

AEP Generating Company

2019 Third Quarter Report

Financial Statements



BOUNDLESS ENERGYSM

TABLE OF CONTENTS

**Page
Number**

Glossary of Terms	1
Condensed Statements of Income – Unaudited	2
Condensed Statements of Changes in Common Shareholder’s Equity – Unaudited	3
Condensed Balance Sheets – Unaudited	4
Condensed Statements of Cash Flows – Unaudited	6
Index of Condensed Notes to Condensed Financial Statements – Unaudited	7

GLOSSARY OF TERMS

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

Term	Meaning
AEGCo	AEP Generating Company, an AEP electric utility subsidiary.
AEP	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.
ASU	Accounting Standards Update.
Excess ADIT	Excess accumulated deferred income taxes.
FASB	Financial Accounting Standards Board.
FERC	Federal Energy Regulatory Commission.
GAAP	Accounting Principles Generally Accepted in the United States of America.
I&M	Indiana Michigan Power Company, an AEP electric utility subsidiary.
IRS	Internal Revenue Service.
MW	Megawatt.
NSR	New Source Review.
OPEB	Other Postretirement Benefits.
Parent	American Electric Power Company, Inc., the equity owner of AEP subsidiaries within the AEP consolidation.
Rockport Plant	A generation plant, consisting of two 1,310 MW coal-fired generating units near Rockport, Indiana. AEGCo and I&M jointly-own Unit 1. In 1989, AEGCo and I&M entered into a sale-and-leaseback transaction with Wilmington Trust Company, an unrelated, unconsolidated trustee for Rockport Plant, Unit 2.
UMWA	United Mine Workers of America.
Utility Money Pool	Centralized funding mechanism AEP uses to meet the short-term cash requirements of certain utility subsidiaries.

AEP GENERATING COMPANY
CONDENSED STATEMENTS OF INCOME
For the Three and Nine Months Ended September 30, 2019 and 2018
(in thousands)
(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2019	2018	2019	2018
REVENUES				
Sales to AEP Affiliates	\$ 85,594	\$ 85,658	\$ 245,902	\$ 259,760
Other Revenues – Affiliated	5,603	3,785	14,065	12,333
Other Revenues – Nonaffiliated	589	162	728	1,301
TOTAL REVENUES	91,786	89,605	260,695	273,394
EXPENSES				
Fuel and Other Consumables Used for Electric Generation	38,838	42,458	108,513	132,598
Rent – Rockport Plant, Unit 2	16,835	17,070	50,505	51,212
Other Operation	10,262	5,578	22,403	17,578
Maintenance	4,881	5,501	15,106	15,976
Depreciation and Amortization	15,729	11,562	47,054	34,796
Taxes Other Than Income Taxes	1,400	1,146	4,485	3,383
TOTAL EXPENSES	87,945	83,315	248,066	255,543
OPERATING INCOME	3,841	6,290	12,629	17,851
Other Income (Expense):				
Interest Income	360	661	1,613	2,020
Allowance for Equity Funds Used During Construction	835	185	1,955	382
Non-Service Cost Components of Net Periodic Benefit Cost	294	261	883	782
Interest Expense	(1,110)	(1,298)	(4,432)	(3,791)
INCOME BEFORE INCOME TAX EXPENSE (BENEFIT)	4,220	6,099	12,648	17,244
Income Tax Expense (Benefit)	(2,046)	915	(3,582)	2,075
NET INCOME	\$ 6,266	\$ 5,184	\$ 16,230	\$ 15,169

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

See Condensed Notes to Condensed Financial Statements beginning on page 7.

AEP GENERATING COMPANY
CONDENSED STATEMENTS OF CHANGES IN
COMMON SHAREHOLDER'S EQUITY
For the Nine Months Ended September 30, 2019 and 2018
(in thousands)
(Unaudited)

