AEP Texas Central Company
and Subsidiaries

2012 Third Quarter Report

Consolidated Financial Statements

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GLOSSARY OF TERMS

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

Term	Meaning
AEP or Parent	American Electric Power Company, Inc., a utility holding company.
AEP System	American Electric Power System, an integrated electric utility system, owned and operated by AEP's electric utility subsidiaries.
AEPSC	American Electric Power Service Corporation, an AEP service subsidiary providing management and professional services to AEP and its subsidiaries.
AOCI	Accumulated Other Comprehensive Income.
CAA	Clean Air Act.
CO_2	Carbon dioxide and other greenhouse gases.
ERCOT	Electric Reliability Council of Texas regional transmission organization.
ETT	Electric Transmission Texas, LLC, an equity interest joint venture between AEP and MidAmerican Energy Holdings Company Texas Transco, LLC formed to own and operate electric transmission facilities in ERCOT.
FERC	Federal Energy Regulatory Commission.
FTR	Financial Transmission Right, a financial instrument that entitles the holder to receive compensation for certain congestion-related transmission charges that arise when the power grid is congested resulting in differences in locational prices.
GAAP	Accounting Principles Generally Accepted in the United States of America.
IRS	Internal Revenue Service.
MTM	Mark-to-Market.
OPEB	Other Postretirement Benefit Plans.
OTC	Over the counter.
PUCT	Public Utility Commission of Texas.
Risk Management Contracts	Trading and nontrading derivatives, including those derivatives designated as cash flow and fair value hedges.
TCC	AEP Texas Central Company, an AEP electric utility subsidiary.
Transition Funding	AEP Texas Central Transition Funding I LLC, AEP Texas Central Transition Funding II LLC and AEP Texas Central Transition Funding III LLC, wholly-owned subsidiaries of TCC and consolidated variable interest entities formed for the purpose of issuing and servicing securitization bonds related to Texas restructuring law.
Utility Money Pool	Centralized funding mechanism AEP uses to meet the short-term cash requirements of certain utility subsidiaries.
VIE	Variable Interest Entity.

AEP TEXAS CENTRAL COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
For the Three and Nine Months Ended September 30, 2012 and 2011
(in thousands)
(Unaudited)

	Three Months Ended		Nine Months Ended	
	2012	**2011**	**2012**	**2011**
REVENUES				
Electric Transmission and Distribution	$ 286,274	$ 263,727	$ 755,139	$ 708,086
Sales to AEP Affiliates	922	931	2,780	2,787
Other Revenues	471	296	1,191	1,316
TOTAL REVENUES	287,667	264,954	759,110	712,189
EXPENSES				
Other Operation	65,361	67,255	178,113	186,496
Maintenance	9,112	9,025	27,439	27,239
Depreciation and Amortization	104,551	85,600	262,764	218,701
Taxes Other Than Income Taxes	21,198	19,804	56,708	55,237
TOTAL EXPENSES	200,222	181,684	525,024	487,673
OPERATING INCOME	87,445	83,270	234,086	224,516
Other Income (Expense):				
Interest Income	27	2,605	224	3,417
Carrying Costs Income	-	261,396	7,775	261,396
Allowance for Equity Funds Used During Construction	352	604	1,684	1,611
Interest Expense	(35,438)	(34,374)	(103,248)	(106,760)
INCOME BEFORE INCOME TAX EXPENSE	52,386	313,501	140,521	384,180
Income Tax Expense	18,756	111,568	49,317	138,049
INCOME BEFORE EXTRAORDINARY ITEM	33,630	201,933	91,204	246,131
EXTRAORDINARY ITEM, NET OF TAX	-	273,452	-	273,452
NET INCOME	33,630	475,385	91,204	519,583
Preferred Stock Dividend Requirements	-	54	-	163
EARNINGS ATTRIBUTABLE TO COMMON STOCK	$ 33,630	$ 475,331	$ 91,204	$ 519,420

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

See Condensed Notes to Condensed Consolidated Financial Statements beginning on page 8.

