AEP Texas North Company

2009 Third Quarter Report

Consolidated Financial Statements

TABLE OF CONTENTS	Page

GLOSSARY OF TERMS

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

Term	Meaning
AEP or Parent	American Electric Power Company, Inc.
AEP Consolidated	AEP and its majority owned consolidated subsidiaries and consolidated affiliates.
AEP East companies	APCo, CSPCo, I&M, KPCo and OPCo.
AEP System	American Electric Power System, an integrated electric utility system, owned and operated by AEP's electric utility subsidiaries.
AEP West companies	PSO, SWEPCo, TCC and TNC.
AEPSC	American Electric Power Service Corporation, a service subsidiary providing management and professional services to AEP and its subsidiaries.
AOCI	Accumulated Other Comprehensive Income.
APB	Accounting Principles Board Opinion.
APCo	Appalachian Power Company, an AEP electric utility subsidiary.
APSC	Arkansas Public Service Commission.
ARO	Asset Retirement Obligations.
ASU	Accounting Standards Update issued by the Financial Accounting Standards Board.
CAA	Clean Air Act.
CSPCo	Columbus Southern Power Company, an AEP electric utility subsidiary.
CSW	Central and South West Corporation, a subsidiary of AEP (Effective January 21, 2003, the legal name of Central and South West Corporation was changed to AEP Utilities, Inc.).
CSW Operating Agreement	Agreement, dated January 1, 1997, by and among PSO, SWEPCo, TCC and TNC governing generating capacity allocation. This agreement was amended in May 2006 to remove TCC and TNC. AEPSC acts as the agent.
CTC	Competition Transition Charge.
CWIP	Construction Work in Progress.
EITF	Financial Accounting Standards Board's Emerging Issues Task Force.
EITF 06-10	EITF Issue No. 06-10 "Accounting for Collateral Assignment Split-Dollar Life Insurance Arrangements."
ERCOT	Electric Reliability Council of Texas.
ETT	Electric Transmission Texas, LLC, a 50% equity interest joint venture with MidAmerican Energy Holdings Company formed to own and operate electric transmission facilities in ERCOT.
FASB	Financial Accounting Standards Board.
Federal EPA	United States Environmental Protection Agency.
FERC	Federal Energy Regulatory Commission.
FSP	FASB Staff Position.
GAAP	Accounting Principles Generally Accepted in the United States of America.
I&M	Indiana Michigan Power Company, an AEP electric utility subsidiary.
KPCo	Kentucky Power Company, an AEP electric utility subsidiary.
MW	Megawatt.
Nonutility Money Pool	AEP Consolidated's Nonutility Money Pool.
OCC	Corporation Commission of the State of Oklahoma.
OPCo	Ohio Power Company, an AEP electric utility subsidiary.
OPEB	Other Postretirement Benefit Plans.
OTC	Over the counter.
PSO	Public Service Company of Oklahoma, an AEP electric utility subsidiary.
PUCT	Public Utility Commission of Texas.
SFAS	Statement of Financial Accounting Standards issued by the Financial Accounting Standards Board.
SFAS 157	Statement of Financial Accounting Standards No. 157, "Fair Value Measurements."
SIA	System Integration Agreement.
SWEPCo	Southwestern Electric Power Company, an AEP electric utility subsidiary.

Term	Meaning
TCC	AEP Texas Central Company, an AEP electric utility subsidiary.
TNC	AEP Texas North Company, an AEP electric utility subsidiary.
Utility Money Pool	AEP System's Utility Money Pool.

AEP TEXAS NORTH COMPANY AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
For the Three and Nine Months Ended September 30, 2009 and 2008
(in thousands)
(Unaudited)

	Three Months Ended 2009	Three Months Ended 2008	Nine Months Ended 2009	Nine Months Ended 2008
REVENUES				
Electric Generation, Transmission and Distribution	$ 48,089	$ 45,117	$ 133,349	$ 126,437
Sales to AEP Affiliates	21,999	26,354	61,098	74,280
Other Revenues	157	132	652	733
TOTAL REVENUES	70,245	71,603	195,099	201,450
EXPENSES				
Fuel and Other Consumables Used for Electric Generation	11,496	15,385	22,117	36,775
Other Operation	19,405	18,342	57,923	55,456
Maintenance	4,697	5,573	17,267	17,308
Depreciation and Amortization	12,049	11,088	35,953	34,231
Taxes Other Than Income Taxes	4,030	3,172	13,487	13,291
TOTAL EXPENSES	51,677	53,560	146,747	157,061
OPERATING INCOME	18,568	18,043	48,352	44,389
Other Income (Expense):				
Interest Income	18	568	167	1,431
Allowance for Equity Funds Used During Construction	189	767	554	1,115
Interest Expense	(5,047)	(4,647)	(16,033)	(14,036)
INCOME BEFORE INCOME TAX EXPENSE	13,728	14,731	33,040	32,899
Income Tax Expense	4,272	3,043	10,522	8,856
NET INCOME	9,456	11,688	22,518	24,043
Preferred Stock Dividend Requirements	26	26	78	78
EARNINGS ATTRIBUTABLE TO COMMON STOCK	$ 9,430	$ 11,662	$ 22,440	$ 23,965

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

See Condensed Notes to Condensed Consolidated Financial Statements.

AEP TEXAS NORTH COMPANY AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN COMMON SHAREHOLDER'S EQUITY AND COMPREHENSIVE INCOME (LOSS)
For the Nine Months Ended September 30, 2009 and 2008
(in thousands)
(Unaudited)

	Common Stock	Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
TOTAL COMMON SHAREHOLDER'S EQUITY – DECEMBER 31, 2007	$ 137,214	$ 2,351	$ 201,639	$ (9,309)	$ 331,895
EITF 06-10 Adoption, Net of Tax of $153			(285)		(285)
Common Stock Dividends			(25,000)		(25,000)
Preferred Stock Dividends			(78)		(78)
SUBTOTAL – COMMON SHAREHOLDER'S EQUITY					306,532
COMPREHENSIVE INCOME					
Other Comprehensive Income, Net of Taxes:					
Amortization of Pension and OPEB Deferred Costs, Net of Tax of $260				483	483
NET INCOME			24,043		24,043
TOTAL COMPREHENSIVE INCOME					24,526
TOTAL COMMON SHAREHOLDER'S EQUITY – SEPTEMBER 30, 2008	$ 137,214	$ 2,351	$ 200,319	$ (8,826)	$ 331,058
TOTAL COMMON SHAREHOLDER'S EQUITY – DECEMBER 31, 2008	$ 137,214	$ 2,351	$ 200,167	$ (16,256)	$ 323,476
Common Stock Dividends			(24,000)		(24,000)
Preferred Stock Dividends			(78)		(78)
Other Changes in Common Shareholder's Equity		1,089	(1,089)		-
SUBTOTAL – COMMON SHAREHOLDER'S EQUITY					299,398
COMPREHENSIVE INCOME					
Other Comprehensive Income, Net of Taxes:					
Cash Flow Hedges, Net of Tax of $23				43	43
Amortization of Pension and OPEB Deferred Costs, Net of Tax of $237				439	439
NET INCOME			22,518		22,518
TOTAL COMPREHENSIVE INCOME					23,000
TOTAL COMMON SHAREHOLDER'S EQUITY – SEPTEMBER 30, 2009	$ 137,214	$ 3,440	$ 197,518	$ (15,774)	$ 322,398

See Condensed Notes to Condensed Consolidated Financial Statements.

