AEP Generating Company

2012 Annual Report

Audited 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
AEGCo	AEP Generating Company, an AEP electric utility subsidiary.
AEP or Parent	American Electric Power Company, Inc., an electric 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, a service subsidiary providing management and professional services to AEP and its subsidiaries.
AFUDC	Allowance for Funds Used During Construction.
APCo	Appalachian Power Company, an AEP electric utility subsidiary.
CAA	Clean Air Act.
CO_2	Carbon dioxide and other greenhouse gases.
CWIP	Construction Work in Progress.
EIS	Energy Insurance Services, Inc., a nonaffiliated captive insurance company and consolidated variable interest entity of AEP.
Federal EPA	United States Environmental Protection Agency.
FERC	Federal Energy Regulatory Commission.
I&M	Indiana Michigan Power Company, an AEP electric utility subsidiary.
KPCo	Kentucky Power Company, an AEP electric utility subsidiary.
MW	Megawatt.
OPCo	Ohio Power Company, an AEP electric utility subsidiary.
Rockport Plant	A generating plant, consisting of two 1,310 MW coal-fired generating units near Rockport, Indiana, owned by AEGCo and I&M.
UPA	Unit Power Agreement.
Utility Money Pool	Centralized funding mechanism AEP uses to meet the short-term cash requirements of certain utility subsidiaries.
VIE	Variable Interest Entity.

INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying financial statements of AEP Generating Company (the "Company"), which comprise the balance sheets as of December 31, 2012 and 2011, and the related statements of income, changes in common shareholder's equity, and cash flows for each of the three years in the period ended December 31, 2012, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the financial statements in order to design 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. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of AEP Generating Company as of December 31, 2012 and 2011, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2012 in accordance with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

Columbus, Ohio
February 26, 2013

AEP GENERATING COMPANY
STATEMENTS OF INCOME
For the Years Ended December 31, 2012, 2011 and 2010
(in thousands)

	Years Ended December 31, 2012	2011	2010
OPERATING REVENUES - AFFILIATED	$ 545,029	$ 512,725	$ 450,780
EXPENSES			
Fuel Used for Electric Generation	349,701	308,217	249,278
Rent – Rockport Plant Unit 2	68,283	68,283	68,283
Other Operation	27,499	26,556	31,825
Maintenance	18,696	22,718	16,018
Depreciation and Amortization	37,584	36,978	36,837
Taxes Other Than Income Taxes	4,851	3,835	4,090
TOTAL EXPENSES	506,614	466,587	406,331
OPERATING INCOME	38,415	46,138	44,449
Other Income (Expense):			
Interest Income	284	73	4
Allowance for Equity Funds Used During Construction	218	7,068	123
Interest Expense	(13,390)	(14,315)	(16,713)
INCOME BEFORE INCOME TAX EXPENSE	25,527	38,964	27,863
Income Tax Expense	2,415	3,330	9,223
NET INCOME	$ 23,112	$ 35,634	$ 18,640

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

See Notes to Financial Statements beginning on page 8.

AEP GENERATING COMPANY
STATEMENTS OF CHANGES IN COMMON SHAREHOLDER'S EQUITY
For the Years Ended December 31, 2012, 2011 and 2010
(in thousands)

	Common Stock	Paid-in Capital	Retained Earnings	Total
TOTAL COMMON SHAREHOLDER'S EQUITY – DECEMBER 31, 2009	$ 1,000	$ 238,184	$ 58,580	$ 297,764
Common Stock Dividends			(20,000)	(20,000)
Subtotal - Common Shareholder's Equity				277,764
Net Income			18,640	18,640
TOTAL COMMON SHAREHOLDER'S EQUITY – DECEMBER 31, 2010	1,000	238,184	57,220	296,404
Common Stock Dividends			(78,500)	(78,500)
Subtotal - Common Shareholder's Equity				217,904
Net Income			35,634	35,634
TOTAL COMMON SHAREHOLDER'S EQUITY – DECEMBER 31, 2011	1,000	238,184	14,354	253,538
Common Stock Dividends			(25,000)	(25,000)
Subtotal - Common Shareholder's Equity				228,538
Net Income			23,112	23,112
TOTAL COMMON SHAREHOLDER'S EQUITY – DECEMBER 31, 2012	$ 1,000	$ 238,184	$ 12,466	$ 251,650

See Notes to Financial Statements beginning on page 8.

AEP GENERATING COMPANY
BALANCE SHEETS
ASSETS
December 31, 2012 and 2011
(in thousands)

	December 31, 2012	December 31, 2011
CURRENT ASSETS		
Advances to Affiliates	$ -	$ 21,708
Accounts Receivable – Affiliated Companies	54,129	65,428
Fuel	28,027	33,188
Materials and Supplies	19,395	18,855
Prepayments and Other Current Assets	509	960
TOTAL CURRENT ASSETS	102,060	140,139
PROPERTY, PLANT AND EQUIPMENT		
Electric:		
Generation	1,483,614	1,478,867
Transmission	9,688	9,688
Other Property, Plant and Equipment	7,350	6,984
Construction Work in Progress	69,034	25,186
Total Property, Plant and Equipment	1,569,686	1,520,725
Accumulated Depreciation and Amortization	942,537	908,558
TOTAL PROPERTY, PLANT AND EQUIPMENT – NET	627,149	612,167
OTHER NONCURRENT ASSETS		
Regulatory Assets	29,015	20,554
Deferred Charges and Other Noncurrent Assets	2,306	2,649
TOTAL OTHER NONCURRENT ASSETS	31,321	23,203
TOTAL ASSETS	$ 760,530	$ 775,509

See Notes to Financial Statements beginning on page 8.

