AEP Texas Central Company

2009 Second Quarter Report

Consolidated 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
AEP or Parent	American Electric Power Company, Inc.
AEP East companies	APCo, CSPCo, I&M, KPCo and OPCo.
AEP System	American Electric Power System, an integrated electric utility system, owned and operated by AEP's electric utility subsidiaries.
AEP West companies	PSO, SWEPCo, TCC and TNC.
AEPSC	American Electric Power Service Corporation, a service subsidiary providing management and professional services to AEP and its subsidiaries.
AFUDC	Allowance for Funds Used During Construction.
AOCI	Accumulated Other Comprehensive Income.
APB	Accounting Principles Board Opinion.
APCo	Appalachian Power Company, an AEP electric utility subsidiary.
APSC	Arkansas Public Service Commission.
CAA	Clean Air Act.
CSPCo	Columbus Southern Power Company, an AEP electric utility subsidiary.
CSW	Central and South West Corporation, a subsidiary of AEP (Effective January 21, 2003, the legal name of Central and South West Corporation was changed to AEP Utilities, Inc.).
CSW Operating Agreement	Agreement, dated January 1, 1997, by and among PSO, SWEPCo, TCC and TNC governing generating capacity allocation. This agreement was amended in May 2006 to remove TCC and TNC. AEPSC acts as the agent.
CTC	Competition Transition Charge.
CWIP	Construction Work in Progress.
EITF	Financial Accounting Standards Board's Emerging Issues Task Force.
EITF 06-10	EITF Issue No. 06-10 "Accounting for Collateral Assignment Split-Dollar Life Insurance Arrangements."
ERCOT	Electric Reliability Council of Texas.
ETT	Electric Transmission Texas, LLC, a 50% equity interest joint venture with MidAmerican Energy Holdings Company formed to own and operate electric transmission facilities in ERCOT.
FASB	Financial Accounting Standards Board.
Federal EPA	United States Environmental Protection Agency.
FERC	Federal Energy Regulatory Commission.
FIN	FASB Interpretation No.
FIN 46R	FIN 46R, "Consolidation of Variable Interest Entities."
FSP	FASB Staff Position.
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.
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.
KPCo	Kentucky Power Company, an AEP electric utility subsidiary.
MW	Megawatt.
OCC	Corporation Commission of the State of Oklahoma.
OPCo	Ohio Power Company, an AEP electric utility subsidiary.
OPEB	Other Postretirement Benefit Plans.
OTC	Over the counter.
PSO	Public Service Company of Oklahoma, an AEP electric utility subsidiary.
PUCT	Public Utility Commission of Texas.

Term	Meaning
REP	Texas Retail Electric Provider.
SFAS	Statement of Financial Accounting Standards issued by the Financial Accounting Standards Board.
SFAS 133	Statement of Financial Accounting Standards No. 133, “Accounting for Derivative Instruments and Hedging Activities.”
SFAS 157	Statement of Financial Accounting Standards No. 157, “Fair Value Measurements.”
SIA	System Integration Agreement.
SWEPCo	Southwestern Electric Power Company, an AEP electric utility subsidiary.
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.
TNC	AEP Texas North Company, an AEP electric utility subsidiary.
True-up Proceeding	A filing made under the Texas Restructuring Legislation to finalize the amount of stranded costs and other true-up items and the recovery of such amounts.
Utility Money Pool	AEP System’s Utility Money Pool.

AEP TEXAS CENTRAL COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
For the Three and Six Months Ended June 30, 2009 and 2008
(in thousands)
(Unaudited)

	Three Months Ended 2009	Three Months Ended 2008	Six Months Ended 2009	Six Months Ended 2008
REVENUES				
Electric Generation, Transmission and Distribution	$ 219,820	$ 203,420	$ 407,887	$ 379,270
Sales to AEP Affiliates	1,195	1,509	2,288	3,703
Other Revenues	1,161	8,060	1,783	11,058
TOTAL REVENUES	222,176	212,989	411,958	394,031
EXPENSES				
Purchased Electricity for Resale	-	-	-	559
Other Operation	59,272	61,080	112,728	119,241
Maintenance	8,409	9,346	16,566	18,584
Depreciation and Amortization	67,062	57,833	117,517	104,367
Taxes Other Than Income Taxes	18,114	18,460	33,504	34,554
TOTAL EXPENSES	152,857	146,719	280,315	277,305
OPERATING INCOME	69,319	66,270	131,643	116,726
Other Income (Expense):				
Interest Income	72	1,677	358	4,948
Allowance for Equity Funds Used During Construction	643	939	1,013	1,594
Interest Expense	(38,784)	(41,249)	(76,651)	(84,297)
INCOME BEFORE INCOME TAX EXPENSE	31,250	27,637	56,363	38,971
Income Tax Expense	10,335	9,442	19,904	13,410
NET INCOME	20,915	18,195	36,459	25,561
Preferred Stock Dividend Requirements	60	60	120	120
EARNINGS ATTRIBUTABLE TO COMMON STOCK	$ 20,855	$ 18,135	$ 36,339	$ 25,441

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

See Condensed Notes to Condensed Consolidated Financial Statements.

