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Of Counsel
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Filed Electronically in TPUC Docket Room on 2/18/2019 at 10:14 a.m.

KPOW.96499

February 12, 2019

VIA EMAIL (tpuc.docketroom@tn.gov) & FEDEX
Ms. Robin Morrison, Chairman
c/o Ectory Lawless, Dockets & Records Manager
Tennessee Public Utility Commission
502 Deaderick Street, 4th Floor
Nashville, TN 37243

Re: Application of Kingsport Power Company d/b/a AEP Appalachian Power Re: Financing
Docket No.: 19-00025

Dear Chairman Morrison:

We herewith submit electronically the Application of Kingsport Power Company d/b/a AEP Appalachian Power seeking permission for a long-term indebtedness program through December 31, 2021, commencing with the effective date of the anticipated order approving the financing program. Also enclosed is a check in the sum of $25.00 for filing.

Authorization for this financing program is requested pursuant to T.C.A. § 65-4-109 and related regulations.

The original and four (4) copies of the Application are being sent via Fed Ex.

Should there be any questions, please direct same to the writer.

Very sincerely yours,

HUNTER, SMITH & DAVIS, LLP

William C. Bovender

Enclosure: As stated
cc: David Foster
Kelly Grams, Esq.
William E. Johnson, Esq.
Will Castle

Before the
TENNESSEE PUBLIC UTILITY COMMISSION

. . . .

In the Matter of the Application
of
KINGSPORT POWER COMPANY

For Permission to Make Notes to Evidence
Indebtedness Not to Exceed $35,000,000

. . . .

Docket No. 19-00025

TO THE HONORABLE TENNESSEE PUBLIC UTILITY COMMISSION:

Comes the Petitioner, Kingsport Power Company d/b/a AEP Appalachian Power (hereinafter called "Kingsport"), and presents this Application for the following purposes:

> Kingsport seeks approval from this Authority to issue up to $35,000,000 of its unsecured long-term indebtedness from time to time through December 31, 2021. The proceeds will be used to reduce the maturing long and short-term unsecured indebtedness of the Company. Short-term indebtedness of the Company was $10,183,344 at September 30, 2018. The proposed financing will bear interest at a fixed rate, a fluctuating rate or some combination of fixed and fluctuating rates. In order to obtain a favorable rate of interest, however, it is generally necessary to be able to commit to the financing within 24 hours from the time that funds become available. Therefore, this Application seeks approval of the financing within the ranges of maturities and interest specified herein without the need for a separate hearing on the final commitment.

In support of this Application, Kingsport respectfully submits the following:

1. It is a corporation duly organized and existing under the laws of the Commonwealth of Virginia, and qualified to transact business in the State of Tennessee and with its principal office in the City of Kingsport, Tennessee.

2. Kingsport proposes to issue and sell from time to time through December 31, 2021 up to $35,000,000 principal amount of its unsecured promissory note or notes (the "Notes") to one or more commercial banks, financial institutions or other institutional investors or lenders pursuant to one or more term loan agreements and/or note purchase agreements (collectively, the "Proposed

Agreement"). In addition, Kingsport proposes to issue one or more unsecured promissory notes ("AEP Notes") to its parent, American Electric Power Company, Inc. ("AEP"), provided that the aggregate amount of Notes and AEP Notes issued will not exceed $35,000,000.

3. Kingsport is requesting an Order of this Authority approving the proposed financing in all respects such that, upon receipt of such Order, Kingsport may unconditionally, and without further Order of this Authority, enter into a definitive agreement with a bank or qualified investor, in the form of a Proposed Agreement and subject to the conditions, restrictions and limitations specified herein.

4. A Proposed Agreement would be a definitive form of agreement with any bank or investor and would provide that the Notes bear interest at either a fixed rate, fluctuating rate or some combination of fixed and fluctuating rates. Kingsport believes that it would be beneficial to commit itself to a long-term obligation. The actual rate of interest which each Note shall bear, and the maturity thereof, shall be subject to further negotiation between Kingsport and the lender.

Any fixed rate of interest of the Notes will not, at the time of issuance of the Notes, be greater than 300 basis points above the yield to maturity of United States Treasury obligations that mature on or about the date of maturity of the Notes.

In the event a bank or financial institution arranges for a borrowing from a third party, such institution may charge Kingsport a placement fee, not to exceed 1% of the principal amount of such borrowing.

Kingsport believes, given its size and the size of the requested indebtedness, that obtaining this financing through private sources is more cost effective than the public markets.

The Proposed Agreement may specify that, in the event a Note bearing interest at a fixed rate is paid prior to maturity in whole or in part and the fixed rate at that time exceeds the yields to maturity of United States Treasury Notes maturing on or close to the Note, Kingsport shall pay to the lender an amount based on the present value of such prepaid amounts discounted at such treasury yield.

The Proposed Agreement may contain restrictive covenants which would prohibit Kingsport from, among other things, (i) creating, incurring, assuming or suffering to exist any liens on its property, with certain stated exceptions; (ii) creating or incurring any indebtedness for borrowed money, except as specified therein; (iii) failing to maintain a specified level of capitalization; (iv) entering into certain mergers, consolidations and dispositions of assets; and (v) permitting certain events to occur in connection with its pension plans.

A borrowing by Kingsport from a bank under the Proposed Agreement may be evidenced by one or more Notes of Kingsport. The Proposed Agreement and such Notes thereunder would be for a term of not less than nine months nor more than forty years from the date of borrowing.

5. The interest rates and maturity dates of any AEP Notes would be designed to reflect prevailing market rates. In addition, the interest rate and maturity parameters governing the Notes would apply to the AEP Notes.

6. Kingsport proposes to apply all of the proceeds of the financing for general corporate purposes relating to Kingsport's utility business. These purposes include redeeming or repurchasing outstanding short or long-term debt, funding its construction program and replenishing working capital. Kingsport's long and short term debt totals $60,183,344 as of September 30, 2018. The amount requested of $35,000,000 will permit Kingsport to refinance the total debt within the requested approval period, and to cover costs of issuance of up to $500,000 for a minimum of $34.5 million in new money.

7. Submitted as EXHIBIT No. 1 are the Pre-Filed Testimony of Renee V. Hawkins and accompanying financial reports (2017 and 2018).

WHEREFORE, Kingsport respectfully prays that an Order be entered (1) authorizing Kingsport from time to time through December 31, 2021 to borrow up to $35,000,000 pursuant to the

Proposed Agreement and to execute a note or notes, substantially in the form of the Notes or AEP Notes in an amount not to exceed $35,000,000 to evidence the borrowings to be made pursuant to the Proposed Agreement and (2) granting to Kingsport such other, further or general relief as, in your judgment, Kingsport may be entitled to have upon the facts hereinabove set forth.

KINGSPORT POWER COMPANY

By: ______________________
Assistant Treasurer

Dated: February 18, 2019

____
William C. Bovender Esq.
Hunter, Smith & Davis LLP
P.O. Box 3740
Kingsport, Tennessee 37664
Attorney for Petitioner

**DIRECT TESTIMONY OF
RENEE V. HAWKINS
ON BEHALF OF KINGSPORT POWER COMPANY
D/B/A AEP APPALACHIAN POWER
BEFORE THE TENNESSEE REGULATORY AUTHORITY
DOCKET NO. 16-00117**

Q. PLEASE STATE YOUR NAME, POSITION AND ADDRESS.

A. My name is Renee V. Hawkins. My business address is 1 Riverside Plaza, Columbus, Ohio 43215. I am employed by the American Electric Power Service Corporation (AEPSC) as a Managing Director, Corporate Finance. In this capacity, I oversee the raising of capital for Kingsport and other American Electric Power Company, Inc. (AEP) utilities. AEPSC supplies engineering, financing, accounting, and planning and advisory services to the subsidiaries of the American Electric Power (AEP) System, one of which is Kingsport Power Company (KgPCo) or the Company.

Q. TELL US BRIEFLY ABOUT YOUR BACKGROUND.

A. I earned a Bachelor of Science in Business Administration in Finance and International Business from the Ohio State University in 1987. I earned a Master of Business Administration from the Simon School at the University of Rochester in 1991. I was first employed by State Teachers Retirement System of Ohio in 1987 in the Real Estate section where I was assigned to asset management. In June 1991, I was employed by General Motors as an analyst for AC Delco, which is now a subsidiary of Delphi East. This rotational program included positions in cost accounting, division finance, and capital planning. In June 1993, I was hired by Cablevision Systems into the treasury group.

In 1996, I joined AEPSC as a Corporate Finance Senior Analyst supporting financing activity for the AEP System operating companies. In 1999, I was named Manager – Corporate Finance of AEPSC. In June 2000, I was named Director – Corporate Finance of the Service Corporation, a position that was renamed Director – Regulated Finance in 2001. In that capacity, I was responsible for capital markets activity for all of the regulated utilities, establishing dividend recommendations and capitalization targets, supporting the rating agency relationships to maintain credit ratings and assisting in the management of liquidity for AEP and its subsidiaries. I was promoted to Managing Director, Corporate Finance in 2003. In January 2008, my responsibilities expanded to include Assistant Treasurer of AEP and its operating companies.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to support the proposed long-term debt financing application of the Company, which, if approved by the Commission, will allow the Company to issue unsecured long-term debt up to the aggregate principal amount of $35,000,000 from time to time through December 31, 2021.

Q. FOR WHAT PURPOSES WILL THE COMPANY BE ISSUING THESE SECURITIES?

A. The securities may be used to repay short-term debt, for construction costs and to fund working capital. KgPCo's short term debt is funded through the AEP Utility Money Pool.

Q. PLEASE FURTHER DESCRIBE THE UNSECURED LONG-TERM DEBT THAT MAY BE ISSUED.

A. Kingsport proposes to issue and sell from time to time unsecured promissory note or notes (the "Notes") to one or more commercial banks, financial institutions or other institutional investors or lenders pursuant to one or more term loan agreements and/or note purchase agreements (collectively, the "Proposed Agreement"). In addition, Kingsport proposes to issue one or more unsecured promissory notes ("AEP Notes") to either its parent, American Electric Power Company, Inc. ("AEP"), or other institutional investors or lenders, provided that the aggregate amount of Notes and AEP Notes issued will not exceed $35,000,000.

Q. WILL THE LONG-TERM DEBT BE SECURED?

A. No.

Q. PLEASE DESCRIBE THE PROPOSED AGREEMENT FOR NOTES ISSUED TO THIRD PARTIES?

A. A definitive notes purchase agreement would be entered between KgPCo and a bank or qualified investors. The terms of the agreement would include fixed or variable interest rates, term, financial covenants and any redemption provisions. The actual interest rate and maturity would be subject to negotiation between KgPCo and the lender. To the extent the notes are fixed rate, they cannot be at a rate higher than 300 basis points (3%) above the comparable US Treasury yield-to-maturity and any placement fee or arranging fee cannot exceed 1% of the principal amount of the borrowing.

Q. WHAT ARE AEP NOTES AND HOW DOES THE COMPANY DETERMINE THE COST OF THE AEP NOTES?

A. An AEP Note is an affiliate borrowing, in this case, between KgPCo and AEP. A determination will be made on the current interest rates for a bond issued by AEP. The interest rate is determined by averaging multiple quotes presented to us by investment or commercial banks estimating the cost of issuing new notes at AEP. An example of setting the rate on a 10-year affiliate note is as follows:

10-year Treasury Rate:	2.70%
Credit Spread Bank 1:	1.35%
Credit Spread Bank 2:	1.25%
Credit Spread Bank 3:	1.28%
Credit Spread Bank 4:	1.30%
+ Average Spread:	1.30%
AEP Notes Rate:	4.00%

As a note, we have not determined if we will be issuing the long term debt as an AEP Note or placing the debt with third parties.

Q. WHY WOULD UTILIZATION OF AEP NOTES BE BENEFICIAL TO KINGSPORT CUSTOMERS?

A. AEP is a utility holding company with senior unsecured credit ratings of Baa1(stable) and BBB (positive), respectively from Moody's Investor Service and Standard & Poor's and fixed income investors are familiar with the company. As such, the credit spreads achievable by AEP are very competitive. In comparison, KgPCo has only a $50 million note outstanding which does not require a credit rating. As a result, investors would require a greater level of diligence prior to making an investment in a KgPCo security. Additionally, by utilizing AEP Notes, KgPCo is able to avoid typical issuance costs such as legal fees, accounting fees, underwriting costs and trustee fees. The fixed costs associated with an external offering would not vary even though the size of a KgPCo issuance may be $25 million or $35 million. Additionally, there is a placing agent fee that is typically a percentage of the notional amount raised. For a larger transaction that fee may be only 0.4%, while for a smaller transaction, one that would be typical for Kingsport, that fee may be 0.75% or more.

Q. WHAT INTEREST RATE WOULD YOU ANTICIPATE FOR AN AEP NOTE?

A. As previously discussed in the question above, the anticipated rate for an AEP Note based upon recent comparable transactions and current interest rates is approximately 4.00% for a 10-year note issuance. I note that interest rates have been volatile this year and the overall rate will depend on current interest rates at the time the agreement is executed.

