

AEP Texas North Company and Subsidiary

2010 Annual Report

Consolidated Financial Statements



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GLOSSARY OF TERMS

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

Term	Meaning
AEP or Parent	American Electric Power Company, Inc.
AEP East companies	APCo, CSPCo, I&M, KPCo and OPCo.
AEPEP	AEP Energy Partners, Inc., a subsidiary of AEP dedicated to wholesale marketing and trading, asset management and commercial and industrial sales in the deregulated Texas market.
AEP System	American Electric Power System, an rated electric utility system, owned and operated by AEP's electric utility subsidiaries.
AEPSC	American Electric Power Service Corporation, a service subsidiary providing management and professional services to AEP and its subsidiaries.
AEP West companies	PSO, SWEPCo, TCC and TNC.
AOCI	Accumulated Other Comprehensive Income.
APCo	Appalachian Power Company, an AEP electric utility subsidiary.
CO ₂	Carbon Dioxide and other greenhouse gases.
CSPCo	Columbus Southern Power Company, an AEP electric utility subsidiary.
CWIP	Construction Work in Progress.
EIS	Energy Insurance Services, Inc., a nonaffiliated captive insurance company.
ERCOT	Electric Reliability Council of Texas.
ETT	Electric Transmission Texas, LLC, an equity interest joint venture between AEP Utilities, Inc. and MidAmerican Energy Holdings Company Texas Transco, LLC formed to own and operate electric transmission facilities in ERCOT.
Federal EPA	United States Environmental Protection Agency.
FERC	Federal Energy Regulatory Commission.
FTR	Financial Transmission Right, a financial instrument that entitles the holder to receive compensation for certain congestion-related transmission charges that arise when the power grid is congested resulting in differences in locational prices.
I&M	Indiana Michigan Power Company, an AEP electric utility subsidiary.
KPCo	Kentucky Power Company, an AEP electric utility subsidiary.
kV	Kilovolt.
MTM	Mark-to-Market.
Nonutility Money Pool	AEP's Nonutility Money Pool.
OATT	Open Access Transmission Tariff.
OPCo	Ohio Power Company, an AEP electric utility subsidiary.
OPEB	Other Postretirement Benefit Plans.
OTC	Over the counter.
PSO	Public Service Company of Oklahoma, an AEP electric utility subsidiary.
PUCT	Public Utility Commission of Texas.
Risk Management Contracts	Trading and nontrading derivatives, including those derivatives designated as cash flow and fair value hedges.
SIA	System Integration Agreement.
SWEPCo	Southwestern Electric Power Company, an AEP electric utility subsidiary.
TCC	AEP Texas Central Company, an AEP electric utility subsidiary.
Texas Restructuring Legislation	Legislation enacted in 1999 to restructure the electric utility industry in Texas.
TNC	AEP Texas North Company, an AEP electric utility subsidiary.
Utility Money Pool	AEP System's Utility Money Pool.
VIE	Variable Interest Entity.

INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Shareholders of
AEP Texas North Company:

We have audited the accompanying consolidated balance sheets of AEP Texas North Company and subsidiary (the "Company") as of December 31, 2010 and 2009, and the related consolidated statements of income, changes in common shareholder's equity and comprehensive income (loss), and cash flows for each of the three years in the period ended December 31, 2010. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards as established by the Auditing Standards Board (United States) and in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing 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 over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of AEP Texas North Company and subsidiary as of December 31, 2010 and 2009, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2010 in conformity with accounting principles generally accepted in the United States of America.

/s/ Deloitte & Touche LLP

Columbus, Ohio
February 25, 2011

AEP TEXAS NORTH COMPANY AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
For the Years Ended December 31, 2010, 2009 and 2008
(in thousands)

	<u>2010</u>	<u>2009</u>	<u>2008</u>
REVENUES			
Electric Transmission and Distribution	\$ 194,139	\$ 178,070	\$ 176,397
Sales to AEP Affiliates	86,483	83,224	100,523
Other Revenues	927	791	866
TOTAL REVENUES	<u>281,549</u>	<u>262,085</u>	<u>277,786</u>
EXPENSES			
Fuel and Other Consumables Used for Electric Generation	39,948	32,802	49,358
Purchased Electricity for Resale	-	2	1,249
Other Operation	93,691	88,235	84,219
Maintenance	20,407	23,723	21,445
Depreciation and Amortization	52,191	48,071	45,406
Taxes Other Than Income Taxes	18,143	17,781	17,889
TOTAL EXPENSES	<u>224,380</u>	<u>210,614</u>	<u>219,566</u>
OPERATING INCOME	57,169	51,471	58,220
Other Income (Expense):			
Other Income (Expense)	(12)	862	11,100
Interest Expense	(21,957)	(22,133)	(21,652)
INCOME BEFORE INCOME TAX EXPENSE	35,200	30,200	47,668
Income Tax Expense	10,662	11,847	13,752
NET INCOME	24,538	18,353	33,916
Preferred Stock Dividend Requirements	103	103	103
EARNINGS ATTRIBUTABLE TO COMMON STOCK	<u>\$ 24,435</u>	<u>\$ 18,250</u>	<u>\$ 33,813</u>

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

See Notes to Consolidated Financial Statements.

AEP TEXAS NORTH COMPANY AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CHANGES IN COMMON SHAREHOLDER'S
EQUITY AND COMPREHENSIVE INCOME (LOSS)
For the Years Ended December 31, 2010, 2009 and 2008
(in thousands)

	<u>Common Stock</u>	<u>Paid-in Capital</u>	<u>Retained Earnings</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Total</u>
TOTAL COMMON SHAREHOLDER'S EQUITY – DECEMBER 31, 2007	\$ 137,214	\$ 2,351	\$ 201,639	\$ (9,309)	\$ 331,895
Adoption of Guidance for Split-Dollar Life Insurance Accounting, Net of Tax of \$153			(285)		(285)
Common Stock Dividends			(35,000)		(35,000)
Preferred Stock Dividends			(103)		(103)
SUBTOTAL – COMMON SHAREHOLDER'S EQUITY					<u>296,507</u>
COMPREHENSIVE INCOME					
Other Comprehensive Income (Loss), Net of Taxes:					
Amortization of Pension and OPEB Deferred Costs, Net of Tax of \$347				644	644
Pension and OPEB Funded Status, Net of Tax of \$4,087				(7,591)	(7,591)
NET INCOME			33,916		<u>33,916</u>
TOTAL COMPREHENSIVE INCOME					<u>26,969</u>
TOTAL COMMON SHAREHOLDER'S EQUITY – DECEMBER 31, 2008	137,214	2,351	200,167	(16,256)	323,476
Common Stock Dividends			(32,000)		(32,000)
Preferred Stock Dividends			(103)		(103)
Other Changes in Common Shareholder's Equity		1,089	(1,089)		-
SUBTOTAL – COMMON SHAREHOLDER'S EQUITY					<u>291,373</u>
COMPREHENSIVE INCOME					
Other Comprehensive Income (Loss), Net of Taxes:					
Cash Flow Hedges, Net of Tax of \$40				74	74
Amortization of Pension and OPEB Deferred Costs, Net of Tax of \$314				584	584
Pension and OPEB Funded Status, Net of Tax of \$255				(473)	(473)
NET INCOME			18,353		<u>18,353</u>
TOTAL COMPREHENSIVE INCOME					<u>18,538</u>
TOTAL COMMON SHAREHOLDER'S EQUITY – DECEMBER 31, 2009	137,214	3,440	185,328	(16,071)	309,911
Common Stock Dividends			(26,500)		(26,500)
Preferred Stock Dividends			(103)		(103)
Other Changes in Common Shareholder's Equity					-
SUBTOTAL – COMMON SHAREHOLDER'S EQUITY					<u>283,308</u>
COMPREHENSIVE INCOME					
Other Comprehensive Income (Loss), Net of Taxes:					
Cash Flow Hedges, Net of Tax of \$11				(20)	(20)
Amortization of Pension and OPEB Deferred Costs, Net of Tax of \$338				628	628
Pension and OPEB Funded Status, Net of Tax of \$460				854	854
NET INCOME			24,538		<u>24,538</u>
TOTAL COMPREHENSIVE INCOME					<u>26,000</u>
TOTAL COMMON SHAREHOLDER'S EQUITY – DECEMBER 31, 2010	<u>\$ 137,214</u>	<u>\$ 3,440</u>	<u>\$ 183,263</u>	<u>\$ (14,609)</u>	<u>\$ 309,308</u>

See Notes to Consolidated Financial Statements.

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

ASSETS

December 31, 2010 and 2009

(in thousands)

	2010	2009
CURRENT ASSETS		
Cash and Cash Equivalents	\$ 223	\$ 200
Advances to Affiliates	9,482	-
Accounts Receivable:		
Customers	11,171	10,500
Affiliated Companies	11,765	46,836
Accrued Unbilled Revenues	7,570	6,900
Miscellaneous	-	874
Allowance for Uncollectible Accounts	(571)	(295)
Total Accounts Receivable	29,935	64,815
Fuel	4,612	6,476
Materials and Supplies	11,510	10,945
Accrued Tax Benefits	1,198	7,670
Prepayments and Other Current Assets	2,618	2,477
TOTAL CURRENT ASSETS	59,578	92,583
PROPERTY, PLANT AND EQUIPMENT		
Electric:		
Generation	304,218	300,291
Transmission	450,506	484,989
Distribution	598,040	568,364
Other Property, Plant and Equipment	109,464	104,380
Construction Work in Progress	39,757	63,470
Total Property, Plant and Equipment	1,501,985	1,521,494
Accumulated Depreciation and Amortization	492,887	479,878
TOTAL PROPERTY, PLANT AND EQUIPMENT – NET	1,009,098	1,041,616
OTHER NONCURRENT ASSETS		
Regulatory Assets	61,484	64,762
Deferred Charges and Other Noncurrent Assets	2,197	1,814
TOTAL OTHER NONCURRENT ASSETS	63,681	66,576
TOTAL ASSETS	\$ 1,132,357	\$ 1,200,775

See Notes to Consolidated Financial Statements.

AEP TEXAS NORTH COMPANY AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
LIABILITIES AND SHAREHOLDERS' EQUITY
December 31, 2010 and 2009

	2010	2009
	(in thousands)	
CURRENT LIABILITIES		
Advances from Affiliates	\$ -	\$ 76,196
Accounts Payable:		
General	8,695	7,155
Affiliated Companies	41,293	45,056
Long-term Debt Due Within One Year – Nonaffiliated	6	5
Accrued Taxes	17,366	27,379
Accrued Interest	5,920	5,914
Other Current Liabilities	7,956	12,419
TOTAL CURRENT LIABILITIES	81,236	174,124
NONCURRENT LIABILITIES		
Long-term Debt – Nonaffiliated	370,139	370,055
Deferred Income Taxes	135,691	122,577
Regulatory Liabilities and Deferred Investment Tax Credits	160,056	145,072
Employee Benefits and Pension Obligations	34,540	40,842
Deferred Credits and Other Noncurrent Liabilities	39,039	35,845
TOTAL NONCURRENT LIABILITIES	739,465	714,391
TOTAL LIABILITIES	820,701	888,515
Cumulative Preferred Stock Not Subject to Mandatory Redemption	2,348	2,349
Rate Matters (Note 2)		
Commitments and Contingencies (Note 4)		
COMMON SHAREHOLDER'S EQUITY		
Common Stock – Par Value – \$25 Per Share:		
Authorized – 7,800,000 Shares		
Outstanding – 5,488,560 Shares	137,214	137,214
Paid-in Capital	3,440	3,440
Retained Earnings	183,263	185,328
Accumulated Other Comprehensive Income (Loss)	(14,609)	(16,071)
TOTAL COMMON SHAREHOLDER'S EQUITY	309,308	309,911
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 1,132,357	\$ 1,200,775

See Notes to Consolidated Financial Statements.

