AEP Texas North Company
and Subsidiary

2011 Second Quarter Report

Consolidated Financial Statements

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GLOSSARY OF TERMS

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

Term	Meaning
AEP or Parent	American Electric Power Company, Inc., a holding company.
AEP System	American Electric Power System, an integrated electric utility system, owned and operated by AEP's electric utility subsidiaries.
AEPSC	American Electric Power Service Corporation, a service subsidiary providing management and professional services to AEP and its subsidiaries.
AOCI	Accumulated Other Comprehensive Income.
CAA	Clean Air Act.
CO_2	Carbon Dioxide and other greenhouse gases.
ERCOT	Electric Reliability Council of Texas, an intrastate RTO.
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.
MTM	Mark-to-Market.
Nonutility Money Pool	AEP's Nonutility Money Pool is the centralized funding mechanism AEP uses to meet the short term cash requirements of pool participants.
OATT	Open Access Transmission Tariff.
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.
Risk Management Contracts	Trading and nontrading derivatives, including those derivatives designated as cash flow and fair value hedges.
RTO	Regional Transmission Organization, responsible for moving electricity over large interstate areas.
SWEPCo	Southwestern Electric Power Company, an AEP electric utility subsidiary.
TNC	AEP Texas North Company, an AEP electric utility subsidiary.
Utility Money Pool	AEP System's Utility Money Pool is the centralized funding mechanism AEP uses to meet the short term cash requirements of pool participants.
VIE	Variable Interest Entity.

AEP TEXAS NORTH COMPANY AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
For the Three and Six Months Ended June 30, 2011 and 2010
(in thousands)
(Unaudited)

	Three Months Ended 2011	Three Months Ended 2010	Six Months Ended 2011	Six Months Ended 2010
REVENUES				
Electric Transmission and Distribution	$ 47,800	$ 47,556	$ 95,967	$ 95,430
Sales to AEP Affiliates	20,666	17,664	42,359	39,262
Other Revenues	128	171	327	819
TOTAL REVENUES	68,594	65,391	138,653	135,511
EXPENSES				
Fuel and Other Consumables Used for Electric Generation	7,913	4,982	18,779	16,009
Other Operation	19,766	28,901	40,027	51,532
Maintenance	6,489	5,910	10,429	10,072
Depreciation and Amortization	13,539	12,901	27,035	26,038
Taxes Other Than Income Taxes	4,699	4,636	8,922	9,177
TOTAL EXPENSES	52,406	57,330	105,192	112,828
OPERATING INCOME	16,188	8,061	33,461	22,683
Other Income (Expense):				
Other Income (Expense)	11	(10)	149	(37)
Interest Expense	(5,628)	(5,437)	(11,173)	(10,897)
INCOME BEFORE INCOME TAX EXPENSE	10,571	2,614	22,437	11,749
Income Tax Expense	4,168	928	8,001	4,200
NET INCOME	6,403	1,686	14,436	7,549
Preferred Stock Dividend Requirements	26	26	52	52
EARNINGS ATTRIBUTABLE TO COMMON STOCK	$ 6,377	$ 1,660	$ 14,384	$ 7,497

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

See Condensed Notes to Condensed Consolidated Financial Statements.

AEP TEXAS NORTH COMPANY AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN COMMON SHAREHOLDER'S EQUITY AND COMPREHENSIVE INCOME (LOSS)
For the Six Months Ended June 30, 2011 and 2010
(in thousands)
(Unaudited)