Q. IN CONNECTION WITH THE SALE OF ANY UNSECURED NOTES, WILL KGPCO AGREE TO ANY RESTRICTIVE COVENANTS?

A. Yes. The Company may agree to restrictive covenants which would prohibit it from, among other things: (i) creating or allowing to exist any liens on its property, with certain stated exceptions; (ii) creating indebtedness except as specified therein; (iii) failing to maintain a specified financial condition; (iv) entering into certain mergers, consolidations and dispositions of asset; and (v) permitting certain event as to occur in connection with pension plans. Also, KgPCo may permit the holder of the Notes to require KgPCo to prepay them after certain specified events, including an ownership change.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

Kingsport Power Company

2017 Annual Report

Audited Financial Statements

AMERICAN ELECTRIC POWER

BOUNDLESS ENERGY

TABLE OF CONTENTS

GLOSSARY OF TERMS

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

Term	Meaning
AEP	American Electric Power Company, Inc., an investor-owned electric public utility holding company which includes American Electric Power Company, Inc. (Parent) and majority owned consolidated subsidiaries and consolidated affiliates.
AEP Credit	AEP Credit, Inc., a consolidated variable interest entity of AEP which securitizes accounts receivable and accrued utility revenues for affiliated electric utility companies.
AEP System	American Electric Power System, an electric system, owned and operated by AEP subsidiaries.
AEPSC	American Electric Power Service Corporation, an AEP service subsidiary providing management and professional services to AEP and its subsidiaries.
AFUDC	Allowance for Funds Used During Construction.
APCo	Appalachian Power Company, an AEP electric utility subsidiary.
ARO	Asset Retirement Obligation.
ASU	Accounting Standards Update.
EIS	Energy Insurance Services, Inc., a nonaffiliated captive insurance company and consolidated variable interest entity of AEP.
FASB	Financial Accounting Standards Board.
Federal EPA	United States Environmental Protection Agency.
FERC	Federal Energy Regulatory Commission.
FTR	Financial Transmission Right, a financial instrument that entitles the holder to receive compensation for certain congestion-related transmission charges that arise when the power grid is congested resulting in differences in locational prices.
GAAP	Accounting Principles Generally Accepted in the United States of America.
I&M	Indiana Michigan Power Company, an AEP electric utility subsidiary.
IRS	Internal Revenue Service.
KGPCo	Kingsport Power Company, an AEP electric utility subsidiary.
KPCo	Kentucky Power Company, an AEP electric utility subsidiary.
MTM	Mark-to-Market.
OATT	Open Access Transmission Tariff.
OPCo	Ohio Power Company, an AEP electric utility subsidiary.
OPEB	Other Postretirement Benefit Plans.
OTC	Over the counter.
Parent	American Electric Power Company, Inc., the equity owner of AEP subsidiaries within the AEP consolidation.
PJM	Pennsylvania – New Jersey – Maryland regional transmission organization.
Risk Management Contracts	Trading and nontrading derivatives, including those derivatives designated as cash flow and fair value hedges.
SEC	U.S. Securities and Exchange Commission.
Tax Reform	On December 22, 2017, President Trump signed into law legislation referred to as the "Tax Cuts and Jobs Act" (the TCJA). The TCJA includes significant changes to the Internal Revenue Code of 1986, including a reduction in the corporate federal income tax rate from 35% to 21% effective January 1, 2018.
TPUC	Tennessee Public Utility Commission, formerly known as Tennessee Regulatory Authority (TRA).

Term	Meaning
Utility Money Pool	Centralized funding mechanism AEP uses to meet the short-term cash requirements of certain utility subsidiaries.
VIE	Variable Interest Entity.
WPCo	Wheeling Power Company, an AEP electric utility subsidiary.

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Report of Independent Auditors

To the Board of Directors and Management of
Kingsport Power Company

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

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

Opinion

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

Other Matter

The financial statements of the Company as of December 31, 2016 and for the year then ended were audited by other auditors whose report, dated March 30, 2017, expressed an unmodified opinion on those statements.

PricewaterhouseCoopers LLP

Columbus, Ohio
March 29, 2018

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

	Years Ended December 31, 2017	2016
REVENUES		
Electricity, Transmission and Distribution	$ 158,319	$ 151,224
Sales to AEP Affiliates	3,653	3,301
Other Revenues	371	156
TOTAL REVENUES	162,343	154,681
EXPENSES		
Purchased Electricity from AEP Affiliates	125,837	126,566
Other Operation	7,492	7,266
Maintenance	3,622	3,915
Depreciation and Amortization	6,841	6,425
Taxes Other Than Income Taxes	10,586	8,395
TOTAL EXPENSES	154,378	152,567
OPERATING INCOME	7,965	2,114
Other Income (Expense):		
Interest Income	7	—
Allowance for Equity Funds Used During Construction	18	—
Interest Expense	(2,053)	(1,457)
INCOME BEFORE INCOME TAX EXPENSE	5,937	657
Income Tax Expense	1,450	252
NET INCOME	$ 4,487	$ 405

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

See Notes to Financial Statements beginning on page 9.

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

	Common Stock	Paid-in Capital	Retained Earnings	Total
TOTAL COMMON SHAREHOLDER'S EQUITY - DECEMBER 31, 2015	$ 4,100	$ 13,800	$ 11,726	$ 29,626
Capital Contribution from Parent		7,500		7,500
Net Income			405	405
TOTAL COMMON SHAREHOLDER'S EQUITY - DECEMBER 31, 2016	4,100	21,300	12,131	37,531
Capital Contribution from Parent		1,500		1,500
Net Income			4,487	4,487
TOTAL COMMON SHAREHOLDER'S EQUITY - DECEMBER 31, 2017	$ 4,100	$ 22,800	$ 16,618	$ 43,518

See Notes to Financial Statements beginning on page 9.

KINGSPORT POWER COMPANY
BALANCE SHEETS
ASSETS
December 31, 2017 and 2016
(in thousands)

	December 31, 2017	December 31, 2016
CURRENT ASSETS		
Cash and Cash Equivalents	$ 94	$ 87
Advances to Affiliates	927	—
Accounts Receivable:		
Customers	3,594	2,634
Affiliated Companies	1,127	1,082
Accrued Unbilled Revenues	374	48
Miscellaneous	5	7
Allowance for Uncollectible Accounts	(153)	—
Total Accounts Receivable	4,947	3,771
Materials and Supplies	284	330
Accrued Tax Benefits	894	838
Prepayments	2,208	2,183
Other Current Assets	25	93
TOTAL CURRENT ASSETS	9,379	7,302
PROPERTY, PLANT AND EQUIPMENT		
Electric:		
Transmission	37,351	30,873
Distribution	156,683	148,967
Other Property, Plant and Equipment	8,008	6,521
Construction Work in Progress	5,459	7,719
Total Property, Plant and Equipment	207,501	194,080
Accumulated Depreciation and Amortization	73,528	71,414
TOTAL PROPERTY, PLANT AND EQUIPMENT – NET	133,973	122,666
OTHER NONCURRENT ASSETS		
Regulatory Assets	12,019	15,612
Deferred Charges and Other Noncurrent Assets	1,747	675
TOTAL OTHER NONCURRENT ASSETS	13,766	16,287
TOTAL ASSETS	$ 157,118	$ 146,255

See Notes to Financial Statements beginning on page 9.

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

	December 31,	
	2017	2016
CURRENT LIABILITIES	(in thousands)	
Advances from Affiliates	$ —	$ 28,438
Accounts Payable:		
General	2,469	1,704
Affiliated Companies	15,263	13,559
Customer Deposits	4,447	4,331
Accrued Taxes	1,925	1,771
Accrued Interest	1,649	1,406
Other Current Liabilities	2,096	2,554
TOTAL CURRENT LIABILITIES	27,849	53,763
NONCURRENT LIABILITIES		
Long-term Debt – Affiliated	50,000	20,000
Deferred Income Taxes	19,560	31,862
Regulatory Liabilities and Deferred Investment Tax Credits	14,097	716
Employee Benefits and Pension Obligations	1,472	1,850
Deferred Credits and Other Noncurrent Liabilities	622	533
TOTAL NONCURRENT LIABILITIES	85,751	54,961
TOTAL LIABILITIES	113,600	108,724
Rate Matters (Note 3)		
Commitments and Contingencies (Note 5)		
COMMON SHAREHOLDER'S EQUITY		
Common Stock – No Par Value:		
Authorized – 500,000 Shares		
Outstanding – 410,000 Shares	4,100	4,100
Paid-in Capital	22,800	21,300
Retained Earnings	16,618	12,131
TOTAL COMMON SHAREHOLDER'S EQUITY	43,518	37,531
TOTAL LIABILITIES AND COMMON SHAREHOLDER'S EQUITY	$ 157,118	$ 146,255

See Notes to Financial Statements beginning on page 9.

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

	Years Ended December 31, 2017	2016
OPERATING ACTIVITIES		
Net Income	$ 4,487	$ 405
Adjustments to Reconcile Net Income to Net Cash Flows from Operating Activities:		
Depreciation and Amortization	6,841	6,425
Deferred Income Taxes	6,033	1,664
Change in Other Noncurrent Assets	(4,818)	(1,376)
Change in Other Noncurrent Liabilities	(146)	688
Changes in Certain Components of Working Capital:		
Accounts Receivable, Net	(1,176)	(1,200)
Materials and Supplies	46	(44)
Accounts Payable	1,668	(213)
Accrued Taxes, Net	98	2,517
Other Current Assets	16	188
Other Current Liabilities	(14)	56
Net Cash Flows from Operating Activities	13,035	9,110
INVESTING ACTIVITIES		
Construction Expenditures	(15,488)	(12,994)
Change in Advances to Affiliates, Net	(927)	—
Other Investing Activities	440	376
Net Cash Flows Used for Investing Activities	(15,975)	(12,618)
FINANCING ACTIVITIES		
Capital Contribution from Parent	1,500	7,500
Issuance of Long-term Debt – Affiliated	30,000	—
Change in Advances from Affiliates, Net	(28,438)	(3,859)
Principal Payments for Capital Lease Obligations	(149)	(146)
Other Financing Activities	34	26
Net Cash Flows from Financing Activities	2,947	3,521
Net Increase in Cash and Cash Equivalents	7	13
Cash and Cash Equivalents at Beginning of Period	87	74
Cash and Cash Equivalents at End of Period	$ 94	$ 87
SUPPLEMENTARY INFORMATION		
Cash Paid for Interest, Net of Capitalized Amounts	$ 1,769	$ 1,331
Net Cash Paid (Received) for Income Taxes	(4,639)	(3,381)
Noncash Acquisitions Under Capital Leases	95	248
Construction Expenditures Included in Current Liabilities as of December 31,	2,100	1,202

See Notes to Financial Statements beginning on page 9.

INDEX OF NOTES TO FINANCIAL STATEMENTS

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

ORGANIZATION

KGPCo is a wholly-owned subsidiary of AEP. KGPCo is engaged in the purchase of electric power and the subsequent sale, transmission and distribution of that power to approximately 48,000 retail customers in its service territory in Kingsport, Tennessee and the surrounding area. As a member of the AEP System, KGPCo's facilities are operated in conjunction with the facilities of certain other AEP affiliated utilities as an integrated utility system. All of the power KGPCo sells and distributes at retail is purchased from APCo, an affiliated AEP System company.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Rates and Service Regulation

KGPCo's wholesale rates are regulated by the FERC and its retail rates are regulated by the TPUC. The FERC also regulates KGPCo's affiliated transactions, including AEPSC intercompany service billings which are generally at cost, under the 2005 Public Utility Holding Company Act and the Federal Power Act. The FERC also has jurisdiction over the issuances and acquisitions of securities, the acquisition or sale of certain utility assets and mergers with another electric utility or holding company. For non-power goods and services, the FERC requires a nonregulated affiliate to bill an affiliated public utility company at no more than market while a public utility must bill the higher of cost or market to a nonregulated affiliate. The TPUC also regulates certain intercompany transactions under its affiliate statutes.

KGPCo purchases electricity at wholesale from APCo. The FERC regulates KGPCo's cost-based wholesale power transactions with APCo. The TPUC regulates KGPCo's bundled transmission and distribution rates on a cost basis.

KGPCo's purchased power agreement with APCo includes a component for the recovery of transmission costs under the FERC's OATT. The transmission cost component of purchased power is cost-based and regulated by the TPUC.

In addition, the FERC regulates the Transmission Agreement, which allocates shared system costs and revenues to the utility subsidiaries that are parties to the agreement.

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

Accounting for the Effects of Cost-Based Regulation

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

Use of Estimates

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

Accounting for the Impacts of Tax Reform

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

KGPCo has made reasonable estimates for the measurement and accounting for the impacts of Tax Reform and these estimates are reflected in the December 31, 2017 financial statements as provisional amounts. While KGPCo was able to make reasonable estimates of the impact of Tax Reform, the final impact may differ from the recorded provisional amounts to the extent refinements are made to the estimated cumulative temporary differences or as a result of additional guidance or technical corrections that may be issued by the IRS or regulatory state commissions that impacts management's interpretation and assumptions utilized. See "Federal Tax Reform" section of Note 9 for additional information.

Cash and Cash Equivalents

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

Inventory

Materials and supplies inventories are carried at average cost.

Accounts Receivable

Customer accounts receivable primarily include receivables from retail energy customers. Revenue is recognized from electric power sales when power is delivered to customers. To the extent that deliveries have occurred but a bill has not been issued, KGPCo accrues and recognizes, as Accrued Unbilled Revenues on the balance sheets, an estimate of the revenues for energy delivered since the last billing.

AEP Credit factors accounts receivable on a daily basis, excluding receivables from risk management activities, for KGPCo. See "Securitized Accounts Receivables – AEP Credit" section of Note 11 for additional information.

Allowance for Uncollectible Accounts

Generally, AEP Credit records bad debt expense related to receivables purchased from KGPCo under a sale of receivables agreement. For other accounts receivable, bad debt expense is recorded for all amounts outstanding 180 days or greater at 100%, unless specifically identified. Accounts receivable items open less than 180 days may be reserved using specific identification for bad debt reserves.

Concentrations of Credit Risk and Significant Customers

Two of KGPCo's industrial customers who manufacture paper and chemical products account for the following percentages of total operating revenues for the years ended December 31 and accounts receivable as of December 31:

Percentage of Operating Revenues	2017	2016
Customer Who Manufactures Paper Products	14%	13%
Customer Who Manufactures Chemical Products	11%	12%

Percentage of Accounts Receivable	2017	2016
Customer Who Manufactures Paper Products	12%	13%
Customer Who Manufactures Chemical Products	8%	10%

Management monitors credit levels and the financial condition of KGPCo's customers on a continuing basis to minimize credit risk. Management believes adequate provision for credit loss has been made in the accompanying financial statements.

Property, Plant and Equipment

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

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

Long-lived assets are required to be tested for impairment when it is determined that the carrying value of the assets may no longer be recoverable or when the assets meet the held-for-sale criteria under the accounting guidance for "Impairment or Disposal of Long-lived Assets."

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

Allowance for Funds Used During Construction

AFUDC represents the estimated cost of borrowed and equity funds used to finance construction projects that is capitalized and recovered through depreciation over the service life of a regulated electric utility facility.

Valuation of Nonderivative Financial Instruments

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

Fair Value Measurements of Assets and Liabilities

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

For commercial activities, exchange traded derivatives, namely futures contracts, are generally fair valued based on unadjusted quoted prices in active markets and are classified as Level 1. Level 2 inputs primarily consist of OTC broker quotes in moderately active or less active markets, as well as exchange traded contracts where there is insufficient market liquidity to warrant inclusion in Level 1. Management verifies price curves using these broker quotes and classifies these fair values within Level 2 when substantially all of the fair value can be corroborated. Management typically obtains multiple broker quotes, which are nonbinding in nature but are based on recent trades in the marketplace. When multiple broker quotes are obtained, the quoted bid and ask prices are averaged. In certain circumstances, a broker quote may be discarded if it is a clear outlier. Management uses a historical correlation analysis between the broker quoted location and the illiquid locations. If the points are highly correlated, these locations are included within Level 2 as well. Certain OTC and bilaterally executed derivative instruments are executed in less active markets with a lower availability of pricing information. Illiquid transactions, complex structured transactions, FTRs and counterparty credit risk may require nonmarket based inputs. Some of these inputs may be internally developed or extrapolated and utilized to estimate fair value. When such inputs have a significant impact on the measurement of fair value, the instrument is categorized as Level 3. The main driver of contracts being classified as Level 3 is the inability to substantiate energy price curves in the market. A portion of the Level 3 instruments have been economically hedged which limits potential earnings volatility.