AEP TEXAS NORTH COMPANY AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2010, 2009 and 2008
(in thousands)

	<u>2010</u>	<u>2009</u>	<u>2008</u>
OPERATING ACTIVITIES			
Net Income	\$ 24,538	\$ 18,353	\$ 33,916
Adjustments to Reconcile Net Income to Net Cash Flows from Operating Activities:			
Depreciation and Amortization	52,191	48,071	45,406
Deferred Income Taxes	16,149	(13,284)	5,386
Provision for SIA Refund	-	-	9,400
Fuel Over/Under-Recovery, Net	-	-	(54)
Change in Other Noncurrent Assets	(1,736)	(1,385)	(8,364)
Change in Other Noncurrent Liabilities	6,575	4,430	3,647
Changes in Certain Components of Working Capital:			
Accounts Receivable, Net	34,224	15,550	(27,373)
Fuel, Materials and Supplies	1,299	2,726	1,422
Accounts Payable	(3,022)	(656)	(1,763)
Accrued Taxes, Net	(12,681)	10,733	(2,449)
Other Current Assets	614	(166)	296
Other Current Liabilities	(4,706)	(7,915)	11,387
Net Cash Flows from Operating Activities	<u>113,445</u>	<u>76,457</u>	<u>70,857</u>
INVESTING ACTIVITIES			
Construction Expenditures	(74,276)	(94,108)	(132,720)
Change in Advances to Affiliates, Net	(9,482)	-	-
Acquisitions of Assets	(347)	(1,798)	(424)
Proceeds from Sales of Assets	74,067	3,888	3,555
Net Cash Flows Used for Investing Activities	<u>(10,038)</u>	<u>(92,018)</u>	<u>(129,589)</u>
FINANCING ACTIVITIES			
Issuance of Long-term Debt – Nonaffiliated	-	-	99,346
Change in Advances from Affiliates, Net	(76,196)	47,510	(4,825)
Retirement of Long-term Debt – Nonaffiliated	(5)	-	-
Principal Payments for Capital Lease Obligations	(750)	(560)	(588)
Dividends Paid on Common Stock	(26,500)	(32,000)	(35,000)
Dividends Paid on Cumulative Preferred Stock	(103)	(103)	(103)
Other Financing Activities	170	714	102
Net Cash Flows from (Used for) Financing Activities	<u>(103,384)</u>	<u>15,561</u>	<u>58,932</u>
Net Increase in Cash and Cash Equivalents	23	-	200
Cash and Cash Equivalents at Beginning of Period	200	200	-
Cash and Cash Equivalents at End of Period	<u>\$ 223</u>	<u>\$ 200</u>	<u>\$ 200</u>
SUPPLEMENTARY INFORMATION			
Cash Paid for Interest, Net of Capitalized Amounts	\$ 21,168	\$ 23,365	\$ 16,495
Net Cash Paid for Income Taxes	10,100	14,749	12,893
Noncash Acquisitions Under Capital Leases	239	853	383
Construction Expenditures Included in Accounts Payable at December 31,	4,193	3,395	5,336
SIA Refund Included in Accounts Receivable at December 31,	-	-	24,763

See Notes to Consolidated Financial Statements.

INDEX OF NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

ORGANIZATION

As a public utility, TNC engages in the transmission and distribution of electric power to 186,000 retail customers through REPs in its service territory in western and central Texas. TNC consolidates AEP Texas North Generation Company, LLC, its wholly-owned subsidiary.

Under the Texas Restructuring Legislation, TNC exited the generation business and ceased serving retail load. Although TNC continues as part owner in the Oklaunion Plant operated by PSO, TNC has leased their entire portion of the output of the plant through 2027 to a non-utility affiliate.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Rates and Service Regulation

TNC's transmission and distribution rates are regulated by the PUCT. The FERC regulates TNC's 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 the 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 that a nonregulated affiliate can bill an affiliated public utility company no more than market while a public utility must bill the higher of cost or market to a nonregulated affiliate. The PUCT also regulates certain intercompany transactions under its affiliate statutes. 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 PUCT also regulates TNC's wholesale transmission operations and rates. The FERC claims jurisdiction over retail transmission rates when retail rates are unbundled in connection with restructuring. TNC's retail transmission rates in Texas are unbundled. Although TNC's retail transmission rates in Texas are unbundled, retail transmission rates are regulated, on a cost basis, by the PUCT.

In addition, the FERC regulates the System Transmission Integration Agreement and the Transmission Coordination Agreement, both of which allocate shared system costs and revenues to the utility subsidiaries that are parties to each agreement.

Principles of Consolidation

TNC's consolidated financial statements include TNC and its wholly-owned subsidiary. Intercompany items are eliminated in consolidation. TNC also has a generating unit that is jointly-owned with an affiliated company and nonaffiliated companies. TNC's proportionate share of the operating costs associated with that facility is included in the financial statements and the assets and liabilities are reflected in the balance sheets. See "Oklaunion PPA between TNC and AEP Energy Partners" section within Note 13 for detail of TNC's agreement to sell its portion of the Oklaunion generation to AEPEP. See "Variable Interest Entities" section of Note 13.

Accounting for the Effects of Cost-Based Regulation

As a rate-regulated electric public utility company, TNC'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," TNC records regulatory assets (deferred expenses) and regulatory liabilities (future revenue reductions or refunds) to reflect the economic effects of regulation by matching expenses with their recovery through regulated revenues and income with its passage to customers through the reduction of regulated revenues. Due to the passage of legislation requiring restructuring and a transition to customer choice and market-based rates, TNC discontinued the application of "Regulated Operations" accounting treatment for the generation portion of its business.

Use of Estimates

The preparation of these financial statements in conformity with accounting principles generally accepted in the United States of America (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, allowance for doubtful accounts, long-lived asset impairment, unbilled electricity revenue, valuation of long-term energy contracts, the effects of regulation, long-lived asset recovery, storm costs, the effects of contingencies and certain assumptions made in accounting for pension and postretirement benefits. 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.

Cash and Cash Equivalents

Cash and Cash Equivalents include temporary cash investments with original maturities of three months or less.

Inventory

Fossil fuel inventories are carried at the lower of average cost or market. Materials and supplies inventories are carried at average cost.

Accounts Receivable

Customer accounts receivable primarily includes receivables from REPs and receivables related to other revenue-generating activities.

Revenue is recognized when power is delivered. To the extent that deliveries have occurred but a bill has not been issued, TNC accrues and recognizes, as Accrued Unbilled Revenues, an estimate of the revenues for deliveries since the last billing.

Allowance for Uncollectible Accounts

TNC records bad debt reserves using the specific identification of receivable balances greater than 120 days delinquent. For miscellaneous accounts receivable, bad debt expense is recorded for all amounts outstanding 180 days or greater at 100%, unless specifically identified. Miscellaneous accounts receivable items open less than 180 days may be reserved using specific identification for bad debt reserves.

Concentrations of Credit Risk and Significant Customers

TNC has significant customers which on a combined basis account for the following percentages of total Operating Revenues for the periods ended and Accounts Receivable – Customers as of December 31:

Significant Customers of TNC:			
Centrica and Reliant Energy (2010 and 2009 only)	2010	2009	2008
Percentage of Operating Revenues	24 %	27 %	21 %
Percentage of Accounts Receivable - Customers	36 %	36 %	31 %

Management monitors credit levels and the financial condition of TNC's customers on a continuing basis to minimize credit risk. The PUCT allows recovery in rates for a reasonable level of bad debt costs. Management believes adequate provision for credit loss has been made in the accompanying financial statements.

Property, Plant and Equipment

Regulated

Electric utility property, plant and equipment for TNC's rate-regulated transmission and distribution operations are stated at original purchase cost. Additions, major replacements and betterments are added to the plant accounts. Normal and routine retirements from the plant accounts, net of salvage, are charged to accumulated depreciation under the group composite method of 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. Under the group composite method of depreciation, continuous interim routine replacements of items such as poles, transformers, etc. result in the original cost, less salvage, being charged to accumulated depreciation. The depreciation rates that are established take into account the past history of interim capital replacements and the amount of salvage received. These rates and the related lives are subject to periodic review. Removal costs are charged to regulatory liabilities. The costs of labor, materials and overhead incurred to operate and maintain the plants 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."

The fair value of an asset or investment is the amount at which that asset or investment 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 or investments in active markets, fair value is estimated using various internal and external valuation methods including cash flow analysis and appraisals.

Nonregulated

The generation operations of TNC generally follow the policies of its cost-based rate-regulated operations listed above but with the following exceptions. Property, plant and equipment are stated at fair value at acquisition (or as adjusted for any applicable impairments) plus the original cost of property acquired or constructed since the acquisition, less disposals. Normal and routine retirements from the plant accounts, net of salvage, are charged to accumulated depreciation under the group composite method of depreciation. A gain or loss would be recorded if the retirement is not considered an interim routine replacement. Removal costs are charged to expense.

Allowance for Funds Used During Construction (AFUDC) and Interest Capitalization

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. For TNC's nonregulated operations, interest is capitalized during construction in accordance with the accounting guidance for "Capitalization of Interest." TNC records the equity component of AFUDC in Other Income (Expense) and the debt component of AFUDC as a reduction to Interest Expense.

Valuation of Nonderivative Financial Instruments

The book values of Cash and Cash Equivalents, Accounts Receivable 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 or credit that include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in inactive markets, market corroborated inputs (i.e. inputs derived principally from, or correlated to, observable market data) and other observable inputs for the asset or liability.

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

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 investment managers perform their 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 plans.

Assets in the benefits trust 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. Fixed income securities do not trade on an exchange and do not have an official closing price. Pricing vendors calculate bond valuations using financial models and matrices. Fixed income securities are typically classified as Level 2 holdings because their valuation inputs are based on observable market data. Observable inputs used for valuing fixed income securities are benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, reference data and economic events. 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. Benefit plan assets included in Level 3 are real estate and private equity investments that are valued using methods requiring judgment including appraisals.

Items classified as Level 2 are primarily investments in individual fixed income securities. These fixed income securities are valued using models with input data as follows:

<u>Type of Input</u>	<u>Type of Fixed Income Security</u>		
	<u>United States Government</u>	<u>Corporate Debt</u>	<u>State and Local Government</u>
Benchmark Yields	X	X	X
Broker Quotes	X	X	X
Discount Margins	X	X	
Treasury Market Update	X		
Base Spread	X	X	X
Corporate Actions		X	
Ratings Agency Updates		X	X
Prepayment Schedule and History			X
Yield Adjustments	X		

Revenue Recognition

Regulatory Accounting

TNC's financial statements reflect the actions of regulators that can result in the recognition of revenues and expenses in different time periods than enterprises that are not rate-regulated. Regulatory assets (deferred expenses) and regulatory liabilities (deferred revenue reductions or refunds) are recorded 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.

When regulatory assets are probable of recovery through regulated rates, TNC records them as assets on its balance sheet. TNC tests for probability of recovery at each balance sheet date or whenever new events occur. Examples of new events include the issuance of a regulatory commission order or passage of new legislation. If it is determined that recovery of a regulatory asset is no longer probable, TNC writes off that regulatory asset as a charge against income.

Traditional Electricity Supply and Delivery Activities

TNC recognizes revenues from wholesale electricity sales and electricity transmission and distribution delivery services. TNC recognizes the revenues in the financial statements upon delivery of the energy to the customer and includes unbilled as well as billed amounts. TNC records expenses upon receipt of purchased electricity and when expenses are incurred. TNC records third party electricity purchases as non-trading and these purchases are accounted for on a gross basis as Purchased Electricity for Resale in the Consolidated Statements of Income.

