AEP Generating Company

2017 Second Quarter Report

Financial Statements

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GLOSSARY OF TERMS

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

Term	Meaning
AEGCo	AEP Generating Company, an AEP electric utility subsidiary.
AEP	American Electric Power Company, Inc., an investor-owned electric public utility holding company which includes American Electric Power Company, Inc. (Parent) and majority owned consolidated subsidiaries and consolidated affiliates.
AEP System	American Electric Power System, an electric system, owned and operated by AEP subsidiaries.
AFUDC	Allowance for Funds Used During Construction.
AGR	AEP Generation Resources Inc., a competitive AEP subsidiary.
ASU	Accounting Standards Update.
FASB	Financial Accounting Standards Board.
FERC	Federal Energy Regulatory Commission.
GAAP	Accounting Principles Generally Accepted in the United States of America.
I&M	Indiana Michigan Power Company, an AEP electric utility subsidiary.
IRS	Internal Revenue Service.
IURC	Indiana Utility Regulatory Commission.
MW	Megawatt.
NO_x	Nitrogen oxide.
NSR	New Source Review.
OPEB	Other Postretirement Benefit Plans.
Parent	American Electric Power Company, Inc., the equity owner of AEP subsidiaries within the AEP consolidation.
Rockport Plant	A generation plant, consisting of two 1,310 MW coal-fired generating units near Rockport, Indiana. AEGCo and I&M jointly-own Unit 1. In 1989, AEGCo and I&M entered into a sale-and-leaseback transaction with Wilmington Trust Company, an unrelated, unconsolidated trustee for Rockport Plant, Unit 2.
UMWA	United Mine Workers of America.
Utility Money Pool	Centralized funding mechanism AEP uses to meet the short-term cash requirements of certain utility subsidiaries.

AEP GENERATING COMPANY
CONDENSED STATEMENTS OF INCOME
For the Three and Six Months Ended June 30, 2017 and 2016
(in thousands)
(Unaudited)

	Three Months Ended June 30, 2017	Three Months Ended June 30, 2016	Six Months Ended June 30, 2017	Six Months Ended June 30, 2016
REVENUES				
Sales to AEP Affiliates	$ 71,310	$ 128,593	$ 169,340	$ 247,942
Other Revenues – Affiliated	4,046	5,649	7,844	9,277
Other Revenues – Nonaffiliated	910	98	1,820	776
TOTAL REVENUES	76,266	134,340	179,004	257,995
EXPENSES				
Fuel and Other Consumables Used for Electric Generation	29,000	69,310	79,454	127,639
Rent – Rockport Plant, Unit 2	17,071	17,071	34,142	34,142
Other Operation	6,295	12,662	14,111	24,913
Maintenance	6,181	5,553	11,662	10,947
Gain on Sale of Lawrenceburg Plant	(37)	—	(355,588)	—
Depreciation and Amortization	10,057	12,152	20,076	24,144
Taxes Other Than Income Taxes	795	2,175	2,213	3,584
TOTAL (INCOME) EXPENSES	69,362	118,923	(193,930)	225,369
OPERATING INCOME	6,904	15,417	372,934	32,626
Other Income (Expense):				
Other Income	1,935	161	3,899	365
Interest Expense	(674)	(2,898)	(2,939)	(5,794)
INCOME BEFORE INCOME TAX EXPENSE (CREDIT)	8,165	12,680	373,894	27,197
Income Tax Expense (Credit)	(24,965)	4,761	115,065	9,100
NET INCOME	$ 33,130	$ 7,919	$ 258,829	$ 18,097

The common stock of AEGCo is wholly-owned by Parent.

See Condensed Notes to Condensed Financial Statements beginning on page 7.

AEP GENERATING COMPANY
CONDENSED STATEMENTS OF CHANGES IN COMMON SHAREHOLDER'S EQUITY
For the Six Months Ended June 30, 2017 and 2016
(in thousands)
(Unaudited)

	Common Stock	Paid-in Capital	Retained Earnings	Total
TOTAL COMMON SHAREHOLDER'S EQUITY - DECEMBER 31, 2015	$ 1,000	$ 260,487	$ 4,989	$ 266,476
Capital Contribution from Parent		25,000		25,000
Common Stock Dividends			(17,500)	(17,500)
Net Income			18,097	18,097
TOTAL COMMON SHAREHOLDER'S EQUITY - JUNE 30, 2016	$ 1,000	$ 285,487	$ 5,586	$ 292,073
TOTAL COMMON SHAREHOLDER'S EQUITY - DECEMBER 31, 2016	$ 1,000	$ 285,487	$ 23,017	$ 309,504
Capital Contribution Returned to Parent		(110,000)		(110,000)
Common Stock Dividends			(200,000)	(200,000)
Net Income			258,829	258,829
TOTAL COMMON SHAREHOLDER'S EQUITY - JUNE 30, 2017	$ 1,000	$ 175,487	$ 81,846	$ 258,333

See Condensed Notes to Condensed Financial Statements beginning on page 7.