AEP TEXAS CENTRAL COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
For the Three and Nine Months Ended September 30, 2012 and 2011
(in thousands)
(Unaudited)

	Three Months Ended		Nine Months Ended	
	2012	**2011**	**2012**	**2011**
Net Income	$ 33,630	$ 475,385	$ 91,204	$ 519,583
OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAXES				
Cash Flow Hedges, Net of Tax of $100 and $171 for the Three Months Ended September 30, 2012 and 2011, Respectively, and $69 and $130 for the Nine Months Ended September 30, 2012 and 2011, Respectively	186	(318)	128	(242)
TOTAL COMPREHENSIVE INCOME	$ 33,816	$ 475,067	$ 91,332	$ 519,341

See Condensed Notes to Condensed Consolidated Financial Statements beginning on page 8.

AEP TEXAS CENTRAL COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN COMMON SHAREHOLDER'S EQUITY
For the Nine Months Ended September 30, 2012 and 2011
(in thousands)
(Unaudited)

	Common Stock	Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
TOTAL COMMON SHAREHOLDER'S EQUITY – DECEMBER 31, 2010	$ 55,292	$ 171,295	$ 394,337	$ 115	$ 621,039
Common Stock Dividends			(47,500)		(47,500)
Preferred Stock Dividends			(163)		(163)
Gain on Reacquired Preferred Stock		51			51
Subtotal – Common Shareholder's Equity					573,427
Net Income			519,583		519,583
Other Comprehensive Loss				(242)	(242)
TOTAL COMMON SHAREHOLDER'S EQUITY – SEPTEMBER 30, 2011	$ 55,292	$ 171,346	$ 866,257	$ (127)	$ 1,092,768
TOTAL COMMON SHAREHOLDER'S EQUITY – DECEMBER 31, 2011	$ 55,292	$ 171,062	$ 1,011,990	$ (83)	$ 1,238,261
Common Stock Dividends			(684,824)		(684,824)
Subtotal – Common Shareholder's Equity					553,437
Net Income			91,204		91,204
Other Comprehensive Income				128	128
TOTAL COMMON SHAREHOLDER'S EQUITY – SEPTEMBER 30, 2012	$ 55,292	$ 171,062	$ 418,370	$ 45	$ 644,769

See Condensed Notes to Condensed Consolidated Financial Statements beginning on page 8.

AEP TEXAS CENTRAL COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
ASSETS
September 30, 2012 and December 31, 2011
(in thousands)
(Unaudited)

	2012	2011
CURRENT ASSETS		
Cash and Cash Equivalents	$ 100	$ 422
Restricted Cash for Securitized Transition Funding	171,363	190,995
Accounts Receivable:		
Customers	95,674	73,696
Affiliated Companies	3,543	4,810
Accrued Unbilled Revenues	53,076	37,606
Miscellaneous	2,378	3,452
Allowance for Uncollectible Accounts	(1,169)	(374)
Total Accounts Receivable	153,502	119,190
Materials and Supplies	35,278	31,181
Prepayments and Other Current Assets	2,754	3,056
TOTAL CURRENT ASSETS	362,997	344,844
PROPERTY, PLANT AND EQUIPMENT		
Electric:		
Transmission	1,174,623	1,135,982
Distribution	2,096,756	2,002,508
Other Property, Plant and Equipment	278,559	259,410
Construction Work in Progress	75,757	58,906
Total Property, Plant and Equipment	3,625,695	3,456,806
Accumulated Depreciation and Amortization	778,483	737,522
TOTAL PROPERTY, PLANT AND EQUIPMENT – NET	2,847,212	2,719,284
OTHER NONCURRENT ASSETS		
Regulatory Assets	325,010	1,022,680
Securitized Transition Assets (September 30, 2012 and December 31, 2011 Amounts Include $2,118,621 and $1,561,658, Respectively, Related to Transition Funding)	2,179,381	1,626,511
Deferred Charges and Other Noncurrent Assets	34,519	25,122
TOTAL OTHER NONCURRENT ASSETS	2,538,910	2,674,313
TOTAL ASSETS	$ 5,749,119	$ 5,738,441

See Condensed Notes to Condensed Consolidated Financial Statements beginning on page 8.

