AEP Texas North Company

2008 Third Quarter Report

Consolidated 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
AEP or Parent	American Electric Power Company, Inc.
AEP Consolidated	AEP and its majority owned consolidated subsidiaries and consolidated affiliates.
AEP East companies	APCo, CSPCo, I&M, KPCo and OPCo.
AEP System or the System	American Electric Power System, an integrated electric utility system, owned and operated by AEP's electric utility subsidiaries.
AEP West companies	PSO, SWEPCo, TCC and TNC.
AEPSC	American Electric Power Service Corporation, a service subsidiary providing management and professional services to AEP and its subsidiaries.
ALJ	Administrative Law Judge.
APCo	Appalachian Power Company, an AEP electric utility subsidiary.
APSC	Arkansas Public Service Commission.
CAA	Clean Air Act.
CSPCo	Columbus Southern Power Company, an AEP electric utility subsidiary.
CSW	Central and South West Corporation, a subsidiary of AEP (Effective January 21, 2003, the legal name of Central and South West Corporation was changed to AEP Utilities, Inc.).
EITF	Financial Accounting Standards Board's Emerging Issues Task Force.
ERCOT	Electric Reliability Council of Texas.
FASB	Financial Accounting Standards Board.
Federal EPA	United States Environmental Protection Agency.
FERC	Federal Energy Regulatory Commission.
FIN	FASB Interpretation No.
FIN 48	FIN 48, "Accounting for Uncertainty in Income Taxes" and FASB Staff Position FIN 48-1 "Definition of *Settlement* in FASB Interpretation No. 48."
FSP	FASB Staff Position.
GAAP	Accounting Principles Generally Accepted in the United States of America.
IRS	Internal Revenue Service.
I&M	Indiana Michigan Power Company, an AEP electric utility subsidiary.
KPCo	Kentucky Power Company, an AEP electric utility subsidiary.
Nonutility Money Pool	AEP System's Nonutility Money Pool.
OCC	Corporation Commission of the State of Oklahoma.
OPCo	Ohio Power Company, an AEP electric utility subsidiary.
OPEB	Other Postretirement Benefit Plans.
PSO	Public Service Company of Oklahoma, an AEP electric utility subsidiary.
PUCT	Public Utility Commission of Texas.
SEC	United States Securities and Exchange Commission.
SFAS	Statement of Financial Accounting Standards issued by the Financial Accounting Standards Board.
SFAS 133	Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities."
SWEPCo	Southwestern Electric Power Company, an AEP electric utility subsidiary.
TCC	AEP Texas Central Company, an AEP electric utility subsidiary.
TNC	AEP Texas North Company, an AEP electric utility subsidiary.
Utility Money Pool	AEP System's Utility Money Pool.

AEP TEXAS NORTH COMPANY AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
For the Three and Nine Months Ended September 30, 2008 and 2007
(in thousands)
(Unaudited)

	Three Months Ended 2008	Three Months Ended 2007	Nine Months Ended 2008	Nine Months Ended 2007
REVENUES				
Electric Generation, Transmission and Distribution	$ 45,117	$ 54,030	$ 126,437	$ 137,606
Sales to AEP Affiliates	26,354	25,292	74,280	78,044
Other	132	125	733	640
TOTAL	71,603	79,447	201,450	216,290
EXPENSES				
Fuel and Other Consumables Used for Electric Generation	15,385	2,523	35,526	24,377
Purchased Electricity for Resale	-	2,089	1,249	6,538
Other Operation	18,342	18,968	55,456	55,845
Maintenance	5,573	4,610	17,308	16,339
Depreciation and Amortization	11,088	10,173	34,231	30,946
Taxes Other Than Income Taxes	3,172	4,796	13,291	14,918
TOTAL	53,560	43,159	157,061	148,963
OPERATING INCOME	18,043	36,288	44,389	67,327
Other Income (Expense):				
Interest Income	568	78	1,431	406
Allowance for Equity Funds Used During Construction	767	29	1,115	73
Interest Expense	(4,647)	(3,503)	(14,036)	(12,179)
INCOME BEFORE INCOME TAX EXPENSE	14,731	32,892	32,899	55,627
Income Tax Expense	3,043	11,343	8,856	18,677
NET INCOME	11,688	21,549	24,043	36,950
Preferred Stock Dividend Requirements	26	26	78	78
EARNINGS APPLICABLE TO COMMON STOCK	$ 11,662	$ 21,523	$ 23,965	$ 36,872

The common stock of TNC is owned by a wholly-owned subsidiary of AEP.

See Condensed Notes to Condensed Consolidated Financial Statements.

AEP TEXAS NORTH COMPANY AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN COMMON SHAREHOLDER'S EQUITY AND COMPREHENSIVE INCOME (LOSS)
For the Nine Months Ended September 30, 2008 and 2007
(in thousands)
(Unaudited)

	Common Stock	Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
DECEMBER 31, 2006	$ 137,214	$ 2,351	$ 176,950	$ (10,159)	$ 306,356
FIN 48 Adoption, Net of Tax			(557)		(557)
Common Stock Dividends			(4,000)		(4,000)
Preferred Stock Dividends			(78)		(78)
TOTAL					301,721
COMPREHENSIVE INCOME					
Other Comprehensive Income, Net of Taxes:					
Cash Flow Hedges, Net of Tax of $378				703	703
NET INCOME			36,950		36,950
TOTAL COMPREHENSIVE INCOME					37,653
SEPTEMBER 30, 2007	$ 137,214	$ 2,351	$ 209,265	$ (9,456)	$ 339,374
DECEMBER 31, 2007	$ 137,214	$ 2,351	$ 201,639	$ (9,309)	$ 331,895
EITF 06-10 Adoption, Net of Tax of $153			(285)		(285)
Common Stock Dividends			(25,000)		(25,000)
Preferred Stock Dividends			(78)		(78)
TOTAL					306,532
COMPREHENSIVE INCOME					
Other Comprehensive Income, Net of Taxes:					
Amortization of Pension and OPEB Deferred Costs, Net of Tax of $260				483	483
NET INCOME			24,043		24,043
TOTAL COMPREHENSIVE INCOME					24,526
SEPTEMBER 30, 2008	$ 137,214	$ 2,351	$ 200,319	$ (8,826)	$ 331,058

See Condensed Notes to Condensed Consolidated Financial Statements.

