AEP Generating Company

2017 Annual Report

Audited Financial Statements

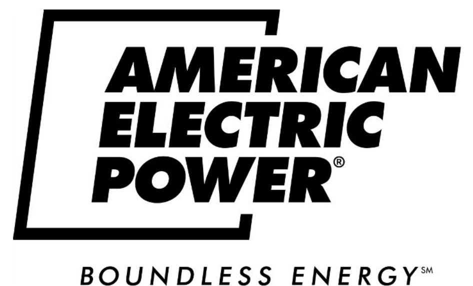

TABLE OF CONTENTS

	Page Number
Glossary of Terms	1
Independent Auditors' Report	2
Statements of Income	4
Statements of Changes in Common Shareholder's Equity	5
Balance Sheets	6
Statements of Cash Flows	8
Index of Notes to Financial Statements	9

- THIS PAGE INTENTIONALLY LEFT BLANK -

GLOSSARY OF TERMS

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

Term	Meaning
AEGCo	AEP Generating Company, an AEP electric utility subsidiary.
AEP	American Electric Power Company, Inc., an investor-owned electric public utility holding company which includes American Electric Power Company, Inc. (Parent) and majority owned consolidated subsidiaries and consolidated affiliates.
AEP System	American Electric Power System, an electric system, owned and operated by AEP subsidiaries.
AEPSC	American Electric Power Service Corporation, an AEP service subsidiary providing management and professional services to AEP and its subsidiaries.
AFUDC	Allowance for Funds Used During Construction.
AGR	AEP Generation Resources Inc., a competitive AEP subsidiary that acquired the generation assets and liabilities of OPCo.
ASU	Accounting Standards Update.
CCT	Cook Coal Terminal.
CWIP	Construction Work in Progress.
EIS	Energy Insurance Services, Inc., a nonaffiliated captive insurance company and consolidated variable interest entity of AEP.
FASB	Financial Accounting Standards Board.
Federal EPA	United States Environmental Protection Agency.
FERC	Federal Energy Regulatory Commission.
GAAP	Accounting Principles Generally Accepted in the United States of America.
I&M	Indiana Michigan Power Company, an AEP electric utility subsidiary.
IRS	Internal Revenue Service.
IURC	Indiana Utility Regulatory Commission.
KPCo	Kentucky Power Company, an AEP electric utility subsidiary.
MW	Megawatt.
NO_x	Nitrogen oxide.
NSR	New Source Review.
OPCo	Ohio Power Company, an AEP electric utility subsidiary.
OPEB	Other Postretirement Benefit Plans.
Parent	American Electric Power Company, Inc., the equity owner of AEP subsidiaries within the AEP consolidation.
PSO	Public Service Company of Oklahoma, an AEP electric utility subsidiary.
Rockport Plant	A generation plant, consisting of two 1,310 MW coal-fired generating units near Rockport, Indiana. AEGCo and I&M jointly-own Unit 1. In 1989, AEGCo and I&M entered into a sale-and-leaseback transaction with Wilmington Trust Company, an unrelated, unconsolidated trustee for Rockport Plant, Unit 2.
SO_2	Sulfur dioxide.
SWEPCo	Southwestern Electric Power Company, an AEP electric utility subsidiary.
Tax Reform	On December 22, 2017, President Trump signed into law legislation referred to as the "Tax Cuts and Jobs Act" (the TCJA). The TCJA includes significant changes to the Internal Revenue Code of 1986, including a reduction in the corporate federal income tax rate from 35% to 21% effective January 1, 2018.
UMWA	United Mine Workers of America.
UPA	Unit Power Agreement.
Utility Money Pool	Centralized funding mechanism AEP uses to meet the short-term cash requirements of certain utility subsidiaries.
VIE	Variable Interest Entity.

Report of Independent Auditors

To the Board of Directors and Management of
AEP Generating Company

We have audited the accompanying financial statements of AEP Generating Company, which comprise the balance sheet as of December 31, 2017, and the related statements of income, of changes in common shareholder's equity, and of cash flows for the year then ended.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on the financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Company's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of AEP Generating Company as of December 31, 2017, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers LLP

Columbus, Ohio
February 22, 2018

INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Shareholder of
AEP Generating Company:

We have audited the accompanying financial statements of AEP Generating Company (the "Company"), which comprise the balance sheet as of December 31, 2016, and the related statements of income, changes in common shareholder's equity, and cash flows for the year ended December 31, 2016, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of AEP Generating Company as of December 31, 2016, and the results of its operations and its cash flows for each of the two years in the period ended December 31, 2016 in accordance with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

Columbus, Ohio
February 27, 2017

AEP GENERATING COMPANY
STATEMENTS OF INCOME
For the Years Ended December 31, 2017 and 2016
(in thousands)

	Years Ended December 31, 2017	2016
REVENUES		
Sales to AEP Affiliates	$ 340,871	$ 563,848
Other Revenues – Affiliated	15,507	18,372
Other Revenues – Nonaffiliated	3,581	2,933
TOTAL REVENUES	359,959	585,153
EXPENSES		
Fuel and Other Consumables Used for Electric Generation	168,079	323,536
Rent – Rockport Plant, Unit 2	68,283	68,283
Other Operation	26,147	42,941
Maintenance	21,354	26,600
Gain on Sale of Lawrenceburg Plant	(355,588)	—
Depreciation and Amortization	42,082	47,918
Taxes Other Than Income Taxes	4,408	7,389
TOTAL (INCOME) EXPENSES	(25,235)	516,667
OPERATING INCOME	385,194	68,486
Other Income (Expense):		
Interest Income	2,572	8
Allowance for Equity Funds Used During Construction	3,060	347
Interest Expense	(4,840)	(11,711)
INCOME BEFORE INCOME TAX EXPENSE	385,986	57,130
Income Tax Expense	114,528	20,002
NET INCOME	$ 271,458	$ 37,128

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

See Notes to Financial Statements beginning on page 9.

AEP GENERATING COMPANY
STATEMENTS OF CHANGES IN COMMON SHAREHOLDER'S EQUITY
For the Years Ended December 31, 2017 and 2016
(in thousands)

	Common Stock	Paid-in Capital	Retained Earnings	Total
TOTAL COMMON SHAREHOLDER'S EQUITY – DECEMBER 31, 2015	$ 1,000	$ 260,487	$ 4,989	$ 266,476
Capital Contribution from Parent		25,000		25,000
Common Stock Dividends			(19,100)	(19,100)
Net Income			37,128	37,128
TOTAL COMMON SHAREHOLDER'S EQUITY – DECEMBER 31, 2016	1,000	285,487	23,017	309,504
Capital Contribution Returned to Parent		(110,000)		(110,000)
Common Stock Dividends			(200,000)	(200,000)
Net Income			271,458	271,458
TOTAL COMMON SHAREHOLDER'S EQUITY – DECEMBER 31, 2017	$ 1,000	$ 175,487	$ 94,475	$ 270,962

See Notes to Financial Statements beginning on page 9.

AEP GENERATING COMPANY
BALANCE SHEETS
ASSETS
December 31, 2017 and 2016
(in thousands)

	December 31, 2017	December 31, 2016
CURRENT ASSETS		
Advances to Affiliates	$ 94,165	$ 19,037
Accounts Receivable:		
Customers	31	—
Affiliated Companies	36,985	63,783
Miscellaneous	1,986	3
Total Accounts Receivable	39,002	63,786
Fuel	31,355	32,256
Materials and Supplies	19,456	17,960
Assets Held for Sale	—	320,365
Prepayments and Other Current Assets	3,379	1,252
TOTAL CURRENT ASSETS	187,357	454,656
PROPERTY, PLANT AND EQUIPMENT		
Electric:		
Generation	1,111,563	955,572
Other Property, Plant and Equipment	35,316	36,334
Construction Work in Progress	27,721	122,060
Total Property, Plant and Equipment	1,174,600	1,113,966
Accumulated Depreciation and Amortization	677,587	645,164
TOTAL PROPERTY, PLANT AND EQUIPMENT – NET	497,013	468,802
OTHER NONCURRENT ASSETS		
Regulatory Assets	15,865	15,146
Deferred Charges and Other Noncurrent Assets	1,512	1,186
TOTAL OTHER NONCURRENT ASSETS	17,377	16,332
TOTAL ASSETS	$ 701,747	$ 939,790

See Notes to Financial Statements beginning on page 9.

AEP GENERATING COMPANY
BALANCE SHEETS
LIABILITIES AND COMMON SHAREHOLDER'S EQUITY
December 31, 2017 and 2016

	December 31,	
	2017	**2016**
CURRENT LIABILITIES	**(in thousands)**	
Accounts Payable:		
General	$ 1,958	$ 25,635
Affiliated Companies	19,988	23,497
Long-term Debt Due Within One Year – Nonaffiliated	169,891	62,280
Accrued Taxes	14,555	9,507
Accrued Rent – Rockport Plant, Unit 2	4,963	4,963
Liabilities Held for Sale	—	141,480
Other Current Liabilities	3,948	4,257
TOTAL CURRENT LIABILITIES	215,303	271,619
NONCURRENT LIABILITIES		
Long-term Debt – Nonaffiliated	—	124,781
Deferred Income Taxes	30,131	91,288
Regulatory Liabilities and Deferred Investment Tax Credits	84,673	46,874
Deferred Gain on Sale-and-Leaseback – Rockport Plant, Unit 2	27,482	33,053
Deferred Credits and Other Noncurrent Liabilities	73,196	62,671
TOTAL NONCURRENT LIABILITIES	215,482	358,667
TOTAL LIABILITIES	430,785	630,286
Commitments and Contingencies (Note 4)		
COMMON SHAREHOLDER'S EQUITY		
Common Stock – Par Value – $1,000 Per Share:		
Authorized – 1,000 Shares		
Outstanding – 1,000 Shares	1,000	1,000
Paid-in Capital	175,487	285,487
Retained Earnings	94,475	23,017
TOTAL COMMON SHAREHOLDER'S EQUITY	270,962	309,504
TOTAL LIABILITIES AND COMMON SHAREHOLDER'S EQUITY	$ 701,747	$ 939,790

See Notes to Financial Statements beginning on page 9.

AEP GENERATING COMPANY
STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2017 and 2016
(in thousands)

	Years Ended December 31, 2017	2016
OPERATING ACTIVITIES		
Net Income	$ 271,458	$ 37,128
Adjustments to Reconcile Net Income to Net Cash Flows from (Used for) Operating Activities:		
Depreciation and Amortization	42,082	47,918
Deferred Income Taxes	(18,890)	11,594
Deferred Investment Tax Credits	(1,969)	(1,965)
Amortization of Deferred Gain on Sale-and-Leaseback – Rockport Plant, Unit 2	(5,571)	(5,571)
Allowance for Equity Funds Used During Construction	(3,060)	(347)
Gain on Sale of Lawrenceburg Plant	(355,588)	—
Change in Other Noncurrent Assets	(563)	2,477
Change in Other Noncurrent Liabilities	136	(3,540)
Changes in Certain Components of Working Capital:		
Accounts Receivable	24,784	(17,287)
Fuel, Materials and Supplies	(522)	13,457
Accounts Payable	(25,336)	(3,277)
Accrued Taxes, Net	2,621	11,871
Other Current Assets	(7,205)	(18)
Other Current Liabilities	(2,600)	(197)
Net Cash Flows from (Used for) Operating Activities	(80,223)	92,243
INVESTING ACTIVITIES		
Construction Expenditures	(61,459)	(89,631)
Change in Advances to Affiliates, Net	(75,128)	(19,037)
Proceeds from Sales of Assets	726,300	2,973
Proceeds from Insurance Settlement	—	5,692
Other Investing Activities	(7)	263
Net Cash Flows from (Used for) Investing Activities	589,706	(99,740)
FINANCING ACTIVITIES		
Capital Contribution from (Returned to) Parent	(110,000)	25,000
Issuance of Long-term Debt – Nonaffiliated	—	124,787
Change in Advances from Affiliates, Net	—	(113,908)
Retirement of Long-term Debt – Nonaffiliated	(152,727)	(7,273)
Principal Payments for Capital Lease Obligations	(1,881)	(2,010)
Dividends Paid on Common Stock	(200,000)	(19,100)
Make Whole Premium on Extinguishment of Long-term Debt	(44,884)	—
Other Financing Activities	9	1
Net Cash Flows from (Used for) Financing Activities	(509,483)	7,497
Net Change in Cash and Cash Equivalents	—	—
Cash and Cash Equivalents at Beginning of Period	—	—
Cash and Cash Equivalents at End of Period	$ —	$ —
SUPPLEMENTARY INFORMATION		
Cash Paid for Interest, Net of Capitalized Amounts	$ 6,658	$ 10,959
Net Cash Paid (Received) for Income Taxes	131,076	(50)
Noncash Acquisitions Under Capital Leases	288	11,955
Construction Expenditures Included in Current Liabilities as of December 31,	86	2,071

See Notes to Financial Statements beginning on page 9.

