

AEP Texas North Company and Subsidiary

2010 Third 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 System	American Electric Power System, an rated electric utility system, owned and operated by AEP's electric utility subsidiaries.
AEPSC	American Electric Power Service Corporation, a service subsidiary providing management and professional services to AEP and its subsidiaries.
AOCI	Accumulated Other Comprehensive Income.
CO ₂	Carbon Dioxide and other greenhouse gases.
CWIP	Construction Work in Progress.
ERCOT	Electric Reliability Council of Texas.
ETT	Electric Transmission Texas, LLC, an equity interest joint venture between AEP Utilities, Inc. and MidAmerican Energy Holdings Company Texas Transco, LLC formed to own and operate electric transmission facilities in ERCOT.
Federal EPA	United States Environmental Protection Agency.
FERC	Federal Energy Regulatory Commission.
GAAP	Accounting Principles Generally Accepted in the United States of America.
MTM	Mark-to-Market.
Nonutility Money Pool	AEP's Nonutility Money Pool.
OPEB	Other Postretirement Benefit Plans.
OTC	Over the counter.
PUCT	Public Utility Commission of Texas.
Risk Management Contracts	Trading and nontrading derivatives, including those derivatives designated as cash flow and fair value hedges.
TNC	AEP Texas North Company, an AEP electric utility subsidiary.
Utility Money Pool	AEP System's Utility Money Pool.

AEP TEXAS NORTH COMPANY AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
For the Three and Nine Months Ended September 30, 2010 and 2009
(in thousands)
(Unaudited)

	Three Months Ended		Nine Months Ended	
	2010	2009	2010	2009
REVENUES				
Electric Transmission and Distribution	\$ 53,799	\$ 48,089	\$ 149,229	\$ 133,349
Sales to AEP Affiliates	24,699	21,999	63,961	61,098
Other Revenues	153	157	972	652
TOTAL REVENUES	78,651	70,245	214,162	195,099
EXPENSES				
Fuel and Other Consumables Used for Electric Generation	13,230	11,496	29,239	22,117
Other Operation	20,594	19,405	72,126	57,923
Maintenance	5,164	4,697	15,236	17,267
Depreciation and Amortization	12,944	12,049	38,982	35,953
Taxes Other Than Income Taxes	4,471	4,030	13,648	13,487
TOTAL EXPENSES	56,403	51,677	169,231	146,747
OPERATING INCOME	22,248	18,568	44,931	48,352
Other Income (Expense):				
Other Income (Expense)	12	207	(25)	721
Interest Expense	(5,521)	(5,047)	(16,418)	(16,033)
INCOME BEFORE INCOME TAX EXPENSE	16,739	13,728	28,488	33,040
Income Tax Expense	5,963	4,272	10,163	10,522
NET INCOME	10,776	9,456	18,325	22,518
Preferred Stock Dividend Requirements	26	26	78	78
EARNINGS ATTRIBUTABLE TO COMMON STOCK	\$ 10,750	\$ 9,430	\$ 18,247	\$ 22,440

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

See Condensed Notes to Condensed Consolidated Financial Statements.

AEP TEXAS NORTH COMPANY AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN COMMON SHAREHOLDER'S
EQUITY AND COMPREHENSIVE INCOME (LOSS)
For the Nine Months Ended September 30, 2010 and 2009
(in thousands)
(Unaudited)

	Common Stock	Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
TOTAL COMMON SHAREHOLDER'S EQUITY – DECEMBER 31, 2008	\$ 137,214	\$ 2,351	\$ 200,167	\$ (16,256)	\$ 323,476
Common Stock Dividends			(24,000)		(24,000)
Preferred Stock Dividends			(78)		(78)
Other Changes in Common Shareholder's Equity		1,089	(1,089)		-
SUBTOTAL – COMMON SHAREHOLDER'S EQUITY					299,398
COMPREHENSIVE INCOME					
Other Comprehensive Income, Net of Taxes:					
Cash Flow Hedges, Net of Tax of \$23				43	43
Amortization of Pension and OPEB Deferred Costs, Net of Tax of \$237				439	439
NET INCOME			22,518		22,518
TOTAL COMPREHENSIVE INCOME					23,000
TOTAL COMMON SHAREHOLDER'S EQUITY – SEPTEMBER 30, 2009	\$ 137,214	\$ 3,440	\$ 197,518	\$ (15,774)	\$ 322,398
TOTAL COMMON SHAREHOLDER'S EQUITY – DECEMBER 31, 2009	\$ 137,214	\$ 3,440	\$ 185,328	\$ (16,071)	\$ 309,911
Common Stock Dividends			(23,500)		(23,500)
Preferred Stock Dividends			(78)		(78)
SUBTOTAL – COMMON SHAREHOLDER'S EQUITY					286,333
COMPREHENSIVE INCOME					
Other Comprehensive Income (Loss), Net of Taxes:					
Cash Flow Hedges, Net of Tax of \$36				(67)	(67)
Amortization of Pension and OPEB Deferred Costs, Net of Tax of \$254				472	472
NET INCOME			18,325		18,325
TOTAL COMPREHENSIVE INCOME					18,730
TOTAL COMMON SHAREHOLDER'S EQUITY – SEPTEMBER 30, 2010	\$ 137,214	\$ 3,440	\$ 180,075	\$ (15,666)	\$ 305,063

See Condensed Notes to Condensed Condolidated Financial Statements.

