CASE NUMBER:

99-149

Raff
Greer

STITES & HARBISON

ATTORNEYS

RECEIVED
APR 28 1999
PUBLIC SERVICE COMMISSION

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Mark R. Overstreet
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April 28, 1999

BY HAND DELIVERY

Ms. Helen Helton
Executive Director
Public Service Commission of Kentucky
P.O. Box 615
Frankfort, KY 40602-0615

RE: Joint Application of Kentucky Power Company, American Electric Power Company, Inc. and Central and South West Corporation, P.S.C. Case No. 99-149

Dear Ms. Helton:

Please accept for filing an original and seven copies of the Joint Applicants' Response to Staff's Oral Data Requests 2-4 made at the April 22, 1999 informal conference. The Joint Applicants' Response to Oral Data Request 1 previously has been filed with the Commission and served on Ms. Blackford and Messrs. Boehm, Brew and Jones. A copy also has been dispatched by overnight delivery for delivery today to those persons on the attached service list.

Thank you for your assistance.

Very truly yours,

Mark R. Overstreet

Mark R. Overstreet

cc: William H. Jones, Jr.
Elizabeth E. Blackford
James W. Brew
Richard G. Raff
Richard S. Taylor

KE057:KE131:2050:FRANKFORT

CERTIFICATE OF SERVICE

I hereby certify that a copy of the Joint Applicants' Response to Staff's Oral Data Requests at the April 22, 1999 Informal Conference was served by overnight delivery on April 27, 1999 for delivery this 28th day of April, 1999 upon:

Elizabeth E. Blackford
Assistant Attorney General
Office of Rate Intervention
1024 Capital Center Drive
Frankfort, Kentucky 40601

David F. Boehm
Boehm, Kurtz & Lowry
2110 CBLD Center
36 East Seventh Street
Cincinnati, Ohio 45202

James W. Brew
Brickfield Burchette Ritts, P.C.
1025 Thomas Jefferson Street, N.W.
Eighth Floor, West Tower
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William H. Jones, Jr.
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1544 Winchester Avenue
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KE057:KE131:2051:FRANKFORT

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APR 28 1999
PUBLIC SERVICE COMMISSION

April 21, 1999

Teri Walker
Central and South West Corporation
1616 Woodall Rodgers Freeway
P.O. Box 75202
Dallas, Texas 75266-0164

Dear Teri:

At Lucas Karavolos' request, I am forwarding to you six signed certificates of service for attachment to our responses to the upcoming data requests. An original certificate should be attached to the **original** of our response to each set of data requests. That is, separate originals should be attached to the original of our responses to KIUC, AG and Commission's first data request (which are due May 4, 1999). The same is true for our response to the second set of data requests.

You will note that the certificate is incomplete. Missing is the date the responses were served, that is, deposited in the mails or delivered to the overnight delivery service. You will have to complete the date when it is known. In addition, I will forward to you later a list of the persons served. The list should immediately follow the certificate. As of now, no one has intervened in our case and thus we do not know the names or addresses of the persons to be served.

If you have any questions, please do not hesitate to contact me.

Very truly yours,

Mark R. Overstreet

cc: Lucas Karavolos
Enclosures

KE057:KE131:2005:FRANKFORT
042199

MARK,

I DID NOT KNOW IF YOU NEEDED THIS. THIS IS THE LIST WE SENT THE RESPONSES TO. THANKS
Jim

JIM CLEMENT
214-777-1709 (FOR TERI WALKER)

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing was served in the manner indicated on this _______ day of May, 1999 upon the persons on the attached list.

Mark R. Overstreet

KENTUCKY MERGER FILING
DISTRIBUTION OF TECHNICAL CONFERENCE DATA REQUESTS

OF COPIES

9 Hon. Mark R. Overstreet
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1 Lucas Karavolos
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CSW:
EDMS 1
Library 1
Rocky Miracle 1
Russell Davis 1
Tevi Walker 1
Jim Clement 1
Extras 2

25 total

KENTUCKY POWER COMPANY
d/b/a

AMERICAN ELECTRIC POWER
KPSC CASE NO. 99-149
Item No. 2

RESPONSE TO DATA REQUEST(TC-1st Set)
KENTUCKY PUBLIC SERVICE COMMISSION
ORDER DATED APRIL 22, 1999

KPSC Case No. 99-149
TC (1st Set)
Order Dated April 22, 1999
Item No. 2
Sheet 1 of 1

KENTUCKY POWER COMPANY
d/b/a AMERICAN ELECTRIC POWER

REQUEST:

Please provide a copy of AEP's and CSW's 1996-1998 Annual Report to Shareholders.

RESPONSE:

Please find attached copies of AEP and CSW's 1996-1998 Reports to Shareholders including Appendix A.

WITNESS: RICHARD E. MUNCZINSKI

1996

American Electric Power

Summary Report to Shareholders

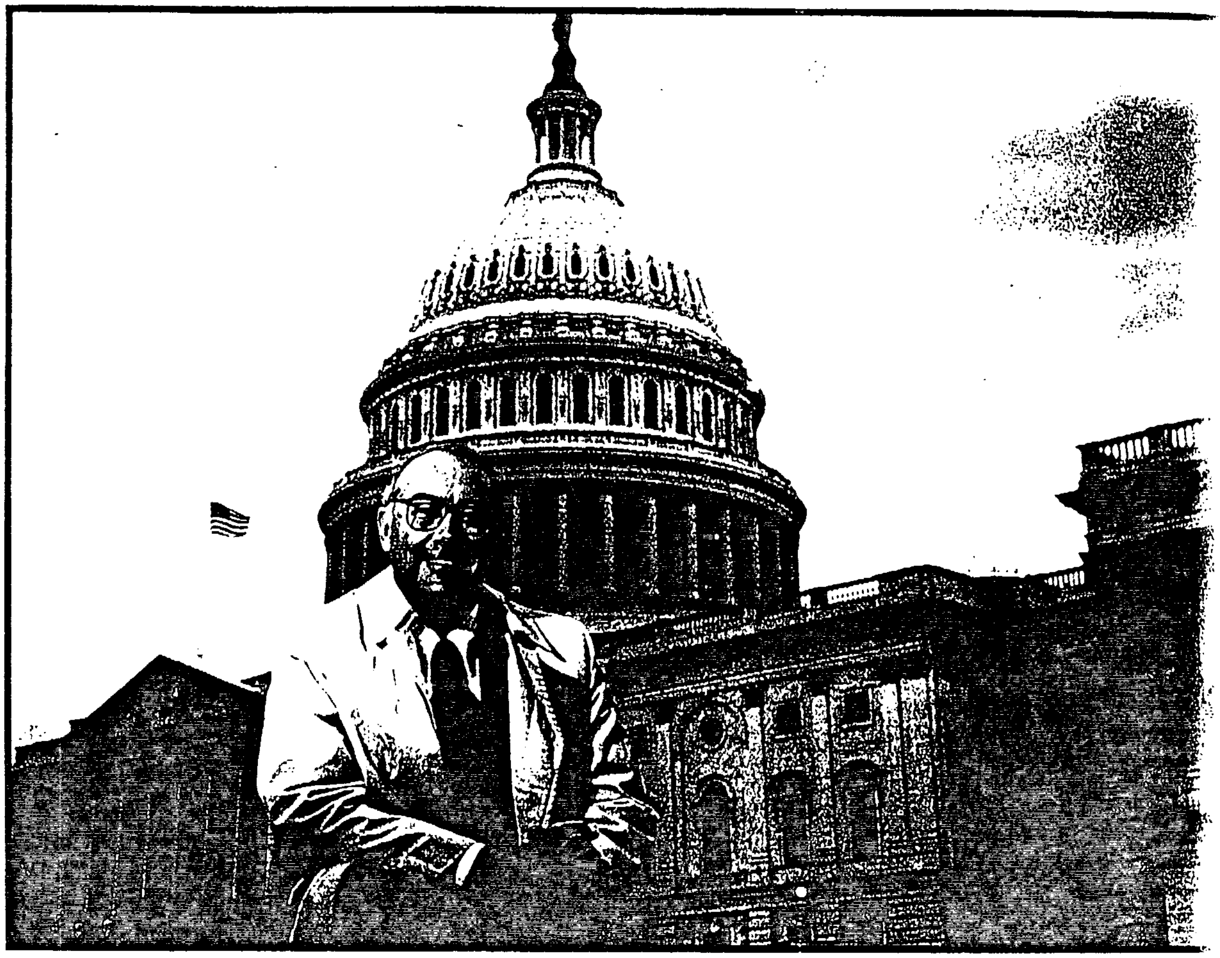
Table of Contents

Highlights of 1996

	1996	1995	% Change
Net Income (in millions)	**$587.4**	$529.9	+10.9
Earnings Per Share	**$3.14**	$2.85	+10.2
Operating Revenues (in billions)	**$5.849**	$5.670	+3.2
Cash Dividends Per Share	**$2.40**	$2.40	—
Dividend Payout Ratio	**76%**	84%	—
Price/Earnings Ratio (at year end)	**13.1**	14.2	—
Year-end Closing Stock Price	**41 1/8**	40 1/2	+1.5
Return on Average Common Equity	**13.2%**	12.4%	—
Book Value at Year End	**$24.15**	$23.25	+3.9
Total Energy Sales (in millions of kilowatthours)	**132,573**	120,653	+9.9
Total Assets (in billions)	**$15.886**	$15.902	-0.1
Retail Customers (at year end)	**2,943,016**	2,911,930	+1.1
Total Employment (at year end)	**17,951**	18,502	-3.0
Fuel Supply Employment (at year end)	**1,757**	1,748	+0.5

AMERICAN ELECTRIC POWER is one of the nation's largest electric utility holding companies, serving almost 7 million people in parts of Ohio, Michigan, Indiana, Kentucky, West Virginia, Virginia and Tennessee. AEP's 38 power plants have a capacity of 23.8 million kilowatts. The AEP transmission and distribution system is one of the largest in the world, with 22,000 circuit miles of transmission lines and 119,000 miles of overhead and underground distribution lines.

American Electric Power is a leading advocate of bringing more competition to the electric utility industry. This report highlights some of the ways that AEP is transforming itself by working with customers and improving internal operations to become America's Energy Partner. This summary report to shareholders contains financial highlights from 1996. Full disclosure of all financial information is included in Appendix A to the Proxy Statement. Additional information about AEP also is available on the Internet at **http://www.aep.com.**



DEAR FELLOW SHAREHOLDERS A new and innovative program that boosted wholesale power sales and continued growth in our service territory contributed to near-record results for AEP in 1996. Earnings per share of $3.14 were the best since 1989 and represent a 10.2 percent gain over 1995's results. Net income reached $587.4 million, a 10.9 percent year-over-year improvement. Operating revenues increased 3.2 percent to $5.85 billion from $5.67 billion.

Dr. E. Linn Draper Jr., Chairman of the Board, Chief Executive Officer and President, in front of the U.S. Capitol. Changes in federal and state laws will have a profound effect on the electric utility industry in coming years.

Our dividends, combined with changes in our stock price, generated a cumulative shareowner return of 35.3 percent for the last three years. That placed us among the top in our industry and well within our goal of being in the top quartile of the Standard & Poor's electric utility index, based on cumulative three-year returns.

Much of our success can be attributed to our system power markets operation. This division, which sells power and transmission services to other utilities and wholesale buyers, scored several significant accomplishments during the year, increasing wholesale sales 46 percent to 32 million megawatthours. Those sales were supported by our ability to boost generation by 10 percent to 137 million megawatthours.

We added 31,086 retail customers during the year and sold more than 100 million megawatthours of electricity at the retail level for the first time. That sales record is an accomplishment that only one other U.S. utility has ever achieved. We also attracted some major new industrial facilities to our service area. Foremost

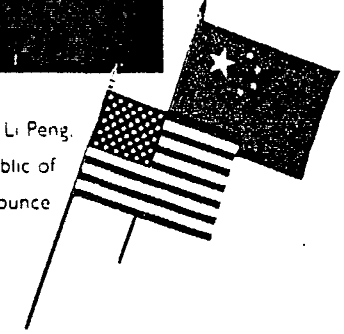
We are taking a giant step to expand our presence worldwide with our recently announced plans to acquire Yorkshire Electricity Group plc in England in conjunction with Public Service of Colorado.

among them is the Toyota Motor Co., which is building an engine plant on land purchased from AEP near Charleston, W.Va. This state-of-the-art factory will provide a substantial economic boost to the area.

Though it will not be located in our service area, AEP will be bidding to supply power to the new AK Steel cold rolling mill in Spencer County, Ind., near our Rockport plant. In addition, AEP Energy Services, Inc., our wholly owned subsidiary, will be providing many of the engineering, design and construction services required to supply electric power to the plant. For both Toyota and AK Steel, AEP's economic development staff was heavily involved in helping to locate these facilities. These projects are a tribute to our competitive position, our ability to work with the communities we serve and our aggressive pursuit of new customers.

Low rates certainly make us an attractive supplier of energy, but AEP is much more than a low-cost provider of electrons. Another success story in 1996 was our selection by one of the nation's largest retailers, Sears, Roebuck & Co., to be a regional provider of energy management services. We were chosen as one of several energy companies in different regions to help improve this retailer's energy efficiency. It's an exciting alliance that will help each of us explore new techniques in the energy management field.

We are taking a giant step to expand our presence worldwide with our recently announced plans to acquire Yorkshire Electricity Group plc in England in conjunction with Public Service of Colorado. Yorkshire distributes electricity to 2.1 million industrial, commercial, agricultural and residential customers in northeast England. AEP and Public Service of Colorado will equally own Yorkshire Holdings plc, which will acquire the Leeds-based utility.



E. Linn Draper meets with Li Peng, premier of the Peoples Republic of China, while in China to announce a joint power plant venture.

This alliance with another strong U.S. utility gives us the opportunity to participate strategically in the energy market in Great Britain, which began moving toward competition ahead of the United States. We expect to learn much about competition while enjoying the benefits of an attractive investment with a strong partner in a new market.

AEP entered into a significant venture last year with two Chinese organizations to build a 250-megawatt power plant near Nanyang City in Henan Province, China. The joint venture company, Nanyang General Light Electric Co. Ltd., was formed with affiliates of the local power supplier and Nanyang City. This venture gives us solid experience in one of the fastest growing markets in the world.

During 1996 we saw a number of proposals to move toward a competitive retail market. We applaud those efforts. We know that competition will benefit our customers and AEP shareholders.

But we also know that more needs to be done on the legislative front. While we believe that each state ultimately should decide for itself when to adopt a competitive market, we recognize that Congress has a key role. To be able to compete on a fair and equitable basis with the many new companies in the energy industry, we must have the Public Utility Holding Company Act of 1935 repealed. This Depression-era law has outlived its usefulness. Rather than providing meaningful regulation, it prevents companies such as AEP from competing effectively and offering the services that businesses and consumers need and want.

Another issue that continues to loom over AEP and, indeed, the entire Midwest, is the ongoing controversy about ozone in the atmosphere. Unfortunately, this important environmental issue is being used as a green smoke screen by some utilities in the Northeast portion of the United States to delay competition. Claims by some that nitrogen oxide emissions from Midwest industry, especially coal-burning power plants, are a major source of the ozone problems in the Northeast simply are not supported by science. Simply put, some utilities in the Northeast feel they can't compete with low-cost power producers, so they want to delay competition or shift the environmental burden to others.

Preliminary studies indicate that the real culprits of the Northeast ozone problem are the millions of autos and trucks that clog the region. Reducing tailpipe emissions is the most direct way of solving any region's smog problem, but also the most unpopular. It means higher fuel costs, stricter vehicle testing and other less popular measures for people who live in that area. We all know it's politically less expensive and more expedient to blame someone else for your problems. AEP has never shirked from its environmental responsibility and we don't believe others should, either.

Looking ahead, we continue to consider ways to offer our customers natural gas, either through an affiliation with a natural gas provider or an outright acquisition. More and more, our customers are looking for one source for all their energy needs and AEP intends to be that source. It's a major goal for 1997.

AEP will face many legislative and regulatory challenges during the coming year as Congress and the various state legislatures consider industry restructuring and environmental issues. We hope that we can count on our shareholders to make their voices heard when opportunities and the need arise. If you would like to contact your state or U.S. representative and senators, please return the postage-paid reply card included in this annual report. We'll track the issues and keep you aware of important trends and perhaps ask you to write your lawmakers as legislation is introduced.

Finally, I want to note the passing of my predecessor, Richard E. Disbrow, this past fall. Dick retired as chairman and chief executive officer in 1993 after 38 distinguished years with AEP. He was a recognized leader in the electric utility industry, particularly in the field of transmission issues, and was known as a man of conviction within the industry he helped shape.

Last year was a good year for AEP. We reached record levels of electricity sales. We developed innovative and profitable new products. We expanded our reach in one of the highest growth markets in the world. And we set the stage to take advantage of more of what competition has to offer. More than ever, we are poised to be America's Energy Partner.

E. Linn Draper Jr.
[illegible]
[illegible]

[illegible]

HELPING CUSTOMERS It's only natural for American Electric Power, one of the nation's largest and geographically widespread investor-owned electric utility holding companies, to be America's Energy Partner. AEP operates in a seven-state region, encompassing almost 7 million people in its service area. It runs one of the largest capacity generating systems in the nation. Its costs are among the lowest in the region.

To enhance that strong position, AEP has been hard at work to upgrade service, lower costs further, improve efficiencies and help its customers do the same in their own businesses. We're not just a utility, but a true energy partner.

The pages that follow show how AEP has improved its own operations while helping its customers operate better, more cleanly and more profitably. It's what an energy partner should do. It's part of AEP's vision to be customer focused, employee oriented, shareholder conscious — the world's premier supplier of electricity and related services.

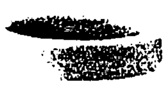
The Associated Business Development group designed the changes needed to bring Jefferson Mills up to the standards demanded by high-tech equipment and installed the substation upgrades.

AEP HELPS TWIST A GOOD YARN Two years ago, Jefferson Mills Inc. had a problem many companies would envy — too much business. Demand for its yarn texturing service, which treats yarn by twisting and heating it to give it elastic qualities, was overwhelming the Pulaski, Va., company.

The owners of the privately held firm decided to install new computerized texturizing equipment that virtually doubled capacity. The new machinery improved speed, accuracy and control. Capacity grew to 500,000 pounds of yarn a week from the 260,000 pounds the plant was able to process previously.

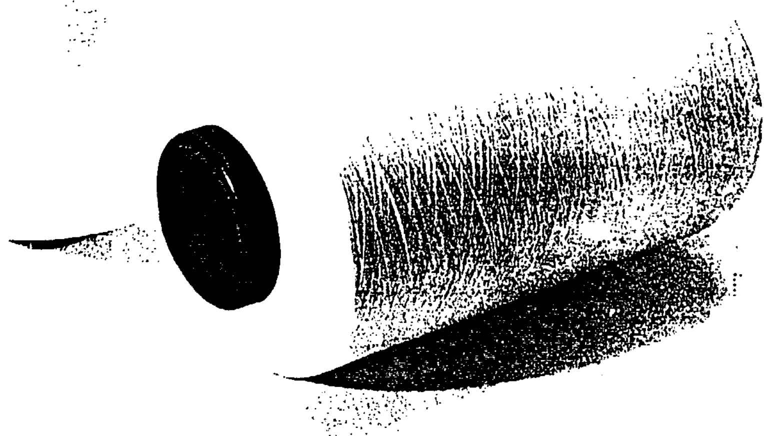
But Jefferson Mills' investment in new technology would mean little if it didn't have protection against power surges, cycle variations and momentary power outages, which can affect production and disrupt computer-controlled machinery.

To help bring its electrical system up to speed, Jefferson Mills turned to AEP and Business Services Major Account Executive Kenneth L. Roberts. Roberts arranged for AEP's Associated Business Development unit to perform a complete diagnostic review of Jefferson Mills' on-site electrical system. The Associated Business Development group engineered the changes needed to bring it up to the higher performance standards demanded by high-tech equipment and installed the substation upgrades.



Power quality issues largely are a thing of the past. Jefferson Mills' equipment upgrade has been so successful that it recently began a 21,000-square-foot addition and expanded its work force by 9 percent. AEP has since been hired to maintain the mills' substation and to ensure that Jefferson Mills always will be able to twist a good yarn.

Attachment 1
Page 7 of 357
KPSC Case No. 99-149
TC (1st Set)
Order Dated April 22, 1999
Item No. 2



AEP was able to help solve Jefferson Mills' power supply problems, enabling it to achieve the greatest efficiency from new high-speed yarn texturing equipment the mill had installed.

