AEP Texas North Company and Subsidiary

2009 Annual 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 East companies	APCo, CSPCo, I&M, KPCo and OPCo.
AEPEP	AEP Energy Partners, Inc., a subsidiary of AEP dedicated to wholesale marketing and trading, asset management and commercial and industrial sales in the deregulated Texas market.
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 rated electric utility system, owned and operated by AEP's electric utility subsidiaries.
AEP West companies	PSO, SWEPCo, TCC and TNC.
AFUDC	Allowance for Funds Used During Construction.
AOCI	Accumulated Other Comprehensive Income.
APCo	Appalachian Power Company, an AEP electric utility subsidiary.
ARO	Asset Retirement Obligations.
CO_2	Carbon Dioxide and other greenhouse gases.
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.).
CWIP	Construction Work in Progress.
EIS	Energy Insurance Services, Inc., a nonaffiliated captive insurance company.
ERCOT	Electric Reliability Council of Texas.
ETT	Electric Transmission Texas, LLC, an equity interest joint venture between AEP Utilities, Inc. and MidAmerican Energy Holdings Company Texas Transco, LLC formed to own and operate electric transmission facilities in ERCOT.
Federal EPA	United States Environmental Protection Agency.
FERC	Federal Energy Regulatory Commission.
FTR	Financial Transmission Right, a financial instrument that entitles the holder to receive compensation for certain congestion-related transmission charges that arise when the power grid is congested resulting in differences in locational prices.
GAAP	Accounting Principles Generally Accepted in the United States of America.
I&M	Indiana Michigan Power Company, an AEP electric utility subsidiary.
KPCo	Kentucky Power Company, an AEP electric utility subsidiary.
kV	Kilovolt.
MTM	Mark-to-Market.
Nonutility Money Pool	AEP's Nonutility Money Pool.
OATT	Open Access Transmission Tariff.
OCC	Corporation Commission of the State of Oklahoma.
OPCo	Ohio Power Company, an AEP electric utility subsidiary.
OPEB	Other Postretirement Benefit Plans.
OTC	Over the counter.
PSO	Public Service Company of Oklahoma, an AEP electric utility subsidiary.
PUCT	Public Utility Commission of Texas.
REP	Texas Retail Electric Provider.
RTO	Regional Transmission Organization.

Term	Meaning
SIA	System Integration Agreement.
SPP	Southwest Power Pool.
SWEPCo	Southwestern Electric Power Company, an AEP electric utility subsidiary.
TCC	AEP Texas Central Company, an AEP electric utility subsidiary.
Texas Restructuring Legislation	Legislation enacted in 1999 to restructure the electric utility industry in Texas.
TNC	AEP Texas North Company, an AEP electric utility subsidiary.
Utility Money Pool	AEP System's Utility Money Pool.

INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Shareholders of
AEP Texas North Company:

We have audited the accompanying consolidated balance sheets of AEP Texas North Company and subsidiary (the "Company") as of December 31, 2009 and 2008, and the related consolidated statements of income, changes in common shareholder's equity and comprehensive income (loss), and cash flows for each of the three years in the period ended December 31, 2009. 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 consolidated financial statements present fairly, in all material respects, the financial position of AEP Texas North Company and subsidiary as of December 31, 2009 and 2008, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2009 in conformity with accounting principles generally accepted in the United States of America.

/s/ Deloitte & Touche LLP

Columbus, Ohio
February 26, 2010

AEP TEXAS NORTH COMPANY AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
For the Years Ended December 31, 2009, 2008 and 2007
(in thousands)

	2009	2008	2007
REVENUES			
Electric Generation, Transmission and Distribution	$ 178,070	$ 176,397	$ 178,763
Sales to AEP Affiliates	83,224	100,523	96,397
Other Revenues	791	866	5,065
TOTAL REVENUES	262,085	277,786	280,225
EXPENSES			
Fuel and Other Consumables Used for Electric Generation	32,802	49,358	37,172
Purchased Electricity for Resale	2	1,249	8,059
Other Operation	88,235	84,219	77,928
Maintenance	23,723	21,445	21,308
Depreciation and Amortization	48,071	45,406	41,335
Taxes Other Than Income Taxes	17,781	17,889	20,421
TOTAL EXPENSES	210,614	219,566	206,223
OPERATING INCOME	51,471	58,220	74,002
Other Income (Expense):			
Interest Income	177	9,199	1,262
Allowance for Equity Funds Used During Construction	685	1,901	265
Interest Expense	(22,133)	(21,652)	(16,088)
INCOME BEFORE INCOME TAX EXPENSE	30,200	47,668	59,441
Income Tax Expense	11,847	13,752	20,092
NET INCOME	18,353	33,916	39,349
Preferred Stock Dividend Requirements	103	103	103
EARNINGS ATTRIBUTABLE TO COMMON STOCK	$ 18,250	$ 33,813	$ 39,246

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

See Notes to Consolidated Financial Statements.

AEP TEXAS NORTH COMPANY AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CHANGES IN COMMON SHAREHOLDER'S EQUITY AND COMPREHENSIVE INCOME (LOSS)
For the Years Ended December 31, 2009, 2008 and 2007
(in thousands)

	Common Stock	Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
TOTAL COMMON SHAREHOLDER'S EQUITY – DECEMBER 31, 2006	$ 137,214	$ 2,351	$ 176,950	$ (10,159)	$ 306,356
Adoption of Guidance for Uncertainty in Income Taxes, Net of Tax			(557)		(557)
Common Stock Dividends			(14,000)		(14,000)
Preferred Stock Dividends			(103)		(103)
SUBTOTAL – COMMON SHAREHOLDER'S EQUITY					291,696
COMPREHENSIVE INCOME					
Other Comprehensive Income, Net of Taxes:					
Cash Flow Hedges, Net of Tax of $378				702	702
Pension and OPEB Funded Status, Net of Tax of $79				148	148
NET INCOME			39,349		39,349
TOTAL COMPREHENSIVE INCOME					40,199
TOTAL COMMON SHAREHOLDER'S EQUITY – DECEMBER 31, 2007	137,214	2,351	201,639	(9,309)	331,895
Adoption of Guidance for Split-Dollar Life Insurance Accounting, Net of Tax of $153			(285)		(285)
Common Stock Dividends			(35,000)		(35,000)
Preferred Stock Dividends			(103)		(103)
SUBTOTAL – COMMON SHAREHOLDER'S EQUITY					296,507
COMPREHENSIVE INCOME					
Other Comprehensive Income (Loss), Net of Taxes:					
Amortization of Pension and OPEB Deferred Costs, Net of Tax of $347				644	644
Pension and OPEB Funded Status, Net of Tax of $4,087				(7,591)	(7,591)
NET INCOME			33,916		33,916
TOTAL COMPREHENSIVE INCOME					26,969
TOTAL COMMON SHAREHOLDER'S EQUITY – DECEMBER 31, 2008	137,214	2,351	200,167	(16,256)	323,476
Common Stock Dividends			(32,000)		(32,000)
Preferred Stock Dividends			(103)		(103)
Other Changes in Common Shareholder's Equity		1,089	(1,089)		-
SUBTOTAL – COMMON SHAREHOLDER'S EQUITY					291,373
COMPREHENSIVE INCOME					
Other Comprehensive Income (Loss), Net of Taxes:					
Cash Flow Hedges, Net of Tax of $40				74	74
Amortization of Pension and OPEB Deferred Costs, Net of Tax of $314				584	584
Pension and OPEB Funded Status, Net of Tax of $255				(473)	(473)
NET INCOME			18,353		18,353
TOTAL COMPREHENSIVE INCOME					18,538
TOTAL COMMON SHAREHOLDER'S EQUITY – DECEMBER 31, 2009	$ 137,214	$ 3,440	$ 185,328	$ (16,071)	$ 309,911

See Notes to Consolidated Financial Statements.

AEP TEXAS NORTH COMPANY AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
ASSETS
December 31, 2009 and 2008
(in thousands)

	2009	2008
CURRENT ASSETS		
Cash and Cash Equivalents	$ 200	$ 200
Accounts Receivable:		
Customers	10,500	9,674
Affiliated Companies	46,836	65,731
Accrued Unbilled Revenues	6,900	4,289
Miscellaneous	874	55
Allowance for Uncollectible Accounts	(295)	(47)
Total Accounts Receivable	64,815	79,702
Fuel	6,476	9,808
Materials and Supplies	10,945	10,339
Risk Management Assets	112	-
Deferred Tax Benefits	7,670	-
Prepayments and Other Current Assets	2,365	1,367
TOTAL CURRENT ASSETS	92,583	101,416
PROPERTY, PLANT AND EQUIPMENT		
Electric:		
Production	300,291	295,065
Transmission	484,989	411,839
Distribution	568,364	548,424
Other Property, Plant and Equipment	104,380	107,844
Construction Work in Progress	63,470	82,283
Total Property, Plant and Equipment	1,521,494	1,445,455
Accumulated Depreciation and Amortization	479,878	458,868
TOTAL PROPERTY, PLANT AND EQUIPMENT – NET	1,041,616	986,587
OTHER NONCURRENT ASSETS		
Regulatory Assets	64,762	67,943
Deferred Charges and Other Noncurrent Assets	1,814	3,076
TOTAL OTHER NONCURRENT ASSETS	66,576	71,019
TOTAL ASSETS	$ 1,200,775	$ 1,159,022

See Notes to Consolidated Financial Statements.

AEP TEXAS NORTH COMPANY AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
LIABILITIES AND SHAREHOLDERS' EQUITY
December 31, 2009 and 2008

	2009	2008
CURRENT LIABILITIES	(in thousands)	
Advances from Affiliates	$ 76,196	$ 28,686
Accounts Payable:		
General	7,155	7,236
Affiliated Companies	45,056	47,572
Long-term Debt Due Within One Year – Nonaffiliated	5	-
Accrued Taxes	27,379	16,714
Accrued Interest	5,914	5,914
Provision for SIA Refund	-	9,400
Other Current Liabilities	12,419	21,231
TOTAL CURRENT LIABILITIES	174,124	136,753
NONCURRENT LIABILITIES		
Long-term Debt – Nonaffiliated	370,055	368,965
Deferred Income Taxes	122,577	124,071
Regulatory Liabilities and Deferred Investment Tax Credits	145,072	131,022
Employee Benefits and Pension Obligations	40,842	42,596
Deferred Credits and Other Noncurrent Liabilities	35,845	29,790
TOTAL NONCURRENT LIABILITIES	714,391	696,444
TOTAL LIABILITIES	888,515	833,197
Cumulative Preferred Stock Not Subject to Mandatory Redemption	2,349	2,349
Rate Matters (Note 2)		
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	3,440	2,351
Retained Earnings	185,328	200,167
Accumulated Other Comprehensive Income (Loss)	(16,071)	(16,256)
TOTAL COMMON SHAREHOLDER'S EQUITY	309,911	323,476
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 1,200,775	$ 1,159,022

See Notes to Consolidated Financial Statements.

