AMCON DISTRIBUTING CO
Form 10-Q
July 17, 2015
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2015

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to

Commission File Number 1-15589

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**47-0702918** (I.R.S. Employer Identification No.)
7405 Irvington Road, Omaha NE (Address of principal executive offices)	**68122** (Zip code)

Registrant s telephone number, including area code: **(402) 331-3727**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files) Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer , accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer o	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act) Yes o No x

The Registrant had 615,822 shares of its $.01 par value common stock outstanding as of July 13, 2015.

Table of Contents

Form 10-Q

3rd Quarter

INDEX

Table of Contents

PART I FINANCIAL INFORMATION

Item 1. Financial Statements

AMCON Distributing Company and Subsidiaries

Condensed Consolidated Balance Sheets

June 30, 2015 and September 30, 2014

		June 2015 (Unaudited)		September 2014
ASSETS				
Current assets:				
Cash	$	149,857	$	99,922
Accounts receivable, less allowance for doubtful accounts of $1.0 million and $0.8 million at June 2015 and September 2014, respectively		33,301,156		33,286,932
Inventories, net		49,896,207		43,635,266
Deferred income taxes		1,550,877		1,606,168
Prepaid and other current assets		4,092,039		5,034,570
Total current assets		88,990,136		83,662,858
Property and equipment, net		13,084,440		13,763,140
Goodwill		6,349,827		6,349,827
Other intangible assets, net		4,182,228		4,455,978
Other assets		329,618		448,149
	$	112,936,249	$	108,679,952
LIABILITIES AND SHAREHOLDERS EQUITY				
Current liabilities:				
Accounts payable	$	16,629,153	$	16,412,895
Accrued expenses		7,350,570		6,891,308
Accrued wages, salaries and bonuses		3,335,949		2,647,969
Income taxes payable		581,042		1,603,614
Current maturities of long-term debt		348,710		341,190
Total current liabilities		28,245,424		27,896,976
Credit facility		14,307,224		15,081,783
Deferred income taxes		3,562,406		3,484,204
Long-term debt, less current maturities		3,473,025		3,735,702
Other long-term liabilities		36,871		139,003
Series A cumulative, convertible preferred stock, $.01 par value 100,000 shares authorized, issued, and outstanding, and a total liquidation preference of $2.5 million at both June 2015 and September 2014		2,500,000		2,500,000
Series B cumulative, convertible preferred stock, $.01 par value 80,000 shares authorized, 16,000 shares issued and outstanding at both June 2015 and September 2014, and a total liquidation preference of $0.4 million at both June 2015 and September 2014		400,000		400,000

Shareholders equity:				
Preferred stock, $.01 par value, 1,000,000 shares authorized, 116,000 shares outstanding and issued in Series A and B referred to above				
Common stock, $.01 par value, 3,000,000 shares authorized, 615,822 shares outstanding at June 2015 and 602,411 shares outstanding at September 2014		6,811		6,677
Additional paid-in capital		14,723,863		13,571,909
Retained earnings		51,646,128		47,829,201
Treasury stock at cost		(5,965,503)		(5,965,503)
Total shareholders equity		60,411,299		55,442,284
	$	112,936,249	$	108,679,952

The accompanying notes are an integral part of these condensed consolidated unaudited financial statements.

Table of Contents

AMCON Distributing Company and Subsidiaries

Condensed Consolidated Unaudited Statements of Operations

for the three and nine months ended June 30, 2015 and 2014

	For the three months ended June		For the nine months ended June	
	2015	2014	2015	2014
Sales (including excise taxes of $101.5 million and $100.4 million, and $285.9 million and $283.5 million, respectively)	$ 334,456,509	$ 322,647,624	$ 937,333,849	$ 900,694,969
Cost of sales	314,957,889	303,353,020	880,575,362	844,139,340
Gross profit	19,498,620	19,294,604	56,758,487	56,555,629
Selling, general and administrative expenses	15,405,676	16,295,082	47,072,555	48,599,519
Depreciation and amortization	542,307	557,736	1,709,469	1,810,610
	15,947,983	16,852,818	48,782,024	50,410,129
Operating income	3,550,637	2,441,786	7,976,463	6,145,500
Other expense (income):				
Interest expense	242,266	228,827	673,783	753,446
Other (income), net	(20,853)	(37,473)	(63,907)	(106,659)
	221,413	191,354	609,876	646,787
Income from operations before income tax expense	3,329,224	2,250,432	7,366,587	5,498,713
Income tax expense	1,333,000	990,000	3,055,000	2,419,000
Net income	1,996,224	1,260,432	4,311,587	3,079,713
Preferred stock dividend requirements	(48,643)	(48,643)	(145,928)	(145,928)
Net income available to common shareholders	$ 1,947,581	$ 1,211,789	$ 4,165,659	$ 2,933,785
Basic earnings per share available to common shareholders	$ 3.16	$ 2.00	$ 6.78	$ 4.79
Diluted earnings per share available to common shareholders	$ 2.69	$ 1.73	$ 5.85	$ 4.18
Basic weighted average shares outstanding	615,822	605,319	614,723	613,032
Diluted weighted average shares outstanding	741,183	729,978	737,325	736,531

The accompanying notes are an integral part of these condensed consolidated unaudited financial statements.

Table of Contents

AMCON Distributing Company and Subsidiaries

Condensed Consolidated Unaudited Statements of Cash Flows

for the nine months ended June 30, 2015 and 2014

	2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 4,311,587	$ 3,079,713
Adjustments to reconcile net income from operations to net cash flows from operating activities:		
Depreciation	1,435,719	1,536,860
Amortization	273,750	273,750
(Gain) loss on sale of property and equipment	5,103	(42,745)
Equity-based compensation	910,920	1,025,694
Deferred income taxes	133,493	421,934
Provision for losses on doubtful accounts	193,000	63,000
Provision for losses on inventory obsolescence	132,793	15,878
Other	(6,034)	(6,034)
Changes in assets and liabilities:		
Accounts receivable	(207,224)	(1,379,031)
Inventories	(6,393,734)	(1,572,589)
Prepaid and other current assets	942,531	(2,048,389)
Other assets	118,531	31,892
Accounts payable	242,760	598,939
Accrued expenses and accrued wages, salaries and bonuses	1,505,917	805,286
Income tax payable	(1,022,572)	(1,589,747)
Net cash flows from operating activities	2,576,540	1,214,411
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(812,624)	(2,337,626)
Proceeds from sales of property and equipment	24,000	47,969
Acquisition		(996,803)
Net cash flows from investing activities	(788,624)	(3,286,460)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net (payments) borrowings on bank credit agreements	(774,559)	6,322,689
Principal payments on long-term debt	(255,157)	(915,350)
Repurchase of Series B Convertible Preferred Stock and common stock		(2,648,318)
Dividends paid on convertible preferred stock	(145,928)	(145,928)
Dividends on common stock	(348,732)	(353,806)
Withholdings on the exercise of equity-based awards	(213,605)	(128,523)
Net cash flows from financing activities	(1,737,981)	2,130,764
Net change in cash	49,935	58,715
Cash, beginning of period	99,922	275,036
Cash, end of period	$ 149,857	$ 333,751

The accompanying notes are an integral part of these condensed consolidated unaudited financial statements.

Table of Contents

		2015		2014
Supplemental disclosure of cash flow information:				
Cash paid during the period for interest	$	677,163	$	751,909
Cash paid during the period for income taxes		3,944,080		3,586,813
Supplemental disclosure of non-cash information:				
Equipment acquisitions classified as accounts payable		8,483		62,414
Issuance of common stock in connection with the vesting and exercise of equity-based awards		1,240,842		1,154,869

The accompanying notes are an integral part of these condensed consolidated unaudited financial statements.

Table of Contents

AMCON Distributing Company and Subsidiaries

Notes to Condensed Consolidated Unaudited Financial Statements

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND BASIS OF PRESENTATION

AMCON Distributing Company and Subsidiaries (AMCON or the Company) operate two business segments:

- Our wholesale distribution segment (Wholesale Segment) distributes consumer products in the Central, Rocky Mountain, and Southern regions of the United States. Additionally, our Wholesale Segment provides a full range of programs and services to assist our customers in managing their business and profitability.

- Our retail health food segment (Retail Segment) operates sixteen health food retail stores located throughout the Midwest and Florida.

WHOLESALE SEGMENT

Our Wholesale Segment is one of the largest wholesale distributors in the United States serving approximately 4,500 retail outlets including convenience stores, grocery stores, liquor stores, drug stores, and tobacco shops. We currently distribute over 16,000 different consumer products, including cigarettes and tobacco products, candy and other confectionery, beverages, groceries, paper products, health and beauty care products, frozen and chilled products and institutional foodservice products. Convenience stores represent our largest customer category. In September 2014, Convenience Store News ranked us as the sixth (6th) largest convenience store distributor in the United States based on annual sales.

Our wholesale business offers retailers the ability to take advantage of manufacturer and Company sponsored sales and marketing programs, merchandising and product category management services, and the use of information systems and data services that are focused on minimizing retailers investment in inventory, while seeking to maximize their sales and profits. In addition, our wholesale distributing capabilities provide valuable services to both manufacturers of consumer products and convenience retailers. Manufacturers benefit from our broad retail coverage, inventory management, efficiency in processing small orders, and frequency of deliveries. Convenience retailers benefit from our distribution capabilities by gaining access to a broad product line, optimizing inventory, merchandising expertise, information systems, and accessing trade credit.

Our Wholesale Segment operates six distribution centers located in Illinois, Missouri, Nebraska, North Dakota, South Dakota, and Tennessee. These distribution centers, combined with cross dock facilities, include approximately 641,000 square feet of permanent floor space. Our principal suppliers include Altria, RJ Reynolds, Commonwealth Brands, Lorillard, Hershey, Kellogg s, Kraft, and Mars. We also market private label lines of water, candy products, batteries, and other products. We do not maintain long-term purchase contracts with our suppliers.

RETAIL SEGMENT

Our Retail Segment is a specialty retailer of natural/organic groceries and dietary supplements which focuses on providing high quality products at affordable prices, with an exceptional level of customer service and nutritional consultation. All of the products carried in our stores must meet strict quality and ingredient guidelines, and include offerings such as gluten-free and antibiotic-free groceries and meat products, as well as products containing no artificial colors, flavors, preservatives, or partially hydrogenated oils. We design our retail sites in an efficient and flexible small-store format, which emphasizes a high energy and shopper-friendly environment.

We operate within the natural products retail industry, which is a subset of the large and stable U.S. grocery industry. This industry includes conventional, natural, gourmet and specialty food markets, mass and discount retailers, warehouse clubs, health food stores, dietary supplement retailers, drug stores, farmers markets, mail order and online retailers, and multi-level marketers. According to The Natural Foods Merchandiser, a leading industry trade publication, retail sales in the natural foods industry exceeded $89 billion during the 2013 calendar year.

Our Retail Segment operates sixteen retail health food stores as Chamberlin s Market & Café and Akin s Natural Foods Market. These stores carry over 32,000 different national and regionally branded and private label products including high-quality natural, organic, and specialty foods consisting of produce, baked goods, frozen foods, nutritional supplements, personal care items, and general merchandise. Chamberlin s, which was established in 1935, operates six stores in and around Orlando, Florida. Akin s, which was also established in 1935, has a total of ten locations in Arkansas, Kansas, Missouri, Nebraska, and Oklahoma.

Table of Contents

FINANCIAL STATEMENTS

The Company s fiscal year ends on September 30. The results for the interim period included with this Quarterly Report may not be indicative of the results which could be expected for the entire fiscal year. All significant intercompany transactions and balances have been eliminated in consolidation. Certain information and footnote disclosures normally included in our annual financial statements prepared in accordance with generally accepted accounting principles (GAAP) have been condensed or omitted. In the opinion of management, the accompanying condensed consolidated unaudited financial statements (financial statements) contain all adjustments necessary to fairly present the financial information included herein, such as adjustments consisting of normal recurring items. The Company believes that although the disclosures contained herein are adequate to prevent the information presented from being misleading, these financial statements should be read in conjunction with the Company s annual audited consolidated financial statements for the fiscal year ended September 30, 2014, as filed with the Securities and Exchange Commission on Form 10-K. For purposes of this report, unless the context indicates otherwise, all references to we , us , our , the Company , and AMCON shall mean AMCON Distributing Company and its subsidiaries. Additionally, the three month fiscal periods ended June 30, 2015 and June 30, 2014 have been referred to throughout this quarterly report as Q3 2015 and Q3 2014, respectively. The fiscal balance sheet dates as of June 30, 2015, June 30, 2014, and September 30, 2014 have been referred to as June 2015, June 2014, and September 2014, respectively.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers. This ASU supersedes the revenue recognition requirements in Accounting Standard Codification 605 - Revenue Recognition and most industry-specific guidance. The standard requires that entities recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which a company expects to be entitled in exchange for those goods or services. This ASU is effective for fiscal years beginning after December 15, 2017, and for interim periods within those fiscal years. The Company is currently assessing the impact of the adoption of ASU 2014-09 on its financial position, results of operations, and cash flow.

2. CONVERTIBLE PREFERRED STOCK

The Company has two series of convertible preferred stock outstanding at June 2015 as identified in the following table:

		Series A		Series B
Date of issuance:		June 17, 2004		October 8, 2004
Optionally redeemable beginning		June 18, 2006		October 9, 2006
Par value (gross proceeds):	$	2,500,000	$	400,000
Number of shares:		100,000		16,000
Liquidation preference per share:	$	25.00	$	25.00
Conversion price per share:	$	30.31	$	24.65
Number of common shares in which to be converted:		82,481		16,227
Dividend rate:		6.785%		6.37%

The Series A Convertible Preferred Stock (Series A) and Series B Convertible Preferred Stock (Series B), (collectively, the Preferred Stock), are convertible at any time by the holders into a number of shares of AMCON common stock equal to the number of preferred shares being converted multiplied by a fraction equal to $25.00 divided by the conversion price. The conversion prices for the Preferred Stock are subject to customary adjustments in the event of stock splits, stock dividends, and certain other distributions on the Common Stock. Cumulative dividends for the Preferred Stock are payable in arrears, when, and if declared by the Board of Directors, on March 31, June 30, September 30 and December 31 of each year.

In the event of a liquidation of the Company, the holders of the Preferred Stock would be entitled to receive the liquidation preference plus any accrued and unpaid dividends prior to the distribution of any amount to the holders of the Common Stock. The shares of Preferred Stock are optionally redeemable by the Company beginning on various dates, as listed in the above table, at redemption prices equal to 112% of the liquidation preference. The redemption prices decrease 1% annually thereafter until the redemption price equals the liquidation preference, after which date it remains the liquidation preference. The Preferred Stock is redeemable at the liquidation value and at the option of the holder. The Series A Preferred Stock and 8,000 shares of the Series B Preferred Stock are owned by Mr. Christopher Atayan, AMCON s Chief Executive Officer and Chairman of the Board. The Series B Preferred Stockholders have the right to elect one member of our Board of Directors, pursuant to the voting rights in the Certificate of Designation creating the Series B. Mr. Atayan was first nominated and elected to this seat in 2004.

Table of Contents

3. INVENTORIES

At June 2015, inventories consisted of finished goods and are stated at the lower of cost determined on a First-in, First-out (FIFO) basis, or market. The wholesale distribution and retail health food segment inventories consist of finished products purchased in bulk quantities to be redistributed to the Company s customers or sold at retail. Finished goods included total reserves of approximately $1.0 million at June 2015 and $0.9 million at September 2014. These reserves include the Company s obsolescence allowance, which reflects estimated unsalable or non-refundable inventory based upon an evaluation of slow moving and discontinued products.

4. GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill by reporting segment of the Company consisted of the following:

		June 2015		September 2014
Wholesale Segment	$	4,436,950	$	4,436,950
Retail Segment		1,912,877		1,912,877
	$	6,349,827	$	6,349,827

Other intangible assets of the Company consisted of the following:

		June 2015		September 2014
Trademarks and tradenames	$	3,373,269	$	3,373,269
Non-competition agreement (less accumulated amortization of $0.4 million and $0.3 million at June 2015 and September 2014, respectively)		91,667		166,667
Customer relationships (less accumulated amortization of $1.4 million and $1.2 million at June 2015 and September 2014, respectively)		717,292		916,042
	$	4,182,228	$	4,455,978

Goodwill, trademarks and tradenames are considered to have indefinite useful lives and therefore no amortization has been taken on these assets. At June 2015, identifiable intangible assets considered to have finite lives were represented by customer relationships and the value of a non-competition agreement acquired as part of acquisitions. The customer relationships are being amortized over eight years and the value of the non-competition agreement is being amortized over five years. These intangible assets are evaluated for accelerated attrition or amortization adjustments if warranted. Amortization expense related to these assets was $0.1 million and $0.3 million for the three and nine month periods ended June 2015, respectively, and $0.1 million and $0.3 million for the three and nine month periods ended June 2014, respectively.

Estimated future amortization expense related to identifiable intangible assets with finite lives is as follows at June 2015:

Customer relationships		June 2015
Fiscal 2015 (1)	$	91,250
Fiscal 2016		331,667
Fiscal 2017		265,000
Fiscal 2018		79,375
Fiscal 2019		41,667
	$	808,959

(1) Represents amortization for the remaining three months of Fiscal 2015.

5. DIVIDENDS

The Company paid cash dividends on its common stock and convertible preferred stock totaling $0.2 million and $0.5 million for the three and nine month periods ended June 2015, respectively, and $0.2 million and $0.5 million for the three and nine month periods ended June 2014, respectively.

Table of Contents

6. EARNINGS PER SHARE

Basic earnings per share available to common shareholders is calculated by dividing net income less preferred stock dividend requirements by the weighted average common shares outstanding for each period. Diluted earnings per share available to common shareholders is calculated by dividing income from operations less preferred stock dividend requirements (when anti-dilutive) by the sum of the weighted average common shares outstanding and the weighted average dilutive options, using the treasury stock method.

	For the three months ended June			
	2015		2014	
	Basic	Diluted	Basic	Diluted
Weighted average common shares outstanding	615,822	615,822	605,319	605,319
Weighted average of net additional shares outstanding assuming dilutive options exercised and proceeds used to purchase treasury stock and conversion of preferred stock (1)		125,361		124,659
Weighted average number of shares outstanding	615,822	741,183	605,319	729,978
Net income	$ 1,996,224	$ 1,996,224	$ 1,260,432	$ 1,260,432
Deduct: convertible preferred stock dividends (2)	(48,643)		(48,643)	
Net income available to common shareholders	$ 1,947,581	$ 1,996,224	$ 1,211,789	$ 1,260,432
Net earnings per share available to common shareholders	$ 3.16	$ 2.69	$ 2.00	$ 1.73

(1) Diluted earnings per share calculation includes all stock options, convertible preferred stock, and restricted stock deemed to be dilutive.

(2) Diluted earnings per share calculation excludes dividends for convertible preferred stock deemed to be dilutive, as those amounts are assumed to have been converted to common stock of the Company.

	For the nine months ended June			
	2015		2014	
	Basic	Diluted	Basic	Diluted
Weighted average common shares outstanding	614,723	614,723	613,032	613,032
Weighted average of net additional shares outstanding assuming dilutive options exercised and proceeds used to purchase treasury stock and conversion of preferred stock (1)		122,602		123,499
Weighted average number of shares outstanding	614,723	737,325	613,032	736,531
Net income	$ 4,311,587	$ 4,311,587	$ 3,079,713	$ 3,079,713
Deduct: convertible preferred stock dividends (2)	(145,928)		(145,928)	
Net income available to common shareholders	$ 4,165,659	$ 4,311,587	$ 2,933,785	$ 3,079,713
Net earnings per share available to common shareholders	$ 6.78	$ 5.85	$ 4.79	$ 4.18

(1) Diluted earnings per share calculation includes all stock options, convertible preferred stock, and restricted stock units deemed to be dilutive.

(2) Diluted earnings per share calculation excludes dividends for convertible preferred stock deemed to be dilutive, as those amounts are assumed to have been converted to common stock of the Company.

Table of Contents

7. DEBT

The Company primarily finances its operations through a credit facility agreement (the Facility) and long term debt agreements with banks. The Facility is provided through Bank of America acting as the senior agent and with BMO Harris Bank participating in a loan syndication. The Facility included the following significant terms at June 2015:

- A July 2018 maturity date without a penalty for prepayment.
- $70.0 million revolving credit limit.
- Loan accordion allowing the Company to increase the size of the credit facility agreement by $25.0 million.
- A provision providing an additional $10.0 million of credit advances for certain inventory purchases.
- Evergreen renewal clause automatically renewing the agreement for one year unless either the borrower or lender provides written notice terminating the agreement at least 90 days prior to the end of any original or renewal term of the agreement.
- The Facility bears interest at either the bank s prime rate, or at LIBOR plus 125 - 175 basis points depending on certain credit facility utilization measures, at the election of the Company.
- Lending limits subject to accounts receivable and inventory limitations.
- An unused commitment fee equal to one-quarter of one percent (1/4%) per annum on the difference between the maximum loan limit and average monthly borrowings.
- Secured by collateral including all of the Company s equipment, intangibles, inventories, and accounts receivable.

- A financial covenant requiring a fixed charge coverage ratio of at least 1.0 as measured by the previous twelve month period then ended only if excess availability falls below 10% of the maximum loan limit as defined in the credit agreement. The Company s availability has not fallen below 10% of the maximum loan limit and the Company s fixed charge coverage ratio is over 1.0.

- Provides that the Company may not pay dividends on its common stock in excess of $1.00 per share on an annual basis. There is, however, no limit on common stock dividends if certain excess availability measurements have been maintained for the thirty day period immediately prior to the payment of any such dividends or distributions and if immediately after giving effect to any such dividend or distribution payments the Company has a fixed charge coverage ratio of at least 1.10 to 1.0 as defined in the credit facility agreement.

Cross Default and Co-Terminus Provisions

The Company s owned real estate in Bismarck, ND, Quincy, IL, and Rapid City, SD, is financed through a term loan with BMO Harris, NA (BMO) which is also a participant lender on the Company s revolving line of credit. The BMO loan contains cross default provisions which cause the loan with BMO to be considered in default if the loans where BMO is the lender, including the revolving credit facility, is in default. There were no such cross defaults as of June 2015. In addition, the BMO loan contains co-terminus provisions which require all loans with BMO to be paid in full if any of the loans are paid in full prior to the end of their specified terms.

Other

AMCON has issued a letter of credit in the amount of approximately $0.4 million to its workers compensation insurance carrier as part of its self-insured loss control program.

Off-Balance Sheet Arrangements

The Company does not have any off-balance sheet arrangements.

Table of Contents

8. EQUITY-BASED INCENTIVE AWARDS

Omnibus Plan

The Company has two Omnibus Incentive Plans, the 2007 Omnibus Plan and 2014 Omnibus Plan (collectively the Omnibus Plans), which provide for equity incentives to employees. Each Omnibus Plan was designed with the intent of encouraging employees to acquire a vested interest in the growth and performance of the Company. The Omnibus Plans together permit the issuance of up to 225,000 shares of the Company s common stock in the form of stock options, restricted stock awards, restricted stock units, performance share awards as well as awards such as stock appreciation rights, performance units, performance shares, bonus shares, and dividend share awards payable in the form of common stock or cash. The number of shares issuable under the Omnibus Plans is subject to customary adjustments in the event of stock splits, stock dividends, and certain other distributions on the Company s common stock. At June 2015, awards with respect to a total of 161,588 shares, net of forfeitures, had been awarded pursuant to the Omnibus Plans and awards with respect to another 63,412 shares may be awarded under the Omnibus Plans.

Stock Options

The stock options issued by the Company expire ten years from the grant date and include graded vesting schedules ranging between three and five years. Stock options issued and outstanding at June 2015 are summarized as follows:

	Exercise Price	Number Outstanding	Remaining Weighted-Average Contractual Life	Weighted-Average Exercise Price	Exercisable Number Exercisable	Exercisable Weighted-Average Exercise Price
Fiscal 2007	$18.00	25,000	1.45 years	$ 18.00	25,000	$ 18.00
Fiscal 2010	$51.50	3,500	4.83 years	$ 51.50	3,500	$ 51.50
Fiscal 2012	$53.80 - $65.97	4,900	6.33 years	$ 55.15	2,700	$ 55.04
Fiscal 2013	$62.33	6,700	7.32 years	$ 62.33	2,900	$ 62.33
Fiscal 2015	$81.03	6,000	9.59 years	$ 81.03		
		46,100		$ 39.13	34,100	$ 28.15

Restricted Stock Units

At June 2015, nonvested restricted stock units awarded pursuant to the Company s Omnibus Plans were as follows:

	Restricted Stock Units(1)	Restricted Stock Units(2)	Restricted Stock Units(3)
Date of award:	October 2012	October 2013	October December 2014
Original number of awards issued:	15,000	17,600	13,000
Service period:	36 months	36-60 months	36 months

Estimated fair value of award at grant date	$935,000	$1,486,000	$1,083,000
Awards outstanding at June 2015	5,000	11,977	13,000
Fair value of non-vested awards at June 2015:	$398,000	$953,000	$1,034,000

---

(1) 10,000 of the restricted stock units were vested as of June 2015. The remaining 5,000 restricted stock units will vest in October 2015.

(2) 5,623 of the restricted stock units were vested as of June 2015. 9,337 restricted stock units will vest in equal amounts in October 2015, and October 2016. The remaining 2,640 restricted stock units will vest in equal amounts in October 2015, October 2016, October 2017, and October 2018.

(3) 13,000 restricted stock units will vest in equal amounts in October 2015, October 2016, and October 2017.

Table of Contents

There is no direct cost to the recipients of the restricted stock units, except for any applicable taxes. The recipients of the restricted stock units are entitled to the customary adjustments in the event of stock splits, stock dividends, and certain other distributions on the Company s common stock. All cash dividends and/or distributions payable to restricted stock recipients will be held in escrow until all the conditions of vesting have been met.

The restricted stock units provide that the recipients can elect, at their option, to receive either common stock in the Company, or a cash settlement based upon the closing price of the Company s shares, at the time of vesting. Based on these award provisions, the compensation expense recorded in the Company s Condensed Statement of Operations reflects the straight-line amortized fair value based on the period end closing price.

	Number of Shares		**Weighted Average Fair Value**
Nonvested restricted stock units at September 2014	32,900	$	84.75
Granted	13,000		83.30
Vested	(15,923)		82.93
Forfeited/Expired			
Nonvested restricted stock units at June 2015	29,977	$	80.40

All Equity-Based Awards (stock options and restricted stock units)

Net income before income taxes included compensation expense related to the amortization of all equity-based compensation awards of $0.3 million and $0.9 million for the three and nine months ended June 2015, respectively, and $0.3 million and $1.0 million for the three and nine months ended June 2014, respectively. Total unamortized compensation expense related to these awards at June 2015 was approximately $1.7 million.

Table of Contents

9. BUSINESS SEGMENTS

AMCON has two reportable business segments: the wholesale distribution of consumer products and the retail sale of health and natural food products. The retail health food stores operations are aggregated to comprise the Retail Segment because such operations have similar economic characteristics, as well as similar characteristics with respect to the nature of products sold, the type and class of customers for the health food products and the methods used to sell the products. Included in the Other column are intercompany eliminations, and assets held and charges incurred by our holding company. The segments are evaluated on revenues, gross margins, operating income (loss), and income before taxes.

	Wholesale Segment	Retail Segment	Other	Consolidated
THREE MONTHS ENDED JUNE 2015:				
External revenue:				
Cigarettes	$ 239,917,539	$	$	$ 239,917,539
Confectionery	22,520,687			22,520,687
Health food		7,744,518		7,744,518
Tobacco, foodservice & other	64,273,765			64,273,765
Total external revenue	326,711,991	7,744,518		334,456,509
Depreciation	341,432	109,625		451,057
Amortization	91,250			91,250
Operating income (loss)	5,053,788	51,812	(1,554,963)	3,550,637
Interest expense	32,269	49,231	160,766	242,266
Income (loss) from operations before taxes	5,037,641	7,312	(1,715,729)	3,329,224
Total assets	99,443,589	13,292,026	200,634	112,936,249
Capital expenditures	187,605	13,913		201,518
THREE MONTHS ENDED JUNE 2014:				
External revenue:				
Cigarettes	$ 231,814,363	$	$	$ 231,814,363
Confectionery	21,214,377			21,214,377
Health food		8,509,813		8,509,813
Tobacco, foodservice & other	61,109,071			61,109,071
Total external revenue	314,137,811	8,509,813		322,647,624
Depreciation	340,287	125,262	937	466,486
Amortization	91,250			91,250
Operating income (loss)	3,657,657	138,969	(1,354,840)	2,441,786
Interest expense	36,657	51,284	140,886	228,827
Income (loss) from operations before taxes	3,627,311	93,097	(1,469,976)	2,250,432
Total assets	98,799,569	13,602,639	280,846	112,683,054
Capital expenditures	949,732	25,062		974,794

Table of Contents

	Wholesale Segment	Retail Segment	Other	Consolidated
NINE MONTHS ENDED JUNE 2015:				
External revenue:				
Cigarettes	$ 671,006,822	$	$	$ 671,006,822
Confectionery	60,589,226			60,589,226
Health food		23,750,098		23,750,098
Tobacco, foodservice & other	181,987,703			181,987,703
Total external revenue	913,583,751	23,750,098		937,333,849
Depreciation	1,088,027	345,818	1,874	1,435,719
Amortization	273,750			273,750
Operating income (loss)	11,629,871	633,735	(4,287,143)	7,976,463
Interest expense	98,400	145,616	429,767	673,783
Income (loss) from operations before taxes	11,581,352	502,145	(4,716,910)	7,366,587
Total assets	99,443,589	13,292,026	200,634	112,936,249
Capital expenditures	692,394	120,230		812,624
NINE MONTHS ENDED JUNE 2014:				
External revenue:				
Cigarettes	$ 647,770,840	$	$	$ 647,770,840
Confectionery	55,921,920			55,921,920
Health food		26,221,759		26,221,759
Tobacco, foodservice & other	170,780,450			170,780,450
Total external revenue	874,473,210	26,221,759		900,694,969
Depreciation	1,154,830	379,218	2,812	1,536,860
Amortization	273,750			273,750
Operating income (loss)	9,548,781	681,990	(4,085,271)	6,145,500
Interest expense	119,310	168,062	466,074	753,446
Income (loss) from operations before taxes	9,463,125	528,267	(4,492,679)	5,498,713
Total assets	98,799,569	13,602,639	280,846	112,683,054
Capital expenditures	2,242,733	94,893		2,337,626

Table of Contents

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q, including the Management s Discussion and Analysis of Financial Condition and Results of Operations and other sections, contains forward-looking statements that are subject to risks and uncertainties and which reflect management s current beliefs and estimates of future economic circumstances, industry conditions, company performance and financial results. Forward-looking statements include information concerning the possible or assumed future results of operations of the Company and those statements preceded by, followed by or that include the words future, position, anticipate(s), expect, believe(s), see, plan, further improve, outlook, should or si For these statements, we claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995. Forward-looking statements are not guarantees of future performance or results. They involve risks, uncertainties and assumptions.

You should understand that the following important factors, in addition to those discussed elsewhere in this document, could affect the future results of the Company and could cause those results to differ materially from those expressed in our forward-looking statements:

- increasing competition in our wholesale segment,
- increases in state and federal excise taxes on cigarette and tobacco products,
- the increasing demand and sales of electronic cigarettes and vapors through specialty shops and over the internet,
- higher commodity prices which could impact food ingredient costs for many of the products we sell,
- regulation of cigarette and tobacco products by the FDA, in addition to existing state and federal regulations by other agencies,
- potential bans or restrictions imposed by the FDA on the manufacture, distribution, and sale of certain cigarette and tobacco products,

- increases in fuel prices,
- increases in manufacturer prices,
- increases in inventory carrying costs and customer credit risk,
- changes in promotional and incentive programs offered by manufacturers,
- demand for the Company s products, particularly cigarette and tobacco products,
- risks associated with opening new retail stores,
- increasing competition in our retail health food segment,
- the expansion of large and well capitalized national and regional health food retail store chains,
- management periodically reviews market conditions and the demand for various assets that may lead to acquisitions, divestitures, new business ventures, or efforts to expand, each which carry integration and execution risk,
- increasing health care costs and the potential impact on discretionary consumer spending,
- changes in laws and regulations and ongoing compliance with the Patient Protection and Affordable Care Act,
- decreased availability of capital resources,
- domestic regulatory and legislative risks,

16

Table of Contents

- poor weather conditions,
- consolidation trends within the convenience store, wholesale distribution, and retail health food industries,
- natural disasters and domestic unrest,
- other risks over which the Company has little or no control, and any other factors not identified herein

Changes in these factors could result in significantly different results. Consequently, future results may differ from management s expectations. Moreover, past financial performance should not be considered a reliable indicator of future performance. Any forward-looking statement contained herein is made as of the date of this document. Except as required by law, the Company undertakes no obligation to publicly update or correct any of these forward-looking statements in the future to reflect changed assumptions, the occurrence of material events or changes in future operating results, financial conditions or business over time.

CRITICAL ACCOUNTING ESTIMATES

Certain accounting estimates used in the preparation of the Company s financial statements require us to make judgments and estimates and the financial results we report may vary depending on how we make these judgments and estimates. Our critical accounting estimates are set forth in our annual report on Form 10-K for the fiscal year ended September 30, 2014, as filed with the Securities and Exchange Commission. There have been no significant changes with respect to these policies during the nine months ended June 2015.

