

AEP Generating Company

2020 Third Quarter Report

Financial Statements



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GLOSSARY OF TERMS

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

Term	Meaning
AEGCo	AEP Generating Company, an AEP electric utility subsidiary.
AEP	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.
NSR	New Source Review.
OPEB	Other Postretirement Benefits.
Parent	American Electric Power Company, Inc., the equity owner of AEP subsidiaries within the AEP consolidation.
Reference Rate Reform	The global transition away from referencing the London Interbank Offered Rate and other interbank offered rates, and toward new reference rates that are more reliable and robust.
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.
Tax Reform	On December 22, 2017, President Trump signed into law legislation referred to as the “Tax Cuts and Jobs Act” (the TCJA). The TCJA includes significant changes to the Internal Revenue Code of 1986, including a reduction in the corporate federal income tax rate from 35% to 21% effective January 1, 2018.
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, 2020 and 2019
(in thousands)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
REVENUES				
Sales to AEP Affiliates	\$ 79,800	\$ 85,594	\$ 193,938	\$ 245,902
Other Revenues – Affiliated	3,645	5,603	11,185	14,065
Other Revenues – Nonaffiliated	54	589	162	728
TOTAL REVENUES	<u>83,499</u>	<u>91,786</u>	<u>205,285</u>	<u>260,695</u>
EXPENSES				
Fuel and Other Consumables Used for Electric Generation	25,899	38,838	56,220	108,513
Rent – Rockport Plant, Unit 2	16,835	16,835	50,505	50,505
Other Operation	7,313	10,262	17,988	22,403
Maintenance	3,650	4,881	11,681	15,106
Depreciation and Amortization	24,250	15,729	56,274	47,054
Taxes Other Than Income Taxes	1,470	1,400	4,198	4,485
TOTAL EXPENSES	<u>79,417</u>	<u>87,945</u>	<u>196,866</u>	<u>248,066</u>
OPERATING INCOME	4,082	3,841	8,419	12,629
Other Income (Expense):				
Interest Income	14	360	386	1,613
Allowance for Equity Funds Used During Construction	266	835	3,078	1,955
Non-Service Cost Components of Net Periodic Benefit Cost	799	294	2,399	883
Interest Expense	(830)	(1,110)	(2,324)	(4,432)
INCOME BEFORE INCOME TAX BENEFIT	4,331	4,220	11,958	12,648
Income Tax Benefit	(687)	(2,046)	(2,146)	(3,582)
NET INCOME	<u>\$ 5,018</u>	<u>\$ 6,266</u>	<u>\$ 14,104</u>	<u>\$ 16,230</u>

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, 2020 and 2019
(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, 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>
TOTAL COMMON SHAREHOLDER'S EQUITY - DECEMBER 31, 2019	\$ 1,000	\$ 165,487	\$ 75,706	\$ 242,193
Common Stock Dividends			(26,500)	(26,500)
Net Income			4,951	4,951
TOTAL COMMON SHAREHOLDER'S EQUITY - MARCH 31, 2020	1,000	165,487	54,157	220,644
Common Stock Dividends			(6,500)	(6,500)
Net Income			4,135	4,135
TOTAL COMMON SHAREHOLDER'S EQUITY - JUNE 30, 2020	1,000	165,487	51,792	218,279
Net Income			5,018	5,018
TOTAL COMMON SHAREHOLDER'S EQUITY - SEPTEMBER 30, 2020	<u>\$ 1,000</u>	<u>\$ 165,487</u>	<u>\$ 56,810</u>	<u>\$ 223,297</u>

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

AEP GENERATING COMPANY
CONDENSED BALANCE SHEETS
ASSETS
September 30, 2020 and December 31, 2019
(in thousands)
(Unaudited)