AEP TEXAS NORTH COMPANY AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2009, 2008 and 2007
(in thousands)

	2009	2008	2007
OPERATING ACTIVITIES			
Net Income	$ 18,353	$ 33,916	$ 39,349
Adjustments to Reconcile Net Income to Net Cash Flows from Operating Activities:			
Depreciation and Amortization	48,071	45,406	41,335
Deferred Income Taxes	(13,284)	5,386	(737)
Provision for SIA Refund	-	9,400	-
Allowance for Equity Funds Used During Construction	(685)	(1,901)	(265)
Fuel Over/Under-Recovery, Net	-	(54)	(7,777)
Change in Other Noncurrent Assets	(700)	(6,463)	(3,562)
Change in Other Noncurrent Liabilities	4,430	3,647	(4,016)
Changes in Certain Components of Working Capital:			
Accounts Receivable, Net	15,550	(27,373)	(22,670)
Fuel, Materials and Supplies	2,726	1,422	(3,691)
Accounts Payable	(656)	(1,763)	4,111
Accrued Taxes, Net	10,733	(2,449)	(838)
Other Current Assets	(166)	296	187
Other Current Liabilities	(7,915)	11,387	(563)
Net Cash Flows from Operating Activities	76,457	70,857	40,863
INVESTING ACTIVITIES			
Construction Expenditures	(94,108)	(132,720)	(88,048)
Change in Other Cash Deposits	-	-	8,858
Change in Advances to Affiliates, Net	-	-	13,543
Acquisitions of Assets	(1,798)	(424)	-
Proceeds from Sales of Assets	3,888	3,555	14,596
Net Cash Flows Used for Investing Activities	(92,018)	(129,589)	(51,051)
FINANCING ACTIVITIES			
Issuance of Long-term Debt – Nonaffiliated	-	99,346	43,681
Change in Advances from Affiliates, Net	47,510	(4,825)	33,511
Retirement of Long-term Debt – Nonaffiliated	-	-	(52,461)
Principal Payments for Capital Lease Obligations	(560)	(588)	(524)
Dividends Paid on Common Stock	(32,000)	(35,000)	(14,000)
Dividends Paid on Cumulative Preferred Stock	(103)	(103)	(103)
Other Financing Activities	714	102	-
Net Cash Flows from Financing Activities	15,561	58,932	10,104
Net Increase (Decrease) in Cash and Cash Equivalents	-	200	(84)
Cash and Cash Equivalents at Beginning of Period	200	-	84
Cash and Cash Equivalents at End of Period	$ 200	$ 200	$ -
SUPPLEMENTARY INFORMATION			
Cash Paid for Interest, Net of Capitalized Amounts	$ 23,365	$ 16,495	$ 15,589
Net Cash Paid for Income Taxes	14,749	12,893	20,698
Noncash Acquisitions Under Capital Leases	853	383	202
Construction Expenditures Included in Accounts Payable at December 31,	3,395	5,336	7,271
SIA Refund Included in Accounts Receivable at December 31,	-	24,763	-

See Notes to Consolidated Financial Statements.

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1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

ORGANIZATION

As a public utility, TNC engages in the transmission and distribution of electric power to 185,000 retail customers through REPs in its service territory in western and central Texas.

Under the Texas Restructuring Legislation, TNC completed the final state of exiting the generation business and ceased serving retail load. Although TNC continues as part owner in the Oklaunion Plant operated by PSO, TNC has leased their entire portion of the output of the plant through 2027 to a non-utility affiliate.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Rates and Service Regulation

TNC's transmission and distribution rates are regulated by the PUCT. The FERC regulates TNC's affiliated transactions, 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 subsidiaries, the acquisition or sale of certain utility assets and mergers with another electric utility or holding company. For non-power goods and services, the FERC requires that a nonregulated affiliate can bill an affiliated public utility company no more than market while a public utility must bill the higher of cost or market to a nonregulated affiliate.

The PUCT also regulates TNC's wholesale transmission operations and rates. The FERC claims jurisdiction over retail transmission rates when retail rates are unbundled in connection with restructuring. TNC's retail transmission rates in Texas are unbundled. Although TNC's retail transmission rates in Texas are unbundled, retail transmission rates are regulated, on a cost basis, by the PUCT.

In addition, the FERC regulates the SIA, the CSW Operating Agreement, the System Transmission Integration Agreement and the Transmission Coordination Agreement, all of which allocate shared system costs and revenues to the utility subsidiaries that are parties to each agreement.

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.

Principles of Consolidation

TNC's consolidated financial statements include TNC and its wholly-owned subsidiary. Intercompany items are eliminated in consolidation. TNC also has a generating unit that is jointly-owned with an affiliated company and nonaffiliated companies. TNC's proportionate share of the operating costs associated with that facility is included in the financial statements and the assets and liabilities are reflected in the balance sheets. See "Oklaunion PPA between TNC and AEP Energy Partners" section within Note 13 for detail of TNC's agreement to sell its portion of the Oklaunion generation to AEPEP. See "Variable Interest Entities" section of Note 13.

Accounting for the Effects of Cost-Based Regulation

As a rate-regulated electric public utility company, TNC'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 accounting guidance for "Regulated Operations," TNC records regulatory assets (deferred expenses) and regulatory liabilities (future revenue reductions or refunds) 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. Due to the passage of legislation requiring restructuring and a transition to customer choice and market-based rates, TNC discontinued the application of "Regulated Operations" accounting treatment for the generation portion of its business.

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, allowance for doubtful accounts, long-lived asset impairment, unbilled electricity revenue, valuation of long-term energy contracts, the effects of regulation, long-lived asset recovery, the effects of contingencies and certain assumptions made in accounting for pension and postretirement benefits. 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.

Cash and Cash Equivalents

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

Inventory

Fossil fuel inventories are carried at the lower of average cost or market. Materials and supplies inventories are carried at average cost.

Accounts Receivable

Customer accounts receivable primarily include receivables from wholesale and retail customers and customer receivables primarily related to other revenue-generating activities.

Revenue is recognized when power is delivered. To the extent that deliveries have occurred but a bill has not been issued, TNC accrues and recognizes, as Accrued Unbilled Revenues, an estimate of the revenues for deliveries since the last billing.

Concentrations of Credit Risk and Significant Customers

TNC has significant customers which on a combined basis account for the following percentages of total Operating Revenues for the periods ended and Accounts Receivable – Customers as of December 31:

Significant Customers of TNC: Centrica and Reliant Energy (2009 only)	**2009**	**2008**	**2007**
Percentage of Operating Revenues	27%	21%	15%
Percentage of Accounts Receivable - Customers	36%	31%	36%

TNC monitors credit levels and the financial condition of its customers on a continuing basis to minimize credit risk. The PUCT allows recovery in rates for a reasonable level of bad debt costs. Management believes adequate provision for credit loss has been made in the accompanying financial statements.

Property, Plant and Equipment

Electric utility property, plant and equipment are stated at original purchase cost. Property, plant and equipment of nonregulated operations and other investments are stated at fair market value at acquisition (or as adjusted for any applicable impairments) plus the original cost of property acquired or constructed since the acquisition, less disposals. 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 both cost-based rate-regulated and nonregulated 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. For TNC's nonregulated generation assets, a gain or loss would be recorded if the retirement is not considered an interim routine replacement. 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 for cost-based rate-regulated operations and charged to expense for nonregulated operations. 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 the accounting guidance for "Impairment or Disposal of Long-lived Assets." Equity investments are required to be tested for impairment when it is determined there may be an other than temporary loss in value.

The fair value of an asset or investment is the amount at which that asset or investment 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) and Interest Capitalization

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. For the nonregulated generation business, operations interest is capitalized during construction in accordance with the accounting guidance for "Capitalization of Interest."

Valuation of Nonderivative Financial Instruments

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

Fair Value Measurements of Assets and Liabilities

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

For commercial activities, exchange traded derivatives, namely futures contracts, are generally fair valued based on unadjusted quoted prices in active markets and are classified as Level 1. Level 2 inputs primarily consist of OTC broker quotes in moderately active or less active markets, as well as exchange traded contracts where there is insufficient market liquidity to warrant inclusion in Level 1. Management verifies price curves using these broker quotes and classifies these fair values within Level 2 when substantially all of the fair value can be corroborated. Management typically obtains multiple broker quotes, which are non-binding in nature, but are based on recent trades in the marketplace. When multiple broker quotes are obtained, the quoted bid and ask prices are averaged. In certain circumstances, a broker quote may be discarded if it is a clear outlier. Management uses a historical correlation analysis between the broker quoted location and the illiquid locations and if the points are highly correlated, these locations are included within Level 2 as well. Certain OTC and bilaterally executed derivative instruments are executed in less active markets with a lower availability of pricing information. Long-dated and illiquid complex or structured transactions and FTRs can introduce the need for internally developed modeling inputs based upon extrapolations and assumptions of observable market data to estimate fair value. When such inputs have a significant impact on the measurement of fair value, the instrument is categorized as Level 3.

AEP utilizes its trustee's external pricing service to estimate the fair value of the underlying investments held in the benefit plan trusts. AEP's investment managers review and validate the prices utilized by the trustee to determine fair value. AEP's investment managers perform their own valuation testing to verify the fair values of the securities. AEP receives audit reports of the trustee's operating controls and valuation processes. The trustee uses multiple pricing vendors for the assets held in the plans. Equities are classified as Level 1 holdings if they are actively traded on exchanges. Fixed income securities do not trade on an exchange and do not have an official closing price. Pricing vendors calculate bond valuations using financial models and matrices. Fixed income securities are typically classified as Level 2 holdings because their valuation inputs are based on observable market data. Observable inputs used for valuing fixed income securities are benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, reference data, and economic events. Other securities with model-derived valuation inputs that are observable are also classified as Level 2 investments. Investments with unobservable valuation inputs are classified as Level 3 investments. Benefit plan assets included in Level 3 are real estate and private equity investments that are valued using methods requiring judgment including appraisals.

Revenue Recognition

Regulatory Accounting

TNC's financial statements reflect the actions of regulators that can result in the recognition of revenues and expenses in different time periods than enterprises that are not rate-regulated. Regulatory assets (deferred expenses) and regulatory liabilities (deferred revenue reductions or refunds) are recorded to reflect the economic effects of regulation in the same accounting period by matching expenses with their recovery through regulated revenues and by matching income with its passage to customers in cost-based regulated rates.

When regulatory assets are probable of recovery through regulated rates, TNC records them as assets on its balance sheet. TNC tests for probability of recovery at each balance sheet date or whenever new events occur. Examples of new events include the issuance of a regulatory commission order or passage of new legislation. If it is determined that recovery of a regulatory asset is no longer probable, TNC writes off that regulatory asset as a charge against income.

Traditional Electricity Supply and Delivery Activities

TNC recognizes revenues from wholesale electricity sales and electricity transmission and distribution delivery services. TNC recognizes the revenues in the financial statements upon delivery of the energy to the customer and includes unbilled as well as billed amounts. TNC records expenses upon receipt of purchased electricity and when expenses are incurred. TNC records third party electricity purchases as non-trading and these purchases are accounted for on a gross basis as Purchased Electricity for Resale in the Consolidated Statements of Income.

Energy Marketing and Risk Management Activities

Prior to TNC's FERC-approved removal from the SIA and CSW Operating Agreement, effective April 1, and May 1, 2006 respectively, AEPSC, on behalf of TNC, engaged in wholesale electricity, natural gas, coal and emission allowances marketing and risk management activities focused on wholesale markets where the AEP System owns assets and adjacent markets. These activities included the purchase and sale of energy under forward contracts at fixed and variable prices and the buying and selling of financial energy contracts which included exchange traded futures and options, and over-the-counter options and swaps. Certain energy marketing and risk management transactions were with RTOs.