AEP TEXAS NORTH COMPANY AND SUBSIDIARY
CONDENSED CONSOLIDATED BALANCE SHEETS
ASSETS
September 30, 2009 and December 31, 2008
(in thousands)
(Unaudited)

	2009	2008
CURRENT ASSETS		
Cash and Cash Equivalents	$ 200	$ 200
Accounts Receivable:		
Customers	11,552	9,674
Affiliated Companies	51,799	65,731
Accrued Unbilled Revenues	4,934	4,289
Miscellaneous	484	55
Allowance for Uncollectible Accounts	(108)	(47)
Total Accounts Receivable	68,661	79,702
Fuel	9,476	9,808
Materials and Supplies	10,378	10,339
Risk Management Assets	46	-
Deferred Tax Benefits	7,538	-
Prepayments and Other Current Assets	1,494	1,367
TOTAL CURRENT ASSETS	97,793	101,416
PROPERTY, PLANT AND EQUIPMENT		
Electric:		
Production	300,164	295,065
Transmission	444,200	411,839
Distribution	560,516	548,424
Other Property, Plant and Equipment	108,470	107,844
Construction Work in Progress	87,223	82,283
Total Property, Plant and Equipment	1,500,573	1,445,455
Accumulated Depreciation and Amortization	477,193	458,868
TOTAL PROPERTY, PLANT AND EQUIPMENT – NET	1,023,380	986,587
OTHER NONCURRENT ASSETS		
Regulatory Assets	65,335	67,943
Long-term Risk Management Assets	8	-
Deferred Charges and Other Noncurrent Assets	5,728	3,076
TOTAL OTHER NONCURRENT ASSETS	71,071	71,019
TOTAL ASSETS	$ 1,192,244	$ 1,159,022

See Condensed Notes to Condensed Consolidated Financial Statements.

AEP TEXAS NORTH COMPANY AND SUBSIDIARY
CONDENSED CONSOLIDATED BALANCE SHEETS
LIABILITIES AND SHAREHOLDERS' EQUITY
September 30, 2009 and December 31, 2008
(Unaudited)

	2009	2008
	(in thousands)	
CURRENT LIABILITIES		
Advances from Affiliates	$ 40,310	$ 28,686
Accounts Payable:		
General	10,447	7,236
Affiliated Companies	59,302	47,572
Accrued Taxes	18,769	16,714
Accrued Interest	4,938	5,914
Provision for Revenue Refund	11,814	9,400
Other Current Liabilities	15,178	21,231
TOTAL CURRENT LIABILITIES	160,758	136,753
NONCURRENT LIABILITIES		
Long-term Debt – Nonaffiliated	369,032	368,965
Deferred Income Taxes	130,480	124,071
Regulatory Liabilities and Deferred Investment Tax Credits	133,947	131,022
Employee Benefits and Pension Obligations	40,358	42,596
Deferred Credits and Other Noncurrent Liabilities	32,922	29,790
TOTAL NONCURRENT LIABILITIES	706,739	696,444
TOTAL LIABILITIES	867,497	833,197
Cumulative Preferred Stock Not Subject to Mandatory Redemption	2,349	2,349
Commitments and Contingencies (Note 4)		
COMMON SHAREHOLDER'S EQUITY		
Common Stock – Par Value – $25 Per Share:		
Authorized – 7,800,000 Shares		
Outstanding – 5,488,560 Shares	137,214	137,214
Paid-in Capital	3,440	2,351
Retained Earnings	197,518	200,167
Accumulated Other Comprehensive Income (Loss)	(15,774)	(16,256)
TOTAL COMMON SHAREHOLDER'S EQUITY	322,398	323,476
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 1,192,244	$ 1,159,022

See Condensed Notes to Condensed Consolidated Financial Statements.

AEP TEXAS NORTH COMPANY AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Nine Months Ended September 30, 2009 and 2008
(in thousands)
(Unaudited)

	2009	2008
OPERATING ACTIVITIES		
Net Income	$ 22,518	$ 24,043
Adjustments to Reconcile Net Income to Net Cash Flows from Operating Activities:		
Depreciation and Amortization	35,953	34,231
Deferred Income Taxes	(5,900)	3,036
Allowance for Equity Funds Used During Construction	(554)	(1,115)
Change in Other Noncurrent Assets	(4,157)	(8,902)
Change in Other Noncurrent Liabilities	3,558	2,399
Changes in Certain Components of Working Capital:		
Accounts Receivable, Net	11,041	(2,036)
Fuel, Materials and Supplies	293	1,866
Accounts Payable	16,279	(3,565)
Accrued Taxes, Net	2,276	(552)
Other Current Assets	(413)	(396)
Other Current Liabilities	(2,601)	52
Net Cash Flows from Operating Activities	78,293	49,061
INVESTING ACTIVITIES		
Construction Expenditures	(67,943)	(92,471)
Other Investing Activities	2,398	3,121
Net Cash Flows Used for Investing Activities	(65,545)	(89,350)
FINANCING ACTIVITIES		
Issuance of Long-term Debt – Nonaffilated	-	99,346
Change in Advances from Affiliates, Net	11,624	(33,335)
Principal Payments for Capital Lease Obligations	(434)	(430)
Dividends Paid on Common Stock	(24,000)	(25,000)
Dividends Paid on Cumulative Preferred Stock	(78)	(78)
Other Financing Activities	140	-
Net Cash Flows from (Used for) Financing Activities	(12,748)	40,503
Net Increase in Cash and Cash Equivalents	-	214
Cash and Cash Equivalents at Beginning of Period	200	-
Cash and Cash Equivalents at End of Period	$ 200	$ 214
SUPPLEMENTARY INFORMATION		
Cash Paid for Interest, Net of Capitalized Amounts	$ 19,212	$ 12,879
Net Cash Paid for Income Taxes	3,124	8,060
Noncash Acquisitions Under Capital Leases	268	281
Construction Expenditures Included in Accounts Payable at September 30,	3,998	7,649

See Condensed Notes to Condensed Consolidated Financial Statements.

CONDENSED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Significant Accounting Matters
2. New Accounting Pronouncements
3. Rate Matters
4. Commitments, Guarantees and Contingencies
5. Disposition
6. Benefit Plans
7. Business Segments
8. Derivatives and Hedging
9. Fair Value Measurements
10. Income Taxes
11. Financing Activities

1. SIGNIFICANT ACCOUNTING MATTERS

General

The accompanying 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, 2009 is not necessarily indicative of results that may be expected for the year ending December 31, 2009. Management reviewed subsequent events through the October 30, 2009 issuance date of TNC's third quarter financial statements and footnotes. The accompanying condensed consolidated financial statements are unaudited and should be read in conjunction with the audited 2008 financial statements and notes thereto, which are included in TNC's 2008 Annual Report.