Power Purchase and Sale Agreement

TNC recognizes revenue from an affiliate, AEPEP, for a 20-year Power Purchase & Sale Agreement (PPA). TNC recognizes revenues for the fuel, operations and maintenance and all other taxes on a billed basis. Revenue is recognized for the capacity and depreciation billed to AEPEP on a straight-line basis over the term of the PPA as these amounts represent the minimum amount due.

Maintenance

Maintenance costs are expensed as incurred. If it becomes probable that TNC will recover specifically-incurred costs through future rates, a regulatory asset is established to match the expensing of those maintenance costs with their recovery in cost-based regulated revenues.

Income Taxes and Investment Tax Credits

TNC 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.

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 are accounted for under the deferral basis and are being amortized over the life of the plant investment.

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

Excise Taxes

As an agent for some state and local governments, TNC collects from customers certain excise taxes levied by those state or local governments on customers. TNC does not recognize these taxes as revenue or expense.

Debt and Preferred Stock

Gains and losses from the reacquisition of debt used to finance regulated electric utility 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 associated with the regulated business is refinanced, the reacquisition costs attributable to the portions of the business that are subject to cost-based regulatory accounting 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.

The excess of par value over costs of preferred stock reacquired is credited to paid-in capital and reclassified to retained earnings upon the redemption of the entire preferred stock series.

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 trust funds is to use a diversified portfolio of investments to achieve an acceptable rate of return while managing the interest rate sensitivity 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 allocation and periodically rebalance the investments to targeted allocation 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 optimizing net returns. Strategies used include:

- Maintaining a long-term investment horizon.
- Diversifying assets to help control volatility of returns at acceptable level.
- 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 target asset allocation and allocation ranges are as follows:

Pension Plan Assets	Minimum	Target	Maximum
Domestic Equity	30.0 %	35.0 %	40.0 %
International and Global Equity	10.0 %	15.0 %	20.0 %
Fixed Income	35.0 %	39.0 %	45.0 %
Real Estate	4.0 %	5.0 %	6.0 %
Other Investments	1.0 %	5.0 %	7.0 %
Cash	0.5 %	1.0 %	3.0 %

OPEB Plans Assets	Minimum	Target	Maximum
Equity	61.0 %	66.0 %	71.0 %
Fixed Income	29.0 %	32.0 %	37.0 %
Cash	1.0 %	2.0 %	4.0 %

The investment policy for each benefit plan contains various investment limitations. The investment policies establish concentration limits for securities. Investment policies prohibit the benefit trust funds from purchasing 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. Each investment manager's portfolio is compared to a diversified benchmark index.

For equity investments, the 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.
- Individual stock must be less than 10% 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, the concentration limits must not exceed:

- 3% in one issuer
- 20% in non-US dollar denominated
- 5% private placements
- 5% convertible securities
- 60% for bonds rated AA+ or lower
- 50% for bonds rated A+ or lower
- 10% for bonds rated BBB- or lower

For obligations of non-government issuers the following limitations apply:

- AAA rated debt: a single issuer should account for no more than 5% of the portfolio.
- AA+, AA, AA- rated debt: a single issuer should account for no more than 3% of the portfolio.
- Debt rated A+ or lower: a single issuer should account for no more than 2% of the portfolio.
- No more than 10% of the portfolio may be invested in high yield and emerging market debt combined at any time.

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 development risk classifications and some investments in Real Estate Investment Trusts (REITs), which are publicly traded real estate securities classified as Level 1.

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 six 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. Commingled private equity funds are used to enhance the holdings' diversity.

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 cash collateral. All loans are collateralized by at least 102% of the loaned asset's market value and the cash collateral is invested. The difference between the rebate owed to the borrower and the cash collateral rate of return determines the earnings on the loaned security. The securities lending program's objective is providing 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 (VEBA) 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 in 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.

Comprehensive Income (Loss)

Comprehensive income (loss) is defined as the change in equity (net assets) of a business enterprise during a period from transactions and other events and circumstances from nonowner sources. It includes all changes in equity during a period except those resulting from investments by owners and distributions to owners. Comprehensive income (loss) has two components: net income (loss) and other comprehensive income (loss).

Components of Accumulated Other Comprehensive Income (Loss) (AOCI)

AOCI is included on the balance sheets in the common shareholder's equity section. TNC's components of AOCI as of December 31, 2010 and 2009 are shown in the following table:

Components	December 31,	
	2010	2009
	(in thousands)	
Cash Flow Hedges, Net of Tax	\$ 54	\$ 74
Amortization of Pension and OPEB Deferred Costs, Net of Tax	1,856	1,228
Pension and OPEB Funded Status, Net of Tax	(16,519)	(17,373)
Total	\$ (14,609)	\$ (16,071)

Earnings Per Share (EPS)

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

Subsequent Events

Management reviewed subsequent events through February 25, 2011, the date that TNC's 2010 annual report was issued.

Adjustments to Benefit Plans Footnote

In Note 6 – Benefit Plans, the disclosure was expanded to reflect disclosure requirements based upon TNC's participation in the AEP System. These omissions were not material to the financial statements and had no impact on TNC's previously reported net income, changes in shareholder's equity, financial position or cash flows.

2. RATE MATTERS

TNC is involved in rate and regulatory proceedings at the FERC and the PUCT. Rate matters can have a material impact on net income, cash flows and possibly financial condition. TNC's recent significant rate orders are addressed in this note.

ETT 2007 Formation Appeal

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

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

3. EFFECTS OF REGULATION

Regulatory assets and liabilities are comprised of the following items:

Regulatory Assets:	December 31,		Remaining
	2010	2009	Recovery Period
	(in thousands)		
Noncurrent Regulatory Assets			
Regulatory assets not yet being recovered pending future proceedings to determine the recovery method and timing:			
<u>Regulatory Assets Currently Not Earning a Return</u>			
Rate Case Expenses	\$ 3	\$ 3	
Total Regulatory Assets Not Yet Being Recovered	<u>3</u>	<u>3</u>	
Regulatory assets being recovered:			
<u>Regulatory Assets Currently Earning a Return</u>			
Unamortized Loss on Reacquired Debt	4,494	5,129	10 years
Other Regulatory Assets Being Recovered	740	585	various
<u>Regulatory Assets Currently Not Earning a Return</u>			
Pension and OPEB Funded Status	54,589	57,137	13 years
Other Regulatory Assets Being Recovered	1,658	1,908	various
Total Regulatory Assets Being Recovered	<u>61,481</u>	<u>64,759</u>	
Total Noncurrent Regulatory Assets	<u>\$ 61,484</u>	<u>\$ 64,762</u>	
Regulatory Liabilities:	December 31,		Remaining
	2010	2009	Refund Period
	(in thousands)		
Noncurrent Regulatory Liabilities and Deferred Investment Tax Credits			
Regulatory liabilities being paid:			
<u>Regulatory Liabilities Currently Paying a Return</u>			
Asset Removal Costs	\$ 119,286	\$ 106,708	(a)
Excess Earnings	10,294	10,790	21 years
Advanced Metering Infrastructure Surcharge	15,135	8,538	10 years
Deferred Investment Tax Credits	11,897	12,939	42 years
Income Taxes, Net	3,444	5,948	20 years
Energy Efficiency/Peak Demand Reduction	-	149	
Total Regulatory Liabilities Being Paid	<u>160,056</u>	<u>145,072</u>	
Total Noncurrent Regulatory Liabilities and Deferred Investment Tax Credits	<u>\$ 160,056</u>	<u>\$ 145,072</u>	

(a) Relieved as removal costs are incurred.

4. COMMITMENTS, GUARANTEES AND CONTINGENCIES

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

COMMITMENTS

TNC has substantial construction commitments to support its operations and environmental investments. In managing the overall construction program and in the normal course of business, TNC contractually commits to third-party construction vendors for certain material purchases and other construction services. Management forecasts approximately \$75 million of construction expenditures excluding AFUDC for 2011. TNC also purchases fuel, materials, supplies, services and property, plant and equipment under contract as part of its normal course of business. Certain supply contracts contain penalty provisions for early termination. TNC has no actual contractual commitments at December 31, 2010.

GUARANTEES

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

Indemnifications and Other Guarantees

Contracts

TNC enters into certain types of contracts which require indemnifications. Typically these contracts include, but are not limited to, sale agreements, lease agreements, purchase agreements and financing agreements. Generally, these agreements may include, but are not limited to, indemnifications around certain tax, contractual and environmental matters. With respect to sale agreements, exposure generally does not exceed the sale price. Prior to December 31, 2010, TNC entered into sale agreements including indemnifications with a maximum exposure of \$3 million related to the sale price of certain generation assets in Texas. There are no material liabilities recorded for any indemnifications and the risk of payment/performance is remote.

Lease Obligations

TNC leases certain equipment under master lease agreements. See "Master Lease Agreements" section of Note 11 for disclosure of lease residual value guarantees.

CONTINGENCIES

Insurance and Potential Losses

TNC maintains insurance coverage normal and customary for an electric utility, subject to various deductibles. 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. Excluded property generally includes transmission and distribution lines, poles and towers. The insurance programs also generally provide coverage against loss arising from certain claims made by third parties and are in excess of TNC'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. Future losses or liabilities, if they occur, which are not completely insured, unless recovered from customers, could have a material adverse effect on net income, cash flows and financial condition.

Carbon Dioxide Public Nuisance Claims

In 2004, eight states and the City of New York filed an action in Federal District Court for the Southern District of New York against AEP, AEPSC, Cinergy Corp, Xcel Energy, Southern Company and Tennessee Valley Authority. The Natural Resources Defense Council, on behalf of three special interest groups, filed a similar complaint against the same defendants. The actions allege that CO₂ emissions from the defendants' power plants constitute a public nuisance under federal common law due to impacts of global warming and sought injunctive relief in the form of specific emission reduction commitments from the defendants. The trial court dismissed the lawsuits.

In September 2009, the Second Circuit Court of Appeals issued a ruling on appeal remanding the cases to the Federal District Court for the Southern District of New York. The Second Circuit held that the issues of climate change and global warming do not raise political questions and that Congress' refusal to regulate CO₂ emissions does not mean that plaintiffs must wait for an initial policy determination by Congress or the President's administration to secure the relief sought in their complaints. The court stated that Congress could enact comprehensive legislation to regulate CO₂ emissions or that the Federal EPA could regulate CO₂ emissions under existing Clean Air Act authorities and that either of these actions could override any decision made by the district court under federal common law. The Second Circuit did not rule on whether the plaintiffs could proceed with their state common law nuisance claims. In December 2010, the defendants' petition for review by the U.S. Supreme Court was granted. Briefing is underway and the case will be heard in April 2011. Management believes the actions are without merit and intends to continue to defend against the claims.

In October 2009, the Fifth Circuit Court of Appeals reversed a decision by the Federal District Court for the District of Mississippi dismissing state common law nuisance claims in a putative class action by Mississippi residents asserting that CO₂ emissions exacerbated the effects of Hurricane Katrina. The Fifth Circuit held that there was no exclusive commitment of the common law issues raised in plaintiffs' complaint to a coordinate branch of government and that no initial policy determination was required to adjudicate these claims. The court granted petitions for rehearing. An additional recusal left the Fifth Circuit without a quorum to reconsider the decision and the appeal was dismissed, leaving the district court's decision in place. Plaintiffs filed a petition with the U.S. Supreme Court asking the court to remand the case to the Fifth Circuit and reinstate the panel decision. The petition was denied in January 2011.