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

	Common Stock	Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total
TOTAL COMMON SHAREHOLDER'S EQUITY – DECEMBER 31, 2007	$ 55,292	$ 133,161	$ 270,741	$ -	$ 459,194
EITF 06-10 Adoption, Net of Tax of $402			(748)		(748)
Common Stock Dividends			(8,000)		(8,000)
Preferred Stock Dividends			(120)		(120)
SUBTOTAL – COMMON SHAREHOLDER'S EQUITY					450,326
COMPREHENSIVE INCOME					
NET INCOME			25,561		25,561
TOTAL COMPREHENSIVE INCOME					25,561
TOTAL COMMON SHAREHOLDER'S EQUITY – JUNE 30, 2008	$ 55,292	$ 133,161	$ 287,434	$ -	$ 475,887
TOTAL COMMON SHAREHOLDER'S EQUITY – DECEMBER 31, 2008	$ 55,292	$ 133,161	$ 325,590	$ -	$ 514,043
Capital Contribution from Parent		35,000			35,000
Common Stock Dividends			(18,000)		(18,000)
Preferred Stock Dividends			(120)		(120)
Other Changes in Common Shareholder's Equity		3,096	(3,096)		-
SUBTOTAL – COMMON SHAREHOLDER'S EQUITY					530,923
COMPREHENSIVE INCOME					
Other Comprehensive Income, Net of Taxes:					
Cash Flow Hedges, Net of Tax of $113				209	209
NET INCOME			36,459		36,459
TOTAL COMPREHENSIVE INCOME					36,668
TOTAL COMMON SHAREHOLDER'S EQUITY – JUNE 30, 2009	$ 55,292	$ 171,257	$ 340,833	$ 209	$ 567,591

See Condensed Notes to Condensed Consolidated Financial Statements.

AEP TEXAS CENTRAL COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
ASSETS
June 30, 2009 and December 31, 2008
(in thousands)
(Unaudited)

	2009	2008
CURRENT ASSETS		
Cash and Cash Equivalents	$ 200	$ 203
Other Cash Deposits	145,942	172,939
Advances to Affiliates	25,811	-
Accounts Receivable:		
Customers	83,133	61,769
Affiliated Companies	20,297	72,642
Accrued Unbilled Revenues	43,005	38,575
Miscellaneous	117	267
Allowance for Uncollectible Accounts	(1,851)	(567)
Total Accounts Receivable	144,701	172,686
Materials and Supplies	27,616	28,559
Risk Management Assets	233	-
Prepayments and Other Current Assets	13,334	10,456
TOTAL CURRENT ASSETS	357,837	384,843
PROPERTY, PLANT AND EQUIPMENT		
Electric:		
Transmission	1,047,367	1,085,999
Distribution	1,797,413	1,769,485
Other Property, Plant and Equipment	236,357	231,899
Construction Work in Progress	103,181	110,690
Total Property, Plant and Equipment	3,184,318	3,198,073
Accumulated Depreciation and Amortization	685,878	664,375
TOTAL PROPERTY, PLANT AND EQUIPMENT – NET	2,498,440	2,533,698
OTHER NONCURRENT ASSETS		
Regulatory Assets	301,735	314,029
Securitized Transition Assets	1,982,770	2,039,768
Long-term Risk Management Assets	65	-
Deferred Charges and Other Noncurrent Assets	50,125	39,863
TOTAL OTHER NONCURRENT ASSETS	2,334,695	2,393,660
TOTAL ASSETS	$ 5,190,972	$ 5,312,201

See Condensed Notes to Condensed Consolidated Financial Statements.

AEP TEXAS CENTRAL COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
LIABILITIES AND SHAREHOLDERS' EQUITY
June 30, 2009 and December 31, 2008
(Unaudited)

	2009	2008
CURRENT LIABILITIES	(in thousands)	
Advances from Affiliates	$ -	$ 107,293
Accounts Payable:		
General	24,291	22,198
Affiliated Companies	15,382	19,976
Long-term Debt Due Within One Year – Nonaffiliated	142,528	137,141
Customer Deposits	21,429	19,671
Accrued Taxes	78,826	36,451
Accrued Interest	63,546	65,674
Provision for Revenue Refund	34,200	33,400
Other Current Liabilities	20,563	54,756
TOTAL CURRENT LIABILITIES	400,765	496,560
NONCURRENT LIABILITIES		
Long-term Debt – Nonaffiliated	2,570,946	2,657,156
Deferred Income Taxes	1,042,342	1,043,627
Regulatory Liabilities and Deferred Investment Tax Credits	459,986	444,134
Deferred Credits and Other Noncurrent Liabilities	143,421	150,760
TOTAL NONCURRENT LIABILITIES	4,216,695	4,295,677
TOTAL LIABILITIES	4,617,460	4,792,237
Cumulative Preferred Stock Not Subject to Mandatory Redemption	5,921	5,921
Commitments and Contingencies (Note 4)		
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	171,257	133,161
Retained Earnings	340,833	325,590
Accumulated Other Comprehensive Income (Loss)	209	-
TOTAL COMMON SHAREHOLDER'S EQUITY	567,591	514,043
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 5,190,972	$ 5,312,201

See Condensed Notes to Condensed Consolidated Financial Statements.

AEP TEXAS CENTRAL COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Six Months Ended June 30, 2009 and 2008
(in thousands)
(Unaudited)

	2009	2008
OPERATING ACTIVITIES		
Net Income	$ 36,459	$ 25,561
Adjustments to Reconcile Net Income to Net Cash Flows from (Used for) Operating Activities:		
Depreciation and Amortization	117,517	104,367
Deferred Income Taxes	(30,938)	26,218
Allowance for Equity Funds Used During Construction	(1,013)	(1,594)
Deferred Property Taxes	(14,313)	(13,300)
Fuel Over/Under-Recovery, Net	-	(339)
Change in Other Noncurrent Assets	4,773	(67,089)
Change in Other Noncurrent Liabilities	178	6,390
Changes in Certain Components of Working Capital:		
Accounts Receivable, Net	27,985	(19,172)
Materials and Supplies	943	(1,003)
Accounts Payable	(1,282)	5,356
Customer Deposits	1,758	1,991
Accrued Taxes, Net	49,352	(40,113)
Accrued Interest	(2,128)	(168)
Other Current Assets	(158)	(6,155)
Other Current Liabilities	(14,310)	(23,418)
Net Cash Flows from (Used for) Operating Activities	174,823	(2,468)
INVESTING ACTIVITIES		
Construction Expenditures	(95,213)	(118,921)
Change in Other Cash Deposits	26,997	43,366
Change in Advances to Affiliates, Net	(25,811)	179,963
Proceeds from Sales of Assets	91,645	1,714
Other Investing Activities	(690)	(485)
Net Cash Flows from (Used for) Investing Activities	(3,072)	105,637
FINANCING ACTIVITIES		
Capital Contribution from Parent	35,000	-
Issuance of Long-term Debt – Nonaffiliated	(45)	159,296
Change in Advances from Affiliates, Net	(107,293)	-
Retirement of Long-term Debt – Nonaffiliated	(80,909)	(253,561)
Principal Payments for Capital Lease Obligations	(798)	(785)
Dividends Paid on Common Stock	(18,000)	(8,000)
Dividends Paid on Cumulative Preferred Stock	(120)	(120)
Other Financing Activities	411	-
Net Cash Used for Financing Activities	(171,754)	(103,170)
Net Decrease in Cash and Cash Equivalents	(3)	(1)
Cash and Cash Equivalents at Beginning of Period	203	101
Cash and Cash Equivalents at End of Period	$ 200	$ 100
SUPPLEMENTARY INFORMATION		
Cash Paid for Interest, Net of Capitalized Amounts	$ 85,904	$ 77,946
Net Cash Paid for Income Taxes	6,471	34,234
Noncash Acquisitions Under Capital Leases	482	395
Construction Expenditures Included in Accounts Payable at June 30,	10,492	14,052
Cash Paid for CTC Refunds	-	67,867