THIRD FISCAL QUARTER 2015 (Q3 2015)

The following discussion and analysis includes the Company s results of operations for the three and nine months ended June 2015 and June 2014.

Wholesale Segment

Our Wholesale Segment is one of the largest wholesale distributors in the United States serving approximately 4,500 retail outlets including convenience stores, grocery stores, liquor stores, drug stores, and tobacco shops. We currently distribute over 16,000 different consumer products, including cigarettes and tobacco products, candy and other confectionery, beverages, groceries, paper products, health and beauty care products, frozen and chilled products and institutional foodservice products. Convenience stores represent our largest customer category. In September 2014, Convenience Store News ranked us as the sixth (6th) largest convenience store distributor in the United States based on annual sales.

Our wholesale business offers retailers the ability to take advantage of manufacturer and Company sponsored sales and marketing programs, merchandising and product category management services, and the use of information systems and data services that are focused on minimizing retailers investment in inventory, while seeking to maximize their sales and profits. In addition, our wholesale distributing capabilities provide valuable services to both manufacturers of consumer products and convenience retailers. Manufacturers benefit from our broad retail coverage, inventory management, efficiency in processing small orders, and frequency of deliveries. Convenience retailers benefit from our distribution capabilities by gaining access to a broad product line, optimizing inventory, merchandising expertise, information systems, and accessing trade credit.

Our Wholesale Segment operates six distribution centers located in Illinois, Missouri, Nebraska, North Dakota, South Dakota, and Tennessee. These distribution centers, combined with cross dock facilities, include approximately 641,000 square feet of permanent floor space. Our principal suppliers include Altria, RJ Reynolds, Commonwealth Brands, Lorillard, Hershey, Kellogg s, Kraft, and Mars. We also market private label lines of water, candy products, batteries, film, and other products. We do not maintain long-term purchase contracts with our suppliers.

Table of Contents

Retail Segment

Our Retail Segment is a specialty retailer of natural/organic groceries and dietary supplements which focuses on providing high quality products at affordable prices, with an exceptional level of customer service and nutritional consultation. All of the products carried in our stores must meet strict quality and ingredient guidelines, and include offerings such as gluten-free and antibiotic-free groceries and meat products, as well as products containing no artificial colors, flavors, preservatives, or partially hydrogenated oils. We design our retail sites in an efficient and flexible small-store format, which emphasizes a high energy and shopper-friendly environment.

We operate within the natural products retail industry, which is a subset of the large and stable U.S. grocery industry. This industry includes conventional, natural, gourmet and specialty food markets, mass and discount retailers, warehouse clubs, health food stores, dietary supplement retailers, drug stores, farmers markets, mail order and online retailers, and multi-level marketers. According to The Natural Foods Merchandiser, a leading industry trade publication, retail sales in the natural foods industry exceeded $89 billion during the 2013 calendar year.

Our Retail Segment operates sixteen retail health food stores as Chamberlin s Market & Café and Akin s Natural Foods Market. These stores carry over 32,000 different national and regionally branded and private label products including high-quality natural, organic, and specialty foods consisting of produce, baked goods, frozen foods, nutritional supplements, personal care items, and general merchandise. Chamberlin s, which was established in 1935, operates six stores in and around Orlando, Florida. Akin s, which was also established in 1935, has a total of ten locations in Arkansas, Kansas, Missouri, Nebraska, and Oklahoma.

Business Update Wholesale Segment

Competition in the marketplace remains brisk as various other retail sales channels such as drug stores, dollar stores, and quick-service restaurants continue to pursue many of the same customers traditionally serviced by convenience stores. At the distributor level, industry-wide gross margins remain pressured as full service distributors and distributors who merely provide logistics services (i.e. doorstep deliveries) compete for market share. In response to price-only competition, we promote a wide range of customizable solutions and programs which can be tailored to specific customers depending on their size, region, size, and needs.

We are closely watching a number of ongoing trends within the industry: 1) the increasing reliance on technology at both the distributor and convenience store level and 2) the increasing demand for fresh/hot foodservice offerings. It is likely that the capital intensive nature of providing these services will largely fall on distributors and over time may force many smaller distributors from the market, presenting potential consolidation opportunities. For our Company in particular, we continue to make targeted investments in a number of areas including technology applications and the expansion of our temperature controlled trucking fleet.

Over the medium to long term, we remain focused on a number of initiatives to help us further monetize different aspects of our business. Strategic and opportunistic acquisitions will also remain an important part of our long term value creation strategy. As always, managing our business in a low risk fashion remains a top priority.

18

Table of Contents

Business Update Retail Segment

The growing demand for natural products has attracted a wide range of well financed competitors. The operating environment for our retail health food segment is highly competitive as regional and national retailers such as Whole Foods Market, Trader Joe s, Sprouts Farmers Market, Natural Grocers, Vitamin Shoppe, and General Nutrition Center (GNC) have all engaged in aggressive new store expansion strategies, often opening new retail sites in close proximity to our existing stores. Additionally, the purchase of consumer health products over the internet continues to grow and compete with brick and mortar retailers.

Our Midwestern stores in particular have experienced increased competition over the past several years which has impacted both sales and gross profit. We expect this highly competitive environment to persist and potentially increase into the foreseeable future. In light of the heightened competition, our management team has focused on a number of key initiatives. These efforts include merchandising and marketing strategies designed to promote customer retention and attract younger customers who are increasingly embracing natural products. Additionally, our management team remains highly focused on optimizing our expense and unit economic structure for each store based on local conditions.

RESULTS OF OPERATIONS THREE MONTHS ENDED JUNE 2015:

	For the three months ended June			
	2015	2014	Incr (Decr)	% Change
CONSOLIDATED:				
Sales (1)	$ 334,456,509	$ 322,647,624	$ 11,808,885	3.7
Cost of sales	314,957,889	303,353,020	11,604,869	3.8
Gross profit	19,498,620	19,294,604	204,016	1.1
Gross profit percentage	5.8%	6.0%		
Operating expense	15,947,983	16,852,818	(904,835)	(5.4)
Operating income	3,550,637	2,441,786	1,108,851	45.4
Interest expense	242,266	228,827	13,439	5.9
Income tax expense	1,333,000	990,000	343,000	34.6
Net income	1,996,224	1,260,432	735,792	58.4
BUSINESS SEGMENTS:				
Wholesale				
Sales	$ 326,711,991	$ 314,137,811	$ 12,574,180	4.0
Gross profit	16,334,296	15,681,005	653,291	4.2
Gross profit percentage	5.0%	5.0%		
Retail				
Sales	$ 7,744,518	$ 8,509,813	$ (765,295)	(9.0)
Gross profit	3,164,324	3,613,599	(449,275)	(12.4)
Gross profit percentage	40.9%	42.5%		

(1) Sales are reported net of costs associated with incentives provided to retailers. These incentives totaled $5.9 million in Q3 2015 and $5.3 million in Q3 2014.

SALES

Changes in sales are driven by two primary components:

(i) changes to selling prices, which are largely controlled by our product suppliers, and excise taxes imposed on cigarettes and tobacco products by various states; and

(ii) changes in the volume of products sold to our customers, either due to a change in purchasing patterns resulting from consumer preferences or the fluctuation in the comparable number of business days in our reporting period.

Table of Contents

SALES Q3 2015 vs. Q3 2014

Sales in our Wholesale Segment increased $12.6 million during Q3 2015 as compared to Q3 2014. Significant items impacting sales during Q3 2015 included a $2.1 million increase in sales related to the volume and mix of cigarette cartons sold, a $6.0 million increase in sales related to price increases implemented by cigarette manufacturers, and a $4.5 million increase in sales related to higher sales in our tobacco, beverage, snacks, candy, grocery, health & beauty products, automotive, foodservice, and store supplies categories (Other Products). Q3 2015 sales in our Retail Segment decreased $0.8 million as compared to Q3 2014. This change in sales was primarily related to increased competition within the markets we operate.

GROSS PROFIT Q3 2015 vs. Q3 2014

Our gross profit does not include fulfillment costs and costs related to the distribution network which are included in selling, general and administrative costs, and may not be comparable to those of other entities. Some entities may classify such costs as a component of cost of sales. Cost of sales, a component used in determining gross profit, for the wholesale and retail segments includes the cost of products purchased from manufacturers, less incentives we receive which are netted against such costs.

Gross profit in our Wholesale Segment increased $0.7 million in Q3 2015 as compared to Q3 2014, primarily due to higher sales in our Other Products category. Q3 2015 gross profit in our Retail Segment decreased $0.4 million as compared to Q3 2014. This change was primarily related to lower sales volume in our retail stores.

OPERATING EXPENSE Q3 2015 vs. Q3 2014

Operating expense includes selling, general and administrative expenses and depreciation and amortization. Selling, general, and administrative expenses include costs related to our sales, warehouse, delivery and administrative departments for all segments. Specifically, purchasing and receiving costs, warehousing costs and costs of picking and loading customer orders are all classified as selling, general and administrative expenses. Our most significant expenses relate to employee costs, facility and equipment leases, transportation costs, fuel costs, insurance, and professional fees. Our Q3 2015 operating expenses decreased $0.9 million as compared to Q3 2014. Significant items impacting operating costs during the three month period ended June 2015 included a $0.9 million decrease in delivery and health insurance costs in our Wholesale Segment, and a $0.4 million reduction in operating costs in our Retail Segment. These decreases were partially offset by a $0.4 million increase in compensation expense and other operating costs.

RESULTS OF OPERATIONS NINE MONTHS ENDED JUNE 2015:

	For the nine months ended June			
	2015	**2014**	**Incr (Decr)**	**% Change**
CONSOLIDATED:				

Sales (1)	$ 937,333,849	$ 900,694,969	$ 36,638,880	4.1
Cost of sales	880,575,362	844,139,340	36,436,022	4.3
Gross profit	56,758,487	56,555,629	202,858	0.4
Gross profit percentage	6.1%	6.3%		
Operating expenses	48,782,024	50,410,129	(1,628,105)	(3.2)
Operating income	7,976,463	6,145,500	1,830,963	29.8
Interest expense	673,783	753,446	(79,663)	(10.6)
Income tax expense	3,055,000	2,419,000	636,000	26.3
Net income	4,311,587	3,079,713	1,231,874	40.0
BUSINESS SEGMENTS:				
Wholesale				
Sales	$ 913,583,751	$ 874,473,210	$ 39,110,541	4.5
Gross profit	46,794,647	45,293,292	1,501,355	3.3
Gross profit percentage	5.1%	5.2%		
Retail				
Sales	$ 23,750,098	$ 26,221,759	$ (2,471,661)	(9.4)
Gross profit	9,963,840	11,262,337	(1,298,497)	(11.5)
Gross profit percentage	42.0%	43.0%		

(1) Sales are reported net of costs associated with incentives provided to retailers. These incentives totaled $16.2 million for the nine month ended June 2015 and $15.0 million for the nine months ended June 2014.

Table of Contents

SALES Nine months Ended June 2015

Sales in our Wholesale Segment increased $39.1 million for the nine months ended June 2015 as compared to the same prior year period. Significant items impacting sales during the period included a $5.3 million increase in sales primarily related to the volume and mix of cigarette cartons sold, a $17.9 million increase in sales related to price increases implemented by cigarette manufacturers, and a $15.9 million increase in sales related to higher sales in our tobacco, beverage, snacks, candy, grocery, health & beauty products, automotive, foodservice, and store supplies categories (Other Products).

Sales in our Retail Segment for the nine months ended June 2015 decreased $2.5 million as compared to the same prior year period. This change in sales was primarily related to increased competition within the markets we operate.

GROSS PROFIT Nine months Ended June 2015

Our gross profit does not include fulfillment costs and costs related to the distribution network which are included in selling, general and administrative costs, and may not be comparable to those of other entities. Some entities may classify such costs as a component of cost of sales. Cost of sales, a component used in determining gross profit, for the wholesale and retail segments includes the cost of products purchased from manufacturers, less incentives we receive which are netted against such costs.

Gross profit in our Wholesale Segment increased $1.5 million for the nine month period ended June 2015 as compared to the same prior year period. This change was primarily related to an increase in our Other Product category sales and gross profit.

Gross profit in our Retail Segment decreased $1.3 million for the nine month period ended June 2015 as compared to the same prior year period. This change was primarily related to lower sales volume in our retail stores.

OPERATING EXPENSE Nine months Ended June 2015

Operating expense includes selling, general and administrative expenses and depreciation and amortization. Selling, general, and administrative expenses include costs related to our sales, warehouse, delivery and administrative departments for all segments. Specifically, purchasing and receiving costs, warehousing costs and costs of picking and loading customer orders are all classified as selling, general and administrative expenses. Our most significant expenses relate to employee costs, facility and equipment leases, transportation costs, fuel costs, insurance, and professional fees. Operating expenses decreased $1.6 million during the nine months ended June 2015 as compared to the same prior year period. Significant items impacting operating costs during the nine month period ended June 2015 included a $1.8 million decrease in delivery and health insurance costs in our Wholesale Segment, and a $1.3 million reduction in operating costs in our Retail Segment. These decreases were partially offset by a $1.5 million increase in compensation expense and other operating costs.

LIQUIDITY AND CAPITAL RESOURCES

Overview

- General. The Company requires cash to pay operating expenses, purchase inventory, and make capital investments. In general, the Company finances its cash flow requirements with cash generated from operating activities and credit facility borrowings.

- Operating Activities. For the nine months ended June 2015, the Company used cash of approximately $2.6 million for operating activities. Significant uses of cash during the period included an increase in inventory and a decrease in income taxes payable. These uses of cash were partially offset by increases in accounts payable and accrued expenses, a decrease in prepaid and other current assets, and the impact of net earnings.

Our variability in cash flows from operating activities is dependent on the timing of inventory purchases and seasonal fluctuations. For example, periodically we have inventory buy-in opportunities which offer more favorable pricing terms. As a result, we may have to hold inventory for a period longer than the payment terms. This generates a cash outflow from operating activities which we expect to reverse in later periods. Additionally, during the warm weather months which is our peak time of operations, we generally carry higher amounts of inventory to ensure high fill rates and customer satisfaction.

Table of Contents

- Investing Activities. The Company used approximately $0.8 million of cash during the nine month period ended June 2015 for investing activities, primarily related to capital expenditures for property and equipment.

- Financing Activities. The Company used cash of $1.7 million from financing activities during the nine month period ended June 2015. Of this amount, approximately $0.8 million related to net payments on the Company s credit facility, $0.2 million related to long-term debt repayments, $0.5 million related to dividends on the Company s common and preferred stock, and $0.2 million related to equity-based awards.

- Cash on Hand/Working Capital. At June 2015, the Company had cash on hand of $0.1 million and working capital (current assets less current liabilities) of $60.7 million. This compares to cash on hand of $0.1 million and working capital of $55.8 million at September 2014.

Credit Agreement

The Company primarily finances its operations with cash generated from operating activities and through a credit facility provided under an agreement with Bank of America (the Facility). The Facility included the following significant terms at June 2015:

- A July 2018 maturity date without a penalty for prepayment.

- $70.0 million revolving credit limit.

- Loan accordion allowing the Company to increase the size of the credit facility agreement by $25.0 million.

- A provision providing an additional $10.0 million of credit advances for certain inventory purchases.

- Evergreen renewal clause automatically renewing the agreement for one year unless either the borrower or lender provides written notice terminating the agreement at least 90 days prior to the end of any original or renewal term of the agreement.

- The Facility bears interest at either the bank s prime rate, or at LIBOR plus 125 - 175 basis points depending on certain credit facility utilization measures, at the election of the Company.

- Lending limits subject to accounts receivable and inventory limitations.

- An unused commitment fee equal to one-quarter of one percent (1/4%) per annum on the difference between the maximum loan limit and average monthly borrowings.

- Secured by collateral including all of the Company s equipment, intangibles, inventories, and accounts receivable.

- A financial covenant requiring a fixed charge coverage ratio of at least 1.0 as measured by the previous twelve month period then ended only if excess availability falls below 10% of the maximum loan limit as defined in the credit agreement. The Company s availability has not fallen below 10% of the maximum loan limit and the Company s fixed charge coverage ratio is over 1.0.

- Provides that the Company may not pay dividends on its common stock in excess of $1.00 per share on an annual basis. There is, however, no limit on common stock dividends if certain excess availability measurements have been maintained for the thirty day period immediately prior to the payment of any such dividends or distributions and if immediately after giving effect to any such dividend or distribution payments the Company has a fixed charge coverage ratio of at least 1.10 to 1.0 as defined in the credit facility agreement.

The amount available for use on the Facility at any given time is subject to a number of factors including eligible accounts receivable and inventory balances that fluctuate day-to-day. Based on our collateral and loan limits as defined in the Facility agreement, the credit limit of the Facility at June 2015 was $69.6 million, of which $14.3 million was outstanding, leaving $55.3 million available.

At June 2015, the revolving portion of the Company s Facility balance bore interest based on the bank s prime rate and various short-term LIBOR rate elections made by the Company. The average interest rate was 2.27% at June 2015.

For the nine months ended June 2015, our peak borrowings under the Facility were $43.1 million, and our average borrowings and average availability under the Facility were $28.5 million and $39.1 million, respectively. Our availability to borrow under the

Table of Contents

Facility generally decreases as inventory and accounts receivable levels increase because of the borrowing limitations that are placed on collateralized assets.

Cross Default and Co-Terminus Provisions

The Company s owned real estate in Bismarck, ND, Quincy, IL, and Rapid City, SD, is financed through a term loan with BMO Harris, NA (BMO) which is also a participant lender on the Company s revolving line of credit. The BMO loan contains cross default provisions which cause the loan with BMO to be considered in default if the loans where BMO is the lender, including the revolving credit facility, is in default. There were no such cross defaults as of June 2015. In addition, the BMO loan contains co-terminus provisions which require all loans with BMO to be paid in full if any of the loans are paid in full prior to the end of their specified terms.

Dividends Payments

The Company paid cash dividends on its common stock and convertible preferred stock totaling $0.2 million and $0.5 million for the three and nine month periods ended June 2015, respectively, and $0.2 million and $0.5 million for the three and nine month periods ended June 2014, respectively.

Contractual Obligations

There have been no significant changes to the Company s contractual obligations as set forth in the Company s annual report on Form 10-K for the fiscal period ended September 30, 2014.

Other

AMCON has issued a letter of credit in the amount of approximately $0.4 million to its workers compensation insurance carrier as part of its self-insured loss control program.

Off-Balance Sheet Arrangements

The Company does not have any off-balance sheet arrangements.

Liquidity Risk

The Company s liquidity position is significantly influenced by its ability to maintain sufficient levels of working capital. For our Company and industry in general, customer credit risk and ongoing access to bank credit heavily influence liquidity positions.

The Company does not currently hedge its exposure to interest rate risk or fuel costs. Accordingly, significant price movements in these areas can and do impact the Company s profitability.

While the Company believes its liquidity position going forward will be adequate to sustain operations. However, a precipitous change in operating environment could materially impact the Company s future revenue stream as well as its ability to collect on customer accounts receivable or secure bank credit.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Not applicable.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed in company reports filed or submitted under the Securities Exchange Act of 1934 (the Exchange Act) is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in company reports filed or submitted under the Exchange Act is accumulated and communicated to management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

As required by Rules 13a-15(b) and 15d-15(b) under the Exchange Act, an evaluation of the effectiveness of our disclosure controls and procedures as of June 30, 2015 was made under the supervision and with the participation of our senior management, including our principal executive officer and principal financial officer. Based upon that evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report.

Limitations on Effectiveness of Controls

Our management, including our Chief Executive Officer and Chief Financial Officer, do not expect that our disclosure controls and procedures will prevent all errors and fraud. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable, not absolute, assurance of achieving the desired control objectives. Further, the design of a control system must reflect the fact that there are resource constraints, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management s override of the control.

The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control that occurred during the fiscal quarter ended June 30, 2015, that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION

Item 1. Legal Proceedings

None.

Item 1A. Risk Factors

There have been no material changes to the Company s risk factors as previously disclosed in Item 1A Risk Factors of the Company s annual report on Form 10-K for the fiscal year ended September 30, 2014.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

No shares of our common stock were purchased by or on behalf of our Company during the quarterly period ended June 30, 2015.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosures

Not applicable.

Table of Contents

Item 5. Other Information

Not applicable.

Item 6. Exhibits

(a) Exhibits

31.1 Certification by Christopher H. Atayan, Chief Executive Officer and Chairman, furnished pursuant to section 302 of the Sarbanes-Oxley Act

31.2 Certification by Andrew C. Plummer, Vice President, Chief Financial Officer, and Principal Financial Officer furnished pursuant to section 302 of the Sarbanes-Oxley Act

32.1 Certification by Christopher H. Atayan, Chief Executive Officer and Chairman, furnished pursuant to section 906 of the Sarbanes-Oxley Act

32.2 Certification by Andrew C. Plummer, Vice President, Chief Financial Officer, and Principal Financial Officer furnished pursuant to section 906 of the Sarbanes-Oxley Act

101 Interactive Data File (filed herewithin electronically)

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

	AMCON DISTRIBUTING COMPANY (registrant)
Date: July 17, 2015	/s/ Christopher H. Atayan Christopher H. Atayan, Chief Executive Officer and Chairman
Date: July 17, 2015	/s/ Andrew C. Plummer Andrew C. Plummer, Vice President, Chief Financial Officer (Principal Financial and Accounting Officer)

RGIN-LEFT: 0px; TEXT-INDENT: 0px; MARGIN-RIGHT: 0px; FONT-FAMILY: Times New Roman">(21,988
)
$

1,056,017

FIN 48 Adoption, Net of Tax

(3,022
)

(3,022
)
Common Stock Dividends

(20,000
)

(20,000
)
Capital Stock Expense

39

(39
)

-

TOTAL

1,032,995

COMPREHENSIVE INCOME

Other Comprehensive Loss, Net of Taxes:

Cash Flow Hedges, Net of Tax of $2,841

(5,276
)

(5,276
)

NET INCOME

46,981

46,981

TOTAL COMPREHENSIVE INCOME

41,705

MARCH 31, 2007

$
41,026

$
580,231

$
480,707

$
(27,264
)

$
1,074,700

See Condensed Notes to Condensed Financial Statements of Registrant Subsidiaries.

COLUMBUS SOUTHERN POWER COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
ASSETS
March 31, 2007 and December 31, 2006
(in thousands)
(Unaudited)

	2007	2006
CURRENT ASSETS		
Cash and Cash Equivalents	$ 237	$ 1,319
Advances to Affiliates	922	-
Accounts Receivable:		
Customers	59,380	49,362
Affiliated Companies	35,351	62,866
Accrued Unbilled Revenues	8,011	11,042
Miscellaneous	5,626	4,895
Allowance for Uncollectible Accounts	(588)	(546)
Total Accounts Receivable	107,780	127,619
Fuel	31,320	37,348
Materials and Supplies	34,575	31,765
Emission Allowances	8,971	3,493
Risk Management Assets	36,969	66,238
Accrued Tax Benefits	-	4,763
Prepayments and Other	11,734	16,107
TOTAL	232,508	288,652
PROPERTY, PLANT AND EQUIPMENT		
Electric:		
Production	1,954,377	1,896,073
Transmission	481,875	479,119
Distribution	1,496,080	1,475,758
Other	190,645	191,103
Construction Work in Progress	269,771	294,138
Total	4,392,748	4,336,191
Accumulated Depreciation and Amortization	1,629,386	1,611,043
TOTAL - NET	2,763,362	2,725,148
OTHER NONCURRENT ASSETS		
Regulatory Assets	277,251	298,304
Long-term Risk Management Assets	46,978	56,206
Deferred Charges and Other	131,818	152,379
TOTAL	456,047	506,889
TOTAL ASSETS	$ 3,451,917	$ 3,520,689

See Condensed Notes to Condensed Financial Statements of Registrant Subsidiaries.

COLUMBUS SOUTHERN POWER COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
LIABILITIES AND SHAREHOLDER'S EQUITY
March 31, 2007 and December 31, 2006
(Unaudited)

	2007	2006
CURRENT LIABILITIES	(in thousands)	
Advances from Affiliates	$ -	$ 696
Accounts Payable:		
General	97,767	112,431
Affiliated Companies	51,552	59,538
Long-term Debt Due Within One Year - Nonaffiliated	52,000	-
Risk Management Liabilities	31,365	49,285
Customer Deposits	37,563	34,991
Accrued Taxes	144,223	166,551
Accrued Interest	17,698	20,868
Other	34,767	37,143
TOTAL	466,935	481,503
NONCURRENT LIABILITIES		
Long-term Debt - Nonaffiliated	1,045,422	1,097,322
Long-term Debt - Affiliated	100,000	100,000
Long-term Risk Management Liabilities	32,396	40,477
Deferred Income Taxes	462,516	475,888
Regulatory Liabilities and Deferred Investment Tax Credits	168,597	179,048
Deferred Credits and Other	101,351	90,434
TOTAL	1,910,282	1,983,169
TOTAL LIABILITIES	2,377,217	2,464,672
Commitments and Contingencies (Note 4)		
COMMON SHAREHOLDER'S EQUITY		
Common Stock - No Par Value:		
Authorized - 24,000,000 Shares		
Outstanding - 16,410,426 Shares	41,026	41,026
Paid-in Capital	580,231	580,192
Retained Earnings	480,707	456,787
Accumulated Other Comprehensive Income (Loss)	(27,264)	(21,988)
TOTAL	1,074,700	1,056,017
TOTAL LIABILITIES AND SHAREHOLDER'S EQUITY	$ 3,451,917	$ 3,520,689

See Condensed Notes to Condensed Financial Statements of Registrant Subsidiaries.

COLUMBUS SOUTHERN POWER COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Three Months Ended March 31, 2007 and 2006
(in thousands)
(Unaudited)

	2007	2006
OPERATING ACTIVITIES		
Net Income	$ 46,981	$ 51,337
Adjustments for Noncash Items:		
Depreciation and Amortization	50,297	45,828
Deferred Income Taxes	(716)	3,816
Carrying Costs Income	(1,092)	(716)
Mark-to-Market of Risk Management Contracts	4,400	(3,624)
Deferred Property Taxes	18,954	10,884
Change in Other Noncurrent Assets	(912)	(11,325)
Change in Other Noncurrent Liabilities	(15,510)	5,800
Changes in Certain Components of Working Capital:		
Accounts Receivable, Net	19,839	33,295
Fuel, Materials and Supplies	3,218	(7,431)
Accounts Payable	(7,659)	12,540
Customer Deposits	2,572	(7,901)
Accrued Taxes, Net	(8,651)	(7,873)
Accrued Interest	(5,658)	(4,127)
Other Current Assets	5,694	(728)
Other Current Liabilities	(5,056)	(6,571)
Net Cash Flows From Operating Activities	106,701	113,204
INVESTING ACTIVITIES		
Construction Expenditures	(85,641)	(65,032)
Change in Other Cash Deposits, Net	(20)	(1,151)
Change in Advances to Affiliates, Net	(922)	(6,867)
Proceeds from Sale of Assets	189	531
Net Cash Flows Used For Investing Activities	(86,394)	(72,519)
FINANCING ACTIVITIES		
Change in Advances from Affiliates, Net	(696)	(17,609)
Principal Payments for Capital Lease Obligations	(693)	(759)
Dividends Paid on Common Stock	(20,000)	(22,500)
Net Cash Flows Used For Financing Activities	(21,389)	(40,868)
Net Decrease in Cash and Cash Equivalents	(1,082)	(183)
Cash and Cash Equivalents at Beginning of Period	1,319	940
Cash and Cash Equivalents at End of Period	$ 237	$ 757
SUPPLEMENTARY INFORMATION		
Cash Paid for Interest, Net of Capitalized Amounts	$ 20,132	$ 22,320
Net Cash Paid (Received) for Income Taxes	(2,907)	2,533
Noncash Acquisitions Under Capital Leases	275	1,102
Construction Expenditures Included in Accounts Payable at March 31,	20,636	12,054

See Condensed Notes to Condensed Financial Statements of Registrant Subsidiaries.

COLUMBUS SOUTHERN POWER COMPANY AND SUBSIDIARIES
INDEX TO CONDENSED NOTES TO CONDENSED FINANCIAL STATEMENTS OF REGISTRANT SUBSIDIARIES

The condensed notes to CSPCo's condensed consolidated financial statements are combined with the condensed notes to condensed financial statements for other registrant subsidiaries. Listed below are the notes that apply to CSPCo.

INDIANA MICHIGAN POWER COMPANY
AND SUBSIDIARIES

INDIANA MICHIGAN POWER COMPANY AND SUBSIDIARIES
MANAGEMENT'S NARRATIVE FINANCIAL DISCUSSION AND ANALYSIS

Results of Operations

First Quarter of 2007 Compared to First Quarter of 2006

Reconciliation of First Quarter of 2006 to First Quarter of 2007
Net Income
(in millions)

First Quarter of 2006		$	58
Changes in Gross Margin:			
Retail Margins	(24)		
FERC Municipals and Cooperatives	9		
Off-system Sales	(4)		
Transmission Revenues	(2)		
Other	(7)		
Total Change in Gross Margin			(28)
Changes in Operating Expenses and Other:			
Other Operation and Maintenance	(6)		
Depreciation and Amortization	(7)		
Other Income	(1)		
Interest Expense	(2)		
Total Change in Operating Expenses and Other			(16)
Income Tax Expense			15
First Quarter of 2007		$	29

Net Income decreased $29 million to $29 million in 2007. The key driver of the decrease was a $28 million decrease in Gross Margin.

The major components of our decrease in Gross Margin, defined as revenues less the related direct cost of fuel, including consumption of chemicals and emissions allowances, and purchased power were as follows:

- Retail Margins decreased $24 million primarily due to a reduction in capacity settlement revenues of $23 million under the Interconnection Agreement reflecting our new peak demand in July 2006.
- FERC Municipals and Cooperatives margins increased $9 million due to the addition of new municipal contracts including new rates and increased demand effective July 2006 and January 2007.
- Margins from Off-system Sales decreased $4 million primarily due to an $11 million decrease in physical sales margins partially offset by a $6 million increase in margins from optimization activities.
-

Transmission Revenues decreased $2 million primarily due to the elimination of SECA revenues as of April 1, 2006. See the "Transmission Rate Proceedings at the FERC" section of Note 3.

- Other revenues decreased $7 million primarily due to decreased River Transportation Division (RTD) revenues for barging coal and decreased gains on sales of emission allowances. RTD related expenses which offset the RTD revenue decrease are included in Other Operation on the Condensed Consolidated Statements of Income resulting in our earning only a return approved under regulatory order.

Operating Expenses and Other changed between years as follows:

- Other Operation and Maintenance expenses increased $6 million primarily due to a $5 million increase in transmission expense due to our reduced credits under the Transmission Equalization Agreement. Our credits decreased due to our July 2006 peak and due to APCo's addition of the Wyoming-Jacksons Ferry 765 kV line, which was energized and placed in service in June 2006 thus decreasing our share of the transmission investment pool.
- Depreciation and Amortization expense increased $7 million primarily due to a $5 million increase in depreciation related to capital additions and a $2 million increase in amortization related to capitalized software development costs.
- Interest Expense increased $2 million primarily due to an increase in outstanding long-term debt and higher interest rates.

Income Taxes

Income Tax Expense decreased $15 million primarily due to a decrease in pretax book income.

Critical Accounting Estimates

See the "Critical Accounting Estimates" section of "Combined Management's Discussion and Analysis of Registrant Subsidiaries" in our 2006 Annual Report for a discussion of the estimates and judgments required for regulatory accounting, revenue recognition, the valuation of long-lived assets, pension and other postretirement benefits and the impact of new accounting pronouncements.

Adoption of New Accounting Pronouncements

See the "Combined Management's Discussion and Analysis of Registrant Subsidiaries" section for a discussion of adoption of new accounting pronouncements.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT RISK MANAGEMENT ACTIVITIES

Market Risks

Our risk management assets and liabilities are managed by AEPSC as agent for us. The related risk management policies and procedures are instituted and administered by AEPSC. See the complete discussion and analysis within AEP's "Quantitative and Qualitative Disclosures About Risk Management Activities" section for disclosures about risk management activities.

VaR Associated with Debt Outstanding

We utilize a VaR model to measure interest rate market risk exposure. The interest rate VaR model is based on a Monte Carlo simulation with a 95% confidence level and a one-year holding period. The risk of potential loss in fair value attributable to our exposure to interest rates primarily related to long-term debt with fixed interest rates was $108 million and $93 million at March 31, 2007 and December 31, 2006, respectively. We would not expect to liquidate our entire debt portfolio in a one-year holding period; therefore, a near term change in interest rates should not negatively affect our results of operations or consolidated financial position.

INDIANA MICHIGAN POWER COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
For the Three Months Ended March 31, 2007 and 2006
(in thousands)
(Unaudited)

		2007		2006
REVENUES				
Electric Generation, Transmission and Distribution	$	405,164	$	403,769
Sales to AEP Affiliates		67,429		88,534
Other - Affiliated		12,667		15,094
Other - Nonaffiliated		7,609		8,382
TOTAL		492,869		515,779
EXPENSES				
Fuel and Other Consumables Used for Electric Generation		96,117		89,452
Purchased Electricity for Resale		17,940		11,010
Purchased Electricity from AEP Affiliates		77,513		86,422
Other Operation		120,733		111,617
Maintenance		42,430		45,219
Depreciation and Amortization		56,307		49,715
Taxes Other Than Income Taxes		17,994		18,906
TOTAL		429,034		412,341
OPERATING INCOME		63,835		103,438
Other Income (Expense):				
Interest Income		588		694
Allowance for Equity Funds Used During Construction		265		1,924
Interest Expense		(19,821)		(17,533)
INCOME BEFORE INCOME TAXES		44,867		88,523
Income Tax Expense		15,404		30,645
NET INCOME		29,463		57,878
Preferred Stock Dividend Requirements		85		85
EARNINGS APPLICABLE TO COMMON STOCK	$	29,378	$	57,793

The common stock of I&M is wholly-owned by AEP.