AEP GENERATING COMPANY
CONDENSED BALANCE SHEETS
ASSETS
June 30, 2017 and December 31, 2016
(in thousands)
(Unaudited)

	June 30, 2017	December 31, 2016
CURRENT ASSETS		
Advances to Affiliates	$ 134,195	$ 19,037
Accounts Receivable:		
Affiliated Companies	30,708	63,783
Miscellaneous	995	3
Total Accounts Receivable	31,703	63,786
Fuel	41,515	32,256
Materials and Supplies	18,631	17,960
Assets Held for Sale	—	320,365
Prepayments and Other Current Assets	352	1,252
TOTAL CURRENT ASSETS	226,396	454,656
PROPERTY, PLANT AND EQUIPMENT		
Electric:		
Generation	971,013	955,572
Other Property, Plant and Equipment	35,675	36,334
Construction Work in Progress	159,573	122,060
Total Property, Plant and Equipment	1,166,261	1,113,966
Accumulated Depreciation and Amortization	662,758	645,164
TOTAL PROPERTY, PLANT AND EQUIPMENT – NET	503,503	468,802
OTHER NONCURRENT ASSETS		
Regulatory Assets	15,080	15,146
Deferred Charges and Other Noncurrent Assets	3,708	1,186
TOTAL OTHER NONCURRENT ASSETS	18,788	16,332
TOTAL ASSETS	$ 748,687	$ 939,790

See Condensed Notes to Condensed Financial Statements beginning on page 7.

AEP GENERATING COMPANY
CONDENSED BALANCE SHEETS
LIABILITIES AND COMMON SHAREHOLDER'S EQUITY
June 30, 2017 and December 31, 2016
(Unaudited)

	June 30, 2017	December 31, 2016
CURRENT LIABILITIES	(in thousands)	
Accounts Payable:		
General	$ 2,819	$ 25,635
Affiliated Companies	19,035	23,497
Long-term Debt Due Within One Year – Nonaffiliated	45,000	62,280
Accrued Taxes	82,976	9,507
Accrued Rent – Rockport Plant, Unit 2	4,963	4,963
Liabilities Held for Sale	—	141,480
Other Current Liabilities	4,542	4,257
TOTAL CURRENT LIABILITIES	159,335	271,619
NONCURRENT LIABILITIES		
Long-term Debt – Nonaffiliated	124,738	124,781
Deferred Income Taxes	53,911	91,288
Regulatory Liabilities and Deferred Investment Tax Credits	50,484	46,874
Deferred Gain on Sale-and-Leaseback – Rockport Plant, Unit 2	30,268	33,053
Deferred Credits and Other Noncurrent Liabilities	71,618	62,671
TOTAL NONCURRENT LIABILITIES	331,019	358,667
TOTAL LIABILITIES	490,354	630,286
Commitments and Contingencies (Note 3)		
COMMON SHAREHOLDER'S EQUITY		
Common Stock – Par Value – $1,000 Per Share:		
Authorized – 1,000 Shares		
Outstanding – 1,000 Shares	1,000	1,000
Paid-in Capital	175,487	285,487
Retained Earnings	81,846	23,017
TOTAL COMMON SHAREHOLDER'S EQUITY	258,333	309,504
TOTAL LIABILITIES AND COMMON SHAREHOLDER'S EQUITY	$ 748,687	$ 939,790

See Condensed Notes to Condensed Financial Statements beginning on page 7.

AEP GENERATING COMPANY
CONDENSED STATEMENTS OF CASH FLOWS
For the Six Months Ended June 30, 2017 and 2016
(in thousands)
(Unaudited)