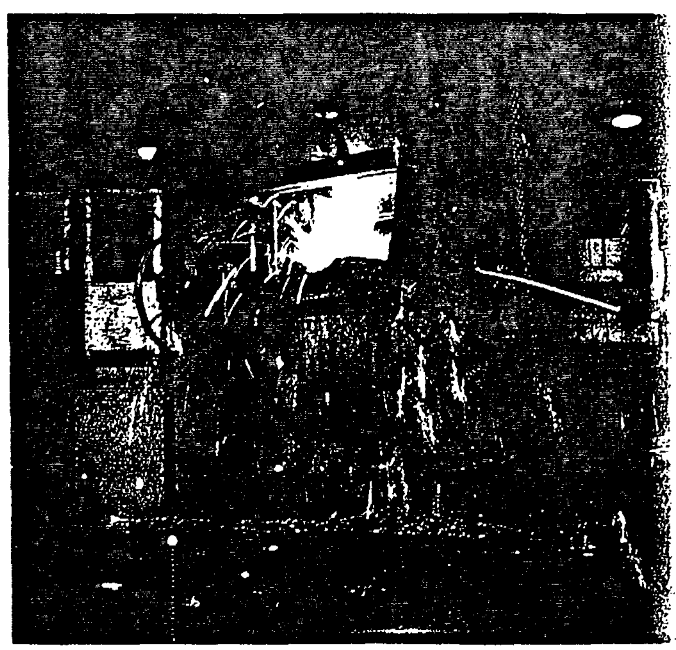
AEP, J.B. FOOTE FORGE SUCCESS When Thomas Updike acquired the family-owned J.B. Foote Foundry in Fredericktown, Ohio, in February 1987, workers were making cast iron pretty much the same way as a century earlier — melting it in a coke-fired cupola. Not only was it inefficient, but quality was difficult to control and the company could not comply with new, stricter clean air regulations.

In fact, many of Ohio's small foundries went out of business in the 1970s and '80s because they were unable to compete and meet new environmental standards. Working with AEP, J.B. Foote turned to electricity-based technologies to solve its competitive and pollution issues by installing two coreless induction electric furnaces. AEP account representatives and engineers were able to help Updike select furnaces that would provide the most versatility and operate at the lowest cost. AEP also offered Updike a special economic development rate that let him phase in certain electric charges over a three-year period.

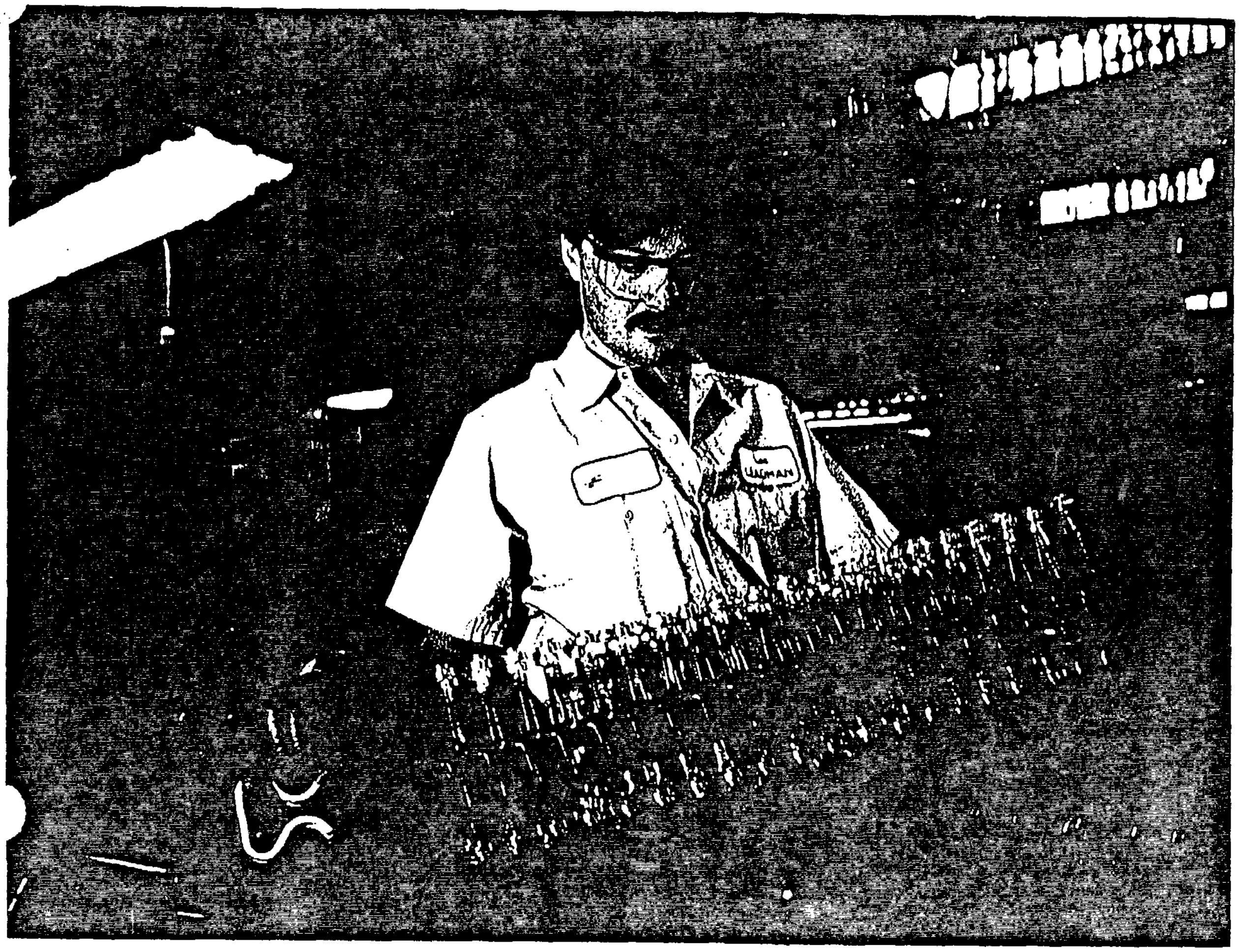
J.B. Foote turned to electricity-based technologies to solve its competitive and pollution issues by installing two coreless induction electric furnaces.

Not only did the foundry eliminate its pollution problem and create a better work environment, but it saw a quantum leap in quality. The induction furnaces allow J.B. Foote to more closely control the tolerances of its cast alloys, enabling the 70-person firm to produce castings that come close to the strength of steel. J.B. Foote has since gone into new, higher-margin specialty markets. Those include some of the nation's largest mining and energy equipment and pump manufacturers.

Today, J.B. Foote is thriving. Working with AEP Business Services Major Account Executive Jeffrey W. VanDine, the company is undertaking a $4.5 million, 19,000-square-foot expansion that will include an increase in the capacity of the existing furnaces and the addition of a third. The extra space not only will add capacity, it will improve work flow, boosting productivity even more. Even with the improved efficiency, J.B. Foote expects to create another 25 jobs in rural Ohio during the next two to three years. Thanks to the improvements in quality and efficiency that electrotechnologies have fostered and with AEP's partnership, Updike believes he can now compete with any comparably sized foundry in the industry.



The J.B. Foote Foundry turned to electric coreless induction furnaces to improve quality, increase production and meet new pollution requirements.

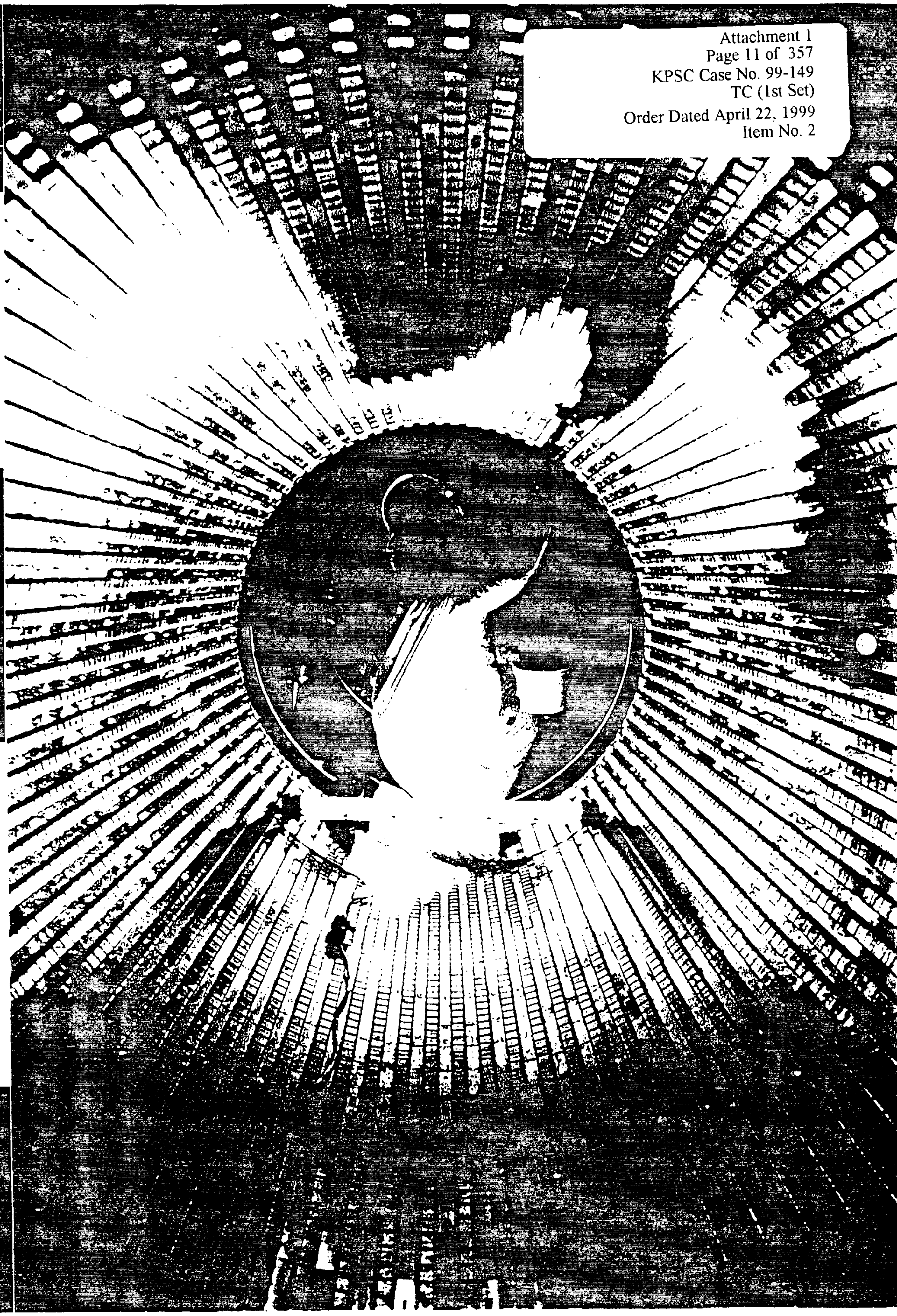


Franke Plating uses electrowinning, an electrotechnology, to help recycle valuable metals left over from its electroplating process.

ELECTROTECHNOLOGY HELPS ELECTROPLATING FIRM CLEAN UP At Franke Plating Works, an electroplating company in Fort Wayne, Ind., pollution control is no small consideration. Electroplating — the process of plating an object using electrolysis — creates byproducts that must be removed from waste water.

With help from AEP, Franke has been able to reduce the amount of sludge its waste water treatment process generates and save money at the same time. An electrical process called electrowinning removes recyclable materials, such as copper, nickel, cadmium and brass, from sludge before it's hauled away. Electrowinning is a form of electroplating — electrodes in the waste water capture the leftover particles of metal by attracting them with electrical charges. The captured metals are then recycled.

Electrowinning is just one part of Franke's overall pollution control program, but an effective one, said Wade Franke, vice president and director of waste treatment and environmental affairs. It reduces costs because there is less sludge to haul away. It captures materials that can be recycled, turning an expense into revenue. And it converts some of the remaining pollutants into forms that are easier to treat chemically. Instead of throwing money down the drain, Franke Plating uses an electrotechnology to help clean up the environment and run its business more efficiently.



PARTNERSHIP THROUGH STRENGTH Continuing the search for ways to improve performance has been a key element in our ability to be a true energy partner. For example, in 1996 we again set some very aggressive goals for our generating operations that simply could not have been achieved without changing the way we run and maintain our facilities. We have a leaner, better trained work force. We improved maintenance and control systems at our coal-fired plants. We instituted more efficient refueling outage processes at our nuclear facility. Combined, these efforts helped us achieve record levels of production and efficiency.

We improved the time during which coal-fired plants were available to respond to demand for energy sales to 85 percent — a gain of 8 percent over 1995.

The challenges brought on by the relentless need to lower costs through improved performance are not new to AEP and are not without risk. Not all of our aggressive generation targets were achieved in 1996, but improvement was apparent in virtually every area we measure. One of the most notable was that we improved the time during which our coal-fired plants were available to respond to demand for energy sales to 85 percent — an 8 percent gain over 1995 and well beyond our target of 80 percent. At the same time, we've continued to reduce fuel costs through increased productivity at our mines and aggressive fuel purchasing strategies.

Dan Bilak from AEP's central machine shop paints the inside of a stator on a low-pressure unit at the Tanners Creek plant. AEP adopted a team approach to performing scheduled maintenance at its coal-fired power plants that will help control maintenance expenses.

On the nuclear side, the refueling of Unit 2 at the Cook Nuclear Plant in Bridgman, Mich., was completed in less than half the time of our last Unit 2 refueling. A process that previously averaged 100 days was finished in 47 days, about 3 days ahead of an aggressive target. Following that refueling, on Dec. 22 Unit 2 broke its continuous operation record of 226 days. In 1996 our two nuclear units generated at a combined capacity factor of 90.6 percent (maximum dependable capacity). This contributed to generation of 16.4 million megawatthours, a plant record.

AEP's River Transportation Division is one of the [illegible] in AEP's overall efficiency. River transportation is an efficient and cost effective way to deliver coal from faraway mines.

All that production came while sustaining a deep commitment to safety. In December, AEP workers at the Cook Nuclear Plant completed their 10 millionth hour worked without a lost-time accident, a record dating to March 1992. The nuclear support staff also completed its move from Columbus to an existing building in Buchanan, Mich., which saves several million dollars annually.

Attachment 1
Page 13 of 357
KPSC Case No. 99-149
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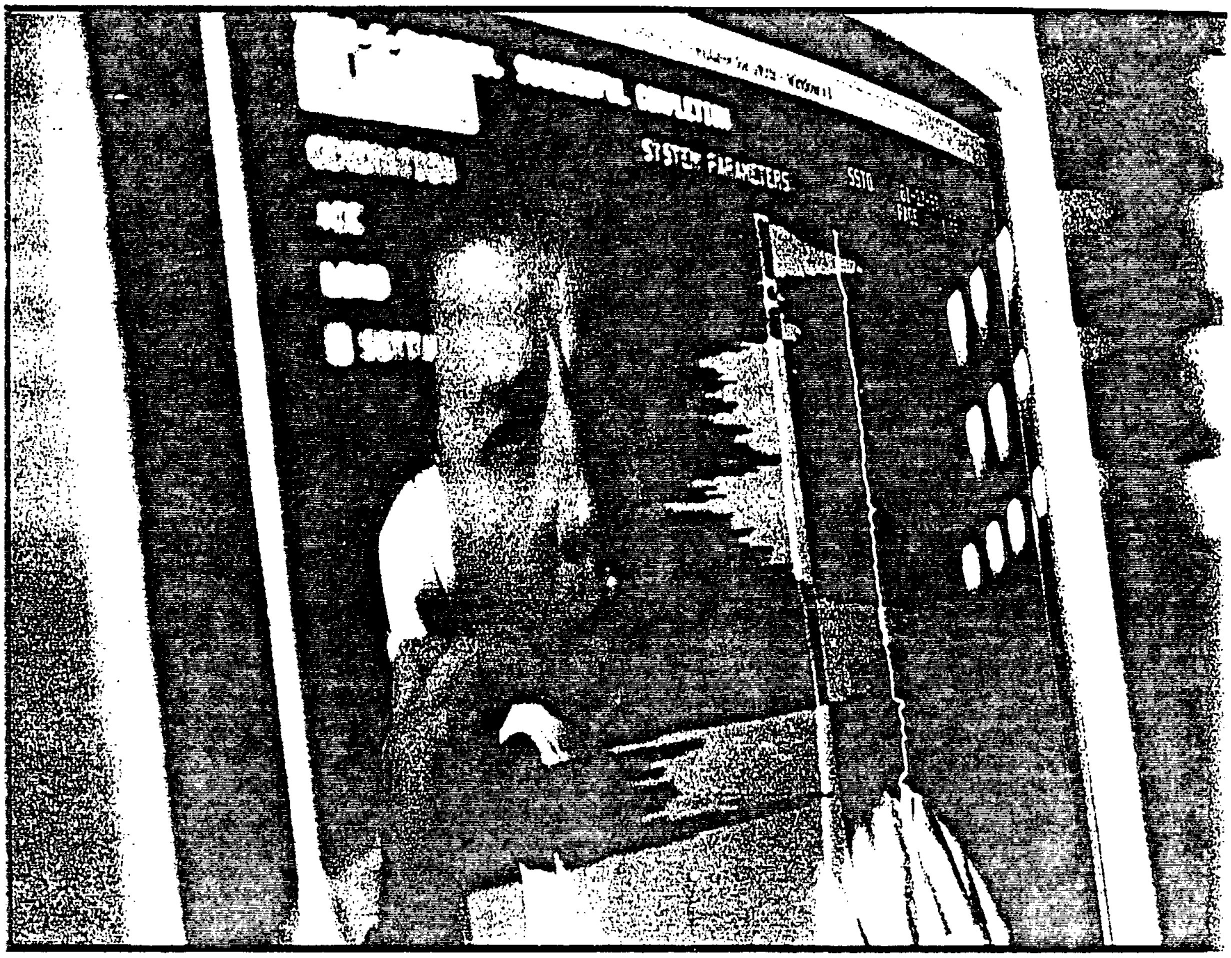

Andy Serri, a trader in the Power Marketing and Trading Group, is intent on making wholesale power sales a success.

Companywide, we generated 137.2 million megawatthours of electricity during 1996, 10.6 percent more than in the preceding year. Our capability to produce and sell more electricity and operate our plants with less down time speaks well of our people and our facilities. The prospects for 1997 look even better as we continue to seek out opportunities that will place us among the top competitors in terms of the cost of generation.

MORE POWER GENERATED MEANS MORE POWER TO SELL Those improvements in generation performance were factors in the success of our wholesale power sales program because they gave us the capability to produce more energy for the wholesale market while continuing to serve the needs of our retail customers — all without building new power plants.

The success of our wholesale power operations was bolstered by the innovation of the Power Marketing and Trading group and its coal conversion program, which allows AEP to convert coal owned by others into electricity. This permits AEP to put otherwise idle capacity to work and generate extra income at little additional expense.

AEP has entered into several important long-term contracts, which will provide stable revenues for a number of years. These include a 205-megawatt sale to North Carolina Electric Membership Corporation and 50 megawatts to Cleveland Public Power. We also put in place a 24-hour trading room that operates apart from our system control room to give Power Marketing and Trading the ability to be a true arm's-length provider of generation services.

ENERGY DELIVERY REDUCES COSTS While much work remains to be done, Energy Delivery increased its efforts to reduce costs by taking a closer look at our business and reworking relationships with our partners.

For example, we played a key role with our meter supplier, General Electric, in the development of a new meter for commercial customers. By using programmable computer components, this meter is easily adaptable to dozens of different applications. Because of this flexibility, we reduced the types of commercial meters we use from more than 50 to two and pay less for each unit. The reduction in meter inventory and purchasing costs results in a substantial annual savings.

AEP has entered into several important long-term contracts, which will provide stable revenues for a number of years.

Along with efforts to reduce costs, Energy Delivery continued its focus on improving customer service. As part of that objective, we opened our third customer service call center, in Ashland, Ky., in 1996 and expect to complete our fourth call center, to be built in Hurricane, W.Va., in 1997. Open 24 hours a day, 7 days a week, these centers make it easier for customers to reach us because of their expanded hours and through the use of toll-free numbers. Once the network is complete, calls can be shifted among them automatically to provide faster service during periods of heavy use, such as weather-related outages. We also established a network of merchants that accept payments from AEP customers, making it easier for them to pay their bills. And we're expanding the number of services we plan to offer over our web site on the Internet to let customers perform certain transactions from their home computer.

Kim Orr, a customer service representative, works in the Groveport, Ohio, Call Center, one of four that will take calls from throughout the AEP system.

