AEP Texas North Company
and Subsidiary

2014 First Quarter Report

Consolidated Financial Statements

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GLOSSARY OF TERMS

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

Term	Meaning
AEP or Parent	American Electric Power Company, Inc., an electric utility holding company.
AEP System	American Electric Power System, an integrated electric utility system, owned and operated by AEP's electric utility subsidiaries.
AEPSC	American Electric Power Service Corporation, an AEP service subsidiary providing management and professional services to AEP and its subsidiaries.
AOCI	Accumulated Other Comprehensive Income.
ASU	Accounting Standards Update.
FASB	Financial Accounting Standards Board.
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.
GAAP	Accounting Principles Generally Accepted in the United States of America.
IRS	Internal Revenue Service.
MTM	Mark-to-Market.
Nonutility Money Pool	Centralized funding mechanism AEP uses to meet the short-term cash requirements of certain nonutility subsidiaries.
OPEB	Other Postretirement Benefit Plans.
OTC	Over the counter.
PUCT	Public Utility Commission of Texas.
Risk Management Contracts	Trading and nontrading derivatives, including those derivatives designated as cash flow and fair value hedges.
TNC	AEP Texas North Company, an AEP electric utility subsidiary.
Utility Money Pool	Centralized funding mechanism AEP uses to meet the short-term cash requirements of certain utility subsidiaries.
VIE	Variable Interest Entity.

AEP TEXAS NORTH COMPANY AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
For the Three Months Ended March 31, 2014 and 2013
(in thousands)
(Unaudited)

	Three Months Ended March 31, 2014	Three Months Ended March 31, 2013
REVENUES		
Electric Transmission and Distribution	$ 54,371	$ 47,927
Sales to AEP Affiliates	22,276	25,052
Other Revenues	212	534
TOTAL REVENUES	76,859	73,513
EXPENSES		
Fuel and Other Consumables Used for Electric Generation	9,658	12,936
Other Operation	21,815	19,139
Maintenance	7,811	5,710
Depreciation and Amortization	14,120	13,598
Taxes Other Than Income Taxes	4,727	2,447
TOTAL EXPENSES	58,131	53,830
OPERATING INCOME	18,728	19,683
Other Income (Expense):		
Other Income	138	11
Interest Expense	(4,832)	(6,290)
INCOME BEFORE INCOME TAX EXPENSE	14,034	13,404
Income Tax Expense	4,695	4,596
NET INCOME	$ 9,339	$ 8,808

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

See Condensed Notes to Condensed Consolidated Financial Statements beginning on page 8.

AEP TEXAS NORTH COMPANY AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
For the Three Months Ended March 31, 2014 and 2013
(in thousands)
(Unaudited)

	Three Months Ended March 31, 2014	Three Months Ended March 31, 2013
Net Income	$ 9,339	$ 8,808
OTHER COMPREHENSIVE INCOME, NET OF TAXES		
Cash Flow Hedges, Net of Tax of $97 and $542 in 2014 and 2013, Respectively	181	1,008
Amortization of Pension and OPEB Deferred Costs, Net of Tax of $52 and $94 in 2014 and 2013, Respectively	97	175
TOTAL OTHER COMPREHENSIVE INCOME	278	1,183
TOTAL COMPREHENSIVE INCOME	$ 9,617	$ 9,991

See Condensed Notes to Condensed Consolidated Financial Statements beginning on page 8.

AEP TEXAS NORTH COMPANY AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN
COMMON SHAREHOLDER'S EQUITY
For the Three Months Ended March 31, 2014 and 2013
(in thousands)
(Unaudited)

	Common Stock	Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
TOTAL COMMON SHAREHOLDER'S EQUITY – DECEMBER 31, 2012	$ 137,214	$ 3,276	$ 218,969	$ (23,217)	$ 336,242
Common Stock Dividends			(2,500)		(2,500)
Net Income			8,808		8,808
Other Comprehensive Income				1,183	1,183
TOTAL COMMON SHAREHOLDER'S EQUITY – MARCH 31, 2013	$ 137,214	$ 3,276	$ 225,277	$ (22,034)	$ 343,733
TOTAL COMMON SHAREHOLDER'S EQUITY – DECEMBER 31, 2013	$ 137,214	$ 3,276	$ 245,882	$ (18,419)	$ 367,953
Common Stock Dividends			(7,500)		(7,500)
Net Income			9,339		9,339
Other Comprehensive Income				278	278
TOTAL COMMON SHAREHOLDER'S EQUITY – MARCH 31, 2014	$ 137,214	$ 3,276	$ 247,721	$ (18,141)	$ 370,070

See Condensed Notes to Condensed Consolidated Financial Statements beginning on page 8.