Variable Interest Entities

The accounting guidance for "Variable Interest Entities" is a consolidation model that considers risk absorption of a variable interest entity (VIE), also referred to as variability. Entities are required to consolidate a VIE when it is determined that they are the primary beneficiary of that VIE, as defined by the accounting guidance for "Variable Interest Entities." In determining whether TNC is the primary beneficiary of a VIE, management considers factors such as equity at risk, the amount of the VIE's variability TNC absorbs, guarantees of indebtedness, voting rights including kick-out rights, the power to direct the VIE and other factors. Management believes that the significant assumptions and judgments were applied consistently. There have been no changes to the reporting of VIEs in the financial statements where it is concluded that TNC is the primary beneficiary. In addition, TNC has not provided financial or other support to any VIE that was not previously contractually required.

TNC holds a significant variable interest in AEPSC. AEPSC provides certain managerial and professional services to TNC. AEP is the sole equity owner of AEPSC. The costs of the services are based on a direct charge or on a prorated basis and billed to TNC and other AEP subsidiaries at AEPSC's cost. TNC and other AEP subsidiaries have not provided financial or other support outside the reimbursement of costs for services rendered. The cost reimbursement nature of AEPSC finances its operations. There are no other terms or arrangements between AEPSC and TNC and other AEP subsidiaries that could require additional financial support from TNC and other AEP subsidiaries or expose them to losses outside of the normal course of business. AEPSC and its billings are subject to regulation by the FERC. TNC and other AEP subsidiaries are exposed to losses to the extent they cannot recover the costs of AEPSC through their normal business operations. TNC is considered to have a significant interest in the variability of AEPSC due to its activity in AEPSC's cost reimbursement structure. AEPSC is consolidated by AEP. In the event AEPSC would require financing or other support outside the cost reimbursement billings, this financing would be provided by AEP. Total billings from AEPSC for the three months ended September 30, 2009 and 2008 were $8 million and $9 million, respectively, and for the nine months ended September 30, 2009 and 2008 were $22 million and $26 million, respectively. The carrying amount of liabilities associated with AEPSC as of September 30, 2009 and December 31, 2008 were $3 million and $4 million, respectively. Management estimates the maximum exposure of loss to be equal to the amount of such liability.

Accounting for Asset Retirement Obligations (ARO)

As a result of the accounting guidance for "Asset Retirement and Environmental Obligations", TNC records a liability at fair value for any legal obligations for future asset retirements when the related assets are acquired or constructed. Upon establishment of a legal liability, a corresponding ARO asset is established, which will be depreciated over its useful life. Upon final settlement of an ARO, any difference between the ARO liability and actual costs is recognized as income or expense.

In February 2008, TNC sold the Fort Phantom, Lake Pauline, Rio Pecos and San Angelo Plants. As part of the sale, the buyer assumed all environmental liabilities existing prior to and after the sale. As a result, the related ARO balances were reversed. The following is a reconciliation of the nine months ended September 30, 2009 and 2008 aggregate carrying amount of ARO for TNC:

	ARO at January 1	Accretion Expense	Liabilities Settled	Revisions in Cash Flow Estimates	ARO at September 30
			(in thousands)		
2009	$ 5,564	$ 255	$ (780)	$ 7	$ 5,046
2008	10,659	303	(5,525)	-	5,437

TNC's aggregate carrying amount includes ARO related to asbestos removal.

2. NEW ACCOUNTING PRONOUNCEMENTS

Upon issuance of final pronouncements, management reviews the new accounting literature to determine the relevance, if any, to TNC's business. The following represents a summary of new pronouncements issued or implemented in 2009 and standards issued but not implemented that management has determined relate to TNC's operations.

Pronouncements Adopted During 2009

The following standards were effective during the first nine months of 2009. Consequently, the financial statements and footnotes reflect their impact.

SFAS 141 (revised 2007) "Business Combinations" (SFAS 141R)

In December 2007, the FASB issued SFAS 141R, improving financial reporting about business combinations and their effects. It established how the acquiring entity recognizes and measures the identifiable assets acquired, liabilities assumed, goodwill acquired, any gain on bargain purchases and any noncontrolling interest in the acquired entity. SFAS 141R no longer allows acquisition-related costs to be included in the cost of the business combination, but rather expensed in the periods they are incurred, with the exception of the costs to issue debt or equity securities which shall be recognized in accordance with other applicable GAAP. The standard requires disclosure of information for a business combination that occurs during the accounting period or prior to the issuance of the financial statements for the accounting period. SFAS 141R can affect tax positions on previous acquisitions. TNC does not have any such tax positions that result in adjustments.

In April 2009, the FASB issued FSP SFAS 141(R)-1 "Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies." The standard clarifies accounting and disclosure for contingencies arising in business combinations. It was effective January 1, 2009.

TNC adopted SFAS 141R, including the FSP, effective January 1, 2009. It is effective prospectively for business combinations with an acquisition date on or after January 1, 2009. TNC had no business combinations in 2009. TNC will apply it to any future business combinations. SFAS 141R is included in the "Business Combination" accounting guidance.

SFAS 160 "Noncontrolling Interests in Consolidated Financial Statements" (SFAS 160)

In December 2007, the FASB issued SFAS 160, modifying reporting for noncontrolling interest (minority interest) in consolidated financial statements. It requires noncontrolling interest be reported in equity and establishes a new framework for recognizing net income or loss and comprehensive income by the controlling interest. Upon deconsolidation due to loss of control over a subsidiary, the standard requires a fair value remeasurement of any remaining noncontrolling equity investment to be used to properly recognize the gain or loss. SFAS 160 requires specific disclosures regarding changes in equity interest of both the controlling and noncontrolling parties and presentation of the noncontrolling equity balance and income or loss for all periods presented.

TNC adopted SFAS 160 effective January 1, 2009 with no impact on its financial statements or footnote disclosures. SFAS 160 is included in the "Consolidation" accounting guidance.

SFAS 161 "Disclosures about Derivative Instruments and Hedging Activities" (SFAS 161)

In March 2008, the FASB issued SFAS 161, enhancing disclosure requirements for derivative instruments and hedging activities. Affected entities are required to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how an entity accounts for derivative instruments and related hedged items and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows. The standard requires that objectives for using derivative instruments be disclosed in terms of the primary underlying risk and accounting designation.

TNC adopted SFAS 161 effective January 1, 2009. This standard increased the disclosures related to derivative instruments and hedging activities. See Note 8. SFAS 161 is included in the "Derivatives and Hedging" accounting guidance.