TNC recognized revenues and expenses from wholesale marketing and risk management transactions that were not derivatives upon delivery of the commodity. TNC used MTM accounting for wholesale marketing and risk management transactions that were derivatives unless the derivative was designated in a qualifying cash flow hedge relationship or a normal purchase or sale. TNC recorded the unrealized and realized gains and losses on wholesale marketing and risk management transactions accounted for using MTM in Revenues in the Consolidated Statements of Income on a net basis.

Certain qualifying wholesale marketing and risk management derivative transactions were designated as hedges of future cash flows as a result of forecasted transactions (cash flow hedge). TNC initially recorded the effective portion of the cash flow hedge's gain or loss as a component of Accumulated Other Comprehensive Income (Loss). When the forecasted transaction was realized and affected earnings, TNC subsequently reclassified the gain or loss on the hedge from Accumulated Other Comprehensive Income into revenues or expenses on its Consolidated Statements of Income, within the same financial statement line item as the forecasted transaction. The ineffective portion of the gain or loss was recognized in revenues in the financial statements immediately.

Power Purchase and Sale Agreement

TNC recognizes revenue from an affiliate, AEPEP, for a 20-year Power Purchase & Sale Agreement (PPA). TNC recognizes revenues for the fuel, operations and maintenance and all other taxes on a billed basis. Revenue is recognized for the capacity and depreciation billed to AEPEP on a straight-line basis over the term of the PPA as these amounts represent the minimum payments due.

Maintenance

Maintenance costs are expensed as incurred. If it becomes probable that TNC will recover specifically-incurred costs through future rates, a regulatory asset is established to match the expensing of those maintenance costs with their recovery in cost-based regulated revenues.

Income Taxes and Investment Tax Credits

TNC 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 deferral basis and are being amortized over the life of the plant investment.

TNC accounts for uncertain tax positions in accordance with the accounting guidance for "Income Taxes." TNC classifies interest expense or income related to uncertain tax positions as interest expense or income as appropriate and classifies penalties as Other Operation.

Excise Taxes

As an agent for some state and local governments, TNC collects from customers certain excise taxes levied by those state or local governments on customers. TNC does not record these taxes as revenue or expense.

Debt and Preferred Stock

Gains and losses from the reacquisition of debt used to finance regulated electric utility 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 associated with the regulated business is refinanced, the reacquisition costs attributable to the portions of the business that are subject to cost-based regulatory accounting are generally deferred and amortized over the term of the replacement debt consistent with its recovery in rates.

Debt discount or premium 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.

The excess of par value over costs of preferred stock reacquired is credited to paid-in capital and reclassified to retained earnings upon the redemption of the entire preferred stock series. The excess of par value over the costs of reacquired preferred stock for nonregulated subsidiaries is credited to retained earnings upon reacquisition.

Investments Held in Trust for Future Liabilities

AEP has several trust funds with significant investments intended to provide for future payments of pension and OPEB benefits. All of the trust funds' investments are diversified and managed in compliance with all laws and regulations. The investment strategy for trust funds is to use a diversified portfolio of investments to achieve an acceptable rate of return while managing the interest rate sensitivity of the assets relative to the associated liabilities. To minimize investment risk, the trust funds are broadly diversified among classes of assets, investment strategies and investment managers. Management regularly reviews the actual asset allocation and periodically rebalance the investments to targeted allocation when appropriate. Investment policies and guidelines allow investment managers in approved strategies to use financial derivatives to obtain or manage market exposures and to hedge assets and liabilities. The investments are reported at fair value under the "Fair Value Measurements and Disclosures" accounting guidance.

Benefit Plans

All benefit plan assets are invested in accordance with each plan's investment policy. The investment policy outlines the investment objectives, strategies and target asset allocations by plan.

The investment philosophies for AEP's benefit plans support the allocation of assets to minimize risks and optimizing net returns. Strategies used include:

- Maintaining a long-term investment horizon.
- Diversifying assets to help control volatility of returns at acceptable level.
- Managing fees, transaction costs and tax liabilities to maximize investment earnings.
- Using active management of investments where appropriate risk/return opportunities exist.
- Keeping portfolio structure style-neutral to limit volatility compared to applicable benchmarks.
- Using alternative asset classes such as real estate and private equity to maximize return and provide additional portfolio diversification.

The target asset allocation and allocation ranges are as follows:

Pension Plan Assets	Minimum	Target	Maximum
Domestic Equity	30.0%	35.0%	40.0%
International and Global Equity	10.0%	15.0%	20.0%
Fixed Income	35.0%	39.0%	45.0%
Real Estate	4.0%	5.0%	6.0%
Other Investments	1.0%	5.0%	7.0%
Cash	0.5%	1.0%	3.0%

OPEB Plans Assets	Minimum	Target	Maximum
Equity	61.0%	66.0%	71.0%
Fixed Income	29.0%	33.0%	37.0%
Cash	1.0%	1.0%	4.0%

The investment policy for each benefit plan contains various investment limitations. The investment policies establish concentration limits for securities. Investment policies prohibit the benefit trust funds from purchasing securities issued by AEP (with the exception of proportionate and immaterial holdings of AEP securities in passive index strategies). However, the investment policies do not preclude the benefit trust funds from receiving contributions in the form of AEP securities, provided that the AEP securities acquired by each plan may not exceed the limitations imposed by law. Each investment manager's portfolio is compared to a diversified benchmark index.

For equity investments, the limits are as follows:

- No security in excess of 5% of all equities.
- Cash equivalents must be less than 10% of an investment manager's equity portfolio.
- Individual stock must be less than 10% of each manager's equity portfolio.
- No investment in excess of 5% of an outstanding class of any company.
- No securities may be bought or sold on margin or other use of leverage.

For fixed income investments, the concentration limits must not exceed:

- 3% in one issuer
- 20% in non-US dollar denominated
- 5% private placements
- 5% convertible securities
- 60% for bonds rated AA+ or lower
- 50% for bonds rated A+ or lower
- 10% for bonds rated BBB- or lower

For obligations of non-government issuers the following limitations apply:

- AAA rated debt: a single issuer should account for no more than 5% of the portfolio.
- AA+, AA, AA- rated debt: a single issuer should account for no more than 3% of the portfolio.
- Debt rated A+ or lower: a single issuer should account for no more than 2% of the portfolio.
- No more than 10% of the portfolio may be invested in high yield and emerging market debt combined at any time.

A portion of the pension assets is invested in real estate funds to provide diversification, add return, and hedge against inflation. Real estate properties are illiquid, difficult to value, and not actively traded. The pension plan uses external real estate investment managers to invest in commingled funds that hold real estate properties. To mitigate investment risk in the real estate portfolio, commingled real estate funds are used to ensure that holdings are diversified by region, property type, and risk classification. Real estate holdings include core, value-added, and development risk classifications and some investments in Real Estate Investment Trusts (REITs), which are publicly traded real estate securities classified as Level 1.

A portion of the pension assets is invested in private equity. Private equity investments add return and provide diversification and typically require a long-term time horizon to evaluate investment performance. Private equity is classified as an alternative investment because it is illiquid, difficult to value, and not actively traded. The pension plan uses limited partnerships and commingled funds to invest across the private equity investment spectrum. The private equity holdings are with six general partners who help monitor the investments and provide investment selection expertise. The holdings are currently comprised of venture capital, buyout, and hybrid debt and equity investment instruments. Commingled private equity funds are used to enhance the holdings' diversity.

AEP participates in a securities lending program with BNY Mellon to provide incremental income on idle assets and to provide income to offset custody fees and other administrative expenses. AEP lends securities to borrowers approved by BNY Mellon in exchange for cash collateral. All loans are collateralized by at least 102% of the loaned asset's market value and the cash collateral is invested. The difference between the rebate owed to the borrower and the cash collateral rate of return determines the earnings on the loaned security. The securities lending program's objective is providing modest incremental income with a limited increase in risk.

Trust owned life insurance (TOLI) underwritten by The Prudential Insurance Company is held in the OPEB plan trusts. The strategy for holding life insurance contracts in the taxable VEBA trust is to minimize taxes paid on the asset growth in the trust. Earnings on plan assets are tax-deferred within the TOLI contract and can be tax-free if held until claims are paid. Life insurance proceeds remain in the trust and are used to fund future retiree medical benefit liabilities. With consideration to other investments held in the trust, the cash value of the TOLI contracts is invested in two diversified funds. A portion is invested in a commingled fund with underlying investments in stocks that are

actively traded on major international equity exchanges. The other portion of the TOLI cash value is invested in a diversified, commingled fixed income fund with underlying investments in government bonds, corporate bonds and asset-backed securities.

Cash and cash equivalents are held in each trust to provide liquidity and meet short-term cash needs. Cash equivalent funds are used to provide diversification and preserve principal. The underlying holdings in the cash funds are investment grade money market instruments including commercial paper, certificates of deposit, treasury bills and other types of investment grade short-term debt securities. The cash funds are valued each business day and provide daily liquidity.

Comprehensive Income (Loss)

Comprehensive income (loss) is defined as the change in equity (net assets) of a business enterprise during a period from transactions and other events and circumstances from nonowner sources. It includes all changes in equity during a period except those resulting from investments by owners and distributions to owners. Comprehensive income (loss) has two components: net income (loss) and other comprehensive income (loss).

Components of Accumulated Other Comprehensive Income (Loss) (AOCI)

AOCI is included on the balance sheets in the common shareholder's equity section. AOCI for TNC as of December 31, 2009 and 2008 is shown in the following table:

Components	December 31, 2009	December 31, 2008
	(in thousands)	
Cash Flow Hedges, Net of Tax	$ 74	$ -
Amortization of Pension and OPEB Deferred Costs, Net of Tax	1,228	644
Pension and OPEB Funded Status, Net of Tax	(17,373)	(16,900)

Earnings Per Share (EPS)

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

Subsequent Events

Management reviewed subsequent events through February 26, 2010, the date that TNC's 2009 annual report was issued.

2. RATE MATTERS

TNC is involved in rate and regulatory proceedings at the FERC and the PUCT. Rate matters can have a material effect on financial condition, net income and cash flows. TNC's recent significant rate orders are addressed in this note.

TEXAS RATE MATTERS

Texas Restructuring Appeals

TNC's final fuel reconciliations under the restructuring legislation have been appealed by TNC and other parties to the Texas Supreme Court. In February 2010, the Texas Supreme Court declined to review the fuel appeals.

ETT 2007 Formation Appeal

ETT is a joint venture between AEP and MidAmerican Energy Holding Company Texas Transco, LLC. TNC has sold transmission assets both in service and under construction to ETT. The PUCT approved ETT's initial rates, a request for a transfer of in-service assets and CWIP and a certificate of convenience and necessity (CCN) to operate as a stand alone transmission utility in ERCOT. ETT was allowed a 9.96% return on equity. Intervenors appealed the

PUCT's decision to the Travis County District Court. The court ruled that the PUCT exceeded its authority by approving ETT's application as a stand alone transmission utility without a service area under the wrong section of the statute. Management believes that ruling is incorrect. Moreover, ETT provided evidence in its application that ETT complied with what the court determined was the proper section of the statute. ETT and the PUCT filed appeals to the Texas Court of Appeals.

