AEP Generating Company

2008 Annual Report

Financial Statements

AEP AMERICAN® ELECTRIC POWER

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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 or Parent	American Electric Power Company, Inc.
AEPSC	American Electric Power Service Corporation, a service subsidiary providing management and professional services to AEP and its subsidiaries.
AEP System or the System	American Electric Power System, an integrated electric utility system, owned and operated by AEP's electric utility subsidiaries.
AFUDC	Allowance for Funds Used During Construction.
APCo	Appalachian Power Company, an AEP electric utility subsidiary.
ARO	Asset Retirement Obligations.
CAA	Clean Air Act.
CO_2	Carbon Dioxide.
CSPCo	Columbus Southern Power Company, an AEP electric utility subsidiary.
CWIP	Construction Work in Progress.
EIS	Energy Insurance Services, Inc., a protected cell insurance company that AEP consolidates due to FIN 46.
EITF	Financial Accounting Standards Board's Emerging Issues Task Force.
FASB	Financial Accounting Standards Board.
Federal EPA	United States Environmental Protection Agency.
FERC	Federal Energy Regulatory Commission.
FIN	FASB Interpretation No.
FIN 46R	FIN 46R, "Consolidation of Variable Interest Entities."
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.
IURC	Indiana Utility Regulatory Commission.
I&M	Indiana Michigan Power Company, an AEP electric utility subsidiary.
KPCo	Kentucky Power Company, an AEP electric utility subsidiary.
MW	Megawatt.
Rockport Plant	A generating plant, consisting of two 1,300 MW coal-fired generating units near Rockport, Indiana, owned by AEGCo and I&M.
SFAS	Statement of Financial Accounting Standards issued by the Financial Accounting Standards Board.
SFAS 71	Statement of Financial Accounting Standards No. 71, "Accounting for the Effects of Certain Types of Regulation."
SFAS 109	Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes."
SFAS 133	Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities."
SFAS 141R	Statement of Financial Accounting Standards No. 141 (revised 2007), "Business Combinations."
UPA	Unit Power Agreement.
Utility Money Pool	AEP System's Utility Money Pool.

INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Shareholder of
AEP Generating Company:

We have audited the accompanying balance sheets of AEP Generating Company (the "Company") as of December 31, 2008 and 2007, and the related statements of income, retained earnings, and cash flows for each of the three years in the period ended December 31, 2008. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards as established by the Auditing Standards Board (United States) and in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of AEP Generating Company as of December 31, 2008 and 2007, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2008, in conformity with accounting principles generally accepted in the United States of America.

/s/ Deloitte & Touche LLP

Columbus, Ohio
February 27, 2009

AEP GENERATING COMPANY
STATEMENTS OF INCOME
For the Years Ended December 31, 2008, 2007 and 2006
(in thousands)

	2008	2007	2006
OPERATING REVENUES	$ 468,275	$ 380,539	$ 309,814
EXPENSES			
Fuel Used for Electric Generation	273,935	205,269	178,654
Rent – Rockport Plant Unit 2	68,283	68,283	68,283
Other Operation	24,838	18,739	12,808
Maintenance	14,681	23,695	9,776
Depreciation and Amortization	33,511	28,954	23,911
Taxes Other Than Income Taxes	3,904	4,484	3,464
TOTAL	419,152	349,424	296,896
OPERATING INCOME	49,123	31,115	12,918
Other Income (Expense):			
Interest Income	141	37	-
Allowance for Equity Funds Used During Construction	6,198	1,015	24
Interest Expense	(16,203)	(11,144)	(2,947)
INCOME BEFORE INCOME TAX EXPENSE (CREDIT)	39,259	21,023	9,995
Income Tax Expense (Credit)	7,692	2,970	(919)
NET INCOME	$ 31,567	$ 18,053	$ 10,914

STATEMENTS OF RETAINED EARNINGS
For the Years Ended December 31, 2008, 2007 and 2006
(in thousands)

	2008	2007	2006
BALANCE AT BEGINNING OF PERIOD	$ 34,722	$ 30,942	$ 26,038
FIN 48 Adoption, Net of Tax	-	27	-
Net Income	31,567	18,053	10,914
Cash Dividends Declared	(12,000)	(14,300)	(6,010)
BALANCE AT END OF PERIOD	$ 54,289	$ 34,722	$ 30,942

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

See Notes to Financial Statements.

AEP GENERATING COMPANY
BALANCE SHEETS
ASSETS
December 31, 2008 and 2007
(in thousands)

	2008	2007
CURRENT ASSETS		
Accounts Receivable – Affiliated Companies	$ 37,721	$ 35,611
Fuel	33,468	40,255
Materials and Supplies	14,512	17,592
Accrued Tax Benefits	-	1,026
Prepayments and Other	874	1,005
TOTAL	86,575	95,489
PROPERTY, PLANT AND EQUIPMENT		
Electric – Production	1,418,716	1,409,822
Other	6,383	5,231
Construction Work in Progress	216,500	111,105
Total	1,641,599	1,526,158
Accumulated Depreciation and Amortization	819,280	800,996
TOTAL – NET	822,319	725,162
OTHER NONCURRENT ASSETS		
Regulatory Assets	6,651	5,300
Deferred Charges and Other	3,065	2,112
TOTAL	9,716	7,412
TOTAL ASSETS	$ 918,610	$ 828,063

See Notes to Financial Statements.

AEP GENERATING COMPANY
BALANCE SHEETS
LIABILITIES AND SHAREHOLDER'S EQUITY
December 31, 2008 and 2007

	2008	2007
	(in thousands)	
CURRENT LIABILITIES		
Advances from Affiliates	$ 46,800	$ 93,391
Accounts Payable:		
General	12,692	9,295
Affiliated Companies	30,771	28,466
Long-term Debt Due Within One Year – Nonaffiliated	7,273	7,273
Accrued Taxes	3,614	4,419
Accrued Rent – Rockport Plant Unit 2	4,963	4,963
Other	6,594	5,167
TOTAL	112,707	152,974
NONCURRENT LIABILITIES		
Long-term Debt – Nonaffiliated	333,491	255,755
Deferred Income Taxes	29,420	24,736
Regulatory Liabilities and Deferred Investment Tax Credits	58,598	68,836
Deferred Gain on Sale and Leaseback – Rockport Plant Unit 2	77,621	83,191
Deferred Credits and Other	18,300	16,415
TOTAL	517,430	448,933
TOTAL LIABILITIES	630,137	601,907
Commitments and Contingencies (Note 4)		
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	233,184	190,434
Retained Earnings	54,289	34,722
TOTAL	288,473	226,156
TOTAL LIABILITIES AND SHAREHOLDER'S EQUITY	$ 918,610	$ 828,063

See Notes to Financial Statements.

