AEP Generating Company

2007 Annual Report

Financial Statements

AEP AMERICAN® ELECTRIC POWER

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GLOSSARY OF TERMS

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

Term	Meaning
AEGCo	AEP Generating Company, an AEP electric utility subsidiary.
AEP or Parent	American Electric Power Company, Inc.
AEPSC	American Electric Power Service Corporation, a service subsidiary providing management and professional services to AEP and its subsidiaries.
AEP System or the System	American Electric Power System, an integrated electric utility system, owned and operated by AEP's electric utility subsidiaries.
AFUDC	Allowance for Funds Used During Construction.
ARO	Asset Retirement Obligations.
CAA	Clean Air Act.
CO_2	Carbon Dioxide.
CSPCo	Columbus Southern Power Company, an AEP electric utility subsidiary.
CSW	Central and South West Corporation, a subsidiary of AEP (Effective January 21, 2003, the legal name of Central and South West Corporation was changed to AEP Utilities, Inc.).
CWIP	Construction Work in Progress.
EITF	Financial Accounting Standards Board's Emerging Issues Task Force.
FASB	Financial Accounting Standards Board.
Federal EPA	United States Environmental Protection Agency.
FERC	Federal Energy Regulatory Commission.
FIN	FASB Interpretation No.
FIN 47	FASB Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations."
FIN 48	FIN 48, "Accounting for Uncertainty in Income Taxes" and FASB Staff Position FIN 48-1 "Definition of *Settlement* in FASB Interpretation No. 48."
GAAP	Accounting Principles Generally Accepted in the United States of America.
IRS	Internal Revenue Service.
IURC	Indiana Utility Regulatory Commission.
I&M	Indiana Michigan Power Company, an AEP electric utility subsidiary.
KPCo	Kentucky Power Company, an AEP electric utility subsidiary.
MW	Megawatt.
OPCo	Ohio Power Company, an AEP electric utility subsidiary.
Rockport Plant	A generating plant, consisting of two 1,300 MW coal-fired generating units near Rockport, Indiana, owned by AEGCo and I&M.
SEC	United States Securities and Exchange Commission.
SFAS	Statement of Financial Accounting Standards issued by the Financial Accounting Standards Board.
SFAS 71	Statement of Financial Accounting Standards No. 71, "Accounting for the Effects of Certain Types of Regulation."
SFAS 109	Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes."
SFAS 133	Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities."
SFAS 143	Statement of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations."
SFAS 157	Statement of Financial Accounting Standards No. 157, "Fair Value Measurements."
SFAS 159	Statement of Financial Accounting Standards No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities."
UPA	Unit Power Agreement.
Utility Money Pool	AEP System's Utility Money Pool.

INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying balance sheets of AEP Generating Company (the "Company") as of December 31, 2007 and 2006, and the related statements of income, retained earnings, and cash flows for each of the three years in the period ended December 31, 2007. 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 financial statements present fairly, in all material respects, the financial position of AEP Generating Company as of December 31, 2007 and 2006, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2007, in conformity with accounting principles generally accepted in the United States of America.

/s/ Deloitte & Touche LLP

Columbus, Ohio
February 28, 2008

AEP GENERATING COMPANY
STATEMENTS OF INCOME
For the Years Ended December 31, 2007, 2006 and 2005
(in thousands)

	2007	2006	2005
OPERATING REVENUES	$ 380,539	$ 309,814	$ 270,755
EXPENSES			
Fuel Used for Electric Generation	205,269	178,654	140,077
Rent – Rockport Plant Unit 2	68,283	68,283	68,283
Other Operation	18,739	12,808	11,902
Maintenance	23,695	9,776	11,518
Depreciation and Amortization	28,954	23,911	24,009
Taxes Other Than Income Taxes	4,484	3,464	4,065
TOTAL	349,424	296,896	259,854
OPERATING INCOME	31,115	12,918	10,901
Other Income (Expense):			
Interest Income	37	-	24
Allowance for Equity Funds Used During Construction	1,015	24	98
Interest Expense	(11,144)	(2,947)	(2,437)
INCOME BEFORE INCOME TAXES	21,023	9,995	8,586
Income Tax Expense (Credit)	2,970	(919)	(109)
NET INCOME	$ 18,053	$ 10,914	$ 8,695

STATEMENTS OF RETAINED EARNINGS
For the Years Ended December 31, 2007, 2006 and 2005
(in thousands)

	2007	2006	2005
BALANCE AT BEGINNING OF PERIOD	$ 30,942	$ 26,038	$ 24,237
FIN 48 Adoption, Net of Tax	27	-	-
Net Income	18,053	10,914	8,695
Cash Dividends Declared	(14,300)	(6,010)	(6,894)
BALANCE AT END OF PERIOD	$ 34,722	$ 30,942	$ 26,038

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

See Notes to Financial Statements.

AEP GENERATING COMPANY
BALANCE SHEETS
ASSETS
December 31, 2007 and 2006
(in thousands)

	2007	2006
CURRENT ASSETS		
Accounts Receivable – Affiliated Companies	$ 35,611	$ 31,060
Fuel	40,255	37,701
Materials and Supplies	17,592	7,873
Accrued Tax Benefits	1,026	3,808
Prepayments and Other	1,005	57
TOTAL	95,489	80,499
PROPERTY, PLANT AND EQUIPMENT		
Electric – Production	1,409,822	686,776
Other	5,231	2,460
Construction Work in Progress	111,105	15,198
Total	1,526,158	704,434
Accumulated Depreciation and Amortization	800,996	398,422
TOTAL – NET	725,162	306,012
OTHER NONCURRENT ASSETS		
Regulatory Assets	5,300	5,438
Deferred Charges and Other	2,112	1,382
TOTAL	7,412	6,820
TOTAL ASSETS	$ 828,063	$ 393,331

See Notes to Financial Statements.