AEP TEXAS CENTRAL COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
LIABILITIES AND COMMON SHAREHOLDER'S EQUITY
September 30, 2012 and December 31, 2011
(dollars in thousands)
(Unaudited)

	2012	2011
CURRENT LIABILITIES		
Advances from Affiliates	$ 64,412	$ 36,043
Accounts Payable:		
General	29,743	38,331
Affiliated Companies	12,145	7,785
Long-term Debt Due Within One Year – Nonaffiliated (September 30, 2012 and December 31, 2011 Amounts Include $245,511 and $171,574, Respectively, Related to Transition Funding)	245,511	231,574
Customer Deposits	20,140	13,283
Accrued Taxes	68,612	54,175
Accrued Interest (September 30, 2012 and December 31, 2011 Amounts Include $27,080 and $44,482, Respectively, Related to Transition Funding)	37,707	55,097
Other Current Liabilities	33,376	34,009
TOTAL CURRENT LIABILITIES	511,646	470,297
NONCURRENT LIABILITIES		
Long-term Debt – Nonaffiliated (September 30, 2012 and December 31, 2011 Amounts Include $2,070,262 and $1,515,697, Respectively, Related to Transition Funding)	2,713,747	2,159,142
Deferred Income Taxes	1,305,864	1,334,421
Regulatory Liabilities and Deferred Investment Tax Credits	476,641	430,980
Deferred Credits and Other Noncurrent Liabilities	96,452	105,340
TOTAL NONCURRENT LIABILITIES	4,592,704	4,029,883
TOTAL LIABILITIES	5,104,350	4,500,180
Rate Matters (Note 2)		
Commitments and Contingencies (Note 3)		
COMMON SHAREHOLDER’S EQUITY		
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	171,062
Retained Earnings	418,370	1,011,990
Accumulated Other Comprehensive Income (Loss)	45	(83)
TOTAL COMMON SHAREHOLDER’S EQUITY	644,769	1,238,261
TOTAL LIABILITIES AND COMMON SHAREHOLDER'S EQUITY	$ 5,749,119	$ 5,738,441

See Condensed Notes to Condensed Consolidated Financial Statements beginning on page 8.

AEP TEXAS CENTRAL COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Nine Months Ended September 30, 2012 and 2011
(in thousands)
(Unaudited)

	2012	2011
OPERATING ACTIVITIES		
Net Income	$ 91,204	$ 519,583
Adjustments to Reconcile Net Income to Net Cash Flows from Operating Activities:		
Depreciation and Amortization	262,764	218,701
Deferred Income Taxes	(31,303)	95,273
Extraordinary Item, Net of Tax	-	(273,452)
Carrying Costs Income	(7,775)	(261,396)
Allowance for Equity Funds Used During Construction	(1,684)	(1,611)
Property Taxes	(6,990)	(6,689)
Change in Other Noncurrent Assets	(10,899)	(6,061)
Change in Other Noncurrent Liabilities	(2,534)	8,238
Changes in Certain Components of Working Capital:		
Accounts Receivable, Net	(34,312)	(34,531)
Materials and Supplies	(4,097)	(4,392)
Accounts Payable	(923)	(21,714)
Customer Deposits	6,857	(7)
Accrued Taxes, Net	18,083	15,049
Accrued Interest	(17,390)	(26,748)
Other Current Assets	(787)	(722)
Other Current Liabilities	(571)	1,914
Net Cash Flows from Operating Activities	259,643	221,435
INVESTING ACTIVITIES		
Construction Expenditures	(189,534)	(153,170)
Change in Restricted Cash for Securitized Transition Funding	19,632	60,870
Change in Advances to Affiliates, Net	-	125,616
Proceeds from Sales of Assets	4,568	14,346
Other Investing Activities	(60)	66
Net Cash Flows from (Used for) Investing Activities	(165,394)	47,728
FINANCING ACTIVITIES		
Issuance of Long-term Debt – Nonaffiliated	793,304	59,656
Change in Advances from Affiliates, Net	28,369	-
Retirement of Long-term Debt – Nonaffiliated	(231,574)	(279,708)
Retirement of Cumulative Preferred Stock	-	(307)
Principal Payments for Capital Lease Obligations	(1,443)	(1,298)
Dividends Paid on Common Stock	(684,824)	(47,500)
Dividends Paid on Cumulative Preferred Stock	-	(163)
Other Financing Activities	1,597	83
Net Cash Flows Used for Financing Activities	(94,571)	(269,237)
Net Decrease in Cash and Cash Equivalents	(322)	(74)
Cash and Cash Equivalents at Beginning of Period	422	274
Cash and Cash Equivalents at End of Period	$ 100	$ 200
SUPPLEMENTARY INFORMATION		
Cash Paid for Interest, Net of Capitalized Amounts	$ 115,554	$ 127,807
Net Cash Paid for Income Taxes	73,547	34,282
Noncash Acquisitions Under Capital Leases	2,721	559
Construction Expenditures Included in Current Liabilities as of September 30,	17,511	11,876