	September 30, 2020	December 31, 2019
CURRENT ASSETS		
Advances to Affiliates	\$ 23,396	\$ 56,773
Accounts Receivable:		
Customers	4	5
Affiliated Companies	29,345	20,527
Total Accounts Receivable	29,349	20,532
Fuel	71,317	56,205
Materials and Supplies	19,144	19,017
Prepayments and Other Current Assets	4,605	2,152
TOTAL CURRENT ASSETS	147,811	154,679
PROPERTY, PLANT AND EQUIPMENT		
Electric Generation	1,243,036	1,130,046
Other Property, Plant and Equipment	35,989	39,399
Construction Work in Progress	25,676	108,241
Total Property, Plant and Equipment	1,304,701	1,277,686
Accumulated Depreciation and Amortization	839,183	784,124
TOTAL PROPERTY, PLANT AND EQUIPMENT – NET	465,518	493,562
OTHER NONCURRENT ASSETS		
Regulatory Assets	8,678	5,672
Operating Lease Assets	166,362	218,949
Deferred Charges and Other Noncurrent Assets	3,451	2,521
TOTAL OTHER NONCURRENT ASSETS	178,491	227,142
TOTAL ASSETS	\$ 791,820	\$ 875,383

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, 2020 and December 31, 2019
(Unaudited)

	September 30, 2020	December 31, 2019
CURRENT LIABILITIES	(in thousands)	
Accounts Payable:		
General	\$ 1,319	\$ 3,588
Affiliated Companies	13,255	18,245
Long-term Debt Due Within One Year – Nonaffiliated	150,000	150,000
Accrued Taxes	8,033	8,283
Accrued Rent – Rockport Plant, Unit 2	2,065	614
Obligations Under Operating Leases	71,993	71,128
Other Current Liabilities	4,227	6,286
TOTAL CURRENT LIABILITIES	250,892	258,144
NONCURRENT LIABILITIES		
Long-term Debt – Nonaffiliated	44,605	44,538
Deferred Income Taxes	22,091	26,240
Regulatory Liabilities and Deferred Investment Tax Credits	78,424	91,736
Obligations Under Operating Leases	112,897	150,799
Deferred Credits and Other Noncurrent Liabilities	59,614	61,733
TOTAL NONCURRENT LIABILITIES	317,631	375,046
TOTAL LIABILITIES	568,523	633,190
Commitments and Contingencies (Note 3)		
COMMON SHAREHOLDER'S EQUITY		
Common Stock – Par Value – \$1,000 Per Share:		
Authorized – 1,000 Shares		
Outstanding – 1,000 Shares	1,000	1,000
Paid-in Capital	165,487	165,487
Retained Earnings	56,810	75,706
TOTAL COMMON SHAREHOLDER'S EQUITY	223,297	242,193
TOTAL LIABILITIES AND COMMON SHAREHOLDER'S EQUITY	\$ 791,820	\$ 875,383

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, 2020 and 2019
(in thousands)
(Unaudited)

	Nine Months Ended September 30,	
	2020	2019
OPERATING ACTIVITIES		
Net Income	\$ 14,104	\$ 16,230
Adjustments to Reconcile Net Income to Net Cash Flows from Operating Activities:		
Depreciation and Amortization	56,274	47,054
Rockport Plant, Unit 2 Operating Lease Amortization	50,505	50,505
Deferred Income Taxes	(8,367)	(1,058)
Allowance for Equity Funds Used During Construction	(3,078)	(1,955)
Change in Other Noncurrent Assets	5,472	3,941
Change in Other Noncurrent Liabilities	(870)	(3,310)
Changes in Certain Components of Working Capital:		
Accounts Receivable	(8,817)	1,813
Fuel, Materials and Supplies	(15,239)	(3,440)
Accounts Payable	(5,931)	(5,892)
Accrued Taxes, Net	(259)	(2,673)
Rockport Plant, Unit 2 Operating Lease Payments	(36,927)	(36,927)
Other Current Assets	(2,446)	(853)
Other Current Liabilities	(6,053)	3,727
Net Cash Flows from Operating Activities	38,368	67,162
INVESTING ACTIVITIES		
Construction Expenditures	(37,346)	(47,570)
Change in Advances to Affiliates, Net	33,377	(18,040)
Other Investing Activities	—	(6)
Net Cash Flows Used for Investing Activities	(3,969)	(65,616)
FINANCING ACTIVITIES		
Issuance of Long-term Debt - Nonaffiliated	—	44,704
Retirement of Long-term Debt – Nonaffiliated	—	(45,000)
Principal Payments for Finance Lease Obligations	(1,390)	(1,261)
Dividends Paid on Common Stock	(33,000)	—
Other Financing Activities	(9)	11
Net Cash Flows Used for Financing Activities	(34,399)	(1,546)
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	\$ 2,123	\$ 3,666
Net Cash Paid for Income Taxes	9,425	1,751
Noncash Acquisitions Under Finance Leases	54	221
Construction Expenditures Included in Current Liabilities as of September 30,	79	288

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

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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, 2020 is not necessarily indicative of results that may be expected for the year ending December 31, 2020. The condensed financial statements are unaudited and should be read in conjunction with the audited 2019 financial statements and notes thereto, which are included in AEGCo's 2019 Annual Report.