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

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

Revenue Recognition

Regulatory Accounting

KGPCo's financial statements reflect the actions of regulators that can result in the recognition of revenues and expenses in different time periods than enterprises that are not rate-regulated. Regulatory assets (deferred expenses) and regulatory liabilities (deferred revenue reductions or refunds) are recorded to reflect the economic effects of regulation in the same accounting period by matching expenses with their recovery through regulated revenues and by matching income with its passage to customers in cost-based regulated rates.

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

Electricity Supply and Delivery Activities

KGPCo recognizes retail revenues upon delivery of the energy to the customer and includes billed revenue as well as an accrual of electricity delivered but unbilled at year-end. In general, expenses are recorded when purchased electricity is received and when expenses are incurred. Changes in the fuel component of affiliated purchased power are expensed as incurred. The fuel rate billed to the customer is on a two-month lag, as permitted by the TPUC.

Maintenance

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

Income Taxes and Investment Tax Credits

KGPCo uses the liability method of accounting for income taxes. Under the liability method, deferred income taxes are provided for all temporary differences between the book and tax basis of assets and liabilities which will result in a future tax consequence. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which the temporary differences are expected to be recovered or settled. KGPCo revalued deferred tax assets and liabilities at the new federal corporate income tax rate of 21% in December 2017. See Note 9 for additional information related to Tax Reform.

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

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

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

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

Excise Taxes

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

Pension and OPEB Plans

KGPCo participates in an AEP sponsored qualified pension plan. Substantially all of KGPCo's employees are covered by the qualified plan. KGPCo also participates in OPEB plans sponsored by AEP to provide health and life insurance benefits for retired employees. KGPCo is allocated a proportionate share of benefit costs and accounts for its participation in these plans as multiple-employer plans. See Note 6 - Benefit Plans for additional information including significant accounting policies associated with the plans.

Investments Held in Trust for Future Liabilities

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

Benefit Plans

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

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

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

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

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

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

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

For equity investments, the concentration limits are as follows:

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

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

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

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

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

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

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

Subsequent Events

Management reviewed subsequent events through March 29, 2018, the date that KGPCo's 2017 annual report was available to be issued.

2. NEW ACCOUNTING PRONOUNCEMENTS

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

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

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

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

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

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

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

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

The new accounting guidance is effective for interim and annual periods beginning after December 15, 2018 with early adoption permitted for certain provisions. Management adopted ASU 2016-01 effective January 1, 2018, by means of a cumulative-effect adjustment to the balance sheet. The adoption of ASU 2016-01 resulted in no impact to results of operations, financial position or cash flows for KGPCo.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

The new accounting guidance is effective for annual periods beginning after December 15, 2018. Early adoption is permitted in any interim or annual period. KGPCo adopted ASU 2016-18 effective for the 2017 Annual Report and had no impact on the statement of cash flows.

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

In March 2017, the FASB issued ASU 2017-07 requiring that an employer report the service cost component of pension and postretirement benefits in the same line item or items as other compensation costs. The other components of net benefit cost are required to be presented in the statements of income separately from the service cost component and outside of a subtotal of income from operations. In addition, only the service cost component will be eligible for capitalization as applicable following labor. For 2017, KGPCo's actual non-service cost components were a credit of $201 thousand, of which approximately 56% was capitalized.

The new accounting guidance is effective for annual periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019. Early adoption is permitted as of the beginning of an annual period for which financial statements have not been issued or made available for issuance. Management is analyzing the impact of the new standard. Management adopted ASU 2017-07 effective January 1, 2018.

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

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

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

3. RATE MATTERS

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

Impact of Tax Reform

Rate and regulatory matters are impacted by federal income tax implications. In December 2017, Tax Reform was enacted, which will impact outstanding rate and regulatory matters. For details on the impact of Tax Reform, see Note 9 - Income Taxes.

Targeted Reliability Plan and Major Storm Rider

In April 2017, KGPCo filed a request with the TPUC to approve a Targeted Reliability Plan and Major Storm Rider (the Rider). The reliability portion of the Rider will recover prospective incremental incurred costs of cycle-based vegetation management and other distribution reliability investments. The major storm portion of the Rider provides KGPCo a mechanism to return to or collect from customers any prospective over or under-recovered costs associated with major storms. A hearing at the TPUC was held in August 2017 in which the TPUC approved the rider which became effective in October 2017.

Deferred Storm Costs Recovery

In December 2017, KGPCo filed a petition with the TPUC to implement a rider to recover $1.5 million of deferred 2009 and 2013 storm costs over a 24 month period. A hearing at the TPUC is proposed for August 2018.

PJM Transmission Rates

In June 2016, PJM transmission owners, including KGPCo and various state commissions, filed a settlement agreement at the FERC to resolve outstanding issues related to cost responsibility for charges to transmission customers for certain transmission facilities that operate at or above 500 kV. In July 2016, certain parties filed comments at the FERC contesting the settlement agreement. Upon final FERC approval, PJM would implement a transmission enhancement charge adjustment through the PJM OATT, billable through 2025. Management expects that any refunds received would generally be returned to retail customers through an existing KGPCo rider mechanism.

FERC Transmission Complaint - AEP's PJM Participants

In October 2016, seven parties filed a complaint at the FERC that alleged the base return on common equity used by AEP's eastern transmission subsidiaries, including KGPCo, in calculating formula transmission rates under the PJM OATT is excessive and should be reduced from 10.99% to 8.32%, effective upon the date of the complaint. In November 2017, a FERC order set the matter for hearing and settlement procedures. In March 2018, the AEP eastern transmission companies, including KGPCo, and six of the complainants filed a settlement agreement with the FERC (the seventh complainant abstained). If approved by the FERC, the settlement agreement (a) establishes a base ROE for AEP's eastern transmission subsidiaries of 9.85% (10.35% inclusive of the RTO incentive adder of 0.5%), effective January 1, 2018, (b) requires the AEP eastern transmission companies to provide a one-time refund of $50 million, attributable from the date of the complaint through December 31, 2017, to be credited to customer bills in the second quarter of 2018 and (c) increases the cap on the equity portion of the capital structure to 55% from 50%. As part of the settlement agreement, AEP's eastern transmission subsidiaries also filed updated transmission formula rates incorporating the reduction in the corporate federal income tax rate from 35% to 21%, effective January 1, 2018 and provides for the amortization of the portion of the excess accumulated deferred income taxes, not subject to the normalization method of accounting, ratably over a ten year period through credits to the federal income tax expense component of the revenue requirement.

Management believes KGPCo's financial statements adequately address the impact of the settlement agreement. If the FERC orders revenue reductions in excess of the terms of the settlement agreement, it could reduce future net income and cash flows and impact financial condition. A decision from the FERC is pending.

Modifications to AEP's PJM Transmission Rates

In November 2016, AEP's eastern transmission subsidiaries, including KGPCo, filed an application at the FERC to modify the PJM OATT formula transmission rate calculation, including an adjustment to recover a tax-related regulatory asset and a shift from historical to projected expenses. In March 2017, the FERC accepted the proposed modifications effective January 1, 2017, subject to refund, and set this matter for hearing and settlement procedures. The modified PJM OATT formula rates are based on projected calendar year financial activity and projected plant balances. In December 2017, AEP's eastern transmission subsidiaries filed an uncontested settlement agreement with the FERC resolving all outstanding issues. If the FERC determines that any of these costs are not recoverable, it could reduce future net income and cash flows and impact financial condition.

4. EFFECTS OF REGULATION

Regulatory assets and liabilities are comprised of the following items:

	December 31, 2017	December 31, 2016	Remaining Recovery Period
	(in thousands)		
Regulatory Assets:			
Noncurrent Regulatory Assets			
Regulatory assets pending final regulatory approval:			
Regulatory Assets Currently Not Earning a Return			
Storm-Related Costs	$ 1,505	$ 1,505	
Total Regulatory Assets Pending Final Regulatory Approval	1,505	1,505	
Regulatory assets approved for recovery:			
Regulatory Assets Currently Not Earning a Return			
Pension and OPEB Funded Status	4,937	6,653	12 years
Fuel and Purchased Power Adjustment Rider	4,029	—	2 years
Postemployment Benefits	539	240	5 years
Peak Demand Reduction/Energy Efficiency	420	473	4 years
Rate Case Expenses	371	472	4 years
Medicare Subsidy	214	244	7 years
Income Taxes, Net	—	6,025	
Other Regulatory Assets Approved for Recovery	4	—	various
Total Regulatory Assets Approved for Recovery	10,514	14,107	
Total Noncurrent Regulatory Assets	$ 12,019	$ 15,612	

	December 31, 2017	December 31, 2016	Remaining Refund Period
	(in thousands)		
Regulatory Liabilities:			
Noncurrent Regulatory Liabilities and Deferred Investment Tax Credits			
Regulatory liabilities pending final regulatory determination:			
Regulatory Liabilities Currently Paying a Return			
Income Taxes, Net (a)	$ 12,309	$ —	
Total Regulatory Liabilities Pending Final Regulatory Determination	12,309	—	
Regulatory liabilities approved for payment:			
Regulatory Liabilities Currently Paying a Return			
Asset Removal Costs	1,597	106	(b)
Regulatory Liabilities Currently Not Paying a Return			
Targeted Reliability Plan and Major Storm Rider Costs	172	—	2 years
Fuel and Purchased Power Adjustment Rider	—	596	
Other Regulatory Liabilities Approved for Payment	19	14	various
Total Regulatory Liabilities Approved for Payment	1,788	716	
Total Noncurrent Regulatory Liabilities and Deferred Investment Tax Credits	$ 14,097	$ 716	

(a) This balance primarily represents regulatory liabilities for excess accumulated deferred income taxes (Excess ADIT) as a result of the reduction in the corporate federal income tax rate from 35% to 21% related to the enactment of Tax Reform. The regulatory liability balance predominately pays a return due to the inclusion of Excess ADIT in rate base. The mechanism and refund period to provide the Excess ADIT to customers will be based on future orders from the respective commission in each jurisdiction. See "Federal Tax Reform" section of Note 9 for additional information.

(b) Relieved as removal costs are incurred.

5. COMMITMENTS, GUARANTEES AND CONTINGENCIES

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

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

COMMITMENTS

KGPCo has construction commitments to support its operations and investments. In managing the overall construction program and in the normal course of business, KGPCo contractually commits to third-party construction vendors for certain material purchases and other construction services. KGPCo also purchases materials, supplies, services and property, plant and equipment under contract as part of its normal course of business. Certain supply contracts contain penalty provisions for early termination.

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

GUARANTEES

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

Indemnifications and Other Guarantees

Contracts

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

Lease Obligations

KGPCo leases certain equipment under master lease agreements. See "Master Lease Agreements" section of Note 10 for disclosure of lease residual value guarantees.

CONTINGENCIES

Insurance and Potential Losses

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

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

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

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

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

6. BENEFIT PLANS

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

KGPCo participates in an AEP sponsored qualified pension plan which covers substantially all of KGPCo's employees. KGPCo also participates in OPEB plans sponsored by AEP to provide health and life insurance benefits for retired employees.

KGPCo recognizes the funded status associated with defined benefit pension and OPEB plans on its balance sheets. Disclosures about the plans are required by the "Compensation – Retirement Benefits" accounting guidance. KGPCo recognizes an asset for a plan's overfunded status or a liability for a plan's underfunded status. KGPCo records a regulatory asset instead of other comprehensive income for qualifying benefit costs of regulated operations that for ratemaking purposes are deferred for future recovery. The cumulative funded status adjustment is equal to the remaining unrecognized deferrals for unamortized actuarial losses or gains, prior service costs and transition obligations, such that remaining deferred costs result in a regulatory asset and deferred gains result in a regulatory liability.

Actuarial Assumptions for Benefit Obligations

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

	Pension Plan		OPEB	
	December 31,			
Assumptions	**2017**	**2016**	**2017**	**2016**
Discount Rate	3.65%	4.05%	3.60%	4.10%
Rate of Compensation Increase	4.70% (a)	4.50% (a)	NA	NA

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

NA Not applicable.

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

For 2017, the rate of compensation increase assumed varies with the age of the employee, ranging from 3.5% per year to 12% per year, with an average increase of 4.7%.

Actuarial Assumptions for Net Periodic Benefit Costs

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

	Pension Plan		OPEB	
	Years Ended December 31,			
Assumptions	**2017**	**2016**	**2017**	**2016**
Discount Rate	4.05%	4.30%	4.10%	4.30%
Expected Return on Plan Assets	6.00%	6.00%	6.75%	7.00%
Rate of Compensation Increase	4.70% (a)	4.50% (a)	NA	NA

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

NA Not applicable.