	<u>Common Stock</u>	<u>Paid-in Capital</u>	<u>Retained Earnings</u>	<u>Total</u>
TOTAL COMMON SHAREHOLDER'S EQUITY – DECEMBER 31, 2017	\$ 1,000	\$ 175,487	\$ 94,475	\$ 270,962
Net Income			4,560	4,560
TOTAL COMMON SHAREHOLDER'S EQUITY – MARCH 31, 2018	1,000	175,487	99,035	275,522
Net Income			5,425	5,425
TOTAL COMMON SHAREHOLDER'S EQUITY – JUNE 30, 2018	1,000	175,487	104,460	280,947
Net Income			5,184	5,184
TOTAL COMMON SHAREHOLDER'S EQUITY – SEPTEMBER 30, 2018	<u>\$ 1,000</u>	<u>\$ 175,487</u>	<u>\$ 109,644</u>	<u>\$ 286,131</u>
TOTAL COMMON SHAREHOLDER'S EQUITY – DECEMBER 31, 2018	\$ 1,000	\$ 165,487	\$ 54,913	\$ 221,400
Net Income			3,378	3,378
TOTAL COMMON SHAREHOLDER'S EQUITY – MARCH 31, 2019	1,000	165,487	58,291	224,778
Net Income			6,586	6,586
TOTAL COMMON SHAREHOLDER'S EQUITY – JUNE 30, 2019	1,000	165,487	64,877	231,364
Net Income			6,266	6,266
TOTAL COMMON SHAREHOLDER'S EQUITY – SEPTEMBER 30, 2019	<u>\$ 1,000</u>	<u>\$ 165,487</u>	<u>\$ 71,143</u>	<u>\$ 237,630</u>

See Condensed Notes to Condensed Financial Statements beginning on page 7.

AEP GENERATING COMPANY
CONDENSED BALANCE SHEETS
ASSETS
September 30, 2019 and December 31, 2018
(in thousands)
(Unaudited)

	September 30, 2019	December 31, 2018
CURRENT ASSETS		
Advances to Affiliates	\$ 88,944	\$ 70,904
Accounts Receivable:		
Customers	—	466
Affiliated Companies	28,849	30,196
Total Accounts Receivable	28,849	30,662
Fuel	39,832	37,289
Materials and Supplies	18,959	18,062
Accrued Tax Benefits	3,038	1,558
Prepayments and Other Current Assets	1,419	570
TOTAL CURRENT ASSETS	181,041	159,045
PROPERTY, PLANT AND EQUIPMENT		
Electric Generation	1,126,972	1,125,208
Other Property, Plant and Equipment	37,087	35,564
Construction Work in Progress	94,945	50,525
Total Property, Plant and Equipment	1,259,004	1,211,297
Accumulated Depreciation and Amortization	768,136	719,684
TOTAL PROPERTY, PLANT AND EQUIPMENT – NET	490,868	491,613
OTHER NONCURRENT ASSETS		
Regulatory Assets	16,499	14,671
Operating Lease Assets	236,158	—
Deferred Charges and Other Noncurrent Assets	2,675	1,871
TOTAL OTHER NONCURRENT ASSETS	255,332	16,542
TOTAL ASSETS	\$ 927,241	\$ 667,200

See Condensed Notes to Condensed Financial Statements beginning on page 7.

AEP GENERATING COMPANY
CONDENSED BALANCE SHEETS
LIABILITIES AND COMMON SHAREHOLDER'S EQUITY
September 30, 2019 and December 31, 2018
(Unaudited)

	September 30,	December 31,
	2019	2018
CURRENT LIABILITIES	(in thousands)	
<hr/>		
Accounts Payable:		
General	\$ 2,854	\$ 2,151
Affiliated Companies	16,826	23,250
Long-term Debt Due Within One Year – Nonaffiliated	—	45,000
Accrued Taxes	5,258	6,451
Accrued Rent – Rockport Plant, Unit 2	2,837	4,963
Obligations Under Operating Leases	69,920	—
Other Current Liabilities	7,387	3,463
TOTAL CURRENT LIABILITIES	105,082	85,278
<hr/>		
NONCURRENT LIABILITIES		
<hr/>		
Long-term Debt – Nonaffiliated	194,562	149,988
Deferred Income Taxes	35,590	30,872
Regulatory Liabilities and Deferred Investment Tax Credits	95,520	90,008
Deferred Gain on Sale-and-Leaseback – Rockport Plant, Unit 2	—	21,911
Obligations Under Operating Leases	184,918	—
Deferred Credits and Other Noncurrent Liabilities	73,939	67,743
TOTAL NONCURRENT LIABILITIES	584,529	360,522
TOTAL LIABILITIES	689,611	445,800
<hr/>		
Commitments and Contingencies (Note 3)		
<hr/>		
COMMON SHAREHOLDER'S EQUITY		
<hr/>		
Common Stock – Par Value – \$1,000 Per Share:		
Authorized – 1,000 Shares		
Outstanding – 1,000 Shares	1,000	1,000
Paid-in Capital	165,487	165,487
Retained Earnings	71,143	54,913
TOTAL COMMON SHAREHOLDER'S EQUITY	237,630	221,400
TOTAL LIABILITIES AND COMMON SHAREHOLDER'S EQUITY	\$ 927,241	\$ 667,200

See Condensed Notes to Condensed Financial Statements beginning on page 7.