SFAS 165 "Subsequent Events" (SFAS 165)

In May 2009, the FASB issued SFAS 165 incorporating guidance on subsequent events into authoritative accounting literature and clarifying the time following the balance sheet date which management reviewed for events and transactions that may require disclosure in the financial statements.

TNC adopted this standard effective second quarter of 2009. The standard increased disclosure by requiring disclosure of the date through which subsequent events have been reviewed. The standard did not change management's procedures for reviewing subsequent events. SFAS 165 is included in the "Subsequent Events" accounting guidance.

SFAS 168 "The FASB Accounting Standards Codification™ and the Hierarchy of Generally Accepted Accounting Principles" (SFAS 168)

In June 2009, the FASB issued SFAS 168 establishing the FASB Accounting Standards Codification™ as the authoritative source of accounting principles for preparation of financial statements and reporting in conformity with GAAP by nongovernmental entities.

TNC adopted SFAS 168 effective third quarter of 2009. It required an update of all references to authoritative accounting literature. SFAS 168 is included in the "Generally Accepted Accounting Principles" accounting guidance.

EITF Issue No. 08-5 "Issuer's Accounting for Liabilities Measured at Fair Value with a Third-Party Credit Enhancement" (EITF 08-5)

In September 2008, the FASB ratified the consensus on liabilities with third-party credit enhancements when the liability is measured and disclosed at fair value. The consensus treats the liability and the credit enhancement as two units of accounting. Under the consensus, the fair value measurement of the liability does not include the effect of the third-party credit enhancement. Consequently, changes in the issuer's credit standing without the support of the credit enhancement affect the fair value measurement of the issuer's liability. Entities will need to provide disclosures about the existence of any third-party credit enhancements related to their liabilities. In the period of adoption, entities must disclose the valuation method(s) used to measure the fair value of liabilities within its scope and any change in the fair value measurement method that occurs as a result of its initial application.

TNC adopted EITF 08-5 effective January 1, 2009. With the adoption of FSP SFAS 107-1 and APB 28-1, it is applied to the fair value of long-term debt. The application of this standard had an immaterial effect on the fair value of debt outstanding. EITF 08-5 is included in the "Fair Value Measurements and Disclosures" accounting guidance.

EITF Issue No. 08-6 "Equity Method Investment Accounting Considerations" (EITF 08-6)

In November 2008, the FASB ratified the consensus on equity method investment accounting including initial and allocated carrying values and subsequent measurements. It requires initial carrying value be determined using the SFAS 141R cost allocation method. When an investee issues shares, the equity method investor should treat the transaction as if the investor sold part of its interest.

TNC adopted EITF 08-6 effective January 1, 2009 with no impact on the financial statements. It was applied prospectively. EITF 08-6 is included in the "Investments – Equity Method and Joint Ventures" accounting guidance.

FSP SFAS 107-1 and APB 28-1 "Interim Disclosures about Fair Value of Financial Instruments" (FSP SFAS 107-1 and APB 28-1)

In April 2009, the FASB issued FSP SFAS 107-1 and APB 28-1 requiring disclosure about the fair value of financial instruments in all interim reporting periods. The standard requires disclosure of the method and significant assumptions used to determine the fair value of financial instruments.

TNC adopted the standard effective second quarter of 2009. This standard increased the disclosure requirements related to financial instruments. See "Fair Value Measurements of Long-term Debt" section of Note 9. FSP SFAS 107-1 and APB 28-1 is included in the "Financial Instruments" accounting guidance.

FSP SFAS 115-2 and SFAS 124-2 "Recognition and Presentation of Other-Than-Temporary Impairments" (FSP SFAS 115-2 and SFAS 124-2)

In April 2009, the FASB issued FSP SFAS 115-2 and SFAS 124-2 amending the other-than-temporary impairment (OTTI) recognition and measurement guidance for debt securities. For both debt and equity securities, the standard requires disclosure for each interim reporting period of information by security class similar to previous annual disclosure requirements.

TNC adopted the standard effective second quarter of 2009 with no impact on the financial statements or disclosures. FSP SFAS 115-2 and SFAS 124-2 is included in the "Investments – Debt and Equity Securities" accounting guidance.

FSP SFAS 142-3 "Determination of the Useful Life of Intangible Assets" (SFAS 142-3)

In April 2008, the FASB issued SFAS 142-3 amending factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset. The standard is expected to improve consistency between the useful life of a recognized intangible asset and the period of expected cash flows used to measure its fair value.

TNC adopted SFAS 142-3 effective January 1, 2009. The guidance is prospectively applied to intangible assets acquired after the effective date. The standard's disclosure requirements are applied prospectively to all intangible assets as of January 1, 2009. The adoption of this standard had no impact on the financial statements. SFAS 142-3 is included in the "Intangibles – Goodwill and Other" accounting guidance.

FSP SFAS 157-2 "Effective Date of FASB Statement No. 157" (SFAS 157-2)

In February 2008, the FASB issued SFAS 157-2 which delays the effective date of SFAS 157 to fiscal years beginning after November 15, 2008 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). As defined in SFAS 157, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. 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.

TNC adopted SFAS 157-2 effective January 1, 2009. TNC will apply these requirements to applicable fair value measurements which include new asset retirement obligations and impairment analyses related to long-lived assets, equity investments, goodwill and intangibles. TNC did not record any fair value measurements for nonrecurring nonfinancial assets and liabilities in the first nine months of 2009. SFAS 157-2 is included in the "Fair Value Measurements and Disclosures" accounting guidance.

FSP SFAS 157-4 "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly" (FSP SFAS 157-4)

In April 2009, the FASB issued FSP SFAS 157-4 providing additional guidance on estimating fair value when the volume and level of activity for an asset or liability has significantly decreased, including guidance on identifying circumstances indicating when a transaction is not orderly. Fair value measurements shall be based on the price that would be received to sell an asset or paid to transfer a liability in an orderly (not a distressed sale or forced liquidation) transaction between market participants at the measurement date under current market conditions. The standard also requires disclosures of the inputs and valuation techniques used to measure fair value and a discussion of changes in valuation techniques and related inputs, if any, for both interim and annual periods.

TNC adopted the standard effective second quarter of 2009 with no impact on the financial statements or disclosures. FSP SFAS 157-4 is included in the "Fair Value Measurements and Disclosures" accounting guidance.

Pronouncements Effective in the Future

The following standards will be effective in the future and their impacts will be disclosed at that time.

ASU 2009-05 "Measuring Liabilities at Fair Value" (ASU 2009-05)

In August 2009, the FASB issued ASU 2009-05 updating the "Fair Value Measurement and Disclosures" accounting guidance. The guidance specifies the valuation techniques that should be used to fair value a liability in the absence of a quoted price in an active market.

The new accounting guidance is effective for interim and annual periods beginning after the issuance date. Although management has not completed an analysis, management does not expect this update to have a material impact on the financial statements. TNC will adopt ASU 2009-05 effective fourth quarter of 2009.