Attachment 1
Page 15 of 357
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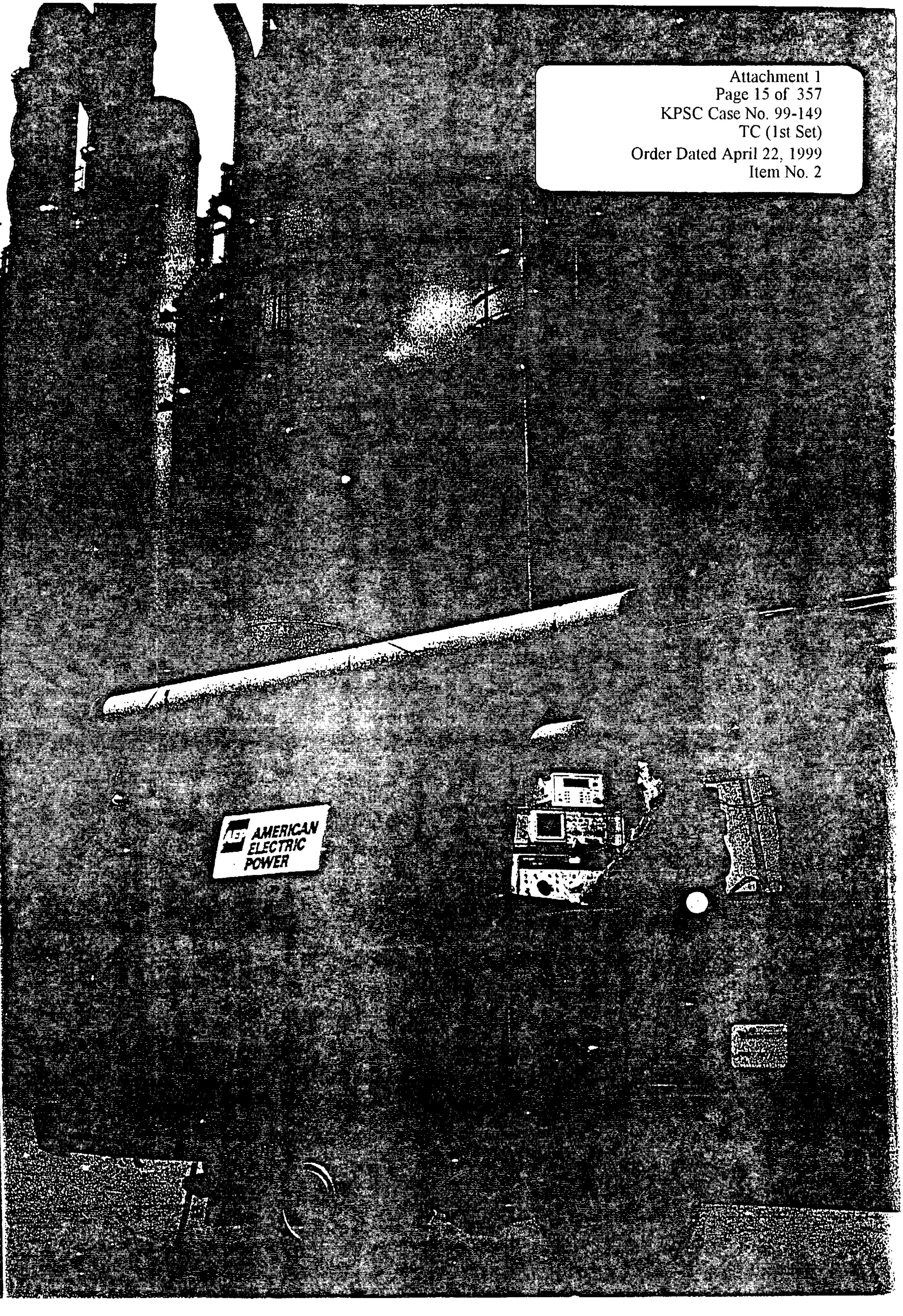


Administratively, we finished installing an Activity Based Management System (ABMS) and enacted several other programs to reduce costs and improve services. For example, we were able to cut millions in accounting service costs by reworking some processes, closing two of our six accounting offices and consolidating certain accounting functions in Canton, Ohio. Further permanent cost reductions will be realized in stages through additional accounting efficiencies and the Accounting Improvement Mission project, which will be implemented through 2001.

ABMS was used to develop our 1997 work plans and budgets. This process allows us to better coordinate resources, improve productivity, understand the scope of work across our system and devote resources where they will do the most good. As actual figures are reported in 1997, we will be able to define our costs more clearly and refocus our efforts where they generate the highest value.

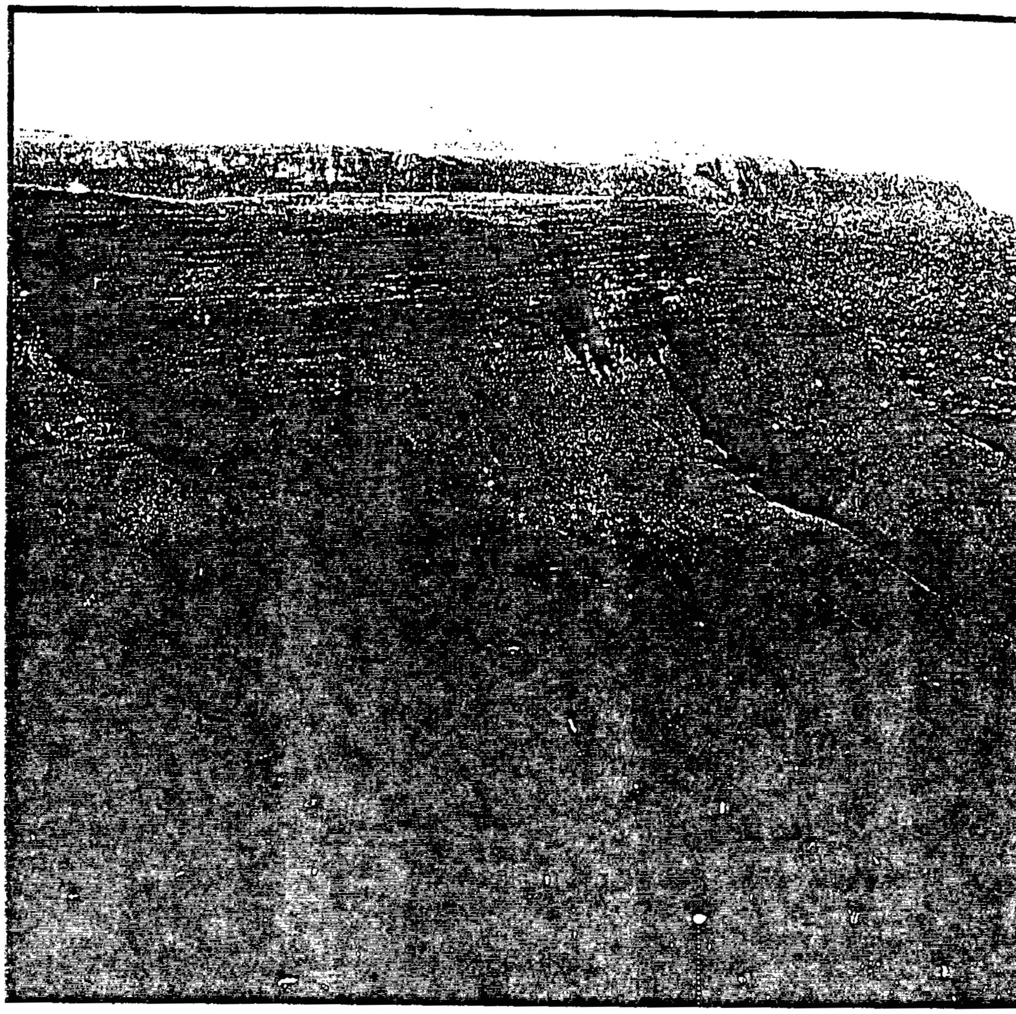
AEP procurement, working with major suppliers, was able to save millions in purchasing costs through better inventory management, just-in-time delivery and the greater use of electronic purchasing. By conducting business with suppliers and customers electronically, we increase productivity, reduce mistakes and lower purchasing, inventory and processing costs.

INNOVATION CONTINUES Innovation is nothing new at AEP. We've been an innovator since we were formed almost 100 years ago. That trend continued in 1996 with the introduction of our motor testing service, offered through the Dolan Laboratories' Electrical Test Center. This service can test large horsepower motors and generators while they are running to reliably determine their condition and predict failures long before they happen. Developed during a 15-year period to help maintain AEP's generating units, the service is now available to anyone.

David A. Klinect from the Dolan Electrical Test Laboratory monitors an EMI test at a customer's facility. AEP's motor testing service can determine when a motor is likely to fail, helping customers avoid lost production or unneeded maintenance.

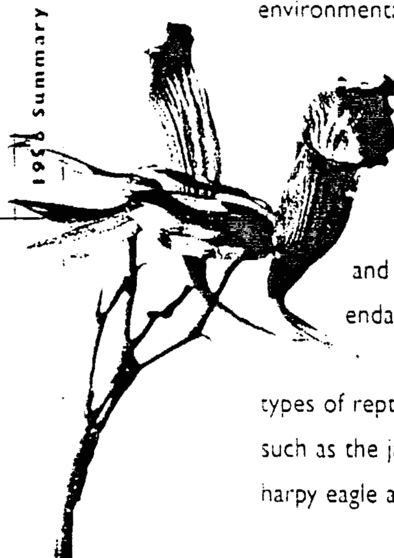
Testing equipment by studying the electrical signals it emits is not new. AEP engineers take that process a step further by using proprietary systems and databases to measure and compare those signals. AEP specialists can determine the condition of a motor's insulation and help customers structure a maintenance plan based on actual conditions rather than a routine schedule. This can result in substantial savings by catching failures before they happen, thus avoiding expensive lost production time, or by deferring unneeded maintenance.

In the field of transmission, AEP is working with the Electric Power Research Institute and Westinghouse to develop the world's first demonstration of Unified Power Flow Control. This system, when implemented in the Inez Station in Kentucky, will offer unprecedented control over power transmission to the area. The benefits will be to alleviate thermal overload and low voltage situations, to ensure adequate power will be available in this region for several years and to reduce power losses. To AEP customers, that means a more reliable, higher quality supply of electricity.



AEP STRENGTHENS ITS ROLE AS AN ENVIRONMENTAL PARTNER — HERE AND ABROAD In December 1996 we undertook one of our most creative environmental projects when we joined with The Nature Conservancy and the Fundacion Amigos de la Naturaleza, a Boli environmental organization, to protect 5 million acres of tropical forest in Bolivia. This historic a; creates the Noel Kempff Mercado Climate Action Project, a 30-year effort to pro national park and capture an estimated 53.2 million metric tons of carbon dioxid otherwise would be released as a result of logging activities.

AEP's participation in the Noel Ke Climate Action Project will help pro acres of tropical forest in Bolivia.



The Noel Kempff Mercado National Park is one of the richest and most biologically diverse ecosystems in the world, with several endangered and threatened species of animals and plant life. In addition to an estimated 650 bird species, 150 mammal species, 105 different types of reptiles and amphibians and 4,000 varieties of plants, are rare animals such as the jaguar, giant river otter, black caiman, giant anteater, giant armadillo, harpy eagle and spider and howler monkeys.

In addition to protecting the tropical forest from deforestation, the project will foster sustainable development in local communities and promote low-impact logging practices. Another goal is to help develop an ecotourism business to showcase this natural treasure and provide much-needed income for the local population.

AEP's environmental leadership continues at home as well. Since the Clean Air Act Amendments of 1990 were passed, AEP has reduced its emissions of sulfur dioxide by almost 400,000 tons — one quarter of AEP's total emissions in that category. Equipment to control emissions of nitrogen oxides has been installed on about one-third of our generating capacity, most of which was done five years before the compliance deadline. This early compliance effort has avoided approximately 100,000 tons of nitrogen oxide emissions during the last two years.

Copies of AEP's 1997 environmental performance report are available by contacting:

Security Owner Relations, American Electric Power, 1 Riverside Plaza, Columbus, OH 43215 ☎ 800-237-2667.

This report, produced biennially as part of AEP's commitment to public accountability, contains costs and data on progress in air and water quality, reduced waste, energy efficiency and protection of natural resources.

Companion publications "Beyond Environmental Compliance," "Clean Power for People" and "Coal Ash: Helping to Mold the Future" also are available.

We formally implemented pollution prevention programs at all of our power plants during 1996. Through reuse, recycling and substituting nonhazardous materials for hazardous supplies, we reduced the generation of hazardous waste by 63 percent between 1993 and 1996. We also lowered low-level radioactive waste from the Donald C. Cook Nuclear Plant by 86 percent from 1993 to 1996. Pollution prevention not only protects the environment, it's good business — the 11,924 cubic feet of low-level radioactive waste that was kept out of the disposal system has saved the Company more than $6 million in disposal fees during that four-year period.

The Gavin Nature Trail allows visitors to get a closer look at the wetlands AEP created near its Gen James M. Gavin Plant.

In October 1996, we opened the Gavin Wetlands Nature Trail, a path through the wetlands we created near the Gen. James M. Gavin Plant in Cheshire, Ohio. The nature trail, already used by civic, school and scouting groups, provides access to the wildlife and plant life that make wetlands an important part of our ecosystem.

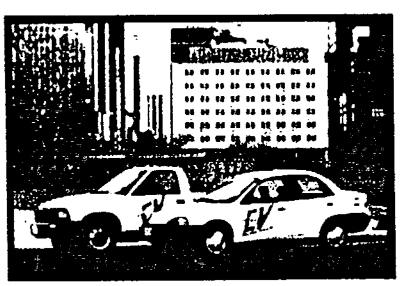
The Gavin Nature Trail is another example of how AEP goes beyond what's required to meet our environmental and community commitments.

SEARS, AEP JOIN FORCES TO MANAGE ENERGY COSTS When Sears, Roebuck & Co., one of the nation's largest retailers, went looking for regional electric utilities to help it manage energy costs, American Electric Power was one of the utilities selected.

AEP was chosen by the Illinois-based retailing giant to be a Midwest affiliate in a program to reduce energy costs and review its energy management programs. AEP will begin work at the Sears store in Northland Mall in Columbus, which will be a prototype as well as an energy management training center for Sears employees. Among the services AEP will provide are energy audits: lighting upgrades: energy-efficient heating, ventilation and cooling systems: budget forecasting: insulation upgrades: and energy control systems. Other regional Sears facilities will be modified as systems are tested, proven and perfected.

AEP LANDS CHINA PROJECT One of the fastest growing markets for electricity in the world is China. With a population of 1.2 billion and Gross Domestic Product growing 9 percent a year, its appetite for electricity is substantial. In 1996 one of AEP's unregulated subsidiaries, AEP Resources, entered into an agreement to help the Chinese solve their electrical problems by participating in the construction of a 250-megawatt plant near Nanyang City in Henan Province.

AEP will help the Chinese design and construct the coal-fired facility. AEP's China subsidiary will own 70 percent of the project, which will be operated by the Chinese with assistance from AEP. The plant will allow AEP to showcase its engineering expertise with coal-fired units in an increasingly significant part of the world as well as become more familiar with doing business in the Far East. Beyond that, it is the first step in what could be a long-term relationship to build additional facilities in that growing market.



The Solectria Sedan joined the E-10 pickup truck as part of AEP's fleet of electric vehicles in 1996.

AEP CALLING In 1996, a new unregulated subsidiary, AEP Communications, was formed to look for opportunities in the growing telecommunications industry that complement our core energy business. This new subsidiary will provide installation, maintenance and engineering services for companies that provide wireless personal communications services and competitive local exchange services. It also plans to provide telecommunications services to AEP customers and existing carriers. The first project will be a 150-mile fiber optic line between Charleston, W.Va., and Roanoke, Va., with Sprint Communications Inc. By participating in fiber optic and similar projects, AEP will enhance its internal communications and add to the value it offers its customers.

INTRODUCTION TO SUMMARY MANAGEMENT DISCUSSION AND FINANCIAL INFORMATION

Instead of traditional financial statements, we have prepared a summary financial section to this annual report. Based on the favorable comments received from shareholders last year, which was the first time we included a summary financial section in the annual report, we have decided to continue this summary approach. This abbreviated financial presentation is intended to present capsule information in an easier to read format and should not be considered a substitute for the full financial statements provided to all shareholders as an appendix to the Proxy Statement. A copy of the Form 10-K and/or the appendix which includes the full financial statements can be obtained by calling AEP Shareholder Direct at 1-800-551-1AEP. Although this summary financial information should help you understand AEP's 1996 results of operations and financial condition, we caution that before making any investment decisions you should review the full financial statements.

BUSINESS OUTLOOK With the issuance of two Federal Energy Regulatory Commission (FERC) orders and the commencement of planning for retail competition at the state level, we are in a better position to identify and develop strategies for addressing the issues that face American Electric Power (AEP) and our changing industry. We recognize that the conventional ways of maintaining and enhancing shareholder value are becoming less effective as the industry moves towards greater competition in the generation and sale of electricity. The industry's transition to competition and customer choice and the ability to fully recover costs are probably the most significant factors affecting AEP's future profitability.

We seek a link between a transition to a competitive marketplace and the maintaining and enhancing of shareholder value. AEP has the financial strength, geographic reach, location and cost structure to be an able competitor and we intend to make every effort to maintain and strengthen our competitive position. However, no assurance can be given that AEP can maintain this position in the future.

FERC orders No. 888 and 889 facilitate increased competition in both the generation and sale of bulk power to wholesale customers. They provide, among other things, for open access to transmission facilities. AEP's support of the FERC's open access transmission rule is evidenced by our being among the first to file a comparability tariff, offering access to our transmission grid at 143 interconnections to all parties under the same terms and conditions available to AEP. This has provided AEP with greater opportunities for transmission service revenues.

Although customer choice proposals and discussions are under way in the states in which we operate, it is difficult to predict their result and the timing of any resultant changes. We are actively involved in discussions on the state and federal level regarding how best to transition to competition in order to represent the best interests of our customers, shareholders and employees. We favor a transition because we believe that AEP will in the long-term fare better in a competitive market than under continued regulation.

As the electric energy market evolves from cost-of-service ratemaking to market-based pricing, many complex issues must be resolved, including the recovery of stranded costs. While FERC orders 888 and 889 provide, under certain conditions, for recovery of stranded costs at the wholesale level, the issue of stranded cost remains open at the much larger state retail level.

Stranded costs occur when a customer switches to a new supplier for its electric energy needs or when a component of the business, for example generation, is no longer subject to cost-based regulation. This creates the issue of who pays for plant investment, purchased power or fuel contracts both non-affiliated and affiliated, inventories, construction work in progress, nuclear decommissioning, plant removal and shutdown costs, previously deferred costs (regulatory assets) and other investments and commitments that are no longer needed, economic or recoverable in a competitive market. The amount of any stranded costs AEP may experience depends on the timing of and the extent to which direct competition is introduced to our business and the then-existing market price of energy.

Under the provisions of Statement of Financial Accounting Standards (SFAS) No. 71, "Accounting for the Effects of Certain Types of Regulation," assets (deferred expenses) and liabilities (deferred revenues) are included in the consolidated financial statements in accordance with regulatory actions to match expenses and revenues in cost-based rates. In the event a portion of the business no longer met the requirements of SFAS 71, net regulatory assets would have to be written off for that portion of the business. Among other requirements, SFAS 71 requires that the rates charged customers be cost based.

Our generation business is still cost-based regulated and should remain so for at least three to five years as the industry transitions to full competition. Although the recent FERC orders provide for competition in the firm wholesale market, that market is a relatively small part of our business and many of our firm wholesale sales are still under cost-of-service contracts. We believe that enabling state legislation should provide for a sufficient transition period to allow for the recovery of any generation-related stranded costs and we are dedicating ourselves to work with regulators, customers and legislators to accomplish both an orderly transition and a reasonable and fair disposition of the stranded cost issue.

We favor the recovery of stranded costs during a transition period in which rates would be fixed or frozen and electric utilities would take steps to achieve cost savings which would be used to reduce or eliminate stranded costs. However, if electric utilities were to no longer be cost-based regulated and it were not possible to recover stranded costs, the results of operations and financial condition of AEP and other electric utilities would be adversely affected.

Since state commissions have jurisdiction over the sale and distribution of electricity to retail customers, we believe that state legislation and regulation should shape the future competitive market for electricity while federal legislation should seek to ensure reciprocity among the states and a level playing field for all power suppliers. Presently states with higher cost power, like California and Massachusetts, are aggressively pursuing deregulation. The states AEP operates in, however, are generally addressing the call for customer choice more cautiously and the transition to competition is expected to evolve at an uneven pace across the states.

AEP'S RESPONSE In 1996 we took some major steps to maintain and enhance AEP's competitive strength and made progress towards our long-term goal of becoming the world's premier supplier of electricity and related services. We restructured our management and operations to allow us to comply with the new FERC orders by separating our generation and energy sales operations from our energy transmission delivery operations and to address increasing competition among electric suppliers through distinct functional business units. This has achieved and should continue to achieve staffing, managerial and operating efficiencies. The generation and marketing business units expect to eventually compete in an open market for customers. Our energy delivery business will remain regulated and may ultimately be subject to some form of incentive or performance-based ratemaking while Corporate Development and Marketing will be working to cultivate new but related nonregulated business opportunities.

We are enhancing our marketing and customer service efforts with programs such as the Key Accounts Program, which strives to build strong partnerships with key customers in order to build customer loyalty. In 1996 AEP also launched a series of new television, radio and print advertisements as part of a branding campaign to inform our customers that we will be operating under the name American Electric Power and that we are AEP: America's Energy Partner. The campaign is intended to position AEP as more than just a supplier of electricity. As we enter an increasingly competitive energy market we want to be the energy and energy services provider of choice.

In the non-rate-regulated environment, AEP offers energy consulting and project management services both domestically and internationally and contracts with other public utilities and government agencies for the licensing of intellectual property and the delivery of energy services. In 1996 an AEP subsidiary and two Chinese companies formed a joint venture company to finance and build a 250-megawatt electric generating facility in China. AEP's share of the total cost of the facility is approximately $120 million and the project is expected to be operational in 1999.

On February 24, 1997, AEP and Public Service Company of Colorado with equal interests in a joint venture announced a cash tender offer for Yorkshire Electricity Group plc in the United Kingdom. The joint venture proposes to pay $2.4 billion to acquire all of the stock of Yorkshire Electricity.

AEP's investment, estimated to be $360 million, will be made through its subsidiary, AEP Resources, Inc., initially using cash borrowed under a revolving credit agreement. We consider the China investment and the Yorkshire tender offer as important steps in our long-term goal to become the premier supplier of energy and energy-related services worldwide.