AEP GENERATING COMPANY
CONDENSED STATEMENTS OF CASH FLOWS
For the Nine Months Ended September 30, 2019 and 2018
(in thousands)
(Unaudited)

	Nine Months Ended September 30,	
	2019	2018
OPERATING ACTIVITIES		
Net Income	\$ 16,230	\$ 15,169
Adjustments to Reconcile Net Income to Net Cash Flows from Operating Activities:		
Depreciation and Amortization	47,054	34,796
Rent - Rockport Plant, Unit 2	50,505	—
Deferred Income Taxes	(1,058)	2,821
Allowance for Equity Funds Used During Construction	(1,955)	(382)
Change in Other Noncurrent Assets	3,941	597
Change in Other Noncurrent Liabilities	(3,310)	(4,860)
Changes in Certain Components of Working Capital:		
Accounts Receivable	1,813	7,730
Fuel, Materials and Supplies	(3,440)	3,671
Accounts Payable	(5,892)	(1,368)
Accrued Taxes, Net	(2,673)	(5,573)
Accrued Rent – Rockport Plant, Unit 2	—	18,464
Payments for Rockport Plant, Unit 2 Operating Lease	(36,927)	—
Other Current Assets	(853)	(3,959)
Other Current Liabilities	3,727	(492)
Net Cash Flows from Operating Activities	67,162	66,614
INVESTING ACTIVITIES		
Construction Expenditures	(47,570)	(18,965)
Change in Advances to Affiliates, Net	(18,040)	(46,627)
Other Investing Activities	(6)	174
Net Cash Flows Used for Investing Activities	(65,616)	(65,418)
FINANCING ACTIVITIES		
Issuance of Long-term Debt - Nonaffiliated	44,704	—
Retirement of Long-term Debt – Nonaffiliated	(45,000)	—
Principal Payments for Finance Lease Obligations	(1,261)	(1,212)
Other Financing Activities	11	16
Net Cash Flows Used for Financing Activities	(1,546)	(1,196)
Net Change in Cash and Cash Equivalents	—	—
Cash and Cash Equivalents at Beginning of Period	—	—
Cash and Cash Equivalents at End of Period	\$ —	\$ —
SUPPLEMENTARY INFORMATION		
Cash Paid for Interest, Net of Capitalized Amounts	\$ 3,666	\$ 3,192
Net Cash Paid for Income Taxes	1,751	6,542
Noncash Acquisitions Under Finance Leases	221	30
Construction Expenditures Included in Current Liabilities as of September 30,	288	112

See Condensed Notes to Condensed Financial Statements beginning on page 7.

INDEX OF CONDENSED NOTES TO CONDENSED FINANCIAL STATEMENTS

Note	Page Number
Significant Accounting Matters	8
New Accounting Standards	9
Commitments, Guarantees and Contingencies	11
Benefit Plans	13
Fair Value Measurements	14
Income Taxes	15
Leases	16
Financing Activities	19
Revenue from Contracts with Customers	20

1. SIGNIFICANT ACCOUNTING MATTERS

General

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

In the opinion of management, the unaudited condensed interim financial statements reflect all normal and recurring accruals and adjustments necessary for a fair statement of the net income, financial position and cash flows for the interim periods. Net income for the three and nine months ended September 30, 2019 is not necessarily indicative of results that may be expected for the year ending December 31, 2019. The condensed financial statements are unaudited and should be read in conjunction with the audited 2018 financial statements and notes thereto, which are included in AEGCo's 2018 Annual Report.

Subsequent Events

Management reviewed subsequent events through October 24, 2019, the date that the third quarter 2019 report was available to be issued.

2. NEW ACCOUNTING STANDARDS

During the FASB's standard-setting process and upon issuance of final standards, management reviews the new accounting literature to determine its relevance, if any, to AEGCo's business. The following standards will impact the financial statements.

