

# **AEP Texas Central Company and Subsidiaries**

2011 Annual Report

Audited 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.

<b>Term</b>	<b>Meaning</b>
AEP or Parent	American Electric Power Company, Inc.
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.
APCo	Appalachian Power Company, an AEP electric utility subsidiary.
CO <sub>2</sub>	Carbon Dioxide and other greenhouse gases.
CTC	Competition Transition Charge.
CWIP	Construction Work in Progress.
EIS	Energy Insurance Services, Inc., a nonaffiliated captive insurance company.
ERCOT	Electric Reliability Council of Texas regional transmission organization.
ETT	Electric Transmission Texas, LLC, a 50% equity interest joint venture with MidAmerican Energy Holdings Company formed to own and operate electric transmission facilities in ERCOT.
Federal EPA	United States Environmental Protection Agency.
FERC	Federal Energy Regulatory Commission.
IRS	Internal Revenue Service.
I&M	Indiana Michigan Power Company, an AEP electric utility subsidiary.
KPCo	Kentucky Power Company, an AEP electric utility subsidiary.
MTM	Mark-to-Market.
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.
Risk Management Contracts	Trading and nontrading derivatives, including those derivatives designated as cash flow and fair value hedges.
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.
True-up Proceeding	A filing made under the Texas Restructuring Legislation to finalize the amount of stranded costs and other true-up items and the recovery of such amounts.
Utility Money Pool	AEP System's Utility Money Pool.
VIE	Variable Interest Entity.
WPCo	Wheeling Power Company, an AEP electric utility subsidiary.

## INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Shareholder of  
AEP Texas Central Company:

We have audited the accompanying consolidated balance sheets of AEP Texas Central Company and subsidiaries (the "Company") as of December 31, 2011 and 2010, and the related consolidated statements of income, comprehensive income (loss), changes in common shareholder's equity, and cash flows for each of the three years in the period ended December 31, 2011. 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 Central Company and subsidiaries as of December 31, 2011 and 2010, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2011 in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2 to the consolidated financial statements, in 2011 the Company changed its method of presenting comprehensive income due to the adoption of FASB Accounting Standards Update No. 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income*. The change in presentation has been applied retrospectively to all periods presented.

/s/ Deloitte & Touche LLP

Columbus, Ohio  
February 28, 2012

**AEP TEXAS CENTRAL COMPANY AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF INCOME**  
For the Years Ended December 31, 2011, 2010, 2009  
(in thousands)

	<u>2011</u>	<u>2010</u>	<u>2009</u>
<b>REVENUES</b>			
Electric Transmission and Distribution	\$ 917,647	\$ 886,611	\$ 871,747
Sales to AEP Affiliates	3,739	4,168	4,459
Other Revenues	1,446	1,686	3,978
<b>TOTAL REVENUES</b>	<u>922,832</u>	<u>892,465</u>	<u>880,184</u>
<b>EXPENSES</b>			
Purchased Electricity for Resale	-	-	3
Other Operation	247,962	279,637	244,097
Maintenance	40,592	35,290	36,528
Depreciation and Amortization	280,567	260,829	256,718
Taxes Other Than Income Taxes	70,889	74,572	68,597
<b>TOTAL EXPENSES</b>	<u>640,010</u>	<u>650,328</u>	<u>605,943</u>
<b>OPERATING INCOME</b>	282,822	242,137	274,241
<b>Other Income (Expense):</b>			
Interest Income	4,535	472	693
Carrying Costs Income	322,608	-	-
Allowance for Equity Funds Used During Construction	2,642	4,653	2,113
Interest Expense	<u>(139,526)</u>	<u>(148,848)</u>	<u>(157,369)</u>
<b>INCOME BEFORE INCOME TAX EXPENSE</b>	473,081	98,414	119,678
Income Tax Expense	<u>165,821</u>	<u>30,147</u>	<u>37,806</u>
<b>INCOME BEFORE EXTRAORDINARY ITEM</b>	307,260	68,267	81,872
<b>EXTRAORDINARY ITEM, NET OF TAX</b>	373,093	-	-
<b>NET INCOME</b>	680,353	68,267	81,872
Preferred Stock Dividend Requirements Including Capital Stock Expense	<u>469</u>	<u>236</u>	<u>240</u>
<b>EARNINGS ATTRIBUTABLE TO COMMON STOCK</b>	<u>\$ 679,884</u>	<u>\$ 68,031</u>	<u>\$ 81,632</u>

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

*See Notes to Consolidated Financial Statements beginning on page 9.*

**AEP TEXAS CENTRAL COMPANY AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**  
**For the Years Ended December 31, 2011, 2010 and 2009**  
(in thousands)

	<b>2011</b>	<b>2010</b>	<b>2009</b>
<b>NET INCOME</b>	\$ 680,353	\$ 68,267	\$ 81,872
<b>OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAXES</b>			
Cash Flow Hedges, Net of Tax of \$107 in 2011, \$26 in 2010 and \$88 in 2009	(198)	(48)	163
<b>TOTAL COMPREHENSIVE INCOME</b>	<b>\$ 680,155</b>	<b>\$ 68,219</b>	<b>\$ 82,035</b>

*See Notes to Consolidated Financial Statements beginning on page 9.*

**AEP TEXAS CENTRAL COMPANY AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CHANGES IN COMMON SHAREHOLDER'S EQUITY**  
For the Years Ended December 31, 2011, 2010 and 2009  
(in thousands)

	<u>Common Stock</u>	<u>Paid-in Capital</u>	<u>Retained Earnings</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Total</u>
<b>TOTAL COMMON SHAREHOLDER'S EQUITY - DECEMBER 31, 2008</b>	\$ 55,292	\$ 133,161	\$ 325,590	\$ -	\$ 514,043
Capital Contribution from Parent		35,000			35,000
Common Stock Dividends			(36,000)		(36,000)
Preferred Stock Dividends			(240)		(240)
Gain on Reacquired Preferred Stock		6			6
Other Changes in Common Shareholder's Equity		3,096	(3,096)		-
<b>SUBTOTAL – COMMON SHAREHOLDER'S EQUITY</b>					<u>512,809</u>
<b>NET INCOME</b>			81,872		81,872
<b>OTHER COMPREHENSIVE INCOME</b>				163	163
<b>TOTAL COMMON SHAREHOLDER'S EQUITY - DECEMBER 31, 2009</b>	<u>55,292</u>	<u>171,263</u>	<u>368,126</u>	<u>163</u>	<u>594,844</u>
Common Stock Dividends			(41,820)		(41,820)
Preferred Stock Dividends			(236)		(236)
Gain on Reacquired Preferred Stock		32			32
<b>SUBTOTAL – COMMON SHAREHOLDER'S EQUITY</b>					<u>552,820</u>
<b>NET INCOME</b>			68,267		68,267
<b>OTHER COMPREHENSIVE LOSS</b>				(48)	(48)
<b>TOTAL COMMON SHAREHOLDER'S EQUITY - DECEMBER 31, 2010</b>	<u>55,292</u>	<u>171,295</u>	<u>394,337</u>	<u>115</u>	<u>621,039</u>
Common Stock Dividends			(62,500)		(62,500)
Preferred Stock Dividends			(200)		(200)
Loss on Reacquired Preferred Stock		(233)			(233)
<b>SUBTOTAL – COMMON SHAREHOLDER'S EQUITY</b>					<u>558,106</u>
<b>NET INCOME</b>			680,353		680,353
<b>OTHER COMPREHENSIVE LOSS</b>				(198)	(198)
<b>TOTAL COMMON SHAREHOLDER'S EQUITY - DECEMBER 31, 2011</b>	<u>\$ 55,292</u>	<u>\$ 171,062</u>	<u>\$ 1,011,990</u>	<u>\$ (83)</u>	<u>\$ 1,238,261</u>

See Notes to Consolidated Financial Statements beginning on page 9.

**AEP TEXAS CENTRAL COMPANY AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**

**ASSETS**

**December 31, 2011 and 2010**  
(in thousands)

	<b>2011</b>	<b>2010</b>
<b>CURRENT ASSETS</b>		
Cash and Cash Equivalents	\$ 422	\$ 274
Restricted Cash for Securitized Transition Funding	190,995	184,040
Advances to Affiliates	-	141,584
Accounts Receivable:		
Customers	73,696	63,405
Affiliated Companies	4,810	6,090
Accrued Unbilled Revenues	37,606	41,880
Miscellaneous	3,452	50
Allowance for Uncollectible Accounts	(374)	(67)
Total Accounts Receivable	119,190	111,358
Materials and Supplies	31,181	25,626
Prepayments and Other Current Assets	3,056	1,880
<b>TOTAL CURRENT ASSETS</b>	<b>344,844</b>	<b>464,762</b>
<b>PROPERTY, PLANT AND EQUIPMENT</b>		
Electric:		
Transmission	1,135,982	1,067,604
Distribution	2,002,508	1,924,518
Other Property, Plant and Equipment	259,410	254,354
Construction Work in Progress	58,906	75,440
<b>Total Property, Plant and Equipment</b>	3,456,806	3,321,916
Accumulated Depreciation and Amortization	737,522	706,640
<b>TOTAL PROPERTY, PLANT AND EQUIPMENT – NET</b>	<b>2,719,284</b>	<b>2,615,276</b>
<b>OTHER NONCURRENT ASSETS</b>		
Regulatory Assets	1,022,680	278,373
Securitized Transition Assets		
(December 31, 2011 and 2010 amounts include \$1,561,658 and \$1,723,117, respectively, related to Transition Funding)	1,626,511	1,741,655
Deferred Charges and Other Noncurrent Assets	25,122	30,783
<b>TOTAL OTHER NONCURRENT ASSETS</b>	<b>2,674,313</b>	<b>2,050,811</b>
<b>TOTAL ASSETS</b>	<b>\$ 5,738,441</b>	<b>\$ 5,130,849</b>

*See Notes to Consolidated Financial Statements beginning on page 9.*



**AEP TEXAS CENTRAL COMPANY AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**  
**LIABILITIES AND SHAREHOLDERS' EQUITY**  
**December 31, 2011 and 2010**  
**(dollars in thousands)**