COVID-19

In March 2020, COVID-19 was declared a pandemic by the World Health Organization and the Centers for Disease Control and Prevention. Its rapid spread around the world and throughout the United States prompted many countries, including the United States, to institute restrictions on travel, public gatherings and certain business operations. These restrictions significantly disrupted economic activity in AEP's service territory and could reduce future demand for energy, particularly from commercial and industrial customers. AEGCo is taking steps to mitigate the potential risks to customers, suppliers and employees posed by the spread of COVID-19.

As of September 30, 2020 and through the date of this report, AEGCo assessed certain accounting matters that require consideration of forecasted financial information, including, but not limited to, the allowance for credit losses and the carrying value of long-lived assets. While there were not any impairments or significant increases in credit allowances resulting from these assessments for the three and nine months ended September 30, 2020, the ultimate impact of COVID-19 also depends on factors beyond management's knowledge or control, including the duration and severity of this outbreak as well as third-party actions taken to contain its spread and mitigate its public health effects. Therefore, management cannot estimate the potential future impact to financial position, results of operations and cash flows, but the impacts could be material.

Subsequent Events

Management reviewed subsequent events through October 22, 2020, the date that the third quarter 2020 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 2020-04 "Reference Rate Reform: Facilitation of the Effects of Reference Rate Reform on Financial Reporting" (ASU 2020-04)

In March 2020, the FASB issued ASU 2020-04 providing guidance to ease the potential burden in accounting for Reference Rate Reform on financial reporting. The new standard is elective and applies to all entities, subject to meeting certain criteria, that have contracts, hedging relationships, and other transactions that reference the London Interbank Offered Rate (LIBOR) or another reference rate expected to be discontinued because of Reference Rate Reform. The new standard establishes a general contract modification principle that entities can apply in other areas that may be affected by Reference Rate Reform and certain elective hedge accounting expedients. Under the new standard, an entity may make a one-time election to sell or to transfer to the available-for-sale or trading classifications (or both sell and transfer), debt securities that both reference an affected rate, and were classified as held to maturity before January 1, 2020.

The new accounting guidance is effective for all entities as of March 12, 2020 through December 31, 2022. The amendments may be applied to contract modifications as of any date from the beginning of an interim period that includes or is subsequent to March 12, 2020, or prospectively from a date within an interim period that includes or is subsequent to March 12, 2020, up to the date that the financial statements are available to be issued. The amendments may be applied to eligible hedging relationships existing as of the beginning of the interim period that includes March 12, 2020 and to new eligible hedging relationships entered into after the beginning of the interim period that includes March 12, 2020. The one-time election to sell, transfer, or both sell and transfer debt securities classified as held to maturity may be made at any time after March 12, 2020 but no later than December 31, 2022. Management has yet to apply the amendments in the new standard to any contract modifications, hedging relationships, or debt securities. Management is analyzing the impact of this new standard and at this time, cannot estimate the impact of adoption on results of operations, financial position or cash flows.

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 2019 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, 2020, there were no material liabilities recorded for any indemnifications.

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, 2020, the maximum potential loss for these lease agreements was \$43 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.

The Owner Trustee owns the Plant and leases equal portions to AEGCo and I&M. The lease is accounted for as an operating lease. 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, 2020 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, 2020 were as follows:

<u>Future Minimum Lease Payments</u>	<u>(in thousands)</u>
2020	\$ 36,927
2021	73,854
2022	73,854
Total Future Minimum Lease Payments	\$ 184,635

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. The district court's stay of the lease litigation expired in August 2020. Upon expiration of the stay, plaintiffs filed a motion for partial summary judgment, arguing that the consent decree violates the facility lease and the participation agreement and requesting that the district court enter a judgment for the plaintiffs on their breach of contract claim. AEP's memorandum in opposition was filed in October 2020. All deadlines, including discovery, are stayed, pending resolution of the motion.