See Condensed Notes to Condensed Financial Statements of Registrant Subsidiaries.

INDIANA MICHIGAN POWER COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN COMMON SHAREHOLDER'S EQUITY AND COMPREHENSIVE INCOME (LOSS)
For the Three Months Ended March 31, 2007 and 2006
(in thousands)
(Unaudited)

	Common Stock	Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
DECEMBER 31, 2005	$ 56,584	$ 861,290	$ 305,787	$ (3,569)	$ 1,220,092
Common Stock Dividends			(10,000)		(10,000)
Preferred Stock Dividends			(85)		(85)
TOTAL					1,210,007
COMPREHENSIVE INCOME					
Other Comprehensive Income, Net of Taxes:					
Cash Flow Hedges, Net of Tax of $2,265				4,207	4,207
NET INCOME			57,878		57,878
TOTAL COMPREHENSIVE INCOME					62,085
MARCH 31, 2006	$ 56,584	$ 861,290	$ 353,580	$ 638	$ 1,272,092
DECEMBER 31, 2006	$ 56,584	$ 861,290	$ 386,616	$ (15,051)	$ 1,289,439
FIN 48 Adoption, Net of Tax			327		327
Common Stock Dividends			(10,000)		(10,000)
Preferred Stock Dividends			(85)		(85)
TOTAL					1,279,681
COMPREHENSIVE INCOME					
Other Comprehensive Loss, Net of Taxes:					
Cash Flow Hedges, Net of Tax of $2,850				(5,293)	(5,293)
NET INCOME			29,463		29,463
TOTAL COMPREHENSIVE INCOME					24,170
MARCH 31, 2007	$ 56,584	$ 861,290	$ 406,321	$ (20,344)	$ 1,303,851

See Condensed Notes to Condensed Financial Statements of Registrant Subsidiaries.

INDIANA MICHIGAN POWER COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
ASSETS
March 31, 2007 and December 31, 2006
(in thousands)
(Unaudited)

	2007	2006
CURRENT ASSETS		
Cash and Cash Equivalents	$ 753	$ 1,369
Accounts Receivable:		
Customers	86,128	82,102
Affiliated Companies	66,155	108,288
Accrued Unbilled Revenues	806	2,206
Miscellaneous	2,571	1,838
Allowance for Uncollectible Accounts	(616)	(601)
Total Accounts Receivable	155,044	193,833
Fuel	47,818	64,669
Materials and Supplies	136,373	129,953
Risk Management Assets	39,175	69,752
Accrued Tax Benefits	8,680	27,378
Prepayments and Other	13,500	15,170
TOTAL	401,343	502,124
PROPERTY, PLANT AND EQUIPMENT		
Electric:		
Production	3,383,343	3,363,813
Transmission	1,052,730	1,047,264
Distribution	1,143,815	1,102,033
Other (including nuclear fuel and coal mining)	516,972	529,727
Construction Work in Progress	144,856	183,893
Total	6,241,716	6,226,730
Accumulated Depreciation, Depletion and Amortization	2,949,796	2,914,131
TOTAL - NET	3,291,920	3,312,599
OTHER NONCURRENT ASSETS		
Regulatory Assets	292,704	314,805
Spent Nuclear Fuel and Decommissioning Trusts	1,262,960	1,248,319
Long-term Risk Management Assets	49,470	59,137
Deferred Charges and Other	117,384	109,453
TOTAL	1,722,518	1,731,714
TOTAL ASSETS	$ 5,415,781	$ 5,546,437

See Condensed Notes to Condensed Financial Statements of Registrant Subsidiaries.

INDIANA MICHIGAN POWER COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
LIABILITIES AND SHAREHOLDERS' EQUITY
March 31, 2007 and December 31, 2006
(Unaudited)

	2007	2006
CURRENT LIABILITIES	(in thousands)	
Advances from Affiliates	$ 45,759	$ 91,173
Accounts Payable:		
General	99,223	146,733
Affiliated Companies	57,940	65,497
Long-term Debt Due Within One Year - Nonaffiliated	50,000	50,000
Risk Management Liabilities	33,643	52,083
Customer Deposits	31,436	34,946
Accrued Taxes	76,087	59,652
Other	115,714	128,461
TOTAL	509,802	628,545
NONCURRENT LIABILITIES		
Long-term Debt - Nonaffiliated	1,508,695	1,505,135
Long-term Risk Management Liabilities	34,243	42,641
Deferred Income Taxes	311,584	335,000
Regulatory Liabilities and Deferred Investment Tax Credits	739,972	753,402
Asset Retirement Obligations	820,371	809,853
Deferred Credits and Other	179,181	174,340
TOTAL	3,594,046	3,620,371
TOTAL LIABILITIES	4,103,848	4,248,916
Cumulative Preferred Stock Not Subject to Mandatory Redemption	8,082	8,082
Commitments and Contingencies (Note 4)		
COMMON SHAREHOLDER'S EQUITY		
Common Stock - No Par Value:		
Authorized - 2,500,000 Shares		
Outstanding - 1,400,000 Shares	56,584	56,584
Paid-in Capital	861,290	861,290
Retained Earnings	406,321	386,616
Accumulated Other Comprehensive Income (Loss)	(20,344)	(15,051)
TOTAL	1,303,851	1,289,439
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 5,415,781	$ 5,546,437

See Condensed Notes to Condensed Financial Statements of Registrant Subsidiaries.

INDIANA MICHIGAN POWER COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Three Months Ended March 31, 2007 and 2006
(in thousands)
(Unaudited)

	2007	2006
OPERATING ACTIVITIES		
Net Income	$ 29,463	$ 57,878
Adjustments for Noncash Items:		
Depreciation and Amortization	56,307	49,715
Deferred Income Taxes	(3,638)	3,493
Amortization (Deferral) of Incremental Nuclear Refueling Outage Expenses, Net	12,191	(1,639)
Amortization of Nuclear Fuel	16,372	13,596
Mark-to-Market of Risk Management Contracts	4,897	(4,060)
Deferred Property Taxes	(10,836)	(9,839)
Change in Other Noncurrent Assets	5,729	4,381
Change in Other Noncurrent Liabilities	(1,971)	18,839
Changes in Certain Components of Working Capital:		
Accounts Receivable, Net	38,789	43,019
Fuel, Materials and Supplies	14,985	(7,194)
Accounts Payable	(38,233)	(7,010)
Customer Deposits	(3,510)	(8,031)
Accrued Taxes, Net	39,525	42,871
Accrued Rent - Rockport Plant Unit 2	18,464	18,464
Other Current Assets	1,959	428
Other Current Liabilities	(35,720)	(20,797)
Net Cash Flows From Operating Activities	144,773	194,114
INVESTING ACTIVITIES		
Construction Expenditures	(62,252)	(89,411)
Purchases of Investment Securities	(204,874)	(150,239)
Sales of Investment Securities	183,927	134,258
Acquisitions of Nuclear Fuel	(5,366)	(34,427)
Proceeds from Sales of Assets and Other	248	1,384
Net Cash Flows Used For Investing Activities	(88,317)	(138,435)
FINANCING ACTIVITIES		
Change in Advances from Affiliates, Net	(45,414)	(44,565)
Principal Payments for Capital Lease Obligations	(1,573)	(1,274)
Dividends Paid on Common Stock	(10,000)	(10,000)
Dividends Paid on Cumulative Preferred Stock	(85)	(85)
Net Cash Flows Used For Financing Activities	(57,072)	(55,924)
Net Decrease in Cash and Cash Equivalents	(616)	(245)
Cash and Cash Equivalents at Beginning of Period	1,369	854
Cash and Cash Equivalents at End of Period	$ 753	$ 609
SUPPLEMENTARY INFORMATION		
Cash Paid for Interest, Net of Capitalized Amounts	$ 15,048	$ 4,776

Net Cash Paid (Received) for Income Taxes	(2,768)	1,324
Noncash Acquisitions Under Capital Leases	369	2,218
Construction Expenditures Included in Accounts Payable at March 31,	20,243	27,624

See Condensed Notes to Condensed Financial Statements of Registrant Subsidiaries.

INDIANA MICHIGAN POWER COMPANY AND SUBSIDIARIES
INDEX TO CONDENSED NOTES TO CONDENSED FINANCIAL STATEMENTS OF REGISTRANT SUBSIDIARIES

The condensed notes to I&M's condensed consolidated financial statements are combined with the condensed notes to condensed financial statements for other registrant subsidiaries. Listed below are the notes that apply to I&M.

KENTUCKY POWER COMPANY

KENTUCKY POWER COMPANY
MANAGEMENT'S NARRATIVE FINANCIAL DISCUSSION AND ANALYSIS

Results of Operations

First Quarter of 2007 Compared to First Quarter of 2006

Reconciliation of First Quarter of 2006 to First Quarter of 2007
Net Income
(in millions)

First Quarter of 2006		$	10
Changes in Gross Margin:			
Retail Margins	17		
Off-system Sales	(2)		
Transmission Revenues	(3)		
Other	(1)		
Total Change in Gross Margin			11
Other Operation and Maintenance			(3)
Income Tax Expense			(3)
First Quarter of 2007		$	15

Net Income increased $5 million to $15 million in 2007. The key driver of the increase was an $11 million increase in Gross Margin, offset by an increase in Other Operation and Maintenance expenses of $3 million and an increase in Income Tax Expense of $3 million.

The major components of our change in Gross Margin, defined as revenues less the related direct cost of fuel, including consumption of chemicals and emissions allowances, and purchased power were as follows:

- Retail Margins increased $17 million primarily due to rate relief of $14 million from the March 2006 approval of the settlement agreement in our base rate case.
- Transmission Revenues decreased $3 million primarily due to the elimination of SECA revenues as of April 1, 2006. See the "Transmission Rate Proceedings at the FERC" section of Note 3.

Other Operation and Maintenance

Other Operation and Maintenance expenses increased $3 million primarily due to an increase in our net allocated transmission costs related to the Transmission Equalization Agreement as a result of the addition of APCo's Wyoming-Jacksons Ferry 765 kV line which was energized and placed into service in June 2006. Other Operation and Maintenance expenses also increased as a result of increased forced outages at the Big Sandy Plant.

Income Taxes

Income Tax Expense increased $3 million primarily due to an increase in pretax book income.

Critical Accounting Estimates

See the “Critical Accounting Estimates” section of “Combined Management’s Discussion and Analysis of Registrant Subsidiaries” in our 2006 Annual Report for a discussion of the estimates and judgments required for regulatory accounting, revenue recognition, the valuation of long-lived assets, pension and other postretirement benefits and the impact of new accounting pronouncements.

Adoption of New Accounting Pronouncements

See the “Combined Management’s Discussion and Analysis of Registrant Subsidiaries” section for a discussion of adoption of new accounting pronouncements.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT RISK MANAGEMENT ACTIVITIES

Market Risks

Our risk management assets and liabilities are managed by AEPSC as agent for us. The related risk management policies and procedures are instituted and administered by AEPSC. See the complete discussion and analysis within AEP's "Quantitative and Qualitative Disclosures About Risk Management Activities" section for disclosures about risk management activities.

VaR Associated with Debt Outstanding

We utilize a VaR model to measure interest rate market risk exposure. The interest rate VaR model is based on a Monte Carlo simulation with a 95% confidence level and a one-year holding period. The risk of potential loss in fair value attributable to our exposure to interest rates primarily related to long-term debt with fixed interest rates was $19 million and $13 million at March 31, 2007 and December 31, 2006, respectively. We would not expect to liquidate our entire debt portfolio in a one-year holding period; therefore, a near term change in interest rates should not negatively affect our results of operations or financial position.

KENTUCKY POWER COMPANY
CONDENSED STATEMENTS OF INCOME
For the Three Months Ended March 31, 2007 and 2006
(in thousands)
(Unaudited)

	2007	2006
REVENUES		
Electric Generation, Transmission and Distribution	$ 140,486	$ 137,620
Sales to AEP Affiliates	13,461	13,968
Other	149	259
TOTAL	154,096	151,847
EXPENSES		
Fuel and Other Consumables Used for Electric Generation	38,304	43,966
Purchased Electricity for Resale	3,305	973
Purchased Electricity from AEP Affiliates	43,257	49,526
Other Operation	15,886	13,726
Maintenance	8,210	7,141
Depreciation and Amortization	11,796	11,479
Taxes Other Than Income Taxes	2,803	2,512
TOTAL	123,561	129,323
OPERATING INCOME	30,535	22,524
Other Income (Expense):		
Interest Income	112	166
Allowance for Equity Funds Used During Construction	14	101
Interest Expense	(7,011)	(7,296)
INCOME BEFORE INCOME TAXES	23,650	15,495
Income Tax Expense	8,439	5,665
NET INCOME	$ 15,211	$ 9,830

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

See Condensed Notes to Condensed Financial Statements of Registrant Subsidiaries.

KENTUCKY POWER COMPANY
CONDENSED STATEMENTS OF CHANGES IN COMMON SHAREHOLDER'S EQUITY AND COMPREHENSIVE INCOME (LOSS)
For the Three Months Ended March 31, 2007 and 2006
(in thousands)
(Unaudited)

	Common Stock	Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
DECEMBER 31, 2005	$ 50,450	$ 208,750	$ 88,864	$ (223)	$ 347,841
Common Stock Dividends			(2,500)		(2,500)
TOTAL					345,341
COMPREHENSIVE INCOME					
Other Comprehensive Income, Net of Taxes:					
Cash Flow Hedges, Net of Tax of $873				1,621	1,621
NET INCOME			9,830		9,830
TOTAL COMPREHENSIVE INCOME					11,451
MARCH 31, 2006	$ 50,450	$ 208,750	$ 96,194	$ 1,398	$ 356,792
DECEMBER 31, 2006	$ 50,450	$ 208,750	$ 108,899	$ 1,552	$ 369,651
FIN 48 Adoption, Net of Tax			(786)		(786)
Common Stock Dividends			(5,000)		(5,000)
TOTAL					363,865
COMPREHENSIVE INCOME					
Other Comprehensive Loss, Net of Taxes:					
Cash Flow Hedges, Net of Tax of $1,100				(2,042)	(2,042)
NET INCOME			15,211		15,211
TOTAL COMPREHENSIVE INCOME					13,169
MARCH 31, 2007	$ 50,450	$ 208,750	$ 118,324	$ (490)	$ 377,034

See Condensed Notes to Condensed Financial Statements of Registrant Subsidiaries.

KENTUCKY POWER COMPANY
CONDENSED BALANCE SHEETS
ASSETS
March 31, 2007 and December 31, 2006
(in thousands)
(Unaudited)

		2007		2006
CURRENT ASSETS				
Cash and Cash Equivalents	$	775	$	702
Accounts Receivable:				
Customers		30,027		30,112
Affiliated Companies		9,142		10,540
Accrued Unbilled Revenues		6,093		3,602
Miscellaneous		684		327
Allowance for Uncollectible Accounts		(242)		(227)
Total Accounts Receivable		45,704		44,354
Fuel		12,852		16,070
Materials and Supplies		10,277		8,726
Risk Management Assets		16,110		25,624
Accrued Tax Benefits		-		1,021
Margin Deposits		1,458		2,923
Prepayments and Other		2,637		2,425
TOTAL		89,813		101,845
PROPERTY, PLANT AND EQUIPMENT				
Electric:				
Production		480,501		478,955
Transmission		395,646		394,419
Distribution		480,690		481,083
Other		60,047		61,089
Construction Work in Progress		27,705		29,587
Total		1,444,589		1,445,133
Accumulated Depreciation and Amortization		441,565		442,778
TOTAL - NET		1,003,024		1,002,355
OTHER NONCURRENT ASSETS				
Regulatory Assets		135,241		136,139
Long-term Risk Management Assets		19,313		21,282
Deferred Charges and Other		46,953		48,944
TOTAL		201,507		206,365
TOTAL ASSETS	$	1,294,344	$	1,310,565

See Condensed Notes to Condensed Financial Statements of Registrant Subsidiaries.

KENTUCKY POWER COMPANY
CONDENSED BALANCE SHEETS
LIABILITIES AND SHAREHOLDER'S EQUITY
March 31, 2007 and December 31, 2006
(Unaudited)

	2007	2006
CURRENT LIABILITIES	(in thousands)	
Advances from Affiliates	$ 20,769	$ 30,636
Accounts Payable:		
General	33,876	31,490
Affiliated Companies	17,615	23,658
Long-term Debt Due Within One Year - Nonaffiliated	322,554	322,048
Risk Management Liabilities	14,167	20,001
Customer Deposits	15,273	16,095
Accrued Taxes	18,933	18,775
Other	22,759	26,303
TOTAL	465,946	489,006
NONCURRENT LIABILITIES		
Long-term Debt - Nonaffiliated	104,944	104,920
Long-term Debt - Affiliated	20,000	20,000
Long-term Risk Management Liabilities	13,464	15,426
Deferred Income Taxes	239,776	242,133
Regulatory Liabilities and Deferred Investment Tax Credits	47,426	49,109
Deferred Credits and Other	25,754	20,320
TOTAL	451,364	451,908
TOTAL LIABILITIES	917,310	940,914
Commitments and Contingencies (Note 4)		
COMMON SHAREHOLDER'S EQUITY		
Common Stock - $50 Par Value Per Share:		
Authorized - 2,000,000 Shares		
Outstanding - 1,009,000 Shares	50,450	50,450
Paid-in Capital	208,750	208,750
Retained Earnings	118,324	108,899
Accumulated Other Comprehensive Income (Loss)	(490)	1,552
TOTAL	377,034	369,651
TOTAL LIABILITIES AND SHAREHOLDER'S EQUITY	$ 1,294,344	$ 1,310,565

See Condensed Notes to Condensed Financial Statements of Registrant Subsidiaries.

KENTUCKY POWER COMPANY
CONDENSED STATEMENTS OF CASH FLOWS
For the Three Months Ended March 31, 2007 and 2006
(in thousands)
(Unaudited)

		2007		2006
OPERATING ACTIVITIES				
Net Income	$	15,211	$	9,830
Adjustments for Noncash Items:				
Depreciation and Amortization		11,796		11,479
Deferred Income Taxes		956		2,217
Mark-to-Market of Risk Management Contracts		1,092		(1,378)
Change in Other Noncurrent Assets		980		2,518
Change in Other Noncurrent Liabilities		(78)		1,845
Changes in Certain Components of Working Capital:				
Accounts Receivable, Net		(1,350)		16,149
Fuel, Materials and Supplies		3,609		(2,808)
Accounts Payable		(2,557)		(6,212)
Customer Deposits		(822)		(3,127)
Accrued Taxes, Net		1,447		2,676
Other Current Assets		1,012		2,069
Other Current Liabilities		(3,348)		(1,480)
Net Cash Flows From Operating Activities		27,948		33,778
INVESTING ACTIVITIES				
Construction Expenditures		(13,001)		(19,376)
Change in Advances to Affiliates, Net		-		(5,923)
Proceeds from Sale of Assets		231		301
Net Cash Flows Used For Investing Activities		(12,770)		(24,998)
FINANCING ACTIVITIES				
Change in Advances from Affiliates, Net		(9,867)		(6,040)
Principal Payments for Capital Lease Obligations		(238)		(343)
Dividends Paid on Common Stock		(5,000)		(2,500)
Net Cash Flows Used For Financing Activities		(15,105)		(8,883)
Net Increase (Decrease) in Cash and Cash Equivalents		73		(103)
Cash and Cash Equivalents at Beginning of Period		702		526
Cash and Cash Equivalents at End of Period	$	775	$	423
SUPPLEMENTARY INFORMATION				
Cash Paid for Interest, Net of Capitalized Amounts	$	5,371	$	4,156
Net Cash Paid for Income Taxes		738		214
Noncash Acquisitions Under Capital Leases		139		224
Construction Expenditures Included in Accounts Payable at March 31,		2,257		3,079

See Condensed Notes to Condensed Financial Statements of Registrant Subsidiaries.

KENTUCKY POWER COMPANY
INDEX TO CONDENSED NOTES TO CONDENSED FINANCIAL STATEMENTS OF REGISTRANT SUBSIDIARIES

The condensed notes to KPCo's condensed financial statements are combined with the condensed notes to condensed financial statements for other registrant subsidiaries. Listed below are the notes that apply to KPCo.

OHIO POWER COMPANY CONSOLIDATED

OHIO POWER COMPANY CONSOLIDATED
MANAGEMENT'S FINANCIAL DISCUSSION AND ANALYSIS

Results of Operations

First Quarter of 2007 Compared to First Quarter of 2006

Reconciliation of First Quarter of 2006 to First Quarter of 2007
Net Income
(in millions)

First Quarter of 2006		$ 95
Changes in Gross Margin:		
Retail Margins	59	
Off-system Sales	(22)	
Transmission Revenues	(9)	
Other	(10)	
Total Change in Gross Margin		18
Changes in Operating Expenses and Other:		
Other Operation and Maintenance	(28)	
Depreciation and Amortization	(5)	
Taxes Other Than Income Taxes	(1)	
Interest Expense	(3)	
Total Change in Operating Expenses and Other		(37)
Income Tax Expense		3
First Quarter of 2007		$ 79

Net Income decreased $16 million to $79 million in 2007. The key driver of the decrease was a $37 million increase in Operating Expenses and Other offset by an $18 million increase in Gross Margin.

The major components of our increase in Gross Margin, defined as revenues less the related direct cost of fuel, including consumption of chemicals and emissions allowances, and purchased power were as follows:

- Retail Margins increased $59 million primarily due to the following:
  - A $25 million increase in capacity settlements under the Interconnection Agreement related to certain of our affiliates' peaks and the expiration of our supplemental capacity and energy obligation to Buckeye Power, Inc. under the Cardinal Station Agreement.
  - A $14 million increase in rate revenues related to an $8 million increase in our RSP, a $3 million increase related to rate recovery of storm costs and a $3 million increase related to rate recovery of IGCC preconstruction costs (see "Ohio Rate Matters" section of Note 3). The increase in rate recovery of storm costs was offset by the amortization of deferred expenses in Other Operation and Maintenance. The increase in rate recovery of IGCC preconstruction costs was offset by the amortization of deferred expenses in

Depreciation and Amortization.

- A $9 million increase in fuel margins.
- A $7 million increase in industrial revenue due to the addition of Ormet, a major industrial customer (see "Ormet" section of Note 3).
- A $6 million increase in residential revenue primarily due to a 25% increase in heating degree days.

These increases were partially offset by:

- A $9 million decrease in revenues associated with SO_2 allowances received in 2006 from Buckeye Power, Inc. under the Cardinal Station Allowances Agreement.

- Margins from Off-system Sales decreased $22 million due to a $19 million decrease in physical sales margins and a $4 million decrease in margins from optimization activities.
- Transmission Revenues decreased $9 million primarily due to the elimination of SECA revenues as of April 1, 2006 (see the "Transmission Rate Proceedings at the FERC" section of Note 3).
- Other revenues decreased $10 million primarily due to a $4 million decrease related to the expiration of an obligation to sell supplemental capacity and energy to Buckeye Power, Inc. under the Cardinal Station Agreement, a $3 million decrease in gains on sales of emission allowances and a $2 million decrease in revenue associated with Cook Coal Terminal.

Operating Expenses and Other changed between years as follows:

- Other Operation and Maintenance expenses increased $28 million primarily due to a $19 million increase in maintenance and removal costs related to planned and forced outages at the Gavin, Muskingum, Mitchell and Cardinal plants and a $5 million increase due to the prior period adjustment of liabilities related to sold coal companies.
- Depreciation and Amortization increased $5 million primarily due to the amortization of IGCC preconstruction costs of $3 million in the first quarter of 2007 and a $1 million increase in depreciation related to environmental improvements placed in service at the Mitchell plant. The increase in amortization of IGCC preconstruction costs was offset by a corresponding increase in Retail Margins.
- Interest Expense increased $3 million primarily due to a $5 million increase related to long-term debt issuances since June 2006 and a $3 million increase related to higher borrowings from the Utility Money Pool partially offset by a $6 million increase in allowance for borrowed funds used during construction.

Income Taxes

Income Tax Expense decreased $3 million primarily due to a decrease in pretax book income offset in part by state income taxes.

<u>Financial Condition</u>

Credit Ratings

The rating agencies currently have us on stable outlook. Current ratings are as follows:

	Moody's	S&P	Fitch
Senior Unsecured Debt	A3	BBB	BBB+

Cash Flow

Cash flows for the three months ended March 31, 2007 and 2006 were as follows:

	2007	2006
	(in thousands)	
Cash and Cash Equivalents at Beginning of Period	$ 1,625	$ 1,240
Cash Flows From (Used For):		
Operating Activities	96,864	182,002
Investing Activities	(306,826)	(221,862)
Financing Activities	209,598	39,577
Net Decrease in Cash and Cash Equivalents	(364)	(283)
Cash and Cash Equivalents at End of Period	$ 1,261	$ 957

Operating Activities

Net Cash Flows From Operating Activities were $97 million in 2007. We produced Net Income of $79 million during the period and a noncash expense item of $84 million for Depreciation and Amortization. The other changes in assets and liabilities represent items that had a current period cash flow impact, such as changes in working capital, as well as items that represent future rights or obligations to receive or pay cash, such as regulatory assets and liabilities. The current period activity in working capital relates to a number of items. Accounts Receivable, Net had a $38 million outflow due to temporary timing differences of rent receivables and an increase in billed revenue for electric customers. Accounts Payable had a $26 million outflow primarily due to emission allowance payments in January 2007. Fuel, Materials and Supplies had a $24 million outflow primarily due to an increase in coal inventories.

Our Net Cash Flows From Operating Activities were $182 million in 2006. We produced income of $95 million during the period and a noncash expense item of $79 million for Depreciation and Amortization. The other changes in assets and liabilities represent items that had a current period cash flow impact, such as changes in working capital, as well as items that represent future rights or obligations to receive or pay cash, such as regulatory assets and liabilities. The current period activity in working capital primarily relates to two items. Accounts Receivable, Net had a $102 million inflow due to receivables collected from our affiliates related to power sales, settled litigation and emission allowances. Accounts Payable had a $60 million outflow due to emission allowance payments in January 2006 and temporary timing differences for payments to affiliates.

Investing Activities

Our Net Cash Used For Investing Activities were $307 million and $222 million in 2007 and 2006, respectively. Construction Expenditures were $302 million and $223 million in 2007 and 2006, respectively, primarily related to environmental upgrades, as well as projects to improve service reliability for transmission and distribution. Environmental upgrades include the installation of selective catalytic reduction equipment and the flue gas desulfurization projects at the Cardinal, Amos and Mitchell plants. In January 2007, environmental upgrades were completed for Unit 2 at the Mitchell plant. For the remainder of 2007, we expect construction expenditures to be approximately $530 million.

Financing Activities

Net Cash Flows From Financing Activities were $210 million in 2007 primarily due to a net increase of $216 million in borrowings from the Utility Money Pool.

Net Cash Flows From Financing Activities were $40 million in 2006 primarily due to a $35 million capital contribution from AEP.

Financing Activity

Long-term debt issuances and retirements during the first three months of 2007 were:

Issuances

None

Retirements

Type of Debt		Principal Amount Paid (in thousands)	Interest Rate (%)	Due Date
Notes Payable - Nonaffiliated	$	1,463	6.81	2008
Notes Payable - Nonaffiliated		6,000	6.27	2009

In April 2007, we issued $400 million of three-year floating rate notes at an initial rate of 5.53% due in 2010. The proceeds from this issuance will contribute to our investment in environmental equipment.

Liquidity

We have solid investment grade ratings, which provide us ready access to capital markets in order to issue new debt, refinance short-term debt or refinance long-term debt maturities. In addition, we participate in the Utility Money Pool, which provides access to AEP's liquidity.

Summary Obligation Information

A summary of our contractual obligations is included in our 2006 Annual Report and has not changed significantly from year-end other than the debt issuance discussed in "Financing Activity" above.

Significant Factors

Litigation and Regulatory Activity

In the ordinary course of business, we are involved in employment, commercial, environmental and regulatory litigation. Since it is difficult to predict the outcome of these proceedings, we cannot state what the eventual outcome of these proceedings will be, or what the timing of the amount of any loss, fine or penalty may be. Management does, however, assess the probability of loss for such contingencies and accrues a liability for cases which have a probable likelihood of loss and the loss amount can be estimated. For details on our pending litigation and regulatory proceedings, see Note 4 - Rate Matters and Note 6 - Commitments, Guarantees and Contingencies in our 2006 Annual Report. Also, see Note 3 - Rate Matters and Note 4 - Commitments, Guarantees and Contingencies in the "Condensed Notes to Condensed Financial Statements of Registrant Subsidiaries". Adverse results in these proceedings have the potential to materially affect our results of operations, financial condition and cash flows.

See the "Combined Management's Discussion and Analysis of Registrant Subsidiaries" section for additional discussion of factors relevant to us.

Critical Accounting Estimates

See the “Critical Accounting Estimates” section of “Combined Management’s Discussion and Analysis of Registrant Subsidiaries” in the 2006 Annual Report for a discussion of the estimates and judgments required for regulatory accounting, revenue recognition, the valuation of long-lived assets, pension and other postretirement benefits and the impact of new accounting pronouncements.

Adoption of New Accounting Pronouncements

See the “Combined Management’s Discussion and Analysis of Registrant Subsidiaries” section for a discussion of adoption of new accounting pronouncements.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT RISK MANAGEMENT ACTIVITIES

Market Risks

Our risk management assets and liabilities are managed by AEPSC as agent for us. The related risk management policies and procedures are instituted and administered by AEPSC. See complete discussion within AEP's "Quantitative and Qualitative Disclosures About Risk Management Activities" section. The following tables provide information about AEP's risk management activities' effect on us.

MTM Risk Management Contract Net Assets

The following two tables summarize the various mark-to-market (MTM) positions included in our condensed consolidated balance sheet as of March 31, 2007 and the reasons for changes in our total MTM value as compared to December 31, 2006.

Reconciliation of MTM Risk Management Contracts to
Condensed Consolidated Balance Sheet
As of March 31, 2007
(in thousands)

	MTM Risk Management Contracts	Cash Flow Hedges	DETM Assignment (a)	Total
Current Assets	$ 49,092	$ 756	$ -	$ 49,848
Noncurrent Assets	57,316	96	-	57,412
Total MTM Derivative Contract Assets	106,408	852	-	107,260
Current Liabilities	(42,532)	(3,980)	(2,071)	(48,583)
Noncurrent Liabilities	(35,731)	(312)	(5,493)	(41,536)
Total MTM Derivative Contract Liabilities	(78,263)	(4,292)	(7,564)	(90,119)
Total MTM Derivative Contract Net Assets (Liabilities)	$ 28,145	$ (3,440)	$ (7,564)	$ 17,141

(a) See "Natural Gas Contracts with DETM" section of Note 16 in the 2006 Annual Report.

MTM Risk Management Contract Net Assets
Three Months Ended March 31, 2007
(in thousands)

Total MTM Risk Management Contract Net Assets at December 31, 2006	$ 33,042
(Gain) Loss from Contracts Realized/Settled During the Period and Entered in a Prior Period	(4,433)
Fair Value of New Contracts at Inception When Entered During the Period (a)	311
Net Option Premiums Paid/(Received) for Unexercised or Unexpired Option Contracts Entered During the Period	(23)
Change in Fair Value Due to Valuation Methodology Changes on Forward Contracts	-
Changes in Fair Value Due to Market Fluctuations During the Period (b)	(317)
Changes in Fair Value Allocated to Regulated Jurisdictions (c)	(435)
Total MTM Risk Management Contract Net Assets	28,145

Net Cash Flow Hedge Contracts		(3,440)
DETM Assignment (d)		(7,564)
Total MTM Risk Management Contract Net Assets at March 31, 2007	$	17,141

(a) Reflects fair value on long-term contracts which are typically with customers that seek fixed pricing to limit their risk against fluctuating energy prices. Inception value is only recorded if observable market data can be obtained for valuation inputs for the entire contract term. The contract prices are valued against market curves associated with the delivery location and delivery term.
(b) Market fluctuations are attributable to various factors such as supply/demand, weather, storage, etc.
(c) "Changes in Fair Value Allocated to Regulated Jurisdictions" relates to the net gains (losses) of those contracts that are not reflected in the Condensed Consolidated Statements of Income. These net gains (losses) are recorded as regulatory liabilities/assets for those subsidiaries that operate in regulated jurisdictions.
(d) See "Natural Gas Contracts with DETM" section of Note 16 in our 2006 Annual Report.

Maturity and Source of Fair Value of MTM Risk Management Contract Net Assets

The following table presents:

· The method of measuring fair value used in determining the carrying amount of our total MTM asset or liability (external sources or modeled internally).
· The maturity, by year, of our net assets/liabilities to give an indication of when these MTM amounts will settle and generate cash.