In a separate development, the Texas governor signed a new law that clarifies the PUCT's authority to grant CCNs to transmission only utilities such as ETT. ETT filed an application with the PUCT for a CCN under the new law for the purpose of confirming its authority to operate as a transmission only utility regardless of the outcome of the pending litigation. All parties to the litigation pending at the Texas Court of Appeals have stipulated agreement or indicated they are not opposed to ETT's request. A decision from the PUCT is expected in the first quarter of 2010.

As of December 31, 2009, ETT's investment in property, plant and equipment was $272 million, of which $133 million was under construction. Depending upon the result of ETT's CCN filing under the new law and the ultimate outcome of the appeals concerning the original CCN filing and any resulting remands, TNC may be required to reacquire assets and projects under construction previously transferred to ETT by TNC. TNC would not be required to acquire the competitive renewable-energy zones projects. If TNC is required to reacquire these assets and projects, it could impact cash flows and financial condition.

Advanced Metering System

The governor of Texas signed legislation directing the PUCT to establish a surcharge for electric utilities relating to advanced meters. TNC filed its Advanced Metering System (AMS) with the PUCT proposing to invest approximately $61 million in AMS to be recovered through customer surcharges. In the filing, TNC proposes to apply a portion of the SIA recorded customer refunds including interest to reduce the AMS investment and the resultant associated customer surcharge. See "Allocation of Off-system Sales Margins" section within "FERC Rate Matters." As of December 31, 2009, TNC has $1 million of capital expenditures, including AFUDC, recorded on its balance sheet.

In December 2009, the PUCT approved an uncontested settlement agreement. The settlement agreement includes a four-year plan for installation of smart maters and an 11-year customer surcharge to recover the costs associated with the installations. The customer surcharge will be reduced by the SIA customer refunds. Starting in January 2010, TNC started collecting the surcharge from customers. The customer surcharge is subject to reconciliation and review by the PUCT. If the PUCT's reconciliation and review requires TNC to make a refund, it could have an adverse effect on future net income and cash flows.

FERC Rate Matters

Allocation of Off-system Sales Margins

The OCC filed a complaint at the FERC alleging that AEP inappropriately allocated off-system sales margins between the AEP East companies and the AEP West companies and did not properly allocate off-system sales margins within the AEP West companies.

In 2008, the FERC issued a final order concluding that AEP inappropriately deviated from off-system sales margin allocation methods in the SIA and the CSW Operating Agreement for the period June 2000 through March 2006. The FERC ordered AEP to recalculate and reallocate the off-system sales margins in compliance with the SIA and to have the AEP East companies issue refunds to the AEP West companies. Although the FERC determined that AEP deviated from the CSW Operating Agreement, the FERC determined the allocation methodology was reasonable. The FERC ordered AEP to submit a revised CSW Operating Agreement for the period June 2000 to March 2006. AEP filed a motion for rehearing and a revised CSW Operating Agreement for the period June 2000 to March 2006. In February 2010, the FERC denied AEP's motion for rehearing.

In 2009, AEP made a compliance filing with the FERC and the AEP East companies refunded approximately $250 million to the AEP West companies. Following authorized regulatory treatment, the AEP West companies shared a

portion of SIA margins with their customers during the period June 2000 to March 2006. In 2008, the AEP West companies recorded a provision for refund reflecting the sharing.

TNC filed its Advanced Metering System (AMS) with the PUCT proposing to invest in AMS to be recovered through customer surcharges. In the filing, TNC proposed to apply a portion of the SIA recorded customer refunds including interest to reduce the AMS investment and the resultant associated customer surcharge. Customers that are not subject to the AMS surcharge will receive refunds. In December 2009, the PUCT approved an uncontested settlement agreement which authorized certain refunds and AMS surcharge reductions. In 2010, TNC refunded $4 million to customers that are not subject to the AMS. The remaining $9 million provision as of December 31, 2009 for TNC will be utilized to reduce the AMS surcharge. See the "Advanced Metering System" section above.

Management cannot predict if there will be any future state regulatory proceedings but believes the AEP West companies' provision for refund regarding related future state regulatory proceedings is adequate.

3. EFFECTS OF REGULATION

Regulatory assets and liabilities are comprised of the following items:

	December 31, 2009	December 31, 2008	Remaining Recovery Period
Regulatory Assets:	(in thousands)		
Noncurrent Regulatory Assets			
Regulatory assets being recovered:			
Regulatory Assets Currently Earning a Return			
Unamortized Loss on Reacquired Debt	$ 5,129	$ 5,764	11 years
Regulatory Assets Currently Not Earning a Return			
Pension and OPEB Funded Status	57,137	59,434	10 to 14 years
Regulatory Asset Being Recovered	62,266	65,198	
Other	2,496	2,745	various
Total Noncurrent Regulatory Assets	$ 64,762	$ 67,943	

	December 31, 2009	December 31, 2008	Remaining Refund Period
Regulatory Liabilities:	(in thousands)		
Noncurrent Regulatory Liabilities and Deferred Investment Tax Credits			
Regulatory liabilities being paid:			
Regulatory Liabilities Currently Paying a Return			
Asset Removal Costs	$ 106,708	$ 98,798	(a)
Excess Earnings	10,790	11,286	22 years
Advanced Metering Infrastructure Surcharge	8,538	-	11 years
Regulatory Liabilities Currently Not Paying a Return			
Deferred Investment Tax Credits	12,939	13,989	43 years
Income Taxes, Net	5,948	6,392	22 years
Regulatory Liabilities Being Paid	144,923	130,465	
Other	149	557	various
Total Noncurrent Regulatory Liabilities and Deferred Investment Tax Credits	$ 145,072	$ 131,022	

(a) Relieved as removal costs are incurred.

4. COMMITMENTS, GUARANTEES AND CONTINGENCIES

TNC is subject to certain claims and legal actions arising in its ordinary course of business. In addition, TNC'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.

COMMITMENTS

TNC has substantial construction commitments to support its operations and environmental investments. In managing the overall construction program and in the normal course of business, TNC contractually commits to third-party construction vendors for certain material purchases and other construction services. TNC also 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.

The following table summarizes TNC's actual contractual commitments at December 31, 2009:

Contractual Commitments	Less Than 1 year	2-3 years	4-5 years	After 5 years	Total
			(in millions)		
Construction Contracts for Capital Assets (a)	$ 0.7	$ -	$ -	$ -	$ 0.7

(a) Represents only capital assets that are contractual commitments. Actual payments are dependent upon and may vary significantly based upon the decision to build, regulatory approval schedules, timing and escalation of project costs.

GUARANTEES

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

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 December 31, 2009, 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 and the risk of payment/performance is remote.

Lease Obligations

TNC leases certain equipment under master lease agreements. See "Master Lease Agreements" section of Note 11 for disclosure of lease residual value guarantees.

CONTINGENCIES

Insurance and Potential Losses

TNC 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. Excluded property generally includes transmission and distribution lines, poles and towers. The insurance programs also generally provide coverage against loss arising from certain claims made by third parties and are in excess of TNC's retentions. Coverage is generally provided by a combination of the protected cell of EIS and/or various industry mutual and/or 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.

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 trial court dismissed the lawsuits.

In September 2009, the Second Circuit Court of Appeals issued a ruling on appeal remanding the cases to the Federal District Court for the Southern District of New York. The Second Circuit held that the issues of climate change and global warming do not raise political questions and that Congress' refusal to regulate CO_2 emissions does not mean that plaintiffs must wait for an initial policy determination by Congress or the President's administration to secure the relief sought in their complaints. The court stated that Congress could enact comprehensive legislation to regulate CO_2 emissions or that the Federal EPA could regulate CO_2 emissions under existing Clean Air Act authorities and that either of these actions could override any decision made by the district court under federal common law. The Second Circuit did not rule on whether the plaintiffs could proceed with their state common law nuisance claims. In November 2009, the defendants filed for rehearing.

In October 2009, the Fifth Circuit Court of Appeals reversed a decision by the Federal District Court for the District of Mississippi dismissing state common law nuisance claims in a putative class action by Mississippi residents asserting that CO_2 emissions exacerbated the effects of Hurricane Katrina. The Fifth Circuit held that there was no exclusive commitment of the common law issues raised in plaintiffs' complaint to a coordinate branch of government and that no initial policy determination was required to adjudicate these claims. TNC was initially dismissed from this case without prejudice, but is named as a defendant in a pending fourth amended complaint.

Management believes the actions are without merit and intends to continue to defend against the claims.

Alaskan Villages' Claims

In 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 and 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. In October 2009, the judge dismissed plaintiffs' federal common law claim for nuisance, finding the claim barred by the political question doctrine and by plaintiffs' lack of standing to bring the claim. The judge also dismissed plaintiffs' state law claims without prejudice to refiling in state court. The plaintiffs appealed the decision. 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, the generating plants and transmission and distribution facilities have used asbestos, polychlorinated biphenyls (PCBs) and other hazardous and nonhazardous materials. TNC currently incurs costs to dispose of these substances safely.

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. At December 31, 2009, TNC has been named potentially liable at one site under state law. In the instance where TNC has been named a defendant, disposal or recycling activities were in accordance with the then-applicable laws and regulations. Superfund does not recognize compliance as a defense, but imposes strict liability on parties who fall within its broad statutory categories. Liability has been resolved for a number of sites with no significant effect on net income.

Management evaluates the potential liability for each site separately, but several general statements can be made about potential future liability. Allegations that materials were disposed at a particular site are often unsubstantiated and the quantity of materials deposited at a site can be small and often nonhazardous. Although Superfund liability has been interpreted by the courts as joint and several, typically many parties are named for each site and several of the parties are financially sound enterprises. At present, management's estimates do not anticipate material cleanup costs for identified sites.

Coal Transportation Dispute

PSO, TCC, TNC, the Oklahoma Municipal Power Authority and the Public Utilities Board of the City of Brownsville, Texas, as joint owners of a generating station, disputed transportation costs for coal received between July 2000 and the present time. The joint plant remitted less than the amount billed. In September 2007, the Surface Transportation Board ruled that the disputed rates were not unreasonable under the standalone cost rate test. The joint owners filed a Petition for Reconsideration. Based upon this ruling, PSO, as operator of the plant, adjusted the provision recorded in prior periods. TNC made an adjustment to its provision based on its ownership share. After mitigation by certain contractual rights, TNC's fuel expense decreased by $9.4 million.

Rail Transportation Litigation

In October 2008, the Oklahoma Municipal Power Authority and the Public Utilities Board of the City of Brownsville, Texas, as co-owners of Oklaunion Plant, filed a lawsuit against AEP alleging breach of contract and breach of fiduciary duties related to negotiations for rail transportation services for the plant. In November 2009, all parties agreed to a settlement during court-ordered mediation.

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 September 2009, the parties reached a settlement.

5. DISPOSITION

2009

None

2008

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.

2007

None

6. BENEFIT PLANS

For a discussion of investment strategy, investment limitations, target asset allocations and the classification of investments within the fair value hierarchy, see "Investments Held in Trust for Future Liabilities" and "Fair Value Measurements of Assets and Liabilities" sections of Note 1.

TNC participates in an AEP sponsored qualified pension plan and two unfunded nonqualified pension plans. AEP merged two qualified plans at December 31, 2008. A substantial majority of employees are covered by the qualified plan or both the qualified and a nonqualified pension plan. In addition, TNC participates in OPEB plans sponsored by AEP to provide medical and life insurance benefits for retired employees.