ASU 2016-02 "Accounting for Leases" (ASU 2016-02)

In February 2016, the FASB issued ASU 2016-02 increasing the transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheets and disclosing key information about leasing arrangements. Under the new standard, an entity must recognize an asset and liability for operating leases on the balance sheets. Additionally, capital leases are known as finance leases going forward. Leases with terms of 12 months or longer are also subject to the new requirements. Fundamentally, the criteria used to determine lease classification remains the same, but is more subjective under the new standard.

New leasing standard implementation activities included the identification of the lease population within the AEP System as well as the sampling of representative lease contracts to analyze accounting treatment under the new accounting guidance. Based upon the completed assessments, management also prepared a gap analysis to outline new disclosure compliance requirements.

Management adopted ASU 2016-02 effective January 1, 2019 by means of a cumulative-effect adjustment to the balance sheet. Management elected the following practical expedients upon adoption:

Practical Expedient	Description
Overall Expedients (for leases commenced prior to adoption date and must be adopted as a package)	Do not need to reassess whether any expired or existing contracts are/or contain leases, do not need to reassess the lease classification for any expired or existing leases and do not need to reassess initial direct costs for any existing leases.
Lease and Non-lease Components (elect by class of underlying asset)	Elect as an accounting policy to not separate non-lease components from lease components and instead account for each lease and associated non-lease component as a single lease component.
Short-term Lease (elect by class of underlying asset)	Elect as an accounting policy to not apply the recognition requirements to short-term leases.
Existing and expired land easements not previously accounted for as leases	Elect optional transition practical expedient to not evaluate under Topic 842 existing or expired land easements that were not previously accounted for as leases under the current leases guidance in Topic 840.
Cumulative-effect adjustment in the period of adoption	Elect the optional transition practical expedient to adopt the new lease requirements through a cumulative-effect adjustment on the balance sheet in the period of adoption.

Management concluded that the result of adoption would not materially change the volume of contracts that qualify as leases going forward. The adoption of the new standard did not materially impact results of operations or cash flows, but did have a material impact on the balance sheet. See Note 7 - Leases for additional disclosures required by the new standard.

ASU 2016-13 "Measurement of Credit Losses on Financial Instruments" (ASU 2016-13)

In June 2016, the FASB issued ASU 2016-13 requiring the recognition of an allowance for expected credit losses for financial instruments within its scope. Examples of financial instruments that are in scope include trade receivables, certain financial guarantees, and held-to-maturity debt securities. The allowance for expected credit losses should be based on historical information, current conditions and reasonable and supportable forecasts. The new standard also revises the other-than-temporary impairment model for available-for-sale debt securities.

The new accounting guidance is effective for interim and annual periods beginning after December 15, 2019, with early adoption permitted for interim and annual periods beginning after December 15, 2018. The amendments will be applied through a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective.

Management continues to analyze the impact of this new standard. Implementation activities to date include the identification of the population of financial instruments within AEGCo that are subject to the new standard, and evaluations to determine whether the new expected loss recognition model will cause any material changes to previously calculated allowance balances and supporting valuation models. Based on the assessments performed to date, Management does not expect the new standard to have a material impact on results of operations, financial position or cash flows.

Management's implementation activities, including an assessment of the new standard's disclosure requirements will continue throughout the fourth quarter of 2019. Management will continue to analyze the related impacts to allowances for credit losses and monitor for any potential industry implementation issues. Additionally, Management does not anticipate any significant changes to current accounting systems because of the adoption of the new standard. Management plans to adopt ASU 2016-13 and its related implementation guidance effective January 1, 2020.

3. COMMITMENTS, GUARANTEES AND CONTINGENCIES

AEGCo is subject to certain claims and legal actions arising in its ordinary course of business. In addition, AEGCo's business activities are subject to extensive governmental regulation related to public health and the environment. The ultimate outcome of such pending or potential litigation against AEGCo 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. The Commitments, Guarantees and Contingencies note within AEGCo's 2018 Annual Report should be read in conjunction with this report.

GUARANTEES

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

Indemnifications and Other Guarantees

Contracts

AEGCo enters into certain types of contracts which require indemnifications. Typically these contracts include, but are not limited to, sale agreements, lease agreements, purchase agreements and financing agreements. Generally, these agreements may include, but are not limited to, indemnifications around certain tax, contractual and environmental matters. With respect to sale agreements, exposure generally does not exceed the sale price. As of September 30, 2019, there were no material liabilities recorded for any indemnifications.