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

Alaskan Villages' Claims

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

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 generating plants and transmission and distribution facilities have used asbestos, polychlorinated biphenyls and other hazardous and nonhazardous materials. TNC currently incurs costs to dispose of these substances safely.

Superfund addresses clean-up of hazardous substances that have been released to the environment. The Federal EPA administers the clean-up programs. Several states have enacted similar laws. At December 31, 2010, TNC has been named potentially liable at one site under state law. In the instance where TNC has been named a defendant, disposal or recycling activities were in accordance with the then-applicable laws and regulations. Superfund does not recognize compliance as a defense, but imposes strict liability on parties who fall within its broad statutory categories. Liability has been resolved for a number of sites with no significant effect on net income.

Management evaluates the potential liability for each site separately, but several general statements can be made about potential future liability. Allegations that materials were disposed at a particular site are often unsubstantiated and the quantity of materials deposited at a site can be small and often nonhazardous. Although Superfund liability has been interpreted by the courts as joint and several, typically many parties are named for each site and several of the parties are financially sound enterprises. At present, management's estimates do not anticipate material cleanup costs for identified sites.

5. DISPOSITIONS

2010

Electric Transmission Texas LLC (ETT)

TNC sold, at cost, \$73 million of transmission facilities to ETT for the year ended December 31, 2010.

2009

None

2008

Texas Plants

In February 2008, TNC sold the mothballed Fort Phantom, Lake Pauline, Rio Pecos and San Angelo Plants for approximately \$2.5 million to a nonaffiliated entity. In 2002, the book values of the plants and the land were impaired to \$434 thousand. As part of the sale, the buyer assumed all environmental liabilities existing prior to and after the sale. As a result, the related ARO balances were reversed. Additionally, TNC recorded sales and related expenses and the impact of a settlement agreement with the City of San Angelo related to a purchase power contract between the City of San Angelo and TNC.

TNC also conveyed the Oak Creek Plant and related land at no cost to the City of Sweetwater. The plant and land assets were impaired to \$89 thousand in 2002.

As a result of these dispositions, TNC recognized an immaterial loss in the first quarter of 2008.

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 "Investments Held in Trust for Future Liabilities" and "Fair Value Measurements of Assets and Liabilities" sections of Note 1.

TNC participates in an AEP sponsored qualified pension plan and one unfunded nonqualified pension plan. Substantially all of TNC's employees are covered by the qualified plan or both the qualified and nonqualified pension plans. TNC also participates in OPEB plans sponsored by AEP to provide medical and life insurance benefits for retired employees.

TNC recognizes its funded status associated with defined benefit pension and OPEB plans in its balance sheets. Disclosures about the plans are required by the "Compensation – Retirement Benefits" accounting guidance. TNC 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. TNC 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 an AOCI equity reduction or regulatory asset and deferred gains result in an AOCI equity addition or regulatory liability.

Actuarial Assumptions for Benefit Obligations

The weighted-average assumptions as of December 31 of each year used in the measurement of TNC's benefit obligations are shown in the following table:

<u>Assumptions</u>	<u>Pension Plans</u>		<u>Other Postretirement Benefit Plans</u>	
	<u>2010</u>	<u>2009</u>	<u>2010</u>	<u>2009</u>
Discount Rate	5.05 %	5.60 %	5.25 %	5.85 %
Rate of Compensation Increase	4.45 % (a)	4.10 % (a)	N/A	N/A

(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.

N/A Not Applicable

A duration-based method is used to determine the discount rate for the plans. A hypothetical portfolio of high quality corporate bonds similar to those included in the Moody's Aa bond index is constructed with a duration matching the benefit plan liability. The composite yield on the hypothetical bond portfolio is used as the discount rate for the plan.

For 2010, the rate of compensation increase assumed varies with the age of the employee, ranging from 3.5% per year to 11.5% per year, with an average increase of 4.45%.

Actuarial Assumptions for Net Periodic Benefit Costs

The weighted-average assumptions as of January 1 of each year used in the measurement of TNC's benefit costs are shown in the following table:

	<u>Pension Plans</u>			<u>Other Postretirement Benefit Plans</u>		
	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>
Discount Rate	5.60 %	6.00 %	6.00 %	5.85 %	6.10 %	6.20 %
Expected Return on Plan Assets	8.00 %	8.00 %	8.00 %	8.00 %	7.75 %	8.00 %
Rate of Compensation Increase	4.10 %	5.40 %	5.40 %	N/A	N/A	N/A

N/A Not Applicable

The expected return on plan assets for 2010 was determined by evaluating historical returns, the current investment climate (yield on fixed income securities and other recent investment market indicators), rate of inflation and current prospects for economic growth.

The health care trend rate assumptions as of January 1 of each year used for OPEB plans measurement purposes are shown below:

<u>Health Care Trend Rates</u>	<u>2010</u>	<u>2009</u>
Initial	8.00 %	6.50 %
Ultimate	5.00 %	5.00 %
Year Ultimate Reached	2016	2012

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:

	<u>1% Increase</u>	<u>1% Decrease</u>
	(in thousands)	
Effect on Total Service and Interest Cost		
Components of Net Periodic Postretirement Health		
Care Benefit Cost	\$ 482	\$ (388)
Effect on the Health Care Component of the		
Accumulated Postretirement Benefit Obligation	5,691	(4,669)

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. At December 31, 2010, 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 as of December 31, 2010 and 2009

The following tables provide a reconciliation of the changes in the plans' benefit obligations, fair value of plan assets and funded status as of December 31. The benefit obligation for the defined benefit pension and OPEB plans are the projected benefit obligation and the accumulated benefit obligation, respectively.

	<u>Pension Plans</u>		<u>Other Postretirement Benefit Plans</u>	
	<u>2010</u>	<u>2009</u>	<u>2010</u>	<u>2009</u>
	(in thousands)			
Change in Benefit Obligation				
Benefit Obligation at January 1	\$ 112,707	\$ 103,229	\$ 45,867	\$ 44,583
Service Cost	1,839	1,843	842	776
Interest Cost	5,720	6,042	2,630	2,624
Actuarial (Gain) Loss	(2,957)	7,094	2,381	(41)
Plan Amendment Prior Service Credit	-	-	(1,070)	-
Benefit Payments	(12,952)	(5,501)	(3,556)	(3,240)
Participant Contributions	-	-	886	812
Medicare Subsidy	-	-	345	353
Benefit Obligation at December 31	<u>\$ 104,357</u>	<u>\$ 112,707</u>	<u>\$ 48,325</u>	<u>\$ 45,867</u>
Change in Fair Value of Plan Assets				
Fair Value of Plan Assets at January 1	\$ 87,757	\$ 81,559	\$ 32,084	\$ 25,575
Actual Gain on Plan Assets	8,147	11,576	1,811	4,638
Company Contributions	3,451	123	3,455	4,299
Participant Contributions	-	-	886	812
Benefit Payments	(12,952)	(5,501)	(3,556)	(3,240)
Fair Value of Plan Assets at December 31	<u>\$ 86,403</u>	<u>\$ 87,757</u>	<u>\$ 34,680</u>	<u>\$ 32,084</u>
Underfunded Status at December 31	<u>\$ (17,954)</u>	<u>\$ (24,950)</u>	<u>\$ (13,645)</u>	<u>\$ (13,783)</u>

Amounts Recognized on the Balance Sheets as of December 31, 2010 and 2009

	Pension Plans		Other Postretirement Benefit Plans	
	December 31,			
	2010	2009	2010	2009
	(in thousands)			
Other Current Liabilities - Accrued Short-term Benefit Liability	\$ (125)	\$ (125)	\$ -	\$ -
Employee Benefits and Pension Obligations - Accrued Long-term Benefit Liability	(17,829)	(24,825)	(13,645)	(13,783)
Underfunded Status	<u>\$ (17,954)</u>	<u>\$ (24,950)</u>	<u>\$ (13,645)</u>	<u>\$ (13,783)</u>

Amounts Included in AOCI and Regulatory Assets as of December 31, 2010 and 2009

Components	Pension Plans		Other Postretirement Benefit Plans	
	December 31,			
	2010	2009	2010	2009
	(in thousands)			
Net Actuarial Loss	\$ 63,987	\$ 69,098	\$ 13,850	\$ 11,391
Prior Service Credit	(431)	(852)	(261)	-
Transition Obligation	-	-	-	2,336
Recorded as				
Regulatory Assets	\$ 43,299	\$ 46,065	\$ 11,290	\$ 11,072
Deferred Income Taxes	7,089	7,762	804	929
Net of Tax AOCI	13,168	14,419	1,495	1,726

Components of the change in amounts included in AOCI and Regulatory Assets during the years ended December 31, 2010 and 2009 are as follows:

Components	Pension Plans		Other Postretirement Benefit Plans	
	Years Ended December 31,			
	2010	2009	2010	2009
	(in thousands)			
Actuarial Loss (Gain) During the Year	\$ (3,105)	\$ 3,722	\$ 3,115	\$ (2,735)
Prior Service Credit	-	-	(1,070)	-
Amortization of Actuarial Loss	(2,006)	(1,394)	(656)	(1,011)
Amortization of Prior Service Credit	421	476	-	-
Amortization of Transition Obligation	-	-	(1,527)	(1,527)
Change for the Year	<u>\$ (4,690)</u>	<u>\$ 2,804</u>	<u>\$ (138)</u>	<u>\$ (5,273)</u>

Pension and Other Postretirement Plans' Assets

The following table presents the classification of pension plan assets within the fair value hierarchy at December 31, 2010:

Asset Class	Level 1	Level 2	Level 3	Other	Total	Year End Allocation
	(in thousands)					
Equities:						
Domestic	\$ 30,229	\$ 62	\$ -	\$ -	\$ 30,291	35.1 %
International	9,024	-	-	-	9,024	10.4 %
Real Estate Investment Trusts	2,516	-	-	-	2,516	2.9 %
Common Collective Trust - International	-	3,642	-	-	3,642	4.2 %
Subtotal - Equities	41,769	3,704	-	-	45,473	52.6 %
Fixed Income:						
United States Government and Agency Securities	-	14,200	-	-	14,200	16.4 %
Corporate Debt	-	15,045	-	-	15,045	17.4 %
Foreign Debt	-	2,847	-	-	2,847	3.3 %
State and Local Government	-	509	-	-	509	0.6 %
Other - Asset Backed	-	1,145	-	-	1,145	1.3 %
Subtotal - Fixed Income	-	33,746	-	-	33,746	39.0 %
Real Estate	-	-	1,863	-	1,863	2.2 %
Alternative Investments	-	-	2,911	-	2,911	3.4 %
Securities Lending	-	5,695	-	-	5,695	6.6 %
Securities Lending Collateral (a)	-	-	-	(6,177)	(6,177)	(7.1)%
Cash and Cash Equivalents (b)	-	2,842	-	36	2,878	3.3 %
Other - Pending Transactions and Accrued Income (c)	-	-	-	14	14	- %
Total	\$ 41,769	\$ 45,987	\$ 4,774	\$ (6,127)	\$ 86,403	100.0 %

- (a) Amounts in "Other" column primarily represent an obligation to repay cash collateral received as part of the Securities Lending Program.
- (b) Amounts in "Other" column primarily represent foreign currency holdings.
- (c) Amounts in "Other" column primarily represent accrued interest, dividend receivables and transactions pending settlement.