	<b>2011</b>	<b>2010</b>
<b>CURRENT LIABILITIES</b>		
Advances from Affiliates	\$ 36,043	\$ -
Accounts Payable:		
General	38,331	27,929
Affiliated Companies	7,785	40,957
Long-term Debt Due Within One Year - Nonaffiliated (December 31, 2011 and 2010 amounts include \$171,574 and \$159,443, respectively, related to Transition Funding)	231,574	279,708
Customer Deposits	13,283	12,873
Accrued Taxes	54,175	49,861
Accrued Interest (December 31, 2011 and 2010 amounts include \$44,482 and \$48,609, respectively, related to Transition Funding)	55,097	63,136
Other Current Liabilities	34,009	28,299
<b>TOTAL CURRENT LIABILITIES</b>	<b>470,297</b>	<b>502,763</b>
<b>NONCURRENT LIABILITIES</b>		
Long-term Debt – Nonaffiliated (December 31, 2011 and 2010 amounts include \$1,515,697 and \$1,687,175, respectively, related to Transition Funding)	2,159,142	2,330,566
Deferred Income Taxes	1,334,421	1,013,232
Regulatory Liabilities and Deferred Investment Tax Credits	430,980	538,964
Deferred Credits and Other Noncurrent Liabilities	105,340	118,581
<b>TOTAL NONCURRENT LIABILITIES</b>	<b>4,029,883</b>	<b>4,001,343</b>
<b>TOTAL LIABILITIES</b>	<b>4,500,180</b>	<b>4,504,106</b>
Cumulative Preferred Stock Not Subject to Mandatory Redemption	-	5,704
Rate Matters (Note 3)		
Commitments and Contingencies (Note 5)		
<b>COMMON SHAREHOLDER'S EQUITY</b>		
Common Stock – Par Value – \$25 Per Share:		
Authorized – 12,000,000 Shares		
Outstanding – 2,211,678 Shares	55,292	55,292
Paid-in Capital	171,062	171,295
Retained Earnings	1,011,990	394,337
Accumulated Other Comprehensive Income (Loss)	(83)	115
<b>TOTAL COMMON SHAREHOLDER'S EQUITY</b>	<b>1,238,261</b>	<b>621,039</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<b>\$ 5,738,441</b>	<b>\$ 5,130,849</b>

*See Notes to Consolidated Financial Statements beginning on page 9.*

**AEP TEXAS CENTRAL COMPANY AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**For the Years Ended December 31, 2011, 2010 and 2009**  
(in thousands)

	<u>2011</u>	<u>2010</u>	<u>2009</u>
<b>OPERATING ACTIVITIES</b>			
<b>Net Income</b>	\$ 680,353	\$ 68,267	\$ 81,872
<b>Adjustments to Reconcile Net Income to Net Cash Flows from Operating Activities:</b>			
Depreciation and Amortization	280,567	260,829	256,718
Deferred Income Taxes	127,155	4,572	(59,939)
Extraordinary Item, Net of Tax	(373,093)	-	-
Carrying Costs Income	(322,608)	-	-
Deferral of Storm Costs	206	(2,676)	1,300
Allowance for Equity Funds Used During Construction	(2,642)	(4,653)	(2,113)
Change in Other Noncurrent Assets	(11,296)	(2,656)	5,478
Change in Other Noncurrent Liabilities	(27,181)	15,985	1,764
<b>Changes in Certain Components of Working Capital:</b>			
Accounts Receivable, Net	(5,193)	10,108	51,220
Fuel, Materials and Supplies	(5,554)	1,299	1,634
Accounts Payable	(25,315)	27,852	(4,049)
Customer Deposits	410	642	(7,439)
Accrued Taxes, Net	2,070	(30,806)	38,419
Accrued Interest	(4,740)	(3,769)	(2,399)
Other Current Assets	51	2,873	(915)
Other Current Liabilities	2,728	(13,943)	(12,475)
<b>Net Cash Flows from Operating Activities</b>	<u>315,918</u>	<u>333,924</u>	<u>349,076</u>
<b>INVESTING ACTIVITIES</b>			
Construction Expenditures	(209,945)	(177,728)	(175,712)
Change in Restricted Cash for Securitized Transition Funding	(6,955)	(4,012)	-
Change in Other Cash Deposits	-	2	(7,105)
Change in Advances to Affiliates, Net	141,584	(27,591)	(113,993)
Proceeds from Sales of Assets	15,327	67,790	97,550
Other Investing Activities	(1,487)	(1,073)	(3,821)
<b>Net Cash Flows Used for Investing Activities</b>	<u>(61,476)</u>	<u>(142,612)</u>	<u>(203,081)</u>
<b>FINANCING ACTIVITIES</b>			
Capital Contribution from Parent	-	-	35,000
Issuance of Long-term Debt – Nonaffiliated	59,656	-	99,745
Change in Advances from Affiliates, Net	36,043	-	(107,293)
Retirement of Long-term Debt – Nonaffiliated	(279,708)	(147,833)	(137,141)
Retirement of Cumulative Preferred Stock	(5,936)	(169)	(11)
Principal Payments for Capital Lease Obligations	(1,739)	(1,542)	(1,426)
Dividends Paid on Common Stock	(62,500)	(41,820)	(36,000)
Dividends Paid on Cumulative Preferred Stock	(200)	(236)	(240)
Other Financing Activities	90	362	1,368
<b>Net Cash Flows Used for Financing Activities</b>	<u>(254,294)</u>	<u>(191,238)</u>	<u>(145,998)</u>
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	148	74	(3)
<b>Cash and Cash Equivalents at Beginning of Period</b>	274	200	203
<b>Cash and Cash Equivalents at End of Period</b>	<u>\$ 422</u>	<u>\$ 274</u>	<u>\$ 200</u>
<b>SUPPLEMENTARY INFORMATION</b>			
Cash Paid for Interest, Net of Capitalized Amounts	\$ 144,285	\$ 144,653	\$ 160,847
Net Cash Paid for Income Taxes	33,735	64,859	55,348
Noncash Acquisitions Under Capital Leases	718	887	1,877
Construction Expenditures Included in Current Liabilities at December 31,	20,747	14,620	6,664

See Notes to Consolidated Financial Statements beginning on page 9.

## **INDEX OF NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

### **ORGANIZATION**

As a public utility, TCC engages in the transmission and distribution of electric power to 787,000 retail customers through REPs in its service territory in southern and central Texas. TCC consolidates AEP Texas Central Transition Funding LLC and AEP Texas Central Transition Funding II LLC, its wholly-owned subsidiaries.

### **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

#### ***Rates and Service Regulation***

TCC's transmission and distribution rates are regulated by the PUCT. The FERC regulates TCC'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 certain intercompany transactions under its affiliate statutes. Both the FERC and state regulatory commissions are permitted to review and audit the relevant books and records of companies within a public utility holding company system.

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

#### ***Principles of Consolidation***

TCC's consolidated financial statements include TCC and its wholly-owned subsidiaries. Intercompany items are eliminated in consolidation. See "Variable Interest Entities" section of Note 14.

#### ***Accounting for the Effects of Cost-Based Regulation***

As a rate-regulated electric public utility company, TCC'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," TCC 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.

#### ***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, storm costs, 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.

### ***Restricted Cash for Securitized Transition Funding***

Restricted Cash for Securitized Transition Funding includes funds held by trustees primarily for the payment of securitization bonds and to secure the payments of the REPs.

### ***Inventory***

Materials and supplies inventories are carried at average cost.

### ***Accounts Receivable***

Customer accounts receivable primarily includes receivables from REPs and receivables 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, TCC accrues and recognizes, as Accrued Unbilled Revenues on the balance sheets, an estimate of the revenues for deliveries since the last billing.

### ***Allowance for Uncollectible Accounts***

TCC records bad debt reserves using the specific identification of receivable balances greater than 120 days delinquent, and for those balances less than 120 days where the collection is doubtful. For miscellaneous accounts receivable, bad debt expense is recorded for all amounts outstanding 180 days or greater at 100%, unless specifically identified. Miscellaneous accounts receivable items open less than 180 days may be reserved using specific identification for bad debt reserves.

### ***Concentrations of Credit Risk and Significant Customers***

TCC 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:

<b>Significant Customers of TCC: Centrica and Reliant Energy</b>	<b>2011</b>	<b>2010</b>	<b>2009</b>
Percentage of Operating Revenues	34 %	37 %	45 %
Percentage of Accounts Receivable - Customers	28 %	29 %	37 %

Management monitors credit levels and the financial condition of TCC's 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. 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 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 poles, transformers, etc. result in the original cost, less salvage, being charged to accumulated depreciation. The depreciation rates that are established take into account the past history of interim capital replacements and the amount of salvage received. These rates and the related lives are subject to periodic review. Removal costs are charged to regulatory liabilities. The costs of labor, materials and overhead incurred to operate and maintain the facilities 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.” When it becomes probable that an asset in service or an asset under construction will be abandoned and regulatory cost recovery has been disallowed, the cost of that asset shall be removed from plant-in-service or CWIP and charged to expense.

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)***

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. TCC records the equity component of AFUDC in Allowance for Equity Funds Used During Construction and the debt component of AFUDC as a reduction to Interest Expense.

### ***Valuation of Nonderivative Financial Instruments***

The book values of Cash and Cash Equivalents, Restricted Cash for Securitized Transition Funding, 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 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 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 management performs its 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 trusts.

Assets in the benefits trusts and Restricted Cash for Securitized Transition Funding are classified using the following methods. Equities are classified as Level 1 holdings if they are actively traded on exchanges. Items classified as Level 1 are investments in money market funds, fixed income and equity mutual funds and domestic equity securities. They are valued based on observable inputs primarily unadjusted quoted prices in active markets for identical assets. Items classified as Level 2 are primarily investments in individual fixed income securities and cash equivalents funds. Fixed income securities do not trade on an exchange and do not have an official closing price but their valuation inputs are based on observable market data. Pricing vendors calculate bond valuations using financial models and matrices. The models use observable inputs including yields on benchmark securities, quotes by securities brokers, rating agency actions, discounts or premiums on securities compared to par prices, changes in yields for U.S. Treasury securities, corporate actions by bond issuers, prepayment schedules and histories, economic events and, for certain securities, adjustments to yields to reflect changes in the rate of inflation. 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 primarily real estate and private equity investments that are valued using methods requiring judgment including appraisals.

### ***Revenue Recognition***

#### *Regulatory Accounting*

TCC'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, TCC records them as assets on its balance sheets. TCC 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, TCC writes off that regulatory asset as a charge against income.

#### *Traditional Electricity Supply and Delivery Activities*

TCC recognizes revenues from electricity transmission and distribution delivery services. TCC recognizes the revenues on the statements of income upon delivery of the energy to the customer and includes unbilled as well as billed amounts.

### ***Maintenance***

Maintenance costs are expensed as incurred. If it becomes probable that TCC 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***

TCC 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.

TCC accounts for uncertain tax positions in accordance with the accounting guidance for “Income Taxes.” TCC 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, TCC collects from customers certain excise taxes levied by those state or local governments on customers. TCC does not recognize these taxes as revenue or expense.

### ***Debt***

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 is refinanced, the reacquisition costs are generally deferred and amortized over the term of the replacement debt consistent with its recovery in rates.

Debt discount 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.