AEP GENERATING COMPANY
BALANCE SHEETS
LIABILITIES AND COMMON SHAREHOLDER'S EQUITY
December 31, 2012 and 2011

	December 31, 2012	December 31, 2011
	(in thousands)	
CURRENT LIABILITIES		
Advances from Affiliates	$ 4,405	$ -
Accounts Payable:		
General	19,564	33,198
Affiliated Companies	32,767	28,918
Long-term Debt Due Within One Year – Nonaffiliated	52,273	52,273
Accrued Taxes	4,665	6,732
Accrued Rent – Rockport Plant Unit 2	4,963	4,963
Other Current Liabilities	3,998	4,809
TOTAL CURRENT LIABILITIES	122,635	130,893
NONCURRENT LIABILITIES		
Long-term Debt – Nonaffiliated	174,546	181,818
Deferred Income Taxes	80,336	70,216
Regulatory Liabilities and Deferred Investment Tax Credits	46,509	48,325
Deferred Gain on Sale-and-Leaseback – Rockport Plant Unit 2	55,337	60,908
Deferred Credits and Other Noncurrent Liabilities	29,517	29,811
TOTAL NONCURRENT LIABILITIES	386,245	391,078
TOTAL LIABILITIES	508,880	521,971
Commitments and Contingencies (Note 3)		
COMMON SHAREHOLDER'S EQUITY		
Common Stock – Par Value – $1,000 Per Share:		
Authorized – 1,000 Shares		
Outstanding – 1,000 Shares	1,000	1,000
Paid-in Capital	238,184	238,184
Retained Earnings	12,466	14,354
TOTAL COMMON SHAREHOLDER'S EQUITY	251,650	253,538
TOTAL LIABILITIES AND COMMON SHAREHOLDER'S EQUITY	$ 760,530	$ 775,509

See Notes to Financial Statements beginning on page 8.

AEP GENERATING COMPANY
STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2012, 2011 and 2010
(in thousands)

	Years Ended December 31,		
	2012	**2011**	**2010**
OPERATING ACTIVITIES			
Net Income	$ 23,112	$ 35,634	$ 18,640
Adjustments to Reconcile Net Income to Net Cash Flows from Operating Activities:			
Depreciation and Amortization	37,584	36,978	36,837
Deferred Income Taxes	2,013	1,717	(479)
Deferred Investment Tax Credits	(3,282)	(3,282)	(3,282)
Amortization of Deferred Gain on Sale-and-Leaseback – Rockport Plant Unit 2	(5,571)	(5,571)	(5,571)
Allowance for Equity Funds Used During Construction	(218)	(7,068)	(123)
Change in Other Noncurrent Assets	876	(3,956)	2,506
Change in Other Noncurrent Liabilities	442	1,181	2,056
Changes in Certain Components of Working Capital:			
Accounts Receivable	4,524	21	(19,092)
Fuel, Materials and Supplies	4,621	11,778	2,092
Accounts Payable	(5,881)	(33,144)	49,454
Accrued Taxes, Net	(1,961)	(3,032)	20,140
Other Current Assets	(4)	476	(199)
Other Current Liabilities	(237)	(1,106)	(188)
Net Cash Flows from Operating Activities	56,018	30,626	102,791
INVESTING ACTIVITIES			
Construction Expenditures	(50,688)	(119,679)	(16,674)
Change in Advances to Affiliates, Net	21,708	(21,708)	-
Proceeds from Sales of Assets	1,560	302,231	522
Other Investing Activities	-	1,519	-
Net Cash Flows from (Used for) Investing Activities	(27,420)	162,363	(16,152)
FINANCING ACTIVITIES			
Issuance of Long-term Debt – Nonaffiliated	-	44,616	-
Change in Advances from Affiliates, Net	4,405	(21,178)	(58,990)
Retirement of Long-term Debt – Nonaffiliated	(7,273)	(137,273)	(7,273)
Principal Payments for Capital Lease Obligations	(730)	(654)	(376)
Dividends Paid on Common Stock	(25,000)	(78,500)	(20,000)
Net Cash Flows Used for Financing Activities	(28,598)	(192,989)	(86,639)
Net Change in Cash and Cash Equivalents	-	-	-
Cash and Cash Equivalents at Beginning of Period	-	-	-
Cash and Cash Equivalents at End of Period	$ -	$ -	$ -
SUPPLEMENTARY INFORMATION			
Cash Paid for Interest, Net of Capitalized Amounts	$ 12,684	$ 14,579	$ 16,213
Net Cash Paid (Received) for Income Taxes	3,775	8,599	(7,221)
Noncash Acquisitions Under Capital Leases	53	1,301	104
Construction Expenditures Included in Current Liabilities as of December 31,	7,908	5,590	386

See Notes to Financial Statements beginning on page 8.