AEP GENERATING COMPANY
STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2008, 2007 and 2006
(in thousands)

	2008	2007	2006
OPERATING ACTIVITIES			
Net Income	$ 31,567	$ 18,053	$ 10,914
Adjustments to Reconcile Net Income to Net Cash Flows from (Used for) Operating Activities:			
Depreciation and Amortization	33,511	28,954	23,911
Deferred Income Taxes	(2,277)	(543)	(6,730)
Deferred Investment Tax Credits	(3,272)	(3,346)	(3,433)
Amortization of Deferred Gain on Sale and Leaseback – Rockport Plant Unit 2	(5,570)	(5,571)	(5,571)
Allowance for Equity Funds Used During Construction	(6,198)	(1,015)	(24)
Change in Other Noncurrent Assets	1,062	1,726	(3,271)
Change in Other Noncurrent Liabilities	119	1,728	3,169
Changes in Certain Components of Working Capital:			
Accounts Receivable	(1,653)	(4,551)	(1,389)
Fuel, Materials and Supplies	9,867	(3,174)	(23,660)
Accounts Payable	(3,026)	4,681	5,397
Accrued Taxes, Net	221	3,071	(1,104)
Other Current Assets	34	(187)	(48)
Other Current Liabilities	1,387	4,097	(28)
Net Cash Flows from (Used for) Operating Activities	55,772	43,923	(1,867)
INVESTING ACTIVITIES			
Construction Expenditures	(116,774)	(42,689)	(10,403)
Acquisition of Lawrenceburg Generating Station	-	(324,782)	-
Acquisition of Dresden Plant	-	(85,327)	-
Other	-	(459)	75
Net Cash Flows Used for Investing Activities	(116,774)	(453,257)	(10,328)
FINANCING ACTIVITIES			
Capital Contribution from Parent	42,750	167,000	-
Issuance of Long-term Debt – Nonaffiliated	84,464	219,034	-
Change in Advances from Affiliates, Net	(46,591)	39,745	18,515
Retirement of Long-term Debt – Nonaffiliated	(7,273)	(1,818)	-
Principal Payments for Capital Lease Obligations	(348)	(327)	(310)
Dividends Paid on Common Stock	(12,000)	(14,300)	(6,010)
Net Cash Flows from Financing Activities	61,002	409,334	12,195
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	$ 15,512	$ 6,778	$ 2,597
Net Cash Paid for Income Taxes	12,521	2,799	10,149
Noncash Acquisitions Under Capital Leases	13	31	84
Construction Expenditures Included in Accounts Payable at December 31,	10,997	2,269	-
Noncash Assumption of Liabilities Related to Acquisition of Lawrenceburg and Dresden Plants	-	5,301	-

See Notes to Financial Statements.

NOTES TO FINANCIAL STATEMENTS

1. Organization and Summary of Significant Accounting Policies
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1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

ORGANIZATION

AEGCo engages in the generation and wholesale sale of electric power to its affiliates, CSPCo, I&M and KPCo. AEGCo and I&M co-own Unit 1 of the Rockport Plant. Unit 2 of the Rockport Plant is owned by a third party and leased to I&M and AEGCo. I&M operates the Rockport Plant. AEGCo derives operating revenues from the sale of Rockport Plant energy and capacity to I&M and KPCo pursuant to FERC-approved long-term unit power agreements through December 2022. Under the terms of its unit power agreement, I&M agreed to purchase all of AEGCo's Rockport energy and capacity unless it is sold to other utilities or affiliates. I&M assigned 30% of its rights to energy and capacity to KPCo.

In May 2007, AEGCo completed the purchase of the Lawrenceburg Generating Station (Lawrenceburg), a combined-cycle, natural-gas power plant. CSPCo and AEGCo entered into a 10-year UPA for the entire output from the plant effective with AEGCo's purchase of the Lawrenceburg. The UPA has an option for an additional 2-year period. I&M operates the plant under an agreement with AEGCo. Under the UPA, CSPCo pays AEGCo for the capacity, depreciation, fuel, operation and maintenance and tax expenses. These payments are due regardless of whether the plant is operating. The fuel and operation and maintenance payments are based on actual costs incurred. All expenses are trued up periodically.

The unit power agreements provide for a FERC-approved rate of return on common equity, a return on other capital (net of temporary cash investments) and recovery of costs including operation and maintenance, fuel and taxes. Under the terms of the unit power agreements, AEGCo accumulates all expenses monthly and prepares bills for its affiliates. In the month the expenses are incurred, AEGCo recognizes the billing revenues and establishes a receivable from the affiliated companies. The costs of operating the plants are billed to the respective parties of the agreements.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Rates and Service Regulation

The FERC regulates AEGCo, including AEPSC intercompany service billings which are generally at cost, under the 2005 Public Utility Holding Company Act and the Federal Power Act. The FERC also has jurisdiction over the issuances and acquisitions of securities of the public utility holding company subsidiaries, such as AEGCo, the acquisition or sale of certain utility assets and mergers with another electric utility or holding company. A FERC order in 2008 pursuant to the Federal Power Act codified that for non-power goods and services, a non-regulated affiliate can bill a public utility company no more than market while a public utility must bill the higher of cost or market to a non-regulated affiliate.

The FERC regulates wholesale power markets and wholesale power transactions. AEGCo's wholesale power transactions are generally cost-based regulated under FERC approved unit power agreements.

Both the FERC and state regulatory commissions are permitted to review and audit the books and records of any company within a public utility holding company system.

Accounting for the Effects of Cost-Based Regulation

As a cost-based rate-regulated electric public utility company, AEGCo's financial statements reflect the actions of regulators that result in the recognition of certain revenues and expenses in different time periods than enterprises that are not rate-regulated. In accordance with SFAS 71, regulatory assets (deferred expenses) and regulatory liabilities (future revenue reductions or refunds) are recorded to reflect the economic effects of regulation by matching expenses with their recovery through regulated revenues and income with its passage to customers through the reduction of regulated revenues.

Use of Estimates

The preparation of these financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. These estimates include, but are not limited to, inventory valuation, long-lived asset impairment, the effects of regulation, long-lived asset recovery and the effects of contingencies. The estimates and assumptions used are based upon management's evaluation of the relevant facts and circumstances as of the date of the financial statements. Actual results could ultimately differ from those estimates.

