analyze the Company's Performance for the Years Ended June 30, 2012 and June 30, 2011**

In addition to the foregoing results of operations presented in accordance with GAAP, we utilize various non-GAAP operating and business metrics to analyze the Company's performance. We believe these metrics provide useful insight into the Company's performance, assist us in identifying trends in our business, and better allow us to compare our performance to others in our industry. We describe below these various non-GAAP metrics and provide a reconciliation of these metrics for the years ended June 30, 2012 and 2011, to the most directly comparable GAAP measures for those periods. See the reconciliation of net loss to EBITDA, adjusted EBITDA, and adjusted plant EBITDA on page 30. This presentation may not include all of the disclosure that SEC regulations would require a company that files periodic reports with the SEC to make, with respect to non-GAAP financial measures.

### Merchant Margin

Merchant margin is equal to the sum of merchant energy margin and merchant capacity sales. Merchant energy margin is defined as energy sales less the related cost of fuel pursuant to arrangements having an original delivery term of less than one year. Merchant capacity sales is defined as capacity sales pursuant to arrangements having an original delivery term of less than one year. We consider our Plants to be merchant plants because they did not sell their energy output and capacity pursuant to long-term sales agreements during these reporting periods.

	<u>For the Year Ended June 30, 2012</u>	<u>For the Year Ended June 30, 2011</u>
Energy sales . . . . .	\$ 52,752	\$ 97,422
<i>Less:</i> Cost of fuel . . . . .	(42,957)	(80,843)
<b>Merchant energy margin</b> . . . . .	<u>9,795</u>	<u>16,579</u>
<b>Merchant capacity sales</b> . . . . .	<u>6,837</u>	<u>4,999</u>
<b>Merchant margin</b> . . . . .	<u>\$ 16,632</u>	<u>\$ 21,578</u>

### Adjusted Plant Expense and Adjusted Corporate Expense

Adjusted plant expenses is defined as total operating expenses adjusted for the removal of (a) cost of fuel captured in merchant energy margin, (b) major maintenance expense, (c) the income effects of noncash amortization of contract-based intangibles of gas transportation expense, (d) all selling, general, and administrative expense, part of which is captured in adjusted corporate expenses (defined below), (e) any nonrecurring items such as contract termination and transition costs, (f) depreciation, (g) director and officer insurance expense captured in adjusted corporate expenses (defined below); and (h) the addition of taxes, other than income taxes, as it largely represents plant property taxes and payments in lieu of taxes.

	<u>For the Year Ended June 30, 2012</u>	<u>For the Year Ended June 30, 2011</u>
Total operating expenses . . . . .	\$ 80,774	\$131,726
<i>Less:</i> Cost of fuel . . . . .	(42,957)	(80,843)
<i>Less:</i> Major maintenance expense . . . . .	(504)	(4,393)
<i>Add:</i> Gas transportation noncash amortization . . . . .	—	1,013
<i>Less:</i> Selling, general, and administrative expense . . . . .	(10,208)	(12,322)
<i>Less:</i> Depreciation . . . . .	(438)	(8,629)
<i>Less:</i> D&O insurance expense . . . . .	(159)	(168)
<i>Add:</i> Taxes, other than income taxes . . . . .	4,412	3,813
<b>Adjusted plant expenses</b> . . . . .	<u>\$ 30,920</u>	<u>\$ 30,197</u>

Adjusted corporate expenses is defined as selling, general, and administrative expense adjusted for (a) the removal of noncash stock compensation, (b) any nonrecurring items such as expenses associated with plant sales and (c) the addition of director and officer insurance expense.

	<u>For the Year Ended June 30, 2012</u>	<u>For the Year Ended June 30, 2011</u>
Selling, general, and administrative expense . . . . .	\$10,208	\$12,322
<i>Less:</i> Noncash employee options/awards expense . . . . .	(211)	(1,601)
<i>Add:</i> Employee severance expenses . . . . .	—	6
<i>Less:</i> Costs associated with plant sales . . . . .	(911)	(1,613)
<i>Add:</i> D&O insurance expense . . . . .	159	168
<b>Adjusted corporate expenses . . . . .</b>	<u>\$ 9,245</u>	<u>\$ 9,282</u>

*Adjusted Plant EBITDA and Adjusted EBITDA:*

Adjusted plant EBITDA is defined as merchant margin less adjusted plant expenses. Adjusted EBITDA is defined as adjusted plant EBITDA less adjusted corporate expenses.

	<u>For the Year Ended June 30, 2012</u>	<u>For the Year Ended June 30, 2011</u>	<u>Favorable/ (Unfavorable)</u>	
			<u>Change</u>	<u>% Change</u>
Merchant energy margin . . . . .	\$ 9,795	\$ 16,579	\$(6,784)	(41)%
Merchant capacity sales . . . . .	6,837	4,999	1,838	37%
<b>Merchant margin . . . . .</b>	<u>16,632</u>	<u>21,578</u>	<u>(4,946)</u>	<u>(23)%</u>
Adjusted plant expenses . . . . .	30,920	30,197	(723)	(2)%
<b>Adjusted plant EBITDA . . . . .</b>	<u>(14,288)</u>	<u>(8,619)</u>	<u>(5,669)</u>	<u>(66)%</u>
Adjusted corporate expenses . . . . .	9,245	9,282	37	0%
<b>Adjusted EBITDA . . . . .</b>	<u>\$(23,533)</u>	<u>\$(17,901)</u>	<u>\$(5,632)</u>	<u>(31)%</u>

*Selected Operating and Business Metrics*

	<u>For the Year Ended June 30, 2012</u>	<u>For the Year Ended June 30, 2011</u>	<u>Favorable/ (Unfavorable)</u>	
			<u>Change</u>	<u>% Change</u>
<b>Selected Financial and Operating Data</b>				
Merchant generation (GWh) . . . . .	1,570	2,493	(923)	(37)%
Merchant margin/merchant generation (\$/MWh) . . . . .	\$10.59	\$ 8.66	\$ 1.93	22%

*Selected Market and Weather Data*

	<u>For the Year Ended June 30, 2012</u>	<u>For the Year Ended June 30, 2011</u>	<u>Change</u>	<u>% Change</u>
<b>Selected Market Data(1)</b>				
Average on-peak market power price—Entergy (\$/MWh) . . . . .	\$29.76	\$37.66	\$ (7.90)	(21)%
Average Henry Hub gas price (\$/MMbtu) . . . . .	\$ 3.05	\$ 4.15	\$ (1.10)	(27)%
<b>Selected Weather Data</b>				
Actual CDDs(2) . . . . .	4,875	5,194	(319)	(6)%
Normal CDDs . . . . .	3,828	3,799	29	1%
Actual HDDs(3) . . . . .	3,638	4,958	(1,320)	(27)%
Normal HDDs . . . . .	4,963	4,950	13	0%

Notes:

- (1) Data from Platt’s Megawatt Daily and Gas Daily publications.
- (2) CDD, or cooling degree days, represents the number of degrees during April through October that the mean temperature for a particular day is above 65 degrees Fahrenheit. The CDDs are then accumulated for a given period.
- (3) HDD, or heating degree days, represents the number of degrees that the mean temperature for a particular day is below 65 degrees Fahrenheit. The HDDs are then accumulated for a given period.

***Historical Results of Operations of KGen for the Year Ended June 30, 2012 compared to the Year Ended June 30, 2011.***

Merchant margin decreased \$4.9 million, to \$16.6 million for the year ended June 30, 2012. Merchant generation decreased by 37% from 2,493 GWh to 1,570 GWh for the year ended June 30, 2012 as compared to the year ended June 30, 2011. The decline in merchant margin and merchant generation was primarily due to the drainage/soils maintenance work at the Hinds facility that began in September 2011 and was completed during the third quarter of our fiscal year; the fall outage at the Hot Spring facility that occurred in November and December 2011; and other plant activities undertaken in preparation for the sales transaction with Entergy. The implied merchant spark spread, or merchant margin divided by merchant generation, increased from \$8.66 per MWh to \$10.59 per MWh. The increase in merchant spark spread can be attributed to higher sales prices at the Plants as compared to the prior period and lower generation as a result of the maintenance work that began in September 2011. The CDDs were lower by 6% during the summer months of fiscal year 2012 while the winter months were substantially warmer with 27% fewer HDDs.

Adjusted plant expenses increased by \$0.7 million, or 2%, to \$30.9 million for the year ended June 30, 2012. The increase was primarily comprised of a \$3.8 million increase in gas transportation, a \$0.8 million increase in property taxes, a \$0.3 million increase in insurance expense, offset by a \$3.7 million decrease in operating and maintenance expenses and a \$0.2 million decrease in auxiliary power. The \$3.8 million increase in gas transportation was primarily due to TETCO fuel transportation agreements that began in June 2011. The \$0.8 million increase in property taxes at Hinds was due primarily to the expiration of the payments in lieu of taxes agreement. The \$3.7 million decrease in operating and maintenance was primarily due to prior year repairs to one of the Hot Spring gas turbine compressors and the inlet chiller system. This decrease was slightly offset by \$1.1 million of insurance proceeds received during the year ended June 30, 2012 related to the prior year repairs to the inlet chiller system.

As a result of the foregoing changes in merchant margin and adjusted plant expenses, adjusted plant EBITDA decreased by \$5.7 million to a loss of \$14.3 million for the year ended June 30, 2012.

Adjusted corporate expenses decreased by \$37.0 thousand to \$9.2 million for the year ended June 30, 2012.

As a result of the foregoing, adjusted EBITDA decreased by \$5.6 million to a loss of \$23.5 million for the year ended June 30, 2012.