TNC recognizes its obligations associated with defined benefit pension plans and OPEB plans in its balance sheets at fair value under the "Fair Value Measurements and Disclosures" accounting guidance. Additional disclosures about the plans are required by "Compensation – Retirement Benefits" accounting guidance. TNC recognizes an asset for a plan's overfunded status or a liability for a plan's underfunded status and recognizes, as a component of other comprehensive income, the changes in the funded status of the plan that arise during the year that are not recognized as a component of net periodic benefit cost. TNC records a regulatory asset for qualifying benefit costs of regulated operations that for ratemaking purposes are deferred for future recovery.

Adjustment of pretax AOCI is required at the end of each year, for both underfunded and overfunded defined benefit pension and OPEB plans, to an amount equal to the remaining unrecognized deferrals for unamortized actuarial losses or gains, prior service costs and transition obligations, such that remaining deferred costs result in an AOCI equity reduction and deferred gains result in an AOCI equity addition. The year-end AOCI measure can be volatile based on fluctuating market conditions, investment returns and discount rates.

The following tables provide a reconciliation of the changes in projected benefit obligations and fair value of assets for AEP's plans over the two-year period ending at the plan's measurement date of December 31, 2009, and their funded status as of December 31 of each year:

Projected Plan Obligations, Plan Assets, Funded Status as of December 31, 2009 and 2008

	Pension Plans		Other Postretirement Benefit Plans	
	December 31,		December 31,	
	2009	2008	2009	2008
Change in Projected Benefit Obligation	(in millions)			
Projected Obligation at January 1	$ 4,301	$ 4,109	$ 1,843	$ 1,773
Service Cost	104	100	42	42
Interest Cost	254	249	110	113
Actuarial Loss	290	139	32	2
Benefit Payments	(248)	(296)	(120)	(120)
Participant Contributions	-	-	25	24
Medicare Subsidy	-	-	9	9
Projected Obligation at December 31	$ 4,701	$ 4,301	$ 1,941	$ 1,843
Change in Fair Value of Plan Assets				
Fair Value of Plan Assets at January 1	$ 3,161	$ 4,504	$ 1,018	$ 1,400
Actual Gain (Loss) on Plan Assets	482	(1,054)	235	(368)
Company Contributions	8	7	150	82
Participant Contributions	-	-	25	24
Benefit Payments	(248)	(296)	(120)	(120)
Fair Value of Plan Assets at December 31	$ 3,403	$ 3,161	$ 1,308	$ 1,018
Underfunded Status at December 31	$ (1,298)	$ (1,140)	$ (633)	$ (825)

Actuarial Assumptions for Benefit Obligations

The weighted-average assumptions as of December 31 of each year used in the measurement of AEP's benefit obligations are shown in the following table:

	Pension Plans		Other Postretirement Benefit Plans	
	December 31,		December 31,	
Assumptions	2009	2008	2009	2008
Discount Rate	5.60%	6.00%	5.85%	6.10%
Rate of Compensation Increase	4.60% (a)	5.90% (a)	N/A	N/A

(a) Rates are for base pay only. In addition, an amount is added to reflect target incentive compensation for exempt employees and overtime and incentive pay for nonexempt employees.

N/A = Not Applicable

To determine a discount rate, AEP uses a duration-based method by constructing a hypothetical portfolio of high quality corporate bonds similar to those included in the Moody's Aa bond index with a duration matching the benefit plan liability. The composite yield on the hypothetical bond portfolio is used as the discount rate for the plan.

For 2009, the rate of compensation increase assumed varies with the age of the employee, ranging from 3% per year to 11.5% per year, with an average increase of 4.6%.

Amounts Recognized on AEP's Balance Sheets as of December 31, 2009 and 2008

	Pension Plans		Other Postretirement Benefit Plans	
	December 31,		December 31,	
	2009	2008	2009	2008
	(in millions)			
Other Current Liabilities – Accrued Short-term Benefit Liability	$ (10)	$ (9)	$ (4)	$ (4)
Employee Benefits and Pension Obligations – Accrued Long-term Benefit Liability	(1,288)	(1,131)	(629)	(821)
Underfunded Status	$ (1,298)	$ (1,140)	$ (633)	$ (825)

Amounts Recognized in AEP's Accumulated Other Comprehensive Income (AOCI) as of December 31, 2009, 2008 and 2007

	Pension Plans			Other Postretirement Benefit Plans		
	December 31,			December 31,		
	2009	2008	2007	2009	2008	2007
Components	(in millions)					
Net Actuarial Loss	$ 2,096	$ 2,024	$ 534	$ 546	$ 715	$ 231
Prior Service Cost	12	13	14	3	3	4
Transition Obligation	-	-	-	43	70	97
Pretax AOCI	$ 2,108	$ 2,037	$ 548	$ 592	$ 788	$ 332
Recorded as						
Regulatory Assets	$ 1,750	$ 1,660	$ 453	$ 380	$ 502	$ 204
Deferred Income Taxes	125	132	33	74	100	45
Net of Tax AOCI	233	245	62	138	186	83
Pretax AOCI	$ 2,108	$ 2,037	$ 548	$ 592	$ 788	$ 332

Components of the Change in AEP's Plan Assets and Benefit Obligations Recognized in Pretax AOCI during the years ended December 31, 2009 and 2008 are as follows:

	Pensions Plans		Other Postretirement Benefit Plans	
	Years Ended December 31,		Years Ended December 31,	
Components	2009	2008	2009	2008
	(in millions)			
Actuarial Loss (Gain) During the Year	$ 130	$ 1,527	$ (127)	$ 492
Amortization of Actuarial Loss	(59)	(37)	(42)	(9)
Prior Service Credit	-	(1)	-	-
Amortization of Transition Obligation	-	-	(27)	(27)
Total Pretax AOCI Change for the Year	$ 71	$ 1,489	$ (196)	$ 456

Pension and Other Postretirement Plans' Assets

The value of AEP's pension plan's assets increased to $3.4 billion at December 31, 2009 from $3.2 billion at December 31, 2008. The qualified plan paid $240 million in benefits to plan participants during 2009 (nonqualified plans paid $8 million in benefits). The value of the OPEB plans' assets increased to $1.3 billion at December 31, 2009 from $1 billion at December 31, 2008. The OPEB plans paid $120 million in benefits to plan participants during 2009.

The following table presents the classification of pension plan assets within the fair value hierarchy at December 31, 2009:

Major Categories of Plan Assets	Level 1	Level 2	Level 3	Other	Total	Year End Allocation
			(in millions)			
Equities:						
Domestic	$ 1,219	$ -	$ -	$ -	$ 1,219	35.8%
International	320	-	-	-	320	9.4%
Real Estate Investment Trusts	87	-	-	-	87	2.6%
Common Collective Trust – International	-	161	-	-	161	4.7%
Subtotal Equities	1,626	161	-	-	1,787	52.5%
Fixed Income:						
United States Government and Agency Securities	-	233	-	-	233	6.9%
Corporate Debt	-	831	-	-	831	24.4%
Foreign Debt	-	171	-	-	171	5.0%
State and Local Government	-	35	-	-	35	1.0%
Other – Asset Backed	-	27	-	-	27	0.8%
Subtotal Fixed Income	-	1,297	-	-	1,297	38.1%
Real Estate	-	-	90	-	90	2.7%
Alternative Investments	-	-	106	-	106	3.1%
Securities Lending	-	173	-	-	173	5.1%
Securities Lending Collateral (a)	-	-	-	(196)	(196)	(5.8)%
Cash and Cash Equivalents (b)	-	116	-	4	120	3.5%
Other – Pending Transactions and Accrued Income (c)	-	-	-	26	26	0.8%
Total	$ 1,626	$ 1,747	$ 196	$ (166)	$ 3,403	100.0%

(a) Amounts in "Other" column primarily represent an obligation to repay cash collateral received as part on the Security Lending Program.
(b) Amounts in "Other" column primarily represent foreign currency holdings.
(c) Amounts in "Other" column primarily represent accrued interest, dividend receivables and transactions pending settlement.

The following table sets forth a reconciliation of changes in the fair value of real estate and alternative investments classified as Level 3 in the fair value hierarchy for the pension assets:

	Real Estate	Alternative Investments	Total Level 3
		(in millions)	
Balance as of January 1, 2009	$ 137	$ 106	$ 243
Actual Return on Plan Assets			
Relating to Assets Still Held as of the Reporting Date	(47)	(14)	(61)
Relating to Assets Sold During the Period	-	1	1
Purchases and Sales	-	13	13
Transfers in and/or out of Level 3	-	-	-
Balance as of December 31, 2009	$ 90	$ 106	$ 196

The following table presents the classification of OPEB plan assets within the fair value hierarchy at December 31, 2009:

Major Categories of Plan Assets	Level 1	Level 2	Level 3	Other	Total	Year End Allocation
			(in millions)			
Equities:						
Domestic	$ 343	$ -	$ -	$ -	$ 343	26.2%
International	375	-	-	-	375	28.7%
Common Collective Trust – International	-	93	-	-	93	7.1%
Subtotal Equities	718	93	-	-	811	62.0%
Fixed Income:						
Common Collective Trust – Debt	-	38	-	-	38	2.9%
United States Government and Agency Securities	-	42	-	-	42	3.2%
Corporate Debt	-	141	-	-	141	10.8%
Foreign Debt	-	32	-	-	32	2.4%
State and Local Government	-	6	-	-	6	0.5%
Other – Asset Backed	-	2	-	-	2	0.2%
Subtotal Fixed Income	-	261	-	-	261	20.0%
Trust Owned Life Insurance:						
International Equities	-	75	-	-	75	5.7%
United States Bonds	-	131	-	-	131	10.0%
Cash and Cash Equivalents (a)	7	14	-	1	22	1.7%
Other – Pending Transactions and Accrued Income (b)	-	-	-	8	8	0.6%
Total	$ 725	$ 574	$ -	$ 9	$ 1,308	100.0%

(a) Amounts in "Other" column primarily represent foreign currency holdings.
(b) Amounts in "Other" column primarily represent accrued interest, dividend receivables and transactions pending settlement.

The asset allocations for AEP's plans at the end of 2008 by asset category, were as follows:

	Percentage of Plan Assets at December 31, 2008	
Asset Category	Pension Plans	Other Postretirement Benefit Plans
Equity Securities	47%	53%
Real Estate	6%	-
Debt Securities	42%	43%
Cash and Cash Equivalents	5%	4%
Total	100%	100%

Significant Concentrations of Risk Within Plan Assets

In addition to establishing the target asset allocation of plan assets, the investment policy also places restrictions on securities to limit significant concentrations within plan assets. The investment policy establishes guidelines that govern maximum market exposure, security restrictions, prohibited asset classes, prohibited types of transactions, minimum credit quality, average portfolio quality, portfolio duration and concentration limits. The guidelines were established to mitigate the risk of loss due to significant concentrations in any investment. AEP monitors the plan to control security diversification and ensure compliance with its investment policy. At December 31, 2009, the assets were invested in compliance with all investment limits. See "Investments Held in Trust for Future Liabilities" section of Note 1 for limit details.

Determination of Pension Expense

AEP bases its determination of pension expense or income on a market-related valuation of assets which reduces year-to-year volatility. This market-related valuation recognizes investment gains or losses over a five-year period from the year in which they occur. Investment gains or losses for this purpose are the difference between the expected return calculated using the market-related value of assets and the actual return based on the market-related value of assets. Since the market-related value of assets recognizes gains or losses over a five-year period, the future value of assets will be impacted as previously deferred gains or losses are recorded.