Property, Plant and Equipment

Electric utility property, plant and equipment are stated at original purchase cost. Additions, major replacements and betterments are added to the plant accounts. Normal and routine retirements from the plant accounts, net of salvage, are charged to accumulated depreciation for cost-based rate-regulated operations under the group composite method of depreciation. The group composite method of depreciation assumes that on average, asset components are retired at the end of their useful lives and thus there is no gain or loss. The equipment in each primary electric plant account is identified as a separate group. Under the group composite method of depreciation, continuous interim routine replacements of items such as boiler tubes, pumps, motors, etc. result in the original cost, less salvage, being charged to accumulated depreciation. The depreciation rates that are established for the generating plants take into account the past history of interim capital replacements and the amount of salvage received. These rates and the related lives are subject to periodic review. Removal costs are charged to regulatory liabilities. The costs of labor, materials and overhead incurred to operate and maintain the plants are included in operating expenses.

Long-lived assets are required to be tested for impairment when it is determined that the carrying value of the assets may no longer be recoverable or when the assets meet the held for sale criteria under SFAS 144, "Accounting for the Impairment or Disposal of Long-lived Assets."

The fair value of an asset and investment is the amount at which that asset could be bought or sold in a current transaction between willing parties, as opposed to a forced or liquidation sale. Quoted market prices in active markets are the best evidence of fair value and are used as the basis for the measurement, if available. In the absence of quoted prices for identical or similar assets or investments in active markets, fair value is estimated using various internal and external valuation methods including cash flow analysis and appraisals.

Allowance for Funds Used During Construction (AFUDC)

AFUDC represents the estimated cost of borrowed and equity funds used to finance construction projects that is capitalized and recovered through depreciation over the service life of regulated electric utility plant.

Valuation of Nonderivative Financial Instruments

The book values of Accounts Receivable and Accounts Payable approximate fair value because of the short-term maturity of these instruments.

Cash and Cash Equivalents

Cash and Cash Equivalents on the Statements of Cash Flows include temporary cash investments with original maturities of three months or less.

Inventory

Fossil fuel inventories and materials and supplies inventories are carried at average cost.

Revenue Recognition and Accounts Receivable

Under terms of the unit power agreement, AEGCo accumulates all expenses monthly and prepares bills for its affiliates. In the month the expenses are incurred, AEGCo recognizes the billing revenues and establishes receivables from the affiliate companies.

Maintenance

Maintenance costs are expensed as incurred.

Income Taxes and Investment Tax Credits

AEGCo uses the liability method of accounting for income taxes. Under the liability method, deferred income taxes are provided for all temporary differences between the book and tax basis of assets and liabilities which will result in a future tax consequence.

When the flow-through method of accounting for temporary differences is reflected in regulated revenues (that is, when deferred taxes are not included in the cost of service for determining regulated rates for electricity), deferred income taxes are recorded and related regulatory assets and liabilities are established to match the regulated revenues and tax expense.

Investment tax credits are accounted for under the flow-through method except where regulatory commissions have reflected investment tax credits in the rate-making process on a deferral basis. Investment tax credits that have been deferred are amortized over the life of the plant investment.

AEGCo accounts for uncertain tax positions in accordance with FIN 48. Effective with the adoption of FIN 48 beginning January 1, 2007, AEGCo classifies interest expense or income related to uncertain tax positions as interest expense or income as appropriate and classifies penalties as Other Operation.

Debt

Gains and losses from the reacquisition of debt used to finance AEGCo's plants are deferred and amortized over the remaining term of the reacquired debt in accordance with their rate-making treatment unless the debt is refinanced. If the reacquired debt is refinanced, the reacquisition costs are generally deferred and amortized over the term of the replacement debt consistent with its recovery in rates.

Debt discount and debt issuance expenses are deferred and amortized generally utilizing the straight-line method over the term of the related debt. The straight-line method approximates the effective interest method and is consistent with the treatment in rates for regulated operations. The net amortization expense is included in Interest Expense.

Earnings Per Share (EPS)

AEGCo is a wholly-owned subsidiary of AEP. Therefore, AEGCo is not required to report EPS.

Reclassifications

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

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 represents a summary of final pronouncements that management has determined relate to AEGCo's operations.

Pronouncements Adopted in 2008

The following standards were effective during 2008. Consequently, the financial statements and footnotes reflect their impact.

SFAS 157 "Fair Value Measurements" (SFAS 157)

AEGCo partially adopted SFAS 157 effective January 1, 2008. The statement defines fair value, establishes a fair value measurement framework and expands fair value disclosures. The adoption of this standard had no impact on the financial statements.

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" and other accounting pronouncements that address fair value measurements for purposes of lease classification or measurement under SFAS 13. SFAS 157-1 was effective upon issuance and had no impact on the financial statements.

In February 2008, the FASB issued FSP SFAS 157-2 "Effective Date of FASB Statement No. 157" 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). AEGCo fully adopted SFAS 157 effective January 1, 2009 for items within the scope of SFAS 157-2. The adoption of SFAS 157-2 had no impact on the financial statements.

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 the financial statements.

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

The FASB permitted entities to choose to measure many financial instruments and certain other items at fair value. The standard also established 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.

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

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.

AEGCo adopted SFAS 162 in the fourth quarter of 2008. The adoption of this standard had no impact on the financial statements.

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" (FSP SFAS 133-1 and FIN 45-4)

In September 2008, the FASB issued FSP SFAS 133-1 and FIN 45-4 amending 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.

AEGCo adopted the standard effective December 31, 2008. The adoption of this standard had no impact on the financial statements and footnote disclosures.

FSP SFAS 140-4 and FIN 46R-8 "Disclosures by Public Entities (Enterprises) about Transfers of Financial Assets and Interests in Variable Interest Entities" (FSP SFAS 140-4 and FIN 46R-8)

In December 2008, the FASB issued FSP SFAS 140-4 and FIN 46R-8 amending SFAS 140 "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities" and FIN 46R "Consolidation of Variable Interest Entities." Under the requirements, the transferor of financial assets in the securitization or asset-backed financing arrangement must disclose the following:

(a) Nature of any restrictions on assets reported by an entity in its balance sheet that relate to a transferred financial asset, including the carrying amounts of such assets.
(b) Method of reporting servicing assets and servicing liabilities.
(c) If reported as sales and the transferor has continuing involvement with the transferred financial assets and the transfers are accounted for as secured borrowings, how the transfer of financial assets affects the transferors' balance sheet, net income and cash flows.

The FIN 46R amendments contain disclosure requirements for a public enterprise that (a) is the primary beneficiary of a variable interest entity (VIE), (b) holds a significant variable interest in a VIE but is not the primary beneficiary or (c) is a sponsor that holds a variable interest in a VIE. The principle objectives of the disclosures required by this standard are to provide financial statement users an understanding of:

(a) Significant judgments and assumptions made to determine whether to consolidate a variable interest entity and/or disclose information about involvement with a variable interest entity.
(b) Nature of the restrictions on a consolidated variable interest entity's assets reported in the balance sheet, including the carrying amounts of such assets.
(c) Nature of, and changes in, risks associated with a company's involvement with a variable interest entity.
(d) A variable interest entity's effect on the balance sheet, net income and cash flows.
(e) The nature, purpose, size and activities of any variable interest equity, including how it is financed.