INDEX OF NOTES TO FINANCIAL STATEMENTS

Note	Page Number
Organization and Summary of Significant Accounting Policies	10
New Accounting Pronouncements	16
Effects of Regulation	20
Commitments, Guarantees and Contingencies	21
Disposition	24
Benefit Plans	25
Fair Value Measurements	35
Income Taxes	36
Leases	41
Financing Activities	43
Related Party Transactions	45
Variable Interest Entities	47
Property, Plant and Equipment	48

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

ORGANIZATION

AEGCo engages in the generation and wholesale sale of electric power to its affiliates, AGR, I&M and KPCo. AEGCo and I&M co-own Unit 1 of the Rockport Plant. Unit 2 of the Rockport Plant is owned by a third party and leased to I&M and AEGCo. I&M operates the Rockport Plant. AEGCo derives operating revenues from the sale of Rockport Plant energy and capacity to I&M and KPCo pursuant to FERC-approved long-term UPAs through December 2022. Under the terms of its UPA, I&M agreed to purchase all of AEGCo's Rockport energy and capacity unless it is sold to other utilities or affiliates. I&M assigned 30% of its rights to AEGCo's energy and capacity to KPCo. AEGCo also owns CCT which performs coal transloading services for I&M and railcar maintenance services for I&M, PSO and SWEPCo.

In 2007, OPCo and AEGCo entered into a 10-year UPA for the entire output from the Lawrenceburg Plant. The UPA had an option for an additional 2-year period. Effective January 2014, OPCo assigned its rights and liabilities under the Lawrenceburg UPA to AGR, which included AGR's option to extend for an additional 2 years. I&M operated the plant under an agreement with AEGCo. Under the UPA, AGR paid AEGCo for the capacity, depreciation, fuel, operation and maintenance and tax expenses. These payments were due regardless of whether the plant was operating. The fuel and operation and maintenance payments were based on actual costs incurred. All expenses were trued up periodically. In September 2016, AEP signed a Purchase and Sale Agreement to sell the Lawrenceburg Plant to a nonaffiliated party. The sale closed in January 2017. The UPA terminated upon closing of the sale.

The UPAs provide for a FERC-approved rate of return on common equity, a return on other capital (net of temporary cash investments) and recovery of costs including operation and maintenance, fuel and taxes. Under the terms of the UPAs, AEGCo accumulates all expenses monthly and prepares bills for its affiliates. In the month the expenses are incurred, AEGCo recognizes the billing revenues and establishes a receivable from the affiliated companies. The costs of operating the plants are billed to the affiliates receiving the benefits under the UPAs.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Rates and Service Regulation

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

The FERC regulates wholesale power markets and wholesale power transactions. AEGCo's wholesale power transactions are generally cost-based regulated under FERC-approved unit power agreements.

Accounting for the Effects of Cost-Based Regulation

As a rate-regulated electric public utility company, AEGCo's financial statements reflect the actions of regulators that result in the recognition of certain revenues and expenses in different time periods than enterprises that are not rate-regulated. In accordance with accounting guidance for "Regulated Operations," AEGCo records regulatory assets (deferred expenses) and regulatory liabilities (deferred revenue reductions or refunds) to reflect the economic effects of regulation in the same accounting period by matching expenses with their recovery through regulated revenues and by matching income with its passage to customers in cost-based regulated rates.

Use of Estimates

The preparation of these financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. These estimates include, but are not limited to, inventory valuation, long-lived asset impairment, the effects of regulation, long-lived asset recovery and the effects of contingencies. The estimates and assumptions used are based upon management's evaluation of the relevant facts and circumstances as of the date of the financial statements. Actual results could ultimately differ from those estimates.

Accounting for the Impacts of Tax Reform

Given the significance of the legislative changes resulting from Tax Reform, the timing of its enactment and the widespread applicability to registrants, the SEC staff recognized the potential challenges faced by registrants when reflecting the effects of Tax Reform in their 2017 financial statements. Accordingly, the SEC staff issued Staff Accounting Bulletin 118 (SAB 118) in December 2017, which provides for a one year measurement period to complete the accounting for Tax Reform.

The Registrants have made reasonable estimates for the measurement and accounting for the impacts of Tax Reform and these estimates are reflected in the December 31, 2017 financial statements as provisional amounts. While the Registrants were able to make reasonable estimates of the impact of Tax Reform, the final impact may differ from the recorded provisional amounts to the extent refinements are made to the estimated cumulative temporary differences or as a result of additional guidance or technical corrections that may be issued by the IRS or regulatory state commissions that impacts management's interpretation and assumptions utilized. See "Federal Tax Reform" section of Note 8 for additional information.

Inventory

Fossil fuel inventories and materials and supplies inventories are carried at average cost.

Property, Plant and Equipment

Electric utility property, plant and equipment are stated at original cost. Additions, major replacements and betterments are added to the plant accounts. Under the group composite method of depreciation, continuous interim routine replacements of items such as boiler tubes, pumps, motors, etc. result in original cost retirements, less salvage, being charged to accumulated depreciation. The group composite method of depreciation assumes that on average, asset components are retired at the end of their useful lives and thus there is no gain or loss. The equipment in each primary electric plant account is identified as a separate group. The depreciation rates that are established take into account the past history of interim capital replacements and the amount of removal cost incurred and salvage received. These rates and the related lives are subject to periodic review. Removal costs accrued are typically recorded as regulatory liabilities when the revenue received for removal costs accrued exceeds actual removal costs incurred. The asset removal costs liability is relieved as removal costs are incurred. A regulatory asset balance will occur if actual removal costs incurred exceed accumulated removal costs accrued.

The costs of labor, materials and overhead incurred to operate and maintain plant and equipment are included in operating expenses.

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

The fair value of an asset is the amount at which that asset could be bought or sold in a current transaction between willing parties, as opposed to a forced or liquidation sale. Quoted market prices in active markets are the best evidence of fair value and are used as the basis for the measurement, if available. In the absence of quoted prices for identical or similar assets in active markets, fair value is estimated using various internal and external valuation methods including cash flow analysis and appraisals.

Allowance for Funds Used During Construction

AFUDC represents the estimated cost of borrowed and equity funds used to finance construction projects that is capitalized and recovered through depreciation over the service life of regulated electric utility plant. AEGCo records the equity component of AFUDC in Other Income and the debt component of AFUDC as a reduction to Interest Expense.

Valuation of Nonderivative Financial Instruments

The book values of Accounts Receivable, Advances from Affiliates and Accounts Payable approximate fair value because of the short-term maturity of these instruments.

Fair Value Measurements of Assets and Liabilities

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

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

Assets in the benefits trusts are classified using the following methods. Equities are classified as Level 1 holdings if they are actively traded on exchanges. Items classified as Level 1 are investments in money market funds, fixed income and equity mutual funds and domestic equity securities. They are valued based on observable inputs primarily unadjusted quoted prices in active markets for identical assets. Items classified as Level 2 are primarily investments in individual fixed income securities. Fixed income securities generally do not trade on exchanges and do not have an official closing price but their valuation inputs are based on observable market data. Pricing vendors calculate bond valuations using financial models and matrices. The models use observable inputs including yields on benchmark securities, quotes by securities brokers, rating agency actions, discounts or premiums on securities compared to par prices, changes in yields for U.S. Treasury securities, corporate actions by bond issuers, prepayment schedules and histories, economic events and, for certain securities, adjustments to yields to reflect changes in the rate of inflation. Other securities with model-derived valuation inputs that are observable are also classified as Level 2 investments. Investments with unobservable valuation inputs are classified as Level 3 investments. Investments classified as Other are valued using Net Asset Value as a practical expedient. Items classified as Other are primarily cash equivalent funds, common collective trusts, commingled funds, structured products, real estate, infrastructure and alternative credit investments. These investments do not have a readily determinable fair value or they contain redemption restrictions which may include the right to suspend redemptions under certain circumstances. Redemption restrictions may also prevent certain investments from being redeemed at the reporting date for the underlying value.

Revenue Recognition and Accounts Receivable

Under terms of the UPAs, AEGCo accumulates all expenses monthly and prepares bills for its affiliates. In the month the expenses are incurred, AEGCo recognizes the billing revenues and establishes receivables from the affiliate companies.

AEGCo also accumulates costs for its CCT division and prepares bills monthly for both affiliated and nonaffiliated companies.

Maintenance

Maintenance costs are expensed as incurred.

Income Taxes and Investment Tax Credits

AEGCo uses the liability method of accounting for income taxes. Under the liability method, deferred income taxes are provided for all temporary differences between the book and tax basis of assets and liabilities which will result in a future tax consequence. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which the temporary differences are expected to be recovered or settled. AEGCo revalued deferred tax assets and liabilities at the new federal corporate income tax rate of 21% in December 2017. See Note 8 for additional information related to Tax Reform.

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

Investment tax credits (ITC) were historically accounted for under the flow-through method, except where regulatory commissions reflected ITC in the rate-making process. In 2016, AEGCo and other AEP subsidiaries changed accounting for the recognition of ITC and elected to apply the preferred deferral methodology. This change had no financial impact to AEGCo.

Deferred ITC is amortized to income tax expense over the life of the asset. Amortization of deferred ITC begins when the asset is placed into service, except where regulatory commissions reflect ITC in the rate-making process, then amortization begins when the cash tax benefit is recognized.

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

Debt

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

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

Pension and OPEB Plans

AEGCo participates in an AEP sponsored qualified pension plan. Substantially all of AEGCo's employees other than certain longer service UMWA members are covered by the qualified plan. UMWA pension benefits are provided through the United Mine Workers of America 1974 Pension Plan, a multiemployer plan, to CCT employees who are not covered by the qualified plan. AEGCo also participates in OPEB plans sponsored by AEP to provide health and life insurance benefits for retired employees as well as certain unionized employees, retirees and their survivors who meet eligibility requirements. AEGCo accounts for its participation in the AEP sponsored pension and OPEB plans using multiple-employer accounting. See Note 6 - Benefit Plans for additional information including significant accounting policies associated with the plans.

Investments Held in Trust for Future Liabilities

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

Benefit Plans

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

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

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

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

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

OPEB Plans Assets	Target
Equity	49%
Fixed Income	49%
Cash and Cash Equivalents	2%

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

For equity investments, the concentration limits are as follows:

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

For fixed income investments, each investment manager's portfolio is compared to investment grade, diversified long and intermediate benchmark indices.

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

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

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

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

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

Earnings Per Share (EPS)

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

Subsequent Events

Management reviewed subsequent events through February 22, 2018, the date that AEGCo's 2017 annual report was available to be issued.

2. NEW ACCOUNTING PRONOUNCEMENTS

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

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

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

The FASB deferred implementation of ASU 2014-09 under the terms in ASU 2015-14, "Revenue from Contracts with Customers (Topic: 606): Deferral of the Effective Date." The new accounting guidance is effective for interim and annual periods beginning after December 15, 2018, with early adoption permitted.