Accumulated Benefit Obligation	December 31, 2009	December 31, 2008
	(in millions)	
Qualified Pension Plans	$ 4,539	$ 4,119
Nonqualified Pension Plans	90	80
Total	$ 4,629	$ 4,199

For the underfunded pension plans that had an accumulated benefit obligation in excess of plan assets, the projected benefit obligation, accumulated benefit obligation and fair value of plan assets of these plans at December 31, 2009 and 2008 were as follows:

	Underfunded Pension Plans December 31, 2009	Underfunded Pension Plans December 31, 2008
	(in millions)	
Projected Benefit Obligation	$ 4,701	$ 4,301
Accumulated Benefit Obligation	$ 4,629	$ 4,199
Fair Value of Plan Assets	3,403	3,161
Underfunded Accumulated Benefit Obligation	$ 1,226	$ 1,038

Estimated Future Benefit Payments and Contributions

AEP expects contributions and payments for the pension plans of $160 million and the OPEB plans of $117 million during 2010. The amount for the pension plans is at least the minimum amount required by the Employee Retirement Income Security Act of 1974, as amended plus payment of unfunded nonqualified benefits. For the qualified pension plan, AEP may make additional discretionary contributions to maintain the funded status of the plan. The contribution to the OPEB plans is generally based on the amount of the OPEB plans' periodic benefit costs for accounting purposes as provided for in agreements with state regulatory authorities, plus the additional discretionary contribution of the Medicare subsidy receipts.

The table below reflects the total benefits expected to be paid from the plan or from the employer's assets, including both the employer's share of the benefit cost and the participants' share of the cost, which is funded by participant contributions to the plan. Medicare subsidy receipts are shown in the year of the corresponding benefit payments, even though actual cash receipts are expected early in the following year. Future benefit payments are dependent on the number of employees retiring, whether the retiring employees elect to receive pension benefits as annuities or as lump sum distributions, future integration of the benefit plans with changes to Medicare and other legislation, future levels of interest rates and variances in actuarial results. The estimated payments for AEP's pension benefits and OPEB are as follows:

	Pension Plans	Other Postretirement Benefit Plans	
	Pension Payments	Benefit Payments	Medicare Subsidy Receipts
		(in millions)	
2010	$ 332	$ 119	$ (10)
2011	342	130	(11)
2012	348	139	(13)
2013	355	148	(14)
2014	358	158	(15)
Years 2015 to 2019, in Total	1,871	923	(95)

Components of Net Periodic Benefit Cost

The following table provides the components of AEP's net periodic benefit cost for the plans for the years ended December 31, 2009, 2008 and 2007:

	Pension Plans			Other Postretirement Benefit Plans		
	Years Ended December 31,					
	2009	2008	2007	2009	2008	2007
	(in millions)					
Service Cost	$ 104	$ 100	$ 96	$ 42	$ 42	$ 42
Interest Cost	254	249	235	110	113	104
Expected Return on Plan Assets	(321)	(336)	(340)	(80)	(111)	(104)
Amortization of Transition Obligation	-	-	-	27	27	27
Amortization of Prior Service Cost	-	1	-	-	-	-
Amortization of Net Actuarial Loss	59	37	59	42	9	12
Net Periodic Benefit Cost	96	51	50	141	80	81
Capitalized Portion	(30)	(16)	(14)	(44)	(25)	(25)
Net Periodic Benefit Cost Recognized as Expense	$ 66	$ 35	$ 36	$ 97	$ 55	$ 56

Estimated amounts expected to be amortized to net periodic benefit costs for AEP's plans during 2010 are shown in the following table:

Components	Pension Plans	Other Postretirement Benefit Plans
	(in millions)	
Net Actuarial Loss	$ 99	$ 29
Prior Service Cost	1	-
Transition Obligation	-	27
Total Estimated 2010 Pretax AOCI Amortization	$ 100	$ 56
Expected to be Recorded as		
Regulatory Asset	$ 82	$ 37
Deferred Income Taxes	6	7
Net of Tax AOCI	12	12
Total	$ 100	$ 56

The following table provides TNC's net periodic benefit cost for the plans for the years ended December 31, 2009, 2008 and 2007:

	Pension Plans			Other Postretirement Benefit Plans		
	Years Ended December 31,					
	2009	2008	2007	2009	2008	2007
	(in thousands)					
Benefit Cost	$ 599	$ 360	$ 281	$ 3,916	$ 2,422	$ 2,523

Actuarial Assumptions for Net Periodic Benefit Costs

The weighted-average assumptions as of January 1 of each year used in the measurement of AEP's benefit costs are shown in the following tables:

	Pension Plans			Other Postretirement Benefit Plans		
	2009	2008	2007	2009	2008	2007
Discount Rate	6.00%	6.00%	5.75%	6.10%	6.20%	5.85%
Expected Return on Plan Assets	8.00%	8.00%	8.50%	7.75%	8.00%	8.00%
Rate of Compensation Increase	5.90%	5.90%	5.90%	N/A	N/A	N/A

N/A = Not Applicable

The expected return on plan assets for 2009 was determined by evaluating historical returns, the current investment climate (yield on fixed income securities and other recent investment market indicators), rate of inflation and current prospects for economic growth.

The health care trend rate assumptions as of January 1 of each year used for OPEB plans measurement purposes are shown below:

Health Care Trend Rates	2009	2008
Initial	6.50%	7.00%
Ultimate	5.00%	5.00%
Year Ultimate Reached	2012	2012

Assumed health care cost trend rates have a significant effect on the amounts reported for the OPEB health care plans. A 1% change in assumed health care cost trend rates would have the following effects:

	1% Increase	1% Decrease
	(in millions)	
Effect on Total Service and Interest Cost Components of Net Periodic Postretirement Health Care Benefit Cost	$ 20	$ (16)
Effect on the Health Care Component of the Accumulated Postretirement Benefit Obligation	217	(180)

American Electric Power System Retirement Savings Plan

TNC participates in an AEP sponsored defined contribution retirement savings plan, the American Electric Power System Retirement Savings Plan, for substantially all employees. This qualified plan offers participants an opportunity to contribute a portion of their pay, includes features under Section 401(k) of the Internal Revenue Code and provides for company matching contributions. The matching contributions to the plan was 75% of the first 6% of eligible compensation contributed by the employee in 2008. Effective January 1, 2009, the match is 100% of the first 1% of eligible employee contributions and 70% of the next 5% of contributions. The cost for contributions to the plan totaled $1.1 million in 2009, $1.2 million in 2008 and $1.1 million in 2007.

7. BUSINESS SEGMENTS

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

8. DERIVATIVES AND HEDGING

Beginning in 2009, AEPSC, on behalf of TNC, executed financial heating oil and gasoline derivative contracts to hedge the price risk of diesel fuel and gasoline purchases. The amount of AOCI, net of taxes, reported in TNC's Consolidated Balance Sheet for these hedges is $74 thousand as of December 31, 2009. Not all fuel price risk exposure is hedged. During the year ended December 31, 2009, TNC recognized no hedge ineffectiveness related to this hedge strategy. The maximum term for exposure to variability of these cash flows is 12 months.

9. FAIR VALUE MEASUREMENTS

Fair Value Measurements of Long-term Debt

The fair values of Long-term Debt are based on quoted market prices, without credit enhancements, for the same or similar issues and the current interest rates offered for instruments with similar maturities. 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 TNC's Long-term Debt at December 31, 2009 and 2008 are summarized in the following table:

	December 31, 2009		December 31, 2008	
	Book Value	Fair Value	Book Value	Fair Value
	(in thousands)			
Long-term Debt	$ 370,060	$ 393,633	$ 368,965	$ 340,971

Fair Value Measurements of Financial Assets and Liabilities

For a discussion of fair value accounting and the classification of assets and liabilities within the fair value hierarchy, see the "Fair Value Measurements of Assets and Liabilities" section of Note 1.

The following table sets forth, by level within the fair value hierarchy, TNC's financial assets and liabilities that were accounted for at fair value on a recurring basis as of December 31, 2009. As required by the accounting guidance for "Fair Value Measurements and Disclosures," financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. Management's assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels. There have not been any significant changes in management's valuation techniques.

Assets and Liabilities Measured at Fair Value on a Recurring Basis as of December 31, 2009

	Level 1	Level 2	Level 3	Other	Total
			(in thousands)		
Risk Management Assets					
Cash Flow Hedges	$ -	$ 113	$ -	$ (1)	$ 112
Risk Management Liabilities					
Cash Flow Hedges	$ -	$ 1	$ -	$ (1)	$ -

10. INCOME TAXES

The details of income taxes as reported are as follows:

	Years Ended December 31,		
	2009	2008	2007
		(in thousands)	
Income Tax Expense (Credit):			
Current	$ 26,180	$ 9,416	$ 21,948
Deferred	(13,283)	5,386	(737)
Deferred Investment Tax Credits	(1,050)	(1,050)	(1,119)
Total Income Taxes	$ 11,847	$ 13,752	$ 20,092

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,		
	2009	2008	2007
		(in thousands)	
Net Income	$ 18,353	$ 33,916	$ 39,349
Income Taxes	11,847	13,752	20,092
Pretax Income	$ 30,200	$ 47,668	$ 59,441
Income Tax on Pretax Income at Statutory Rate (35%)	$ 10,570	$ 16,684	$ 20,804
Increase (Decrease) in Income Tax resulting from the following items:			
Depreciation	(193)	(330)	(444)
Investment Tax Credits, Net	(1,050)	(1,050)	(1,119)
State and Local Income Taxes	2,093	(28)	1,010
Other	427	(1,524)	(159)
Total Income Taxes	$ 11,847	$ 13,752	$ 20,092
Effective Income Tax Rate	39.2%	28.8%	33.8%

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

	December 31,	
	2009	2008
	(in thousands)	
Deferred Tax Assets	$ 46,751	$ 31,804
Deferred Tax Liabilities	(161,658)	(157,843)
Net Deferred Tax Liabilities	$ (114,907)	$ (126,039)
Property Related Temporary Differences	$ (130,136)	$ (126,235)
Amounts Due from Customers for Future Federal Income Taxes	2,082	2,237
Deferred State Income Taxes	(1,208)	(1,306)
Deferred Income Taxes on Other Comprehensive Loss	8,653	8,704
Accrued Pensions	(922)	(1,678)
Provision for Refund	1,493	(5,212)
Regulatory Assets	(16,631)	(20,769)
All Other, Net	21,762	18,220
Net Deferred Tax Liabilities	$ (114,907)	$ (126,039)

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 2001. TNC and other AEP subsidiaries have completed the exam for the years 2001 through 2006 and have issues that are being pursued at the appeals level. The years 2007 and 2008 are currently under examination. 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 previously filed tax returns have positions that may be challenged by these tax authorities. However, management believes that the ultimate resolution of these audits will not 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.

TNC recognizes interest accruals related to uncertain tax positions in interest income or expense as applicable, and penalties in Other Operation in accordance with the accounting guidance for "Income Taxes."