AEP TEXAS NORTH COMPANY AND SUBSIDIARY
CONDENSED CONSOLIDATED BALANCE SHEETS
ASSETS
September 30, 2008 and December 31, 2007
(in thousands)
(Unaudited)

	2008	2007
CURRENT ASSETS		
Cash and Cash Equivalents	$ 214	$ -
Accounts Receivable:		
Customers	10,566	10,255
Affiliated Companies	39,651	37,999
Accrued Unbilled Revenues	4,201	4,053
Miscellaneous	60	47
Allowance for Uncollectible Accounts	(113)	(25)
Total Accounts Receivable	54,365	52,329
Fuel	8,778	11,575
Materials and Supplies	10,925	9,994
Prepayments and Other	10,135	5,534
TOTAL	84,417	79,432
PROPERTY, PLANT AND EQUIPMENT		
Electric:		
Production	293,429	292,109
Transmission	369,809	344,339
Distribution	539,228	523,248
Other	109,831	160,494
Construction Work in Progress	100,894	66,761
Total	1,413,191	1,386,951
Accumulated Depreciation and Amortization	458,253	498,590
TOTAL - NET	954,938	888,361
OTHER NONCURRENT ASSETS		
Regulatory Assets	32,997	36,536
Deferred Charges and Other	23,729	18,160
TOTAL	56,726	54,696
TOTAL ASSETS	$ 1,096,081	$ 1,022,489

See Condensed Notes to Condensed Consolidated Financial Statements.

AEP TEXAS NORTH COMPANY AND SUBSIDIARY
CONDENSED CONSOLIDATED BALANCE SHEETS
LIABILITIES AND SHAREHOLDERS' EQUITY
September 30, 2008 and December 31, 2007
(Unaudited)

	2008	2007
CURRENT LIABILITIES	(in thousands)	
Advances from Affiliates	$ 176	$ 33,511
Accounts Payable:		
General	11,853	11,651
Affiliated Companies	43,466	46,855
Accrued Taxes	18,389	18,941
Accrued Interest	4,953	4,024
Other	8,599	9,688
TOTAL	87,436	124,670
NONCURRENT LIABILITIES		
Long-term Debt – Nonaffiliated	368,942	268,875
Deferred Income Taxes	134,853	126,667
Regulatory Liabilities and Deferred Investment Tax Credits	129,406	128,139
Deferred Credits and Other	42,037	39,894
TOTAL	675,238	563,575
TOTAL LIABILITIES	762,674	688,245
Cumulative Preferred Stock Not Subject to Mandatory Redemption	2,349	2,349
Commitments and Contingencies (Note 4)		
COMMON SHAREHOLDER'S EQUITY		
Common Stock – Par Value – $25 Per Share:		
Authorized – 7,800,000 Shares		
Outstanding – 5,488,560 Shares	137,214	137,214
Paid-in Capital	2,351	2,351
Retained Earnings	200,319	201,639
Accumulated Other Comprehensive Income (Loss)	(8,826)	(9,309)
TOTAL	331,058	331,895
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 1,096,081	$ 1,022,489

See Condensed Notes to Condensed Consolidated Financial Statements.

AEP TEXAS NORTH COMPANY AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Nine Months Ended September 30, 2008 and 2007
(in thousands)
(Unaudited)

	2008	2007
OPERATING ACTIVITIES		
Net Income	$ 24,043	$ 36,950
Adjustments to Reconcile Net Income to Net Cash Flows from Operating Activities:		
Depreciation and Amortization	34,231	30,946
Deferred Income Taxes	3,036	2,083
Allowance for Equity Funds Used During Construction	(1,115)	(73)
Fuel Over/Under-Recovery, Net	-	(7,752)
Change in Other Noncurrent Assets	(8,902)	(9,779)
Change in Other Noncurrent Liabilities	2,399	(3,755)
Changes in Certain Components of Working Capital:		
Accounts Receivable, Net	(2,036)	(15,943)
Fuel, Materials and Supplies	1,866	(3,438)
Accounts Payable	(3,565)	(671)
Accrued Taxes, Net	(552)	3,332
Other Current Assets	(396)	(298)
Other Current Liabilities	52	(5,274)
Net Cash Flows from Operating Activities	49,061	26,328
INVESTING ACTIVITIES		
Construction Expenditures	(92,471)	(62,088)
Change in Other Cash Deposits, Net	-	8,858
Change in Advances to Affiliates, Net	-	13,543
Proceeds from Sales of Assets	3,121	12,050
Net Cash Flows Used for Investing Activities	(89,350)	(27,637)
FINANCING ACTIVITIES		
Issuance of Long-term Debt – Nonaffiliated	99,346	43,709
Change in Advances from Affiliates, Net	(33,335)	14,517
Retirement of Long-term Debt – Nonaffiliated	-	(52,461)
Principal Payments for Capital Lease Obligations	(430)	(390)
Dividends Paid on Common Stock	(25,000)	(4,000)
Dividends Paid on Cumulative Preferred Stock	(78)	(78)
Net Cash Flows from Financing Activities	40,503	1,297
Net Increase (Decrease) in Cash and Cash Equivalents	214	(12)
Cash and Cash Equivalents at Beginning of Period	-	84
Cash and Cash Equivalents at End of Period	$ 214	$ 72
SUPPLEMENTARY INFORMATION		
Cash Paid for Interest, Net of Capitalized Amounts	$ 12,879	$ 14,098
Net Cash Paid for Income Taxes	8,060	11,400
Noncash Acquisitions Under Capital Leases	281	159
Construction Expenditures Included in Accounts Payable at September 30,	7,649	4,019

See Condensed Notes to Condensed Consolidated Financial Statements.