AEP GENERATING COMPANY
BALANCE SHEETS
LIABILITIES AND SHAREHOLDER'S EQUITY
December 31, 2007 and 2006

	2007	2006
	(in thousands)	
CURRENT LIABILITIES		
Advances from Affiliates	$ 93,391	$ 53,646
Accounts Payable:		
General	9,295	549
Affiliated Companies	28,466	27,935
Long-term Debt Due Within One Year – Nonaffiliated	7,273	-
Accrued Taxes	4,419	3,685
Accrued Rent – Rockport Plant Unit 2	4,963	4,963
Other	5,167	1,200
TOTAL	152,974	91,978
NONCURRENT LIABILITIES		
Long-term Debt – Nonaffiliated	255,755	44,837
Deferred Income Taxes	24,736	19,749
Regulatory Liabilities and Deferred Investment Tax Credits	68,836	79,650
Deferred Gain on Sale and Leaseback – Rockport Plant Unit 2	83,191	88,762
Deferred Credits and Other	16,415	12,979
TOTAL	448,933	245,977
TOTAL LIABILITIES	601,907	337,955
Commitments and Contingencies (Note 4)		
COMMON SHAREHOLDER'S EQUITY		
Common Stock – Par Value – $1,000 Per Share:		
Authorized – 1,000 Shares		
Outstanding – 1,000 Shares	1,000	1,000
Paid-in Capital	190,434	23,434
Retained Earnings	34,722	30,942
TOTAL	226,156	55,376
TOTAL LIABILITIES AND SHAREHOLDER'S EQUITY	$ 828,063	$ 393,331

See Notes to Financial Statements.

AEP GENERATING COMPANY
STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2007, 2006 and 2005
(in thousands)

	2007	2006	2005
OPERATING ACTIVITIES			
Net Income	$ 18,053	$ 10,914	$ 8,695
Adjustments to Reconcile Net Income to Net Cash Flows from (Used for) Operating Activities:			
Depreciation and Amortization	28,954	23,911	24,009
Deferred Income Taxes	(543)	(6,730)	(1,666)
Deferred Investment Tax Credits	(3,346)	(3,433)	(3,532)
Amortization of Deferred Gain on Sale and Leaseback – Rockport Plant Unit 2	(5,571)	(5,571)	(5,571)
Allowance for Equity Funds Used During Construction	(1,015)	(24)	(98)
Change in Other Noncurrent Assets	1,726	(3,271)	(556)
Change in Other Noncurrent Liabilities	1,728	3,169	2,204
Changes in Certain Components of Working Capital:			
Accounts Receivable	(4,551)	(1,389)	(6,593)
Fuel, Materials and Supplies	(3,174)	(23,660)	452
Accounts Payable	4,681	5,397	4,739
Accrued Taxes, Net	3,071	(1,104)	(7,825)
Other Current Assets	(187)	(48)	(9)
Other Current Liabilities	4,097	(28)	34
Net Cash Flows from (Used for) Operating Activities	43,923	(1,867)	14,283
INVESTING ACTIVITIES			
Construction Expenditures	(42,689)	(10,403)	(15,372)
Acquisition of Lawrenceburg Generating Station	(324,782)	-	-
Acquisition of Dresden Plant	(85,327)	-	-
Other	(459)	75	-
Net Cash Flows Used for Investing Activities	(453,257)	(10,328)	(15,372)
FINANCING ACTIVITIES			
Capital Contributions from Parent	167,000	-	-
Issuance of Long-term Debt – Nonaffiliated	219,034	-	-
Change in Advances from Affiliates, Net	39,745	18,515	8,216
Retirement of Long-term Debt – Nonaffiliated	(1,818)	-	-
Principal Payments for Capital Lease Obligations	(327)	(310)	(233)
Dividends Paid on Common Stock	(14,300)	(6,010)	(6,894)
Net Cash Flows from Financing Activities	409,334	12,195	1,089
Net Change in Cash and Cash Equivalents	-	-	-
Cash and Cash Equivalents at Beginning of Period	-	-	-
Cash and Cash Equivalents at End of Period	$ -	$ -	$ -
SUPPLEMENTARY INFORMATION			
Cash Paid for Interest, Net of Capitalized Amounts	$ 6,778	$ 2,597	$ 2,170
Net Cash Paid for Income Taxes	2,799	10,149	13,435
Noncash Acquisitions Under Capital Leases	31	84	45
Construction Expenditures Included in Accounts Payable at December 31,	2,269	-	-
Noncash Assumption of Liabilities Related to Acquisition of Lawrenceburg and Dresden Plants	5,301	-	-

See Notes to Financial Statements.

NOTES TO FINANCIAL STATEMENTS

1. Organization and Summary of Significant Accounting Policies
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1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

ORGANIZATION

AEGCo engages in the generation and wholesale sale of electric power to its affiliates, CSPCo, I&M and KPCo. AEGCo and I&M co-own Unit 1 of the Rockport Plant. Unit 2 of the Rockport Plant is owned by a third party and leased to I&M and AEGCo. I&M operates the Rockport Plant.

AEGCo derives operating revenues from the sale of Rockport Plant energy and capacity to I&M and KPCo pursuant to FERC-approved long-term unit power agreements through December 2022. Under the terms of its unit power agreement, I&M agreed to purchase all of AEGCo's Rockport energy and capacity unless it is sold to other utilities or affiliates. I&M assigned 30% of its rights to energy and capacity to KPCo.

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

In March 2007, CSPCo and AEGCo entered into a 10-year UPA for the entire output from the Lawrenceburg Plant effective with AEGCo's purchase of the plant in May 2007. The UPA has an option for an additional 2-year period. I&M operates the plant under an agreement with AEGCo. Under the UPA, CSPCo pays AEGCo for the capacity, depreciation, fuel, operation and maintenance and tax expenses. These payments are due regardless of whether the plant is operating. The fuel and operation and maintenance payments are based on actual costs incurred. All expenses are trued up periodically.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Rates and Service Regulation

AEGCo is regulated by the FERC under the 2005 Public Utility Holding Company Act (2005 PUHCA). The FERC regulates certain, mostly affiliated, transactions under the 2005 PUHCA.

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

In 2005 and prior years, AEGCo was subject to regulation by the SEC under the Public Utility Holding Company Act of 1935 (1935 PUHCA). The Energy Policy Act of 2005 repealed the 1935 PUHCA effective February 8, 2006 and replaced it with the 2005 PUHCA. With the repeal of the 1935 PUHCA, the SEC no longer has jurisdiction over the activities of registered holding companies, their respective service corporations and their affiliated transactions, which it regulated since 1935 predominantly at cost. With the passage of 2005 PUHCA jurisdiction over certain holding company-related activities was transferred to the FERC and the required reporting was reduced. The FERC also has jurisdiction over the issuances and acquisitions of securities of the public utility holding company subsidiaries, such as AEGCo, the acquisition or sale of certain utility assets, mergers with another electric utility or holding company, affiliate transactions, accounting and AEPSC affiliated service billings which are generally at cost. The intercompany sale of non-power goods and non-AEPSC services to affiliates cannot exceed market under the 2005 PUHCA.