INDEX OF NOTES TO FINANCIAL STATEMENTS

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

ORGANIZATION

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

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

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

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Rates and Service Regulation

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

Accounting for the Effects of Cost-Based Regulation

As a rate-regulated electric public utility company, AEGCo's financial statements reflect the actions of regulators that result in the recognition of certain revenues and expenses in different time periods than enterprises that are not rate-regulated. In accordance with accounting guidance for "Regulated Operations," AEGCo records regulatory assets (deferred expenses) and regulatory liabilities (deferred revenue reductions or refunds) 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.

Use of Estimates

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

Cash and Cash Equivalents

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

Inventory

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

Property, Plant and Equipment

Electric utility property, plant and equipment are stated at original cost. Additions, major replacements and betterments are added to the plant accounts. Under the group composite method of depreciation, continuous interim routine replacements of items such as boiler tubes, pumps, motors, etc. result in the original cost, less salvage, being charged to accumulated depreciation. The 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. 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 plants are included in operating expenses.

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

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. AEGCo records the equity component of AFUDC in Other Income and the debt component of AFUDC as a reduction to Interest Expense.

Valuation of Nonderivative Financial Instruments

The book values of Advances to Affiliates, 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.

Revenue Recognition and Accounts Receivable

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

Maintenance

Maintenance costs are expensed as incurred.

Income Taxes and Investment Tax Credits

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

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

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

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

Debt

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

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

Earnings Per Share (EPS)

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

Subsequent Events

Management reviewed subsequent events through February 26, 2013, the date that AEGCo's 2012 annual report was issued.

2. EFFECTS OF REGULATION

Regulatory assets and liabilities are comprised of the following items:

Regulatory Assets:	**December 31, 2012**	**2011**	**Remaining Recovery Period**
	(in thousands)		
Noncurrent Regulatory Assets			
Regulatory assets not yet being recovered pending future proceedings to determine the recovery method and timing:			
Regulatory Assets Currently Not Earning a Return			
Asset Retirement Obligation	$ 2,957	$ 2,624	(a)
Total Regulatory Assets Not Yet Being Recovered	2,957	2,624	
Regulatory assets being recovered:			
Regulatory Assets Currently Earning a Return			
Unamortized Loss on Reacquired Debt	2,599	2,836	13 years
Regulatory Assets Currently Not Earning a Return			
Income Taxes, Net	23,459	15,094	17 years
Total Regulatory Assets Being Recovered	26,058	17,930	
Total Noncurrent Regulatory Assets	$ 29,015	$ 20,554	

(a) In January 2013, AEGCo received approval from the FERC to include in rate base and amortize over 32 years.

Regulatory Liabilities:	**December 31, 2012**	**2011**	**Remaining Refund Period**
	(in thousands)		
Noncurrent Regulatory Liabilities and Deferred Investment Tax Credits			
Regulatory liabilities being paid:			
Regulatory Liabilities Currently Paying a Return			
Asset Removal Costs	$ 26,973	$ 25,506	(b)
Deferred Investment Tax Credits	19,536	22,819	10 years
Total Regulatory Liabilities Being Paid	46,509	48,325	
Total Noncurrent Regulatory Liabilities and Deferred Investment Tax Credits	$ 46,509	$ 48,325	

(b) Relieved as removal costs are incurred.

3. <u>COMMITMENTS, GUARANTEES AND CONTINGENCIES</u>

AEGCo is subject to certain claims and legal actions arising in its ordinary course of business. In addition, AEGCo's business activities are subject to extensive governmental regulation related to public health and the environment. The ultimate outcome of such pending or potential litigation cannot be predicted. For current proceedings not specifically discussed below, management does not anticipate that the liabilities, if any, arising from such proceedings would have a material effect on the financial statements.

COMMITMENTS

Construction and Commitments

AEGCo has substantial construction commitments to support its operations and environmental investments. In managing the overall construction program and in the normal course of business, AEGCo contractually commits to third-party construction vendors for certain material purchases and other construction services. Management forecasts approximately $62 million of construction expenditures, excluding equity AFUDC, for 2013. AEGCo also purchases fuel, materials, supplies, services and property, plant and equipment under contract as part of its normal course of business. Certain supply contracts contain penalty provisions for early termination. AEGCo has no actual contractual commitments as of December 31, 2012.

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.

Letters of Credit

AEGCo has $45 million of variable rate Pollution Control Bonds supported by bilateral letters of credit for $46 million. The letters of credit mature in July 2014.

Indemnifications and Other Guarantees

Contracts

AEGCo enters into certain types of contracts which require indemnifications. Typically these contracts include, but are not limited to, sale agreements, lease agreements, purchase agreements and financing agreements. Generally, these agreements may include, but are not limited to, indemnifications around certain tax, contractual and environmental matters. With respect to sale agreements, exposure generally does not exceed the sale price. As of December 31, 2012, there were no material liabilities recorded for any indemnifications.