CONDENSED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Significant Accounting Matters
2. New Accounting Pronouncements
3. Rate Matters
4. Commitments, Guarantees and Contingencies
5. Disposition
6. Benefit Plans
7. Business Segments
8. Income Taxes
9. Financing Activities

1. SIGNIFICANT ACCOUNTING MATTERS

General

The accompanying unaudited condensed consolidated 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 consolidated 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. The net income for the three and nine months ended September 30, 2008 are not necessarily indicative of results that may be expected for the year ending December 31, 2008. The accompanying condensed consolidated financial statements are unaudited and should be read in conjunction with the audited 2007 financial statements and notes thereto, which are included in TNC's 2007 Annual Report.

Accounting for Asset Retirement Obligations (ARO)

As a result of SFAS 143 "Accounting for Asset Retirement Obligations" (SFAS 143) and FASB Interpretation No. 47 "Accounting for Conditional Asset Retirement Obligations" (FIN 47), TNC records a liability at fair value for any legal obligations for future asset retirements when the related assets are acquired or constructed. Upon establishment of a legal liability, SFAS 143 requires a corresponding ARO asset to be established, which will be depreciated over its useful life. Upon final settlement of an ARO, any difference between the ARO liability and actual costs is recognized as income or expense.

In February 2008, TNC sold the Fort Phantom, Lake Pauline, Rio Pecos and San Angelo Plants. As part of the sale, the buyer assumed all environmental liabilities existing prior to and after the sale. As a result, the related ARO balances were reversed. The following is a reconciliation of the September 30, 2008 aggregate carrying amount of ARO for TNC:

ARO at January 1, 2008	Accretion Expense	Liabilities Settled	ARO at September 30, 2008
	(in thousands)		
$ 10,659	$ 303	$ (5,525)	$ 5,437

TNC's aggregate carrying amount includes ARO related to asbestos removal.

Reclassifications

Certain prior period financial statement items have been reclassified to conform to current period presentation. These reclassifications had no impact on TNC's previously reported net income or changes in shareholders' equity.

2. NEW ACCOUNTING PRONOUNCEMENTS

Upon issuance of final pronouncements, management thoroughly reviews the new accounting literature to determine the relevance, if any, to TNC's business. The following represents a summary of new pronouncements issued or implemented in 2008 and standards issued but not implemented that management has determined relate to TNC's operations.

SFAS 141 (revised 2007) "Business Combinations" (SFAS 141R)

In December 2007, the FASB issued SFAS 141R, improving financial reporting about business combinations and their effects. It establishes how the acquiring entity recognizes and measures the identifiable assets acquired, liabilities assumed, goodwill acquired, any gain on bargain purchases and any noncontrolling interest in the acquired entity. SFAS 141R no longer allows acquisition-related costs to be included in the cost of the business combination, but rather expensed in the periods they are incurred, with the exception of the costs to issue debt or equity securities which shall be recognized in accordance with other applicable GAAP. SFAS 141R requires disclosure of information for a business combination that occurs during the accounting period or prior to the issuance of the financial statements for the accounting period.

SFAS 141R is effective prospectively for business combinations with an acquisition date on or after the beginning of the first annual reporting period after December 15, 2008. Early adoption is prohibited. TNC will adopt SFAS 141R effective January 1, 2009 and apply it to any business combinations on or after that date.

SFAS 157 "Fair Value Measurements" (SFAS 157)

In September 2006, the FASB issued SFAS 157, enhancing existing guidance for fair value measurement of assets and liabilities and instruments measured at fair value that are classified in shareholders' equity. The statement defines fair value, establishes a fair value measurement framework and expands fair value disclosures. It emphasizes that fair value is market-based with the highest measurement hierarchy level being market prices in active markets. The standard requires fair value measurements be disclosed by hierarchy level, an entity includes its own credit standing in the measurement of its liabilities and modifies the transaction price presumption. The standard also nullifies the consensus reached in EITF Issue No. 02-3 "Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities" (EITF 02-3) that prohibited the recognition of trading gains or losses at the inception of a derivative contract, unless the fair value of such derivative is supported by observable market data.

In February 2008, the FASB issued FSP SFAS 157-1 "Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13" (SFAS 157-1) which amends SFAS 157 to exclude SFAS 13 "Accounting for Leases" (SFAS 13) and other accounting pronouncements that address fair value measurements for purposes of lease classification or measurement under SFAS 13.

In February 2008, the FASB issued FSP SFAS 157-2 "Effective Date of FASB Statement No. 157" (SFAS 157-2) which delays the effective date of SFAS 157 to fiscal years beginning after November 15, 2008 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually).

In October 2008, the FASB issued FSP SFAS 157-3 "Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active" which clarifies application of SFAS 157 in markets that are not active and provides an illustrative example. The FSP was effective upon issuance. The adoption of this standard had no impact on TNC's financial statements.