The following table shows the amounts reported for interest expense, interest income and reversal of prior period interest expense:

	Years Ended December 31,		
	2009	2008	2007
		(in thousands)	
Interest Expense	$ 146	$ -	$ 156
Interest Income	-	336	-
Reversal of Prior Period Interest Expense	152	585	313

The following table shows balances for amounts accrued for the receipt of interest and the payment of interest and penalties:

	December 31,	
	2009	2008
	(in thousands)	
Accrual for Receipt of Interest	$ 184	$ 918
Accrual for Payment of Interest and Penalties	74	814

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

	2009	2008	2007
		(in thousands)	
Balance at January 1,	$ 2,545	$ 5,597	$ 6,923
Increase - Tax Positions Taken During a Prior Period	838	52	-
Decrease - Tax Positions Taken During a Prior Period	(980)	(3,787)	(1,512)
Increase - Tax Positions Taken During the Current Year	-	863	188
Decrease - Tax Positions Taken During the Current Year	(158)	(180)	-
Decrease - Settlements with Taxing Authorities	-	-	(2)
Decrease - Lapse of the Applicable Statute of Limitations	(275)	-	-
Balance at December 31,	$ 1,970	$ 2,545	$ 5,597

The total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate is $181 thousand. 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 2007 and 2008, including the Tax Technical Corrections Act of 2007, the Tax Increase Prevention Act of 2007, the Energy Independence and Security Act of 2007 and the Emergency Economic Stabilization Act of 2008. These tax law changes enacted in 2007 and 2008 did not materially affect TNC's net income, cash flows or financial condition.

The Economic Stimulus Act of 2008 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 or financial condition, but provided a material favorable cash flow benefit of approximately $8 million.

The American Recovery and Reinvestment Tax Act of 2009 provided for several new grant programs and expanded tax credits and an extension of the 50% bonus depreciation provision enacted in the Economic Stimulus Act of 2008. The enacted provisions did not have a material impact on TNC's net income or financial condition. However, the bonus depreciation contributed to AEP's 2009 federal net operating tax loss and will result in a future cash flow benefit to TNC.

11. LEASES

Leases of property, plant and equipment are for periods up to 13 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,		
Lease Rental Costs	**2009**	**2008**	**2007**
		(in thousands)	
Net Lease Expense on Operating Leases	$ 2,565	$ 2,976	$ 3,137
Amortization of Capital Leases	560	587	526
Interest on Capital Leases	18	46	93
Total Lease Rental Costs	$ 3,143	$ 3,609	$ 3,756

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

	December 31,	
	2009	**2008**
	(in thousands)	
Property, Plant and Equipment Under Capital Leases		
Total Property, Plant and Equipment Under Capital Leases – Other	$ 2,567	$ 2,502
Accumulated Amortization	1,186	1,413
Net Property, Plant and Equipment Under Capital Leases	$ 1,381	$ 1,089
Obligations Under Capital Leases		
Noncurrent Liability	$ 653	$ 566
Liability Due Within One Year	728	523
Total Obligations Under Capital Leases	$ 1,381	$ 1,089

Future minimum lease payments consisted of the following at December 31, 2009:

Future Minimum Lease Payments	Capital Leases	Noncancelable Operating Leases
	(in thousands)	
2010	$ 775	$ 2,055
2011	607	5,009
2012	40	520
2013	21	163
2014	8	134
Later Years	-	334
Total Future Minimum Lease Payments	$ 1,451	$ 8,215
Less Estimated Interest Element	70	
Estimated Present Value of Future Minimum Lease Payments	$ 1,381	

Master Lease Agreements

TNC leases certain equipment under master lease agreements. GE Capital Commercial Inc. (GE) notified management in November 2008 that they elected to terminate the Master Leasing Agreements in accordance with the termination rights specified within the contract. In 2011, TNC will be required to purchase all equipment under the lease and pay GE an amount equal to the unamortized value of all equipment then leased. As a result, the unamortized value of this equipment of $6 million is reflected in TNC's future minimum lease payments for 2011. In December 2008, management signed new master lease agreements with one-year commitment periods that include lease terms of up to 10 years.

For equipment under the GE master lease agreements that expire in 2011, the lessor is guaranteed receipt of 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 is 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. Under the new master lease agreements, the lessor is guaranteed a residual value up to a stated percentage of either the unamortized balance or the equipment cost at the end of the lease term. If the actual fair market value of the leased equipment is below the guaranteed residual value at the end of the lease term, TNC is committed to pay the difference between the actual fair market value and the residual value guarantee. At December 31, 2009, the maximum potential loss for these lease agreements was approximately $335 thousand assuming the fair market value of the equipment is zero at the end of the lease term. Historically, at the end of the lease term the fair market value has been in excess of the unamortized balance.

12. FINANCING ACTIVITIES

Preferred Stock

Par Value	Authorized Shares	Shares Outstanding at December 31, 2009	Call Price at December 31, 2009(a)	Series	Redemption	December 31, 2009	December 31, 2008
						(in thousands)	
$ 100	810,000	23,486	$ 107.00	4.40%	Any time	$ 2,349	$ 2,349

(a) The cumulative preferred stock is callable at the price indicated plus accrued dividends. If TNC defaults on preferred stock dividend payments for a period of one year or longer, preferred stock holders are entitled, voting separately as one class, to elect the number of directors necessary to constitute a majority of the full board of directors.

There were no shares redeemed for the years ended December 31, 2009, 2008 and 2007.

Long-term Debt

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

The following details long-term debt outstanding at December 31, 2009 and 2008:

Type of Debt	Maturity	Weighted Average Interest Rate at December 31, 2009	Interest Rate Ranges at December 31, 2009	Interest Rate Ranges at December 31, 2008	Outstanding at December 31, 2009	Outstanding at December 31, 2008
					(in thousands)	
Senior Unsecured Notes	2013-2038	5.81%	5.50%-6.76%	5.50%-6.76%	$ 325,000	$ 325,000
Pollution Control Bonds (a)	2020	4.45%	4.45%	4.45%	44,310	44,310
Other Long-term Debt	2059	4.50%	4.50%	-	1,006	-
Unamortized Discount					(256)	(345)
Total Long-term Debt					370,060	368,965
Less: Long-term Debt Due Within One Year					5	-
Long-term Debt					$ 370,055	$ 368,965

(a) Under the terms of the pollution control bonds, TNC 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.

Long-term debt outstanding at December 31, 2009 is payable as follows:

	2010	2011	2012	2013	2014	After 2014	Total
				(in thousands)			
Principal Amount	$ 5	$ 6	$ 6	$ 225,006	$ 7	$ 145,286	$ 370,316
Unamortized Discount							(256)
Total Long-term Debt							$ 370,060

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, and a Nonutility Money Pool, which funds the majority of the nonutility subsidiaries. The AEP System Utility Money Pool operates in accordance with the terms and conditions approved in a regulatory order. The amount of outstanding loans (borrowings) to/from the Utility Money Pool and the Nonutility Money Pool are shown as a net borrowing position as of December 31, 2009 and 2008 and are included in Advances from Affiliates on TNC's balance sheets. TNC's Utility Money Pool activity and corresponding authorized borrowing limits for the years ended December 31, 2009 and 2008 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)			
2009	$ 94,512	$ -	$ 59,080	$ -	$ 87,996	$ 250,000
2008	88,094	18,701	42,176	8,885	40,660	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 years ended December 31, 2009 and 2008, TNGC had the following activity in the Nonutility Money Pool:

Year	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 December 31,
			(in thousands)		
2009	$ -	$ 14,021	$ -	$ 12,458	$ 11,800
2008	-	18,656	-	17,479	11,974

Maximum, minimum and average interest rates for funds either borrowed from or loaned to the Utility Money Pool for the years ended December 31, 2009, 2008 and 2007 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
2009	2.28%	0.15%	-%	-%	0.75%	-%
2008	5.47%	2.28%	3.41%	2.91%	3.88%	3.08%
2007	5.94%	5.16%	5.35%	5.34%	5.43%	5.35%

Maximum, minimum and average interest rates for funds either borrowed from or loaned to the Nonutility Money Pool for the years ended December 31, 2009 and 2008 are summarized in the following table:

Years Ended December 31,	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 Rates for Funds Borrowed from the Nonutility Money Pool	Average Interest Rates for Funds Loaned to the Nonutility Money Pool
2009	-%	-%	2.28%	0.24%	-%	0.88%
2008	-%	-%	5.47%	2.28%	-%	3.52%

Interest expense and interest income related to the Utility Money Pool are included in Interest Expense and Interest Income, respectively, in TNC's Consolidated Statements of Income. For amounts borrowed from and advanced to the Utility Money Pool, TNC incurred the following amounts of interest expense and earned the following amounts of interest income, respectively, for the years ended December 31, 2009, 2008 and 2007:

	Years Ended December 31,		
	2009	2008	2007
		(in thousands)	
Interest Expense	$ 452	$ 1,146	$ 1,747
Interest Income	-	87	1

Interest expense and interest income related to the Nonutility Money Pool are included in Interest Expense and Interest Income, respectively, in TNC's Consolidated Statements of Income. For amounts borrowed from and advanced to the Nonutility Money Pool, TNC incurred the following amounts of interest expense and earned the following amounts of interest income, respectively, for the years ended December 31, 2009 and 2008:

	Years Ended December 31,	
	2009	2008
	(in thousands)	
Interest Expense	$ -	$ -
Interest Income	112	627

Dividend Restrictions

Federal Power Act

The Federal Power Act prohibits TNC from participating "in the making or paying of any dividends of such public utility from any funds properly included in capital account." The term "capital account" is not defined in the Federal Power Act or its regulations. Management understands "capital account" to mean the par value of the common stock multiplied by the number of shares outstanding. This restriction does not limit the ability of TNC to pay dividends out of retained earnings.

Charter and Leverage Restrictions

Provisions within the articles or certificates of incorporation of TNC relating to preferred stock or shares restrict the payment of cash dividends on common and preferred stock or shares. Pursuant to credit agreement leverage restrictions, as of December 31, 2009, approximately $72 million of the retained earnings of TNC have restrictions related to the payment of dividends.

Credit Facilities

TNC and certain other companies in the AEP System have a $627 million 3-year credit agreement. Under the facility, letters of credit may be issued. As of December 31, 2009, there were no outstanding amounts for TNC under the facility. TNC and certain other companies in the AEP System had a $350 million 364-day credit agreement that expired in April 2009.

13. RELATED PARTY TRANSACTIONS

For other related party transactions, also see "Money Pool – AEP System" section of Note 12.

Affiliated Revenues and Purchases

The following table shows the revenues derived from direct sales to affiliates and other revenues for the years ended December 31, 2009, 2008 and 2007:

	Years Ended December 31,		
Related Party Revenues	**2009**	**2008**	**2007**
		(in thousands)	
Direct Sales to AEPEP Affiliate	$ 79,258	$ 94,060	$ 92,591
Other	3,966	6,463	3,806
Total Revenues	$ 83,224	$ 100,523	$ 96,397

The above summarized related party revenues are reported as Sales to AEP Affiliates on TNC's Consolidated Statements of Income.

TNC's other expenses derived from purchases from affiliates for the year ended December 31, 2007 was $739 thousand. This related party expense is reported as Purchased Electricity for Resale on TNC's 2007 Consolidated Statement of Income. TNC did not have purchases from affiliates during 2009 and 2008.