Management analyzed the impact of the new revenue standard and related ASUs. During 2016 and 2017, revenue contract assessments were completed. Material revenue streams were identified within the AEP System and representative contract/transaction types were sampled. Performance obligations identified within each material revenue stream were evaluated to determine whether the obligations were satisfied at a point in time or over time. Contracts determined to be satisfied over time generally qualified for the invoicing practical expedient since the invoiced amounts reasonably represented the value to customers of performance obligations fulfilled to date. Additionally, the new standard did not give rise to any changes in current accounting systems. Management continues to develop disclosures to comply with the requirements of ASU 2014-09, including disclosures of significant disaggregated revenue streams, and information about fixed performance obligations that are unsatisfied (or partially unsatisfied) as of the end of a reporting period.

Management adopted ASU 2014-09 effective January 1, 2018, by means of the modified retrospective approach. The adoption of ASU 2014-09 did not have a material impact on results of operations, financial position or cash flows. Management will continue to actively participate in informal industry forums throughout the period of initial adoption.

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

In January 2016, the FASB issued ASU 2016-01 revising the reporting model for financial instruments. Under the new standard, equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) are required to be measured at fair value with changes in fair value recognized in net income. For equity investments that do not have a readily determinable fair value, entities are permitted to elect a practicality exception and measure the investment at cost, less impairment, plus or minus observable price changes. The new standard also amends disclosure requirements and requires separate presentation of financial assets and liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheets or the accompanying notes to the financial statements. The amendments also clarify that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets.

The new accounting guidance is effective for interim and annual periods beginning after December 15, 2018, with early adoption permitted for certain provisions. Management adopted ASU 2016-01 effective January 1, 2018, by means of a cumulative-effect adjustment to the balance sheet. The adoption of ASU 2016-01 did not have an impact on results of operations, financial position or cash flows of AEGCo.

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

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

The new accounting guidance is effective for annual periods beginning after December 15, 2019, with early adoption permitted. The guidance will be applied by means of a modified retrospective approach. The modified retrospective approach will require lessees and lessors to recognize and measure leases at the beginning of the earliest period presented; however, the FASB is currently evaluating whether to provide reporting entities with an additional expedient to adopt the new lease requirements through a cumulative-effect adjustment in the period of adoption. Accordingly, management continues to monitor these standard-setting activities that may impact the transition requirements of the lease standard.

Management continues to analyze the impact of the new lease standard. During 2016 and 2017, lease contract assessments were completed. The AEP System lease population was identified and representative lease contracts were sampled. Based upon the completed assessments, management prepared a system gap analysis to outline new disclosure compliance requirements compared to current system capabilities. Multiple lease system options were also evaluated. Management plans to elect certain of the following practical expedients upon adoption:

Practical Expedient	Description
Overall Expedients (for leases commenced prior to adoption date and must be adopted as a package)	Do not need to reassess whether any expired or existing contracts are/or contain leases, do not need to reassess the lease classification for any expired or existing leases and do not need to reassess initial direct costs for any existing leases.
Lease and Non-lease Components (elect by class of underlying asset)	Elect as an accounting policy to not separate non-lease components from lease components and instead account for each lease and associated non-lease component as a single lease component.
Short-term Lease (elect by class of underlying asset)	Elect as an accounting policy to not apply the recognition requirements to short-term leases.
Lease term	Elect to use hindsight to determine the lease term.

Evaluation of new lease contracts continues and the process of implementing a compliant lease system solution began in the third quarter of 2017. Management expects the new standard to impact financial position and, at this time, cannot estimate the impact. Management expects no impact to results of operations or cash flows.

Management continues to monitor unresolved industry implementation issues, including items related to easements and right-of-ways, and will analyze the related impacts to lease accounting. In this regard, to address stakeholder concerns about the costs and complexity of complying with the transition provisions of the new lease standard, the FASB issued ASU 2018-01 in January 2018. This ASU provides an optional transition practical expedient that allows companies to exclude in their evaluation of Topic 842 existing or expired land easements that were not previously accounted for as leases under Topic 840, which reduces the volume of contracts requiring evaluation. Management intends to elect this practical expedient upon adoption of ASU 2016-02.

Management continues to monitor FASB's ongoing standard-setting activities that may result in the issuance of additional targeted improvements to the new lease guidance. Management plans to adopt ASU 2016-02 effective January 1, 2019.

ASU 2016-09 "Compensation – Stock Compensation" (ASU 2016-09)

In March 2016, the FASB issued ASU 2016-09 simplifying the accounting for share-based payment transactions including the income tax consequences, classification of awards as either equity or liabilities and classification on the statements of cash flows. Under the new standard, all excess tax benefits and tax deficiencies (including tax benefits of dividends on share-based payment awards) should be recognized as income tax expense or benefit on the statements of income. Under previous GAAP, excess tax benefits are recognized in additional paid-in capital while tax deficiencies are recognized either as an offset to accumulated excess tax benefits, if any, or on the statements of income.

Management adopted ASU 2016-09 effective January 1, 2017. As a result of the adoption of this guidance, management made an accounting policy election to recognize the effect of forfeitures in compensation cost when they occur. There was an immaterial impact on results of operations and financial position and no impact on cash flows at adoption.

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

In June 2016, the FASB issued ASU 2016-13 requiring an allowance to be recorded for all expected credit losses for financial assets. The allowance for credit losses is based on historical information, current conditions and reasonable and supportable forecasts. The new standard also makes revisions to the other than temporary impairment model for available-for-sale debt securities. Disclosures of credit quality indicators in relation to the amortized cost of financing receivables are further disaggregated by year of origination.

The new accounting guidance is effective for interim and annual periods beginning after December 15, 2020, with early adoption permitted for interim and annual periods beginning after December 15, 2018. The amendments will be applied through a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective. Management is analyzing the impact of this new standard and, at this time, cannot estimate the impact of adoption on net income. Management plans to adopt ASU 2016-13 effective January 1, 2020.

ASU 2016-18 "Restricted Cash" (ASU 2016-18)

In November 2016, the FASB issued ASU 2016-18 clarifying the treatment of restricted cash on the statements of cash flows. Under the new standard, amounts considered restricted cash will be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts on the statements of cash flows.

The new accounting guidance is effective for annual periods beginning after December 15, 2018. Early adoption is permitted in any interim or annual period. Management adopted ASU 2016-18 for the 2017 Annual Report and applied the new standard retrospectively for all periods presented.

ASU 2017-07 "Compensation - Retirement Benefits" (ASU 2017-07)

In March 2017, the FASB issued ASU 2017-07 requiring that an employer report the service cost component of pension and postretirement benefits in the same line item or items as other compensation costs. The other components of net benefit cost are required to be presented on the statements of income separately from the service cost component and outside of a subtotal of income from operations. In addition, only the service cost component will be eligible for capitalization as applicable following labor. For 2017, AEGCo's actual non-service cost components were a credit of $253 thousand, none of which was capitalized.

The new accounting guidance is effective for interim and annual periods beginning after December 15, 2018. Early adoption is permitted as of the beginning of an annual period for which financial statements have not been issued or made available for issuance. Management adopted ASU 2017-07 effective January 1, 2018.

ASU 2017-12 "Derivatives and Hedging" (ASU 2017-12)

In August 2017, the FASB issued ASU 2017-12 amending the recognition and presentation requirements for hedge accounting activities. The objectives are to improve the financial reporting of hedging relationships to better portray the economic results of an entity's risk management activities in its financial statements and reduce the complexity of applying hedge accounting. Under the new standard, the concept of recognizing hedge ineffectiveness within the statements of income for cash flow hedges, which has historically been immaterial to AEP, will be eliminated. In addition, certain required tabular disclosures relating to fair value and cash flow hedges will be modified.

The new accounting guidance is effective for interim and annual periods beginning after December 15, 2019, with early adoption permitted for any interim or annual period after August 2017. Management is analyzing the impact of this new standard, including the possibility of early adoption, and at this time, cannot estimate the impact of adoption on results of operations, financial position or cash flows.

ASU 2018-02 "Reclassification of Certain Tax Effects from AOCI" (ASU 2018-02)

In February 2018, the FASB issued ASU 2018-02 allowing a reclassification from AOCI to Retained Earnings for stranded tax effects resulting from Tax Reform. Under existing accounting guidance for "Income Taxes", deferred tax assets and liabilities must be adjusted for the effect of a change in tax laws or rates with the effect included in income from continuing operations in the reporting period that includes the enactment date. This guidance is applicable for the tax effects of items in AOCI that were originally recognized in Other Comprehensive Income. As a result and absent the new guidance in this ASU, the tax effects of items within AOCI do not reflect the newly enacted corporate tax rate. While the reclassification between AOCI and Retained Earnings is optional under the new guidance, the ASU also requires certain new disclosure requirements regardless of whether the reclassification is made.

The new accounting guidance is effective for interim and annual periods beginning after December 15, 2018, with early adoption permitted. The new guidance must be applied either retrospectively to each period (or periods) in which the income tax effects of Tax Reform related to items remaining in AOCI are recognized, or at the beginning of the period of adoption. Management is analyzing the impact of this new standard, including the possibility of early adoption.

3. EFFECTS OF REGULATION

Regulatory assets and liabilities are comprised of the following items:

Regulatory Assets:	December 31, 2017	December 31, 2016	Remaining Recovery Period
	(in thousands)		
Noncurrent Regulatory Assets			
Regulatory assets approved for recovery:			
Regulatory Assets Currently Earning a Return			
Asset Retirement Obligation	$ 2,488	$ 2,582	27 years
Regulatory Assets Currently Not Earning a Return			
Pension and OPEB Funded Status	11,097	10,853	12 years
Unamortized Loss on Reacquired Debt	1,500	1,711	8 years
Other Regulatory Assets Approved for Recovery	780	—	various
Total Regulatory Assets Approved for Recovery	15,865	15,146	
Total Noncurrent Regulatory Assets	$ 15,865	$ 15,146	

Regulatory Liabilities:	December 31, 2017	December 31, 2016	Remaining Refund Period
	(in thousands)		
Noncurrent Regulatory Liabilities and Deferred Investment Tax Credits			
Regulatory liabilities pending final regulatory determination:			
Regulatory Liabilities Currently Paying a Return			
Income Taxes, Net (a)	$ 42,358	$ —	
Total Regulatory Liabilities Pending Final Regulatory Determination	42,358	—	
Regulatory liabilities approved for payment:			
Regulatory Liabilities Currently Paying a Return			
Asset Removal Costs	32,629	32,641	(b)
Deferred Investment Tax Credits	9,686	11,655	5 years
Regulatory Liabilities Currently Not Paying a Return			
UMWA Pension Withdrawal	—	2,487	
Other Regulatory Liabilities Approved for Payment	—	91	
Total Regulatory Liabilities Approved for Payment	42,315	46,874	
Total Noncurrent Regulatory Liabilities and Deferred Investment Tax Credits	$ 84,673	$ 46,874	

(a) This balance primarily represents regulatory liabilities for excess accumulated deferred income taxes (Excess ADIT) as a result of the reduction in the corporate federal income tax rate from 35% to 21% related to the enactment of Tax Reform. The regulatory liability balance predominately pays a return due to the inclusion of Excess ADIT in rate base. The mechanism and refund period to provide the Excess ADIT to customers will be based on future orders from the respective commission in each jurisdiction. See “Federal Tax Reform” section of Note 8 for additional information.

(b) Relieved as removal costs are incurred.

4. COMMITMENTS, GUARANTEES AND CONTINGENCIES

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

For current proceedings not specifically discussed below, management does not anticipate that the liabilities, if any, arising from such proceedings would have a material effect on the financial statements.

COMMITMENTS

In accordance with the accounting guidance for "Commitments", AEGCo had no contractual commitments as of December 31, 2017.

GUARANTEES

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

Letters of Credit

AEGCo has $45 million of variable rate Pollution Control Bonds supported by bilateral letters of credit for $45.5 million. The letters of credit mature in July 2019.

Indemnifications and Other Guarantees

Contracts

AEGCo enters into certain types of contracts which require indemnifications. Typically these contracts include, but are not limited to, sale agreements, lease agreements, purchase agreements and financing agreements. Generally, these agreements may include, but are not limited to, indemnifications around certain tax, contractual and environmental matters. With respect to sale agreements, exposure generally does not exceed the sale price. As of December 31, 2017, there were no material liabilities recorded for any indemnifications.