TNC partially adopted SFAS 157 effective January 1, 2008. TNC will fully adopt SFAS 157 effective January 1, 2009 for items within the scope of FSP SFAS 157-2. Management expects that the adoption of FSP SFAS 157-2 will have an immaterial impact on the financial statements. Due to TNC's removal from the CSW Operating Agreement and the SIA in 2006, TNC no longer has Risk Management Assets or Liabilities. The provisions of SFAS 157 are applied prospectively, except for a) changes in fair value measurements of existing derivative financial instruments measured initially using the transaction price under EITF 02-3, b) existing hybrid financial instruments measured initially at fair value using the transaction price and c) blockage discount factors. Although the statement is applied prospectively upon adoption, in accordance with the provisions of SFAS 157 related to EITF 02-3, amounts for transition adjustment are recorded to beginning retained earnings. The consideration of AEP's own credit risk when measuring the fair value of liabilities, including derivatives, impacts fair value measurements upon adoption. The adoption of this standard had no impact on TNC's financial statements.

SFAS 159 "The Fair Value Option for Financial Assets and Financial Liabilities" (SFAS 159)

In February 2007, the FASB issued SFAS 159, permitting entities to choose to measure many financial instruments and certain other items at fair value. The standard also establishes presentation and disclosure requirements designed to facilitate comparison between entities that choose different measurement attributes for similar types of assets and liabilities. If the fair value option is elected, the effect of the first remeasurement to fair value is reported as a cumulative effect adjustment to the opening balance of retained earnings. The statement is applied prospectively upon adoption.

TNC adopted SFAS 159 effective January 1, 2008. At adoption, TNC did not elect the fair value option for any assets or liabilities.

SFAS 160 "Noncontrolling Interest in Consolidated Financial Statements" (SFAS 160)

In December 2007, the FASB issued SFAS 160, modifying reporting for noncontrolling interest (minority interest) in consolidated financial statements. It requires noncontrolling interest be reported in equity and establishes a new framework for recognizing net income or loss and comprehensive income by the controlling interest. Upon deconsolidation due to loss of control over a subsidiary, the standard requires a fair value remeasurement of any remaining noncontrolling equity investment to be used to properly recognize the gain or loss. SFAS 160 requires specific disclosures regarding changes in equity interest of both the controlling and noncontrolling parties and presentation of the noncontrolling equity balance and income or loss for all periods presented.

SFAS 160 is effective for interim and annual periods in fiscal years beginning after December 15, 2008. The statement is applied prospectively upon adoption. Early adoption is prohibited. Upon adoption, prior period financial statements will be restated for the presentation of the noncontrolling interest for comparability. Management expects that the adoption of this standard will have an immaterial impact on the financial statements. TNC will adopt SFAS 160 effective January 1, 2009.

SFAS 161 "Disclosures about Derivative Instruments and Hedging Activities" (SFAS 161)

In March 2008, the FASB issued SFAS 161, enhancing disclosure requirements for derivative instruments and hedging activities. Affected entities are required to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under SFAS 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows. SFAS 161 requires that objectives for using derivative instruments be disclosed in terms of underlying risk and accounting designation. This standard is intended to improve upon the existing disclosure framework in SFAS 133.

SFAS 161 is effective for fiscal years and interim periods beginning after November 15, 2008. Management expects this standard to increase the disclosure requirements related to derivative instruments and hedging activities. It encourages retrospective application to comparative disclosure for earlier periods presented. TNC will adopt SFAS 161 effective January 1, 2009.

SFAS 162 "The Hierarchy of Generally Accepted Accounting Principles" (SFAS 162)

In May 2008, the FASB issued SFAS 162, clarifying the sources of generally accepted accounting principles in descending order of authority. The statement specifies that the reporting entity, not its auditors, is responsible for its compliance with GAAP.

SFAS 162 is effective 60 days after the SEC approves the Public Company Accounting Oversight Board's amendments to AU Section 411, "The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles." Management expects the adoption of this standard will have no impact on TNC's financial statements. TNC will adopt SFAS 162 when it becomes effective.

EITF Issue No. 06-10 "Accounting for Collateral Assignment Split-Dollar Life Insurance Arrangements" (EITF 06-10)

In March 2007, the FASB ratified EITF 06-10, a consensus on collateral assignment split-dollar life insurance arrangements in which an employee owns and controls the insurance policy. Under EITF 06-10, an employer should recognize a liability for the postretirement benefit related to a collateral assignment split-dollar life insurance arrangement in accordance with SFAS 106 "Employers' Accounting for Postretirement Benefits Other Than Pension" or Accounting Principles Board Opinion No. 12 "Omnibus Opinion – 1967" if the employer has agreed to maintain a life insurance policy during the employee's retirement or to provide the employee with a death benefit based on a substantive arrangement with the employee. In addition, an employer should recognize and measure an asset based on the nature and substance of the collateral assignment split-dollar life insurance arrangement. EITF 06-10 requires recognition of the effects of its application as either (a) a change in accounting principle through a cumulative effect adjustment to retained earnings or other components of equity or net assets in the statement of financial position at the beginning of the year of adoption or (b) a change in accounting principle through retrospective application to all prior periods. TNC adopted EITF 06-10 effective January 1, 2008 with a cumulative effect reduction of $438 thousand ($285 thousand, net of tax) to beginning retained earnings.