### GAAP to Non-GAAP Adjusted EBITDA Reconciliation

Following is an alternative calculation of adjusted EBITDA and adjusted plant EBITDA starting from net loss before taxes. EBITDA is equal to net loss before taxes adjusted for interest expenses, income taxes, depreciation, and amortization. Adjusted EBITDA is equal to EBITDA minus certain other items (such as major maintenance and other nonrecurring expenses). Adjusted plant EBITDA is equal to total adjusted EBITDA less certain corporate expenses.

	<u>For the Year Ended June 30, 2012</u>	<u>For the Year Ended June 30, 2011</u>
Net loss before taxes . . . . .	\$(24,930)	\$(43,275)
<i>Less:</i> Other revenue . . . . .	(900)	—
<i>Add:</i> Interest expense . . . . .	—	9,782
<i>Add:</i> Depreciation . . . . .	438	8,629
<i>Less:</i> Gas transportation noncash amortization . . . . .	—	(1,013)
<i>Add:</i> Other expense . . . . .	233	375
<b>EBITDA</b> . . . . .	<u>(25,159)</u>	<u>(25,502)</u>
<i>Add:</i> Major maintenance expense . . . . .	504	4,393
<i>Add:</i> Noncash employee options/awards expense . . . . .	211	1,601
<i>Add (Less):</i> Employee severance expense . . . . .	—	(6)
<i>Add:</i> Costs associated with plant sales . . . . .	911	1,613
<b>Adjusted EBITDA</b> . . . . .	<u>(23,533)</u>	<u>(17,901)</u>
<i>Add:</i> Selling, general, and administrative expense . . . . .	10,208	12,322
<i>Less:</i> Noncash employee options/awards expense . . . . .	(211)	(1,601)
<i>Add (Less):</i> Employee severance expense . . . . .	—	6
<i>Less:</i> Costs associated with plant sales . . . . .	(911)	(1,613)
<i>Add:</i> D&O insurance expense . . . . .	159	168
<b>Adjusted plant EBITDA</b> . . . . .	<u><u>\$(14,288)</u></u>	<u><u>\$ (8,619)</u></u>

The following describes changes to specified financial measures of our performance. As indicated above, in calculating our adjusted EBITDA, we made adjustments to our net loss before taxes using these financial measures for the year ended June 30, 2012 compared to the year ended June 30, 2011.

- Other revenue for the year ended June 30, 2012 was \$0.9 million compared to zero for the same period in 2011. We received \$0.9 million of business interruption insurance proceeds for reimbursement of potential revenues lost during the repairs to the Hot Spring inlet chiller system in the prior period.
- Interest expense for the year ended June 30, 2012 was zero compared to \$9.8 million for the same period in 2011. The \$9.8 million decrease was due to the April 2011 repayment of all of the outstanding debt under KGen LLC's former credit agreement and the termination of the related interest rate swap agreements.
- Depreciation was \$0.4 million and \$8.6 million for the years ended June 30, 2012 and 2011, respectively. The \$8.2 million decrease was due to the suspension of depreciation related to the Hinds and Hot Spring plants due to their held for sale status.
- Amortization of contract-based natural gas transportation rights and obligations was zero and \$1.0 million for the years ended June 30, 2012 and 2011, respectively, and was recorded as an increase of gas transportation expense. The \$1.0 million decrease was due to the suspension of amortization on the Hot Spring intangibles due to their held for sale status.
- Major maintenance expense for the years ended June 30, 2012 and 2011 was \$0.5 million and \$4.4 million, respectively. The \$0.5 million expense in the current period related to major maintenance at the Hot Spring facility. The \$4.4 million expense in the prior period primarily represented a \$1.7 million payment to GE as a result of restructuring the long-term service agreements with GE, \$0.4 million of major maintenance performed at the Hinds facility, and \$2.3 million performed at the Hot Spring facility.
- Noncash employee options/awards expense for the years ended June 30, 2012 and 2011 was \$0.2 million and \$1.6 million, respectively, and was recorded as an increase of selling, general, and administrative expense.
- Costs associated with plant sales for the years ended June 30, 2012 and 2011 were \$0.9 million and \$1.6 million, respectively, and were recorded as an increase of selling, general, and administrative expense.
- Selling, general, and administrative expense was \$10.2 million and \$12.3 million for the years ended June 30, 2012 and 2011, respectively. The \$2.1 million decrease was primarily due to a \$1.4 million decrease in RSU expense and a \$0.7 million decrease in costs associated with plant sales.

## **Liquidity and Capital Resources**

### ***Liquidity Position***

As of June 30, 2012, our current cash on hand consisted of \$69.2 million of unrestricted cash, \$43.4 million of restricted cash supporting our outstanding letters of credit, and \$79.7 million of restricted cash in escrow. We anticipate that our cash on hand and cash flow provided by operations will satisfy our short term liquidity needs with respect to our current portfolio of assets. Historically, our principal sources of funds were cash flows from operations and borrowings under our former Credit Facility. Our principal use of funds consisted of operating expenditures and capital expenditures.

Subsequent to the repayment of all outstanding debt under KGen LLC's former credit agreement, a \$75.0 million cash collateralized replacement letter of credit facility was entered into on April 8, 2011 of which \$43.4 million of letters of credit have been issued. The \$43.4 million of cash collateral securing the

outstanding letters of credit was recorded in restricted cash and cash equivalents. The letters of credit issued under this facility support obligations associated with ongoing long-term gas transportation contracts at the Hinds and Hot Spring facilities. Fees related to this letter of credit facility were \$0.4 million for the year ended June 30, 2012 and were expensed as incurred.

In connection with the April 8, 2011 sale of the Murray I and II combined-cycle power generation facilities, \$79.7 million was placed in escrow for a period of 18 months after closing to secure customary post-closing indemnification obligations and will be subject to taxation. This escrow balance was recorded in restricted cash in escrow and is expected to be released in October 2012.

### ***Contractual Obligations***

Our contractual obligations consist primarily of obligations under firm gas transportation agreements, minimum LTSA payments, and leasehold payments. We intend to fund our contractual obligations through our internally generated cash flows from operations and asset sales. We believe that our sources of liquidity will be sufficient to meet our contractual obligations.

The following table sets forth our contractual obligations as of June 30, 2012 (in thousands of dollars):

	<u>Total</u>	<u>Less than 1 year</u>	<u>1 - 3 years</u>	<u>3 - 5 years</u>	<u>More than 5 years</u>
Pipeline payments . . . . .	\$164,382	\$10,450	\$31,351	\$31,351	\$ 91,230
LTSA . . . . .	29,538	1,099	3,500	3,824	21,115
Other(1) . . . . .	3,253	715	1,692	846	—
Total . . . . .	<u>\$197,173</u>	<u>\$12,264</u>	<u>\$36,543</u>	<u>\$36,021</u>	<u>\$112,345</u>

(1) Minimum lease rental payments have not been reduced by minimum sublease rentals of \$1.0 million due in the future under noncancelable subleases.

### ***Capital Expenditures and Major Maintenance***

Total capital expenditures for the year ended June 30, 2012 were \$6.7 million and primarily related to the drainage/soils master plan for the Hinds facility, which is required by the asset purchase agreement with Entergy Mississippi, Inc. This work was substantially completed in January 2012.

Major maintenance expense was \$0.5 million and \$4.4 million for the years ended June 30, 2012 and 2011, respectively. The \$0.5 million expense in the current period related to major maintenance at the Hot Spring facility. The \$4.4 million expense primarily related to a \$1.7 million payment to GE as a result of restructuring the long-term service agreements with GE, \$0.4 million performed at the Hinds facility, and \$2.3 million performed at the Hot Spring facility.

The timing of major maintenance expenditures is uncertain and can be delayed or accelerated depending on many factors including plant utilization, unexpected plant shut-downs for other reasons, and unanticipated dispatch schedules. We budget anticipated major maintenance costs by using our estimate of future anticipated run time at each facility. This schedule can change based upon changes to actual run time.

We incur costs for major maintenance on the Plants which are expensed in the period incurred. We expect to incur \$1.0 million in major maintenance expenses in fiscal 2013.



## Cash Flow Analysis

The following table summarizes our changes in cash (in thousands of dollars):

	<u>For the Year Ended June 30, 2012</u>	<u>For the Year Ended June 30, 2011</u>
<b>Statements of Cash Flows Data:</b>		
Cash flows provided by (used in):		
Operating activities . . . . .	\$(17,452)	\$ (4,555)
Investing activities . . . . .	(2,783)	529,432
Financing activities . . . . .	(33)	(483,612)
(Decrease) increase in cash and cash equivalents . . . . .	(20,268)	41,265
Cash and cash equivalents at beginning of period . . . . .	<u>89,442</u>	<u>48,177</u>
Cash and cash equivalents at end of period . . . . .	<u>\$ 69,174</u>	<u>\$ 89,442</u>

*Cash Flows from Operating Activities.* Our cash flows used in operations were \$17.5 million for the year ended June 30, 2012, related primarily to a net loss of \$15.2 million, a \$0.2 million decrease in spare parts inventories, a decrease in deferred tax assets of \$9.7 million, and a decrease in accounts payable and accrued liabilities of \$2.0 million which was offset primarily by depreciation expense of \$0.4 million, stock-based compensation of \$0.2 million, an increase in accounts receivable of \$2.5 million, and an increase in prepaid expenses and other current assets of \$6.5 million.

*Cash Flows from Investing Activities.* Our cash flows used in investing activities for the year ended June 30, 2012 were \$2.8 million and related mainly to \$6.8 million in purchases of property, plant, and equipment, which was offset by a redemption of short-term investments of \$4.0 million.

*Cash Flows from Financing Activities.* Our cash flows used in financing activities for the year ended June 30, 2012 was \$33.0 thousand.

### Off-Balance Sheet Arrangements

The Company did not participate in or have any off-balance sheet arrangements for the years ended June 30, 2012 and 2011, respectively.

