

AEP Texas Central Company and Subsidiaries

2015 Annual Report

Audited Consolidated Financial Statements



TABLE OF CONTENTS

Page Number

Glossary of Terms	1
Independent Auditors' Report	2
Consolidated Statements of Income	3
Consolidated Statements of Comprehensive Income (Loss)	4
Consolidated Statements of Changes in Common Shareholder's Equity	5
Consolidated Balance Sheets	6
Consolidated Statements of Cash Flows	8
Index of Notes to Consolidated Financial Statements	9

- THIS PAGE INTENTIONALLY LEFT BLANK -

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	American Electric Power Company, Inc., an investor-owned electric public utility holding company which includes American Electric Power Company, Inc. (Parent) and majority owned consolidated subsidiaries and consolidated affiliates.
AEP System	American Electric Power System, an electric system, owned and operated by AEP subsidiaries.
AEPSC	American Electric Power Service Corporation, an AEP service subsidiary providing management and professional services to AEP and its subsidiaries.
AFUDC	Allowance for Funds Used During Construction.
AOCI	Accumulated Other Comprehensive Income.
ASU	Accounting Standards Update.
CWIP	Construction Work in Progress.
EIS	Energy Insurance Services, Inc., a nonaffiliated captive insurance company and consolidated variable interest entity of AEP.
ERCOT	Electric Reliability Council of Texas regional transmission organization.
ETT	Electric Transmission Texas, LLC, an equity interest joint venture between Parent and Berkshire Hathaway Energy 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.
FTR	Financial Transmission Right, a financial instrument that entitles the holder to receive compensation for certain congestion-related transmission charges that arise when the power grid is congested resulting in differences in locational prices.
IRS	Internal Revenue Service.
MTM	Mark-to-Market.
OPEB	Other Postretirement Benefit Plans.
OTC	Over the counter.
Parent	American Electric Power Company, Inc., the equity owner of AEP subsidiaries within the AEP consolidation.
PUCT	Public Utility Commission of Texas.
REP	Texas Retail Electric Provider.
Risk Management Contracts	Trading and nontrading derivatives, including those derivatives designated as cash flow and fair value hedges.
TCC	AEP Texas Central Company, an AEP electric utility subsidiary.
Texas Restructuring Legislation	Legislation enacted in 1999 to restructure the electric utility industry in Texas.
Transition Funding	AEP Texas Central Transition Funding I LLC, AEP Texas Central Transition Funding II LLC and AEP Texas Central Transition Funding III LLC, wholly-owned subsidiaries of TCC and consolidated variable interest entities formed for the purpose of issuing and servicing securitization bonds related to Texas Restructuring Legislation.
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 Texas Central Company:

We have audited the accompanying consolidated financial statements of AEP Texas Central Company and subsidiaries (the "Company"), which comprise the consolidated balance sheets as of December 31, 2015 and 2014, and the related consolidated statements of income, comprehensive income (loss), changes in common shareholder's equity, and cash flows for each of the three years in the period ended December 31, 2015, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated 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 consolidated 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 consolidated 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of AEP Texas Central Company and subsidiaries as of December 31, 2015 and 2014, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2015 in accordance with accounting principles generally accepted in the United States of America.

Deloitte + Touche LLP

Columbus, Ohio
February 23, 2016

AEP TEXAS CENTRAL COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
For the Years Ended December 31, 2015, 2014 and 2013
(in thousands)

	Years Ended December 31,		
	2015	2014	2013
REVENUES			
Electric Transmission and Distribution	\$ 1,143,137	\$ 1,114,318	\$ 996,951
Sales to AEP Affiliates	4,227	3,904	3,937
Other Revenues	4,846	3,528	2,627
TOTAL REVENUES	1,152,210	1,121,750	1,003,515
EXPENSES			
Other Operation	346,954	316,506	253,901
Maintenance	55,430	47,123	39,684
Depreciation and Amortization	406,612	386,997	343,106
Taxes Other Than Income Taxes	85,928	81,206	75,222
TOTAL EXPENSES	894,924	831,832	711,913
OPERATING INCOME	257,286	289,918	291,602
Other Income (Expense):			
Interest Income	301	182	160
Allowance for Equity Funds Used During Construction	6,453	4,630	2,576
Interest Expense	(127,748)	(132,211)	(138,385)
INCOME BEFORE INCOME TAX EXPENSE	136,292	162,519	155,953
Income Tax Expense	45,043	59,588	50,655
NET INCOME	\$ 91,249	\$ 102,931	\$ 105,298

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

See Notes to Consolidated Financial Statements beginning on page 9.

AEP TEXAS CENTRAL COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
For the Years Ended December 31, 2015, 2014 and 2013
(in thousands)

	Years Ended December 31,		
	2015	2014	2013
Net Income	\$ 91,249	\$ 102,931	\$ 105,298
OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAXES			
Cash Flow Hedges, Net of Tax of \$0, \$(40) and \$25 in 2015, 2014 and 2013, Respectively	—	(75)	46
TOTAL COMPREHENSIVE INCOME	\$ 91,249	\$ 102,856	\$ 105,344

See Notes to Consolidated Financial Statements beginning on page 9.

AEP TEXAS CENTRAL COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN COMMON SHAREHOLDER'S EQUITY
For the Years Ended December 31, 2015, 2014 and 2013
(in thousands)

	<u>Common Stock</u>	<u>Paid-in Capital</u>	<u>Retained Earnings</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Total</u>
TOTAL COMMON SHAREHOLDER'S EQUITY – DECEMBER 31, 2012	\$ 55,292	\$ 171,062	\$ 431,632	\$ 29	\$ 658,015
Common Stock Dividends			(5,000)		(5,000)
Net Income			105,298		105,298
Other Comprehensive Income				46	46
TOTAL COMMON SHAREHOLDER'S EQUITY – DECEMBER 31, 2013	55,292	171,062	531,930	75	758,359
Common Stock Dividends			(5,000)		(5,000)
Net Income			102,931		102,931
Other Comprehensive Loss				(75)	(75)
TOTAL COMMON SHAREHOLDER'S EQUITY – DECEMBER 31, 2014	55,292	171,062	629,861	—	856,215
Capital Contribution from Parent		150,000			150,000
Common Stock Dividends			(5,000)		(5,000)
Net Income			91,249		91,249
TOTAL COMMON SHAREHOLDER'S EQUITY – DECEMBER 31, 2015	<u>\$ 55,292</u>	<u>\$ 321,062</u>	<u>\$ 716,110</u>	<u>\$ —</u>	<u>\$ 1,092,464</u>

See Notes to Consolidated Financial Statements beginning on page 9.

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

ASSETS

December 31, 2015 and 2014

(in thousands)

	December 31,	
	2015	2014
CURRENT ASSETS		
Cash and Cash Equivalents	\$ 100	\$ 100
Restricted Cash for Securitized Transition Funding	203,393	205,682
Advances to Affiliates	124,483	—
Accounts Receivable:		
Customers	81,455	83,688
Affiliated Companies	2,727	5,901
Accrued Unbilled Revenues	34,877	42,540
Miscellaneous	31	25
Allowance for Uncollectible Accounts	(1,515)	(567)
Total Accounts Receivable	117,575	131,587
Materials and Supplies	40,356	41,964
Prepayments and Other Current Assets	2,393	11,692
TOTAL CURRENT ASSETS	488,300	391,025
PROPERTY, PLANT AND EQUIPMENT		
Electric:		
Transmission	1,722,059	1,511,307
Distribution	2,567,567	2,425,327
Other Property, Plant and Equipment	306,729	307,739
Construction Work in Progress	211,951	202,281
Total Property, Plant and Equipment	4,808,306	4,446,654
Accumulated Depreciation and Amortization	888,649	871,681
TOTAL PROPERTY, PLANT AND EQUIPMENT – NET	3,919,657	3,574,973
OTHER NONCURRENT ASSETS		
Regulatory Assets	245,734	245,768
Securitized Transition Assets (December 31, 2015 and 2014 Amounts Include \$1,297,519 and \$1,566,361, Respectively, Related to Transition Funding)	1,335,926	1,612,193
Deferred Charges and Other Noncurrent Assets	12,549	23,151
TOTAL OTHER NONCURRENT ASSETS	1,594,209	1,881,112
TOTAL ASSETS	\$ 6,002,166	\$ 5,847,110

See Notes to Consolidated Financial Statements beginning on page 9.

AEP TEXAS CENTRAL COMPANY AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
LIABILITIES AND COMMON SHAREHOLDER'S EQUITY
December 31, 2015 and 2014
(dollars in thousands)

	December 31,	
	2015	2014
CURRENT LIABILITIES		
Advances from Affiliates	\$ —	\$ 72,604
Accounts Payable:		
General	70,825	60,410
Affiliated Companies	12,666	19,662
Long-term Debt Due Within One Year – Nonaffiliated (December 31, 2015 and 2014 Amounts Include \$253,709 and \$273,690, Respectively, Related to Transition Funding)	353,709	273,690
Risk Management Liabilities	209	697
Customer Deposits	12,620	16,698
Accrued Taxes	81,981	39,946
Accrued Interest (December 31, 2015 and 2014 Amounts Include \$25,335 and \$31,188, Respectively, Related to Transition Funding)	41,320	44,409
Other Current Liabilities	60,960	54,646
TOTAL CURRENT LIABILITIES	634,290	582,762
NONCURRENT LIABILITIES		
Long-term Debt – Nonaffiliated (December 31, 2015 and 2014 Amounts Include \$1,243,495 and \$1,493,601, Respectively, Related to Transition Funding)	2,546,836	2,650,379
Deferred Income Taxes	1,259,143	1,273,435
Regulatory Liabilities and Deferred Investment Tax Credits	443,984	451,927
Deferred Credits and Other Noncurrent Liabilities	25,449	32,392
TOTAL NONCURRENT LIABILITIES	4,275,412	4,408,133
TOTAL LIABILITIES	4,909,702	4,990,895
Rate Matters (Note 4)		
Commitments and Contingencies (Note 5)		
COMMON SHAREHOLDER'S EQUITY		
Common Stock – Par Value – \$25 Per Share:		
Authorized – 12,000,000 Shares		
Outstanding – 2,211,678 Shares	55,292	55,292
Paid-in Capital	321,062	171,062
Retained Earnings	716,110	629,861
TOTAL COMMON SHAREHOLDER'S EQUITY	1,092,464	856,215
TOTAL LIABILITIES AND COMMON SHAREHOLDER'S EQUITY	\$ 6,002,166	\$ 5,847,110

See Notes to Consolidated Financial Statements beginning on page 9.

AEP TEXAS CENTRAL COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2015, 2014 and 2013
(in thousands)

	Years Ended December 31,		
	2015	2014	2013
OPERATING ACTIVITIES			
Net Income	\$ 91,249	\$ 102,931	\$ 105,298
Adjustments to Reconcile Net Income to Net Cash Flows from Operating Activities:			
Depreciation and Amortization	406,612	386,997	343,106
Deferred Income Taxes	(22,813)	(18,782)	(34,880)
Allowance for Equity Funds Used During Construction	(6,453)	(4,630)	(2,576)
Change in Other Noncurrent Assets	(32,568)	(29,210)	(20,499)
Change in Other Noncurrent Liabilities	3,661	6,164	(1,821)
Changes in Certain Components of Working Capital:			
Accounts Receivable, Net	14,012	(7,922)	(6,697)
Materials and Supplies	1,608	(988)	(3,553)
Accounts Payable	(9,540)	6,017	8,839
Customer Deposits	(4,078)	(1,015)	(2,570)
Accrued Taxes, Net	51,411	7,872	(4,174)
Accrued Interest	(3,089)	(3,115)	(2,912)
Other Current Assets	(51)	(598)	280
Other Current Liabilities	8,839	6,909	215
Net Cash Flows from Operating Activities	<u>498,800</u>	<u>450,630</u>	<u>378,056</u>
INVESTING ACTIVITIES			
Construction Expenditures	(449,353)	(464,604)	(370,167)
Change in Restricted Cash for Securitized Transition Funding	2,289	(8,823)	18,359
Change in Advances to Affiliates, Net	(124,483)	—	—
Proceeds from Sales of Assets	3,318	7,189	11,279
Other Investing Activities	27,004	14,340	(9,241)
Net Cash Flows Used for Investing Activities	<u>(541,225)</u>	<u>(451,898)</u>	<u>(349,770)</u>
FINANCING ACTIVITIES			
Capital Contribution from Parent	150,000	—	—
Issuance of Long-term Debt – Nonaffiliated	245,683	298,552	218,782
Change in Advances from Affiliates, Net	(72,604)	(32,934)	2,203
Retirement of Long-term Debt – Nonaffiliated	(273,690)	(258,099)	(243,378)
Principal Payments for Capital Lease Obligations	(2,132)	(2,124)	(1,942)
Dividends Paid on Common Stock	(5,000)	(5,000)	(5,000)
Other Financing Activities	168	819	1,103
Net Cash Flows from (Used for) Financing Activities	<u>42,425</u>	<u>1,214</u>	<u>(28,232)</u>
Net Increase (Decrease) in Cash and Cash Equivalents	—	(54)	54
Cash and Cash Equivalents at Beginning of Period	100	154	100
Cash and Cash Equivalents at End of Period	<u>\$ 100</u>	<u>\$ 100</u>	<u>\$ 154</u>
SUPPLEMENTARY INFORMATION			
Cash Paid for Interest, Net of Capitalized Amounts	\$ 124,707	\$ 128,446	\$ 132,732
Net Cash Paid for Income Taxes	20,629	74,262	92,239
Noncash Acquisitions Under Capital Leases	3,372	2,828	3,807
Construction Expenditures Included in Current Liabilities as of December 31,	49,346	37,673	48,720

See Notes to Consolidated Financial Statements beginning on page 9.