See Condensed Notes to Condensed Consolidated Financial Statements beginning on page 8.

INDEX OF CONDENSED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. <u>SIGNIFICANT ACCOUNTING MATTERS</u>

General

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

In the opinion of management, the unaudited condensed consolidated interim financial statements reflect all normal and recurring accruals and adjustments necessary for a fair presentation of the net income, financial position and cash flows for the interim periods. Net income for the three and nine months ended September 30, 2012 is not necessarily indicative of results that may be expected for the year ending December 31, 2012. The condensed consolidated financial statements are unaudited and should be read in conjunction with the audited 2011 financial statements and notes thereto, which are included in TCC's 2011 Annual Report.

Management reviewed subsequent events through October 26, 2012, the date that the third quarter 2012 report was issued.

Variable Interest Entities

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

AEP Texas Central Transition Funding I LLC, AEP Texas Central Transition Funding II LLC and AEP Texas Central Transition Funding III 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 $2.3 billion and $1.7 billion as of September 30, 2012 and December 31, 2011, respectively, and are included in current and long-term debt on the condensed balance sheets. Transition Funding has securitized transition assets of $2.2 billion and $1.6 billion as of September 30, 2012 and December 31, 2011, respectively, which are presented separately on the face of the condensed 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 Transition Funding that are consolidated. These balances include intercompany transactions that are eliminated upon consolidation.

AEP TEXAS CENTRAL COMPANY AND SUBSIDIARIES
VARIABLE INTEREST ENTITIES
September 30, 2012 and December 31, 2011
(in thousands)

	Transition Funding	
ASSETS	**2012**	**2011**
Current Assets	$ 221,627	$ 219,708
Other Noncurrent Assets	2,230,718 (a)	1,580,149
Total Assets	$ 2,452,345	$ 1,799,857
LIABILITIES AND EQUITY		
Current Liabilities	$ 292,773	$ 229,374
Noncurrent Liabilities	2,141,524	1,556,446
Equity	18,048	14,037
Total Liabilities and Equity	$ 2,452,345	$ 1,799,857

(a) Includes an intercompany item eliminated in consolidation of $90 million.

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 three months ended September 30, 2012 and 2011 were both $16 million, and for the nine months ended September 30, 2012 and 2011 were $45 million and $47 million, respectively. The carrying amount of liabilities associated with AEPSC as of September 30, 2012 and December 31, 2011 were both $7 million. Management estimates the maximum exposure of loss to be equal to the amount of such liability.

Extraordinary Item

In February 2006, the PUCT issued an order that denied recovery of capacity auction true-up amounts. Based on the 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. Based upon the Supreme Court of Texas opinion, TCC recorded a pretax gain of $421 million ($273 million, net of tax) in Extraordinary Item, Net of Tax on the condensed statements of income in the third quarter of 2011.

2. RATE MATTERS

As discussed in TCC's 2011 Annual Report, TCC is involved in rate and regulatory proceedings at the FERC and the PUCT. The Rate Matters note within TCC's 2011 Annual Report should be read in conjunction with this report to gain a complete understanding of material rate matters still pending that could impact net income, cash flows and possibly financial condition. The following discusses ratemaking developments in 2012 and updates TCC's 2011 Annual Report.