EITF Issue No. 06-11 "Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards" (EITF 06-11)

In June 2007, the FASB ratified the EITF consensus on the treatment of income tax benefits of dividends on employee share-based compensation. The issue is how a company should recognize the income tax benefit received on dividends that are paid to employees holding equity-classified nonvested shares, equity-classified nonvested share units or equity-classified outstanding share options and charged to retained earnings under SFAS 123R, "Share-Based Payments." Under EITF 06-11, a realized income tax benefit from dividends or dividend equivalents that are charged to retained earnings and are paid to employees for equity-classified nonvested equity shares, nonvested equity share units and outstanding equity share options should be recognized as an increase to additional paid-in capital. EITF 06-11 is applied prospectively to the income tax benefits of dividends on equity-classified employee share-based payment awards that are declared in fiscal years after December 15, 2007.

TNC adopted EITF 06-11 effective January 1, 2008. The adoption of this standard had an immaterial impact on the financial statements.

EITF Issue No. 08-5 "Issuer's Accounting for Liabilities Measured at Fair Value with a Third-Party Credit Enhancement" (EITF 08-5)

In September 2008, the FASB ratified the EITF consensus on liabilities with third-party credit enhancements when the liability is measured and disclosed at fair value. The consensus treats the liability and the credit enhancement as two units of accounting. Under the consensus, the fair value measurement of the liability does not include the effect of the third-party credit enhancement. Consequently, changes in the issuer's credit standing without the support of the credit enhancement affect the fair value measurement of the issuer's liability. Entities will need to provide disclosures about the existence of any third-party credit enhancements related to their liabilities.

EITF 08-5 is effective for the first reporting period beginning after December 15, 2008. It will be applied prospectively upon adoption with the effect of initial application included as a change in fair value of the liability in the period of adoption. In the period of adoption, entities must disclose the valuation method(s) used to measure the fair value of liabilities within its scope and any change in the fair value measurement method that occurs as a result of its initial application. Early adoption is permitted. Although management has not completed an analysis, management expects that the adoption of this standard will have an immaterial impact on the financial statements. TNC will adopt this standard effective January 1, 2009.

FSP SFAS 133-1 and FIN 45-4 "Disclosures about Credit Derivatives and Certain Guarantees: An Amendment of FASB Statement No. 133 and FASB Interpretation No. 45; and Clarification of the Effective Date of FASB Statement No. 161" (SFAS 133-1 and FIN 45-4)

In September 2008, the FASB issued SFAS 133-1 and FIN 45-4 as amendments to original statements SFAS 133 and FIN 45 "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." Under the SFAS 133 requirements, the seller of a credit derivative shall disclose the following information for each derivative, including credit derivatives embedded in a hybrid instrument, even if the likelihood of payment is remote:

(a) The nature of the credit derivative.
(b) The maximum potential amount of future payments.
(c) The fair value of the credit derivative.
(d) The nature of any recourse provisions and any assets held as collateral or by third parties.

Further, the standard requires the disclosure of current payment status/performance risk of all FIN 45 guarantees. In the event an entity uses internal groupings, the entity shall disclose how those groupings are determined and used for managing risk.

The standard is effective for interim and annual reporting periods ending after November 15, 2008. Upon adoption, the guidance will be prospectively applied. Management expects that the adoption of this standard will have an immaterial impact on the financial statements but increase the FIN 45 guarantees disclosure requirements. TNC will adopt the standard effective December 31, 2008.

FSP SFAS 142-3 "Determination of the Useful Life of Intangible Assets" (SFAS 142-3)

In April 2008, the FASB issued SFAS 142-3 amending factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS 142, "Goodwill and Other Intangible Assets." The standard is expected to improve consistency between the useful life of a recognized intangible asset and the period of expected cash flows used to measure its fair value.

SFAS 142-3 is effective for interim and annual periods in fiscal years beginning after December 15, 2008. Early adoption is prohibited. Upon adoption, the guidance within SFAS 142-3 will be prospectively applied to intangible assets acquired after the effective date. Management expects that the adoption of this standard will have an immaterial impact on the financial statements. TNC will adopt SFAS 142-3 effective January 1, 2009.

FSP FIN 39-1 "Amendment of FASB Interpretation No. 39" (FIN 39-1)

In April 2007, the FASB issued FIN 39-1. It amends FASB Interpretation No. 39, "Offsetting of Amounts Related to Certain Contracts" by replacing the interpretation's definition of contracts with the definition of derivative instruments per SFAS 133. It also requires entities that offset fair values of derivatives with the same party under a netting agreement to also net the fair values (or approximate fair values) of related cash collateral. The entities must disclose whether or not they offset fair values of derivatives and related cash collateral and amounts recognized for cash collateral payables and receivables at the end of each reporting period.

TNC adopted FIN 39-1 effective January 1, 2008. This standard changed the method of netting certain balance sheet amounts. It requires retrospective application as a change in accounting principle for all periods presented. It had no impact on TNC.

Future Accounting Changes

The FASB's standard-setting process is ongoing and until new standards have been finalized and issued by the FASB, management cannot determine the impact on the reporting of operations and financial position that may result from any such future changes. The FASB is currently working on several projects including revenue recognition, contingencies, liabilities and equity, emission allowances, leases, hedge accounting, consolidation policy, trading inventory and related tax impacts. Management also expects to see more FASB projects as a result of its desire to converge International Accounting Standards with GAAP. The ultimate pronouncements resulting from these and future projects could have an impact on future net income and financial position.

3. RATE MATTERS

As discussed in TNC's 2007 Annual Report, TNC is involved in rate and regulatory proceedings at the FERC and the PUCT. The Rate Matters note within the 2007 Annual Report should be read in conjunction with this report to gain a complete understanding of material rate matters still pending that could impact net income, cash flows and possibly financial condition. The following discusses ratemaking developments in 2008 and updates the 2007 Annual Report.