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 is reasonably possible of occurring.

Claims Challenging Transition of American Electric Power System Retirement Plan to Cash Balance Formula

The American Electric Power System Retirement Plan (the Plan) has received a letter written on behalf of four participants (the Claimants) making a claim for additional plan benefits and purporting to advance such claims on behalf of a class. When the Plan's benefit formula was changed in the year 2000, AEP provided a special provision for employees hired before January 1, 2001, allowing them to continue benefit accruals under the then benefit formula for a full 10 years alongside of the new cash balance benefit formula then being implemented. Employees who were hired on or after January 1, 2001 accrued benefits only under the new cash balance benefit formula. The Claimants have asserted claims that (a) the Plan violates the requirements under the Employee Retirement Income Security Act (ERISA) intended to preclude back-loading the accrual of benefits to the end of a participant's career; (b) the Plan violates the age discrimination prohibitions of ERISA and the Age Discrimination in Employment Act; and (c) the company failed to provide required notice regarding the changes to the Plan. AEP has responded to the Claimants providing a reasoned explanation for why each of their claims have been denied. The denial of those claims was appealed to the AEP System Retirement Plan Appeal Committee and the Committee upheld the denial of claims. Management will continue to defend against the claims. Management is unable to 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, 2020	2019	Three Months Ended September 30, 2020	2019
	(in thousands)			
Service Cost	\$ 35	\$ 23	\$ 188	\$ 203
Interest Cost	27	31	376	508
Expected Return on Plan Assets	(62)	(67)	(666)	(621)
Amortization of Prior Service Credit	—	—	(17)	(17)
Amortization of Net Actuarial Loss	14	9	1	98
Net Periodic Benefit Cost (Credit)	\$ 14	\$ (4)	\$ (118)	\$ 171

	Pension Plan		OPEB	
	Nine Months Ended September 30, 2020	2019	Nine Months Ended September 30, 2020	2019
	(in thousands)			
Service Cost	\$ 104	\$ 69	\$ 562	\$ 607
Interest Cost	82	93	1,129	1,523
Expected Return on Plan Assets	(185)	(201)	(1,999)	(1,864)
Amortization of Prior Service Credit	—	—	(51)	(51)
Amortization of Net Actuarial Loss	43	25	3	296
Net Periodic Benefit Cost (Credit)	\$ 44	\$ (14)	\$ (356)	\$ 511

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, 2020		December 31, 2019	
	Book Value	Fair Value	Book Value	Fair Value
	(in thousands)			
Long-term Debt	\$ 194,605	\$ 195,413	\$ 194,538	\$ 194,825

6. INCOME TAXES

Federal Legislation

In March 2020, the "Coronavirus Aid, Relief, and Economic Security Act" (CARES Act) was signed into law. The CARES Act includes tax relief provisions such as: (a) an Alternative Minimum Tax (AMT) Credit Refund, (b) a 5-year net operating losses (NOL) carryback from years 2018-2020 and (c) delayed payment of employer payroll taxes. In May 2020, the House passed the "Health and Economic Recovery Omnibus Emergency Solutions Act" (HEROES Act) pending decision by the Senate. If enacted, the HEROES Act would disallow NOL carrybacks to any tax year beginning before January 1, 2018. Pursuant to the CARES Act, AEGCo and other AEP subsidiaries requested a partial refund of taxes paid in 2014 under the 5-year NOL carryback provision of the CARES Act. On October 1, 2020, after AEGCo and other AEP subsidiaries filed its request with the IRS, the House passed a revised version of the HEROES Act; which similar to the original legislation would disallow NOL carryback to years prior to 2018. Management will continue to monitor the potential impact of this legislation. AEGCo is currently deferring payments of the employer share of payroll taxes for the period March 27, 2020 through December 31, 2020 and will pay 50% of the obligation by December 31, 2021 and the remaining 50% by December 31, 2022.

Effective Tax Rates (ETR)

AEGCo's interim ETR reflects the estimated annual ETR for 2020 and 2019, adjusted for tax expense associated with certain discrete items.