ASU 2009-12 "Investments in Certain Entities That Calculate Net Asset Value per Share (or its Equivalent)" (ASU 2009-12)

In September 2009, the FASB issued ASU 2009-12 updating the "Fair Value Measurement and Disclosures" accounting guidance for the fair value measurement of investments in certain entities that calculate net asset value per share (or its equivalent). The guidance permits a reporting entity to measure the fair value of an investment within its scope on the basis of the net asset value per share of the investment (or its equivalent).

The new accounting guidance is effective for interim and annual periods ending after December 15, 2009. Although management has not completed an analysis, management does not expect this update to have a material impact on the financial statements. TNC will adopt ASU 2009-12 effective fourth quarter of 2009.

ASU 2009-13 "Multiple-Deliverable Revenue Arrangements" (ASU 2009-13)

In October 2009, the FASB issued ASU 2009-13 updating the "Revenue Recognition" accounting guidance by providing criteria for separating consideration in multiple-deliverable arrangements. It establishes a selling price hierarchy for determining the price of a deliverable and expands the disclosures related to a vendor's multiple-deliverable revenue arrangements.

The new accounting guidance is effective prospectively for arrangements entered into or materially modified in years beginning after June 15, 2010. Although management has not completed an analysis, management does not expect this update to have a material impact on the financial statements. TNC will adopt ASU 2009-13 effective January 1, 2011.

SFAS 167 "Amendments to FASB Interpretation No. 46(R)" (SFAS 167)

In June 2009, the FASB issued SFAS 167 amending the analysis an entity must perform to determine if it has a controlling interest in a variable interest entity (VIE). This new guidance provides that the primary beneficiary of a VIE must have both:

- The power to direct the activities of the VIE that most significantly impact the VIE's economic performance.
- The obligation to absorb the losses of the entity that could potentially be significant to the VIE or the right to receive benefits from the entity that could potentially be significant to the VIE.

The standard also requires separate presentation on the face of the statement of financial position for assets which can only be used to settle obligations of a consolidated VIE and liabilities for which creditors do not have recourse to the general credit of the primary beneficiary.

SFAS 167 is effective for interim and annual reporting in fiscal years beginning after November 15, 2009. Early adoption is prohibited. Management continues to review the impact of the changes in the consolidation guidance on the financial statements. This standard will increase disclosure requirements related to transactions with VIEs and may change the presentation of consolidated VIE's assets and liabilities on TNC's balance sheets. TNC will adopt SFAS 167 effective January 1, 2010. SFAS 167 is included in the "Consolidation" accounting guidance.

FSP SFAS 132R-1 "Employers' Disclosures about Postretirement Benefit Plan Assets" (FSP SFAS 132R-1)

In December 2008, the FASB issued FSP SFAS 132R-1 providing additional disclosure guidance for pension and OPEB plan assets. The rule requires disclosure of investment policies including target allocations by investment class, investment goals, risk management policies and permitted or prohibited investments. It specifies a minimum of investment classes by further dividing equity and debt securities by issuer grouping. The standard adds disclosure requirements including hierarchical classes for fair value and concentration of risk.

This standard is effective for fiscal years ending after December 15, 2009. Management expects this standard to increase the disclosure requirements related to AEP's benefit plans. TNC will adopt the standard effective for the 2009 Annual Report. FSP SFAS 132R-1 is included in the "Compensation – Retirement Benefits" accounting guidance.

Future Accounting Changes

The FASB's standard-setting process is ongoing and until new standards have been finalized and issued by the FASB, management cannot determine the impact on the reporting of operations and financial position that may result from any such future changes. The FASB is currently working on several projects including revenue recognition, contingencies, financial instruments, emission allowances, leases, insurance, hedge accounting, discontinued operations and income tax. Management also expects to see more FASB projects as a result of its desire to converge International Accounting Standards with GAAP. The ultimate pronouncements resulting from these and future projects could have an impact on future net income and financial position.

3. RATE MATTERS

As discussed in TNC's 2008 Annual Report, TNC is involved in rate and regulatory proceedings at the FERC and the PUCT. The Rate Matters note within TNC's 2008 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 2009 and updates TNC's 2008 Annual Report.

Texas Restructuring Appeals

TNC received its final true-up order in May 2005 that resulted in refunds via a CTC which have been completed. TNC appealed its final true-up order, which remains pending in state court. Management cannot predict the outcome of this court proceeding. If TNC ultimately succeeds in its appeals, it could have a material favorable effect on future net income, cash flows and possibly financial condition. If TNC does not succeed in its appeals, it could have a material adverse effect on future net income, cash flows and possibly financial condition.

2008 Interim Transmission Rates

In March 2008, TNC filed an application with the PUCT for an annual interim update of wholesale-transmission rates. The proposed new interim transmission rates are estimated to increase annual transmission revenues by $4 million. In May 2008, the PUCT and the FERC approved the new interim transmission rates as filed. TNC implemented the new rates effective May 2008, subject to review during the next base rate case. This review could result in a refund if the PUCT finds that TNC has not prudently incurred the requested transmission investment. TNC has not recorded any provision for refund regarding the interim transmission rates because management believes these new rates are reasonable and necessary to recover costs associated with prudently incurred new transmission investment. A refund of the interim transmission rates would have an adverse impact on net income and cash flows.

2009 Interim Transmission Rates

In February 2009, TNC filed an application with the PUCT for an annual interim update of wholesale-transmission rates. The proposed new interim transmission rates are estimated to increase annual transmission revenues by $9 million. In May 2009, the PUCT and the FERC approved the new interim transmission rates as filed. TNC implemented the new rates effective May 2009, subject to review during the next base rate case. This review could result in a refund if the PUCT finds that TNC has not prudently incurred the requested transmission investment. TNC has not recorded any provision for refund regarding the interim transmission rates because management believes these new rates are reasonable and necessary to recover costs associated with prudently incurred new transmission investment. A refund of the interim transmission rates would have an adverse impact on net income and cash flows.

ETT

ETT is an AEP joint venture accounted for using the equity method. The PUCT approved ETT's initial rates, a request for a transfer of facilities and a certificate of convenience and necessity (CCN) to operate as a stand alone transmission utility in the ERCOT region. ETT was allowed a 9.96% after tax return on equity rate in those approvals. In 2008, intervenors filed a notice of appeal to the Travis County District Court. In October 2008, the court ruled that the PUCT exceeded its authority by approving ETT’s application as a stand alone transmission utility without a service area under the wrong section of the statute. Management believes that ruling is incorrect. Moreover, ETT provided evidence in its application that ETT complied with what the court determined was the proper section of the statute.

In January 2009, ETT and the PUCT filed appeals to the Texas Court of Appeals. In June 2009, the Texas governor signed a new law that clarifies the PUCT’s authority to grant CCNs to transmission-only utilities such as ETT. In September 2009, ETT filed an application with the PUCT for a CCN under the new law for the purpose of confirming its authority to operate as a transmission-only utility regardless of the outcome of the pending litigation. The parties to the litigation pending at the Texas Court of Appeals have stipulated agreement or indicated they are not opposed to ETT’s request.