CONTINGENCIES

Insurance and Potential Losses

AEGCo maintains insurance coverage normal and customary for an electric utility, subject to various deductibles. Insurance coverage includes all risks of physical loss or damage to assets, subject to insurance policy conditions and exclusions. Covered property generally includes power plants, substations, facilities and inventories. The insurance programs also generally provide coverage against loss arising from certain claims made by third parties and are in excess of AEGCo's retentions. Coverage is generally provided by a combination of the protected cell of EIS and/or various industry mutual and/or commercial 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 reduce future net income and cash flows and impact financial condition.

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' petition for rehearing by the full court was denied in November 2012, but the plaintiffs could seek further review in the U.S. Supreme 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.

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

By-products from the generation of electricity include materials such as ash, slag and sludge. Coal combustion by-products, which constitute the overwhelming percentage of these materials, are typically treated and deposited in captive disposal facilities or are beneficially utilized. In addition, AEGCo's generating plants and transmission facilities have used asbestos, polychlorinated biphenyls and other hazardous and nonhazardous materials. AEGCo 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. Superfund does not recognize compliance as a defense, but imposes strict liability on parties who fall within its broad statutory categories. Present estimates do not anticipate material cleanup costs.

4. DISPOSITION

2011

Dresden Plant

In August 2011, AEGCo sold the partially completed Dresden Plant to APCo, at cost, for $302 million. The Dresden Plant was completed and placed in service by APCo in January 2012. The Dresden Plant is located near Dresden, Ohio and is a natural gas, combined cycle power plant with a generating capacity of 608 MW.

5. BUSINESS SEGMENTS

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

6. FAIR VALUE MEASUREMENTS

Fair Value Measurements of Long-term Debt

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 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 AEGCo's Long-term Debt as of December 31, 2012 and 2011 are summarized in the following table:

	December 31,			
	2012		2011	
	Book Value	Fair Value	Book Value	Fair Value
	(in thousands)			
Long-term Debt	$ 226,819	$ 294,633	$ 234,091	$ 287,723

7. INCOME TAXES

The details of AEGCo's income taxes as reported are as follows:

	Years Ended December 31,		
	2012	2011	2010
	(in thousands)		
Income Tax Expense (Credit):			
Current	$ 3,684	$ 4,895	$ 12,984
Deferred	2,013	1,717	(479)
Deferred Investment Tax Credits	(3,282)	(3,282)	(3,282)
Income Tax Expense	$ 2,415	$ 3,330	$ 9,223

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,		
	2012	2011	2010
		(in thousands)	
Net Income	$ 23,112	$ 35,634	$ 18,640
Income Tax Expense	2,415	3,330	9,223
Pretax Income	$ 25,527	$ 38,964	$ 27,863
Income Taxes on Pretax Income at Statutory Rate (35%)	$ 8,934	$ 13,637	$ 9,752
Increase (Decrease) in Income Taxes resulting from the following items:			
Depreciation	(1,307)	(3,345)	2,162
AFUDC	(1,170)	(3,557)	(1,133)
Rockport Plant Unit 2 Investment Tax Credit	374	374	374
Investment Tax Credits, Net	(3,282)	(3,282)	(3,282)
State and Local Income Taxes, Net	141	909	723
Other	(1,275)	(1,406)	627
Income Tax Expense	$ 2,415	$ 3,330	$ 9,223
Effective Income Tax Rate	9.5 %	8.5 %	33.1 %

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

	December 31,	
	2012	2011
	(in thousands)	
Deferred Tax Assets	$ 35,452	$ 44,865
Deferred Tax Liabilities	(115,659)	(114,499)
Net Deferred Tax Liabilities	$ (80,207)	$ (69,634)
Property Related Temporary Differences	$ (87,467)	$ (86,254)
Amounts Due from Customers for Future Federal Income Taxes	(6,318)	(3,136)
Deferred State Income Taxes	(5,340)	(6,080)
Net Deferred Gain on Sale-and-Leaseback – Rockport Plant Unit 2	18,592	20,597
All Other, Net	326	5,239
Net Deferred Tax Liabilities	$ (80,207)	$ (69,634)

AEP System Tax Allocation Agreement

AEGCo joins in the filing of a consolidated federal income tax return with its affiliates in the AEP System. The allocation of the AEP System's current consolidated federal income tax to the AEP System companies allocates the benefit of current tax losses to the AEP System companies giving rise to such losses in determining their current tax expense. The tax benefit of the Parent is allocated to its subsidiaries with taxable income. With the exception of the loss of the Parent, the method of allocation reflects a separate return result for each company in the consolidated group.

Federal and State Income Tax Audit Status

AEGCo and other AEP subsidiaries are no longer subject to U.S. federal examination for years before 2009. AEGCo 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 materially impact AEGCo 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, AEGCo accrues interest on these uncertain tax positions. Management is not aware of any issues for open tax years that upon final resolution are expected to materially impact net income.