**AEP TEXAS NORTH COMPANY AND SUBSIDIARY
CONDENSED CONSOLIDATED BALANCE SHEETS**

ASSETS

September 30, 2010 and December 31, 2009

(in thousands)

(Unaudited)

	2010	2009
CURRENT ASSETS		
Cash and Cash Equivalents	\$ 200	\$ 200
Accounts Receivable:		
Customers	12,901	10,500
Affiliated Companies	44,906	46,836
Accrued Unbilled Revenues	8,517	6,900
Miscellaneous	660	874
Allowance for Uncollectible Accounts	(182)	(295)
Total Accounts Receivable	66,802	64,815
Fuel	4,713	6,476
Materials and Supplies	11,573	10,945
Risk Management Assets	11	112
Deferred Income Tax Benefits	6,470	7,670
Prepayments and Other Current Assets	2,242	2,365
TOTAL CURRENT ASSETS	92,011	92,583
PROPERTY, PLANT AND EQUIPMENT		
Electric:		
Production	304,030	300,291
Transmission	449,393	484,989
Distribution	589,410	568,364
Other Property, Plant and Equipment	105,196	104,380
Construction Work in Progress	31,833	63,470
Total Property, Plant and Equipment	1,479,862	1,521,494
Accumulated Depreciation and Amortization	487,848	479,878
TOTAL PROPERTY, PLANT AND EQUIPMENT – NET	992,014	1,041,616
OTHER NONCURRENT ASSETS		
Regulatory Assets	61,424	64,762
Deferred Charges and Other Noncurrent Assets	5,030	1,814
TOTAL OTHER NONCURRENT ASSETS	66,454	66,576
TOTAL ASSETS	\$ 1,150,479	\$ 1,200,775

See Condensed Notes to Condensed Consolidated Financial Statements.

**AEP TEXAS NORTH COMPANY AND SUBSIDIARY
CONDENSED CONSOLIDATED BALANCE SHEETS
LIABILITIES AND SHAREHOLDERS' EQUITY
September 30, 2010 and December 31, 2009
(Unaudited)**

	2010	2009
	(in thousands)	
CURRENT LIABILITIES		
Advances from Affiliates	\$ 30,031	\$ 76,196
Accounts Payable:		
General	6,071	7,155
Affiliated Companies	40,259	45,056
Long-term Debt Due Within One Year – Nonaffiliated	6	5
Accrued Taxes	31,223	27,379
Accrued Interest	4,938	5,914
Other Current Liabilities	8,314	12,419
TOTAL CURRENT LIABILITIES	120,842	174,124
NONCURRENT LIABILITIES		
Long-term Debt – Nonaffiliated	370,118	370,055
Deferred Income Taxes	120,599	122,577
Regulatory Liabilities and Deferred Investment Tax Credits	155,600	145,072
Employee Benefits and Pension Obligations	36,757	40,842
Deferred Credits and Other Noncurrent Liabilities	39,151	35,845
TOTAL NONCURRENT LIABILITIES	722,225	714,391
TOTAL LIABILITIES	843,067	888,515
Cumulative Preferred Stock Not Subject to Mandatory Redemption	2,349	2,349
Rate Matters (Note 2)		
Commitments and Contingencies (Note 3)		
COMMON SHAREHOLDER'S EQUITY		
Common Stock – Par Value – \$25 Per Share:		
Authorized – 7,800,000 Shares		
Outstanding – 5,488,560 Shares	137,214	137,214
Paid-in Capital	3,440	3,440
Retained Earnings	180,075	185,328
Accumulated Other Comprehensive Income (Loss)	(15,666)	(16,071)
TOTAL COMMON SHAREHOLDER'S EQUITY	305,063	309,911
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 1,150,479	\$ 1,200,775

See Condensed Notes to Condensed Consolidated Financial Statements.