Lease Obligations

AEGCo leases certain equipment under master lease agreements. See "Master Lease Agreements" section of Note 9 for disclosure of lease residual value guarantees.

CONTINGENCIES

Insurance and Potential Losses

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

Some potential losses or liabilities may not be insurable or the amount of insurance carried may not be sufficient to meet potential losses and liabilities, including, but not limited to, liabilities relating to a cyber security incident. Future losses or liabilities, if they occur, which are not completely insured, unless recovered from customers, could reduce future net income and cash flows and impact financial condition.

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

By-products from the generation of electricity include materials such as ash, slag and sludge. Coal combustion by-products, which constitute the overwhelming percentage of these materials, are typically treated and deposited in captive disposal facilities or are beneficially utilized. In addition, the generation plants and transmission facilities have used asbestos, polychlorinated biphenyls and other hazardous and nonhazardous materials. AEGCo currently incurs costs to dispose of these substances safely.

Superfund addresses clean-up of hazardous substances that are released to the environment. The Federal EPA administers the clean-up programs. Several states enacted similar laws. Superfund does not recognize compliance as a defense, but imposes strict liability on parties who fall within its broad statutory categories. Present estimates do not anticipate material cleanup costs.

Rockport Plant Litigation

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

In January 2015, the court issued an opinion and order granting the motion in part and denying the motion in part. The court dismissed certain of the plaintiffs' claims, including the dismissal without prejudice of plaintiffs' claims seeking compensatory damages. Several claims remained, including the claim for breach of the participation agreement and a claim alleging breach of an implied covenant of good faith and fair dealing. In June 2015, AEGCo and I&M filed a motion for partial judgment on the claims seeking dismissal of the breach of participation agreement claim as well as any claim for indemnification of costs associated with this case. The plaintiffs subsequently filed an amended complaint to add another claim under the lease and also filed a motion for partial summary judgment. In November 2015, AEGCo and I&M filed a motion to strike the plaintiffs' motion for partial judgment and filed a motion to dismiss the case for failure to state a claim.

In March 2016, the court entered an opinion and order in favor of AEGCo and I&M, dismissing certain of the plaintiffs' claims for breach of contract and dismissing claims for breach of implied covenant of good faith and fair dealing, and further dismissing plaintiffs' claim for indemnification of costs. By the same order, the court permitted plaintiffs to move forward with their claim that AEGCo and I&M failed to exercise prudent utility practices in the maintenance and operation of Rockport Plant, Unit 2. In April 2016, the plaintiffs filed a notice of voluntary dismissal of all remaining claims with prejudice and the court subsequently entered a final judgment. In May 2016, plaintiffs filed an appeal in

the U.S. Court of Appeals for the Sixth Circuit on whether AEGCo and I&M are in breach of certain contract provisions that plaintiffs allege operate to protect the plaintiffs' residual interests in the unit and whether the trial court erred in dismissing plaintiffs' claims that AEGCo and I&M breached the covenant of good faith and fair dealing.

In April 2017, the U.S. Court of Appeals for the Sixth Circuit issued an opinion reversing the district court's decisions which had dismissed certain of plaintiffs' claims for breach of contract and remanding the case to the district court to enter summary judgment in plaintiffs' favor consistent with that ruling. In April 2017, AEGCo and I&M filed a petition for rehearing with the U.S. Court of Appeals for the Sixth Circuit, which was granted. In June 2017, the U.S. Court of Appeals for the Sixth Circuit issued an amended opinion and judgment which reverses the district court's dismissal of certain of the owners' claims under the lease agreements, vacates the denial of the owners' motion for partial summary judgment and remands the case to the district court for further proceedings. The amended opinion and judgment also affirms the district court's dismissal of the owners' breach of good faith and fair dealing claim as duplicative of the breach of contract claims and removes the instruction to the district court in the original opinion to enter summary judgment in favor of the owners.

In July 2017, AEP filed a motion with the U.S. District Court for the Southern District of Ohio in the original NSR litigation, seeking to modify the consent decree to eliminate the obligation to install certain future controls at Rockport Plant, Unit 2 if AEP does not acquire ownership of that Unit, and to modify the consent decree in other respects to preserve the environmental benefits of the consent decree. In November 2017, the district court granted the owners' unopposed motion to stay the lease litigation to afford time for resolution of AEP's motion to modify the consent decree.

Management will continue to defend against the claims. Given that the district court dismissed plaintiffs' claims seeking compensatory relief as premature, and that plaintiffs have yet to present a methodology for determining or any analysis supporting any alleged damages, management is unable to determine a range of potential losses that are reasonably possible of occurring.

Rockport Plant, Unit 2 Selective Catalytic Reduction (SCR)

In October 2016, I&M filed an application with the IURC for approval of a Certificate of Public Convenience and Necessity (CPCN) to install SCR technology at Rockport Plant, Unit 2 by December 2019. The equipment will allow I&M to reduce emissions of NO_x from Rockport Plant, Unit 2 in order for I&M to continue to operate that unit under current environmental requirements. The estimated cost of the SCR project is $274 million, excluding AFUDC, to be shared equally between I&M and AEGCo. As of December 31, 2017, total costs incurred related to this project, including AFUDC, were approximately $23 million. The AEGCo ownership share of the proposed SCR project will be billable under the Rockport Unit Power Agreement to I&M and KPCo and will be subject to future regulatory approval for recovery.

In February 2017, the Indiana Office of Utility Consumer Counselor (OUCC) and other parties filed testimony with the IURC. The OUCC recommended approval of the CPCN but also stated that any decision regarding recovery of any under-depreciated plant due to retirement should be fully investigated in a base rate case, not in a tracker or other abbreviated proceeding. The other parties recommended either denial of the CPCN or approval of the CPCN with conditions including a cap on the amount of SCR costs allowed to be recovered in the rider and limitations on other costs related to legal issues involving the Rockport Plant, Unit 2 lease. A hearing at the IURC was held in March 2017. An order from the IURC is pending. In July 2017, I&M filed a motion with the U.S. District Court for the Southern District of Ohio to remove the requirement to install SCR technology at Rockport Plant, Unit 2, which plaintiffs opposed. The district court has delayed the deadline for installation of the SCR technology until June 2020. In January 2018, I&M filed a supplemental motion with the U.S. District Court for the Southern District of Ohio proposing to install the SCR at Rockport Plant, Unit 2 and achieve the final SO_2 emission cap applicable to the plant under the consent decree by the end of 2020, before the expiration of the initial lease term. Responsive filings were filed in February 2018 and a decision is anticipated in the first quarter of 2018.

5. DISPOSITION

Lawrenceburg Plant

In September 2016, AEP signed a Purchase and Sale Agreement to sell AEGCo's Lawrenceburg Plant as well as other affiliated plants totaling 5,329 MWs of competitive generation assets as one disposal group to a nonaffiliated party. The sale closed in January 2017 for $2.2 billion, of which $726 million related to AEGCo's Lawrenceburg Plant were recorded in Investing Activities on AEGCo's statement of cash flows. The net proceeds from the transaction are $363 million in cash after taxes, repayment of debt associated with this plant including a make whole payment related to the debt and transaction fees. The sale resulted in a pretax gain of $356 million that was recorded in Gain on Sale of Lawrenceburg Plant on AEGCo's statement of income for the year ended December 31, 2017.

In the third quarter of 2016, management determined the disposal group met the classification of held for sale. Accordingly, Lawrenceburg Plant's assets and liabilities have been recorded as Assets Held for Sale and Liabilities Held for Sale on AEGCo's balance sheet as of December 31, 2016 and as shown in the table below. The Income before Income Tax Expense of the plant was $3.8 million (excluding the $356 million pretax gain) for the year ended December 31, 2017.

	December 31, 2016
Assets:	**(in thousands)**
Fuel	$ 89
Materials and Supplies	8,476
Property, Plant and Equipment - Net	311,799
Other Classes of Assets That Are Not Major	1
Total Assets Classified as Held for Sale on the Balance Sheets	$ 320,365
Liabilities:	
Long-term Debt	$ 134,784
Other Classes of Liabilities That Are Not Major	6,696
Total Liabilities Classified as Held for Sale on the Balance Sheets	$ 141,480

6. BENEFIT PLANS

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

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

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

Actuarial Assumptions for Benefit Obligations

The weighted-average assumptions used in the measurement of benefit obligations are shown in the following table:

	Pension Plan		OPEB	
	December 31,			
Assumptions	2017	2016	2017	2016
Discount Rate	3.65%	4.05%	3.60%	4.10%
Rate of Compensation Increase	5.85% (a)	5.75% (a)	NA	NA

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

NA Not applicable.

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

For 2017, the rate of compensation increase assumed varies with the age of the employee, ranging from 3.5% per year to 12% per year, with an average increase of 5.85%.

Actuarial Assumptions for Net Periodic Benefit Costs

The weighted-average assumptions used in the measurement of benefit costs are shown in the following table:

	Pension Plan		OPEB	
	Year Ended December 31,			
Assumptions	2017	2016	2017	2016
Discount Rate	4.05%	4.30%	4.10%	4.30%
Expected Return on Plan Assets	6.00%	6.00%	6.75%	7.00%
Rate of Compensation Increase	5.85% (a)	5.75% (a)	NA	NA

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

NA Not applicable.

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

The health care trend rate assumptions used for OPEB plans measurement purposes are shown below:

Health Care Trend Rates	December 31, 2017	December 31, 2016
Initial	6.50%	7.00%
Ultimate	5.00%	5.00%
Year Ultimate Reached	2024	2024

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

	1% Increase	1% Decrease
	(in thousands)	
Effect on Total Service and Interest Cost Components of Net Periodic Postretirement Health Care Benefit Cost	$ 519	$ (395)
Effect on the Health Care Component of the Accumulated Postretirement Benefit Obligation	7,636	(6,025)

Significant Concentrations of Risk within Plan Assets

In addition to establishing the target asset allocation of plan assets, the investment policy also places restrictions on securities to limit significant concentrations within plan assets. The investment policy establishes guidelines that govern maximum market exposure, security restrictions, prohibited asset classes, prohibited types of transactions, minimum credit quality, average portfolio credit quality, portfolio duration and concentration limits. The guidelines were established to mitigate the risk of loss due to significant concentrations in any investment. The plans are monitored to control security diversification and ensure compliance with the investment policy. As of December 31, 2017, the assets were invested in compliance with all investment limits. See "Investments Held in Trust for Future Liabilities" section of Note 1 for limit details.