### ***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 allocations and periodically rebalances the investments to targeted allocations 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 levels.
- 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 investment policy for the pension fund allocates assets based on the funded status of the pension plan. The objective of the asset allocation policy is to reduce the investment volatility of the plan over time. Generally, more of the investment mix will be allocated to fixed income investments as the plan becomes better funded. Assets will be transferred away from equity investments into fixed income investments based on the market value of plan assets compared to the plan's projected benefit obligation. The target asset allocations are as follows:

<u>Pension Plan Assets</u>	<u>Target</u>
Equity	45.0 %
Fixed Income	45.0 %
Other Investments	10.0 %
<u>OPEB Plans Assets</u>	<u>Target</u>
Equity	66.0 %
Fixed Income	33.0 %
Cash	1.0 %

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.
- No individual stock may be more 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
- 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 eleven 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 Voluntary Employees' Beneficiary Association (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).

***Accumulated Other Comprehensive Income (Loss) (AOCI)***

AOCI is included on the balance sheets in the common shareholder's equity section. TCC's components of AOCI as of December 31, 2011 and 2010 are shown in the following table:

Components	December 31,	
	2011	2010
	(in thousands)	
Cash Flow Hedges, Net of Tax	\$ (83)	\$ 115

***Earnings Per Share (EPS)***

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

***Subsequent Events***

Management reviewed subsequent events through February 28, 2012, the date that TCC's 2011 annual report was issued.

## **2. NEW ACCOUNTING PRONOUNCEMENTS AND EXTRAORDINARY ITEMS**

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

### **Pronouncements Adopted During 2011**

The following standards were adopted during 2011. Consequently, their impact is reflected in the financial statements. The following paragraphs discuss their impact.

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

TCC adopted ASU 2011-05 effective for the 2011 Annual Report. 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.

This standard requires retrospective application to all reporting periods presented in the financial statements. This standard changed the presentation of the financial statements but did not affect the calculation of net income or comprehensive income. The FASB deferred the reclassification adjustment presentation provisions of ASU 2011-05 under the terms in ASU 2011-12, "Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income."

## **EXTRAORDINARY ITEMS**

### ***TCC Texas Restructuring***

In February 2006, the PUCT issued an order that denied recovery of capacity auction true-up amounts. Based on the February 2006 PUCT order, TCC recorded the disallowance as a \$421 million (\$273 million, net of tax) extraordinary loss in the December 31, 2005 financial statements. In July 2011, the Supreme Court of Texas reversed the PUCT's February 2006 disallowance of capacity auction true-up amounts and remanded for reconsideration the treatment of certain tax balances under normalization rules. Based upon the Supreme Court of Texas reversal of the PUCT's capacity auction true-up disallowance, TCC recorded a pretax gain of \$421 million (\$273 million, net of tax) in Extraordinary Items, Net of Tax on the statements of income in the third quarter of 2011.

Following a remand proceeding, the PUCT allowed TCC to retain contested tax balances in full satisfaction of its true-up proceeding, including carrying charges. Based upon the PUCT order, TCC recorded the reversal of regulatory credits of \$65 million (\$42 million, net of tax) and the reversal of \$89 million of accumulated deferred investment tax credits (\$58 million, net of tax) in Extraordinary Items, Net of Tax on the statements of income in the fourth quarter of 2011. See "Texas Restructuring" section of Note 3.

## **3. RATE MATTERS**

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

## **TEXAS RESTRUCTURING**

### ***Texas Restructuring Appeals***

Pursuant to PUCT restructuring orders, TCC securitized net recoverable stranded generation costs of \$2.5 billion and is recovering the principal and interest on the securitization bonds through the end of 2020. TCC also refunded other net true-up regulatory liabilities of \$375 million during the period October 2006 through June 2008 via a CTC credit rate rider under PUCT restructuring orders. TCC and intervenors appealed the PUCT's true-up related orders. After rulings from the Texas District Court and the Texas Court of Appeals, TCC, the PUCT and intervenors filed

petitions for review with the Supreme Court of Texas. In July 2011, the Supreme Court of Texas issued its opinion reversing the PUCT's 2006 order denying recovery of capacity auction true-up amounts and remanding for reconsideration the treatment of certain tax balances under normalization rules. In December 2011, the PUCT approved an unopposed stipulation agreement allowing TCC to recover \$800 million, including carrying charges, and retain contested tax balances in full satisfaction of its true-up proceeding. The following actions resulted from these decisions:

- Based upon the Supreme Court of Texas' reversal of the PUCT's capacity auction true-up disallowance, TCC recorded \$421 million of pretax income (\$273 million, net of tax) in Extraordinary Item, Net of Tax on the statement of income in the third quarter of 2011.
- In 2011, TCC recorded \$271 million in pretax Carrying Costs Income on the statement of income related to the debt component of carrying costs for the period from January 2002 through December 2011. This carrying costs income represents previously unrecorded earnings associated with restructuring in Texas since 2002. The total regulatory asset related to the capacity auction true-up as of December 31, 2011 was \$692 million, excluding unrecognized equity carrying costs. TCC plans to continue to recognize debt carrying costs income until securitization occurs and plans to recognize equity carrying costs income as collected from customers over the life of the securitization.
- The PUCT allowed TCC to retain contested tax balances in full satisfaction of its true-up proceeding, including carrying charges. TCC recorded the reversal of regulatory credits of \$65 million (\$42 million, net of tax) in Extraordinary Item, Net of Tax on the statement of income in the fourth quarter of 2011. Also, in the fourth quarter of 2011, TCC recorded \$52 million in pretax Carrying Costs Income on the statement of income. TCC also recorded the reversal of \$89 million of accumulated deferred investment tax credits (\$58 million, net of tax) in Extraordinary Item, Net of Tax on the statement of income in the fourth quarter of 2011. See the "TCC Deferred Investment Tax Credits and Excess Deferred Federal Income Taxes" section below.
- The Supreme Court of Texas reversed the Texas Court of Appeals' decision and found that the PUCT could adjust the net book value for what it determined to be commercially unreasonable conduct. This portion of the decision is unfavorable, but was already reflected in the financial statements.
- The Supreme Court of Texas affirmed the PUCT's finding that the sales price should be used to value TCC's nuclear generation. This portion of the decision is favorable, but this issue will have no impact on TCC's rate recovery as this was already reflected in the financial statements.
- The Supreme Court of Texas reversed the Texas Court of Appeals' decision and found it was appropriate for the PUCT to take into account previously refunded excess mitigation credits to affiliate retail electricity providers. This portion of the decision upheld the PUCT's decision.
- The PUCT decisions allowing recovery of construction work in progress balances and specifying the interest rate on stranded costs were upheld. These decisions are already reflected in the financial statements and were not addressed in the remand proceeding.

The approved stipulation agreement resolved all remaining issues in these dockets. In December 2011, TCC filed an application with the PUCT for a financing order to recover the \$800 million through the issuance of securitization bonds as permitted by Texas statutory provisions. In January 2012, the PUCT approved the request. TCC anticipates issuing the bonds in March 2012.

### ***TCC Deferred Investment Tax Credits and Excess Deferred Federal Income Taxes***

In 2006, the PUCT reduced recovery of the amount securitized by \$103 million of tax benefits including associated carrying costs related to TCC's generation assets. In 2006, TCC obtained a private letter ruling from the IRS which confirmed that such a reduction was an IRS normalization violation. In 2008, the IRS issued final regulations, which supported the IRS's private letter ruling which would make the refunding of or the reduction of the amount securitized by such tax benefits a normalization violation. After the IRS issued its final regulations, the tax

normalization issue was remanded to the PUCT for its consideration of additional evidence including the IRS regulations. In December 2011, the PUCT approved an unopposed stipulation allowing TCC to retain contested tax balances in full satisfaction of its true-up proceeding, including carrying charges, in final resolution of this issue. See the “Texas Restructuring Appeals” section above.

### ***TCC Excess Earnings***

In 2005, a Texas appellate court issued a decision finding that a PUCT order requiring TCC to refund to the Texas Retail Electric Providers excess earnings prior to and outside of the true-up process was unlawful under the Texas Restructuring Legislation. From 2002 to 2005, TCC refunded \$55 million of excess earnings, including interest, under the overturned PUCT order. In the true-up proceeding, the PUCT adjusted stranded costs for TCC’s payment of excess earnings under the PUCT order. However, the PUCT did not properly recognize TCC’s payment of interest under the prior order, causing TCC to refund interest twice. The Supreme Court of Texas approved the PUCT treatment of these matters in the true-up case, noting that TCC could pursue its additional interest claim in further proceedings related to the excess earnings order. TCC agreed to dismiss its claims as part of the stipulation approved by the PUCT in the true-up proceeding. See the “Texas Restructuring Appeals” section above. The dismissal did not have any impact on TCC’s rate recovery as this was already reflected in the financial statements.

#### 4. EFFECTS OF REGULATION

Regulatory assets and liabilities are comprised of the following items:

<b>Regulatory Assets:</b>	<b>December 31,</b>		<b>Remaining</b>
	<b>2011</b>	<b>2010</b>	<b>Recovery Period</b>
	<b>(in thousands)</b>		
<b>Noncurrent Regulatory Assets</b>			
<b>Regulatory assets not yet being recovered pending future proceedings to determine the recovery method and timing:</b>			
<u>Regulatory Assets Currently Earning a Return</u>			
Storm Related Costs	\$ 24,166	\$ 24,372	
<u>Regulatory Assets Currently Not Earning a Return</u>			
Rate Case Expense	145	139	
<b>Total Regulatory Assets Not Yet Being Recovered</b>	<b>24,311</b>	<b>24,511</b>	
<b>Regulatory assets being recovered:</b>			
<u>Regulatory Assets Currently Earning a Return</u>			
Capacity Auction True-Up	691,610	-	13 years
Meter Replacement Costs	31,070	3,388	18 years
Unamortized Loss on Reacquired Debt	15,412	17,275	26 years
Advanced Metering System	1,409	1,565	9 years
<u>Regulatory Assets Currently Not Earning a Return</u>			
Pension and OPEB Funded Status	234,694	215,704	13 years
Income Taxes, Net	13,683	-	28 years
Restructuring Transition Costs	8,499	13,659	5 years
Transmission Cost Recovery Factor	1,992	1,202	1 year
Deferred Rate Case Expense	-	1,069	
<b>Total Regulatory Assets Being Recovered</b>	<b>998,369</b>	<b>253,862</b>	
<b>Total Noncurrent Regulatory Assets</b>	<b>\$ 1,022,680</b>	<b>\$ 278,373</b>	
<b>Regulatory Liabilities:</b>	<b>December 31,</b>		<b>Remaining</b>
	<b>2011</b>	<b>2010</b>	<b>Refund Period</b>
	<b>(in thousands)</b>		
<b>Noncurrent Regulatory Liabilities and Deferred Investment Tax Credits</b>			
<b>Regulatory liabilities not yet being paid:</b>			
<u>Regulatory Liabilities Currently Not Paying a Return</u>			
Other Regulatory Liabilities Not Yet Being Paid	\$ -	\$ 207	
<b>Total Regulatory Liabilities Not Yet Being Paid</b>	<b>-</b>	<b>207</b>	
<b>Regulatory liabilities being paid:</b>			
<u>Regulatory Liabilities Currently Paying a Return</u>			
Asset Removal Costs	314,892	299,486	(a)
Advanced Metering Infrastructure Surcharge	60,954	46,300	9 years
<u>Regulatory Liabilities Currently Not Paying a Return</u>			
Over-recovery of Transition Charges	40,749	37,881	10 years
Deferred Investment Tax Credits	11,614	101,220	51 years
Energy Efficiency/Peak Demand Reduction	2,771	2,354	1 year
Income Taxes, Net	-	51,516	
<b>Total Regulatory Liabilities Being Paid</b>	<b>430,980</b>	<b>538,757</b>	
<b>Total Noncurrent Regulatory Liabilities and Deferred Investment Tax Credits</b>	<b>\$ 430,980</b>	<b>\$ 538,964</b>	

(a) Relieved as removal costs are incurred.