INDEX OF NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note	Page Number
Organization and Summary of Significant Accounting Policies	10
New Accounting Pronouncements	18
Comprehensive Income	20
Effects of Regulation	22
Commitments, Guarantees and Contingencies	23
Benefit Plans	25
Business Segments	35
Derivatives and Hedging	36
Fair Value Measurements	39
Income Taxes	40
Leases	43
Financing Activities	44
Related Party Transactions	46
Variable Interest Entities	47
Property, Plant and Equipment	49
Cost Reduction Program	51
Unaudited Quarterly Financial Information	52

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

ORGANIZATION

As a public utility, TCC engages in the transmission and distribution of electric power to 826,000 retail customers through REPs in its service territory in southern and central Texas. TCC consolidates AEP Texas Central Transition Funding LLC, AEP Texas Central Transition Funding II LLC and AEP Texas Central Transition Funding III LLC, its wholly-owned subsidiaries.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Rates and Service Regulation

TCC's transmission and distribution operations and related rates are regulated by the PUCT. The FERC regulates TCC's affiliated transactions, including AEPSC intercompany service billings which are generally at cost, under the 2005 Public Utility Holding Company Act and the Federal Power Act. The FERC also has jurisdiction over the issuances and acquisitions of securities of the public utility subsidiaries, the acquisition or sale of certain utility assets and mergers with another electric utility or holding company. For non-power goods and services, the FERC requires a nonregulated affiliate to bill an affiliated public utility company at no more than market while a public utility must bill the higher of cost or market to a nonregulated affiliate. The PUCT also regulates certain intercompany transactions under its affiliate statutes. Both the FERC and state regulatory commissions are permitted to review and audit the relevant books and records of companies within a public utility holding company system.

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

Principles of Consolidation

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

Accounting for the Effects of Cost-Based Regulation

As a rate-regulated electric public utility company, TCC's financial statements reflect the actions of regulators that result in the recognition of certain revenues and expenses in different time periods than enterprises that are not rate-regulated. In accordance with accounting guidance for "Regulated Operations," TCC records regulatory assets (deferred expenses) and regulatory liabilities (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, allowance for doubtful accounts, long-lived asset impairment, unbilled electricity revenue, valuation of long-term energy contracts, the effects of regulation, long-lived asset recovery, storm costs, the effects of contingencies and certain assumptions made in accounting for pension and postretirement benefits. The estimates and assumptions used are based upon management's evaluation of the relevant facts and circumstances as of the date of the financial statements. Actual results could ultimately differ from those estimates.

Cash and Cash Equivalents

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

Restricted Cash for Securitized Transition Funding

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

Inventory

Materials and supplies inventories are carried at average cost.

Accounts Receivable

Customer accounts receivable primarily includes receivables from REPs and receivables related to other revenue-generating activities.

Revenue is recognized when power is delivered. To the extent that deliveries have occurred but a bill has not been issued, TCC accrues and recognizes, as Accrued Unbilled Revenues on the balance sheets, an estimate of the revenues for deliveries since the last billing.

Allowance for Uncollectible Accounts

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

Concentrations of Credit Risk and Significant Customers

TCC has significant customers which on a combined basis account for the following percentages of total operating revenues for the years ended December 31 and Accounts Receivable – Customers as of December 31:

Significant Customers of TCC: Centrica and Reliant Energy	2015	2014	2013
Percentage of Operating Revenues	45%	48%	45%
Percentage of Accounts Receivable – Customers	33%	34%	25%

Management monitors credit levels and the financial condition of TCC's customers on a continuing basis to minimize credit risk. The PUCT allows recovery in rates for a reasonable level of bad debt costs. Management believes adequate provision for credit loss has been made in the accompanying financial statements.

Property, Plant and Equipment

Electric utility property, plant and equipment are stated at original 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 poles, transformers, etc. result in original cost retirements, 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 removal cost incurred and 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 plant and equipment are included in operating expenses.

Long-lived assets are required to be tested for impairment when it is determined that the carrying value of the assets may no longer be recoverable or when the assets meet the held-for-sale criteria under the accounting guidance for “Impairment or Disposal of Long-lived Assets.” When it becomes probable that an asset in service or an asset under construction will be abandoned and regulatory cost recovery has been disallowed, the cost of that asset shall be removed from plant-in-service or CWIP and charged to expense.

The fair value of an asset is the amount at which that asset 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 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 represents the estimated cost of borrowed and equity funds used to finance construction projects that is capitalized and recovered through depreciation over the service life of regulated electric utility plant. TCC records the equity component of AFUDC in Allowance for Equity Funds Used During Construction and the debt component of AFUDC as a reduction to Interest Expense.

Valuation of Nonderivative Financial Instruments

The book values of Cash and Cash Equivalents, Advances to/from 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. The amount of risk taken is determined by the Commercial Operations and Finance groups in accordance with established risk management policies as approved by the Finance Committee of AEP’s Board of Directors. The AEP System’s market risk oversight staff independently monitors risk policies, procedures and risk levels and provides members of the Commercial Operations Risk Committee (Regulated Risk Committee) various reports regarding compliance with policies, limits and procedures. The Regulated Risk Committee consists of AEPSC’s Chief Operating Officer, Chief Financial Officer, Executive Vice President of Generation, Senior Vice President of Commercial Operations and Chief Risk Officer.

For commercial activities, exchange traded derivatives, namely futures contracts, are generally fair valued based on unadjusted quoted prices in active markets and are classified as Level 1. Level 2 inputs primarily consist of OTC broker quotes in moderately active or less active markets, as well as exchange traded contracts where there is insufficient market liquidity to warrant inclusion in Level 1. Management verifies price curves using these broker quotes and classifies these fair values within Level 2 when substantially all of the fair value can be corroborated. Management typically obtains multiple broker quotes, which are nonbinding in nature but are based on recent trades in the marketplace. When multiple broker quotes are obtained, the quoted bid and ask prices are averaged. In certain circumstances, a broker quote may be discarded if it is a clear outlier. Management uses a historical correlation analysis between the broker quoted location and the illiquid locations. If the points are highly correlated, these locations are included within Level 2 as well. Certain OTC and bilaterally executed derivative instruments are executed in less active markets with a lower availability of pricing information. Illiquid transactions, complex structured transactions, FTRs and counterparty credit risk may require nonmarket based inputs. Some of these inputs may be internally

developed or extrapolated and utilized to estimate fair value. When such inputs have a significant impact on the measurement of fair value, the instrument is categorized as Level 3. The main driver of contracts being classified as Level 3 is the inability to substantiate energy price curves in the market. A portion of the Level 3 instruments have been economically hedged which limits potential earnings volatility.

AEP utilizes its trustee's external pricing service to estimate the fair value of the underlying investments held in the benefit plan trusts. AEP's investment managers review and validate the prices utilized by the trustee to determine fair value. AEP's management performs its own valuation testing to verify the fair values of the securities. AEP receives audit reports of the trustee's operating controls and valuation processes. The trustee uses multiple pricing vendors for the assets held in the trusts.

Assets in the benefits trusts and Restricted Cash for Securitized Transition Funding are classified using the following methods. Equities are classified as Level 1 holdings if they are actively traded on exchanges. Items classified as Level 1 are investments in money market funds, fixed income and equity mutual funds and domestic equity securities. They are valued based on observable inputs primarily unadjusted quoted prices in active markets for identical assets. Items classified as Level 2 are primarily investments in individual fixed income securities and cash equivalent funds. Fixed income securities generally do not trade on exchanges and do not have an official closing price but their valuation inputs are based on observable market data. Pricing vendors calculate bond valuations using financial models and matrices. The models use observable inputs including yields on benchmark securities, quotes by securities brokers, rating agency actions, discounts or premiums on securities compared to par prices, changes in yields for U.S. Treasury securities, corporate actions by bond issuers, prepayment schedules and histories, economic events and, for certain securities, adjustments to yields to reflect changes in the rate of inflation. Other securities with model-derived valuation inputs that are observable are also classified as Level 2 investments. Investments with unobservable valuation inputs are classified as Level 3 investments. Benefit plan assets included in Level 3 are primarily real estate and private equity investments that are valued using methods requiring judgment including appraisals. The fair value of real estate investments is measured using market capitalization rates, recent sales of comparable investments and independent third-party appraisals. The fair value of private equity investments is measured using cost and purchase multiples, operating results, discounted future cash flows and market based comparable data. Depending on the specific situation, one or multiple approaches are used to determine the valuation of a real estate or private equity investment.

Revenue Recognition

Regulatory Accounting

TCC's financial statements reflect the actions of regulators that can result in the recognition of revenues and expenses in different time periods than enterprises that are not rate-regulated. Regulatory assets (deferred expenses) and regulatory liabilities (deferred revenue reductions or refunds) are recorded to reflect the economic effects of regulation in the same accounting period by matching expenses with their recovery through regulated revenues and by matching income with its passage to customers in cost-based regulated rates.

When regulatory assets are probable of recovery through regulated rates, TCC records them as assets on its balance sheets. TCC tests for probability of recovery at each balance sheet date or whenever new events occur. Examples of new events include the issuance of a regulatory commission order or passage of new legislation. If it is determined that recovery of a regulatory asset is no longer probable, TCC writes off that regulatory asset as a charge against income.

Electricity Supply and Delivery Activities

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

Maintenance

Maintenance costs are expensed as incurred. If it becomes probable that TCC will recover specifically-incurred costs through future rates, a regulatory asset is established to match the expensing of those maintenance costs with their recovery in cost-based regulated revenues.

Income Taxes and Investment Tax Credits

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

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

Investment tax credits are accounted for under the deferral basis and are being amortized over the life of the plant investment.

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

Excise Taxes

As an agent for some state and local governments, TCC collects from customers certain excise taxes levied by those state or local governments on customers. TCC does not recognize these taxes as revenue or expense.

Debt

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

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

Investments Held in Trust for Future Liabilities

AEP has several trust funds with significant investments intended to provide for future payments of pension and OPEB benefits. All of the trust funds' investments are diversified and managed in compliance with all laws and regulations. The investment strategy for the trust funds is to use a diversified portfolio of investments to achieve an acceptable rate of return while managing the investment risk of the assets relative to the associated liabilities. To minimize investment risk, the trust funds are broadly diversified among classes of assets, investment strategies and investment managers. Management regularly reviews the actual asset allocations and periodically rebalances the investments to targeted allocations when appropriate. Investment policies and guidelines allow investment managers in approved strategies to use financial derivatives to obtain or manage market exposures and to hedge assets and liabilities. The investments are reported at fair value under the "Fair Value Measurements and Disclosures" accounting guidance.

Benefit Plans

All benefit plan assets are invested in accordance with each plan's investment policy. The investment policy outlines the investment objectives, strategies and target asset allocations by plan.

The investment philosophies for AEP's benefit plans support the allocation of assets to minimize risks and optimize net returns. Strategies used include:

- Maintaining a long-term investment horizon.
- Diversifying assets to help control volatility of returns at acceptable levels.
- Managing fees, transaction costs and tax liabilities to maximize investment earnings.
- Using active management of investments where appropriate risk/return opportunities exist.
- Keeping portfolio structure style-neutral to limit volatility compared to applicable benchmarks.
- Using alternative asset classes such as real estate and private equity to maximize return and provide additional portfolio diversification.

The objective of the investment policy for the pension fund is to maintain the funded status of the plan while providing for growth in the plan assets to offset the growth in the plan liabilities. The current target asset allocations are as follows:

Pension Plan Assets	Target
Equity	25%
Fixed Income	59%
Other Investments	15%
Cash and Cash Equivalents	1%

OPEB Plans Assets	Target
Equity	65%
Fixed Income	33%
Cash and Cash Equivalents	2%

The investment policy for each benefit plan contains various investment limitations. The investment policies establish concentration limits for securities and prohibit the purchase of securities issued by AEP (with the exception of proportionate and immaterial holdings of AEP securities in passive index strategies). However, the investment policies do not preclude the benefit trust funds from receiving contributions in the form of AEP securities, provided that the AEP securities acquired by each plan may not exceed the limitations imposed by law.