The following table sets forth a reconciliation of changes in the fair value of real estate and alternative investments classified as Level 3 in the fair value hierarchy for the pension assets:

	Real Estate	Alternative Investments	Total Level 3
	(in thousands)		
Balance as of January 1, 2010	\$ 2,334	\$ 2,725	\$ 5,059
Actual Return on Plan Assets			
Relating to Assets Still Held as of the Reporting Date	(471)	30	(441)
Relating to Assets Sold During the Period	-	10	10
Purchases and Sales	-	146	146
Transfers into Level 3	-	-	-
Transfers out of Level 3	-	-	-
Balance as of December 31, 2010	\$ 1,863	\$ 2,911	\$ 4,774

The following table presents the classification of OPEB plan assets within the fair value hierarchy at December 31, 2010:

<u>Asset Class</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Other</u>	<u>Total</u>	<u>Year End Allocation</u>
	(in thousands)					
Equities:						
Domestic	\$ 13,867	\$ -	\$ -	\$ -	\$ 13,867	40.0 %
International	5,234	-	-	-	5,234	15.1 %
Common Collective Trust - Global	-	2,725	-	-	2,725	7.9 %
Subtotal - Equities	<u>19,101</u>	<u>2,725</u>	<u>-</u>	<u>-</u>	<u>21,826</u>	<u>63.0 %</u>
Fixed Income:						
Common Collective Trust - Debt United States Government and Agency Securities	-	1,133	-	-	1,133	3.3 %
Corporate Debt	-	2,224	-	-	2,224	6.4 %
Foreign Debt	-	589	-	-	589	1.7 %
State and Local Government	-	83	-	-	83	0.2 %
Other - Asset Backed	-	22	-	-	22	0.1 %
Subtotal - Fixed Income	<u>-</u>	<u>6,664</u>	<u>-</u>	<u>-</u>	<u>6,664</u>	<u>19.2 %</u>
Trust Owned Life Insurance:						
International Equities	-	1,165	-	-	1,165	3.3 %
United States Bonds	-	3,860	-	-	3,860	11.1 %
Cash and Cash Equivalents (a)	487	594	-	20	1,101	3.2 %
Other - Pending Transactions and Accrued Income (b)	-	-	-	64	64	0.2 %
Total	<u>\$ 19,588</u>	<u>\$ 15,008</u>	<u>\$ -</u>	<u>\$ 84</u>	<u>\$ 34,680</u>	<u>100.0 %</u>

(a) Amounts in "Other" column primarily represent foreign currency holdings.

(b) Amounts in "Other" column primarily represent accrued interest, dividend receivables and transactions pending settlement.

The following table presents the classification of pension plan assets within the fair value hierarchy at December 31, 2009:

<u>Asset Class</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Other</u>	<u>Total</u>	<u>Year End Allocation</u>
	(in thousands)					
Equities:						
Domestic	\$ 31,449	\$ -	\$ -	\$ -	\$ 31,449	35.8 %
International	8,250	-	-	-	8,250	9.4 %
Real Estate Investment Trusts	2,235	-	-	-	2,235	2.6 %
Common Collective Trust - International	-	4,154	-	-	4,154	4.7 %
Subtotal - Equities	41,934	4,154	-	-	46,088	52.5 %
Fixed Income:						
United States Government and Agency Securities	-	6,004	-	-	6,004	6.9 %
Corporate Debt	-	21,424	-	-	21,424	24.4 %
Foreign Debt	-	4,407	-	-	4,407	5.0 %
State and Local Government	-	888	-	-	888	1.0 %
Other - Asset Backed	-	707	-	-	707	0.8 %
Subtotal - Fixed Income	-	33,430	-	-	33,430	38.1 %
Real Estate	-	-	2,334	-	2,334	2.7 %
Alternative Investments	-	-	2,725	-	2,725	3.1 %
Securities Lending	-	4,470	-	-	4,470	5.1 %
Securities Lending Collateral (a)	-	-	-	(5,050)	(5,050)	(5.8) %
Cash and Cash Equivalents (b)	-	2,981	-	104	3,085	3.5 %
Other - Pending Transactions and Accrued Income (c)	-	-	-	675	675	0.8 %
Total	<u>\$ 41,934</u>	<u>\$ 45,035</u>	<u>\$ 5,059</u>	<u>\$ (4,271)</u>	<u>\$ 87,757</u>	<u>100.0 %</u>

- (a) Amounts in "Other" column primarily represent an obligation to repay cash collateral received as part of the Securities Lending Program.
- (b) Amounts in "Other" column primarily represent foreign currency holdings.
- (c) Amounts in "Other" column primarily represent accrued interest, dividend receivables and transactions pending settlement.

The following table sets forth a reconciliation of changes in the fair value of real estate and alternative investments classified as Level 3 in the fair value hierarchy for the pension assets:

	<u>Real Estate</u>	<u>Alternative Investments</u>	<u>Total Level 3</u>
	(in thousands)		
Balance as of January 1, 2009	\$ 3,542	\$ 2,745	\$ 6,287
Actual Return on Plan Assets			
Relating to Assets Still Held as of the Reporting Date	(1,208)	(357)	(1,565)
Relating to Assets Sold During the Period	-	11	11
Purchases and Sales	-	326	326
Transfers in and/or out of Level 3	-	-	-
Balance as of December 31, 2009	<u>\$ 2,334</u>	<u>\$ 2,725</u>	<u>\$ 5,059</u>

The following table presents the classification of OPEB plan assets within the fair value hierarchy at December 31, 2009:

<u>Asset Class</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Other</u>	<u>Total</u>	<u>Year End Allocation</u>
	(in thousands)					
Equities:						
Domestic	\$ 8,429	\$ -	\$ -	\$ -	\$ 8,429	26.2 %
International	9,196	-	-	-	9,196	28.7 %
Common Collective Trust - Global	-	2,285	-	-	2,285	7.1 %
Subtotal - Equities	<u>17,625</u>	<u>2,285</u>	<u>-</u>	<u>-</u>	<u>19,910</u>	<u>62.0 %</u>
Fixed Income:						
Common Collective Trust - Debt United States Government and Agency Securities	-	931	-	-	931	2.9 %
Corporate Debt	-	1,028	-	-	1,028	3.2 %
Foreign Debt	-	3,472	-	-	3,472	10.8 %
State and Local Government	-	788	-	-	788	2.4 %
Other - Asset Backed	-	147	-	-	147	0.5 %
Subtotal - Fixed Income	<u>-</u>	<u>6,400</u>	<u>-</u>	<u>-</u>	<u>6,400</u>	<u>20.0 %</u>
Trust Owned Life Insurance:						
International Equities	-	1,827	-	-	1,827	5.7 %
United States Bonds	-	3,215	-	-	3,215	10.0 %
Cash and Cash Equivalents (a)	161	353	-	24	538	1.7 %
Other - Pending Transactions and Accrued Income (b)	-	-	-	194	194	0.6 %
Total	<u>\$ 17,786</u>	<u>\$ 14,080</u>	<u>\$ -</u>	<u>\$ 218</u>	<u>\$ 32,084</u>	<u>100.0 %</u>

(a) Amounts in "Other" column primarily represent foreign currency holdings.

(b) Amounts in "Other" column primarily represent accrued interest, dividend receivables and transactions pending settlement.

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 based on the market-related value of assets. Since the market-related value of assets recognizes gains or losses over a five-year period, the future value of assets will be impacted as previously deferred gains or losses are recorded.

<u>Accumulated Benefit Obligation</u>	<u>December 31,</u>	
	<u>2010</u>	<u>2009</u>
	(in thousands)	
Qualified Pension Plan	\$ 101,762	\$ 110,932
Nonqualified Pension Plan	1,521	1,570
Total	<u>\$ 103,283</u>	<u>\$ 112,502</u>

For the underfunded pension plans that had an accumulated benefit obligation in excess of plan assets, the projected benefit obligation, accumulated benefit obligation and fair value of plan assets of these plans at December 31, 2010 and 2009 were as follows:

	Underfunded Pension Plans	
	2010	2009
	(in thousands)	
Projected Benefit Obligation	\$ 104,357	\$ 112,707
Accumulated Benefit Obligation	\$ 103,283	\$ 112,502
Fair Value of Plan Assets	86,403	87,757
Underfunded Accumulated Benefit Obligation	\$ (16,880)	\$ (24,745)

Estimated Future Benefit Payments and Contributions

TNC expects contributions and payments for the pension plans of \$1.5 million and the OPEB plans of \$1.9 million during 2011. The estimated pension benefit payments for the unfunded plan and contributions to the trust are at least the minimum amount required by ERISA plus payment of unfunded nonqualified benefits. For the qualified pension plan, additional discretionary contributions may be made to the trust to maintain the funded status of the plan. The contributions to the OPEB plans are generally based on the amount of the OPEB plans' periodic benefit costs for accounting purposes as provided in agreements with state regulatory authorities, plus the additional discretionary contribution of Medicare subsidy receipts.

The table below reflects the total benefits expected to be paid from the plan or from TNC's assets. The payments include the participants' contributions to the plan for their share of the cost. Medicare subsidy receipts are shown in the year of the corresponding benefit payments, even though actual cash receipts are expected early in the following year. 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 Plans	Other Postretirement Benefit Plans	
	Pension Payments	Benefit Payments	Medicare Subsidy Receipts
	(in thousands)		
2011	\$ 7,403	\$ 3,526	\$ (380)
2012	7,611	3,672	(406)
2013	7,821	3,948	(428)
2014	8,465	4,134	(454)
2015	8,566	4,279	(479)
Years 2016 to 2020, in Total	44,495	24,399	(2,664)

Components of Net Periodic Benefit Cost

The following table provides the components of net periodic benefit cost for the years ended December 31, 2010, 2009 and 2008:

	Pension Plans			Other Postretirement Benefit Plans		
	Years Ended December 31,					
	2010	2009	2008	2010	2009	2008
	(in thousands)					
Service Cost	\$ 1,839	\$ 1,843	\$ 1,787	\$ 842	\$ 776	\$ 796
Interest Cost	5,720	6,042	5,952	2,630	2,624	2,699
Expected Return on Plan Assets	(7,950)	(8,204)	(8,607)	(2,549)	(2,022)	(2,787)
Amortization of Transition Obligation	-	-	-	1,527	1,527	1,527
Amortization of Prior Service Credit	(421)	(476)	(476)	-	-	-
Amortization of Net Actuarial Loss	2,006	1,394	1,704	656	1,011	187
Net Periodic Benefit Cost	<u>1,194</u>	<u>599</u>	<u>360</u>	<u>3,106</u>	<u>3,916</u>	<u>2,422</u>
Capitalized Portion	(564)	(283)	(193)	(1,466)	(1,852)	(1,298)
Net Periodic Benefit Cost Recognized as Expense	<u>\$ 630</u>	<u>\$ 316</u>	<u>\$ 167</u>	<u>\$ 1,640</u>	<u>\$ 2,064</u>	<u>\$ 1,124</u>

Estimated amounts expected to be amortized to net periodic benefit costs and the impact on the balance sheet during 2011 are shown in the following table:

Components	Pension Plans	Other Postretirement Benefit Plans
	(in thousands)	
Net Actuarial Loss	\$ 2,623	\$ 730
Prior Service Credit	(420)	(22)
Total Estimated 2011 Amortization	<u>\$ 2,203</u>	<u>\$ 708</u>
Expected to be Recorded as		
Regulatory Asset	\$ 1,715	\$ 582
Deferred Income Taxes	171	44
Net of Tax AOCI	317	82
Total	<u>\$ 2,203</u>	<u>\$ 708</u>

American Electric Power System Retirement Savings Plan

TNC participates in an AEP sponsored defined contribution retirement savings plan, the American Electric Power System Retirement Savings Plan, for substantially all employees. 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 were 75% of the first 6% of eligible compensation contributed by the employee in 2008. Effective January 1, 2009, the match is 100% of the first 1% of eligible employee contributions and 70% of the next 5% of contributions. The cost for contributions to the plan totaled \$1 million in 2010, \$1.1 million in 2009 and \$1.2 million in 2008.