In addition to pursuing foreign power generation, transmission and distribution investments, we formed new subsidiaries in 1996 to explore other new complementary business opportunities including AEP Communications, Inc., which was formed to provide data transmission and related telecommunications products and services. In January 1997 AEP Communications, Inc. entered into an agreement with Sprint Communications, Inc. to construct jointly a 150-mile fiber optic line between Charleston, W.Va., and Roanoke, Va. Another new subsidiary, AEP Power Marketing, is presently seeking approval to market power outside of our traditional service territory. Plans are also in place to commence gas marketing. We are pursuing non-regulated related business opportunities because we believe they offer the opportunity to earn enhanced returns as compared with our traditional regulated business. However, we recognize that these opportunities are generally riskier. Investments in new business opportunities may be made after management carefully assesses the risks versus the potential for enhanced shareholder value.

In 1996 we continued our efforts to reduce costs in order to maintain our competitiveness. Reviews of our major processes led to decisions to consolidate the management and operations of internal service functions performed at multiple locations. Among the functions being consolidated are fossil generation plant maintenance, nuclear operations support staff, system operations, accounting and load research. A study of the Company's procurement and supply chain operations led to cost reductions through better inventory management, just-in-time delivery and the increased use of electronic purchasing. Also in 1996 we completed the installation of an activity based management budgeting system throughout the system. This tool will enable managers to better analyze work and control costs. While staff reductions and cost savings are being achieved in these and other areas, expenses for new marketing and customer services and modern efficient management information systems are being increased to prepare for competition. These expenditures for the future should produce further improvements and efficiencies, enabling AEP to maintain its position as a low-cost producer.

Coal is 70% of the production cost of electricity for AEP. Although our coal costs per unit of electricity (per Kwh) have declined by one-half in constant dollars in the last 10 years, we recognize that we must continue to manage our coal costs to continue to maintain our competitive position. Approximately 15% of the coal we burn is supplied by affiliated mines; the remainder is acquired under long-term contracts and in the spot market. As long-term contracts expire we are negotiating with non-affiliated suppliers to lower purchased coal costs. Efforts also continued in 1996 to reduce the cost of affiliated coal. We intend to continue to prudently supplement our long-term coal supplies with spot market purchases as long as favorable spot market prices exist.

In recent years we have agreed in our Ohio jurisdiction to certain limitations on the recovery of affiliated coal costs. Our analysis shows that we should be able to recover over the term of the agreement (through 2009) the Ohio jurisdictional portion of the current and deferred costs of our affiliated mining operations including future mine closure costs. Management intends to seek recovery of its non-Ohio jurisdictional portion of the investment in and the liabilities and closing costs of our affiliated mines estimated at $180 million after tax. However, should it become apparent that the costs will not be recoverable from Ohio and/or non-Ohio jurisdictional customers, the mines may have to be closed and future earnings and possibly financial condition adversely affected. In addition, compliance with Phase II requirements of the Clean Air Act, which become effective in January 2000, could also cause the mining operations to close. Unless the cost of any mine closure is recovered either in regulated rates or as a stranded cost in a transition to competition, future earnings and possibly financial condition could be adversely affected.

Significant efforts have been made to enhance our competitiveness in nuclear power generation and to improve our nuclear organizational efficiency. Net generation in 1996 for the Company's only nuclear plant, the two-unit Donald C. Cook Nuclear Plant, located on the shores of Lake Michigan, was 16,396 gigawatts, the highest in the plant's 20-year history. The generation record was set in part due to Unit 2's best continuous run in its history, 226 days, reached in December 1996. Refueling costs and related outage time have been reduced. We also reduced nuclear staff support costs in 1996 by relocating our Columbus-based nuclear management and support staff to Michigan to consolidate it with the plant staff. It is difficult to further reduce nuclear generation costs since certain major cost components are impacted by federal laws and Nuclear Regulatory Commission (NRC) requirements. The cost to store and dispose of spent nuclear fuel continues to increase, mainly due to the lack of progress by the federal government to secure and construct a repository. In addition estimated nuclear decommissioning costs continue to increase due in part to the delay in securing a storage site for spent fuel. Presently we are recovering the cost of on-site nuclear fuel storage and estimated nuclear decommissioning costs over the plant's remaining life. However, our future earnings and possibly financial condition could be adversely affected if the cost of these items continues to increase and if for some reason such costs cannot be fully recovered either in regulated rates or as a stranded cost as we transition to competition.

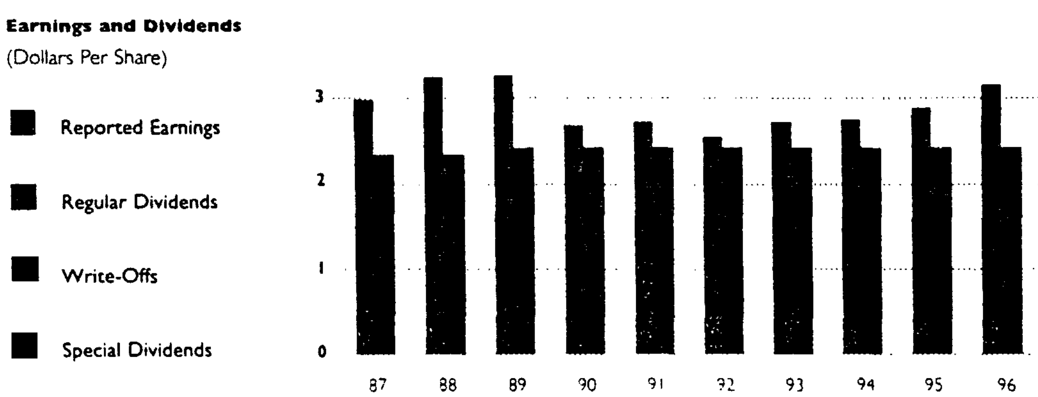
In connection with the audit of AEP's 1991, 1992 and 1993 federal income tax returns the Internal Revenue Service agents sought a ruling from the IRS National Office that certain interest deductions relating to a corporate owned life insurance (COLI) program should not be allowed. The Company established the COLI program in 1990 as a part of its strategy to fund and reduce the cost of medical benefits for retired employees. AEP filed a brief with the IRS National Office refuting the agents' position. Although no adjustments have been proposed, a disallowance of the COLI interest deductions through December 31, 1996 would reduce earnings by approximately $247 million (including interest). AEP believes it will ultimately prevail on this issue and will vigorously contest any disallowance that may be assessed.

In 1996 Congress enacted legislation that prospectively phases out the tax benefits for COLI interest deductions over a three-year period beginning in 1996. As a result the Company intends to restructure its COLI program. The restructuring of the COLI program is not expected to have a material impact on results of operations.

RESULTS OF OPERATIONS 1996 was a good year for AEP, with earnings the best since 1989 and total shareholder return placing us among the best in our industry. We continue to be well within our goal of being in the top quartile of the companies in the Standard & Poor's Electric Utility Index, based on cumulative three-year returns.

In 1996 earnings increased 11% to $587 million or $3.14 per share from $530 million or $2.85 per share in 1995. The increase is mainly attributable to increased sales of energy and services and reduced interest charges and preferred stock dividends. The sales increase was due mainly to increased transmission and other services provided to power marketers and other utilities and increased energy sales to non-affiliated utilities and industrial customers. The reduction in interest and preferred stock dividends resulted from the Company's refinancing program. Also contributing to the improvement in earnings were the effect of severance pay charges recorded in 1995 related to the planned corporate restructuring and gains recorded in 1996 from emission allowance transactions.

The following displays AEP's earnings and dividends paid on common stock for the period 1987 to 1996:



Consolidated Condensed Statements of Income

Year ended December 31,
(In Thousands – Except Per Share Amounts)

	1996	1995	% Change
Revenues	$5,849,234	$5,670,330	3.2
Expenses:			
Fuel and Purchased Power	1,686,754	1,625,531	3.8
Maintenance	502,841	541,825	(7.2)
Depreciation and Amortization	600,851	593,019	1.3
Taxes Other Than Federal Income Tax	498,567	489,223	1.9
Other Operations Expense	1,210,027	1,184,158	2.2
Interest Charges & Preferred Stock Dividends	422,754	454,848	(7.1)
Total Expenses	4,921,794	4,888,604	0.7
Nonoperating Income (Loss)	(17,404)	10,912	N.M.
Income Before Federal Income Taxes	910,036	792,638	14.8
Federal Income Taxes	322,606	262,735	22.8
Net Income	$ 587,430	$ 529,903	10.9
Average Number of Shares Outstanding	187,321	185,847	0.8
Earnings Per Share	$3.14	$2.85	10.2
Cash Dividends Paid Per Share	$2.40	$2.40	–

N.M.=Not Meaningful

REVENUES The 3% increase in revenues was mainly due to the increased wholesale energy sales and transmission and coal conversion service revenues, reflecting the recent changes in the utility business. Coal conversion services are a new product which resulted in 6.8 billion kilowatthours of electricity generated for power marketers and other utilities under a FERC-approved interruptible, contingent sales tariff. Wholesale revenues increased 16%, reflecting a 46% increase in wholesale sales attributable largely to new wholesale transactions with power marketers and other utilities. Also contributing to the increased wholesale sales was a new long-term contract with an unaffiliated utility. Transmission service revenues increased $24 million. The new FERC rules, which require utilities with transmission lines to offer transmission services to other entities on the same terms and conditions as they offer to themselves, and AEP's aggressive efforts to provide flexible and discounted transmission services encouraged the expanded use of transmission services. Retail revenues increased slightly as sales of electricity to retail customers increased 1.7%, reaching a record 100 billion kilowatthours due to growth in the number of customers. More than 31,000 new retail customers were added in 1996 and the addition of a major new industrial customer in December 1995 also added to retail revenues. Revenues from sales to residential customers, the most weather-sensitive customer class, increased slightly as the effect of cold winter weather in early 1996 was largely offset by mild summer and December temperatures. Revenues from commercial and industrial customers increased 1%, primarily reflecting growth in the number of customers.

TOTAL EXPENSES REMAIN RELATIVELY UNCHANGED Total expenses increased slightly as lower interest charges, preferred stock dividend requirements and maintenance expense were offset by increased fuel and purchased power expense and expenditures for marketing, information systems and other items necessary to prepare for the transition to competition. The increase in fuel and purchased power expense resulted from increased generation to meet the rise in demand of wholesale and industrial customers. Interest charges and preferred stock dividend requirements decreased as the Company's subsidiaries continued their refinancing programs. The programs reduced the average interest rate and the amount of long-term debt and preferred stock outstanding. Maintenance expense decreased due to the recovery of previously expensed storm damage costs and reduced nuclear plant maintenance expenses due to work force reductions and the reduction of contract labor at the Cook Nuclear Plant.

NONOPERATING INCOME The decrease in nonoperating income in 1996 was mainly due to the cost of the AEP branding campaign and the start-up cost of complementary businesses.

FEDERAL INCOME TAXES The significant increase in federal income taxes was largely the result of the increase in taxable income and changes in certain book/tax differences accounted for on a flow-through basis.

COMMON DIVIDEND REMAINS CONSTANT; PAYOUT RATIO DECREASES The Company paid a quarterly dividend in 1996 of 60 cents a share maintaining the annual dividend rate at $2.40 per share. With the increase in earnings, the payout ratio continued an improving trend to 76% in 1996 from 84% in 1995 and 89% in 1994. It has been a management objective to reduce the payout ratio through efforts to increase earnings in order to enhance AEP's ability to invest in new business ventures that complement our core competencies and can maintain and improve shareholder value.

TOTAL SHAREHOLDER RETURN In 1996 AEP outperformed the Standard & Poor's Electric Utility Index companies in total shareholder return primarily due to the strength of our stock price. Our stock price started the year at 40 1/2 and finished 1996 at 41 1/8 while the stock prices of most of the other 25 utilities in the Index fell. Total shareholder return, the percentage change in the common stock price plus the percentage yield of quarterly dividends, is important to us and our owners. Our long-term objective is to rank consistently in the top quartile of the Standard & Poor's Electric Utility Index, based on the cumulative three-year total shareholder return. We achieved this goal for 1994-1996, as we did for 1993-1995 and 1992-1994.

	Three-Year Total Shareholder Return		
	1992-4	1993-5	1994-6
AEP	19.0%	50.8%	35.3%
S&P Electric Utility Index	3.9%	28.2%	13.9%

Consolidated Condensed Balance Sheets

At December 31,
(In Thousands)

	1996	1995
Assets		
Electric Utility Plant in Service	$18,616,337	$18,181,844
Construction Work in Progress	353,832	314,118
Accumulated Depreciation and Amortization	(7,549,798)	(7,111,123)
Net Electric Utility Plant	11,420,371	11,384,839
Other Property and Investments	892,674	825,781
Cash and Cash Equivalents	57,539	79,955
Other Current Assets	1,297,342	1,321,903
Regulatory Assets	1,889,482	1,979,446
Deferred Charges	328,139	310,377
Total	$15,885,547	$15,902,301
Capitalization and Liabilities		
Common Shareholders' Equity	$ 4,545,327	$ 4,339,796
Cumulative Preferred Stocks of Subsidiaries	600,223	663,325
Long Term Debt	4,796,768	4,920,329
Total Capitalization	9,942,318	9,923,450
Current Liabilities	1,496,037	1,625,062
Deferred Income Taxes and Investment Tax Credits	3,047,193	3,086,692
Other Liabilities	1,399,999	1,267,097
Total	$15,885,547	$15,902,301

FINANCIAL CONDITION The Company's financial position continues to improve. As a result of the issuance of common stock through the Dividend Reinvestment Program and the reduction of long-term debt over the past several years, the common equity to capitalization ratio has steadily improved. At the end of 1996 the common equity to capitalization ratio was 45.3%, an improvement from 43.1% at the end of 1995 and 42.1% at the end of 1994. Unrestricted retained earnings increased to $1.5 billion at year-end 1996.

CAPITAL RESOURCES AND NEEDS Electric utility construction expenditures in the United States have been declining in recent years due to slow growth in the demand for electricity due to energy conservation and efficiency programs, as well as continued difficulty in the construction of transmission facilities due to environmental and other concerns. Also, substantial amounts of new generation have been added by non-utility entities. AEP's construction expenditures have followed the industry trend and have been declining since 1991, when we last completed a new generating facility. As indicated on the following page, cash from operating activities provided substantially all the funding for construction, payment of dividends, and other investing and financing activities.

Consolidated Condensed Statements of Cash Flows

Year ended December 31, (In Thousands)	1996	1995
Operating Activities:		
Net Income	$ 587,430	$ 529,903
Adjustments for Noncash Items	649,632	526,707
Net Cash Flows from Operating Activities	1,237,062	1,056,610
Investing Activities:		
Construction	(577,691)	(605,974)
Proceeds from Sale of Property and Other	12,283	20,567
Net Cash Flows Used for Investing Activities	(565,408)	(585,407)
Financing Activities:		
Issuance of Common Stock	65,461	48,707
Change in Cumulative Preferred Stock (net)	(70,761)	(158,839)
Change in Long-term Debt (net)	(193,987)	53,709
Change in Short-term Debt (net)	(45,430)	48,140
Dividends Paid on Common Stock	(449,353)	(445,831)
Net Cash Flows Used for Financing Activities	(694,070)	(454,114)
Net Increase (Decrease) in Cash and Cash Equivalents	(22,416)	17,089
Cash and Cash Equivalents January 1	79,955	62,866
Cash and Cash Equivalents December 31	$ 57,539	$ 79,955

At December 31, 1996, outstanding long-term debt and preferred stock totaled $4.88 billion and $600 million, respectively. Unless certain earnings or coverage tests are met, additional long-term debt and/or preferred stock cannot be issued by the subsidiaries. The tests stipulate the amount of earnings required to support the issuance of new securities and impose a limitation on the amount of additional debt and preferred stock that can be issued. AEP's operating companies presently exceed these minimum coverage requirements and are in a position, if required, to issue additional long-term debt and/or preferred stock.

In January 1997 the Company announced a tender offer for certain subsidiaries' preferred stock in conjunction with special shareholder meetings to be held on February 28, 1997. The special meetings' purpose is to consider amendments to the subsidiaries' articles of incorporation to remove certain capitalization ratio requirements. These restrictions limit the subsidiaries' financial flexibility and could place them at a competitive disadvantage in the future. The subsidiaries expect to use a combination of short-term debt and unsecured long-term debt to pay for the preferred stock tendered.

Selected Financial Highlights

For the twelve months ended December 31 (In Thousands) – Except Per Share Amounts

	1996	1995	1994	1993	1992
Operating Revenues	**$5,849,234**	$5,670,330	$5,504,670	$5,268,842	$5,044,792
Income before Preferred Dividends	**628,856**	584,674	554,738	412,618	527,686
Preferred Dividends	**41,426**	54,771	54,726	58,849	59,383
Earnings Applicable to Common Shares	**587,430**	529,903	500,012	353,769	468,303
Average Common Shares Outstanding	**187,321**	185,847	184,666	184,535	184,535
Earnings per Common Share	**$3.14**	$2.85	$2.7!	$1.92	$2.54
Disallowance of Zimmer Costs					
(Included in EPS Above)				($0.78)	

Operating Revenues

For the twelve months ended December 31 (In Thousands)

	1996	1995	1994	1993	1992
Residential	**$1,958,551**	$1,953,937	$1,835,442	$1,780,802	$1,663,348
Commercial	**1,284,670**	1,265,776	1,217,921	1,153,207	1,097,735
Industrial	**1,618,843**	1,606,451	1,578,579	1,514,691	1,506,234
Miscellaneous	**66,930**	67,047	64,668	62,879	67,507
Total Retail	**4,928,994**	4,893,211	4,696,610	4,511,579	4,334,824
Wholesale	**792,592**	680,905	714,076	687,072	647,286
Total from KWH Sales	**5,721,586**	5,574,116	5,410,686	5,198,651	4,982,110
Provision for Revenue Refund	**(7,581)**	(1,100)	5,560	(926)	(4,680)
Total Net of Provision	**5,714,005**	5,573,016	5,416,246	5,197,725	4,977,430
Other Operating Revenues	**135,229**	97,314	88,424	71,117	67,362
Total Operating Revenues	**$5,849,234**	$5,670,330	$5,504,670	$5,268,842	$5,044,792

KWH Sales by Class

For the twelve months ended December 31 (In Millions)

	1996	1995	1994	1993	1992
Residential	**30,853**	30,620	28,818	28,876	26,998
Commercial	**22,558**	22,190	21,209	20,711	19,661
Industrial	**45,395**	44,367	43,579	42,479	41,327
Miscellaneous	**1,264**	1,238	1,201	1,187	1,269
Total Retail	**100,070**	98,415	94,807	93,253	89,255
Wholesale	**32,503**	22,238	21,907	23,588	21,596
Total Kilowatthour Sales	**132,573**	120,653	116,714	116,841	110,851

INDEPENDENT AUDITORS' REPORT

To the Shareholders and Board of Directors
of American Electric Power Company, Inc.:

We have audited the consolidated balance sheets of American Electric Power Company, Inc. and its subsidiaries as of December 31, 1996 and 1995, and the related consolidated statements of income, retained earnings, and cash flows for each of the three years in the period ended December 31, 1996. Such consolidated financial statements and our report thereon dated February 25, 1997, expressing an unqualified opinion (which are not included herein) are included in Appendix A to the Proxy Statement for the 1997 annual meeting of shareholders. The accompanying condensed consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on such condensed consolidated financial statements in relation to the complete consolidated financial statements.

In our opinion, the information set forth in the accompanying condensed consolidated balance sheets as of December 31, 1996 and 1995 and the related condensed consolidated statements of income and of cash flows for the years then ended is fairly stated in all material respects in relation to the basic consolidated financial statements from which it has been derived.

Deloitte & Touche LLP

Deloitte & Touche LLP
Columbus, Ohio
February 25, 1997

STATE PRESIDENTS

Our state presidents and their staffs are available to help customers, consumer groups, legislators and others who deal with energy usage, safety, conservation, education, environmental matters and public policy. They can be contacted at the following locations:

Coulter R. Boyle III
AEP Indiana
AEP Michigan
One Summit Square
P.O. Box 60
Fort Wayne, IN 46801-2604
(219) 425-2101
Fax (219) 425-2157

R. Daniel Carson Jr.
AEP Virginia
AEP Tennessee
40 Franklin Road SW
P.O. Box 2021
Roanoke, VA 24022-2121
(540) 985-2900
Fax (540) 985-2340

Timothy C. Mosher
AEP Kentucky
1701 Central Avenue
P.O. Box 1428
Ashland, KY 41105-1428
(606) 327-1261
Fax (606) 327-3128

Marsha P. Ryan
AEP Ohio
1 Riverside Plaza
Columbus, OH 43215-2373
(614) 223-1400
Fax (614) 628-4631

Dana E. Waldo
AEP West Virginia
301 Virginia Street East
P.O. Box 1986
Charleston, WV 25327-1986
(304) 348-4710
Fax (304) 348-5744

Annual Meeting — The 90th annual meeting of shareholders of American Electric Power Company will be held at 9:30 a.m. Wednesday, April 23, 1997, at the MeadowView Conference Resort & Convention Center, 1901 Meadowview Parkway, Kingsport, Tennessee. Admission is by ticket only. To obtain a ticket, please note the instructions in the Notice of Annual Meeting to be mailed to shareholders in March or call the Company.

Shareholder Inquiries — If you have questions about your account, you can call the Company toll-free at 800-AEP-COMP (800-237-2667), or write to Bette Jo Rozsa, Security Owner Relations Division, American Electric Power Company, 1 Riverside Plaza, Columbus, Ohio 43215-2373. You should have your Social Security number or account number ready; we will not speak to third parties about an account without the shareholder's approval or appropriate documents.