Texas Interim Transmission Rates

In March 2008, TNC filed an application with the PUCT for an interim update of wholesale-transmission rates. The PUCT issued an order in May 2008 that provided for increased interim transmission rates for TNC, subject to review during the next TNC base rate case. This review could result in a refund if the PUCT finds that TNC has not prudently incurred the transmission investment. The FERC approved the new interim transmission rates in May 2008 which increased annual transmission revenues by $4 million. TNC has not recorded any provision for refund regarding the interim transmission rates because management believes these new rates are reasonable and necessary to recover costs associated with new transmission plant. Management cannot predict the outcome of future proceedings related to the interim transmission rates. A refund of the interim transmission rates would have an adverse impact on net income and cash flows.

FERC Rate Matters

Allocation of Off-system Sales Margins

In 2004, intervenors and the OCC staff argued that AEP had inappropriately under-allocated off-system sales credits to PSO by $37 million for the period June 2000 to December 2004 under a FERC-approved allocation agreement. An ALJ assigned to hear intervenor claims found that the OCC lacked authority to examine whether AEP deviated from the FERC-approved allocation methodology for off-system sales margins and held that any such complaints should be addressed at the FERC. In October 2007, the OCC adopted the ALJ's recommendation and orally directed the OCC staff to explore filing a complaint at the FERC alleging the allocation of off-system sales margins to PSO is not in compliance with the FERC-approved methodology which could result in an adverse effect on future net income and cash flows for AEP Consolidated, the AEP East companies and the AEP West companies. In June 2008, the ALJ issued a final recommendation and incorporated the prior finding that the OCC lacked authority to review AEP's application of a FERC-approved methodology. In June 2008, the Oklahoma Industrial Energy Consumers appealed the ALJ recommendation to the OCC. In August 2008, the OCC heard the appeal and a decision is pending. In August 2008, the OCC filed a complaint at the FERC alleging that AEPSC inappropriately allocated off-system trading margins between the AEP East companies and the AEP West companies and did not properly allocate off-system trading margins within the AEP West companies. The PUCT, the APSC and the Oklahoma Industrial Energy Consumers have all intervened in this filing.

TCC, TNC and the PUCT have been involved in litigation in the federal courts concerning whether the PUCT has the right to order a reallocation of off-system sales margins thereby reducing recoverable fuel costs in the final fuel reconciliation in Texas under the restructuring legislation. In 2005, TNC recorded a provision for refund after the PUCT ordered such reallocation. After receipt of favorable federal court decisions and the refusal of the U.S. Supreme Court to hear a PUCT appeal, TNC reversed its provision of $9 million in the third quarter of 2007.

Management cannot predict the outcome of these proceedings. However, management believes its allocations were in accordance with the then-existing FERC-approved allocation agreements and additional off-system sales margins should not be retroactively reallocated. The results of these proceedings could have an adverse effect on future net income and cash flows for AEP Consolidated, the AEP East companies and the AEP West companies.

4. COMMITMENTS, GUARANTEES AND CONTINGENCIES

TNC is subject to certain claims and legal actions arising in its ordinary course of business. In addition, business activities are subject to extensive governmental regulation related to public health and the environment. The ultimate outcome of such pending or potential litigation cannot be predicted. For current proceedings not specifically discussed below, management does not anticipate that the liabilities, if any, arising from such proceedings would have a material adverse effect on the financial statements. The Commitments, Guarantees and Contingencies note within the 2007 Annual Report should be read in conjunction with this report.

GUARANTEES

There are certain immaterial liabilities recorded for guarantees in accordance with FIN 45 "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." There is no collateral held in relation to any guarantees. In the event any guarantee is drawn, there is no recourse to third parties.

Indemnifications and Other Guarantees

Contracts

TNC 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. Prior to September 30, 2008, TNC entered into sale agreements including indemnifications with a maximum exposure of $3 million related to the sale price of certain generation assets in Texas. There are no material liabilities recorded for any indemnifications.

Master Operating Lease

TNC leases certain equipment under a master operating lease. Under the lease agreement, the lessor is guaranteed to receive up to 87% of the unamortized balance of the equipment at the end of the lease term. If the fair market value of the leased equipment is below the unamortized balance at the end of the lease term, TNC has committed to pay the difference between the fair market value and the unamortized balance, with the total guarantee not to exceed 87% of the unamortized balance. Historically, at the end of the lease term the fair market value has been in excess of the unamortized balance. Assuming the fair market value of the equipment is zero at the end of the lease term, the maximum potential loss for these lease agreements was approximately $3 million as of September 30, 2008.

CONTINGENCIES

Carbon Dioxide (CO_2) Public Nuisance Claims

In 2004, eight states and the City of New York filed an action in federal district court for the Southern District of New York against AEP, AEPSC, Cinergy Corp, Xcel Energy, Southern Company and Tennessee Valley Authority. The Natural Resources Defense Council, on behalf of three special interest groups, filed a similar complaint against the same defendants. The actions allege that CO_2 emissions from the defendants' power plants constitute a public nuisance under federal common law due to impacts of global warming, and sought injunctive relief in the form of specific emission reduction commitments from the defendants. The dismissal of this lawsuit was appealed to the Second Circuit Court of Appeals. Briefing and oral argument have concluded. In April 2007, the U.S. Supreme Court issued a decision holding that the Federal EPA has authority to regulate emissions of CO_2 and other greenhouse gases under the CAA, which may impact the Second Circuit's analysis of these issues. The Second Circuit requested supplemental briefs addressing the impact of the U.S. Supreme Court's decision on this case. Management believes the actions are without merit and intends to defend against the claims.