	Six Months Ended June 30, 2017	2016
OPERATING ACTIVITIES		
Net Income	$ 258,829	$ 18,097
Adjustments to Reconcile Net Income to Net Cash Flows from (Used for) Operating Activities:		
Depreciation and Amortization	20,076	24,144
Deferred Income Taxes	(29,799)	4,998
Amortization of Deferred Gain on Sale-and-Leaseback – Rockport Plant, Unit 2	(2,785)	(2,785)
Allowance for Equity Funds Used During Construction	(2,369)	(371)
Gain on Sale of Lawrenceburg Plant	(355,588)	—
Change in Other Noncurrent Assets	(3,532)	(198)
Change in Other Noncurrent Liabilities	(1,288)	(2,705)
Changes in Certain Components of Working Capital:		
Accounts Receivable	32,083	(5,851)
Fuel, Materials and Supplies	(9,859)	(18,057)
Accounts Payable	(25,597)	(9,070)
Accrued Taxes, Net	73,576	9,794
Other Current Assets	(6,821)	(819)
Other Current Liabilities	(1,947)	946
Net Cash Flows from (Used for) Operating Activities	(55,021)	18,123
INVESTING ACTIVITIES		
Construction Expenditures	(47,557)	(47,555)
Change in Advances to Affiliates, Net	(115,158)	—
Proceeds from Sale of Lawrenceburg Plant	726,300	—
Other Investing Activities	2	(1)
Net Cash Flows from (Used for) Investing Activities	563,587	(47,556)
FINANCING ACTIVITIES		
Capital Contribution from (Returned to) Parent	(110,000)	25,000
Change in Advances from Affiliates, Net	—	26,572
Retirement of Long-term Debt – Nonaffiliated	(152,727)	(3,636)
Principal Payments for Capital Lease Obligations	(955)	(1,004)
Dividends Paid on Common Stock	(200,000)	(17,500)
Make Whole Premium on Extinguishment of Long-term Debt	(44,884)	—
Other Financing Activities	—	1
Net Cash Flows from (Used for) Financing Activities	(508,566)	29,433
Net Change in Cash and Cash Equivalents	—	—
Cash and Cash Equivalents at Beginning of Period	—	—
Cash and Cash Equivalents at End of Period	$ —	$ —
SUPPLEMENTARY INFORMATION		
Cash Paid for Interest, Net of Capitalized Amounts	$ 5,048	$ 5,452
Net Cash Paid (Received) for Income Taxes	75,222	(837)
Noncash Acquisitions Under Capital Leases	14	11,951
Construction Expenditures Included in Current Liabilities as of June 30,	255	1,253

See Condensed Notes to Condensed Financial Statements beginning on page 7.

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1. SIGNIFICANT ACCOUNTING MATTERS

General

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

In the opinion of management, the unaudited condensed interim financial statements reflect all normal and recurring accruals and adjustments necessary for a fair presentation of the net income, financial position and cash flows for the interim periods. Net income for the three and six months ended June 30, 2017 is not necessarily indicative of results that may be expected for the year ending December 31, 2017. The condensed financial statements are unaudited and should be read in conjunction with the audited 2016 financial statements and notes thereto, which are included in AEGCo's 2016 Annual Report.

Subsequent Events

Management reviewed subsequent events through July 27, 2017, the date that the second quarter 2017 report was issued.

2. NEW ACCOUNTING PRONOUNCEMENTS

Upon issuance of final pronouncements, management reviews the new accounting literature to determine its relevance, if any, to AEGCo's business. The following final pronouncements will impact the financial statements.

ASU 2014-09 "Revenue from Contracts with Customers" (ASU 2014-09)

In May 2014, the FASB issued ASU 2014-09 clarifying the method used to determine the timing and requirements for revenue recognition on the statements of income. Under the new standard, an entity must identify the performance obligations in a contract, determine the transaction price and allocate the price to specific performance obligations to recognize the revenue when the obligation is completed. The amendments in this update also require disclosure of sufficient information to allow users to understand the nature, amount, timing and uncertainty of revenue and cash flow arising from contracts.

The FASB deferred implementation of ASU 2014-09 under the terms in ASU 2015-14, "Revenue from Contracts with Customers (Topic: 606): Deferral of the Effective Date." The new accounting guidance is effective for interim and annual periods beginning after December 15, 2017 with early adoption permitted.

Management continues to analyze the impact of the new revenue standard and related ASUs. During 2016 and 2017, revenue contract assessments were completed. Material revenue streams were identified within the AEP System and representative contract/transaction types were sampled. Performance obligations identified within each material revenue stream were evaluated to determine whether the obligations were satisfied at a point in time or over time. Contracts determined to be satisfied over time generally qualified for the invoicing practical expedient since the invoiced amounts reasonably represented the value to customers of performance obligations fulfilled to date. Based upon the completed assessments, management does not expect a material impact to the timing of revenue recognized or net income and plans to elect the modified retrospective transition approach upon adoption. Evaluation of revenue streams and new contracts continues during the second half of 2017. Given industry conclusions related to implementation issues, including contributions in aid of construction and collectability, management does not anticipate changes to current accounting systems. Management will also continue to monitor any industry implementation issues that arise and analyze the related impacts to revenue recognition. Management plans to adopt ASU 2014-09 effective January 1, 2018.