### Discussion of Critical Accounting Policies

In preparing our consolidated financial statements in accordance with accounting principles generally accepted in the United States, KGen is required to use its judgment in making estimates and assumptions that affect the amounts reported in its financial statements and related notes. Management bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Many of our critical accounting policies are those subject to significant judgments and uncertainties which could potentially result in materially different results under different conditions and assumptions. Future events rarely develop exactly as forecast, and the best estimates routinely require adjustment.

**Number 7. *Financial Statements and Supplementary Data***

**KGen Power Corporation  
Consolidated Financial Statements  
For the Years Ended June 30, 2012 and 2011**

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## INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Stockholders of  
KGen Power Corporation  
Houston, Texas

We have audited the accompanying consolidated balance sheets of KGen Power Corporation and subsidiaries (the "Company") as of June 30, 2012 and 2011, and the related consolidated statements of operations, stockholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Company as of June 30, 2012 and 2011, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

*/s/ DELOITTE & TOUCHE LLP*

Houston, Texas  
September 28, 2012

**KGen Power Corporation**  
**Consolidated Balance Sheets**  
(in thousands, except per share amounts)

	<u>June 30, 2012</u>	<u>June 30, 2011</u>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents . . . . .	\$ 69,174	\$ 89,442
Restricted cash and cash equivalents . . . . .	43,384	43,384
Restricted cash in escrow . . . . .	79,694	—
Short-term investments . . . . .	—	4,005
Accounts receivable . . . . .	12	994
Prepaid expenses and other current assets . . . . .	237	6,731
Assets held for sale . . . . .	<u>260,292</u>	<u>254,901</u>
Total current assets . . . . .	452,793	399,457
Property, plant, and equipment . . . . .	3,488	3,488
Less: accumulated depreciation . . . . .	<u>2,936</u>	<u>2,498</u>
Net property, plant, and equipment . . . . .	552	990
Restricted cash in escrow . . . . .	—	79,688
Deferred tax assets . . . . .	<u>10,354</u>	<u>688</u>
Total assets . . . . .	<u>\$463,699</u>	<u>\$480,823</u>
<b>Liabilities and stockholders' equity</b>		
Current liabilities:		
Accounts payable and accrued liabilities . . . . .	\$ 1,494	\$ 2,571
Liabilities associated with assets held for sale . . . . .	<u>19,163</u>	<u>20,179</u>
Total current liabilities . . . . .	20,657	22,750
Other noncurrent liabilities . . . . .	6	13
Commitments and contingencies (Note 4)		
Stockholders' equity:		
Common stock (par value \$.01; 150,000 shares authorized; 56,129 shares and 56,122 shares issued and outstanding at June 30, 2012 and June 30, 2011, respectively . . . . .	561	561
Additional paid in capital . . . . .	463,472	463,295
Accumulated deficit . . . . .	<u>(20,997)</u>	<u>(5,796)</u>
Total stockholders' equity . . . . .	<u>443,036</u>	<u>458,060</u>
Total liabilities and stockholders' equity . . . . .	<u>\$463,699</u>	<u>\$480,823</u>

The accompanying notes are an integral part of these consolidated financial statements.

**KGen Power Corporation**  
**Consolidated Statements of Operations**  
(in thousands, except per share amounts)

	<u>For the Year Ended June 30, 2012</u>	<u>For the Year Ended June 30, 2011</u>
<b>Revenues:</b>		
Energy sales . . . . .	\$ 52,752	\$ 97,422
Capacity sales . . . . .	6,837	4,999
Other revenue . . . . .	900	—
Total revenues . . . . .	<u>60,489</u>	<u>102,421</u>
<b>Operating expenses:</b>		
Cost of fuel . . . . .	42,957	80,843
Operating and maintenance . . . . .	11,859	19,478
Gas transportation . . . . .	10,693	5,926
Selling, general, and administrative . . . . .	10,208	12,322
Depreciation . . . . .	438	8,629
Auxiliary power . . . . .	2,781	2,953
Insurance . . . . .	1,838	1,575
Total operating expenses . . . . .	<u>80,774</u>	<u>131,726</u>
<b>Operating loss</b> . . . . .	<b>(20,285)</b>	<b>(29,305)</b>
<b>Other expenses</b>		
Interest expense . . . . .	—	(9,782)
Taxes, other than income taxes . . . . .	(4,412)	(3,813)
Other . . . . .	(233)	(375)
Total other expenses . . . . .	<u>(4,645)</u>	<u>(13,970)</u>
<b>Net loss from continuing operations before taxes</b> . . . . .	<b>(24,930)</b>	<b>(43,275)</b>
Income tax benefit from continuing operations . . . . .	9,729	16,489
<b>Net loss from continuing operations after taxes</b> . . . . .	<b>\$(15,201)</b>	<b>\$(26,786)</b>
<b>Net income from discontinued operations, net of taxes</b> . . . . .	<b>\$ —</b>	<b>\$234,386</b>
<b>Net (loss) income</b> . . . . .	<b>\$(15,201)</b>	<b>\$207,600</b>
<b>Net (loss) income per share—basic and diluted</b>		
Continuing operations . . . . .	\$ (0.27)	\$ (0.48)
Discontinued operations . . . . .	\$ —	\$ 4.18
Total . . . . .	<u>\$ (0.27)</u>	<u>\$ 3.70</u>
Weighted average shares outstanding—basic . . . . .	56,124	56,027
Weighted average shares outstanding—diluted . . . . .	56,124	56,118

The accompanying notes are an integral part of these consolidated financial statements.

**KGen Power Corporation**  
**Consolidated Statements of Stockholders' Equity**  
(in thousands)  
**For the Years Ended June 30, 2012 and 2011**

	<u>Common Stock</u>		<u>Additional Paid in Capital</u>	<u>Accumulated Deficit</u>	<u>Total</u>
	<u>Shares</u>	<u>Amount</u>			
<b>Balance at June 30, 2010</b> .....	55,974	\$560	\$ 742,477	\$(213,396)	\$ 529,641
Stock-based compensation .....	148	1	1,430	—	1,431
Net income .....	—	—	—	207,600	207,600
Distribution to stockholders .....	—	—	(280,612)	—	(280,612)
<b>Balance at June 30, 2011</b> .....	56,122	\$561	\$ 463,295	\$ (5,796)	\$ 458,060
Stock-based compensation .....	7	—	210	—	210
Net loss .....	—	—	—	(15,201)	(15,201)
Distribution to stockholders .....	—	—	(33)	—	(33)
<b>Balance at June 30, 2012</b> .....	<u>56,129</u>	<u>\$561</u>	<u>\$ 463,472</u>	<u>\$ (20,997)</u>	<u>\$ 443,036</u>

The accompanying notes are an integral part of these consolidated financial statements.

**KGen Power Corporation**  
**Consolidated Statements of Cash Flows**  
(in thousands)

	<u>For the Year Ended June 30, 2012</u>	<u>For the Year Ended June 30, 2011</u>
<b>Cash flows from operating activities</b>		
Net (loss) income . . . . .	\$(15,201)	\$ 207,600
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Net gain on sale of assets . . . . .	—	(240,517)
Depreciation . . . . .	438	15,535
Amortization of deferred financing fees . . . . .	—	3,232
Amortization of contract-based intangibles . . . . .	—	5,164
Valuation of derivative instruments . . . . .	—	1,720
Stock-based compensation . . . . .	210	1,431
Income on investment in restricted cash in escrow . . . . .	(6)	—
Deferred tax assets . . . . .	(9,666)	(688)
Payments from settlement of derivative instruments . . . . .	—	(8,065)
Changes in operating assets and liabilities:		
Accounts receivable . . . . .	2,510	16,791
Spare parts inventories . . . . .	(207)	(116)
Prepaid expenses and other current assets . . . . .	6,494	(4,784)
Deferred charge . . . . .	—	674
Accounts payable and accrued liabilities . . . . .	(2,017)	(2,525)
Other noncurrent liabilities . . . . .	(7)	(7)
Net cash used in operating activities . . . . .	<u>(17,452)</u>	<u>(4,555)</u>
<b>Cash flows from investing activities</b>		
Purchases of property, plant, and equipment . . . . .	(6,788)	(2,245)
Sale of assets . . . . .	—	651,587
Change in short-term investments . . . . .	4,005	(4,005)
Investment in restricted cash and cash equivalents . . . . .	—	(36,217)
Investment in restricted cash in escrow . . . . .	—	(79,688)
Net cash (used in) provided by investing activities . . . . .	<u>(2,783)</u>	<u>529,432</u>
<b>Cash flows from financing activities</b>		
Repayment of debt . . . . .	—	(203,000)
Distribution to stockholders . . . . .	(33)	(280,612)
Net cash used in financing activities . . . . .	<u>(33)</u>	<u>(483,612)</u>
(Decrease) increase in cash and cash equivalents . . . . .	<u>(20,268)</u>	<u>41,265</u>
Cash and cash equivalents at beginning of period . . . . .	<u>89,442</u>	<u>48,177</u>
Cash and cash equivalents at end of period . . . . .	<u>\$ 69,174</u>	<u>\$ 89,442</u>
<b>Cash paid for</b>		
Interest . . . . .	\$ —	\$ 4,829
Taxes . . . . .	\$ —	\$ 5,347
<b>Noncash transactions</b>		
Accounts payable related to purchases of property, plant, and equipment . . . . .	\$ 76	\$ 470

The accompanying notes are an integral part of these consolidated financial statements.

**KGen Power Corporation**  
**Notes to Consolidated Financial Statements**  
**For the Years ended June 30, 2012 and 2011**

**1. Nature of Business and Significant Accounting Policies**

KGen Power Corporation (the “Company”) was incorporated in Delaware on December 4, 2006, which is the date of its inception. The Company owns and operates electric power generation plants and sells electricity and electrical generation capacity in the United States to wholesale purchasers such as retail electric providers, power trading organizations, municipal utilities, electric power cooperatives, and other power generation companies. As of June 30, 2012, the Company’s portfolio of facilities consisted of two operational and fully permitted combined-cycle power plants (Hot Spring and Hinds), or (the “Plants”), located in the southeastern United States with an aggregate capacity of 1,140 megawatts (“MW”).