Transfer Agent & Registrar —
First Chicago Trust Company of New York
P.O. Box 2500
Jersey City, NJ 07303-2500
Telephone Response Group: 800-328-6955;
E-Mail Correspondence: FCTC@ DELPHI.COM
World Wide Web address: http://www.fctc.com

Replacement of Dividend Checks — If you do not receive your dividend check within five business days after the dividend payment date, or if your check is lost, destroyed or stolen, you should notify the transfer agent or Security Owner Relations for a replacement.

Lost or Stolen Stock Certificates — If your stock certificate is lost, destroyed or stolen, you should notify the transfer agent or Security Owner Relations immediately so a "stop transfer" order can be placed on the missing certificate. The transfer agent then will send you the required documents to obtain a replacement certificate.

Address Changes — It is important that we have your current address on file so that you do not become a lost shareholder. Please contact Security Owner Relations or the transfer agent for address changes for both record and dividend mailing addresses. We also can provide automatic seasonal address changes.

Stock Transfer — Please contact Security Owner Relations or the transfer agent if you have questions regarding the transfer of stock and related legal requirements.

Dividend Reinvestment and Stock Purchase Plan — A Dividend Reinvestment and Stock Purchase Plan is available to registered shareholders and AEP System employees. It is a simple and convenient method of purchasing additional shares of AEP common stock. You may obtain the Plan prospectus and enrollment authorization form by contacting the transfer agent or Security Owner Relations.

Direct Deposit of Dividends — The Company offers electronic deposit of your dividends. Contact Security Owner Relations or the transfer agent for details.

Taxes on Dividends — The Company paid $2.40 in cash dividends in 1996, all of which are taxable for federal income tax purposes.

Stock Held in Brokerage Account ("Street Name") — When you purchase stock and it is held for you by your broker, it is listed with the Company in the broker's name, or "street name." AEP does not know the identity of individual shareholders who hold their shares in this manner; we simply know that a broker holds a certain number of shares which may be for any number of customers. If you hold your stock in street name, you receive all dividend payments, annual reports and proxy materials through your broker. Therefore, if your shares are held in this manner, any questions you may have about your account should be directed to your broker.

How To Consolidate Accounts — If you want to consolidate separate accounts into one account, you should contact the transfer agent or the Security Owner Relations office to obtain the necessary instructions. When accounts are consolidated, it may be necessary to reissue the stock certificates.

How To Eliminate Duplicate Mailings — If you want to maintain more than one account but eliminate additional mailings of annual reports, you may do so by contacting the transfer agent or Security Owner Relations, indicating the names you wish to keep on the mailing list for annual reports and the names you wish to delete. This will affect only these mailings; dividend checks and proxy materials will continue to be sent to each account.

Stock Trading — The Company's common stock is traded principally on the New York Stock Exchange under the symbol AEP.

Shareholder Direct — An array of timely recorded messages about AEP, including dividends and earnings information, recent news releases and a message from the Chief Executive Officer, is available at AEP Shareholder Direct at 800-551-1AEP (1237) anytime day or night. Hard copies of information can be obtained via fax or mail. Requests for 10-K's, 10-Q's, Proxy Statements, Proxy Statement Appendixes and Summary Report to Shareholders should be made through Shareholder Direct. Also, during normal business hours you can choose to be transferred to shareholder service representatives at the transfer agent or the Company.

Financial Community Inquiries — Institutional investors and securities analysts should direct inquiries to John Bilacic, Finance Department, American Electric Power Company, 1 Riverside Plaza, Columbus, Ohio 43215-2373.

Internet Home Page — Information about AEP, including financial documents, SEC filings, news releases and customer service information, is available on the Company's home page on the Internet at http://www.aep.com.

Market Price Range, Common Stock:

	1996		1995	
	High	Low	High	Low
First Quarter	$44 3/4	$40 1/8	$35 3/4	$31 1/4
Second Quarter	$42 3/4	$38 5/8	$35 3/8	$31 1/2
Third Quarter	$43 1/8	$40	$36 1/2	$33 5/8
Fourth Quarter	$42 1/2	$39 1/2	$40 5/8	$35 7/8

E. Linn Draper Jr., Ann H. Zwinger, Robert W. Fri, Morris Tanenbaum, Angus E. Peyton, Arthur G. Hansen, Linda Gillespie Stuntz, Gerald P. Maloney, Robert M. Duncan, Lester A. Hudson Jr., Donald G. Smith, Peter J. DeMaria

DIRECTORS

Dr. E. Linn Draper Jr., 55
Chairman, President &
Chief Executive Officer
(1992)

Ann H. Zwinger, 72
Natural History Writer & Illustrator
Colorado Springs, Colorado
(1977)

Angus E. Peyton, 70
Partner, Brown & Peyton
Charleston, West Virginia
(1978)

Dr. Arthur G. Hansen, 72
Zionsville, Indiana
Retired Chancellor
Texas A&M University System
(1979)

Robert M. Duncan, 69
Columbus, Ohio
Retired U.S. District Judge
Southern District of Ohio
(1985)

Lester A. Hudson Jr., 57
Chairman
H&E Associates
Greenville, South Carolina
(1987)

Dr. Morris Tanenbaum, 68
Short Hills, New Jersey
Retired Vice Chairman &
Chief Financial Officer
AT&T
(1989)

Linda Gillespie Stuntz, 42
Partner, Stuntz & Davis, P.C.
Washington, D.C.
(1993)

Peter J. DeMaria, 62
Controller;
Executive Vice President-
Administration & Chief Accounting
Officer, AEP Service Corporation
(1993)

Gerald P. Maloney, 64
Vice President & Secretary;
Executive Vice President &
Chief Financial Officer,
AEP Service Corporation
(1994)

Donald G. Smith, 61
Chairman, President &
Chief Executive Officer
Roanoke Electric Steel Corporation
Roanoke, Virginia
(1994)

Robert W. Fri, 61
Director, National Museum
of Natural History
Smithsonian Institution
Washington, D.C.
(1995)

Committees of the Board The chairman is listed in ( ) Audit Directors Executive Finance Human Resources Public Policy

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CORPORATE COMMUNICATIONS
19TH FLOOR
PO BOX 16631
COLUMBUS OH 43272-2204

Together, we can work to ensure that electric utility competition is fair and equitable

As legislation surfaces that will restructure the electric utility industry, we want to make sure that our shareholders are kept informed of the changes that are proposed. Together we can work to ensure that competition is fair and equitable. If you would like to participate with AEP in the legislative process, please fill out and return this postage-paid card. When you do, we'll let you know about issues which may interest you concerning the energy industry.

By working together, we can enhance AEP's role as America's Energy Partner.

AEP AMERICAN® ELECTRIC POWER

AEP: America's Energy Partner™

Yes! I want to participate in shaping America's energy future

Please let me know when my help may be needed to write my elected representatives on legislation that will affect the electric utility industry.

Name

Address

City

State Zip

( )

Phone Number (Optional)

Common AEP and Electric Utility Industry Terms

Book value per share — The value of each common share of stock if all of a company's assets, after all debts are paid, are divided by the number of common shares outstanding.

Coal conversion — A service under which AEP converts coal owned by others into electricity for their use.

Distribution line — Power lines that feed electricity to customer meters.

Dividend payout ratio — Dividends paid as a percentage of net income.

Earnings per share — The company's net income divided by the average number of common shares outstanding.

Electrotechnology — Extensions of conventional electric-based technologies to new applications or processes.

Electroplating — The process of depositing a layer of metals, such as copper, chromium, gold or tin, on an object using electrolysis.

FERC — Federal Energy Regulatory Commission, the federal agency that regulates interstate sales and transmission of electricity.

FERC Rules 888 and 889 — Rules and code of conduct enacted in 1996 requiring public utilities to make their transmission system available to anyone on a comparable cost and service basis.

Kilowatt — A measure of the rate at which electric energy is generated or consumed. A kilowatt is 1,000 watts.

Kilowatthour — A measure of the quantity of electric energy equal to one kilowatt of power generated or consumed in one hour.

Megawatt — One thousand kilowatts.

Net income — The company's income after all expenses, taxes and preferred dividends have been deducted.

Nitrogen oxides — Gases formed from the combustion of fossil fuels.

Ozone — A gas in the atmosphere that occurs naturally and through a mixture of nitrogen oxides, volatile organic compounds and sunlight.

Price/earnings ratio — The value of the company's stock price in relation to the earnings per share. The P/E ratio is calculated by dividing the stock price by the earnings per share.

PUHCA — Public Utility Holding Company Act of 1935. Regulates the corporate structure and securities issuance of electric utilities and places limitations on utilities that are structured as registered holding companies. It is enforced by the Securities and Exchange Commission.

PURPA — Public Utility Regulatory Policies Act of 1978. Designed to encourage conservation, more efficient use of energy sources and the use of alternative energy sources. It also requires utilities to purchase excess power produced by cogenerators.

Retail customer — A customer that purchases electricity for their own use.

RSO — Regional Service Organization, an AEP organization established to perform scheduled maintenance on AEP power plants.

Return on average common equity — The percentage return the company generated on the average amount of money that common shareholders have invested in the company.

Sulfur dioxide — A gas of sulfur and oxygen compounds created when fossil fuels, such as coal, are burned.

Total investor return — The return to common shareholders based on dividends paid plus changes in the stock price from the previous year.

Transmission line — Power lines used to transmit bulk electricity, such as from state to state or region to region, at high voltages.

Wholesale customer — A customer, such as a municipal, cooperative or investor-owned electric company or power marketer, that buys electricity for resale.

American Electric Power

1 Riverside Plaza

Columbus, OH 43215 2373

614 223 1000

American Electric Power

1996 Annual Report

Appendix A to Proxy

AEP AMERICAN® ELECTRIC POWER

AEP: America's Energy Partner ℠

AMERICAN ELECTRIC POWER
1 Riverside Plaza
Columbus, Ohio 43215-2373

CONTENTS

AMERICAN ELECTRIC POWER COMPANY, INC. AND SUBSIDIARY COMPANIES

SELECTED CONSOLIDATED FINANCIAL DATA

Year Ended December 31,	1996	1995	1994	1993	1992
INCOME STATEMENTS DATA (in millions):					
Operating Revenues	$5,849	$5,670	$5,505	$5,269	$5,045
Operating Income	1,008	965	932	929	883
Net Income	587	530	500	354	468

December 31,	1996	1995	1994	1993	1992
BALANCE SHEETS DATA (in millions):					
Electric Utility Plant	$18,970	$18,496	$18,175	$17,712	$17,509
Accumulated Depreciation and Amortization	7,550	7,111	6,827	6,612	6,281
Net Electric Utility Plant	$11,420	$11,385	$11,348	$11,100	$11,228
Total Assets	$15,886	$15,902	$15,739	$15,362	$14,217
Common Shareholders' Equity	4,545	4,340	4,229	4,151	4,245
Cumulative Preferred Stocks of Subsidiaries:					
Not Subject to Mandatory Redemption	90	148	233	268	535
Subject to Mandatory Redemption*	510	523	590	501	234
Long-term Debt*	4,884	5,057	4,980	4,995	5,311
Obligations Under Capital Leases*	414	405	400	284	300

*Including portion due within one year

Year Ended December 31,	1996	1995	1994	1993	1992
COMMON STOCK DATA:					
Earnings per Share	$3.14	$2.85	$2.71	$1.92	$2.54
Average Number of Shares Outstanding (in thousands)	187,321	185,847	184,666	184,535	184,535
Market Price Range: High	$44-3/4	$40-5/8	$37-3/8	$40-3/8	$35-1/4
Low	38-5/8	31-1/4	27-1/4	32	30-3/8
Year-end Market Price	41-1/8	40-1/2	32-7/8	37-1/8	33-1/8
Cash Dividends Paid	$2.40	$2.40	$2.40	$2.40	$2.40
Dividend Payout Ratio	76.5%	84.1%	88.6%	125.2%	94.6%
Book Value per Share	$24.15	$23.25	$22.83	$22.50	$23.01

Business Outlook

With the issuance of two Federal Energy Regulatory Commission (FERC) orders and the commencement of planning for retail competition at the state level, we are in a better position to identify and develop strategies for addressing the issues that face American Electric Power (AEP) and our changing industry. We recognize that the conventional ways of maintaining and enhancing shareholder value are becoming less effective as the industry moves towards greater competition in the generation and sale of electricity. The industry's transition to competition and customer choice and the ability to fully recover costs are probably the most significant factors affecting AEP's future profitability.

Although AEP has the financial strength, geographic reach, location and cost structure to be an able competitor, no assurance can be given that AEP can maintain this position in the future. However, we intend to make every effort to maintain and strengthen our competitive position. We see a link between a smooth transition to a competitive marketplace and the maintaining and enhancing of shareholder value.

The new FERC orders facilitate increased competition in both the generation and sale of bulk power to wholesale customers. They provide, among other things, for open access to transmission facilities. AEP's support of the FERC's open access transmission rule is evidenced by our being among the first to file a comparability tariff, offering access to our transmission grid at 143 interconnections to all parties under the same terms and conditions available to AEP. This has provided AEP with greater opportunities for transmission service revenues.

Although customer choice proposals and discussions are under way in the states in which we operate, it is difficult to predict their result and the timing of any resultant changes. We are actively involved in discussions on the state and federal level regarding how best to transition to competition in order to represent the best interests of our customers, shareholders and employees. We favor a transition because we believe that AEP will in the long-term fare better in a competitive market than under continued regulation.

As the electric energy market evolves from cost-of-service ratemaking to market-based pricing, many complex issues must be resolved, including the recovery of stranded costs. While the new FERC orders provide, under certain conditions, for recovery of stranded costs at the wholesale level, the issue of stranded cost remains open at the much larger state retail level.

Stranded Costs

Stranded costs occur when a customer switches to a new supplier for its electric energy needs or when a component of the business, for example generation, is no longer subject to cost-based regulation, creating the issue of who pays for plant investment, purchased power or fuel contracts both non-affiliated and affiliated, inventories, construction work in progress, nuclear decommissioning, plant removal and shutdown costs, previously deferred costs (regulatory assets) and other investments and commitments that are no longer needed, economic or recoverable in a competitive market. The amount of any stranded costs AEP may experience depends on the timing of and the extent to which direct competition is introduced to our business and the then-existing market price of energy.

Under the provisions of Statement of Financial Accounting Standards (SFAS) No. 71, "Accounting for the Effects of Certain Types of Regulation," assets (deferred expenses) and liabilities (deferred revenues) are included in the consolidated financial statements in accordance with regulatory actions to match expenses and revenues in cost-based rates. In the event a portion of the business no longer met the requirements of SFAS 71, net regulatory assets would have to be written off for that portion of the business. Among other requirements SFAS 71 requires that the rates charged customers be cost based.

Our generation business is still cost-based regulated and should remain so for at least three to five years as the industry transitions to full competition. Although the recent FERC orders provide for competition in the firm wholesale market, that market is a relatively small part of our business and many of our firm wholesale sales are still under cost-of-service contracts. We believe that enabling state legislation should provide for a sufficient transition period to allow for the recovery of any generation-related stranded costs and we are dedicating ourselves to work with regulators, customers and legislators to accomplish both an orderly transition and a reasonable and fair disposition of the stranded cost issue.

We favor the recovery of stranded costs during a transition period in which rates would be fixed or frozen and electric utilities would take steps to achieve cost savings which would be used to reduce or eliminate stranded costs. However, if electric utilities were to no longer be cost-based regulated and it were not possible to recover stranded costs, the results of operations and financial condition of AEP and other electric utilities would be adversely affected.

Since state commissions have jurisdiction over the sale and distribution of electricity to retail customers, we believe that state legislation and regulation should shape the future competitive market for electricity while federal legislation should seek to ensure reciprocity among the states and a level playing field for all power suppliers. Presently states with higher cost power, like California and Massachusetts, are aggressively pursuing deregulation. The states AEP operates in, however, are generally addressing the call for customer choice more cautiously and the transition to competition is expected to evolve at an uneven pace across the states.

Restructuring/Functional Unbundling

In 1996 we took some major steps to maintain and enhance AEP's competitive strength and made progress towards our long-term goal of becoming the world's premier supplier of energy and related services. We restructured our management and operations to allow us to comply with the new FERC orders by separating our generation and energy sales operations from our energy transmission delivery operations and to address increasing competition among electric suppliers through distinct functional business units. This has achieved and should continue to achieve staffing, managerial and operating efficiencies. The generation and marketing business units expect to eventually compete in an open market for customers. Our energy delivery business will remain regulated and may ultimately be subject to some form of incentive or performance-based ratemaking while Corporate Development and Marketing will be working to cultivate new but related non-regulated business opportunities.

Corporate Branding and Positioning

We are enhancing our marketing and customer service efforts with programs like the Key Accounts Program which strives to build strong partnerships with key customers in order to build customer loyalty. In 1996 AEP also launched a series of new television commercials as part of a branding campaign to inform our customers that we will be operating under the name American Electric Power and that we are AEP: America's Energy Partner. The commercials are intended to position AEP as more than just a supplier of electricity. As we enter an increasingly competitive energy market we want to be the energy and energy services provider of choice.

New Business Opportunities

In the non-rate-regulated environment, AEP offers energy consulting and project management services both domestically and internationally and contracts with other public utilities and government agencies for the licensing of intellectual property and the delivery of energy services. In 1996 an AEP subsidiary and two Chinese companies formed a joint venture company to finance and build a 250-megawatt electric generating facility in China. AEP's share of the total cost of the facility is approximately $120 million and the project is expected to be operational in 1999.

On February 24, 1997 AEP and Public Service Company of Colorado with equal interests in a joint venture announced a cash tender offer for Yorkshire Electricity Group plc in the United Kingdom. The joint venture proposes to pay $2.4 billion to acquire all of the stock of Yorkshire Electricity. AEP's equity investment, estimated to be $360 million, will be made through its subsidiary AEP Resources Inc., initially using cash borrowed under a revolving credit agreement. We consider the China investment and Yorkshire tender offer as important steps in our long-term goal to become the premier provider of energy and energy services worldwide.

In addition to pursuing foreign power generation, transmission and distribution investments we formed new subsidiaries in 1996 to explore other new complementary business opportunities including AEP Communications, Inc. which was formed to provide data transmission and related telecommunications products and services. In January 1997 AEP Communications, Inc. entered into an agreement with Sprint Communications, Inc. to construct jointly a 150 mile fiber optic line between Charleston, West Virginia and Roanoke, Virginia. Another new subsidiary AEP Power Marketing is presently seeking approval to market and broker power outside of our traditional service territory. Plans are also in place to commence gas marketing. We are pursuing non-regulated related business opportunities because we believe they offer the opportunity to earn enhanced returns as compared with our traditional regulated business. However, we recognize that these opportunities are generally riskier. Investments in new business opportunities may be made after management carefully assesses the risks versus the potential for enhanced shareholder value.

Cost Containment

In 1996 we continued our efforts to reduce costs in order to maintain our competitiveness. Reviews of our major processes led to decisions to consolidate the management and operations of internal service functions performed at multiple locations. Among the functions being consolidated are fossil generation plant maintenance, nuclear operations support staff, system operations, accounting and load research. A study of the Company's procurement and supply chain operations led to cost reductions through better inventory management, just-in-time delivery and the increased use of electronic purchasing. Also in 1996 we completed the installation of an activity based management budgeting system throughout the system. This tool will enable managers to better analyze work and control costs. While staff reductions and cost savings are being achieved in these and other areas, expenses for new marketing and customer services and modern efficient management information systems are being increased to prepare for competition. These expenditures for the future should produce further improvements and efficiencies, enabling AEP to maintain its position as a low-cost producer.

Fuel Costs

Coal is 70% of the production cost of electricity for AEP. Although our coal costs per unit of electricity (per Kwh) have declined by one-half in constant dollars in the last 10 years, we recognize that we must continue to manage our coal costs to continue to maintain our competitive position. Approximately 15% of the coal we burn is supplied by affiliated mines; the remainder is acquired under long-term contracts and in the spot market. As long-term contracts expire we are negotiating with non-affiliated suppliers to lower purchased coal costs. Efforts also continued in 1996 to reduce the cost of affiliated coal. We intend to continue to prudently supplement our long-term coal supplies with spot market purchases as long as favorable spot market prices exist.

In recent years we have agreed in our Ohio jurisdiction to certain limitations on the recovery of affiliated coal costs. Our analysis shows that we should be able to recover over the term of the agreement (through 2009) the Ohio jurisdictional portion of the current and deferred costs of our affiliated mining operations including future mine closure costs. Management intends to seek recovery of its non-Ohio jurisdictional portion of the investment in and the liabilities and closing costs of our affiliated mines estimated at $180 million after tax. However, should it become apparent that the costs will not be recoverable from Ohio and/or non-Ohio jurisdictional customers, the mines may have to be closed and future earnings and possibly financial condition adversely affected. In addition compliance with Phase II requirements of the Clean Air Act, which become effective in January 2000, could also cause the mining operations to close. Unless the cost of any mine closure is recovered either in regulated rates or as a stranded cost in a transition to competition, future earnings and possibly financial condition could be adversely affected.