AEP TEXAS NORTH COMPANY AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Nine Months Ended September 30, 2010 and 2009
(in thousands)
(Unaudited)

	2010	2009
OPERATING ACTIVITIES		
Net Income	\$ 18,325	\$ 22,518
Adjustments to Reconcile Net Income to Net Cash Flows from Operating Activities:		
Depreciation and Amortization	38,982	35,953
Deferred Income Taxes	(3,519)	(5,900)
Change in Other Noncurrent Assets	(3,966)	(4,711)
Change in Other Noncurrent Liabilities	5,015	3,558
Changes in Certain Components of Working Capital:		
Accounts Receivable, Net	(1,987)	11,041
Fuel, Materials and Supplies	1,135	293
Accounts Payable	(5,266)	16,279
Accrued Taxes, Net	3,844	2,276
Other Current Assets	284	(413)
Other Current Liabilities	(5,156)	(2,601)
Net Cash Flows from Operating Activities	47,691	78,293
INVESTING ACTIVITIES		
Construction Expenditures	(51,119)	(67,943)
Proceeds from Sales of Assets	73,846	2,726
Other Investing Activities	(234)	(328)
Net Cash Flows from (Used for) Investing Activities	22,493	(65,545)
FINANCING ACTIVITIES		
Change in Advances from Affiliates, Net	(46,165)	11,624
Retirement of Long-term Debt – Nonaffiliated	(4)	-
Principal Payments for Capital Lease Obligations	(560)	(434)
Dividends Paid on Common Stock	(23,500)	(24,000)
Dividends Paid on Cumulative Preferred Stock	(78)	(78)
Other Financing Activities	123	140
Net Cash Flows Used for Financing Activities	(70,184)	(12,748)
Net Change in Cash and Cash Equivalents	-	-
Cash and Cash Equivalents at Beginning of Period	200	200
Cash and Cash Equivalents at End of Period	\$ 200	\$ 200
SUPPLEMENTARY INFORMATION		
Cash Paid for Interest, Net of Capitalized Amounts	\$ 16,935	\$ 19,212
Net Cash Paid for Income Taxes	11,004	3,124
Noncash Acquisitions Under Capital Leases	174	268
Construction Expenditures Included in Accounts Payable at September 30,	2,780	3,998

See Condensed Notes to Condensed Consolidated Financial Statements.

INDEX TO CONDENSED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

General

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

In the opinion of management, the unaudited condensed consolidated interim financial statements reflect all normal and recurring accruals and adjustments necessary for a fair presentation of the net income, financial position and cash flows for the interim periods. Net income for the three and nine months ended September 30, 2010 is not necessarily indicative of results that may be expected for the year ending December 31, 2010. The condensed consolidated financial statements are unaudited and should be read in conjunction with the audited 2009 financial statements and notes thereto, which are included in TNC's 2009 Annual Report.

Management reviewed subsequent events through November 1, 2010, the date that the 2010 third quarter report was issued.

Variable Interest Entities

The accounting guidance for "Variable Interest Entities" is a consolidation model that considers if a company has a controlling financial interest in a VIE. A controlling financial interest will have both (a) the power to direct the activities of a VIE that most significantly impact the VIE's economic performance and (b) the obligation to absorb losses of the VIE that could potentially be significant to the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE. Entities are required to consolidate a VIE when it is determined that they have a controlling financial interest in a VIE and therefore, are the primary beneficiary of that VIE, as defined by the accounting guidance for "Variable Interest Entities." In determining whether TNC is the primary beneficiary of a VIE, management considers factors such as equity at risk, the amount of the VIE's variability TNC absorbs, guarantees of indebtedness, voting rights including kick-out rights, power to direct the VIE and other factors. Management believes that significant assumptions and judgments were applied consistently. There have been no changes to the reporting of VIEs in the financial statements where it is concluded that TNC is the primary beneficiary. In addition, TNC has not provided financial or other support to any VIE that was not previously contractually required.

AEPSC provides certain managerial and professional services to TNC and other subsidiaries. AEP is the sole equity owner of AEPSC. AEP management controls the activities of AEPSC. The costs of the services are based on a direct charge or on a prorated basis and billed to TNC and other subsidiaries at AEPSC's cost. TNC and other subsidiaries have not provided financial or other support outside the reimbursement of costs for services rendered. AEPSC finances its operations through cost reimbursement from other AEP subsidiaries. There are no other terms or arrangements between AEPSC and TNC and other subsidiaries that could require additional financial support from TNC and other subsidiaries or expose them to losses outside of the normal course of business. AEPSC and its billings are subject to regulation by the FERC. TNC and other subsidiaries are exposed to losses to the extent they cannot recover the costs of AEPSC through their normal business operations. TNC is considered to have a significant interest in AEPSC due to its activity in AEPSC's cost reimbursement structure. However, TNC does not have control over AEPSC. AEPSC is consolidated by AEP. In the event AEPSC would require financing or other support outside the cost reimbursement billings, this financing would be provided by AEP. Total billings from AEPSC for the three months ended September 30, 2010 and 2009 were \$6 million and \$8 million, respectively, and for the nine months ended September 30, 2010 and 2009 were \$26 million and \$22 million, respectively. The carrying amount of liabilities associated with AEPSC as of September 30, 2010 and December 31, 2009 were \$2 million and \$3 million, respectively. Management estimates the maximum exposure of loss to be equal to the amount of such liability.