AEP TEXAS NORTH COMPANY AND SUBSIDIARY
CONDENSED CONSOLIDATED BALANCE SHEETS
ASSETS
March 31, 2014 and December 31, 2013
(in thousands)
(Unaudited)

	March 31, 2014	December 31, 2013
CURRENT ASSETS		
Cash and Cash Equivalents	$ 1	$ -
Advances to Affiliates	9,597	10,177
Accounts Receivable:		
Customers	13,785	12,460
Affiliated Companies	12,011	16,039
Accrued Unbilled Revenues	6,098	5,483
Miscellaneous	5	-
Allowance for Uncollectible Accounts	(23)	(22)
Total Accounts Receivable	31,876	33,960
Fuel	2,270	3,265
Materials and Supplies	15,341	15,343
Risk Management Assets	20	55
Accrued Tax Benefits	763	6,211
Prepayments and Other Current Assets	1,626	1,987
TOTAL CURRENT ASSETS	61,494	70,998
PROPERTY, PLANT AND EQUIPMENT		
Electric:		
Generation	310,864	310,917
Transmission	543,496	540,045
Distribution	695,883	682,766
Other Property, Plant and Equipment	103,195	101,746
Construction Work in Progress	56,714	46,356
Total Property, Plant and Equipment	1,710,152	1,681,830
Accumulated Depreciation and Amortization	560,335	550,657
TOTAL PROPERTY, PLANT AND EQUIPMENT – NET	1,149,817	1,131,173
OTHER NONCURRENT ASSETS		
Regulatory Assets	47,366	47,232
Deferred Charges and Other Noncurrent Assets	25,713	15,511
TOTAL OTHER NONCURRENT ASSETS	73,079	62,743
TOTAL ASSETS	$ 1,284,390	$ 1,264,914

See Condensed Notes to Condensed Consolidated Financial Statements beginning on page 8.

AEP TEXAS NORTH COMPANY AND SUBSIDIARY
CONDENSED CONSOLIDATED BALANCE SHEETS
LIABILITIES AND COMMON SHAREHOLDER'S EQUITY
March 31, 2014 and December 31, 2013
(Unaudited)

	March 31, 2014	December 31, 2013
	(in thousands)	
CURRENT LIABILITIES		
Advances from Affiliates	$ 39,905	$ 23,533
Accounts Payable:		
General	14,969	11,661
Affiliated Companies	11,091	15,563
Long-term Debt Due Within One Year – Nonaffiliated	7	7
Accrued Taxes	17,176	13,115
Accrued Interest	4,777	4,480
Other Current Liabilities	10,001	22,537
TOTAL CURRENT LIABILITIES	97,926	90,896
NONCURRENT LIABILITIES		
Long-term Debt – Nonaffiliated	420,284	420,286
Deferred Income Taxes	147,615	148,464
Regulatory Liabilities and Deferred Investment Tax Credits	182,966	181,339
Oklaunion Purchase Power Agreement	45,720	44,944
Deferred Credits and Other Noncurrent Liabilities	19,809	11,032
TOTAL NONCURRENT LIABILITIES	816,394	806,065
TOTAL LIABILITIES	914,320	896,961
Rate Matters (Note 4)		
Commitments and Contingencies (Note 5)		
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	3,276	3,276
Retained Earnings	247,721	245,882
Accumulated Other Comprehensive Income (Loss)	(18,141)	(18,419)
TOTAL COMMON SHAREHOLDER'S EQUITY	370,070	367,953
TOTAL LIABILITIES AND COMMON SHAREHOLDER'S EQUITY	$ 1,284,390	$ 1,264,914

See Condensed Notes to Condensed Consolidated Financial Statements beginning on page 8.

AEP TEXAS NORTH COMPANY AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Three Months Ended March 31, 2014 and 2013
(in thousands)
(Unaudited)