See Condensed Notes to Condensed Consolidated Financial Statements.

CONDENSED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Significant Accounting Matters

2. New Accounting Pronouncements

3. Rate Matters

4. Commitments, Guarantees and Contingencies

5. Benefit Plans

6. Business Segments

7. Derivatives and Hedging

8. Fair Value Measurements

9. Income Taxes

10. Financing Activities

1. SIGNIFICANT ACCOUNTING MATTERS

General

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

In the opinion of management, the unaudited condensed consolidated interim financial statements reflect all normal and recurring accruals and adjustments necessary for a fair presentation of the net income, financial position and cash flows for the interim periods. Net income for the three and six months ended June 30, 2009 are not necessarily indicative of results that may be expected for the year ending December 31, 2009. Management reviewed subsequent events through the August 4, 2009 issuance date of TCC's second quarter financial statements and footnotes. The accompanying condensed consolidated financial statements are unaudited and should be read in conjunction with the audited 2008 financial statements and notes thereto, which are included in TCC's 2008 Annual Report.

Variable Interest Entities

FIN 46R is a consolidation model that considers risk absorption of a variable interest entity (VIE), also referred to as variability. Entities are required to consolidate a VIE when it is determined that they are the primary beneficiary of that VIE, as defined by FIN 46R. 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 and other factors. Management believes that the significant assumptions and judgments were applied consistently and that there are no other reasonable judgments or assumptions that would result in a different conclusion. There have been no changes to the reporting of VIEs in the financial statements where it is concluded that TCC is the primary beneficiary. In addition, TCC has not provided financial or other support to any VIE that was not previously contractually required.

TCC holds a significant variable interest in AEPSC. AEPSC provides certain managerial and professional services to TCC. AEP is the sole equity owner of AEPSC. The costs of the services are based on a direct charge or on a prorated basis and billed to TCC and other AEP subsidiaries at AEPSC's costs. TCC and other AEP subsidiaries have not provided financial or other support outside the reimbursement of costs for services rendered. The cost reimbursement nature of AEPSC finances its operations. There are no other terms or arrangements between AEPSC and TCC and other AEP subsidiaries that could require additional financial support from TCC and other AEP subsidiaries or expose them to losses outside of the normal course of business. AEPSC and its billings are subject to regulation by the FERC. TCC and other AEP subsidiaries are exposed to losses to the extent they cannot recover the cost of AEPSC through their normal business operations. TCC is considered to have a significant interest in the variability of AEPSC due to its activity in AEPSC's cost reimbursement structure. AEPSC is consolidated by AEP. In the event AEPSC would require financing or other support outside the cost reimbursement billings, this financing would be provided by AEP. Total billings from AEPSC for the three months ended June 30, 2009 and 2008 were $18 million and $19 million, respectively, and for the six months ended June 30, 2009 and 2008 were $34 million and $41 million, respectively. The carrying amount of liabilities associated with AEPSC as of June 30, 2009 and December 31, 2008 were $7 million and $8 million, respectively. Management estimates the maximum exposure of loss to be equal to the amount of such liability.

2. NEW ACCOUNTING PRONOUNCEMENTS

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

Pronouncements Adopted During 2009

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

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

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

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

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

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

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

TCC adopted SFAS 160 effective January 1, 2009 with no impact on its financial statements or footnote disclosures.

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

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

TCC adopted SFAS 161 effective January 1, 2009. This standard increased disclosures related to derivative instruments and hedging activities. See Note 7.

SFAS 165 "Subsequent Events" (SFAS 165)

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

TCC adopted this standard effective second quarter of 2009. The standard increased disclosure by requiring disclosure of the date through which subsequent events have been reviewed. The standard did not change management's procedures for reviewing subsequent events.

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

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

TCC adopted EITF 08-5 effective January 1, 2009. With the adoption of FSP SFAS 107-1 and APB 28-1, it is applied to the fair value of long-term debt. The application of this standard had an immaterial effect on the fair value of debt outstanding.

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

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

TCC adopted EITF 08-6 effective January 1, 2009 with no impact on the financial statements. It was applied prospectively.

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

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

TCC adopted the standard effective second quarter of 2009. This standard increased the disclosure requirements related to financial instruments. See "Fair Value Measurements of Long-term Debt" section of Note 8.

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

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

TCC adopted the standard effective second quarter of 2009. The adoption of this standard had no impact.

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

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

TCC adopted SFAS 142-3 effective January 1, 2009. The guidance is prospectively applied to intangible assets acquired after the effective date. The standard's disclosure requirements are applied prospectively to all intangible assets as of January 1, 2009. The adoption of this standard had no impact on the financial statements.