Benefit Plan Obligations, Plan Assets and Funded Status

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

	Pension Plan		OPEB	
	2017	2016	2017	2016
Change in Benefit Obligation	(in thousands)			
Benefit Obligation as of January 1,	$ 3,652	$ 3,727	$ 43,490	$ 41,649
Service Cost	75	104	858	1,129
Interest Cost	147	151	1,684	1,814
Actuarial (Gain) Loss	166	(118)	4,226	(422)
Benefit Payments	(178)	(212)	(1,025)	(809)
Participant Contributions	—	—	52	38
Medicare Subsidy	—	—	89	91
Benefit Obligation as of December 31,	$ 3,862	$ 3,652	$ 49,374	$ 43,490
Change in Fair Value of Plan Assets				
Fair Value of Plan Assets as of January 1,	$ 4,172	$ 4,021	$ 32,788	$ 30,303
Actual Gain on Plan Assets	525	354	5,707	1,886
Company Contributions	7	9	856	1,370
Participant Contributions	—	—	52	38
Benefit Payments	(178)	(212)	(1,025)	(809)
Fair Value of Plan Assets as of December 31,	$ 4,526	$ 4,172	$ 38,378	$ 32,788
Funded (Underfunded) Status as of December 31,	$ 664	$ 520	$ (10,996)	$ (10,702)

Amounts Recognized on the Balance Sheets

	Pension Plan		OPEB	
	December 31,			
	2017	2016	2017	2016
	(in thousands)			
Deferred Charges and Other Noncurrent Assets – Prepaid Benefit Costs	$ 664	$ 520	$ 446	$ 141
Deferred Credits and Other Noncurrent Liabilities – Accrued Long-term Benefit Liability	—	—	(11,442)	(10,843)
Funded (Underfunded) Status	$ 664	$ 520	$ (10,996)	$ (10,702)

Amounts Included in Regulatory Assets

Components	Pension Plan 2017	Pension Plan 2016	OPEB 2017	OPEB 2016
	December 31,			
	(in thousands)			
Net Actuarial (Gain) Loss	$ (215)	$ (43)	$ 11,722	$ 11,373
Prior Service Cost (Credit)	—	1	(410)	(478)
Recorded as				
Regulatory Assets	$ (215)	$ (42)	$ 11,312	$ 10,895

Components of the change in amounts included in Regulatory Assets are as follows:

Components	Pension Plan 2017	Pension Plan 2016	OPEB 2017	OPEB 2016
	(in thousands)			
Actuarial (Gain) Loss During the Year	$ (113)	$ (230)	$ 725	$ (172)
Amortization of Actuarial Loss	(59)	(59)	(376)	(435)
Amortization of Prior Service Credit (Cost)	(1)	(1)	68	67
Change for the Year Ended December 31,	$ (173)	$ (290)	$ 417	$ (540)

Determination of Pension Expense

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

Pension and OPEB Assets

The fair value tables within Pension and OPEB Assets present the classification of assets for AEP within the fair value hierarchy. All Level 1, 2, 3 and Other amounts can be allocated to AEGCo using the percentages in the table below:

Pension Plan 2017	Pension Plan 2016	OPEB 2017	OPEB 2016
December 31,			
0.1%	0.1%	2.2%	2.1%

The following table presents the classification of pension plan assets for AEP within the fair value hierarchy as of December 31, 2017:

Asset Class	Level 1	Level 2	Level 3	Other	Total	Year End Allocation
			(in millions)			
Equities:						
Domestic	$ 318.6	$ —	$ —	$ —	$ 318.6	6.2 %
International	507.7	—	—	—	507.7	9.8 %
Options	—	26.9	—	—	26.9	0.5 %
Common Collective Trusts (c)	—	—	—	452.9	452.9	8.7 %
Subtotal – Equities	826.3	26.9	—	452.9	1,306.1	25.2 %
Fixed Income:						
United States Government and Agency Securities	—	1,376.5	—	—	1,376.5	26.6 %
Corporate Debt	—	1,277.0	—	—	1,277.0	24.7 %
Foreign Debt	—	296.9	—	—	296.9	5.7 %
State and Local Government	—	31.7	—	—	31.7	0.6 %
Other – Asset Backed	—	10.2	—	—	10.2	0.2 %
Subtotal – Fixed Income	—	2,992.3	—	—	2,992.3	57.8 %
Infrastructure (c)	—	—	—	59.5	59.5	1.2 %
Real Estate (c)	—	—	—	290.3	290.3	5.6 %
Alternative Investments (c)	—	—	—	446.0	446.0	8.6 %
Securities Lending	—	501.8	—	—	501.8	9.7 %
Securities Lending Collateral (a)	—	—	—	(503.5)	(503.5)	(9.7)%
Cash and Cash Equivalents (c)	0.4	35.6	—	21.2	57.2	1.1 %
Other – Pending Transactions and Accrued Income (b)	—	—	—	24.4	24.4	0.5 %
Total	$ 826.7	$ 3,556.6	$ —	$ 790.8	$ 5,174.1	100.0 %

(a) Amounts in “Other” column primarily represent an obligation to repay collateral received as part of the Securities Lending Program.
(b) Amounts in “Other” column primarily represent accrued interest, dividend receivables and transactions pending settlement.
(c) Amounts in “Other” column represent investments for which fair value is measured using net asset value per share.

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

	Infrastructure	Real Estate	Alternative Investments	Total Level 3
		(in millions)		
Balance as of January 1, 2017	$ 57.6	$ 254.9	$ 411.1	$ 723.6
Actual Return on Plan Assets				
Relating to Assets Still Held as of the Reporting Date	—	—	—	—
Relating to Assets Sold During the Period	—	—	—	—
Purchases and Sales	—	—	—	—
Transfers into Level 3	—	—	—	—
Transfers out of Level 3 (a)	(57.6)	(254.9)	(411.1)	(723.6)
Balance as of December 31, 2017	$ —	$ —	$ —	$ —

(a) The classification of Level 3 assets from the prior year was corrected in the current year presentation and included within the fair value hierarchy table as of December 31, 2017 as “Other” investments for which fair value is measured using net asset value per share in accordance with ASU 2015-07, Disclosure for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent). Management concluded that these disclosure errors were immaterial individually and in the aggregate to all prior periods presented.

The following table presents the classification of OPEB plan assets for AEP within the fair value hierarchy as of December 31, 2017:

Asset Class	Level 1	Level 2	Level 3	Other	Total	Year End Allocation
			(in millions)			
Equities:						
Domestic	$ 307.1	$ —	$ —	$ —	$ 307.1	17.7 %
International	306.9	—	—	—	306.9	17.7 %
Options	—	9.4	—	—	9.4	0.5 %
Common Collective Trusts (b)	—	—	—	153.6	153.6	8.9 %
Subtotal – Equities	614.0	9.4	—	153.6	777.0	44.8 %
Fixed Income:						
Common Collective Trust – Debt (b)	—	—	—	185.0	185.0	10.7 %
United States Government and Agency Securities	—	187.4	—	—	187.4	10.8 %
Corporate Debt	—	214.1	—	—	214.1	12.4 %
Foreign Debt	—	40.7	—	—	40.7	2.4 %
State and Local Government	49.7	16.8	—	—	66.5	3.8 %
Other – Asset Backed	—	0.2	—	—	0.2	— %
Subtotal – Fixed Income	49.7	459.2	—	185.0	693.9	40.1 %
Trust Owned Life Insurance:						
International Equities	—	105.4	—	—	105.4	6.1 %
United States Bonds	—	118.2	—	—	118.2	6.8 %
Subtotal – Trust Owned Life Insurance	—	223.6	—	—	223.6	12.9 %
Cash and Cash Equivalents (b)	36.7	—	—	4.2	40.9	2.4 %
Other – Pending Transactions and Accrued Income (a)	—	—	—	(2.9)	(2.9)	(0.2)%
Total	$ 700.4	$ 692.2	$ —	$ 339.9	$ 1,732.5	100.0 %

(a) Amounts in “Other” column primarily represent accrued interest, dividend receivables and transactions pending settlement.
(b) Amounts in “Other” column represent investments for which fair value is measured using net asset value per share.

The following table presents the classification of pension plan assets for AEP within the fair value hierarchy as of December 31, 2016:

Asset Class	Level 1	Level 2	Level 3	Other	Total	Year End Allocation
			(in millions)			
Equities:						
Domestic	$ 357.8	$ —	$ —	$ —	$ 357.8	7.4 %
International	439.2	—	—	—	439.2	9.1 %
Options	—	20.0	—	—	20.0	0.4 %
Common Collective Trusts (c)	—	14.0	—	400.5	414.5	8.6 %
Subtotal – Equities	797.0	34.0	—	400.5	1,231.5	25.5 %
Fixed Income:						
Common Collective Trust – Debt (c)	—	—	—	32.3	32.3	0.7 %
United States Government and Agency Securities (c)	—	423.3	—	17.7	441.0	9.1 %
Corporate Debt (c)	—	1,932.2	—	10.0	1,942.2	40.2 %
Foreign Debt (c)	—	373.7	—	12.1	385.8	8.0 %
State and Local Government	—	11.5	—	—	11.5	0.2 %
Other – Asset Backed (c)	—	5.4	—	7.4	12.8	0.3 %
Subtotal – Fixed Income	—	2,746.1	—	79.5	2,825.6	58.5 %
Infrastructure	—	—	57.6	—	57.6	1.2 %
Real Estate	—	—	254.9	—	254.9	5.3 %
Alternative Investments	—	—	411.1	—	411.1	8.5 %
Securities Lending	—	161.6	—	—	161.6	3.4 %
Securities Lending Collateral (a)	—	—	—	(163.3)	(163.3)	(3.4)%
Cash and Cash Equivalents (c)	—	—	—	29.7	29.7	0.6 %
Other – Pending Transactions and Accrued Income (b)	—	—	—	18.6	18.6	0.4 %
Total	$ 797.0	$ 2,941.7	$ 723.6	$ 365.0	$ 4,827.3	100.0 %

(a) Amounts in "Other" column primarily represent an obligation to repay collateral received as part of the Securities Lending Program.
(b) Amounts in "Other" column primarily represent accrued interest, dividend receivables and transactions pending settlement.
(c) Amounts in "Other" column represent investments for which fair value is measured using net asset value per share.

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

	Foreign Debt	Infrastructure	Real Estate	Alternative Investments	Total Level 3
			(in millions)		
Balance as of January 1, 2016	$ 0.1	$ 42.0	$ 253.7	$ 378.7	$ 674.5
Actual Return on Plan Assets					
Relating to Assets Still Held as of the Reporting Date	—	5.9	5.3	13.7	24.9
Relating to Assets Sold During the Period	—	0.9	23.2	21.1	45.2
Purchases and Sales	(0.1)	8.8	(27.3)	(2.4)	(21.0)
Transfers into Level 3	—	—	—	—	—
Transfers out of Level 3	—	—	—	—	—
Balance as of December 31, 2016	$ —	$ 57.6	$ 254.9	$ 411.1	$ 723.6

The following table presents the classification of OPEB plan assets for AEP within the fair value hierarchy as of December 31, 2016:

Asset Class	Level 1	Level 2	Level 3	Other	Total	Year End Allocation
			(in millions)			
Equities:						
Domestic	$ 517.1	$ —	$ —	$ —	$ 517.1	33.5 %
International	435.5	—	—	—	435.5	28.2 %
Options	—	15.2	—	—	15.2	1.0 %
Common Collective Trusts (b)	—	10.9	—	20.5	31.4	2.0 %
Subtotal – Equities	952.6	26.1	—	20.5	999.2	64.7 %
Fixed Income:						
Common Collective Trust – Debt (b)	—	—	—	93.7	93.7	6.0 %
United States Government and Agency Securities	—	64.7	—	—	64.7	4.2 %
Corporate Debt	—	121.6	—	—	121.6	7.9 %
Foreign Debt	—	18.6	—	—	18.6	1.2 %
State and Local Government	—	3.0	—	—	3.0	0.2 %
Other – Asset Backed	—	5.9	—	—	5.9	0.4 %
Subtotal – Fixed Income	—	213.8	—	93.7	307.5	19.9 %
Trust Owned Life Insurance:						
International Equities (b)	—	—	—	110.1	110.1	7.1 %
United States Bonds (b)	—	—	—	97.4	97.4	6.3 %
Subtotal – Trust Owned Life Insurance	—	—	—	207.5	207.5	13.4 %
Cash and Cash Equivalents	24.0	10.5	—	—	34.5	2.2 %
Other – Pending Transactions and Accrued Income (a)	—	—	—	(2.8)	(2.8)	(0.2)%
Total	$ 976.6	$ 250.4	$ —	$ 318.9	$ 1,545.9	100.0 %

(a) Amounts in “Other” column primarily represent accrued interest, dividend receivables and transactions pending settlement.
(b) Amounts in “Other” column represent investments for which fair value is measured using net asset value per share.

Accumulated Benefit Obligation

As of December 31, 2017 and 2016, the accumulated benefit obligation for the qualified pension plan was $3.6 million and $3.5 million, respectively.

Estimated Future Benefit Payments and Contributions

AEGCo expects contributions and payments for the OPEB plans of $920 thousand during 2018. Contributions to the pension trust, when needed, are at least the minimum amount required by the Employee Retirement Income Security Act and additional discretionary contributions may also be made to maintain the funded status of the plan.