## 5. COMMITMENTS, GUARANTEES AND CONTINGENCIES

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

#### *Construction and Commitments*

TCC has substantial construction commitments to support its operations and environmental investments. In managing the overall construction program and in the normal course of business, TCC contractually commits to third-party construction vendors for certain material purchases and other construction services. Management forecasts approximately \$200 million of construction expenditures, excluding equity AFUDC, for 2012. TCC also purchases 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 TCC's actual contractual commitments at December 31, 2011:

<b>Contractual Commitments</b>	<b>Less Than 1 year</b>	<b>2-3 years</b>	<b>4-5 years</b>	<b>After 5 years</b>	<b>Total</b>
			<b>(in thousands)</b>		
Construction Contracts for Capital Assets (a)	\$ 4,519	\$ -	\$ -	\$ -	\$ 4,519

(a) Represents only capital assets for which there are signed contracts. 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*

TCC 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. The status of certain sale agreements is discussed in the "Dispositions" section of Note 6. As of December 31, 2011, there were no material liabilities recorded for any indemnifications.

##### *Lease Obligations*

TCC leases certain equipment under master lease agreements. See "Master Lease Agreements" section of Note 12 for disclosure of lease residual value guarantees.

## CONTINGENCIES

### *Insurance and Potential Losses*

TCC 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 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 TCC'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<sub>2</sub> 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<sub>2</sub> 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. 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. After the remand, the plaintiffs asked the Second Circuit to return the case to the district court so that they could withdraw their complaints. The cases were returned to the district court and the plaintiffs' federal common law claims were dismissed in December 2011.

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<sub>2</sub> 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. The court ordered all defendants to respond to the refiled complaints in October 2011. 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 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<sub>2</sub> 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 refile in state court. The plaintiffs appealed the decision. The defendants requested that the court defer setting this case for oral argument until after the Supreme Court issues its decision in the CO<sub>2</sub> public nuisance case discussed above. The court accepted supplemental briefing on the impact of the Supreme Court's decision and heard oral argument in November 2011. 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.

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

The transmission and distribution facilities have used asbestos, polychlorinated biphenyls and other hazardous and nonhazardous materials. TCC 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, 2011, TCC has been named potentially liable at two sites under state law. In the instances where TCC 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.

### ***Claims by the City of Brownsville, Texas Against TCC***

In 2007, the City of Brownsville, Texas filed an original petition in litigation pending in the District Court of Dallas County, Texas. The petition seeks recovery against TCC based on allegations of breach of contract, breach of fiduciary duty, unjust enrichment, constructive trust, conversion, breach of the Texas theft liability act and fraud allegedly occurring in connection with a transaction in which Brownsville purchased TCC's interest in the Oklaunion electric generating station. The court signed the Final Summary Judgment in favor of TCC on Brownsville's claims against TCC and severed TCC's claims against Brownsville for further proceedings. Brownsville filed an appeal to the Dallas Court of Appeals. The Court of Appeals ordered the parties to mediate this dispute. Mediation was unsuccessful. Oral argument was heard by the Court of Appeals in December 2010. In July 2011, the Court of Appeals partially reversed the district court decision and remanded certain issues to the district court. TCC's motion for rehearing was denied by the Court of Appeals. In October 2011, TCC filed a petition for review of the court of appeals opinion in the Supreme Court of Texas. Management believes that the claims are without merit and intends to defend against them vigorously. Management is unable to determine a range of potential losses that are reasonably possible of occurring.

## **6. DISPOSITIONS**

### **2011**

#### ***Electric Transmission Texas LLC (ETT)***

In 2011, TCC sold \$10 million of transmission facilities to ETT. There were no gains or losses recorded on these sale transactions.

### **2010**

#### ***Electric Transmission Texas LLC (ETT)***

In 2010, TCC sold \$66 million of transmission facilities to ETT. There were no gains or losses recorded on these sale transactions.

### **2009**

#### ***Electric Transmission Texas LLC (ETT)***

In 2009, TCC sold \$93 million of transmission facilities to ETT. There were no gains or losses recorded on these sale transactions.

## **7. 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.

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

TCC recognizes its funded status associated with defined benefit pension and OPEB plans in its balance sheets. Disclosures about the plans are required by the “Compensation – Retirement Benefits” accounting guidance. TCC 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. TCC records a regulatory asset instead of other comprehensive income for qualifying benefit costs of regulated operations that for ratemaking purposes are deferred for future recovery. The cumulative funded status adjustment is 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 a regulatory asset and deferred gains result in a regulatory liability.

### *Actuarial Assumptions for Benefit Obligations*

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

<u>Assumptions</u>	<u>Pension Plans</u>		<u>Other Postretirement Benefit Plans</u>	
	<u>2011</u>	<u>2010</u>	<u>2011</u>	<u>2010</u>
Discount Rate	4.55 %	5.05 %	4.75 %	5.25 %
Rate of Compensation Increase	4.90 % (a)	5.05 % (a)	NA	NA

(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.

NA Not Applicable

A duration-based method is used to determine the discount rate for the plans. A hypothetical portfolio of high quality corporate bonds similar to those included in the Moody's Aa bond index is constructed 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 2011, the rate of compensation increase assumed varies with the age of the employee, ranging from 3.5% per year to 11.5% per year, with an average increase of 4.9%.

### *Actuarial Assumptions for Net Periodic Benefit Costs*

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

	<u>Pension Plans</u>			<u>Other Postretirement Benefit Plans</u>		
	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>
Discount Rate	5.05 %	5.60 %	6.00 %	5.25 %	5.85 %	6.10 %
Expected Return on Plan Assets	7.75 %	8.00 %	8.00 %	7.50 %	8.00 %	7.75 %
Rate of Compensation Increase	4.90 %	4.70 %	6.00 %	NA	NA	NA

NA Not Applicable

The expected return on plan assets for 2011 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:

<u>Health Care Trend Rates</u>	<u>2011</u>	<u>2010</u>
Initial	7.50 %	8.00 %
Ultimate	5.00 %	5.00 %
Year Ultimate Reached	2016	2016

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:

	<u>1% Increase</u>	<u>1% Decrease</u>
	(in thousands)	
Effect on Total Service and Interest Cost		
Components of Net Periodic Postretirement Health		
Care Benefit Cost	\$ 1,352	\$ (1,078)
Effect on the Health Care Component of the		
Accumulated Postretirement Benefit Obligation	16,868	(13,766)

### ***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 credit quality, portfolio duration and concentration limits. The guidelines were established to mitigate the risk of loss due to significant concentrations in any investment. The plans are monitored to control security diversification and ensure compliance with the investment policy. At December 31, 2011, 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.

### ***Benefit Plan Obligations, Plan Assets and Funded Status as of December 31, 2011 and 2010***

The following tables provide a reconciliation of the changes in the plans' benefit obligations, fair value of plan assets and funded status as of December 31. The benefit obligation for the defined benefit pension and OPEB plans are the projected benefit obligation and the accumulated benefit obligation, respectively.

	<u>Pension Plans</u>		<u>Other Postretirement Benefit Plans</u>	
	<u>2011</u>	<u>2010</u>	<u>2011</u>	<u>2010</u>
	(in thousands)			
<b>Change in Benefit Obligation</b>				
Benefit Obligation at January 1	\$ 333,234	\$ 364,244	\$ 131,786	\$ 123,810
Service Cost	5,000	5,555	2,218	2,462
Interest Cost	16,520	18,592	6,797	7,132
Actuarial (Gain) Loss	13,744	(5,078)	19,122	8,179
Plan Amendment Prior Service Credit	-	-	(12,963)	(2,597)
Benefit Payments	(21,225)	(50,079)	(10,139)	(10,217)
Participant Contributions	-	-	2,342	2,212
Medicare Subsidy	-	-	766	805
<b>Benefit Obligation at December 31</b>	<u>\$ 347,273</u>	<u>\$ 333,234</u>	<u>\$ 139,929</u>	<u>\$ 131,786</u>
<b>Change in Fair Value of Plan Assets</b>				
Fair Value of Plan Assets at January 1	\$ 267,959	\$ 282,211	\$ 94,575	\$ 86,605
Actual Gain on Plan Assets	19,191	26,868	1,536	7,228
Company Contributions	39,460	8,959	4,577	8,747
Participant Contributions	-	-	2,342	2,212
Benefit Payments	(21,225)	(50,079)	(10,139)	(10,217)
<b>Fair Value of Plan Assets at December 31</b>	<u>\$ 305,385</u>	<u>\$ 267,959</u>	<u>\$ 92,891</u>	<u>\$ 94,575</u>
<b>Underfunded Status at December 31</b>	<u>\$ (41,888)</u>	<u>\$ (65,275)</u>	<u>\$ (47,038)</u>	<u>\$ (37,211)</u>

*Amounts Recognized on the Balance Sheets as of December 31, 2011 and 2010*

	<u>Pension Plans</u>		<u>Other Postretirement Benefit Plans</u>	
	<u>December 31,</u>			
	<u>2011</u>	<u>2010</u>	<u>2011</u>	<u>2010</u>
	(in thousands)			
Other Current Liabilities - Accrued Short-term Benefit Liability	\$ (284)	\$ (266)	\$ -	\$ -
Deferred Credits and Other Noncurrent Liabilities - Accrued Long-term Benefit Liability	(41,604)	(65,009)	(47,038)	(37,211)
<b>Underfunded Status</b>	<u>\$ (41,888)</u>	<u>\$ (65,275)</u>	<u>\$ (47,038)</u>	<u>\$ (37,211)</u>