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

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

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

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

	1% Increase	1% Decrease
	(in thousands)	
Effect on Total Service and Interest Cost Components of Net Periodic Postretirement Health Care Benefit Cost	$ 6	$ (5)
Effect on the Health Care Component of the Accumulated Postretirement Benefit Obligation	109	(99)

Significant Concentrations of Risk within Plan Assets

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

Benefit Plan Obligations, Plan Assets and Funded Status

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

	Pension Plan		OPEB	
	2017	2016	2017	2016
Change in Benefit Obligation	(in thousands)			
Benefit Obligation as of January 1,	$ 16,436	$ 16,170	$ 4,931	$ 5,049
Service Cost	268	223	35	31
Interest Cost	651	684	209	208
Actuarial (Gain) Loss	453	456	(361)	(17)
Benefit Payments	(966)	(1,097)	(457)	(496)
Participant Contributions	—	—	142	154
Medicare Subsidy	—	—	1	2
Benefit Obligation as of December 31,	$ 16,842	$ 16,436	$ 4,500	$ 4,931
Change in Fair Value of Plan Assets				
Fair Value of Plan Assets as of January 1,	$ 14,809	$ 14,656	$ 5,491	$ 5,737
Actual Gain on Plan Assets	1,856	1,008	1,014	96
Company Contributions	291	242	—	—
Participant Contributions	—	—	142	154
Benefit Payments	(966)	(1,097)	(457)	(496)
Fair Value of Plan Assets as of December 31,	$ 15,990	$ 14,809	$ 6,190	$ 5,491
Funded (Underfunded) Status as of December 31,	$ (852)	$ (1,627)	$ 1,690	$ 560

Amounts Recognized on the Balance Sheets

	Pension Plan		OPEB	
	December 31,			
	2017	2016	2017	2016
	(in thousands)			
Deferred Charges and Other Noncurrent Assets – Prepaid Benefit Costs	$ —	$ —	$ 1,690	$ 560
Employee Benefits and Pension Obligations – Accrued Long-term Benefit Liability	(852)	(1,627)	—	—
Funded (Underfunded) Status	$ (852)	$ (1,627)	$ 1,690	$ 560

Amounts Included in Regulatory Assets

	Pension Plan		OPEB	
	December 31,			
	2017	2016	2017	2016
Components	(in thousands)			
Net Actuarial Loss	$ 5,556	$ 6,348	$ 690	$ 1,829
Prior Service Cost (Credit)	—	3	(1,309)	(1,527)
Recorded as				
Regulatory Assets	$ 5,556	$ 6,351	$ (619)	$ 302

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

	Pension Plan		OPEB	
	2017	2016	2017	2016
Components	(in thousands)			
Actuarial (Gain) Loss During the Year	$ (529)	$ 312	$ (1,004)	$ 270
Amortization of Actuarial Loss	(263)	(270)	(135)	(111)
Amortization of Prior Service Credit (Cost)	(3)	(4)	218	218
Change for the Year Ended December 31,	$ (795)	$ 38	$ (921)	$ 377

Determination of Pension Expense

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

Pension and OPEB Assets

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

Pension Plan		OPEB	
December 31,			
2017	2016	2017	2016
0.3%	0.3%	0.4%	0.4%

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

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

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

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

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

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

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

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

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

(b) Amounts in "Other" column represent investments for which fair value is measured using net asset value per share.

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

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

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

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

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

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

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

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

Accumulated Benefit Obligation

As of December 31, 2017 and 2016, the accumulated benefit obligation for the qualified pension plan was $16.3 million and $16.1 million, respectively.

For the underfunded pension plan that had an accumulated benefit obligation in excess of plan assets, the projected benefit obligation, accumulated benefit obligation and fair value of plan assets of the plan were as follows:

	Underfunded Pension Plan	
	December 31,	
	2017	2016
	(in thousands)	
Projected Benefit Obligation	$ 16,842	$ 16,436
Accumulated Benefit Obligation	$ 16,315	$ 16,058
Fair Value of Plan Assets	15,990	14,809
Underfunded Accumulated Benefit Obligation	$ (325)	$ (1,249)

Estimated Future Benefit Payments and Contributions

KGPCo expects contributions for the pension plan of $430 thousand during 2018. The estimated contributions to the pension trust are at least the minimum amount required by the Employee Retirement Income Security Act and additional discretionary contributions may be made to maintain the funded status of the plan.

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

	Estimated Payments	
	Pension Plan	**OPEB**
	(in thousands)	
2018	$ 1,087	$ 445
2019	1,143	426
2020	1,055	436
2021	1,052	437
2022	1,080	434
Years 2023 to 2027, in Total	5,748	2,173

Components of Net Periodic Benefit Cost

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

	Pension Plan		**OPEB**	
	Years Ended December 31,			
	2017	**2016**	**2017**	**2016**
	(in thousands)			
Service Cost	$ 268	$ 223	$ 35	$ 31
Interest Cost	651	684	209	208
Expected Return on Plan Assets	(873)	(865)	(371)	(382)
Amortization of Prior Service Cost (Credit)	3	4	(218)	(218)
Amortization of Net Actuarial Loss	263	270	135	111
Net Periodic Benefit Cost (Credit)	312	316	(210)	(250)
Capitalized Portion	(174)	(155)	117	123
Net Periodic Benefit Cost (Credit) Recognized in Expense	$ 138	$ 161	$ (93)	$ (127)

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

Components	Pension Plan	OPEB
	(in thousands)	
Net Actuarial Loss	$ 273	$ 31
Prior Service Credit	—	(218)
Total Estimated 2018 Amortization	$ 273	$ (187)
Expected to be Recorded as		
Regulatory Asset	$ 273	$ (187)

American Electric Power System Retirement Savings Plan

KGPCo participates in an AEP sponsored defined contribution retirement savings plan, the American Electric Power System Retirement Savings Plan, for substantially all employees. This qualified plan offers participants an opportunity to contribute a portion of their pay, includes features under Section 401(k) of the Internal Revenue Code and provides for matching contributions. The matching contributions to the plan are 100% of the first 1% of eligible employee contributions and 70% of the next 5% of contributions. The cost for matching contributions totaled $193 thousand in 2017 and $186 thousand in 2016.

7. <u>DERIVATIVES AND HEDGING</u>

AEPSC is agent for and transacts on behalf of KGPCo.

Risk Management Strategies

KGPCo's vehicle fleet is exposed to gasoline and diesel fuel price volatility. KGPCo utilizes financial heating oil and gasoline derivative contracts in order to mitigate price risk of future fuel purchases. KGPCo does not hedge all fuel price risk. The gross notional volumes of KGPCo's outstanding derivative contracts for heating oil and gasoline as of December 31, 2017 and 2016 were 52 thousand gallons and 52 thousand gallons, respectively.

ACCOUNTING FOR DERIVATIVE INSTRUMENTS AND THE IMPACT ON KGPCo's FINANCIAL STATEMENTS

According to the accounting guidance for "Derivatives and Hedging," KGPCo reflects the fair values of derivative instruments subject to netting agreements with the same counterparty net of related cash collateral. For certain risk management contracts, KGPCo is required to post or receive cash collateral based on third party contractual agreements and risk profiles. For the December 31, 2017 and 2016 balance sheets, KGPCo netted $0 and $6 thousand, respectively, of cash collateral received from third parties against short-term and long-term risk management assets and had no netting of cash collateral paid to third parties against short-term and long-term risk management liabilities.

The following tables represent the gross fair value impact of KGPCo's derivative activity on the balance sheets:

Fair Value of Derivative Instruments
December 31, 2017

Balance Sheet Location	Risk Management Contracts Commodity (a)	Gross Amounts Offset in the Statement of Financial Position (b)	Net Amounts of Assets/Liabilities Presented in the Statement of Financial Position (c)
		(in thousands)	
Other Current Assets	$ 18	$ —	$ 18
Deferred Charges and Other Noncurrent Assets	—	—	—
Total Assets	18	—	18
Other Current Liabilities	—	—	—
Deferred Credits and Other Noncurrent Liabilities	—	—	—
Total Liabilities	—	—	—
Total MTM Derivative Contract Net Assets	$ 18	$ —	$ 18

Fair Value of Derivative Instruments
December 31, 2016

Balance Sheet Location	Risk Management Contracts Commodity (a)	Gross Amounts Offset in the Statement of Financial Position (b)	Net Amounts of Assets/Liabilities Presented in the Statement of Financial Position (c)
		(in thousands)	
Other Current Assets	$ 14	$ (6)	$ 8
Deferred Charges and Other Noncurrent Assets	—	—	—
Total Assets	14	(6)	8
Other Current Liabilities	—	—	—
Deferred Credits and Other Noncurrent Liabilities	—	—	—
Total Liabilities	—	—	—
Total MTM Derivative Contract Net Assets	$ 14	$ (6)	$ 8

(a) Derivative instruments within this category are reported gross. These instruments are subject to master netting agreements and are presented on the balance sheets on a net basis in accordance with the accounting guidance for "Derivatives and Hedging."

(b) Amounts represent counterparty netting of risk management and hedging contracts and associated cash collateral in accordance with the accounting guidance for "Derivatives and Hedging."

(c) There are no derivative contracts subject to a master netting arrangement or similar agreement which are not offset in the statement of financial position.

The table below presents KGPCo's activity of derivative risk management contracts:

Amount of Gain (Loss) Recognized on Risk Management Contracts

Location of Gain (Loss)	Years Ended December 31, 2017	2016
	(in thousands)	
Other Operation	$ 4	$ (7)
Maintenance	4	(14)
Regulatory Assets (a)	—	23
Regulatory Liability (a)	5	14
Total Gain on Risk Management Contracts	$ 13	$ 16

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

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

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

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

8. FAIR VALUE MEASUREMENTS

Fair Value Measurements of Long-term Debt

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

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

	December 31,			
	2017		2016	
	Book Value	Fair Value	Book Value	Fair Value
	(in thousands)			
Long-term Debt	$ 50,000	$ 51,662	$ 20,000	$ 21,608

Fair Value Measurements of Financial Assets and Liabilities

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

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

Assets and Liabilities Measured at Fair Value on a Recurring Basis
December 31, 2017

	Level 1	Level 2	Level 3	Other	Total
Risk Management Assets			(in thousands)		
Risk Management Commodity Contracts (a)	$ —	$ 18	$ —	$ —	$ 18

Assets and Liabilities Measured at Fair Value on a Recurring Basis
December 31, 2016

	Level 1	Level 2	Level 3	Other	Total
Risk Management Assets			(in thousands)		
Risk Management Commodity Contracts (a)	$ —	$ 14	$ —	$ (6)	$ 8

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

As of December 31, 2017 and 2016, KGPCo had no liabilities measured at fair value on a recurring basis.

There were no transfers between Level 1 and Level 2 during the years ended December 31, 2017 and 2016.

9. INCOME TAXES

Federal Tax Reform

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

Provisional Amounts

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

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

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

Impact of Tax Reform on the Financial Statements

Changes in the Code due to Tax Reform had a material impact on KGPCo's 2017 financial statements. In accordance with the accounting guidance for "Income Taxes", the effect of a change in tax law must be recognized at the date of enactment. The accounting guidance for "Income Taxes" also requires deferred tax assets and liabilities to be measured at the enacted tax rate expected to apply when temporary differences will be realized or settled. As a result, KGPCo's deferred tax assets and liabilities were re-measured using the newly enacted tax rate of 21% in December 2017. This re-measurement resulted in a significant reduction in KGPCo's net accumulated deferred income tax liability. With respect to KGPCo's operations, the reduction of the net accumulated deferred income tax liability was primarily offset by a corresponding decrease in income tax related regulatory assets and an increase in income tax related regulatory liabilities because the benefit of the lower federal tax rate is expected to be provided to customers. However, when the underlying asset or liability giving rise to the temporary difference was not previously contemplated in regulated rates, the re-measurement of the deferred taxes on those assets or liabilities was recorded as an adjustment to income tax expense.

KGPCo reflected a decrease in Deferred Income Tax Liabilities of $17.3 million and resulted in an increase in income tax related Regulatory Liabilities of $17 million, a decrease in income tax related Regulatory Assets of $285 thousand and an adjustment to Income Tax Expense of $32 thousand.

Regulatory Treatment

As a result of Tax Reform, KGPCo recognized a regulatory liability for approximately $17 million of excess accumulated deferred income taxes (Excess ADIT), as well as an incremental liability of $3.5 million to reflect the $17 million Excess ADIT on a pretax basis, which is presented in Regulatory Liabilities and Deferred Income Taxes on the balance sheets. The Excess ADIT is reflected on a pretax basis to appropriately contemplate future tax consequences in the periods when the regulatory liability is settled. Approximately $12.3 million of the Excess ADIT relates to temporary differences associated with depreciable property. The Tax Reform legislation includes certain rate normalization requirements that stipulate how the portion of the total Excess ADIT that is related to certain depreciable property must be returned to customers. For KGPCo, Excess ADIT resulting from the reduction of the corporate tax rate with respect to prior depreciation or recovery deductions on property will be normalized using the average rate assumption method. As a result, once the amortization of Excess ADIT related to depreciable property is reflected in rates, customers will receive the benefits over the remaining weighted average useful life of the applicable property.

For the remaining $4.7 million of Excess ADIT, KGPCo expects to continue working with the TPUC to determine the appropriate mechanism and time period over which to provide the benefits of Tax Reform to customers.

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

State Regulatory Matters

The TPUC has recently issued orders requiring public utilities, including KGPCo, to record regulatory liabilities to reflect the corporate federal income taxes currently collected in utility rates in excess of the enacted corporate federal income tax rate of 21% beginning January 1, 2018. See Note 3 - Rate Matters for additional information regarding state utility commission orders received impacting KGPCo.

Income Tax Expense

The details of KGPCo's income taxes as reported are as follows:

	Year Ended December 31, 2017	2016
	(in thousands)	
Federal:		
Current	$ (5,089)	$ (1,309)
Deferred	7,703	1,664
Total Federal	2,614	355
State and Local:		
Current	506	(103)
Deferred	(1,670)	—
Total State and Local	(1,164)	(103)
Income Tax Expense	$ 1,450	$ 252

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

	Years Ended December 31, 2017	2016
	(in thousands)	
Net Income	$ 4,487	$ 405
Income Tax Expense	1,450	252
Pretax Income	$ 5,937	$ 657
Income Taxes on Pretax Income at Statutory Rate (35%)	$ 2,078	$ 230
Increase (Decrease) in Income Taxes Resulting from the Following Items:		
Depreciation	351	224
Removal Costs	(238)	(251)
State and Local Income Taxes, Net	(301)	(67)
Tax Reform	(424)	—
Other	(16)	116
Income Tax Expense	$ 1,450	$ 252
Effective Income Tax Rate	24.4 %	38.4 %

Net Deferred Tax Liability

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

	December 31,	
	2017	2016
	(in thousands)	
Deferred Tax Assets	$ 5,616	$ 1,115
Deferred Tax Liabilities	(25,176)	(32,977)
Net Deferred Tax Liabilities	$ (19,560)	$ (31,862)
Property Related Temporary Differences	$ (18,127)	$ (26,328)
Amounts Due to/(from) Customers for Future Federal Income Taxes	3,524	(961)
Deferred State Income Taxes	(4,462)	(3,271)
Accrued Pensions	406	933
Regulatory Assets	(2,130)	(2,665)
State Net Operating Loss, Net of Federal Benefit	1,320	—
All Other, Net	(91)	430
Net Deferred Tax Liabilities	$ (19,560)	$ (31,862)

AEP System Tax Allocation Agreement

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

Federal and State Income Tax Audit Status

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

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

Net Income Tax Operating Loss Carryforward

KGPCo has Tennessee state net income tax operating loss carryforwards of $25.7 million in 2017. As a result, KGPCo recognized deferred state income tax benefits in 2017 of $1.7 million. Management anticipates future taxable income will be sufficient to realize the state net income tax operating loss tax benefits before the state carryforward expires for Tennessee in 2029.

Federal Tax Legislation

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

10. LEASES

Leases of property, plant and equipment are for remaining periods up to 10 years and require payments of related property taxes, maintenance and operating costs. The majority of the leases have purchase or renewal options and will be renewed or replaced by other leases.