Both the FERC and state regulatory commissions are permitted to review and audit the books and records of any company within a public utility holding company system.

Accounting for the Effects of Cost-Based Regulation

As a cost-based rate-regulated electric public utility company, AEGCo's financial statements reflect the actions of regulators that result in the recognition of certain revenues and expenses in different time periods than enterprises that are not rate-regulated. In accordance with SFAS 71, regulatory assets (deferred expenses) and regulatory liabilities (future revenue reductions or refunds) are recorded 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.

Use of Estimates

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

Property, Plant and Equipment

Electric utility property, plant and equipment 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 for cost-based rate-regulated operations 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 boiler tubes, pumps, motors, etc. result in the original cost, less salvage, being charged to accumulated depreciation. The depreciation rates that are established for the generating plants 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 SFAS 144, "Accounting for the Impairment or Disposal of Long-lived Assets."

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

Allowance for Funds Used During Construction (AFUDC)

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 domestic regulated electric utility plant.

Valuation of Nonderivative Financial Instruments

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

Cash and Cash Equivalents

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

Inventory

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

Revenue Recognition and Accounts Receivable

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

Maintenance

Maintenance costs are expensed as incurred.

Income Taxes and Investment Tax Credits

AEGCo uses the liability method of accounting for income taxes. Under the liability method, deferred income taxes are provided for all temporary differences between the book and tax basis of assets and liabilities which will result in a future tax consequence.

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 flow-through method except where regulatory commissions have reflected investment tax credits in the rate-making process on a deferral basis. Investment tax credits that have been deferred are amortized over the life of the plant investment.

AEGCo accounts for uncertain tax positions in accordance with FIN 48. Effective with the adoption of FIN 48, AEGCo classifies interest expense or income related to uncertain tax positions as interest expense or income as appropriate and classifies penalties as Other Operation.

Debt

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

Debt discount 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.

Earnings Per Share (EPS)

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

Reclassifications

Certain prior period financial statement items have been reclassified to conform to current period presentation. These revisions had no impact on AEGCo's previously reported results of operations or changes in shareholder's equity.

2. NEW ACCOUNTING PRONOUNCEMENTS

Upon issuance of exposure drafts or final pronouncements, management thoroughly reviews the new accounting literature to determine the relevance, if any, to AEGCo's business. The following represents a summary of final pronouncements that management has determined relate to AEGCo's operations.

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

In December 2007, the FASB issued SFAS 141R, improving financial reporting about business combinations and their effects. It establishes how the acquiring entity recognizes and measures the identifiable assets acquired, liabilities assumed, goodwill acquired, any gain on bargain purchases and any noncontrolling interest in the acquired entity. SFAS 141R no longer allows acquisition-related costs to be included in the cost of the business combination, but rather expensed in the periods they are incurred, with the exception of the costs to issue debt or equity securities which shall be recognized in accordance with other applicable GAAP. SFAS 141R requires disclosure of information for a business combination that occurs during the accounting period or prior to the issuance of the financial statements for the accounting period.

SFAS 141R is effective prospectively for business combinations with an acquisition date on or after the beginning of the first annual reporting period after December 15, 2008. Early adoption is prohibited. AEGCo will adopt SFAS 141R effective January 1, 2009 and apply it to any business combinations on or after that date.

SFAS 157 "Fair Value Measurements" (SFAS 157)

In September 2006, the FASB issued SFAS 157, enhancing existing guidance for fair value measurement of assets and liabilities and instruments measured at fair value that are classified in shareholder's equity. The statement defines fair value, establishes a fair value measurement framework and expands fair value disclosures. It emphasizes that fair value is market-based with the highest measurement hierarchy level being market prices in active markets. The standard requires fair value measurements be disclosed by hierarchy level, an entity include its own credit standing in the measurement of its liabilities and modifies the transaction price presumption. The standard also nullifies the consensus reached in EITF Issue No. 02-3 "Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities" (EITF 02-3) that prohibited the recognition of trading gains or losses at the inception of a derivative contract, unless the fair value of such derivative is supported by observable market data.

In February 2008, the FASB issued FASB Staff Position (FSP) FAS 157-1 "Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13" which amends SFAS 157 to exclude SFAS 13 "Accounting for Leases" and other accounting pronouncements that address fair value measurements for purposes of lease classification or measurement under SFAS 13.

In February 2008, the FASB issued FSP FAS 157-2 "Effective Date of FASB Statement No. 157" which delays the effective date of SFAS 157 to fiscal years beginning after November 15, 2008 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually).

AEGCo partially adopted SFAS 157 effective January 1, 2008. AEGCo will adopt SFAS 157 effective January 1, 2009 for items within the scope of FSP FAS 157-2. The provisions of SFAS 157 are applied prospectively, except for a) changes in fair value measurements of existing derivative financial instruments measured initially using the transaction price under EITF 02-3, b) existing hybrid financial instruments measured initially at fair value using the transaction price and c) blockage discount factors. Although the statement is applied prospectively upon adoption, in accordance with the provisions of SFAS 157 related to EITF 02-3, amounts for transition adjustment are recorded to beginning retained earnings. The consideration of AEP's own credit risk when measuring the fair value of liabilities, including derivatives, impacts fair value measurements upon adoption. The adoption of this standard had no impact on AEGCo's financial statements.

SFAS 159 "The Fair Value Option for Financial Assets and Financial Liabilities" (SFAS 159)

In February 2007, the FASB issued SFAS 159, permitting entities to choose to measure many financial instruments and certain other items at fair value. The standard also establishes presentation and disclosure requirements designed to facilitate comparison between entities that choose different measurement attributes for similar types of assets and liabilities. If the fair value option is elected, the effect of the first remeasurement to fair value is reported as a cumulative effect adjustment to the opening balance of retained earnings. The statement is applied prospectively upon adoption.

AEGCo adopted SFAS 159 effective January 1, 2008. At adoption, AEGCo did not elect the fair value option for any assets or liabilities.

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

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

SFAS 160 is effective for interim and annual periods in fiscal years beginning after December 15, 2008. The statement is applied prospectively upon adoption. Early adoption is prohibited. Upon adoption, prior period financial statements will be restated for the presentation of the noncontrolling interest for comparability. Although management has not completed its analysis, management expects that the adoption of this standard will have an immaterial impact on the financial statements. AEGCo will adopt SFAS 160 effective January 1, 2009.