Maturity and Source of Fair Value of MTM
Risk Management Contract Net Assets
Fair Value of Contracts as of March 31, 2007
(in thousands)

	Remainder 2007	**2008**	**2009**	**2010**	**2011**	**After 2011**	**Total**
Prices Actively Quoted - Exchange Traded Contracts	$ 11,122	$ (399)	$ 464	$ -	$ -	$ -	$ 11,187
Prices Provided by Other External Sources - OTC Broker Quotes (a)	(621)	9,668	7,524	2,985	-	-	19,556
Prices Based on Models and Other Valuation Methods (b)	(5,725)	(3,527)	1,165	3,608	812	1,069	(2,598)
Total	$ 4,776	$ 5,742	$ 9,153	$ 6,593	$ 812	$ 1,069	$ 28,145

(a) "Prices Provided by Other External Sources - OTC Broker Quotes" reflects information obtained from over-the-counter brokers, industry services, or multiple-party on-line platforms.
(b) "Prices Based on Models and Other Valuation Methods" is used in absence of pricing information from external sources. Modeled information is derived using valuation models developed by the reporting entity, reflecting when appropriate, option pricing theory, discounted cash flow concepts, valuation adjustments, etc. and may require projection of prices for underlying commodities beyond the period that prices are available from third-party sources. In addition, where external pricing information or market liquidity are limited, such valuations are classified

as modeled. The determination of the point at which a market is no longer liquid for placing it in the modeled category varies by market.

Contract values that are measured using models or valuation methods other than active quotes or OTC broker quotes (because of the lack of such data for all delivery quantities, locations and periods) incorporate in the model or other valuation methods, to the extent possible, OTC broker quotes and active quotes for deliveries in years and at locations for which such quotes are available.

Cash Flow Hedges Included in Accumulated Other Comprehensive Income (Loss) (AOCI) on the Condensed Consolidated Balance Sheet

We are exposed to market fluctuations in energy commodity prices impacting our power operations. We monitor these risks on our future operations and may use various commodity instruments designated in qualifying cash flow hedge strategies to mitigate the impact of these fluctuations on the future cash flows. We do not hedge all commodity price risk.

We use interest rate derivative transactions to manage interest rate risk related to anticipated borrowings of fixed-rate debt. We do not hedge all interest rate risk.

We use forward contracts and collars as cash flow hedges to lock in prices on certain transactions denominated in foreign currencies where deemed necessary. We do not hedge all foreign currency exposure.

The following table provides the detail on designated, effective cash flow hedges included in AOCI on our Condensed Consolidated Balance Sheets and the reasons for the changes from December 31, 2006 to March 31, 2007. Only contracts designated as cash flow hedges are recorded in AOCI. Therefore, economic hedge contracts that are not designated as effective cash flow hedges are marked-to-market and included in the previous risk management tables. All amounts are presented net of related income taxes.

Total Accumulated Other Comprehensive Income (Loss) Activity
Three Months Ended March 31, 2007
(in thousands)

	Power	Foreign Currency	Interest Rate	Total
Beginning Balance in AOCI December 31, 2006	$ 4,040	$ (331)	$ 3,553	$ 7,262
Changes in Fair Value	(4,677)	-	-	(4,677)
Reclassifications from AOCI to Net Income for Cash Flow Hedges Settled	(1,595)	3	(202)	(1,794)
Ending Balance in AOCI March 31, 2007	$ (2,232)	$ (328)	$ 3,351	$ 791

The portion of cash flow hedges in AOCI expected to be reclassified to earnings during the next twelve months is a $1,292 thousand loss.

Credit Risk

Our counterparty credit quality and exposure is generally consistent with that of AEP.

VaR Associated with Risk Management Contracts

We use a risk measurement model, which calculates Value at Risk (VaR) to measure our commodity price risk in the risk management portfolio. The VaR is based on the variance-covariance method using historical prices to estimate volatilities and correlations and assumes a 95% confidence level and a one-day holding period. Based on this VaR analysis, at March 31, 2007, a near term typical change in commodity prices is not expected to have a material effect on our results of operations, cash flows or financial condition.

The following table shows the end, high, average, and low market risk as measured by VaR for the periods indicated:

Three Months Ended March 31, 2007 (in thousands)				Twelve Months Ended December 31, 2006 (in thousands)			
End	**High**	**Average**	**Low**	**End**	**High**	**Average**	**Low**
$678	$2,054	$924	$255	$573	$1,451	$500	$271

The High VaR for the twelve months ended December 31, 2006 occurred in the third quarter due to volatility in the ECAR/PJM region.

VaR Associated with Debt Outstanding

We utilize a VaR model to measure interest rate market risk exposure. The interest rate VaR model is based on a Monte Carlo simulation with a 95% confidence level and a one-year holding period. The risk of potential loss in fair value attributable to our exposure to interest rates primarily related to long-term debt with fixed interest rates was $131 million and $110 million at March 31, 2007 and December 31, 2006, respectively. We would not expect to liquidate our entire debt portfolio in a one-year holding period; therefore, a near term change in interest rates should not negatively affect our results of operations or consolidated financial position.

OHIO POWER COMPANY CONSOLIDATED
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
For the Three Months Ended March 31, 2007 and 2006
(in thousands)
(Unaudited)

	2007	2006
REVENUES		
Electric Generation, Transmission and Distribution	$ 492,534	$ 544,639
Sales to AEP Affiliates	178,894	149,259
Other - Affiliated	4,038	3,709
Other - Nonaffiliated	3,975	4,999
TOTAL	679,441	702,606
EXPENSES		
Fuel and Other Consumables Used for Electric Generation	198,293	235,130
Purchased Electricity for Resale	24,854	21,714
Purchased Electricity from AEP Affiliates	20,966	28,572
Other Operation	102,987	86,629
Maintenance	59,148	47,524
Depreciation and Amortization	84,276	78,821
Taxes Other Than Income Taxes	48,385	47,153
TOTAL	538,909	545,543
OPERATING INCOME	140,532	157,063
Other Income (Expense):		
Interest Income	412	637
Carrying Costs Income	3,541	3,383
Allowance for Equity Funds Used During Construction	571	738
Interest Expense	(25,931)	(23,414)
INCOME BEFORE INCOME TAXES	119,125	138,407
Income Tax Expense	39,864	43,375
NET INCOME	79,261	95,032
Preferred Stock Dividend Requirements	183	183
EARNINGS APPLICABLE TO COMMON STOCK	$ 79,078	$ 94,849

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

See Condensed Notes to Condensed Financial Statements of Registrant Subsidiaries.

OHIO POWER COMPANY CONSOLIDATED
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN COMMON SHAREHOLDER'S EQUITY AND COMPREHENSIVE INCOME (LOSS)
For the Three Months Ended March 31, 2007 and 2006
(in thousands)
(Unaudited)

	Common Stock	Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
DECEMBER 31, 2005	$ 321,201	$ 466,637	$ 979,354	$ 755	$ 1,767,947
Capital Contribution From Parent		35,000			35,000
Preferred Stock Dividends			(183)		(183)
TOTAL					1,802,764
COMPREHENSIVE INCOME					
Other Comprehensive Income, Net of Taxes:					
Cash Flow Hedges, Net of Tax of $3,326				6,176	6,176
NET INCOME			95,032		95,032
TOTAL COMPREHENSIVE INCOME					101,208
MARCH 31, 2006	$ 321,201	$ 501,637	$ 1,074,203	$ 6,931	$ 1,903,972
DECEMBER 31, 2006	$ 321,201	$ 536,639	$ 1,207,265	$ (56,763)	$ 2,008,342
FIN 48 Adoption, Net of Tax			(5,380)		(5,380)
Preferred Stock Dividends			(183)		(183)
TOTAL					2,002,779
COMPREHENSIVE INCOME					
Other Comprehensive Loss, Net of Taxes:					
Cash Flow Hedges, Net of Tax of $3,485				(6,471)	(6,471)
NET INCOME			79,261		79,261
TOTAL COMPREHENSIVE INCOME					72,790
MARCH 31, 2007	$ 321,201	$ 536,639	$ 1,280,963	$ (63,234)	$ 2,075,569

See Condensed Notes to Condensed Financial Statements of Registrant Subsidiaries.

OHIO POWER COMPANY CONSOLIDATED
CONDENSED CONSOLIDATED BALANCE SHEETS
ASSETS
March 31, 2007 and December 31, 2006
(in thousands)
(Unaudited)

	2007	2006
CURRENT ASSETS		
Cash and Cash Equivalents	$ 1,261	$ 1,625
Accounts Receivable:		
Customers	114,608	86,116
Affiliated Companies	109,029	108,214
Accrued Unbilled Revenues	17,082	10,106
Miscellaneous	3,620	1,819
Allowance for Uncollectible Accounts	(838)	(824)
Total Accounts Receivable	243,501	205,431
Fuel	139,950	120,441
Materials and Supplies	78,866	74,840
Emission Allowances	12,302	10,388
Risk Management Assets	49,848	86,947
Accrued Tax Benefits	3,181	22,909
Prepayments and Other	28,395	18,416
TOTAL	557,304	540,997
PROPERTY, PLANT AND EQUIPMENT		
Electric:		
Production	4,747,459	4,413,340
Transmission	1,038,642	1,030,934
Distribution	1,336,874	1,322,103
Other	300,054	299,637
Construction Work in Progress	1,226,985	1,339,631
Total	8,650,014	8,405,645
Accumulated Depreciation and Amortization	2,867,416	2,836,584
TOTAL - NET	5,782,598	5,569,061
OTHER NONCURRENT ASSETS		
Regulatory Assets	387,201	414,180
Long-term Risk Management Assets	57,412	70,092
Deferred Charges and Other	209,873	224,403
TOTAL	654,486	708,675
TOTAL ASSETS	$ 6,994,388	$ 6,818,733

See Condensed Notes to Condensed Financial Statements of Registrant Subsidiaries.

OHIO POWER COMPANY CONSOLIDATED
CONDENSED CONSOLIDATED BALANCE SHEETS
LIABILITIES AND SHAREHOLDERS' EQUITY
March 31, 2007 and December 31, 2006
(Unaudited)

	2007	2006
CURRENT LIABILITIES	(in thousands)	
Advances from Affiliates	$ 397,127	$ 181,281
Accounts Payable:		
General	225,809	250,025
Affiliated Companies	116,297	145,197
Short-term Debt - Nonaffiliated	4,503	1,203
Long-term Debt Due Within One Year - Nonaffiliated	17,854	17,854
Risk Management Liabilities	48,583	73,386
Customer Deposits	31,547	31,465
Accrued Taxes	148,057	165,338
Accrued Interest	34,561	35,497
Other	126,845	123,631
TOTAL	1,151,183	1,024,877
NONCURRENT LIABILITIES		
Long-term Debt - Nonaffiliated	2,176,601	2,183,887
Long-term Debt - Affiliated	200,000	200,000
Long-term Risk Management Liabilities	41,536	52,929
Deferred Income Taxes	891,761	911,221
Regulatory Liabilities and Deferred Investment Tax Credits	173,946	185,895
Deferred Credits and Other	249,254	219,127
TOTAL	3,733,098	3,753,059
TOTAL LIABILITIES	4,884,281	4,777,936
Minority Interest	17,910	15,825
Cumulative Preferred Stock Not Subject to Mandatory Redemption	16,628	16,630
Commitments and Contingencies (Note 4)		
COMMON SHAREHOLDER'S EQUITY		
Common Stock - No Par Value:		
Authorized - 40,000,000 Shares		
Outstanding - 27,952,473 Shares	321,201	321,201
Paid-in Capital	536,639	536,639
Retained Earnings	1,280,963	1,207,265
Accumulated Other Comprehensive Income (Loss)	(63,234)	(56,763)
TOTAL	2,075,569	2,008,342
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 6,994,388	$ 6,818,733

See Condensed Notes to Condensed Financial Statements of Registrant Subsidiaries.

OHIO POWER COMPANY CONSOLIDATED
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Three Months Ended March 31, 2007 and 2006
(in thousands)
(Unaudited)

	2007	2006
OPERATING ACTIVITIES		
Net Income	$ 79,261	$ 95,032
Adjustments for Noncash Items:		
Depreciation and Amortization	84,276	78,821
Deferred Income Taxes	2,851	3,604
Carrying Costs Income	(3,541)	(3,383)
Mark-to-Market of Risk Management Contracts	3,958	(3,616)
Deferred Property Taxes	17,920	17,331
Change in Other Noncurrent Assets	(4,406)	2,455
Change in Other Noncurrent Liabilities	(4,434)	13,855
Changes in Certain Components of Working Capital:		
Accounts Receivable, Net	(38,070)	101,866
Fuel, Materials and Supplies	(23,535)	(18,238)
Accounts Payable	(25,807)	(60,411)
Customer Deposits	82	(12,497)
Accrued Taxes, Net	6,360	3,116
Accrued Interest	(2,986)	(10,998)
Other Current Assets	1,706	(739)
Other Current Liabilities	3,229	(24,196)
Net Cash Flows From Operating Activities	96,864	182,002
INVESTING ACTIVITIES		
Construction Expenditures	(301,635)	(222,600)
Change in Other Cash Deposits, Net	(7,988)	(1,651)
Proceeds from Sale of Assets	2,797	2,389
Net Cash Flows Used For Investing Activities	(306,826)	(221,862)
FINANCING ACTIVITIES		
Capital Contributions from Parent Company	-	35,000
Change in Short-term Debt, Net - Nonaffiliated	3,300	636
Change in Advances from Affiliates, Net	215,846	10,972
Retirement of Long-term Debt - Nonaffiliated	(7,463)	(4,713)
Principal Payments for Capital Lease Obligations	(1,902)	(2,135)
Dividends Paid on Cumulative Preferred Stock	(183)	(183)
Net Cash Flows From Financing Activities	209,598	39,577
Net Decrease in Cash and Cash Equivalents	(364)	(283)
Cash and Cash Equivalents at Beginning of Period	1,625	1,240
Cash and Cash Equivalents at End of Period	$ 1,261	$ 957
SUPPLEMENTARY INFORMATION		
Cash Paid for Interest, Net of Capitalized Amounts	$ 29,646	$ 29,152
Net Cash Paid (Received) for Income Taxes	(8,899)	922
Noncash Acquisitions Under Capital Leases	608	927

Construction Expenditures Included in Accounts Payable at March 31,	98,653	82,024

See Condensed Notes to Condensed Financial Statements of Registrant Subsidiaries.

OHIO POWER COMPANY CONSOLIDATED
INDEX TO CONDENSED NOTES TO CONDENSED FINANCIAL STATEMENTS OF REGISTRANT SUBSIDIARIES

The condensed notes to OPCo's condensed consolidated financial statements are combined with the condensed notes to condensed financial statements for other registrant subsidiaries. Listed below are the notes that apply to OPCo.

PUBLIC SERVICE COMPANY OF OKLAHOMA

PUBLIC SERVICE COMPANY OF OKLAHOMA
MANAGEMENT'S NARRATIVE FINANCIAL DISCUSSION AND ANALYSIS

Results of Operations

First Quarter of 2007 Compared to First Quarter of 2006

Reconciliation of First Quarter of 2006 to First Quarter of 2007
Net Loss
(in millions)

First Quarter of 2006		$	(5)
Changes in Gross Margin:			
Retail and Off-system Sales Margins	5		
Transmission Revenues	1		
Other	(1)		
Total Change in Gross Margin			5
Changes in Operating Expenses and Other:			
Other Operation and Maintenance	(27)		
Depreciation and Amortization	(2)		
Interest Expense	(2)		
Total Change in Operating Expenses and Other			(31)
Income Tax Credit			11
First Quarter of 2007		$	(20)

Net Loss increased $15 million to $20 million in 2007. The key driver of the increased loss was a $31 million increase in Operating Expenses and Other, partially offset by an $11 million increase in Income Tax Credit and a $5 million increase in Gross Margin.

The major component of our increase in Gross Margin, defined as revenues less the related direct cost of fuel, including consumption of chemicals and emissions allowances, and purchased power was a $5 million increase in Retail and Off-system Sales Margins primarily due to a $4 million increase in retail margins resulting from an increase in heating degree days.

Operating Expenses and Other increased between years as follows:

- Other Operation and Maintenance expenses increased $27 million due to:
  - A $21 million increase in distribution maintenance expense primarily due to a January 2007 ice storm.
  - A $2 million increase in administrative and general expenses, mostly due to increased employee-related expenses.
- Interest Expense increased $2 million primarily due to increased borrowings.

Income Taxes

Income Tax Credit increased $11 million primarily due to an increase in pretax book loss and a decrease in state income taxes.

Critical Accounting Estimates

See the "Critical Accounting Estimates" section of "Combined Management's Discussion and Analysis of Registrant Subsidiaries" in our 2006 Annual Report for a discussion of the estimates and judgments required for regulatory accounting, revenue recognition, the valuation of long-lived assets, pension and other postretirement benefits and the impact of new accounting pronouncements.

Adoption of New Accounting Pronouncements

See the "Combined Management's Discussion and Analysis of Registrant Subsidiaries" section for a discussion of adoption of new accounting pronouncements.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT RISK MANAGEMENT ACTIVITIES

Market Risks

Our risk management assets and liabilities are managed by AEPSC as agent for us. The related risk management policies and procedures are instituted and administered by AEPSC. See the complete discussion and analysis within AEP's "Quantitative and Qualitative Disclosures About Risk Management Activities" section for disclosures about risk management activities.

VaR Associated with Debt Outstanding

We utilize a VaR model to measure interest rate market risk exposure. The interest rate VaR model is based on a Monte Carlo simulation with a 95% confidence level and a one-year holding period. The risk of potential loss in fair value attributable to our exposure to interest rates primarily related to long-term debt with fixed interest rates was $42 million and $39 million at March 31, 2007 and December 31, 2006, respectively. We would not expect to liquidate our entire debt portfolio in a one-year holding period; therefore, a near term change in interest rates should not negatively affect our results of operations or financial position.

PUBLIC SERVICE COMPANY OF OKLAHOMA
CONDENSED STATEMENTS OF OPERATIONS
For the Three Months Ended March 31, 2007 and 2006
(in thousands)
(Unaudited)

	2007	2006
REVENUES		
Electric Generation, Transmission and Distribution	$ 290,080	$ 339,601
Sales to AEP Affiliates	24,593	14,068
Other	640	1,060
TOTAL	315,313	354,729
EXPENSES		
Fuel and Other Consumables Used for Electric Generation	142,515	213,173
Purchased Electricity for Resale	67,409	33,217
Purchased Electricity from AEP Affiliates	13,484	21,231
Other Operation	41,007	36,756
Maintenance	43,085	20,307
Depreciation and Amortization	22,706	21,132
Taxes Other Than Income Taxes	10,294	10,076
TOTAL	340,500	355,892
OPERATING LOSS	(25,187)	(1,163)
Other Income (Expense):		
Interest Income	646	569
Interest Expense	(11,383)	(9,135)
LOSS BEFORE INCOME TAXES	(35,924)	(9,729)
Income Tax Credit	(15,498)	(4,372)
NET LOSS	(20,426)	(5,357)
Preferred Stock Dividend Requirements	53	53
LOSS APPLICABLE TO COMMON STOCK	$ (20,479)	$ (5,410)

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

See Condensed Notes to Condensed Financial Statements of Registrant Subsidiaries.

PUBLIC SERVICE COMPANY OF OKLAHOMA
CONDENSED STATEMENTS OF CHANGES IN COMMON SHAREHOLDER'S EQUITY AND COMPREHENSIVE INCOME (LOSS)
For the Three Months Ended March 31, 2007 and 2006
(in thousands)
(Unaudited)

	Common Stock	Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
DECEMBER 31, 2005	$ 157,230	$ 230,016	$ 162,615	$ (1,264)	$ 548,597
Preferred Stock Dividends			(53)		(53)
TOTAL					548,544
COMPREHENSIVE LOSS					
Other Comprehensive Income, Net of Taxes:					
Cash Flow Hedges, Net of Tax of $749				1,391	1,391
NET LOSS			(5,357)		(5,357)
TOTAL COMPREHENSIVE LOSS					(3,966)
MARCH 31, 2006	$ 157,230	$ 230,016	$ 157,205	$ 127	$ 544,578
DECEMBER 31, 2006	$ 157,230	$ 230,016	$ 199,262	$ (1,070)	$ 585,438
FIN 48 Adoption, Net of Tax			(386)		(386)
Capital Contribution from Parent Company		20,000			20,000
Preferred Stock Dividends			(53)		(53)
TOTAL					604,999
COMPREHENSIVE LOSS					
Other Comprehensive Income, Net of Taxes:					
Cash Flow Hedges, Net of Tax of $24				45	45
NET LOSS			(20,426)		(20,426)
TOTAL COMPREHENSIVE LOSS					(20,381)
MARCH 31, 2007	$ 157,230	$ 250,016	$ 178,397	$ (1,025)	$ 584,618

See Condensed Notes to Condensed Financial Statements of Registrant Subsidiaries.

PUBLIC SERVICE COMPANY OF OKLAHOMA
CONDENSED BALANCE SHEETS
ASSETS
March 31, 2007 and December 31, 2006
(in thousands)
(Unaudited)

		2007		2006
CURRENT ASSETS				
Cash and Cash Equivalents	$	1,584	$	1,651
Accounts Receivable:				
Customers		51,680		70,319
Affiliated Companies		73,191		73,318
Miscellaneous		13,004		10,270
Allowance for Uncollectible Accounts		(89)		(5)
Total Accounts Receivable		137,786		153,902
Fuel		19,028		20,082
Materials and Supplies		52,951		48,375
Risk Management Assets		56,139		100,802
Accrued Tax Benefits		25,206		4,679
Regulatory Asset for Under-Recovered Fuel Costs		-		7,557
Margin Deposits		22,705		35,270
Prepayments and Other		5,718		5,732
TOTAL		321,117		378,050
PROPERTY, PLANT AND EQUIPMENT				
Electric:				
Production		1,095,466		1,091,910
Transmission		505,326		503,638
Distribution		1,248,077		1,215,236
Other		237,383		234,227
Construction Work in Progress		158,637		141,283
Total		3,244,889		3,186,294
Accumulated Depreciation and Amortization		1,200,212		1,187,107
TOTAL - NET		2,044,677		1,999,187
OTHER NONCURRENT ASSETS				
Regulatory Assets		138,815		142,905
Long-term Risk Management Assets		13,748		17,066
Employee Benefits and Pension Assets		29,761		30,161
Deferred Charges and Other		34,237		11,677
TOTAL		216,561		201,809
TOTAL ASSETS	$	2,582,355	$	2,579,046

See Condensed Notes to Condensed Financial Statements of Registrant Subsidiaries.

PUBLIC SERVICE COMPANY OF OKLAHOMA
CONDENSED BALANCE SHEETS
LIABILITIES AND SHAREHOLDERS' EQUITY
March 31, 2007 and December 31, 2006
(Unaudited)

	2007	2006
CURRENT LIABILITIES	(in thousands)	
Advances from Affiliates	$ 135,694	$ 76,323
Accounts Payable:		
General	173,021	165,618
Affiliated Companies	68,782	65,134
Risk Management Liabilities	46,530	88,469
Customer Deposits	41,404	51,335
Accrued Taxes	35,144	19,984
Regulatory Liability for Over-Recovered Fuel Costs	9,015	-
Other	29,898	58,651
TOTAL	539,488	525,514
NONCURRENT LIABILITIES		
Long-term Debt - Nonaffiliated	670,042	669,998
Long-term Risk Management Liabilities	8,514	11,448
Deferred Income Taxes	407,365	414,197
Regulatory Liabilities and Deferred Investment Tax Credits	306,194	315,584
Deferred Credits and Other	60,872	51,605
TOTAL	1,452,987	1,462,832
TOTAL LIABILITIES	1,992,475	1,988,346
Cumulative Preferred Stock Not Subject to Mandatory Redemption	5,262	5,262
Commitments and Contingencies (Note 4)		
COMMON SHAREHOLDER'S EQUITY		
Common Stock - $15 Par Value Per Share:		
Authorized - 11,000,000 Shares		
Issued - 10,482,000 Shares		
Outstanding - 9,013,000 Shares	157,230	157,230
Paid-in Capital	250,016	230,016
Retained Earnings	178,397	199,262
Accumulated Other Comprehensive Income (Loss)	(1,025)	(1,070)
TOTAL	584,618	585,438
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 2,582,355	$ 2,579,046

See Condensed Notes to Condensed Financial Statements of Registrant Subsidiaries.

PUBLIC SERVICE COMPANY OF OKLAHOMA
CONDENSED STATEMENTS OF CASH FLOWS
For the Three Months Ended March 31, 2007 and 2006
(in thousands)
(Unaudited)

		2007		2006
OPERATING ACTIVITIES				
Net Loss	$	(20,426)	$	(5,357)
Adjustments for Noncash Items:				
Depreciation and Amortization		22,706		21,132
Deferred Income Taxes		1,039		(23,436)
Mark-to-Market of Risk Management Contracts		3,108		9,106
Deferred Property Taxes		(24,809)		(24,295)
Change in Other Noncurrent Assets		4,393		11,118
Change in Other Noncurrent Liabilities		(11,269)		(20,806)
Changes in Certain Components of Working Capital:				
Accounts Receivable, Net		16,116		33,852
Fuel, Materials and Supplies		(3,513)		(26)
Margin Deposits		12,565		5,065
Accounts Payable		6,941		(77,217)
Customer Deposits		(9,931)		(13,056)
Accrued Taxes, Net		(4,378)		34,196
Fuel Over/Under Recovery, Net		16,572		74,281
Other Current Assets		(139)		1,021
Other Current Liabilities		(26,677)		(23,048)
Net Cash Flows From (Used for) Operating Activities		(17,702)		2,530
INVESTING ACTIVITIES				
Construction Expenditures		(61,301)		(45,539)
Change in Other Cash Deposits, Net		(29)		6
Proceeds from Sales of Assets		17		-
Net Cash Flows Used For Investing Activities		(61,313)		(45,533)
FINANCING ACTIVITIES				
Capital Contributions from Parent Company		20,000		-
Change in Advances from Affiliates, Net		59,371		42,932
Principal Payments for Capital Lease Obligations		(370)		(206)
Dividends Paid on Cumulative Preferred Stock		(53)		(53)
Net Cash Flows From Financing Activities		78,948		42,673
Net Decrease in Cash and Cash Equivalents		(67)		(330)
Cash and Cash Equivalents at Beginning of Period		1,651		1,520
Cash and Cash Equivalents at End of Period	$	1,584	$	1,190
SUPPLEMENTARY INFORMATION				
Cash Paid for Interest, Net of Capitalized Amounts	$	12,921	$	8,681
Net Cash Paid for Income Taxes		2,623		575
Noncash Acquisitions Under Capital Leases		283		564
Construction Expenditures Included in Accounts Payable at March 31,		19,038		6,052

See Condensed Notes to Condensed Financial Statements of Registrant Subsidiaries.

PUBLIC SERVICE COMPANY OF OKLAHOMA
INDEX TO CONDENSED NOTES TO CONDENSED FINANCIAL STATEMENTS OF REGISTRANT SUBSIDIARIES

The condensed notes to PSO’s condensed financial statements are combined with the condensed notes to condensed financial statements for other registrant subsidiaries. Listed below are the notes that apply to PSO.

SOUTHWESTERN ELECTRIC POWER COMPANY CONSOLIDATED

SOUTHWESTERN ELECTRIC POWER COMPANY CONSOLIDATED
MANAGEMENT'S FINANCIAL DISCUSSION AND ANALYSIS

Results of Operations

First Quarter of 2007 Compared to First Quarter of 2006

Reconciliation of First Quarter of 2006 to First Quarter of 2007
Net Income
(in millions)

First Quarter of 2006		$	18
Changes in Gross Margin:			
Retail and Off-system Sales Margins (a)	(1)		
Other	(4)		
Total Change in Gross Margin			(5)
Changes in Operating Expenses and Other:			
Other Operation and Maintenance	(6)		
Depreciation and Amortization	(1)		
Other Income	1		
Interest Expense	(3)		
Total Change in Operating Expenses and Other			(9)
Income Tax Expense			6
First Quarter of 2007		$	10

(a) Includes firm wholesale sales to municipals and cooperatives.

Net Income decreased $8 million to $10 million in 2007. The key drivers of the decrease were a $9 million increase in Operating Expenses and Other and a $5 million decrease in Gross Margin, offset by a $6 million decrease in Income Tax Expense.

The major component of our decrease in Gross Margin, defined as revenues less the related direct cost of fuel, including consumption of chemicals and emissions allowances, and purchased power was a $4 million decrease in Other changes in gross margin, primarily due to lower gains on sales of emission allowances.

Operating Expenses and Other changed between years as follows:

- Other Operation and Maintenance expenses increased $6 million primarily due to a $2 million increase in generation operation and maintenance, a $1 million increase in transmission expenses due to higher SPP administration fees and a $1 million increase in administrative and general expenses, primarily associated with outside services and employee-related expenses.
- Interest Expense increased $3 million primarily due to increased long-term debt.

Income Taxes

Income Tax Expense decreased $6 million primarily due to a decrease in pretax book income and state income taxes.

Financial Condition

Credit Ratings

The rating agencies currently have us on stable outlook. Current ratings are as follows:

	Moody's	S&P	Fitch
First Mortgage Bonds	A3	A-	A
Senior Unsecured Debt	Baa1	BBB	A-

Cash Flow

Cash flows for the three months ended March 31, 2007 and 2006 were as follows:

	2007	2006
	(in thousands)	
Cash and Cash Equivalents at Beginning of Period	$ 2,618	$ 3,049
Cash Flows From (Used For):		
Operating Activities	65,590	41,293
Investing Activities	(120,639)	(54,294)
Financing Activities	54,331	12,501
Net Decrease in Cash and Cash Equivalents	(718)	(500)
Cash and Cash Equivalents at End of Period	$ 1,900	$ 2,549

Operating Activities

Net Cash Flows From Operating Activities were $66 million in 2007. We produced Net Income of $10 million during the period and a noncash expense item of $34 million for Depreciation and Amortization. The other changes in assets and liabilities represent items that had a current period cash flow impact, such as changes in working capital, as well as items that represent future rights or obligations to receive or pay cash, such as regulatory assets and liabilities. The activity in working capital relates to a number of items. The $36 million inflow from Accrued Taxes, Net was the result of increased accruals related to property and income taxes. The $22 million inflow from Margin Deposits was due to decreased trading-related deposits resulting from normal trading activities. The $20 million inflow from Accounts Receivable, Net was primarily due to the assignment of certain ERCOT contracts to an affiliate company.

Our Net Cash Flows From Operating Activities were $41 million in 2006. We produced Net Income of $18 million during the period and noncash expense items of $33 million for Depreciation and Amortization. The other changes in assets and liabilities represent items that had a current period cash flow impact, such as changes in working capital, as well as items that represent future rights or obligations to receive or pay cash, such as regulatory assets and liabilities. The current period activity in working capital relates to a number of items. The $27 million inflow from Accounts Receivable, Net was due to lower affiliated energy transactions. The $18 million outflow from Fuel, Materials and Supplies was the result of reduced fuel consumption during scheduled power plant outages. The $45 million inflow from Accrued Taxes, Net was due to increased income taxes. We did not make a federal income tax payment in 2006. The $16 million outflow from Customer Deposits was due to lower trading-related deposits. In addition, our cash flow related to Over/Under Fuel Recovery was favorably impacted by the new fuel surcharges effective December 2005 in our Arkansas service territory and in January 2006 in our Texas service territory. The $15 million outflow from

Accounts Payable was the result of lower expenditures related to tree trimming and right-of-way clearing, energy purchases and general operations.

Investing Activities

Cash Flows Used For Investing Activities during 2007 and 2006 were $121 million and $54 million, respectively. The $108 million of cash flows for Construction Expenditures during 2007 were primarily related to new generation facilities. In addition, we had a net increase of $9 million in loans to the Utility Money Pool. The cash flows during 2006 were comprised primarily of Construction Expenditures related to projects for improved transmission and distribution service reliability.

Financing Activities

Cash Flows From Financing Activities were $54 million during 2007. We issued $250 million of Senior Unsecured Notes. We had a net decrease of $189 million in borrowings from the Utility Money Pool.

Cash Flows From Financing Activities were $13 million during 2006. We had a net increase of $21 million in borrowings from the Utility Money Pool. We paid $10 million in common stock dividends.

Financing Activity

Long-term debt issuances and retirements during the first three months of 2007 were:

Issuances

Type of Debt	Principal Amount Paid (in thousands)	Interest Rate (%)	Due Date
Senior Unsecured Notes	$ 250,000	5.55	2017

Retirements

Type of Debt	Principal Amount Paid (in thousands)	Interest Rate (%)	Due Date
Notes Payable - Nonaffiliated	$ 1,645	4.47	2011
Notes Payable - Nonaffiliated	4,000	6.36	2007
Notes Payable - Nonaffiliated	750	Variable	2008

Liquidity

We have solid investment grade ratings, which provide us ready access to capital markets in order to issue new debt or refinance long-term debt maturities. In addition, we participate in the Utility Money Pool, which provides access to AEP's liquidity.

Summary Obligation Information

A summary of our contractual obligations is included in our 2006 Annual Report and has not changed significantly since year-end other than the debt issuance discussed in "Financing Activity" above and Energy and Capacity Purchase Contracts. Effective January 1, 2007, we transferred a significant amount of ERCOT energy marketing contracts to AEPEP; thereby decreasing our future obligations in Energy and Capacity Purchase Contracts. See "ERCOT Contracts Transferred to AEPEP" section of Note 1.