ASU 2016-01 "Recognition and Measurement of Financial Assets and Financial Liabilities" (ASU 2016-01)

In January 2016, the FASB issued ASU 2016-01 enhancing the reporting model for financial instruments. Under the new standard, equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) are required to be measured at fair value with changes in fair value recognized in net income. The new standard also amends disclosure requirements and requires separate presentation of financial assets and liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements. The amendments also clarify that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets.

The new accounting guidance is effective for interim and annual periods beginning after December 15, 2017 with early adoption permitted. The amendments will be applied by means of a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. Management is analyzing the impact of this new standard and, at this time, cannot estimate the impact of adoption on net income. Management plans to adopt ASU 2016-01 effective January 1, 2018.

ASU 2016-02 "Accounting for Leases" (ASU 2016-02)

In February 2016, the FASB issued ASU 2016-02 increasing the transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. Under the new standard, an entity must recognize an asset and liability for operating leases on the balance sheets. Additionally, a capital lease will be known as a finance lease going forward. Leases with lease terms of 12 months or longer will be subject to the new requirements. Fundamentally, the criteria used to determine lease classification will remain the same, but will be more subjective under the new standard.

The new accounting guidance is effective for annual periods beginning after December 15, 2018 with early adoption permitted. The guidance will be applied by means of a modified retrospective approach. The modified retrospective approach will require lessees and lessors to recognize and measure leases at the beginning of the earliest period presented.

Management continues to analyze the impact of the new lease standard. During 2016 and 2017, lease contract assessments were completed. The AEP System lease population was identified and representative lease contracts were sampled. Based upon the completed assessments, management prepared a system gap analysis to outline new disclosure compliance requirements compared to current system capabilities. Multiple lease system options were also evaluated. Management plans to elect certain of the following practical expedients upon adoption:

Practical Expedient	Description
Overall Expedients (for leases commenced prior to adoption date and must be adopted as a package)	Do not need to reassess whether any expired or existing contracts are/or contain leases, do not need to reassess the lease classification for any expired or existing leases and do not need to reassess initial direct costs for any existing leases.
Lease and Non-lease Components (elect by class of underlying asset)	Elect as an accounting policy to not separate non-lease components from lease components and instead account for each lease and associated non-lease component as a single lease component.
Short-term Lease (elect by class of underlying asset)	Elect as an accounting policy to not apply the recognition requirements to short-term leases.
Lease term	Elect to use hindsight to determine the lease term.

Evaluation of new lease contracts continues and a compliant lease system solution will be implemented during the second half of 2017. Management expects the new standard to impact financial position, but not results of operations or cash flows. Management also continues to monitor unresolved industry implementation issues, including items related to pole attachments, easements and right-of-ways, and will analyze the related impacts to lease accounting. Management plans to adopt ASU 2016-02 effective January 1, 2019.

ASU 2016-09 "Compensation – Stock Compensation" (ASU 2016-09)

In March 2016, the FASB issued ASU 2016-09 simplifying the accounting for share-based payment transactions including the income tax consequences, classification of awards as either equity or liabilities and classification on the statements of cash flows. Under the new standard, all excess tax benefits and tax deficiencies (including tax benefits of dividends on share-based payment awards) should be recognized as income tax expense or benefit on the statements of income. Under current GAAP, excess tax benefits are recognized in additional paid-in capital while tax deficiencies are recognized either as an offset to accumulated excess tax benefits, if any, or on the statements of income.

Management adopted ASU 2016-09 effective January 1, 2017. As a result of the adoption of this guidance, management made an accounting policy election to recognize the effect of forfeitures in compensation cost when they occur. There was an immaterial impact on results of operations and financial position and no impact on cash flows at adoption.

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

In June 2016, the FASB issued ASU 2016-13 requiring an allowance to be recorded for all expected credit losses for financial assets. The allowance for credit losses is based on historical information, current conditions and reasonable and supportable forecasts. The new standard also makes revisions to the other than temporary impairment model for available-for-sale debt securities. Disclosures of credit quality indicators in relation to the amortized cost of financing receivables are further disaggregated by year of origination.

The new accounting guidance is effective for interim and annual periods beginning after December 15, 2019 with early adoption permitted for interim and annual periods beginning after December 15, 2018. The amendments will be applied through a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective. Management is analyzing the impact of this new standard and, at this time, cannot estimate the impact of adoption on net income. Management plans to adopt ASU 2016-13 effective January 1, 2020.