Regulatory Assets Not Yet Being Recovered

Noncurrent Regulatory Assets (excluding fuel)	September 30, 2012	December 31, 2011
	(in thousands)	
Regulatory assets not yet being recovered pending future proceedings to determine the recovery method and timing:		
Regulatory Assets Currently Earning a Return		
Storm Related Costs	$ 23,191	$ 24,166
Regulatory Assets Currently Not Earning a Return		
Rate Case Expenses	145	145
Total Regulatory Assets Not Yet Being Recovered	$ 23,336	$ 24,311

If these costs are ultimately determined not to be recoverable, it would reduce future net income and cash flows and impact financial condition.

3. 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 effect on the financial statements. The Commitments, Guarantees and Contingencies note within TCC's 2011 Annual Report should be read in conjunction with this report.

GUARANTEES

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

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 TCC's 2011 Annual Report "Dispositions" section of Note 6. As of September 30, 2012, there were no material liabilities recorded for any indemnifications.

Master Lease Agreements

TCC leases certain equipment under master lease agreements. Under the 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.

Historically, at the end of the lease term the fair value has been in excess of the unamortized balance. As of September 30, 2012, the maximum potential loss for these lease agreements was approximately $2.6 million assuming the fair value of the equipment is zero at the end of the lease term.

CONTINGENCIES

Carbon Dioxide Public Nuisance Claims

In October 2009, the Fifth Circuit Court of Appeals reversed a decision by the Federal District Court for the District of Mississippi dismissing state common law nuisance claims in a putative class action by Mississippi residents asserting that CO_2 emissions exacerbated the effects of Hurricane Katrina. The Fifth Circuit held that there was no exclusive commitment of the common law issues raised in plaintiffs' complaint to a coordinate branch of government and that no initial policy determination was required to adjudicate these claims. The court granted petitions for rehearing. An additional recusal left the Fifth Circuit without a quorum to reconsider the decision and the appeal was dismissed, leaving the district court's decision in place. Plaintiffs filed a petition with the U.S. Supreme Court asking the court to remand the case to the Fifth Circuit and reinstate the panel decision. The petition was denied in January 2011. Plaintiffs refiled their complaint in federal district court. The court ordered all defendants to respond to the refiled complaints in October 2011. In March 2012, the court granted the defendants' motion for dismissal on several grounds, including the doctrine of collateral estoppel and the applicable statute of limitations. Plaintiffs appealed the decision to the Fifth Circuit Court of Appeals. Management will continue 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_2 contribute to global warming and constitute a public and private nuisance and that the defendants are acting together. The complaint further alleges that some of the defendants, including AEP, conspired to create a false scientific debate about global warming in order to deceive the public and perpetuate the alleged nuisance. The plaintiffs also allege that the effects of global warming will require the relocation of the village at an alleged cost of $95 million to $400 million. In October 2009, the judge dismissed plaintiffs' federal common law claim for nuisance, finding the claim barred by the political question doctrine and by plaintiffs' lack of standing to bring the claim. The judge also dismissed plaintiffs' state law claims without prejudice to refiling in state court. The plaintiffs appealed the decision. In September 2012, the Ninth Circuit Court of Appeals affirmed the trial court's decision, holding that the CAA displaced Kivalina's claims for damages. Plaintiffs have filed a petition for rehearing by the full court. Management believes the action is without merit and will continue to defend against the claims. Management is unable to determine a range of potential losses that are reasonably possible of occurring.

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 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. In May 2012, the Supreme Court of Texas issued an order declining review of the Court of Appeals decision. The matter has been remanded to the trial court for further proceedings. The parties agreed to a second mediation, which occurred in August 2012. The parties were unable to resolve the matter. Management believes that the claims are without merit and intends to defend against them. Management is unable to determine a range of potential losses that are reasonably possible of occurring.

4. DISPOSITION

2011

During the nine months ended September 30, 2011, TCC sold $10 million of transmission facilities to ETT. There were no gains or losses recorded on these sale transactions.

5. BENEFIT PLANS

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 plan and a nonqualified pension plan. TCC also participates in OPEB plans sponsored by AEP to provide medical and life insurance benefits for retired employees.