	Common Stock	Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
TOTAL COMMON SHAREHOLDER'S EQUITY – DECEMBER 31, 2009	$ 137,214	$ 3,440	$ 185,328	$ (16,071)	$ 309,911
Common Stock Dividends			(13,750)		(13,750)
Preferred Stock Dividends			(52)		(52)
SUBTOTAL – COMMON SHAREHOLDER'S EQUITY					296,109
COMPREHENSIVE INCOME					
Other Comprehensive Income (Loss), Net of Taxes:					
Cash Flow Hedges, Net of Tax of $52				(97)	(97)
Amortization of Pension and OPEB Deferred Costs, Net of Tax of $169				314	314
NET INCOME			7,549		7,549
TOTAL COMPREHENSIVE INCOME					7,766
TOTAL COMMON SHAREHOLDER'S EQUITY – JUNE 30, 2010	$ 137,214	$ 3,440	$ 179,075	$ (15,854)	$ 303,875
TOTAL COMMON SHAREHOLDER'S EQUITY – DECEMBER 31, 2010	$ 137,214	$ 3,440	$ 183,263	$ (14,609)	$ 309,308
Common Stock Dividends			(7,500)		(7,500)
Preferred Stock Dividends			(52)		(52)
SUBTOTAL – COMMON SHAREHOLDER'S EQUITY					301,756
COMPREHENSIVE INCOME					
Other Comprehensive Income, Net of Taxes:					
Cash Flow Hedges, Net of Tax of $18				33	33
Amortization of Pension and OPEB Deferred Costs, Net of Tax of $104				193	193
NET INCOME			14,436		14,436
TOTAL COMPREHENSIVE INCOME					14,662
TOTAL COMMON SHAREHOLDER'S EQUITY – JUNE 30, 2011	$ 137,214	$ 3,440	$ 190,147	$ (14,383)	$ 316,418

See Condensed Notes to Condensed Consolidated Financial Statements.

AEP TEXAS NORTH COMPANY AND SUBSIDIARY
CONDENSED CONSOLIDATED BALANCE SHEETS
ASSETS
June 30, 2011 and December 31, 2010
(in thousands)
(Unaudited)

	2011	2010
CURRENT ASSETS		
Cash and Cash Equivalents	$ 200	$ 223
Advances to Affiliates	-	9,482
Accounts Receivable:		
Customers	13,487	11,171
Affiliated Companies	14,448	11,765
Accrued Unbilled Revenues	7,249	7,570
Allowance for Uncollectible Accounts	(351)	(571)
Total Accounts Receivable	34,833	29,935
Fuel	3,559	4,612
Materials and Supplies	12,555	11,510
Prepayments and Other Current Assets	2,108	3,816
TOTAL CURRENT ASSETS	53,255	59,578
PROPERTY, PLANT AND EQUIPMENT		
Electric:		
Generation	309,520	304,218
Transmission	469,225	450,506
Distribution	613,923	598,040
Other Property, Plant and Equipment	110,498	109,464
Construction Work in Progress	29,012	39,757
Total Property, Plant and Equipment	1,532,178	1,501,985
Accumulated Depreciation and Amortization	510,184	492,887
TOTAL PROPERTY, PLANT AND EQUIPMENT – NET	1,021,994	1,009,098
OTHER NONCURRENT ASSETS		
Regulatory Assets	59,872	61,484
Deferred Charges and Other Noncurrent Assets	8,708	2,197
TOTAL OTHER NONCURRENT ASSETS	68,580	63,681
TOTAL ASSETS	$ 1,143,829	$ 1,132,357

See Condensed Notes to Condensed Consolidated Financial Statements.

AEP TEXAS NORTH COMPANY AND SUBSIDIARY
CONDENSED CONSOLIDATED BALANCE SHEETS
LIABILITIES AND SHAREHOLDERS' EQUITY
June 30, 2011 and December 31, 2010
(Unaudited)

	2011	2010
	(in thousands)	
CURRENT LIABILITIES		
Advances from Affiliates	$ 25,795	$ -
Accounts Payable:		
General	5,419	8,695
Affiliated Companies	10,015	41,293
Long-term Debt Due Within One Year – Nonaffiliated	6	6
Accrued Taxes	19,280	17,366
Accrued Interest	5,931	5,920
Other Current Liabilities	8,586	7,956
TOTAL CURRENT LIABILITIES	75,032	81,236
NONCURRENT LIABILITIES		
Long-term Debt – Nonaffiliated	370,181	370,139
Deferred Income Taxes	140,452	135,691
Regulatory Liabilities and Deferred Investment Tax Credits	164,143	160,056
Employee Benefits and Pension Obligations	32,899	34,540
Deferred Credits and Other Noncurrent Liabilities	42,356	39,039
TOTAL NONCURRENT LIABILITIES	750,031	739,465
TOTAL LIABILITIES	825,063	820,701
Cumulative Preferred Stock Not Subject to Mandatory Redemption	2,348	2,348
Rate Matters (Note 3)		
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	3,440
Retained Earnings	190,147	183,263
Accumulated Other Comprehensive Income (Loss)	(14,383)	(14,609)
TOTAL COMMON SHAREHOLDER'S EQUITY	316,418	309,308
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 1,143,829	$ 1,132,357

See Condensed Notes to Condensed Consolidated Financial Statements.