During 2009, TNC sold $1 million of transmission facilities to ETT. Depending upon ETT’s filing under the new law, the ultimate outcome of the appeals and any resulting remands, TNC may be required to reacquire transferred assets and projects under construction by ETT if ETT cannot obtain the appropriate approvals. As of September 30, 2009, ETT’s net investment in property, plant and equipment was $236 million, of which $100 million was under construction.

In September 2008, ETT and a group of other Texas transmission providers filed a comprehensive plan with the PUCT for completion of the Competitive Renewable Energy Zone (CREZ) initiative. The CREZ initiative is the development of 2,400 miles of new transmission lines to transport electricity from 18,000 MWs of planned wind farm capacity in west Texas to rapidly growing cities in eastern Texas. In March 2009, the PUCT issued an order pursuant to a January 2009 decision that authorized ETT to pursue the construction of $841 million of new CREZ transmission assets and also initiated a proceeding to develop a sequence of regulatory filings for routing the CREZ transmission lines. In June 2009, ETT and other parties entered into a settlement agreement establishing dates for these filings. Pursuant to the settlement agreement, which is pending PUCT approval, ETT would make regulatory filings in 2010 and initiate construction upon receipt of PUCT approval.

ETT and TNC are involved in transactions relating to the transfer to ETT of other transmission assets, which are in various stages of review and approval. In October 2009, ETT and TNC filed joint application with the PUCT for approval to transfer from TNC to ETT approximately $72 million of transmission assets and CWIP. The transfers are planned to be completed by the end of the first quarter of 2010. A decision from the PUCT is pending.

Advanced Metering System

In 2007, the governor of Texas signed legislation directing the PUCT to establish a surcharge for electric utilities relating to advanced meters. In April 2009, TNC filed its Advanced Metering System (AMS) with the PUCT proposing to invest approximately $61 million in AMS to be recovered through customer surcharges beginning in October 2009. The filing is modeled on similar filings by other Texas ERCOT investor owned utilities who have already received PUCT approval for their plans. In the filing, TNC proposes to apply recorded customer refunds including interest related to the FERC SIA ruling to reduce the AMS investment and the resultant associated customer surcharge. See "Allocation of Off-system Sales Margins" section within "FERC Rate Matters." As of September 30, 2009, TNC has $1 million of capital expenditures, including AFUDC, recorded on its balance sheet. Management is unable to predict whether the PUCT will allow TNC to apply recorded customer refunds related to the FERC SIA ruling to reduce the AMS investment and the resultant associated customer surcharge.

FERC Rate Matters

Allocation of Off-system Sales Margins

In August 2008, the OCC filed a complaint at the FERC alleging that AEP inappropriately allocated off-system sales margins between the AEP East companies and the AEP West companies and did not properly allocate off-system sales margins within the AEP West companies. The PUCT, the APSC and the Oklahoma Industrial Energy Consumers intervened in this filing. In November 2008, the FERC issued a final order concluding that AEP inappropriately deviated from off-system sales margin allocation methods in the SIA and the CSW Operating Agreement for the period June 2000 through March 2006. The FERC ordered AEP to recalculate and reallocate the off-system sales margins in compliance with the SIA and to have the AEP East companies issue refunds to the AEP West companies. Although the FERC determined that AEP deviated from the CSW Operating Agreement, the FERC determined the allocation methodology was reasonable. The FERC ordered AEP to submit a revised CSW Operating Agreement for the period June 2000 to March 2006. In December 2008, AEP filed a motion for rehearing and a revised CSW Operating Agreement for the period June 2000 to March 2006. The motion for rehearing is still pending. In January 2009, AEP filed a compliance filing with the FERC and refunded approximately $250 million from the AEP East companies to the AEP West companies. Following authorized regulatory treatment, the AEP West companies shared a portion of SIA margins with their customers during the period June 2000 to March 2006. In December 2008, the AEP West companies recorded a provision for refund reflecting the sharing. In April 2009, TNC filed its Advanced Metering System (AMS) with the PUCT proposing to invest in AMS to be recovered through customer surcharges beginning in October 2009. In the filing, TNC proposed to apply the SIA recorded customer refunds including interest to reduce the AMS investment and the resultant associated customer surcharge. See the "Advanced Metering System" section above. Management cannot predict the outcome of the requested FERC rehearing proceeding or any future state regulatory proceedings but believes the AEP West companies' provision for refund regarding related future state regulatory proceedings is adequate.

4. COMMITMENTS, GUARANTEES AND CONTINGENCIES

TNC is subject to certain claims and legal actions arising in its ordinary course of business. In addition, TNC's business activities are subject to extensive governmental regulation related to public health and the environment. The ultimate outcome of such pending or potential litigation cannot be predicted. For current proceedings not specifically discussed below, management does not anticipate that the liabilities, if any, arising from such proceedings would have a material adverse effect on the financial statements. The Commitments, Guarantees and Contingencies note within the 2008 Annual Report should be read in conjunction with this report.

GUARANTEES

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

Indemnifications and Other Guarantees

Contracts

TNC enters into certain types of contracts which require indemnifications. Typically these contracts include, but are not limited to, sale agreements, lease agreements, purchase agreements and financing agreements. Generally, these agreements may include, but are not limited to, indemnifications around certain tax, contractual and environmental matters. With respect to sale agreements, exposure generally does not exceed the sale price. Prior to September 30, 2009, TNC entered into sale agreements including indemnifications with a maximum exposure of $3 million related to the sale price of certain generation assets in Texas. There are no material liabilities recorded for any indemnifications and the risk of payment/performance is remote.

Master Lease Agreements

TNC leases certain equipment under master lease agreements. GE Capital Commercial Inc. (GE) notified management in November 2008 that they elected to terminate the Master Leasing Agreements in accordance with the termination rights specified within the contract. In 2011, TNC will be required to purchase all equipment under the lease and pay GE an amount equal to the unamortized value of all equipment then leased. In December 2008, management signed new master lease agreements with one-year commitment periods that include lease terms of up to 10 years. Management expects to enter into replacement leasing arrangements for the equipment affected by this notification prior to the termination dates of 2011.

For equipment under the GE master lease agreements that expire prior to 2011, the lessor is guaranteed receipt of up to 87% of the unamortized balance of the equipment at the end of the lease term. If the fair market value of the leased equipment is below the unamortized balance at the end of the lease term, TNC is committed to pay the difference between the fair market value and the unamortized balance, with the total guarantee not to exceed 87% of the unamortized balance. Under the new master lease agreements, the lessor is guaranteed receipt of up to 68% of the unamortized balance at the end of the lease term. If the actual fair market value of the leased equipment is below the unamortized balance at the end of the lease term, TNC is committed to pay the difference between the actual fair market value and unamortized balance, with the total guarantee not to exceed 68% of the unamortized balance. At September 30, 2009, the maximum potential loss for these lease agreements was approximately $656 thousand assuming the fair market value of the equipment is zero at the end of the lease term. Historically, at the end of the lease term the fair market value has been in excess of the unamortized balance.