Components of Net Periodic Benefit Cost

The following tables provide the components of TCC's net periodic benefit cost for the plans for the three and nine months ended September 30, 2012 and 2011:

	Pension Plans		Other Postretirement Benefit Plans	
	Three Months Ended September 30,		Three Months Ended September 30,	
	2012	2011	2012	2011
	(in thousands)			
Service Cost	$ 1,300	$ 1,250	$ 616	$ 555
Interest Cost	3,775	4,130	1,603	1,700
Expected Return on Plan Assets	(5,571)	(5,453)	(1,651)	(1,775)
Amortization of Prior Service Credit	(316)	(318)	(296)	(16)
Amortization of Net Actuarial Loss	2,537	2,118	889	440
Net Periodic Benefit Cost	$ 1,725	$ 1,727	$ 1,161	$ 904

	Pension Plans		Other Postretirement Benefit Plans	
	Nine Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in thousands)			
Service Cost	$ 3,899	$ 3,750	$ 1,845	$ 1,664
Interest Cost	11,325	12,390	4,810	5,098
Expected Return on Plan Assets	(16,715)	(16,358)	(4,953)	(5,325)
Amortization of Prior Service Credit	(947)	(953)	(887)	(47)
Amortization of Net Actuarial Loss	7,612	6,354	2,667	1,320
Net Periodic Benefit Cost	$ 5,174	$ 5,183	$ 3,482	$ 2,710

6. BUSINESS SEGMENTS

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

7. 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 September 30, 2012 and December 31, 2011 were 664 thousand gallons and 812 thousand gallons, respectively.

According to the accounting guidance for "Derivatives and Hedging," TCC reflects the fair values of derivative instruments subject to netting agreements with the same counterparty net of related cash collateral. For certain risk management contracts, TCC is required to post or receive cash collateral based on third party contractual agreements and risk profiles. For the September 30, 2012 balance sheet, TCC netted $7 thousand of cash collateral paid to third parties against short-term and long-term risk management liabilities.

The following tables represent the gross fair value impact of TCC's derivative activity on the condensed balance sheets as of September 30, 2012 and December 31, 2011:

Fair Value of Derivative Instruments
September 30, 2012

Balance Sheet Location	**Hedging Contracts (a)**	**Other (b)**	**Total**
		(in thousands)	
Prepayments and Other Current Assets	$ 74	$ (18)	$ 56
Deferred Charges and Other Noncurrent Assets	5	(2)	3
Total Assets	79	(20)	59
Other Current Liabilities	22	(19)	3
Deferred Credits and Other Noncurrent Liabilities	10	(9)	1
Total Liabilities	32	(28)	4
Total MTM Derivative Contract Net Assets (Liabilities)	$ 47	$ 8	$ 55

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	-	-	-
Total Assets	-	-	-
Other Current Liabilities	129	(129)	-
Deferred Credits and Other Noncurrent Liabilities	-	-	-
Total Liabilities	129	(129)	-
Total MTM Derivative Contract Net Assets (Liabilities)	$ (129)	$ 129	$ -

(a) Derivative instruments within these categories are reported gross. These instruments are subject to master netting agreements and are presented on the condensed 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."

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 condensed 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 heating oil and gasoline derivative contracts designated as cash flow hedges from Accumulated Other Comprehensive Income (Loss) on its condensed balance sheets into Other Operation expense, Maintenance expense or Depreciation and Amortization expense, as it relates to capital projects, on its condensed statements of income. During the three and nine months ended September 30, 2012 and 2011, TCC designated heating oil and gasoline derivatives as cash flow hedges. Hedge ineffectiveness was immaterial for this hedge strategy.

The following tables provide details on designated, effective cash flow hedges included in Accumulated Other Comprehensive Income (Loss) on TCC's condensed balance sheets and the reasons for changes in cash flow hedges for the three and nine months ended September 30, 2012 and 2011. All amounts in the following tables are presented net of related income taxes.