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

	Pension Plan	OPEB	
	Pension Payments	Benefit Payments	Medicare Subsidy Receipts
		(in thousands)	
2018	$ 200	$ 1,291	$ (35)
2019	192	1,363	(43)
2020	188	1,439	(55)
2021	182	1,491	(65)
2022	515	1,512	(76)
Years 2023 to 2027, in Total	1,058	8,291	(530)

Components of Net Periodic Benefit Cost

The following table provides the components of net periodic benefit cost:

	Pension Plan		OPEB	
	Years Ended December 31,			
	2017	2016	2017	2016
	(in thousands)			
Service Cost	$ 75	$ 104	$ 858	$ 1,129
Interest Cost	147	151	1,684	1,814
Expected Return on Plan Assets	(246)	(242)	(2,206)	(2,136)
Amortization of Prior Service Cost (Credit)	1	1	(68)	(67)
Amortization of Net Actuarial Loss	59	59	376	435
Net Periodic Benefit Cost	$ 36	$ 73	$ 644	$ 1,175

Estimated amounts expected to be amortized to net periodic benefit costs and the impact on the balance sheet during 2018 are shown in the following table:

	Pension Plan	OPEB
Components	(in thousands)	
Net Actuarial Loss	$ 63	$ 669
Prior Service Credit	—	(68)
Total Estimated 2018 Amortization	$ 63	$ 601
Expected to be Recorded as		
Regulatory Asset	$ 63	$ 601

American Electric Power System Retirement Savings Plan

AEGCo participates in an AEP sponsored defined contribution retirement savings plan, the American Electric Power System Retirement Savings Plan, for substantially all employees who are not covered by a retirement savings plan of the UMWA. This qualified plan offers participants an opportunity to contribute a portion of their pay, includes features under Section 401(k) of the Internal Revenue Code and provides for matching contributions. The matching contributions to the plan are 100% of the first 1% of eligible employee contributions and 70% of the next 5% of contributions. The cost for matching contributions totaled $60 thousand in 2017 and $95 thousand in 2016.

UMWA Benefits

Health and Welfare Benefits

AEGCo provides health and welfare benefits for certain unionized employees, retirees and their survivors who meet eligibility requirements. AEGCo administers the health and welfare benefits and pays them from its general assets.

Multiemployer Pension Benefits

UMWA pension benefits are provided through the United Mine Workers of America 1974 Pension Plan (Employer Identification Number: 52-1050282, Plan Number 002), a multiemployer plan. The UMWA pension benefits are administered by a board of trustees appointed in equal numbers by the UMWA and the Bituminous Coal Operators' Association (BCOA), an industry bargaining association. AEP makes contributions to the United Mine Workers of America 1974 Pension Plan based on provisions in its labor agreement and the plan documents. The UMWA pension plan is different from single-employer plans as an employer's contributions may be used to provide benefits to employees of other participating employers. A withdrawing employer may be subject to a withdrawal liability, which is calculated based upon that employer's share of the plan's unfunded benefit obligations. If an employer fails to make required contributions or if its payments in connection with its withdrawal liability fall short of satisfying its share of the plan's unfunded benefit obligations, the remaining employers may be allocated a greater share of the remaining unfunded plan obligations. Under the Pension Protection Act of 2006 (PPA), the UMWA pension plan was in Critical and Declining Status for the plan years ending June 30, 2017 and 2016, without utilization of extended amortization provisions. As required under the PPA, the Plan adopted a Rehabilitation Plan in February 2015 which was updated in May 2016, August 2016 and May 2017.

The amounts contributed in 2017 and 2016 were $483 thousand and $889 thousand, respectively, and represent less than 5% of the total contributions in the plan's latest annual report based on the plan year ended June 30, 2016. UMWA pension contributions included a surcharge of 5% from December 2014 through June 2015. UMWA pension contributions included a surcharge of 10% from July 2015 through June 2016 at which time new base contribution rates went into effect with no associated surcharges.

Under the terms of the UMWA pension plan, contributions will be required to continue beyond the February 28, 2018 expiration of the current collective bargaining agreement, whether or not the term of that agreement is extended or a subsequent agreement is entered, so long as both the UMWA pension plan remains in effect and AEGCo continues to operate the facility covered by the current collective bargaining agreement. The contribution rate applicable would be determined in accordance with the terms of the UMWA pension plan by reference to the National Bituminous Coal Wage Agreement, subject to periodic revisions, between the UMWA and the BCOA. If the UMWA pension plan would terminate or AEGCo would cease operation of the facility without arranging for a successor operator to assume its liability, the withdrawal liability obligation would be triggered.

Based upon the planned closure of CCT in 2022, AEGCo records a UMWA pension withdrawal liability on the balance sheet. The UMWA pension withdrawal liability is re-measured annually and is related to the company's proportionate share of the plan's unfunded vested liabilities. As of December 31, 2017 and 2016, the liability balance was $18.6 million and $15.9 million, respectively. AEGCo recovers the estimated UMWA pension withdrawal liability through billings for transloading services to regulated affiliates. A regulatory asset is recorded on the balance sheet when the UMWA pension withdrawal liability exceeds the cumulative billings collected from regulated affiliates. A regulatory liability is recorded on the balance sheet when the cumulative billings from regulated affiliates is in excess of the UMWA pension withdrawal liability. As of December 31, 2017 and 2016, AEGCo recorded a regulatory asset of $509 thousand and a regulatory liability of $2.5 million, respectively. If any portion of the UMWA pension withdrawal liability is not recovered from regulated affiliates, it could reduce AEGCo's future net income and cash flows and impact financial condition.

7. FAIR VALUE MEASUREMENTS

Fair Value Measurements of Long-term Debt

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

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

The book values and fair values of AEGCo's Long-term Debt are summarized in the following table:

	December 31,			
	2017		2016	
	Book Value	Fair Value	Book Value (a)	Fair Value (a)
	(in thousands)			
Long-term Debt	$ 169,891	$ 170,000	$ 321,845	$ 364,299

(a) Amount includes debt related to the Lawrenceburg Plant that has been classified as Liabilities Held for Sale on the Balance Sheet and has a fair value of $172.2 million. See the "Lawrenceburg Plant" section of Note 5 for additional information.

8. INCOME TAXES

Federal Tax Reform

In December 2017, legislation referred to as Tax Reform was signed into law. The majority of the provisions in the new legislation are effective for taxable years beginning after December 31, 2017. Tax Reform includes significant changes to the Internal Revenue Code of 1986 (as amended, the Code), including amendments which significantly change the taxation of business entities and also includes provisions specific to regulated public utilities. The more significant changes that affect AEGCo include the reduction in the corporate federal income tax rate from 35% to 21%, and several technical provisions including, among others, limiting the utilization of net operating losses arising after December 31, 2017 to 80% of taxable income with an indefinite carryforward period. The Tax Reform provisions related to regulated public utilities generally allow for the continued deductibility of interest expense, eliminate bonus depreciation for certain property acquired after September 27, 2017 and continue certain rate normalization requirements for accelerated depreciation benefits.

Provisional Amounts

Given the significance of the legislative changes resulting from Tax Reform, the timing of its enactment, and the widespread applicability to registrants, the SEC staff recognized the potential challenges faced by registrants when reflecting the effects of Tax Reform in their 2017 financial statements. Accordingly, in order to address potential uncertainty or diversity of views in practice regarding the application of the accounting guidance for "Income Taxes" in situations where a registrant does not have the necessary information available, prepared, or analyzed (including computations) in reasonable detail to complete the accounting for "Income Taxes" for certain tax effects of Tax Reform for the reporting period in which the legislation was enacted, the SEC staff issued Staff Accounting Bulletin 118 (SAB 118) in December 2017. For such areas of analysis that are incomplete, SAB 118 provides for up to a one year period in which to complete the required analyses and accounting required by the accounting guidance for "Income Taxes," referred to as the measurement period. In January 2018, the FASB issued guidance allowing non-public entities to apply SAB 118.

SAB 118 describes three categories associated with a registrant's status of accounting for Tax Reform during the measurement period: (a) a registrant is complete with its accounting for certain effects of Tax Reform, (b) a registrant's accounting is incomplete but is able to determine a reasonable estimate for certain effects of Tax Reform and records that estimate as a provisional amount, or (c) the accounting is incomplete and a registrant is not able to determine a reasonable estimate and therefore continues to apply existing accounting guidance for income taxes, based on the provisions of the tax laws that were in effect immediately prior to the enactment of the Tax Reform legislation. For items in which the accounting assessment is complete or a reasonable estimate can be made, a registrant must reflect the income tax effects of Tax Reform for those items in its financial statements that include the enactment of the Tax Reform legislation. SAB 118 also requires certain disclosures to provide information about the material financial reporting impacts, if any, due to Tax Reform for which the accounting is not complete. Subsequent disclosures in future reporting periods in which the accounting is completed are also a requirement of the guidance.

AEGCo has made a reasonable estimate for the measurement and accounting of the effects of Tax Reform which have been reflected in the December 31, 2017 financial statements as provisional amounts based on information available. While AEGCo was able to make reasonable estimates of the impact of Tax Reform, the final impact may differ from the recorded provisional amounts to the extent refinements are made to the estimated cumulative temporary differences or as a result of additional guidance or technical corrections that may be issued by the IRS that may impact management's interpretation and assumptions utilized. AEGCo expects to complete the analysis of the provisional items during the second half of 2018.

Impact of Tax Reform on the Financial Statements

Changes in the Code due to Tax Reform had a material impact on AEGCo's 2017 financial statements. In accordance with the accounting guidance for "Income Taxes", the effect of a change in tax law must be recognized at the date of enactment. The accounting guidance for "Income Taxes" also requires deferred tax assets and liabilities to be measured

at the enacted tax rate expected to apply when temporary differences will be realized or settled. As a result, AEGCo's deferred tax assets and liabilities were re-measured using the newly enacted tax rate of 21% in December 2017. This re-measurement resulted in a significant reduction in AEGCo's net accumulated deferred income tax liability. With respect to AEGCo's operations, the reduction of the net accumulated deferred income tax liability was primarily offset by a corresponding increase in income tax related regulatory assets and an increase in income tax related regulatory liabilities because the benefit of the lower federal tax rate is expected to be provided to customers. However, when the underlying asset or liability giving rise to the temporary difference was not previously contemplated in regulated rates, the re-measurement of the deferred taxes on those assets or liabilities was recorded as an adjustment to income tax expense.

AEGCo reflected a decrease in Deferred Income Tax Liabilities of $33.1 million and resulted in an increase in income tax related Regulatory Liabilities of $35.8 million, an increase in income tax related Regulatory Assets of $2.7 million and an immaterial adjustment to Income Tax Expense.

Regulatory Treatment

As a result of Tax Reform, AEGCo recognized a regulatory liability for approximately $30 million of excess accumulated deferred income taxes (Excess ADIT), as well as an incremental liability of $8 million to reflect the $38 million Excess ADIT on a pretax basis, which is presented in Regulatory Liabilities and Deferred Income Taxes on the balance sheets. The Excess ADIT is reflected on a pretax basis to appropriately contemplate future tax consequences in the periods when the regulatory liability is settled. Approximately $16 million of the Excess ADIT relates to temporary differences associated with depreciable property. The Tax Reform legislation includes certain rate normalization requirements that stipulate how the portion of the total Excess ADIT that is related to certain depreciable property must be returned to customers. Specifically, AEGCo is subject to those rate normalization requirements. Excess ADIT resulting from the reduction of the corporate tax rate with respect to prior depreciation or recovery deductions on property will be normalized using the average rate assumption method. As a result, once the amortization of the Excess ADIT is reflected in rates, customers will receive the benefits over the remaining weighted average useful life of the applicable property.

For the remaining $14 million of Excess ADIT, AEGCo expects to continue working to determine the appropriate mechanism and time period over which to provide the benefits of Tax Reform to customers.

AEGCo expects the mechanism and time period to provide the benefits of Tax Reform to customers. Tax Reform will reduce future cash flows and may impact financial condition, but is not expected to have a material impact on future net income.