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

Lease Rental Costs	Years Ended December 31, 2017	2016
	(in thousands)	
Net Lease Expense on Operating Leases	$ 554	$ 581
Amortization of Capital Leases	149	147
Interest on Capital Leases	24	19
Total Lease Rental Costs	$ 727	$ 747

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

	December 31, 2017	2016
	(in thousands)	
Electric Property, Plant and Equipment Under Capital Leases		
Total Electric Property, Plant and Equipment – Other	$ 950	$ 855
Accumulated Amortization	414	265
Net Electric Property, Plant and Equipment Under Capital Leases	$ 536	$ 590
Obligations Under Capital Leases		
Noncurrent Liability	$ 380	$ 451
Liability Due Within One Year	156	139
Total Obligations Under Capital Leases	$ 536	$ 590

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

Future Minimum Lease Payments	Capital Leases	Noncancelable Operating Leases
	(in thousands)	
2018	$ 175	$ 564
2019	135	498
2020	98	463
2021	49	435
2022	38	406
Later Years	105	337
Total Future Minimum Lease Payments	600	$ 2,703
Less Estimated Interest Element	64	
Estimated Present Value of Future Minimum Lease Payments	$ 536	

Master Lease Agreements

KGPCo leases certain equipment under master lease agreements. Under the lease agreements, the lessor is guaranteed a residual value up to a stated percentage of either the unamortized balance or the equipment cost at the end of the lease term. If the actual fair value of the leased equipment is below the guaranteed residual value at the end of the lease term, KGPCo is committed to pay the difference between the actual fair value and the residual value guarantee. Historically, at the end of the lease term the fair value has been in excess of the unamortized balance. As of December 31, 2017, the maximum potential loss for these lease agreements was approximately $186 thousand assuming the fair value of the equipment is zero at the end of the lease term.

11. FINANCING ACTIVITIES

Long-term Debt

The following table details long-term debt outstanding:

Type of Debt	Maturity	Weighted Average Interest Rate as of December 31, 2017	Interest Rate Ranges as of December 31, 2017	2016	Outstanding as of December 31, 2017	2016
					(in thousands)	
Notes Payable - Affiliated	2020-2027	3.81%	3.19%-4.52%	4.52%	$ 50,000	$ 20,000
Total Long-term Debt Outstanding					$ 50,000	$ 20,000

Dividend Restrictions

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

All of the dividends declared by KGPCo are subject to a Federal Power Act restriction that prohibits the payment of dividends out of capital accounts without regulatory approval; payment of dividends is allowed out of retained earnings only. As of December 31, 2017, the maximum amount of restricted net assets of KGPCo that may not be distributed to Parent in the form of a loan, advance or dividend was $26.9 million.

As of December 31, 2017, the Federal Power Act restriction does not limit the ability of KGPCo to pay dividends out of retained earnings.

Corporate Borrowing Program – AEP System

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

Years Ended December 31,	Maximum Borrowings from the Utility Money Pool	Maximum Loans to the Utility Money Pool	Average Borrowings from the Utility Money Pool	Average Loans to the Utility Money Pool	Net Loans to (Borrowings from) the Utility Money Pool as of December 31,	Authorized Short-Term Borrowing Limit
			(in thousands)			
2017	$ 28,556	$ 8,486	$ 11,019	$ 3,109	$ 927	$ 30,000
2016	38,292	—	28,988	—	(28,438)	50,000

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

Years Ended December 31,	Maximum Interest Rates for Funds Borrowed from the Utility Money Pool	Minimum Interest Rates for Funds Borrowed from the Utility Money Pool	Maximum Interest Rates for Funds Loaned to the Utility Money Pool	Minimum Interest Rates for Funds Loaned to the Utility Money Pool	Average Interest Rates for Funds Borrowed from the Utility Money Pool	Average Interest Rates for Funds Loaned to the Utility Money Pool
2017	1.83%	0.92%	1.85%	0.94%	1.28%	1.24%
2016	1.02%	0.69%	—%	—%	0.82%	—%

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

	Years Ended December 31, 2017	2016
	(in thousands)	
Interest Expense	$ 120	$ 242
Interest Income	6	—

Securitized Accounts Receivables – AEP Credit

Under a sale of receivables arrangement, KGPCo sells, without recourse, certain of its customer accounts receivable and accrued unbilled revenue balances to AEP Credit and is charged a fee based on AEP Credit's financing costs, administrative costs and uncollectible accounts experience for KGPCo's receivables. The costs of customer accounts receivable sold are reported in Other Operation expense on KGPCo's statements of income. KGPCo manages and services its accounts receivable sold.

AEP Credit's receivables securitization agreement provides a commitment of $750 million from bank conduits to purchase receivables and expires in June 2019.

KGPCo's factored accounts receivable revenues were $12.4 million and $13.4 million as of December 31, 2017 and 2016, respectively. KGPCo's factored accrued unbilled revenues were $2.8 million and $1.7 million as of December 31, 2017 and 2016, respectively.

The fees paid by KGPCo to AEP Credit for customer accounts receivable sold were $531 thousand and $579 thousand for the years ended December 31, 2017 and 2016, respectively.

KGPCo's proceeds on the sale of receivables to AEP Credit were $154 million and $144.8 million as of December 31, 2017 and 2016, respectively.

12. RELATED PARTY TRANSACTIONS

For other related party transactions, also see "AEP System Tax Allocation Agreement" section of Note 9 in addition to "Corporate Borrowing Program – AEP System" and "Securitized Accounts Receivables – AEP Credit" sections of Note 11.

Affiliated Revenues and Purchases

KGPCo provides transmission services directly to APCo which are approved by the FERC. KGPCo's revenues of $99 thousand and $21 thousand for these services for the years ended December 31, 2017 and 2016, respectively, were recorded in Sales to AEP Affiliates on KGPCo's statements of income. KGPCo also purchases all of its power from APCo based on a FERC-approved rate. KGPCo's purchases of $105.2 million and $104.1 million for the years ended December 31, 2017 and 2016, respectively, were recorded in Purchased Electricity from AEP Affiliates on KGPCo's statements of income. Effective September 1, 2016, KGPCo implemented the Fuel and Purchased Power Adjustment Rider (FPPAR) rates per the approved TPUC order in KGPCo's base rate case, which included, for the first time, monthly over-recovery or under-recovery accounting for the difference between the actual total costs billed monthly to KGPCo from APCo, and the actual monthly revenues recorded under the FPPAR. As of December 31, 2017, KGPCo had a regulatory asset of $4 million. The activity above is excluded from the Transmission Agreement activity discussed below.

Transmission Agreement (TA)

APCo, I&M, KGPCo, KPCo, OPCo and WPCo (AEP East Companies) are parties to the TA, effective November 2010, which defines how transmission costs through PJM OATT are allocated among the AEP East Companies, KGPCo and WPCo on a 12-month average coincident peak basis.

KGPCo's revenues recorded in Sales to AEP Affiliates on its statements of income as a result of the TA for the years ended December 31, 2017 and 2016 were $3.6 million and $3.3 million, respectively. KGPCo's charges recorded in Purchased Electricity from AEP Affiliates on its statements of income as a result of the TA for the years ended December 31, 2017 and 2016 were $25.3 million and $21.9 million, respectively.

Sales and Purchases of Property

KGPCo had affiliated sales and purchases of meters and transformers. There were no gains or losses recorded on the transactions. The following table shows the sales and purchases that were recorded at net book value:

	Years Ended December 31,	
	2017	2016
	(in thousands)	
Sales	$ 150	$ 218
Purchases	359	516

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

Global Borrowing Notes

As of December 31, 2017 and 2016, AEP has three intercompany notes in place with KGPCo. The debt is reflected in Long-term Debt – Affiliated on KGPCo's balance sheets. KGPCo accrues interest for its share of the global borrowing and remits the interest to AEP. The accrued interest is reflected in Accrued Interest on KGPCo's balance sheets.

Intercompany Billings

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

13. VARIABLE INTEREST ENTITIES

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

AEPSC provides certain managerial and professional services to AEP's subsidiaries. Parent is the sole equity owner of AEPSC. AEP management controls the activities of AEPSC. The costs of the services are based on a direct charge or on a prorated basis and billed to the AEP subsidiary companies at AEPSC's cost. AEP subsidiaries have not provided financial or other support outside the reimbursement of costs for services rendered. AEPSC finances its operations through cost reimbursement from other AEP subsidiaries. There are no other terms or arrangements between AEPSC and any of the AEP subsidiaries that could require additional financial support from an AEP subsidiary or expose them to losses outside of the normal course of business. AEPSC and its billings are subject to regulation by the FERC. AEP subsidiaries are exposed to losses to the extent they cannot recover the costs of AEPSC through their normal business operations. AEP subsidiaries are considered to have a significant interest in AEPSC due to their activity in AEPSC's cost reimbursement structure. However, AEP subsidiaries do not have control over AEPSC. AEPSC is consolidated by AEP. In the event AEPSC would require financing or other support outside the cost reimbursement billings, this financing would be provided by AEP. KGPCo's total billings from AEPSC for the years ended December 31, 2017 and 2016 were $6.6 million and $6.8 million, respectively. The carrying amount of liabilities associated with AEPSC as of December 31, 2017 and 2016 was $929 thousand and $982 thousand, respectively. Management estimates the maximum exposure of loss to be equal to the amount of such liability.

14. PROPERTY, PLANT AND EQUIPMENT

Depreciation

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

Functional Class of Property	Years Ended December 31, 2017	2016
Transmission	1.3%	2.2%
Distribution	3.6%	3.5%
Other	11.3%	11.1%

Expenditures for demolition and removal of property, plant and equipment are charged to the accumulated provision for depreciation and recovered through depreciation charges included in rates. The higher composite depreciation rate in the other class of property compared to the rate of transmission and distribution is due to capitalized software, which has a relatively shorter expected useful life compared to the transmission and distribution functional property classes.

The composite depreciation rate generally includes a component for removal costs, which is credited to Accumulated Depreciation and Amortization. Actual removal costs incurred are charged to Accumulated Depreciation and Amortization. Any excess of accrued removal costs over actual removal costs incurred is reclassified from Accumulated Depreciation and Amortization and reflected as a regulatory liability.

Asset Retirement Obligations

KGPCo has identified, but not recognized, ARO liabilities related to electric transmission and distribution assets, as a result of certain easements on property on which assets are owned. Generally, such easements are perpetual and require only the retirement and removal of assets upon the cessation of the property's use. The retirement obligation is not estimable for such easements since KGPCo plans to use its facilities indefinitely. The retirement obligation would only be recognized if and when KGPCo abandons or ceases the use of specific easements, which is not expected.

Allowance for Funds Used During Construction

KGPCo's amounts of allowance for borrowed funds used during construction were $56 thousand and $40 thousand in 2017 and 2016, respectively, and are included in Interest Expense on KGPCo's statements of income.

Kingsport Power Company

2018 Third Quarter Report

Financial Statements

BOUNDLESS ENERGY℠

TABLE OF CONTENTS	Page Number

GLOSSARY OF TERMS

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

Term	Meaning
AEP	American Electric Power Company, Inc., an investor-owned electric public utility holding company which includes American Electric Power Company, Inc. (Parent) and majority owned consolidated subsidiaries and consolidated affiliates.
AEP Credit	AEP Credit, Inc., a consolidated variable interest entity of AEP which securitizes accounts receivable and accrued utility revenues for affiliated electric utility companies.
AEP System	American Electric Power System, an electric system, owned and operated by AEP subsidiaries.
AEPSC	American Electric Power Service Corporation, an AEP service subsidiary providing management and professional services to AEP and its subsidiaries.
AEPTCo	AEP Transmission Company, LLC, a subsidiary of AEP Transmission Holdco, is an intermediate holding company that owns seven wholly-owned transmission companies.
APCo	Appalachian Power Company, an AEP electric utility subsidiary.
ARAM	Average Rate Assumption Method, an IRS approved method used to calculate the reversal of Excess ADIT for ratemaking purposes.
ASU	Accounting Standards Update.
Excess ADIT	Excess accumulated deferred income taxes.
FASB	Financial Accounting Standards Board.
FERC	Federal Energy Regulatory Commission.
FTR	Financial Transmission Right, a financial instrument that entitles the holder to receive compensation for certain congestion-related transmission charges that arise when the power grid is congested resulting in differences in locational prices.
GAAP	Accounting Principles Generally Accepted in the United States of America.
I&M	Indiana Michigan Power Company, an AEP electric utility subsidiary.
IRS	Internal Revenue Service.
KGPCo	Kingsport Power Company, an AEP electric utility subsidiary.
KPCo	Kentucky Power Company, an AEP electric utility subsidiary.
kV	Kilovolt.
MTM	Mark-to-Market.
OATT	Open Access Transmission Tariff.
OPCo	Ohio Power Company, an AEP electric utility subsidiary.
OPEB	Other Postretirement Benefit Plans.
OTC	Over the counter.
Parent	American Electric Power Company, Inc., the equity owner of AEP subsidiaries within the AEP consolidation.
PJM	Pennsylvania-New Jersey-Maryland regional transmission organization.
Risk Management Contracts	Trading and nontrading derivatives, including those derivatives designated as cash flow and fair value hedges.
RTO	Regional Transmission Organization, responsible for moving electricity over large interstate areas.
Tax Reform	On December 22, 2017, President Trump signed into law legislation referred to as the "Tax Cuts and Jobs Act" (the TCJA). The TCJA includes significant changes to the Internal Revenue Code of 1986, including a reduction in the corporate federal income tax rate from 35% to 21% effective January 1, 2018.
TPUC	Tennessee Public Utility Commission, formerly known as Tennessee Regulatory Authority (TRA).
Utility Money Pool	Centralized funding mechanism AEP uses to meet the short-term cash requirements of certain utility subsidiaries.
WPCo	Wheeling Power Company, an AEP electric utility subsidiary.