Alaskan Villages' Claims

In February 2008, the Native Village of Kivalina and the City of Kivalina, Alaska filed a lawsuit in federal court in the Northern District of California against AEP, AEPSC and 22 other unrelated defendants including oil & gas companies, a coal company, and other electric generating companies. The complaint alleges that the defendants' emissions of CO_2 contribute to global warming and constitute a public and private nuisance and that the defendants are acting together. The complaint further alleges that some of the defendants, including AEP, conspired to create a false scientific debate about global warming in order to deceive the public and perpetuate the alleged nuisance. The plaintiffs also allege that the effects of global warming will require the relocation of the village at an alleged cost of $95 million to $400 million. The defendants filed motions to dismiss the action. The motions are pending before the court. Management believes the action is without merit and intends to defend against the claims.

FERC Long-term Contracts

In 2002, the FERC held a hearing related to a complaint filed by Nevada Power Company and Sierra Pacific Power Company (the Nevada utilities). The complaint sought to break long-term contracts entered during the 2000 and 2001 California energy price spike which the customers alleged were "high-priced." The complaint alleged that TNC and other AEP subsidiaries sold power at unjust and unreasonable prices because the market for power was allegedly dysfunctional at the time such contracts were executed. In 2003, the FERC rejected the complaint. In 2006, the U.S. Court of Appeals for the Ninth Circuit reversed the FERC order and remanded the case to the FERC for further proceedings. That decision was appealed to the U.S. Supreme Court. In June 2008, the U.S. Supreme Court affirmed the validity of contractually-agreed rates except in cases of serious harm to the public. The U.S. Supreme Court affirmed the Ninth Circuit's remand on two issues, market manipulation and excessive burden on consumers. Management is unable to predict the outcome of these proceedings or their impact on future net income and cash flows. Management asserted claims against certain companies that sold power to TNC and other AEP subsidiaries, which was resold to the Nevada utilities, seeking to recover a portion of any amounts that may be owed to the Nevada utilities.

5. DISPOSITION

Texas Plants

In February 2008, TNC sold the mothballed Fort Phantom, Lake Pauline, Rio Pecos and San Angelo Plants for approximately $2.5 million to a nonaffiliated entity. In 2002, the book values of the plants and the land were impaired to $434 thousand. As part of the sale, the buyer assumed all environmental liabilities existing prior to and after the sale. As a result, the related ARO balances were reversed. Additionally, TNC recorded sales and related expenses and the impact of a settlement agreement with the City of San Angelo related to a purchase power contract between the City of San Angelo and TNC.

TNC also conveyed the Oak Creek Plant and related land at no cost to the City of Sweetwater. The plant and land assets were impaired to $89 thousand in 2002.

As a result of these dispositions, TNC recognized an immaterial loss in the first quarter of 2008.

6. BENEFIT PLANS

TNC participates in AEP sponsored qualified pension plans and nonqualified pension plans. A substantial majority of employees are covered by either one qualified plan or both a qualified and a nonqualified pension plan. In addition, TNC participates in other postretirement benefit plans sponsored by AEP to provide medical and death benefits for retired employees.

Components of Net Periodic Benefit Cost

The following tables provide the components of AEP's net periodic benefit cost for the plans for the three and nine months ended September 30, 2008 and 2007:

	Pension Plans		Other Postretirement Benefit Plans	
	Three Months Ended September 30,		Three Months Ended September 30,	
	2008	2007	2008	2007
	(in millions)			
Service Cost	$ 25	$ 24	$ 10	$ 11
Interest Cost	62	59	28	26
Expected Return on Plan Assets	(84)	(85)	(27)	(26)
Amortization of Transition Obligation	-	-	7	6
Amortization of Net Actuarial Loss	10	15	3	3
Net Periodic Benefit Cost	$ 13	$ 13	$ 21	$ 20

	Pension Plans		Other Postretirement Benefit Plans	
	Nine Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
	(in millions)			
Service Cost	$ 75	$ 72	$ 31	$ 32
Interest Cost	187	176	84	78
Expected Return on Plan Assets	(252)	(254)	(83)	(78)
Amortization of Transition Obligation	-	-	21	20
Amortization of Net Actuarial Loss	29	44	8	9
Net Periodic Benefit Cost	$ 39	$ 38	$ 61	$ 61

The following table provides TNC's net periodic benefit cost for the plans for the three and nine months ended September 30, 2008 and 2007:

	Pension Plans		Other Postretirement Benefit Plans	
	2008	2007	2008	2007
	(in thousands)			
Three Months Ended September 30,	$ 90	$ 70	$ 616	$ 631
Nine Months Ended September 30,	270	210	1,820	1,892

AEP has significant investments in several trust funds to provide for future pension and OPEB payments. All of the trust funds' investments are well-diversified and managed in compliance with all laws and regulations. The value of the investments in these trusts has declined due to the decreases in the equity and fixed income markets. Although the asset values are currently lower, this decline has not affected the funds' ability to make their required payments.

7. BUSINESS SEGMENTS

TNC has one reportable segment, a generation, transmission and distribution business. TNC's other activities are insignificant.

8. INCOME TAXES

TNC adopted FIN 48 as of January 1, 2007. As a result, TNC recognized an increase in the liabilities for unrecognized tax benefits, as well as related interest expense and penalties, which was accounted for as a reduction to the January 1, 2007 balance of retained earnings.

TNC joins in the filing of a consolidated federal income tax return with its affiliates in the AEP System. The allocation of the AEP System's current consolidated federal income tax to the AEP System companies allocates the benefit of current tax losses to the AEP System companies giving rise to such losses in determining their current tax expense. The tax benefit of the Parent is allocated to its subsidiaries with taxable income. With the exception of the loss of the Parent, the method of allocation reflects a separate return result for each company in the consolidated group.