CONTINGENCIES

Rockport Plant Litigation

In 2013, the Wilmington Trust Company filed a complaint in the U.S. District Court for the Southern District of New York against AEGCo and I&M alleging that it would be unlawfully burdened by the terms of the modified NSR consent decree after the Rockport Plant, Unit 2 lease expiration in December 2022. The terms of the consent decree allow the installation of environmental emission control equipment, repowering, refueling or retirement of the unit. The plaintiffs seek a judgment declaring that the defendants breached the lease, must satisfy obligations related to installation of emission control equipment and indemnify the plaintiffs. The New York court granted a motion to transfer this case to the U.S. District Court for the Southern District of Ohio.

AEGCo and I&M sought and were granted dismissal by the U.S. District Court for the Southern District of Ohio of certain of the plaintiffs' claims, including claims for compensatory damages, breach of contract, breach of the implied covenant of good faith and fair dealing and indemnification of costs. Plaintiffs voluntarily dismissed the surviving claims that AEGCo and I&M failed to exercise prudent utility practices with prejudice, and the court issued a final judgment. The plaintiffs subsequently filed an appeal in the U.S. Court of Appeals for the Sixth Circuit.

In 2017, the U.S. Court of Appeals for the Sixth Circuit issued an opinion and judgment affirming the district court's dismissal of the owners' breach of good faith and fair dealing claim as duplicative of the breach of contract claims, reversing the district court's dismissal of the breach of contract claims and remanding the case for further proceedings.

Thereafter, AEP filed a motion with the U.S. District Court for the Southern District of Ohio in the original NSR litigation, seeking to modify the consent decree. The district court granted the owners' unopposed motion to stay the lease litigation to afford time for resolution of AEP's motion to modify the consent decree. The consent decree was modified based on an agreement among the parties in July 2019. As part of the modification to the consent decree, I&M agreed to provide an additional \$7.5 million to citizens' groups and the states for environmental mitigation projects. As joint owners in the Rockport Plant, the \$7.5 million payment was shared between AEGCo and I&M based on the joint ownership agreement.

Management will continue to defend against the claims. Given that the district court dismissed plaintiffs' claims seeking compensatory relief as premature, and that plaintiffs have yet to present a methodology for determining or any analysis supporting any alleged damages, management cannot determine a range of potential losses that are reasonably possible of occurring.

4. BENEFIT PLANS

AEGCo participates in an AEP sponsored qualified pension plan. Substantially all of AEGCo's employees who are not UMWA members are covered by the qualified plan. AEGCo also participates in OPEB plans sponsored by AEP to provide health and life insurance benefits for retired employees.

Components of Net Periodic Benefit Cost

The following tables provide the components of AEGCo's net periodic benefit cost (credit) for the plans:

	Pension Plan		OPEB	
	Three Months Ended September 30, 2019	2018	Three Months Ended September 30, 2019	2018
	(in thousands)			
Service Cost	\$ 23	\$ 21	\$ 203	\$ 291
Interest Cost	31	30	508	504
Expected Return on Plan Assets	(67)	(64)	(621)	(685)
Amortization of Prior Service Credit	—	—	(17)	(17)
Amortization of Net Actuarial Loss	9	13	98	180
Net Periodic Benefit Cost (Credit)	\$ (4)	\$ —	\$ 171	\$ 273

	Pension Plan		OPEB	
	Nine Months Ended September 30, 2019	2018	Nine Months Ended September 30, 2019	2018
	(in thousands)			
Service Cost	\$ 69	\$ 63	\$ 607	\$ 871
Interest Cost	93	89	1,523	1,513
Expected Return on Plan Assets	(201)	(191)	(1,864)	(2,055)
Amortization of Prior Service Credit	—	—	(51)	(51)
Amortization of Net Actuarial Loss	25	39	296	541
Net Periodic Benefit Cost (Credit)	\$ (14)	\$ —	\$ 511	\$ 819

5. FAIR VALUE MEASUREMENTS

Fair Value Hierarchy and Valuation Techniques

The accounting guidance for “Fair Value Measurements and Disclosures” establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement). Where observable inputs are available for substantially the full term of the asset or liability, the instrument is categorized in Level 2. When quoted market prices are not available, pricing may be completed using comparable securities, dealer values, operating data and general market conditions to determine fair value. Valuation models utilize various inputs such as commodity, interest rate and, to a lesser degree, volatility and credit that include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in inactive markets, market corroborated inputs (i.e. inputs derived principally from, or correlated to, observable market data) and other observable inputs for the asset or liability.