Nuclear Costs

Significant efforts have been made to enhance our competitiveness in nuclear power generation and to improve our nuclear organizational efficiency. Net generation in 1996 for the Company's only nuclear plant, the two-unit Donald C. Cook Nuclear Plant, located on the shores of Lake Michigan, was

16,396 gigawatts, the highest in the plant's 20-year history. The generation record was set in part due to Unit 2's best continuous run in its history, 226 days, reached in December 1996. Refueling costs and related outage time have been reduced. We also reduced nuclear staff support costs in 1996 by relocating our Columbus-based nuclear management and support staff to Michigan to consolidate it with the plant staff.

It is difficult to reduce nuclear generation costs since certain major cost components are impacted by federal laws and Nuclear Regulatory Commission (NRC) regulations. The Nuclear Waste Policy Act of 1982 established federal responsibility for the permanent off-site disposal of spent nuclear fuel and high-level radioactive waste. By law we participate in the Department of Energy's (DOE's) Spent Nuclear Fuel (SNF) disposal program which is described in Note 4 of the Notes to Consolidated Financial Statements. Since 1983 our customers have paid $254 million for the disposal of spent nuclear fuel consumed at the Cook Nuclear Plant. Under the provisions of the Nuclear Waste Policy Act, collections from customers are to provide the DOE with money to build a repository for spent fuel. To date the federal government has not made sufficient progress towards a permanent repository or otherwise assuming responsibility for SNF. As long as there is a delay in the storage repository for SNF, the cost of both temporary and permanent storage will continue to increase.

The cost to decommission the Cook Nuclear Plant is also affected by NRC regulations and the DOE's SNF disposal program. Studies completed in 1994 estimate the cost to decommission the Cook Nuclear Plant and dispose of low-level nuclear waste accumulation to range from $634 million to $988 million in 1993 dollars. This estimate could escalate due to uncertainty in the DOE's SNF disposal program and the length of time that SNF may need to be stored at the plant site delaying decommissioning. Presently we are recovering the estimated cost of decommissioning the Cook Nuclear Plant over its remaining life. However, AEP's future results of operations and possibly its financial condition could be adversely affected if the cost of spent nuclear fuel disposal and decommissioning continues to increase and cannot be recovered in regulated rates or as a stranded cost in a future competitive market.

Environmental Concerns

We take great pride in our efforts to economically produce and deliver electricity while minimizing the impact on the environment. AEP has spent millions of dollars to equip our facilities with the latest economical clean air and water technologies and to research possible new technologies. We are also proud of our award winning efforts to reclaim our mining properties. We intend to continue to take a leadership role to foster economically prudent efforts to protect and preserve the environment.

Hazardous Material

By-products from the generation of electricity include materials such as ash, slag, sludge, low-level radioactive waste and spent nuclear fuel. Coal combustion by-products, which constitute the overwhelming percentage of these materials, are typically disposed of or treated in captive disposal facilities or are beneficially utilized. In addition, our generating plants and transmission and distribution facilities have used asbestos, polychlorinated biphenyls (PCBs) and other hazardous and non-hazardous materials. We are currently incurring costs to safely dispose of such substances, and additional costs could be incurred to comply with new laws and regulations if enacted.

The Comprehensive Environmental Response, Compensation and Liability Act (CERCLA or Superfund) addresses clean-up of hazardous substances at disposal sites and authorized the United States Environmental Protection Agency (Federal EPA) to administer the clean-up programs. As of year-end 1996, we are currently involved in litigation with respect to five sites being overseen by the Federal EPA and have been named by the Federal EPA as "Potentially Responsible Parties" (PRPs) for six other sites. There are eight additional sites for which AEP companies have received information requests which could lead to PRP designation. Also, an AEP subsidiary has received an information request with respect to one site administered by state authorities. Our liability has been resolved for a number of sites with no significant effect on results of operations. In those instances where we have been named a PRP or defendant, our disposal or recycling activity was in accordance with the then-applicable laws and regulations. Unfortunately, CERCLA does not recognize compliance as a defense, but imposes strict liability on parties who fall within its broad statutory categories.

While the potential liability for each Superfund site must be evaluated separately, several general statements can be made regarding such potential liability. The disposal at a particular site by AEP is often unsubstantiated; the quantity of material we disposed of at a site was generally small; and the nature of the material we generally disposed of was non-hazardous. Typically, we are one of many parties named as PRPs for a site and, although liability is joint and several, generally some of the other parties are financially sound enterprises. Therefore, our present estimates do not anticipate material cleanup costs for identified sites for which we have been declared PRPs. However, if for reasons not currently identified significant costs are incurred for cleanup, future results of operations and possibly financial condition would be adversely affected unless the costs can be recovered from customers.

Federal EPA Actions

Federal EPA is required by the Clean Air Act Amendments of 1990 (CAAA) to issue rules to implement the law. In December 1996 Federal EPA issued final rules governing nitrogen oxide emissions that must be met after January 1, 2000 (Phase II of the CAAA). The final rules will require substantial reductions in nitrogen oxide emissions from certain types of power plant boilers including those in AEP's power plants. In December 1996 a group of utilities including AEP operating companies filed a petition for review of the rules in a U.S. Court of Appeals and requested expedited consideration of the appeal. The cost to comply with the emission reductions required by the final rules is expected to be substantial and could have a material adverse impact on results of operations and possibly financial condition if these costs are not recovered from customers.

Federal EPA is considering proposals to revise the existing ambient air quality standard for ozone and to establish a new ambient air quality standard for fine particulate matter. The rules being considered could result in requirements for reductions of nitrogen oxides and sulfur dioxide emitted from coal fired power plants and could have a significant impact on AEP's operations. The proposals being considered are of particular concern because they do not appear to have a sound scientific basis. The cost of complying with any new emission reduction requirements imposed as a result of the adoption of revised ambient air quality standards can not be precisely determined but could be substantial. If Federal EPA ultimately promulgates stricter ambient air quality standards, they could have a material adverse impact on results of operations and possibly financial condition if these costs are not recovered from customers.

Results of Operations

1996 was a good year for AEP with earnings the best since 1989 and total shareholder return placing us among the best in our industry. We continued to be well within our goal of being in the upper quartile of the companies in the Standard & Poor's electric utility index, based on cumulative three-year return.

Earnings Increase

In 1996 earnings increased 11% to $587 million or $3.14 per share from $530 million or $2.85 per share in 1995. The increase is mainly attributable to increased sales of energy and services and reduced interest charges and preferred stock dividends. Sales increased due to increased transmission and other services provided to power marketers and utilities and increased energy sales to non-affiliated utilities and industrial customers. The reduction in interest and preferred stock dividends resulted from the Company's refinancing program. Also contributing to the improvement in earnings were severance pay charges recorded in 1995 in connection with realigning operations and management and gains recorded in 1996 from emission allowance transactions.

Earnings increased 6% in 1995 to $530 million or $2.85 per share from $500 million or $2.71 per share in 1994. The primary reason for the earnings improvement was increased retail energy sales reflecting increased usage and growth in the number of customers. Unseasonably warm weather in the summer of 1995 and colder weather in the fourth quarter of 1995, were the primary factors accounting for the increased usage. The positive earnings impact of the increased sales was partly offset by the unfavorable effect of severance pay.

Revenues And Sales Increase

Operating revenues increased 3% in 1996 and 1995. Increased wholesale energy sales and transmission and coal conversion service revenues were the primary reasons for the increase in 1996 revenues. In 1995 the revenue increase resulted primarily from an increase in retail customers' energy usage, growth in the number of retail customers and the effects of rate increases.

The change in revenues can be analyzed as follows:

(Revenues in Millions)	Increase (Decrease) From Previous Year 1996 Amount	1996 %	1995 Amount	1995 %
Retail:				
Price Variance	$ (42.9)		$ 46.5	
Volume Variance	63.7		173.0	
Fuel Cost Recoveries	15.0		(22.9)	
	35.8	0.7	196.6	4.2
Wholesale:				
Price Variance	(202.0)		(39.3)	
Volume Variance	317.3		10.8	
Fuel Cost Recoveries	(3.6)		(4.6)	
	111.7	16.4	(33.1)	(4.6)
Other Operating Revenues	31.4		2.2	
Total	$ 178.9	3.2	$165.7	3.0

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In 1996 retail revenues increased slightly due to growth in the number of customers and the addition of a major new industrial customer in December 1995. Revenues from sales to residential customers, the most weather-sensitive customer class, were flat, increasing less than one percent, as the effect of cold winter weather in early 1996 was offset by mild summer and December temperatures. Revenues from commercial and industrial customers increased 1% reflecting growth in the number of customers.

Wholesale revenues increased 16% in 1996 reflecting a 46% increase in wholesale sales attributable largely to new wholesale transactions with power marketers and other utilities. As the wholesale energy market evolves into a competitive marketplace the Company intends to take advantage of new ways to market and price electricity and related services. During 1996 the Company provided coal conversion services resulting in 6.8 billion kilowatthours of electricity generated for power marketers and certain other utilities under a new FERC-approved interruptible, contingent sales tariff. As a result of these new sales, the average price per kilowatthour was significantly less in 1996 than in 1995. Also contributing to the increased wholesale sales was a new long-term contract with an unaffiliated utility to supply 205 MW of energy for 15 years beginning January 1, 1996.

An increased level of activity in the wholesale energy markets encouraged by the 1996 issuance of FERC open access transmission rules and AEP's aggressive efforts to provide flexible and competitively priced transmission services led to an increase in transmission service revenues. As a result transmission revenues, which are recorded in other operating revenues, increased by approximately $24 million.

The increase in 1995 operating revenues resulted primarily from a 4% increase in energy sales to retail customers due mainly to increased usage and continued growth in the number of customers in all retail customer classes. Energy sales to residential customers, the most weather-sensitive customer class, rose more than 6% in 1995 mainly as a result of increased weather related usage in the last half of the year. Sales to commercial and industrial customers rose 5% and 2%, respectively, reflecting the effects of weather and the expanding economy.

Although revenues from wholesale customers declined in 1995, wholesale energy sales increased by more than 1% largely due to increased short-term sales made on an hourly basis to unaffiliated utilities. This type of short-term sale is typically made when the unaffiliated utility can purchase energy at a lower cost than the cost at which that utility can generate the energy or when the customer is short on generating capacity. Such sales increase in periods of extreme weather. The increase in 1995 wholesale energy sales occurred during the last six months of the year when the summer was unseasonably warm and fall temperatures were colder compared with the prior year. While wholesale energy sales increased, wholesale revenues declined in 1995 reflecting increasing price related competition.

The level of wholesale sales tends to fluctuate due to the highly competitive nature of the short-term energy market and other factors, such as unaffiliated generating plant availability, the weather and the economy. The recently adopted FERC rules which introduce a greater degree of competition into the wholesale energy market have had the effect of increasing short-term wholesale sales and transmission service revenues. The Company's sales and in turn its results of operations were impacted in 1996 and prior years by the quantities of energy and services sold in wholesale transactions. Future results of operations will be affected by the quantity and price of wholesale transactions which often depends on the weather and power plant availability.

Operating Expenses Increase

Operating expenses increased 3% in 1996 and 1995. The primary items accounting for the increase in 1996 were increased fuel costs, federal income taxes and expenditures for marketing, information systems and other items necessary to prepare for the transition to competition. In 1995 increased rent and related operating costs of the newly installed Gavin Plant flue gas desulfurization systems (scrubbers) and expenses related to severance pay charges were the main reasons for the increase in operating expenses. Changes in the components of operating expenses were as follows:

	Increase (Decrease) From Previous Year			
	1996		1995	
(Dollars in Millions)	Amount	%	Amount	%
Fuel and Purchased Power	$ 61.2	3.8	$(119.7)	(6.9)
Other Operation	25.9	2.2	181.3	18.1
Maintenance	(39.0)	(7.2)	(2.4)	(0.5)
Depreciation and Amortization	7.8	1.3	20.8	3.6
Taxes Other Than Federal Income Taxes	9.4	1.9	(5.0)	(1.0)
Federal Income Taxes	70.2	25.8	58.6	27.5
Total	$135.5	2.9	$ 133.6	2.9

Fuel and purchased power expense increased in 1996 due to an increase in generation to meet the increase in industrial and wholesale customer demand. The effect of increased generation was partially offset by reduced average fossil fuel costs resulting from increased usage of lower cost spot market coal and lower cost nuclear fuel.

Although generation increased 3% in 1995, fuel and purchased power expense declined as a result of a decrease in the average cost of fossil fuel resulting from reduced coal prices reflecting the renegotiation of certain long-term coal contracts and other lower priced purchases under existing and new contracts. Other factors which reduced fuel and purchased power expense in 1995 were increased utilization of low cost nuclear generation; decreased energy purchases due to the mild weather during the first half of 1995 and the operation of fuel clause mechanisms. Changes in fuel expense are generally deferred pending recovery in various fuel clause mechanisms, as such they generally do not affect earnings.

The significant increase in other operation expense during 1995 was primarily due to rent and other operating costs of the Gavin Plant scrubbers which went into service in December 1994 and the first quarter of 1995; a $41 million ($27 million after-tax) provision for severance pay recorded in 1995 related mainly to a functional realignment of operations; and costs related to the development of a new activity based budgeting system.

Maintenance expense decreased in 1996 due to the recovery of previously expensed storm damage costs and reduced nuclear plant maintenance expense due to workforce reductions and the reduction of contract labor at the Cook Nuclear Plant.

The increases in federal income tax expense attributable to operations was primarily due to an increase in pre-tax operating income and changes in certain book/tax differences accounted for on a flow-through basis and in 1995 the effects of accrual adjustments for prior year tax returns.

Nonoperating Income

Nonoperating income decreased in 1996 due to the cost of the AEP branding program and startup costs of the new business ventures. The increase in nonoperating income in 1995 was mainly due to a 1994 loss of $8.2 million on a demand side management investment.

Interest Charges and Preferred Stock Dividend Requirements

In 1996 interest charges and preferred stock dividend requirements decreased as the Company's subsidiaries continued their refinancing programs. The programs reduced the average interest rate and the amount of long-term debt and preferred stock outstanding. The cost of short-term borrowings in 1996 increased slightly reflecting an increased average balance of short-term debt outstanding.

Interest charges increased in 1995 mainly due to an increase in interest on short-term debt resulting from a higher average interest rate in 1995 on larger levels of outstanding short-term debt.

Common Dividend Remains Constant; Payout Ratio Decreases

The Company paid a quarterly dividend in 1996 of 60 cents a share maintaining the annual dividend rate at $2.40 per share. The payout ratio continued an improving trend to 76% in 1996 from 84% in 1995 and 89% in 1994. It has been a management objective to reduce the payout ratio through efforts to increase earnings in order to enhance AEP's ability to invest in new business ventures that complement our core competencies and can maintain and improve shareholder value.

Liquidity and Capital Resources

Electric utility construction expenditures in the United States have been declining in recent years due to slow growth in the demand for electricity, environmental restrictions, and delays in obtaining approvals to construct transmission facilities. Demand-side management programs such as direct load control, interruptible load, energy efficiency, and other demand and load reduction programs have lessened the need for new plant expenditures. Also in some parts of the country substantial portions of new generation additions have been by non-utility entities. AEP's construction expenditures have followed the industry trend and have been generally declining since 1991 when we last completed a new generating facility. Our electric generating plant expenditures for 1996 accounted for only 27% of the total electric utility plant expenditures, as compared to the historic level of investment in electric generating plant of 49%. Transmission and distribution (T&D) expenditures, on the other hand, accounted for approximately 68% of expenditures, compared with the historic investment level of 46%. Construction expenditures for our domestic utility operations are estimated to be $2 billion over the next three years with no major plant construction planned for our service territory. Total T&D expenditures will be related to the improvement of and additions to delivery facilities. Approximately 88% of the domestic construction expenditures for the next three years will be financed internally. Allowance for funds used during construction (AFUDC) accruals also declined during this period. The decline in AFUDC in recent years is primarily due to the decrease in the level of generation plant construction combined with a decrease in interest rates.

The operating subsidiaries generally issue short-term debt to provide for interim financing of capital expenditures that exceed internally generated funds. They periodically reduce their outstanding short-term debt through issuances of long-term debt and historically preferred stock and with additional capital contributions by the parent company. In 1996 short-term borrowing decreased by $45 million. At December 31, 1996 American Electric Power Co., Inc. (the parent company) and its utility subsidiaries had unused short-term lines of credit of $409 million, and several of AEP's subsidiaries engaged in providing non-regulated energy services had an unused line of credit of $100 million available under a revolving credit agreement. In February 1997 the credit available under the revolving credit agreement was increased to $500 million. The sources of funds available to the parent company are dividends from its subsidiaries, short-term and long-term borrowings and, when necessary, proceeds from the issuance of common stock. The parent company issued 1,600,000 shares in 1996, 1,400,000 shares in 1995 and 700,000 shares in 1994 of common stock through a Dividend Reinvestment Program raising $65 million, $49 million and $22 million, respectively. As a result of the common stock issuances and the reduction in long-term debt over the past several years, the common equity to capitalization ratio has steadily improved. At December 31, 1996 the ratio increased to 45.3% from 43.1% at year-end 1995 and from 42.1% at year-end 1994.

The debt and preferred stock coverages of the principal operating subsidiaries remained strong in 1996.

Coverages at December 31, 1996

	Mortgage and Long-term Debt	Preferred Stock
Appalachian Power Co.	3.98	1.99
Columbus Southern Power Co.	4.44	N/A
Indiana Michigan Power Co.	6.66	3.07
Kentucky Power Co.	3.22	N/A
Ohio Power Co.	6.62	3.63

N/A = Not Applicable

Unless the subsidiaries meet certain earnings or coverage tests, they cannot issue additional mortgage bonds or preferred stock. In order to issue mortgage bonds (without refunding existing debt), each subsidiary must have pre-tax earnings equal to at least two times the annual interest charges on mortgage bonds after giving effect to the issuance of the new debt. Generally, issuance of additional preferred stock requires after-tax gross income at least equal to one and one-half times annual interest and preferred stock dividend requirements after giving effect to the issuance of the new preferred stock. The subsidiaries presently exceed these minimum coverage requirements.

In January 1997 the Company announced a tender offer for certain subsidiaries' preferred stock in conjunction with special meetings scheduled to be held on February 28, 1997. The special meetings' purpose is to consider amendments to the subsidiaries' articles of incorporation to remove certain capitalization ratio requirements. These restrictions limit the subsidiaries' financial flexibility and could place them at a competitive disadvantage in the future. The amount paid to redeem the preferred stock that is tendered could total as much as $514 million. The subsidiaries expect to use a combination of short-term debt and unsecured long-term debt to pay for the preferred stock tendered.

Litigation

AEP is involved in a number of legal proceedings and claims. While we are unable to predict the outcome of such litigation, it is not expected that the ultimate resolution of these matters will have a material adverse effect on the results of operations and/or financial condition.

Effect of Inflation

Inflation affects AEP's cost of replacing utility plant and the cost of operating and maintaining its plant. The rate-making process limits our recovery to the historical cost of assets resulting in economic losses when the effects of inflation are not recovered from customers on a timely basis. However, economic gains that results from the repayment of long-term debt with inflated dollars partly offset such losses.

Corporate Owned Life Insurance

In connection with the audit of AEP's 1991, 1992 and 1993 federal income tax returns the Internal Revenue Service agents sought a ruling from the IRS National Office that certain interest deductions relating to a corporate owned life insurance (COLI) program should not be allowed. The Company established the COLI program in 1990 as a part of its strategy to fund and reduce the cost of medical benefits for retired employees. AEP filed a brief with the IRS National Office refuting the agents' position. Although no adjustments have been proposed, a disallowance of the COLI interest deductions through December 31, 1996 would reduce earnings by approxiately $247 million (including interest). AEP believes it will ultimately prevail on this issue and will vigorously contest any disallowance that may be assessed.

In 1996 Congress enacted legislation that prospectively phases out the tax benefits for COLI interest deductions over a three year period beginning in 1996. As a result the Company intends to restructure its COLI program. The restructuring of the COLI program is not expected to have a material impact on results of operations.

New Accounting Rules

In 1996 the Financial Accounting Standards Board (FASB) issued an exposure draft "Accounting for Certain Liabilities Related to Closure or Removal of Long-Lived Assets." The proposal suggests that the present value of decommissioning and certain other closure or removal obligations be recorded as a liability when the obligation is incurred. A corresponding asset would be recorded in the plant investment account and recovered through depreciation charges over the asset's life. A proposed transition rule would require that an entity report in income the cumulative effect of initially applying the new standard. The FASB is reconsidering the exposure draft proposal. It is unclear at this time in what manner the FASB will adopt the proposal. Until it becomes apparent what the FASB will decide and how certain questions raised by the exposure draft are resolved the Company cannot determine its impact.