*Amounts Included in Regulatory Assets as of December 31, 2011 and 2010*

<u>Components</u>	<u>Pension Plans</u>		<u>Other Postretirement Benefit Plans</u>	
	<u>December 31,</u>			
	<u>2011</u>	<u>2010</u>	<u>2011</u>	<u>2010</u>
	(in thousands)			
Net Actuarial Loss	\$ 187,753	\$ 179,859	\$ 60,668	\$ 37,941
Prior Service Credit	(67)	(1,337)	(13,660)	(759)
<b>Recorded as</b>				
Regulatory Assets	\$ 187,686	\$ 178,522	\$ 47,008	\$ 37,182

Components of the change in amounts included in Regulatory Assets during the years ended December 31, 2011 and 2010 are as follows:

<u>Components</u>	<u>Pension Plans</u>		<u>Other Postretirement Benefit Plans</u>	
	<u>Years Ended December 31,</u>			
	<u>2011</u>	<u>2010</u>	<u>2011</u>	<u>2010</u>
	(in thousands)			
Actuarial Loss (Gain) During the Year	\$ 16,366	\$ (6,218)	\$ 24,487	\$ 7,839
Prior Service Credit	-	-	(12,963)	(2,597)
Amortization of Actuarial Loss	(8,472)	(6,522)	(1,760)	(1,779)
Amortization of Prior Service Credit	1,270	1,271	62	-
Amortization of Transition Obligation	-	-	-	(3,468)
<b>Change for the Year</b>	<u>\$ 9,164</u>	<u>\$ (11,469)</u>	<u>\$ 9,826</u>	<u>\$ (5)</u>

### Pension and Other Postretirement Plans' Assets

The following table presents the classification of pension plan assets within the fair value hierarchy at December 31, 2011:

Asset Class	Level 1	Level 2	Level 3	Other	Total	Year End Allocation
	(in thousands)					
Equities:						
Domestic	\$ 103,245	\$ -	\$ -	\$ -	\$ 103,245	33.8 %
International	28,306	-	-	-	28,306	9.3 %
Real Estate Investment Trusts	7,381	-	-	-	7,381	2.4 %
Common Collective Trust - International	-	9,116	-	-	9,116	3.0 %
Subtotal - Equities	138,932	9,116	-	-	148,048	48.5 %
Fixed Income:						
Common Collective Trust - Debt	-	1,863	-	-	1,863	0.6 %
United States Government and Agency Securities	-	40,151	-	-	40,151	13.2 %
Corporate Debt	-	69,881	452	-	70,333	23.0 %
Foreign Debt	-	13,531	-	-	13,531	4.4 %
State and Local Government	-	3,410	-	-	3,410	1.1 %
Other - Asset Backed	-	1,845	-	-	1,845	0.6 %
Subtotal - Fixed Income	-	130,681	452	-	131,133	42.9 %
Real Estate	-	-	11,592	-	11,592	3.8 %
Alternative Investments	-	-	11,380	-	11,380	3.7 %
Securities Lending	-	15,243	-	-	15,243	5.0 %
Securities Lending Collateral (a)	-	-	-	(16,734)	(16,734)	(5.5)%
Cash and Cash Equivalents	-	6,584	-	-	6,584	2.2 %
Other - Pending Transactions and Accrued Income (b)	-	-	-	(1,861)	(1,861)	(0.6)%
<b>Total</b>	<b>\$ 138,932</b>	<b>\$ 161,624</b>	<b>\$ 23,424</b>	<b>\$ (18,595)</b>	<b>\$ 305,385</b>	<b>100.0 %</b>

(a) Amounts in "Other" column primarily represent an obligation to repay cash collateral received as part of the Securities Lending Program.

(b) 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 assets classified as Level 3 in the fair value hierarchy for TCC's pension assets:

	Corporate Debt	Real Estate	Alternative Investments	Total Level 3
	(in thousands)			
<b>Balance as of January 1, 2011</b>	\$ -	\$ 5,779	\$ 9,029	\$ 14,808
Actual Return on Plan Assets				
Relating to Assets Still Held as of the Reporting Date	-	1,618	673	2,291
Relating to Assets Sold During the Period	-	-	231	231
Purchases and Sales	-	4,195	1,447	5,642
Transfers into Level 3	452	-	-	452
Transfers out of Level 3	-	-	-	-
<b>Balance as of December 31, 2011</b>	<b>\$ 452</b>	<b>\$ 11,592</b>	<b>\$ 11,380</b>	<b>\$ 23,424</b>

The following table presents the classification of OPEB plan assets within the fair value hierarchy at December 31, 2011:

<u>Asset Class</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Other</u>	<u>Total</u>	<u>Year End Allocation</u>
	(in thousands)					
Equities:						
Domestic	\$ 22,914	\$ -	\$ -	\$ -	\$ 22,914	24.7 %
International	25,062	-	-	-	25,062	27.0 %
Common Collective Trust - Global	-	6,534	-	-	6,534	7.0 %
Subtotal - Equities	<u>47,976</u>	<u>6,534</u>	<u>-</u>	<u>-</u>	<u>54,510</u>	<u>58.7 %</u>
Fixed Income:						
Common Collective Trust - Debt	-	4,561	-	-	4,561	4.9 %
United States Government and Agency Securities	-	5,323	-	-	5,323	5.7 %
Corporate Debt	-	10,024	-	-	10,024	10.8 %
Foreign Debt	-	2,125	-	-	2,125	2.3 %
State and Local Government	-	554	-	-	554	0.6 %
Other - Asset Backed	-	126	-	-	126	0.1 %
Subtotal - Fixed Income	<u>-</u>	<u>22,713</u>	<u>-</u>	<u>-</u>	<u>22,713</u>	<u>24.4 %</u>
Trust Owned Life Insurance:						
International Equities	-	3,046	-	-	3,046	3.3 %
United States Bonds	-	10,399	-	-	10,399	11.2 %
Cash and Cash Equivalents	1,108	1,543	-	-	2,651	2.9 %
Other - Pending Transactions and Accrued Income (a)	<u>-</u>	<u>-</u>	<u>-</u>	<u>(428)</u>	<u>(428)</u>	<u>(0.5)%</u>
<b>Total</b>	<u>\$ 49,084</u>	<u>\$ 44,235</u>	<u>\$ -</u>	<u>\$ (428)</u>	<u>\$ 92,891</u>	<u>100.0 %</u>

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

The following table presents the classification of pension plan assets within the fair value hierarchy at December 31, 2010:

Asset Class	Level 1	Level 2	Level 3	Other	Total	Year End Allocation
	(in thousands)					
<b>Equities:</b>						
Domestic	\$ 93,747	\$ 191	\$ -	\$ -	\$ 93,938	35.1 %
International	27,985	-	-	-	27,985	10.4 %
Real Estate Investment Trusts	7,802	-	-	-	7,802	2.9 %
Common Collective Trust - International	-	11,296	-	-	11,296	4.2 %
<b>Subtotal - Equities</b>	<b>129,534</b>	<b>11,487</b>	<b>-</b>	<b>-</b>	<b>141,021</b>	<b>52.6 %</b>
<b>Fixed Income:</b>						
United States Government and Agency Securities	-	44,037	-	-	44,037	16.4 %
Corporate Debt	-	46,658	-	-	46,658	17.4 %
Foreign Debt	-	8,831	-	-	8,831	3.3 %
State and Local Government	-	1,578	-	-	1,578	0.6 %
Other - Asset Backed	-	3,552	-	-	3,552	1.3 %
<b>Subtotal - Fixed Income</b>	<b>-</b>	<b>104,656</b>	<b>-</b>	<b>-</b>	<b>104,656</b>	<b>39.0 %</b>
Real Estate	-	-	5,779	-	5,779	2.2 %
Alternative Investments	-	-	9,029	-	9,029	3.4 %
Securities Lending	-	17,663	-	-	17,663	6.6 %
Securities Lending Collateral (a)	-	-	-	(19,157)	(19,157)	(7.1)%
Cash and Cash Equivalents (b)	-	8,815	-	111	8,926	3.3 %
Other - Pending Transactions and Accrued Income (c)	-	-	-	42	42	- %
<b>Total</b>	<b>\$ 129,534</b>	<b>\$ 142,621</b>	<b>\$ 14,808</b>	<b>\$ (19,004)</b>	<b>\$ 267,959</b>	<b>100.0 %</b>

- (a) Amounts in "Other" column primarily represent an obligation to repay cash collateral received as part of the Securities 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 thousands)		
<b>Balance as of January 1, 2010</b>	\$ 7,505	\$ 8,763	\$ 16,268
Actual Return on Plan Assets			
Relating to Assets Still Held as of the Reporting Date	(1,726)	43	(1,683)
Relating to Assets Sold During the Period	-	14	14
Purchases and Sales	-	209	209
Transfers into Level 3	-	-	-
Transfers out of Level 3	-	-	-
<b>Balance as of December 31, 2010</b>	<b>\$ 5,779</b>	<b>\$ 9,029</b>	<b>\$ 14,808</b>



The following table presents the classification of OPEB plan assets within the fair value hierarchy at December 31, 2010:

Asset Class	Level 1	Level 2	Level 3	Other	Total	Year End Allocation
	(in thousands)					
Equities:						
Domestic	\$ 37,814	\$ -	\$ -	\$ -	\$ 37,814	40.0 %
International	14,274	-	-	-	14,274	15.1 %
Common Collective Trust - Global	-	7,431	-	-	7,431	7.9 %
Subtotal - Equities	52,088	7,431	-	-	59,519	63.0 %
Fixed Income:						
Common Collective Trust - Debt United States Government and Agency Securities	-	3,091	-	-	3,091	3.3 %
Corporate Debt	-	6,066	-	-	6,066	6.4 %
Foreign Debt	-	7,125	-	-	7,125	7.5 %
State and Local Government	-	1,606	-	-	1,606	1.7 %
Other - Asset Backed	-	226	-	-	226	0.2 %
Subtotal - Fixed Income	-	18,175	-	-	18,175	19.2 %
Trust Owned Life Insurance:						
International Equities	-	3,177	-	-	3,177	3.3 %
United States Bonds	-	10,526	-	-	10,526	11.1 %
Cash and Cash Equivalents (a)	1,328	1,621	-	56	3,005	3.2 %
Other - Pending Transactions and Accrued Income (b)	-	-	-	173	173	0.2 %
<b>Total</b>	<b>\$ 53,416</b>	<b>\$ 40,930</b>	<b>\$ -</b>	<b>\$ 229</b>	<b>\$ 94,575</b>	<b>100.0 %</b>

(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.