Income Tax Expense (Credit)

The details of AEGCo's income taxes are as follows:

	Years Ended December 31,	
	2017	2016
	(in thousands)	
Federal:		
Current	$ 125,424	$ 9,776
Deferred	(18,866)	11,981
Deferred Investment Tax Credits	(1,969)	(1,965)
Total Federal	104,589	19,792
State and Local:		
Current	9,963	597
Deferred	(24)	(387)
Total State and Local	9,939	210
Income Tax Expense	$ 114,528	$ 20,002

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

	Years Ended December 31,	
	2017	2016
	(in thousands)	
Net Income	$ 271,458	$ 37,128
Income Tax Expense	114,528	20,002
Pretax Income	$ 385,986	$ 57,130
Income Taxes on Pretax Income at Statutory Rate (35%)	$ 135,095	$ 19,996
Increase (Decrease) in Income Taxes Resulting from the Following Items:		
Depreciation	2,580	3,268
Plant Sales	(26,705)	—
AFUDC	(1,228)	(306)
Rockport Plant, Unit 2 Investment Tax Credit	374	374
Investment Tax Credits, Net	(1,969)	(1,965)
State and Local Income Taxes, Net	6,460	136
Tax Adjustments	(351)	(1,202)
Other	272	(299)
Income Tax Expense	$ 114,528	$ 20,002
Effective Income Tax Rate	29.7 %	35.0 %

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

	December 31,	
	2017	2016
	(in thousands)	
Deferred Tax Assets	$ 41,645	$ 34,029
Deferred Tax Liabilities	(71,776)	(125,317)
Net Deferred Tax Liabilities	$ (30,131)	$ (91,288)
Property Related Temporary Differences	$ (43,771)	$ (100,001)
Amounts Due To/From Customers for Future Federal Income Taxes	9,282	2,677
Deferred State Income Taxes	(1,598)	(7,334)
Net Deferred Gain on Sale-and-Leaseback – Rockport Plant, Unit 2	5,870	11,769
Postretirement Benefits	4,290	2,161
All Other, Net	(4,204)	(560)
Net Deferred Tax Liabilities	$ (30,131)	$ (91,288)

AEP System Tax Allocation Agreement

AEGCo 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 consolidated net operating loss of the AEP System is allocated to each company in the consolidated group with taxable losses. The tax benefit of the Parent is allocated to its subsidiaries with taxable income. With the exception of the allocation of the consolidated AEP System net operating loss and the loss of the Parent, the method of allocation reflects a separate return result for each company in the consolidated group.

Federal and State Income Tax Audit Status

AEGCo and other AEP subsidiaries are no longer subject to U.S. federal examination for years before 2011. The IRS examination of years 2011, 2012 and 2013 started in April 2014. AEP and subsidiaries received a Revenue Agents Report in April 2016, completing the 2011 through 2013 audit cycle indicating an agreed upon audit. The 2011 through 2013 audit was submitted to the Congressional Joint Committee on Taxation for approval. The Joint Committee referred the audit back to the IRS exam team for further consideration. Although the outcome of tax audits is uncertain, in management's opinion, adequate provisions for federal income taxes have been made for potential liabilities resulting from such matters. In addition, AEGCo accrues interest on these uncertain tax positions. Management is not aware of any issues for open tax years that upon final resolution are expected to materially impact net income.

AEGCo and other AEP subsidiaries file income tax returns in various state and local jurisdictions. These taxing authorities routinely examine the tax returns. AEGCo and other AEP subsidiaries are currently under examination in several state and local jurisdictions. However, it is possible that previously filed tax returns have positions that may be challenged by these tax authorities. Management believes that adequate provisions for income taxes have been made for potential liabilities resulting from such challenges and that the ultimate resolution of these audits will not materially impact net income. AEGCo is no longer subject to state or local income tax examinations by tax authorities for years before 2009.

Uncertain Tax Positions

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

The following table shows amounts reported for interest expense:

	Years Ended December 31,	
	2017	2016
	(in thousands)	
Interest Expense	$ 125	$ 104

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

	December 31,	
	2017	2016
	(in thousands)	
Accrual for Payment of Interest and Penalties	$ 576	$ 433

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

	2017	2016
	(in thousands)	
Balance as of January 1,	$ 4,928	$ 4,928
Increase – Tax Positions Taken During a Prior Period	—	—
Decrease – Tax Positions Taken During a Prior Period	—	—
Increase – Tax Positions Taken During the Current Year	—	—
Decrease – Tax Positions Taken During the Current Year	—	—
Increase – Settlements with Taxing Authorities	—	—
Decrease – Settlements with Taxing Authorities	—	—
Decrease – Lapse of the Applicable Statute of Limitations	—	—
Balance as of December 31,	$ 4,928	$ 4,928

The total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate is $3.2 million for 2017 and $3.2 million for 2016. Management believes there will be no significant net increase or decrease in unrecognized tax benefits within 12 months of the reporting date.

Federal Tax Legislation

The Protecting Americans from Tax Hikes Act of 2015 (PATH) included an extension of the 50% bonus depreciation for three years through 2017, phasing down to 40% in 2018 and 30% in 2019. PATH also provided for the extension of research and development, employment and several energy tax credits for 2015. PATH also includes provisions to extend the wind energy production tax credit through 2016 with a three-year phase-out (2017-2019), and to extend the 30% temporary solar investment tax credit for three years through 2019 and with a two-year phase-out (2020-2021). PATH also provided for a permanent extension of the Research and Development tax credit. The enacted provisions did not materially impact AEGCo's net income or financial condition but did have a favorable impact on future cash flows. The federal Tax Reform eliminated bonus depreciation for certain property acquired after September 27, 2017.

State Tax Legislation

Legislation was passed by the state of Indiana in May 2011 enacting a phased reduction in corporate income tax rate from 8.5% to 6.5%. The 8.5% Indiana corporate income tax rate was reduced 0.5% each year beginning after June 30, 2012, with the final reduction occurring in years beginning after June 30, 2015. Additional legislation was passed by the state of Indiana reducing the corporate income tax rate from 6.5% in 2016 to 4.9% beginning after June 30, 2016 with the final reduction occurring in years beginning after June 30, 2021.

The enacted provision did not materially impact AEGCo's net income, cash flows or financial condition.

9. LEASES

Leases of property, plant and equipment are for remaining periods up to 7 years and require payments of related property taxes, maintenance and operating costs. The majority of the leases have purchase or renewal options and will be renewed or replaced by other leases.

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

Lease Rental Costs	Years Ended December 31, 2017	2016
	(in thousands)	
Net Lease Expense on Operating Leases	$ 72,960	$ 69,943
Amortization of Capital Leases	1,880	2,012
Interest on Capital Leases	1,642	1,770
Total Lease Rental Costs	$ 76,482	$ 73,725

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

	December 31, 2017	2016
	(in thousands)	
Property, Plant and Equipment Under Capital Leases		
Generation	$ 25,906	$ 26,430
Other Property, Plant and Equipment	1,459	2,107
Total Property, Plant and Equipment Under Capital Leases	27,365	28,537
Accumulated Amortization	7,494	7,006
Net Property, Plant and Equipment Under Capital Leases	$ 19,871	$ 21,531
Obligations Under Capital Leases		
Noncurrent Liability	$ 18,101	$ 19,655
Liability Due Within One Year	1,770	1,876
Total Obligations Under Capital Leases	$ 19,871	$ 21,531

Future minimum lease payments consisted of the following as of December 31, 2017:

Future Minimum Lease Payments	Capital Leases	Noncancelable Operating Leases
	(in thousands)	
2018	$ 3,286	$ 78,448
2019	3,202	78,439
2020	3,187	78,328
2021	3,128	77,997
2022	3,033	77,971
Later Years	11,464	351
Total Future Minimum Lease Payments	27,300	$ 391,534
Less Estimated Interest Element	7,429	
Estimated Present Value of Future Minimum Lease Payments	$ 19,871	

Master Lease Agreements

AEGCo leases certain equipment under master lease agreements. Under the lease agreements, the lessor is guaranteed a residual value up to a stated percentage of 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, AEGCo is committed to pay the difference between the actual fair value and the residual value guarantee. Historically, at the end of the lease term the fair value has been in excess of the unamortized balance. As of December 31, 2017, the maximum potential loss for these lease agreements was $41 thousand assuming the fair value of the equipment is zero at the end of the lease term.

Rockport Lease

AEGCo and I&M entered into a sale-and-leaseback transaction in 1989 with Wilmington Trust Company (Owner Trustee), an unrelated, unconsolidated trustee for Rockport Plant, Unit 2 (the Plant). The Owner Trustee was capitalized with equity from six owner participants with no relationship to AEP or any of its subsidiaries and debt from a syndicate of banks and securities in a private placement to certain institutional investors.

The gain from the sale was deferred and is being amortized over the term of the lease, which expires in 2022. The Owner Trustee owns the Plant and leases it to AEGCo and I&M. The lease is accounted for as an operating lease with the payment obligations included in the future minimum lease payments schedule earlier in this note. The lease term is for 33 years with potential renewal options. At the end of the lease term, AEGCo and I&M have the option to renew the lease or the Owner Trustee can sell the Plant. AEP, AEGCo and I&M have no ownership interest in the Owner Trustee and do not guarantee its debt. AEGCo's future minimum lease payments for this sale-and-leaseback transaction as of December 31, 2017 are as follows:

Future Minimum Lease Payments		(in thousands)
2018	$	73,854
2019		73,854
2020		73,854
2021		73,854
2022		73,854
Later Years		—
Total Future Minimum Lease Payments	$	369,270

10. FINANCING ACTIVITIES

Long-term Debt

The following table details long-term debt outstanding:

Type of Debt	Maturity	Weighted Average Interest Rate as of December 31, 2017	Interest Rate as of December 31, 2017	2016	Outstanding as of December 31, 2017	2016	
					(in thousands)		
Senior Unsecured Notes	2037	—%	—%	6.33%	$ —	$ 152,064	(c)
Pollution Control Bonds (a)	2017-2018 (b)	1.60%	1.59%-1.60%	0.75%	44,998	45,000	
Other Long-term Debt	2018	2.35%	2.35%	1.50%	124,893	124,781	
Total Long-term Debt Outstanding					$ 169,891	$ 321,845	(c)

(a) For AEGCo's pollution control bonds, interest rates are subject to periodic adjustment and may be purchased on demand at periodic interest adjustment dates.

(b) AEGCo's pollution control bonds are subject to redemption earlier than the maturity date. Consequently, these bonds have been classified for maturity purposes as Long-term Debt Due Within One Year - Nonaffiliated on AEGCo's balance sheets.

(c) Amounts include debt related to the Lawrenceburg Plant that has been classified as Liabilities Held for Sale on the balance sheet. See "Lawrenceburg Plant" section of Note 5 for additional information.

Long-term debt outstanding as of December 31, 2017 is payable as follows:

	2018	2019	2020	2021	2022	After 2022	Total
				(in thousands)			
Principal Amount	$ 170,000	$ —	$ —	$ —	$ —	$ —	$ 170,000
Debt Issuance Costs							(109)
Total Long-term Debt Outstanding							$ 169,891

Dividend Restrictions

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

AEGCo has credit agreements that contain a covenant that limit its debt to capitalization ratio to 67.5%. As of December 31, 2017, AEGCo did not exceed its debt to capitalization limit. The method for calculating outstanding debt and capitalization is contractually defined in the credit agreements.

As of December 31, 2017, the maximum amount of restricted net assets of AEGCo that may not be distributed to Parent in the form of a loan, advance or dividend was $91 million.

The credit agreement covenant restrictions can limit the ability of AEGCo to pay dividends out of retained earnings. As of December 31, 2017, there were no restrictions on AEGCo's ability to pay dividends out of retained earnings.