AEGCo includes the amortization of Excess ADIT not subject to normalization requirements in the annual estimated ETR when regulatory proceedings instruct AEGCo to provide the benefits of Tax Reform to customers over multiple interim periods. Certain regulatory proceedings instruct AEGCo to provide the benefits of Tax Reform to customers in a single period (e.g. by applying the Excess ADIT not subject to normalization requirements against an existing regulatory asset balance) and in these circumstances, AEGCo recognizes the tax benefit discretely in the period recorded. The annual amount of Excess ADIT approved by AEGCo's regulatory commissions may not impact the ETR ratably during each interim period due to the variability of pretax book income between interim periods and the application of an annual estimated ETR.

The ETR for AEGCo are included in the following table:

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2020</u>	<u>2019</u>	<u>2020</u>	<u>2019</u>
U.S. Federal Statutory Rate	21.0 %	21.0 %	21.0 %	21.0 %
Increase (decrease) due to:				
State Income Tax, net of Federal Benefit	7.9 %	14.6 %	7.9 %	3.2 %
Tax Reform Excess ADIT Reversal	(24.9)%	(35.4)%	(24.9)%	(39.9)%
Production and Investment Tax Credits	(10.6)%	(12.6)%	(10.6)%	(14.2)%
Flow Through	3.5 %	(34.7)%	3.5 %	(2.4)%
AFUDC Equity	(2.8)%	(3.9)%	(2.8)%	(5.7)%
Parent Company Loss Benefit	(10.9)%	5.0 %	(10.9)%	(2.0)%
Discrete Tax Adjustments	0.8 %	— %	(1.3)%	12.3 %
Other	0.1 %	(2.5)%	0.2 %	(0.6)%
Effective Income Tax Rate	<u>(15.9)%</u>	<u>(48.5)%</u>	<u>(17.9)%</u>	<u>(28.3)%</u>

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 2015. During the third quarter of 2019, AEP and subsidiaries elected to amend the 2014 and 2015 federal returns. In the first quarter of 2020, the IRS notified AEP that it was beginning an examination of these amended returns, including the net operating loss carryback to 2015 that originated in the 2017 return. The IRS may examine only the amended items on the 2014 and 2015 federal returns.

7. FINANCING ACTIVITIES

Long-term Debt

AEGCo did not have any long-term debt issuances or retirements during the first nine months of 2020.

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, 2020, 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, 2020 and December 31, 2019 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, 2020 are described in the following table:

Maximum Borrowings from the Utility Money Pool	Maximum Loans to the Utility Money Pool	Average Borrowings from the Utility Money Pool	Average Loans to the Utility Money Pool	Loans to the Utility Money Pool as of September 30, 2020	Authorized Short-Term Borrowing Limit
(in thousands)					
\$ 28,993	\$ 65,268	\$ 5,871	\$ 35,744	\$ 23,396	\$ 150,000

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

Nine Months Ended September 30,	Maximum Interest Rate for Funds Borrowed from the Utility Money Pool	Minimum Interest Rate for Funds Borrowed from the Utility Money Pool	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 Borrowed from the Utility Money Pool	Average Interest Rate for Funds Loaned to the Utility Money Pool
2020	1.01 %	0.33 %	2.70 %	0.50 %	0.56 %	1.87 %
2019	— %	— %	3.43 %	1.83 %	— %	2.71 %

8. PROPERTY, PLANT AND EQUIPMENT

Asset Retirement Obligations (ARO)

AEGCo records ARO in accordance with the accounting guidance for “Asset Retirement and Environmental Obligations” for the retirement of ash disposal facilities and asbestos removal.

The following is a reconciliation of the aggregate carrying amounts of ARO for AEGCo:

<u>ARO as of December 31, 2019</u>	<u>Accretion Expense</u>	<u>Liabilities Incurred</u>	<u>Liabilities Settled</u>	<u>Revisions in Cash Flow Estimates</u>	<u>ARO as of September 30, 2020</u>
(in thousands)					
\$ 19,757	\$ 706	\$ —	\$ (23)	\$ (5,181)	\$ 15,259

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 September 30, 2020 and September 30, 2019.

Fixed Performance Obligations

As of September 30, 2020, 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, 2020 and December 31, 2019.

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, 2020 and December 31, 2019.

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, 2020 and December 31, 2019.