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 AEGCo’s Long-term Debt are summarized in the following table:

	September 30, 2019		December 31, 2018	
	Book Value	Fair Value	Book Value	Fair Value
		(in thousands)		
Long-term Debt	\$ 194,562	\$ 194,679	\$ 194,988	\$ 195,000

6. INCOME TAXES

Effective Tax Rates (ETR)

AEGCo's interim ETR reflects the estimated annual ETR for 2019 and 2018, adjusted for tax expense associated with certain discrete items. The interim ETR differ from the federal statutory tax rate of 21% primarily due to increased amortization of Excess ADIT, tax credits and other book/tax differences which are accounted for on a flow-through basis.

The ETR for AEGCo are included in the following table. Significant variances in the ETR are described below.

Three Months Ended September 30,		Nine Months Ended September 30,	
2019	2018	2019	2018
<u>(48.5)%</u>	<u>15.0%</u>	<u>(28.3)%</u>	<u>12.0%</u>

Three Months Ended September 30, 2019 Compared to Three Months Ended September 30, 2018

The decrease in ETR was primarily due to \$1.7 million of increased favorable book/tax differences accounted for on a flow-through basis and \$1 million of increased amortization of Excess ADIT subject to normalization requirements which impacted the ETR by (39.2)% and (24.4)%, respectively. The increased amortization of Excess ADIT was primarily driven by the acceleration in the expected retirement date of Rockport Plant, Unit 1 from 2044 to 2028.

Nine Months Ended September 30, 2019 Compared to Nine Months Ended September 30, 2018

The decrease in ETR was primarily due to \$3.3 million of increased amortization of Excess ADIT subject to normalization requirements and \$1.5 million of increased amortization of Excess ADIT not subject to normalization requirements which impacted the ETR by (26.5)% and (12)%, respectively. The increased amortization of Excess ADIT was primarily driven by the acceleration in the expected retirement date of Rockport Plant, Unit 1 from 2044 to 2028.

Federal and State Income Tax Audit Status

AEGCo and other AEP subsidiaries are no longer subject to U.S. federal examination by the IRS for all years through 2013. During the IRS examination of years 2011 through 2014, the statute of limitations for these years was extended to coincide with the examination of 2015. During the third quarter of 2019, AEGCo and other AEP subsidiaries amended the 2014 and 2015 federal returns. Due to the amendment of these federal returns, the 2014 and 2015 years will remain open for possible IRS examination of the items that were amended on the 2014 and 2015 federal returns. The IRS examination of 2016 began in October 2018 and concluded in March 2019.

7. LEASES

AEGCo leases property, plant and equipment which primarily includes the lease of Rockport Plant, Unit 2. AEGCo's lease portfolio also includes fleet and real estate leases. These leases require payments of non-lease components, including related property taxes, operating and maintenance costs. As of the adoption date of ASU 2016-02, management elected not to separate non-lease components from associated lease components in accordance with the accounting guidance for "Leases." Many of these leases have purchase or renewal options. Leases not renewed are often replaced by other leases. Options to renew or purchase a lease are included in the measurement of lease assets and liabilities if it is reasonably certain that AEGCo will exercise the option.

Lease obligations are measured using the discount rate implicit in the lease when that rate is readily determinable. When the implicit rate is not readily determinable, AEGCo measures its lease obligation using its estimated secured incremental borrowing rate. Incremental borrowing rates are comprised of an underlying risk free rate and a secured credit spread relative to the lessee on a matched maturity basis.

Lease rentals for both operating and finance leases are generally charged to Other Operation and Maintenance expense in accordance with rate-making treatment for regulated operations. Additionally, for regulated operations with finance leases, a finance 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 were as follows:

Lease Rental Costs	Three Months Ended September 30, 2019	Nine Months Ended September 30, 2019
	(in thousands)	
Operating Lease Cost	\$ 19,375	\$ 58,114
Amortization of Finance Leases	475	1,384
Interest on Finance Leases	343	1,054
Total Lease Rental Costs (a)	\$ 20,193	\$ 60,552

- (a) Excludes variable and short-term lease costs, which were immaterial for the three and nine months ended September 30, 2019.