	Three Months Ended March 31,	
	2014	**2013**
OPERATING ACTIVITIES		
Net Income	$ 9,339	$ 8,808
Adjustments to Reconcile Net Income to Net Cash Flows from Operating Activities:		
Depreciation and Amortization	14,120	13,598
Deferred Income Taxes	(1,072)	2,078
Property Taxes	(10,070)	(9,086)
Change in Other Noncurrent Assets	(1,551)	(1,929)
Change in Other Noncurrent Liabilities	833	(11,514)
Changes in Certain Components of Working Capital:		
Accounts Receivable, Net	2,084	1,944
Fuel, Materials and Supplies	997	4,096
Accounts Payable	(4,223)	(5,132)
Accrued Taxes, Net	9,509	2,166
Other Current Assets	90	(137)
Other Current Liabilities	(2,894)	(2,971)
Net Cash Flows from Operating Activities	17,162	1,921
INVESTING ACTIVITIES		
Construction Expenditures	(28,552)	(20,589)
Change in Advances to Affiliates, Net	580	231
Proceeds from Sales of Assets	889	1,676
Other Investing Activities	983	3,167
Net Cash Flows Used for Investing Activities	(26,100)	(15,515)
FINANCING ACTIVITIES		
Issuance of Long-term Debt – Nonaffiliated	-	199,496
Change in Advances from Affiliates, Net	16,372	41,516
Retirement of Long-term Debt – Nonaffiliated	(2)	(225,002)
Principal Payments for Capital Lease Obligations	(168)	(113)
Dividends Paid on Common Stock	(7,500)	(2,500)
Other Financing Activities	237	293
Net Cash Flows from Financing Activities	8,939	13,690
Net Increase in Cash and Cash Equivalents	1	96
Cash and Cash Equivalents at Beginning of Period	-	-
Cash and Cash Equivalents at End of Period	$ 1	$ 96
SUPPLEMENTARY INFORMATION		
Cash Paid for Interest, Net of Capitalized Amounts	$ 3,945	$ 6,320
Noncash Acquisitions Under Capital Leases	505	385
Construction Expenditures Included in Current Liabilities as of March 31,	8,293	2,723

See Condensed Notes to Condensed Consolidated Financial Statements beginning on page 8.

INDEX OF CONDENSED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. SIGNIFICANT ACCOUNTING MATTERS

General

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

In the opinion of management, the unaudited condensed consolidated interim financial statements reflect all normal and recurring accruals and adjustments necessary for a fair presentation of the net income, financial position and cash flows for the interim periods. Net income for the three months ended March 31, 2014 is not necessarily indicative of results that may be expected for the year ending December 31, 2014. The condensed consolidated financial statements are unaudited and should be read in conjunction with the audited 2013 financial statements and notes thereto, which are included in TNC's 2013 Annual Report.

Management reviewed subsequent events through April 25, 2014, the date that the first quarter 2014 report was issued.

2. NEW ACCOUNTING PRONOUNCEMENT

Upon issuance of final pronouncements, management reviews the new accounting literature to determine its relevance, if any, to TNC's business. The following summary of a final pronouncement will impact the financial statements.

ASU 2014-08 "Presentation of Financial Statements and Property, Plant and Equipment" (ASU 2014-08)

In April 2014, the FASB issued ASU 2014-08 changing the presentation of discontinued operations on the statements of income and other requirements for reporting discontinued operations. Under the new standard, a disposal of a component or a group of components of an entity is required to be reported in discontinued operations if the disposal represents a strategic shift that has (or will have) a major effect on an entity's operations and financial results when the component meets the criteria to be classified as held for sale or is disposed. The amendments in this update also require additional disclosures about discontinued operations and disposal of an individually significant component of an entity that does not qualify for discontinued operations. This standard must be prospectively applied to all reporting periods presented in financial reports issued after the effective date. Early adoption is permitted for disposals that have not been reported in financial statements previously issued or available for issuance.

The new accounting guidance is effective for interim and annual periods beginning after December 15, 2014. If applicable, this standard will change the presentation of financial statements but will not affect the calculation of net income, comprehensive income or earnings per share. Management plans to adopt ASU 2014-08 effective January 1, 2015.

3. COMPREHENSIVE INCOME

Presentation of Comprehensive Income

The following tables provide the components of changes in AOCI for the three months ended March 31, 2014 and 2013. All amounts in the following tables are presented net of related income taxes.

Changes in Accumulated Other Comprehensive Income (Loss) by Component
For the Three Months Ended March 31, 2014

	Cash Flow Hedges			
	Commodity	Interest Rate and Foreign Currency	Pension and OPEB	Total
		(in thousands)		
Balance in AOCI as of December 31, 2013	$ 36	$ (7,965)	$ (10,490)	$ (18,419)
Change in Fair Value Recognized in AOCI	-	-	-	-
Amounts Reclassified from AOCI	(36)	217	97	278
Net Current Period Other Comprehensive Income	(36)	217	97	278
Balance in AOCI as of March 31, 2014	$ -	$ (7,748)	$ (10,393)	$ (18,141)

Changes in Accumulated Other Comprehensive Income (Loss) by Component
For the Three Months Ended March 31, 2013

	Cash Flow Hedges			
	Commodity	Interest Rate and Foreign Currency	Pension and OPEB	Total
		(in thousands)		
Balance in AOCI as of December 31, 2012	$ 13	$ (9,608)	$ (13,622)	$ (23,217)
Change in Fair Value Recognized in AOCI	26	340	-	366
Amounts Reclassified from AOCI	(10)	652	175	817
Net Current Period Other Comprehensive Income	16	992	175	1,183
Balance in AOCI as of March 31, 2013	$ 29	$ (8,616)	$ (13,447)	$ (22,034)

Reclassifications Out of Accumulated Other Comprehensive Income

The following table provides details of reclassifications from AOCI for the three months ended March 31, 2014 and 2013. The amortization of pension and OPEB AOCI components are included in the computation of net periodic pension and OPEB costs. See Note 6 for additional details.