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

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

TCC adopted SFAS 157-2 effective January 1, 2009. TCC will apply these requirements to applicable fair value measurements which include new asset retirement obligations and impairment analyses related to long-lived assets, equity investments, goodwill and intangibles. TCC did not record any fair value measurements for nonrecurring nonfinancial assets and liabilities in the first six months of 2009.

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

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

TCC adopted the standard effective second quarter of 2009. This standard had no impact on the financial statements but increased disclosure requirements. See "Fair Value Measurements of Financial Assets and Liabilities" section of Note 8.

Pronouncements Effective in the Future

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

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

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

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

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

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

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

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

This standard is effective for interim and annual reporting periods ending after September 15, 2009. It requires an update of all references to authoritative accounting literature. TCC will adopt SFAS 168 effective third quarter of 2009.

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

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

This standard is effective for fiscal years ending after December 15, 2009. Management expects this standard to increase the disclosure requirements related to AEP's benefit plans. TCC will adopt the standard effective for the 2009 Annual Report.

Future Accounting Changes

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

3. RATE MATTERS

As discussed in TCC's 2008 Annual Report, TCC is involved in rate and regulatory proceedings at the FERC and the PUCT. The Rate Matters note within TCC's 2008 Annual Report should be read in conjunction with this report to gain a complete understanding of material rate matters still pending that could impact net income, cash flows and possibly financial condition. The following discusses ratemaking developments in 2009 and updates TCC's 2008 Annual Report.

TEXAS RESTRUCTURING

Texas Restructuring Appeals

Pursuant to PUCT orders, TCC securitized net recoverable stranded generation costs of $2.5 billion and is recovering the principal and interest on the securitization bonds through the end of 2020. TCC refunded net other true-up regulatory liabilities of $375 million during the period October 2006 through June 2008 via a CTC credit rate rider. Although earnings were not affected by this CTC refund, cash flow was adversely impacted for 2008, 2007 and 2006 by $75 million, $238 million and $69 million, respectively. Municipal customers and other intervenors appealed the PUCT true-up orders seeking to further reduce TCC's true-up recoveries. TCC also appealed the PUCT stranded costs true-up and related orders seeking relief in both state and federal court on the grounds that certain aspects of the orders are contrary to the Texas Restructuring Legislation, PUCT rulemakings and federal law and fail to fully compensate TCC for its net stranded cost and other true-up items. The significant items appealed by TCC were:

- The PUCT ruling that TCC did not comply with the Texas Restructuring Legislation and PUCT rules regarding the required auction of 15% of its Texas jurisdictional installed capacity, which led to a significant disallowance of capacity auction true-up revenues.
- The PUCT ruling that TCC acted in a manner that was commercially unreasonable, because TCC failed to determine a minimum price at which it would reject bids for the sale of its nuclear generating plant and TCC bundled out-of-the-money gas units with the sale of its coal unit, which led to the disallowance of a significant portion of TCC's net stranded generation plant costs.
- Two federal matters regarding the allocation of off-system sales related to fuel recoveries and a potential tax normalization violation.

In March 2007, the Texas District Court judge hearing the appeals of the true-up order affirmed the PUCT's April 2006 final true-up order for TCC with two significant exceptions. The judge determined that the PUCT erred by applying an invalid rule to determine the carrying cost rate for the true-up of stranded costs and remanded this matter to the PUCT for further consideration. This remand could potentially have an adverse effect on TCC's future net income and cash flows if upheld on appeal. The District Court judge also determined that the PUCT improperly reduced TCC's net stranded plant costs for commercial unreasonableness which could have a favorable effect on TCC's future net income and cash flows.

TCC, the PUCT and intervenors appealed the District Court decision to the Texas Court of Appeals. In May 2008, the Texas Court of Appeals affirmed the District Court decision in all but two major respects. It reversed the District Court's unfavorable decision which found that the PUCT erred by applying an invalid rule to determine the carrying cost rate. It also determined that the PUCT erred by not reducing stranded costs by the "excess earnings" that had already been refunded to affiliated REPs. Management does not believe that TCC will be adversely affected by the Court of Appeals ruling on excess earnings based upon the reasons discussed in the "TCC Excess Earnings" section below. The favorable commercial unreasonableness judgment entered by the District Court was not reversed. In June 2008, the Texas Court of Appeals denied intervenors' motions for rehearing. In August 2008, TCC, the PUCT and intervenors filed petitions for review with the Texas Supreme Court. Review is discretionary and the Texas Supreme Court has not determined if it will grant review. In January 2009, the Texas Supreme Court requested full briefing of the proceedings which concluded in June 2009.

Management cannot predict the outcome of these court proceedings and PUCT remand decisions. If TCC ultimately succeeds in its appeals, it could have a material favorable effect on future net income, cash flows and possibly financial condition. If municipal customers and other intervenors succeed in their appeals, it could have a material adverse effect on future net income, cash flows and possibly financial condition.

TCC Deferred Investment Tax Credits and Excess Deferred Federal Income Taxes

TCC's appeal remains outstanding related to the stranded costs true-up and related orders regarding whether the PUCT may require TCC to refund certain tax benefits to customers. Subsequent to the PUCT's ordered reduction to TCC's securitized stranded costs by certain tax benefits, the PUCT, reacting to possible IRS normalization violations, allowed TCC to defer $103 million of ordered CTC refunds for other true-up items to negate the securitization reduction. Of the $103 million, $61 million relates to the present value of certain tax benefits applied to reduce the securitization stranded generating assets and $42 million was for subsequent carrying costs. The deferral of the CTC refunds is pending resolution on whether the PUCT's securitization refund is an IRS normalization violation.