7. BUSINESS SEGMENTS

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

8. DERIVATIVES AND HEDGING

Cash Flow Hedging Strategies

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

The gross notional volumes of TNC's outstanding derivative contracts for heating oil and gasoline as of December 31, 2010 and 2009 were 379 thousand gallons and 418 thousand gallons, respectively.

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

Fair Value of Derivative Instruments December 31, 2010

Balance Sheet Location	Hedging Contracts (a)	Other (a) (b)	Total
	(in thousands)		
Prepayments and Other Current Assets	\$ 83	\$ -	\$ 83
Deferred Charges and Other Noncurrent Assets	-	-	-
Total Assets	<u>83</u>	<u>-</u>	<u>83</u>
Other Current Liabilities	-	-	-
Deferred Credits and Other Noncurrent Liabilities	-	-	-
Total Liabilities	<u>-</u>	<u>-</u>	<u>-</u>
Total MTM Derivative Contract Net Assets	<u>\$ 83</u>	<u>\$ -</u>	<u>\$ 83</u>

Fair Value of Derivative Instruments December 31, 2009

Balance Sheet Location	Hedging Contracts (a)	Other (a) (b)	Total
	(in thousands)		
Prepayments and Other Current Assets	\$ 113	\$ (1)	\$ 112
Deferred Charges and Other Noncurrent Assets	-	-	-
Total Assets	<u>113</u>	<u>(1)</u>	<u>112</u>
Other Current Liabilities	1	(1)	-
Deferred Credits and Other Noncurrent Liabilities	-	-	-
Total Liabilities	<u>1</u>	<u>(1)</u>	<u>-</u>
Total MTM Derivative Contract Net Assets	<u>\$ 112</u>	<u>\$ -</u>	<u>\$ 112</u>

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

Accounting for Cash Flow Hedging Strategies

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

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

The following table provides details on designated, effective cash flow hedges included in AOCI on TNC's Consolidated Balance Sheets and the reasons for changes in cash flow hedges for the years ended December 31, 2010 and 2009. All amounts in the following tables are presented net of related income taxes.

Total Accumulated Other Comprehensive Income (Loss) Activity for Cash Flow Hedges Years Ended December 31, 2010 and 2009

	<u>2010</u>	<u>2009</u>
	(in thousands)	
Balance in AOCI as of January 1,	\$ 74	\$ -
Changes in Fair Value Recognized in AOCI	48	128
Amount of (Gain) or Loss Reclassified from AOCI to Income Statement/within Balance Sheet:		
Other Operation Expense	(29)	(33)
Maintenance Expense	(12)	-
Property, Plant and Equipment	(27)	(21)
Balance in AOCI as of December 31,	<u>\$ 54</u>	<u>\$ 74</u>

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

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

	<u>2010</u>	<u>2009</u>
	(in thousands)	
Hedging Assets	\$ 83	\$ 112
Hedging Liabilities	-	-
AOCI Gain Net of Tax	54	74
Portion Expected to be Reclassified to Net Income During the Next Twelve Months	54	74

The actual amounts that TNC reclassifies from Accumulated Other Comprehensive Income (Loss) to Net Income can differ from the estimate above due to market price changes. As of December 31, 2010, the maximum length of time that TNC is hedging (with contracts subject to the accounting guidance for "Derivatives and Hedging") exposure to variability in future cash flows related to forecasted transactions is 12 months.

9. FAIR VALUE MEASUREMENTS

Fair Value Measurements of Long-term Debt

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

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

	December 31,			
	2010		2009	
	Book Value	Fair Value	Book Value	Fair Value
	(in thousands)			
Long-term Debt	\$ 370,145	\$ 399,492	\$ 370,060	\$ 393,633

Fair Value Measurements of Financial Assets and Liabilities

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

Assets and Liabilities Measured at Fair Value on a Recurring Basis December 31, 2010

	Level 1	Level 2	Level 3	Other	Total
	(in thousands)				
Risk Management Assets					
Cash Flow Hedges:					
Commodity Hedges	\$ -	\$ 83	\$ -	\$ -	\$ 83

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

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

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

There have been no transfers between Level 1 and Level 2 during the year ended December 31, 2010.

10. INCOME TAXES

The details of income taxes as reported are as follows:

	Years Ended December 31,		
	2010	2009	2008
	(in thousands)		
Income Tax Expense (Credit):			
Current	\$ (4,445)	\$ 26,180	\$ 9,416
Deferred	16,149	(13,283)	5,386
Deferred Investment Tax Credits	(1,042)	(1,050)	(1,050)
Total Income Taxes	<u>\$ 10,662</u>	<u>\$ 11,847</u>	<u>\$ 13,752</u>

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 rate and the amount of income taxes reported.

	Years Ended December 31,		
	2010	2009	2008
	(in thousands)		
Net Income	\$ 24,538	\$ 18,353	\$ 33,916
Income Taxes	10,662	11,847	13,752
Pretax Income	<u>\$ 35,200</u>	<u>\$ 30,200</u>	<u>\$ 47,668</u>
Income Taxes on Pretax Income at Statutory Rate (35%)	\$ 12,320	\$ 10,570	\$ 16,684
Increase (Decrease) in Income Taxes resulting from the following items:			
Depreciation	49	(193)	(330)
Investment Tax Credits, Net	(1,042)	(1,050)	(1,050)
State and Local Income Taxes	853	2,093	(28)
Other	(1,518)	427	(1,524)
Total Income Taxes	<u>\$ 10,662</u>	<u>\$ 11,847</u>	<u>\$ 13,752</u>
Effective Income Tax Rate	30.3 %	39.2 %	28.8 %

The following table shows elements of the net deferred tax liability and significant temporary differences:

	December 31,	
	2010	2009
	(in thousands)	
Deferred Tax Assets	\$ 39,384	\$ 46,751
Deferred Tax Liabilities	(173,877)	(161,658)
Net Deferred Tax Liabilities	<u>\$ (134,493)</u>	<u>\$ (114,907)</u>
Property-Related Temporary Differences	\$ (143,247)	\$ (130,136)
Amounts Due from Customers for Future Federal Income Taxes	1,206	2,082
Deferred State Income Taxes	(1,208)	(1,208)
Deferred Income Taxes on Other Comprehensive Loss	7,866	8,653
Accrued Pensions	(2,719)	(922)
Post Retirement Benefits	8,282	6,869
Regulatory Assets	(15,524)	(16,631)
Deferred Revenues	10,541	8,171
All Other, Net	310	8,215
Net Deferred Tax Liabilities	<u>\$ (134,493)</u>	<u>\$ (114,907)</u>

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

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

TNC, along with other AEP subsidiaries, files income tax returns in various state and local jurisdictions. These taxing authorities routinely examine the tax returns and TNC and other AEP subsidiaries are currently under examination in several state and local jurisdictions. Management believes that previously filed tax returns have positions that may be challenged by these tax authorities. However, management believes that 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. With few exceptions, TNC is no longer subject to state or local income tax examinations by tax authorities for years before 2000.

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

The following table shows the amounts reported for interest expense, interest income and reversal of prior period interest expense:

	Year Ended December 31,		
	2010	2009	2008
	(in thousands)		
Interest Expense	\$ 103	\$ 146	\$ -
Interest Income	-	-	336
Reversal of Prior Period Interest Expense	6	152	585

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

	December 31,	
	2010	2009
	(in thousands)	
Accrual for Receipt of Interest	\$ 35	\$ 184
Accrual for Payment of Interest Penalties	22	74

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

	2010	2009	2008
	(in thousands)		
Balance at January 1,	\$ 1,970	\$ 2,545	\$ 5,597
Increase - Tax Positions Taken During a Prior Period	149	838	52
Decrease - Tax Positions Taken During a Prior Period	(67)	(980)	(3,787)
Increase - Tax Positions Taken During the Current Year	-	-	863
Decrease - Tax Positions Taken During the Current Year	(149)	(158)	(180)
Increase - Settlements with Taxing Authorities	-	-	-
Decrease - Lapse of the Applicable Statute of Limitations	-	(275)	-
Balance at December 31,	<u>\$ 1,903</u>	<u>\$ 1,970</u>	<u>\$ 2,545</u>

The total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate is \$221 thousand, \$181 thousand and \$206 thousand for 2010, 2009 and 2008, respectively. 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 Economic Stimulus Act of 2008 provided enhanced expensing provisions for certain assets placed in service in 2008 and a 50% bonus depreciation provision similar to the one in effect in 2003 through 2004 for assets placed in service in 2008. The enacted provisions did not have a material impact on net income or financial condition, but provided a material favorable cash flow benefit of approximately \$8 million.

The American Recovery and Reinvestment Tax Act of 2009 provided for several new grant programs and expanded tax credits and an extension of the 50% bonus depreciation provision enacted in the Economic Stimulus Act of 2008. The enacted provisions did not have a material impact on TNC's net income or financial condition.

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

The Small Business Jobs Act (the Act) was enacted in September 2010. Included in the Act was a one-year extension of the 50% bonus depreciation provision. The Tax Relief, Unemployment Insurance Reauthorization and the Job Creation Act of 2010 extended the life of research and development, employment and several energy tax credits originally scheduled to expire at the end of 2010. In addition, the Act extended the time for claiming bonus depreciation and increased the deduction to 100% for part of 2010 and 2011. The enacted provisions will not have a material impact on net income or financial condition but had a favorable impact on cash flows of \$13 million in 2010.

11. LEASES

Leases of property, plant and equipment are for periods up to 13 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. The components of rental costs are as follows:

Lease Rental Costs	Years Ended December 31,		
	2010	2009	2008
		(in thousands)	
Net Lease Expense on Operating Leases	\$ 2,225	\$ 2,565	\$ 2,976
Amortization of Capital Leases	749	560	587
Interest on Capital Leases	69	18	46
Total Lease Rental Costs	\$ 3,043	\$ 3,143	\$ 3,609

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

	December 31,	
	2010	2009
(in thousands)		
Property, Plant and Equipment Under Capital Leases		
Total Property, Plant and Equipment Under Capital Leases – Other	\$ 3,030	\$ 2,567
Accumulated Amortization	1,217	1,186
Net Property, Plant and Equipment Under Capital Leases	\$ 1,813	\$ 1,381
Obligations Under Capital Leases		
Noncurrent Liability	\$ 918	\$ 653
Liability Due Within One Year	895	728
Total Obligations Under Capital Leases	\$ 1,813	\$ 1,381

Future minimum lease payments consisted of the following at December 31, 2010:

Future Minimum Lease Payments	Capital Leases		Noncancelable Operating Leases
	(in thousands)		
2011	\$ 947	\$	2,313
2012	448		1,715
2013	152		1,205
2014	113		851
2015	98		644
Later Years	163		635
Total Future Minimum Lease Payments	\$ 1,921	\$	7,363
Less Estimated Interest Element	108		
Estimated Present Value of Future Minimum Lease Payments	\$ 1,813		

Master Lease Agreements

TNC leases certain equipment under master lease agreements. In December 2010, management signed a new master lease agreement with GE Capital Commercial Inc. (GE) to replace existing operating and capital leases with GE. These assets were included in existing master lease agreements that were to be terminated in 2011 since GE exercised the termination provision related to these leases in 2008. Certain assets were not included in the refinancing, but the assets will be purchased or refinanced in 2011. In addition, certain operating leases that were previously under lease with GE are now recorded as capital leases after the refinancing. The amounts refinanced for TNC are as follows:

Leases Refinanced with GE	TNC	
	(in thousands)	
Operating Lease to Operating Lease	\$	5,569
Capital Lease to Capital Lease		80
Operating Lease to Capital Lease		960

These obligations are included in the future minimum lease payments schedule earlier in this note.