Reclassifications from Accumulated Other Comprehensive Income (Loss)
For the Three Months Ended March 31, 2014 and 2013

	Amount of (Gain) Loss Reclassified from AOCI	
	Three Months Ended March 31,	
Gains and Losses on Cash Flow Hedges	2014	2013
	(in thousands)	
Commodity:		
Other Operation Expense	$ (7)	$ (4)
Maintenance Expense	(7)	(4)
Property, Plant and Equipment	(12)	(7)
Regulatory Assets/(Liabilities), Net (a)	(29)	-
Subtotal - Commodity	(55)	(15)
Interest Rate and Foreign Currency:		
Interest Expense	334	1,003
Subtotal - Interest Rate and Foreign Currency	334	1,003
Reclassifications from AOCI, before Income Tax (Expense) Credit	279	988
Income Tax (Expense) Credit	98	346
Reclassifications from AOCI, Net of Income Tax (Expense) Credit	181	642
Pension and OPEB		
Amortization of Prior Service Cost (Credit)	(15)	(15)
Amortization of Actuarial (Gains)/Losses	164	284
Reclassifications from AOCI, before Income Tax (Expense) Credit	149	269
Income Tax (Expense) Credit	52	94
Reclassifications from AOCI, Net of Income Tax (Expense) Credit	97	175
Total Reclassifications from AOCI, Net of Income Tax (Expense) Credit	$ 278	$ 817

(a) Represents realized gains and losses subject to regulatory accounting treatment recorded as either current or noncurrent on the condensed balance sheets.

4. RATE MATTERS

As discussed in TNC's 2013 Annual Report, TNC is involved in rate and regulatory proceedings at the FERC and the PUCT. The Rate Matters note within TNC's 2013 Annual Report should be read in conjunction with this report to gain a complete understanding of material rate matters still pending that could impact net income, cash flows and possibly financial condition. The following discusses ratemaking developments in 2014 and updates TNC's 2013 Annual Report.

Regulatory Assets Not Yet Being Recovered

Noncurrent Regulatory Assets	March 31, 2014	December 31, 2013
	(in thousands)	
Regulatory assets not yet being recovered pending future proceedings:		
Regulatory Assets Currently Not Earning a Return		
Rate Case Expenses	$ 3	$ 3
Total Regulatory Assets Not Yet Being Recovered	$ 3	$ 3

If these costs are ultimately determined not to be recoverable, it could reduce future net income and cash flows and impact financial condition.

5. 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 effect on the financial statements. The Commitments, Guarantees and Contingencies note within TNC's 2013 Annual Report should be read in conjunction with this report.

GUARANTEES

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

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. As of March 31, 2014, there were no material liabilities recorded for any indemnifications.

Master Lease Agreements

TNC leases certain equipment under master lease agreements. Under the lease agreements, the lessor is guaranteed a residual value up to a stated percentage of either the unamortized balance or the equipment cost at the end of the lease term. If the actual fair value of the leased equipment is below the guaranteed residual value at the end of the lease term, TNC is committed to pay the difference between the actual fair value and the residual value guarantee. Historically, at the end of the lease term the fair value has been in excess of the unamortized balance. As of March 31, 2014, the maximum potential loss for these lease agreements was approximately $1.2 million assuming the fair value of the equipment is zero at the end of the lease term.

6. BENEFIT PLANS

TNC participates in an AEP sponsored qualified pension plan and an 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 health and life insurance benefits for retired employees.

Components of Net Periodic Benefit Cost

The following table provides the components of TNC's net periodic benefit cost (credit) for the plans for the three months ended March 31, 2014 and 2013:

	Pension Plans		Other Postretirement Benefit Plans	
	Three Months Ended March 31,		Three Months Ended March 31,	
	2014	2013	2014	2013
	(in thousands)			
Service Cost	$ 361	$ 400	$ 59	$ 102
Interest Cost	1,136	1,046	372	398
Expected Return on Plan Assets	(1,411)	(1,532)	(658)	(643)
Amortization of Prior Service Cost (Credit)	27	27	(395)	(394)
Amortization of Net Actuarial Loss	645	943	116	367
Net Periodic Benefit Cost (Credit)	$ 758	$ 884	$ (506)	$ (170)

7. BUSINESS SEGMENTS

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

8. DERIVATIVES AND HEDGING

Risk Management 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. For disclosure purposes, these contracts were included with other hedging activities as "Commodity" as of December 31, 2013. As of March 31, 2014, these contracts will be grouped as "Commodity" with other risk management activities. TNC does not hedge all fuel price risk. The gross notional volumes of TNC's outstanding derivative contracts for heating oil and gasoline as of March 31, 2014 and December 31, 2013 were 285 thousand gallons and 392 thousand gallons, respectively.