Total Accumulated Other Comprehensive Income (Loss) Activity for Cash Flow Hedges
For the Three Months Ended September 30, 2012 and 2011

	2012	2011
	(in thousands)	
Balance in AOCI as of July 1,	$ (141)	$ 191
Changes in Fair Value Recognized in AOCI	182	(198)
Amount of (Gain) or Loss Reclassified from AOCI		
to Statement of Income/within Balance Sheet:		
Other Operation Expense	-	(43)
Maintenance Expense	3	(31)
Property, Plant and Equipment	1	(46)
Balance in AOCI as of September 30,	$ 45	$ (127)

Total Accumulated Other Comprehensive Income (Loss) Activity for Cash Flow Hedges
For the Nine Months Ended September 30, 2012 and 2011

	2012	2011
	(in thousands)	
Balance in AOCI as of January 1,	$ (83)	$ 115
Changes in Fair Value Recognized in AOCI	160	71
Amount of (Gain) or Loss Reclassified from AOCI		
to Statement of Income/within Balance Sheet:		
Other Operation Expense	(13)	(113)
Maintenance Expense	(7)	(82)
Property, Plant and Equipment	(12)	(118)
Balance in AOCI as of September 30,	$ 45	$ (127)

Cash flow hedges included in Accumulated Other Comprehensive Income (Loss) on TCC's condensed balance sheets as of September 30, 2012 and December 31, 2011 were:

Impact of Cash Flow Hedges on the Condensed Balance Sheet
September 30, 2012 and December 31, 2011

	September 30, 2012	December 31, 2011
	(in thousands)	
Hedging Assets	$ 58	$ -
Hedging Liabilities	11	129
AOCI Gain (Loss) Net of Tax	45	(83)
Portion Expected to be Reclassified to Net Income During the Next Twelve Months	49	(83)

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 September 30, 2012, 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 15 months.

8. FAIR VALUE MEASUREMENTS

Fair Value Hierarchy and Valuation Techniques

The accounting guidance for "Fair Value Measurements and Disclosures" establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement). Where observable inputs are available for substantially the full term of the asset or liability, the instrument is categorized in Level 2. When quoted market prices are not available, pricing may be completed using comparable securities, dealer values, operating data and general market conditions to determine fair value. Valuation models utilize various inputs such as commodity, interest rate and, to a lesser degree, volatility and credit that include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in inactive markets, market corroborated inputs (i.e. inputs derived principally from, or correlated to, observable market data) and other observable inputs for the asset or liability. The AEP System's market risk oversight staff independently monitors its valuation policies and procedures and provides members of the Commercial Operations Risk Committee (CORC) various daily, weekly and monthly reports, regarding compliance with policies and procedures. The CORC consists of AEPSC's Chief Operation Officer, Chief Financial Officer, Senior Vice President of Commercial Operations and Chief Risk Officer.

For commercial activities, exchange traded derivatives, namely futures contracts, are generally fair valued based on unadjusted quoted prices in active markets and are classified as Level 1. Level 2 inputs primarily consist of OTC broker quotes in moderately active or less active markets, as well as exchange traded contracts where there is insufficient market liquidity to warrant inclusion in Level 1. Management verifies price curves using these broker quotes and classifies these fair values within Level 2 when substantially all of the fair value can be corroborated. Management typically obtains multiple broker quotes, which are non-binding in nature, but are based on recent trades in the marketplace. When multiple broker quotes are obtained, the quoted bid and ask prices are averaged. In certain circumstances, a broker quote may be discarded if it is a clear outlier. Management uses a historical correlation analysis between the broker quoted location and the illiquid locations. If the points are highly correlated, these locations are included within Level 2 as well. Certain OTC and bilaterally executed derivative instruments are executed in less active markets with a lower availability of pricing information. Long-dated and illiquid complex or structured transactions, FTRs and counterparty credit risk 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. The main driver of the contracts being classified as Level 3 is the inability to substantiate energy price curves in the market. A significant portion of the Level 3 instruments have been economically hedged which greatly limits potential earnings volatility.

For Restricted Cash for Securitized Transition Funding, items classified as Level 1 are investments in money market funds. They are valued based on observable inputs primarily unadjusted quoted prices in active markets for identical assets.