Significant Factors

Litigation and Regulatory Activity

In the ordinary course of business, we are involved in employment, commercial, environmental and regulatory litigation. Since it is difficult to predict the outcome of these proceedings, we cannot state what the eventual outcome of these proceedings will be, or what the timing of the amount of any loss, fine or penalty may be. Management does, however, assess the probability of loss for such contingencies and accrues a liability for cases which have a probable likelihood of loss and the loss amount can be estimated. For details on our pending litigation and regulatory proceedings, see Note 4 - Rate Matters and Note 6 - Commitments, Guarantees and Contingencies in our 2006 Annual Report. Also, see Note 3 - Rate Matters and Note 4 - Commitments, Guarantees and Contingencies in the "Condensed Notes to Condensed Financial Statements of Registrant Subsidiaries" section. Adverse results in these proceedings have the potential to materially affect our results of operations, financial condition and cash flows.

New Generation

In December 2005, we sought proposals for new peaking, intermediate and base load generation to be online between 2008 and 2011. In May 2006, we announced plans to construct new generation to satisfy the demands of its customers. We will build up to 480 MW of simple-cycle natural gas combustion turbine peaking generation in Tontitown, Arkansas and will build a 480 MW combined-cycle natural gas fired plant at its existing Arsenal Hill Power Plant in Shreveport, Louisiana. We also plan to build a new 600 MW base load coal plant, of which our investment will be 73%, in Hempstead County, Arkansas by 2011 to meet the long-term generation needs of its customers. Preliminary cost estimates our share of the new facilities are approximately $1.4 billion (this total excludes the related transmission investment and AFUDC). These new facilities are subject to regulatory approvals from our three state commissions. The peaking generation facility in Tontitown, Arkansas has been approved by all three state commissions and Units 3 and 4 are projected to be online in July 2007 and the remaining two units by 2008. Construction is expected to begin in 2007 on the intermediate and base load facilities upon approval from the state regulatory commissions. Expenditures related to construction of these facilities are expected to total $349 million in 2007.

See the "Combined Management's Discussion and Analysis of Registrant Subsidiaries" section for additional discussion of factors relevant to us.

Critical Accounting Estimates

See the "Critical Accounting Estimates" section of "Combined Management's Discussion and Analysis of Registrant Subsidiaries" in the 2006 Annual Report for a discussion of the estimates and judgments required for regulatory accounting, revenue recognition, the valuation of long-lived assets, pension and other postretirement benefits and the impact of new accounting pronouncements.

Adoption of New Accounting Pronouncements

See the "Combined Management's Discussion and Analysis of Registrant Subsidiaries" section for a discussion of adoption of new accounting pronouncements.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT RISK MANAGEMENT ACTIVITIES

Market Risks

Our risk management assets and liabilities are managed by AEPSC as agent for us. The related risk management policies and procedures are instituted and administered by AEPSC. See complete discussion within AEP's "Quantitative and Qualitative Disclosures About Risk Management Activities" section. The following tables provide information about AEP's risk management activities' effect on us.

MTM Risk Management Contract Net Assets

The following two tables summarize the various mark-to-market (MTM) positions included in our condensed consolidated balance sheet as of March 31, 2007 and the reasons for changes in our total MTM value as compared to December 31, 2006.

Reconciliation of MTM Risk Management Contracts to Condensed Consolidated Balance Sheet As of March 31, 2007 (in thousands)

	MTM Risk Management Contracts	Cash Flow Hedges	Total
Current Assets	$ 66,352	$ 582	$ 66,934
Noncurrent Assets	16,264	37	16,301
Total MTM Derivative Contract Assets	82,616	619	83,235
Current Liabilities	(55,257)	(6)	(55,263)
Noncurrent Liabilities	(10,158)	(16)	(10,174)
Total MTM Derivative Contract Liabilities	(65,415)	(22)	(65,437)
Total MTM Derivative Contract Net Assets (Liabilities)	$ 17,201	$ 597	$ 17,798

MTM Risk Management Contract Net Assets Three Months Ended March 31, 2007 (in thousands)

Total MTM Risk Management Contract Net Assets at December 31, 2006	$ 20,166
(Gain) Loss from Contracts Realized/Settled During the Period and Entered in a Prior Period	(1,013)
Fair Value of New Contracts at Inception When Entered During the Period (a)	-
Net Option Premiums Paid/(Received) for Unexercised or Unexpired Option Contracts Entered During the Period	-
Change in Fair Value Due to Valuation Methodology Changes on Forward Contracts	-
Changes in Fair Value Due to Market Fluctuations During the Period (b)	21
Changes in Fair Value Allocated to Regulated Jurisdictions (c)	(1,973)
Total MTM Risk Management Contract Net Assets	17,201
Net Cash Flow Hedge Contracts	597
Total MTM Risk Management Contract Net Assets at March 31, 2007	$ 17,798

(a) Reflects fair value on long-term contracts which are typically with customers that seek fixed pricing to limit their risk against fluctuating energy prices. Inception value is only recorded if observable market data can be obtained for valuation inputs for the entire contract term. The contract prices are valued against market curves associated with the delivery location and delivery term.
(b) Market fluctuations are attributable to various factors such as supply/demand, weather, etc.
(c) "Changes in Fair Value Allocated to Regulated Jurisdictions" relates to the net gains (losses) of those contracts that are not reflected in the Condensed Consolidated Statements of Income. These net gains (losses) are recorded as regulatory liabilities/assets for those subsidiaries that operate in regulated jurisdictions.

Maturity and Source of Fair Value of MTM Risk Management Contract Net Assets

The following table presents:

- The method of measuring fair value used in determining the carrying amount of our total MTM asset or liability (external sources or modeled internally).
- The maturity, by year, of our net assets/liabilities to give an indication of when these MTM amounts will settle and generate cash.

Maturity and Source of Fair Value of MTM
Risk Management Contract Net Assets
Fair Value of Contracts as of March 31, 2007
(in thousands)

	Remainder 2007	2008	2009	2010	2011	After 2011	Total
Prices Actively Quoted - Exchange Traded Contracts	$ (16,029)	$ 1,742	$ (283)	$ -	$ -	$ -	$ (14,570)
Prices Provided by Other External Sources - OTC Broker Quotes (a)	29,194	4,143	(813)	-	-	-	32,524
Prices Based on Models and Other Valuation Methods (b)	(2,551)	335	1,461	2	-	-	(753)
Total	$ 10,614	$ 6,220	$ 365	$ 2	$ -	$ -	$ 17,201

(a) "Prices Provided by Other External Sources - OTC Broker Quotes" reflects information obtained from over-the-counter brokers, industry services, or multiple-party on-line platforms.
(b) "Prices Based on Models and Other Valuation Methods" is used in absence of pricing information from external sources. Modeled information is derived using valuation models developed by the reporting entity, reflecting when appropriate, option pricing theory, discounted cash flow concepts, valuation adjustments, etc. and may require projection of prices for underlying commodities beyond the period that prices are available from third-party sources. In addition, where external pricing information or market liquidity are limited, such valuations are classified as modeled. The determination of the point at which a market is no longer liquid for placing it in the modeled category varies by market.

Contract values that are measured using models or valuation methods other than active quotes or OTC broker quotes (because of the lack of such data for all delivery quantities, locations and periods) incorporate in the model or other valuation methods, to the extent possible, OTC broker quotes and active quotes for deliveries in years and at locations for which such quotes are available.

Cash Flow Hedges Included in Accumulated Other Comprehensive Income (Loss) (AOCI) on the Condensed Consolidated Balance Sheet

We are exposed to market fluctuations in energy commodity prices impacting our power operations. We monitor these risks on our future operations and may use various commodity instruments designated in qualifying cash flow hedge strategies to mitigate the impact of these fluctuations on the future cash flows. We do not hedge all commodity price risk.

We use interest rate derivative transactions to manage interest rate risk related to anticipated borrowings of fixed-rate debt. We do not hedge all interest rate risk.

We use forward contracts and collars as cash flow hedges to lock in prices on certain transactions denominated in foreign currencies where deemed necessary. We do not hedge all foreign currency exposure.

The following table provides the detail on designated, effective cash flow hedges included in AOCI on our Condensed Consolidated Balance Sheets and the reasons for the changes from December 31, 2006 to March 31, 2007. Only contracts designated as cash flow hedges are recorded in AOCI. Therefore, economic hedge contracts that are not designated as effective cash flow hedges are marked-to-market and included in the previous risk management tables. All amounts are presented net of related income taxes.

Total Accumulated Other Comprehensive Income (Loss) Activity
Three Months Ended March 31, 2007
(in thousands)

	Interest Rate	Foreign Currency	Total
Beginning Balance in AOCI December 31, 2006	$ (6,435)	$ 25	$ (6,410)
Changes in Fair Value	(1,019)	509	(510)
Reclassifications from AOCI to Net Income for Cash Flow Hedges Settled	183	-	183
Ending Balance in AOCI March 31, 2007	$ (7,271)	$ 534	$ (6,737)

The portion of cash flow hedges in AOCI expected to be reclassified to earnings during the next twelve months is a $249 thousand loss.

Credit Risk

Our counterparty credit quality and exposure is generally consistent with that of AEP.

VaR Associated with Risk Management Contracts

We use a risk measurement model, which calculates Value at Risk (VaR) to measure our commodity price risk in the risk management portfolio. The VaR is based on the variance-covariance method using historical prices to estimate volatilities and correlations and assumes a 95% confidence level and a one-day holding period. Based on this VaR analysis, at March 31, 2007, a near term typical change in commodity prices is not expected to have a material effect on our results of operations, cash flows or financial condition.

The following table shows the end, high, average, and low market risk as measured by VaR for the periods indicated:

Three Months Ended March 31, 2007 (in thousands)				Twelve Months Ended December 31, 2006 (in thousands)			
End	**High**	**Average**	**Low**	**End**	**High**	**Average**	**Low**
$83	$245	$100	$25	$447	$2,171	$794	$68

The High VaR for the twelve months ended December 31, 2006 occurred in the fourth quarter due to volatility in the ERCOT region.

VaR Associated with Debt Outstanding

We also utilize a VaR model to measure interest rate market risk exposure. The interest rate VaR model is based on a Monte Carlo simulation with a 95% confidence level and a one-year holding period. The risk of potential loss in fair value attributable to our exposure to interest rates primarily related to long-term debt with fixed interest rates was $43 million and $25 million at March 31, 2007 and December 31, 2006, respectively. We would not expect to liquidate our entire debt portfolio in a one-year holding period; therefore, a near term change in interest rates should not negatively affect our results of operations or consolidated financial position.

SOUTHWESTERN ELECTRIC POWER COMPANY CONSOLIDATED
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
For the Three Months Ended March 31, 2007 and 2006
(in thousands)
(Unaudited)

		2007		2006
REVENUES				
Electric Generation, Transmission and Distribution	$	327,284	$	293,993
Sales to AEP Affiliates		16,415		10,765
Other		400		374
TOTAL		344,099		305,132
EXPENSES				
Fuel and Other Consumables Used for Electric Generation		111,987		90,661
Purchased Electricity for Resale		52,498		29,218
Purchased Electricity from AEP Affiliates		22,917		23,337
Other Operation		53,783		49,700
Maintenance		26,339		24,657
Depreciation and Amortization		34,122		32,617
Taxes Other Than Income Taxes		15,991		15,982
TOTAL		317,637		266,172
OPERATING INCOME		26,462		38,960
Other Income (Expense):				
Interest Income		705		543
Allowance for Equity Funds Used During Construction		1,391		185
Interest Expense		(15,490)		(12,771)
INCOME BEFORE INCOME TAXES AND MINORITY INTEREST EXPENSE		13,068		26,917
Income Tax Expense		2,621		8,823
Minority Interest Expense		842		222
NET INCOME		9,605		17,872
Preferred Stock Dividend Requirements		57		57
EARNINGS APPLICABLE TO COMMON STOCK	$	9,548	$	17,815

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

See Condensed Notes to Condensed Financial Statements of Registrant Subsidiaries.

SOUTHWESTERN ELECTRIC POWER COMPANY CONSOLIDATED
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN COMMON SHAREHOLDER'S EQUITY AND COMPREHENSIVE INCOME (LOSS)
For the Three Months Ended March 31, 2007 and 2006
(in thousands)
(Unaudited)

	Common Stock	Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
DECEMBER 31, 2005	$ 135,660	$ 245,003	$ 407,844	$ (6,129)	$ 782,378
Common Stock Dividends			(10,000)		(10,000)
Preferred Stock Dividends			(57)		(57)
TOTAL					772,321
COMPREHENSIVE INCOME					
Other Comprehensive Income, Net of Taxes:					
Cash Flow Hedges, Net of Tax of $930				1,728	1,728
NET INCOME			17,872		17,872
TOTAL COMPREHENSIVE INCOME					19,600
MARCH 31, 2006	$ 135,660	$ 245,003	$ 415,659	$ (4,401)	$ 791,921
DECEMBER 31, 2006	$ 135,660	$ 245,003	$ 459,338	$ (18,799)	$ 821,202
FIN 48 Adoption, Net of Tax			(1,642)		(1,642)
Preferred Stock Dividends			(57)		(57)
TOTAL					819,503
COMPREHENSIVE INCOME					
Other Comprehensive Loss, Net of Taxes:					
Cash Flow Hedges, Net of Tax of $39				(327)	(327)
NET INCOME			9,605		9,605
TOTAL COMPREHENSIVE INCOME					9,278
MARCH 31, 2007	$ 135,660	$ 245,003	$ 467,244	$ (19,126)	$ 828,781

See Condensed Notes to Condensed Financial Statements of Registrant Subsidiaries.

**SOUTHWESTERN ELECTRIC POWER COMPANY CONSOLIDATED
CONDENSED CONSOLIDATED BALANCE SHEETS
ASSETS
March 31, 2007 and December 31, 2006
(in thousands)
(Unaudited)**

		2007		2006
CURRENT ASSETS				
Cash and Cash Equivalents	$	1,900	$	2,618
Advances to Affiliates		8,959		-
Accounts Receivable:				
Customers		74,382		88,245
Affiliated Companies		48,598		59,679
Miscellaneous		13,077		8,595
Allowance for Uncollectible Accounts		(137)		(130)
Total Accounts Receivable		135,920		156,389
Fuel		73,479		69,426
Materials and Supplies		46,101		46,001
Risk Management Assets		66,934		120,036
Margin Deposits		19,353		41,579
Prepayments and Other		28,581		18,256
TOTAL		381,227		454,305
PROPERTY, PLANT AND EQUIPMENT				
Electric:				
Production		1,586,238		1,576,200
Transmission		690,384		668,008
Distribution		1,262,203		1,228,948
Other		611,255		595,429
Construction Work in Progress		301,251		259,662
Total		4,451,331		4,328,247
Accumulated Depreciation and Amortization		1,868,974		1,834,145
TOTAL - NET		2,582,357		2,494,102
OTHER NONCURRENT ASSETS				
Regulatory Assets		153,080		156,420
Long-term Risk Management Assets		16,301		20,531
Employee Benefits and Pension Assets		25,302		26,029
Deferred Charges and Other		68,855		39,581
TOTAL		263,538		242,561
TOTAL ASSETS	$	3,227,122	$	3,190,968

See Condensed Notes to Condensed Financial Statements of Registrant Subsidiaries.

SOUTHWESTERN ELECTRIC POWER COMPANY CONSOLIDATED
CONDENSED CONSOLIDATED BALANCE SHEETS
LIABILITIES AND SHAREHOLDERS' EQUITY
March 31, 2007 and December 31, 2006
(Unaudited)

	2007	2006
CURRENT LIABILITIES	(in thousands)	
Advances from Affiliates	$ -	$ 188,965
Accounts Payable:		
General	155,206	140,424
Affiliated Companies	72,448	68,680
Short-term Debt - Nonaffiliated	20,433	17,143
Long-term Debt Due Within One Year - Nonaffiliated	97,768	102,312
Risk Management Liabilities	55,263	109,578
Customer Deposits	36,798	48,277
Accrued Taxes	64,418	31,591
Regulatory Liability for Over-Recovered Fuel Costs	33,791	26,012
Other	66,871	85,086
TOTAL	602,996	818,068
NONCURRENT LIABILITIES		
Long-term Debt - Nonaffiliated	822,519	576,694
Long-term Debt - Affiliated	50,000	50,000
Long-term Risk Management Liabilities	10,174	14,083
Deferred Income Taxes	362,321	374,548
Regulatory Liabilities and Deferred Investment Tax Credits	347,951	346,774
Deferred Credits and Other	196,064	183,087
TOTAL	1,789,029	1,545,186
TOTAL LIABILITIES	2,392,025	2,363,254
Minority Interest	1,619	1,815
Cumulative Preferred Stock Not Subject to Mandatory Redemption	4,697	4,697
Commitments and Contingencies (Note 4)		
COMMON SHAREHOLDER'S EQUITY		
Common Stock - Par Value - $18 Per Share:		
Authorized - 7,600,000 Shares		
Outstanding - 7,536,640 Shares	135,660	135,660
Paid-in Capital	245,003	245,003
Retained Earnings	467,244	459,338
Accumulated Other Comprehensive Income (Loss)	(19,126)	(18,799)
TOTAL	828,781	821,202
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 3,227,122	$ 3,190,968

See Condensed Notes to Condensed Financial Statements of Registrant Subsidiaries.

SOUTHWESTERN ELECTRIC POWER COMPANY CONSOLIDATED
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Three Months Ended March 31, 2007 and 2006
(in thousands)
(Unaudited)

	2007	2006
OPERATING ACTIVITIES		
Net Income	$ 9,605	$ 17,872
Adjustments for Noncash Items:		
Depreciation and Amortization	34,122	32,617
Deferred Income Taxes	(6,677)	(9,101)
Mark-to-Market of Risk Management Contracts	2,965	10,468
Deferred Property Taxes	(28,815)	(28,997)
Change in Other Noncurrent Assets	(3,198)	9,458
Change in Other Noncurrent Liabilities	(178)	(19,121)
Changes in Certain Components of Working Capital:		
Accounts Receivable, Net	20,469	26,848
Fuel, Materials and Supplies	(4,141)	(17,521)
Margin Deposits	22,226	7,915
Accounts Payable	13,806	(15,304)
Customer Deposits	(11,479)	(15,861)
Accrued Taxes, Net	36,113	45,238
Fuel Over/Under Recovery, Net	4,212	15,216
Other Current Assets	(2,868)	2,821
Other Current Liabilities	(20,572)	(21,255)
Net Cash Flows From Operating Activities	65,590	41,293
INVESTING ACTIVITIES		
Construction Expenditures	(107,613)	(54,238)
Change in Advances to Affiliates, Net	(8,959)	-
Other	(4,067)	(56)
Net Cash Flows Used For Investing Activities	(120,639)	(54,294)
FINANCING ACTIVITIES		
Issuance of Long-term Debt - Nonaffiliated	247,548	-
Change in Short-term Debt, Net - Nonaffiliated	3,290	4,394
Change in Advances from Affiliates, Net	(188,965)	20,988
Retirement of Long-term Debt - Nonaffiliated	(6,395)	(2,457)
Principal Payments for Capital Lease Obligations	(1,090)	(367)
Dividends Paid on Common Stock	-	(10,000)
Dividends Paid on Cumulative Preferred Stock	(57)	(57)
Net Cash Flows From Financing Activities	54,331	12,501
Net Decrease in Cash and Cash Equivalents	(718)	(500)
Cash and Cash Equivalents at Beginning of Period	2,618	3,049
Cash and Cash Equivalents at End of Period	$ 1,900	$ 2,549
SUPPLEMENTARY INFORMATION		
Cash Paid for Interest, Net of Capitalized Amounts	$ 16,747	$ 11,892
Net Cash Paid for Income Taxes	580	1,282

Noncash Acquisitions Under Capital Leases	3,192	3,412
Construction Expenditures Included in Accounts Payable at March 31,	32,460	12,800

See Condensed Notes to Condensed Financial Statements of Registrant Subsidiaries.

SOUTHWESTERN ELECTRIC POWER COMPANY CONSOLIDATED
INDEX TO CONDENSED NOTES TO CONDENSED FINANCIAL STATEMENTS OF REGISTRANT SUBSIDIARIES

The condensed notes to SWEPCo's condensed consolidated financial statements are combined with the condensed notes to condensed financial statements for other registrant subsidiaries. Listed below are the notes that apply to SWEPCo.

CONDENSED NOTES TO CONDENSED FINANCIAL STATEMENTS OF REGISTRANT SUBSIDIARIES

The condensed notes to condensed financial statements that follow are a combined presentation for the Registrant Subsidiaries. The following list indicates the registrants to which the footnotes apply:

1.	Significant Accounting Matters	AEGCo, APCo, CSPCo, I&M, KPCo, OPCo, PSO, SWEPCo, TCC, TNC
2.	New Accounting Pronouncements	AEGCo, APCo, CSPCo, I&M, KPCo, OPCo, PSO, SWEPCo, TCC, TNC
3.	Rate Matters	APCo, CSPCo, I&M, KPCo, OPCo, PSO, SWEPCo, TCC, TNC
4.	Commitments, Guarantees and Contingencies	AEGCo, APCo, CSPCo, I&M, KPCo, OPCo, PSO, SWEPCo, TCC, TNC
5.	Acquisitions, Dispositions and Assets Held for Sale	AEGCo, CSPCo, TCC
6.	Benefit Plans	APCo, CSPCo, I&M, KPCo, OPCo, PSO, SWEPCo, TCC, TNC
7.	Business Segments	AEGCo, APCo, CSPCo, I&M, KPCo, OPCo, PSO, SWEPCo, TCC, TNC
8.	Income Taxes	AEGCo, APCo, CSPCo, I&M, KPCo, OPCo, PSO, SWEPCo, TCC, TNC
9.	Financing Activities	AEGCo, APCo, CSPCo, I&M, KPCo, OPCo, PSO, SWEPCo, TCC, TNC

1. SIGNIFICANT ACCOUNTING MATTERS

General

The accompanying unaudited condensed financial statements and footnotes were prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X of the SEC. Accordingly, they do not include all the information and footnotes required by GAAP for complete financial statements.

In the opinion of management, the unaudited interim financial statements reflect all normal and recurring accruals and adjustments necessary for a fair presentation of the results of operations, financial position and cash flows for the interim periods for each Registrant Subsidiary. The results of operations for the three months March 31, 2007 are not necessarily indicative of results that may be expected for the year ending December 31, 2007. The accompanying condensed financial statements are unaudited and should be read in conjunction with the audited 2006 financial statements and notes thereto, which are included in the Registrant Subsidiaries' Annual Reports on Form 10-K for the year ended December 31, 2006 as filed with the SEC on February 28, 2007.

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

AOCI is included on the balance sheets in the common shareholder's equity section. AOCI for Registrant Subsidiaries as of March 31, 2007 and December 31, 2006 is shown in the following table.

Components		March 31, 2007		December 31, 2006
		(in thousands)		
Cash Flow Hedges:				
APCo	$	(10,031)	$	(2,547)
CSPCo		(1,878)		3,398
I&M		(14,255)		(8,962)
KPCo		(490)		1,552
OPCo		791		7,262
PSO		(1,025)		(1,070)
SWEPCo		(6,737)		(6,410)
TNC		-		(702)
SFAS 158 Adoption:				
APCo	$	(52,244)	$	(52,244)
CSPCo		(25,386)		(25,386)
I&M		(6,089)		(6,089)
OPCo		(64,025)		(64,025)
SWEPCo		(12,389)		(12,389)
TNC		(9,457)		(9,457)

Related Party Transactions

Oklaunion PPA between TNC and AEP Energy Partners

On January 1, 2007, TNC began a 20-year Power Purchase & Sale Agreement (PPA) with an affiliate, AEP Energy Partners (AEPEP), whereby TNC agrees to sell AEPEP 100% of TNC's capacity and associated energy from its undivided interest (54.69%) in the Oklaunion plant. AEPEP is to pay TNC for the capacity and associated energy delivered to the delivery point, the sum of fuel, operation and maintenance, depreciation, capacity and all taxes other than federal income taxes applicable. A portion of the payment is fixed and is payable regardless of the level of output. There are no penalties if TNC fails to maintain a minimum availability level or exceeds a maximum heat rate level. The PPA was approved by the FERC on July 12, 2006.

TNC recorded revenue of $23.4 million from AEPEP in the first quarter of 2007, which is included in Sales to AEP Affiliates on its 2007 Condensed Consolidated Statement of Income.

ERCOT Contracts Transferred to AEPEP

Effective January 1, 2007, PSO and SWEPCo transferred certain existing ERCOT energy marketing contracts to AEPEP and entered into intercompany financial and physical purchase and sale agreements with AEPEP. This was done to lock in PSO and SWEPCo's margins on ERCOT trading and marketing contracts and to transfer the future associated commodity price and credit risk to AEPEP. The contracts will mature over the next three years.

PSO and SWEPCo have historically presented third party ERCOT trading and marketing activity on a net basis in Revenues - Electric Generation, Transmission and Distribution. The applicable ERCOT third party trading and marketing contracts that were not transferred to AEPEP will remain until maturity on PSO and SWEPCo and will be presented on a net basis in Sales to AEP Affiliates on PSO's and SWEPCo's Statements of Income.

The following table indicates the sales to AEPEP and the amounts reclassified from third party to affiliate:

Company	Net Settlement With AEPEP	Third Party Amounts Reclassified to Affiliate	Net Amount included in Sales to AEP Affiliates
	For the Three Months Ended March 31, 2007		
		(in thousands)	
PSO	$ 43,150	$ (35,837)	$ 7,313
SWEPCo	46,876	(38,259)	8,617

The following table indicates the affiliated portion of risk management assets and liabilities reflected on PSO's and SWEPCo's balance sheets associated with these contracts:

	As of March 31, 2007	
	PSO	**SWEPCo**
Current	**(in thousands)**	
Risk Management Assets	$ -	$ -
Risk Management Liabilities	(8,282)	(9,758)
Noncurrent		
Long-term Risk Management Assets	$ 584	$ 688
Long-term Risk Management Liabilities	(2,097)	(2,471)

Texas Restructuring - SPP - Affecting TNC and SWEPCo

In August 2006, the PUCT adopted a rule extending the delay in implementation of customer choice in the SPP area of Texas until no sooner than January 1, 2011. SWEPCo's and approximately 3% of TNC's businesses were in SPP. A petition was filed in May 2006 requesting approval to transfer Mutual Energy SWEPCO L.P.'s (a subsidiary of AEP

C&I Company, LLC) customers and TNC's facilities and certificated service territory located in the SPP area to SWEPCo. In January 2007, the final regulatory approval was received for the transfers. The transfers were effective February 2007 and were recorded at net book value of $11.6 million. The Arkansas Public Service Commission's approval requires SWEPCo to amend its fuel recovery tariff so that Arkansas customers do not pay the incremental cost of serving the additional load.

Reclassifications

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

On their statements of income, the Registrant Subsidiaries reclassified regulatory credits related to regulatory asset cost deferral on ARO from Depreciation and Amortization to Other Operation and Maintenance to offset the ARO accretion expense. The following table shows the credits reclassified by the Registrant Subsidiaries in 2006:

Company	Three Months Ended March 31, 2006 (in thousands)
AEGCo	$ 27
APCo	296
I&M	5,589

2. NEW ACCOUNTING PRONOUNCEMENTS

Upon issuance of exposure drafts or final pronouncements, we thoroughly review the new accounting literature to determine the relevance, if any, to our business. The following represents a summary of new pronouncements issued or implemented in 2007 and standards issued but not implemented that we have determined relate to our operations.

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 shareholders' 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 being market prices in active markets. The standard requires fair value measurements be disclosed by hierarchy level and an entity include its own credit standing in the measurement of its liabilities and modifies the transaction price presumption.

SFAS 157 is effective for interim and annual periods in fiscal years beginning after November 15, 2007. Management expects that the adoption of this standard will impact MTM valuations of certain contracts, but is unable to quantify the effect. Although the statement is applied prospectively upon adoption, the effect of certain transactions is applied retrospectively as of the beginning of the fiscal year of application, with a cumulative effect adjustment to the appropriate balance sheet items. The Registrant Subsidiaries will adopt SFAS 157 effective January 1, 2008.

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.

SFAS 159 is effective for annual periods in fiscal years beginning after November 15, 2007. 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. In the event we elect the fair value option promulgated by this standard, the valuations of certain assets and liabilities may be impacted. The statement is applied prospectively upon adoption. The Registrant Subsidiaries will adopt SFAS 159 effective January 1, 2008.

FIN 48 "Accounting for Uncertainty in Income Taxes" and FASB Staff Position FIN 48-1 "Definition of Settlement in FASB Interpretation No. 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. The Registrant Subsidiaries adopted FIN 48 effective January 1, 2007. The impact of this interpretation was an unfavorable (favorable) adjustment to retained earnings as follows:

Company		**(in thousands)**
AEGCo	$	(27)
APCo		2,685
CSPCo		3,022
I&M		(327)
KPCo		786
OPCo		5,380
PSO		386
SWEPCo		1,642
TCC		2,187
TNC		557

Future Accounting Changes

The FASB's standard-setting process is ongoing and until new standards have been finalized and issued by FASB, we cannot determine the impact on the reporting of our operations and financial position that may result from any such future changes. The FASB is currently working on several projects including business combinations, revenue recognition, liabilities and equity, derivatives disclosures, emission allowances, leases, insurance, subsequent events and related tax impacts. We also expect 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. RATE MATTERS

The Registrant subsidiaries are involved in rate and regulatory proceedings at the FERC and their state commissions. The Rate Matters note within the 2006 Annual Report should be read in conjunction with this report to gain a complete understanding of material rate matters still pending that could impact results of operations, cash flows and possibly financial condition. The following discusses ratemaking developments in 2007 and updates the 2006 Annual Report.

Ohio Rate Matters

Ohio Restructuring and Rate Stabilization Plans - Affecting CSPCo and OPCo

In January 2007, CSPCo and OPCo filed with the PUCO under the 4% provision of their RSPs to increase their annual generation rates for 2007 by $24 million and $8 million, respectively, to recover governmentally-mandated costs. Pursuant to the RSPs, CSPCo and OPCo implemented these proposed increases effective with the beginning of the May 2007 billing cycle. These increases are subject to refund until the PUCO issues a final order in the matter. The hearing is scheduled to begin in late May 2007.

In March 2007, CSPCo filed an application under the 4% provision of the RSP to adjust the Power Acquisition Rider (PAR) which was authorized in 2005 by the PUCO in connection with CSPCo's acquisition of Monongahela Power Company's certified territory in Ohio. The PAR is intended to recover the difference between CSPCo's tariffed generation service rates and the cost of power acquired to serve the former Monongahela Power load. The PAR was set for an initial 17-month period of January 2006 through May 2007. The filing would adjust the PAR for the nineteen month period of June 2007 through December 2008. The filing reflects a true up for estimated under-recoveries during the initial period, $8 million as of March 31, 2007, as well as the power acquisition costs for the upcoming nineteen-month period. If approved, CSPCo's revenues would increase by $22 million and $38 million for 2007 and 2008, respectively.

In March 2007, CSPCo and OPCo filed a settlement agreement at the PUCO resolving the Ohio Supreme Court's remand of the PUCO’s RSP order. The Supreme Court indicated concern with the absence of a competitive bid process as an alternative to the generation rates set by the RSP. In response, the settling parties agreed to have CSPCo and OPCo take bids for Renewable Energy Certificates (RECs). CSPCo and OPCo will give customers the option to pay a generation rate premium that would encourage the development of renewable energy sources by reimbursing CSPCo and OPCo for the cost of the RECs and the administrative costs of the program. This settlement agreement was supported by the Office of Consumers' Counsel, the Ohio Partners for Affordable Energy, the Ohio Energy Group and the PUCO staff. In May 2007, the PUCO adopted the settlement agreement in its entirety.

CSPCo and OPCo are involved in discussions with various stakeholders in Ohio about potential legislation to address the period following the expiration of the RSPs on December 31, 2008. At this time, management is unable to predict whether CSPCo and OPCo will transition to market pricing, as permitted by the current Ohio restructuring legislation, extend their RSP rates, with or without modification, or become subject to a legislative reinstatement of some form of cost-based regulation for their generation supply business on January 1, 2009 when the RSP period ends.

Customer Choice Deferrals - Affecting CSPCo and OPCo

As provided in the restructuring settlement agreement approved by the PUCO in 2000, CSPCo and OPCo established regulatory assets for customer choice implementation costs and related carrying costs in excess of $20 million each for recovery in the next general base rate filing which changes distribution rates after December 31, 2007 for OPCo and December 31, 2008 for CSPCo. Pursuant to the RSPs, recovery of these amounts for OPCo was further deferred until the next base rate filing to change distribution rates after the end of the RSP period of December 31, 2008. Through March 31, 2007, CSPCo and OPCo incurred $50 million and $51 million, respectively, of such costs and established regulatory assets of $25 million each for such costs. CSPCo and OPCo have not recognized $5 million and $6 million, respectively, of equity carrying costs, which are recognizable when collected. Management believes that the deferred customer choice implementation costs were prudently incurred to implement customer choice in Ohio and are probable of recovery in future distribution rates.

IGCC Plant - Affecting CSPCo and OPCo

In March 2005, CSPCo and OPCo filed a joint application with the PUCO seeking authority to recover costs related to building and operating a 629 MW IGCC power plant using clean-coal technology. The application proposed three phases of cost recovery associated with the IGCC plant: Phase 1, recovery of $24 million in pre-construction costs during 2006; Phase 2, concurrent recovery of construction-financing costs; and Phase 3, recovery or refund in distribution rates of any difference between the market-based standard service offer price for generation and the cost of operating and maintaining the plant, including a return on and return of the ultimate cost to construct the plant, originally projected to be $1.2 billion, along with fuel, consumables and replacement power costs. The proposed recoveries in Phases 1 and 2 would be applied against the 4% limit on additional generation rate increases CSPCo and OPCo could request under their RSPs.