AEPSC, on behalf of TNC, enters into a variety of interest rate derivative transactions in order to manage interest rate risk exposure. Some interest rate derivative transactions effectively modify exposure to interest rate risk by converting a portion of floating-rate debt to a fixed rate. AEPSC, on behalf of TNC, also enters into interest rate derivative contracts to manage interest rate exposure related to future borrowings of fixed-rate debt. The forecasted fixed-rate debt offerings have a high probability of occurrence as the proceeds will be used to fund existing debt maturities and projected capital expenditures. TNC does not hedge all interest rate exposure. As of March 31, 2014 and December 31, 2013, TNC did not have any outstanding derivative contracts for interest rate hedges.

According to the accounting guidance for "Derivatives and Hedging," TNC reflects the fair values of derivative instruments subject to netting agreements with the same counterparty net of related cash collateral. For certain risk management contracts, TNC is required to post or receive cash collateral based on third party contractual agreements and risk profiles. For the March 31, 2014 condensed balance sheet, TNC netted $1 thousand of cash collateral received from third parties against short-term and long-term risk management assets. For the December 31, 2013 condensed balance sheet, TNC had no netting of cash collateral received from third parties against short-term and long-term risk management assets and cash collateral paid to third parties against short-term and long-term risk management liabilities.

The following tables represent the gross fair value impact of TNC's derivative activity on the condensed balance sheets as of March 31, 2014 and December 31, 2013:

Fair Value of Derivative Instruments
March 31, 2014

Balance Sheet Location	Risk Management Contracts Commodity (a)	Hedging Contracts Commodity (a)	Gross Amounts of Risk Management Assets/ Liabilities Recognized	Gross Amounts Offset in the Statement of Financial Position (b)	Net Amounts of Asset/Liabilities Presented in the Statement of Financial Position (c)
			(in thousands)		
Current Risk Management Assets	$ 23	$ -	$ 23	$ (3)	$ 20
Long-term Risk Management Assets	-	-	-	-	-
Total Assets	23	-	23	(3)	20
Current Risk Management Liabilities	2	-	2	(2)	-
Long-term Risk Management Liabilities	-	-	-	-	-
Total Liabilities	2	-	2	(2)	-
Total MTM Derivative Contract Net Assets (Liabilities)	$ 21	$ -	$ 21	$ (1)	$ 20

Fair Value of Derivative Instruments
December 31, 2013

Balance Sheet Location	Risk Management Contracts Commodity (a)	Hedging Contracts Commodity (a)	Gross Amounts of Risk Management Assets/ Liabilities Recognized	Gross Amounts Offset in the Statement of Financial Position (b)	Net Amounts of Asset/Liabilities Presented in the Statement of Financial Position (c)
			(in thousands)		
Current Risk Management Assets	$ -	$ 55	$ 55	$ -	$ 55
Long-term Risk Management Assets	-	-	-	-	-
Total Assets	-	55	55	-	55
Current Risk Management Liabilities	-	-	-	-	-
Long-term Risk Management Liabilities	-	-	-	-	-
Total Liabilities	-	-	-	-	-
Total MTM Derivative Contract Net Assets (Liabilities)	$ -	$ 55	$ 55	$ -	$ 55

(a) Derivative instruments within these categories are reported gross. These instruments are subject to master netting agreements and are presented on the condensed balance sheets on a net basis in accordance with the accounting guidance for "Derivatives and Hedging."
(b) Amounts include counterparty netting of risk management and hedging contracts and associated cash collateral in accordance with the accounting guidance for "Derivatives and Hedging."
(c) There are no derivative contracts subject to a master netting arrangement or similar agreement which are not offset in the statement of financial position.

The table below presents TNC's activity of derivative risk management contracts for the three months ended March 31, 2014 and 2013:

Amount of Gain (Loss) Recognized on
Risk Management Contracts
For the Three Months Ended March 31, 2014 and 2013

Location of Gain	2014	2013
	(in thousands)	
Regulatory Liabilities (a)	$ 21	$ -

(a) Represents realized and unrealized gains and losses subject to regulatory accounting treatment recorded as either current or noncurrent on the condensed balance sheets.