FIN 48 "Accounting for Uncertainty in Income Taxes" and FASB Staff Position FIN 48-1 "Definition of Settlement in FASB Interpretation No. 48" (FIN 48)

In July 2006, the FASB issued FASB Interpretation No. 48 "Accounting for Uncertainty in Income Taxes" and in May 2007, the FASB issued FASB Staff Position FIN 48-1 "Definition of *Settlement* in FASB Interpretation No. 48." FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements by prescribing a recognition threshold (whether a tax position is more likely than not to be sustained) without which, the benefit of that position is not recognized in the financial statements. It requires a measurement determination for recognized tax positions based on the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

FIN 48 requires that the cumulative effect of applying this interpretation be reported and disclosed as an adjustment to the opening balance of retained earnings for that fiscal year and presented separately. AEGCo adopted FIN 48 effective January 1, 2007. The impact of this interpretation was a favorable adjustment to retained earnings of $27 thousand.

FIN 39-1 "Amendment of FASB Interpretation No. 39" (FIN 39-1)

In April 2007, the FASB issued FIN 39-1. It amends FASB Interpretation No. 39, "Offsetting of Amounts Related to Certain Contracts" by replacing the interpretation's definition of contracts with the definition of derivative instruments per SFAS 133. It also requires entities that offset fair values of derivatives with the same party under a netting agreement to also net the fair values (or approximate fair values) of related cash collateral. The entities must disclose whether or not they offset fair values of derivatives and related cash collateral and amounts recognized for cash collateral payables and receivables at the end of each reporting period.

AEGCo adopted FIN 39-1 effective January 1, 2008. This standard changed the method of netting certain balance sheet amounts. It requires retrospective application as a change in accounting principle for all periods presented. It had no impact on AEGCo.

Future Accounting Changes

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

3. EFFECTS OF REGULATION

Regulatory Assets and Liabilities

Regulatory assets and liabilities are comprised of the following items:

	December 31, 2007	December 31, 2006	Notes
	(in thousands)		
Regulatory Assets:			
Unamortized Loss on Reacquired Debt	$ 3,784	$ 4,021	(b) (g)
Other	1,516	1,417	(a) (e)
Total Noncurrent Regulatory Assets	$ 5,300	$ 5,438	
Regulatory Liabilities:			
Asset Removal Costs	$ 28,102	$ 30,896	(d)
Deferred Investment Tax Credits	35,938	39,285	(c) (f)
SFAS 109 Regulatory Liability, Net	4,796	9,469	(a) (e)
Total Noncurrent Regulatory Liabilities	$ 68,836	$ 79,650	

(a) Amount does not earn a return.
(b) Amount effectively earns a return.
(c) A portion of this amount effectively earns a return.
(d) The liability for removal costs, which reduces rate base and the resultant return, will be discharged as removal costs are incurred.
(e) Recovery/refund period – various periods.
(f) Recovery/refund period – up to 15 years.
(g) Recovery/refund period – 7 to 18 years.

4. COMMITMENTS, GUARANTEES AND CONTINGENCIES

AEGCo is subject to certain claims and legal actions arising in its ordinary course of business. In addition, AEGCo's business activities are subject to extensive governmental regulation related to public health and the environment. The ultimate outcome of such pending or potential litigation 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.

Insurance and Potential Losses

AEGCo 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. The insurance programs also generally provide coverage against loss arising from certain claims made by third parties and are in excess of AEGCo's retentions. Coverage is generally provided by a combination of a South Carolina domiciled protected-cell captive insurance company together with and/or in addition to various industry mutual and 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 results of operations, cash flows and financial condition.

COMMITMENTS

Construction and Commitments

AEGCo has substantial construction commitments to support its operations and environmental investments. In managing the overall construction program and in the normal course of business, AEGCo contractually commits to third-party construction vendors for certain material purchases and other construction services. Aggregate construction expenditures for 2008 through 2010 are estimated at approximately $296.5 million. The amounts for 2008, 2009 and 2010 are $158.5 million, $84.6 million and $53.4 million, respectively. Estimated construction expenditures are subject to periodic review and modification and may vary based on the ongoing effects of regulatory constraints, environmental regulations, business opportunities, market volatility, economic trends, weather, legal reviews and the ability to access capital.

AEGCo purchases 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. Management does not expect to incur penalty payments under these provisions that would materially affect results of operations, cash flows or financial condition.

Rockport Plant Environmental Upgrades

In 1999, the Federal EPA, a number of states and certain special interest groups filed complaints alleging that certain of AEGCo's affiliates including Appalachian Power Company, CSPCo, I&M and OPCo modified units at certain of their coal-fired generating plants in violation of the New Source Review (NSR) requirements of the CAA. The alleged modifications occurred at the AEP System's generating units over a 20-year period.

As part of a global consent decree covering all coal-fired units in the five eastern states of the AEP System to resolve all past NSR allegations and secure a covenant not to sue for future claims from the Federal EPA, AEGCo and I&M will install additional emissions control equipment at Rockport Plant. Unit 1's controls will be completed no later than the end of 2017 and Unit 2's controls will be completed no later than the end of 2019. The estimated total cost of the investment in additional environmental controls for Rockport Plant will be shared equally by AEGCo and I&M and included in future construction budgets.

Management believes AEGCo can recover any capital and operating costs of additional pollution control equipment that may be required as a result of the consent decree through regulated rates. If AEGCo is unable to recover such costs, it would adversely affect future results of operations, cash flows and possibly financial condition.

GUARANTEES

There are certain immaterial liabilities recorded for guarantees in accordance with FIN 45 "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." 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

<u>Contracts</u>

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

CONTINGENCIES

Carbon Dioxide Public Nuisance Claims

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

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, AEGCo's generating plants have used asbestos, polychlorinated biphenyls (PCBs) and other hazardous and nonhazardous materials. AEGCo currently incurs costs to safely dispose of these substances.

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. Superfund does not recognize compliance as a defense, but imposes strict liability on parties who fall within its broad statutory categories. Present estimates do not anticipate material cleanup costs.

5. COMPANY-WIDE STAFFING AND BUDGET REVIEW

AEGCo recorded $0.3 million of severance benefits expense in 2005 (primarily in Other Operation and Maintenance) resulting from a company-wide staffing and budget review, including the allocation of approximately $19.2 million of severance benefits expense associated with AEPSC employees. AEGCo has no employees, but received allocated expenses. Payments and accrual adjustments recorded during 2006 were immaterial and were settled by June 30, 2006.