CONTINGENCIES

Carbon Dioxide (CO_2) Public Nuisance Claims

In 2004, eight states and the City of New York filed an action in Federal District Court for the Southern District of New York against AEP, AEPSC, Cinergy Corp, Xcel Energy, Southern Company and Tennessee Valley Authority. The Natural Resources Defense Council, on behalf of three special interest groups, filed a similar complaint against the same defendants. The actions allege that CO_2 emissions from the defendants' power plants constitute a public nuisance under federal common law due to impacts of global warming, and sought injunctive relief in the form of specific emission reduction commitments from the defendants. The dismissal of this lawsuit was appealed to the Second Circuit Court of Appeals. In April 2007, the U.S. Supreme Court issued a decision holding that the Federal EPA has authority to regulate emissions of CO_2 and other greenhouse gases (GHG) under the CAA. The Second Circuit requested supplemental briefs addressing the impact of the Supreme Court's decision on this case.

In September 2009, the Second Circuit Court issued a ruling vacating the dismissal and remanding the case to the Federal District Court for the Southern District of New York. The Second Circuit held that the issues of climate change and global warming do not raise political questions and that Congress' refusal to regulate GHG emissions does not mean that plaintiffs must wait for an initial policy determination by Congress or the President's administration to secure the relief sought in their complaints. The court stated that Congress could enact comprehensive legislation to regulate CO_2 emissions or that the Federal EPA could regulate CO_2 emissions under existing CAA authorities, and that either of these actions could override any decision made by the district court under federal common law. The Second Circuit did not rule on whether the plaintiffs could proceed with their state common law nuisance claims. Management believes the actions are without merit and intends to continue to defend against the claims including seeking further review by the Second Circuit and, if necessary, the United States Supreme Court.

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 GHG 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. AEP companies, including TNC, were initially dismissed from this case without prejudice, but are named as a defendant in a pending fourth amended complaint.

Alaskan Villages' Claims

In February 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.

Rail Transportation Litigation

In October 2008, the Oklahoma Municipal Power Authority and the Public Utilities Board of the City of Brownsville, Texas, as co-owners of Oklaunion Plant, filed a lawsuit in United States District Court, Western District of Oklahoma against AEP alleging breach of contract and breach of fiduciary duties related to negotiations for rail transportation services for the plant. The plaintiffs allege that AEP assumed the duties of the project manager, PSO, and operated the plant for the project manager and is therefore responsible for the alleged breaches. TNC is also a co-owner of the Oklaunion Plant. Trial is scheduled for December 2009. Management intends to vigorously defend against these allegations. Management believes a provision recorded in 2008 should be sufficient.

FERC Long-term Contracts

In 2002, the FERC held a hearing related to a complaint filed by Nevada Power Company and Sierra Pacific Power Company (the Nevada utilities). The complaint sought to break long-term contracts entered during the 2000 and 2001 California energy price spike which the customers alleged were "high-priced." The complaint alleged that TNC and other AEP subsidiaries sold power at unjust and unreasonable prices because the market for power was allegedly dysfunctional at the time such contracts were executed. In 2003, the FERC rejected the complaint. In 2006, the U.S. Court of Appeals for the Ninth Circuit reversed the FERC order and remanded the case to the FERC for further proceedings. That decision was appealed to the U.S. Supreme Court. In June 2008, the U.S. Supreme Court affirmed the validity of contractually-agreed rates except in cases of serious harm to the public. The U.S. Supreme Court affirmed the Ninth Circuit's remand on two issues, market manipulation and excessive burden on consumers. The FERC initiated remand procedures and gave the parties time to attempt to settle the issues. Management recorded a provision in 2008. In September 2009, the parties reached a settlement and a portion of the provision was reversed.

5. DISPOSITION

2009

None

2008

In February 2008, TNC sold the mothballed Fort Phantom, Lake Pauline, Rio Pecos and San Angelo Plants for approximately $2.5 million to a nonaffiliated entity. In 2002, the book values of the plants and the land were impaired to $434 thousand. As part of the sale, the buyer assumed all environmental liabilities existing prior to and after the sale. As a result, the related ARO balances were reversed. Additionally, TNC recorded sales and related expenses and the impact of a settlement agreement with the City of San Angelo related to a purchase power contract between the City of San Angelo and TNC.

TNC also conveyed the Oak Creek Plant and related land at no cost to the City of Sweetwater. The plant and land assets were impaired to $89 thousand in 2002.

As a result of these dispositions, TNC recognized an immaterial loss in the first quarter of 2008.

6. BENEFIT PLANS

TNC participates in AEP sponsored qualified pension plans and nonqualified pension plans. A substantial majority of employees are covered by either one qualified plan or both a qualified and a nonqualified pension plan. In addition, TNC participates in other postretirement benefit plans sponsored by AEP to provide medical and death benefits for retired employees.

Components of Net Periodic Benefit Cost

The following tables provide the components of AEP's net periodic benefit cost for the plans for the three and nine months ended September 30, 2009 and 2008:

	Pension Plans		Other Postretirement Benefit Plans	
	Three Months Ended September 30,		Three Months Ended September 30,	
	2009	2008	2009	2008
	(in millions)			
Service Cost	$ 26	$ 25	$ 11	$ 10
Interest Cost	64	62	27	28
Expected Return on Plan Assets	(80)	(84)	(21)	(27)
Amortization of Transition Obligation	-	-	7	7
Amortization of Net Actuarial Loss	14	10	11	3
Net Periodic Benefit Cost	$ 24	$ 13	$ 35	$ 21

	Pension Plans		Other Postretirement Benefit Plans	
	Nine Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
	(in millions)			
Service Cost	$ 78	$ 75	$ 32	$ 31
Interest Cost	191	187	82	84
Expected Return on Plan Assets	(241)	(252)	(61)	(83)
Amortization of Transition Obligation	-	-	20	21
Amortization of Net Actuarial Loss	44	29	32	8
Net Periodic Benefit Cost	$ 72	$ 39	$ 105	$ 61

The following table provides TNC's net periodic benefit cost for the plans for the three and nine months ended September 30, 2009 and 2008:

	Pension Plans		Other Postretirement Benefit Plans	
	2009	2008	2009	2008
	(in thousands)			
Three Months Ended September 30,	$ 149	$ 90	$ 979	$ 616
Nine Months Ended September 30,	449	270	2,937	1,820

7. BUSINESS SEGMENTS

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

8. DERIVATIVES AND HEDGING

Beginning in 2009, AEPSC, on behalf of TNC, executed financial heating oil and gasoline derivative contracts to hedge the price risk of diesel fuel and gasoline purchases. The amount of AOCI, net of taxes, reported in TNC's Condensed Consolidated Balance Sheet for these hedges is $43 thousand as of September 30, 2009. Not all fuel price risk exposure is hedged. During the three and nine months ended September 30, 2009, TNC recognized no hedge ineffectiveness related to this hedge strategy. The maximum term for exposure to variability of these cash flows is 14 months.