AEP TEXAS NORTH COMPANY AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Six Months Ended June 30, 2011 and 2010
(in thousands)
(Unaudited)

	2011	2010
OPERATING ACTIVITIES		
Net Income	$ 14,436	$ 7,549
Adjustments to Reconcile Net Income to Net Cash Flows from Operating Activities:		
Depreciation and Amortization	27,035	26,038
Deferred Income Taxes	4,016	(2,200)
Property Taxes	(6,652)	(6,934)
Change in Other Noncurrent Assets	(1,134)	(447)
Change in Other Noncurrent Liabilities	4,089	3,987
Changes in Certain Components of Working Capital:		
Accounts Receivable, Net	(4,902)	3,821
Fuel, Materials and Supplies	8	(2,056)
Accounts Payable	(31,660)	(1,874)
Accrued Taxes, Net	3,686	(2,706)
Other Current Assets	6	482
Other Current Liabilities	347	(1,854)
Net Cash Flows from Operating Activities	9,275	23,806
INVESTING ACTIVITIES		
Construction Expenditures	(38,218)	(32,016)
Change in Advances to Affiliates, Net	9,482	-
Proceeds from Sales of Assets	1,543	71,399
Other Investing Activities	43	(80)
Net Cash Flows from (Used for) Investing Activities	(27,150)	39,303
FINANCING ACTIVITIES		
Change in Advances from Affiliates, Net	25,795	(48,953)
Retirement of Long-term Debt – Nonaffiliated	(3)	(3)
Principal Payments for Capital Lease Obligations	(412)	(379)
Dividends Paid on Common Stock	(7,500)	(13,750)
Dividends Paid on Cumulative Preferred Stock	(52)	(52)
Other Financing Activities	24	31
Net Cash Flows from (Used for) Financing Activities	17,852	(63,106)
Net Increase (Decrease) in Cash and Cash Equivalents	(23)	3
Cash and Cash Equivalents at Beginning of Period	223	200
Cash and Cash Equivalents at End of Period	$ 200	$ 203
SUPPLEMENTARY INFORMATION		
Cash Paid for Interest, Net of Capitalized Amounts	$ 10,531	$ 10,714
Net Cash Paid for Income Taxes	1,704	10,712
Noncash Acquisitions Under Capital Leases	132	21
Construction Expenditures Included in Current Liabilities at June 30,	1,778	1,865

See Condensed Notes to Condensed Consolidated Financial Statements.

INDEX OF CONDENSED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. SIGNIFICANT ACCOUNTING MATTERS

General

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

In the opinion of management, the unaudited condensed consolidated interim financial statements reflect all normal and recurring accruals and adjustments necessary for a fair presentation of the net income, financial position and cash flows for the interim periods. Net income for the three and six months ended June 30, 2011 is not necessarily indicative of results that may be expected for the year ending December 31, 2011. The condensed consolidated financial statements are unaudited and should be read in conjunction with the audited 2010 financial statements and notes thereto, which are included in TNC's 2010 Annual Report.

Management reviewed subsequent events through July 29, 2011, the date that the second quarter 2011 report was issued.

Variable Interest Entities

The accounting guidance for "Variable Interest Entities" is a consolidation model that considers if a company has a controlling financial interest in a VIE. A controlling financial interest will have both (a) the power to direct the activities of a VIE that most significantly impact the VIE's economic performance and (b) the obligation to absorb losses of the VIE that could potentially be significant to the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE. Entities are required to consolidate a VIE when it is determined that they have a controlling financial interest in a VIE and therefore, 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 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.