System Transmission Integration Agreement

AEP's System Transmission Integration Agreement provides for the integration and coordination of the planning, operation and maintenance of the transmission facilities of AEP East companies' and AEP West companies' zones. The System Transmission Integration Agreement functions as an umbrella agreement in addition to the Transmission Agreement (TA) and the Transmission Coordination Agreement (TCA). The System Transmission Integration Agreement contains two service schedules that govern:

- The allocation of transmission costs and revenues and
- The allocation of third-party transmission costs and revenues and AEP System dispatch costs.

The System Transmission Integration Agreement anticipates that additional service schedules may be added as circumstances warrant.

APCo, CSPCo, I&M, KPCo and OPCo are parties to the TA, dated April 1, 1984, as amended, defining how they share the costs associated with their relative ownership of the extra-high-voltage transmission system (facilities rated 345 kV and above) and certain facilities operated at lower voltages (138 kV and above).

PSO, SWEPCo, TNC and AEPSC are parties to the TCA, originally dated January 1, 1997, as amended. The TCA has been approved by the FERC and establishes a coordinating committee, which is charged with overseeing the coordinated planning of the transmission facilities of the parties to the agreement, including the performance of transmission planning studies, the interaction of such companies with independent system operators (ISO) and other regional bodies interested in transmission planning and compliance with the terms of the OATT filed with the FERC and the rules of the FERC relating to such tariff.

Under the TCA, the parties to the agreement delegated to AEPSC the responsibility of monitoring the reliability of their transmission systems and administering the OATT on their behalf. The allocations have been governed by the FERC-approved OATT for the SPP (with respect to PSO, TNC and SWEPCo) and PUCT-approved protocols for ERCOT (with respect to TCC and TNC).

TNC's net credits allocated under the TCA pursuant to the ERCOT protocols as described above during the years ended December 31, 2009, 2008 and 2007 were $1.7 million, $1.5 million and $1.1 million, respectively. The net credits are recorded in Other Operation on TNC's Consolidated Statements of Income.

Assignment from SWEPCo, TCC and TNC to AEPEP

On March 1, 2008, SWEPCo, TCC and TNC assigned a 20-year Purchase Power Agreement (PPA) to AEPEP. In addition to the PPA assignment, an intercompany agreement was executed between AEPEP and SWEPCo to provide SWEPCo with future margins related to its share. The PPA and intercompany agreements are effective through 2019.

Jointly-Owned Electric Facilities

PSO and TNC jointly own the Oklaunion Plant along with two nonaffiliated companies. The costs of operating the facility are apportioned between owners based on ownership interests. Each company's share of these costs is included in the appropriate expense accounts on its respective income statements. TNC's investment in this plant is included in Property, Plant and Equipment on its Consolidated Balance Sheets.

Oklaunion PPA between TNC and AEP Energy Partners

On January 1, 2007, TNC began a 20-year Power Purchase & Sale Agreement (PPA) with an affiliate, AEP Energy Partners (AEPEP), whereby TNC agrees to sell AEPEP 100% of TNC's capacity and associated energy from its undivided interest (54.69%) in the Oklaunion Plant. AEPEP is to pay TNC for the capacity and associated energy delivered to the delivery point, the sum of fuel, operation and maintenance, depreciation, capacity and all taxes other than federal income taxes applicable. A portion of the payment is fixed and is payable regardless of the level of output. There are no penalties if TNC fails to maintain a minimum availability level or exceeds a maximum heat rate level. The PPA was approved by the FERC. TNC recognizes revenues for the fuel, operations and maintenance and all other taxes on an as-billed basis. Revenue is recognized for the capacity and depreciation billed to AEPEP, on a straight-line basis over the term of the PPA as these represent the minimum payments due.

TNC recorded revenue of $79 million, $94 million and $93 million from AEPEP for the years ended December 31, 2009, 2008 and 2007, respectively. These amounts are included in Sales to AEP Affiliates on TNC's 2009, 2008 and 2007 Consolidated Statements of Income.

Sales and Purchases of Property

TNC had affiliated sales and purchases of electric property individually amounting to $100 thousand or more for the years ended December 31, 2009, 2008 and 2007 as shown in the following table:

Companies	Years Ended December 31, 2009	2008	2007
		(in thousands)	
TNC to SWEPCo	$ -	$ -	$ 11,649
TNC to TCC	-	-	2,300

In addition, TNC had aggregate affiliated sales and purchases of meters and transformers for the years ended December 31, 2009, 2008 and 2007 as shown in the following table:

	APCo	I&M	OPCo	PSO	SWEPCo	TCC	Total
Sales				(in thousands)			
2009	$ 8	$ 10	$ 17	$ 18	$ 25	$ 750	$ 828
2008	-	-	9	28	26	334	397
2007	-	1	-	10	456	199	666
Purchases							
2009	$ -	$ 75	$ 44	$ 1	$ 28	$ 873	$ 1,021
2008	-	-	11	25	9	494	539
2007	-	-	-	2	13	763	778

The amounts above are recorded in Property, Plant and Equipment. Transfers are performed at cost.

Intercompany Billings

TNC performs certain utility services for other AEP subsidiaries when necessary or practical. The costs of these services are billed on a direct-charge basis, whenever possible, or on reasonable bases of proration for services that benefit multiple companies. The billings for services are made at cost and include no compensation for the use of equity capital. Billings are capitalized or expensed depending on the nature of the services rendered.

Variable Interest Entities

The accounting guidance for "Variable Interest Entities" 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 the accounting guidance for "Variable Interest Entities." In determining whether TNC is the primary beneficiary of a VIE, management considers factors such as equity at risk, the amount of the VIE's variability TNC 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. There have been no changes to the reporting of VIEs in the financial statements where it is concluded that TNC is the primary beneficiary. In addition, TNC has not provided financial or other support to any VIE that was not previously contractually required.

TNC holds a significant variable interest in AEPSC. AEPSC provides certain managerial and professional services to TNC. 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 TNC and other AEP subsidiaries at AEPSC's cost. TNC and other AEP subsidiaries have 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 TNC and other AEP subsidiaries that could require additional financial support from TNC and other AEP subsidiaries or expose them to losses outside of the normal course of business. AEPSC and its billings are subject to regulation by the FERC. TNC and other AEP subsidiaries are exposed to losses to the extent they cannot recover the costs of AEPSC through their normal business operations. TNC 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, 2009 and 2008 were $31 million and $35 million, respectively. The carrying amount of liabilities associated with AEPSC for the years ended December 31, 2009 and 2008 were $3 million and $4 million, respectively. Management estimates the maximum exposure of loss to be equal to the amount of such liability.

14. PROPERTY, PLANT AND EQUIPMENT

Depreciation

TNC 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:

2009	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	$ -	$ -	-	-	$ 300,291	$ 139,020	2.5%	20-49
Transmission	484,989	107,838	2.7%	45-75	-	-	-	-
Distribution	568,364	166,125	3.5%	28-70	-	-	-	-
CWIP	59,014	(706)	N.M.	N.M.	4,456	24	N.M.	N.M.
Other	99,785	63,830	8.6%	N.M.	4,595	3,747	N.M.	N.M.
Total	$ 1,212,152	$ 337,087			$ 309,342	$ 142,791		

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	$ -	$ -	-	-	$ 295,065	$ 135,754	2.6%	20-49
Transmission	411,839	99,549	2.6%	45-75	-	-	-	-
Distribution	548,424	146,560	3.5%	28-70	-	-	-	-
CWIP	76,779	(2,534)	N.M.	N.M.	5,504	-	N.M.	N.M.
Other	103,343	75,807	9.1%	N.M.	4,501	3,732	N.M.	N.M.
Total	$ 1,140,385	$ 319,382			$ 305,070	$ 139,486		

2007	Regulated		Nonregulated	
Functional Class of Property	Annual Composite Depreciation Rate	Depreciable Life Ranges	Annual Composite Depreciation Rate	Depreciable Life Ranges
		(in years)		(in years)
Production	-	-	2.6%	20-49
Transmission	3.0%	45-75	N.M.	N.M.
Distribution	3.4%	28-70	N.M.	N.M.
CWIP	N.M.	N.M.	-	-
Other	6.6%	N.M.	N.M.	N.M.

N.M. = Not Meaningful

For cost-based rate-regulated operations, 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. For nonregulated operations, non-ARO removal cost is expensed as incurred.

Asset Retirement Obligations (ARO)

TNC records ARO in accordance with the accounting guidance for "Asset Retirement and Environmental Obligations" for asbestos removal. TNC has identified, but not recognized, ARO liabilities related to electric transmission and distribution assets, as a result of certain easements on property on which assets are owned. Generally, such easements are perpetual and require only the retirement and removal of assets upon the cessation of the property's use. The retirement obligation is not estimable for such easements since TNC plans to use its facilities indefinitely. The retirement obligation would only be recognized if and when TNC abandons or ceases the use of specific easements, which is not expected.

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 2009 and 2008 aggregate carrying amounts of ARO for TNC:

Year	ARO at January 1,	Accretion Expense	Liabilities Incurred	Liabilities Settled	Revisions in Cash Flow Estimates	ARO at December 31,
			(in thousands)			
2009	$ 5,564	$ 334	$ 118	$ (1,301)	$ 100	$ 4,815
2008	10,659	388	-	(5,535)	52	5,564

Allowance for Funds Used During Construction (AFUDC)

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

	Years Ended December 31, 2009	2008	2007
		(in thousands)	
Allowance for Equity Funds Used During Construction	$ 685	$ 1,901	$ 265
Allowance for Borrowed Funds Used During Construction	1,076	1,945	1,412

Jointly-owned Electric Facilities

TNC has a 54.7% ownership share of Unit No. 1 at the Oklaunion Generating Station. In addition to TNC, the Oklaunion Generating Station is jointly-owned by PSO and various nonaffiliated companies. Each of the participating companies is obligated to pay its share of the costs in the same proportion as its ownership interest. TNC's proportionate share of the operating costs associated with this facility is included in its Consolidated Statements of Income and the investment and accumulated depreciation are reflected in its Consolidated Balance Sheets under Property, Plant and Equipment at December 31, 2009 and 2008 as follows:

	Fuel Type	Percent of Ownership	Utility Plant in Service	Construction Work in Progress	Accumulated Depreciation
TNC's Share at December 31, 2009				(in thousands)	
Oklaunion Generating Station (Unit No. 1) (a)	Coal	54.7%	$ 300,291	$ 4,693	$ 139,025
TNC's Share at December 31, 2008					
Oklaunion Generating Station (Unit No. 1) (a)	Coal	54.7%	$ 295,065	$ 5,389	$ 135,752

(a) Operated by PSO.

15. 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. TNC's unaudited quarterly financial information is as follows:

	2009 Quarterly Periods Ended			
	March 31	June 30	September 30	December 31
	(in thousands)			
Revenues	$ 63,746	$ 61,108	$ 70,245	$ 66,986
Operating Income	16,567	13,217	18,568	3,119
Net Income (Loss)	7,990	5,072	9,456	(4,165)

	2008 Quarterly Periods Ended			
	March 31	June 30	September 30	December 31
	(in thousands)			
Revenues	$ 64,218	$ 65,629	$ 71,603	$ 76,336 (a)
Operating Income	11,601	14,745	18,043	13,831 (a)
Net Income	5,125	7,230	11,688	9,873 (a)

(a) See "Allocation of Off-system Sales Margins" section of Note 2 for discussion of the financial statement impact of the FERC's November 2008 order related to the SIA.

There were no significant events in 2009.