On July 9, 2010, the Company completed the sale of KGen Sandersville LLC, its former wholly-owned subsidiary and owner of the Sandersville power plant, a 640 MW simple-cycle plant and on April 8, 2011, the Company completed the sale of KGen Murray I and II LLC, its former wholly-owned subsidiary and the owner of the Murray I and Murray II combined-cycle power plants with an aggregate capacity of 1,250 MW. The results of operations for Sandersville and Murray I and II are reported in discontinued operations for the fiscal 2011 periods presented herein.

On April 28, 2011, the Company executed separate definitive agreements for the sale of its Hinds and Hot Spring power plants having an aggregate capacity of 1,140 MW. Assets held for sale and liabilities associated with the assets held for sale related to the Hinds and Hot Spring power generation facilities were recorded as current assets and current liabilities as of June 30, 2012 and June 30, 2011 (See Note 9).

**Principles of Consolidation**

The consolidated financial statements include the accounts of the Company and those of KGen Partners LLC, KGen Power Management Inc., KGen LLC, KGen Hot Spring LLC, KGen Hinds LLC, and KGen Acquisition I LLC, all direct or indirect 100% owned subsidiaries of the Company, as well as any variable interest entities for which the Company is the primary beneficiary during the year ended June 30, 2012. The consolidated financial statements include the accounts of the Company and those of KGen Partners LLC, KGen Power Management Inc., KGen LLC, KGen Murray LLC, KGen Murray I and II LLC, KGen Hot Spring LLC, KGen Hinds LLC, KGen Sandersville LLC, and KGen Acquisition I LLC, all direct or indirect 100% owned subsidiaries of the Company, as well as any variable interest entities for which the Company is the primary beneficiary during the year ended June 30, 2011. All significant intercompany balances and transactions have been eliminated in consolidation.

**Use of Estimates**

The preparation of the consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Such estimates include the utilization of deferred tax assets and share-based compensation. Actual results could differ from these estimates.

**Revenue Recognition**

Revenues derived from electric power energy sales are recognized as power is delivered. Revenues derived from long-term capacity sales contracts are recognized based on the monthly minimum



**KGen Power Corporation**  
**Notes to Consolidated Financial Statements (Continued)**  
**For the Years ended June 30, 2012 and 2011**

**1. Nature of Business and Significant Accounting Policies (Continued)**

commitment component adjusted for seasonal and other factors as appropriate on a straight-line basis over the terms of the contracts.

**Effects of Seasonality**

The electric power industry is highly seasonal. In the summer months, especially in the southeastern United States, demand for electricity is usually much higher as a result of increased use of air conditioning. The Company's results of operations are subject to seasonal variations since demand for electricity and production varies with weather conditions. The Hinds and Hot Spring plants operate on a merchant basis without long-term purchase agreements, and therefore are exposed to significant volatility in prices and generation demand. The Company earns the majority of its annual revenues in the five summer months, May through September. The shoulder periods, months other than the peak summer months, historically have not been profitable for the Company and are typically the months during which the Company seeks to perform scheduled maintenance-related activities.

**Cash and Cash Equivalents, Restricted Cash and Cash Equivalents, and Restricted Cash in Escrow**

Short-term investments, consisting of money market instruments with original maturities of three months or less, are considered to be cash equivalents and are recorded at cost, which approximates current market value.

Cash and cash equivalents and cash in escrow that are contractually restricted for specific purposes are classified as restricted on the balance sheet. Such restricted funds are classified as current and noncurrent based upon the nature of the purpose for which the funds can be used and the expected timing of use of such funds.

**Short-Term Investments**

Short-term investments, consisting of money market instruments with original maturities of less than twelve months but more than three months, are considered to be short-term investments and are recorded at cost, which approximates current market value.

**Spare Parts Inventories**

Inventories consist primarily of various consumable spare parts and tools, which are valued at the weighted-average cost method, and are stated at the lower of cost or market.

**Contract-Based Intangibles**

Contract-based intangibles consist of the estimated fair value of contractual rights and obligations related to power purchase agreements and firm transportation contracts. The intangibles are being amortized using the straight-line method over the life of the specific contracts, and such amortization is reflected as an adjustment to the associated revenue or expense item. The Company suspended related amortization of these assets upon their classification of assets held for sale on April 28, 2011. The contract-based intangibles are reviewed annually for impairment. No impairment was indicated at June 30, 2012 or 2011.

**KGen Power Corporation**  
**Notes to Consolidated Financial Statements (Continued)**  
**For the Years ended June 30, 2012 and 2011**

**1. Nature of Business and Significant Accounting Policies (Continued)**

**Property, Plant, and Equipment**

Property, plant, and equipment is recorded at cost and is depreciated on a straight-line basis over the estimated useful life of the various classes of assets.

**Long-Lived Assets**

Assets held for use are carried at cost less accumulated depreciation, unless recognition of impairment is necessary. The Company suspended related depreciation of these assets upon their classification of assets held for sale on April 28, 2011. For the years ended June 30, 2012 and 2011, no events or changes in circumstances indicated the carrying value of long-lived assets held for use might not be fully recoverable.

**Fair Value of Financial Instruments**

The Company's current financial instruments consisted primarily of cash and cash equivalents, restricted cash and cash equivalents, restricted cash in escrow, short-term investments, accounts receivable, and accounts payable and accrued liabilities. The carrying values are representative of their respective fair value due to the short-term nature of these instruments.

**Concentration of Credit Risk**

The Company's only major customer at June 30, 2012 was Twin Eagle Resource Management, LLC ("Twin Eagle") and at June 30, 2011 was BNP Paribas Energy Trading GP ("BNP"). The Company does not believe Twin Eagle represents a significant credit risk. However, changes in economic, regulatory, or other factors could have a significant impact on the Company's contractual relationships (See Note 4). Operations of the facilities are dependent on the continued performance by customers and suppliers of their obligations under the relevant power sales contracts and operation and maintenance agreements. The Company does not believe Twin Eagle represents a significant credit risk due to its payment history and, therefore, does not require collateral for accounts receivable. However, the contract does provide for Twin Eagle to post collateral in the event our exposure to Twin Eagle exceeds certain limits and upon certain defined credit-related events.

**Insurance Proceeds**

Property insurance proceeds that consist of property damage and professional fee reimbursements of amounts previously paid by the Company are recorded as an offset to operating and maintenance expense on the consolidated statement of operations. Property insurance proceeds that relate to business interruption are recorded as an increase to other revenue on the consolidated statement of operations.

**Repair and Maintenance**

Costs incurred to repair and maintain the power plants, including major maintenance costs, are expensed as incurred.

**KGen Power Corporation**  
**Notes to Consolidated Financial Statements (Continued)**  
**For the Years ended June 30, 2012 and 2011**

**1. Nature of Business and Significant Accounting Policies (Continued)**

**Contingencies**

The Company, in the course of its operations, is subject to claims, lawsuits, and contingencies. Accruals are made in specific instances where it is probable that liabilities will be incurred and where such liabilities can be reasonably estimated.

**Income Taxes**

The Company accounts for income taxes using the asset and liability method. The asset and liability method requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of (i) temporary differences between financial statement carrying amounts of assets and liabilities and the basis of these assets and liabilities for tax purposes and (ii) operating loss and tax credit carryforwards for tax purposes. Deferred tax assets are reduced by a valuation allowance when management concludes that it is more likely than not that a portion of the deferred tax assets will not be realized in a future period.

**Net Earnings (Loss) per Share**

Basic earnings (loss) per share is calculated by dividing net income (loss) by the weighted average number of shares of common stock outstanding during the period. Due to the net loss from continuing operations for the years ended June 30, 2012 and 2011, diluted earnings per share was calculated on the same basis as basic loss per share as the inclusion of any other potential shares outstanding would be anti-dilutive. Due to the net income from discontinued operations for the year ended June 30, 2011, diluted earnings per share was calculated by adjusting the weighted average number of shares of common stock outstanding by the dilutive effect of incremental shares attributable to unvested restricted stock units (“RSUs”) and unexercised in-the-money stock options of 91,710 shares. Unexercised out-of-the-money stock options to purchase a weighted average of 796,297 shares and 507,300 shares of common stock for years ended June 30, 2012 and 2011, respectively, were not considered in the earnings (loss) per share

**KGen Power Corporation**  
**Notes to Consolidated Financial Statements (Continued)**  
**For the Years ended June 30, 2012 and 2011**

**1. Nature of Business and Significant Accounting Policies (Continued)**

calculation as the impact of such inclusion would have been anti-dilutive. Amounts shown below are in thousands, except per share amounts.

	<u>For the Year Ended June 30, 2012</u>	<u>For the Year Ended June 30, 2011</u>
<b>Numerator:</b>		
Net loss from continuing operations after taxes . . . . .	\$(15,201)	\$(26,786)
Net income from discontinued operations after taxes . . . . .	—	234,386
Net (loss) income . . . . .	<u>\$(15,201)</u>	<u>\$207,600</u>
<b>Denominator:</b>		
Weighted average shares outstanding—basic . . . . .	<u>56,124</u>	<u>56,027</u>
Weighted average shares outstanding—diluted . . . . .	<u>56,124</u>	<u>56,118</u>
Net loss per share from continuing operations—basic and diluted . . . . .	\$ (0.27)	\$ (0.48)
Net income per share from discontinued operations—basic and diluted . . . . .	—	4.18
Total . . . . .	<u>\$ (0.27)</u>	<u>\$ 3.70</u>

**Other Comprehensive Income**

The Company has no comprehensive income (loss) other than net income (loss).