For equity investments, the concentration limits are as follows:

- No security in excess of 5% of all equities.
- Cash equivalents must be less than 10% of an investment manager's equity portfolio.
- No individual stock may be more than 10% and 7% for pension and OPEB investments, respectively, of each manager's equity portfolio.
- No investment in excess of 5% of an outstanding class of any company.
- No securities may be bought or sold on margin or other use of leverage.

For fixed income investments, the concentration limits must not exceed:

- 3% in any single issuer.
- 5% for private placements.
- 5% for convertible securities.
- 60% for bonds rated AA+ or lower.
- 50% for bonds rated A+ or lower.
- 10% for bonds rated BBB- or lower.

For obligations of non-government issuers within the fixed income portfolio, the following limitations apply:

- AAA rated debt: a single issuer should account for no more than 5% of the portfolio.
- AA+, AA, AA- rated debt: a single issuer should account for no more than 3% of the portfolio.
- Debt rated A+ or lower: a single issuer should account for no more than 2% of the portfolio.
- No more than 10% of the portfolio may be invested in high yield and emerging market debt combined at any time.

Each investment manager's portfolio is compared to a diversified benchmark index.

A portion of the pension assets is invested in real estate funds to provide diversification, add return and hedge against inflation. Real estate properties are illiquid, difficult to value and not actively traded. The pension plan uses external real estate investment managers to invest in commingled funds that hold real estate properties. To mitigate investment risk in the real estate portfolio, commingled real estate funds are used to ensure that holdings are diversified by region, property type and risk classification. Real estate holdings include core, value-added and development risk classifications and some investments in Real Estate Investment Trusts, which are publicly traded real estate securities.

A portion of the pension assets is invested in private equity. Private equity investments add return and provide diversification and typically require a long-term time horizon to evaluate investment performance. Private equity is classified as an alternative investment because it is illiquid, difficult to value and not actively traded. The pension plan uses limited partnerships and commingled funds to invest across the private equity investment spectrum. The private equity holdings are with multiple general partners who help monitor the investments and provide investment selection expertise. The holdings are currently comprised of venture capital, buyout and hybrid debt and equity investment instruments. Commingled private equity funds are used to enhance the holdings' diversity.

AEP participates in a securities lending program with BNY Mellon to provide incremental income on idle assets and to provide income to offset custody fees and other administrative expenses. AEP lends securities to borrowers approved by BNY Mellon in exchange for collateral. All loans are collateralized by at least 102% of the loaned asset's market value and the collateral is invested. The difference between the rebate owed to the borrower and the collateral rate of return determines the earnings on the loaned security. The securities lending program's objective is providing modest incremental income with a limited increase in risk.

Trust owned life insurance (TOLI) underwritten by The Prudential Insurance Company is held in the OPEB plan trusts. The strategy for holding life insurance contracts in the taxable Voluntary Employees' Beneficiary Association trust is to minimize taxes paid on the asset growth in the trust. Earnings on plan assets are tax-deferred within the TOLI contract and can be tax-free if held until claims are paid. Life insurance proceeds remain in the trust and are used to fund future retiree medical benefit liabilities. With consideration to other investments held in the trust, the cash value of the TOLI contracts is invested in two diversified funds. A portion is invested in a commingled fund with underlying investments in stocks that are actively traded on major international equity exchanges. The other portion of the TOLI cash value is invested in a diversified, commingled fixed income fund with underlying investments in government bonds, corporate bonds and asset-backed securities.

Cash and cash equivalents are held in each trust to provide liquidity and meet short-term cash needs. Cash equivalent funds are used to provide diversification and preserve principal. The underlying holdings in the cash funds are investment grade money market instruments including commercial paper, certificates of deposit, treasury bills and other types of investment grade short-term debt securities. The cash funds are valued each business day and provide daily liquidity.

Comprehensive Income (Loss)

Comprehensive income (loss) is defined as the change in equity (net assets) of a business enterprise during a period from transactions and other events and circumstances from nonowner sources. It includes all changes in equity during a period except those resulting from investments by owners and distributions to owners. Comprehensive income (loss) has two components: net income (loss) and other comprehensive income (loss).

Earnings Per Share (EPS)

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

Supplementary Income Statement Information

The following table provides the components of Depreciation and Amortization for the years ended December 31, 2015, 2014 and 2013:

Depreciation and Amortization	Years Ended December 31,		
	2015	2014	2013
		(in thousands)	
Depreciation and Amortization of Property, Plant and Equipment	\$ 130,239	\$ 119,526	\$ 112,119
Amortization of Securitized Transition Assets	275,542	266,900	228,224
Amortization of Regulatory Assets and Liabilities	831	571	2,763
Total Depreciation and Amortization	\$ 406,612	\$ 386,997	\$ 343,106

Subsequent Events

Management reviewed subsequent events through February 23, 2016, the date that TCC's 2015 annual report was issued.

2. NEW ACCOUNTING PRONOUNCEMENTS

Upon issuance of final pronouncements, management reviews the new accounting literature to determine its relevance, if any, to TCC's business. The following final pronouncements will impact the financial statements.

ASU 2014-08 "Presentation of Financial Statements and Property, Plant and Equipment" (ASU 2014-08)

In April 2014, the FASB issued ASU 2014-08 changing the presentation of discontinued operations on the statements of income and other requirements for reporting discontinued operations. Under the new standard, a disposal of a component or a group of components of an entity is required to be reported in discontinued operations if the disposal represents a strategic shift that has (or will have) a major effect on an entity's operations and financial results when the component meets the criteria to be classified as held-for-sale or is disposed. The amendments in this update also require additional disclosures about discontinued operations and disposal of an individually significant component of an entity that does not qualify for discontinued operations. This standard must be prospectively applied to all reporting periods presented in financial reports issued after the effective date.

The new accounting guidance is effective for interim and annual periods beginning after December 15, 2014. If applicable, this standard will change the presentation of financial statements but will not affect the calculation of net income, comprehensive income or earnings per share. Management adopted ASU 2014-08 effective January 1, 2015. There were no events requiring the application of this new accounting guidance.

ASU 2014-09 "Revenue from Contracts with Customers" (ASU 2014-09)

In May 2014, the FASB issued ASU 2014-09 clarifying the method used to determine the timing and requirements for revenue recognition on the statements of income. Under the new standard, an entity must identify the performance obligations in a contract, determine the transaction price and allocate the price to specific performance obligations to recognize the revenue when the obligation is completed. The amendments in this update also require disclosure of sufficient information to allow users to understand the nature, amount, timing and uncertainty of revenue and cash flow arising from contracts.

The FASB deferred implementation of ASU 2014-09 under the terms in ASU 2015-14, "Revenue from Contracts with Customers (Topic: 606): Deferral of the Effective Date." The new accounting guidance is effective for interim and annual periods beginning after December 15, 2017. Early adoption is permitted for annual periods beginning after December 15, 2016. As applicable, this standard may change the amount of revenue recognized in the income statements in each reporting period. Management is analyzing the impact of this new standard and, at this time, cannot estimate the impact of adoption on revenue or net income. Management plans to adopt ASU 2014-09 effective January 1, 2018.

ASU 2015-01 "Income Statement – Extraordinary and Unusual Items" (ASU 2015-01)

In January 2015, the FASB issued ASU 2015-01 eliminating the concept of extraordinary items for presentation on the face of the income statement. Under the new standard, a material event or transaction that is unusual in nature, infrequent or both shall be reported as a separate component of income from continuing operations. Alternatively, it may be disclosed in the notes to financial statements.

The new accounting guidance is effective for interim and annual periods beginning after December 15, 2015. As applicable, this standard may change the presentation of amounts in the income statements. Management adopted ASU 2015-01 effective January 1, 2016.

ASU 2015-03 "Simplifying the Presentation of Debt Issuance Costs" (ASU 2015-03)

In April 2015, the FASB issued ASU 2015-03 simplifying the presentation of debt issuance costs on the balance sheets. Under the new standard, debt issuance costs related to a recognized debt liability will be presented on the balance sheets as a direct deduction from the carrying amount of that debt liability, consistent with discounts.

The new accounting guidance is effective for interim and annual periods beginning after December 15, 2015 with early adoption permitted. Management adopted ASU 2015-03 in October 2015 and applied the new standard retrospectively for all periods presented. Prior to adoption, TCC included debt issuance costs in Deferred Charges and Other Noncurrent Assets on the balance sheets. The effect of the reclassification between assets and liabilities for TCC was \$19.6 million as of December 31, 2014.

ASU 2015-05 “Customer’s Accounting for Fees Paid in a Cloud Computing Arrangement” (ASU 2015-05)

In April 2015, the FASB issued ASU 2015-05 providing guidance to customers about whether a cloud computing arrangement includes a software license. The new accounting guidance is effective for interim and annual periods beginning after December 15, 2015 with early adoption permitted. Management adopted ASU 2015-05 prospectively, effective January 1, 2016, with no impact on results of operations, financial position or cash flows.

ASU 2015-11 “Simplifying the Measurement of Inventory” (ASU 2015-11)

In July 2015, the FASB issued ASU 2015-11 simplifying the guidance on the subsequent measurement of inventory, excluding inventory measured using last-in, first-out or the retail inventory method. Under the new standard, inventory should be at the lower of cost and net realizable value. The new accounting guidance is effective for interim and annual periods beginning after December 15, 2016 with early adoption permitted. Management does not expect the new standard to impact its results of operations, financial position or cash flows. Management plans to adopt ASU 2015-11 prospectively, effective January 1, 2017.

ASU 2015-17 “Balance Sheet Classification of Deferred Taxes” (ASU 2015-17)

In November 2015, the FASB issued ASU 2015-17 simplifying the presentation of deferred income taxes on the balance sheets. Under the new standard, deferred tax assets and liabilities are classified as noncurrent on the balance sheets. The new accounting guidance is effective for annual periods beginning after December 15, 2016 with early adoption permitted. Management adopted ASU 2015-17 upon its issuance date and applied the new standard prospectively. As a result, the new standard impacted the December 31, 2015 presentation of deferred tax assets and liabilities on the balance sheet.

ASU 2016-01 “Recognition and Measurement of Financial Assets and Financial Liabilities” (ASU 2016-01)

In January 2016, the FASB issued ASU 2016-01 enhancing the reporting model for financial instruments. Under the new standard, equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) are required to be measured at fair value with changes in fair value recognized in net income. The new standard also amends disclosure requirements and requires separate presentation of financial assets and liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements. The amendments also clarify that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for sale securities in combination with the entity’s other deferred tax assets.

The new accounting guidance is effective for interim and annual periods beginning after December 15, 2017 with early adoption permitted. The amendments should be applied by means of a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. Management is analyzing the impact of this new standard and, at this time, cannot estimate the impact of adoption on net income. Management plans to adopt ASU 2016-01 effective January 1, 2018.

3. COMPREHENSIVE INCOME

Presentation of Comprehensive Income

The following tables provide the components of changes in AOCI for the years ended December 31, 2015, 2014 and 2013. All amounts in the following tables are presented net of related income taxes.

Changes in Accumulated Other Comprehensive Income (Loss) by Component For the Year Ended December 31, 2015

	<u>Cash Flow Hedges</u>		<u>Total</u>
	<u>Commodity</u>	<u>Interest Rate and Foreign Currency</u> (in thousands)	
Balance in AOCI as of December 31, 2014	\$ —	\$ —	\$ —
Change in Fair Value Recognized in AOCI	—	—	—
Amounts Reclassified from AOCI	—	—	—
Net Current Period Other			
Comprehensive Income	—	—	—
Balance in AOCI as of December 31, 2015	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>

Changes in Accumulated Other Comprehensive Income (Loss) by Component For the Year Ended December 31, 2014

	<u>Cash Flow Hedges</u>		<u>Total</u>
	<u>Commodity</u>	<u>Interest Rate and Foreign Currency</u> (in thousands)	
Balance in AOCI as of December 31, 2013	\$ 75	\$ —	\$ 75
Change in Fair Value Recognized in AOCI	—	—	—
Amounts Reclassified from AOCI	(75)	—	(75)
Net Current Period Other			
Comprehensive Loss	(75)	—	(75)
Balance in AOCI as of December 31, 2014	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>

Changes in Accumulated Other Comprehensive Income (Loss) by Component For the Year Ended December 31, 2013

	<u>Cash Flow Hedges</u>		<u>Total</u>
	<u>Commodity</u>	<u>Interest Rate and Foreign Currency</u> (in thousands)	
Balance in AOCI as of December 31, 2012	\$ 29	\$ —	\$ 29
Change in Fair Value Recognized in AOCI	97	—	97
Amounts Reclassified from AOCI	(51)	—	(51)
Net Current Period Other			
Comprehensive Income	46	—	46
Balance in AOCI as of December 31, 2013	<u>\$ 75</u>	<u>\$ —</u>	<u>\$ 75</u>

Reclassifications from Accumulated Other Comprehensive Income

The following tables provide details of reclassifications from AOCI for the years ended December 31, 2015, 2014 and 2013.