AEPSC provides certain managerial and professional services to AEP's subsidiaries. AEP is the sole equity owner of AEPSC. AEP management controls the activities of AEPSC. The costs of the services are based on a direct charge or on a prorated basis and billed to the AEP subsidiary companies at AEPSC's cost. AEP subsidiaries have not provided financial or other support outside the reimbursement of costs for services rendered. AEPSC finances its operations through cost reimbursement from other AEP subsidiaries. There are no other terms or arrangements between AEPSC and any of the AEP subsidiaries that could require additional financial support from an AEP subsidiary or expose them to losses outside of the normal course of business. AEPSC and its billings are subject to regulation by the FERC. AEP subsidiaries are exposed to losses to the extent they cannot recover the costs of AEPSC through their normal business operations. AEP subsidiaries are considered to have a significant interest in AEPSC due to their activity in AEPSC's cost reimbursement structure. However, AEP subsidiaries do not have control over AEPSC. 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. TNC's total billings from AEPSC for the three months ended June 30, 2011 and 2010 were $6 million and $12 million, respectively, and for the six months ended June 30, 2011 and 2010 were $12 million and $20 million, respectively. The carrying amount of liabilities associated with AEPSC as of June 30, 2011 and December 31, 2010 were $3 million and $4 million, respectively. Management estimates the maximum exposure of loss to be equal to the amount of such liability.

2. NEW ACCOUNTING PRONOUNCEMENTS

Upon issuance of final pronouncements, management reviews the new accounting literature to determine its relevance, if any, to TNC's business. The following represents a summary of final pronouncements that impact the financial statements.

Pronouncements Issued During 2011

The following standard was issued during the first six months of 2011. The following paragraphs discuss its impact on future financial statements.

ASU 2011-05 "Presentation of Comprehensive Income" (ASU 2011-05)

In June 2011, the FASB issued ASU 2011-05 eliminating the option to present the components of other comprehensive income as a part of the statement of shareholders' equity. The standard requires other comprehensive income be presented as part of a single continuous statement of comprehensive income or in a statement of other comprehensive income immediately following the statement of net income. Reclassification adjustments from other comprehensive income to net income must be presented on the face of the financial statements. This standard must be retrospectively applied to all reporting periods presented in financial reports issued after the effective date.

The new accounting guidance is effective for interim and annual periods beginning after December 15, 2011. This standard will change the presentation of the financial statements but will not affect the calculation of net income or comprehensive income. TNC will adopt ASU 2011-05 effective January 1, 2012.

3. RATE MATTERS

As discussed in TNC's 2010 Annual Report, TNC is involved in rate and regulatory proceedings at the FERC and the PUCT. The Rate Matters note within TNC's 2010 Annual Report should be read in conjunction with this report to gain a complete understanding of material rate matters still pending that could impact net income, cash flows and possibly financial condition. The following discusses ratemaking developments in 2011 and updates TNC's 2010 Annual Report.

Regulatory Assets Not Yet Being Recovered

Noncurrent Regulatory Assets (excluding fuel)	June 30, 2011	December 31, 2010
	(in thousands)	
Regulatory assets not yet being recovered pending future proceedings to determine the recovery method and timing:		
Regulatory Assets Currently Not Earning a Return		
Rate Case Expenses	$ 3	$ 3
Total Regulatory Assets Not Yet Being Recovered	$ 3	$ 3

Modification of the Transmission Coordination Agreement (TCA)

PSO, SWEPCo and TNC are parties to the TCA, originally dated January 1, 1997, as amended. The TCA provides for the allocation among the parties of revenues collected for transmission and ancillary services provided under the Open Access Transmission Tariff.

In April 2011, the FERC accepted proposed revisions to the TCA. Under this amendment, TNC was removed from the TCA. The amended TCA is effective May 1, 2011.

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. The Commitments, Guarantees and Contingencies note within TNC's 2010 Annual Report should be read in conjunction with this report.

GUARANTEES

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

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 June 30, 2011, 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. As of June 30, 2011, there were no material liabilities recorded for any indemnifications and the risk of payment/performance is remote.

Master Lease Agreements

TNC leases certain equipment under master lease agreements. In December 2010, management signed a new master lease agreement with GE Capital Commercial Inc. (GE) to replace existing operating and capital leases with GE. These assets were included in existing master lease agreements that were to be terminated in 2011 since GE exercised the termination provision related to these leases in 2008. Certain previously leased assets were not included in the 2010 refinancing, but were purchased in January 2011.

For equipment under the GE master lease agreements, the lessor is guaranteed receipt of up to 78% of the unamortized balance of the equipment at the end of the lease term. If the fair 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 value and the unamortized balance, with the total guarantee not to exceed 78% of the unamortized balance. For equipment under other 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 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 value and the residual value guarantee. At June 30, 2011, the maximum potential loss for these lease agreements was approximately $1 million assuming the fair value of the equipment is zero at the end of the lease term. Historically, at the end of the lease term the fair value has been in excess of the unamortized balance.