**2. Property, Plant, and Equipment**

Property, plant, and equipment consists of the following (in thousands of dollars):

	<u>Estimated Useful Life</u>	<u>June 30, 2012</u>	<u>June 30, 2011</u>
Systems and equipment . . . . .	3 - 6 years	\$3,488	\$3,488
Less: accumulated depreciation . . . . .		<u>2,936</u>	<u>2,498</u>
Net property, plant, and equipment . . . . .		<u>\$ 552</u>	<u>\$ 990</u>

During the year ended June 30, 2011, the companies that own the assets of the Sandersville simple-cycle power generation facility and the Murray I and II combined-cycle power generation facilities were sold. In addition, on April 28, 2011, the assets of the Hinds and Hot Spring power combined-cycle generation facilities, which are the subject of purchase and sale agreements entered into on April 28, 2011 with subsidiaries of Entergy Corporation, were classified as held for sale and were no longer presented in property, plant, and equipment (See Note 9).

**KGen Power Corporation**  
**Notes to Consolidated Financial Statements (Continued)**  
**For the Years ended June 30, 2012 and 2011**

**3. Restricted Cash and Cash Equivalents and Restricted Cash in Escrow**

Subsequent to the repayment of all outstanding debt under the Credit Agreement, a \$75.0 million cash collateralized replacement letter of credit facility was entered into on April 8, 2011. There were \$43.4 million of outstanding letters of credit issued under the \$75.0 million letter of credit facility, at both June 30, 2012 and 2011. The balance securing the outstanding letters of credit was recorded in restricted cash and cash equivalents. The letters of credit issued under this facility support obligations associated with ongoing long-term gas transportation contracts at the Hinds and Hot Spring facilities. Fees related to this letter of credit facility were expensed as incurred and totaled \$0.4 million and \$0.1 million for the years ended June 30, 2012 and 2011, respectively.

In addition, in connection with the sale of the Murray I and II power generation facilities, \$79.7 million was placed in escrow for a period of 18 months after closing to secure customary post-closing indemnification obligations. This escrow balance was recorded in restricted cash in escrow as of June 30, 2012 and 2011 and is expected to be released in October 2012.

**4. Commitments and Contingencies**

*Litigation*—The Company may be a party to various legal and regulatory actions arising in the normal course of business. Matters that are probable of unfavorable outcome to the Company and which can be reasonably estimated are accrued.

*Commitments*—BNP was the commercial marketer for all of the Company's facilities. The Company compensated BNP based on a percentage of gross margin not to be less than a minimum management fee. For the years ended June 30, 2012 and 2011, the Company paid BNP zero and \$5.6 million for energy management related expenses. On July 21, 2011, the Company was notified by BNP that they were terminating the contract to provide energy management services.

On September 26, 2011, the Company retained Twin Eagle as its new energy management services provider with services commencing on October 1, 2011. The Company compensates Twin Eagle based on a percentage of gross margin not to be less than a minimum management fee. Twin Eagle does not have an investment grade rating. Accordingly, under the Company's agreements with Twin Eagle, Twin Eagle is required to post collateral in the form of letters of credit or cash in the event the Company's exposure to Twin Eagle exceeds certain specified thresholds. No collateral was posted as of June 30, 2012. For the year ended June 30, 2012, the Company paid Twin Eagle \$0.6 million for energy management related expenses.

The Company has long-term gas transportation contracts with Texas Eastern Transmission, LP ("TETCO") to deliver gas to the Hinds facility. The contract provides firm capacity of 80,000 Dth/day in the summer peak period and lesser amounts in the other parts of the year. On April 1, 2010, the Company extended the long-term gas transportation contract with TETCO to deliver gas to the Hinds facility through March 2022.

The Company has long-term gas transportation contracts with a subsidiary of CenterPoint Energy, Inc. ("CenterPoint") to deliver gas to the Hot Spring facility. The contracts provide firm capacity of 98,000 Dth/day in the summer peak period and 50,000 Dth/day in the other parts of the year. The transportation contracts with CenterPoint to deliver gas to the Hot Spring facility continue through October 2022.

**KGen Power Corporation**  
**Notes to Consolidated Financial Statements (Continued)**  
**For the Years ended June 30, 2012 and 2011**

**4. Commitments and Contingencies (Continued)**

The Hot Spring facility is also served by TETCO, a subsidiary of Spectra Energy Transmission Services, LLC, through an 8.5 mile pipeline lateral (112,000 Dth/day of firm capacity) which connects to TETCO's 24-inch line on which the Company has 100,000 Dth/day of firm transportation services. The transportation contracts with TETCO to deliver gas to the Hot Spring facility continue through June 2031.

The Company entered into long-term service agreements with General Electric International ("GE") to provide maintenance services at the Hinds and Hot Spring facilities. All maintenance costs paid to GE are expensed as incurred. The term of each agreement ends following completion of the fourth hot gas path cycle which is determined based on attainment of specified aggregate factored hours or starts and performance of the attendant planned maintenance activities. Payments to GE are variable based on parts and work required, plant run time, or equivalent starts and stops.

NAES Corporation ("NAES") is the operations and maintenance provider for KGen Hinds LLC and KGen Hot Spring LLC. The Company paid NAES \$6.4 million and \$5.7 million for the years ended June 30, 2012 and 2011, respectively, for operations and maintenance services.

*Corporate Matters*—The Company has a ten-year operating lease for its executive office space expiring December 31, 2017, which includes its current space of 20,200 square feet. Rent expense under this lease was \$0.4 million for both the years ended June 30, 2012 and 2011.

The Company entered into an agreement on September 29, 2009 to sublease approximately 6,318 square feet of corporate office space in exchange for monthly payments of \$15,775. The commencement date of the sublease was December 17, 2009 and the expiration date is December 31, 2017. Sublease payments began on February 17, 2010.

The future minimum lease payments for the five years subsequent to June 30, 2012, and thereafter are as follows (in thousands of dollars):

2013 . . . . .	\$ 564
2014 . . . . .	564
2015 . . . . .	564
2016 . . . . .	564
2017 . . . . .	564
Thereafter . . . . .	<u>282</u>
Total . . . . .	<u>\$3,102</u>

(1) Minimum lease rental payments have not been reduced by minimum sublease rentals of \$1.0 million due in the future under noncancelable subleases.

As of June 30, 2012 and 2011, the Company employed 17 people.

The Company has adopted an Employee Performance Bonus and Retention Plan (the "Plan") for its employees. Payments under the Plan are based on the continued employment of the recipient and bonuses are triggered in connection with the consummation of any sale of a facility and/or a change in control, in each case in accordance with, and subject to the terms set forth in, the Plan. During the year ended June 30, 2011, the Company paid cash bonuses totaling \$2.4 million in connection with the sales of

**KGen Power Corporation**  
**Notes to Consolidated Financial Statements (Continued)**  
**For the Years ended June 30, 2012 and 2011**

**4. Commitments and Contingencies (Continued)**

Sandersville and Murray. As of both June 30, 2012 and 2011, the Company accrued \$0.2 million for amounts held in escrow in connection with the sale of Murray.

During the year ended June 30, 2011, the companies that own the assets of the Sandersville simple-cycle power generation facility and the Murray I and II combined-cycle power generation facilities were sold. In addition, on April 28, 2011, the assets of the Hinds and Hot Spring combined-cycle power generation facilities were classified as held for sale (See Note 9).

**5. Industrial Development Revenue Bonds**

Construction of the Hot Spring, Murray, and Sandersville facilities was financed by various development authorities through the issuance of Industrial Development Revenue Bonds (the "Bonds"). Simultaneous with the Bonds' issuance, the facilities were leased to the project companies subsequently acquired by the Company by the development authority pursuant to either 20-year or 30-year lease agreements. As part of the bond agreements, the development authorities assigned the leases to the bond trustee to secure the Bonds in accordance with the terms of trust indentures. The lease payments are set exactly equal to the bond repayments and are the sole source of retirement for the Bonds. The Company was the sole holder of the Bonds.

The agreements executed in connection with the transfer of the Bonds permitted the limited liability companies to make payments to the Company in the form of intercompany book entries without the actual transfer of cash. At both June 30, 2012 and 2011, \$10.0 million remained outstanding related to the Hot Spring project.

Upon expiration of the lease term or earlier termination of the lease by the repayment of the Bonds, the Company may purchase the Hot Spring property for a nominal amount.

Under the terms of the Bonds and the related trust indentures and agreements, the Company has constructive ownership of the facilities, which are included in property, plant, and equipment within the assets held for sale line item in the accompanying consolidated balance sheets. As the Company has the unilateral right to terminate the lease and trust indentures by repaying the Bonds to itself, the principal balance of the Bonds and the lease obligation have been presented net in the accompanying consolidated balance sheets. Additionally, the lease payments and the bond interest income have been presented net in the accompanying consolidated statements of operations.

Following the sale of 100% of the ownership interests in KGen Sandersville LLC and KGen Murray I and II LLC, the Industrial Development Revenue Bonds related to Sandersville and Murray I and II were no longer held by the Company (See Note 9).

**6. Derivatives and Investments**

The Company recognized all derivatives and investments as either assets or liabilities on the balance sheet and measured those instruments at fair value. The ongoing effects were dependent on future market conditions.

On May 4, 2007, KGen LLC entered into six interest rate swap agreements ("Swaps") for the purpose of reducing exposure to interest rate fluctuations as required under the terms of KGen LLC's former Credit Agreement. Each of the six individual swap agreements had a notional amount of \$33.0 million and

**KGen Power Corporation**  
**Notes to Consolidated Financial Statements (Continued)**  
**For the Years ended June 30, 2012 and 2011**

**6. Derivatives and Investments (Continued)**

had a term that expired in each consecutive year, beginning on March 31, 2008 continuing through March 31, 2013. Each of the Swaps was terminated on April 8, 2011 in connection with the termination of KGen LLC's former Credit Agreement.