Since the deferral through the CTC refund, the IRS issued a favorable final regulation in March 2008 addressing the normalization requirements for the treatment of Accumulated Deferred Investment Tax Credit (ADITC) and Excess Deferred Federal Income Tax (EDFIT) in a stranded cost determination. Consistent with a Private Letter Ruling TCC received in 2006, the final regulations clearly state that TCC will sustain a normalization violation if the PUCT orders TCC in a final order after all appeals to flow the tax benefits to customers as part of the stranded cost true-up. TCC notified the PUCT that the final regulations were issued. The PUCT made a request to the Texas Court of Appeals for the matter to be remanded back to the PUCT for further action. In May 2008, as requested by the PUCT, the Texas Court of Appeals ordered a remand of the tax normalization issue for the consideration of this favorable additional evidence.

TCC expects that the PUCT will allow TCC to retain the deferred amounts. This will have a favorable effect on future net income as TCC will be able to amortize the deferred ADITC and EDFIT tax benefits to income over the remaining securitization period. Since management expects that the PUCT will allow TCC to retain the deferred CTC refund amounts in order to avoid an IRS normalization violation, no related interest expense has been accrued related to refunds of these amounts. If accrued, management estimates interest expense would have been approximately $8 million higher for the period July 2008 through June 2009 based on a CTC interest rate of 7.5% with $4 million relating to 2008.

If the PUCT orders TCC to return the tax benefits to customers, thereby causing a violation of the IRS normalization regulations, the violation could result in TCC's repayment to the IRS, under the normalization rules, of ADITC on all property, including transmission and distribution property. This amount approximates $102 million as of June 30, 2009. It could also lead to a loss of TCC's right to claim accelerated tax depreciation in future tax returns. If TCC is required to repay to the IRS its ADITC and is also required to refund ADITC to customers, it would have an unfavorable effect on future net income and cash flows. Tax counsel advised management that a normalization violation should not occur until all remedies under law have been exhausted and the tax benefits are actually returned to ratepayers under a nonappealable final order. Management intends to continue to work with the PUCT to favorably resolve the issue and avoid the adverse effects of a normalization violation on future net income, cash flows and financial condition.

TCC Excess Earnings

In 2005, a Texas appellate court issued a decision finding that a PUCT order requiring TCC to refund to the REPs excess earnings prior to and outside of the true-up process was unlawful under the Texas Restructuring Legislation. From 2002 to 2005, TCC refunded $55 million of excess earnings, including interest, under the overturned PUCT order. On remand, the PUCT must determine how to implement the Court of Appeals decision given that the unauthorized refunds were made to the REPs in lieu of reducing stranded cost recoveries from REPs in the True-up Proceeding. It is possible that TCC's stranded cost recovery, which is currently on appeal, may be affected by a PUCT remedy.

In May 2008, the Texas Court of Appeals issued a decision in TCC's True-up Proceeding determining that even though excess earnings had been previously refunded to REPs, TCC still must reduce stranded cost recoveries in its True-up Proceeding. In 2005, TCC reflected the obligation to refund excess earnings to customers through the true-up process and recorded a regulatory asset of $55 million representing a receivable from the REPs for prior excess earnings refunds made to them by TCC. However, certain parties have taken positions that, if adopted, could result in TCC being required to refund additional amounts of excess earnings or interest through the true-up process without receiving a refund from the REPs. If this were to occur, it would have an adverse effect on future net income and cash flows. AEP sold its affiliate REPs in December 2002. While AEP owned the affiliate REPs, TCC refunded $11 million of excess earnings to the affiliate REPs. Management cannot predict the outcome of the excess earnings remand and whether it would have an adverse effect on future net income and cash flows.

OTHER TEXAS RATE MATTERS

Hurricanes Dolly and Ike

In July and September 2008, TCC's service territory in south Texas was hit by Hurricanes Dolly and Ike, respectively. TCC incurred $23 million and $2 million in incremental maintenance costs related to service restoration efforts for Hurricanes Dolly and Ike, respectively. TCC has a PUCT-approved catastrophe reserve which permits TCC to collect $1.3 million annually until the catastrophe reserve reaches $13 million. Any incremental storm-related maintenance costs can be charged against the catastrophe reserve if the total incremental maintenance costs for a storm exceed $500 thousand. In June 2008, prior to these hurricanes, TCC had a $2 million balance in its catastrophe reserve account. Therefore, TCC established a net regulatory asset for $23 million. The balance in the catastrophe reserve regulatory asset account as of June 30, 2009 is approximately $22 million.

Under Texas law and as previously approved by the PUCT in prior base rate cases, the regulatory asset will be included in rate base in the next base rate filing. In connection with the filing of the next base rate case, TCC will evaluate the existing catastrophe reserve ratepayer funding and review potential future events to determine the appropriate funding level to request to both recover the then existing regulatory asset balance and to adequately fund a reserve for future storms in a reasonable time period. TCC has no current plans to file a base rate case in 2009.

2008 Interim Transmission Rates

In March 2008, TCC filed an application with the PUCT for an annual interim update of wholesale-transmission rates. The proposed new interim transmission rates are estimated to increase annual transmission revenues by $9 million. In May 2008, the PUCT and the FERC approved the new interim transmission rates as filed. TCC implemented the new rates effective May 2008, subject to review during the next base rate case. This review could result in a refund if the PUCT finds that TCC has not prudently incurred the requested transmission investment. TCC has not recorded any provision for refund regarding the interim transmission rates because management believes these new rates are reasonable and necessary to recover costs associated with prudently incurred new transmission investment. A refund of the interim transmission rates would have an adverse impact on net income and cash flows.

2009 Interim Transmission Rates

In February 2009, TCC filed an application with the PUCT for an annual interim update of wholesale-transmission rates. The proposed new interim transmission rates are estimated to increase annual transmission revenues by $8 million. In May 2009, the PUCT and the FERC approved the new interim transmission rates as filed. TCC implemented the new rates effective May 2009, subject to review during the next base rate case. This review could result in a refund if the PUCT finds that TCC has not prudently incurred the requested transmission investment. TCC has not recorded any provision for refund regarding the interim transmission rates because management believes these new rates are reasonable and necessary to recover costs associated with prudently incurred new transmission investment. A refund of the interim transmission rates would have an adverse impact on net income and cash flows.