CONTINGENCIES

Carbon Dioxide Public Nuisance Claims

In 2004, eight states and the City of New York filed an action in Federal District Court for the Southern District of New York against AEP, AEPSC, Cinergy Corp, Xcel Energy, Southern Company and Tennessee Valley Authority. The Natural Resources Defense Council, on behalf of three special interest groups, filed a similar complaint against the same defendants. The actions allege that CO_2 emissions from the defendants' power plants constitute a public nuisance under federal common law due to impacts of global warming and sought injunctive relief in the form of specific emission reduction commitments from the defendants. The 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 CAA 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 2010, the U.S. Supreme Court granted the defendants' petition for review. In June 2011, the U.S. Supreme Court reversed and remanded the case to the Court of Appeals, finding that plaintiffs' federal common law claims are displaced by the regulatory authority granted to the Federal EPA under the CAA.

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. The court granted petitions for rehearing. An additional recusal left the Fifth Circuit without a quorum to reconsider the decision and the appeal was dismissed, leaving the district court's decision in place. Plaintiffs filed a petition with the U.S. Supreme Court asking the court to remand the case to the Fifth Circuit and reinstate the panel decision. The petition was denied in January 2011. Plaintiffs refiled their complaint in federal district court. Management believes the claims are without merit, and in addition to other defenses, are barred by the doctrine of collateral estoppel and the applicable statute of limitations. Management intends to vigorously defend against the claims. Management is unable to determine a range of potential losses that are reasonably possible of occurring.

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. Briefing is complete and no date has been set for oral argument. The defendants requested that the court defer setting this case for oral argument until after the Supreme Court issues its decision in the CO_2 public nuisance case discussed above. The court entered an order deferring argument until after June 2011 and the parties requested supplemental briefing on the impact of the Supreme Court's decision. Management believes the action is without merit and intends to defend against the claims. Management is unable to determine a range of potential losses that are reasonably possible of occurring.

5. <u>DISPOSITION</u>

<u>2010</u>

During the six months ended June 30, 2010, TNC sold, at cost, $71 million of transmission facilities to ETT.

6. <u>BENEFIT PLANS</u>

TNC participates in an AEP sponsored qualified pension plan and one unfunded nonqualified pension plan. Substantially all of TNC's employees are covered by the qualified plan or both the qualified and nonqualified pension plans. TNC also participates in OPEB plans sponsored by AEP to provide medical and life insurance benefits for retired employees.

Components of Net Periodic Benefit Cost

The following tables provide the components of TNC's net periodic benefit cost for the plans for the three and six months ended June 30, 2011 and 2010:

	Pension Plans		Other Postretirement Benefit Plans	
	Three Months Ended June 30,		Three Months Ended June 30,	
	2011	2010	2011	2010
	(in thousands)			
Service Cost	$ 422	$ 460	$ 192	$ 211
Interest Cost	1,305	1,430	614	657
Expected Return on Plan Assets	(1,760)	(1,988)	(641)	(637)
Amortization of Transition Obligation	-	-	-	382
Amortization of Prior Service Credit	(106)	(105)	(5)	-
Amortization of Net Actuarial Loss	673	502	159	164
Net Periodic Benefit Cost	$ 534	$ 299	$ 319	$ 777

	Pension Plans		Other Postretirement Benefit Plans	
	Six Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
	(in thousands)			
Service Cost	$ 844	$ 919	$ 384	$ 421
Interest Cost	2,574	2,860	1,228	1,315
Expected Return on Plan Assets	(3,521)	(3,975)	(1,282)	(1,274)
Amortization of Transition Obligation	-	-	-	763
Amortization of Prior Service Credit	(210)	(210)	(11)	-
Amortization of Net Actuarial Loss	1,321	1,003	318	328
Net Periodic Benefit Cost	$ 1,008	$ 597	$ 637	$ 1,553

7. BUSINESS SEGMENTS

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

8. DERIVATIVES AND HEDGING

Cash Flow Hedging Strategies

TNC's vehicle fleet is exposed to gasoline and diesel fuel price volatility. AEPSC, on behalf of TNC, enters into financial heating oil and gasoline derivative contracts in order to mitigate price risk of future fuel purchases. Not all fuel price risk exposure is hedged.