Reclassifications from Accumulated Other Comprehensive Income (Loss)

Gains and Losses on Cash Flow Hedges	Amount of (Gain) Loss Reclassified from AOCI		
	Years Ended December 31,		
	2015	2014	2013
	(in thousands)		
Commodity:			
Other Operation Expense	\$ —	\$ (9)	\$ (29)
Maintenance Expense	—	(8)	(18)
Property, Plant and Equipment		(12)	(32)
Regulatory Assets/(Liabilities), Net (a)	—	(86)	—
Subtotal – Commodity	<u>—</u>	<u>(115)</u>	<u>(79)</u>
Interest Rate and Foreign Currency:			
Interest Expense	—	—	—
Subtotal – Interest Rate and Foreign Currency	<u>—</u>	<u>—</u>	<u>—</u>
Reclassifications from AOCI, before Income Tax (Expense) Credit	—	(115)	(79)
Income Tax (Expense) Credit	—	(40)	(28)
Total Reclassifications from AOCI, Net of Income Tax (Expense) Credit	<u><u>\$ —</u></u>	<u><u>\$ (75)</u></u>	<u><u>\$ (51)</u></u>

- (a) Represents realized gains and losses subject to regulatory accounting treatment recorded as either current or noncurrent on the balance sheets.

4. EFFECTS OF REGULATION

Regulatory assets and liabilities are comprised of the following items:

Regulatory Assets:	December 31,		Remaining Recovery Period
	2015	2014	
	(in thousands)		
Noncurrent Regulatory Assets			
Regulatory assets pending final regulatory approval:			
<u>Regulatory Assets Currently Earning a Return</u>			
Storm Related Costs	\$ 24,156	\$ 20,266	
<u>Regulatory Assets Currently Not Earning a Return</u>			
Rate Case Expense	145	145	
Total Regulatory Assets Pending Final Regulatory Approval	24,301	20,411	
Regulatory assets approved for recovery:			
<u>Regulatory Assets Currently Earning a Return</u>			
Meter Replacement Costs	44,365	47,989	12 years
Advanced Metering System	1,642	939	5 years
<u>Regulatory Assets Currently Not Earning a Return</u>			
Pension and OPEB Funded Status	139,451	132,743	12 years
Income Taxes, Net	13,398	11,868	33 years
Unamortized Loss on Reacquired Debt	8,262	9,994	22 years
Transmission Cost Recovery Factor	7,260	11,053	1 year
Medicare Subsidy	4,786	5,317	9 years
Peak Demand Reduction/Energy Efficiency	1,738	3,626	2 years
Unrealized Loss on Forward Commitments	478	767	1 year
Restructuring Transition Costs	53	1,061	1 year
Total Regulatory Assets Approved for Recovery	221,433	225,357	
Total Noncurrent Regulatory Assets	\$ 245,734	\$ 245,768	
	December 31,		Remaining Refund Period
Regulatory Liabilities:	2015	2014	
	(in thousands)		
Noncurrent Regulatory Liabilities and Deferred Investment Tax Credits			
Regulatory liabilities approved for payment:			
<u>Regulatory Liabilities Currently Paying a Return</u>			
Asset Removal Costs	\$ 373,855	\$ 361,224	(a)
Advanced Metering Infrastructure Surcharge	15,151	34,648	5 years
<u>Regulatory Liabilities Currently Not Paying a Return</u>			
Transition Charges	46,501	46,815	12 years
Deferred Investment Tax Credits	8,477	9,240	47 years
Total Regulatory Liabilities Approved for Payment	443,984	451,927	
Total Noncurrent Regulatory Liabilities and Deferred Investment Tax Credits	\$ 443,984	\$ 451,927	

(a) Relieved as removal costs are incurred

5. COMMITMENTS, GUARANTEES AND CONTINGENCIES

TCC is subject to certain claims and legal actions arising in its ordinary course of business. In addition, TCC's business activities are subject to extensive governmental regulation related to public health and the environment. The ultimate outcome of such pending or potential litigation against TCC cannot be predicted. Management accrues contingent liabilities only when management concludes that it is both probable that a liability has been incurred at the date of the financial statements and the amount of loss can be reasonably estimated. When management determines that it is not probable, but rather reasonably possible that a liability has been incurred at the date of the financial statements, management discloses such contingencies and the possible loss or range of loss if such estimate can be made. Any estimated range is based on currently available information and involves elements of judgment and significant uncertainties. Any estimated range of possible loss may not represent the maximum possible loss exposure. Circumstances change over time and actual results may vary significantly from estimates.

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

TCC has substantial construction commitments to support its operations and environmental investments. In managing the overall construction program and in the normal course of business, TCC contractually commits to third-party construction vendors for certain material purchases and other construction services. TCC also purchases materials, supplies, services and property, plant and equipment under contract as part of its normal course of business. Certain supply contracts contain penalty provisions for early termination.

In accordance with the accounting guidance for "Commitments", the following table summarizes TCC's actual contractual commitments as of December 31, 2015:

<u>Contractual Commitments</u>	<u>Less Than 1 Year</u>	<u>2-3 Years</u>	<u>4-5 Years</u>	<u>After 5 Years</u>	<u>Total</u>
			(in thousands)		
Construction Contracts for Capital Assets (a)	\$ 15,737	\$ —	\$ —	\$ —	\$ 15,737

- (a) Represents only capital assets for which there are signed contracts. Actual payments are dependent upon and may vary significantly based upon the decision to build, regulatory approval schedules, timing and escalation of project costs.

GUARANTEES

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

Letters of Credit

AEP has two revolving credit facilities totaling \$3.5 billion, under which up to \$1.2 billion may be issued as letters of credit on behalf of subsidiaries. As of December 31, 2015, TCC's maximum future payment for letters of credit issued under the revolving credit facilities was \$3 million with a maturity of February 2016. In January 2016, the letter of credit maturing in February 2016 was replaced with a new letter of credit expiring in January 2017.

Indemnifications and Other Guarantees

Contracts

TCC enters into certain types of contracts which require indemnifications. Typically these contracts include, but are not limited to, sale agreements, lease agreements, purchase agreements and financing agreements. Generally, these agreements may include, but are not limited to, indemnifications around certain tax, contractual and environmental matters. With respect to sale agreements, exposure generally does not exceed the sale price. As of December 31, 2015, there were no material liabilities recorded for any indemnifications.

Lease Obligations

TCC leases certain equipment under master lease agreements. See “Master Lease Agreements” section of Note 11 for disclosure of lease residual value guarantees.

CONTINGENCIES

Insurance and Potential Losses

TCC maintains insurance coverage normal and customary for an electric utility, subject to various deductibles. TCC also maintains property and casualty insurance that may cover certain physical damage or third-party injuries caused by cyber security incidents. Insurance coverage includes all risks of physical loss or damage to assets, subject to insurance policy conditions and exclusions. Covered property generally includes substations, facilities and inventories. Excluded property generally includes transmission and distribution lines, poles and towers. The insurance programs also generally provide coverage against loss arising from certain claims made by third parties and are in excess of TCC’s retentions. Coverage is generally provided by a combination of the protected cell of EIS and/or various industry mutual and/or commercial insurance carriers.

Some potential losses or liabilities may not be insurable or the amount of insurance carried may not be sufficient to meet potential losses and liabilities, including, but not limited to, liabilities relating to a cyber security incident. 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.

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

The transmission and distribution facilities have used asbestos, polychlorinated biphenyls and other hazardous and nonhazardous materials. TCC currently incurs costs to dispose of these substances safely.

Superfund addresses clean-up of hazardous substances that are released to the environment. The Federal EPA administers the clean-up programs. Several states enacted similar laws. As of December 31, 2015, TCC has been named potentially liable at one site under state law. In the instance where TCC has been named a defendant, disposal or recycling activities were in accordance with the then-applicable laws and regulations. Superfund does not recognize compliance as a defense, but imposes strict liability on parties who fall within its broad statutory categories. Liability has been resolved for a number of sites with no significant effect on net income.

Management evaluates the potential liability for each site separately, but several general statements can be made about potential future liability. Allegations that materials were disposed at a particular site are often unsubstantiated and the quantity of materials deposited at a site can be small and often nonhazardous. Although Superfund liability has been interpreted by the courts as joint and several, typically many parties are named for each site and several of the parties are financially sound enterprises. At present, management’s estimates do not anticipate material cleanup costs for identified sites.

6. BENEFIT PLANS

For a discussion of investment strategy, investment limitations, target asset allocations and the classification of investments within the fair value hierarchy, see “Fair Value Measurements of Assets and Liabilities” and “Investments Held in Trust for Future Liabilities” sections of Note 1.

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

TCC recognizes its funded status associated with defined benefit pension and OPEB plans in its balance sheets. Disclosures about the plans are required by the “Compensation - Retirement Benefits” accounting guidance. TCC recognizes an asset for a plan’s overfunded status or a liability for a plan’s underfunded status and recognizes, as a component of other comprehensive income, the changes in the funded status of the plan that arise during the year that are not recognized as a component of net periodic benefit cost. TCC records a regulatory asset instead of other comprehensive income for qualifying benefit costs of regulated operations that for ratemaking purposes are deferred for future recovery. The cumulative funded status adjustment is equal to the remaining unrecognized deferrals for unamortized actuarial losses or gains, prior service costs and transition obligations, such that remaining deferred costs result in a regulatory asset and deferred gains result in a regulatory liability.

Actuarial Assumptions for Benefit Obligations

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

<u>Assumptions</u>	<u>Pension Plans</u>		<u>Other Postretirement Benefit Plans</u>	
	<u>2015</u>	<u>2014</u>	<u>2015</u>	<u>2014</u>
Discount Rate	4.30%	4.00%	4.30%	4.00%
Rate of Compensation Increase	4.85% (a)	4.70% (a)	NA	NA

(a) Rates are for base pay only. In addition, an amount is added to reflect target incentive compensation for exempt employees and overtime and incentive pay for nonexempt employees.

NA Not applicable.

A duration-based method is used to determine the discount rate for the plans. A hypothetical portfolio of high quality corporate bonds is constructed with cash flows matching the benefit plan liability. The composite yield on the hypothetical bond portfolio is used as the discount rate for the plan.

For 2015, the rate of compensation increase assumed varies with the age of the employee, ranging from 3.5% per year to 12% per year, with an average increase of 4.85%.

Actuarial Assumptions for Net Periodic Benefit Costs

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

Assumptions	Pension Plans			Other Postretirement Benefit Plans		
	2015	2014	2013	2015	2014	2013
Discount Rate	4.00%	4.70%	3.95%	4.00%	4.70%	3.95%
Expected Return on Plan Assets	6.00%	6.00%	6.50%	6.75%	6.75%	7.00%
Rate of Compensation Increase	4.70% (a)	4.80% (a)	4.90% (a)	NA	NA	NA

(a) Rates are for base pay only. In addition, an amount is added to reflect target incentive compensation for exempt employees and overtime and incentive pay for nonexempt employees.

NA Not applicable.

The expected return on plan assets was determined by evaluating historical returns, the current investment climate (yield on fixed income securities and other recent investment market indicators), rate of inflation and current prospects for economic growth.

The health care trend rate assumptions as of January 1 of each year used for OPEB plans measurement purposes are shown below:

Health Care Trend Rates	2015	2014
Initial	6.25%	6.50%
Ultimate	5.00%	5.00%
Year Ultimate Reached	2020	2020

Assumed health care cost trend rates have a significant effect on the amounts reported for the OPEB health care plans. A 1% change in assumed health care cost trend rates would have the following effects:

	1% Increase	1% Decrease
	(in thousands)	
Effect on Total Service and Interest Cost Components of Net Periodic Postretirement Health Care Benefit Cost	\$ 158	\$ (132)
Effect on the Health Care Component of the Accumulated Postretirement Benefit Obligation	3,660	(3,002)

Significant Concentrations of Risk within Plan Assets

In addition to establishing the target asset allocation of plan assets, the investment policy also places restrictions on securities to limit significant concentrations within plan assets. The investment policy establishes guidelines that govern maximum market exposure, security restrictions, prohibited asset classes, prohibited types of transactions, minimum credit quality, average portfolio credit quality, portfolio duration and concentration limits. The guidelines were established to mitigate the risk of loss due to significant concentrations in any investment. The plans are monitored to control security diversification and ensure compliance with the investment policy. As of December 31, 2015, the assets were invested in compliance with all investment limits. See "Investments Held in Trust for Future Liabilities" section of Note 1 for limit details.