TNC and other AEP subsidiaries are no longer subject to U.S. federal examination for years before 2000. However, TNC and other AEP subsidiaries have filed refund claims with the IRS for years 1997 through 2000 for the CSW pre-merger tax period, which are currently being reviewed. TNC and other AEP subsidiaries have completed the exam for the years 2001 through 2003 and have issues that are being pursued at the appeals level. The returns for the years 2004 through 2006 are presently under audit by the IRS. Although the outcome of tax audits is uncertain, in management's opinion, adequate provisions for income taxes have been made for potential liabilities resulting from such matters. In addition, TNC 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 have a material adverse effect on net income.

TNC, along with other AEP subsidiaries, files income tax returns in various state and local jurisdictions. These taxing authorities routinely examine the tax returns and TNC and other AEP subsidiaries are currently under examination in several state and local jurisdictions. Management believes that TNC and other AEP subsidiaries have filed tax returns with positions that may be challenged by these tax authorities. However, management does not believe that the ultimate resolution of these audits will materially impact net income. With few exceptions, TNC is no longer subject to state or local income tax examinations by tax authorities for years before 2000.

Federal Tax Legislation

In October 2008, the Emergency Economic Stabilization Act of 2008 (the Act) was signed into law. The Act extended several expiring tax provisions and added new energy incentive provisions. The legislation impacted the availability of research credits, accelerated depreciation of smart meters, production tax credits and energy efficient commercial building deductions. Management has evaluated the impact of the law change and the application of the law change will not materially impact net income, cash flows or financial condition.

9. FINANCING ACTIVITIES

Long-term Debt

Long-term debt and other securities issued during the first nine months of 2008 were:

	Type of Debt	Principal Amount	Interest Rate	Due Date
		(in thousands)		
Issuances:	Senior Unsecured Notes	$ 30,000	5.89%	2018
	Senior Unsecured Notes	70,000	6.76%	2038

Lines of Credit

The AEP System uses a corporate borrowing program to meet the short-term borrowing needs of its subsidiaries. The corporate borrowing program includes a Utility Money Pool, which funds the utility subsidiaries, and a Nonutility Money Pool, which funds the majority of the nonutility subsidiaries. The AEP System corporate borrowing program operates in accordance with the terms and conditions approved in a regulatory order. The amount of outstanding loans to/borrowings from the Utility Money Pool and the Nonutility Money Pool are shown as either a net loan or a net borrowing position as of September 30, 2008 and December 31, 2007 and are included in either Advances to Affiliates or Advances from Affiliates on TNC's balance sheets. TNC's Utility Money Pool activity and corresponding authorized borrowing limit for the nine months ended September 30, 2008 are described on the following table:

Maximum Borrowings from Utility Money Pool	Maximum Loans to Utility Money Pool	Average Borrowings From Utility Money Pool	Average Loans to Utility Money Pool	Borrowings from Utility Money Pool as of September 30, 2008	Authorized Short-Term Borrowing Limit
		(in thousands)			
$ 88,094	$ 18,701	$ 45,181	$ 8,885	$ 18,333	$ 250,000

The activity in the above table does not include short-term lending activity of TNC's wholly-owned subsidiary, AEP Texas North Generation Company LLC (TNGC), who is a participant in the Nonutility Money Pool. For the nine months ended September 30, 2008, TNGC had the following activity in the Nonutility Money Pool:

Maximum Borrowings from Nonutility Money Pool	Maximum Loans to Nonutility Money Pool	Average Borrowings from Nonutility Money Pool	Average Loans to Nonutility Money Pool	Loans to Nonutility Money Pool as of September 30, 2008
		(in thousands)		
$ -	$ 18,656	$ -	$ 17,727	$ 18,157

Maximum, minimum and average interest rates for funds either borrowed from or loaned to the Utility Money Pool for the nine months ended September 30, 2008 and 2007 are summarized in the following table:

	Maximum Interest Rates for Funds Borrowed from the Utility Money Pool	Minimum Interest Rates for Funds Borrowed from the Utility Money Pool	Maximum Interest Rates for Funds Loaned to the Utility Money Pool	Minimum Interest Rates 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
2008	5.37%	2.91%	3.41%	2.91%	4.06%	3.08%
2007	5.94%	5.30%	5.35%	5.34%	5.47%	5.35%

Maximum, minimum and average interest rates for funds either borrowed from or loaned to the Nonutility Money Pool for the nine months ended September 30, 2008 and 2007 are summarized in the following table:

	Maximum Interest Rates for Funds Borrowed from the Nonutility Money Pool	Minimum Interest Rates for Funds Borrowed from the Nonutility Money Pool	Maximum Interest Rates for Funds Loaned to the Nonutility Money Pool	Minimum Interest Rates For Funds Loaned to the Nonutility Money Pool	Average Interest Rate for Funds Borrowed from the Nonutility Money Pool	Average Interest Rate for Funds Loaned to the Nonutility Money Pool
2008	-%	-%	5.37%	2.87%	-%	3.38%
2007	-%	-%	5.94%	5.17%	-%	5.44%

Credit Facilities

In April 2008, TNC and certain other companies in the AEP System entered into a $650 million 3-year credit agreement and a $350 million 364-day credit agreement which were reduced by Lehman Brothers Holdings Inc.'s commitment amount of $23 million and $12 million, respectively, following its bankruptcy. Under the facilities, letters of credit may be issued. As of September 30, 2008, there were no outstanding amounts for TNC under either facility.