The gross notional volumes of TNC's outstanding derivative contracts for heating oil and gasoline as of June 30, 2011 and December 31, 2010 were 452 thousand gallons and 379 thousand gallons, respectively.

The following tables represent the gross fair value impact of TNC's derivative activity on the Condensed Consolidated Balance Sheets as of June 30, 2011 and December 31, 2010:

Fair Value of Derivative Instruments
June 30, 2011

Balance Sheet Location	Hedging Contracts (a)	Other (a) (b)	Total
		(in thousands)	
Prepayments and Other Current Assets	$ 119	$ (1)	$ 118
Deferred Charges and Other Noncurrent Assets	6	(2)	4
Total Assets	125	(3)	122
Other Current Liabilities	6	(2)	4
Deferred Credits and Other Noncurrent Liabilities	4	(3)	1
Total Liabilities	10	(5)	5
Total MTM Derivative Contract Net Assets	$ 115	$ 2	$ 117

Fair Value of Derivative Instruments
December 31, 2010

Balance Sheet Location	Hedging Contracts (a)	Other (a) (b)	Total
		(in thousands)	
Prepayments and Other Current Assets	$ 83	$ -	$ 83
Deferred Charges and Other Noncurrent Assets	-	-	-
Total Assets	83	-	83
Other Current Liabilities	-	-	-
Deferred Credits and Other Noncurrent Liabilities	-	-	-
Total Liabilities	-	-	-
Total MTM Derivative Contract Net Assets	$ 83	$ -	$ 83

(a) Derivative instruments within these categories are reported gross. These instruments are subject to master netting agreements and are presented on the Condensed Consolidated Balance Sheets on a net basis in accordance with the accounting guidance for "Derivatives and Hedging."

(b) Amounts include counterparty netting of risk management and hedging contracts and associated cash collateral in accordance with the accounting guidance for "Derivatives and Hedging." Amounts also include dedesignated risk management contracts.

Accounting for Cash Flow Hedging Strategies

For cash flow hedges (i.e. hedging the exposure to variability in expected future cash flows that is attributable to a particular risk), TNC initially reports the effective portion of the gain or loss on the derivative instrument as a component of Accumulated Other Comprehensive Income (Loss) on its Condensed Consolidated Balance Sheets until the period the hedged item affects Net Income. TNC records hedge ineffectiveness as a regulatory asset (for losses) or a regulatory liability (for gains).

TNC reclassifies gains and losses on financial fuel derivative contracts designated as cash flow hedges from Accumulated Other Comprehensive Income (Loss) on its balance sheets into Other Operation expense, Maintenance expense or Depreciation and Amortization expense, as it relates to capital projects, on its Condensed Consolidated Statements of Income. During the three and six months ended June 30, 2011 and 2010, TNC designated cash flow hedging strategies of forecasted fuel purchases. Hedge ineffectiveness was immaterial for this hedge strategy.

The following tables provide details on designated, effective cash flow hedges included in Accumulated Other Comprehensive Income (Loss) on TNC's Condensed Consolidated Balance Sheets and the reasons for changes in cash flow hedges for the three and six months ended June 30, 2011 and 2010. All amounts in the following tables are presented net of related income taxes.

Total Accumulated Other Comprehensive Income (Loss) Activity for Cash Flow Hedges
For the Three Months Ended June 30, 2011 and 2010

	2011	2010
	(in thousands)	
Balance in AOCI as of April 1,	$ 164	$ 67
Changes in Fair Value Recognized in AOCI	(26)	(66)
Amount of (Gain) or Loss Reclassified from AOCI to Income Statement/within Balance Sheet:		
Other Operation Expense	(19)	(11)
Maintenance Expense	(12)	(4)
Property, Plant and Equipment	(20)	(9)
Balance in AOCI as of June 30,	$ 87	$ (23)

Total Accumulated Other Comprehensive Income (Loss) Activity for Cash Flow Hedges
For the Six Months Ended June 30, 2011 and 2010