Corporate Borrowing Program – AEP System

The AEP System uses a corporate borrowing program to meet the short-term borrowing needs of AEP's subsidiaries. The corporate borrowing program includes a Utility Money Pool, which funds AEP's utility subsidiaries. The AEP System Utility Money Pool operates in accordance with the terms and conditions of the AEP System Utility Money Pool agreement filed with the FERC. The amounts of outstanding loans to the Utility Money Pool as of December 31, 2017 and 2016 are included in Advances to Affiliates on AEGCo's balance sheets. AEGCo's Utility Money Pool activity and corresponding authorized borrowing limits are described in the following table:

Years Ended December 31,	Maximum Borrowings from the Utility Money Pool	Maximum Loans to the Utility Money Pool	Average Borrowings from the Utility Money Pool	Average Loans to the Utility Money Pool	Loans to the Utility Money Pool as of December 31,	Authorized Short-Term Borrowing Limit
			(in thousands)			
2017	$ 12,217	$ 787,348	$ 12,217	$ 208,052	$ 94,165	$ 200,000
2016	165,758	36,042	108,612	22,100	19,037	200,000

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

Years Ended December 31,	Maximum Interest Rate for Funds Borrowed from the Utility Money Pool	Minimum Interest Rate for Funds Borrowed from the Utility Money Pool	Maximum Interest Rate for Funds Loaned to the Utility Money Pool	Minimum Interest Rate for Funds Loaned to the Utility Money Pool	Average Interest Rate for Funds Borrowed from the Utility Money Pool	Average Interest Rate for Funds Loaned to the Utility Money Pool
2017	1.00%	1.00%	1.85%	0.92%	1.00%	1.23%
2016	0.96%	0.69%	1.02%	0.93%	0.81%	0.98%

Interest expense and interest income related to the Utility Money Pool are included in Interest Expense and Interest Income, respectively, on AEGCo's statements of income. For amounts borrowed from and advanced to the Utility Money Pool, AEGCo incurred the following amounts of interest expense and earned the following amounts of interest income:

	Years Ended December 31,	
	2017	2016
	(in thousands)	
Interest Expense	$ 1	$ 839
Interest Income	2,549	13

11. RELATED PARTY TRANSACTIONS

For other related party transactions, also see “AEP System Tax Allocation Agreement” section of Note 8 and “Corporate Borrowing Program – AEP System” section of Note 10.

Affiliated Revenues

AEGCo’s revenues derived from sales to affiliates for the years ended December 31, 2017 and 2016 were $341 million and $564 million, respectively. These related party revenues are reported in Sales to AEP Affiliates on AEGCo’s statements of income.

Unit Power Agreements (UPA)

Lawrenceburg UPA

In March 2007, OPCo and AEGCo entered into a 10-year UPA for the entire output from the Lawrenceburg Generating Station effective with AEGCo’s purchase of the plant in May 2007. AEGCo’s gross investment in the plant was $762 million as of December 31, 2016, net depreciation of $452 million. Effective January 1, 2014, the Lawrenceburg UPA was assigned by OPCo to AGR. AGR had an option to extend the UPA for an additional two years. I&M operated the plant under an agreement with AEGCo. Under the UPA, AGR paid AEGCo for the capacity, depreciation, fuel, operation and maintenance and tax expenses. These payments were due regardless of whether the plant was operating. The fuel and operation and maintenance payments were based on actual costs incurred. All expenses were trued up periodically. The revenues from this agreement are included in Affiliated Revenues discussed above. This agreement terminated upon completion of the sale of the Lawrenceburg Generating Station in January 2017.

UPA between AEGCo and I&M

A UPA between AEGCo and I&M (the I&M Power Agreement) provides for the sale by AEGCo to I&M of all the power (and the energy associated therewith) available to AEGCo at the Rockport Plant unless it is sold to another utility. Subsequently, I&M assigns 30% of the power to KPCo. See the “UPA between AEGCo and KPCo” section below. I&M is obligated, whether or not power is available from AEGCo, to pay as a demand charge for the right to receive such power (and as an energy charge for any associated energy taken by I&M) net of amounts received by AEGCo from any other sources, sufficient to enable AEGCo to pay all its operating and other expenses, including a rate of return on the common equity of AEGCo as approved by the FERC. The revenues from this agreement are included in Affiliated Revenues discussed above. The I&M Power Agreement will continue in effect until the expiration of the lease term of Unit 2 of the Rockport Plant unless extended in specified circumstances.

UPA between AEGCo and KPCo

Pursuant to an assignment between I&M and KPCo and a UPA between KPCo and AEGCo, AEGCo sells KPCo 30% of the power (and the energy associated therewith) available to AEGCo from both units of the Rockport Plant. KPCo pays to AEGCo in consideration for the right to receive such power the same amounts which I&M would have paid AEGCo under the terms of the I&M Power Agreement for such entitlement. The revenues from this agreement are included in Affiliated Revenues discussed above. The KPCo UPA ends in December 2022.

Cook Coal Terminal

Cook Coal Terminal performs coal transloading and storage services at cost for I&M. AEGCo recorded revenues of $10.2 million and $12.8 million for the years ended December 31, 2017 and 2016, respectively, for transloading services provided. AEGCo included revenues for these services in Other Revenues - Affiliated on the statements of income.

Cook Coal Terminal also performs railcar maintenance services at cost for I&M, PSO and SWEPCo. AEGCo recorded revenues of $5.3 million and $5.6 million for the years ended December 31, 2017 and 2016, respectively, for railcar maintenance provided. AEGCo included revenues for these services in Other Revenues - Affiliated on the statements of income.

I&M Barging and Other Services

I&M provides barging and other transportation services to affiliates. AEGCo recorded expenses of $15.3 million and $14.8 million for the years ended December 31, 2017 and 2016, respectively, for barging services provided by I&M. These expenses were recorded in Fuel and Other Consumables Used for Electric Generation on AEGCo's statements of income.

Sales and Purchases of Property

AEGCo had affiliated sales and purchases of electric property individually amounting to $100 thousand or more. There were no gains or losses recorded on the transactions. The following table shows the sales and purchases, recorded at net book value, for the years ended December 31, 2017 and 2016:

	Years Ended December 31,	
	2017	2016
	(in thousands)	
Sales	$ —	$ 2,973
Purchases	—	—

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

12. VARIABLE INTEREST ENTITIES

The accounting guidance for "Variable Interest Entities" is a consolidation model that considers if a company has a variable interest in a VIE. A VIE is a legal entity that possesses any of the following conditions: the entity's equity at risk is not sufficient to permit the legal entity to finance its activities without additional subordinated financial support, equity owners are unable to direct the activities that most significantly impact the legal entity's economic performance (or they possess disproportionate voting rights in relation to the economic interest in the legal entity), or the equity owners lack the obligation to absorb the legal entity's expected losses or the right to receive the legal entity's expected residual returns. 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 AEGCo is the primary beneficiary of a VIE, management considers whether AEGCo has the power to direct the most significant activities of the VIE and is obligated to absorb losses or receive the expected residual returns that are significant to the VIE. Management believes that significant assumptions and judgments were applied consistently. AEGCo is not the primary beneficiary of any VIE and has not provided financial or other support to any VIE that was not previously contractually required.

AEPSC provides certain managerial and professional services to AEP's subsidiaries. Parent is the sole equity owner of AEPSC. AEP management controls the activities of AEPSC. The costs of the services are based on a direct charge or on a prorated basis and billed to the AEP subsidiary companies at AEPSC's cost. AEP subsidiaries have not provided financial or other support outside the reimbursement of costs for services rendered. AEPSC finances its operations through cost reimbursement from other AEP subsidiaries. There are no other terms or arrangements between AEPSC and any of the AEP subsidiaries that could require additional financial support from an AEP subsidiary or expose them to losses outside of the normal course of business. AEPSC and its billings are subject to regulation by the FERC. AEP subsidiaries are exposed to losses to the extent they cannot recover the costs of AEPSC through their normal business operations. AEP subsidiaries are considered to have a significant interest in AEPSC due to their activity in AEPSC's cost reimbursement structure. However, AEP subsidiaries do not have control over AEPSC. AEPSC is consolidated by AEP. In the event AEPSC would require financing or other support outside the cost reimbursement billings, this financing would be provided by AEP. AEGCo's total billings from AEPSC for the years ended December 31, 2017 and 2016 were $2 million and $9.3 million, respectively. The carrying amount of liabilities associated with AEPSC as of December 31, 2017 and 2016 was $150 thousand and $1.3 million, respectively. Management estimates the maximum exposure of loss to be equal to the amount of such liability.

13. PROPERTY, PLANT AND EQUIPMENT

Property, Plant and Equipment is shown functionally on the face of AEGCo's balance sheets. The following table includes AEGCo's total plant balances as of December 31, 2017 and 2016:

	December 31, 2017	December 31, 2016
	(in thousands)	
Regulated Property, Plant and Equipment		
Generation	$ 1,111,563	$ 955,572
Other	35,186	36,204
CWIP	27,721	122,060
Less: Accumulated Depreciation	677,587	645,164
Total Regulated Property, Plant and Equipment - Net	496,883	468,672
Nonregulated Property, Plant and Equipment - Net	130	130
Total Property, Plant and Equipment - Net	$ 497,013	$ 468,802 (a)

(a) Amount excludes $312 million of Property, Plant and Equipment - Net classified as Assets Held for Sale on the balance sheet. See "Lawrenceburg Plant" section of Note 5 for additional information.

Depreciation

AEGCo provides for depreciation of Property, Plant and Equipment on a straight-line basis over the estimated useful lives of property, generally using composite rates by functional class. The following table provides total regulated annual composite depreciation rates and depreciable lives for AEGCo. Nonregulated depreciation rate ranges and depreciable life ranges are not applicable or Not Meaningful (NM) for 2017 and 2016.

	2017		2016	
Functional Class of Property	Annual Composite Depreciation Rate	Depreciable Life Ranges	Annual Composite Depreciation Rate	Depreciable Life Ranges
		(in years)		(in years)
Generation	3.7%	60	4.0%	60
Other	9.2%	NM	7.9%	NM

The composite depreciation rate generally includes a component for non-asset retirement obligation (non-ARO) removal costs, which is credited to Accumulated Depreciation and Amortization on the balance sheets. Actual removal costs incurred are charged to Accumulated Depreciation and Amortization. Any excess of accrued non-ARO removal costs over actual removal costs incurred is reclassified from Accumulated Depreciation and Amortization and reflected as a regulatory liability.

Asset Retirement Obligations (ARO)

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

The following is a reconciliation of the 2017 and 2016 aggregate carrying amounts of ARO for AEGCo:

Year	ARO as of January 1,	Accretion Expense	Liabilities Incurred	Liabilities Settled	Revisions in Cash Flow Estimates	ARO as of December 31,
			(in thousands)			
2017	$ 8,550	$ 608	$ 22	$ (3)	$ 7,895 (a)	$ 17,072
2016	7,921	453	—	(5)	181	8,550

(a) Revision is related to the timing of cash flows due to a change in the expected retirement date for Rockport Plant, Unit 1 from 2044 to 2028.

Allowance for Funds Used During Construction

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

	Years Ended December 31, 2017	2016
	(in thousands)	
Allowance for Equity Funds Used During Construction	$ 3,060	$ 347
Allowance for Borrowed Funds Used During Construction	937	791

Jointly-owned Electric Facilities

AEGCo, jointly with I&M, owns one generating unit (Unit 1) of the Rockport Plant. AEGCo and I&M each have a 50% ownership share of the Rockport Plant. Using its own financing, each participating company is obligated to pay its share of the costs in the same proportion as its ownership interest. AEGCo's proportionate share of the operating costs associated with this facility is included in its statements of income and the investment and accumulated depreciation are reflected in its balance sheets under Property, Plant and Equipment as follows:

	Fuel	Percent of Ownership	Utility Plant in Service	Construction Work In Progress	Accumulated Depreciation
				(in thousands)	
AEGCo's Share as of December 31, 2017					
Rockport Generating Plant (a)(b)	Coal	50.0%	$ 1,084,622	$ 27,535	$ 687,286
AEGCo's Share as of December 31, 2016					
Rockport Generating Plant (a)(b)	Coal	50.0%	$ 928,108	$ 121,890	$ 655,354

(a) Operated by I&M.

(b) Amounts include AEGCo's 50% ownership of both Unit 1 and capital additions for Unit 2. Unit 2 is subject to an operating lease with a non-affiliated company. See the "Rockport Lease" section of Note 9.