Advanced Metering System

In 2007, the governor of Texas signed legislation directing the PUCT to establish a surcharge for electric utilities relating to advanced meters. In April 2009, TCC filed its Advanced Metering System (AMS) with the PUCT proposing to invest approximately $223 million in AMS to be recovered through customer surcharges beginning in October 2009. The filing is modeled on similar filings by other Texas ERCOT Investor Owned Utilities who have already received PUCT approval for their plans. In the filing, TCC proposes to apply recorded customer refunds including interest related to the FERC SIA ruling to reduce the AMS investment and the resultant associated customer surcharge. See "Allocation of Off-system Sales Margins" section within "FERC Rate Matters". As of June 30, 2009, TCC has $3.3 million of capital expenditures recorded on its balance sheet including interest related to advanced meters. Management is unable to predict whether the PUCT will allow TCC to apply recorded customer refunds related to the FERC SIA ruling to reduce the AMS investment and the resultant associated customer surcharge.

Texas Rate Filing

In November 2006, TCC filed a base rate case seeking to increase transmission and distribution energy delivery services (wires) base rate in Texas. TCC's revised requested increase in annual base rates was $70 million based on a requested return on common equity of 10.75%.

TCC implemented the rate change in June 2007, subject to refund. In March 2008, the PUCT issued an order approving rates to collect a $20 million base rate increase based on a return on common equity of 9.96% and an additional $20 million increase in revenues related to the expiration of TCC's merger credits. In addition, depreciation expense was decreased by $7 million and discretionary fee revenues were increased by $3 million. TCC estimates the order will increase TCC's annual pretax income by $50 million. Various parties appealed the PUCT decision.

In February 2009, the Texas District Court affirmed the PUCT in most respects. However, it also ruled that the PUCT improperly denied TCC an AFUDC return on the prepaid pension asset that the PUCT ruled to be CWIP. In March 2009, various intervenors appealed the Texas District Court decision to the Texas Court of Appeals. Management is unable to predict the outcome of these proceedings. If the appeals are successful, it could have an adverse effect on future net income and cash flows.

ETT

In December 2007, TCC contributed $70 million of transmission facilities to ETT, an AEP joint venture accounted for using the equity method. The PUCT approved ETT's initial rates, a request for a transfer of facilities and a certificate of convenience and necessity (CCN) to operate as a stand alone transmission utility in the ERCOT region. ETT was allowed a 9.96% after tax return on equity rate in those approvals. In 2008, intervenors filed a notice of appeal to the Travis County District Court. In October 2008, the court ruled that the PUCT exceeded its authority by approving ETT's application as a stand alone transmission utility without a service area under the wrong section of the statute. Management believes that ruling is incorrect. Moreover, ETT provided evidence in its application that ETT complied with what the court determined was the proper section of the statute.

In January 2009, ETT and the PUCT filed appeals to the Texas Court of Appeals. In June 2009, the Texas governor signed a new law that clarifies the PUCT's authority to grant CCNs to transmission-only utilities such as ETT. During 2009, TCC sold $91 million of additional transmission facilities to ETT. Depending upon the ultimate outcome of the appeals and any resulting remands, TCC may be required to reacquire transferred assets and projects under construction by ETT if ETT cannot obtain the appropriate approvals. As of June 30, 2009, ETT's net investment in property, plant and equipment was $196 million, of which $61 million was under construction.

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

FERC Rate Matters

Allocation of Off-system Sales Margins

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

4. COMMITMENTS, GUARANTEES AND CONTINGENCIES

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 cannot be predicted. For current proceedings not specifically discussed below, management does not anticipate that the liabilities, if any, arising from such proceedings would have a material adverse effect on the financial statements. The Commitments, Guarantees and Contingencies note within the 2008 Annual Report should be read in conjunction with this report.

GUARANTEES

There are certain immaterial liabilities recorded for guarantees in accordance with FIN 45 “Guarantor’s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others.” In addition, TCC adopted FSP SFAS 133-1 and FIN 45-4 “Disclosures about Credit Derivatives and Certain Guarantees: An amendment of FASB Statement No. 133 and FASB Interpretation No. 45; and Clarification of the Effective Date of FASB Statement No. 161” effective December 31, 2008. There is no collateral held in relation to any guarantees. In the event any guarantee is drawn, there is no recourse to third parties.

Indemnifications and Other Guarantees

Contracts

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. Prior to June 30, 2009, TCC entered into sale agreements including indemnifications with a maximum exposure of $13 million related to the sale price of generation assets and ETT. See “Texas Plants – Oklaunion Power Station” and “Electric Transmission Texas LLC (ETT)” sections of Note 6 of the 2008 Annual Report. There are no material liabilities recorded for any indemnifications and the risk of payment/performance is remote.

Master Lease Agreements

TCC leases certain equipment under master lease agreements. GE Capital Commercial Inc. (GE) notified management in November 2008 that they elected to terminate the Master Leasing Agreements in accordance with the termination rights specified within the contract. In 2010 and 2011, TCC will be required to purchase all equipment under the lease and pay GE an amount equal to the unamortized value of all equipment then leased. In December 2008, management signed new master lease agreements with one-year commitment periods that include lease terms of up to 10 years. Management expects to enter into replacement leasing arrangements for the equipment affected by this notification prior to the termination dates of 2010 and 2011.

For equipment under the GE master lease agreements that expire prior to 2011, the lessor is guaranteed receipt of up to 87% of the unamortized balance of the equipment at the end of the lease term. If the fair market value of the leased equipment is below the unamortized balance at the end of the lease term, TCC is committed to pay the difference between the fair market value and the unamortized balance, with the total guarantee not to exceed 87% of the unamortized balance. Under the new master lease agreements, the lessor is guaranteed receipt of up to 68% of the unamortized balance at the end of the lease term. If the actual fair market value of the leased equipment is below the unamortized balance at the end of the lease term, TCC is committed to pay the difference between the actual fair market value and unamortized balance, with the total guarantee not to exceed 68% of the unamortized balance. At June 30, 2009, the maximum potential loss for these lease agreements was approximately $1.3 million assuming the fair market value of the equipment is zero at the end of the lease term. Historically, at the end of the lease term the fair market value has been in excess of the unamortized balance.