AEGCo and other AEP subsidiaries file income tax returns in various state and local jurisdictions. These taxing authorities routinely examine the tax returns and AEGCo and other AEP subsidiaries are currently under examination in several state and local jurisdictions. Management believes that 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, AEGCo is no longer subject to state or local income tax examinations by tax authorities for years before 2008.

Tax Credit Carryforward

A federal income tax operating loss sustained in 2009 along with lower federal taxable income in 2012, 2011 and 2010 resulted in unused federal income tax credits of $14 thousand as of December 31, 2012.

AEGCo 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

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

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

	Years Ended December 31,		
	2012	**2011**	**2010**
		(in thousands)	
Interest Expense	$ -	$ 336	$ -
Interest Income	-	-	40
Reversal of Prior Period Interest Expense	5	-	3

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

	December 31,	
	2012	**2011**
	(in thousands)	
Accrual for Receipt of Interest	$ 1	$ 8
Accrual for Payment of Interest and Penalties	37	46

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

	2012	**2011**	**2010**
		(in thousands)	
Balance as of January 1,	$ 967	$ 250	$ (622)
Increase - Tax Positions Taken During a Prior Period	90	2,056	1,047
Decrease - Tax Positions Taken During a Prior Period	(86)	(384)	(110)
Increase - Tax Positions Taken During the Current Year	-	-	-
Decrease - Tax Positions Taken During the Current Year	-	-	(65)
Decrease - Settlements with Taxing Authorities	-	(1,530)	-
Increase - Lapse of the Applicable Statute of Limitations	-	575	-
Balance as of December 31,	$ 971	$ 967	$ 250

The total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate is $0 thousand for 2012 and 2011 and $(24) thousand for 2010. 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 materially impact AEGCo's net income or financial condition. However, the bonus depreciation contributed to AEP's 2009 federal net operating tax loss and resulted in a 2010 cash flow benefit to AEGCo of approximately $7 million.

The Small Business Jobs Act (the 2010 Act) was enacted in September 2010. Included in the 2010 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 2010 Act extended the time for claiming bonus depreciation and increased the deduction to 100% for part of 2011 and 2010. The enacted provisions did not materially impact AEGCo's net income or financial condition but had a favorable impact on cash flows of approximately $2 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. In November 2012, the effective date was moved to tax years beginning in 2014. Further, the notice stated that the U. S. Treasury Department anticipates that the final regulations will contain changes from the temporary regulations. Management will evaluate the impact of these regulations once they are issued.

The American Taxpayer Relief Act of 2012 (the 2012 Act) was enacted in January 2013. Included in the 2012 Act was a one-year extension of the 50% bonus depreciation. The 2012 Act also retroactively extended the life of research and development, employment and several energy tax credits, which expired at the end of 2011. The enacted provisions will not materially impact AEGCo's net income or financial condition but are expected to have a favorable impact on cash flows in 2013.

State Tax Legislation

Legislation was passed by the state of Indiana in May 2011 enacting a phased reduction in corporate income tax rates from 8.5% to 6.5%. The 8.5% Indiana corporate income tax rate will be reduced 0.5% each year beginning after June 30, 2012 with the final reduction occurring in years beginning after June 30, 2015.

During the third quarter of 2012, the state of West Virginia achieved certain minimum levels of shortfall reserve funds. As a result, the West Virginia corporate income tax rate will be reduced from 7.75% to 7.0% in 2013. The enacted provisions will not materially impact AEGCo's net income, cash flows or financial condition.

8. LEASES

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

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

	Years Ended December 31,		
Lease Rental Costs	**2012**	**2011**	**2010**
		(in thousands)	
Net Lease Expense on Operating Leases	$ 70,680	$ 71,866	$ 72,271
Amortization of Capital Leases	730	661	378
Interest on Capital Leases	659	778	654
Total Lease Rental Costs	$ 72,069	$ 73,305	$ 73,303

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

	December 31,	
	2012	**2011**
	(in thousands)	
Property, Plant and Equipment Under Capital Leases		
Generation	$ 14,253	$ 14,408
Other Property, Plant and Equipment	384	335
Total Property, Plant and Equipment Under Capital Leases	14,637	14,743
Accumulated Amortization	2,823	2,252
Net Property, Plant and Equipment Under Capital Leases	$ 11,814	$ 12,491
Obligations Under Capital Leases		
Noncurrent Liability	$ 11,110	$ 11,764
Liability Due Within One Year	704	727
Total Obligations Under Capital Leases	$ 11,814	$ 12,491

Future minimum lease payments consisted of the following as of December 31, 2012:

Future Minimum Lease Payments	**Capital Leases**	**Noncancelable Operating Leases**
	(in thousands)	
2013	$ 1,331	$ 76,235
2014	1,289	76,235
2015	1,289	75,674
2016	1,196	75,518
2017	1,192	74,554
Later Years	10,908	373,060
Total Future Minimum Lease Payments	17,205	$ 751,276
Less Estimated Interest Element	5,391	
Estimated Present Value of Future Minimum Lease Payments	$ 11,814	