6. ACQUISITIONS

Lawrenceburg Generating Station

In January 2007, AEGCo agreed to purchase Lawrenceburg Generating Station (Lawrenceburg) from an affiliate of Public Service Enterprise Group (PSEG) for $325 million and the assumption of liabilities of $3 million. AEGCo completed the purchase in May 2007. Lawrenceburg is located in Lawrenceburg, Indiana, adjacent to I&M's Tanners Creek Plant, and is a natural gas, combined cycle power plant with a generating capacity of 1,096 MW. AEGCo sells the power to CSPCo through a FERC-approved unit power contract.

On June 15, 2007, AEGCo filed a capital funds agreement for approval with the IURC in connection with the acquisition and financing of Lawrenceburg. Under the agreement, AEP has committed to provide all such amounts of capital to enable AEGCo to perform its financial obligations. This agreement will terminate after AEGCo's obligations related to Lawrenceburg are paid in full.

Dresden Plant

In August 2007, AEGCo agreed to purchase the partially completed Dresden Plant from Dominion Resources, Inc. for $85 million and the assumption of liabilities of $2 million. AEGCo completed the purchase in September 2007. AEGCo incurred approximately $7 million in construction costs at the Dresden Plant in 2007 and expects to incur approximately $175 million in additional costs (excluding AFUDC) prior to completion. The Dresden Plant is located near Dresden, Ohio and is a natural gas, combined cycle power plant. When completed in 2010, the Dresden Plant will have a generating capacity of 580 MW.

7. BUSINESS SEGMENTS

AEGCo has one reportable segment, an electricity generation business. AEGCo's other activities are insignificant.

8. FINANCIAL INSTRUMENTS

The fair values of Long-term Debt are based on quoted market prices 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 AEGCo's significant financial instruments at December 31, 2007 and 2006 are summarized in the following table.

	December 31,			
	2007		2006	
	Book Value	Fair Value	Book Value	Fair Value
	(in thousands)			
Long-term Debt	$ 263,028	$ 254,657	$ 44,837	$ 45,928

9. INCOME TAXES

The details of income taxes as reported are as follows:

	Years Ended December 31,		
	2007	2006	2005
	(in thousands)		
Income Tax Expense (Credit):			
Current	$ 6,859	$ 9,244	$ 5,089
Deferred	(543)	(6,730)	(1,666)
Deferred Investment Tax Credits	(3,346)	(3,433)	(3,532)
Total Income Tax	$ 2,970	$ (919)	$ (109)

Shown below 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, 2007	2006	2005
	(in thousands)		
Net Income	$ 18,053	$ 10,914	$ 8,695
Income Taxes	2,970	(919)	(109)
Pretax Income	$ 21,023	$ 9,995	$ 8,586
Income Tax on Pretax Income at Statutory Rate (35%)	$ 7,358	$ 3,498	$ 3,005
Increase (Decrease) in Income Tax resulting from the following items:			
Depreciation	(255)	120	757
Allowance for Funds Used During Construction	(1,483)	(1,075)	(1,097)
Rockport Plant Unit 2 Investment Tax Credit	374	374	374
Investment Tax Credits, Net	(3,346)	(3,433)	(3,532)
State and Local Income Taxes	708	634	723
Other	(386)	(1,037)	(339)
Total Income Taxes	$ 2,970	$ (919)	$ (109)
Effective Income Tax Rate	14.1%	N.M.	N.M.

N.M. = Not Meaningful

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

	December 31, 2007	2006
	(in thousands)	
Deferred Tax Assets	$ 53,362	$ 56,758
Deferred Tax Liabilities	(77,747)	(76,507)
Net Deferred Tax Liabilities	$ (24,385)	$ (19,749)
Property Related Temporary Differences	$ (50,984)	$ (51,683)
Amounts Due From Customers For Future Federal Income Taxes	2,794	4,036
Deferred State Income Taxes	(3,175)	(2,060)
Net Deferred Gain on Sale and Leaseback – Rockport Plant Unit 2	28,118	30,068
All Other, Net	(1,138)	(110)
Net Deferred Tax Liabilities	$ (24,385)	$ (19,749)

AEGCo joins in the filing of a consolidated federal income tax return with its affiliates in the AEP System. The allocation of the AEP System's current consolidated federal income tax to the AEP System companies allocates the benefit of current tax losses to the AEP System companies giving rise to such losses in determining their current tax expense. The 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.

AEGCo and other AEP Subsidiaries are no longer subject to U.S. federal examination for years before 2000. However, AEGCo and other AEP Subsidiaries have filed refund claims with the IRS for years 1997 through 2000 for the CSW pre-merger tax period, which are currently being reviewed. AEGCo and other AEP Subsidiaries have completed the exam for the years 2001 through 2003 and have issues that will be pursued at the appeals level. The returns for the years 2004 through 2006 are presently under audit by the IRS. Although the outcome of tax audits is uncertain, in management's opinion, adequate provisions for income taxes have been made for potential liabilities resulting from such matters. In addition, AEGCo accrues interest on these uncertain tax positions. Management is not aware of any issues for open tax years that upon final resolution are expected to have a material adverse effect on results of operations.

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

Prior to the adoption of FIN 48, AEGCo recorded interest and penalty expense related to uncertain tax positions in tax expense accounts. With the adoption of FIN 48, AEGCo began recognizing interest accruals related to uncertain tax positions in interest income or expense as applicable, and penalties in Other Operation. In 2007, AEGCo reversed $300 thousand of prior period interest expense. AEGCo had approximately $100 thousand and $300 thousand for the receipt of interest accrued at December 31, 2007 and 2006, respectively.

As a result of the implementation of FIN 48 on January 1, 2007, AEGCo recognized a $27 thousand decrease in the liabilities for unrecognized tax benefits, as well as related interest expense and penalties, which was accounted for as a reduction to the January 1, 2007 balance of retained earnings.