Benefit Plan Obligations, Plan Assets and Funded Status as of December 31, 2015 and 2014

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

	Pension Plans		Other Postretirement Benefit Plans	
	2015	2014	2015	2014
(in thousands)				
Change in Benefit Obligation				
Benefit Obligation as of January 1,	\$ 342,709	\$ 316,337	\$ 89,494	\$ 91,309
Service Cost	5,722	4,506	595	716
Interest Cost	12,992	14,417	3,485	4,135
Actuarial (Gain) Loss	(21,452)	28,888	1,582	(1,079)
Benefit Payments	(22,811)	(21,439)	(8,312)	(8,852)
Participant Contributions	—	—	2,225	2,761
Medicare Subsidy	—	—	38	504
Benefit Obligation as of December 31,	\$ 317,160	\$ 342,709	\$ 89,107	\$ 89,494
Change in Fair Value of Plan Assets				
Fair Value of Plan Assets as of January 1,	\$ 330,446	\$ 317,344	\$ 112,053	\$ 113,090
Actual Gain (Loss) on Plan Assets	(749)	28,586	(4,709)	5,054
Company Contributions	6,785	5,955	—	—
Participant Contributions	—	—	2,225	2,761
Benefit Payments	(22,811)	(21,439)	(8,312)	(8,852)
Fair Value of Plan Assets as of December 31,	\$ 313,671	\$ 330,446	\$ 101,257	\$ 112,053
Funded (Underfunded) Status as of December 31,	\$ (3,489)	\$ (12,263)	\$ 12,150	\$ 22,559

Amounts Recognized on the Balance Sheets as of December 31, 2015 and 2014

	Pension Plans		Other Postretirement Benefit Plans	
	2015	2014	2015	2014
(in thousands)				
December 31,				
Deferred Charges and Other Noncurrent Assets – Prepaid Benefit Costs	\$ —	\$ —	\$ 12,150	\$ 22,559
Other Current Liabilities – Accrued Short-term Benefit Liability	(214)	(213)	—	—
Deferred Credits and Other Noncurrent Liabilities – Accrued Long-term Benefit Liability	(3,275)	(12,050)	—	—
Funded (Underfunded) Status	\$ (3,489)	\$ (12,263)	\$ 12,150	\$ 22,559

Amounts Included in Regulatory Assets as of December 31, 2015 and 2014

Components	Pension Plans		Other Postretirement Benefit Plans	
	2015	2014	2015	2014
(in thousands)				
December 31,				
Net Actuarial Loss	\$ 139,257	\$ 148,616	\$ 34,310	\$ 22,269
Prior Service Cost (Credit)	294	557	(34,410)	(38,699)
Recorded as				
Regulatory Assets	\$ 139,551	\$ 149,173	\$ (100)	\$ (16,430)

Components of the change in amounts included in Regulatory Assets during the years ended December 31, 2015 and 2014 are as follows:

Components	Pension Plans		Other Postretirement Benefit Plans	
	2015	2014	2015	2014
	(in thousands)			
Actuarial (Gain) Loss During the Year	\$ (2,588)	\$ 17,766	\$ 13,154	\$ 1,192
Amortization of Actuarial Loss	(6,771)	(8,105)	(1,113)	(1,289)
Amortization of Prior Service Credit (Cost)	(263)	(318)	4,289	4,288
Change for the Year Ended December 31,	\$ (9,622)	\$ 9,343	\$ 16,330	\$ 4,191

Pension and Other Postretirement Benefits Plans' Assets

The fair value tables within Pension and Other Postretirement Benefits Plans' Assets present the classification of assets for AEP within the fair value hierarchy. All Level 1, 2, 3 and Other amounts can be allocated to TCC as of December 31, 2015 and 2014 using the percentages in the table below:

Pension Plan		Other Postretirement Benefit Plans	
2015	2014	2015	2014
6.6%	6.7%	6.4%	6.6%

The following table presents the classification of pension plan assets for AEP within the fair value hierarchy as of December 31, 2015:

Asset Class	Level 1	Level 2	Level 3	Other	Total	Year End Allocation
			(in millions)			
Equities:						
Domestic	\$ 315.7	\$ —	\$ —	\$ —	\$ 315.7	6.6 %
International	402.3	—	—	—	402.3	8.4 %
Options	—	15.6	—	—	15.6	0.3 %
Real Estate Investment Trusts	4.0	—	—	—	4.0	0.1 %
Common Collective Trust – Global	—	369.7	—	—	369.7	7.8 %
Common Collective Trust – International	—	16.1	—	—	16.1	0.3 %
Subtotal – Equities	722.0	401.4	—	—	1,123.4	23.5 %
Fixed Income:						
Common Collective Trust – Debt	—	34.2	—	—	34.2	0.7 %
United States Government and Agency Securities	—	421.9	—	—	421.9	8.9 %
Corporate Debt	—	1,983.2	—	—	1,983.2	41.6 %
Foreign Debt	—	421.4	0.1	—	421.5	8.8 %
State and Local Government	—	12.8	—	—	12.8	0.3 %
Other – Asset Backed	—	23.4	—	—	23.4	0.5 %
Subtotal – Fixed Income	—	2,896.9	0.1	—	2,897.0	60.8 %
Infrastructure	—	—	42.0	—	42.0	0.9 %
Real Estate	—	—	253.7	—	253.7	5.3 %
Alternative Investments	—	—	378.7	—	378.7	8.0 %
Securities Lending	—	263.0	—	—	263.0	5.5 %
Securities Lending Collateral (a)	—	—	—	(264.7)	(264.7)	(5.5)%
Cash and Cash Equivalents	—	48.6	—	—	48.6	1.0 %
Other – Pending Transactions and Accrued Income (b)	—	—	—	25.9	25.9	0.5 %
Total	\$ 722.0	\$ 3,609.9	\$ 674.5	\$ (238.8)	\$ 4,767.6	100.0 %

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

(b) Amounts in “Other” column primarily represent accrued interest, dividend receivables and transactions pending settlement.

The following table sets forth a reconciliation of changes in the fair value of AEP’s assets classified as Level 3 in the fair value hierarchy for the pension assets:

	Foreign Debt	Infrastructure	Real Estate	Alternative Investments	Total Level 3
	(in millions)				
Balance as of January 1, 2015	\$ 0.1	\$ 12.5	\$ 235.8	\$ 378.9	\$ 627.3
Actual Return on Plan Assets					
Relating to Assets Still Held as of the Reporting Date	—	(3.6)	12.5	(25.9)	(17.0)
Relating to Assets Sold During the Period	—	0.3	23.8	37.6	61.7
Purchases and Sales	—	32.8	(18.4)	(11.9)	2.5
Transfers into Level 3	—	—	—	—	—
Transfers out of Level 3	—	—	—	—	—
Balance as of December 31, 2015	\$ 0.1	\$ 42.0	\$ 253.7	\$ 378.7	\$ 674.5

The following table presents the classification of OPEB plan assets for AEP within the fair value hierarchy as of December 31, 2015:

Asset Class	Level 1	Level 2	Level 3	Other	Total	Year End Allocation
			(in millions)			
Equities:						
Domestic	\$ 465.1	\$ —	\$ —	\$ —	\$ 465.1	29.5%
International	484.3	—	—	—	484.3	30.7%
Options	—	15.6	—	—	15.6	1.0%
Common Collective Trust – Global	—	19.0	—	—	19.0	1.2%
Common Collective Trust – International	—	12.6	—	—	12.6	0.8%
Subtotal – Equities	949.4	47.2	—	—	996.6	63.2%
Fixed Income:						
Common Collective Trust – Debt	—	100.9	—	—	100.9	6.4%
United States Government and Agency Securities	—	58.4	—	—	58.4	3.7%
Corporate Debt	—	117.7	—	—	117.7	7.4%
Foreign Debt	—	20.7	—	—	20.7	1.3%
State and Local Government	—	4.2	—	—	4.2	0.3%
Other – Asset Backed	—	8.4	—	—	8.4	0.5%
Subtotal – Fixed Income	—	310.3	—	—	310.3	19.6%
Trust Owned Life Insurance:						
International Equities	—	28.3	—	—	28.3	1.8%
United States Bonds	—	184.3	—	—	184.3	11.7%
Subtotal – Trust Owned Life Insurance	—	212.6	—	—	212.6	13.5%
Cash and Cash Equivalents	44.9	7.2	—	—	52.1	3.3%
Other – Pending Transactions and Accrued Income (a)	—	—	—	5.8	5.8	0.4%
Total	\$ 994.3	\$ 577.3	\$ —	\$ 5.8	\$ 1,577.4	100.0%

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

The following table presents the classification of pension plan assets for AEP within the fair value hierarchy as of December 31, 2014:

Asset Class	Level 1	Level 2	Level 3 (in millions)	Other	Total	Year End Allocation
Equities:						
Domestic	\$ 588.6	\$ —	\$ —	\$ —	\$ 588.6	11.9 %
International	502.2	—	—	—	502.2	10.1 %
Options	—	14.1	—	—	14.1	0.3 %
Real Estate Investment Trusts	54.3	—	—	—	54.3	1.1 %
Common Collective Trust – Global	—	377.0	—	—	377.0	7.6 %
Common Collective Trust – International	—	18.5	—	—	18.5	0.4 %
Subtotal – Equities	1,145.1	409.6	—	—	1,554.7	31.4 %
Fixed Income:						
Common Collective Trust – Debt	—	30.2	—	—	30.2	0.6 %
United States Government and Agency Securities	—	449.8	—	—	449.8	9.0 %
Corporate Debt	—	1,799.5	—	—	1,799.5	36.2 %
Foreign Debt	—	400.5	0.1	—	400.6	8.1 %
State and Local Government	—	14.9	—	—	14.9	0.3 %
Other – Asset Backed	—	29.1	—	—	29.1	0.6 %
Subtotal – Fixed Income	—	2,724.0	0.1	—	2,724.1	54.8 %
Infrastructure	—	—	12.5	—	12.5	0.3 %
Real Estate	—	—	235.8	—	235.8	4.7 %
Alternative Investments	—	—	378.9	—	378.9	7.6 %
Securities Lending	—	219.8	—	—	219.8	4.4 %
Securities Lending Collateral (a)	—	—	—	(221.5)	(221.5)	(4.5)%
Cash and Cash Equivalents	—	53.3	—	—	53.3	1.1 %
Other – Pending Transactions and Accrued Income (b)	—	—	—	9.9	9.9	0.2 %
Total	\$ 1,145.1	\$ 3,406.7	\$ 627.3	\$ (211.6)	\$ 4,967.5	100.0 %

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

(b) Amounts in “Other” column primarily represent accrued interest, dividend receivables and transactions pending settlement.

The following table sets forth a reconciliation of changes in the fair value of AEP’s assets classified as Level 3 in the fair value hierarchy for the pension assets:

	Foreign Debt	Infrastructure	Real Estate	Alternative Investments	Total Level 3
	(in millions)				
Balance as of January 1, 2014	\$ 0.1	\$ —	\$ 238.2	\$ 329.6	\$ 567.9
Actual Return on Plan Assets					
Relating to Assets Still Held as of the Reporting Date	—	(0.3)	5.5	32.0	37.2
Relating to Assets Sold During the Period	—	0.1	19.0	15.8	34.9
Purchases and Sales	—	12.7	(26.9)	1.5	(12.7)
Transfers into Level 3	—	—	—	—	—
Transfers out of Level 3	—	—	—	—	—
Balance as of December 31, 2014	\$ 0.1	\$ 12.5	\$ 235.8	\$ 378.9	\$ 627.3

The following table presents the classification of OPEB plan assets for AEP within the fair value hierarchy as of December 31, 2014:

Asset Class	Level 1	Level 2	Level 3	Other	Total	Year End Allocation
			(in millions)			
Equities:						
Domestic	\$ 466.1	\$ —	\$ —	\$ —	\$ 466.1	27.5%
International	566.6	—	—	—	566.6	33.5%
Options	—	16.4	—	—	16.4	1.0%
Common Collective Trust – Global	—	29.6	—	—	29.6	1.8%
Subtotal – Equities	1,032.7	46.0	—	—	1,078.7	63.8%
Fixed Income:						
Common Collective Trust – Debt	—	103.7	—	—	103.7	6.1%
United States Government and Agency Securities	—	71.1	—	—	71.1	4.2%
Corporate Debt	—	125.5	—	—	125.5	7.4%
Foreign Debt	—	21.3	—	—	21.3	1.3%
State and Local Government	—	5.9	—	—	5.9	0.3%
Other – Asset Backed	—	4.9	—	—	4.9	0.3%
Subtotal – Fixed Income	—	332.4	—	—	332.4	19.6%
Trust Owned Life Insurance:						
International Equities	—	10.3	—	—	10.3	0.6%
United States Bonds	—	212.1	—	—	212.1	12.5%
Subtotal – Trust Owned Life Insurance	—	222.4	—	—	222.4	13.1%
Cash and Cash Equivalents	46.8	9.6	—	—	56.4	3.3%
Other – Pending Transactions and Accrued Income (a)	—	—	—	4.0	4.0	0.2%
Total	\$ 1,079.5	\$ 610.4	\$ —	\$ 4.0	\$ 1,693.9	100.0%

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

Determination of Pension Expense

The determination of pension expense or income is based on a market-related valuation of assets which reduces year-to-year volatility. This market-related valuation recognizes investment gains or losses over a five-year period from the year in which they occur. Investment gains or losses for this purpose are the difference between the expected return calculated using the market-related value of assets and the actual return.