Supplemental information related to leases as of and for the nine months ended September 30, 2019 are shown in the tables below.

Lease Type	Weighted-Average Remaining Lease Term (years):	Weighted-Average Discount Rate
Operating Leases	3.34	3.49%
Finance Leases	4.97	4.54%
Nine Months Ended September 30, 2019 (in thousands)		
Cash paid for amounts included in the measurement of lease liabilities:		
Operating Cash Flows Used for Operating Leases	\$	41,059
Operating Cash Flows Used for Finance Leases		953
Financing Cash Flows Used for Finance Leases		1,261
Non-cash Acquisitions Under Operating Leases	\$	—

The following tables show the property, plant and equipment under finance leases and noncurrent assets under operating leases and related obligations recorded on AEGCo's balance sheets. Unless shown as a separate line on the balance sheets due to materiality, current finance lease obligations are included in Other Current Liabilities and long-term finance lease obligations are included in Deferred Credits and Other Noncurrent Liabilities on AEGCo's balance sheets. Lease obligations are not recognized on the balance sheets for lease agreements with a lease term of less than twelve months.

	September 30, 2019	
	(in thousands)	
Property, Plant and Equipment Under Finance Leases		
Generation	\$	25,291
Other Property, Plant and Equipment		1,706
Total Property, Plant and Equipment Under Capital Leases		26,997
Accumulated Amortization		9,894
Net Property, Plant and Equipment Under Finance Leases	\$	17,103
Obligations Under Finance Leases		
Noncurrent Liability	\$	15,249
Liability Due Within One Year		1,854
Total Obligations Under Finance Leases	\$	17,103
Operating Lease Assets		
	\$	236,158
Obligations Under Operating Leases		
Noncurrent Liability	\$	184,918
Liability Due Within One Year		69,920
Total Obligations Under Operating Leases	\$	254,838

Future minimum lease payments as of September 30, 2019 are presented on a rolling 12-month basis as shown in the table below:

Future Minimum Lease Payments	Finance Leases Operating Leases	
	(in thousands)	
Year 1	\$ 3,268	\$ 78,409
Year 2	3,235	77,997
Year 3	3,108	77,976
Year 4	3,029	38,784
Year 5	2,904	10
Later Years	6,726	7
Total Future Minimum Lease Payments	22,270	273,183
Less Imputed Interest	5,167	18,345
Estimated Present Value of Future Minimum Lease Payments	\$ 17,103	\$ 254,838

Future minimum lease payments consisted of the following as of December 31, 2018:

<u>Future Minimum Lease Payments</u>	<u>Finance Leases</u>	<u>Operating Leases</u>
	(in thousands)	
2019	\$ 3,240	\$ 78,415
2020	3,230	78,309
2021	3,169	77,993
2022	3,074	77,968
2023	2,964	336
Later Years	8,524	13
Total Future Minimum Lease Payments	<u>24,201</u>	<u>\$ 313,034</u>
Less Imputed Interest	5,936	
Estimated Present Value of Future Minimum Lease Payments	<u>\$ 18,265</u>	

Master Lease Agreements

AEGCo leases certain equipment under master lease agreements. Under the lease agreements, the lessor is guaranteed a residual value up to a stated percentage of 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, AEGCo 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 amount guaranteed. As of September 30, 2019, the maximum potential loss for these lease agreements was \$33 thousand assuming the fair value of the equipment is zero at the end of the lease term.

Rockport Lease

AEGCo and I&M entered into a sale-and-leaseback transaction in 1989 with Wilmington Trust Company (Owner Trustee), an unrelated, unconsolidated trustee for Rockport Plant, Unit 2 (the Plant). The Owner Trustee was capitalized with equity from six owner participants with no relationship to AEP or any of its subsidiaries and debt from a syndicate of banks and securities in a private placement to certain institutional investors. In the first quarter of 2019, in accordance with ASU 2016-02, the \$21.9 million unamortized gain associated with the sale-and-leaseback of the Plant was recognized as an adjustment to equity. The adjustment to equity was then reclassified to regulatory liabilities in accordance with accounting guidance for “Regulated Operations” as AEGCo and I&M will continue to provide the benefit of the unamortized gain to customers in future periods.