Certain qualifying derivative instruments have been designated as normal purchase or normal sale contracts, as provided in the accounting guidance for "Derivatives and Hedging." Derivative contracts that have been designated as normal purchases or normal sales under that accounting guidance are not subject to MTM accounting treatment and are recognized on the condensed statements of income on an accrual basis.

TNC's accounting for the changes in the fair value of a derivative instrument depends on whether it qualifies for and has been designated as part of a hedging relationship and further, on the type of hedging relationship. Depending on the exposure, management designates a hedging instrument as a fair value hedge or a cash flow hedge.

For contracts that have not been designated as part of a hedging relationship, the accounting for changes in fair value depends on whether the derivative instrument is held for trading purposes. Unrealized and realized gains and losses on derivative instruments held for trading purposes are included in revenues on a net basis on TNC's condensed statements of income. Unrealized and realized gains and losses on derivative instruments not held for trading purposes are included in revenues or expenses on TNC's condensed statements of income depending on the relevant facts and circumstances. However, unrealized and some realized gains and losses for both trading and non-trading derivative instruments are recorded as regulatory assets (for losses) or regulatory liabilities (for gains), in accordance with the accounting guidance for "Regulated Operations."

Accounting for Cash Flow Hedging Strategies

For cash flow hedges (i.e. hedging the exposure to variability in expected future cash flows that is attributable to a particular risk), TNC initially reports the effective portion of the gain or loss on the derivative instrument as a component of Accumulated Other Comprehensive Income (Loss) on its condensed 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 heating oil and gasoline derivative contracts designated as cash flow hedges from Accumulated Other Comprehensive Income (Loss) on its condensed balance sheets into Other Operation expense, Maintenance expense or Depreciation and Amortization expense, as it relates to capital projects, on its condensed statements of income. TNC discontinued cash flow hedge accounting for these derivative contracts effective March 31, 2014. During the three months ended March 31, 2013, TNC designated heating oil and gasoline derivatives as cash flow hedges.

TNC reclassifies gains and losses on interest rate derivative hedges related to debt financings from Accumulated Other Comprehensive Income (Loss) on its condensed balance sheets into Interest Expense on its condensed statements of income in those periods in which hedged interest payments occur. During the three months ended March 31, 2014 and 2013, TNC designated interest rate derivatives as cash flow hedges.

During the three months ended March 31, 2014 and 2013, hedge ineffectiveness was immaterial or nonexistent for all cash flow hedge strategies discussed above.

For details on designated, effective cash flow hedges included in Accumulated Other Comprehensive Income (Loss) on TNC's condensed balance sheets and the reasons for changes in cash flow hedges for the three months ended March 31, 2014 and 2013, see Note 3.

Cash flow hedges included in Accumulated Other Comprehensive Income (Loss) on TNC's condensed balance sheets as of March 31, 2014 and December 31, 2013 were:

Impact of Cash Flow Hedges on the Condensed Balance Sheet
March 31, 2014

	Commodity	Interest Rate	Total
		(in thousands)	
Hedging Assets (a)	$ -	$ -	$ -
Hedging Liabilities (a)	-	-	-
AOCI Loss Net of Tax	-	(7,748)	(7,748)
Portion Expected to be Reclassified to Net Income During the Next Twelve Months	-	(869)	(869)

Impact of Cash Flow Hedges on the Condensed Balance Sheet
December 31, 2013

	Commodity	Interest Rate	Total
		(in thousands)	
Hedging Assets (a)	$ 55	$ -	$ 55
Hedging Liabilities (a)	-	-	-
AOCI Gain (Loss) Net of Tax	36	(7,965)	(7,929)
Portion Expected to be Reclassified to Net Income During the Next Twelve Months	36	(869)	(833)

(a) Hedging Assets and Hedging Liabilities are included in Risk Management Assets and Liabilities on TNC's condensed balance sheets.

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 March 31, 2014, TNC is not hedging (with contracts subject to the accounting guidance for "Derivatives and Hedging") its exposure to variability in future cash flows related to forecasted transactions.

TNC's interest rate hedging liabilities have cross-default provisions that could be triggered if there was a non-performance event by Parent or the obligor under outstanding debt or a third party obligation in excess of $50 million. As of March 31, 2014 and December 31, 2013, TNC had no liabilities for contracts with cross-default provisions prior to contractual netting arrangements.