In April 2006, the PUCO issued an order authorizing CSPCo and OPCo to implement Phase 1 of the cost recovery proposal. In June 2006, the PUCO issued another order approving a tariff to recover Phase 1 pre-construction costs over no more than a twelve-month period effective July 1, 2006. Through March 31, 2007, CSPCo and OPCo each recorded pre-construction IGCC regulatory assets of $10 million and each recovered $9 million of those costs. CSPCo and OPCo will recover the remaining amounts through June 30, 2007. The PUCO indicated that if CSPCo and OPCo have not commenced a continuous course of construction of the IGCC plant within five years of the June 2006 PUCO order, all charges collected for pre-construction costs, associated with items that may be utilized in IGCC projects at other sites, must be refunded to Ohio ratepayers with interest. The PUCO deferred ruling on Phases 2 and 3 cost recovery until further hearings are held. A date for further rehearings has not been set.

In August 2006, the Industrial Energy Users, Ohio Consumers' Counsel, FirstEnergy Solutions and Ohio Energy Group filed four separate appeals of the PUCO's order in the IGCC proceeding. Management believes that the PUCO's authorization to begin collection of Phase 1 rates is lawful. Management, however, cannot predict the outcome of these appeals. If the PUCO's order is found to be unlawful, CSPCo and OPCo could be required to refund Phase I cost-related recoveries.

Distribution Reliability Plan - Affecting CSPCo and OPCo

In January 2006, CSPCo and OPCo initiated a proceeding at the PUCO seeking a new distribution rate rider to fund enhanced distribution reliability programs. In the fourth quarter of 2006, as directed by the PUCO, CSPCo and OPCo filed a proposed enhanced reliability plan. The plan contemplated CSPCo and OPCo recovering approximately $28 million and $43 million, respectively, in additional distribution revenue during an eighteen month period beginning July 2007. In January 2007, the OCC filed testimony, which argued that CSPCo and OPCo should be required to improve distribution service reliability with funds from their existing rates.

In April 2007, CSPCo and OPCo filed a joint motion with the PUCO staff, the Ohio Consumers' Counsel, the Appalachian People's Action Coalition, the Ohio Partners for Affordable Energy and the Ohio Manufacturers Association to withdraw the proposed enhanced reliability plan.

Ormet - Affecting CSPCo and OPCo

Effective January 1, 2007, CSPCo and OPCo began to serve Ormet, a major industrial customer with a 520 MW load, under a PUCO encouraged settlement agreement. The settlement agreement between CSPCo and OPCo, Ormet, its employees' union and certain other interested parties was approved by the PUCO in November 2006. The settlement agreement provides for the recovery in 2007 and 2008 by CSPCo and OPCo of the difference between $43 per MWH to be paid by Ormet for power and a PUCO approved market price, if higher. The recovery will be accomplished by the amortization of a $57 million ($15 million for CSPCo and $42 million for OPCo) Ohio franchise tax phase-out regulatory liability recorded in 2005 and, if that is not sufficient, an increase in RSP generation rates under the additional 4% provision of the RSPs. The $43 per MWH price to be paid by Ormet for generation services is above the industrial RSP generation tariff but below current market prices. In December 2006, CSPCo and OPCo submitted a market price of $47.69 per MWH for 2007, which is pending PUCO approval. If the PUCO approves a lower market price, it could have an adverse effect on results of operations and cash flows. If CSPCo and OPCo serve the Ormet load after 2008 without any special provisions, they could experience incremental costs to acquire additional capacity to meet their reserve requirements and/or forgo off-system sales margins, which could have an adverse effect on future results of operations and cash flows.

Texas Rate Matters

TCC TEXAS RESTRUCTURING - Affecting TCC

Texas District Court Appeal Proceedings

TCC recovered its net recoverable stranded generation costs through a securitization financing and is refunding its net other true-up items through a CTC rate rider credit under 2006 PUCT orders. TCC appealed the PUCT stranded costs true-up orders seeking relief in both state and federal court on the grounds that certain aspects of the orders are contrary to the Texas Restructuring Legislation, PUCT rulemakings, federal law and fail to fully compensate TCC for its net stranded cost and other true-up items. The significant items appealed by TCC are:

- The PUCT ruling that TCC did not comply with the statute and PUCT rules regarding the required auction of 15% of its Texas jurisdictional installed capacity, which led to a significant disallowance of capacity auction true-up revenues,
- The PUCT ruling that TCC acted in a manner that was commercially unreasonable, because it failed to determine a minimum price at which it would reject bids for the sale of its nuclear generating plant and it bundled out of the money gas units with the sale of its coal unit, which led to the disallowance of a significant portion of TCC's net stranded generation plant cost, and
- The two federal matters regarding the allocation of off-system sales related to fuel recoveries and the potential tax normalization violation. See "TCC and TNC Deferred Fuel" and"TCC Deferred Investment Tax Credits and Excess Deferred Federal Income Taxes" sections below.

Municipal customers and other intervenors also appealed the PUCT true-up orders seeking to further reduce TCC's true-up recoveries. On February 1, 2007, the Texas District Court judge hearing the various appeals issued a letter containing his preliminary determinations. He generally affirmed the PUCT's April 4, 2006 final true-up order for TCC with two significant exceptions. The judge determined that the PUCT erred when it determined TCC's stranded cost using the sale of assets method instead of the Excess Cost Over Market (ECOM) method to value TCC's nuclear plant. The judge also determined that the PUCT erred when it concluded it was required to use the carrying cost rate specified in the true-up order. However, the District Court did not rule that the carrying cost rate was inappropriate. The judge directed that these matters should be remanded to the PUCT to determine the specific impact on TCC's future true-up revenues.

In March 2007, the District Court judge reversed his earlier preliminary decision and concluded the sale of assets method to value TCC's nuclear plant was appropriate. The District Court judge did not reconsider his preliminary ruling that the PUCT erred when it concluded it was required to use the carrying cost rate specified in the true-up order. The District Court judge also determined the PUCT improperly reduced TCC's net stranded plant costs from the sale of its generating units through the commercial unreasonableness disallowance, which could have a materially favorable effect on TCC. Management cannot predict the ultimate outcome of any future court appeals or any future remanded PUCT proceeding. If the District Court's carrying cost rate remand ruling is ultimately upheld on appeal and remanded to the PUCT for reconsideration, the PUCT could either confirm the existing weighted average carrying cost (WACC) rate or redetermine a new rate. If the PUCT changes the rate, it could result in a material adverse change to TCC's recoverable carrying costs, results of operations, cash flows and financial condition. TCC, the PUCT and intervenors appealed the District Court ruling to the Court of Appeals. Management cannot predict what actions, if any, the PUCT will take regarding the carrying costs.

If TCC ultimately succeeds in its appeals, it could have a favorable effect on future results of operations, cash flows and financial condition. If municipal customers and other intervenors succeed in their appeals, it could have a substantial adverse effect on future results of operations, cash flows and financial condition.

OTHER TEXAS RESTRUCTURING MATTERS

TCC Deferred Investment Tax Credits and Excess Deferred Federal Income Taxes - Affecting TCC

In TCC's 2006 true-up and securitization orders, the PUCT reduced net regulatory assets and the amount to be securitized by $51 million related to the present value of ADITC and by $10 million related to EDFIT associated with TCC's generation assets for a total reduction of $61 million.

TCC filed a request for a private letter ruling with the IRS in June 2005 regarding the permissibility under the IRS rules and regulations of the ADITC and EDFIT reduction proposed by the PUCT. The IRS issued its private letter ruling in May 2006, which stated that the PUCT's flow-through to customers of the present value of the ADITC and EDFIT benefits would result in a normalization violation. To address the matter and avoid a normalization violation, the PUCT agreed to allow TCC to defer an amount of the CTC refund totaling $103 million ($61 million in present value of ADITC and EDFIT associated with TCC's generation assets plus $42 million of related carrying costs) pending resolution of the normalization issue. If it is ultimately determined that a refund to customers through the true-up process of the ADITC and EDFIT, discussed above, is not a normalization violation, then TCC will be required to refund the $103 million, plus additional carrying costs. However, if such refund of ADITC and EDFIT is ultimately determined to cause a normalization violation, TCC anticipates it will be permitted to retain the $61 million present value of ADITC and EDFIT plus carrying costs, favorably impacting future results of operations.

If a normalization violation occurs, it could result in TCC's repayment to the IRS of ADITC on all property, including transmission and distribution property, which approximates $104 million as of March 31, 2007, and a loss of TCC's right to claim accelerated tax depreciation in future tax returns. Tax counsel advised management that a normalization violation should not occur until all remedies under law have been exhausted and the tax benefits are returned to ratepayers under a nonappealable order. Management intends to continue its efforts to avoid a normalization violation that would adversely affect future results of operations and cash flows.

TCC and TNC Deferred Fuel - Affecting TCC and TNC

The TCC deferred fuel over-recovery regulatory liability is a component of the other true-up items net regulatory liability refunded through the CTC rate rider credit. In 2002, TCC and TNC filed with the PUCT seeking to reconcile fuel costs and establish their final deferred fuel balances. In its final fuel reconciliation orders, the PUCT ordered a reduction in TCC's and TNC's recoverable fuel costs for, among other things, the reallocation of additional AEP System off-system sales margins under a FERC-approved SIA. Both TCC and TNC appealed the PUCT's rulings regarding a number of issues in the fuel orders in state court and challenged the jurisdiction of the PUCT over the allocation of off-system sales margin allocations in the federal court. Intervenors also appealed the PUCT's rulings in state court.

In 2006, the Federal District Court issued orders precluding the PUCT from enforcing the off-system sales reallocation portion of its ruling in the final TNC and TCC fuel reconciliation proceedings. The Federal court ruled, in both cases, that the FERC, not the PUCT, has jurisdiction over the allocation. The PUCT appealed both Federal District Court decisions to the United States Court of Appeals. In TNC's case, the Court of Appeals affirmed the District Court's decision. The PUCT has indicated they will appeal this ruling to the United States Supreme Court.

TCC has filed a Motion for Summary Affirmance based on the outcome of the TNC appeal. For TCC, the PUCT has conceded the issue concerning the allocation of off-system sales margins to AEP West companies under the SIA as governed by the TNC case. However, the PUCT continues to challenge the allocation of those margins among AEP West companies under the CSW Operating Agreement. If the PUCT's appeals are ultimately unsuccessful, TCC and TNC could record income of $16 million and $8 million, respectively, related to the reversal of the previously recorded fuel over-recovery regulatory liabilities.

If the PUCT is unsuccessful in the federal court system, it or another interested party may file a complaint at the FERC to address the allocation issue. If a complaint at the FERC results in the PUCT's decisions being adopted by the FERC, there could be an adverse effect on results of operations and cash flows. An unfavorable FERC ruling may result in a retroactive reallocation of off-system sales margins from AEP East companies to AEP West companies under the then existing SIA allocation method. If the adjustments were applied retroactively, the AEP East companies may be unable to recover the amounts reallocated to the West companies from their customers due to past frozen rates, past inactive fuel clauses and fuel clauses that do not include off-system sales credits. Although management cannot predict the ultimate outcome of this federal litigation, management believes that its allocations were in accordance with the then existing FERC-approved SIA and that it should not have to allocate additional off-system sales margins to the West companies including TCC and TNC.

In January 2007, TCC began refunding as part of the CTC rate rider credit described above, $149 million of its $165 million over-recovered deferred fuel regulatory liability. The remaining $16 million refund related to the favorable Federal District Court order has been deferred pending the outcome of the federal court appeal and would be subject to refund only upon a successful appeal by the PUCT.

Excess Earnings - Affecting TCC

In 2005, the Texas Court of Appeals issued a decision finding the PUCT's prior order from the unbundled cost of service case requiring TCC to refund excess earnings prior to and outside of the true-up process was unlawful under the Texas Restructuring Legislation. TCC refunded $55 million of excess earnings, including interest, of which $30 million went to the affiliated REP. In November 2005, the PUCT filed a petition for review with the Supreme Court of Texas seeking reversal of the Texas Court of Appeals' decision. The Supreme Court of Texas requested briefing, which has been provided, but it has not decided whether it will hear the case. If the Court of Appeals decision is upheld and the refund mechanism is found to be unlawful, the impact on TCC would then depend on: (a) how and if TCC is ordered by the PUCT to refund the excess earnings through the true-up process to ultimate customers and (b) whether TCC will be able to recover the amounts previously refunded to the REPs including the REP TCC sold to Centrica. Management is unable to predict the ultimate outcome of this litigation and its effect on future results of operations and cash flows.

OTHER TEXAS RATE MATTERS

TCC and TNC Energy Delivery Base Rate Filings - Affecting TCC and TNC

TCC and TNC each filed a base rate case seeking to increase transmission and distribution energy delivery services (wires) base rates in Texas. TCC and TNC requested $81 million and $25 million in annual increases, respectively. Both requests include a return on common equity of 11.25% and the impact of the expiration of the CSW merger savings rate credits. In March 2007, various intervenors and the PUCT staff filed their recommendations. Though the recommendations varied, the range of recommended increase was $8 million to $30 million for TCC and $1 million to $14 million for TNC. The recommended return on common equity ranged from 9.00% to 9.75%. In April 2007, TCC and TNC filed rebuttal testimony reducing the requested annual increases to $70 million for TCC and $22 million for TNC including a reduced requested return on common equity of 10.75%. Hearings began in April 2007 and are scheduled to be concluded in May 2007. Management expects the new base wires rates to become effective, subject to refund, in the second quarter of 2007 with a decision from the PUCT expected in the third quarter of 2007.

Management is unable to predict the ultimate effect of this filing on future results of operations, cash flows and financial condition.

SWEPCo Fuel Reconciliation - Texas - Affecting SWEPCo

In June 2006, SWEPCo filed a fuel reconciliation proceeding with the PUCT for its Texas retail operations. SWEPCo sought, in the proceedings, to include under-recoveries related to the reconciliation period of $50 million. In January 2007, intervenors filed testimony recommending that SWEPCo's reconcilable fuel costs be reduced. The intervenor recommendations ranged from a $10 million to $28 million reduction. In February 2007, the PUCT staff filed testimony recommending that SWEPCo's reconcilable fuel costs be reduced by $10 million. SWEPCo does not agree with the intervenor's or staff's recommendations and filed rebuttal testimony in February 2007. Hearings have been held and briefs have been filed. Results of operations could be adversely affected by $28 million plus carrying costs if the PUCT adopts all of the intervenor and staff recommendations. Management is unable to predict the outcome of this proceeding or its effect on future results of operations and cash flows.

Virginia Rate Matters

Virginia Restructuring - Affecting APCo

In April 2004, Virginia enacted legislation that extended the transition period for electricity restructuring, including capped rates, through December 31, 2010. The legislation provides APCo with specified cost recovery opportunities during the capped rate period, including two optional bundled general base rate changes and an opportunity for timely recovery, through a separate rate mechanism, of certain incremental environmental and reliability costs incurred on and after July 1, 2004. Under the restructuring law, APCo continues to have an active fuel clause recovery mechanism in Virginia and continues to practice deferred fuel accounting. Also, under the restructuring law, APCo defers incremental environmental generation costs and incremental transmission and distribution reliability costs for future recovery, to the extent such costs are not being recovered when incurred, and amortizes a portion of such deferrals commensurate with recovery.

In April 2007, the Virginia legislature adopted a comprehensive law providing for the re-regulation of electric utilities' generation/supply rates. The amendments shorten the transition period by two years (from 2010 to 2008) after which rates for retail generation/supply will return to a form of cost-based regulation. The legislation provides for, among other things, biennial rate reviews beginning in 2009, rate adjustment clauses for the recovery of the costs of (a) transmission services and new transmission investment, (b) Demand Side Management, load management, and energy efficiency programs, (c) renewable energy programs, and (d) environmental retrofit and new generation investments, significant return on equity enhancements for large investments in new generation and, subject to Virginia SCC approval, certain environmental retrofits, and a floor on the allowed return on equity based on the average earned return on equities' of regional vertically integrated electric utilities. Effective July 1, 2007, the amendments allow utilities to retain a minimum of 25% of the margins from off-system sales with the remaining margins from such sales credited against fuel factor expenses. The legislation also allows APCo to continue to defer and recover incremental environmental and reliability costs incurred through December 31, 2008. APCo expects this new form of cost-based ratemaking should improve its annual return on equity and cash flow from operations when new ratemaking begins in 2009. However, with the return of cost-based regulation, APCo's generation business will again meet the criteria for application of regulatory accounting principles under SFAS 71. Results of operations and financial condition could be adversely affected when APCo is required to re-establish certain net regulatory liabilities applicable to its generation/supply business. The timing and earnings effect from such reapplication of SFAS 71 regulatory accounting for APCo's Virginia generation/supply business are uncertain at this time.

APCo Virginia Base Rate Case - Affecting APCo

In May 2006, APCo filed a request with the Virginia SCC seeking an increase in base rates of $225 million to recover increasing costs including the cost of its investment in environmental equipment and a return on equity of 11.5%. In addition, APCo requested to move off-system sales margins, currently credited to customers through base rates, to the fuel factor where they can be trued-up to actual. APCo also proposed to share the off-system sales margins with customers with 40% going to reduce rates and 60% being retained by APCo. This proposed off-system sales fuel rate credit, which is estimated to be $27 million, partially offsets the $225 million requested increase in base rates for a net increase in base rate revenues of $198 million. The major components of the $225 million base rate request include $73 million for the impact of removing off-system sales margins from the rate year ending September 30, 2007, $60 million mainly due to projected net environmental plant additions through September 30, 2007 and $48 million for return on equity.

In May 2006, the Virginia SCC issued an order, consistent with Virginia law, placing the net requested base rate increase of $198 million into effect on October 2, 2006, subject to refund. The $198 million base rate increase being collected, subject to refund, includes recovery of incremental environmental compliance and transmission and distribution system reliability (E&R) costs projected to be incurred during the rate year beginning October 2006. These incremental E&R costs can be deferred and recovered through the E&R surcharge mechanism if not recovered through this base rate request. In October 2006, the Virginia SCC staff filed its direct testimony recommending a base rate increase of $13 million with a return on equity of 9.9% and no off-system sales margin sharing. Other intervenors have recommended base rate increases ranging from $42 million to $112 million. APCo filed rebuttal testimony in November 2006. Hearings were held in December 2006.

In March 2007, the Hearing Examiner (HE) issued a report recommending a $76 million increase in APCo’s base rates and $45 million credit to the fuel factor for off-system sales margins. The HE’s recommendations include a return on equity of 10.1% which would reduce APCo’s revenue requirement by approximately $23 million. The HE also recommended limiting forward looking ratemaking adjustments to June 30, 2006 as opposed to September 30, 2007, which would reduce APCo’s revenue requirement by approximately $72 million, of which approximately $60 million relates to incremental E&R costs that can be deferred for future recovery through the E&R surcharge mechanism. The HE further proposed to share the off-system sales margins using the twelve months ended June 30, 2006 of $101 million with 50% reducing base rates, 45% reducing fuel rates and 5% retained by APCo to determine the revenue requirement. APCo’s proposal did not reduce base rates for off-system sales margins, but reduced fuel rates approximately $27 million for off-system sales margins. APCo expects a final order to be issued during 2007.

APCo is providing for a possible refund of revenues collected subject to refund consistent with the HE recommendations. Management is unable to predict the ultimate effect of this filing on future results of operations, cash flows and financial condition.

West Virginia Rate Matters

APCo Expanded Net Energy Cost (ENEC) Filing - Affecting APCo

In April 2007, the WVPSC issued an order establishing an investigation and hearing of APCo’s and WPCo’s 2007 ENEC joint compliance filing. The ENEC is an expanded form of fuel clause mechanism, which includes all energy-related costs including fuel, purchased power expenses, off-system sales credits and other energy/transmission items. In the March 2007 ENEC joint compliance filing, APCo filed for an increase of approximately $91 million including a $65 million increase in ENEC and a $26 million increase in construction surcharges to become effective July 1, 2007. A hearing on the joint compliance filing is scheduled for May 2007.

APCo IGCC - Affecting APCo

In January 2006, APCo filed a petition with the WVPSC requesting its approval of a Certificate of Public Convenience and Necessity to construct a 629 MW IGCC plant adjacent to APCo’s existing Mountaineer Generating

Station in Mason County, WV. In January 2007, at APCo's request, the WVPSC issued an order delaying the Commission's deadline for issuing an order on the certificate to December 2007. Through March 31, 2007, APCo deferred pre-construction IGCC costs totaling $10 million. If the plant is not built and these costs are not recoverable, future results of operations and cash flows would be adversely affected.

Indiana Rate Matters

I&M Depreciation Study Filing - Affecting I&M

In February 2007, I&M filed a request with the IURC for approval of revised book depreciation rates effective January 1, 2007. The filing included a settlement agreement entered into with the Indiana Office of the Utility Consumer Counsel that would provide direct benefits to I&M's customers if new depreciation rates are approved by the IURC. The direct benefits would include a $5 million credit to fuel costs and an approximate $8 million smart metering pilot program. In addition, if the agreement is approved, I&M would initiate a general rate proceeding on or before July 1, 2007 and initiate two studies, one to investigate a general smart metering program and the other to study the market viability of demand side management programs. Based on the depreciation study included in the filing, I&M recommended a decrease in pretax annual depreciation expense on an Indiana jurisdictional basis of approximately $69 million reflecting an NRC-approved 20-year extension of the Cook Plant licenses for Units 1 and 2 and an extension of the service life of the Tanners Creek coal-fired generating units. This petition was not a request for a change in customers' electric service rates. As proposed, the book depreciation reduction would increase earnings but would not impact cash flows until rates are revised. The IURC held a public hearing in April 2007. I&M requested expeditious review and approval of its filing, but management cannot predict the outcome of the request or the timing of any approved depreciation reduction. If approved as filed, pretax earnings would increase by $64 million in 2007.

Kentucky Rate Matters

KPCo Environmental Surcharge Filing - Affecting KPCo

In July 2006, KPCo filed for approval of an amended environmental compliance plan and revised tariff to implement an adjusted environmental surcharge. KPCo estimates the amended environmental compliance plan and revised tariff would increase revenues over 2006 levels by approximately $2 million in 2007 and $6 million in 2008 for a total of $8 million of additional revenue at current cost projections. In January 2007, the KPSC issued an order approving KPCo's proposed plan and surcharge. Future recovery is based upon actual environmental costs and is subject to periodic review and approval of those actual costs by the KPSC.

In November 2006, the Kentucky Attorney General and the Kentucky Industrial Utility Consumers (KIUC) filed an appeal with the Kentucky Court of Appeals of the Franklin Circuit Court's 2006 order upholding the KPSC's 2005 Environmental Surcharge order. In its order, the KPSC approved KPCo's recovery of its environmental costs at its Big Sandy Plant and its share of environmental costs incurred as a result of the AEP Power Pool capacity settlement. The KPSC has allowed KPCo to recover these FERC-approved allocated costs, via the environmental surcharge, since the KPSC's first environmental surcharge order in 1997. KPCo presently recovers $7 million a year in environmental surcharge revenues.

In March 2007, the KPSC issued an order, at the request of the Kentucky Attorney General, stating the environmental surcharge collections authorized in the January 2007 order that are associated with out-of-state generating facilities should be collected over the six months beginning March 2007, subject to refund, pending the outcome of the court of appeals process. At this time, management is unable to predict the outcome of this proceeding and its effect on KPCo's current environmental surcharge revenues or on the January 2007 KPSC order increasing KPCo's environmental rates.

Oklahoma Rate Matters

PSO Fuel and Purchased Power and its Possible Impact on AEP East companies and AEP West companies

In 2002, PSO under-recovered $44 million of fuel costs resulting from a reallocation among AEP West companies of purchased power costs for periods prior to January 1, 2002. In July 2003, PSO proposed collection of those reallocated costs over eighteen months. In August 2003, the OCC staff filed testimony recommending PSO recover $42 million of the reallocated purchased power costs over three years and PSO reduced its regulatory asset deferral by $2 million. The OCC subsequently expanded the case to include a full prudence review of PSO's 2001 fuel and purchased power practices. In January 2006, the OCC staff and intervenors issued supplemental testimony alleging that AEP deviated from the FERC-approved method of allocating off-system sales margins between AEP East companies and AEP West companies and among AEP West companies. The OCC staff proposed that the OCC offset the $42 million of under-recovered fuel with the proposed reallocation of off-system sales margins of $27 million to $37 million and with $9 million attributed to wholesale customers, which they claimed had not been refunded. In February 2006, the OCC staff filed a report concluding that the $9 million of reallocated purchased power costs assigned to wholesale customers had been refunded, thus removing that issue from its recommendation.

In 2004, an Oklahoma ALJ found that the OCC lacks authority to examine whether PSO deviated from the FERC-approved allocation methodology and held that any such complaints should be addressed at the FERC. The OCC has not ruled on appeals by intervenors of the ALJ's finding. The United States District Court for the Western District of Texas issued orders in September 2005 regarding a TNC fuel proceeding and in August 2006 regarding a TCC fuel proceeding, preempting the PUCT from reallocating off-system sales margins between the AEP East companies and AEP West companies. The federal court agreed that the FERC has sole jurisdiction over that allocation. The PUCT appealed the ruling. The United States Court of Appeals for the Fifth Circuit, issued a decision in December 2006 regarding the TNC fuel proceeding that affirmed the United States District Court ruling.

PSO does not agree with the intervenors' and the OCC staff's recommendations and proposals other than the staff's original recommendation that PSO be allowed to recover the $42 million over three years and will defend its right to recover its under-recovered fuel balance. Management believes that if the position taken by the federal courts in the Texas proceeding is applied to PSO's case, then the OCC should be preempted from disallowing fuel recoveries for alleged improper allocations of off-system sales margins between AEP East companies and AEP West companies. The OCC or another party could file a complaint at the FERC alleging the allocation of off-system sales margins to PSO is improper, which could result in an adverse effect on future results of operations and cash flows for AEP and the AEP East companies. However, to date, there has been no claim asserted at the FERC that AEP deviated from the approved allocation methodologies, but even if one were asserted, management believes that it would not prevail.

In June 2005, the OCC issued an order directing its staff to conduct a prudence review of PSO's fuel and purchased power practices for the year 2003. The OCC staff filed testimony finding no disallowances in the test year data. The Attorney General of Oklahoma filed testimony stating that they could not determine if PSO's gas procurement activities were prudent, but did not include a recommended disallowance. However, an intervenor filed testimony in June 2006 proposing the disallowance of $22 million in fuel costs based on a historical review of potential hedging opportunities that he alleges existed during the year. A hearing was held in August 2006 and management expects a recommendation from the ALJ in 2007.

In February 2006, a law was enacted requiring the OCC to conduct prudence reviews on all generation and fuel procurement processes, practices and costs on either a two or three-year cycle depending on the number of customers served. PSO is subject to the required biennial reviews. In compliance with an OCC order, PSO is required to file its testimony by June 15, 2007. This proceeding will cover the year 2005.

Management cannot predict the outcome of the pending fuel and purchased power reviews or planned future reviews, but believes that PSO's fuel and purchased power procurement practices and costs are prudent and properly incurred. If the OCC disagrees and disallows fuel or purchased power costs including the unrecovered 2002 reallocation of such costs incurred by PSO, it would have an adverse effect on future results of operations and cash flows.

PSO Rate Filing - Affecting PSO

In November 2006, PSO filed a request to increase base rates $50 million for Oklahoma jurisdictional customers with a proposed effective date in the second quarter of 2007. PSO sought a return on equity of 11.75%. PSO also proposed a formula rate plan that, if approved as filed, will permit PSO to defer any unrecovered costs as a result of a revenue deficiency that exceeds 50 basis points of the allowed return on equity for recovery within twelve months beginning six months after the test year. The formula would enable PSO to recover on a timely basis the cost of its new generation, transmission and distribution construction (including carrying costs during construction), provide the opportunity to achieve the approved return on equity and avoid recording a significant AFUDC that would have been recorded during the construction time period.

In March 2007, the OCC staff and various intervenors filed testimony. The recommendations were base rate reductions that ranged from $18 million to $52 million. The recommended returns on equity ranged from 9.25% to 10.09%. These recommendations included reductions in depreciation expense of approximately $25 million, which has no earnings impact. The OCC staff filed testimony supporting a formula rate plan, generally similar to the one proposed by PSO. In April 2007, PSO filed rebuttal testimony regarding various issues raised by the OCC Staff and the intervenors. As a result of rebuttal testimony, PSO reduced its base rate request by $2 million. Hearings commenced on May 1, 2007.

Management is unable to predict the outcome of these proceedings, however, if rates are not increased in an amount sufficient to recover expected unavoidable cost increases future results of operations, cash flows and possibly financial condition could be adversely affected.

PSO Lawton and Peaking Generation Settlement Agreement - Affecting PSO

On November 26, 2003, pursuant to an application by Lawton Cogeneration, L.L.C. (Lawton) seeking approval of a Power Supply Agreement (the Agreement) with PSO and associated avoided cost payments, the OCC issued an order approving the Agreement and setting the avoided costs. The order did not address recovery by PSO of the resultant purchased power costs.

In December 2003, PSO filed an appeal of the OCC's order with the Oklahoma Supreme Court (the Court). In the appeal, PSO maintained that the OCC exceeded its authority under state and federal laws to require PSO to enter into the Agreement. The Court issued a decision on June 21, 2005, affirming portions of the OCC's order and remanding certain provisions. The Court affirmed the OCC's finding that Lawton established a legally enforceable obligation and ruled that it was within the OCC's discretion to award a 20-year contract and to base the capacity payment on a peaking unit. The Court directed the OCC to revisit its determination of PSO's avoided energy cost. Hearings were held on the remanded issues in April and May 2006.

In April 2007, all parties in the case filed a settlement agreement with the OCC resolving all issues. The OCC approved the settlement agreement in April 2007. The settlement agreement provides for a purchase fee of $35 million to be paid by PSO to Lawton and for Lawton to provide, at PSO's direction, all rights to the Lawton Cogeneration Facility for permits, options and engineering studies. PSO will record the purchase fee as a regulatory asset and recover it through a rider over a three-year period with a carrying charge of 8.25% beginning in September 2007. In addition, PSO will recover through a rider, subject to a $135 million cost cap, all of the traditional costs associated with plant in service of its new peaking units to be located at the Southwestern Station and Riverside Station at the time these units are placed in service. PSO may request approval from the OCC for recovery of costs exceeding the cost cap if special circumstances occurred necessitating a higher level of costs. Such costs will continue to be recovered through the rider until cost recovery occurs through base rates or formula rates in a subsequent proceeding. PSO must file a rate case within eighteen months of the beginning of recovery through the rider unless the OCC approves a formula-based rate mechanism that provides for recovery of the peaking units. Once the cost recovery for the new peaking units begins in mid-2008, PSO expects annual revenues of an estimated $36 million related to cost recovery of the peaking units and the purchase fee. This settlement agreement was supported by the OCC Staff, the Attorney General, the Oklahoma Industrial Energy Consumers and Lawton Cogeneration, L.L.C.

Louisiana Rate Matters

SWEPCo Louisiana Compliance Filing - Affecting SWEPCo

In October 2002, SWEPCo filed with the LPSC detailed financial information typically utilized in a revenue requirement filing, including a jurisdictional cost of service. This filing was required by the LPSC as a result of its order approving the merger between AEP and CSW. Due to multiple delays, in April 2006, the LPSC and SWEPCo agreed to update the financial information based on a 2005 test year. SWEPCo filed updated financial review schedules in May 2006 showing a return on equity of 9.44% compared to the previously authorized return on equity of 11.1%.

In July 2006, the LPSC staff's consultants filed direct testimony recommending a base rate reduction in the range of $12 million to $20 million for SWEPCo's Louisiana jurisdiction customers, based on a proposed 10% return on equity. The recommended reduction range is subject to SWEPCo validating certain ongoing operations and maintenance expense levels. SWEPCo filed rebuttal testimony in October 2006 strongly refuting the consultants' recommendations. In December 2006, the LPSC staff's consultants filed reply testimony asserting that SWEPCo's Louisiana base rates are excessive by $17 million which includes a proposed return on equity of 9.8%. SWEPCo filed rebuttal testimony in January 2007. A decision is not expected until mid or late 2007. At this time, management is unable to predict the outcome of this proceeding. If a rate reduction is ultimately ordered, it would adversely impact future results of operations, cash flows and possibly financial condition.

FERC Rate Matters

Transmission Rate Proceedings at the FERC - Affecting APCo, CSPCo, I&M, KPCo and OPCo

The FERC PJM Regional Transmission Rate Proceeding

At AEP's urging, the FERC instituted an investigation of PJM's zonal rate regime, indicating that the present rate regime may need to be replaced through establishment of regional rates that would compensate AEP and other transmission owners for the regional transmission facilities they provide to PJM, which provides service for the benefit of customers throughout PJM. In September 2005, AEP and a nonaffiliated utility (Allegheny Power or AP) jointly filed a regional transmission rate design proposal with the FERC. This filing proposes and supports a new PJM rate regime generally referred to as Highway/Byway.