Rockport Lease

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

The gain from the sale was deferred and is being amortized over the term of the lease, which expires in 2022. The Owner Trustee owns the Plant and leases it to AEGCo and I&M. The lease is accounted for as an operating lease with the payment obligations included in the future minimum lease payments schedule earlier in this note. The lease term is for 33 years with potential renewal options. At the end of the lease term, AEGCo and I&M have the option to renew the lease or the Owner Trustee can sell the Plant. AEP, AEGCo and I&M have no ownership interest in the Owner Trustee and do not guarantee its debt. AEGCo's future minimum lease payments for this sale-and-leaseback transaction as of December 31, 2012 are as follows:

Future Minimum Lease Payments	**(in millions)**	
2013	$	74
2014		74
2015		74
2016		74
2017		74
Later Years		369
Total Future Minimum Lease Payments	$	739

9. FINANCING ACTIVITIES

Long-term Debt

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

The following details long-term debt outstanding as of December 31, 2012 and 2011:

		Interest Rate as of December 31,		**Outstanding as of December 31,**			
Type of Debt	**Maturity**	**2012**	**2011**		**2012**		**2011**
				(in thousands)			
Senior Unsecured Notes	2037	6.33%	6.33%	$	181,819	$	189,091
Pollution Control Bonds (a)	2012-2013 (b)	0.12%	0.10%		45,000		45,000
Total Long-term Debt Outstanding					226,819		234,091
Long-term Debt Due Within One Year					52,273		52,273
Long-term Debt				$	174,546	$	181,818

(a) For AEGCo's pollution control bonds, interest rates are subject to periodic adjustment and may be purchased on demand at periodic interest adjustment dates. Standby bond purchase agreements and insurance policies support certain series.
(b) AEGCo's 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 AEGCo's balance sheets.

Long-term debt outstanding as of December 31, 2012 is payable as follows:

	2013	**2014**	**2015**	**2016**	**2017**	**After 2017**	**Total**
				(in thousands)			
Principal Amount	$ 52,273	$ 7,273	$ 7,273	$ 7,273	$ 7,273	$ 145,454	$ 226,819
Total Long-term Debt Outstanding							$ 226,819

Dividend Restrictions

AEGCo pays dividends to Parent provided funds are legally available. Various financing arrangements and regulatory requirements may impose certain restrictions on the ability of AEGCo to transfer funds to Parent in the form of dividends.

Federal Power Act

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

Leverage Restrictions

Pursuant to the credit agreement leverage restrictions, AEGCo must maintain a percentage of debt to total capitalization at a level that does not exceed 67.5%. As of December 31, 2012, none of AEGCo's retained earnings have restrictions related to the payment of dividends to Parent.

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 December 31, 2012 is included in Advances from Affiliates on AEGCo's balance sheet. The amount of outstanding loans to the Utility Money Pool as of December 31, 2011 is included in Advances to Affiliates on AEGCo's balance sheet. AEGCo's Utility Money Pool activity and corresponding authorized borrowing limits for the years ended December 31, 2012 and 2011 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)			
2012	$ 30,911	$ 66,282	$ 8,633	$ 34,018	$ (4,405)	$ 200,000
2011	119,637	131,561	58,694	62,543	21,708	200,000

Maximum, minimum and average interest rates for funds either borrowed from or loaned to the Utility Money Pool for the years ended December 31, 2012, 2011 and 2010 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
2012	0.47 %	0.39 %	0.56 %	0.39 %	0.42 %	0.47 %
2011	0.56 %	0.06 %	0.51 %	0.40 %	0.34 %	0.42 %
2010	0.55 %	0.09 %	- %	- %	0.27 %	- %

Interest expense and interest income related to the Utility Money Pool are included in Interest Expense and Interest Income, respectively, on AEGCo's statements of income. For amounts borrowed from and advanced to the Utility Money Pool, AEGCo incurred the following amounts of interest expense and earned the following amounts of interest income, respectively, for the years ended December 31, 2012, 2011 and 2010:

	Years Ended December 31,		
	2012	**2011**	**2010**
		(in thousands)	
Interest Expense	$ 131	$ 137	$ 167
Interest Income	283	84	-

10. RELATED PARTY TRANSACTIONS

For other related party transactions, also see "AEP System Tax Allocation Agreement" section of Note 7 and "Utility Money Pool – AEP System" section of Note 9.

Affiliated Revenues

AEGCo's revenues derived from sales to affiliates for the years ended December 31, 2012, 2011 and 2010 were $545 million, $513 million and $451 million, respectively. These revenues are reported in Operating Revenues – Affiliated on AEGCo's statements of income.

Unit Power Agreements (UPA)

Lawrenceburg UPA between OPCo and AEGCo

In March 2007, OPCo and AEGCo entered into a ten-year UPA for the entire output from the Lawrenceburg Generating Station effective with AEGCo's purchase of the plant in May 2007. AEGCo's gross investment in the plant was $734 million and $723 million as of December 31, 2012 and 2011, respectively, net depreciation of $422 million and $415 million, respectively. The UPA has an option for an additional two-year period. I&M operates the plant under an agreement with AEGCo. Under the UPA, OPCo pays AEGCo for the capacity, depreciation, fuel, operation and maintenance and tax expenses. These payments are due regardless of whether the plant is operating. The fuel and operation and maintenance payments are based on actual costs incurred. All expenses are trued up periodically.