9. FAIR VALUE MEASUREMENTS

With the adoption of new accounting guidance, TNC is required to provide certain fair value disclosures which were previously only required in the annual report. The new accounting guidance did not change the method to calculate the amounts reported on TNC's Condensed Consolidated Balance Sheets.

Fair Value Measurements of Long-term Debt

The fair values of Long-term Debt are based on quoted market prices, without credit enhancements, for the same or similar issues and the current interest rates offered for instruments with similar maturities. These instruments are not marked-to-market. The estimates presented are not necessarily indicative of the amounts that could be realized in a current market exchange. The book values and fair values of TNC's Long-term Debt at September 30, 2009 and December 31, 2008 are summarized in the following table:

	September 30, 2009		December 31, 2008	
	Book Value	Fair Value	Book Value	Fair Value
	(in thousands)			
Long-term Debt	$ 369,032	$ 393,525	$ 368,965	$ 340,971

Fair Value Measurements of Financial 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).

Exchange traded derivatives, namely futures contracts, are generally fair valued based on unadjusted quoted prices in active markets and are classified within 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. Where observable inputs are available for substantially the full term of the asset or liability, the instrument is categorized in Level 2. Certain OTC and bilaterally executed derivative instruments are executed in less active markets with a lower availability of pricing information. In addition, long-dated and illiquid complex or structured transactions and FTRs can introduce the need for internally developed modeling inputs based upon extrapolations and assumptions of observable market data to estimate fair value. When such inputs have a significant impact on the measurement of fair value, the instrument is categorized in Level 3. Valuation models utilize various inputs that include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in inactive markets, market corroborated inputs (i.e. inputs derived principally from, or correlated to, observable market data) and other observable inputs for the asset or liability.

The following table sets forth by level within the fair value hierarchy TNC's financial assets and liabilities that were accounted for at fair value on a recurring basis as of September 30, 2009. As required by the accounting guidance for "Fair Value Measurements and Disclosures," financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. Management's assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels. There have not been any significant changes in management's valuation techniques.

Assets and Liabilities Measured at Fair Value on a Recurring Basis as of September 30, 2009

	Level 1	Level 2	Level 3	Other	Total
			(in thousands)		
Risk Management Assets					
Risk Management Contracts	$ -	$ 54	$ -	$ -	$ 54

10. INCOME TAXES

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

TNC and other AEP subsidiaries are no longer subject to U.S. federal examination for years before 2000. TNC and other AEP subsidiaries have completed the exam for the years 2001 through 2006 and have issues that are being pursued at the appeals level. The years 2007 and 2008 are currently under examination. Although the outcome of tax audits is uncertain, in management's opinion, adequate provisions for income taxes have been made for potential liabilities resulting from such matters. In addition, TNC accrues interest on these uncertain tax positions. Management is not aware of any issues for open tax years that upon final resolution are expected to have a material adverse effect on net income.

TNC, along with other AEP subsidiaries, files income tax returns in various state and local jurisdictions. These taxing authorities routinely examine the tax returns and TNC and other AEP subsidiaries are currently under examination in several state and local jurisdictions. Management believes that TNC and other AEP subsidiaries have filed tax returns with positions that may be challenged by these tax authorities. However, management does not believe that the ultimate resolution of these audits will materially impact net income. With few exceptions, TNC is no longer subject to state or local income tax examinations by tax authorities for years before 2000.

Federal Tax Legislation

The American Recovery and Reinvestment Act of 2009 was signed into law by the President in February 2009. It 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 are not expected to have a material impact on net income or financial condition. However, management forecasts the bonus depreciation provision could provide a significant favorable cash flow benefit in 2009.

11. FINANCING ACTIVITIES

Money Pool – AEP System

The AEP System uses a corporate borrowing program to meet the short-term borrowing needs of its subsidiaries. The corporate borrowing program includes a Utility Money Pool, which funds the utility subsidiaries, and a Nonutility Money Pool, which funds the majority of the nonutility subsidiaries. The AEP System Utility Money Pool operates in accordance with the terms and conditions approved in a regulatory order. The amount of outstanding loans (borrowings) to/from the Utility Money Pool and the Nonutility Money Pool are shown as a net borrowing position as of September 30, 2009 and December 31, 2008 and are included in Advances from Affiliates on TNC's balance sheets. TNC's Utility Money Pool activity and corresponding authorized borrowing limits for the nine months ended September 30, 2009 are described on 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, 2009	Authorized Short-Term Borrowing Limit
		(in thousands)			
$ 67,670	$ -	$ 54,022	$ -	$ 52,822	$ 250,000

The activity in the above table does not include short-term lending activity of TNC's wholly-owned subsidiary, AEP Texas North Generation Company LLC (TNGC), who is a participant in the Nonutility Money Pool. For the nine months ended September 30, 2009, TNGC had the following activity in the Nonutility Money Pool:

Maximum Borrowings from Nonutility Money Pool	Maximum Loans to Nonutility Money Pool	Average Borrowings from Nonutility Money Pool	Average Loans to Nonutility Money Pool	Loans to Nonutility Money Pool as of September 30, 2009
		(in thousands)		
$ -	$ 14,021	$ -	$ 12,546	$ 12,512

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, 2009 and 2008 are summarized in the following table:

	Maximum Interest Rates for Funds Borrowed from the Utility Money Pool	Minimum Interest Rates for Funds Borrowed from the Utility Money Pool	Maximum Interest Rates for Funds Loaned to the Utility Money Pool	Minimum Interest Rates for Funds Loaned to the Utility Money Pool	Average Interest Rate for Funds Borrowed from the Utility Money Pool	Average Interest Rate for Funds Loaned to the Utility Money Pool
2009	2.28%	0.27%	-%	-%	1.00%	-%
2008	5.37%	2.91%	3.41%	2.91%	4.06%	3.08%

Maximum, minimum and average interest rates for funds either borrowed from or loaned to the Nonutility Money Pool for the nine months ended September 30, 2009 and 2008 are summarized in the following table:

	Maximum Interest Rates for Funds Borrowed from the Nonutility Money Pool	Minimum Interest Rates for Funds Borrowed from the Nonutility Money Pool	Maximum Interest Rates for Funds Loaned to the Nonutility Money Pool	Minimum Interest Rates For Funds Loaned to the Nonutility Money Pool	Average Interest Rate for Funds Borrowed from the Nonutility Money Pool	Average Interest Rate for Funds Loaned to the Nonutility Money Pool
2009	-%	-%	2.28%	0.43%	-%	1.06%
2008	-%	-%	5.37%	2.87%	-%	3.38%

Credit Facilities

TNC and certain other companies in the AEP System have a $627 million 3-year credit agreement. Under the facility, letters of credit may be issued. As of September 30, 2009, there were no outstanding amounts for TNC under this credit facility. TNC and certain other companies in the AEP System had a $350 million 364-day credit agreement that expired in April 2009.