AMERICAN ELECTRIC POWER COMPANY, INC. AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENTS OF INCOME

(in thousands - except per share amounts)

	Year Ended December 31,		
	1996	1995	1994
OPERATING REVENUES	$5,849,234	$5,670,330	$5,504,670
OPERATING EXPENSES:			
Fuel and Purchased Power	1,686,754	1,625,531	1,745,245
Other Operation	1,210,027	1,184,158	1,002,822
Maintenance	502,841	541,825	544,312
Depreciation and Amortization	600,851	593,019	572,189
Taxes Other Than Federal Income Taxes	498,567	489,223	494,210
Federal Income Taxes	342,222	272,027	213,399
TOTAL OPERATING EXPENSES	4,841,262	4,705,783	4,572,177
OPERATING INCOME	1,007,972	964,547	932,493
NONOPERATING INCOME	2,212	20,204	11,485
INCOME BEFORE INTEREST CHARGES AND PREFERRED DIVIDENDS	1,010,184	984,751	943,978
INTEREST CHARGES (net)	381,328	400,077	389,240
PREFERRED STOCK DIVIDEND REQUIREMENTS OF SUBSIDIARIES	41,426	54,771	54,726
NET INCOME	$ 587,430	$ 529,903	$ 500,012
AVERAGE NUMBER OF SHARES OUTSTANDING	187,321	185,847	184,666
EARNINGS PER SHARE	$3.14	$2.85	$2.71
CASH DIVIDENDS PAID PER SHARE	$2.40	$2.40	$2.40

CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

(in thousands)

	Year Ended December 31,		
	1996	1995	1994
RETAINED EARNINGS JANUARY 1	$1,409,645	$1,325,581	$1,269,283
NET INCOME	587,430	529,903	500,012
DEDUCTIONS:			
Cash Dividends Declared	449,353	445,831	443,101
Other	(24)	8	613
RETAINED EARNINGS DECEMBER 31	$1,547,746	$1,409,645	$1,325,581

See Notes to Consolidated Financial Statements.

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AMERICAN ELECTRIC POWER COMPANY, INC. AND SUBSIDIARY COMPANIES

CONSOLIDATED BALANCE SHEETS

(In Thousands - Except Share Data)

	December 31, 1996	December 31, 1995
ASSETS		
ELECTRIC UTILITY PLANT:		
Production	$ 9,341,849	$ 9,238,843
Transmission	3,380,258	3,316,664
Distribution	4,402,449	4,184,251
General (including mining assets and nuclear fuel)	1,491,781	1,442,086
Construction Work in Progress	353,832	314,118
Total Electric Utility Plant	18,970,169	18,495,962
Accumulated Depreciation and Amortization	7,549,798	7,111,123
NET ELECTRIC UTILITY PLANT	11,420,371	11,384,839
OTHER PROPERTY AND INVESTMENTS	892,674	825,781
CURRENT ASSETS:		
Cash and Cash Equivalents	57,539	79,955
Accounts Receivable:		
Customers (less allowance for uncollectible accounts of $3,692 in 1996 and $5,430 in 1995)	415,413	417,854
Miscellaneous	115,919	74,429
Fuel - at average cost	235,257	271,933
Materials and Supplies - at average cost	251,896	251,051
Accrued Utility Revenues	174,966	207,919
Prepayments and Other	103,891	98,717
TOTAL CURRENT ASSETS	1,354,881	1,401,858
REGULATORY ASSETS	1,889,482	1,979,446
DEFERRED CHARGES	328,139	310,377
TOTAL	$15,885,547	$15,902,301

See Notes to Consolidated Financial Statements.

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AMERICAN ELECTRIC POWER COMPANY, INC. AND SUBSIDIARY COMPANIES

CONSOLIDATED BALANCE SHEETS

	December 31, 1996	December 31, 1995
CAPITALIZATION AND LIABILITIES		
CAPITALIZATION:		
Common Stock-Par Value $6.50:		
1996 / 1995		
Shares Authorized. .300,000,000 / 300,000,000		
Shares Issued . . . . .197,234,992 / 195,634,992		
(8,999,992 shares were held in treasury)	$ 1,282,027	$ 1,271,627
Paid-in Capital	1,715,554	1,658,524
Retained Earnings	1,547,746	1,409,645
Total Common Shareholders' Equity	4,545,327	4,339,796
Cumulative Preferred Stocks of Subsidiaries:*		
Not Subject to Mandatory Redemption	90,323	148,240
Subject to Mandatory Redemption	509,900	515,085
Long-term Debt*	4,796,768	4,920,329
TOTAL CAPITALIZATION	9,942,318	9,923,450
OTHER NONCURRENT LIABILITIES	1,002,208	884,707
CURRENT LIABILITIES:		
Preferred Stock and Long-term Debt Due Within One Year*	86,942	144,597
Short-term Debt	319,695	365,125
Accounts Payable	206,227	220,142
Taxes Accrued	414,173	420,192
Interest Accrued	75,124	80,848
Obligations Under Capital Leases	89,553	89,692
Other	304,323	304,466
TOTAL CURRENT LIABILITIES	1,496,037	1,625,062
DEFERRED INCOME TAXES	2,643,143	2,656,651
DEFERRED INVESTMENT TAX CREDITS	404,050	430,041
DEFERRED GAIN ON SALE AND LEASEBACK - ROCKPORT PLANT UNIT 2	240,598	249,875
DEFERRED CREDITS	157,193	132,515
CONTINGENCIES (Note 4)		
TOTAL	$15,885,547	$15,902,301

*See Accompanying Schedules on pages 36 - 37.

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AMERICAN ELECTRIC POWER COMPANY, INC. AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Year Ended December 31, 1996	1995	1994
OPERATING ACTIVITIES:			
Net Income	$ 587,430	$ 529,903	$ 500,012
Adjustments for Noncash Items:			
Depreciation and Amortization	590,657	578,003	561,188
Deferred Federal Income Taxes	(21,478)	11,916	(16,033)
Deferred Investment Tax Credits	(25,808)	(25,819)	(31,275)
Amortization of Operating Expenses and Carrying Charges (net)	55,458	53,479	16,022
Changes in Certain Current Assets and Liabilities:			
Accounts Receivable (net)	(39,049)	(71,804)	34,302
Fuel, Materials and Supplies	35,831	457	(1,627)
Accrued Utility Revenues	32,953	(40,433)	2,419
Accounts Payable	(13,915)	(31,044)	(7,959)
Taxes Accrued	(6,019)	37,515	(26,521)
Other (net)	41,002	14,437	(52,803)
Net Cash Flows From Operating Activities	1,237,062	1,056,610	977,725
INVESTING ACTIVITIES:			
Construction Expenditures	(577,691)	(605,974)	(643,457)
Proceeds from Sale of Property and Other	12,283	20,567	49,802
Net Cash Flows Used For Investing Activities	(565,408)	(585,407)	(593,655)
FINANCING ACTIVITIES:			
Issuance of Common Stock	65,461	48,707	22,256
Issuance of Cumulative Preferred Stock	-	-	88,787
Issuance of Long-term Debt	407,291	523,476	411,869
Retirement of Cumulative Preferred Stock	(70,761)	(158,839)	(35,949)
Retirement of Long-term Debt	(601,278)	(469,767)	(445,636)
Change in Short-term Debt (net)	(45,430)	48,140	38,009
Dividends Paid on Common Stock	(449,353)	(445,831)	(443,101)
Net Cash Flows Used For Financing Activities	(694,070)	(454,114)	(363,765)
Net Increase (Decrease) in Cash and Cash Equivalents	(22,416)	17,089	20,305
Cash and Cash Equivalents January 1	79,955	62,866	42,561
Cash and Cash Equivalents December 31	$ 57,539	$ 79,955	$ 62,866

See Notes to Consolidated Financial Statements.

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1. Significant Accounting Policies:

The American Electric Power System (AEP, AEP System or the Company) is a public utility engaged in the generation, purchase, transmission and distribution of electric power to over 2.9 million retail customers in its seven state service territory which covers portions of Ohio, Michigan, Indiana, Kentucky, West Virginia, Virginia and Tennessee. Electric power is also supplied at wholesale to neighboring utility systems and power marketers.

The organization of the AEP System consists of American Electric Power Company, Inc., the parent holding company; seven electric utility operating companies (utility subsidiaries); a generating subsidiary, AEP Generating Company (AEPGEN); a service company, American Electric Power Service Corporation (AEPSC); three active coal-mining companies and a group of subsidiaries that complement utility activities. The following utility subsidiaries pool their generating and transmission facilities and operate them as an integrated system:

- Appalachian Power Company (APCo)
- Columbus Southern Power Company (CSPCo)
- Indiana Michigan Power Company (I&M)
- Kentucky Power Company (KEPCo)
- Ohio Power Company (OPCo)

The remaining two utility subsidiaries, Kingsport Power Company and Wheeling Power Company, are distribution companies that purchase power from APCo and OPCo, respectively. AEPSC provides management and professional services to the AEP System. The active coal-mining companies are wholly-owned by OPCo and sell most of their production to OPCo. AEPGEN has a 50% interest in the Rockport Plant which is comprised of two of the AEP System's six 1,300 megawatt (mw) generating units. The group of subsidiaries that complement utility activities are engaged in providing non-regulated energy services and are seeking and considering new business opportunities domestically and internationally that will permit AEP to utilize its expertise and core competencies.

Effective January 1, 1996, AEPSC and the seven utility subsidiaries began operating as American Electric Power. There has been no change to the legal names of these companies. The AEP System's operations are divided into major business units which are managed centrally by AEPSC.

Rate Regulation - The AEP System is subject to regulation by the Securities and Exchange Commission (SEC) under the Public Utility Holding Company Act of 1935 (1935 Act). The rates charged by the utility subsidiaries are approved by the Federal Energy Regulatory Commission (FERC) or one of the state utility commissions as applicable. The FERC regulates wholesale rates and the state commissions regulate retail rates.

Principles of Consolidation - The consolidated financial statements include American Electric Power Company, Inc. (AEPCo., Inc.) and its wholly-owned subsidiaries consolidated with their wholly-owned subsidiaries. Significant intercompany items are eliminated in consolidation.

Basis of Accounting - As the owner of cost-based rate-regulated electric public utility companies, AEPCo., Inc.'s consolidated financial statements reflect the actions of regulators that result in the recognition of revenues and expenses in different time periods than enterprises that are not rate regulated. In accordance with Statement of Financial Accounting Standards (SFAS) No. 71, "Accounting for the Effects of Certain Types of Regulation," regulatory assets (deferred expenses) and regulatory liabilities (deferred income) are recorded to reflect the economic effects of regulation.

Use of Estimates - The preparation of these financial statements in conformity with generally accepted accounting principles requires in certain instances the use of management's estimates. Actual results could differ from those estimates.

Utility Plant - Electric utility plant is stated at original cost and is generally subject to first mortgage liens. Additions, major replacements and betterments are added to the plant accounts. Retirements from the plant accounts and associated removal costs, net of salvage, are deducted from accumulated depreciation. The costs of labor, materials and overheads incurred to operate and maintain utility plant are included in operating expenses.

Allowance for Funds Used During Construction (AFUDC) - AFUDC is a noncash nonoperating income item that is recovered over the service life of utility plant through depreciation and represents the estimated cost of borrowed and equity funds used to finance construction projects. The average rates used to accrue AFUDC were 6.09%, 6.91%, and 6.59% in 1996, 1995 and 1994, respectively.

Depreciation, Depletion and Amortization - Depreciation is provided on a straight-line basis over the estimated useful lives of property other than coal-mining property and is calculated largely through the use of composite rates by functional class as follows:

Functional Class of Property	Composite Depreciation Annual Rates
Production:	
Steam-Nuclear	3.4%
Steam-Fossil-Fired	3.2% to 4.4%
Hydroelectric-Conventional and Pumped Storage	2.7% to 3.2%
Transmission	1.7% to 2.7%
Distribution	3.3% to 4.2%
General	2.5% to 3.8%

The utility subsidiaries presently recover amounts to be used for demolition of non-nuclear plant through depreciation charges included in rates. Depreciation, depletion and amortization of coal-mining assets is provided over each asset's estimated useful life, ranging up to 30 years, and is calculated using the straight-line method for mining structures and equipment. The units-of-production method is used to amortize coal rights and mine development costs based on estimated recoverable tonnages at a current average rate of $1.49 per ton. These costs are included in the cost of coal charged to fuel expense.

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

Sale of Receivables - Under an agreement that was terminated in January 1997, CSPCo sold $50 million of undivided interests in designated pools of accounts receivable and accrued utility revenues with limited recourse. As collections reduced previously sold pools, interests in new pools were sold. At December 31, 1996, 1995 and

1994, $50 million remained to be collected and remitted to the buyer.

Operating Revenues - Revenues include the accrual of electricity consumed but unbilled at month-end as well as billed revenues.

Fuel Costs - Fuel costs are matched with revenues in accordance with rate commission orders. Generally in the retail jurisdictions, changes in fuel costs are deferred or revenues accrued until approved by the regulatory commission for billing or refund to customers in later months. Wholesale jurisdictional fuel cost changes are expensed and billed as incurred.

Levelization of Nuclear Refueling Outage Costs - Incremental operation and maintenance costs associated with refueling outages at I&M's Donald C. Cook Nuclear Plant (Cook Plant) are deferred and amortized over the period (generally eighteen months) beginning with the commencement of an outage and ending with the beginning of the next outage.

Income Taxes - The Company follows the liability method of accounting for income taxes as prescribed by SFAS 109, "Accounting for Income Taxes." Under the liability method, deferred income taxes are provided for all temporary differences between book cost and tax basis of assets and liabilities which will result in a future tax consequence. Where the flow-through method of accounting for temporary differences is reflected in rates, deferred income taxes are recorded with related regulatory assets and liabilities in accordance with SFAS 71.

Investment Tax Credits - Investment tax credits have been accounted for under the flow-through method except where regulatory commissions have reflected investment tax credits in the rate-making process on a deferral basis. Deferred investment tax credits are being amortized over the life of the related plant investment.

Debt and Preferred Stock - Gains and losses on reacquired debt are deferred and amortized over the remaining term of the reacquired debt in accordance with rate-making treatment. If the debt is refinanced the reacquisition costs are deferred and amortized over the term of the replacement debt commensurate with their recovery in rates.

Debt discount or premium and debt issuance expenses are amortized over the term of the related debt, with the amortization included in interest charges.

Redemption premiums paid to reacquire preferred stock are included in paid-in capital and amortized to retained earnings in accordance with rate-making treatment. The excess of par value over costs of preferred stock reacquired to meet sinking fund requirements is credited to paid-in capital and amortized to retained earnings.

Other Property and Investments - Excluding decommissioning and spent nuclear fuel disposal trust funds, other property and investments are stated at cost. Securities held in trust funds for decommissioning nuclear facilities and for the disposal of spent nuclear fuel are recorded at market value in accordance with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities." Securities in the trust funds have been classified as available-for-sale due to their long-term purpose. Due to the rate-making process, adjustments for unrealized gains and losses are not reported in equity but result in adjustments to regulatory assets and liabilities.

2. Rate Matters:

Recovery of Fuel Costs - Under the terms of a 1992 stipulation agreement the cost of coal burned at the Gavin Plant is subject to a 15-year predetermined price of $1.575 per million Btu's with quarterly escalation adjustments through November 2009. A 1995 Settlement Agreement set the fuel component of the EFC factor at 1.465 cents per kwh for the period June 1, 1995 through November 30, 1998 and reserved certain items including emission allowances for later consideration in determining total fuel recovery. The agreements provide OPCo with the opportunity to recover over the term of the stipulation agreement the Ohio jurisdictional share of OPCo's investment in and the liabilities and future shut-down costs of its affiliated mines as well as any fuel costs incurred above the fixed rate to the extent the actual cost of coal burned at the Gavin Plant is below the predetermined price. After November 2009 the price that OPCo can recover for coal from its affiliated Meigs mine which supplies the Gavin Plant will be limited to the lower of cost or the then-current market price. Pursuant to these agreements the Company has deferred $28.5 million for future recovery at December 31, 1996.

Based on the estimated future cost of coal burned at Gavin Plant, management believes that the Ohio jurisdictional portion of the investment in and liabilities and closing costs of the affiliated mining operations including deferred amounts will be recovered under the terms of the predetermined price agreement. Management intends to seek from non-Ohio jurisdictional ratepayers recovery of the non-Ohio jurisdictional portion of the investment in and the liabilities and closing costs of the affiliated Meigs, Muskingum and Windsor mines. The non-Ohio jurisdictional portion of shutdown costs for these mines which includes the investment in the mines, leased asset buy-outs, reclamation costs and employee benefits is estimated to be approximately $180 million after tax at December 31, 1996.

The affiliated Muskingum and Windsor mines may have to close by January 2000 in order to comply with the Phase II requirements of the Clean Air Act Amendments of 1990. The Muskingum and/or Windsor mines could close prior to January 2000 depending on the economics of continued operation under the terms of the above Settlement Agreement. Unless future shutdown costs and/or the cost of affiliated coal production of the Meigs, Muskingum and Windsor mines can be recovered, results of operations would be adversely affected.

3. Effects of Regulation and Phase-In Plans:

In accordance with SFAS 71 the consolidated financial statements include assets (deferred expenses) and liabilities (deferred income) recorded in accordance with regulatory actions to match expenses and revenues in cost-based rates. Regulatory assets are expected to be recovered in future periods through the rate-making process and the regulatory liabilities are expected to reduce future cost recoveries. The Company has reviewed all the evidence currently available and concluded that it continues to meet the requirements to apply SFAS 71. In the event a portion of the Company's business no longer met these requirements net regulatory assets would have to be written off for that portion of the business.

Regulatory assets and liabilities are comprised of the following at:

	December 31, 1996	December 31, 1995
	(In Thousands)	
Regulatory Assets:		
Amounts Due From Customers For Future Income Taxes	$1,459,086	$1,446,485
Rate Phase-in Plan Deferrals	27,249	74,402
Unamortized Loss on Reacquired Debt	107,305	109,551
Other	295,842	349,008
Total Regulatory Assets	$1,889,482	$1,979,446
Regulatory Liabilities:		
Deferred Investment Tax Credits	$404,050	$430,041
Other Regulatory Liabilities*	86,609	86,347
Total Regulatory Liabilities	$490,659	$516,388

* Included in Deferred Credits on Consolidated Balance Sheets

The rate phase-in plan deferrals are applicable to the Zimmer Plant and Rockport Plant Unit 1. The Zimmer Plant is a 1,300 mw coal-fired plant which commenced commercial operation in 1991. CSPCo owns 25.4% of the plant with the remainder owned by two unaffiliated companies. In May 1992 the Public Utilities Commission of Ohio (PUCO) issued an order providing for a phased in rate increase of $123 million to be implemented in three steps over a two-year period and disallowed $165 million of Zimmer Plant investment. CSPCo appealed the PUCO ordered Zimmer disallowance and phase-in plan to the Ohio Supreme Court. In November 1993 the Supreme Court issued a decision on CSPCo's appeal affirming the disallowance and finding that the PUCO did not have statutory authority to order phased-in rates. The Court instructed the PUCO to fix rates to provide gross annual revenues in accordance with the law and to provide a mechanism to recover the amounts deferred as regulatory assets under the phase-in order.

As a result of the Supreme Court decision, in January 1994 the PUCO approved a 7.11% rate increase effective February 1, 1994. The increase is comprised of a 3.72% base rate increase to complete the rate increase phase-in and a temporary 3.39% surcharge, which will be in effect until the deferrals are recovered, estimated to be 1997. In 1996, 1995 and 1994 $31.5 million, $28.5 million and $18.5 million, respectively, of net phase-in deferrals were collected through the surcharge. The deferrals were $15.4 million at December 31, 1996 and $46.9 million at December 31, 1995. The recovery of amounts deferred under the phase-in plan and the increase in rates to the full rate level did not affect net income. From the in-service date of March 1991 until rates went into effect in May 1992 deferred carrying charges of $43 million were recorded on the Zimmer Plant investment. Recovery of the deferred carrying charges will be sought in the next PUCO base rate proceeding in accordance with the PUCO accounting order that authorized the deferral.

The Rockport Plant consists of two 1,300 mw coal-fired units. I&M and AEPGEN each own 50% of one unit (Rockport 1) and lease a 50% interest in the other unit (Rockport 2) from unaffiliated lessors under an operating lease. The gain on the sale and leaseback of Rockport 2 was deferred and is being amortized, with related taxes, over the initial lease term which expires in 2022. Rate phase-in plans in I&M's Indiana and FERC jurisdictions for its share of Rockport 1 provide for the recovery and straight-line amortization through 1997 of prior-year cost deferrals. Unamortized deferred amounts under the phase-in plans were $11.9 million and $27.5 million at December 31, 1996 and 1995, respectively. Amortization was $16 million in 1996, 1995 and 1994.

4. Commitments and Contingencies:

Construction and Other Commitments - The AEP System has made substantial construction commitments for utility operations. Such commitments do not presently include any expenditures for new generating capacity. The aggregate construction program expenditures for 1997-1999 are estimated to be $2 billion.

Long-term fuel supply contracts contain clauses for periodic adjustments, and most jurisdictions have fuel clause mechanisms that provide for recovery of changes in the cost of fuel with the regulators' review and approval. The contracts are for various terms, the longest of which extend to the year 2014, and contain various clauses that would release the Company from its obligation under certain force majeure conditions.

The AEP System has contracted to sell up to 1,350 mw of capacity on a long-term basis to unaffiliated utilities. Certain contracts totaling 705 mw of capacity are unit power agreements requiring the delivery of energy regardless of whether the unit capacity is available. The power sales contracts expire from 1997 to 2010.

Tender Offer - On February 24, 1997 AEP and Public Service Company of Colorado with equal interests in a joint venture announced a cash tender offer for Yorkshire Electricity Group plc in the United Kingdom. The joint venture proposes to pay $2.4 billion to acquire all of the stock of Yorkshire Electricity. AEP's equity investment, estimated to be $360 million, will be made through its subsidiary AEP Resources Inc., initially using cash borrowed under a revolving credit agreement.