### ***Determination of Pension Expense***

The determination of pension expense or income is based 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,	
	2011	2010
	(in thousands)	
Qualified Pension Plan	\$ 337,865	\$ 325,661
Nonqualified Pension Plans	3,491	3,367
<b>Total</b>	<b>\$ 341,356</b>	<b>\$ 329,028</b>

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, 2011 and 2010 were as follows:

	<b>Underfunded Pension Plans</b>	
	<b>2011</b>	<b>2010</b>
	<b>(in thousands)</b>	
<b>Projected Benefit Obligation</b>	\$ 347,273	\$ 333,234
Accumulated Benefit Obligation	\$ 341,356	\$ 329,028
Fair Value of Plan Assets	305,385	267,959
<b>Underfunded Accumulated Benefit Obligation</b>	<b>\$ (35,971)</b>	<b>\$ (61,069)</b>

### *Estimated Future Benefit Payments and Contributions*

TCC expects contributions and payments for the pension plans of \$17 million and the OPEB plans of \$5.9 million during 2012. The estimated pension benefit payments for the unfunded plan and contributions to the trust are at least the minimum amount required by the Employee Retirement Income Security Act plus payment of unfunded nonqualified benefits. For the qualified pension plan, additional discretionary contributions may be made to the trust to maintain the funded status of the plan. The contributions to the OPEB plans are generally based on the amount of the OPEB plans' periodic benefit costs for accounting purposes as provided in agreements with state regulatory authorities, plus the additional discretionary contribution of Medicare subsidy receipts.

The table below reflects the total benefits expected to be paid from the plan or from TCC's assets. The payments include the participants' contributions to the plan for their share of the cost. In December 2011, the prescription drug plan was amended for certain participants. The impact of the change is reflected in the Benefit Plan Obligation table as a plan amendment. As a result of this amendment to the plan, the Medicare subsidy receipts in the following table are reduced from prior published estimates. 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 pension benefits and OPEB are as follows:

	<b>Pension Plans</b>		<b>Other Postretirement Benefit Plans</b>	
	<b>Pension Payments</b>		<b>Benefit Payments</b>	<b>Medicare Subsidy Receipts</b>
	<b>(in thousands)</b>			
2012	\$ 24,461		\$ 9,715	\$ 736
2013	24,027		9,903	-
2014	25,476		10,005	-
2015	27,614		10,307	-
2016	26,191		10,694	-
Years 2017 to 2021, in Total	134,256		59,590	-

### Components of Net Periodic Benefit Cost

The following table provides the components of net periodic benefit cost for the years ended December 31, 2011, 2010 and 2009:

	Pension Plans			Other Postretirement Benefit Plans		
	Years Ended December 31,					
	2011	2010	2009	2011	2010	2009
	(in thousands)					
Service Cost	\$ 5,000	\$ 5,555	\$ 5,388	\$ 2,218	\$ 2,462	\$ 2,244
Interest Cost	16,520	18,592	19,492	6,797	7,132	7,067
Expected Return on Plan Assets	(21,811)	(25,727)	(26,430)	(7,100)	(6,910)	(5,438)
Amortization of Transition Obligation	-	-	-	-	3,468	3,468
Amortization of Prior Service Credit	(1,270)	(1,271)	(1,438)	(62)	-	-
Amortization of Net Actuarial Loss	8,472	6,522	4,479	1,760	1,779	2,720
<b>Net Periodic Benefit Cost</b>	<b>6,911</b>	<b>3,671</b>	<b>1,491</b>	<b>3,613</b>	<b>7,931</b>	<b>10,061</b>
Capitalized Portion	(2,744)	(1,520)	(577)	(1,434)	(3,283)	(3,894)
<b>Net Periodic Benefit Cost Recognized as Expense</b>	<b>\$ 4,167</b>	<b>\$ 2,151</b>	<b>\$ 914</b>	<b>\$ 2,179</b>	<b>\$ 4,648</b>	<b>\$ 6,167</b>

Estimated amounts expected to be amortized to net periodic benefit costs and the impact on the balance sheet during 2012 are shown in the following table:

Components	Pension Plans	Other Postretirement Benefit Plans
	(in thousands)	
Net Actuarial Loss	\$ 10,113	\$ 3,684
Prior Service Credit	(1,262)	(1,182)
<b>Total Estimated 2012 Amortization</b>	<b>\$ 8,851</b>	<b>\$ 2,502</b>
<b>Expected to be Recorded as</b>		
Regulatory Asset	\$ 8,851	\$ 2,502
<b>Total</b>	<b>\$ 8,851</b>	<b>\$ 2,502</b>

### American Electric Power System Retirement Savings Plan

TCC 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 matching contributions. The matching contributions to the plan are 100% of the first 1% of eligible employee contributions and 70% of the next 5% of contributions. The cost for matching contributions totaled \$3 million in 2011, \$2.8 million in 2010 and \$3.3 million in 2009.

## 8. BUSINESS SEGMENTS

TCC has one reportable segment, an integrated electricity transmission and distribution business. TCC's other activities are insignificant.

## 9. DERIVATIVES AND HEDGING

### Cash Flow Hedging Strategies

TCC's vehicle fleet is exposed to gasoline and diesel fuel price volatility. AEPSC, on behalf of TCC, 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 TCC's outstanding derivative contracts for heating oil and gasoline as of December 31, 2011 and 2010 were 812 thousand gallons and 808 thousand gallons, respectively.

The following tables represent the gross fair value impact of TCC's derivative activity on the balance sheets as of December 31, 2011 and 2010:

#### Fair Value of Derivative Instruments December 31, 2011

Balance Sheet Location	Hedging Contracts (a)	Other (b)	Total
(in thousands)			
Prepayments and Other Current Assets	\$ -	\$ -	\$ -
Deferred Charges and Other Noncurrent Assets	-	-	-
<b>Total Assets</b>	-	-	-
Other Current Liabilities	129	(129)	-
Deferred Credits and Other Noncurrent Liabilities	-	-	-
<b>Total Liabilities</b>	129	(129)	-
<b>Total MTM Derivative Contract Net Assets</b>	<u>\$ (129)</u>	<u>\$ 129</u>	<u>\$ -</u>

#### Fair Value of Derivative Instruments December 31, 2010

Balance Sheet Location	Hedging Contracts (a)	Other (b)	Total
(in thousands)			
Prepayments and Other Current Assets	\$ 175	\$ -	\$ 175
Deferred Charges and Other Noncurrent Assets	-	-	-
<b>Total Assets</b>	175	-	175
Other Current Liabilities	-	-	-
Deferred Credits and Other Noncurrent Liabilities	-	-	-
<b>Total Liabilities</b>	-	-	-
<b>Total MTM Derivative Contract Net Assets</b>	<u>\$ 175</u>	<u>\$ -</u>	<u>\$ 175</u>

- (a) Derivative instruments within these categories are reported gross. These instruments are subject to master netting agreements and are presented on the 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 de-designated 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), TCC 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 balance sheets until the period the hedged item affects Net Income. TCC records hedge ineffectiveness as a regulatory asset (for losses) or a regulatory liability (for gains).

TCC 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 statements of income. During 2011, 2010 and 2009, TCC designated heating oil and gasoline derivatives as cash flow hedges. Hedge ineffectiveness was immaterial for this hedge strategy.

The following table provides details on designated, effective cash flow hedges included in Accumulated Other Comprehensive Income (Loss) on TCC's balance sheets and the reasons for changes in cash flow hedges for the years ended December 31, 2011, 2010 and 2009. All amounts in the following tables are presented net of related income taxes.

### Total Accumulated Other Comprehensive Income (Loss) Activity for Cash Flow Hedges Years Ended December 31, 2011, 2010 and 2009

	Years Ended December 31,		
	2011	2010	2009
	(in thousands)		
<b>Balance in AOCI as of January 1,</b>	\$ 115	\$ 163	\$ -
Changes in Fair Value Recognized in AOCI	190	105	290
Amount of (Gain) or Loss Reclassified from AOCI to Statement of Income/within Balance Sheet:			
Other Operation Expense	(137)	(65)	(86)
Maintenance Expense	(101)	(36)	-
Property, Plant and Equipment	(150)	(52)	(41)
<b>Balance in AOCI as of December 31,</b>	<u>\$ (83)</u>	<u>\$ 115</u>	<u>\$ 163</u>

Cash flow hedges included in Accumulated Other Comprehensive Income (Loss) on TCC's balance sheets at December 31, 2011 and 2010 were:

### Impact of Cash Flow Hedges on the Balance Sheet December 31, 2011 and 2010

	December 31,	
	2011	2010
	(in thousands)	
Hedging Assets	\$ -	\$ 175
Hedging Liabilities	129	-
AOCI Gain (Loss) Net of Tax	(83)	115
Portion Expected to be Reclassified to Net Income During the Next Twelve Months	(83)	115

The actual amounts that TCC reclassifies from Accumulated Other Comprehensive Income (Loss) to Net Income can differ from the estimate above due to market price changes. As of December 31, 2011, the maximum length of time that TCC 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 12 months.

## **10. 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 TCC's Long-term Debt as of December 31, 2011 and 2010 are summarized in the following table:

	<b>December 31,</b>			
	<b>2011</b>		<b>2010</b>	
	<b><u>Book Value</u></b>	<b><u>Fair Value</u></b>	<b><u>Book Value</u></b>	<b><u>Fair Value</u></b>
	<b>(in thousands)</b>			
Long-term Debt	\$ 2,390,716	\$ 2,742,800	\$ 2,610,274	\$ 2,827,552

## ***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 tables set forth, by level within the fair value hierarchy, TCC’s financial assets and liabilities that were accounted for at fair value on a recurring basis as of December 31, 2011 and 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 December 31, 2011**

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Other</u>	<u>Total</u>
	<b>(in thousands)</b>				
<b>Assets:</b>					
Other Cash Deposits (a)	\$ 190,995	\$ -	\$ -	\$ 14	\$ 191,009
<b>Liabilities:</b>					
<b><u>Risk Management Liabilities</u></b>					
Cash Flow Hedges:					
Commodity Hedges (b)	\$ -	\$ 129	\$ -	\$ (129)	\$ -

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

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Other</u>	<u>Total</u>
	<b>(in thousands)</b>				
<b>Assets:</b>					
Other Cash Deposits (a)	\$ 184,040	\$ -	\$ -	\$ 14	\$ 184,054
<b><u>Risk Management Assets</u></b>					
Cash Flow Hedges:					
Commodity Hedges	-	175	-	-	175
<b>Total Assets</b>	<u>\$ 184,040</u>	<u>\$ 175</u>	<u>\$ -</u>	<u>\$ 14</u>	<u>\$ 184,229</u>

- (a) Amounts in “Other” column primarily represent cash deposits with third parties. Level 1 amounts primarily represent investments in money market funds.
- (b) 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, TCC had no liabilities measured at fair value on a recurring basis.

There have been no transfers between Level 1 and Level 2 during the years ended December 31, 2011 and 2010.