For equipment under the GE master lease agreements, the lessor is guaranteed receipt of up to 84% of the unamortized balance of the equipment at the end of the lease term. If the fair value of the leased equipment is below the unamortized balance at the end of the lease term, TNC is committed to pay the difference between the fair value and the unamortized balance, with the total guarantee not to exceed 84% of the unamortized balance. For equipment under other master lease agreements, the lessor is guaranteed a residual value up to a stated percentage of either the unamortized balance or the equipment cost at the end of the lease term. If the actual fair value of the leased equipment is below the guaranteed residual value at the end of the lease term, TNC is committed to pay the

difference between the actual fair value and the residual value guarantee. At December 31, 2010, the maximum potential loss for these lease agreements was approximately \$1 million (\$760 thousand net of tax) assuming the fair value of the equipment is zero at the end of the lease term. Historically, at the end of the lease term the fair value has been in excess of the unamortized balance.

12. FINANCING ACTIVITIES

Preferred Stock

Par Value	Authorized Shares	Shares Outstanding at December 31, 2010	Call Price at December 31, 2010 (a)	Series	Redemption	December 31, (in thousands)	
						2010	2009
\$ 100	810,000	23,481	\$ 107.00	4.40%	Any time	\$ 2,348	\$ 2,349

- (a) The cumulative preferred stock is callable at the price indicated plus accrued dividends. If the subsidiary defaults on preferred stock dividend payments for a period of one year or longer, preferred stock holders are entitled, voting separately as one class, to elect the number of directors necessary to constitute a majority of TNC's full board of directors.

There were 5 shares of 4.4% shares redeemed for the year ended December 31, 2010 and none redeemed for the years ended December 31, 2009 and 2008.

Long-term Debt

There are certain limitations on establishing liens against TNC's assets under its indentures. None of the long-term debt obligations of TNC have been guaranteed or secured by AEP or any of its affiliates.

The following details long-term debt outstanding as of December 31, 2010 and 2009:

Type of Debt	Maturity	Weighted Average Interest rate at December 31, 2010	Interest Rate Ranges at December 31, 2010		Outstanding at December 31, (in thousands)	
			2010	2009	2010	2009
Senior Unsecured Notes	2013-2038	5.81%	5.50%-6.76%	5.50%-6.76%	\$ 325,000	\$ 325,000
Pollution Control Bonds (a)	2020	4.45%	4.45%	4.45%	44,310	44,310
Other Long-term Debt	2059	4.50%	4.50%	4.50%	1,001	1,006
Unamortized Discount (net)					(166)	(256)
Total Long-term Debt Outstanding					370,145	370,060
Less Portion Due Within One Year					6	5
Long-term Portion					\$ 370,139	\$ 370,055

- (a) Standby bond purchase agreements and insurance policies support certain series.

Long-term debt outstanding at December 31, 2010 is payable as follows:

	2011	2012	2013	2014	2015	After 2015	Total
	(in thousands)						
Principal Amount	\$ 6	\$ 6	\$ 225,006	\$ 7	\$ 7	\$ 145,279	\$ 370,311
Unamortized Discount							(166)
Total Long-term Debt Outstanding							\$ 370,145

Dividend Restrictions

Federal Power Act

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

Charter and Leverage Restrictions

Provisions within the articles or certificates of incorporation of TNC relating to preferred stock or shares restrict the payment of cash dividends on common and preferred stock or shares. Pursuant to credit agreement leverage restrictions, at December 31, 2010, approximately \$36 million of the retained earnings of TNC have restrictions related to the payment of dividends.

Money Pool – AEP System

The AEP System uses a corporate borrowing program to meet the short-term borrowing needs of its subsidiaries. The corporate borrowing program includes a Utility Money Pool, which funds the utility subsidiaries, and a Nonutility Money Pool, which funds the majority of the nonutility subsidiaries. The AEP System Utility Money Pool operates in accordance with the terms and conditions approved in a regulatory order. The amount of outstanding loans (borrowings) to/from the Utility Money Pool and the Nonutility Money Pool is shown in a net position in Advances to Affiliates and Advances from Affiliates for the years ended December 31, 2010 and 2009, respectively, on TNC’s balance sheets. TNC’s Utility Money Pool activity and corresponding authorized borrowing limit for the years ended December 31, 2010 and 2009 are described in the following table:

Year	Maximum Borrowings from Utility Money Pool	Maximum Loans to Utility Money Pool	Average Borrowings from Utility Money Pool	Average Loans to Utility Money Pool	Borrowings from Utility Money Pool as of December 31,	Authorized Short-Term Borrowing Limit
			(in thousands)			
2010	\$ 108,321	\$ -	\$ 56,079	\$ -	\$ 1,722	\$ 250,000
2009	94,512	-	59,080	-	87,996	250,000

The activity in the above table does not include short-term lending activity of TNC’s wholly-owned subsidiary, AEP Texas North Generation Company LLC (TNGC), who is a participant in the Nonutility Money Pool. For the years ended December 31, 2010 and 2009, TNC had the following activity related to TNGC in the Nonutility Money Pool:

Year	Maximum Borrowings from Nonutility Money Pool	Maximum Loans to Nonutility Money Pool	Average Borrowings from Nonutility Money Pool	Average Loans to Nonutility Money Pool	Loans to Nonutility Money Pool as of December 31,
			(in thousands)		
2010	\$ -	\$ -	\$ -	\$ 11,303	\$ 11,204
2009	-	-	-	12,458	11,800

Maximum, minimum and average interest rates for funds either borrowed from or loaned to the Utility Money Pool for the years ended December 31, 2010, 2009 and 2008 are summarized in the following table:

Years Ended December 31,	Maximum Interest Rates for Funds Borrowed from Utility Money Pool	Minimum Interest Rates for Funds Borrowed from Utility Money Pool	Maximum Interest Rates for Funds Loaned to Utility Money Pool	Minimum Interest Rates for Funds Loaned to Utility Money Pool	Average Interest Rates for Funds Borrowed from Utility Money Pool	Average Interest Rates for Funds Loaned to Utility Money Pool
2010	0.55 %	0.09 %	- %	- %	0.24 %	- %
2009	2.28 %	0.15 %	- %	- %	0.75 %	- %
2008	5.47 %	2.28 %	3.41 %	2.91 %	3.88 %	3.08 %

Maximum, minimum and average interest rates for funds either borrowed from or loaned to the Nonutility Money Pool for the years ended December 31, 2010, 2009 and 2008 are summarized in the following table:

Years Ended December 31,	Maximum Interest Rates for Funds Borrowed from Nonutility Money Pool	Minimum Interest Rates for Funds Borrowed from Nonutility Money Pool	Maximum Interest Rates for Funds Loaned to Nonutility Money Pool	Minimum Interest Rates for Funds Loaned to Nonutility Money Pool	Average Interest Rates for Funds Borrowed from Nonutility Money Pool	Average Interest Rates for Funds Loaned to Nonutility Money Pool
2010	- %	- %	0.55 %	0.20 %	- %	0.43 %
2009	- %	- %	2.28 %	0.24 %	- %	0.88 %
2008	- %	- %	5.47 %	2.28 %	- %	3.52 %

Interest expense and interest income related to the Utility Money Pool are included in Interest Expense and Interest Income, respectively, in TNC's Consolidated Statements of Income. For amounts borrowed from and advanced to the Utility Money Pool, TNC incurred the following amounts of interest expense and earned the following amounts of interest income, respectively, for the years ended December 31, 2010, 2009 and 2008:

	Years Ended December 31,		
	2010	2009	2008
	(in thousands)		
Interest Expense	\$ 138	\$ 452	\$ 1,146
Interest Income	-	-	87

Interest expense and interest income related to the Nonutility Money Pool are included in Interest Expense and Interest Income, respectively, in TNC's Consolidated Statements of Income. For amounts borrowed from and advanced to the Nonutility Money Pool, TNC incurred the following amounts of interest expense and earned the following amounts of interest income, respectively, for the years ended December 31, 2010, 2009 and 2008:

	Years Ended December 31,		
	2010	2009	2008
	(in thousands)		
Interest Expense	\$ -	\$ -	\$ -
Interest Income	49	112	627

Credit Facilities

In June 2010, TNC and certain other companies in the AEP System reduced a \$627 million credit agreement that matures in April 2011 to \$478 million. Under the facility, letters of credit may be issued. As of December 31, 2010, there were no outstanding amounts for TNC under the facility.

13. RELATED PARTY TRANSACTIONS

For other related party transactions, also see “Electric Transmission Texas LLC (ETT)” section of Note 5 and “Money Pool – AEP System” section of Note 12.

Affiliated Revenues

The following table shows the revenues derived from direct sales to affiliates and other revenues for the years ended December 31, 2010, 2009 and 2008:

<u>Related Party Revenues</u>	<u>Years Ended December 31,</u>		
	<u>2010</u>	<u>2009</u>	<u>2008</u>
	(in thousands)		
Direct Sales to AEPEP Affiliate	\$ 82,212	\$ 79,258	\$ 94,060
Other Revenues	4,271	3,966	6,463
Total Affiliated Revenues	<u>\$ 86,483</u>	<u>\$ 83,224</u>	<u>\$ 100,523</u>

The above summarized related party revenues are reported as Sales to AEP Affiliates on TNC’s Consolidated Statements of Income.

System Transmission Integration Agreement

AEP’s System Transmission Integration Agreement provides for the integration and coordination of the planning, operation and maintenance of the transmission facilities of AEP East companies’ and AEP West companies’ zones. The System Transmission Integration Agreement functions as an umbrella agreement in addition to the Transmission Agreement (TA) and the Transmission Coordination Agreement (TCA). The System Transmission Integration Agreement contains two service schedules that govern:

- The allocation of transmission costs and revenues and
- The allocation of third-party transmission costs and revenues and AEP System dispatch costs.

The System Transmission Integration Agreement anticipates that additional service schedules may be added as circumstances warrant.

APCo, CSPCo, I&M, KPCo and OPCo are parties to the TA, dated April 1, 1984, as amended, defining how they share the costs associated with their relative ownership of the extra-high-voltage transmission system (facilities rated 345 kV and above) and certain facilities operated at lower voltages (138 kV and above). The FERC approved a new TA effective November 2010.

PSO, SWEPCo, TNC and AEPSC are parties to the TCA, originally dated January 1, 1997, as amended. The TCA has been approved by the FERC and establishes a coordinating committee, which is charged with overseeing the coordinated planning of the transmission facilities of the parties to the agreement, including the performance of transmission planning studies, the interaction of such companies with independent system operators (ISO) and other regional bodies interested in transmission planning and compliance with the terms of the Open Access Transmission Tariff (OATT) filed with the FERC and the rules of the FERC relating to such tariff.

Under the TCA, the parties to the agreement delegated to AEPSC the responsibility of monitoring the reliability of their transmission systems and administering the OATT on their behalf. The allocations have been governed by the FERC-approved OATT for the Southwest Power Pool (with respect to PSO, TNC and SWEPCo) and PUCT-approved protocols for ERCOT (with respect to TNC).

TNC’s net credits allocated under the TCA pursuant to the ERCOT protocols as described above during the years ended December 31, 2010, 2009 and 2008 were \$2.1 million, \$1.7 million and \$1.5 million, respectively. The net credits are recorded in Other Operation expense on TNC’s Consolidated Statements of Income.