9. FAIR VALUE MEASUREMENTS

Fair Value Hierarchy and Valuation Techniques

The accounting guidance for "Fair Value Measurements and Disclosures" establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement). Where observable inputs are available for substantially the full term of the asset or liability, the instrument is categorized in Level 2. When quoted market prices are not available, pricing may be completed using comparable securities, dealer values, operating data and general market conditions to determine fair value. Valuation models utilize various inputs such as commodity, interest rate and, to a lesser degree, volatility and credit that include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in inactive markets, market corroborated inputs (i.e. inputs derived principally from, or correlated to, observable market data) and other observable inputs for the asset or liability. The amount of risk taken is determined by the Commercial Operations and Finance groups in accordance with established risk management policies as approved by the Finance Committee of AEP's Board of Directors. The AEP System's market risk oversight staff independently monitors the risk policies, procedures and risk levels and provides members of the Commercial Operations Risk Committee (Regulated Risk Committee) various daily, weekly and/or monthly reports regarding compliance with policies, limits and procedures. The Regulated Risk Committee consists of AEPSC's Chief Operating Officer, Chief Financial Officer, Executive Vice President of Generation, Senior Vice President of Commercial Operations and Chief Risk Officer.

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 nonbinding 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. 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. Illiquid transactions, complex structured transactions, FTRs and counterparty credit risk may require nonmarket based inputs. Some of these inputs may be internally developed or extrapolated and utilized to estimate fair value. When such inputs have a significant impact on the measurement of fair value, the instrument is categorized as Level 3. The main driver of the contracts being classified as Level 3 is the inability to substantiate energy price curves in the market. A significant portion of the Level 3 instruments have been economically hedged which greatly limits potential earnings volatility.

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 classified as Level 2 measurement inputs. These instruments are not marked-to-market. The estimates presented are not necessarily indicative of the amounts that could be realized in a current market exchange.

The book values and fair values of TNC's Long-term Debt as of March 31, 2014 and December 31, 2013 are summarized in the following table:

	March 31, 2014		December 31, 2013	
	Book Value	**Fair Value**	**Book Value**	**Fair Value**
	(in thousands)			
Long-term Debt	$ 420,291	$ 441,115	$ 420,293	$ 419,622

Fair Value Measurements of Financial Assets and Liabilities

The following tables set forth, by level within the fair value hierarchy, TNC's financial assets and liabilities that were accounted for at fair value on a recurring basis as of March 31, 2014 and December 31, 2013. 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
March 31, 2014

	Level 1	Level 2	Level 3	Other	Total
			(in thousands)		
Risk Management Assets					
Risk Management Commodity Contracts (a)	$ -	$ 23	$ -	$ (3)	$ 20
Risk Management Liabilities					
Risk Management Commodity Contracts (a)	$ -	$ 2	$ -	$ (2)	$ -

Assets and Liabilities Measured at Fair Value on a Recurring Basis
December 31, 2013

	Level 1	Level 2	Level 3	Other	Total
			(in thousands)		
Risk Management Assets					
Cash Flow Hedges:					
Commodity Hedges (a)	$ -	$ 55	$ -	$ -	$ 55

(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."

As of December 31, 2013, TNC had no liabilities measured at fair value on a recurring basis.

There were no transfers between Level 1 and Level 2 during the three months ended March 31, 2014 and 2013.

10. INCOME TAXES

AEP System Tax Allocation Agreement

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.

Federal and State Income Tax Audit Status

The IRS examination of years 2009 and 2010 started in October 2011 and was completed in the second quarter of 2013. Cash flows were negatively impacted in 2013 by $8 million with the payment of the previously accrued taxes. The IRS examination of years 2011 and 2012 started in April 2014. 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 materially impact net income.

TNC and other AEP subsidiaries file income tax returns in various state and local jurisdictions. These taxing authorities routinely examine the tax returns. TNC and other AEP subsidiaries are currently under examination in several state and local jurisdictions. However, it is possible that previously filed tax returns have positions that may be challenged by these tax authorities. Management believes that adequate provisions for income taxes have been made for potential liabilities resulting from such challenges and that the ultimate resolution of these audits will not materially impact net income. TNC is no longer subject to state or local income tax examinations by tax authorities for years before 2008.

11. FINANCING ACTIVITIES

Long-term Debt

A long-term debt principal payment made during the first three months of 2014 is shown in the table below:

Type of Debt	Principal Amount Paid	Interest Rate	Due Date
	(in thousands)	(%)	
Other Long-term Debt	$ 2	4.50	2059

Dividend Restrictions

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

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 book value of the common stock. This restriction does not limit the ability of TNC to pay dividends out of retained earnings.

Leverage Restrictions

Pursuant to the credit agreement leverage restrictions, TNC must maintain a percentage of debt to total capitalization at a level that does not exceed 67.5%.