KINGSPORT POWER COMPANY
CONDENSED STATEMENTS OF INCOME
For the Three and Nine Months Ended September 30, 2018 and 2017
(in thousands)
(Unaudited)

	Three Months Ended September 30, 2018	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2018	Nine Months Ended September 30, 2017
REVENUES				
Electricity, Transmission and Distribution	$ 41,137	$ 40,506	$ 123,174	$ 117,985
Sales to AEP Affiliates	742	912	2,611	2,736
Other Revenues	96	168	193	275
TOTAL REVENUES	41,975	41,586	125,978	120,996
EXPENSES				
Purchased Electricity from AEP Affiliates	33,248	32,177	99,941	93,881
Other Operation	1,874	1,910	5,136	5,154
Maintenance	889	706	2,522	2,876
Depreciation and Amortization	1,819	1,734	5,434	5,089
Taxes Other Than Income Taxes	2,788	2,833	8,310	8,023
TOTAL EXPENSES	40,618	39,360	121,343	115,023
OPERATING INCOME	1,357	2,226	4,635	5,973
Other Income (Expense):				
Interest Income	—	1	22	1
Allowance for Equity Funds Used During Construction	24	—	112	1
Non-Service Cost Components of Net Periodic Benefit Cost	100	21	301	66
Interest Expense	(552)	(514)	(1,650)	(1,502)
INCOME BEFORE INCOME TAX EXPENSE	929	1,734	3,420	4,539
Income Tax Expense	76	295	494	1,189
NET INCOME	$ 853	$ 1,439	$ 2,926	$ 3,350

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

See Condensed Notes to Condensed Financial Statements beginning on page 7.

KINGSPORT POWER COMPANY
CONDENSED STATEMENTS OF CHANGES IN COMMON SHAREHOLDER'S EQUITY
For the Nine Months Ended September 30, 2018 and 2017
(in thousands)
(Unaudited)

	Common Stock	Paid-in Capital	Retained Earnings	Total
TOTAL COMMON SHAREHOLDER'S EQUITY - DECEMBER 31, 2016	$ 4,100	$ 21,300	$ 12,131	$ 37,531
Capital Contribution from Parent		1,500		1,500
Net Income			3,350	3,350
TOTAL COMMON SHAREHOLDER'S EQUITY - SEPTEMBER 30, 2017	$ 4,100	$ 22,800	$ 15,481	$ 42,381
TOTAL COMMON SHAREHOLDER'S EQUITY - DECEMBER 31, 2017	$ 4,100	$ 22,800	$ 16,618	$ 43,518
Capital Contribution from Parent		5,000		5,000
Net Income			2,926	2,926
TOTAL COMMON SHAREHOLDER'S EQUITY - SEPTEMBER 30, 2018	$ 4,100	$ 27,800	$ 19,544	$ 51,444

See Condensed Notes to Condensed Financial Statements beginning on page 7.

KINGSPORT POWER COMPANY
CONDENSED BALANCE SHEETS
ASSETS
September 30, 2018 and December 31, 2017
(in thousands)
(Unaudited)

	September 30, 2018	December 31, 2017
CURRENT ASSETS		
Cash and Cash Equivalents	$ 66	$ 94
Advances to Affiliates	—	927
Accounts Receivable:		
Customers	6,179	3,594
Affiliated Companies	1,922	1,127
Accrued Unbilled Revenues	288	374
Miscellaneous	5	5
Allowance for Uncollectible Accounts	(9)	(153)
Total Accounts Receivable	8,385	4,947
Materials and Supplies	338	284
Accrued Tax Benefits	686	894
Prepayments	3,595	2,208
Other Current Assets	33	25
TOTAL CURRENT ASSETS	13,103	9,379
PROPERTY, PLANT AND EQUIPMENT		
Electric:		
Transmission	38,910	37,351
Distribution	163,238	156,683
Other Property, Plant and Equipment	8,698	8,008
Construction Work in Progress	12,310	5,459
Total Property, Plant and Equipment	223,156	207,501
Accumulated Depreciation and Amortization	76,158	73,528
TOTAL PROPERTY, PLANT AND EQUIPMENT – NET	146,998	133,973
OTHER NONCURRENT ASSETS		
Regulatory Assets	13,532	12,019
Deferred Charges and Other Noncurrent Assets	3,846	1,747
TOTAL OTHER NONCURRENT ASSETS	17,378	13,766
TOTAL ASSETS	$ 177,479	$ 157,118

See Condensed Notes to Condensed Financial Statements beginning on page 7.

KINGSPORT POWER COMPANY
CONDENSED BALANCE SHEETS
LIABILITIES AND COMMON SHAREHOLDER'S EQUITY
September 30, 2018 and December 31, 2017
(Unaudited)

	September 30, 2018	December 31, 2017
	(in thousands)	
CURRENT LIABILITIES		
Advances from Affiliates	$ 10,183	$ —
Accounts Payable:		
General	2,938	2,469
Affiliated Companies	11,405	15,263
Customer Deposits	4,428	4,447
Accrued Taxes	1,916	1,925
Accrued Interest	1,701	1,649
Other Current Liabilities	2,324	2,096
TOTAL CURRENT LIABILITIES	34,895	27,849
NONCURRENT LIABILITIES		
Long-term Debt – Affiliated	50,000	50,000
Deferred Income Taxes	20,073	19,560
Regulatory Liabilities and Deferred Investment Tax Credits	18,490	14,097
Employee Benefits and Pension Obligations	1,315	1,472
Deferred Credits and Other Noncurrent Liabilities	1,262	622
TOTAL NONCURRENT LIABILITIES	91,140	85,751
TOTAL LIABILITIES	126,035	113,600
Rate Matters (Note 3)		
Commitments and Contingencies (Note 4)		
COMMON SHAREHOLDER'S EQUITY		
Common Stock – No Par Value:		
Authorized – 500,000 Shares		
Outstanding – 410,000 Shares	4,100	4,100
Paid-in Capital	27,800	22,800
Retained Earnings	19,544	16,618
TOTAL COMMON SHAREHOLDER'S EQUITY	51,444	43,518
TOTAL LIABILITIES AND COMMON SHAREHOLDER'S EQUITY	$ 177,479	$ 157,118

See Condensed Notes to Condensed Financial Statements beginning on page 7.

KINGSPORT POWER COMPANY
CONDENSED STATEMENTS OF CASH FLOWS
For the Nine Months Ended September 30, 2018 and 2017
(in thousands)
(Unaudited)

	Nine Months Ended September 30, 2018	2017
OPERATING ACTIVITIES		
Net Income	$ 2,926	$ 3,350
Adjustments to Reconcile Net Income to Net Cash Flows from Operating Activities:		
Depreciation and Amortization	5,434	5,089
Deferred Income Taxes	(74)	5,056
Change in Regulatory Assets	(1,675)	(2,559)
Change in Other Noncurrent Assets	(1,471)	(1,199)
Change in Other Noncurrent Liabilities	166	47
Changes in Certain Components of Working Capital:		
Accounts Receivable, Net	(137)	(1,863)
Materials and Supplies	(54)	25
Prepayments	(1,387)	(1,291)
Accounts Payable	(3,385)	(1,874)
Accrued Taxes, Net	162	(728)
Other Current Assets	(8)	(65)
Other Current Liabilities	(43)	(226)
Net Cash Flows from Operating Activities	454	3,762
INVESTING ACTIVITIES		
Construction Expenditures	(16,716)	(10,724)
Change in Advances to Affiliates, Net	927	—
Other Investing Activities	242	309
Net Cash Flows Used for Investing Activities	(15,547)	(10,415)
FINANCING ACTIVITIES		
Capital Contribution from Parent	5,000	1,500
Issuance of Long-term Debt – Affiliated	—	30,000
Change in Advances from Affiliates, Net	10,183	(24,783)
Principal Payments for Capital Lease Obligations	(118)	(108)
Other Financing Activities	—	34
Net Cash Flows from Financing Activities	15,065	6,643
Net Decrease in Cash and Cash Equivalents	(28)	(10)
Cash and Cash Equivalents at Beginning of Period	94	87
Cash and Cash Equivalents at End of Period	$ 66	$ 77
SUPPLEMENTARY INFORMATION		
Cash Paid for Interest, Net of Capitalized Amounts	$ 1,570	$ 1,294
Net Cash Paid (Received) for Income Taxes	372	(3,203)
Noncash Acquisitions Under Capital Leases	11	95
Construction Expenditures Included in Current Liabilities as of September 30,	2,349	1,104

See Condensed Notes to Condensed Financial Statements beginning on page 7.

INDEX OF CONDENSED NOTES TO CONDENSED FINANCIAL STATEMENTS

1. SIGNIFICANT ACCOUNTING MATTERS

General

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

In the opinion of management, the unaudited condensed interim financial statements reflect all normal and recurring accruals and adjustments necessary for a fair presentation of the net income, financial position and cash flows for the interim periods. Net income for the three and nine months ended September 30, 2018 is not necessarily indicative of results that may be expected for the year ending December 31, 2018. The condensed financial statements are unaudited and should be read in conjunction with the audited 2017 financial statements and notes thereto, which are included in KGPCo's 2017 Annual Report.

Subsequent Events

Management reviewed subsequent events through November 20, 2018, the date that KGPCo's third quarter 2018 report was available to be issued.

2. NEW ACCOUNTING PRONOUNCEMENTS

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

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

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

Management adopted ASU 2014-09 effective January 1, 2018, by means of the modified retrospective approach for all contracts. The adoption of ASU 2014-09 did not have a material impact on results of operations, financial position or cash flows. In that regard, the application of the new standard did not cause any significant differences in any individual financial statement line items had those line items been presented in accordance with the guidance that was in effect prior to the adoption of the new standard. Further, given the lack of material impact to the financial statements, the adoption of the new standard did not give rise to any material changes in KGPCo's previously established accounting policies for revenue. See Note 10 - Revenue from Contracts with Customers for additional disclosures required by the new standard.

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

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

The new accounting guidance is effective for annual periods beginning after December 15, 2019, with early adoption permitted. In July 2018, the FASB issued ASU 2018-11 "Leases (Topic 842): Targeted Improvements", which provides an optional expedient to adopt the new lease requirements through a cumulative-effect adjustment in the period of adoption. Management plans to apply the new optional transition guidance.

New leasing standard implementation activities to date include the identification of the lease population within the AEP System as well as the sampling of representative lease contracts to analyze accounting treatment under the new accounting guidance. Based upon the completed assessments, management also prepared a gap analysis to outline new disclosure compliance requirements. A lease system was selected after reviewing multiple system options. System implementation activities of core functionality continue in the fourth quarter of 2018. Implementation of reporting functionality designed to meet new disclosure requirements is ongoing.

Management plans to elect certain of the optional practical expedients upon adoption:

Practical Expedient	Description
Overall Expedients (for leases commenced prior to adoption date and must be adopted as a package)	Do not need to reassess whether any expired or existing contracts are/or contain leases, do not need to reassess the lease classification for any expired or existing leases and do not need to reassess initial direct costs for any existing leases.
Lease and Non-lease Components (elect by class of underlying asset)	Elect as an accounting policy to not separate non-lease components from lease components and instead account for each lease and associated non-lease component as a single lease component.
Short-term Lease (elect by class of underlying asset)	Elect as an accounting policy to not apply the recognition requirements to short-term leases.
Existing and expired land easements not previously accounted for as leases	Elect optional transition practical expedient to not evaluate under Topic 842 existing or expired land easements that were not previously accounted for as leases under the current leases guidance in Topic 840.

Evaluation of new lease contracts will continue through the fourth quarter. Management expects the new standard to impact financial position and, at this time, cannot estimate the impact. Management does not expect any impact to results of operations or cash flows. Management plans to adopt ASU 2016-02 and its related guidance effective January 1, 2019.

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

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

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

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

In March 2017, the FASB issued ASU 2017-07 requiring that an employer report the service cost component of pension and postretirement benefits in the same line item or items as other compensation costs. The other components of net benefit cost are required to be presented on the statements of income separately from the service cost component and outside of a subtotal of income from operations. In addition, only the service cost component will be eligible for capitalization as applicable following labor.

Management adopted ASU 2017-07 effective January 1, 2018. Presentation of the non-service components on a separate line outside of operating income was applied on a retrospective basis, using the amounts disclosed in the benefit plan note for the estimation basis as a practical expedient. Capitalization of only the service cost component was applied on a prospective basis.

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

In August 2017, the FASB issued ASU 2017-12 amending the recognition and presentation requirements for hedge accounting activities. The objectives are to improve the financial reporting of hedging relationships to better portray the economic results of an entity's risk management activities in its financial statements and reduce the complexity of applying hedge accounting. Among other things, ASU 2017-12: (a) expands the types of transactions eligible for hedge accounting, (b) eliminates the separate measurement and presentation of hedge ineffectiveness, (c) simplifies the requirements around the assessment of hedge effectiveness, (d) provides companies more time to finalize hedge documentation and (e) enhances presentation and disclosure requirements.

Management early adopted ASU 2017-12 in the second quarter of 2018, effective January 1, 2018, by means of a modified retrospective approach. The adoption of ASU 2017-12 did not have an impact on results of operations, financial position or cash flows. Further, given the lack of impact to the financial statements, the adoption of the new standard did not give rise to any material changes in KGPCo's previously established accounting policies for derivatives and hedging.

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

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

Management adopted ASU 2018-02 effective January 1, 2018, electing to reclassify the effects of the change in the federal corporate tax rate due to Tax Reform from AOCI to Retained Earnings. A portion of the reclassification was recorded to Regulatory Liabilities to adjust the tax effects of certain interest rate hedges in AEP's regulated jurisdictions that were previously deferred as a part of the accounting for Tax Reform. There were no other effects from Tax Reform that impacted AOCI. Management applied the new guidance at the beginning of the period of adoption. The adoption of the new standard did not have a material impact on the statement of financial position and did not impact results of operations or cash flows.

ASU 2018-15 "Internal-Use Software: Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract" (ASU 2018-15)

In August 2018, the FASB issued ASU 2018-15 aligning the requirements for capitalizing implementation costs incurred in a cloud computing arrangement (hosting arrangement) that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. The new standard requires an entity (customer) in a hosting arrangement that is a service contract to follow the accounting guidance for "Internal-Use Software" to determine which implementation costs to capitalize as an asset related to the service contract and which costs to expense. Capitalized implementation costs of a hosting arrangement that is a service contract should be amortized over the term of the hosting arrangement. The expense related to the capitalized implementation costs should be presented in the same line item in the statement of income as the fees associated with the hosting element (service) of the arrangement. Payments for capitalized implementation costs in the statement of cash flows should be classified in the same manner as payments made for fees associated with the hosting element. Capitalized implementation costs in the statement of financial position should be presented in the same line item that a prepayment for the fees of the associated hosting arrangement would be presented.

The new accounting guidance is effective for interim and annual periods beginning after December 15, 2020, with early adoption permitted. The amendments may be applied either retrospectively or prospectively to applicable implementation costs incurred after the date of adoption. Management is analyzing the impact of this new standard and at this time, cannot estimate the impact of adoption on results of operations, financial position or cash flows. Management plans to adopt ASU 2018-15 prospectively, effective January 1, 2020.