Assignment from SWEPCo, TCC and TNC to AEPEP

On March 1, 2008, SWEPCo, TCC and TNC assigned a 20-year Purchase Power Agreement (PPA) to AEPEP. In addition to the PPA assignment, an intercompany agreement was executed between AEPEP and SWEPCo to provide SWEPCo with future margins related to its share. The PPA and intercompany agreements are effective through 2019.

ERCOT Transmission Service Charges

Pursuant to an order from the PUCT, ETT bills TNC for its ERCOT wholesale transmission services. ETT billed TNC \$628 thousand for transmission services in 2010. The billings are recorded in Other Operation expense on TNC's Consolidated Statement of Income.

Oklunion PPA between TNC and AEP Energy Partners

On January 1, 2007, TNC began a 20-year Power Purchase & Sale Agreement (PPA) with an affiliate, AEP Energy Partners (AEPEP), whereby TNC agrees to sell AEPEP 100% of TNC's capacity and associated energy from its undivided interest (54.69%) in the Oklaunion Plant. AEPEP is to pay TNC for the capacity and associated energy delivered to the delivery point, the sum of fuel, operation and maintenance, depreciation, capacity and all taxes other than federal income taxes applicable. A portion of the payment is fixed and is payable regardless of the level of output. There are no penalties if TNC fails to maintain a minimum availability level or exceeds a maximum heat rate level. The PPA was approved by the FERC. TNC recognizes revenues for the fuel, operations and maintenance and all other taxes as-billed. Revenue is recognized for the capacity and depreciation billed to AEPEP, on a straight-line basis over the term of the PPA as these represent the minimum payments due.

TNC recorded revenue of \$82 million, \$79 million and \$94 million from AEPEP for the years ended December 31, 2010, 2009 and 2008, respectively. These amounts are included in Sales to AEP Affiliates on TNC's Consolidated Statements of Income.

Sales and Purchases of Property

TNC had aggregate affiliated sales and purchases of meters and transformers for the years ended December 31, 2010, 2009 and 2008 as shown in the following table:

	<u>APCo</u>	<u>I&M</u>	<u>OPCo</u>	<u>PSO</u>	<u>SWEPCo</u>	<u>TCC</u>	<u>WPCo</u>	<u>Total</u>
Sales	(in thousands)							
2010	\$ 8	\$ -	\$ -	\$ 1	\$ 70	\$ 642	\$ 4	\$ 725
2009	8	10	17	18	25	750	-	828
2008	-	-	9	28	26	334	-	397
Purchases								
2010	-	63	10	3	11	966	-	1,053
2009	-	75	44	1	28	873	-	1,021
2008	-	-	11	25	9	494	-	539

The amounts above are recorded in Property, Plant and Equipment. Transfers are recorded at cost.

Intercompany Billings

TNC performs certain utility services for other AEP subsidiaries when necessary or practical. The costs of these services are billed on a direct-charge basis, whenever possible, or on reasonable bases of proration for services that benefit multiple companies. The billings for services are made at cost and include no compensation for the use of equity capital. Billings are capitalized or expensed depending on the nature of the services rendered.

Variable Interest Entities

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

AEPSC provides certain managerial and professional services to TNC and other subsidiaries. AEP is the sole equity owner of AEPSC. AEP management controls the activities of AEPSC. The costs of the services are based on a direct charge or on a prorated basis and billed to TNC and other subsidiaries at AEPSC’s cost. TNC and other subsidiaries have not provided financial or other support outside the reimbursement of costs for services rendered. AEPSC finances its operations through cost reimbursement from other AEP subsidiaries. There are no other terms or arrangements between AEPSC and TNC and other subsidiaries that could require additional financial support from TNC and other subsidiaries or expose them to losses outside of the normal course of business. AEPSC and its billings are subject to regulation by the FERC. TNC and other subsidiaries are exposed to losses to the extent they cannot recover the costs of AEPSC through their normal business operations. TNC is considered to have a significant interest in AEPSC due to its activity in AEPSC’s cost reimbursement structure. However, TNC does not have control over AEPSC. AEPSC is consolidated by AEP. In the event AEPSC would require financing or other support outside the cost reimbursement billings, this financing would be provided by AEP. Total billings from AEPSC for the years ended December 31, 2010, 2009 and 2008 were \$34 million, \$31 million and \$35 million, respectively. The carrying amount of liabilities associated with AEPSC for the years ended December 31, 2010 and 2009 were \$4 million and \$3 million, respectively. Management estimates the maximum exposure of loss to be equal to the amount of such liability.

14. PROPERTY, PLANT AND EQUIPMENT

Depreciation

TNC 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 the annual composite depreciation rates by functional class:

2010		Regulated				Nonregulated			
Functional Class of Property	Property, Plant and Equipment	Accumulated Depreciation	Annual Composite		Property, Plant and Equipment	Accumulated Depreciation	Annual Composite		
			Depreciation Rate	Depreciable Life Ranges			Depreciation Rate	Depreciable Life Ranges	
		(in thousands)		(in years)		(in thousands)		(in years)	
Generation	\$ -	\$ -	-	-	\$ 304,218	\$ 145,206	2.6%	20-49	
Transmission	450,506	76,249	3.0%	45-75	-	-	-	-	
Distribution	598,040	166,483	3.9%	28-70	-	-	-	-	
CWIP	36,493	20,117	N.M.	N.M.	3,264	12	N.M.	N.M.	
Other	106,646	82,742	8.0%	N.M.	2,818	2,078	N.M.	N.M.	
Total	\$ 1,191,685	\$ 345,591			\$ 310,300	\$ 147,296			

2009		Regulated				Nonregulated			
Functional Class of Property	Property, Plant and Equipment	Accumulated Depreciation	Annual Composite		Property, Plant and Equipment	Accumulated Depreciation	Annual Composite		
			Depreciation Rate	Depreciable Life Ranges			Depreciation Rate	Depreciable Life Ranges	
		(in thousands)		(in years)		(in thousands)		(in years)	
Generation	\$ -	\$ -	-	-	\$ 300,291	\$ 139,020	2.5%	20-49	
Transmission	484,989	107,838	2.7%	45-75	-	-	-	-	
Distribution	568,364	166,125	3.5%	28-70	-	-	-	-	
CWIP	59,014	(706)	N.M.	N.M.	4,456	24	N.M.	N.M.	
Other	99,785	63,830	8.6%	N.M.	4,595	3,747	N.M.	N.M.	
Total	\$ 1,212,152	\$ 337,087			\$ 309,342	\$ 142,791			

2008		Regulated		Nonregulated	
Functional Class of Property	Annual Composite		Annual Composite		
	Depreciation Rate	Depreciable Life Ranges	Depreciation Rate	Depreciable Life Ranges	
		(in years)		(in years)	
Generation	-	-	2.6%	20-49	
Transmission	2.6%	45-75	-	-	
Distribution	3.5%	28-70	-	-	
CWIP	N.M.	N.M.	N.M.	N.M.	
Other	9.1%	N.M.	N.M.	N.M.	

N.M. Not Meaningful

For cost-based rate-regulated operations, the composite depreciation rate generally includes a component for nonasset retirement obligation (non-ARO) removal costs, which is credited to Accumulated Depreciation and Amortization. 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. For nonregulated operations, non-ARO removal cost is expensed as incurred.

Asset Retirement Obligations (ARO)

TNC records ARO in accordance with the accounting guidance for “Asset Retirement and Environmental Obligations” for asbestos removal. TNC has identified, but not recognized, ARO liabilities related to electric transmission and distribution assets, as a result of certain easements on property on which assets are owned. Generally, such easements are perpetual and require only the retirement and removal of assets upon the cessation of the property’s use. The retirement obligation is not estimable for such easements since TNC plans to use its facilities indefinitely. The retirement obligation would only be recognized if and when TNC abandons or ceases the use of specific easements, which is not expected.

The following is a reconciliation of the 2010 and 2009 aggregate carrying amounts of ARO for TNC:

<u>Year</u>	<u>ARO at January 1,</u>	<u>Accretion Expense</u>	<u>Liabilities Incurred</u>	<u>Liabilities Settled</u>	<u>Revisions in</u>		<u>ARO at December 31,</u>
					<u>Cash Flow Estimates</u>		
(in thousands)							
2010	\$ 4,815	\$ 250	\$ -	\$ (799)	\$ (448)		3,818
2009	5,564	334	118	(1,301)	100		4,815

Allowance for Funds Used During Construction (AFUDC) and Interest Capitalization

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

	<u>Years Ended December 31,</u>		
	<u>2010</u>	<u>2009</u>	<u>2008</u>
(in thousands)			
Allowance for Equity Funds Used During Construction	\$ 60	\$ 685	\$ 1,901
Allowance for Borrowed Funds Used During Construction	172	1,076	1,945

Jointly-owned Electric Facilities

TNC has a 54.7% ownership share of Unit No. 1 at the Oklaunion Generating Station. In addition to TNC, the Oklaunion Generating Station is jointly-owned by PSO and various nonaffiliated companies. Using its own financing, each participating company is obligated to pay its share of the costs in the same proportion as its ownership interest. TNC’s proportionate share of the operating costs associated with this facility is included in its Consolidated Statements of Income and the investment and accumulated depreciation are reflected in its Consolidated Balance Sheets under Property, Plant and Equipment at December 31, 2010 and 2009 as follows:

	<u>Fuel Type</u>	<u>Percent of Ownership</u>	<u>Utility Plant in Service</u>	<u>Construction</u>		<u>Accumulated Depreciation</u>
				<u>Work in Progress</u>		
(in thousands)						
TNC's Share at December 31, 2010						
Oklaunion Generating Station (Unit No. 1) (a)	Coal	54.7 %	\$ 304,218	\$ 3,264	\$	145,206
TNC's Share at December 31, 2009						
Oklaunion Generating Station (Unit No. 1) (a)	Coal	54.7 %	\$ 300,291	\$ 4,693	\$	139,025

(a) Operated by PSO.

15. COST REDUCTION INITIATIVES

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

TNC recorded a charge to expense in 2010 primarily related to the headcount reduction initiatives. Management does not expect additional costs to be incurred related to this initiative.

<u>Expense Allocation from AEPSC</u>	<u>Incurred</u>	<u>Settled</u>	<u>Adjustments</u>	<u>Remaining Balance at December 31, 2010</u>
		(in thousands)		
\$ 4,538	\$ 4,000	\$ 8,359	\$ 257	\$ 436

These costs relate primarily to severance benefits. They are included primarily in Other Operation on the Consolidated Statements of Income and Other Current Liabilities on the Consolidated Balance Sheets.

16. UNAUDITED QUARTERLY FINANCIAL INFORMATION

In management's opinion, the unaudited quarterly information reflects all normal and recurring accruals and adjustments necessary for a fair presentation of the results of operations for interim periods. Quarterly results are not necessarily indicative of a full year's operations because of various factors. TNC's unaudited quarterly financial information is as follows:

	2010 Quarterly Periods Ended			
	<u>March 31</u>	<u>June 30</u>	<u>September 30</u>	<u>December 31</u>
		(in thousands)		
Total Revenues	\$ 70,120	\$ 65,391	\$ 78,651	\$ 67,387
Operating Income	14,622	8,061 (a)	22,248	12,238
Net Income	5,863	1,686 (a)	10,776	6,213
	2009 Quarterly Periods Ended			
	<u>March 31</u>	<u>June 30</u>	<u>September 30</u>	<u>December 31</u>
		(in thousands)		
Total Revenues	\$ 63,746	\$ 61,108	\$ 70,245	\$ 66,986
Operating Income	16,567	13,217	18,568	3,119
Net Income (Loss)	7,990	5,072	9,456	(4,165)

(a) See Note 15 for discussion of expenses related to cost reduction initiatives recorded in the second quarter of 2010.

There were no significant events in 2009.