ASU 2016-18 "Restricted Cash" (ASU 2016-18)

In November 2016, the FASB issued ASU 2016-18 clarifying the treatment of restricted cash on the statements of cash flows. Under the new standard, amounts considered restricted cash will be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts on the statements of cash flows.

The new accounting guidance is effective for annual periods beginning after December 15, 2017. Early adoption is permitted in any interim or annual period. The guidance will be applied by means of a retrospective approach. Management is analyzing the impact of the new standard. Management plans to adopt ASU 2016-18 effective for the 2017 Annual Report.

ASU 2017-07 "Compensation - Retirement Benefits" (ASU 2017-07)

In March 2017, the FASB issued ASU 2017-07 requiring that an employer report the service cost component of pension and postretirement benefits in the same line item or items as other compensation costs. The other components of net benefit cost are required to be presented in the income statement separately from the service cost component and outside of a subtotal of income from operations. In addition, only the service cost component will be eligible for capitalization as applicable following labor.

The new accounting guidance is effective for interim and annual periods beginning after December 15, 2017. Early adoption is permitted as of the beginning of an annual period for which financial statements have not been issued or made available for issuance. Management is analyzing the impact of the new standard and assessing an implementation program which will likely require changes in the way accounting systems capture and report the required information. Unresolved industry implementation issues also continue to be monitored, including balance sheet presentation when a credit related to the non-service cost components is greater than service cost component. Management plans to adopt ASU 2017-07 effective January 1, 2018.

3. COMMITMENTS, GUARANTEES AND CONTINGENCIES

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

For current proceedings not specifically discussed below, management does not anticipate that the liabilities, if any, arising from such proceedings would have a material effect on the financial statements. The Commitments, Guarantees and Contingencies note within AEGCo's 2016 Annual Report should be read in conjunction with this report.

GUARANTEES

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

Letters of Credit

AEGCo has $45 million of variable rate Pollution Control Bonds supported by bilateral letters of credit for $46 million. In June 2017, the letters of credit were extended to mature in July 2019.

Indemnifications and Other Guarantees

Contracts

AEGCo enters into certain types of contracts which require indemnifications. Typically these contracts include, but are not limited to, sale agreements, lease agreements, purchase agreements and financing agreements. Generally, these agreements may include, but are not limited to, indemnifications around certain tax, contractual and environmental matters. With respect to sale agreements, exposure generally does not exceed the sale price. As of June 30, 2017, there were no material liabilities recorded for any indemnifications.

Master Lease Agreements

AEGCo leases certain equipment under master lease agreements. Under the lease agreements, the lessor is guaranteed a residual value up to a stated percentage of either the unamortized balance or the equipment cost at the end of the lease term. If the actual fair value of the leased equipment is below the guaranteed residual value at the end of the lease term, AEGCo is committed to pay the difference between the actual fair value and the residual value guarantee. Historically, at the end of the lease term the fair value has been in excess of the unamortized balance. As of June 30, 2017, the maximum potential loss for these lease agreements was $48 thousand assuming the fair value of the equipment is zero at the end of the lease term.