The accumulated benefit obligation for the pension plans is as follows:

Accumulated Benefit Obligation	2015	2014
	(in thousands)	
Qualified Pension Plan	\$ 305,225	\$ 328,369
Nonqualified Pension Plan	2,435	2,594
Total as of December 31,	\$ 307,660	\$ 330,963

For the underfunded pension plans that had an accumulated benefit obligation in excess of plan assets, the projected benefit obligation, accumulated benefit obligation and fair value of plan assets of these plans as of December 31, 2015 and 2014 were as follows:

	Underfunded Pension Plans	
	December 31,	
	2015	2014
	(in thousands)	
Projected Benefit Obligation	\$ 2,480	\$ 2,616
Accumulated Benefit Obligation	\$ 2,435	\$ 2,594
Fair Value of Plan Assets	—	—
Underfunded Accumulated Benefit Obligation	\$ (2,435)	\$ (2,594)

Estimated Future Benefit Payments and Contributions

TCC expects contributions and payments for the pension plans of \$6.1 million during 2016. The estimated contributions to the pension trust are at least the minimum amount required by the Employee Retirement Income Security Act and additional discretionary contributions may also be made to maintain the funded status of the plan.

The table below reflects the total benefits expected to be paid from the plan or from TCC's assets. The payments include the participants' contributions to the plan for their share of the cost. Future benefit payments are dependent on the number of employees retiring, whether the retiring employees elect to receive pension benefits as annuities or as lump sum distributions, future integration of the benefit plans with changes to Medicare and other legislation, future levels of interest rates and variances in actuarial results. The estimated payments for pension benefits and OPEB are as follows:

	Estimated Payments	
	Pension Plans	Other Postretirement Benefit Plans
	(in thousands)	
2016	\$ 22,858	\$ 8,665
2017	25,237	8,755
2018	24,411	8,847
2019	24,888	8,934
2020	25,625	9,102
Years 2021 to 2025, in Total	125,850	47,649

Components of Net Periodic Benefit Cost

The following table provides the components of net periodic benefit cost (credit) for the years ended December 31, 2015, 2014 and 2013:

	Pension Plans			Other Postretirement Benefit Plans		
	Years Ended December 31,			Years Ended December 31,		
	2015	2014	2013	2015	2014	2013
	(in thousands)					
Service Cost	\$ 5,722	\$ 4,506	\$ 4,844	\$ 595	\$ 716	\$ 1,180
Interest Cost	12,992	14,417	13,263	3,485	4,135	4,414
Expected Return on Plan Assets	(18,116)	(17,464)	(18,807)	(7,264)	(7,325)	(7,125)
Amortization of Prior Service Cost (Credit)	263	318	320	(4,289)	(4,288)	(4,288)
Amortization of Net Actuarial Loss	6,771	8,105	11,952	1,113	1,289	4,068
Net Periodic Benefit Cost (Credit)	7,632	9,882	11,572	(6,360)	(5,473)	(1,751)
Capitalized Portion	(3,534)	(4,535)	(4,999)	2,945	2,512	756
Net Periodic Benefit Cost (Credit) Recognized in Expense	\$ 4,098	\$ 5,347	\$ 6,573	\$ (3,415)	\$ (2,961)	\$ (995)

Estimated amounts expected to be amortized to net periodic benefit costs (credits) and the impact on the balance sheet during 2016 are shown in the following table:

Components	Pension Plans	Other Postretirement Benefit Plans
	(in thousands)	
Net Actuarial Loss	\$ 5,238	\$ 1,890
Prior Service Cost (Credit)	257	(4,288)
Total Estimated 2016 Amortization	\$ 5,495	\$ (2,398)
Expected to be Recorded as		
Regulatory Asset	\$ 5,495	\$ (2,398)
Total	\$ 5,495	\$ (2,398)

American Electric Power System Retirement Savings Plan

TCC participates in an AEP sponsored defined contribution retirement savings plan, the American Electric Power System Retirement Savings Plan, for substantially all employees. This qualified plan offers participants an opportunity to contribute a portion of their pay, includes features under Section 401(k) of the Internal Revenue Code and provides for matching contributions. The matching contributions to the plan are 100% of the first 1% of eligible employee contributions and 70% of the next 5% of contributions. The cost for matching contributions totaled \$3.7 million in 2015, \$3.4 million in 2014 and \$3.2 million in 2013.

7. BUSINESS SEGMENTS

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

8. DERIVATIVES AND HEDGING

AEPS is agent for and transacts on behalf of TCC.

Risk Management Strategies

TCC's vehicle fleet is exposed to gasoline and diesel fuel price volatility. TCC utilizes financial heating oil and gasoline derivative contracts in order to mitigate price risk of future fuel purchases. TCC does not hedge all fuel price risk. The gross notional volumes of TCC's outstanding derivative contracts for heating oil and gasoline as of December 31, 2015 and 2014 were 1 million gallons and 789 thousand gallons, respectively.

ACCOUNTING FOR DERIVATIVE INSTRUMENTS AND THE IMPACT ON THE FINANCIAL STATEMENTS

According to the accounting guidance for "Derivatives and Hedging," TCC reflects the fair values of derivative instruments subject to netting agreements with the same counterparty net of related cash collateral. For certain risk management contracts, TCC is required to post or receive cash collateral based on third party contractual agreements and risk profiles. For the December 31, 2015 and 2014 balance sheets, TCC had no netting of cash collateral received from third parties against short-term and long-term risk management assets and \$269 thousand and \$70 thousand, respectively, of cash collateral paid to third parties against short-term and long-term risk management liabilities.

The following tables represent the gross fair value impact of TCC's derivative activity on the balance sheets as of December 31, 2015 and 2014:

Fair Value of Derivative Instruments December 31, 2015					
Balance Sheet Location	Risk Management Contracts Commodity (a)	Hedging Contracts Commodity (a)	Gross Amounts of Risk Management Assets/Liabilities Recognized (in thousands)	Gross Amounts Offset in the Statement of Financial Position (b)	Net Amounts of Assets/Liabilities Presented in the Statement of Financial Position (c)
Current Risk Management Assets	\$ —	\$ —	\$ —	\$ —	\$ —
Long-term Risk Management Assets	—	—	—	—	—
Total Assets	—	—	—	—	—
Current Risk Management Liabilities	478	—	478	(269)	209
Long-term Risk Management Liabilities	—	—	—	—	—
Total Liabilities	478	—	478	(269)	209
Total MTM Derivative Contract Net Assets (Liabilities)	\$ (478)	\$ —	\$ (478)	\$ 269	\$ (209)

Fair Value of Derivative Instruments
December 31, 2014

Balance Sheet Location	Risk Management Contracts	Hedging Contracts	Gross Amounts of Risk Management Assets/Liabilities Recognized	Gross Amounts Offset in the Statement of Financial Position (b)	Net Amounts of Assets/Liabilities Presented in the Statement of Financial Position (c)
Commodity (a)	Commodity (a)	(in thousands)			
Current Risk Management Assets	\$ —	\$ —	\$ —	\$ —	\$ —
Long-term Risk Management Assets	—	—	—	—	—
Total Assets	—	—	—	—	—
Current Risk Management Liabilities	767	—	767	(70)	697
Long-term Risk Management Liabilities	—	—	—	—	—
Total Liabilities	767	—	767	(70)	697
Total MTM Derivative Contract Net Assets (Liabilities)	\$ (767)	\$ —	\$ (767)	\$ 70	\$ (697)

- (a) Derivative instruments within these categories are reported gross. These instruments are subject to master netting agreements and are presented on the balance sheets on a net basis in accordance with the accounting guidance for “Derivatives and Hedging.”
- (b) Amounts include counterparty netting of risk management and hedging contracts and associated cash collateral in accordance with the accounting guidance for “Derivatives and Hedging.”
- (c) There are no derivative contracts subject to a master netting arrangement or similar agreement which are not offset in the statement of financial position.

The table below presents TCC’s activity of derivative risk management contracts for the years ended December 31, 2015 and 2014:

Amount of Gain (Loss) Recognized on Risk Management Contracts

Location of Gain (Loss)	Years Ended December 31,	
	2015	2014
	(in thousands)	
Electric Generation, Transmission and Distribution Revenues	\$ —	\$ 34
Other Operation Expense	(465)	—
Maintenance Expense	(388)	—
Regulatory Assets (a)	289	(767)
Regulatory Liabilities (a)	—	—
Total Loss on Risk Management Contracts	\$ (564)	\$ (733)

- (a) Represents realized and unrealized gains and losses subject to regulatory accounting treatment recorded as either current or noncurrent on the balance sheets.

Certain qualifying derivative instruments have been designated as normal purchase or normal sale contracts, as provided in the accounting guidance for “Derivatives and Hedging.” Derivative contracts that have been designated as normal purchases or normal sales under that accounting guidance are not subject to MTM accounting treatment and are recognized on the statements of income on an accrual basis.

The accounting for the changes in the fair value of a derivative instrument depends on whether it qualifies for and has been designated as part of a hedging relationship and further, on the type of hedging relationship. Depending on the exposure, management designates a hedging instrument as a fair value hedge or a cash flow hedge.

For contracts that have not been designated as part of a hedging relationship, the accounting for changes in fair value depends on whether the derivative instrument is held for trading purposes. Unrealized and realized gains and losses on derivative instruments held for trading purposes are included in revenues on a net basis on TCC’s statements of income. Unrealized and realized gains and losses on derivative instruments not held for trading purposes are included in revenues or expenses on TCC’s statements of income depending on the relevant facts and circumstances. However, unrealized and some realized gains and losses for both trading and non-trading derivative instruments are recorded as regulatory assets (for losses) or regulatory liabilities (for gains), in accordance with the accounting guidance for “Regulated Operations.”

Accounting for Cash Flow Hedging Strategies

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

TCC reclassifies gains and losses on heating oil and gasoline derivative contracts designated as cash flow hedges from Accumulated Other Comprehensive Income (Loss) on its balance sheets into Other Operation expense, Maintenance expense or Depreciation and Amortization expense, as it relates to capital projects, on its statements of income. During 2013, TCC applied cash flow hedging to outstanding heating oil and gasoline derivatives. The impact of cash flow hedge accounting for these derivative contracts was immaterial and was discontinued effective March 31, 2014.

For details on effective cash flow hedges included in Accumulated Other Comprehensive Income (Loss) on TCC's balance sheets and the reasons for changes in cash flow hedges, see Note 3.

9. FAIR VALUE MEASUREMENTS

Fair Value Measurements of Long-term Debt

The fair values of Long-term Debt are based on quoted market prices, without credit enhancements, for the same or similar issues and the current interest rates offered for instruments with similar maturities classified as Level 2 measurement inputs. These instruments are not marked-to-market. The estimates presented are not necessarily indicative of the amounts that could be realized in a current market exchange.

The book values and fair values of TCC's Long-term Debt as of December 31, 2015 and 2014 are summarized in the following table:

	December 31,			
	2015		2014	
	<u>Book Value</u>	<u>Fair Value</u>	<u>Book Value</u>	<u>Fair Value</u>
	(in thousands)			
Long-term Debt	\$ 2,900,545	\$ 3,101,488	\$ 2,924,069	\$ 3,202,697

Fair Value Measurements of Financial Assets and Liabilities

For a discussion of fair value accounting and the classification of assets and liabilities within the fair value hierarchy, see the "Fair Value Measurements of Assets and Liabilities" section of Note 1.

The following tables set forth, by level within the fair value hierarchy, TCC's financial assets and liabilities that were accounted for at fair value on a recurring basis as of December 31, 2015 and 2014. As required by the accounting guidance for "Fair Value Measurements and Disclosures," financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. Management's assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels. There have not been any significant changes in management's valuation techniques.

Assets and Liabilities Measured at Fair Value on a Recurring Basis December 31, 2015

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Other</u>	<u>Total</u>
	(in thousands)				
Assets:					
Restricted Cash for Securitized Transition Funding (a)	<u>\$ 203,393</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 37</u>	<u>\$ 203,430</u>
Liabilities:					
Risk Management Liabilities					
Risk Management Commodity Contracts (b)	<u>\$ —</u>	<u>\$ 478</u>	<u>\$ —</u>	<u>\$ (269)</u>	<u>\$ 209</u>

Assets and Liabilities Measured at Fair Value on a Recurring Basis December 31, 2014

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Other</u>	<u>Total</u>
	(in thousands)				
Assets:					
Restricted Cash for Securitized Transition Funding (a)	<u>\$ 205,682</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 4</u>	<u>\$ 205,686</u>
Liabilities:					
Risk Management Liabilities					
Risk Management Commodity Contracts (b)	<u>\$ —</u>	<u>\$ 767</u>	<u>\$ —</u>	<u>\$ (70)</u>	<u>\$ 697</u>

- (a) Amounts in "Other" column primarily represent cash deposits with third parties. Level 1 amounts primarily represent investments in money market funds.
- (b) Amounts in "Other" column primarily represent counterparty netting of risk management and hedging contracts and associated cash collateral under the accounting guidance for "Derivatives and Hedging."