## 11. INCOME TAXES

The details of TCC's income taxes before extraordinary item as reported are as follows:

	Years Ended December 31,		
	2011	2010	2009
	(in thousands)		
Income Tax Expense (Credit):			
Current	\$ 39,471	\$ 26,383	\$ 98,559
Deferred	127,155	4,572	(59,939)
Deferred Investment Tax Credits	(805)	(808)	(814)
<b>Income Tax Expense</b>	<u>\$ 165,821</u>	<u>\$ 30,147</u>	<u>\$ 37,806</u>

The following 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,		
	2011	2010	2009
	(in thousands)		
Net Income	\$ 680,353	\$ 68,267	\$ 81,872
Extraordinary Item, Net of Tax of \$112,095	(373,093)	-	-
Income Tax Expense	165,821	30,147	37,806
<b>Pretax Income</b>	<u>\$ 473,081</u>	<u>\$ 98,414</u>	<u>\$ 119,678</u>
Income Taxes on Pretax Income at Statutory Rate (35%)	\$ 165,578	\$ 34,445	\$ 41,887
Increase (Decrease) in Income Taxes resulting from the following items:			
Depreciation	1,227	1,291	99
Investment Tax Credits, Net	(805)	(808)	(814)
State and Local Income Taxes, Net	1,244	2,483	3,631
Parent Company Loss Benefit	(2,620)	(3,097)	(8,088)
Other	1,197	(4,167)	1,091
<b>Income Tax Expense</b>	<u>\$ 165,821</u>	<u>\$ 30,147</u>	<u>\$ 37,806</u>
<b>Effective Income Tax Rate</b>	35.1 %	30.6 %	31.6 %

The following table shows elements of TCC's net deferred tax liability and significant temporary differences:

	December 31,	
	2011	2010
	(in thousands)	
Deferred Tax Assets	\$ 121,789	\$ 155,713
Deferred Tax Liabilities	(1,464,073)	(1,174,806)
<b>Net Deferred Tax Liabilities</b>	<u>\$ (1,342,284)</u>	<u>\$ (1,019,093)</u>
Property Related Temporary Differences	\$ (487,044)	\$ (392,069)
Amounts Due from Customers for Future Federal Income Taxes	(4,789)	(1,208)
Accrued Pensions	17,792	21,554
Regulatory Assets	(271,165)	(26,595)
Securitized Transition Assets	(621,384)	(650,562)
All Other, Net	24,306	29,787
<b>Net Deferred Tax Liabilities</b>	<u>\$ (1,342,284)</u>	<u>\$ (1,019,093)</u>



### ***AEP System Tax Allocation Agreement***

TCC 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.

### ***Federal and State Income Tax Audit Status***

TCC and other AEP subsidiaries are no longer subject to U.S. federal examination for years before 2009. TCC and other AEP subsidiaries completed the examination of the years 2007 and 2008 in April 2011 and settled all outstanding issues on appeal for the years 2001 through 2006 in October 2011. The settlements did not have a material impact on TCC and other AEP subsidiaries' net income, cash flows or financial condition. The IRS examination of years 2009 and 2010 started in October 2011. 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, TCC 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 effect on net income.

TCC and other AEP subsidiaries file income tax returns in various state and local jurisdictions. These taxing authorities routinely examine the tax returns and TCC 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, TCC is no longer subject to state or local income tax examinations by tax authorities for years before 2000.

### ***Tax Credit Carryforward***

At December 31, 2011, TCC had unused federal income tax credits of \$2.8 million, not all of which have an expiration date. Included in the credit carryforward are federal general business tax credits of \$100 thousand. If these credits are not utilized, the federal general business tax credits will expire in the years 2028 through 2031.

TCC anticipates future federal taxable income will be sufficient to realize the tax benefits of the federal tax credits before they expire unused.

### ***Uncertain Tax Positions***

TCC 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:

	<b>Years Ended December 31,</b>		
	<b>2011</b>	<b>2010</b>	<b>2009</b>
	<b>(in thousands)</b>		
Interest Expense	\$ 238	\$ 648	\$ 1,137
Interest Income	(3,655)	-	-
Reversal of Prior Period Interest Expense	1,785	-	455

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

	<b>December 31,</b>	
	<b>2011</b>	<b>2010</b>
	<b>(in thousands)</b>	
Accrual for Receipt of Interest	\$ 122	\$ 992
Accrual for Payment of Interest Penalties	259	3,682

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

	<b>2011</b>	<b>2010</b>	<b>2009</b>
	<b>(in thousands)</b>		
<b>Balance at January 1,</b>	\$ 14,991	\$ 15,526	\$ 15,602
Increase - Tax Positions Taken During a Prior Period	1,948	849	3,042
Decrease - Tax Positions Taken During a Prior Period	(2,300)	(1,028)	(1,961)
Increase - Tax Positions Taken During the Current Year	-	-	-
Decrease - Tax Positions Taken During the Current Year	-	(356)	(423)
Decrease - Settlements with Taxing Authorities	(7,659)	-	-
Decrease - Lapse of the Applicable Statute of Limitations	(4,057)	-	(734)
<b>Balance at December 31,</b>	<u>\$ 2,923</u>	<u>\$ 14,991</u>	<u>\$ 15,526</u>

The total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate is \$800 thousand, \$1.3 million and \$1.1 million for 2011, 2010 and 2009, respectively. Management believes there will be no significant net increase or decrease in unrecognized tax benefits within 12 months of the reporting date.

### ***Federal Tax Legislation***

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 TCC's net income or financial condition.

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 TCC in March 2010. This reduction, which was offset by recording net tax regulatory assets, did not materially affect TCC's net income, cash flows or financial condition for the year ended December 31, 2010.

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 did not have a material impact on TCC's net income or financial condition but had a favorable impact on cash flows of approximately \$43 million in 2010.

In December 2011, the U.S. Treasury Department issued guidance regarding the deduction and capitalization of expenditures related to tangible property. The guidance was in the form of proposed and temporary regulations and generally is effective for tax years beginning in 2012. These regulations did not have an impact on either net income or cash flow in 2011. Management is still evaluating the impact these regulations will have on future periods.

## 12. LEASES

Leases of property, plant and equipment are for periods up to 10 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:

Lease Rental Costs	Years Ended December 31,		
	2011	2010	2009
	(in thousands)		
Net Lease Expense on Operating Leases	\$ 4,952	\$ 4,656	\$ 5,622
Amortization of Capital Leases	1,738	1,543	1,425
Interest on Capital Leases	253	177	68
<b>Total Lease Rental Costs</b>	<b>\$ 6,943</b>	<b>\$ 6,376</b>	<b>\$ 7,115</b>

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

	December 31,	
	2011	2010
	(in thousands)	
<b>Property, Plant and Equipment Under Capital Leases</b>		
Total Property, Plant and Equipment Under Capital Leases – Other	\$ 4,503	\$ 5,899
Accumulated Amortization	1,558	1,824
<b>Net Property, Plant and Equipment Under Capital Leases</b>	<b>\$ 2,945</b>	<b>\$ 4,075</b>
<b>Obligations Under Capital Leases</b>		
Noncurrent Liability	\$ 1,758	\$ 2,315
Liability Due Within One Year	1,187	1,760
<b>Total Obligations Under Capital Leases</b>	<b>\$ 2,945</b>	<b>\$ 4,075</b>

Future minimum lease payments consisted of the following at December 31, 2011:

Future Minimum Lease Payments	Capital Leases	Noncancelable Operating Leases
	(in thousands)	
2012	\$ 1,289	\$ 3,688
2013	581	2,446
2014	454	1,817
2015	378	1,539
2016	224	1,293
Later Years	312	2,037
<b>Total Future Minimum Lease Payments</b>	<b>3,238</b>	<b>\$ 12,820</b>
Less Estimated Interest Element	293	
<b>Estimated Present Value of Future Minimum Lease Payments</b>	<b>\$ 2,945</b>	

### *Master Lease Agreements*

TCC 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 or refinanced in 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, TCC 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, TCC is committed to pay the difference between the actual fair value and the residual value guarantee. At December 31, 2011, the maximum potential loss for these lease agreements was approximately \$2 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.

### 13. FINANCING ACTIVITIES

#### *Preferred Stock*

In December 2011, TCC redeemed all of its outstanding preferred stock with a par value of \$5.3 million at a premium, resulting in a \$269 thousand loss, which is included in Preferred Stock Dividend Requirements Including Capital Stock Expense on TCC's statement of income. The redeemed shares are no longer outstanding and represent only the right to receive the applicable redemption price, to the extent the shares have not yet been presented for payment.

Series	Number of Shares Redeemed for the Years Ended December 31,		
	2011	2010	2009
4.00%	41,736	11	165
4.20%	15,301	2,000	-

#### *Long-term Debt*

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

The following details long-term debt outstanding as of December 31, 2011 and 2010:

Type of Debt	Maturity	Weighted Average Interest Rate at December 31,			Outstanding at December 31,	
		2011	2011	2010	2011	2010
(in thousands)						
Senior Unsecured Notes	2033	6.65%	6.65%	6.65%	\$ 275,000	\$ 275,000
Pollution Control Bonds (a)	2011-2030 (b)	4.63%	1.125%-6.30%	4.40%-6.30%	429,555	489,820
Securitization Bonds	2013-2020 (c)	5.36%	4.98%-6.25%	4.98%-6.25%	1,687,746	1,847,188
Unamortized Discount, Net					(1,585)	(1,734)
<b>Total Long-term Debt Outstanding</b>					<u>2,390,716</u>	<u>2,610,274</u>
<b>Long-term Debt Due Within One Year</b>					<u>231,574</u>	<u>279,708</u>
<b>Long-term Debt</b>					<u>\$ 2,159,142</u>	<u>\$ 2,330,566</u>

- For certain series of pollution control bonds, interest rates are subject to periodic adjustment. Certain series may be purchased on demand at periodic interest adjustment dates. Standby bond purchase agreements and insurance policies support certain series.
- Certain pollution control bonds are subject to redemption earlier than the maturity date. Consequently, these bonds have been classified for maturity purposes as Long-term Debt Due Within One Year – Nonaffiliated on TCC's balance sheets.
- Dates represent the scheduled final payment dates for this class of TCC's securitization bonds. The maturity date is one to two years later. These bonds have been classified for maturity and repayment purposes based on the scheduled final payment date.

Long-term debt outstanding at December 31, 2011 is payable as follows:

	2012	2013	2014	2015	2016	After 2016	Total
	(in thousands)						
Principal Amount	\$ 231,574	\$ 184,518	\$ 198,720	\$ 213,787	\$ 193,278	\$ 1,370,424	\$ 2,392,301
Unamortized Discount, Net							(1,585)
<b>Total Long-term Debt Outstanding</b>							<b>\$ 2,390,716</b>

In January 2012, TCC retired \$98 million of its outstanding Securitization Bonds.