Adjustments to Benefit Plans Footnote

In Note 5 – Benefit Plans, the disclosure was expanded for TNC to reflect certain prior period amounts related to the Net Periodic Benefit Costs and the Estimated Future Benefit Payments and Contributions that were not previously disclosed. These omissions were not material to the financial statements and had no impact on TNC's previously reported net income, changes in shareholder's equity, financial position or cash flows.

2. RATE MATTERS

As discussed in TNC's 2009 Annual Report, TNC is involved in rate and regulatory proceedings at the FERC and the PUCT. The Rate Matters note within TNC's 2009 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 2010 and updates TNC's 2009 Annual Report.

ETT 2007 Formation Appeal

ETT is a joint venture between AEP Utilities, Inc. and MidAmerican Energy Holdings Company Texas Transco, LLC. TCC and TNC have sold transmission assets both in service and under construction to ETT. The PUCT approved ETT's initial rates, a request for a transfer of in-service assets and CWIP and a certificate of convenience and necessity (CCN) to operate as a stand alone transmission utility in ERCOT. ETT was allowed a 9.96% return on common equity. Intervenors appealed the PUCT's decision. In March 2010, the Texas Court of Appeals affirmed the PUCT's decision in all material respects. Intervenors filed for rehearing at the Texas Court of Appeals which was denied in May 2010. The deadline to appeal this decision to the Texas Supreme Court has expired.

In a separate development, the Texas governor signed a new law that clarifies the PUCT's authority to grant CCNs to transmission only utilities such as ETT. ETT filed an application with the PUCT for a CCN under the new law. In March 2010, the PUCT approved the application for a CCN under the new law.

3. COMMITMENTS, GUARANTEES AND CONTINGENCIES

TNC is subject to certain claims and legal actions arising in its ordinary course of business. In addition, TNC's business activities are subject to extensive governmental regulation related to public health and the environment. The ultimate outcome of such pending or potential litigation cannot be predicted. For current proceedings not specifically discussed below, management does not anticipate that the liabilities, if any, arising from such proceedings would have a material adverse effect on the financial statements. The Commitments, Guarantees and Contingencies note within the 2009 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.

Indemnifications and Other Guarantees

Contracts

TNC enters into certain types of contracts which require indemnifications. Typically these contracts include, but are not limited to, sale agreements, lease agreements, purchase agreements and financing agreements. Generally, these agreements may include, but are not limited to, indemnifications around certain tax, contractual and environmental matters. With respect to sale agreements, exposure generally does not exceed the sale price. Prior to September 30, 2010, TNC entered into sale agreements including indemnifications with a maximum exposure of \$3 million related to the sale price of certain generation assets in Texas. There are no material liabilities recorded for any indemnifications and the risk of payment/performance is remote.

Master Lease Agreements

TNC leases certain equipment under master lease agreements. GE Capital Commercial Inc. (GE) notified management in November 2008 that they elected to terminate the Master Leasing Agreements in accordance with the termination rights specified within the contract. In 2011, TNC will be required to purchase all equipment under the lease and pay GE an amount equal to the unamortized value of all equipment then leased. Management is currently in negotiations to replace this agreement. In December 2008 and 2009, management signed new master lease agreements that include lease terms of up to 10 years.

For equipment under the GE master lease agreements that expire in 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 value of the leased equipment is below the unamortized balance at the end of the lease term, TNC is committed to pay the difference between the fair 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 a residual value up to a stated percentage of either the unamortized balance or the equipment cost at the end of the lease term. If the actual fair value of the leased equipment is below the guaranteed residual value at the end of the lease term, TNC is committed to pay the difference between the actual fair value and the residual value guarantee. At September 30, 2010, the maximum potential loss for these lease agreements was approximately \$213 thousand assuming the fair value of the equipment is zero at the end of the lease term. Historically, at the end of the lease term the fair value has been in excess of the unamortized balance.

CONTINGENCIES

Carbon Dioxide 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 (TVA). The Natural Resources Defense Council, on behalf of three special interest groups, filed a similar complaint against the same defendants. The actions allege that CO₂ 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 trial court dismissed the lawsuits.

In September 2009, the Second Circuit Court of Appeals issued a ruling on appeal remanding the cases to the Federal District Court for the Southern District of New York. The Second Circuit held that the issues of climate change and global warming do not raise political questions and that Congress' refusal to regulate CO₂ emissions does not mean that plaintiffs must wait for an initial policy determination by Congress or the President's administration to secure the relief sought in their complaints. The court stated that Congress could enact comprehensive legislation to regulate CO₂ emissions or that the Federal EPA could regulate CO₂ emissions under existing Clean Air Act authorities and that either of these actions could override any decision made by the district court under federal common law. The Second Circuit did not rule on whether the plaintiffs could proceed with their state common law nuisance claims. The defendants' petition for rehearing was denied. Management believes the actions are without merit and intends to continue to defend against the claims. The defendants, excluding TVA, filed a petition for review with the U.S. Supreme Court in August 2010. The Solicitor General filed a brief in support of the petition on behalf of TVA. Responses to the petition are due in November 2010.