AEGCo adopted the standard effective December 31, 2008. The adoption of this standard had no impact on the financial statements but increased the footnote disclosures for variable interest entities. See "Variable Interest Entities" section of Note 11.

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

In April 2007, the FASB issued FSP FIN 39-1 amending FIN 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. The amendment 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.

AEGCo adopted FSP 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. It had no impact on AEGCo.

<u>Pronouncements Adopted During The First Quarter of 2009</u>

The following standards are effective during the first quarter of 2009. Consequently, their impact will be reflected in the first quarter of 2009 financial statements when filed. The following paragraphs discuss their expected impact on future financial statement and footnote disclosures.

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 established 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. The standard 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 can affect tax positions on previous acquisitions. AEGCo does not have any such tax positions that result in adjustments.

AEGCo adopted SFAS 141R effective January 1, 2009. It is effective prospectively for business combinations with an acquisition date on or after January 1, 2009. AEGCo will apply it to any future business combinations.

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. The statement 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.

AEGCo adopted SFAS 160 effective January 1, 2009. The adoption of this standard had no impact.

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 an entity accounts for derivative instruments and related hedged items and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows. The standard requires that objectives for using derivative instruments be disclosed in terms of underlying risk and accounting designation.

AEGCo adopted SFAS 161 effective January 1, 2009. This standard will increase the disclosure requirements related to derivative instruments and hedging activities in future reports.

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 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. 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.

AEGCo adopted EITF 08-5 effective January 1, 2009. It will be applied prospectively with the effect of initial application included as a change in fair value of the liability in the period of adoption. The adoption of this standard will impact the financial statements in the 2009 Annual Report as AEGCo reports fair value of long-term debt annually.

EITF Issue No. 08-6 "Equity Method Investment Accounting Considerations" (EITF 08-6)

In November 2008, the FASB ratified the consensus on equity method investment accounting including initial and allocated carrying values and subsequent measurements. It requires initial carrying value be determined using the SFAS 141R cost allocation method. When an investee issues shares, the equity method investor should treat the transaction as if the investor sold part of its interest.

AEGCo adopted EITF 08-6 effective January 1, 2009 with no impact on its financial statements. It was applied prospectively.

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. 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.

AEGCo adopted SFAS 142-3 effective January 1, 2009. The guidance is prospectively applied to intangible assets acquired after the effective date. The standard's disclosure requirements are applied prospectively to all intangible assets as of January 1, 2009. The adoption of this standard had no impact on the financial statements.

Future Accounting Changes

The FASB's standard-setting process is ongoing and until new standards have been finalized and issued, 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, insurance, hedge accounting 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. EFFECTS OF REGULATION

Regulatory assets and liabilities are comprised of the following items:

Regulatory Assets:	December 31, 2008	December 31, 2007	Notes
	(in thousands)		
Noncurrent Regulatory Assets			
Unamortized Loss on Reacquired Debt	$ 3,547	$ 3,784	(b) (g)
SFAS 109 Regulatory Asset, Net (See Note 8)	1,492	-	(a) (e)
Other	1,612	1,516	(a) (e)
Total Noncurrent Regulatory Assets	$ 6,651	$ 5,300	

Regulatory Liabilities:	December 31, 2008	December 31, 2007	Notes
Noncurrent Regulatory Liabilities and Deferred Investment Tax Credits			
Deferred Investment Tax Credits	$ 32,667	$ 35,938	(c) (f)
Asset Removal Costs	25,931	28,102	(d)
SFAS 109 Regulatory Liability, Net (See Note 8)	-	4,796	(a) (e)
Total Noncurrent Regulatory Liabilities and Deferred Investment Tax Credits	$ 58,598	$ 68,836	

(a) Amount does not earn a return.
(b) Amount earns a return.
(c) A portion of this amount earns a return.
(d) The liability for removal costs, which reduces rate base and the resultant return, will be discharged as removal costs are incurred.
(e) Recovery/refund period – various periods.
(f) Recovery/refund period – up to 14 years.
(g) Recovery/refund period – up to 17 years.

4. 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 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.

Insurance and Potential Losses

AEGCo maintains insurance coverage normal and customary for an electric utility, subject to various deductibles. Insurance coverage includes all risks of physical loss or damage to assets, subject to insurance policy conditions and exclusions. Covered property generally includes power plants, substations, facilities and inventories. The insurance programs also generally provide coverage against loss arising from certain claims made by third parties and are in excess of AEGCo's retentions. Coverage is generally provided by a combination of a South Carolina domiciled insurance company, EIS, together with and/or in addition to various industry mutual and commercial insurance carriers.

Some potential losses or liabilities may not be insurable or the amount of insurance carried may not be sufficient to meet potential losses and liabilities. Future losses or liabilities, if they occur, which are not completely insured, unless recovered from customers, could have a material adverse effect on net income, cash flows and financial condition.

COMMITMENTS

Construction and Commitments

AEGCo has substantial construction commitments to support its operations and environmental investments. In managing the overall construction program and in the normal course of business, AEGCo contractually commits to third-party construction vendors for certain material purchases and other construction services. Budgeted construction expenditures for 2009 are $45.2 million. Budgeted construction expenditures are subject to periodic review and modification and may vary based on the ongoing effects of regulatory constraints, environmental regulations, business opportunities, market volatility, economic trends, weather, legal reviews and the ability to access capital.

AEGCo purchases fuel, materials, supplies, services and property, plant and equipment under contract as part of its normal course of business. Certain supply contracts contain penalty provisions for early termination. Management does not expect to incur penalty payments under these provisions that would materially affect net income, cash flows or financial condition.

The following table summarizes AEGCo's actual contractual commitments at December 31, 2008:

Contractual Commitments	Less Than 1 year	2-3 years	4-5 years	After 5 years	Total
			(in millions)		
Construction Contracts for Capital Assets (a)	$ 49.4	$ 8.6	$ 13.1	$ -	$ 71.1

(a) Represents only capital assets that are contractual commitments.

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.

Indemnifications and Other Guarantees

<u>*Contracts*</u>

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. There are no material liabilities recorded for any indemnifications.

CONTINGENCIES

Carbon Dioxide 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 concluded in 2006. 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 Supreme Court's decision on this case which were provided in 2007. 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.