Parties to the regional rate proceeding proposed the following rate regimes:

- AEP/AP proposed a Highway/Byway rate design in which:
  - The cost of all transmission facilities in the PJM region operated at 345 kV or higher would be included in a "Highway" rate that all load serving entities (LSEs) would pay based on peak demand. The AEP/AP proposal would produce about $125 million in additional revenues per year for AEP from users in other zones of PJM.
  - The cost of transmission facilities operating at lower voltages would be collected in the zones where those costs are presently charged under PJM's existing rate design.
- Two other utilities, Baltimore Gas & Electric Company (BG&E) and Old Dominion Electric Cooperative (ODEC), proposed a Highway/Byway rate that includes transmission facilities above 200 kV, which would produce lower

revenues for AEP than the AEP/AP proposal.

- In another competing Highway/Byway proposal, a group of LSEs proposed rates that would include existing 500 kV and higher voltage facilities and new facilities above 200 kV in the Highway rate, which would produce considerably lower revenues for AEP than the AEP/AP proposal.
- In January 2006, the FERC staff issued testimony and exhibits supporting a PJM-wide flat rate or "Postage Stamp" type of rate design that would include all transmission facilities, which would produce higher transmission revenues for AEP than the AEP/AP proposal.

All of these proposals were challenged by a majority of other transmission owners in the PJM region, who favor continuation of the existing PJM rate design which provides AEP with no compensation for through and out traffic on its east zone transmission system. Hearings were held in April 2006 and the ALJ issued an initial decision in July 2006. The ALJ found the existing PJM zonal rate design to be unjust and determined that it should be replaced. The ALJ found that the Highway/Byway rates proposed by AEP/AP and BG&E/ODEC and the Postage Stamp rate proposed by the FERC staff to be just and reasonable alternatives. The ALJ also found FERC staff's proposed Postage Stamp rate to be just and reasonable and recommended that it be adopted. The ALJ also found that the effective date of the rate change should be April 1, 2006 to coincide with SECA rate elimination. Because the Postage Stamp rate was found to produce greater cost shifts than other proposals, the judge also recommended that the design be phased-in. Without a phase-in, the Postage Stamp method would produce more revenue for AEP than the AEP/AP proposal. The phase-in of Postage Stamp rates would delay the full impact of that result until about 2012.

AEP filed briefs noting exceptions to the initial decision and replies to the exceptions of other parties. AEP argued that a phase-in should not be required. Nevertheless, AEP argued that if the FERC adopts the Postage Stamp rate and a phase-in plan, the revenue collections curtailed by the phase-in should be deferred and paid later with interest.

During 2006, the AEP East companies sought to increase retail rates in most of their states to recover lost T&O and SECA revenues. The status of such state retail rate proceedings is as follows:

- In Kentucky, KPCo settled a rate case, which provided for the recovery of its share of the transmission revenue reduction in new rates effective March 30, 2006.
- In Ohio, CSPCo and OPCo recover their FERC-approved OATT that reflects their share of the full transmission revenue requirement retroactive to April 1, 2006 under a May 2006 PUCO order.
- In West Virginia, APCo settled a rate case, which provided for the recovery of its share of the T&O/SECA transmission revenue reduction beginning July 28, 2006.
- In Virginia, APCo filed a request for revised rates, which includes recovery of its share of the T&O/SECA transmission revenue reduction starting October 2, 2006, subject to refund.
- In Indiana, I&M is precluded by a rate cap from raising its rates until July 1, 2007.
- In Michigan, I&M has not filed to seek recovery of the lost transmission revenues.

In April 2007, the FERC issued an order reversing the ALJ decision. The FERC ruled that the current PJM rate design is just and reasonable. The FERC further ruled that the cost of new facilities of 500 kV and above would be shared among all PJM participants. As a result of this order, the AEP East companies retail customers will be asked to bear the full cost of the existing AEP east transmission zone facilities. However, the AEP East companies customers will also be charged a share of the cost of new 500 kV and higher voltage transmission facilities built in PJM, of which the vast majority for the foreseeable future will not be needed by their customers, but will bolster service and reduce costs in other zones of PJM. The AEP East companies will need to obtain regulatory approvals for recovery of any costs of new facilities that are assigned to them as a result of this order, if upheld. AEP will request rehearing of this order. Management cannot estimate at this time what effect, if any, this order will have on their future construction of new east transmission facilities, results of operations, cash flows and financial condition.

The AEP East companies presently recover from retail customers approximately 85% of the reduction in transmission revenues of $128 million a year. Future results of operations, cash flows and financial condition will continue to be adversely affected in Indiana and Michigan until these lost transmission revenues are recovered in retail rates.

SECA Revenue Subject to Refund

The AEP East companies ceased collecting through-and-out transmission service (T&O) revenues in accordance with FERC orders, and collected SECA rates to mitigate the loss of T&O revenues from December 1, 2004 through March 31, 2006, when SECA rates expired. Intervenors objected to the SECA rates, raising various issues. As a result, the FERC set SECA rate issues for hearing and ordered that the SECA rate revenues be collected, subject to refund or surcharge. The AEP East companies paid SECA rates to other utilities at considerably lesser amounts than collected. If a refund is ordered, the AEP East companies would also receive refunds related to the SECA rates they paid to third parties. The AEP East companies recognized gross SECA revenues as follows:

	Year Ended December 31,		
	2006 (a)	2005	2004
Company		(in millions)	
APCo	$ 13.4	$ 52.4	$ 4.4
CSPCo	7.9	28.4	2.5
I&M	8.1	30.4	2.8
KPCo	3.2	12.4	1.0
OPCo	10.4	39.4	3.5

(a) Represents revenues through March 31, 2006, when SECA rates expired, and excludes all provisions for refund.

Approximately $19 million of these recorded SECA revenues billed by PJM were never collected. The AEP East companies filed a motion with the FERC to force payment of these uncollected SECA billings.

In August 2006, the ALJ issued an initial decision, finding that the rate design for the recovery of SECA charges was flawed and that a large portion of the "lost revenues" reflected in the SECA rates was not recoverable. The ALJ found that the SECA rates charged were unfair, unjust and discriminatory and that new compliance filings and refunds should be made. The ALJ also found that the unpaid SECA rates must be paid in the recommended reduced amount.

Since the implementation of SECA rates in December 2004, the AEP East companies recorded approximately $220 million of gross SECA revenues, subject to refund. The AEP East companies reached settlements with certain customers related to approximately $70 million of such revenues. The unsettled gross SECA revenues total approximately $150 million. If the ALJ's initial decision is upheld in its entirety, it would disallow $126 million of the AEP East companies' unsettled gross SECA revenues.

The AEP East companies provided for net refunds as shown in the following table:

	Year Ended December 31,	
	2006	2005
Company	(in millions)	
APCo	$ 11.0	$ 1.0
CSPCo	6.1	0.6
I&M	6.4	0.6
KPCo	2.6	0.2
OPCo	8.3	0.8

In September 2006, AEP, together with Exelon and DP&L, filed an extensive post-hearing brief and reply brief noting exceptions to the ALJ's initial decision and asking the FERC to reverse the decision in large part. Management believes that the FERC should reject the initial decision because it is contrary to prior related FERC decisions, which are presently subject to rehearing. Furthermore, management believes the ALJ's findings on key issues are largely without merit. Although management believes they have meritorious arguments, management cannot predict the ultimate outcome of any future FERC proceedings or court appeals. If the FERC adopts the ALJ's decision, it will have an adverse effect on future results of operations and cash flows.

4. COMMITMENTS, GUARANTEES AND CONTINGENCIES

The Registrant Subsidiaries are subject to certain claims and legal actions arising in their ordinary course of business. In addition, their business activities are subject to extensive governmental regulation related to public health and the environment. The ultimate outcome of such pending or potential litigation cannot be predicted. For current proceedings not specifically discussed below, management does not anticipate that the liabilities, if any, arising from such proceedings would have a material adverse effect on the financial statements. The Commitments, Guarantees and Contingencies note within the 2006 Annual Report should be read in conjunction with this report.

GUARANTEES

There are certain immaterial liabilities recorded for guarantees in accordance with FASB Interpretation No. 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 unless specified below.

Letters of Credit

Certain Registrant Subsidiaries enter into standby letters of credit (LOCs) with third parties. These LOCs cover items such as insurance programs, security deposits, debt service reserves and credit enhancements for issued bonds. All of these LOCs were issued in the subsidiaries' ordinary course of business. At March 31, 2007, the maximum future payments of the LOCs include $1 million and $4 million for I&M and SWEPCo, respectively, with maturities ranging from June 2007 to March 2008.

Guarantees of Third-Party Obligations

SWEPCo

As part of the process to receive a renewal of a Texas Railroad Commission permit for lignite mining, SWEPCo provides guarantees of mine reclamation in the amount of approximately $85 million. Since SWEPCo uses self-bonding, the guarantee provides for SWEPCo to commit to use its resources to complete the reclamation in the event the work is not completed by Sabine Mining Company (Sabine), an entity consolidated under FIN 46. This guarantee ends upon depletion of reserves and completion of final reclamation. Based on the latest study, it is estimated the reserves will be depleted in 2029 with final reclamation completed by 2036, at an estimated cost of approximately $39 million. As of March 31, 2007, SWEPCo collected approximately $30 million through a rider for final mine closure costs, which is recorded in Deferred Credits and Other on SWEPCo's Condensed Consolidated Balance Sheets.

Sabine charges SWEPCo, its only customer, all its costs. SWEPCo passes these costs through its fuel clause.

Indemnifications and Other Guarantees

Contracts

All of the Registrant Subsidiaries enter into certain types of contracts which require indemnifications. Typically these contracts include, but are not limited to, sale agreements, lease agreements, purchase agreements and financing agreements. Generally, these agreements may include, but are not limited to, indemnifications around certain tax, contractual and environmental matters. With respect to sale agreements, exposure generally does not exceed the sale price. Prior to March 31, 2007, Registrant Subsidiaries entered into sale agreements including indemnifications with a maximum exposure that was not significant for any individual Registrant Subsidiary except TCC. TCC sale agreements include indemnifications with a maximum exposure of $456 million related to the sale price of its generation assets. See "Texas Plants - South Texas Project", "Texas Plants - TCC Generation Assets" and "Texas Plants - Oklaunion Power Station" sections of Note 8 of the 2006 Annual Report. There are no material liabilities recorded for any indemnifications.

AEP East companies, PSO and SWEPCo are jointly and severally liable for activity conducted by AEPSC on behalf of AEP East companies, PSO and SWEPCo related to power purchase and sale activity conducted pursuant to the SIA.

<u>*Master Operating Lease*</u>

Certain Registrant Subsidiaries lease certain equipment under a master operating lease. Under the lease agreement, the lessor is guaranteed to receive up to 87% of the unamortized balance of the equipment at the end of the lease term. If the fair market value of the leased equipment is below the unamortized balance at the end of the lease term, the subsidiary has committed to pay the difference between the fair market value and the unamortized balance, with the total guarantee not to exceed 87% of the unamortized balance. At March 31, 2007, the maximum potential loss by subsidiary for these lease agreements assuming the fair market value of the equipment is zero at the end of the lease term is as follows:

Company	Maximum Potential Loss (in millions)	
APCo	$	7
CSPCo		4
I&M		5
KPCo		2
OPCo		7
PSO		5
SWEPCo		6
TCC		6
TNC		3

CONTINGENCIES

Federal EPA Complaint and Notice of Violation - Affecting APCo, CSPCo, I&M, and OPCo

The Federal EPA, certain special interest groups and a number of states allege that APCo, CSPCo, I&M, OPCo and other nonaffiliated utilities including the Tennessee Valley Authority, Alabama Power Company, Cincinnati Gas & Electric Company, Ohio Edison Company, Southern Indiana Gas & Electric Company, Illinois Power Company, Tampa Electric Company, Virginia Electric Power Company and Duke Energy, modified certain units at coal-fired generating plants in violation of the NSR requirements of the CAA. The Federal EPA filed its complaints against AEP subsidiaries in U.S. District Court for the Southern District of Ohio. The alleged modifications occurred at our generating units over a twenty-year period. A bench trial on the liability issues was held during July 2005. In June 2006, the judge stayed the liability decision pending the issuance of a decision by the U.S. Supreme Court in the Duke

Energy case.

Under the CAA, if a plant undertakes a major modification that results in an emissions increase, permitting requirements might be triggered and the plant may be required to install additional pollution control technology. This requirement does not apply to activities such as routine maintenance, replacement of degraded equipment or failed components or other repairs needed for the reliable, safe and efficient operation of the plant. The CAA authorizes civil penalties of up to $27,500 ($32,500 after March 15, 2004) per day per violation at each generating unit. In 2001, the District Court ruled claims for civil penalties based on activities that occurred more than five years before the filing date of the complaints cannot be imposed. There is no time limit on claims for injunctive relief.

The Federal EPA and eight northeastern states each filed an additional complaint containing additional allegations against the Amos and Conesville plants. APCo and CSPCo filed an answer to the northeastern states' complaint and the Federal EPA's complaint, denying the allegations and stating their defenses. Cases are also pending that could affect CSPCo's share of jointly-owned units at Beckjord (12.5% owned), Zimmer (25.4% owned), and Stuart (26% owned) Stations. Similar cases have been filed against other nonaffiliated utilities, including Allegheny Energy, Eastern Kentucky Electric Cooperative, Public Service Enterprise Group, Santee Cooper, Wisconsin Electric Power Company, Mirant, NRG Energy and Niagara Mohawk. Several of these cases were resolved through consent decrees.

Courts have reached different conclusions regarding whether the activities at issue in these cases are routine maintenance, repair, or replacement, and therefore are excluded from NSR. Similarly, courts have reached different results regarding whether the activities at issue increased emissions from the power plants. Appeals on these and other issues were filed in certain appellate courts, including a petition to appeal to the U.S. Supreme Court that was granted in the Duke Energy case. The Federal EPA issued a final rule that would exclude activities similar to those challenged in these cases from NSR as "routine replacements." In March 2006, the Court of Appeals for the District of Columbia Circuit issued a decision vacating the rule. The Court denied the Federal EPA's request for rehearing, and the Federal EPA and other parties filed a petition for review by the U.S. Supreme Court. In April 2007, the Supreme Court denied the petition for review. The Federal EPA also proposed a rule that would define "emissions increases" in a way that most of the challenged activities would be excluded from NSR.

On April 2, 2007, the U.S. Supreme Court reversed the Fourth Circuit Court of Appeals' decision that had supported the statutory construction argument of Duke Energy in its NSR proceeding. In a unanimous decision, the Court ruled that the Federal EPA was not obligated to define "major modification" in two different CAA provisions in the same way. The Court also found that the Fourth Circuit's interpretation of "major modification" as applying only to projects that increased hourly emission rates amounted to an invalidation of the relevant Federal EPA regulations, which under the CAA can only be challenged in the Court of Appeals within 60 days of the Federal EPA rulemaking. The U.S. Supreme Court did acknowledge, however, that Duke Energy may argue on remand that the Federal EPA has been inconsistent in its interpretations of the CAA and the regulations and may not retroactively change 20 years of accepted practice.

In addition to providing guidance on certain of the merits of the NSR proceedings brought against APCo, CSPCo, I&M and OPCo in U.S. District Court for the Southern District of Ohio, the U.S. Supreme Court's issuance of a ruling in the Duke Energy cases has an impact on the timing of our NSR proceedings. First, the court in the case for which a trial on liability issues has been conducted has indicated an intent to issue a decision on liability. Second, the bench trial on remedy issues, if necessary, is likely to be scheduled to begin in the third quarter of 2007.

Management is unable to estimate the loss or range of loss related to any contingent liability, if any, AEP subsidiaries might have for civil penalties under the CAA proceedings. Management is also unable to predict the timing of resolution of these matters due to the number of alleged violations and the significant number of issues yet to be determined by the Court. If AEP subsidiaries do not prevail, management believes AEP subsidiaries can recover any capital and operating costs of additional pollution control equipment that may be required through regulated rates and market prices for electricity. If any of the AEP subsidiaries are unable to recover such costs or if material penalties are imposed, it would adversely affect future results of operations, cash flows and possibly financial condition.

Notice of Enforcement and Notice of Citizen Suit - Affecting SWEPCo

In March 2005, two special interest groups, Sierra Club and Public Citizen, filed a complaint in Federal District Court for the Eastern District of Texas alleging violations of the CAA at SWEPCo's Welsh Plant. SWEPCo filed a response to the complaint in May 2005. A trial in this matter is scheduled for the second quarter of 2007.

In 2004, the Texas Commission on Environmental Quality (TCEQ) issued a Notice of Enforcement to SWEPCo relating to the Welsh Plant containing a summary of findings resulting from a compliance investigation at the plant. In April 2005, TCEQ issued an Executive Director's Preliminary Report and Petition recommending the entry of an enforcement order to undertake certain corrective actions and assessing an administrative penalty of approximately $228 thousand against SWEPCo based on alleged violations of certain representations regarding heat input in SWEPCo's permit application and the violations of certain recordkeeping and reporting requirements. SWEPCo responded to the preliminary report and petition in May 2005. The enforcement order contains a recommendation that would limit the heat input on each Welsh unit to the referenced heat input contained within the permit application within 10 days of the issuance of a final TCEQ order and until a permit amendment is issued. SWEPCo had previously requested a permit alteration to remove the reference to a specific heat input value for each Welsh unit and to clarify the sulfur content requirement for fuels consumed at the plant. A permit alteration was issued in March 2007 removing the heat input references from the Welsh permit and clarifying the sulfur content of fuels burned at the plant is limited to 0.5% on an as-received basis. The Sierra Club and Public Citizen filed a motion to overturn the permit alteration.

Management is unable to predict the timing of any future action by TCEQ or the special interest groups or the effect of such actions on results of operations, cash flows or financial condition.

Carbon Dioxide (CO_2) Public Nuisance Claims - Affecting AEP East Companies and AEP West Companies

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 defendant's 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 defendants' motion to dismiss the lawsuits was granted in September 2005. The dismissal was appealed to the Second Circuit Court of Appeals. Briefing and oral argument have concluded. On April 2, 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. Management believes the actions are without merit and intends to defend against the claims.

TEM Litigation - Affecting OPCo

OPCo agreed to sell up to approximately 800 MW of energy to Tractebel Energy Marketing, Inc. (TEM) (now known as SUEZ Energy Marketing NA, Inc.) for a period of 20 years under a Power Purchase and Sale Agreement dated November 15, 2000 (PPA). Beginning May 1, 2003, OPCo tendered replacement capacity, energy and ancillary services to TEM pursuant to the PPA that TEM rejected as nonconforming.

In September 2003, TEM and OPCo separately filed declaratory judgment actions in the United States District Court for the Southern District of New York. OPCo alleged that TEM breached the PPA, and sought a determination of its rights under the PPA. TEM alleged that the PPA never became enforceable, or alternatively, that the PPA was terminated as the result of OPCo's breaches. The corporate parent of TEM (SUEZ-TRACTEBEL S.A.) provided a limited guaranty.

In August 2005, a federal judge ruled that TEM had breached the contract and awarded damages to OPCo of $123 million plus prejudgment interest. Any eventual proceeds will be recorded as a gain when received.

In September 2005, TEM posted a $142 million letter of credit as security pending appeal of the judgment. Both parties filed Notices of Appeal with the United States Court of Appeals for the Second Circuit, which heard oral argument on the appeals in December 2006. Management cannot predict the ultimate outcome of this proceeding.

Coal Transportation Dispute - Affecting PSO, TCC and TNC

PSO, TCC, TNC, the Oklahoma Municipal Power Authority and the Public Utilities Board of the City of Brownsville, Texas, as joint owners of a generating station, disputed transportation costs for coal received between July 2000 and the present time. The joint plant remitted less than the amount billed and the dispute is pending before the Surface Transportation Board. Based upon a weighted average probability analysis of possible outcomes, PSO, as operator of the plant, recorded provisions for possible loss in 2004, 2005, 2006 and the first quarter of 2007. The provision was deferred as a regulatory asset under PSO’s fuel mechanism and immaterially affected income for TCC and TNC for their respective ownership shares. Management continues to work toward mitigating the disputed amounts to the extent possible.

Coal Transportation Rate Dispute - Affecting PSO

In 1985, the Burlington Northern Railroad Co. (now BNSF) entered into a coal transportation agreement with PSO. The agreement contained a base rate subject to adjustment, a rate floor, a reopener provision and an arbitration provision. In 1992, PSO reopened the pricing provision. The parties failed to reach an agreement and the matter was arbitrated, with the arbitration panel establishing a lowered rate as of July 1, 1992 (the 1992 Rate), and modifying the rate adjustment formula. The decision did not mention the rate floor. From April 1996 through the contract termination in December 2001, the 1992 Rate exceeded the adjusted rate, determined according to the decision. PSO paid the adjusted rate and contended that the panel eliminated the rate floor. BNSF invoiced at the 1992 Rate and contended that the 1992 Rate was the new rate floor. At the end of 1991, PSO terminated the contract by paying a termination fee, as required by the agreement. BNSF contends that the termination fee should have been calculated on the 1992 Rate, not the adjusted rate, resulting in an underpayment of approximately $9.5 million, including interest.

This matter was submitted to an arbitration board. In April 2006, the arbitration board filed its decision, denying BNSF’s underpayments claim. PSO filed a request for an order confirming the arbitration award and a request for entry of judgment on the award with the U.S. District Court for the Northern District of Oklahoma. On July 14, 2006, the U.S. District Court issued an order confirming the arbitration award. On July 24, 2006, BNSF filed a Motion to Reconsider the July 14, 2006 Arbitration Confirmation Order and Final Judgment and its Motion to Vacate and Correct the Arbitration Award with the U.S. District Court. In February 2007, the U.S. District Court granted BNSF’s Motion to Reconsider. PSO filed a substantive response to BNSF’s motion and BNSF filed a reply. Management continues to work toward mitigating the disputed amounts to the extent possible.

Claims by the City of Brownsville, Texas Against TCC - Affecting TCC

On April 27, 2007, the City of Brownsville, Texas served its Fifth Amended Answer and Cross-Claims in litigation pending in the District Court of Dallas County, Texas. The cross-claims seek recovery against TCC based on allegations of breach of contract, breach of fiduciary duty, unjust enrichment, constructive trust, conversion, breach of the Texas theft liability act and fraud allegedly occurring in connection with a transaction in which Brownsville purchased TCC’s interest in the Oklaunion electric generating station. Management believes that the claims are without merit and intends to defend against them vigorously.

FERC Long-term Contracts - Affecting AEP East Companies and AEP West Companies

In 2002, the FERC held a hearing related to a complaint filed by Nevada Power Company and Sierra Pacific Power Company (the Nevada utilities). The complaint sought to break long-term contracts entered during the 2000 and 2001 California energy price spike which the customers alleged were “high-priced.” The complaint alleged that AEP subsidiaries sold power at unjust and unreasonable prices. In December 2002, a FERC ALJ ruled in AEP’s favor and dismissed the complaint filed by the Nevada utilities. In 2001, the Nevada utilities filed complaints asserting that the prices for power supplied under those contracts should be lowered because the market for power was allegedly dysfunctional at the time such contracts were executed. The ALJ rejected the complaint, held that the markets for future delivery were not dysfunctional, and that the Nevada utilities failed to demonstrate that the public interest required that changes be made to the contracts. In June 2003, the FERC issued an order affirming the ALJ’s decision. In December 2006, the U.S. Court of Appeals for the Ninth Circuit reversed the FERC order and remanded the case to the FERC for further proceedings. Management is unable to predict the outcome of these proceedings or their impact on future results of operations and cash flows. We have asserted claims against certain companies that sold power to us, which we resold to the Nevada utilities, seeking to recover a portion of any amounts we may owe to the Nevada utilities.

5. ACQUISITIONS, DISPOSITIONS AND ASSETS HELD FOR SALE

ACQUISITIONS

2007

Darby Electric Generating Station - Affecting CSPCo

In November 2006, CSPCo agreed to purchase Darby Electric Generating Station (Darby) from DPL Energy, LLC, a subsidiary of The Dayton Power and Light Company, for $102 million and the assumption of liabilities of approximately $2 million. CSPCo completed the purchase in April 2007. The Darby plant is located near Mount Sterling, Ohio and is a natural gas, simple cycle power plant with a generating capacity of 480 MW.

Lawrenceburg Generating Station - Affecting AEGCo

In January 2007, AEGCo agreed to purchase Lawrenceburg Generating Station (Lawrenceburg) from an affiliate of Public Service Enterprise Group (PSEG) for approximately $325 million and the assumption of liabilities of approximately $2 million. AEGCo will complete the purchase in May 2007. The Lawrenceburg plant 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.

2006

None

DISPOSITIONS

2007

Texas Plants - Oklaunion Power Station - Affecting TCC

In February 2007, TCC sold its 7.81% share of Oklaunion Power Station to the Public Utilities Board of the City of Brownsville for $42.8 million plus adjustments. The sale did not have a significant effect on TCC’s results of operations. See "Claims by the City of Brownsville, Texas Against TCC" section of Note 4.

2006

None

ASSETS HELD FOR SALE

Texas Plants - Oklaunion Power Station - Affecting TCC

In February 2007, TCC sold its 7.81% share of Oklaunion Power Station to the Public Utilities Board of the City of Brownsville. The sale did not have a significant effect on TCC's results of operations nor does TCC expect any remaining litigation to have a significant effect on its results of operations.

TCC's assets related to the Oklaunion Power Station were classified in Assets Held for Sale - Texas Generation Plant on TCC's Condensed Consolidated Balance Sheet at December 31, 2006. The plant does not meet the "component-of-an-entity" criteria because it does not have cash flows that can be clearly distinguished operationally. The plant also does not meet the "component-of-an-entity" criteria for financial reporting purposes because it does not operate individually, but rather as a part of the AEP System, which includes all of the generation facilities owned by the Registrant Subsidiaries except TNC.

The Assets Held for Sale were as follows:

Texas Plants (TCC)	March 31, 2007	December 31, 2006
	(in millions)	
Assets:		
Other Current Assets	$ -	$ 1
Property, Plant and Equipment, Net	-	43
Total Assets Held for Sale - Texas Generation Plant	$ -	$ 44

6. <u>BENEFIT PLANS</u>

APCo, CSPCo, I&M, KPCo, OPCo, PSO, SWEPCo, TCC and TNC participate in AEP sponsored qualified pension plans and nonqualified pension plans. A substantial majority of employees are covered by either one qualified plan or both a qualified and a nonqualified pension plan. In addition, APCo, CSPCo, I&M, KPCo, OPCo, PSO, SWEPCo, TCC and TNC participate in other postretirement benefit plans sponsored by AEP to provide medical and death benefits for retired employees.

APCo, CSPCo, I&M, KPCo, OPCo, PSO, SWEPCo, TCC and TNC adopted SFAS 158 as of December 31, 2006. They recorded a SFAS 71 regulatory asset for their qualifying SFAS 158 costs of regulated operations that for ratemaking purposes will be deferred for future recovery.

Components of Net Periodic Benefit Cost

The following table provides the components of AEP's net periodic benefit cost for the plans for the three months ended March 31, 2007 and 2006:

	Pension Plans	Other Postretirement Benefit Plans

	2007	2006	2007	2006
		(in millions)		
Service Cost	$ 24	$ 24	$ 10	$ 10
Interest Cost	59	57	26	25
Expected Return on Plan Assets	(85)	(83)	(26)	(23)
Amortization of Transition Obligation	-	-	7	7
Amortization of Net Actuarial Loss	15	20	3	5
Net Periodic Benefit Cost	$ 13	$ 18	$ 20	$ 24

The following table provides the net periodic benefit cost (credit) for the plans by Registrant Subsidiary for the three months ended March 31, 2007 and 2006:

	Pension Plans		Other Postretirement Benefit Plans	
	2007	2006	2007	2006
Company		(in thousands)		
APCo	$ 842	$ 1,468	$ 3,560	$ 4,489
CSPCo	(257)	205	1,491	1,805
I&M	1,900	2,331	2,530	2,953
KPCo	255	358	426	513
OPCo	245	826	2,802	3,396
PSO	424	977	1,431	1,588
SWEPCo	746	1,225	1,419	1,578
TCC	101	773	1,575	1,696
TNC	70	325	631	715

7. BUSINESS SEGMENTS

All of AEP's Registrant Subsidiaries have one reportable segment. The one reportable segment is an integrated electricity generation, transmission and distribution business except AEGCo, which is an electricity generation business, and TCC and TNC, which are transmission and distribution businesses. All of the Registrant Subsidiaries' other activities are insignificant. The Registrant Subsidiaries' operations are managed on an integrated basis because of the substantial impact of cost-based rates and regulatory oversight on the business process, cost structures and operating results.

8. INCOME TAXES

We join in the filing of a consolidated federal income tax return with our subsidiaries in the American Electric Power (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 expense. The tax benefit of the parent is allocated to our subsidiaries with taxable income. With the exception of the loss of the parent company, the method of allocation approximates a separate return result for each company in the consolidated group.

Audit Status

AEP System companies also file income tax returns in various state, local, and foreign jurisdictions. With few exceptions, we are no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for years before 2000. The IRS and other taxing authorities routinely examine our tax returns. We believe that we have filed tax returns with positions that may be challenged by these tax authorities. We are currently under exam in several state and local jurisdictions. However, management does not believe that the ultimate resolution of these audits will materially impact results of operations.

We have settled with the IRS all issues from the audits of our consolidated federal income tax returns for years prior to 1997. We have effectively settled all outstanding proposed IRS adjustments for years 1997 through 1999 and through June 2000 for the CSW pre-merger tax period and anticipate payment for the agreed adjustments to occur during 2007. Returns for the years 2000 through 2003 are presently being audited by the IRS and we anticipate that the audit will be completed by the end of 2007.

The IRS has proposed certain significant adjustments to AEP's foreign tax credit and interest allocation positions. Management is currently evaluating those proposed adjustments to determine if it agrees, but if accepted, we do not anticipate the adjustments would result in a material change to our financial position.

FIN 48 Adoption

We adopted the provisions of FIN 48 on January 1, 2007. As a result of the implementation of FIN 48, the approximate increase (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 was recognized by each Registrant Subsidiary as follows:

Company		**(in thousands)**
AEGCo	$	(27)
APCo		2,685
CSPCo		3,022
I&M		(327)
KPCo		786
OPCo		5,380
PSO		386
SWEPCo		1,642
TCC		2,187
TNC		557

At January 1, 2007, the total amount of unrecognized tax benefits under FIN 48 for each Registrant Subsidiary was as follows:

Company		**(in millions)**
AEGCo	$	0.1
APCo		21.7
CSPCo		25.0
I&M		18.2
KPCo		3.4
OPCo		49.8
PSO		8.9
SWEPCo		7.1
TCC		20.7
TNC		6.9

We believe it is reasonably possible that there will be a net decrease in unrecognized tax benefits due to the settlement of audits and the expiration of statute of limitations within 12 months of the reporting date for each Registrant

Subsidiary as follows:

Company		(in millions)
AEGCo	$	0.5
APCo		5.5
CSPCo		9.3
I&M		6.0
KPCo		1.4
OPCo		9.0
PSO		4.4
SWEPCo		2.8
TCC		3.4
TNC		1.6

At January 1, 2007, the total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate for each Registrant Subsidiary was as follows:

Company		(in millions)
APCo	$	5.4
CSPCo		13.8
I&M		5.4
KPCo		0.6
OPCo		23.4
PSO		1.2
SWEPCo		1.2
TCC		9.3
TNC		2.6

At January 1, 2007, tax positions for each Registrant Subsidiary, for which the ultimate deductibility is highly certain but for which there is uncertainty about the timing of such deductibility was as follows:

Company		(in millions)
AEGCo	$	0.1
APCo		13.7
CSPCo		3.9
I&M		10.3
KPCo		2.5
OPCo		14.2
PSO		7.1
SWEPCo		5.1
TCC		6.4
TNC		2.9

Because of the impact of deferred tax accounting, other than interest and penalties, the disallowance of the shorter deductibility period would not affect the annual effective tax rate but would accelerate the payment of cash to the taxing authority to an earlier period.

Prior to the adoption of FIN 48, we recorded interest and penalty accruals related to income tax positions in tax accrual accounts. With the adoption of FIN 48, we began recognizing interest accruals related to income tax positions in interest income or expense as applicable, and penalties in operating expenses. As of January 1, 2007, each Registrant Subsidiary accrued for the payment of uncertain interest and penalties as follows:

Company	(in millions)
AEGCo	$ 0.1
APCo	4.6
CSPCo	1.7
I&M	2.8
KPCo	1.2
OPCo	4.3
PSO	2.7
SWEPCo	2.0
TCC	2.5
TNC	1.0

9. FINANCING ACTIVITIES

Long-term Debt

Long-term debt and other securities issued, retired and principal payments made during the first three months of 2007 were:

Company	Type of Debt	Principal Amount (in thousands)	Interest Rate (%)	Due Date
Issuances:				
SWEPCo	Senior Unsecured Notes	$ 250,000	5.55	2017

Company	Type of Debt	Principal Amount (in thousands)	Interest Rate (%)	Due Date
Retirements and Principal Payments:				
OPCo	Notes Payable	$ 1,463	6.81	2008
OPCo	Notes Payable	6,000	6.27	2009
SWEPCo	Notes Payable	1,645	4.47	2011
SWEPCo	Notes Payable	4,000	6.36	2007
SWEPCo	Notes Payable	750	Variable	2008
TCC	Securitization Bonds	32,125	5.01	2008

In April 2007, OPCo issued $400 million of three-year floating rate notes at an initial rate of 5.53% due in 2010. The proceeds from this issuance will contribute to our investment in environmental equipment.