There were no transfers between Level 1 and Level 2 during the years ended December 31, 2015, 2014 and 2013.

10. INCOME TAXES

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

	Years Ended December 31,		
	<u>2015</u>	<u>2014</u>	<u>2013</u>
	(in thousands)		
Income Tax Expense (Credit):			
Current	\$ 68,619	\$ 79,151	\$ 86,324
Deferred	(22,813)	(18,782)	(34,880)
Deferred Investment Tax Credits	(763)	(781)	(789)
Income Tax Expense	<u>\$ 45,043</u>	<u>\$ 59,588</u>	<u>\$ 50,655</u>

The following is a reconciliation of the difference between the amount of federal income taxes computed by multiplying book income before income taxes by the federal statutory tax rate and the amount of income taxes reported:

	Years Ended December 31,		
	<u>2015</u>	<u>2014</u>	<u>2013</u>
	(in thousands)		
Net Income	\$ 91,249	\$ 102,931	\$ 105,298
Income Tax Expense	45,043	59,588	50,655
Pretax Income	<u>\$ 136,292</u>	<u>\$ 162,519</u>	<u>\$ 155,953</u>
Income Taxes on Pretax Income at Statutory Rate (35%)	\$ 47,702	\$ 56,882	\$ 54,584
Increase (Decrease) in Income Taxes Resulting from the Following Items:			
Depreciation	586	442	788
Investment Tax Credits, Net	(763)	(781)	(789)
State and Local Income Taxes, Net	2,844	5,395	4,557
Parent Company Loss Benefit	(3,113)	(2,101)	(1,977)
Tax Adjustments	(909)	601	(6,035)
Other	(1,304)	(850)	(473)
Income Tax Expense	<u>\$ 45,043</u>	<u>\$ 59,588</u>	<u>\$ 50,655</u>
Effective Income Tax Rate	33.0 %	36.7 %	32.5 %

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

	December 31,	
	<u>2015</u>	<u>2014</u>
	(in thousands)	
Deferred Tax Assets	\$ 97,924	\$ 102,267
Deferred Tax Liabilities	(1,357,067)	(1,383,480)
Net Deferred Tax Liabilities	<u>\$ (1,259,143)</u>	<u>\$ (1,281,213)</u>
Property Related Temporary Differences	\$ (745,413)	\$ (667,636)
Amounts Due from Customers for Future Federal Income Taxes	(4,689)	(4,154)
Regulatory Assets	(28,822)	(22,375)
Securitized Transition Assets	(488,355)	(592,181)
All Other, Net	8,136	5,133
Net Deferred Tax Liabilities	<u>\$ (1,259,143)</u>	<u>\$ (1,281,213)</u>

AEP System Tax Allocation Agreement

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

Federal and State Income Tax Audit Status

TCC and other AEP subsidiaries are no longer subject to U.S. federal examination for years before 2011. The IRS examination of years 2011, 2012 and 2013 started in April 2014. Although the outcome of tax audits is uncertain, in management's opinion, adequate provisions for federal income taxes have been made for potential liabilities resulting from such matters. In addition, TCC accrues interest on these uncertain tax positions. Management is not aware of any issues for open tax years that upon final resolution are expected to materially impact net income.

TCC and other AEP subsidiaries file income tax returns in various state and local jurisdictions. These taxing authorities routinely examine the tax returns. TCC and other AEP subsidiaries are currently under examination in several state and local jurisdictions. However, it is possible that previously filed tax returns have positions that may be challenged by these tax authorities. 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. TCC is no longer subject to state or local income tax examinations by tax authorities for years before 2009.

Tax Credit Carryforward

As of December 31, 2015 and 2014, TCC had unused federal income tax credits of \$220 thousand and \$294 thousand, respectively, not all of which have an expiration date. Included in the credit carryforward are federal general business tax credits of \$85 thousand and \$159 thousand as of December 31, 2015 and 2014, respectively. If these credits are not utilized, the federal general business tax credits will expire in the years 2031 through 2034.

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

Uncertain Tax Positions

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

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

	Years Ended December 31,		
	2015	2014	2013
	(in thousands)		
Interest Expense	\$ 163	\$ 146	\$ 194
Interest Income	—	—	103
Reversal of Prior Period Interest Expense	—	142	—

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

	December 31,	
	2015	2014
	(in thousands)	
Accrual for Receipt of Interest	\$ —	\$ —
Accrual for Payment of Interest and Penalties	551	388

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

	<u>2015</u>	<u>2014</u>	<u>2013</u>
		(in thousands)	
Balance as of January 1,	\$ 2,702	\$ 3,020	\$ 2,750
Increase – Tax Positions Taken During a Prior Period	1,808	702	—
Decrease – Tax Positions Taken During a Prior Period	—	(110)	(72)
Increase – Tax Positions Taken During the Current Year	—	—	342
Decrease – Tax Positions Taken During the Current Year	—	—	—
Decrease – Settlements with Taxing Authorities	—	—	—
Decrease – Lapse of the Applicable Statute of Limitations	—	(910)	—
Balance as of December 31,	<u>\$ 4,510</u>	<u>\$ 2,702</u>	<u>\$ 3,020</u>

The total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate is \$2.9 million, \$1.8 million and \$1.4 million for 2015, 2014 and 2013, respectively. Management believes there will be no significant net increase or decrease in unrecognized tax benefits within 12 months of the reporting date.

Federal Tax Legislation

The American 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 did not materially impact TCC's net income or financial condition but did have a favorable impact on cash flows in 2013.

The Tax Increase Prevention Act of 2014 (the 2014 Act) was enacted in December 2014. Included in the 2014 Act was a one-year extension of the 50% bonus depreciation. The 2014 Act also retroactively extended the life of research and development, employment and several energy tax credits, which expired at the end of 2013. The enacted provisions did not materially impact TCC's net income or financial condition but did have a favorable impact on cash flows in 2015.

The Protecting Americans from Tax Hikes Act of 2015 (PATH) included an extension of the 50% bonus depreciation for three years through 2017, phasing down to 40% in 2018 and 30% in 2019. PATH also provided for the extension of research and development, employment and several energy tax credits for 2015. PATH also includes provisions to extend the wind energy production tax credit through 2016 with a three-year phase-out (2017-2019), and to extend the 30% temporary solar investment tax credit for three years through 2019 and with a two-year phase-out (2020-2021). PATH also provided for a permanent extension of the Research and Development tax credit. The enacted provisions did not materially impact TCC's net income or financial condition but will have a favorable impact on future cash flows.

Federal Tax Regulations

In 2013, the U.S. Treasury Department issued final and re-proposed regulations regarding the deduction and capitalization of expenditures related to tangible property, effective for the tax years beginning in 2014. In addition, the IRS issued Revenue Procedures under the Industry Issue Resolutions program that provides specific guidance for the implementation of the regulations for the electric utility industry. These final regulations did not materially impact TCC's net income, cash flows or financial condition.

State Tax Regulations

House Bill 32 was passed by the state of Texas in June 2015, permanently reducing the Texas income/franchise tax rate from 0.95% to 0.75% effective January 1, 2016, applicable to reports originally due on or after the effective date. The Texas income/franchise tax rate had been scheduled to return to 1% in 2016. The enacted provision did not materially impact TCC's net income, cash flows or financial condition.

11. LEASES

Leases of property, plant and equipment are for periods up to 10 years and require payments of related property taxes, maintenance and operating costs. The majority of the leases have purchase or renewal options and will be renewed or replaced by other leases.

Lease rentals for both operating and capital leases are generally charged to Other Operation and Maintenance expense in accordance with rate-making treatment for regulated operations. For capital leases, a capital lease asset and offsetting liability are recorded at the present value of the remaining lease payments for each reporting period. The components of rental costs are as follows:

Lease Rental Costs	2015	December 31, 2014	2013
		(in thousands)	
Net Lease Expense on Operating Leases	\$ 5,072	\$ 3,735	\$ 3,309
Amortization of Capital Leases	2,133	2,124	1,942
Interest on Capital Leases	376	340	227
Total Lease Rental Costs	\$ 7,581	\$ 6,199	\$ 5,478

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

	December 31, 2015	2014
	(in thousands)	
Property, Plant and Equipment Under Capital Leases		
Total Property, Plant and Equipment Under Capital Leases – Other	\$ 14,901	\$ 13,001
Accumulated Amortization	4,530	3,866
Net Property, Plant and Equipment Under Capital Leases	\$ 10,371	\$ 9,135
Obligations Under Capital Leases		
Noncurrent Liability	\$ 8,177	\$ 7,087
Liability Due Within One Year	2,194	2,048
Total Obligations Under Capital Leases	\$ 10,371	\$ 9,135

Future minimum lease payments consisted of the following as of December 31, 2015:

Future Minimum Lease Payments	Capital Leases	Noncancelable Operating Leases
	(in thousands)	
2016	\$ 2,577	\$ 6,131
2017	2,240	5,781
2018	1,939	5,251
2019	1,234	4,298
2020	1,077	3,852
Later Years	2,950	11,221
Total Future Minimum Lease Payments	12,017	\$ 36,534
Less Estimated Interest Element	1,646	
Estimated Present Value of Future Minimum Lease Payments	\$ 10,371	

Master Lease Agreements

TCC leases certain equipment under master lease agreements. Under the lease agreements, the lessor is guaranteed a residual value up to a stated percentage of either the unamortized balance or the equipment cost at the end of the lease term. If the actual fair value of the leased equipment is below the guaranteed residual value at the end of the lease term, TCC is committed to pay the difference between the actual fair value and the residual value guarantee. Historically, at the end of the lease term the fair value has been in excess of the unamortized balance. As of December 31, 2015, the maximum potential loss for these lease agreements was \$5.4 million assuming the fair value of the equipment is zero at the end of the lease term.

12. FINANCING ACTIVITIES

Long-term Debt

The following details long-term debt outstanding as of December 31, 2015 and 2014:

Type of Debt	Maturity	Weighted Average Interest Rate as of December 31,	Interest Rate Ranges as of December 31,		Outstanding as of December 31,	
		2015	2015	2014	2015	2014
(in thousands)						
Senior Unsecured Notes	2019-2044	4.92%	2.61%-6.65%	2.61%-6.65%	\$ 817,342	\$ 571,287
Pollution Control Bonds (a)	2017-2030	4.91%	4.00%-6.30%	4.00%-6.30%	486,136	485,864
Securitization Bonds	2015-2024 (b)	4.11%	0.88%-6.25%	0.88%-6.25%	1,497,204	1,767,291
Other Long-term Debt	2016	1.823%	1.823%	1.732%	99,863	99,627
Total Long-term Debt Outstanding					<u>\$ 2,900,545</u>	<u>\$ 2,924,069</u>

(a) Insurance policies support certain series.

(b) Dates represent the scheduled final payment dates for TCC's securitization bonds. The maturity date is one to two years later. These bonds have been classified for maturity and repayment purposes based on the scheduled final payment date.

Long-term debt outstanding as of December 31, 2015 is payable as follows:

	2016	2017	2018	2019	2020	After 2020	Total
(in thousands)							
Principal Amount	\$ 353,709	\$ 263,060	\$ 236,057	\$ 301,131	\$ 273,350	\$ 1,493,784	\$ 2,921,091
Unamortized Discount, Net and Debt Issuance Costs							(20,546)
Total Long-term Debt Outstanding							<u>\$ 2,900,545</u>

In January 2016, TCC retired \$128 million of Securitization Bonds.

Dividend Restrictions

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

Federal Power Act

The Federal Power Act prohibits TCC from participating "in the making or paying of any dividends of such public utility from any funds properly included in capital account." This restriction does not limit the ability of TCC to pay dividends out of retained earnings.

Leverage Restrictions

Pursuant to the credit agreement leverage restrictions, TCC must maintain a percentage of debt to total capitalization at a level that does not exceed 67.5%. As of December 31, 2015, \$301 million of TCC's retained earnings have restrictions related to the payment of dividends to Parent.