The Comprehensive Environmental Response Compensation and Liability Act (Superfund) and State Remediation

By-products from the generation of electricity include materials such as ash, slag and sludge. Coal combustion by-products, which constitute the overwhelming percentage of these materials, are typically treated and deposited in captive disposal facilities or are beneficially utilized. In addition, AEGCo's generating plants have used asbestos, polychlorinated biphenyls (PCBs) and other hazardous and nonhazardous materials. AEGCo currently incurs costs to safely dispose of these substances.

Superfund addresses clean-up of hazardous substances that have been released to the environment. The Federal EPA administers the clean-up programs. Several states have enacted similar laws. Superfund does not recognize compliance as a defense, but imposes strict liability on parties who fall within its broad statutory categories. Present estimates do not anticipate material cleanup costs.

5. ACQUISITIONS

2008

None

2007

Lawrenceburg Generating Station

In January 2007, AEGCo agreed to purchase Lawrenceburg Generating Station (Lawrenceburg) from an affiliate of Public Service Enterprise Group (PSEG) for $325 million and the assumption of liabilities of $3 million. AEGCo completed the purchase in May 2007. Lawrenceburg is located in Lawrenceburg, Indiana, adjacent to I&M's Tanners Creek Plant, and is a natural gas, combined cycle power plant with a generating capacity of 1,096 MW. AEGCo sells the power to CSPCo through a FERC-approved unit power agreement.

On June 15, 2007, AEGCo filed a capital funds agreement for approval with the IURC in connection with the acquisition and financing of Lawrenceburg. Under the agreement, AEP has committed to provide all such amounts of capital to enable AEGCo to perform its financial obligations. This agreement will terminate after AEGCo's obligations related to Lawrenceburg are paid in full.

Dresden Plant

In August 2007, AEGCo agreed to purchase the partially completed Dresden Plant from Dominion Resources, Inc. for $85 million and the assumption of liabilities of $2 million. AEGCo completed the purchase in September 2007. AEGCo incurred approximately $78 million and $3 million in construction costs (excluding AFUDC) at the Dresden Plant in 2008 and 2007, respectively, and expects to incur approximately $142 million in additional costs (excluding AFUDC) prior to completion in 2013. The Dresden Plant is located near Dresden, Ohio and is a natural gas, combined cycle power plant. When completed, the Dresden Plant will have a generating capacity of 580 MW.

2006

None

6. BUSINESS SEGMENTS

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

7. FINANCIAL INSTRUMENTS

The fair values of Long-term Debt are based on quoted market prices for the same or similar issues and the current interest rates offered for instruments with similar maturities. 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 significant financial instruments at December 31, 2008 and 2007 are summarized in the following table:

	December 31,			
	2008		2007	
	Book Value	Fair Value	Book Value	Fair Value
	(in thousands)			
Long-term Debt	$ 340,764	$ 297,852	$ 263,028	$ 254,657

8. INCOME TAXES

The details of income taxes as reported are as follows:

	Years Ended December 31,		
	2008	2007	2006
	(in thousands)		
Income Tax Expense (Credit):			
Current	$ 13,241	$ 6,859	$ 9,244
Deferred	(2,277)	(543)	(6,730)
Deferred Investment Tax Credits	(3,272)	(3,346)	(3,433)
Total Income Tax	$ 7,692	$ 2,970	$ (919)

Shown below is a reconciliation of the difference between the amount of federal income taxes computed by multiplying book income before income taxes by the federal statutory rate and the amount of income taxes reported.

	Years Ended December 31,		
	2008	2007	2006
	(in thousands)		
Net Income	$ 31,567	$ 18,053	$ 10,914
Income Taxes	7,692	2,970	(919)
Pretax Income	$ 39,259	$ 21,023	$ 9,995
Income Tax on Pretax Income at Statutory Rate (35%)	$ 13,741	$ 7,358	$ 3,498
Increase (Decrease) in Income Tax resulting from the following items:			
Depreciation	(677)	(255)	120
Allowance for Funds Used During Construction	(3,269)	(1,483)	(1,075)
Rockport Plant Unit 2 Investment Tax Credit	374	374	374
Investment Tax Credits, Net	(3,272)	(3,346)	(3,433)
State and Local Income Taxes	1,431	708	634
Other	(636)	(386)	(1,037)
Total Income Taxes	$ 7,692	$ 2,970	$ (919)
Effective Income Tax Rate	19.6%	14.1%	N.M.

N.M. = Not Meaningful

The following table shows the elements of the net deferred tax liability and the significant temporary differences:

	December 31, 2008	December 31, 2007
	(in thousands)	
Deferred Tax Assets	$ 52,763	$ 53,362
Deferred Tax Liabilities	(81,472)	(77,747)
Net Deferred Tax Liabilities	$ (28,709)	$ (24,385)
Property Related Temporary Differences	$ (52,906)	$ (50,984)
Amounts Due From Customers For Future Federal Income Taxes	619	2,794
Deferred State Income Taxes	(3,274)	(3,175)
Net Deferred Gain on Sale and Leaseback – Rockport Plant Unit 2	26,168	28,118
All Other, Net	684	(1,138)
Net Deferred Tax Liabilities	$ (28,709)	$ (24,385)

AEGCo 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.

AEGCo and other AEP Subsidiaries are no longer subject to U.S. federal examination for years before 2000. AEGCo 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, 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 have a material adverse effect on net income.

AEGCo, along with other AEP Subsidiaries, files income tax returns in various state and local jurisdictions. These taxing authorities routinely examine the tax returns and AEGCo and other AEP Subsidiaries are currently under examination in several state and local jurisdictions. Management believes that AEGCo 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, AEGCo is no longer subject to state or local income tax examinations by tax authorities for years before 2000.

Prior to the adoption of FIN 48, AEGCo recorded interest and penalty expense related to uncertain tax positions in tax expense accounts. With the adoption of FIN 48 on January 1, 2007, AEGCo began recognizing interest accruals related to uncertain tax positions in interest income or expense as applicable, and penalties in Other Operation. The impact of this interpretation was a favorable adjustment to the 2007 opening balance of retained earnings of $27 thousand. In 2008, AEGCo reported $134 thousand of interest income and $97 thousand of interest expense. In 2007, AEGCo reversed $335 thousand of prior period interest expense. AEGCo had approximately $201 thousand and $98 thousand for the receipt of interest accrued at December 31, 2008 and 2007, respectively.

The reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

	2008	2007
	(in thousands)	
Balance at January 1,	$ (485)	$ 110
Increase - Tax Positions Taken During a Prior Period	-	23
Decrease - Tax Positions Taken During a Prior Period	(608)	(621)
Increase - Tax Positions Taken During the Current Year	509	3
Decrease - Tax Positions Taken During the Current Year	(88)	-
Increase - Settlements with Taxing Authorities	-	-
Decrease - Lapse of the Applicable Statute of Limitations	-	-
Balance at December 31,	$ (672)	$ (485)

The total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate is $51 thousand and $(10) thousand in 2008 and 2007, respectively. Management believes there will be no significant net increase or decrease in unrecognized tax benefits within 12 months of the reporting date.