The following is a schedule by years of minimum future rentals associated with the Lawrenceburg operating lease as of December 31, 2012:

Future Minimum Lease Rentals	(in millions)
2013	$ 34
2014	31
2015	31
2016	30
2017	29
Total Future Minimum Lease Rentals	$ 155

UPA between AEGCo and I&M

A UPA between AEGCo and I&M (the I&M Power Agreement) provides for the sale by AEGCo to I&M of all the power (and the energy associated therewith) available to AEGCo at the Rockport Plant unless it is sold to another utility. Subsequently, I&M assigns 30% of the power to KPCo. See the "UPA between AEGCo and KPCo" section below. I&M is obligated, whether or not power is available from AEGCo, to pay as a demand charge for the right to receive such power (and as an energy charge for any associated energy taken by I&M) net of amounts received by AEGCo from any other sources, sufficient to enable AEGCo to pay all its operating and other expenses, including a rate of return on the common equity of AEGCo as approved by the FERC. The I&M Power Agreement will continue in effect until the expiration of the lease term of Unit 2 of the Rockport Plant unless extended in specified circumstances.

UPA between AEGCo and KPCo

Pursuant to an assignment between I&M and KPCo and a UPA between KPCo and AEGCo, AEGCo sells KPCo 30% of the power (and the energy associated therewith) available to AEGCo from both units of the Rockport Plant. KPCo pays to AEGCo in consideration for the right to receive such power the same amounts which I&M would have paid AEGCo under the terms of the I&M Power Agreement for such entitlement. The KPCo UPA ends in December 2022.

I&M Barging and Other Services

I&M provides barging and other transportation services to affiliates. AEGCo recorded expenses of $20 million, $15 million and $13 million for the years ended December 31, 2012, 2011 and 2010, respectively, for barging services provided by I&M. These expenses were recorded in Fuel Used for Electric Generation on AEGCo's statements of income.

Central Machine Shop

APCo operates a facility which repairs and rebuilds specialized components for the generation plants across the AEP System. APCo defers the cost of performing these services on the balance sheet, then transfers the cost to the affiliate for reimbursement. AEGCo recorded its assigned portion of these billings as capital or maintenance expenses depending on the nature of the services received. These billings are recoverable under the UPAs. AEGCo's billed amounts were $80 thousand, $102 thousand and $180 thousand for the years ended December 31, 2012, 2011 and 2010, respectively.

Sales and Purchases of Property

AEGCo had affiliated sales and purchases of electric property individually amounting to $100 thousand or more and sales and purchases of meters and transformers. There were no gains or losses recorded on the transactions. The following table shows the sales and purchases, that were recorded at net book value, for the years ended December 31, 2012, 2011 and 2010:

	Years Ended December 31,		
	2012	**2011**	**2010**
		(in thousands)	
Sales	$ 1,560	$ -	$ 522
Purchases	346	-	-

The amounts above are recorded in Property, Plant and Equipment on the balance sheets.

11. 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 AEGCo is the primary beneficiary of a VIE, management considers factors such as equity at risk, the amount of the VIE's variability AEGCo 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. AEGCo is not the primary beneficiary of any VIE and has not provided financial or other support to any VIE that was not previously contractually required.

AEPSC provides certain managerial and professional services to AEP's subsidiaries. AEP is the sole equity owner of AEPSC. AEP management controls the activities of AEPSC. The costs of the services are based on a direct charge or on a prorated basis and billed to the AEP subsidiary companies at AEPSC's cost. AEP subsidiaries have not provided financial or other support outside the reimbursement of costs for services rendered. AEPSC finances its operations through cost reimbursement from other AEP subsidiaries. There are no other terms or arrangements between AEPSC and any of the AEP subsidiaries that could require additional financial support from an AEP subsidiary or expose them to losses outside of the normal course of business. AEPSC and its billings are subject to regulation by the FERC. AEP subsidiaries are exposed to losses to the extent they cannot recover the costs of AEPSC through their normal business operations. AEP subsidiaries are considered to have a significant interest in AEPSC due to their activity in AEPSC's cost reimbursement structure. However, AEP subsidiaries do not have control over AEPSC. AEPSC is consolidated by AEP. In the event AEPSC would require financing or other support outside the cost reimbursement billings, this financing would be provided by AEP. AEGCo's total billings from AEPSC for the years ended December 31, 2012, 2011 and 2010 were $7 million, $12 million and $11 million, respectively. The carrying amount of liabilities associated with AEPSC as of December 31, 2012 and 2011 was $1 million and $1.7 million, respectively. Management estimates the maximum exposure of loss to be equal to the amount of such liability.