Money Pool – AEP System

The AEP System uses a corporate borrowing program to meet the short-term borrowing needs of AEP's subsidiaries. The corporate borrowing program includes a Utility Money Pool, which funds AEP's utility subsidiaries, and a Nonutility Money Pool, which funds a majority of AEP's nonutility subsidiaries. The AEP System Utility Money Pool operates in accordance with the terms and conditions of the AEP System Utility Money Pool agreement filed with the FERC. The amounts of outstanding borrowings from the Utility Money Pool as of March 31, 2014 and December 31, 2013 are included in Advances from Affiliates on TNC's condensed balance sheets. TNC's Utility Money Pool activity and corresponding authorized borrowing limit for the three months ended March 31, 2014 are described in the following table:

Maximum Borrowings from the Utility Money Pool	Maximum Loans to the Utility Money Pool	Average Borrowings from the Utility Money Pool	Average Loans to the Utility Money Pool	Borrowings from the Utility Money Pool as of March 31, 2014	Authorized Short-Term Borrowing Limit
		(in thousands)			
$ 48,821	$ -	$ 37,563	$ -	$ 39,905	$ 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), which is a participant in the Nonutility Money Pool. The amounts of outstanding loans to the Nonutility Money Pool as of March 31, 2014 and December 31, 2013 are included in Advances to Affiliates on TNC's condensed balance sheets. For the three months ended March 31, 2014, TNGC had the following activity in the Nonutility Money Pool:

Maximum Borrowings from the Nonutility Money Pool	Maximum Loans to the Nonutility Money Pool	Average Borrowings from the Nonutility Money Pool	Average Loans to the Nonutility Money Pool	Loans to the Nonutility Money Pool as of March 31, 2014
		(in thousands)		
$ -	$ 10,179	$ -	$ 9,837	$ 9,597

Maximum, minimum and average interest rates for funds either borrowed from or loaned to the Utility Money Pool for the three months ended March 31, 2014 and 2013 are summarized in the following table:

Three Months Ended March 31,	Maximum Interest Rate for Funds Borrowed from the Utility Money Pool	Minimum Interest Rate for Funds Borrowed from the Utility Money Pool	Maximum Interest Rate for Funds Loaned to the Utility Money Pool	Minimum Interest Rate for Funds Loaned to the Utility Money Pool	Average Interest Rate for Funds Borrowed from the Utility Money Pool	Average Interest Rate for Funds Loaned to the Utility Money Pool
2014	0.33 %	0.28 %	- %	- %	0.31 %	- %
2013	0.43 %	0.35 %	0.36 %	0.36 %	0.37 %	0.36 %

Maximum, minimum and average interest rates for funds either borrowed from or loaned to the Nonutility Money Pool for the three months ended March 31, 2014 and 2013 are summarized in the following table:

Three Months Ended March 31,	Maximum Interest Rate for Funds Borrowed from the Nonutility Money Pool	Minimum Interest Rate for Funds Borrowed from the Nonutility Money Pool	Maximum Interest Rate for Funds Loaned to the Nonutility Money Pool	Minimum Interest Rate for Funds Loaned to the Nonutility Money Pool	Average Interest Rate for Funds Borrowed from the Nonutility Money Pool	Average Interest Rate for Funds Loaned to the Nonutility Money Pool
2014	- %	- %	0.33 %	0.28 %	- %	0.31 %
2013	- %	- %	0.43 %	0.35 %	- %	0.37 %

12. 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, variable interests held by related parties and other factors. Management believes that significant assumptions and judgments were applied consistently. TNC is not the primary beneficiary of any VIE and has not provided financial or other support to any VIE that was not previously contractually required.

AEPSC provides certain managerial and professional services to AEP's subsidiaries. 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 the AEP subsidiary companies at AEPSC's cost. AEP subsidiaries have not provided financial or other support outside the reimbursement of costs for services rendered. AEPSC finances its operations through cost reimbursement from other AEP subsidiaries. There are no other terms or arrangements between AEPSC and any of the AEP subsidiaries that could require additional financial support from an AEP subsidiary or expose them to losses outside of the normal course of business. AEPSC and its billings are subject to regulation by the FERC. AEP subsidiaries are exposed to losses to the extent they cannot recover the costs of AEPSC through their normal business operations. AEP subsidiaries are considered to have a significant interest in AEPSC due to their activity in AEPSC's cost reimbursement structure. However, AEP subsidiaries do not have control over AEPSC. AEPSC is consolidated by AEP. In the event AEPSC would require financing or other support outside the cost reimbursement billings, this financing would be provided by AEP. TNC's total billings from AEPSC for the three months ended March 31, 2014 and 2013 were $7 million and $5 million, respectively. The carrying amount of liabilities associated with AEPSC as of March 31, 2014 and December 31, 2013 was $3 million and $3 million, respectively. Management estimates the maximum exposure of loss to be equal to the amount of such liability.

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