In October 2009, the Fifth Circuit Court of Appeals reversed a decision by the Federal District Court for the District of Mississippi dismissing state common law nuisance claims in a putative class action by Mississippi residents asserting that CO₂ emissions exacerbated the effects of Hurricane Katrina. The Fifth Circuit held that there was no exclusive commitment of the common law issues raised in plaintiffs' complaint to a coordinate branch of government and that no initial policy determination was required to adjudicate these claims. The court granted petitions for rehearing. An additional recusal left the Fifth Circuit without a quorum to reconsider the decision and the appeal was dismissed, leaving the district court's decision in place. TNC was initially dismissed from this case without prejudice, but is named as a defendant in a pending fourth amended complaint. Plaintiffs filed a petition with the U.S. Supreme Court asking the court to remand the case to the Fifth Circuit and reinstate the panel decision. Responses to the petition are due in November 2010.

Management is unable to determine a range of potential losses that are reasonably possible of occurring.

Alaskan Villages' Claims

In 2008, the Native Village of Kivalina and the City of Kivalina, Alaska filed a lawsuit in Federal Court in the Northern District of California against AEP, AEPSC and 22 other unrelated defendants including oil and gas companies, a coal company and other electric generating companies. The complaint alleges that the defendants' emissions of CO₂ contribute to global warming and constitute a public and private nuisance and that the defendants are acting together. The complaint further alleges that some of the defendants, including AEP, conspired to create a false scientific debate about global warming in order to deceive the public and perpetuate the alleged nuisance. The plaintiffs also allege that the effects of global warming will require the relocation of the village at an alleged cost of \$95 million to \$400 million. In October 2009, the judge dismissed plaintiffs' federal common law claim for nuisance, finding the claim barred by the political question doctrine and by plaintiffs' lack of standing to bring the claim. The judge also dismissed plaintiffs' state law claims without prejudice to refile in state court. The plaintiffs appealed the decision. Briefing is complete and no date has been set for oral argument. Management believes the action is without merit and intends to defend against the claims. Management is unable to determine a range of potential losses that are reasonably possible of occurring.

4. DISPOSITIONS

2010

TNC sold \$73 million of transmission facilities to ETT for the nine months ended September 30, 2010. There were no gains or losses recorded on these transactions.

2009

TNC sold \$1 million of transmission facilities to ETT for the nine months ended September 30, 2009. There were no gains or losses recorded on these transactions.

5. BENEFIT PLANS

TNC participates in an AEP sponsored qualified pension plan and two unfunded nonqualified pension plans. A substantial majority of employees are covered by the qualified plan or both the qualified and a nonqualified pension plan. In addition, TNC participates in OPEB plans sponsored by AEP to provide medical and life insurance benefits for retired employees.

Components of Net Periodic Benefit Cost

The following tables provide the components of TNC's net periodic benefit cost for the plans for the three and nine months ended September 30, 2010 and 2009:

	Pension Plans		Other Postretirement Benefit Plans	
	Three Months Ended September 30,		Three Months Ended September 30,	
	2010	2009	2010	2009
	(in thousands)			
Service Cost	\$ 460	\$ 460	\$ 211	\$ 195
Interest Cost	1,430	1,511	657	656
Expected Return on Plan Assets	(1,988)	(2,052)	(638)	(506)
Amortization of Transition Obligation	-	-	382	382
Amortization of Prior Service Credit	(105)	(119)	-	-
Amortization of Net Actuarial Loss	501	349	164	252
Net Periodic Benefit Cost	\$ 298	\$ 149	\$ 776	\$ 979

	Pension Plans		Other Postretirement Benefit Plans	
	Nine Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(in thousands)			
Service Cost	\$ 1,379	\$ 1,382	\$ 632	\$ 583
Interest Cost	4,290	4,532	1,972	1,968
Expected Return on Plan Assets	(5,963)	(6,154)	(1,912)	(1,517)
Amortization of Transition Obligation	-	-	1,145	1,145
Amortization of Prior Service Credit	(315)	(357)	-	-
Amortization of Net Actuarial Loss	1,504	1,046	492	758
Net Periodic Benefit Cost	\$ 895	\$ 449	\$ 2,329	\$ 2,937

The following table provides TNC's actual contributions and payments for the pension and OPEB plans during the first nine months of 2010 and the expected contributions and payments for the remainder of 2010:

Paid as of September 30, 2010		Remainder Expected to be Paid in 2010	
Pension Plans	Other Postretirement Benefit Plans	Pension Plans	Other Postretirement Benefit Plans
(in thousands)			
\$ 2,883	\$ 2,569	\$ 499	\$ 840

6. BUSINESS SEGMENTS

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

7. DERIVATIVES AND HEDGING

Cash Flow Hedging Strategies

TNC's vehicle fleet is exposed to gasoline and diesel fuel price volatility. AEPSC, on behalf of TNC, enters into financial heating oil and gasoline derivative contracts in order to mitigate price risk of future fuel purchases. Not all fuel price risk exposure is hedged.