Federal Tax Legislation

Several tax bills and other legislation with tax-related sections were enacted in 2006 and 2007, including the Pension Protection Act of 2006, the Tax Relief and Health Care Act of 2006, the Tax Technical Corrections Act of 2007, the Tax Increase Prevention Act of 2007 and the Energy Independence and Security Act of 2007. The tax law changes enacted in 2006 and 2007 did not materially affect AEGCo's net income, cash flows or financial condition.

The Economic Stimulus Act of 2008 was signed into law by the President in February 2008. It provided enhanced expensing provisions for certain assets placed in service in 2008 and a 50% bonus depreciation provision similar to the one in effect in 2003 through 2004 for assets placed in service in 2008. The enacted provisions did not have a material impact on net income, cash flows or financial condition.

In October 2008, the Emergency Economic Stabilization Act of 2008 (the 2008 Act) was signed into law. The 2008 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 AEGCo's net income, cash flows or financial condition.

In February 2009, the American Recovery and Reinvestment Tax Act of 2009 (the 2009 Act) was signed into law. The 2009 Act extended the bonus depreciation deduction for one year and provides for a long-term extension of the renewable production tax credit for wind energy and other properties. The 2009 Act also establishes a new investment tax credit for the manufacture of advanced energy property as well as appropriations for advanced energy research projects, carbon capture and storage and gridSMART technology. Management has evaluated the impact of the law change and the application of the law change will not materially impact net income or financial condition, but is expected to have a positive material impact on cash flows.

State Tax Legislation

In March 2008, the Governor of West Virginia signed legislation providing for, among other things, a reduction in the West Virginia corporate income tax rate from 8.75% to 8.5% beginning in 2009. The corporate income tax rate could also be reduced to 7.75% in 2012 and 7% in 2013 contingent upon the state government achieving certain minimum levels of shortfall reserve funds. Management has evaluated the impact of the law change and the application of the law change will not materially impact AEGCo's net income, cash flows or financial condition.

9. LEASES

Leases of property, plant and equipment are for periods up to 33 years and require payments of related property taxes, maintenance and operating costs. The majority of the leases have purchase or renewal options and will be renewed or replaced by other leases.

Lease rentals for both operating and capital leases are generally charged to Other Operation and Maintenance expense in accordance with rate-making treatment for regulated operations. The components of rental costs are as follows:

	Years Ended December 31,		
	2008	2007	2006
Lease Rental Costs		(in thousands)	
Net Lease Expense on Operating Leases	$ 72,506	$ 71,985	$ 72,205
Amortization of Capital Leases	350	327	310
Interest on Capital Leases	689	687	702
Total Lease Rental Costs	$ 73,545	$ 72,999	$ 73,217

The following table shows the property, plant and equipment under capital leases and related obligations recorded on AEGCo's Balance Sheets. Capital lease obligations are included in Current Liabilities – Other and Noncurrent Liabilities – Deferred Credits and Other on AEGCo's Balance Sheets.

	December 31,	
	2008	2007
	(in thousands)	
Property, Plant and Equipment Under Capital Leases		
Production	$ 12,246	$ 12,272
Other	415	420
Total Property, Plant and Equipment Under Capital Leases	12,661	12,692
Accumulated Amortization	1,317	988
Net Property, Plant and Equipment Under Capital Leases	$ 11,344	$ 11,704
Obligations Under Capital Leases		
Noncurrent Liability	$ 10,987	$ 11,361
Liability Due Within One Year	357	343
Total Obligations Under Capital Leases	$ 11,344	$ 11,704

Future minimum lease payments consisted of the following at December 31, 2008:

Future Minimum Lease Payments	Capital Leases	Noncancelable Operating Leases
	(in thousands)	
2009	$ 999	$ 78,012
2010	978	77,846
2011	935	78,541
2012	933	75,109
2013	933	75,109
Later Years	14,202	671,827
Total Future Minimum Lease Payments	$ 18,980	$ 1,056,444
Less Estimated Interest Element	7,636	
Estimated Present Value of Future Minimum Lease Payments	$ 11,344	

Rockport Lease

AEGCo and I&M entered into a sale-and-leaseback transaction in 1989 with Wilmington Trust Company (Owner Trustee), an unrelated, unconsolidated trustee for Rockport Plant Unit 2 (the Plant). The Owner Trustee was capitalized with equity from six owner participants with no relationship to AEP or any of its subsidiaries and debt from a syndicate of banks and securities in a private placement to certain institutional investors.

The gain from the sale was deferred and is being amortized over the term of the lease, which expires in 2022. The Owner Trustee owns the Plant and leases it to AEGCo and I&M. The lease is accounted for as an operating lease with the payment obligations included in the future minimum lease payments schedule earlier in this note. The lease term is for 33 years with potential renewal options. At the end of the lease term, AEGCo and I&M have the option to renew the lease or the Owner Trustee can sell the Plant. Neither AEGCo, I&M nor AEP has an ownership interest in the Owner Trustee and do not guarantee its debt. The future minimum lease payments for this sale-and-leaseback transaction for AEGCo are as follows:

Future Minimum Lease Payments	(in millions)
2009	$ 74
2010	74
2011	74
2012	74
2013	74
Later Years	665
Total Future Minimum Lease Payments	$ 1,035

10. FINANCING ACTIVITIES

Long-term Debt

There are certain limitations on establishing liens against AEGCo's assets under its indentures. None of the long-term debt obligations of AEGCo have been guaranteed or secured by AEP or any of its affiliates.

The following details long-term debt outstanding as of December 31, 2008 and 2007:

		Interest Rates at December 31,		Outstanding at December 31,	
Type of Debt	**Maturity**	**2008**	**2007**	**2008**	**2007**
				(in thousands)	
Senior Unsecured Notes	2037	6.33%	6.33%	$ 210,909	$ 218,182
Pollution Control Bonds (a)	2011 (b)	4.15%	4.15%	45,000	45,000
Other Long-term Debt (c)	2011	3.20125%	-	85,000	-
Unamortized Discount				(145)	(154)
Total Long-term Debt				340,764	263,028
Less: Long-term Debt Due Within One Year				7,273	7,273
Long-term Debt				$ 333,491	$ 255,755

(a) Under the terms of the pollution control bonds, AEGCo is required to pay amounts sufficient to enable the payment of interest on and the principal of (at stated maturities and upon mandatory redemptions) related pollution control revenue bonds issued to finance the construction of pollution control facilities at certain plants. Interest rates are subject to periodic adjustment. Interest payments are made semi-annually. Letters of credit from banks, standby bond purchase agreements and insurance policies support certain series.