3. RATE MATTERS

As discussed in KGPCo's 2017 Annual Report, KGPCo is involved in rate and regulatory proceedings at the FERC and the TPUC. The Rate Matters and Effects of Regulation notes within KGPCo's 2017 Annual Report should be read in conjunction with this report to gain a complete understanding of material rate matters still pending that could impact net income, cash flows and possibly financial condition. The following discusses ratemaking developments in 2018 and updates KGPCo's 2017 Annual Report.

Regulatory Assets Pending Final Regulatory Approval

Noncurrent Regulatory Assets	September 30, 2018	December 31, 2017
	(in thousands)	
Regulatory Assets Currently Not Earning a Return		
Storm-Related Costs	$ 1,505	$ 1,505
Total Regulatory Assets Pending Final Regulatory Approval	$ 1,505	$ 1,505

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

Impact of Tax Reform

Rate and regulatory matters are impacted by federal income tax implications. In December 2017, Tax Reform was enacted, which will impact outstanding rate and regulatory matters. For details on the impact of Tax Reform, see Note 8 - Income Taxes.

Deferred Storm Costs Recovery

In December 2017, KGPCo filed a petition with the TPUC to implement a rider to recover $1.5 million of deferred 2009 and 2013 storm costs over a 24 month period. In August 2018, KGPCo and the parties to this proceeding filed a joint motion with the TPUC for a temporary stay until the issues related to the impact of Tax Reform on KGPCo's revenue requirement are resolved in a separate proceeding.

Tennessee Tax Reform

In March 2018, KGPCo submitted a filing to the TPUC to resolve outstanding issues related to Tax Reform. If approved, the filing proposes to: (a) refund approximately $1 million over 12 months, through a rider, of excess federal income tax collected from January 1, 2018 until implementation of the rider, (b) refund an estimated $1 million annually, through a rider, of excess federal income taxes collected from the implementation of the rider until new base rates are implemented, (c) refund an estimated $9.3 million of Excess ADIT associated with certain depreciable property using ARAM and (d) utilize an estimated $4.3 million of Excess ADIT that is not subject to rate normalization to offset regulatory asset balances related to storm damage and uncollected fuel and purchase power balances. In October 2018, intervenors filed testimony that materially supports KGPCo's proposals. A hearing at the TPUC is scheduled for December 2018.

PJM Transmission Rates

In June 2016, AEP's transmission owning subsidiaries within PJM, including KGPCo and various state commissions, filed a settlement agreement at the FERC to resolve outstanding issues related to cost responsibility for charges to transmission customers for certain transmission facilities that operate at or above 500 kV. In July 2016, certain parties filed comments at the FERC contesting the settlement agreement. In May 2018, the FERC approved the contested settlement agreement. PJM implemented a transmission enhancement charge adjustment through the PJM OATT, which will be billable through 2025. Management expects that any refunds received would generally be returned to retail customers through existing state rider mechanisms and has recorded $2.5 million to Customer Accounts Receivable and $1.4 million to Deferred Charges and Other Noncurrent Assets, with offsets to Regulatory Liabilities and Deferred Investment Tax Credits.

FERC Transmission Complaint - AEP's PJM Participants

In October 2016, seven parties filed a complaint at the FERC that alleged the base return on common equity used by AEP's transmission owning subsidiaries within PJM, including KGPCo, in calculating formula transmission rates under the PJM OATT is excessive and should be reduced from 10.99% to 8.32%, effective upon the date of the complaint. In November 2017, a FERC order set the matter for hearing and settlement procedures. In March 2018, AEP's transmission owning subsidiaries within PJM and six of the complainants filed a settlement agreement with the FERC (the seventh complainant abstained). If approved by the FERC the settlement agreement: (a) establishes a base ROE for AEP's transmission owning subsidiaries within PJM of 9.85% (10.35% inclusive of the RTO incentive adder of 0.5%), effective January 1, 2018, (b) requires AEP's transmission owning subsidiaries within PJM to provide a one-time refund of $50 million, attributable from the date of the complaint through December 31, 2017, which was credited to customer bills in the second quarter of 2018 and (c) increases the cap on the equity portion of the capital structure to 55% from 50%. As part of the settlement agreement, AEP's transmission owning subsidiaries within PJM also filed updated transmission formula rates incorporating the reduction in the corporate federal income tax rate due to Tax Reform, effective January 1, 2018 and providing for the amortization of the portion of the Excess ADIT that is not subject to the normalization method of accounting, ratably over a ten-year period through credits to the federal income tax expense component of the revenue requirement. In April 2018, an ALJ accepted the interim settlement rates, which included the $50 million one-time refund that occurred in the second quarter of 2018. These interim rates are subject to refund or surcharge, with interest.

In April 2018, certain intervenors filed comments at the FERC recommending a base ROE of 8.48% and a one-time refund of $184 million. The FERC trial staff filed comments recommending a base ROE of 8.41% and one-time refund of $175 million. Another intervenor recommended the refund be calculated in accordance with the base ROE that will ultimately be approved by the FERC. In May 2018, management filed reply comments providing further support for the 9.85% base ROE agreed to in the settlement agreement.

If the FERC orders revenue reductions in excess of the terms of the settlement agreement, it could reduce future net income and cash flows and impact financial condition. A decision from the FERC is pending.

Modifications to AEP's PJM Transmission Rates

In November 2016, AEP's transmission owning subsidiaries within PJM, including KGPCo, filed an application at the FERC to modify the PJM OATT formula transmission rate calculation, including an adjustment to recover a tax-related regulatory asset and a shift from historical to projected expenses. In March 2017, the FERC accepted the proposed modifications effective January 1, 2017, subject to refund, and set this matter for hearing and settlement procedures. The modified PJM OATT formula rates are based on projected calendar year financial activity and projected plant balances. In December 2017, AEP's transmission owning subsidiaries within PJM filed an uncontested settlement agreement with the FERC resolving all outstanding issues. In April 2018, the FERC approved the uncontested settlement agreement and rates were implemented effective January 1, 2018.

4. COMMITMENTS, GUARANTEES AND CONTINGENCIES

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

For current proceedings not specifically discussed below, management does not anticipate that the liabilities, if any, arising from such proceedings would have a material effect on the financial statements. The Commitments, Guarantees and Contingencies note within KGPCo's 2017 Annual Report should be read in conjunction with this report.

GUARANTEES

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

Indemnifications and Other Guarantees

Contracts

KGPCo enters into certain types of contracts which require indemnifications. Typically these contracts include, but are not limited to, sale agreements, lease agreements, purchase agreements and financing agreements. Generally, these agreements may include, but are not limited to, indemnifications around certain tax, contractual and environmental matters. With respect to sale agreements, exposure generally does not exceed the sale price. As of September 30, 2018, there were no material liabilities recorded for any indemnifications.

Master Lease Agreements

KGPCo leases certain equipment under master lease agreements. Under the lease agreements, the lessor is guaranteed a residual value up to a stated percentage of either the unamortized balance or the equipment cost at the end of the lease term. If the actual fair value of the leased equipment is below the guaranteed residual value at the end of the lease term, KGPCo is committed to pay the difference between the actual fair value and the residual value guarantee. Historically, at the end of the lease term the fair value has been in excess of the unamortized balance. As of September 30, 2018, the maximum potential loss for these lease agreements was approximately $197 thousand assuming the fair value of the equipment is zero at the end of the lease term.

5. BENEFIT PLANS

KGPCo participates in an AEP sponsored qualified pension plan which covers substantially all of KGPCo's employees. KGPCo also participates in OPEB plans sponsored by AEP to provide health and life insurance benefits for retired employees.

Components of Net Periodic Benefit Cost

The following tables provide the components of KGPCo's net periodic benefit cost (credit) for the plans:

	Pension Plan		Other Postretirement Benefit Plans	
	Three Months Ended September 30,		Three Months Ended September 30,	
	2018	2017	2018	2017
	(in thousands)			
Service Cost	$ 65	$ 67	$ 10	$ 8
Interest Cost	152	163	39	52
Expected Return on Plan Assets	(224)	(218)	(89)	(93)
Amortization of Prior Service Cost (Credit)	—	—	(54)	(54)
Amortization of Net Actuarial Loss	68	66	8	34
Net Periodic Benefit Cost (Credit)	$ 61	$ 78	$ (86)	$ (53)

	Pension Plan		Other Postretirement Benefit Plans	
	Nine Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(in thousands)			
Service Cost	$ 194	$ 201	$ 30	$ 26
Interest Cost	456	489	117	156
Expected Return on Plan Assets	(673)	(655)	(266)	(278)
Amortization of Prior Service Cost (Credit)	—	2	(163)	(163)
Amortization of Net Actuarial Loss	204	197	24	101
Net Periodic Benefit Cost (Credit)	$ 181	$ 234	$ (258)	$ (158)

6. DERIVATIVES AND HEDGING

KGPCo adopted ASU 2017-12 in the second quarter of 2018, effective January 1, 2018. See Note 2 - New Accounting Pronouncements for additional information.

AEPSC is agent for and transacts on behalf of KGPCo.

Risk Management Strategies

KGPCo's vehicle fleet is exposed to gasoline and diesel fuel price volatility. KGPCo utilizes financial heating oil and gasoline derivative contracts in order to mitigate price risk of future fuel purchases. KGPCo does not hedge all fuel price risk. The gross notional volumes of KGPCo's outstanding derivative contracts for heating oil and gasoline as of September 30, 2018 and December 31, 2017 were 63 thousand gallons and 52 thousand gallons, respectively.

ACCOUNTING FOR DERIVATIVE INSTRUMENTS AND THE IMPACT ON KGPCo's FINANCIAL STATEMENTS

According to the accounting guidance for "Derivatives and Hedging," KGPCo reflects the fair values of derivative instruments subject to netting agreements with the same counterparty net of related cash collateral. For certain risk management contracts, KGPCo is required to post or receive cash collateral based on third party contractual agreements and risk profiles. For the September 30, 2018 and December 31, 2017 balance sheets, KGPCo had no netting of cash collateral received from third parties against short-term and long-term risk management assets and had no netting of cash collateral paid to third parties against short-term and long-term risk management liabilities.

The following tables represent the gross fair value impact of KGPCo's derivative activity on the balance sheets:

Fair Value of Derivative Instruments
September 30, 2018

Balance Sheet Location	Risk Management Contracts Commodity (a)	Gross Amounts Offset in the Statement of Financial Position (b)	Net Amounts of Assets/Liabilities Presented in the Statement of Financial Position (c)
		(in thousands)	
Other Current Assets	$ 18	$ —	$ 18
Deferred Charges and Other Noncurrent Assets	2	—	2
Total Assets	20	—	20
Other Current Liabilities	—	—	—
Deferred Credits and Other Noncurrent Liabilities	—	—	—
Total Liabilities	—	—	—
Total MTM Derivative Contract Net Assets	$ 20	$ —	$ 20

Fair Value of Derivative Instruments
December 31, 2017

Balance Sheet Location	Risk Management Contracts Commodity (a)	Gross Amounts Offset in the Statement of Financial Position (b)	Net Amounts of Assets/Liabilities Presented in the Statement of Financial Position (c)
		(in thousands)	
Other Current Assets	$ 18	$ —	$ 18
Deferred Charges and Other Noncurrent Assets	—	—	—
Total Assets	18	—	18
Other Current Liabilities	—	—	—
Deferred Credits and Other Noncurrent Liabilities	—	—	—
Total Liabilities	—	—	—
Total MTM Derivative Contract Net Assets	$ 18	$ —	$ 18

(a) Derivative instruments within this category are reported gross. These instruments are subject to master netting agreements and are presented on the balance sheets on a net basis in accordance with the accounting guidance for "Derivatives and Hedging."

(b) Amounts include counterparty netting of risk management and hedging contracts and associated cash collateral in accordance with the accounting guidance for "Derivatives and Hedging."

(c) All derivative contracts subject to a master netting arrangement or similar agreement are offset in the statement of financial position.

The table below presents KGPCo's activity of derivative risk management contracts:

Amount of Gain (Loss) Recognized on Risk Management Contracts

Location of Gain (Loss)	Three Months Ended September 30, 2018	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2018	Nine Months Ended September 30, 2017
	(in thousands)			
Other Operation	$ 3	$ —	$ 7	$ 2
Maintenance	4	1	11	2
Regulatory Assets (a)	—	3	—	—
Regulatory Liabilities (a)	(1)	8	1	(6)
Total Gain (Loss) on Risk Management Contracts	$ 6	$ 12	$ 19	$ (2)

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

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

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

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

7. FAIR VALUE MEASUREMENTS

Fair Value Hierarchy and Valuation Techniques

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

For commercial activities, exchange traded derivatives, namely futures contracts, are generally fair valued based on unadjusted quoted prices in active markets and are classified as Level 1. Level 2 inputs primarily consist of OTC broker quotes in moderately active or less active markets, as well as exchange traded contracts where there is insufficient market liquidity to warrant inclusion in Level 1. Management verifies price curves using these broker quotes and classifies these fair values within Level 2 when substantially all of the fair value can be corroborated. Management typically obtains multiple broker quotes, which are nonbinding in nature, but are based on recent trades in the marketplace. When multiple broker quotes are obtained, the quoted bid and ask prices are averaged. In certain circumstances, a broker quote may be discarded if it is a clear outlier. Management uses a historical correlation analysis between the broker quoted location and the illiquid locations. If the points are highly correlated, these locations are included within Level 2 as well. Certain OTC and bilaterally executed derivative instruments are executed in less active markets with a lower availability of pricing information. Illiquid transactions, complex structured transactions, FTRs and counterparty credit risk may require nonmarket based inputs. Some of these inputs may be internally developed or extrapolated and utilized to estimate fair value. When such inputs have a significant impact on the measurement of fair value, the instrument is categorized as Level 3. The main driver of contracts being classified as Level 3 is the inability to substantiate energy price curves in the market. A portion of the Level 3 instruments have been economically hedged which limits potential earnings volatility.

Fair Value Measurements of Long-term Debt

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

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

	September 30, 2018		December 31, 2017	
	Book Value	Fair Value	Book Value	Fair Value
	(in thousands)			
Long-term Debt	$ 50,000	$ 49,234	$ 50,000	$ 51,662

Fair Value Measurements of Financial Assets and Liabilities

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

Assets and Liabilities Measured at Fair Value on a Recurring Basis
September 30, 2018

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

Assets and Liabilities Measured at Fair Value on a Recurring Basis
December 31, 2017

Risk Management Assets	Level 1	Level 2	Level 3	Other	Total
			(in thousands)		
Risk Management Commodity Contracts (a)	$ —	$ 18	$ —	$ —	$ 18

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

As of September 30, 2018 and December 31, 2017, KGPCo had no liabilities measured at fair value on a recurring basis.