CONTINGENCIES

Rockport Plant Litigation

In July 2013, the Wilmington Trust Company filed a complaint in U.S. District Court for the Southern District of New York against AEGCo and I&M alleging that it will be unlawfully burdened by the terms of the modified NSR consent decree after the Rockport Plant, Unit 2 lease expiration in December 2022. The terms of the consent decree allow the installation of environmental emission control equipment, repowering or retirement of the unit. The plaintiffs further allege that the defendants' actions constitute breach of the lease and participation agreement. The plaintiffs seek a judgment declaring that the defendants breached the lease, must satisfy obligations related to installation of emission control equipment and indemnify the plaintiffs. The New York court granted a motion to transfer this case to the U.S. District Court for the Southern District of Ohio. In October 2013, a motion to dismiss the case was filed on behalf of AEGCo and I&M. In January 2015, the court issued an opinion and order granting the motion in part and denying the motion in part. The court dismissed certain of the plaintiffs' claims, including the dismissal without prejudice of plaintiffs' claims seeking compensatory damages. Several claims remained, including the claim for breach of the participation agreement and a claim alleging breach of an implied covenant of good faith and fair dealing. In June 2015, AEGCo and I&M filed a motion for partial judgment on the claims seeking dismissal of the breach of participation agreement claim as well as any claim for indemnification of costs associated with this case. The plaintiffs subsequently filed an amended complaint to add another claim under the lease and also filed a motion for partial summary judgment. In November 2015, AEGCo and I&M filed a motion to strike the plaintiffs' motion for partial judgment and filed a motion to dismiss the case for failure to state a claim. In March 2016, the court entered an opinion and order in favor of AEGCo and I&M, dismissing certain of the plaintiffs' claims for breach of contract and dismissing claims for breach of implied covenant of good faith and fair dealing, and further dismissing plaintiffs' claim for indemnification of costs. By the same order, the court permitted plaintiffs to move forward with their claim that AEGCo and I&M failed to exercise prudent utility practices in the maintenance and operation of Rockport Plant, Unit 2. In April 2016, the plaintiffs filed a notice of voluntary dismissal of all remaining claims with prejudice and the court subsequently entered a final judgment. In May 2016, plaintiffs filed an appeal in the U.S. Court of Appeals for the Sixth Circuit on whether AEGCo and I&M are in breach of certain contract provisions that plaintiffs allege operate to protect the plaintiffs' residual interests in the unit and whether the trial court erred in dismissing plaintiffs' claims that AEGCo and I&M breached the covenant of good faith and fair dealing. In April 2017, the U.S. Court of Appeals for the Sixth Circuit issued an opinion reversing the district court's decisions which had dismissed certain of plaintiffs' claims for breach of contract. The U.S. Court of Appeals for the Sixth Circuit determined that the district court erred in holding that the modification to the consent decree was permitted under the terms of the lease agreement and remanded the case to the district court to enter summary judgment in plaintiffs' favor consistent with that ruling. In April 2017, AEGCo and I&M filed a petition for rehearing with the U.S. Court of Appeals for the Sixth Circuit, which was granted. In June 2017, the U.S. Court of Appeals for the Sixth Circuit issued an amended opinion and judgment which reverses the district court's dismissal of certain of the owners' claims under the lease agreements, vacates the denial of the owners' motion for partial summary judgment and remands the case to the district court for further proceedings. The amended opinion and judgment also affirms the district court's dismissal of the owners' breach of good faith and fair dealing claim as duplicative of the breach of contract claims and removes the instruction to the district court in the original opinion to enter summary judgment in favor of the owners. Given that the district court dismissed plaintiffs' claims seeking compensatory relief as premature, and that plaintiffs have yet to present a methodology for determining or any analysis supporting any alleged damages, management is unable to determine a range of potential losses that are reasonably possible of occurring. In July 2017, AEP filed a motion with the U.S. District Court for the Southern District of Ohio seeking to modify the consent decree to eliminate the obligation to install future controls at Rockport Unit 2 if AEP does not acquire ownership of that Unit, and to modify the consent decree in other respects to preserve the environmental benefits of the consent decree.

Rockport Plant, Unit 2 Selective Catalytic Reduction (SCR)

In October 2016, I&M filed an application with the IURC for approval of a Certificate of Public Convenience and Necessity (CPCN) to install SCR technology at Rockport Plant, Unit 2 by December 2019. The equipment will allow I&M to reduce emissions of NO_x from Rockport Plant, Unit 2 in order for I&M to continue to operate that unit under current environmental requirements. The estimated cost of the SCR project is $274 million, excluding AFUDC, to be shared equally between I&M and AEGCo. As of June 30, 2017, AEG's share of the total costs incurred related to this project, including AFUDC, is approximately $4 million. The AEGCo ownership share of the proposed SCR project will be billable under the Rockport Unit Power Agreement to affiliates, including I&M, with I&M's share recoverable in its base rates. In February 2017, the Indiana Office of Utility Consumer Counselor (OUCC) and other parties filed testimony with the IURC. The OUCC recommended approval of the CPCN but also stated that any decision regarding recovery of any under-depreciated plant due to retirement should be fully investigated in a base rate case, not in a tracker or other abbreviated proceeding. The other parties recommended either denial of the CPCN or approval of the CPCN with conditions including a cap on the amount of SCR costs allowed to be recovered in the rider and limitations on other costs related to legal issues involving the Rockport lease. A hearing at the IURC was held in March 2017. An order from the IURC is pending. In July 2017, I&M filed a request with the U.S. District Court for the Southern District of Ohio to delay the existing deadline for installation of SCR technology at Rockport Plant, Unit 2.

4. DISPOSITION

Lawrenceburg Plant

In September 2016, AEP signed a Purchase and Sale Agreement to sell AEGCo's Lawrenceburg Plant as well as other affiliated plants totaling 5,329 MWs of competitive generation assets as one disposal group to a nonaffiliated party. The sale closed in January 2017 for $2.2 billion, of which $726 million related to AEGCo's Lawrenceburg Plant were recorded in Investing Activities on AEGCo's statement of cash flows. The net proceeds from the transaction are $363 million in cash after taxes, repayment of debt associated with this plant including a make whole payment related to the debt and transaction fees. The sale resulted in a pretax gain of $356 million that was recorded in Gain on Sale of Lawrenceburg Plant on AEGCo's statement of income.