The gross notional volumes of TNC's outstanding derivative contracts for heating oil and gasoline as of September 30, 2010 and December 31, 2009 were 495 thousand gallons and 418 thousand gallons, respectively.

The following tables represent the gross fair value impact of TNC's derivative activity on the Condensed Consolidated Balance Sheets as of September 30, 2010 and December 31, 2009:

**Fair Value of Derivative Instruments
September 30, 2010**

<u>Balance Sheet Location</u>	<u>Hedging Contracts (a)</u>	<u>Other (a) (b) (in thousands)</u>	<u>Total</u>
Current Risk Management Assets	\$ 32	\$ (21)	\$ 11
Long-term Risk Management Assets	2	-	2
Total Assets	<u>34</u>	<u>(21)</u>	<u>13</u>
Current Risk Management Liabilities	26	(26)	-
Long-term Risk Management Liabilities	4	(4)	-
Total Liabilities	<u>30</u>	<u>(30)</u>	<u>-</u>
Total MTM Derivative Contract Net Assets	<u>\$ 4</u>	<u>\$ 9</u>	<u>\$ 13</u>

**Fair Value of Derivative Instruments
December 31, 2009**

<u>Balance Sheet Location</u>	<u>Hedging Contracts (a)</u>	<u>Other (a) (b) (in thousands)</u>	<u>Total</u>
Current Risk Management Assets	\$ 113	\$ (1)	\$ 112
Long-term Risk Management Assets	-	-	-
Total Assets	<u>113</u>	<u>(1)</u>	<u>112</u>
Current Risk Management Liabilities	1	(1)	-
Long-term Risk Management Liabilities	-	-	-
Total Liabilities	<u>1</u>	<u>(1)</u>	<u>-</u>
Total MTM Derivative Contract Net Assets	<u>\$ 112</u>	<u>\$ -</u>	<u>\$ 112</u>

- (a) Derivative instruments within these categories are reported gross. These instruments are subject to master netting agreements and are presented on the Condensed Consolidated Balance Sheets on a net basis in accordance with the accounting guidance for "Derivatives and Hedging."
- (b) Amounts represent counterparty netting of risk management and hedging contracts, associated cash collateral in accordance with the accounting guidance for "Derivatives and Hedging" and dedesignated risk management contracts.

Accounting for Cash Flow Hedging Strategies

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

TNC reclassifies gains and losses on financial fuel derivative contracts designated as cash flow hedges from Accumulated Other Comprehensive Income (Loss) on its balance sheets into Other Operation expense, Maintenance expense or Depreciation and Amortization expense, as it relates to capital projects, on its Condensed Consolidated Statements of Income. During the three and nine months ended September 30, 2010 and 2009, TNC designated cash flow hedging strategies of forecasted fuel purchases. Hedge ineffectiveness was immaterial for this hedge strategy.

The following tables provide details on designated, effective cash flow hedges included in AOCI on TNC's Condensed Consolidated Balance Sheets and the reasons for changes in cash flow hedges for the three and nine months ended September 30, 2010 and 2009. All amounts in the following tables are presented net of related income taxes.

Total Accumulated Other Comprehensive Income (Loss) Activity for Cash Flow Hedges For the Three Months Ended September 30, 2010 and 2009

	<u>2010</u>	<u>2009</u>
	(in thousands)	
Balance in AOCI as of July 1,	\$ (23)	\$ 95
Changes in Fair Value Recognized in AOCI	41	(30)
Amount of (Gain) or Loss Reclassified from AOCI to Income Statement/within Balance Sheet:		
Other Operation Expense	(5)	(14)
Maintenance Expense	(2)	-
Property, Plant and Equipment	(4)	(8)
Balance in AOCI as of September 30,	<u>\$ 7</u>	<u>\$ 43</u>

Total Accumulated Other Comprehensive Income (Loss) Activity for Cash Flow Hedges For the Nine Months Ended September 30, 2010 and 2009

	<u>2010</u>	<u>2009</u>
	(in thousands)	
Balance in AOCI as of January 1,	\$ 74	\$ -
Changes in Fair Value Recognized in AOCI	(21)	68
Amount of (Gain) or Loss Reclassified from AOCI to Income Statement/within Balance Sheet:		
Other Operation Expense	(21)	(16)
Maintenance Expense	(8)	-
Property, Plant and Equipment	(17)	(9)
Balance in AOCI as of September 30,	<u>\$ 7</u>	<u>\$ 43</u>

Cash flow hedges included in Accumulated Other Comprehensive Income (Loss) on TNC's Condensed Consolidated Balance Sheets at September 30, 2010 and December 31, 2009 were:

**Impact of Cash Flow Hedges on the Condensed Consolidated Balance Sheet
September 30, 2010 and December 31, 2009**

	<u>September 30, 2010</u>	<u>December 31, 2009</u>
	(in thousands)	
Hedging Assets	\$ 12	\$ 112
Hedging Liabilities	(8)	-
AOCI Gain Net of Tax	7	74
Portion Expected to be Reclassified to Net Income During the Next Twelve Months	9	74

The actual amounts that TNC reclassifies from Accumulated Other Comprehensive Income (Loss) to Net Income can differ from the estimate above due to market price changes. As of September 30, 2010, the maximum length of time that TNC is hedging (with contracts subject to the accounting guidance for "Derivatives and Hedging") exposure to variability in future cash flows related to forecasted transactions is 15 months.

8. 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.

For commercial activities, exchange traded derivatives, namely futures contracts, are generally fair valued based on unadjusted quoted prices in active markets and are classified as Level 1. Level 2 inputs primarily consist of OTC broker quotes in moderately active or less active markets, as well as exchange traded contracts where there is insufficient market liquidity to warrant inclusion in Level 1. Management verifies price curves using these broker quotes and classifies these fair values within Level 2 when substantially all of the fair value can be corroborated. Management typically obtains multiple broker quotes, which are non-binding in nature, but are based on recent trades in the marketplace. When multiple broker quotes are obtained, the quoted bid and ask prices are averaged. In certain circumstances, a broker quote may be discarded if it is a clear outlier. Management uses a historical correlation analysis between the broker quoted location and the illiquid locations and if the points are highly correlated, these locations are included within Level 2 as well. Certain OTC and bilaterally executed derivative instruments are executed in less active markets with a lower availability of pricing information. 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 as Level 3.

Fair Value Measurements of Long-term Debt

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

The book values and fair values of TNC's Long-term Debt as of September 30, 2010 and December 31, 2009 are summarized in the following table:

	<u>September 30, 2010</u>		<u>December 31, 2009</u>	
	<u>Book Value</u>	<u>Fair Value</u>	<u>Book Value</u>	<u>Fair Value</u>
	(in thousands)			
Long-term Debt	\$ 370,124	\$ 413,353	\$ 370,060	\$ 393,633

Fair Value Measurements of Financial Assets and Liabilities

The following tables set forth, by level within the fair value hierarchy, TNC's financial assets and liabilities that were accounted for at fair value on a recurring basis as of September 30, 2010 and December 31, 2009. As required by the accounting guidance for "Fair Value Measurements and Disclosures," financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. Management's assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels. There have not been any significant changes in management's valuation techniques.

**Assets and Liabilities Measured at Fair Value on a Recurring Basis
September 30, 2010**

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Other</u>	<u>Total</u>
	(in thousands)				
Risk Management Assets					
Cash Flow Hedges:					
Commodity Hedges (a)	\$ -	\$ 34	\$ -	\$ (21)	\$ 13
Risk Management Liabilities					
Cash Flow Hedges:					
Commodity Hedges (a)	\$ -	\$ 30	\$ -	\$ (30)	\$ -

**Assets and Liabilities Measured at Fair Value on a Recurring Basis
December 31, 2009**

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Other</u>	<u>Total</u>
	(in thousands)				
Risk Management Assets					
Cash Flow Hedges:					
Commodity Hedges (a)	\$ -	\$ 113	\$ -	\$ (1)	\$ 112
Risk Management Liabilities					
Cash Flow Hedges:					
Commodity Hedges (a)	\$ -	\$ 1	\$ -	\$ (1)	\$ -

(a) Amounts in "Other" column primarily represent counterparty netting of risk management and hedging contracts and associated cash collateral under the accounting guidance for "Derivatives and Hedging."

There have been no transfers between Level 1 and Level 2 during the nine months ended September 30, 2010.

9. INCOME TAXES

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

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

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

Federal Legislation

The Patient Protection and Affordable Care Act and the related Health Care and Education Reconciliation Act (Health Care Acts) were enacted in March 2010. The Health Care Acts amend tax rules so that the portion of employer health care costs that are reimbursed by the Medicare Part D prescription drug subsidy will no longer be deductible by the employer for federal income tax purposes effective for years beginning after December 31, 2012. Because of the loss of the future tax deduction, a reduction in the deferred tax asset related to the nondeductible OPEB liabilities accrued to date was recorded by TNC in March 2010. This reduction, which was partially offset by recording net tax regulatory assets, did not materially affect TNC's cash flows or financial condition, but decreased net income by approximately \$300 thousand for the nine months ended September 30, 2010.

The Small Business Jobs Act was enacted in September 2010. Included in this act was a one-year extension of the 50% bonus depreciation provision. The enacted provision will not have a material impact on TNC's net income or financial condition but will have a material favorable impact on cash flows.