As of December 31, 2007, the reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

	(in millions)
Balance at January 1, 2007	$ 0.1
Increase - Tax Positions Taken During a Prior Period	-
Decrease - Tax Positions Taken During a Prior Period	(0.6)
Increase - Tax Positions Taken During the Current Year	-
Decrease - Settlements with Taxing Authorities	-
Decrease - Lapse of the Applicable Statute of Limitations	-
Balance at December 31, 2007	$ (0.5)

None of the unrecognized tax benefits that, if recognized, would affect the effective tax rate. 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

In 2005, the Energy Tax Incentives Act of 2005 was signed into law. This act created a limited amount of tax credits for the building of IGCC plants. The credit is 20% of the eligible property in the construction of new plant or 20% of the total cost of repowering of an existing plant using IGCC technology. In the case of a newly constructed IGCC plant, eligible property is defined as the components necessary for the gasification of coal, including any coal handling and gas separation equipment. AEP announced plans to construct two new IGCC plants that may be eligible for the allocation of these credits. AEP filed applications for the Mountaineer and Great Bend projects with the DOE and the IRS. Both projects were certified by the DOE and qualified by the IRS. However, neither project was awarded credits during this round of credit awards. AEP will continue to pursue credits for the next round of available credits.

The Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA 2005) was passed May 17, 2006. The majority of the provisions in TIPRA 2005 were directed toward individual income tax relief including the extension of reduced tax rates for dividends and capital gains through 2010. Management believes the application of this act will not materially affect AEGCo’s results of operations, cash flows or financial condition.

The President signed the Pension Protection Act of 2006 (PPA 2006) into law on August 17, 2006. This law is directed toward strengthening qualified retirement plans and adding new restrictions on charitable contributions. Specifically, PPA 2006 concentrates on the funding of defined benefit plans and the health of the Pension Benefit Guaranty Corporation. PPA 2006 imposes new minimum funding rules for multiemployer plans as well as increasing the deduction limitation for contributions to multiemployer defined benefit plans. Due to the significant funding of the AEP pension plans in 2005, the Act will not materially affect AEGCo's results of operations, cash flows or financial condition.

On December 20, 2006, the Tax Relief and Health Care Act of 2006 (TRHCA 2006) was signed into law. The primary purpose of the bill was to extend expiring tax provisions for individuals and business taxpayers and provide increased tax flexibility around medical benefits. In addition to extending the lower capital gains and dividend tax rates for individuals, TRHCA 2006 extended the research credit and for 2007 provided a new alternative formula for determining the research credit. The application of TRHCA 2006 is not expected to materially affect AEGCo's results of operations, cash flows or financial condition.

Several tax bills and other legislation with tax-related sections were enacted in 2007, including the Tax Technical Corrections Act of 2007, the Tax Increase Prevention Act of 2007 and the Energy Independence and Security Act of 2007. The tax law changes enacted in 2007 are not expected to materially affect AEGCo's results of operations, cash flows or financial condition.

State Tax Legislation

On June 30, 2005, the Governor of Ohio signed Ohio House Bill 66 into law enacting sweeping tax changes impacting all companies doing business in Ohio. Most of the significant tax changes will be phased in over a five-year period, while some of the less significant changes became fully effective July 1, 2005. Changes to the Ohio franchise tax, nonutility property taxes and the new commercial activity tax are subject to phase-in. The Ohio franchise tax will fully phase-out over a five-year period beginning with a 20% reduction in state franchise tax for taxable income accrued during 2005.

The new legislation also imposes a new commercial activity tax at a fully phased-in rate of 0.26% on all Ohio gross receipts. The new tax is being phased-in over a five-year period that began July 1, 2005 at 23% of the full 0.26% rate.

10. LEASES

Leases of property, plant and equipment are for periods up to 33 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:

	Years Ended December 31,		
	2007	2006	2005
Lease Rental Costs		(in thousands)	
Net Lease Expense on Operating Leases	$ 71,985	$ 72,205	$ 72,301
Amortization of Capital Leases	327	310	284
Interest on Capital Leases	687	702	709
Total Lease Rental Costs	$ 72,999	$ 73,217	$ 73,294

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

	December 31, 2007	December 31, 2006
	(in thousands)	
Property, Plant and Equipment Under Capital Leases		
Production	$ 12,272	$ 12,272
Other	420	428
Total Property, Plant and Equipment Under Capital Leases	12,692	12,700
Accumulated Amortization	988	699
Net Property, Plant and Equipment Under Capital Leases	$ 11,704	$ 12,001
Obligations Under Capital Leases		
Noncurrent Liability	$ 11,361	$ 11,675
Liability Due Within One Year	343	326
Total Obligations Under Capital Leases	$ 11,704	$ 12,001

Future minimum lease payments consisted of the following at December 31, 2007:

Future Minimum Lease Payments	Capital Leases	Noncancelable Operating Leases
	(in thousands)	
2008	$ 1,012	$ 78,090
2009	1,000	78,094
2010	981	77,919
2011	943	77,472
2012	935	75,298
Later Years	15,167	747,396
Total Future Minimum Lease Payments	$ 20,038	$ 1,134,269
Less Estimated Interest Element	8,334	
Estimated Present Value of Future Minimum Lease Payments	$ 11,704	

Rockport Lease

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

The gain from the sale was deferred and is being amortized over the term of the lease, which expires in 2022. The Owner Trustee owns the Plant and leases it to AEGCo and I&M. The lease is accounted for as an operating lease with the payment obligations included in the future minimum lease payments schedule earlier in this note. The lease term is for 33 years with potential renewal options. At the end of the lease term, AEGCo and I&M have the option to renew the lease or the Owner Trustee can sell the Plant. Neither AEGCo, I&M nor AEP has an ownership interest in the Owner Trustee and do not guarantee its debt. The future minimum lease payments for this sale-and-leaseback transaction for AEGCo are as follows:

Future Minimum Lease Payments	(in millions)
2008	$ 74
2009	74
2010	74
2011	74
2012	74
Later Years	738
Total Future Minimum Lease Payments	$ 1,108

11. FINANCING ACTIVITIES

Long-term Debt

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

The following details long-term debt outstanding as of December 31, 2007 and 2006:

Type of Debt	Maturity	Interest Rates at December 31, 2007	Interest Rates at December 31, 2006	December 31, 2007	December 31, 2006
				(in thousands)	
Pollution Control Bonds, City of Rockport, Series 1995 A and B (a) (b)	2025	4.15%	4.15%	$ 45,000	$ 45,000
Unamortized Premium (Discount)				(154)	(163)
Total Pollution Control Bonds				44,846	44,837
Senior Unsecured Notes	2037	6.33%	-	218,182	-
Total Senior Unsecured Notes				218,182	-
Total Long-term Debt				263,028	44,837
Less: Long-term Debt Due Within One Year				7,273	-
Long-Term Debt				$ 255,755	$ 44,837

(a) Under the terms of the Pollution Control Bonds, AEGCo is required to pay amounts sufficient to enable the payment of interest on and the principal of (at stated maturities and upon mandatory redemptions) related pollution control revenue bonds issued to finance the construction of pollution control facilities at certain plants. Interest rates are subject to periodic adjustment. Interest payments are made semi-annually. Letters of credit from banks, standby bond purchase agreements and insurance policies support certain series.