In the third quarter of 2016, management determined the disposal group met the classification of held for sale. Accordingly, Lawrenceburg Plant's assets and liabilities have been recorded as Assets Held for Sale and Liabilities Held for Sale on AEGCo's balance sheet as of December 31, 2016 and as shown in the table below. The Income before Income Tax Expense of the plant was $3.8 million (excluding the $356 million pretax gain) for the six months ended June 30, 2017.

	December 31, 2016
Assets:	**(in thousands)**
Fuel	$ 89
Materials and Supplies	8,476
Property, Plant and Equipment - Net	311,799
Other Classes of Assets That Are Not Major	1
Total Assets Classified as Held for Sale on the Balance Sheets	$ 320,365
Liabilities:	
Long-term Debt	$ 134,784
Other Classes of Liabilities That Are Not Major	6,696
Total Liabilities Classified as Held for Sale on the Balance Sheets	$ 141,480

5. BENEFIT PLANS

AEGCo participates in an AEP sponsored qualified pension plan. Substantially all of AEGCo's employees who are not UMWA members are covered by the qualified plan. AEGCo also participates in OPEB plans sponsored by AEP to provide health and life insurance benefits for retired employees.

Components of Net Periodic Benefit Cost

The following tables provide the components of AEGCo's net periodic benefit cost for the plans:

	Pension Plan		Other Postretirement Benefit Plans	
	Three Months Ended June 30,		Three Months Ended June 30,	
	2017	2016	2017	2016
	(in thousands)			
Service Cost	$ 19	$ 26	$ 215	$ 283
Interest Cost	37	38	421	453
Expected Return on Plan Assets	(61)	(61)	(552)	(534)
Amortization of Prior Service Credit	—	—	(17)	(17)
Amortization of Net Actuarial Loss	14	15	94	109
Net Periodic Benefit Cost	$ 9	$ 18	$ 161	$ 294

	Pension Plan		Other Postretirement Benefit Plans	
	Six Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
	(in thousands)			
Service Cost	$ 38	$ 52	$ 429	$ 565
Interest Cost	74	76	842	907
Expected Return on Plan Assets	(123)	(121)	(1,103)	(1,068)
Amortization of Prior Service Credit	—	—	(34)	(34)
Amortization of Net Actuarial Loss	29	29	188	218
Net Periodic Benefit Cost	$ 18	$ 36	$ 322	$ 588

6. BUSINESS SEGMENTS

AEGCo has one reportable segment, an electricity generation business. AEGCo's other activities are insignificant.

7. FAIR VALUE MEASUREMENTS

Fair Value Hierarchy and Valuation Techniques

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

Fair Value Measurements of Long-term Debt

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

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

	June 30, 2017		December 31, 2016	
	Book Value	**Fair Value**	**Book Value (a)**	**Fair Value (a)**
	(in thousands)			
Long-term Debt	$ 169,738	$ 170,000	$ 321,845	$ 364,299

(a) Amount includes debt related to the Lawrenceburg Plant that has been classified as Liabilities Held for Sale on the balance sheet and has a fair value of $172.2 million. See the "Lawrenceburg Plant" section of Note 4 for additional information.

8. INCOME TAXES

Effective Tax Rates (ETR)

The ETR for AEGCo are included in the following table. Significant variances in the ETR are described below.

Three Months Ended June 30,		Six Months Ended June 30,	
2017	**2016**	**2017**	**2016**
(305.8)%	37.5%	30.8%	33.5%

Three Months Ended June 30, 2017 Compared to Three Months Ended June 30, 2016

The decrease in the ETR is primarily due to a permanent book/tax difference related to the sale of certain merchant generation assets, including Lawrenceburg Plant, which was completed in the first quarter of 2017. In the second quarter of 2017, AEP updated the allocation of the $2.2 billion total purchase price among the Lawrenceburg Plant and AGR's Darby, Gavin and Waterford plants based on the final purchase price allocation received in the second quarter of 2017. This change in estimate resulted in a $29.3 million decrease in income tax expense in the second quarter of 2017.

Six Months Ended June 30, 2017 Compared to Six Months Ended June 30, 2016

The decrease in the ETR is primarily due to a permanent book/tax difference related to the sale of certain merchant generation assets, including Lawrenceburg Plant, discussed above.