The Swaps were not accounted for utilizing hedge accounting; they were marked to market with gains and losses shown on the consolidated statements of operations as follows (in thousands of dollars):

	<u>Location of Loss on Derivatives</u>	<u>Hierarchy</u>	<u>Loss on Derivatives</u>
For the year ended June 30, 2011 . . . . .	Interest expense	Level II	\$(1,720)

The Company evaluated the requirements of FASB ASC 820, *Fair Value Measurement and Disclosures* ("FASB ASC 820") and believed the Swaps were valued using Level II fair value measurements. Under FASB ASC 820, instruments valued using Level II measurements were valued based on either quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that were not active, and/or model-based valuations whose inputs were observable or whose significant value drivers were observable.

On December 9, 2010, the Company entered into short-term investments consisting of two cash collateralized letters of credit supported by certificates of deposit. The balance of the short-term investments was zero and \$4.0 million as of June 30, 2012 and 2011, respectively. The short-term investments were redeemed on December 14, 2011 and are currently included in unrestricted cash as of June 30, 2012.

The Company evaluated the requirements of FASB ASC 820 and believes the short-term investments are valued using Level I fair value measurements. Under FASB ASC 820, instruments valued using Level I measurements are valued based on accessible quoted prices in active markets for identical instruments.

**7. Share-Based Payments**

Effective January 1, 2007, the Company adopted the KGen Power Corporation 2006 Equity Incentive Plan ("the Plan"). Under the Plan, 4,870,568 shares are currently authorized and reserved for equity awards.

On February 8, 2007, options were granted under the Plan to purchase 730,585 shares of common stock at an exercise price equal to \$14.00 per share and to purchase 1,704,699 shares of common stock in four equal parts at four different exercise prices: (i) \$14.00 per share, (ii) \$15.40 per share, (iii) \$16.80 per share, and (iv) \$18.20 per share. Options from both grants have a ten-year term and vested equally over three years from February 8, 2007. On May 28, 2008, options were granted under the KGen Power Corporation Chairman Stock Option Plan to purchase 100,000 shares of common stock at an exercise price equal to \$19.50 per share. Options from this grant have a ten-year term and vested one year from the date of issuance. The Company's policy is to recognize option awards subject to periodic vesting on a straight-line basis over the requisite service period for the entire award. As of June 30, 2012 and 2011, there were 796,297 vested options outstanding with a weighted average exercise price per share of \$10.98 and no unrecognized compensation expense remaining. For the years ended June 30, 2012 and 2011, no options were granted or exercised.



**KGen Power Corporation**  
**Notes to Consolidated Financial Statements (Continued)**  
**For the Years ended June 30, 2012 and 2011**

**7. Share-Based Payments (Continued)**

On May 22, 2009, 20,000 restricted stock units (“RSUs”) were granted to an employee and director of the company at a fair value at grant date of \$6.00 per share and were to vest equally upon the first, second, and third anniversaries of March 13, 2009, the first day of employment. Upon vesting, the RSUs were granted as one share of common stock with a par value of \$0.01 per share for each restricted stock unit granted. The RSUs did not have voting rights. Stock compensation expense related to the RSUs was \$49.0 thousand and \$0.2 million for the years ended June 30, 2012 and 2011. The RSUs have completely vested and have been issued as of March 2012.

On August 13, 2010, the Board of Directors granted a total of 237,268 RSUs to senior employees and the Chairman of the Board of Directors. Each RSU will entitle its holder to receive, upon vesting of the RSU, one share of common stock of the Company. Under the terms of the RSU awards, 35,592 RSUs vested immediately upon grant due to the completed sale of 100% of the ownership interests in KGen Sandersville LLC, the entity that owns the Sandersville power generation facility. Upon the consummation of the sale of the Murray I and II power generation facilities on April 8, 2011, 106,769 of the remaining RSU awards vested. Of the remaining unvested RSUs, 47,454 will vest upon the consummation of a sale of the Hot Spring power generation facility and 47,453 will vest upon the consummation of a sale of the Hinds power generation facility. All unvested RSUs will vest upon the consummation of a change in control of the Company.

The Company recorded compensation expense of \$0.2 million and \$1.4 million for the years ended June 30, 2012 and 2011, respectively, related to the above outstanding RSUs. As of June 30, 2012 and 2011, there was zero and \$0.2 million, respectively, of total unrecognized compensation expense related to the unvested RSUs.

On October 5, 2010, the Board of Directors granted 15,000 RSUs to the CEO of the company pursuant to the Plan. Each RSU entitled the CEO to receive, upon vesting of the RSU, one share of common stock of the Company. Under the terms of the RSU awards, all 15,000 shares vested immediately upon grant and the Company recorded the full compensation expense of \$0.2 million during the year ended June 30, 2011.

On June 24, 2011, the Company paid a cash liquidating distribution to the holders of common stock of the Company in an amount of \$5.00 per share. As such, the exercise price applicable to each of the options outstanding under the Plan was reduced by \$5.00 per share.

**KGen Power Corporation**  
**Notes to Consolidated Financial Statements (Continued)**  
**For the Years ended June 30, 2012 and 2011**

**8. Income Taxes**

The Company's provision for income taxes differed from that determined by applying the federal income tax rate (statutory rate) to income before income taxes, as follows (in thousands of dollars):

	<u>For the Year Ended June 30, 2012</u>	<u>For the Year Ended June 30, 2011</u>
<b>Continuing Operations:</b>		
Statutory rate . . . . .	35%	35%
Tax at statutory rate . . . . .	\$(8,726)	\$(15,146)
Increase (decrease) due to:		
Nondeductible meals and entertainment . . . . .	10	8
State tax expense (benefit) . . . . .	(910)	(1,342)
Return to provision . . . . .	(74)	(9)
Adjustment to valuation allowance . . . . .	(29)	—
Total provision . . . . .	<u>\$(9,729)</u>	<u>\$(16,489)</u>
<b>Discontinued Operations:</b>		
Total provision . . . . .	<u>\$ —</u>	<u>\$(17,319)</u>

Temporary differences and carryforwards which gave rise to deferred tax assets and liabilities were as follows (in thousands of dollars):

	<u>June 30, 2012</u>	<u>June 30, 2011</u>
Deferred tax assets:		
Contract-based intangible assets . . . . .	\$ 30	\$ 33
Nonqualified stock options expense . . . . .	5,910	5,828
Accrued expenses . . . . .	195	84
Net operating loss . . . . .	17,241	437
Contribution carryforward . . . . .	2	—
Net deferred tax assets . . . . .	<u>23,378</u>	<u>6,382</u>
Deferred tax liabilities:		
Property, plant, and equipment . . . . .	7,361	(557)
Prepaid expenses . . . . .	(17)	542
Contract-based intangible liabilities . . . . .	5,313	5,313
Net deferred tax liability . . . . .	12,657	5,298
Valuation allowance . . . . .	367	396
Deferred tax asset (liabilities), net . . . . .	<u>\$10,354</u>	<u>\$ 688</u>

During the fiscal year ended June 30, 2011, the Company utilized the majority of its net operating loss carryforwards against federal and state taxable income generated. A portion of the Georgia net operating loss will be used in the future. A valuation allowance on this net operating loss remains. Through June 30, 2012, the Company generated a tax loss of \$43.5 million. The Company expects to sell its remaining plants within the next twelve months at an estimated tax gain of \$228.0 million, which is in excess of the projected

**KGen Power Corporation**  
**Notes to Consolidated Financial Statements (Continued)**  
**For the Years ended June 30, 2012 and 2011**

**8. Income Taxes (Continued)**

tax losses that will be incurred prior to that time. Accordingly, the Company does not believe that a valuation allowance is appropriate at this time as it has determined that its deferred tax assets meet the more-likely-than-not recognition criteria.

The Company recognizes interest and penalties related to unrecognized tax benefits within the provision for income taxes on continuing operations in the consolidated statements of operations. There are no unrecognized tax benefits. There are no unrecognized tax benefits that if recognized would affect the tax rate. There are no interest and penalties recognized as of June 30, 2012.

The Company filed income tax returns in the United States federal jurisdiction and in various U.S. states. In all material respects, the Company will not be subject to United States federal, state, and local income tax examination by tax authorities for fiscal years ended before 2005.

**9. Asset Sales and Assets Held for Sale**

*KGen Murray I & II LLC Sale*

On January 31, 2011, it was determined that the assets held for sale criteria were met when the Company executed a definitive agreement for the sale of the Company's Murray I and II electric generation facilities to Oglethorpe Power Corporation ("OPC"). The sale closed on April 8, 2011. The Company received \$530.3 million in cash sales proceeds and \$79.7 million was placed in escrow for a period of 18 months after closing to secure customary post-closing indemnification obligations. The net gain on the sale was \$175.5 million. The Company used a majority of its remaining tax NOLs to offset all but approximately \$36.1 million of the taxable gain resulting from the sale. In connection with the closing of the transaction, the Company's credit, working capital, and synthetic letter of credit facilities were terminated and the related interest rate swaps were unwound. The Company used \$138.0 million of the net proceeds of the sale to repay outstanding debt under these facilities and satisfy related obligations. In connection with the termination of these facilities, the restricted cash and cash equivalents associated with these facilities was released. The Company transferred the Industrial Revenue Bonds associated with Murray I and II to OPC. Additionally, all contractual commitments associated with Murray I and II were transferred in connection with the sale. RSUs of 106,769 vested upon the consummation of the sale of Murray I and II power generation facilities.

*Commitments related to KGen Murray I & II LLC*—KGen Murray I and II LLC had a power purchase agreement with GPC ("GPC PPA") expiring May 31, 2012. Under the terms of the GPC PPA, the Company sold a unit contingent 550 to 680 MW of capacity and associated energy to GPC. The capacity price under the GPC PPA escalated annually. The monthly minimum commitment of 550 MW was recognized separately for summer and non-summer months as capacity revenue on a straight-line basis over the remaining term of the GPC PPA. Actual capacity revenue recognized for the year ended June 30, 2011 was based on a 630 MW designation, which was in excess of the monthly minimum commitment.