(b) The fixed rate bonds due in 2025 are subject to mandatory tender for purchase on July 15, 2011. Consequently, the fixed rate bonds have been classified for repayment purposes in 2011.

At December 31, 2007 future annual long-term debt payments are as follows:

	2008	2009	2010	2011	2012	After 2012	Total
				(in thousands)			
Principal Amount	$ 7,273	$ 7,273	$ 7,273	$ 52,272	$ 7,273	$ 181,818	$ 263,182
Unamortized Discount							(154)
Total Long-term Debt							$ 263,028

Lines of Credit – AEP System

The AEP System uses a corporate borrowing program to meet the short-term borrowing needs of its subsidiaries. The corporate borrowing program includes a Utility Money Pool, which funds the utility subsidiaries. The AEP System corporate borrowing program operates in accordance with the terms and conditions approved in a regulatory order. The amount of outstanding loans (borrowings) to/from the Utility Money Pool as of December 31, 2007 and 2006 are included in Advances to/from Affiliates on AEGCo's balance sheets. AEGCo's Utility Money Pool activity and corresponding authorized borrowing limits for the years ended December 31, 2007 and 2006 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)			
2007	$ 261,636(a)	$ 20,124	$ 64,770	$ 8,211	$ 93,391	$ 200,000(a)
2006	79,828	2,247	21,940	2,247	53,646	125,000

(a) In April 2007, AEGCo's short-term borrowing limit increased to $410 million under regulatory orders to facilitate the acquisition of Lawrenceburg Generating Station until long-term financing could be arranged. Following the issuance of AEGCo's long-term debt of $220 million in June 2007, AEGCo's short-term borrowing limit was reduced to $200 million under regulatory orders.

Maximum, minimum and average interest rates for funds either borrowed from or loaned to the Utility Money Pool for the years ended December 31, 2007, 2006 and 2005 are summarized in the following table:

Years Ended December 31,	Maximum Interest Rates for Funds Borrowed from the Utility Money Pool	Minimum Interest Rates for Funds Borrowed from the Utility Money Pool	Maximum Interest Rates for Funds Loaned to the Utility Money Pool	Minimum Interest Rates for Funds Loaned to the Utility Money Pool	Average Interest Rates for Funds Borrowed from the Utility Money Pool	Average Interest Rates for Funds Loaned to the Utility Money Pool
2007	5.94%	5.16%	5.94%	5.49%	5.39%	5.86 %
2006	5.41%	3.32%	5.11%	5.11%	4.79%	5.11 %
2005	4.49%	1.63%	4.17%	2.80%	3.27%	3.17 %

Interest expense and interest income related to the Utility Money Pool are included in Interest Expense and Interest Income, respectively, in AEGCo's Statements of Income. For amounts borrowed from and advanced to the Utility Money Pool, AEGCo incurred the following amounts of interest expense and earned the following amounts of interest income, respectively, for the years ended December 31, 2007, 2006 and 2005:

	Years Ended December 31, 2007	2006	2005
		(in thousands)	
Interest Expense	$ 3,297	$ 1,046	$ 418
Interest Income	35	-	24

Dividend Restrictions

Under the Federal Power Act, AEGCo is restricted from paying dividends out of stated capital.

12. RELATED PARTY TRANSACTIONS

For other related party transactions, also see "Lines of Credit – AEP System" section of Note 11.

Affiliated Revenues

AEGCo's revenues derived from sales to affiliates for the years ended December 31, 2007, 2006 and 2005 were $380 million, $310 million and $271 million, respectively. These revenues are reported as Operating Revenues on AEGCo's Statements of Income.

Unit Power Agreements (UPA)

Lawrenceburg UPA between CSPCo and AEGCo

In March 2007, CSPCo and AEGCo entered into a 10-year UPA for the entire output from the Lawrenceburg Plant effective with AEGCo's purchase of the plant in May 2007. The UPA has an option for an additional 2-year period. I&M operates the plant under an agreement with AEGCo. Under the UPA, CSPCo pays AEGCo for the capacity, depreciation, fuel, operation and maintenance and tax expenses. These payments are due regardless of whether the plant is operating. The fuel and operation and maintenance payments are based on actual costs incurred. All expenses are trued up periodically. CSPCo paid AEGCo $84.4 million for the year ended December 31, 2007.

I&M UPA between AEGCo and I&M

A unit power agreement between AEGCo and I&M (the I&M Power Agreement) provides for the sale by AEGCo to I&M of all the power (and the energy associated therewith) available to AEGCo at the Rockport Plant unless it is sold to another utility. I&M is obligated, whether or not power is available from AEGCo, to pay as a demand charge for the right to receive such power (and as an energy charge for any associated energy taken by I&M) for such amounts, as when added to amounts received by AEGCo from any other sources, will be at least sufficient to enable AEGCo to pay all its operating and other expenses, including a rate of return on the common equity of AEGCo as approved by the FERC. The I&M Power Agreement will continue in effect until the expiration of the lease term of Unit 2 of the Rockport Plant unless extended in specified circumstances.

KPCo UPA between AEGCo and KPCo

Pursuant to an assignment between I&M and KPCo, and a unit power agreement between KPCo and AEGCo, AEGCo sells KPCo 30% of the power (and the energy associated therewith) available to AEGCo from both units of the Rockport Plant. KPCo has agreed to pay to AEGCo in consideration for the right to receive such power the same amounts which I&M would have paid AEGCo under the terms of the I&M Power Agreement for such entitlement. The KPCo unit power agreement ends in December 2022. See "Affiliated Revenues" section of this note.

Jointly-Owned Electric Utility Plants

AEGCo and I&M jointly own one generating unit and jointly lease the other generating unit of the Rockport Plant. The costs of operating this facility are equally apportioned between AEGCo and I&M since each company has a 50% interest. AEGCo's share of costs is included in the appropriate expense accounts on the income statements. AEGCo's investment in these plants is included in Property, Plant and Equipment on its balance sheets.