Federal and State Income Tax Audit Status

AEGCo and other AEP subsidiaries are no longer subject to U.S. federal examination for years before 2011. The IRS examination of years 2011, 2012 and 2013 started in April 2014. AEGCo and other AEP subsidiaries received a Revenue Agents Report in April 2016, completing the 2011 through 2013 audit cycle indicating an agreed upon audit. The 2011 through 2013 audit was submitted to the Congressional Joint Committee on Taxation for approval. The Joint Committee referred the audit back to the IRS exam team for further consideration. Although the outcome of tax audits is uncertain, in management's opinion, adequate provisions for federal income taxes have been made for potential liabilities resulting from such matters. In addition, AEGCo accrues interest on these uncertain tax positions. Management is not aware of any issues for open tax years that upon final resolution are expected to materially impact net income.

AEGCo and other AEP subsidiaries file income tax returns in various state and local jurisdictions. These taxing authorities routinely examine the tax returns. AEGCo and other AEP subsidiaries are currently under examination in several state and local jurisdictions. However, it is possible that previously filed tax returns have positions that may be challenged by these tax authorities. Management believes that adequate provisions for income taxes have been made for potential liabilities resulting from such challenges and that the ultimate resolution of these audits will not materially impact net income. AEGCo is no longer subject to state or local income tax examinations by tax authorities for years before 2009.

State Tax Legislation

Legislation was passed by the state of Illinois in July 2017 increasing the corporate income tax rate from 5.25% to 7% effective July 1, 2017, with the increased rate applied to the portion of the tax year falling on or after that date. With the inclusion of the 2.5% Illinois Replacement Tax, the total Illinois corporate income tax rate will increase from 7.75% to 9.5%, effective July 1, 2017. The legislation will not materially impact AEGCo's net income, cash flows or financial condition.

9. FINANCING ACTIVITIES

Long-term Debt

Long-term debt principal payments made during the first six months of 2017 are shown in the table below:

Type of Debt		Principal Amount Paid	Interest Rate	Due Date
		(in thousands)	(%)	
Senior Unsecured Notes	$	152,727	6.33	2037

Dividend Restrictions

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

Leverage Restrictions

AEGCo has credit agreements that contain a covenant that limit its debt to capitalization ratio to 67.5%. The payment of cash dividends indirectly results in an increase in the percentage of AEGCo's debt to total capitalization. The method for calculating outstanding debt and capitalization is contractually defined in the credit agreements.

Corporate Borrowing Program - AEP System

The AEP System uses a corporate borrowing program to meet the short-term borrowing needs of AEP's subsidiaries. The corporate borrowing program includes a Utility Money Pool, which funds AEP's utility subsidiaries. The AEP System Utility Money Pool operates in accordance with the terms and conditions of the AEP System Utility Money Pool agreement filed with the FERC. The amounts of outstanding loans to the Utility Money Pool as of June 30, 2017 and December 31, 2016 are included in Advances to Affiliates on AEGCo's balance sheets. AEGCo's Utility Money Pool activity and corresponding authorized borrowing limit for the six months ended June 30, 2017 are described in the following table:

Maximum Borrowings from the Utility Money Pool	Maximum Loans to the Utility Money Pool	Average Borrowings from the Utility Money Pool	Average Loans to the Utility Money Pool	Loans to the Utility Money Pool as of June 30, 2017	Authorized Short-Term Borrowing Limit
		(in thousands)			
$ 12,217	$ 787,348	$ 12,217	$ 268,864	$ 134,195	$ 200,000

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

Six Months Ended June 30,	Maximum Interest Rate for Funds Borrowed from the Utility Money Pool	Minimum Interest Rate for Funds Borrowed from the Utility Money Pool	Maximum Interest Rate for Funds Loaned to the Utility Money Pool	Minimum Interest Rate for Funds Loaned to the Utility Money Pool	Average Interest Rate for Funds Borrowed from the Utility Money Pool	Average Interest Rate for Funds Loaned to the Utility Money Pool
2017	1.00%	1.00%	1.44%	0.92%	1.00%	1.14%
2016	0.84%	0.69%	—%	—%	0.75%	—%

10. PROPERTY, PLANT AND EQUIPMENT

Asset Retirement Obligations (ARO)

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

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

ARO as of December 31, 2016	Accretion Expense	Liabilities Incurred	Liabilities Settled	Revisions in Cash Flow Estimates	ARO as of June 30, 2017
		(in thousands)			
$ 8,550	$ 237	$ —	$ —	$ 7,895	$ 16,682