As of December 31, 2011, trustees held, on TCC's behalf, \$60 million of its reacquired Pollution Control Bonds.

### ***Dividend Restrictions***

#### *Federal Power Act*

The Federal Power Act prohibits TCC 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 value of the common stock. This restriction does not limit the ability of TCC to pay dividends out of retained earnings.

#### ***Utility Money Pool – AEP System***

The AEP System uses a corporate borrowing program to meet the short-term borrowing needs of its subsidiaries. The corporate borrowing program includes a Utility Money Pool, which funds the utility subsidiaries. The AEP System Utility Money Pool operates in accordance with the terms and conditions approved in a regulatory order. The amount of outstanding borrowings from the Utility Money Pool as of December 31, 2011 is included in Advances from Affiliates on TCC's balance sheet. The amount of outstanding loans to the Utility Money Pool as of December 31, 2010 is included in Advances to Affiliates on TCC's balance sheet. TCC's Utility Money Pool activity and corresponding authorized borrowing limit for the years ended December 31, 2011 and 2010 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	Loans (Borrowings) to/from Utility Money Pool as of December 31,	Authorized Short-Term Borrowing Limit
	(in thousands)					
2011	\$ 36,043	\$ 141,586	\$ 19,326	\$ 53,569	\$ (36,043)	\$ 250,000
2010	-	161,589	-	129,700	141,584	250,000

Maximum, minimum and average interest rates for funds either borrowed from or loaned to the Utility Money Pool for the years ended December 31, 2011, 2010 and 2009 are summarized in the following table:

Years Ended December 31,	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	0.51 %	0.39 %	0.56 %	0.06 %	0.46 %	0.29 %
2010	-	-	0.55 %	0.09 %	-	0.27 %
2009	2.28 %	0.65 %	1.76 %	0.15 %	1.66 %	0.39 %

Interest expense and interest income related to the Utility Money Pool are included in Interest Expense and Interest Income, respectively, on TCC's statements of income. For amounts borrowed from and advanced to the Utility Money Pool, TCC incurred the following amounts of interest expense and earned the following amounts of interest income for the years ended December 31, 2011, 2010 and 2009:

	Years Ended December 31,		
	2011	2010	2009
	(in thousands)		
Interest Expense	\$ 13	\$ -	\$ 263
Interest Income	138	351	280

#### **14. RELATED PARTY TRANSACTIONS**

For other related party transactions, also see "Electric Transmission Texas LLC (ETT)" sections of Note 6, "AEP System Tax Allocation Agreement" section of Note 11 and "Utility Money Pool – AEP System" section of Note 13.

##### ***Affiliated Revenues***

TCC's other revenues derived from sales to affiliates for the years ended December 31, 2011, 2010 and 2009 were \$3.7 million, \$4.2 million and \$4.5 million, respectively. These related party revenues are reported in Sales to AEP Affiliates on TCC's statements of income.

##### ***ERCOT Transmission Cost of Service***

TCC's net expenses allocated pursuant to the PUCT-approved ERCOT protocols for the years ended December 31, 2011, 2010 and 2009 were \$2.1 million, \$2.1 million and \$1.7 million, respectively. The net expenses are recorded in Other Operation expense on TCC's statements of income.

##### ***ERCOT Transmission Service Charges***

Pursuant to an order from the PUCT, ETT bills TCC for its ERCOT wholesale transmission services. ETT billed TCC \$4.4 million and \$2.7 million for transmission services in 2011 and 2010, respectively. The billings are recorded in Other Operation expense on TCC's statements of income.

##### ***Sales and Purchases of Property***

TCC had affiliated sales and purchases of electric property individually amounting to \$100 thousand or more for the years ended December 31, 2011, 2010 and 2009 as shown in the following table:

Companies	Years Ended December 31,		
	2011	2010	2009
	(in thousands)		
OPCo to TCC	\$ -	\$ -	\$ 526
TCC to APCo	-	-	426
TCC to SWEPCo	-	360	684
TNC to TCC	273	-	-

In addition, TCC had aggregate affiliated sales and purchases of meters and transformers for the years ended December 31, 2011, 2010 and 2009 as shown in the following table:

	APCo	I&M	KPCo	OPCo	PSO	SWEPCo	TNC	WPCo	Total
<b>Sales</b>	(in thousands)								
2011	\$ 550	\$ 11	\$ 240	\$ 568	\$ 19	\$ 1,410	\$ 2,106	\$ 11	\$ 4,915
2010	22	38	-	23	6	266	966	-	1,321
2009	13	72	-	19	2	87	873	-	1,066
<b>Purchases</b>									
2011	333	14	2	90	2	145	2,021	-	2,607
2010	-	-	-	165	6	70	642	-	883
2009	44	37	-	1	26	162	750	-	1,020

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

### ***Intercompany Billings***

TCC 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.

### ***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 TCC is the primary beneficiary of a VIE, management considers factors such as equity at risk, the amount of the VIE’s variability TCC absorbs, guarantees of indebtedness, voting rights including kick-out rights, the power to direct the VIE, variable interests held by related parties 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 TCC is the primary beneficiary. In addition, TCC has not provided financial or other support to any VIE that was not previously contractually required.

AEP Texas Central Transition Funding I LLC and AEP Texas Central Transition Funding II LLC, wholly-owned subsidiaries of TCC, (collectively Transition Funding) were formed for the sole purpose of issuing and servicing securitization bonds related to Texas Restructuring Legislation. Management has concluded that TCC is the primary beneficiary of Transition Funding because TCC has the power to direct the most significant activities of the VIE and TCC’s equity interest could potentially be significant. Therefore, TCC is required to consolidate Transition Funding. The securitized bonds totaled \$1.7 billion and \$1.8 billion at December 31, 2011 and 2010, respectively, and are included in current and long-term debt on the balance sheets. Transition Funding has securitized transition assets of \$1.6 billion and \$1.7 billion at December 31, 2011 and 2010, respectively, which are presented separately on the face of the balance sheets. The securitized transition assets represent the right to impose and collect Texas true-up costs from customers receiving electric transmission or distribution service from TCC under recovery mechanisms approved by the PUCT. The securitization bonds are payable only from and secured by the securitized transition assets. The bondholders have no recourse to TCC or any other AEP entity. TCC acts as the servicer for Transition Funding’s securitized transition asset and remits all related amounts collected from customers to Transition Funding for interest and principal payments on the securitization bonds and related costs.

The balances below represent the assets and liabilities of the Transition Funding that are consolidated. These balances include intercompany transactions that are eliminated upon consolidation.

**AEP TEXAS CENTRAL COMPANY AND SUBSIDIARIES**  
**VARIABLE INTEREST ENTITIES**  
**December 31, 2011 and 2010**  
(in millions)

ASSETS	Transition Funding	
	2011	2010
Current Assets	\$ 220	\$ 214
Other Noncurrent Assets	1,580	1,746
<b>Total Assets</b>	<b>\$ 1,800</b>	<b>\$ 1,960</b>
<b>LIABILITIES AND EQUITY</b>		
Current Liabilities	\$ 229	\$ 221
Noncurrent Liabilities	1,557	1,725
Equity	14	14
<b>Total Liabilities and Equity</b>	<b>\$ 1,800</b>	<b>\$ 1,960</b>

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. TCC's total billings from AEPSC for the years ended December 31, 2011, 2010 and 2009 were \$63 million, \$76 million and \$71 million, respectively. The carrying amount of liabilities associated with AEPSC for the years ended December 31, 2011 and 2010 was \$7 million and \$6 million, respectively. Management estimates the maximum exposure of loss to be equal to the amount of such liability.



## 15. PROPERTY, PLANT AND EQUIPMENT

### Depreciation

TCC 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:

2011	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)
Transmission	\$ 1,135,982	\$ 217,177	1.5%	50-81	\$ -	\$ -	-	-	-
Distribution	2,002,508	402,267	3.6%	22-64	-	-	-	-	-
CWIP	58,906	6,634	NM	NM	-	-	-	-	-
Other	256,064	110,317	7.3%	NM	3,346	1,127	NM	NM	
<b>Total</b>	<b>\$ 3,453,460</b>	<b>\$ 736,395</b>			<b>\$ 3,346</b>	<b>\$ 1,127</b>			

2010	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)
Transmission	\$ 1,067,604	\$ 201,635	1.6%	50-81	\$ -	\$ -	-	-	-
Distribution	1,924,518	377,576	3.5%	22-64	-	-	-	-	-
CWIP	75,440	17,085	NM	NM	-	-	-	-	-
Other	251,008	109,244	6.5%	NM	3,346	1,100	NM	NM	
<b>Total</b>	<b>\$ 3,318,570</b>	<b>\$ 705,540</b>			<b>\$ 3,346</b>	<b>\$ 1,100</b>			

2009	Regulated		Nonregulated		
	Functional Class of Property	Annual Composite Depreciation Rate	Depreciable Life Ranges	Annual Composite Depreciation Rate	Depreciable Life Ranges
			(in years)		(in years)
Transmission		1.5%	50-81	-	-
Distribution		3.0%	22-64	-	-
CWIP		NM	NM	-	-
Other		7.3%	NM	NM	NM

NM Not Meaningful

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



## 17. 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 the results of operations for interim periods. Quarterly results are not necessarily indicative of a full year's operations because of various factors. TCC's unaudited quarterly financial information is as follows:

	<u>March 31</u>	<u>2011 Quarterly Periods Ended</u>		<u>December 31</u>
		<u>June 30</u>	<u>September 30</u>	
		<u>(in thousands)</u>		
Total Revenues	\$ 209,100	\$ 238,135	\$ 264,954	\$ 210,643
Operating Income	63,518	77,728	83,270	58,306
Income Before Extraordinary Items (a)	-	-	201,933	61,129
Extraordinary Items, Net of Tax (a)	-	-	273,452	99,641
Net Income	18,332	25,866	475,385 (b)	160,770 (b)

	<u>March 31</u>	<u>2010 Quarterly Periods Ended</u>		<u>December 31</u>
		<u>June 30</u>	<u>September 30</u>	
		<u>(in thousands)</u>		
Total Revenues	\$ 213,866	\$ 226,550	\$ 249,973	\$ 202,076
Operating Income	60,287	44,949 (c)	80,116	56,785
Net Income	14,101	4,619 (c)	30,628	18,919

- (a) See Note 2 and Note 3 for discussion of extraordinary item related to Texas Restructuring appeals recorded in the third and fourth quarter of 2011.
- (b) See Note 3 for discussion of carrying costs income related to Texas Restructuring appeals recorded in the third and fourth quarter of 2011.
- (c) See Note 16 for discussion of expenses related to cost reduction initiatives recorded in the second quarter of 2010.