10. FINANCING ACTIVITIES

Long-term Debt

Long-term debt principal payments made during the first nine months of 2010 were:

Type of Debt	Principal Amount Paid (in thousands)	Interest Rate (%)	Due Date
Notes Payable	\$ 4	4.50	2059

Dividend Restrictions

Federal Power Act

The Federal Power Act prohibits TNC from participating “in the making or paying of any dividends of such public utility from any funds properly included in capital account.” The term “capital account” is not defined in the Federal Power Act or its regulations. Management understands “capital account” to mean the par value of the common stock multiplied by the number of shares outstanding. This restriction does not limit the ability of TNC to pay dividends out of retained earnings.

Charter and Leverage Restrictions

Provisions within the articles or certificates of incorporation of TNC relating to preferred stock or shares restrict the payment of cash dividends on common and preferred stock or shares. Pursuant to credit agreement leverage restrictions, as of September 30, 2010, approximately \$50 million of the retained earnings of TNC have restrictions related to the payment of dividends.

Money Pool – AEP System

The AEP System uses a corporate borrowing program to meet the short-term borrowing needs of its subsidiaries. The corporate borrowing program includes a Utility Money Pool, which funds the utility subsidiaries, and a Nonutility Money Pool, which funds the majority of the nonutility subsidiaries. The AEP System Utility Money Pool operates in accordance with the terms and conditions approved in a regulatory order. The amount of outstanding loans (borrowings) to/from the Utility Money Pool and the Nonutility Money Pool is shown as a net borrowing position as of September 30, 2010 and December 31, 2009 and is included in Advances from Affiliates on TNC’s balance sheets. TNC’s Utility Money Pool activity and corresponding authorized borrowing limit for the nine months ended September 30, 2010 is 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	Borrowings from Utility Money Pool as of September 30, 2010	Authorized Short-Term Borrowing Limit
(in thousands)					
\$ 108,321	\$ -	\$ 60,919	\$ -	\$ 41,339	\$ 250,000

The activity in the above table does not include short-term lending activity of TNC’s wholly-owned subsidiary, AEP Texas North Generation Company LLC (TNGC), who is a participant in the Nonutility Money Pool. For the nine months ended September 30, 2010, TNGC had the following activity in the Nonutility Money Pool:

Maximum Borrowings from Nonutility Money Pool	Maximum Loans to Nonutility Money Pool	Average Borrowings from Nonutility Money Pool	Average Loans to Nonutility Money Pool	Loans to Nonutility Money Pool as of September 30, 2010
(in thousands)				
\$ -	\$ 11,917	\$ -	\$ 11,327	\$ 11,308

Maximum, minimum and average interest rates for funds either borrowed from or loaned to the Utility Money Pool for the nine months ended September 30, 2010 and 2009 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 Rates for Funds Borrowed from the Utility Money Pool	Average Interest Rates for Funds Loaned to the Utility Money Pool
2010	0.55 %	0.09 %	- %	- %	0.23 %	- %
2009	2.28 %	0.27 %	- %	- %	1.00 %	- %

Maximum, minimum and average interest rates for funds either borrowed from or loaned to the Nonutility Money Pool for the nine months ended September 30, 2010 and 2009 are summarized in the following table:

	Maximum Interest Rates for Funds Borrowed from the Nonutility Money Pool	Minimum Interest Rates for Funds Borrowed from the Nonutility Money Pool	Maximum Interest Rates for Funds Loaned to the Nonutility Money Pool	Minimum Interest Rates for Funds Loaned to the Nonutility Money Pool	Average Interest Rates for Funds Borrowed from the Nonutility Money Pool	Average Interest Rates for Funds Loaned to the Nonutility Money Pool
2010	- %	- %	0.55 %	0.20 %	- %	0.40 %
2009	- %	- %	2.28 %	0.43 %	- %	1.06 %

Credit Facilities

In June 2010, TNC and certain other companies in the AEP System reduced the \$627 million credit agreement to \$478 million. Under the facility, letters of credit may be issued. As of September 30, 2010, there were no outstanding amounts for TNC under the facility.

11. COST REDUCTION INITIATIVES

In April 2010, management began initiatives to decrease both labor and non-labor expenses with a goal of achieving significant reductions in operation and maintenance expenses. A total of 2,461 positions were eliminated across the AEP System as a result of process improvements, streamlined organizational designs and other efficiencies. Most of the affected employees terminated employment May 31, 2010. The severance program provides two weeks of base pay for every year of service along with other severance benefits.

TNC recorded a charge to expense in the second quarter of 2010 primarily related to the headcount reduction initiatives.

Expense Allocation from AEPSC	Incurred	Settled (in thousands)	Adjustments	Remaining Balance at September 30, 2010
\$ 4,538	\$ 4,000	\$ 7,704	\$ 81	\$ 915

These costs relate primarily to severance benefits. They are included primarily in Other Operation on the income statement and Other Current Liabilities on the balance sheet.