Lines of Credit and Short-term Debt - AEP System

The AEP System uses a corporate borrowing program to meet the short-term borrowing needs of its subsidiaries. The corporate borrowing program includes a Utility Money Pool, which funds the utility subsidiaries, and a Nonutility Money Pool, which funds the majority of the nonutility subsidiaries. The AEP System 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 March 31, 2007 and December 31, 2006 are included in Advances to/from Affiliates on each of the Registrant Subsidiaries' balance sheets. The Utility Money Pool participants' money pool activity and their corresponding authorized borrowing limits for the three months ended March 31, 2007 are described in the following table:

Company	Maximum Borrowings from Utility Money Pool	Maximum Loans to Utility Money Pool	Average Borrowings from Utility Money Pool	Average Loans to Utility Money Pool	Loans (Borrowings) to/from Utility Money Pool as of March 31, 2007	Authorized Short-Term Borrowing Limit
			(in thousands)			
AEGCo	$ 75,425	$ -	$ 44,340	$ -	$ (29,997)	$ 125,000(a)
APCo	109,259	-	71,378	-	(82,860)	600,000
CSPCo	15,693	35,270	6,204	14,543	922	350,000
I&M	100,374	-	66,570	-	(45,759)	500,000
KPCo	46,317	-	30,845	-	(20,769)	200,000
OPCo	444,153	-	333,467	-	(397,127)	600,000
PSO	135,694	-	76,776	-	(135,694)	300,000
SWEPCo	240,786	48,979	215,207	30,267	8,959	350,000
TCC	-	394,180	-	295,542	216,953	600,000
TNC (b)	35,191	3,200	22,179	2,365	(24,487)	250,000

(a) In April 2007, limit increased by $285 million under regulatory orders.

(b) Does not include short-term lending activity of TNC's wholly-owned subsidiary, AEP Texas North Generation Company LLC (TNGC), who is a participant in the Nonutility Money Pool. As of March 31, 2007, TNGC had $13.3 million in outstanding loans to the Nonutility Money Pool.

The maximum and minimum interest rates for funds either borrowed from or loaned to the Utility Money Pool were as follows:

	Three Months Ended March 31, 2007	2006
Maximum Interest Rate	5.43%	4.85%
Minimum Interest Rate	5.30%	4.37%

The average interest rates for funds borrowed from and loaned to the Utility Money Pool for the three months ended March 31, 2007 and 2006 are summarized for all Registrant Subsidiaries in the following table:

	Average Interest Rate for Funds Borrowed from the Utility Money Pool for	Average Interest Rate for Funds Loaned to the Utility Money Pool for

	Three Months Ended March 31,		Three Months Ended March 31,	
	2007	2006	2007	2006
Company	(in percentage)			
AEGCo	5.34	4.57	-	-
APCo	5.34	4.60	-	-
CSPCo	5.35	4.58	5.33	4.66
I&M	5.34	4.59	-	-
KPCo	5.34	4.54	-	4.75
OPCo	5.34	4.60	-	-
PSO	5.34	4.63	-	-
SWEPCo	5.35	4.60	5.34	-
TCC	-	4.47	5.34	4.68
TNC (a)	5.34	4.57	5.34	4.54

(a) Does not include short-term lending activity for TNGC, who is a participant in the Nonutility Money Pool. For the three months ended March 31, 2007, the average interest rate for funds loaned to the Nonutility Money Pool by TNGC was 5.31%.

The Registrant Subsidiaries' outstanding short-term debt was as follows:

		March 31, 2007		December 31, 2006	
Company	Type of Debt	Outstanding Amount (in millions)	Interest Rate	Outstanding Amount (in millions)	Interest Rate
OPCo	Commercial Paper - JMG	$ 5	5.56%	$ 1	5.56%
SWEPCo	Line of Credit - Sabine	20	6.52%	17	6.38%

COMBINED MANAGEMENT'S DISCUSSION AND ANALYSIS OF REGISTRANT SUBSIDIARIES

The following is a combined presentation of certain components of the registrants' management's discussion and analysis. The information in this section completes the information necessary for management's discussion and analysis of financial condition and results of operations and is meant to be read with (i) Management's Financial Discussion and Analysis, (ii) financial statements and (iii) footnotes of each individual registrant. The combined Management's Discussion and Analysis of Registrant Subsidiaries section of the 2006 Annual Report should also be read in conjunction with this report.

Significant Factors

Ohio New Generation

In March 2005, CSPCo and OPCo filed a joint application with the PUCO seeking authority to recover costs related to building and operating a 629 MW IGCC power plant using clean-coal technology. The application proposed three phases of cost recovery associated with the IGCC plant: Phase 1, recovery of $24 million in pre-construction costs during 2006; Phase 2, concurrent recovery of construction-financing costs; and Phase 3, recovery or refund in distribution rates of any difference between the market-based standard service offer price for generation and the cost of operating and maintaining the plant, including a return on and return of the ultimate cost to construct the plant, originally projected to be $1.2 billion, along with fuel, consumables and replacement power costs. The proposed recoveries in Phases 1 and 2 would be applied against the 4% limit on additional generation rate increases CSPCo and OPCo could request under their RSPs.

In April 2006, the PUCO issued an order authorizing CSPCo and OPCo to implement Phase 1 of the cost recovery proposal. In June 2006, the PUCO issued another order approving a tariff to recover Phase 1 pre-construction costs over no more than a twelve-month period effective July 1, 2006. Through March 31, 2007, CSPCo and OPCo each recorded pre-construction IGCC regulatory assets of $10 million and each recovered $9 million of those costs. CSPCo and OPCo will recover the remaining amounts through June 30, 2007. The PUCO indicated that if CSPCo and OPCo have not commenced a continuous course of construction of the IGCC plant within five years of the June 2006 PUCO order, all charges collected for pre-construction costs, associated with items that may be utilized in IGCC projects at other sites, must be refunded to Ohio ratepayers with interest. The PUCO deferred ruling on Phases 2 and 3 cost recovery until further hearings are held. A date for further rehearings has not been set.

In August 2006, the Industrial Energy Users, Ohio Consumers' Counsel, FirstEnergy Solutions and Ohio Energy Group filed four separate appeals of the PUCO's order in the IGCC proceeding. CSPCo and OPCo believe that the PUCO's authorization to begin collection of Phase 1 rates is lawful. Management, however, cannot predict the outcome of these appeals. If the PUCO's order is found to be unlawful, CSPCo and OPCo could be required to refund Phase I cost-related recoveries.

SECA Revenue Subject to Refund

The AEP East Companies ceased collecting through-and-out transmission service (T&O) revenues in accordance with FERC orders and implemented SECA rates to mitigate the loss of T&O revenues from December 1, 2004 through March 31, 2006, when SECA rates expired. Intervenors objected to the SECA rates, raising various issues. In August 2006, the ALJ issued an initial decision, finding that the rate design for the recovery of SECA charges was flawed and that a large portion of the "lost revenues" reflected in the SECA rates was not recoverable. The ALJ found that the SECA rates charged were unfair, unjust and discriminatory and that new compliance filings and refunds should be made.

Since the implementation of SECA rates in December 2004, the AEP East companies recorded approximately $220 million of gross SECA revenues, subject to refund. The AEP East companies have reached settlements with certain customers related to approximately $70 million of such revenues. The unsettled gross SECA revenues total approximately $150 million. If the ALJ's initial decision is upheld in its entirety, it would disallow $126 million of the AEP East companies' unsettled gross SECA revenues. In the second half of 2006, the AEP East companies provided a reserve of $37 million in net refunds.

In September 2006, AEP, together with Exelon and the Dayton Power and Light Company, filed an extensive post hearing brief and reply brief noting exceptions to the ALJ's initial decision and asking the FERC to reverse the decision in large part. Management believes that the FERC should reject the initial decision because it is contrary to prior related FERC decisions, which are presently subject to rehearing. Furthermore, management believes the ALJ's findings on key issues are largely without merit. Although management believes they have meritorious arguments, management cannot predict the ultimate outcome of any future FERC proceedings or court appeals. If the FERC adopts the ALJ's decision, it will have an adverse effect on future results of operations and cash flows.

Environmental Matters

The Registrant Subsidiaries are implementing a substantial capital investment program and incurring additional operational costs to comply with new environmental control requirements. The sources of these requirements include:

- Requirements under the Clean Air Act (CAA) to reduce emissions of sulfur dioxide (SO_2), nitrogen oxide (NO_x), particulate matter (PM) and mercury from fossil fuel-fired power plants; and
- Requirements under the Clean Water Act (CWA) to reduce the impacts of water intake structures on aquatic species at certain power plants.

In addition, the Registrant Subsidiaries are engaged in litigation with respect to certain environmental matters, have been notified of potential responsibility for the clean-up of contaminated sites and incur costs for disposal of spent nuclear fuel and future decommissioning of I&M's nuclear units. Management also monitors possible future requirements to reduce carbon dioxide (CO_2) emissions to address concerns about global climate change.

Environmental Litigation

New Source Review (NSR) Litigation: In 1999, the Federal EPA and a number of states filed complaints alleging that APCo, CSPCo, I&M, OPCo and other nonaffiliated utilities including the Tennessee Valley Authority, Alabama Power Company, Cincinnati Gas & Electric Company, Ohio Edison Company, Southern Indiana Gas & Electric Company, Illinois Power Company, Tampa Electric Company, Virginia Electric Power Company and Duke Energy, modified certain units at coal-fired generating plants in violation of the NSR requirements of the CAA. A separate lawsuit, initiated by certain special interest groups, has been consolidated with the Federal EPA case. Several similar complaints were filed in 1999 and thereafter against nonaffiliated utilities including Allegheny Energy, Eastern Kentucky Electric Cooperative, Public Service Enterprise Group, Santee Cooper, Wisconsin Electric Power Company, Mirant, NRG Energy and Niagara Mohawk. Several of these cases were resolved through consent decrees. The alleged modifications at the Registrant Subsidiaries' power plants occurred over a twenty-year period. A bench trial on the liability issues was held during 2005. Briefing has concluded. In June 2006, the judge stayed the liability decision pending the issuance of a decision by the U.S. Supreme Court in the Duke Energy case.

Under the CAA, if a plant undertakes a major modification that directly results in an emissions increase, permitting requirements might be triggered and the plant may be required to install additional pollution control technology. This requirement does not apply to activities such as routine maintenance, replacement of degraded equipment or failed components, or other repairs needed for the reliable, safe and efficient operation of the plant.

Courts that considered whether the activities at issue in these cases are routine maintenance, repair, or replacement, and therefore are excluded from NSR, reached different conclusions. Similarly, courts that considered whether the activities at issue increased emissions from the power plants have reached different results. Appeals on these and other issues were filed in certain appellate courts, including a petition to appeal to the U.S. Supreme Court that was granted in the Duke Energy case. The Federal EPA issued a final rule that would exclude activities similar to those challenged in these cases from NSR as "routine replacements." In March 2006, the Court of Appeals for the District of Columbia Circuit issued a decision vacating the rule. The Court denied the Federal EPA's request for rehearing, and the Federal EPA and other parties filed a petition for review by the U.S. Supreme Court. In April 2007, the Supreme Court denied the petition for review. The Federal EPA also proposed a rule that would define "emissions increases" in a way that would exclude most of the challenged activities from NSR.

On April 2, 2007, the U.S. Supreme Court reversed the Fourth Circuit Court of Appeals' decision that had supported the statutory construction argument of Duke Energy in its NSR proceeding. In a unanimous decision, the Court ruled that the Federal EPA was not obligated to define "major modification" in two different CAA provisions in the same way. The Court also found that the Fourth Circuit's interpretation of "major modification" as applying only to projects that increased hourly emission rates amounted to an invalidation of the relevant Federal EPA regulations, which under the CAA can only be challenged in the Court of Appeals within 60 days of the Federal EPA rulemaking. The U.S. Supreme Court did acknowledge, however, that Duke Energy may argue on remand that the Federal EPA has been inconsistent in its interpretations of the CAA and the regulations and may not retroactively change 20 years of accepted practice.

In addition to providing guidance on certain of the merits of the NSR proceedings brought against APCo, CSPCo, I&M and OPCo in U.S. District Court for the Southern District of Ohio, the U.S. Supreme Court's issuance of a ruling in the Duke Energy cases has an impact on the timing of our NSR proceedings. First, the court in the case for which a trial on liability issues has been conducted has indicated an intent to issue a decision on liability. Second, the bench trial on remedy issues, if necessary, is likely to be scheduled to begin in the third quarter of 2007.

Management is unable to estimate the loss or range of loss related to any contingent liability, if any, the Registrant Subsidiaries might have for civil penalties under the CAA proceedings. Management is also unable to predict the timing of resolution of these matters due to the number of alleged violations and the significant number of issues to be determined by the court. If the Registrant Subsidiaries do not prevail, management believes the Registrant Subsidiaries can recover any capital and operating costs of additional pollution control equipment that may be required through regulated rates and market prices for electricity. If the Registrant Subsidiaries are unable to recover such costs or if material penalties are imposed, it would adversely affect future results of operations, cash flows and possibly financial condition.

Adoption of New Accounting Pronouncements

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. The Registrant Subsidiaries adopted FIN 48 effective January 1, 2007. See "FIN 48 "Accounting for Uncertainty in Income Taxes"" section of Note 2 and see Note 8 - Income Taxes. The impact of this interpretation was an unfavorable (favorable) adjustment to retained earnings as follows:

Company	(in thousands)	
AEGCo	$	(27)

APCo	2,685
CSPCo	3,022
I&M	(327)
KPCo	786
OPCo	5,380
PSO	386
SWEPCo	1,642
TCC	2,187
TNC	557

CONTROLS AND PROCEDURES

During the first quarter of 2007, management, including the principal executive officer and principal financial officer of each of AEP, AEGCo, APCo, CSPCo, I&M, KPCo, OPCo, PSO, SWEPCo, TCC and TNC (collectively, the Registrants), evaluated the Registrants' disclosure controls and procedures. Disclosure controls and procedures are defined as controls and other procedures of the Registrants that are designed to ensure that information required to be disclosed by the Registrants in the reports that they file or submit under the Exchange Act are recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by the Registrants in the reports that they file or submit under the Exchange Act is accumulated and communicated to the Registrants' management, including the principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

As of March 31, 2007 these officers concluded that the disclosure controls and procedures in place are effective and provide reasonable assurance that the disclosure controls and procedures accomplished their objectives. The Registrants continually strive to improve their disclosure controls and procedures to enhance the quality of their financial reporting and to maintain dynamic systems that change as events warrant.

The only change in the Registrants' internal control over financial reporting (as such term is defined in Rule 13a-15(f) and 15d-15(f) under the Exchange Act) during the first quarter 2007 that materially affected, or is reasonably likely to materially affect, the Registrants' internal controls over financial reporting, relates to the Southwest Power Pool's (SPP) implementation of an Energy Imbalance Service Market. In connection with this market implementation, two of AEP's subsidiaries (Public Service Company of Oklahoma and Southwestern Electric Power Company) implemented or modified a number of business processes and controls to facilitate participation in, and resultant settlement within, the SPP Energy Imbalance Service Market.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

For a discussion of material legal proceedings, see Note 4, *Commitments, Guarantees and Contingencies,* incorporated herein by reference.

Item 1A. Risk Factors

Our Annual Report on Form 10-K for the year ended December 31, 2006 includes a detailed discussion of our risk factors. The information presented below amends and restates in their entirety certain of those risk factors that have been updated and should be read in conjunction with the risk factors and information disclosed in our 2006 Annual Report on Form 10-K.

General Risks of Our Regulated Operations

Our request for rate recovery of additional costs may not be approved in Virginia. *(Applies to AEP and APCo.)*

APCo filed a request with the Virginia SCC in May 2006 seeking a net increase in base rates of $198 million to recover increasing costs, including a return on equity of 11.5%. APCo also requested to apply its off-system sales margins (currently credited to customers through base rates) to the fuel factor where they can be adjusted annually. APCo also requested to retain a portion of the off-system sales margins. In May 2006, the Virginia SCC issued an order placing the net requested base rate increase into effect as of October 2, 2006, subject to refund. In October 2006, the Virginia SCC staff filed direct testimony recommending a base rate increase of $13 million with a return on equity of 9.9% and no off-system sales margin sharing. Other intervenors have recommended base rate increases ranging from $42 million to $112 million. APCo has filed rebuttal testimony and hearings were held in December 2006. In March 2007, the Hearing Examiner released a report recommending a base rate increase of $31 million with a return on equity of 10.1% and a 5% retention of off-system sales margin sharing. If the Virginia SCC denies the requested rate recovery, it could adversely impact future results of operations, cash flows and financial condition.

Our request for rate recovery of additional costs may not be approved in Texas. *(Applies to AEP, TCC and TNC.)*

TCC and TNC have filed requests with the PUCT to increase their transmission and distribution rates. The rate requests include the amounts charged for the delivery of electricity over TCC´s and TNC´s transmission and distribution lines. TCC is seeking approval of an $81 million increase, which includes the expiration of $20 million in billing credits that the PUCT required in approving the merger of CSW into AEP. The credits have been in place since 2000. TNC is seeking approval of a $25 million increase, which includes the expiration of $6 million in billing credits. TCC and TNC are requesting a return on equity of 11.25% with a capital structure of approximately 60% debt/40% equity. As part of rebuttal testimony filed in April 2007, TCC and TNC reduced their base rate request by $11 million and $3 million, respectively, and reduced their return on equity by 0.5%. If the PUCT denies the requested rate recovery, it could adversely impact future results of operations, cash flows and financial condition.

Our request for rate recovery of additional costs may not be approved in Oklahoma. *(Applies to AEP and PSO.)*

PSO filed a request with the OCC in November 2006 seeking approval of a $50 million overall increase in base rates, an annually adjusted rate mechanism to recover the expected significant investment PSO will be making in new facilities, several new and restructured tariffs to allow PSO to begin to reduce the relationship between its revenues and its sales volumes, and to implement some demand side management tariffs. PSO´s planned investments over the next five years include new generation facilities ($1.12 billion), new and refurbished transmission substations and lines ($302 million) and new distribution lines and equipment ($582 million). In April 2007, PSO filed rebuttal testimony regarding various issues raised by the OCC Staff and the intervenors. As part of rebuttal testimony, PSO reduced its base rate request by $2 million. If the OCC denies the requested rate recovery, it could adversely impact future results of operations, cash flows and financial condition.

The amount we charged third parties for using our transmission facilities has been reduced, is subject to refund and may not be completely restored in the future. *(Applies to AEP and the AEP East companies.)*

In July 2003, the FERC issued an order directing PJM and MISO to make compliance filings for their respective tariffs to eliminate the transaction-based charges for through and out (T&O) transmission service on transactions where the energy is delivered within those RTOs. The elimination of the T&O rates reduces the transmission service revenues collected by the RTOs and thereby reduces the revenues received by transmission owners under the RTOs' revenue distribution protocols. To mitigate the impact of lost T&O revenues, the FERC approved temporary replacement seams elimination cost allocation (SECA) transition rates beginning in December 2004 and extending through March 2006. Intervenors objected to this decision; therefore the SECA fees we collected ($220 million) are subject to refund. Approximately $19 million of the SECA revenues that we billed were never collected. AEP filed a motion with the FERC to force payment of these SECA billings.

A hearing was held in May 2006 to determine whether any of the SECA revenues should be refunded. In August 2006, the ALJ issued an initial decision, finding that the rate design for the recovery of SECA charges was flawed and that a large portion of the "lost revenues" reflected in the SECA rates was not recoverable. The ALJ found that the SECA rates charged were unfair, unjust and discriminatory, and that new compliance filings and refunds should be made. The ALJ also found that unpaid SECA rates must be paid in the recommended reduced amount. The FERC has not ruled on the matter. If the FERC upholds the decision of the ALJ, up to $126 million of collected SECA rates could be refunded by the AEP East companies. We have recorded provisions in the aggregate amount of $37 million related to the potential refund of SECA rates pending settlement negotiations with various intervenors.

SECA transition rates expired on March 31, 2006 and did not fully compensate AEP East companies for ongoing lost T&O revenues. As a result of rate relief in certain jurisdictions, however, approximately 85% of the ongoing lost T&O revenues are now being recovered from native load customers of AEP East companies in those jurisdictions. The portion attributable to Virginia is being collected subject to refund.

In addition to seeking retail rate recovery from native load customers in the applicable states, AEP and another member of PJM have filed an application with the FERC seeking compensation from other unaffiliated members of PJM for the costs associated with those members' use of the filers' the AEP East companies respective transmission assets. A majority of PJM members have filed in opposition to the proposal. Hearings were held in April 2006. An ALJ recommended a rate design that would result in greater recovery for AEP than the proposal AEP had submitted. The ALJ also recommended, however, that the design be phased-in, which could limit the amount of recovery for AEP. In April 2007, the FERC issued an order reversing the ALJ decision. The FERC ruled that the current PJM rate design is just and reasonable. The FERC further ruled that the cost of new facilities of 500 kV and above would be shared among all PJM participants. Management cannot estimate at this time what affect, if any, this order will have on our future construction of new east transmission facilities, results of operations, cash flows and financial condition.

We are exposed to losses resulting from the bankruptcy of Enron Corp. *(Applies to AEP.)*

On June 1, 2001, we purchased HPL from Enron Corp. (Enron). Later that year, Enron and its subsidiaries filed bankruptcy proceedings in the U.S. Bankruptcy Court for the Southern District of New York. Various HPL-related contingencies and indemnities from Enron remained unsettled at the date of Enron's bankruptcy. In connection with the 2001 acquisition of HPL, we entered into an agreement with BAM Lease Company, which granted HPL the exclusive right to use approximately 65 BCF of cushion gas required for the normal operation of the Bammel gas storage facility. At the time of our acquisition of HPL, Bank of America (BOA) and certain other banks (together with BOA, BOA Syndicate) and Enron entered into an agreement granting HPL the exclusive use of 65 BCF of cushion gas. Additionally, Enron and the BOA Syndicate released HPL from all prior and future liabilities and obligations in connection with the financing arrangement. After the Enron bankruptcy, HPL was informed by the BOA Syndicate of a purported default by Enron under the terms of the financing arrangement. We purchased 10 BCF of gas from Enron and are currently litigating the rights to the remaining 55 BCF of cushion gas.

In February 2004, in connection with BOA's dispute, Enron filed Notices of Rejection regarding the cushion gas use agreement and other incidental agreements. We have objected to Enron's attempted rejection of these agreements. In 2005, we sold HPL, including the Bammel gas storage facility. We indemnified the purchaser for damages, if any, arising from the litigation with BOA. Management is unable to predict the final resolution of these disputes, however the impact on results of operations, cash flows and financial condition could be material.

Risks Relating To State Restructuring

In Ohio, our costs may not be recovered and rates may be reduced. *(Applies to AEP, OPCo and CSPCo.)*

In January 2005, the PUCO approved RSPs for CSPCo and OPCo. The RSPs provide, among other things, for CSPCo and OPCo to raise their generation rates on an annual basis through 2008 by 3% and 7%, respectively. The RSPs also provide for possible additional annual generation rate increases of up to an average of 4% per year for specified costs. The RSPs also provide that CSPCo and OPCo can recover certain environmental carrying costs, PJM-related administrative costs and certain congestion costs. In 2006, CSPCo and OPCo collected an additional estimated $244 million in gross margin as a result of the RSPs. This amount is expected to increase in 2007 and 2008.

In 2005, the Ohio Consumers' Counsel filed an appeal to the Ohio Supreme Court that challenged the validity of the RSPs under Ohio's electricity restructuring law. In July 2006, the Ohio Supreme Court vacated the PUCO's RSP orders for CSPCo and OPCo and remanded the case to the PUCO for further proceedings.

In August 2006, the PUCO directed CSPCo and OPCo to file a plan providing an option for customer participation in the electric market through competitive bids or other reasonable means. The PUCO also held that the RSPs shall remain effective. Accordingly, CSPCo and OPCo continued collecting RSP revenues. In September 2006, CSPCo and OPCo submitted their proposals to provide additional options for customer participation in the electric market.

In March 2007, CSPCo and OPCo filed a settlement agreement at the PUCO resolving the Ohio Supreme Court's remand of the PUCO's RSP order. Management expects the PUCO will approve this settlement agreement.

Some laws and regulations governing restructuring in Virginia have not yet been interpreted or adopted and could harm our business, operating results and financial condition. *(Applies to AEP and APCo.)*

Virginia restructuring legislation was enacted in 1999 providing for retail choice of generation suppliers to be phased in over two years beginning January 1, 2002. It required jurisdictional utilities to unbundle their power supply and energy delivery rates and to file functional separation plans by January 1, 2002. APCo filed its plan with the Virginia SCC and, following Virginia SCC approval of a settlement agreement, now operates in Virginia as a functionally separated electric utility charging unbundled rates for its retail sales of electricity. The settlement agreement addressed functional separation, leaving decisions related to legal separation for later Virginia SCC consideration. While the electric restructuring law in Virginia established the general framework governing the retail electric market, it required the Virginia SCC to issue rules and determinations implementing the law.

In April 2007, Virginia enacted a law providing for cost-based regulation of electric utilities' generation/supply rates. With the return of cost-based regulation, APCo's generation business will again meet the criteria for application of regulatory accounting principles under SFAS 71. Results of operations and financial condition could be adversely affected if and when APCo is required to re-establish certain net regulatory liabilities applicable to its generation/supply business. The timing and one-time earnings effect from such reapplication of SFAS 71 regulatory accounting for APCo's Virginia generation/supply business are uncertain at this time.

There is uncertainty as to our recovery of stranded costs resulting from industry restructuring in Texas. *(Applies to AEP and TCC.)*

Restructuring legislation in Texas required utilities with stranded costs to use market-based methods to value certain generating assets for determining stranded costs. We elected to use the sale of assets method to determine the market value of TCC's generation assets for stranded cost purposes. In general terms, the amount of stranded costs under this market valuation methodology is the amount by which the book value of generating assets, including regulatory assets and liabilities that were not securitized, exceeds the market value of the generation assets, as measured by the net proceeds from the sale of the assets. In May 2005, TCC filed its stranded cost quantification application with the PUCT seeking recovery of $2.4 billion of net stranded generation costs and other recoverable true-up items. A final order was issued in April 2006. In the final order, the PUCT determined TCC's net stranded generation costs and other recoverable true-up items to be approximately $1.475 billion. We have appealed the PUCT's final order seeking additional recovery consistent with the Texas Restructuring Legislation and related rules, other parties have appealed the PUCT's final order as unwarranted or too large. In a preliminary ruling filed in February 2007, the Texas state district court (District Court) adjudicating the appeal of the final order in the true-up proceeding found that the PUCT erred in several respects, including the method used to determine stranded costs and the awarding of certain carrying costs. Following the preliminary ruling, the court granted a rehearing of the issue regarding the method to determine stranded costs.

In March 2007, the District Court judge reversed the earlier preliminary decision concluding the sale of assets method to value TCC's nuclear plant was appropriate. It is expected that the parties and intervenors will appeal various portions of the District Court ruling along with other items to the Texas Court of Appeals. Management cannot predict the ultimate outcome of any future court appeals or any future remanded PUCT proceeding.

Risks Related to Owning and Operating Generation Assets and Selling Power

Our costs of compliance with environmental laws are significant and the cost of compliance with future environmental laws could harm our cash flow and profitability. *(Applies to AEP and each Registrant Subsidiary other than TCC and TNC.)*

Our operations are subject to extensive federal, state and local environmental statutes, rules and regulations relating to air quality, water quality, waste management, natural resources and health and safety. Compliance with these legal requirements requires us to commit significant capital toward environmental monitoring, installation of pollution control equipment, emission fees and permits at all of our facilities. These expenditures have been significant in the past, and we expect that they will increase in the future. On April 2, 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. Costs of compliance with environmental regulations could adversely affect our results of operations and financial position, especially if emission and/or discharge limits are tightened, more extensive permitting requirements are imposed, additional substances become regulated and the number and types of assets we operate increase. All of our estimates are subject to significant uncertainties about the outcome of several interrelated assumptions and variables, including timing of implementation, required levels of reductions, allocation requirements of the new rules and our selected compliance alternatives. As a result, we cannot estimate our compliance costs with certainty. The actual costs to comply could differ significantly from our estimates. All of the costs are incremental to our current investment base and operating cost structure.

If Federal and/or State requirements are imposed on electric utility companies mandating further emission reductions, including limitations on CO_2 emissions, such requirements could make some of our electric

generating units uneconomical to maintain or operate. *(Applies to AEP and each Registrant Subsidiary other than TCC and TNC.)*

Emissions of nitrogen and sulfur oxides, mercury and particulates from fossil fueled generating plants are potentially subject to increased regulations, controls and mitigation expenses. Environmental advocacy groups, other organizations and some agencies in the United States are focusing considerable attention on CO_2 emissions from power generation facilities and their potential role in climate change. Although several bills have been introduced in Congress that would compel CO_2 emission reductions, none have advanced through the legislature. On April 2, 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. Future changes in environmental regulations governing these pollutants could make some of our electric generating units uneconomical to maintain or operate. In addition, any legal obligation that would require us to substantially reduce our emissions beyond present levels could require extensive mitigation efforts and, in the case of CO_2 legislation, would raise uncertainty about the future viability of fossil fuels, particularly coal, as an energy source for new and existing electric generation facilities. While mandatory requirements for further emission reductions from our fossil fleet do not appear to be imminent, we continue to monitor regulatory and legislative developments in this area.

Governmental authorities may assess penalties on us if it is determined that we have not complied with environmental laws and regulations. *(Applies to AEP and each Registrant Subsidiary other than TCC and TNC.)*

If we fail to comply with environmental laws and regulations, even if caused by factors beyond our control, that failure may result in the assessment of civil or criminal penalties and fines against us. Recent lawsuits by the Federal EPA and various states filed against us highlight the environmental risks faced by generating facilities, in general, and coal-fired generating facilities, in particular.

Since 1999, we have been involved in litigation regarding generating plant emissions under the CAA. The Federal EPA and a number of states alleged that we and other unaffiliated utilities modified certain units at coal-fired generating plants in violation of the CAA. The Federal EPA filed complaints against certain AEP subsidiaries in U.S. District Court for the Southern District of Ohio. A separate lawsuit initiated by certain special interest groups was consolidated with the Federal EPA case. The alleged modification of the generating units occurred over a 20-year period. A bench trial on the liability issues was held during July 2005. Briefing has concluded and the court has indicated an intent to issue a decision on liability. Additionally, in July 2004 attorneys general of eight states and others sued AEP and other utilities alleging that CO_2 emissions from power generating facilities constitute a public nuisance under federal common law. The trial court dismissed the suits and plaintiffs have appealed the dismissal. While we believe the claims are without merit, the costs associated with reducing CO_2 emissions could harm our business and our results of operations and financial position.

If these or other future actions are resolved against us, substantial modifications of our existing coal-fired power plants could be required. In addition, we could be required to invest significantly in additional emission control equipment, accelerate the timing of capital expenditures, pay penalties and/or halt operations. Moreover, our results of operations and financial position could be reduced due to the timing of recovery of these investments and the expense of ongoing litigation.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following table provides information about purchases by AEP (or its publicly-traded subsidiaries) during the quarter ended March 31, 2007 of equity securities that are registered by AEP (or its publicly-traded subsidiaries) pursuant to Section 12 of the Exchange Act:

ISSUER PURCHASES OF EQUITY SECURITIES

Period	Total Number	Average Price

	of Shares Purchased	Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs
01/01/07 - 01/31/07	30(a)	$ 79	-	$ -
02/01/07 - 02/28/07	-	-	-	-
03/01/07 - 03/31/07	-	-	-	-

(a) OPCo repurchased 30 shares of its 4.40% cumulative preferred stock, in a privately-negotiated transaction outside of an announced program.

Item 5. Other Information

NONE

Item 6. Exhibits

AEP, APCo, CSPCo, I&M, KPCo, OPCo, PSO, SWEPCo, TCC and TNC

12 - Computation of Consolidated Ratio of Earnings to Fixed Charges.

AEP

31(a) - Certification of AEP Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31(c) - Certification of AEP Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

AEGCo, APCo, CSPCo, I&M, KPCo, OPCo, PSO, SWEPCo, TCC and TNC

31(b) - Certification of Registrant Subsidiaries' Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31(d) - Certification of Registrant Subsidiaries' Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

AEP, AEGCo, APCo, CSPCo, I&M, KPCo, OPCo, PSO, SWEPCo, TCC and TNC

32(a) - Certification of Chief Executive Officer Pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code.
32(b) - Certification of Chief Financial Officer Pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, each registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized. The signature for each undersigned company shall be deemed to relate only to matters having reference to such company and any subsidiaries thereof.

AMERICAN ELECTRIC POWER COMPANY, INC.

By: /s/Joseph M. Buonaiuto
Joseph M. Buonaiuto
Controller and Chief Accounting Officer

AEP GENERATING COMPANY
AEP TEXAS CENTRAL COMPANY
AEP TEXAS NORTH COMPANY
APPALACHIAN POWER COMPANY
COLUMBUS SOUTHERN POWER COMPANY
INDIANA MICHIGAN POWER COMPANY
KENTUCKY POWER COMPANY
OHIO POWER COMPANY
PUBLIC SERVICE COMPANY OF OKLAHOMA
SOUTHWESTERN ELECTRIC POWER COMPANY

By: /s/Joseph M. Buonaiuto
Joseph M. Buonaiuto
Controller and Chief Accounting Officer

Date: May 4, 2007