CONTINGENCIES

Carbon Dioxide (CO_2) Public Nuisance Claims

In 2004, eight states and the City of New York filed an action in Federal District Court for the Southern District of New York against AEP, AEPSC, Cinergy Corp, Xcel Energy, Southern Company and Tennessee Valley Authority. The Natural Resources Defense Council, on behalf of three special interest groups, filed a similar complaint against the same defendants. The actions allege that CO_2 emissions from the defendants' power plants constitute a public nuisance under federal common law due to impacts of global warming, and sought injunctive relief in the form of specific emission reduction commitments from the defendants. The dismissal of this lawsuit was appealed to the Second Circuit Court of Appeals. Briefing and oral argument concluded in 2006. In April 2007, the U.S. Supreme Court issued a decision holding that the Federal EPA has authority to regulate emissions of CO_2 and other greenhouse gases under the CAA, which may impact the Second Circuit's analysis of these issues. The Second Circuit requested supplemental briefs addressing the impact of the Supreme Court's decision on this case which were provided in 2007. Management believes the actions are without merit and intends to defend against the claims.

Alaskan Villages' Claims

In February 2008, the Native Village of Kivalina and the City of Kivalina, Alaska filed a lawsuit in Federal Court in the Northern District of California against AEP, AEPSC and 22 other unrelated defendants including oil & gas companies, a coal company and other electric generating companies. The complaint alleges that the defendants' emissions of CO_2 contribute to global warming and constitute a public and private nuisance and that the defendants are acting together. The complaint further alleges that some of the defendants, including AEP, conspired to create a false scientific debate about global warming in order to deceive the public and perpetuate the alleged nuisance. The plaintiffs also allege that the effects of global warming will require the relocation of the village at an alleged cost of $95 million to $400 million. The defendants filed motions to dismiss the action. The motions are pending before the court. Management believes the action is without merit and intends to defend against the claims.

Claims by the City of Brownsville, Texas

In July 2007, the City of Brownsville, Texas filed an original petition in litigation pending in the District Court of Dallas County, Texas. The petition seeks recovery against TCC based on allegations of breach of contract, breach of fiduciary duty, unjust enrichment, constructive trust, conversion, breach of the Texas theft liability act and fraud allegedly occurring in connection with a transaction in which Brownsville purchased TCC's interest in the Oklaunion electric generating station. In 2007 and 2008, the court heard various motions for partial summary judgment. The court signed the Final Summary Judgment in favor of TCC on Brownsville's claims against TCC on June 11, 2009 and on May 28, 2009, severed TCC's claims against Brownsville for further proceedings. Brownsville filed its notice of appeal to the Dallas Court of Appeals in July 2009. The record from the trial court is due to be filed in the Court of Appeals on August 10, 2009. Management believes that the claims are without merit and intends to defend against them vigorously.

FERC Long-term Contracts

In 2002, the FERC held a hearing related to a complaint filed by Nevada Power Company and Sierra Pacific Power Company (the Nevada utilities). The complaint sought to break long-term contracts entered during the 2000 and 2001 California energy price spike which the customers alleged were “high-priced.” The complaint alleged that TCC and other AEP subsidiaries sold power at unjust and unreasonable prices because the market for power was allegedly dysfunctional at the time such contracts were executed. In 2003, the FERC rejected the complaint. In 2006, the U.S. Court of Appeals for the Ninth Circuit reversed the FERC order and remanded the case to the FERC for further proceedings. That decision was appealed to the U.S. Supreme Court. In June 2008, the U.S. Supreme Court affirmed the validity of contractually-agreed rates except in cases of serious harm to the public. The U.S. Supreme Court affirmed the Ninth Circuit’s remand on two issues, market manipulation and excessive burden on consumers. The FERC initiated remand procedures and gave the parties time to attempt to settle the issues. Management believes a provision recorded in 2008 should be sufficient. Management asserted claims against certain companies that sold power to TCC and other AEP subsidiaries, which was resold to the Nevada utilities, seeking to recover a portion of any amounts that may be owed to the Nevada utilities. Management is unable to predict the outcome of these proceedings or their impact on future net income and cash flows.

5. BENEFIT PLANS

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

Components of Net Periodic Benefit Cost

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

	Pension Plans		Other Postretirement Benefit Plans	
	Three Months Ended June 30,		Three Months Ended June 30,	
	2009	2008	2009	2008
	(in millions)			
Service Cost	$ 26	$ 25	$ 11	$ 11
Interest Cost	64	62	28	28
Expected Return on Plan Assets	(81)	(84)	(20)	(28)
Amortization of Transition Obligation	-	-	6	7
Amortization of Net Actuarial Loss	15	10	10	2
Net Periodic Benefit Cost	$ 24	$ 13	$ 35	$ 20

	Pension Plans		Other Postretirement Benefit Plans	
	Six Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
	(in millions)			
Service Cost	$ 52	$ 50	$ 21	$ 21
Interest Cost	127	125	55	56
Expected Return on Plan Assets	(161)	(168)	(40)	(56)
Amortization of Transition Obligation	-	-	13	14
Amortization of Net Actuarial Loss	30	19	21	5
Net Periodic Benefit Cost	$ 48	$ 26	$ 70	$ 40

The following table provides TCC's net periodic benefit cost for the plans for the three and six months ended June 30, 2009 and 2008:

	Pension Plans		Other Postretirement Benefit Plans	
	2009	2008	2009	2008
	(in thousands)			
Three Months Ended June 30,	$ 373	$ 208	$ 2,516	$ 1,503
Six Months Ended June 30,	746	416	5,031	3,005

6. BUSINESS SEGMENTS

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

7. DERIVATIVES AND HEDGING

Beginning in 2009, AEPSC, on behalf of TCC, executed financial heating oil and gasoline derivative contracts to hedge the price risk of diesel fuel and gasoline purchases. The amount of AOCI, net of taxes, reported in TCC's Condensed Consolidated Balance Sheet for these hedges is $209 thousand as of June 30, 2009. Not all fuel price risk exposure is hedged. During the three and six months ended June 30, 2009, TCC recognized no hedge ineffectiveness related to this hedge strategy. The maximum term for exposure to variability of these cash flows is 17 months.