(b) AEGCo's pollution control bonds are subject to mandatory redemption earlier than the maturity date. Consequently, these bonds have been classified for maturity and repayment purposes based on the mandatory redemption date.

(c) AEGCo issued an $85 million 3-year credit facility to be used for working capital and other general corporate purposes.

At December 31, 2008 future annual long-term debt payments are as follows:

	2009	2010	2011	2012	2013	After 2013	Total
				(in thousands)			
Principal Amount	$ 7,273	$ 7,273	$ 137,272	$ 7,273	$ 7,273	$ 174,545	$ 340,909
Unamortized Discount							(145)
Total Long-term Debt							$ 340,764

Utility Money Pool – AEP System

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. The AEP System corporate borrowing program operates in accordance with the terms and conditions approved in a regulatory order. The amount of outstanding borrowings from the Utility Money Pool as of December 31, 2008 and 2007 are included in Advances from Affiliates on AEGCo's balance sheets. AEGCo's Utility Money Pool activity and corresponding authorized borrowing limits for the years ended December 31, 2008 and 2007 are described in the following table:

Year	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 December 31,	Authorized Short-Term Borrowing Limit
			(in thousands)			
2008	$ 125,091	$ -	$ 81,742	$ -	$ 46,800	$ 200,000
2007	261,636 (a)	20,124	64,770	8,211	93,391	200,000 (a)

(a) In April 2007, AEGCo's short-term borrowing limit increased to $410 million under regulatory orders to facilitate the acquisition of Lawrenceburg Generating Station until long-term financing could be arranged. Following the issuance of AEGCo's long-term debt of $220 million in June 2007, AEGCo's short-term borrowing limit was reduced to $200 million under regulatory orders.

Maximum, minimum and average interest rates for funds either borrowed from or loaned to the Utility Money Pool for the years ended December 31, 2008, 2007 and 2006 are summarized in the following table:

Years Ended December 31,	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 Rates for Funds Borrowed from the Utility Money Pool	Average Interest Rates for Funds Loaned to the Utility Money Pool
2008	5.47%	2.28%	-%	-%	4.75%	-%
2007	5.94%	5.16%	5.94%	5.49%	5.39%	5.86%
2006	5.41%	3.32%	5.11%	5.11%	4.79%	5.11%

Interest expense and interest income related to the Utility Money Pool are included in Interest Expense and Interest Income, respectively, in AEGCo's Statements of Income. For amounts borrowed from and advanced to the Utility Money Pool, AEGCo incurred the following amounts of interest expense and earned the following amounts of interest income, respectively, for the years ended December 31, 2008, 2007 and 2006:

	Years Ended December 31, 2008	2007	2006
		(in thousands)	
Interest Expense	$ 2,967	$ 3,297	$ 1,046
Interest Income	-	35	-

Dividend Restrictions

Under the Federal Power Act, AEGCo is restricted from paying dividends out of stated capital.

11. RELATED PARTY TRANSACTIONS

For other related party transactions, also see "Utility Money Pool – AEP System" section of Note 10.

Affiliated Revenues

AEGCo's revenues derived from sales to affiliates for the years ended December 31, 2008, 2007 and 2006 were $468 million, $380 million and $310 million, respectively. These revenues are reported as Operating Revenues on AEGCo's Statements of Income.

Unit Power Agreements

Lawrenceburg UPA between CSPCo and AEGCo

In March 2007, CSPCo and AEGCo entered into a 10-year UPA for the entire output from the Lawrenceburg Generating Station effective with AEGCo's purchase of the plant in May 2007. The UPA has an option for an additional 2-year period. I&M operates the plant under an agreement with AEGCo. Under the UPA, CSPCo pays AEGCo for the capacity, depreciation, fuel, operation and maintenance and tax expenses. These payments are due regardless of whether the plant is operating. The fuel and operation and maintenance payments are based on actual costs incurred. All expenses are trued up periodically.

I&M UPA between AEGCo and I&M

A unit power agreement between AEGCo and I&M (the I&M Power Agreement) provides for the sale by AEGCo to I&M of all the power (and the energy associated therewith) available to AEGCo at the Rockport Plant unless it is sold to another utility. I&M is obligated, whether or not power is available from AEGCo, to pay as a demand charge for the right to receive such power (and as an energy charge for any associated energy taken by I&M) net of amounts received by AEGCo from any other sources, sufficient to enable AEGCo to pay all its operating and other expenses, including a rate of return on the common equity of AEGCo as approved by the FERC. The I&M Power Agreement will continue in effect until the expiration of the lease term of Unit 2 of the Rockport Plant unless extended in specified circumstances.

KPCo UPA between AEGCo and KPCo

Pursuant to an assignment between I&M and KPCo, and a unit power agreement between KPCo and AEGCo, AEGCo sells KPCo 30% of the power (and the energy associated therewith) available to AEGCo from both units of the Rockport Plant. KPCo has agreed to pay to AEGCo in consideration for the right to receive such power the same amounts which I&M would have paid AEGCo under the terms of the I&M Power Agreement for such entitlement. The KPCo unit power agreement ends in December 2022. See "Affiliated Revenues" section of this note.

Jointly-Owned Electric Utility Plants

AEGCo and I&M jointly own one generating unit and jointly lease the other generating unit of the Rockport Plant. The costs of operating this facility are equally apportioned between AEGCo and I&M since each company has a 50% interest. AEGCo's share of costs is included in the appropriate expense accounts on its Statements of Income. AEGCo's investment in these plants is included in Property, Plant and Equipment on its Balance Sheets.

I&M Barging and Other Services

I&M provides barging and other transportation services to affiliates. AEGCo recorded costs of $17 million, $9.2 million and $14.9 million for the years ended December 31, 2008, 2007 and 2006, respectively, for barging services provided by I&M. These costs were recorded as Fuel Used for Electric Generation.

Central Machine Shop

APCo operates a facility which repairs and rebuilds specialized components for the generation plants across the AEP System. APCo defers on its balance sheet the cost of performing the services, then transfers the cost to the affiliate for reimbursement. AEGCo recorded these billings as capital or maintenance expense depending on the nature of the services received. These billings are recoverable under UPAs. AEGCo's billed amount was $138 thousand for the year ended December 31, 2008. There were no billed amounts for the years ended December 31, 2007 and 2006.