Corporate Borrowing Program – AEP System

The AEP System uses a corporate borrowing program to meet the short-term borrowing needs of AEP’s 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 of the AEP System Utility Money Pool agreement filed with the FERC. The amounts of outstanding loans to (borrowings from) the Utility Money Pool as of December 31, 2015 and 2014 are included in Advances to Affiliates and Advances from Affiliates, respectively, on TCC’s balance sheets. TCC’s Utility Money Pool activity and corresponding authorized borrowing limit for the years ended December 31, 2015 and 2014 are described in the following table:

<u>Year</u>	<u>Maximum Borrowings from the Utility Money Pool</u>	<u>Maximum Loans to the Utility Money Pool</u>	<u>Average Borrowings from the Utility Money Pool</u>	<u>Average Loans to the Utility Money Pool</u>	<u>Net Loans to (Borrowings from) the Utility Money Pool as of December 31,</u>	<u>Authorized Short-Term Borrowing Limit</u>
			(in thousands)			
2015	\$ 144,511	\$ 180,236	\$ 88,834	\$ 152,724	\$ 124,483	\$ 250,000
2014	200,988	23,015	89,233	10,069	(72,604)	250,000

Maximum, minimum and average interest rates for funds either borrowed from or loaned to the Utility Money Pool for the years ended December 31, 2015, 2014 and 2013 are summarized in the following table:

<u>Years Ended December 31,</u>	<u>Maximum Interest Rate for Funds Borrowed from the Utility Money Pool</u>	<u>Minimum Interest Rate for Funds Borrowed from the Utility Money Pool</u>	<u>Maximum Interest Rate for Funds Loaned to the Utility Money Pool</u>	<u>Minimum Interest Rate for Funds Loaned to the Utility Money Pool</u>	<u>Average Interest Rate for Funds Borrowed from the Utility Money Pool</u>	<u>Average Interest Rate for Funds Loaned to the Utility Money Pool</u>
2015	0.59%	0.39%	0.87%	0.37%	0.46%	0.50%
2014	0.59%	0.24%	0.32%	0.30%	0.29%	0.31%
2013	0.43%	0.24%	0.31%	0.28%	0.34%	0.30%

Interest expense and interest income related to the Utility Money Pool are included in Interest Expense and Interest Income, respectively, on TCC’s statements of income. For amounts borrowed from and advanced to the Utility Money Pool, TCC incurred the following amounts of interest expense and earned the following amounts of interest income for the years ended December 31, 2015, 2014 and 2013:

	<u>Years Ended December 31,</u>		
	<u>2015</u>	<u>2014</u>	<u>2013</u>
	(in thousands)		
Interest Expense	\$ 295	\$ 259	\$ 324
Interest Income	220	1	4

Credit Facilities

For a discussion of credit facilities, see “Letters of Credit” section of Note 5.

13. RELATED PARTY TRANSACTIONS

For other related party transactions, also see “AEP System Tax Allocation Agreement” section of Note 10 and “Utility Money Pool – AEP System” section of Note 12.

Affiliated Revenues

TCC’s other revenues derived from sales to affiliates for the years ended December 31, 2015, 2014 and 2013 were \$4.2 million, \$3.9 million and \$3.9 million, respectively. These related party revenues are reported in Sales to AEP Affiliates on TCC’s statements of income.

ERCOT Transmission Cost of Service

TCC’s net expenses allocated pursuant to the PUCT-approved ERCOT protocols for the years ended December 31, 2015, 2014 and 2013 were \$2.2 million, \$2.1 million and \$2.1 million, respectively. The net expenses are recorded in Other Operation expenses on TCC’s statements of income.

ERCOT Transmission Service Charges

Pursuant to an order from the PUCT, ETT bills TCC for its ERCOT wholesale transmission services. ETT billed TCC \$21.8 million, \$20.1 million and \$10.4 million for transmission services in 2015, 2014 and 2013, respectively. The billings are recorded in Other Operation expenses on TCC’s statements of income.

Sales and Purchases of Property

TCC had affiliated sales and purchases of electric property individually amounting to \$100 thousand or more 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, recorded at net book value, for the years ended December 31, 2015, 2014 and 2013:

	Years Ended December 31,		
	2015	2014	2013
	(in thousands)		
Sales	\$ 2,972	\$ 7,189	\$ 10,848
Purchases	3,351	4,793	7,778

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

Intercompany Billings

TCC performs certain utility services for other AEP subsidiaries when necessary or practical. The costs of these services are billed on a direct-charge basis, whenever possible, or on reasonable basis of proration for services that benefit multiple companies. The billings for services are made at cost and include no compensation for the use of equity capital.

14. VARIABLE INTEREST ENTITIES

The accounting guidance for “Variable Interest Entities” is a consolidation model that considers if a company has a controlling financial interest in a VIE. A controlling financial interest will have both (a) the power to direct the activities of a VIE that most significantly impact the VIE’s economic performance and (b) the obligation to absorb losses of the VIE that could potentially be significant to the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE. Entities are required to consolidate a VIE when it is determined that they have a controlling financial interest in a VIE and therefore, are the primary beneficiary of that VIE, as defined by the accounting guidance for “Variable Interest Entities.” In determining whether TCC is the primary beneficiary of a VIE, management considers factors such as equity at risk, the amount of the VIE’s variability TCC absorbs, guarantees of indebtedness, voting rights including kick-out rights, the power to direct the VIE, variable interests held by related parties and other factors. Management believes that significant assumptions and judgments were applied consistently.

AEP Texas Central Transition Funding I LLC, AEP Texas Central Transition Funding II LLC and AEP Texas Central Transition Funding III LLC, wholly-owned subsidiaries of TCC, (collectively Transition Funding) were formed for the sole purpose of issuing and servicing securitization bonds related to Texas Restructuring Legislation. Management has concluded that TCC is the primary beneficiary of Transition Funding because TCC has the power to direct the most significant activities of the VIE and TCC’s equity interest could potentially be significant. Therefore, TCC is required to consolidate Transition Funding. The securitized bonds totaled \$1.5 billion and \$1.8 billion as of December 31, 2015 and 2014, respectively, and are included in Long-term Debt Due Within One Year - Nonaffiliated and Long-term Debt - Nonaffiliated on the balance sheets. Transition Funding has securitized transition assets of \$1.3 billion and \$1.6 billion as of December 31, 2015 and 2014, respectively, which are presented separately on the face of the balance sheets. The securitized transition assets represent the right to impose and collect Texas true-up costs from customers receiving electric transmission or distribution service from TCC under recovery mechanisms approved by the PUCT. The securitization bonds are payable only from and secured by the securitized transition assets. The bondholders have no recourse to TCC or any other AEP entity. TCC acts as the servicer for Transition Funding’s securitized transition asset and remits all related amounts collected from customers to Transition Funding for interest and principal payments on the securitization bonds and related costs.

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

AEP TEXAS CENTRAL COMPANY AND SUBSIDIARIES
VARIABLE INTEREST ENTITIES
December 31, 2015 and 2014
(in thousands)

<u>ASSETS</u>	<u>Transition Funding</u>	
	<u>2015</u>	<u>2014</u>
Current Assets	\$ 234,122	\$ 238,509
Other Noncurrent Assets (a)	1,365,684	1,641,540
Total Assets	\$ 1,599,806	\$ 1,880,049
 <u>LIABILITIES AND EQUITY</u>		
Current Liabilities	\$ 291,735	\$ 321,564
Noncurrent Liabilities	1,289,996	1,540,416
Equity	18,075	18,069
Total Liabilities and Equity	\$ 1,599,806	\$ 1,880,049

- (a) Includes an intercompany item eliminated in consolidation as of December 31, 2015 and 2014 of \$68.2 million and \$75.2 million, respectively.

AEPSC provides certain managerial and professional services to AEP's subsidiaries. Parent is the sole equity owner of AEPSC. AEP management controls the activities of AEPSC. The costs of the services are based on a direct charge or on a prorated basis and billed to the AEP subsidiary companies at AEPSC's cost. AEP subsidiaries have not provided financial or other support outside the reimbursement of costs for services rendered. AEPSC finances its operations through cost reimbursement from other AEP subsidiaries. There are no other terms or arrangements between AEPSC and any of the AEP subsidiaries that could require additional financial support from an AEP subsidiary or expose them to losses outside of the normal course of business. AEPSC and its billings are subject to regulation by the FERC. AEP subsidiaries are exposed to losses to the extent they cannot recover the costs of AEPSC through their normal business operations. AEP subsidiaries are considered to have a significant interest in AEPSC due to their activity in AEPSC's cost reimbursement structure. However, AEP subsidiaries do not have control over AEPSC. AEPSC is consolidated by AEP. In the event AEPSC would require financing or other support outside the cost reimbursement billings, this financing would be provided by AEP. TCC's total billings from AEPSC for the years ended December 31, 2015, 2014 and 2013 were \$94.7 million, \$87.4 million and \$69.4 million, respectively. The carrying amount of liabilities associated with AEPSC as of December 31, 2015 and 2014 was \$12.1 million and \$13.3 million, respectively. Management estimates the maximum exposure of loss to be equal to the amount of such liability.

15. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment is shown functionally on the face of TCC's balance sheets. The following table includes TCC's total plant balances for the years ended December 31, 2015 and 2014:

	Years Ended December 31,	
	2015	2014
	(in thousands)	
Regulated Property, Plant and Equipment		
Transmission	\$ 1,722,059	\$ 1,511,307
Distribution	2,567,567	2,425,327
Other	303,496	305,207
CWIP	211,951	202,281
Less: Accumulated Depreciation	887,966	871,019
Total Regulated Property, Plant and Equipment - Net	3,917,107	3,573,103
Nonregulated Property, Plant and Equipment - Net	2,550	1,870
Total Property, Plant and Equipment - Net	\$ 3,919,657	\$ 3,574,973

Depreciation

TCC provides for depreciation of Property, Plant and Equipment on a straight-line basis over the estimated useful lives of property, generally using composite rates by functional class. The following table provides total regulated annual composite depreciation rates and depreciable lives for TCC. Nonregulated depreciation rate ranges and depreciable life ranges are Not Applicable or Not Meaningful (NM) for 2015, 2014 and 2013.

Functional Class of Property	2015		2014		2013	
	Annual Composite Depreciation Rate	Depreciable Life Ranges	Annual Composite Depreciation Rate	Depreciable Life Ranges	Annual Composite Depreciation Rate	Depreciable Life Ranges
		(in years)		(in years)		(in years)
Transmission	1.4%	50 - 81	1.4%	50 - 81	1.5%	50 - 81
Distribution	3.1%	7 - 64	3.1%	22 - 64	3.3%	22 - 64
Other	9.4%	5 - 40	8.2%	15 - 40	7.4%	15 - 40

The composite depreciation rate generally includes a component for non-asset 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)

TCC records ARO in accordance with the accounting guidance for "Asset Retirement and Environmental Obligations" for asbestos removal. TCC has identified, but not recognized, ARO liabilities related to electric transmission and distribution assets, as a result of certain easements on property on which assets are owned. Generally, such easements are perpetual and require only the retirement and removal of assets upon the cessation of the property's use. The retirement obligation is not estimable for such easements since TCC plans to use its facilities indefinitely. The retirement obligation would only be recognized if and when TCC abandons or ceases the use of specific easements, which is not expected.

The following is a reconciliation of the 2015 and 2014 aggregate carrying amounts of ARO for TCC:

<u>Year</u>	<u>ARO as of January 1,</u>	<u>Accretion Expense</u>	<u>Liabilities Incurred</u>	<u>Liabilities Settled</u>	<u>Revisions in Cash Flow Estimates</u>	<u>ARO as of December 31,</u>
	(in thousands)					
2015	\$ 2,333	\$ 143	\$ —	\$ (8)	\$ —	\$ 2,468
2014	2,094	130	20	—	89	2,333

Allowance for Funds Used During Construction (AFUDC)

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

	<u>Years Ended December 31,</u>		
	<u>2015</u>	<u>2014</u>	<u>2013</u>
	(in thousands)		
Allowance for Equity Funds Used During Construction	\$ 6,453	\$ 4,630	\$ 2,576
Allowance for Borrowed Funds Used During Construction	4,096	3,164	1,824

16. COST REDUCTION PROGRAM

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 facilitate an organizational and process evaluation and a second firm to evaluate current employee benefit programs. The process resulted in involuntary severances and was 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.

TCC recorded charges to Other Operation expense of \$23 thousand for the year ended December 31, 2013, primarily related to the sustainable cost reductions initiative.

17. UNAUDITED QUARTERLY FINANCIAL INFORMATION

In management's opinion, the unaudited quarterly information reflects all normal and recurring accruals and adjustments necessary for a fair presentation of the results of operations for interim periods. Quarterly results are not necessarily indicative of a full year's operations because of various factors. TCC's unaudited quarterly financial information is as follows:

	2015 Quarterly Periods Ended			
	<u>March 31</u>	<u>June 30</u>	<u>September 30</u>	<u>December 31</u>
	(in thousands)			
Total Revenues	\$ 273,719	\$ 281,716	\$ 323,374	\$ 273,401
Operating Income	67,129	69,891	73,533	46,733
Net Income	22,848	24,994	28,391	15,016

	2014 Quarterly Periods Ended			
	<u>March 31</u>	<u>June 30</u>	<u>September 30</u>	<u>December 31</u>
	(in thousands)			
Total Revenues	\$ 259,085	\$ 270,104	\$ 308,460	\$ 284,101
Operating Income	72,874	73,826	73,619	69,599
Net Income	26,510	26,088	26,363	23,970