	2011	2010
	(in thousands)	
Balance in AOCI as of January 1,	$ 54	$ 74
Changes in Fair Value Recognized in AOCI	103	(62)
Amount of (Gain) or Loss Reclassified from AOCI to Income Statement/within Balance Sheet:		
Other Operation Expense	(27)	(16)
Maintenance Expense	(16)	(6)
Property, Plant and Equipment	(27)	(13)
Balance in AOCI as of June 30,	$ 87	$ (23)

Cash flow hedges included in Accumulated Other Comprehensive Income (Loss) on TNC's Condensed Consolidated Balance Sheets at June 30, 2011 and December 31, 2010 were:

Impact of Cash Flow Hedges on the Condensed Consolidated Balance Sheet
June 30, 2011 and December 31, 2010

	June 30, 2011	December 31, 2010
	(in thousands)	
Hedging Assets	$ 122	$ 83
Hedging Liabilities	7	-
AOCI Gain Net of Tax	87	54
Portion Expected to be Reclassified to Net Income During the Next Twelve Months	87	54

The actual amounts that TNC reclassifies from Accumulated Other Comprehensive Income (Loss) to Net Income can differ from the estimate above due to market price changes. As of June 30, 2011, the maximum length of time that TNC is hedging (with contracts subject to the accounting guidance for "Derivatives and Hedging") exposure to variability in future cash flows related to forecasted transactions is 18 months.

9. FAIR VALUE MEASUREMENTS

Fair Value Hierarchy and Valuation Techniques

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

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. 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.

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 as of June 30, 2011 and December 31, 2010 are summarized in the following table:

	June 30, 2011		December 31, 2010	
	Book Value	**Fair Value**	**Book Value**	**Fair Value**
	(in thousands)			
Long-term Debt	$ 370,187	$ 397,601	$ 370,145	$ 399,492

Fair Value Measurements of Financial Assets and Liabilities

The following tables set 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 June 30, 2011 and December 31, 2010. 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
June 30, 2011

	Level 1	Level 2	Level 3	Other	Total
			(in thousands)		
Risk Management Assets					
Cash Flow Hedges:					
Commodity Hedges (a)	$ -	$ 125	$ -	$ (3)	$ 122
Risk Management Liabilities					
Cash Flow Hedges:					
Commodity Hedges (a)	-	10	-	(5)	5

Assets and Liabilities Measured at Fair Value on a Recurring Basis
December 31, 2010

	Level 1	Level 2	Level 3	Other	Total
			(in thousands)		
Risk Management Assets					
Cash Flow Hedges:					
Commodity Hedges	$ -	$ 83	$ -	$ -	$ 83

(a) Amounts in "Other" column primarily represent counterparty netting of risk management and hedging contracts and associated cash collateral under the accounting guidance for "Derivatives and Hedging."

At December 31, 2010, TNC had no liabilities measured at fair value on a recurring basis.

There were no transfers between Level 1 and Level 2 during the six months ended June 30, 2011 and 2010.

10. INCOME TAXES

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. In April 2011, the IRS's examination of the years 2007 and 2008 was concluded with a settlement of all outstanding issues. The settlement will not have a material impact on net income, cash flows or financial condition. Although the outcome of tax audits is uncertain, in management's opinion, adequate provisions for federal income taxes have been made for potential liabilities resulting from such matters. In addition, 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 and other AEP subsidiaries file 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 adequate provisions for income taxes have been made for potential liabilities resulting from such challenges and that the ultimate resolution of these audits will not materially impact net income. With few exceptions, TNC is no longer subject to state or local income tax examinations by tax authorities for years before 2000.

Federal Legislation

The Patient Protection and Affordable Care Act and the related Health Care and Education Reconciliation Act (Health Care Acts) were enacted in March 2010. The Health Care Acts amend tax rules so that the portion of employer health care costs that are reimbursed by the Medicare Part D prescription drug subsidy will no longer be deductible by the employer for federal income tax purposes effective for years beginning after December 31, 2012. Because of the loss of the future tax deduction, a reduction in the deferred tax asset related to the nondeductible OPEB liabilities accrued to date was recorded by TNC in March 2010. This reduction, which was partially offset by recording net tax regulatory assets, did not materially affect TNC's cash flows or financial condition.