8. FAIR VALUE MEASUREMENTS

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

Fair Value Measurements of Long-term Debt

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

	June 30, 2009		December 31, 2008	
	Book Value	Fair Value	Book Value	Fair Value
	(in thousands)			
Long-term Debt	$ 2,713,474	$ 2,701,624	$ 2,794,297	$ 2,706,381

Fair Value Measurements of Financial Assets and Liabilities

As described in TCC's 2008 Annual Report, SFAS 157 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). The Derivatives, Hedging and Fair Value Measurements note within TCC's 2008 Annual Report should be read in conjunction with this report.

Exchange traded derivatives, namely futures contracts, are generally fair valued based on unadjusted quoted prices in active markets and are classified within Level 1. Level 2 inputs primarily consist of OTC broker quotes in moderately active or less active markets, as well as exchange traded contracts where there is insufficient market liquidity to warrant inclusion in Level 1. Where observable inputs are available for substantially the full term of the asset or liability, the instrument is categorized in Level 2. Certain OTC and bilaterally executed derivative instruments are executed in less active markets with a lower availability of pricing information. In addition, long-dated and illiquid complex or structured transactions and FTRs can introduce the need for internally developed modeling inputs based upon extrapolations and assumptions of observable market data to estimate fair value. When such inputs have a significant impact on the measurement of fair value, the instrument is categorized in Level 3. Valuation models utilize various inputs that include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in inactive markets, market corroborated inputs (i.e. inputs derived principally from, or correlated to, observable market data) and other observable inputs for the asset or liability.

The following 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 June 30, 2009 and December 31, 2008. As required by SFAS 157, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. Management's assessment of the significance of a particular input to the fair value measurement requires judgment, and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels. There have not been any significant changes in management's valuation techniques.

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

	Level 1	Level 2	Level 3	Other	Total
Assets:			**(in thousands)**		
Other Cash Deposits (a)	$ 145,926	$ -	$ -	$ 16	$ 145,942

Assets and Liabilities Measured at Fair Value on a Recurring Basis as of December 31, 2008

	Level 1	Level 2	Level 3	Other	Total
Assets:			**(in thousands)**		
Other Cash Deposits (a)	$ 172,923	$ -	$ -	$ 16	$ 172,939

(a) Amounts in "Other" column primarily represent cash deposits with third-parties. Level 1 amounts primarily represent investments in money market funds.

9. INCOME TAXES

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.

TCC and other AEP subsidiaries are no longer subject to U.S. federal examination for years before 2000. TCC and other AEP subsidiaries have completed the exam for the years 2001 through 2006 and have issues that are being pursued at the appeals level. Although the outcome of tax audits is uncertain, in management's opinion, adequate provisions for income taxes have been made for potential liabilities resulting from such matters. In addition, 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 have a material adverse effect on net income.

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

Federal Tax Legislation

The American Recovery and Reinvestment Act of 2009 was signed into law by the President in February 2009. It provided for several new grant programs and expanded tax credits and an extension of the 50% bonus depreciation provision enacted in the Economic Stimulus Act of 2008. The enacted provisions are not expected to have a material impact on net income or financial condition. However, management forecasts the bonus depreciation provision could provide a significant favorable cash flow benefit in 2009.

10. FINANCING ACTIVITIES

Long-term Debt

Principal payments made during the first six months of 2009 were:

	Type of Debt	Principal Amount Paid (in thousands)	Interest Rate	Due Date
Principal Payments:	Securitization Bonds	$ 30,890	5.56%	2010
	Securitization Bonds	50,019	4.98%	2010

In July 2009, TCC issued $101 million of 6.3% Pollution Control Bonds due in 2029.

Utility Money Pool – AEP System

The AEP System uses a corporate borrowing program to meet the short-term borrowing needs of its subsidiaries. The corporate borrowing program includes a Utility Money Pool, which funds the utility subsidiaries. The AEP System Utility Money Pool operates in accordance with the terms and conditions approved in a regulatory order. The amount of outstanding loans (borrowings) to/from the Utility Money Pool as of June 30, 2009 and December 31, 2008 are included in Advances to/from Affiliates on TCC's balance sheets. TCC's Utility Money Pool activity and corresponding authorized borrowing limits for the six months ended June 30, 2009 are described in the following table:

Maximum Borrowings from Utility Money Pool	Maximum Loans to Utility Money Pool	Average Borrowings from Utility Money Pool	Average Loans to Utility Money Pool	Loans to Utility Money Pool as of June 30, 2009	Authorized Short-Term Borrowing Limit
		(in thousands)			
$ 119,935	$ 25,811	$ 31,965	$ 20,415	$ 25,811	$ 200,000

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

	Maximum Interest Rates for Funds Borrowed from the Utility Money Pool	Minimum Interest Rates for Funds Borrowed from the Utility Money Pool	Maximum Interest Rates for Funds Loaned to the Utility Money Pool	Minimum Interest Rates For Funds Loaned to the Utility Money Pool	Average Interest Rate for Funds Borrowed from the Utility Money Pool	Average Interest Rate for Funds Loaned to the Utility Money Pool
2009	2.28%	0.65%	1.76%	0.72%	1.66%	0.73%
2008	2.92%	2.92%	5.37%	2.91%	2.92%	4.09%

Credit Facilities

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