Variable Interest Entities

FIN 46R is a consolidation model that considers risk absorption of a variable interest entity (VIE), also referred to as variability. Entities are required to consolidate a VIE when it is determined that they are the primary beneficiary of that VIE, as defined by FIN 46R. In determining whether AEGCo is the primary beneficiary of a VIE, management considers factors such as equity at risk, the amount of variability of the VIE AEGCo absorbs, guarantees of indebtedness, voting rights including kick-out rights, the power to direct the VIE and other factors. Management believes that the significant assumptions and judgments were applied consistently and that there are no other reasonable judgments or assumptions that would result in a different conclusion. There have been no changes to the reporting of VIEs in the financial statements where it is concluded that AEGCo is the primary beneficiary. In addition, AEGCo has not provided financial or other support that was not previously contractually required to any VIE.

As of December 31, 2008, AEGCo holds a significant variable interest in AEPSC. AEPSC provides certain managerial and professional services to AEGCo. AEP is the sole equity owner of AEPSC. The costs of the services are based on a direct charge or on a prorated basis and billed to AEGCo at AEPSC's cost. AEGCo has not provided financial or other support outside the reimbursement of costs for services rendered. The cost reimbursement nature of AEPSC finances its operations. There are no other terms or arrangements between AEPSC and AEGCo that could require additional financial support from AEGCo or expose them to losses outside of the normal course of business. AEPSC and its billings are subject to regulation by the FERC. AEGCo is exposed to losses to the extent it cannot recover the costs of AEPSC through its normal business operations. AEGCo is considered to have a significant interest in the variability of AEPSC due to its activity in AEPSC's cost reimbursement structure. AEPSC is consolidated by AEP. In the event AEPSC would require financing or other support outside the cost reimbursement billings, this financing would be provided by AEP. Total billings from AEPSC for the years ended December 31, 2008 and 2007 were $10.3 million and $4.8 million, respectively. The carrying amount of liabilities associated with AEPSC for the years ended December 31, 2008 and 2007 were $0.8 million and $0.7 million, respectively. Management estimates the maximum exposure of loss to be equal to the amount of such liability.

12. PROPERTY, PLANT AND EQUIPMENT

Depreciation

AEGCo provides for depreciation of Property, Plant and Equipment on a straight-line basis over the estimated useful lives of property, generally using composite rates by functional class. The following table provides the annual composite depreciation rates by functional class:

2008	Regulated				Nonregulated			
Functional Class of Property	Property, Plant and Equipment	Accumulated Depreciation	Annual Composite Depreciation Rate	Depreciable Life Ranges	Property, Plant and Equipment	Accumulated Depreciation	Annual Composite Depreciation Rate	Depreciable Life Ranges
	(in thousands)			(in years)	(in thousands)			(in years)
Production	$ 1,418,716	$ 817,798	2.4%	31-37	$ -	$ -	-	-
Transmission	-	-	-	-	-	-	-	-
Distribution	-	-	-	-	-	-	-	-
CWIP	216,500	(561)	N.M.	N.M.	-	-	-	-
Other	6,338	2,043	8.4%	N.M.	45	-	N.M.	N.M.
Total	$ 1,641,554	$ 819,280			$ 45	$ -		

2007	Regulated				Nonregulated			
Functional Class of Property	Property, Plant and Equipment	Accumulated Depreciation	Annual Composite Depreciation Rate	Depreciable Life Ranges	Property, Plant and Equipment	Accumulated Depreciation	Annual Composite Depreciation Rate	Depreciable Life Ranges
	(in thousands)			(in years)	(in thousands)			(in years)
Production	$ 1,409,822	$ 801,184	3.2%	31-37	$ -	$ -	-	-
Transmission	-	-	-	-	-	-	-	-
Distribution	-	-	-	-	-	-	-	-
CWIP	111,105	(2,358)	N.M.	N.M.	-	-	-	-
Other	5,186	2,170	6.9%	N.M.	45	-	N.M.	N.M.
Total	$ 1,526,113	$ 800,996			$ 45	$ -		

2006	Regulated		Nonregulated	
Functional Class of Property	Annual Composite Depreciation Rate Ranges	Depreciable Life Ranges	Annual Composite Depreciation Rate Ranges	Depreciable Life Ranges
		(in years)		(in years)
Production	3.6%	31	-	-
Transmission	-	-	-	-
Distribution	-	-	-	-
Other	11.5%	N.M.	N.M.	N.M.

N.M. = Not Meaningful

The composite depreciation rate generally includes a component for nonasset retirement obligation (non-ARO) removal costs, which is credited to Accumulated Depreciation and Amortization. Actual removal costs incurred are charged to Accumulated Depreciation and Amortization. Any excess of accrued non-ARO removal costs over actual removal costs incurred is reclassified from Accumulated Depreciation and Amortization and reflected as a regulatory liability.

Asset Retirement Obligations (ARO)

AEGCo records ARO in accordance with SFAS 143 "Accounting for Asset Retirement Obligations" and FIN 47 "Accounting for Conditional Asset Retirement Obligations" for the retirement of ash ponds and asbestos removal. The following is a reconciliation of the 2008 and 2007 aggregate carrying amounts of ARO for AEGCo:

Year	ARO at January 1,	Accretion Expense	Liabilities Incurred	Liabilities Settled	Revisions in Cash Flow Estimates	ARO at December 31,
			(in thousands)			
2008	$ 1,326	$ 101	$ 746	$ (199)	$ 1,026	$ 3,000
2007	1,304	102	-	(80)	-	1,326

Allowance for Funds Used During Construction (AFUDC)

AEGCo's amounts of allowance for borrowed and equity funds used during construction are summarized in the following table:

	Years Ended December 31, 2008	2007	2006
		(in thousands)	
Allowance for Equity Funds Used During Construction	$ 6,198	$ 1,015	$ 24
Allowance for Borrowed Funds Used During Construction	3,250	1,609	411

13. UNAUDITED QUARTERLY FINANCIAL INFORMATION

In management's opinion, the unaudited quarterly information reflects all normal and recurring accruals and adjustments necessary for a fair presentation of net income for interim periods. Quarterly results are not necessarily indicative of a full year's operations because of various factors. AEGCo's unaudited quarterly financial information is as follows:

	2008 Quarterly Periods Ended March 31	June 30	September 30	December 31
		(in thousands)		
Operating Revenues	$ 109,012	$ 106,944	$ 139,230	$ 113,089
Operating Income	11,606	12,179	11,681	13,657
Net Income	6,810	7,563	7,545	9,649

	2007 Quarterly Periods Ended March 31	June 30	September 30	December 31
		(in thousands)		
Operating Revenues	$ 77,151	$ 83,425	$ 118,506	$ 101,457
Operating Income	2,223	6,952	10,264	11,676
Net Income	1,591	4,219	4,741	7,502

There were no significant events in the fourth quarter of 2008 or 2007.