The Small Business Jobs Act (the Act) was enacted in September 2010. Included in the Act was a one-year extension of the 50% bonus depreciation provision. The Tax Relief, Unemployment Insurance Reauthorization and the Job Creation Act of 2010 extended the life of research and development, employment and several energy tax credits originally scheduled to expire at the end of 2010. In addition, the Act extended the time for claiming bonus depreciation and increased the deduction to 100% for part of 2010 and 2011. The enacted provisions will not have a material impact on TNC's net income or financial condition.

11. <u>FINANCING ACTIVITIES</u>

Long-term Debt

Long-term debt principal payments made during the first six months of 2011 are shown in the table below:

Type of Debt	Principal Amount Paid	Interest Rate	Due Date
	(in thousands)	(%)	
Notes Payable	$ 3	4.50	2059

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.

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 is shown in a net position in Advances from Affiliates and Advances to Affiliates as of June 30, 2011 and December 31, 2010, respectively, on TNC's balance sheets. TNC's Utility Money Pool activity and corresponding authorized borrowing limit for the six months ended June 30, 2011 are described in the following table:

Maximum Borrowings from Utility Money Pool	Maximum Loans to Utility Money Pool	Average Borrowings from Utility Money Pool	Average Loans to Utility Money Pool	Borrowings from Utility Money Pool as of June 30, 2011	Authorized Short-Term Borrowing Limit
		(in thousands)			
$ 53,865	$ -	$ 43,657	$ -	$ 36,847	$ 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 six months ended June 30, 2011, TNGC had the following activity in the Nonutility Money Pool:

Maximum Borrowings from Nonutility Money Pool	Maximum Loans to Nonutility Money Pool	Average Borrowings from Nonutility Money Pool	Average Loans to Nonutility Money Pool	Loans to Nonutility Money Pool as of June 30, 2011
		(in thousands)		
$ -	$ 11,324	$ -	$ 11,040	$ 11,052

Maximum, minimum and average interest rates for funds either borrowed from or loaned to the Utility Money Pool for the six months ended June 30, 2011 and 2010 are summarized in the following table:

Year	Maximum Interest Rates for Funds Borrowed from Utility Money Pool	Minimum Interest Rates for Funds Borrowed from Utility Money Pool	Maximum Interest Rates for Funds Loaned to Utility Money Pool	Minimum Interest Rates for Funds Loaned to Utility Money Pool	Average Interest Rates for Funds Borrowed from Utility Money Pool	Average Interest Rates for Funds Loaned to Utility Money Pool
2011	0.56 %	0.06 %	- %	- %	0.29 %	- %
2010	0.51 %	0.09 %	- %	- %	0.20 %	- %

Maximum, minimum and average interest rates for funds either borrowed from or loaned to the Nonutility Money Pool for the six months ended June 30, 2011 and 2010 are summarized in the following table:

Year	Maximum Interest Rates for Funds Borrowed from Nonutility Money Pool	Minimum Interest Rates for Funds Borrowed from Nonutility Money Pool	Maximum Interest Rates for Funds Loaned to Nonutility Money Pool	Minimum Interest Rates for Funds Loaned to Nonutility Money Pool	Average Interest Rates for Funds Borrowed from Nonutility Money Pool	Average Interest Rates for Funds Loaned to Nonutility Money Pool
2011	- %	- %	0.58 %	0.41 %	- %	0.48 %
2010	- %	- %	0.51 %	0.20 %	- %	0.35 %

12. COST REDUCTION INITIATIVES

In April 2010, management began initiatives to decrease both labor and non-labor expenses with a goal of achieving significant reductions in operation and maintenance expenses. A total of 2,461 positions was eliminated across the AEP System as a result of process improvements, streamlined organizational designs and other efficiencies. Most of the affected employees terminated employment May 31, 2010. The severance program provided two weeks of base pay for every year of service along with other severance benefits.

TNC recorded a charge of $8.5 million to Other Operation expense during the second quarter of 2010 primarily related to severance benefits as the result of headcount reduction initiatives.

The following table shows the cost reduction activity for the six months ended June 30, 2011:

Balance at December 31, 2010	Incurred	Settled	Adjustments	Balance at June 30, 2011
		(in thousands)		
$ 436	$ -	$ (397)	$ 15	$ 54

The remaining accrual is included in Other Current Liabilities on the Condensed Consolidated Balance Sheets.