The Company recognized \$37.6 million, related to capacity sales on the GPC PPA for the year ended June 30, 2011. The Company recognized expense of \$0.7 million in deferred charges for the year ended June 30, 2011 which consisted of the difference between the monthly minimum commitment calculated on a straight line-basis over the remaining term of the GPC PPA and actual minimum capacity sales payments due under the GPC PPA.

**KGen Power Corporation**  
**Notes to Consolidated Financial Statements (Continued)**  
**For the Years ended June 30, 2012 and 2011**

**9. Asset Sales and Assets Held for Sale (Continued)**

The price of the associated energy was calculated to approximate a pass-through of fuel and variable operations and maintenance costs. The Company recognized \$43.9 million related to energy sales on the GPC PPA for the year ended June 30, 2011.

The GPC PPA was subject to seasonal and monthly availability adjustments (positive or negative) if available capacity differs from a specified availability level. These adjustments were recognized as capacity sales revenue as associated capacity was provided.

A letter of credit, issued pursuant to the synthetic letter of credit facility under the Credit Agreement, supported a performance guarantee under the GPC PPA of \$120.0 million through May 2008, \$100.0 million from June 2008 through May 2010, \$80.0 million from June 2010 through May 2011, and \$40.0 million from June 2011 through May 2012. This letter of credit was terminated upon the repayment of all obligations under the Credit Agreement on April 8, 2011.

KGen Murray I and II LLC had a fuel supply agreement with Sequent Energy Management (“Sequent”), a subsidiary of AGL Resources, which supported the GPC PPA. This full requirement contract was for firm delivery of 85,106 decatherms per day (“Dth/day”) and was to expire May 31, 2012, with evergreen annual renewals absent notice from either party. Sequent retained a continuing first priority lien on and security interest in the Company’s energy payment receivables from GPC, to the extent of fuel costs owed. The fuel pricing was based on a combination of related gas price indices and other components similar to the pricing in the GPC PPA. Sequent delivered natural gas to several pipeline receipt points from which the Company had long-term gas transportation contracts with East Tennessee Natural Gas Company for 168,000 Dth/day of firm capacity.

KGen Murray I and II LLC entered into long-term service agreements with GE to provide maintenance services at the Murray facilities. All maintenance costs paid to GE were expensed as incurred. The term of each agreement ends following completion of the fourth hot gas path cycle which is determined based on attainment of specified aggregate factored hours or starts and performance of the attendant planned maintenance activities. Payments to GE were variable based on parts and work required, plant run time, or equivalent starts and stops.

The operating and maintenance agreement between Duke Energy Generation Services (“DEGS”) and KGen Murray I and II LLC remained in place through the date of the sale of the Murray facilities. The Company paid DEGS \$3.7 million for the year ended June 30, 2011, for all operations and maintenance services, and termination fees.

*Discontinued Operations*

The Company has determined it no longer has a presence in the Southern control area given the sale of KGen Sandersville LLC and the sale of KGen Murray I and II LLC and therefore has reflected the results of operations for KGen Sandersville LLC and KGen Murray I and II LLC as discontinued

**KGen Power Corporation**  
**Notes to Consolidated Financial Statements (Continued)**  
**For the Years ended June 30, 2012 and 2011**

**9. Asset Sales and Assets Held for Sale (Continued)**

operations for the year ended June 30, 2011. The following table presents the results of discontinued operations for Sandersville and Murray I and II.

	<u>For the Year Ended June 30, 2011</u>
<b>Revenues:</b>	
Energy sales . . . . .	\$ 72,831
Capacity sales . . . . .	<u>37,595</u>
Total revenues . . . . .	110,426
<b>Operating expenses:</b>	
Cost of fuel . . . . .	62,483
Operating and maintenance . . . . .	13,494
Gas transportation . . . . .	9,593
Selling, general, and administrative . . . . .	936
Depreciation . . . . .	6,905
Auxiliary power . . . . .	4,287
Insurance . . . . .	<u>842</u>
Total operating expenses . . . . .	98,540
<b>Operating income</b> . . . . .	11,886
<b>Other income (expenses):</b>	
Net gain on sale of assets . . . . .	240,517
Taxes, other than income taxes . . . . .	<u>(698)</u>
Total other income . . . . .	<u>239,819</u>
<b>Net income before taxes</b> . . . . .	251,705
Income tax expense . . . . .	<u>17,319</u>
<b>Net income</b> . . . . .	<u><u>\$234,386</u></u>

*KGen Hinds LLC and KGen Hot Spring LLC Held for Sale*

On April 28, 2011, it was determined that the assets held for sale criteria were met when the Company executed a definitive agreement for the sale of the Company's Hinds power generation facility to Entergy Mississippi, Inc. for a cash purchase price of \$206.0 million, subject to certain adjustments. The Company received approval from holders of a majority of the Company's outstanding shares for the sale of this facility. The transaction is conditioned on the satisfaction of various regulatory approvals and other conditions described in the 2011 Special Meeting Proxy Statement. Substantially all of the regulatory conditions to closing have been satisfied or waived. Although the mandatory waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the "HSR Act") applicable to the transaction has expired, at the request of the Antitrust Division of the U.S. Department of Justice ("DOJ"), made in connection with the DOJ's ongoing review of the Hinds and Hot Spring transactions, we and Entergy agreed to delay closing of the transaction. We are currently in discussions with the DOJ and Entergy

**KGen Power Corporation**  
**Notes to Consolidated Financial Statements (Continued)**  
**For the Years ended June 30, 2012 and 2011**

**9. Asset Sales and Assets Held for Sale (Continued)**

regarding the DOJ's concerns and the potential timing for closing of the transaction. The transaction also remains subject to customary contractual closing conditions. Under the terms of the transaction agreement, \$30.0 million of the purchase price will be held in escrow to secure customary post-closing indemnification obligations. An escrow amount of \$10.0 million is subject to release 12 months after closing, an additional \$10.0 million is subject to release 18 months after closing, and the remaining balance will be subject to release 42 months after closing.

The Company incurred approximately \$6.5 million in capital expenditures during fiscal 2012, primarily related to the drainage/soils master plan for the Hinds facility, which is required by the asset purchase agreement with Entergy Mississippi, Inc.

On April 28, 2011, it was determined that the assets held for sale criteria were met when the Company executed a definitive agreement for the sale of the Company's Hot Spring power generation facility to Entergy Arkansas, Inc. for a cash purchase price of \$253.0 million, subject to certain adjustments. The Company received approval from holders of a majority of the Company's outstanding shares for the sale of this facility. The transaction is conditioned on the satisfaction of various regulatory approvals and other conditions described in the 2011 Special Meeting Proxy Statement. Substantially all of the regulatory conditions to closing have been satisfied or waived. Although the mandatory waiting period under the HSR Act applicable to the transaction has expired, at the request of the DOJ, made in connection with the DOJ's ongoing review of the Hinds and Hot Spring transactions, we and Entergy agreed to delay closing of the transaction. We are currently in discussions with the DOJ and Entergy regarding the DOJ's concerns and the potential timing for closing of the transaction. The transaction also remains subject to customary contractual closing conditions. Under the terms of the transaction agreement, \$38.0 million of the purchase price will be held in escrow to secure customary post-closing indemnification obligations. An escrow amount of \$12.0 million is subject to release 12 months after closing, an additional \$13.8 million is subject to release 18 months after closing, and the remaining balance will be subject to release 42 months after closing.

Under Delaware law, stockholder approval will be required for the ultimate dissolution of the Company. No such approval of the stockholders of the Company has yet been obtained.

Assets held for sale and liabilities associated with the assets held for sale related to the Hinds and Hot Spring power generation facilities were valued at the lower of historical book value or fair value less cost of disposal and were recorded as current assets and current liabilities as of June 30, 2012 and June 30, 2011. The Company suspended related depreciation and amortization of these assets upon their classification of

**KGen Power Corporation**  
**Notes to Consolidated Financial Statements (Continued)**  
**For the Years ended June 30, 2012 and 2011**

**9. Asset Sales and Assets Held for Sale (Continued)**

assets held for sale on April 28, 2011. Their combined total consisted of the following (in thousands of dollars):

	<u>June 30, 2012</u>	<u>June 30, 2011</u>
Accounts receivable . . . . .	\$ 2,472	\$ 4,000
Spare parts inventories . . . . .	4,086	3,879
Property, plant, and equipment (net of \$40,323 of accumulated depreciation for both years.) . . . . .	253,489	246,777
Other assets . . . . .	<u>245</u>	<u>245</u>
Assets held for sale . . . . .	<u>\$260,292</u>	<u>\$254,901</u>
Accounts payable and accrued liabilities . . . . .	\$ 5,463	\$ 6,479
Contract-based intangibles (net of \$5,161 of accumulated amortization for both years) . . . . .	<u>13,700</u>	<u>13,700</u>
Liabilities associated with assets held for sale . . . . .	<u>\$ 19,163</u>	<u>\$ 20,179</u>

Contract-based intangibles related to the held for sale assets consist of the following (in thousands of dollars):

	<u>Term</u>	<u>Original Cost</u>	<u>Accumulated Amortization</u>	<u>June 30, 2012</u>	<u>June 30, 2011</u>
Hot Spring firm transportation contracts . .	Various	<u>\$18,861</u>	<u>\$(5,161)</u>	<u>\$13,700</u>	<u>\$13,700</u>
Total liabilities . . . . .		<u>\$18,861</u>	<u>\$(5,161)</u>	<u>\$13,700</u>	<u>\$13,700</u>

**10. Subsequent Events**

Subsequent events were analyzed and considered through September 28, 2012, the date this report was available for issuance.