I&M Barging and Other Services

I&M provides barging and other transportation services to affiliates. AEGCo recorded costs of $9.2 million, $14.9 million and $11.4 million for the years ended December 31, 2007, 2006 and 2005, respectively, for barging services provided by I&M. These costs were recorded as Fuel Used for Electric Generation.

AEPSC

AEPSC provides certain managerial and professional services to AEP System companies. The costs of the services are billed to AEGCo by AEPSC on a direct-charge basis, whenever possible, and 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, which is furnished to AEPSC by AEP. Billings from AEPSC are capitalized or expensed depending on the nature of the services rendered and are recoverable from customers. During 2005, AEPSC and its billings were subject to regulation by the SEC under the PUHCA of 1935. Effective February 8, 2006, the PUHCA of 2005 was enacted, which repealed the PUHCA of 1935 and transferred the regulatory responsibility from the SEC to the FERC.

Intercompany Billings

AEGCo 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.

13. PROPERTY, PLANT AND EQUIPMENT

Depreciation

AEGCo provides for depreciation of Property, Plant and Equipment on a straight-line basis over the estimated useful lives of property, generally using composite rates by functional class. The following table provides the annual composite depreciation rates by functional class:

2007	Regulated				Nonregulated			
Functional Class of Property	**Property, Plant and Equipment**	**Accumulated Depreciation**	**Annual Composite Depreciation Rate**	**Depreciable Life Ranges**	**Property, Plant and Equipment**	**Accumulated Depreciation**	**Annual Composite Depreciation Rate**	**Depreciable Life Ranges**
	(in thousands)			(in years)	(in thousands)			(in years)
Production	$ 1,409,822	$ 801,184	3.2%	31-37	$ -	$ -	N.M.	N.M.
Transmission	-	-	N.M.	N.M.	-	-	N.M.	N.M.
Distribution	-	-	N.M.	N.M.	-	-	N.M.	N.M.
CWIP	111,105	(2,358)	N.M.	N.M.	-	-	N.M.	N.M.
Other	5,186	2,170	6.9%	N.M.	45	-	N.M.	N.M.
Total	$ 1,526,113	$ 800,996			$ 45	$ -		

2006	Regulated				Nonregulated			
Functional Class of Property	**Property, Plant and Equipment**	**Accumulated Depreciation**	**Annual Composite Depreciation Rate**	**Depreciable Life Ranges**	**Property, Plant and Equipment**	**Accumulated Depreciation**	**Annual Composite Depreciation Rate**	**Depreciable Life Ranges**
	(in thousands)			(in years)	(in thousands)			(in years)
Production	$ 686,776	$ 395,736	3.6%	31	$ -	$ -	-%	-
Transmission	-	-	N.M.	N.M.	-	-	-	-
Distribution	-	-	N.M.	N.M.	-	-	-	-
CWIP	15,198	942	N.M.	N.M.	-	-	-	-
Other	2,415	1,744	11.5%	N.M.	45	-	N.M.	N.M.
Total	$ 704,389	$ 398,422			$ 45	$ -		

2005	Regulated		Nonregulated	
Functional Class of Property	**Annual Composite Depreciation Rate**	**Depreciable Life Ranges**	**Annual Composite Depreciation Rate**	**Depreciable Life Ranges**
		(in years)		(in years)
Production	3.5%	31	-%	-
Transmission	N.M.	N.M.	-	-
Distribution	N.M.	N.M.	-	-
Other	16.0%	N.M.	N.M.	N.M.

N.M. = Not Meaningful

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.

Asset Retirement Obligations (ARO)

AEGCo implemented SFAS 143 effective January 1, 2003. SFAS 143 requires entities to record a liability at fair value for any legal obligations for future asset retirements when the related assets are acquired or constructed. Upon establishment of a legal liability, SFAS 143 requires a corresponding ARO asset to be established, which will be depreciated over its useful life. Upon settlement of an ARO, AEGCo recognizes any difference between the ARO liability and actual costs as income or expense.

AEGCo adopted FIN 47 during the fourth quarter of 2005. FIN 47 interprets the application of SFAS 143. It clarifies that conditional ARO refers to a legal obligation to perform an asset retirement activity in which the timing and/or method of settlement are conditional on a future event that may or may not be within the control of the entity. Entities are required to record a liability for the fair value of a conditional ARO if the fair value of the liability can be reasonably estimated. FIN 47 also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an ARO.

AEGCo completed a review of its FIN 47 conditional ARO and concluded that legal liabilities exist for asbestos removal and disposal in general buildings and generating plants. In 2005, AEGCo recorded $56 thousand of conditional ARO in accordance with FIN 47.

The following is a reconciliation of the 2007 and 2006 aggregate carrying amounts of ARO for AEGCo:

Year	ARO at January 1,	Accretion Expense	Liabilities Incurred	Liabilities Settled	Revisions in Cash Flow Estimates	ARO at December 31,
			(in thousands)			
2007	$ 1,304	$ 102	$ -	$ (80)	$ -	$ 1,326
2006	1,370	107	-	(173)	-	1,304

AEGCo's aggregate carrying amounts include ARO related to ash ponds and asbestos removal.

Allowance for Funds Used During Construction (AFUDC)

The amounts of AFUDC included in Allowance For Equity Funds Used During Construction on AEGCo's Statements of Income was $1.0 million, $0 million and $0.1 million for December 31, 2007, 2006 and 2005, respectively.

The amounts of allowance for borrowed funds used during construction included in Interest Expense on AEGCo's Statements of Income was $1.6 million, $0.4 million and $0.2 million for December 31, 2007, 2006 and 2005, respectively.

14. 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. AEGCo's unaudited quarterly financial information is as follows:

	2007 Quarterly Periods Ended			
	March 31	June 30	September 30	December 31
	(in thousands)			
Operating Revenues	$ 77,151	$ 83,425	$ 118,506	$ 101,457
Operating Income	2,223	6,952	10,264	11,676
Net Income	1,591	4,219	4,741	7,502

	2006 Quarterly Periods Ended			
	March 31	June 30	September 30	December 31
	(in thousands)			
Operating Revenues	$ 78,151	$ 77,195	$ 74,756	$ 79,712
Operating Income	4,220	2,998	3,110	2,590
Net Income	2,928	2,220	2,219	3,547

There were no significant events in the fourth quarter of 2007 or 2006.