There were no transfers between Level 1 and Level 2 during the three and nine months ended September 30, 2018 and 2017.

8. INCOME TAXES

Federal Tax Reform

In December 2017, Tax Reform legislation was signed into law. Tax Reform includes significant changes to the Internal Revenue Code of 1986, as amended, and had a material impact on KGPCo's financial statements in the reporting period of its enactment. Tax Reform lowered the corporate federal income tax rate from 35% to 21%. Tax Reform provisions related to regulated public utilities generally allow for the continued deductibility of interest expense, impact bonus depreciation for certain property acquired and placed in service after September 27, 2017 and continue certain rate normalization requirements for accelerated depreciation benefits.

Provisional Amounts

KGPCo applied Staff Accounting Bulletin 118 (SAB 118), issued by the SEC staff in December 2017, and made reasonable estimates for the measurement and accounting of the effects of Tax Reform which are reflected in the financial statements as provisional amounts based on the best information available. SAB 118 provides for up to a one-year period to complete the required analysis and accounting for Tax Reform referred to as the measurement period. While KGPCo was able to make reasonable estimates of the impact of Tax Reform in 2017, the final impact may differ from the recorded provisional amounts to the extent refinements are made to the estimated cumulative differences or as a result of additional guidance or technical corrections that may be issued by the IRS that may impact management's interpretation and assumptions utilized. The measurement period adjustments recorded during the third quarter of 2018 to the provisional amounts were immaterial.

During the third quarter of 2018, the IRS proposed new regulations that reflect changes made by Tax Reform and affect taxpayers with qualified depreciable property acquired and placed in service after September 27, 2017. KGPCo expects to complete the analysis of the provisional items, including analysis of the new regulations proposed by the IRS, during the fourth quarter of 2018.

Reduction in the Corporate Federal Income Tax Rate - Pending Rate Reductions

State utility commissions have issued orders or instructions requiring public utilities, including KGPCo, to record liabilities to reflect the impact of the reduction in the corporate federal income tax rate in excess of the enacted corporate federal income tax rate of 21% beginning in 2018. KGPCo recorded an increase of $722 thousand in Deferred Credits and Other Noncurrent Liabilities for estimated provisions for refund related to the reduction in the corporate federal tax rate as of September 30, 2018.

Excess ADIT

As reflected in KGPCo's estimated annual ETR for 2018, KGPCo began amortizing the Excess ADIT associated with certain depreciable property subject to rate normalization requirements using the ARAM during the first quarter of 2018. The amortization resulted in a reduction in the Excess ADIT balance recorded in Regulatory Liabilities and Deferred Investment Tax Credits and a reduction in Income Tax Expense. As a result of state utility commission orders or instructions, KGPCo recorded $236 thousand of estimated provisions for revenue refund offsetting the amortization of the Excess ADIT.

In addition, with respect to Excess ADIT balances recorded in Regulatory Liabilities and Deferred Investment Tax Credits that are not subject to rate normalization requirements, KGPCo continues to work with the TPUC to determine the appropriate mechanism, amount and time period to provide these benefits of Tax Reform to customers. The corresponding reduction in Income Tax Expense will be reported in the interim period in which these benefits of Tax Reform are provided to customers.

Effective Tax Rates (ETR)

The interim ETR for KGPCo reflects the estimated annual ETR for 2018 and 2017, adjusted for tax expense associated with certain discrete items. The interim ETR differs from the federal statutory tax rate of 21% and 35% in 2018 and 2017, respectively, primarily due to the amortization of Excess ADIT associated with certain depreciable property using ARAM, and tax credits and other book/tax differences which are accounted for on a flow-through basis.

The ETR for KGPCo are included in the following table. Significant variances in the ETR are described below.

Three Months Ended September 30,		Nine Months Ended September 30,	
2018	**2017**	**2018**	**2017**
8.2%	17.0%	14.4%	26.2%

Three Months Ended September 30, 2018 Compared to Three Months Ended September 30, 2017

The decrease in ETR is primarily due to the change in the corporate federal income tax rate from 35% in 2017 to 21% in 2018 as a result of Tax Reform.

Nine Months Ended September 30, 2018 Compared to Nine Months Ended September 30, 2017

The decrease in ETR is primarily due to the change in the corporate federal income tax rate from 35% in 2017 to 21% in 2018 as a result of Tax Reform.

Federal and State Income Tax Audit Status

KGPCo and other AEP subsidiaries are no longer subject to U.S. federal examination for years before 2011. The IRS examination of years 2011 through 2013 started in April 2014. KGPCo and other AEP subsidiaries received a Revenue Agents Report in April 2016, completing the 2011 through 2013 audit cycle indicating an agreed upon audit. The 2011 through 2013 audit was submitted to the Congressional Joint Committee on Taxation for approval. The Joint Committee referred the audit back to the IRS exam team for further consideration. To resolve the issue under consideration, KGPCo and other AEP subsidiaries and the IRS exam team agreed to utilize the Fast Track Settlement Program in December 2017. The program was completed in March 2018 and tax years 2014 and 2015 were added to the IRS examination to reflect the impact of the Fast Track changes that were carried forward to 2014 and 2015. In June 2018, KGPCo and other AEP subsidiaries settled all outstanding issues under audit for tax years 2011-2013 and the settlement did not materially impact KGPCo's net income, cash flows or financial condition. In the third quarter of 2018, KGPCo and other AEP subsidiaries were notified that the IRS would commence an audit of the 2016 tax year in October 2018.

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

9. FINANCING ACTIVITIES

Long-term Debt

KGPCo did not have any long-term debt issuances or retirements during the first nine months of 2018.

Dividend Restrictions

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

All of the dividends declared by KGPCo are subject to a Federal Power Act restriction that prohibits the payment of dividends out of capital accounts without regulatory approval; payment of dividends is allowed out of retained earnings only.

The Federal Power Act restriction does not limit the ability of KGPCo to pay dividends out of retained earnings.

Corporate Borrowing Program - AEP System

The AEP System uses a corporate borrowing program to meet the short-term borrowing needs of AEP's subsidiaries. The corporate borrowing program includes a Utility Money Pool, which funds AEP's utility subsidiaries. The AEP System Utility Money Pool operates in accordance with the terms and conditions of the AEP System Utility Money Pool agreement filed with the FERC. The amounts of outstanding loans to (borrowings from) the Utility Money Pool as of September 30, 2018 and December 31, 2017 are included in Advances from Affiliates and Advances to Affiliates, respectively, on KGPCo's balance sheets. KGPCo's Utility Money Pool activity and corresponding authorized borrowing limits for the nine months ended September 30, 2018 are described in the following table:

Maximum Borrowings from the Utility Money Pool	Maximum Loans to the Utility Money Pool	Average Borrowings from the Utility Money Pool	Average Loans to the Utility Money Pool	Borrowings from the Utility Money Pool as of September 30, 2018	Authorized Short-Term Borrowing Limit
		(in thousands)			
$ 16,997	$ 18,089	$ 8,296	$ 6,251	$ 10,183	$ 30,000

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

Nine Months Ended September 30,	Maximum Interest Rate for Funds Borrowed from the Utility Money Pool	Minimum Interest Rate for Funds Borrowed from the Utility Money Pool	Maximum Interest Rate for Funds Loaned to the Utility Money Pool	Minimum Interest Rate for Funds Loaned to the Utility Money Pool	Average Interest Rate for Funds Borrowed from the Utility Money Pool	Average Interest Rate for Funds Loaned to the Utility Money Pool
2018	2.52%	1.81%	2.51%	1.83%	2.26%	1.97%
2017	1.49%	0.92%	1.30%	0.94%	1.27%	1.02%

Securitized Accounts Receivables - AEP Credit

Under a sale of receivables arrangement, KGPCo sells, without recourse, certain of its customer accounts receivable and accrued unbilled revenue balances to AEP Credit and is charged a fee based on AEP Credit's financing costs, administrative costs and uncollectible accounts experience for KGPCo's receivables. The costs of customer accounts receivable sold are reported in Other Operation expense on KGPCo's statements of income. KGPCo manages and services its accounts receivable sold.

AEP Credit's receivables securitization agreement provides a commitment of $750 million from bank conduits to purchase receivables and was amended in July 2018 to include a $125 million and a $625 million facility which expire in July 2020 and 2021, respectively.

KGPCo's factored accounts receivable revenues were $11.7 million and $12.4 million as of September 30, 2018 and December 31, 2017, respectively. KGPCo's factored accrued unbilled revenues were $1.4 million and $2.8 million as of September 30, 2018 and December 31, 2017, respectively.

The fees paid by KGPCo to AEP Credit for customer accounts receivable sold for the three months ended September 30, 2018 and 2017 were $184 thousand and $134 thousand, respectively, and for the nine months ended September 30, 2018 and 2017 were $499 thousand and $398 thousand, respectively.

KGPCo's proceeds on the sale of receivables to AEP Credit for the three months ended September 30, 2018 and 2017 were $40.2 million and $38.2 million, respectively, and for the nine months ended September 30, 2018 and 2017 were $122.1 million and $114.1 million, respectively.

10. REVENUE FROM CONTRACTS WITH CUSTOMERS

Disaggregated Revenues from Contracts with Customers

The table below represents KGPCo's revenues from contracts with customers, net of respective provisions for refund, by type of revenue:

	Three Months Ended September 30, 2018	Nine Months Ended September 30, 2018
	(in thousands)	
Retail Revenues:		
Residential Revenues	$ 14,843	$ 47,301
Commercial Revenues	10,021	28,530
Industrial Revenues	14,737	42,988
Other Retail Revenues	972	2,929
Total Retail Revenues	40,573	121,748
Wholesale Revenues:		
Transmission Revenues (a)	641	2,711
Total Wholesale Revenues	641	2,711
Other Revenues from Contracts with Customers (a)	797	1,521
Total Revenues from Contracts with Customers	42,011	125,980
Other Revenues:		
Alternative Revenues	(36)	(2)
Total Other Revenues	(36)	(2)
Total Revenues	$ 41,975	$ 125,978

(a) Amounts include affiliated and nonaffiliated revenues.

Performance Obligations

KGPCo has performance obligations as part of its normal course of business. A performance obligation is a promise to transfer a distinct good or service, or a series of distinct goods or services that are substantially the same and have the same pattern of transfer to a customer. The invoice practical expedient within the accounting guidance for "Revenue from Contracts with Customers" allows for the recognition of revenue from performance obligations in the amount of consideration to which there is a right to invoice the customer and when the amount for which there is a right to invoice corresponds directly to the value transferred to the customer.

The purpose of the invoice practical expedient is to depict an entity's measure of progress toward completion of the performance obligation within a contract and can only be applied to performance obligations that are satisfied over time and when the invoice is representative of services provided to date. AEP subsidiaries, including KGPCo, elected to apply the invoice practical expedient to recognize revenue for performance obligations satisfied over time as the invoices from the respective revenue streams are representative of services or goods provided to date to the customer. Performance obligations for KGPCo are summarized as follows:

Retail Revenues

KGPCo has performance obligations to purchase, sell, transmit and distribute electricity for sale to rate-regulated retail customers. The performance obligation to deliver electricity is satisfied over time as the customer simultaneously receives and consumes the benefits provided. Revenues are variable as they are subject to the customer's usage requirements.

Rate-regulated retail customers typically have the right to discontinue receiving service at will, therefore these contracts between KGPCo and their customers for rate-regulated services are generally limited to the services requested and received to date for such arrangements. Retail customers are generally billed on a monthly basis, and payment is typically due within 15 to 20 days after the issuance of the invoice.

Wholesale Revenues - Transmission

KGPCo has performance obligations to transmit electricity to wholesale customers through assets owned and operated by KGPCo and other AEP subsidiaries. The performance obligation to provide transmission services in PJM encompass a time frame greater than a year, where the performance obligation within PJM is partially fixed for a period of one year or less. Payments from the RTO for transmission services are typically received within one week from the issuance of the invoice, which is issued weekly for PJM.

KGPCo collects revenues through Transmission Formula Rates. The FERC-approved rates establish the annual transmission revenue requirement (ATRR) and transmission service rates for transmission owners. The formula rates establish rates for a one year period and also include a true-up calculation for the prior year's billings, allowing for over/under-recovery of the transmission owner's ATRR. The annual true-ups meet the definition of alternative revenues in accordance with the accounting guidance for "Regulated Operations," and are therefore presented as such in the disaggregated revenues table above.

APCo, I&M, KGPCo, KPCo, OPCo and WPCo (AEP East Companies) are parties to the Transmission Agreement (TA), which defines how transmission costs are allocated among the AEP East Companies on a 12-month average coincident peak basis. AEPTCo is a load serving entity within PJM providing transmission services to affiliates in accordance with the OATT and TA. Affiliate revenues as a result of the TA are reflected as Transmission Revenues - Affiliated in the disaggregated revenues table above.

Fixed Performance Obligations

As of September 30, 2018, the fixed performance obligations related to KGPCo were immaterial.

Contract Assets and Liabilities

Contract assets are recognized when KGPCo has a right to consideration that is conditional upon the occurrence of an event other than the passage of time, such as future performance under a contract. KGPCo did not have any material contract assets as of September 30, 2018.

When KGPCo receives consideration, or such consideration is unconditionally due from a customer prior to transferring goods or services to the customer under the terms of a sales contract, they recognize a contract liability on the balance sheet in the amount of that consideration. Revenue for such consideration is subsequently recognized in the period or periods in which the remaining performance obligations in the contract are satisfied. KGPCo did not have any material contract liabilities as of September 30, 2018.

Accounts Receivable from Contracts with Customers

Accounts receivable from contracts with customers are presented on KGPCo's balance sheets within the Accounts Receivable - Customers line item. KGPCo's balances for receivables from contracts that are not recognized in accordance with the accounting guidance for "Revenue from Contracts with Customers" included in Accounts Receivable - Customers were not material as of September 30, 2018. See "Securitized Accounts Receivable - AEP Credit" section of Note 9 for additional information related to AEP Credit's securitized accounts receivable.

The amount of affiliated accounts receivable from contracts with customers included in Accounts Receivable - Affiliated Companies on KGPCo's balance sheets were $1.2 million and $333 thousand, respectively as of September 30, 2018 and January 1, 2018.

Contract Costs

Contract costs to obtain or fulfill a contract are accounted for under the guidance for "Other Assets and Deferred Costs" and presented as a single asset and neither bifurcated nor reclassified between current and noncurrent assets on KGPCo's balance sheets. Contract costs to acquire a contract are amortized in a manner consistent with the transfer of goods or services to the customer in Other Operation on KGPCo's statements of income. KGPCo did not have material contract costs as of September 30, 2018.