The Owner Trustee owns the Plant and leases equal portions to AEGCo and I&M. The lease is accounted for as an operating lease with the payment obligations included in the future minimum lease payments schedule earlier in this note. The lease term is for 33 years and at the end of the lease term, AEGCo and I&M have the option to renew the lease at a rate that approximates fair value. The option to renew was not included in the measurement of the lease obligation as of September 30, 2019 as the execution of the option was not reasonably certain. AEP, AEGCo and I&M have no ownership interest in the Owner Trustee and do not guarantee its debt. AEGCo’s future minimum lease payments for this sale-and-leaseback transaction as of September 30, 2019 were as follows:

<u>Future Minimum Lease Payments</u>	(in thousands)
2019	\$ 37,127
2020	73,854
2021	73,854
2022	73,654
Total Future Minimum Lease Payments	<u>\$ 258,489</u>

Lessor Activity

AEGCo’s lessor activity was immaterial as of and for the three and nine months ended September 30, 2019.

8. FINANCING ACTIVITIES

Long-term Debt

Long-term debt issued and retired during the first nine months of 2019 are shown in the following tables.

Type of Issuance	Principal Amount (a) (in thousands)	Interest Rate (%)	Due Date
Pollution Control Bonds	\$ 45,000	1.35	2022

(a) Amounts indicated on the statements of cash flows are net of issuance costs and premium or discount and will not tie to the issuance amounts.

Type of Retirement	Principal Amount Paid (in thousands)	Interest Rate (%)	Due Date
Pollution Control Bonds	\$ 45,000	Variable	2019

Dividend Restrictions

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

AEGCo has credit agreements that contain a covenant that limit its debt to capitalization ratio to 67.5%. As of September 30, 2019, AEGCo did not exceed its debt to capitalization limit. The method for calculating outstanding debt and capitalization is contractually-defined in the credit agreements.

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 its agreement filed with the FERC. The amounts of outstanding loans to the Utility Money Pool as of September 30, 2019 and December 31, 2018 are included in Advances to Affiliates on AEGCo's balance sheets. AEGCo's Utility Money Pool activity and corresponding authorized borrowing limit for the nine months ended September 30, 2019 are described in the following table:

Maximum Loans to the Utility Money Pool	Average Loans to the Utility Money Pool	Loans to the Utility Money Pool as of September 30, 2019	Authorized Short-Term Borrowing Limit
(in thousands)			
\$ 112,593	\$ 78,490	\$ 88,944	\$ 200,000

Maximum, minimum and average interest rates for funds loaned to the Utility Money Pool are summarized in the following table:

Nine Months Ended September 30,	Maximum Interest Rate for Funds Loaned to the Utility Money Pool	Minimum Interest Rate for Funds Loaned to the Utility Money Pool	Average Interest Rate for Funds Loaned to the Utility Money Pool
2019	3.43%	1.83%	2.71%
2018	2.52%	1.81%	2.19%

9. REVENUE FROM CONTRACTS WITH CUSTOMERS

Disaggregated Revenues from Contracts with Customers

AEGCo's statements of income represent revenues from contracts with customers by type of revenue. AEGCo did not have alternative revenues for the three and nine months ended September 30, 2019 and September 30, 2018.

Fixed Performance Obligations

As of September 30, 2019, there are no fixed performance obligations related to AEGCo.

Contract Assets and Liabilities

Contract assets are recognized when AEGCo has a right to consideration that is conditional upon the occurrence of an event other than the passage of time, such as future performance under a contract. AEGCo did not have material contract assets as of September 30, 2019 and December 31, 2018.

When AEGCo receives consideration, or such consideration is unconditionally due from a customer prior to transferring goods or services to the customer under the terms of a sales contract, they recognize a contract liability on the balance sheet in the amount of that consideration. Revenue for such consideration is subsequently recognized in the period or periods in which the remaining performance obligations in the contract are satisfied. AEGCo did not have material contract liabilities as of September 30, 2019 and December 31, 2018.

Accounts Receivable from Contracts with Customers

Accounts receivable from contracts with customers are presented on AEGCo's balance sheets within the Accounts Receivable - Customers and Accounts Receivable - Affiliated Companies line items. AEGCo's balances for receivables from contracts that are not recognized in accordance with the accounting guidance for "Revenue from Contracts with Customers" included in Accounts Receivable - Customers and Accounts Receivable - Affiliated Companies were not material as of September 30, 2019 and December 31, 2018.