### Part III

#### Number 8. *Directors, Officers and Corporate Governance*

##### Directors and Officers

The following table sets forth certain information about the persons currently serving as our directors and officers as of June 30, 2012:

<u>Name</u>	<u>Age</u>	<u>Position</u>
Thomas B. White . . . . .	56	President, Chief Executive Officer, and Director
James H. Sweeney . . . . .	53	Executive Vice President, Energy Management
William R. Marlow . . . . .	45	General Counsel and Secretary
Charles L. Holland . . . . .	70	Executive Vice President, Operations
W. Kevin Redmond . . . . .	47	Chief Accounting Officer and Controller
Tina C. Lee . . . . .	41	Vice President, Energy Management
Stuart J. Prall . . . . .	38	Vice President, Operations
Steven B. McDowell . . . . .	37	Vice President, Mergers & Acquisitions and Finance
Daniel T. Hudson . . . . .	46	Chairman of the Board
Gerald J. Stalun . . . . .	53	Director

##### Officers

###### *Thomas B. White*

Mr. White became a director in April 2008 and was named President and Chief Executive Officer in March 2009. Prior to joining the management of KGen, Mr. White was employed as a director by Stark Investments, a multi-strategy asset management firm with over \$14 billion in assets under management. At Stark, Mr. White was responsible for the identification, evaluation, and closing on private equity type investments in physical energy assets and businesses, as well as supporting asset management activities for investments made by Stark through the energy asset team and investments employed through other asset strategies including risk arbitrage and commodity hedging structures. From 2002 to 2006, Mr. White was employed by Marathon Capital, LLC, a boutique investment banking firm focusing on the power generation and renewable energy markets, where he was an officer and Managing Director from 2003 to 2006. At Marathon, Mr. White was the principal executive responsible for banking, origination and marketing activities which included the sourcing, evaluation, and closing of non-recourse financing structures for renewable and conventional energy assets and for managing financial consulting efforts with corporate clients in the acquisition and divestiture of energy assets and portfolios in these markets. From 1996 to 2002, Mr. White was employed by Duke Energy, where he was senior director, Development, for Duke Energy North America from 2001 to 2002 and Vice President, Industrial Services, for DukeSolutions, Inc. for 1997 to 2001. Mr. White received his Bachelor of Sciences in Mechanical Engineering from the University of Illinois and is a Registered Professional Engineer in the State of Illinois. From 2004 to 2007, Mr. White was a Registered Representative and held Series 7 and Series 63 Licenses. Mr. White is currently a Director of Renewable Biofuels, a Houston-based biofuel production company.

###### *James H. Sweeney*

Mr. Sweeney is our Executive Vice President, Energy Management. Mr. Sweeney has been an officer with KGen since our formation and held that position with our predecessor from June 2004. Prior to joining KGen, Mr. Sweeney was employed by American Electric Power as Vice President—M&A and Divestitures from 2002 to 2004, and as Vice President—Latin America from 1998 to 2002. From 1987 to 1998, Mr. Sweeney held various senior positions at LG&E Energy (formerly Hadson & Ultrasystems)



including Vice President—Latin American Development. Mr. Sweeney has a BS in electrical engineering from Worcester Polytechnic Institute and an ME in power systems from Rensselaer Polytechnic Institute.

*William R. Marlow*

Mr. Marlow has been our General Counsel and Secretary since our formation and held that position with our predecessor from March 2005. Mr. Marlow was an attorney at Bracewell & Patterson LLP from 1992 to 2005 where he left as a partner in the Real Estate, Energy, and Finance practice group. Mr. Marlow holds a BBA from the University of Houston and a JD from The University of Texas School of Law.

*Charles L. Holland*

Mr. Holland is our Executive Vice President, Operations. Mr. Holland joined our predecessor as Vice President, Operations in October 2004. He was previously employed with Duke Energy from 1995 to 2004. Initially in his career with Duke Energy he held the position of Vice President, Asia Pacific, and was responsible for the development of power projects in that region. Immediately prior to joining the Company he was a Managing Director in the North American merchant power business unit with responsibility for managing the plants that the Company acquired from Duke Energy. Prior to 1995, Mr. Holland held a number of officer-level positions with companies involved in the development, design, construction, and operation of power generating facilities. Mr. Holland holds a Bachelor of Science degree in nuclear engineering from North Carolina State University.

*W. Kevin Redmond*

Mr. Redmond has been our Chief Accounting Officer & Controller since our formation. Mr. Redmond joined our predecessor as Controller in March 2005. He began his career working as an internal auditor for a national printing company. He subsequently joined Ernst and Young, LLP, an international accounting firm and worked primarily in the Energy group focusing on power/energy clients during his four-year tenure. Mr. Redmond later joined Tractebel Power, Inc. (aka GDF Suez Energy North America) and ultimately became Vice President, Controller during his eight-year tenure from 1996 to 2004. He also worked with a local consulting firm, Sirius Solutions, from 2004 to 2005, providing Sarbanes Oxley implementation assistance to energy companies. Mr. Redmond has a BS degree from Texas A&M University and an MBA from University of Houston. He is a licensed Certified Public Accountant.

*Tina C. Lee*

Ms. Lee is our Vice President, Energy Management. She joined KGen in November 2004 as Director, Energy Management. Before KGen, Ms. Lee was a wholesale structurer at Reliant Energy from 1999 to 2003 and at RWE Energy Trading from 2003 to 2004. At Navigant Consulting in 2004, she worked on various advisory projects for energy clients. She began her energy career at Columbia Energy in 1997 where she worked in the natural gas pipeline and energy marketing groups as part of a MBA rotational program until 1999. Before getting her MBA from the Wharton Business School at the University of Pennsylvania, Ms. Lee was an investment banking analyst at Morgan Stanley where she worked on mergers and acquisitions and equity and debt financings for insurance companies. She has a BBA in finance honors and BA in liberal arts honors from The University of Texas at Austin.

*Stuart J. Prall*

Mr. Prall is our Vice President, Operations. Mr. Prall joined us in March 2007. He was previously employed with Duke Energy North America where he held several positions including; Director of Supply Chain Management, Manager of Engineering, and Manager of Valuation and Strategic Review. Mr. Prall was previously employed with TXU Electric as Plant Engineer and Operations Supervisor at a steam

electric station. Mr. Prall received a Bachelors of Science in Mechanical Engineering from The University of Texas at Austin.

*Steven B. McDowell*

Mr. McDowell is our Vice President, Mergers & Acquisitions and Finance. Mr. McDowell joined our organization in April of 2007 as a Director, Strategic Planning. Prior to joining KGen, Mr. McDowell was employed by El Paso Corporation from 2004 to 2007. During that period he worked in a number of capacities in the Strategy & Planning group which included leading the creation of the corporate 5 year plan, M&A transaction review and long term treasury forecasts for over \$15 billion of corporate debt. Prior to 2004, Mr. McDowell worked for Dynegy where he managed the analysis of M&A transactions and commercial development projects. During this time, he was also responsible for the forecasts of long term power curves used to value outstanding power contracts and M&A projects. Mr. McDowell holds a BA in Economics and an MBA, both from The University of Texas at Austin.

**Directors**

*Daniel T. Hudson*

Mr. Hudson became a director in February of 2008 and was elected Chairman of the Board in May 2008. Mr. Hudson is the president and CFO and a principal owner of Navasota Energy Services LLC and Montgomery Power Partners LP. He is responsible for M&A, capital formation/management from private equity, third-party debt, and equity-raising. Navasota Energy Services LLC is currently the Asset Manager for 1,079 MW Guadalupe Power Partners LP located in New Braunfels, Texas. Montgomery Power Partners LP is a majority owner in 600 MW Hartland Wind Farm LLC located in North Dakota. Mr. Hudson, in 2012, joined as Director of Alinta Energy based in Sydney, Australia. Until April 2010, Mr. Hudson was a Director and CFO of Navasota Holdings Texas Partners LP, a 1,650 MW ERCOT portfolio. During 24 years of industry experience, Mr. Hudson has focused on wholesale electric and gas markets. His background includes asset acquisition and divestiture strategies, implementation, and financing at Navigant Consulting, Duke Energy North America, and NRG Energy. Prior to joining Navigant, Hudson served as Managing Director of Acquisitions and Divestitures for Duke where he led the company's acquisition and divestiture program. Mr. Hudson received a BS in Mechanical Engineering from the University of Minnesota and an MBA from the University of St. Thomas.

*Gerald J. Stalun*

Mr. Stalun became a director in May 2008. Mr. Stalun is a Managing Director and the global head of power at EIG Global Energy Partners, LLC, (EIG) formerly TCW Group, Inc's Energy & Infrastructure Group (TCW EIG). EIG currently has approximately \$11 billion of energy and infrastructure investments under management. Mr. Stalun has more than 25 years of experience in the global power business, most recently as Head of Asset Based Investments for Arcapita, a leading private equity firm active in the sector. Previous positions in the industry include SVP of GE Energy Financial Services, Managing Director and Executive Vice President of Duke Capital Partners and Managing Director and Co-Head of Power Project Finance for Bank of America. He received a B.S. in Accounting from the University of Illinois and an MBA from the University of Chicago. Mr. Stalun previously practiced as a Certified Public Accountant in Illinois. Previous board memberships include Bosque Power, Falcon Gas Storage, Milford Holdings LLC, as well as a current board membership of Kelson Energy, Inc.

**Code of Ethics**

We have adopted a code of conduct for each of our employees to follow. Our management insists on integrity, honesty and ethical behavior in the workplace.

**Number 9. *Certain Relationships and Related Transactions, and Director Independence***

**Independence of Directors**

The Company has affirmatively determined that no member of the Board of Directors, other than Thomas B. White who is our President and Chief Executive Officer, has a relationship which, in the opinion of the Company, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director of the Company. Based on this determination, the Board of Directors considers all of its members, other than Mr. White, to be “independent.”