12. PROPERTY, PLANT AND EQUIPMENT

Depreciation

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

2012	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)
Generation	$ 1,483,614	$ 933,229	2.5%	31-37	$ -	$ -	NA	NA
Transmission	9,688	4,956	1.5%	NM	-	-	NA	NA
CWIP	69,034	1,378	NM	NM	-	-	NA	NA
Other	7,220	2,974	8.4%	NM	130	-	NM	NM
Total	$ 1,569,556	$ 942,537			$ 130	$ -		

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)
Generation	$ 1,478,867	$ 905,773	2.5%	31-37	$ -	$ -	NA	NA
Transmission	9,688	4,676	1.5%	NM	-	-	NA	NA
CWIP	25,186	(4,314)	NM	NM	-	-	NA	NA
Other	6,854	2,423	7.8%	NM	130	-	NM	NM
Total	$ 1,520,595	$ 908,558			$ 130	$ -		

2010	Regulated		Nonregulated	
Functional Class of Property	Annual Composite Depreciation Rate	Depreciable Life Ranges	Annual Composite Depreciation Rate	Depreciable Life Ranges
		(in years)		(in years)
Generation	2.5%	31-37	NA	NA
Transmission	1.5%	NM	NA	NA
CWIP	NM	NM	NA	NA
Other	12.5%	NM	NM	NM

NA Not applicable.
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.

Asset Retirement Obligations (ARO)

AEGCo records ARO in accordance with the accounting guidance for “Asset Retirement and Environmental Obligations” for the retirement of ash disposal facilities and asbestos removal. The following is a reconciliation of the 2012 and 2011 aggregate carrying amounts of ARO for AEGCo:

Year	ARO as of January 1,	Accretion Expense	Liabilities Incurred	Liabilities Settled	Revisions in Cash Flow Estimates	ARO as of December 31,
			(in thousands)			
2012	$ 3,748	$ 295	$ -	$ (21)	$ -	$ 4,022
2011	4,204	337	-	(190)	(603)	3,748

Allowance for Funds Used During Construction (AFUDC)

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

	Years Ended December 31, 2012	2011	2010
		(in thousands)	
Allowance for Equity Funds Used During Construction	$ 218	$ 7,068	$ 123
Allowance for Borrowed Funds Used During Construction	171	1,566	61

Jointly-owned Electric Facilities

AEGCo, jointly with I&M, owns one generating unit (Unit 1) of the Rockport Plant. AEGCo and I&M each have a 50.0% ownership share of the Rockport Plant. Using its own financing, each participating company is obligated to pay its share of the costs in the same proportion as its ownership interest. AEGCo’s proportionate share of the operating costs associated with this facility is included in its statements of income and the investment and accumulated depreciation are reflected in its balance sheets under Property, Plant and Equipment as follows:

	Fuel Type	Percent of Ownership	Utility Plant in Service	Construction Work in Progress	Accumulated Depreciation
				(in thousands)	
AEGCo's Share as of December 31, 2012					
Rockport Generating Plant (Unit 1) (a)	Coal	50.0 %	$ 764,259	$ 54,235	$ 542,854
AEGCo's Share as of December 31, 2011					
Rockport Generating Plant (Unit 1) (a)	Coal	50.0 %	$ 760,686	$ 19,237	$ 519,406

(a) Operated by I&M.

13. COST REDUCTION PROGRAMS

2012 Sustainable Cost Reductions

In April 2012, management initiated a process to identify strategic repositioning opportunities and efficiencies that will result in sustainable cost savings. Management selected a consulting firm to conduct an organizational and process evaluation and a second firm to evaluate current employee benefit programs. The process resulted in involuntary severances and is expected to be completed by the end of the first quarter of 2013. The severance program provides two weeks of base pay for every year of service along with other severance benefits.

AEGCo recorded charges to expense during 2012 related to the sustainable cost reductions initiative. AEGCo has no employees but receives allocated expenses.

Expense Allocation from AEPSC	Incurred	Settled	Remaining Balance as of December 31, 2012
	(in thousands)		
$ 660	$ -	$ (660)	$ -

These expenses relate primarily to severance benefits. They are included primarily in Other Operation expense on the statement of income.

2010 Cost Reduction Initiatives

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

AEGCo recorded a charge to Other Operation expense during 2010 primarily related to severance benefits as the result of headcount reduction initiatives. The total amount incurred in 2010 by AEGCo was $3.9 million. AEGCo has no employees but receives allocated expenses.

14. 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. AEGCo's unaudited quarterly financial information is as follows:

	2012 Quarterly Periods Ended			
	March 31	June 30	September 30	December 31
	(in thousands)			
Operating Revenues	$ 142,500	$ 121,900	$ 139,167	$ 141,462
Operating Income	13,777	6,788	11,116	6,734
Net Income	9,194	855	6,108	6,955

	2011 Quarterly Periods Ended			
	March 31	June 30	September 30	December 31
	(in thousands)			
Operating Revenues	$ 126,548	$ 112,252	$ 140,548	$ 133,377
Operating Income	13,791	11,182	13,754	7,411
Net Income	9,675	7,517	10,171	8,271

There were no significant events in 2012 and 2011.