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 classified as Level 2 measurement inputs. 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 September 30, 2012 and December 31, 2011 are summarized in the following table:

	September 30, 2012		December 31, 2011	
	Book Value	Fair Value	Book Value	Fair Value
	(in thousands)			
Long-term Debt	$ 2,959,258	$ 3,265,350	$ 2,390,716	$ 2,742,800

Fair Value Measurements of Financial Assets and Liabilities

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 September 30, 2012 and December 31, 2011. 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
September 30, 2012

	Level 1	Level 2	Level 3	Other	Total
Assets:			(in thousands)		
Restricted Cash for Securitized Transition Funding (a)	$ 171,363	$ -	$ -	$ -	$ 171,363
Risk Management Assets					
Cash Flow Hedges:					
Commodity Hedges (b)	-	79	-	(20)	59
Total Assets	$ 171,363	$ 79	$ -	$ (20)	$ 171,422
Liabilities:					
Risk Management Liabilities					
Cash Flow Hedges:					
Commodity Hedges (b)	$ -	$ 32	$ -	$ (28)	$ 4

Assets and Liabilities Measured at Fair Value on a Recurring Basis
December 31, 2011

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

(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."

There were no transfers between Level 1 and Level 2 during the three and nine months ended September 30, 2012 and 2011.

9. INCOME TAXES

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.

10. FINANCING ACTIVITIES

Long-term Debt

Long-term debt issued, retired and principal payments made during the first nine months of 2012 are shown in the tables below:

	Type of Debt	Principal Amount	Interest Rate	Due Date
Issuances:		**(in thousands)**	**(%)**	
	Securitization Bonds	$ 311,900	2.845	2024
	Securitization Bonds	307,900	0.88	2017
	Securitization Bonds	180,200	1.976	2020

	Type of Debt	Principal Amount Paid	Interest Rate	Due Date
Retirements and		**(in thousands)**	**(%)**	
Principal Payments:	Securitization Bonds	$ 108,141	4.98	2013
	Securitization Bonds	63,433	5.96	2013
	Pollution Control Bonds	60,000	1.125	2012

As of September 30, 2012, trustees held, on TCC's behalf, $120 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 the subsidiaries. The corporate borrowing program includes a Utility Money Pool, which funds AEP's 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 September 30, 2012 and December 31, 2011 is included in Advances from Affiliates on condensed TCC's balance sheets. TCC's Utility Money Pool activity and corresponding authorized borrowing limit for the nine months ended September 30, 2012 are described in the following table:

Maximum Borrowings from Utility Money Pool	Maximum Loans to Utility Money Pool	Average Borrowings from Utility Money Pool	Average Loans to Utility Money Pool	Borrowings from Utility Money Pool as of September 30, 2012	Authorized Short-Term Borrowing Limit
		(in thousands)			
$ 82,573	$ 720,746	$ 45,768	$ 53,036	$ 64,412	$ 250,000

Maximum, minimum and average interest rates for funds either borrowed from or loaned to the Utility Money Pool for the nine months ended September 30, 2012 and 2011 are summarized in the following table:

Nine Months Ended September 30,	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
2012	0.56 %	0.44 %	0.48 %	0.46 %	0.48 %	0.47 %
2011	0.42 %	0.39 %	0.56 %	0.06 %	0.41 %	0.29 %

11. SUSTAINABLE COST REDUCTIONS

In April 2012, management initiated a process to identify employee repositioning opportunities and efficiencies that will result in sustainable cost savings. The process will result in involuntary severances and is expected to be completed in early 2013. The severance program provides two weeks of base pay for every year of service along with other severance benefits.

TCC recorded charges to expense in 2012 related to the sustainable cost reductions initiative.

Expense Allocation from AEPSC	Incurred	Settled	Remaining Balance at September 30, 2012
	(in thousands)		
$ 793	$ 3	$ (796)	$ -

These expenses relate primarily to severance benefits. They are included primarily in Other Operation on the condensed statements of income. At this time, management is unable to estimate the total amount to be incurred in future periods related to this initiative or to quantify the effects on future net income, cash flows and financial condition.