Nuclear Plant - I&M owns and operates the two-unit 2,110 mw Cook Nuclear Plant under licenses granted by the Nuclear Regulatory Commission. The operation of a nuclear facility involves special risks, potential liabilities, and specific regulatory and safety requirements. Should a nuclear incident occur at any nuclear power plant facility in the United States, the resultant liability could be substantial. By agreement I&M is partially liable together with all other electric utility companies that own nuclear generating units for a nuclear power plant incident. In the event nuclear losses or liabilities are underinsured or exceed accumulated funds and recovery in rates is not possible, results of operations and financial condition could be negatively affected.

Nuclear Incident Liability - Public liability is limited by law to $8.9 billion should an incident occur at any licensed reactor in the United States. Commercially available insurance provides $200 million of coverage. In the event of a nuclear incident at any nuclear plant in the United States the remainder of the liability would be provided by a deferred premium assessment of $79.3 million on each licensed reactor payable in annual installments of $10 million. As a result, I&M could be assessed $158.6 million per nuclear incident payable in annual installments of $20 million. The number of incidents for which payments could be required is not limited.

Nuclear insurance pools and other insurance policies provide $3.6 billion of property damage, decommissioning and decontamination coverage for the Cook Plant. Additional insurance provides coverage for extra costs resulting from a prolonged accidental Cook Plant outage. Some of the policies have deferred premium provisions which could be triggered by losses in excess of the insurer's resources. The losses could result from claims at the Cook Plant or certain other non-affiliated nuclear units. I&M could be assessed up to $35.8 million under these policies.

Spent Nuclear Fuel Disposal - Federal law provides for government responsibility for permanent spent nuclear fuel disposal and assesses nuclear plant owners fees for spent fuel disposal. A fee of one mill per kilowatthour for fuel consumed after April 6, 1983 is being collected from customers and remitted to the U.S. Treasury. Fees and related interest of $172 million for fuel consumed prior to April 7, 1983 have been recorded as long-term debt. I&M has not paid the government the pre-April 1983 fees due to continued delays and uncertainties related to the federal disposal program. At December 31, 1996, funds collected from customers towards payment of the pre-April 1983 fee and related earnings thereon approximate the liability.

Decommissioning and Low Level Waste Accumulation Disposal - Decommissioning costs are accrued over the service life of the Cook Plant. The licenses to operate the two nuclear units expire in 2014 and 2017. After expiration of the licenses the plant is expected to be decommissioned through dismantlement. The Company's latest estimate for decommissioning and low level radioactive waste accumulation disposal costs range from $634 million to $988 million in 1993 nondiscounted dollars. The wide range is caused by variables in assumptions including the estimated length of time spent nuclear fuel must be stored at the plant subsequent to ceasing operations. This in turn depends on future developments in the federal government's spent nuclear fuel disposal program. Continued delays in the federal fuel disposal program can result in increased decommissioning costs. I&M is recovering estimated decommissioning costs in its three rate-making jurisdictions based on at least the lower end of the range in the most recent decommissioning study at the time of the last rate proceeding. I&M records decommissioning costs in other operation expense and records a noncurrent liability equal to the decommissioning cost recovered in rates; such amount was $27 million in 1996, $30 million in 1995 including $4 million of special deposits and $26 million in 1994. Decommissioning costs recovered from customers are deposited in external trusts. Trust fund earnings increase the fund assets and the recorded liability and decrease the amount needed to be recovered from ratepayers. At December 31, 1996 I&M has recognized a decommissioning liability of $314 million which is included in other noncurrent liabilities.

Litigation - The Company is involved in a number of legal proceedings and claims. While management is unable to predict the ultimate outcome of litigation, it is not expected that the resolution of these matters will have a material adverse effect on the results of operations or financial condition.

5. Dividend Restrictions:

Mortgage indentures, charter provisions and orders of regulatory authorities place various restrictions on the use of the subsidiaries' retained earnings for the payment of cash dividends on their common stocks. At December 31, 1996, $30 million of retained earnings were restricted. To pay dividends out of paid-in capital the subsidiaries need regulatory approval.

6. Lines of Credit and Commitment Fees:

At December 31, 1996 and 1995 unused short-term bank lines of credit were available in the amounts of $409 million and $372 million, respectively. Commitment fees of approximately 1/8 of 1% of the unused short-term lines of credit are required to maintain the lines of credit. In addition several of the subsidiaries engaged in providing non-regulated energy services share a $100 million line of credit under a revolving credit agreement which requires the payment of a commitment fee of approximately 1/8 of 1% of the unused balance. At December 31, 1996 no borrowings were outstanding under the revolving credit agreement. In February 1997 the credit available under this agreement was increased to $500 million.

Outstanding short-term debt consisted of:

(Dollars In Thousands)	December 31, 1996	December 31, 1995
Balance Outstanding:		
Notes Payable	$ 91,293	$ 128,425
Commercial Paper	228,402	236,700
Total	$319,695	$365,125
Year-End Weighted Average Interest Rate:		
Notes Payable	6.2%	6.1%
Commercial Paper	7.2%	6.1%
Total	6.9%	6.1%

7. Benefit Plans:

AEP System Pension Plan - The AEP pension plan is a trusteed, noncontributory defined benefit plan covering all employees meeting eligibility requirements, except participants in the United Mine Workers of America (UMWA) pension plans. Benefits are based on service years and compensation levels. The funding policy is to make annual contributions to a qualified trust fund equal to the net periodic pension cost up to the maximum amount deductible for federal income taxes, but not less than the minimum required contribution in accordance with the Employee Retirement Income Security Act of 1974.

Net AEP pension plan costs were computed as follows:

	Year Ended December 31,		
	1996	1995	1994
	(In Thousands)		
Service Cost-Benefits Earned During the Year	$ 40,000	$ 30,400	$ 40,000
Interest Cost on Projected Benefit Obligation	119,500	116,700	114,500
Actual Return on Plan Assets	(302,400)	(416,800)	(6,700)
Net Amortization (Deferral)	161,800	281,800	(123,300)
Net AEP Pension Plan Costs	$ 18,900	$ 12,100	$ 24,500

AEP pension plan assets and actuarially computed benefit obligations are:

	December 31,	
	1996	1995
	(In Thousands)	
AEP Pension Plan Assets at Fair Value (a)	$2,009,500	$1,805,300
Actuarial Present Value of Benefit Obligation:		
Vested	1,377,000	1,321,600
Nonvested	136,500	147,400
Accumulated Benefit Obligation	1,513,500	1,469,000
Effects of Salary Progression	162,700	181,000
Projected Benefit Obligation	1,676,200	1,650,000
Funded Status - AEP Pension Plan Assets in Excess of Projected Benefit Obligation	333,300	155,300
Unrecognized Prior Service Cost	133,200	147,000
Unrecognized Net Gain	(488,200)	(295,200)
Unrecognized Net Transition Assets (Being Amortized Over 17 Years)	(68,900)	(78,700)
Accrued Net AEP Pension Plan Liability	$ (90,600)	$ (71,600)

(a) AEP pension plan assets primarily consist of common stocks, bonds and cash equivalents and are included in a separate entity trust fund.

Assumptions used to determine AEP pension plan's funded status were:

	December 31,		
	1996	1995	1994
Discount Rate	7.75%	7.25%	8.5%
Average Rate of Increase in Compensation Levels	3.2%	3.2%	3.2%
Expected Long-Term Rate of Return on Plan Assets	9.0%	9.0%	8.5%

AEP System Savings Plan - An employee savings plan is offered to non-UMWA employees which allows participants to contribute up to 17% of their salaries into various investment alternatives, including AEP common stock. An employer matching contribution, equaling one-half of the employees' contribution to the plan up to a maximum of 3% of the employees' base salary, is invested in AEP common stock. The employer's annual contributions totaled $19 million in 1996, $18.8 million in 1995 and $18.6 million in 1994.

UMWA Pension Plans - The coal-mining subsidiaries of OPCo provide UMWA pension benefits for UMWA employees meeting eligibility requirements. Benefits are based on age at retirement and years of service. As of June 30, 1996, the UMWA actuary estimates the OPCo coal-mining subsidiaries' share of the UMWA pension plans' unfunded vested liabilities was approximately $26 million. In the event the OPCo coal-mining subsidiaries cease or significantly reduce mining operations or contributions to the UMWA pension plans, a withdrawal obligation may be triggered for all or a portion of their share of the unfunded vested liability. Contributions are based on the number of hours worked, are expensed when paid and totaled $1.6 million in 1996, $1.4 million in 1995 and $1.6 million in 1994.

Postretirement Benefits Other Than Pensions (OPEB) - The AEP System provides certain other benefits for retired employees. Substantially all non-UMWA employees are eligible for postretirement health care and life insurance if they retire from active service after reaching age 55 and have at least 10 service years.

Postretirement medical benefits for UMWA employees at affiliated mining operations who have or will retire after January 1, 1976 are the liability of the OPCo coal-mining subsidiaries. They are eligible for postretirement medical benefits if they retire from active service after reaching age 55 and have at least 10 service years. In addition, non-active UMWA employees will become eligible for postretirement benefits at age 55 if they have had 20 service years.

The funding policy for AEP's plan is to make contributions to an external Voluntary Employees Beneficiary Association trust fund equal to the incremental OPEB costs (i.e., the amount that the total postretirement benefits cost under SFAS 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," exceeds the pay-as-you-go amount). Contributions were $45.8 million in 1996, $53 million in 1995 and $29.5 million in 1994. In several jurisdictions the utility subsidiaries deferred the increased OPEB costs resulting from the SFAS 106 required change from pay-as-you-go to accrual accounting which were not being recovered in rates. No additional deferrals were made in 1996. At December 31, 1996 and 1995, $14.5 million and $24.6 million, respectively, of incremental OPEB costs were deferred.

Aggregate OPEB costs were computed as follows:

	Year Ended December 31,		
	1996	1995	1994
	(In Thousands)		
Service Cost	$ 15,300	$ 13,500	$16,500
Interest Cost on Projected Benefit Obligation	53,500	54,900	47,300
Net Amortization of Transition Obligation	32,300	32,000	31,100
Return on Plan Assets	(21,100)	(25,400)	900
Net Amortization (Deferral)	9,900	16,800	(6,800)
Net OPEB Costs	$ 89,900	$ 91,800	$89,000

OPEB assets and actuarially computed benefit obligations are:

	December 31,	
	1996	1995
	(In Thousands)	
Fair Market Value of Plan Assets (a)	$ 232,500	$ 165,600
Accumulated Postretirement Benefit Obligation:		
Active Employees		
Fully Eligible for Benefits	57,800	59,200
Current Retirees	423,000	398,400
Other Active Employees	245,600	282,400
Total Benefit Obligation	726,400	740,000
Unfunded Benefit Obligation	(493,900)	(574,400)
Unrecognized Net Loss (Gain)	(3,300)	48,500
Unrecognized Net Transition Obligation Being Amortized Over 20 Years	448,500	485,600
Accrued Net OPEB Liability	$ (48,700)	$ (40,300)

(a) Plan assets consist of cash surrender value of life insurance contracts on certain employees owned by the trust and short-term tax exempt municipal bonds.

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Assumptions used to determine OPEB's funded status were:

	December 31,		
	1996	1995	1994
Discount Rate	7.75%	7.25%	8.5%
Expected Long-Term Rate of Return on Plan Assets	8.75%	8.75%	8.25%
Initial Medical Cost Trend Rate	7.5%	8.0%	8.0%
Ultimate Medical Cost Trend Rate	4.75%	4.5%	5.25%
Medical Cost Trend Rate Decreases to Ultimate Rate in Year	2005	2005	2005

Assuming a one percent increase in the medical cost trend rate, the 1996 OPEB cost for all employees, both non-UMWA and UMWA, would increase by $8 million and the accumulated benefit obligations would increase by $82 million.

Several UMWA health plans pay the postretirement medical benefits for the Company's UMWA retirees who retired before January 2, 1976 and their survivors plus retirees and others whose last employer is no longer a signatory to the UMWA contract or is no longer in business. The UMWA health plans are funded by payments from current and former UMWA wage agreement signatories, the 1950 UMWA Pension Plan surplus and the Abandoned Mine Land Reclamation Fund Surplus. Required annual payments to the UMWA health funds made by AEP's active and inactive coal-mining subsidiaries were recognized as expense when paid and totaled $0.9 million in 1996, $2.8 million in 1995 and $3.1 million in 1994.

By law, excess Black Lung Trust funds may be used to pay certain postretirement medical benefits under one of the UMWA health plans. Excess AEP Black Lung Trust funds used to reimburse the coal companies totaled $7.4 million in 1996, $7.9 million in 1995 and $6.9 million in 1994. The Black Lung Trust had excess funds at December 31, 1996 of approximately $12 million, of which $10.8 million may be used to pay future costs.

8. Fair Value of Financial Instruments:

Nuclear Trust Funds Recorded at Market Value - The trust investments, reported in other property and investments, are recorded at market value in accordance with SFAS 115 and consist of long-term tax-exempt municipal bonds and other securities.

At December 31, 1996 and 1995 the fair values of the trust investments were $491 million and $434 million, respectively. Accumulated gross unrealized holding gains were $21.9 million and $19.1 million and accumulated gross unrealized holding losses were $1.2 million and $1 million at December 31, 1996 and 1995, respectively. The change in market value in 1996 was a net unrealized holding gain of $2.6 million, in 1995 a net unrealized holding gain of $24.9 million and in 1994 a net unrealized holding loss of $27.1 million.

The trust investments' cost basis by security type were:

	December 31,	
	1996	1995
	(In Thousands)	
Tax-Exempt Bonds	$340,290	$336,073
Equity Securities	54,389	24,101
Treasury Bonds	26,958	12,992
Corporate Bonds	7,977	1,971
Cash, Cash Equivalents and Accrued Interest	40,430	40,356
Total	$470,044	$415,493

Proceeds from sales and maturities of securities of $115.3 million during 1996 resulted in $2.6 million of realized gains and

2.1 million of realized losses. Proceeds from sales and maturities of securities of $78.2 million during 1995 resulted in $1.4 million of realized gains and $0.3 million of realized losses. During 1994 proceeds from sales and maturities of securities of $20.1 million resulted in $52,000 of realized gains and $155,000 of realized losses. The cost of securities for determining realized gains and losses is original acquisition cost including amortized premiums and discounts.

At December 31, 1996, the year of maturity of trust fund investments other than equity securities, was:

	(In Thousands)
1997	$ 56,452
1998 - 2001	120,327
2002 - 2006	163,250
After 2006	75,626
Total	$415,655

Other Financial Instruments Recorded at Historical Cost - The carrying amounts of cash and cash equivalents, accounts receivable, short-term debt, and accounts payable approximate fair value because of the short-term maturity of these instruments. Fair values for preferred stock subject to mandatory redemption were $517 million and $544 million and for long-term debt were $5.0 billion and $5.3 billion at December 31, 1996 and 1995, respectively. The carrying amounts on the financial statements for preferred stock subject to mandatory redemption were $510 million and $523 million and for long-term debt were $4.9 billion and $5.1 billion at December 31, 1996 and 1995, respectively. Fair values are based on quoted market prices for the same or similar issues and the current dividend or interest rates offered for instruments of the same remaining maturities. The carrying amount of the pre-April 1983 spent nuclear fuel disposal liability approximates the Company's best estimate of its fair value.

9. Federal Income Taxes:

The details of federal income taxes as reported are as follows:

	Year Ended December 31,		
	1996	1995	1994
	(In Thousands)		
Charged *(Credited)* to Operating Expenses (net):			
Current	$375,528	$265,313	$240,655
Deferred	(17,008)	22,990	(10,177)
Deferred Investment Tax Credits	(16,298)	(16,276)	(17,079)
Total	342,222	272,027	213,399
Charged *(Credited)* to Nonoperating Income (net):			
Current	(5,636)	11,325	(2,907)
Deferred	(4,470)	(11,074)	(5,856)
Deferred Investment Tax Credits	(9,510)	(9,543)	(14,196)
Total	(19,616)	(9,292)	(22,959)
Total Federal Income Tax as Reported	$322,606	$262,735	$190,440

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

	Year Ended December 31,		
	1996	1995	1994
	(In Thousands)		
Income Before Preferred Stock Dividend Requirements of Subsidiaries	$628,856	$584,674	$554,738
Federal Income Taxes	322,606	262,735	190,440
Pre-Tax Book Income	$951,462	$847,409	$745,178
Federal Income Tax on Pre-Tax Book Income at Statutory Rate *(35%)*	$333,012	$296,593	$260,812
Increase (Decrease) in Federal Income Tax Resulting from the Following Items:			
Depreciation	50,537	46,453	31,212
Removal Costs	(15,327)	(14,640)	(13,818)
Corporate Owned Life Insurance	(12,009)	(25,506)	(22,970)
Investment Tax Credits (net)	(25,813)	(26,179)	(31,273)
Federal Income Tax Accrual Adjustments	-	-	(16,100)
Other	(7,794)	(13,986)	(17,423)
Total Federal Income Taxes as Reported	$322,606	$262,735	$190,440
Effective Federal Income Tax Rate	33.9%	31.0%	25.6%

The following tables show the elements of the net deferred tax liability and the significant temporary differences:

	December 31, 1996	December 31, 1995
	(In Thousands)	
Deferred Tax Assets	$ 784,349	$ 723,196
Deferred Tax Liabilities	(3,427,492)	(3,379,847)
Net Deferred Tax Liabilities	$(2,643,143)	$(2,656,651)
Property Related Temporary Differences	$(2,162,099)	$(2,139,387)
Amounts Due From Customers For Future Federal Income Taxes	(428,698)	(442,311)
Deferred State Income Taxes	(229,429)	(183,981)
All Other (net)	177,083	109,028
Total Net Deferred Tax Liabilities	$(2,643,143)	$(2,656,651)

The Company has settled with the Internal Revenue Service (IRS) all issues from the audits of the consolidated federal income tax returns for the years prior to 1991. Returns for the years 1991 through 1993 are presently being audited by the IRS. During the audit the IRS agents requested a ruling from their National Office that certain interest deductions relating to corporate owned life insurance (COLI) claimed by the Company for 1991 through 1993 should not be allowed. The Company filed a brief with the IRS National Office refuting the agents' position. Although no adjustments have been proposed, a disallowance of the COLI interest deductions through December 31, 1996 would reduce earnings by approximately $247 million (including interest). AEP believes it will ultimately prevail on this issue and will vigorously contest any adjustments that may be assessed. Accordingly, no provision for this amount has been recorded. In the opinion of management, the final settlement of open years will not have a material effect on results of operations.

10. Leases:

Leases of property, plant and equipment are for periods up to 35 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 are primarily charged to operating expenses in accordance with rate-making treatment. The components of rentals are as follows:

	Year Ended December 31, 1996	1995	1994
	(In Thousands)		
Operating Leases	$262,451	$259,877	$233,805
Amortization of Capital Leases	114,050	101,068	79,116
Interest on Capital Leases	28,696	27,542	23,280
Total Rental Payments	$405,197	$388,487	$336,201

Properties under capital leases and related obligations on the Consolidated Balance Sheets are as follows:

	December 31, 1996	December 31, 1995
	(In Thousands)	
ELECTRIC UTILITY PLANT:		
Production	$ 44,390	$ 44,849
Transmission	6	7
Distribution	14,699	14,753
General:		
Nuclear Fuel (net of amortization)	59,681	69,442
Mining Plant and Other	466,797	424,952
Total Electric Utility Plant	585,573	554,003
Accumulated Amortization	200,931	179,952
Net Electric Utility Plant	384,642	374,051
OTHER PROPERTY	33,439	34,536
Accumulated Amortization	3,854	3,994
Net Other Property	29,585	30,542
Net Property under Capital Leases	$414,227	$404,593
Obligations under Capital Leases	$414,227	$404,593
Less Portion Due Within One Year	89,553	89,692
Noncurrent Capital Lease Liability	$324,674	$314,901

Properties under operating leases and related obligations are not included in the Consolidated Balance Sheets.

Future minimum lease rentals, consisted of the following at December 31, 1996:

	Capital Leases		Noncancelable Operating Leases
	(In Thousands)		
1997	$ 90,813		$ 240,923
1998	73,817		232,903
1999	63,356		230,994
2000	53,027		229,039
2001	41,634		225,733
Later Years	150,278		3,858,008
Total Future Minimum Lease Rentals	472,925	(a)	$5,017,600
Less Estimated Interest Element	118,379		
Estimated Present Value of Future Minimum Lease Rentals	354,546		
Unamortized Nuclear Fuel	59,681		
Total	$414,227		

(a) Minimum lease rentals do not include nuclear fuel rentals. The rentals are paid in proportion to heat produced and carrying charges on the unamortized nuclear fuel balance. There are no minimum lease payment requirements for leased nuclear fuel.

11. SUPPLEMENTARY INFORMATION:

	Year Ended December 31, 1996	1995	1994
	(In Thousands)		
Purchased Power - Ohio Valley Electric Corp. (44.2% owned by AEP)	$22,156	$10,546	$5,755
Cash was paid for:			
Interest (net of capitalized amounts)	$373,570	$395,169	$379,361
Income Taxes	$404,297	$273,671	$312,233
Noncash Acquisitions under Capital Leases were	$136,988	$106,256	$227,055

12. CAPITAL STOCKS AND PAID-IN CAPITAL:

Changes in capital stocks and paid-in capital during the period January 1, 1994 through December 31, 1996 were:

	Shares: Common Stock-Par Value $6.50(a)	Shares: Cumulative Preferred Stocks of Subsidiaries	Common Stock (Dollars in Thousands)	Paid-in Capital (Dollars in Thousands)	Cumulative Preferred Stocks of Subsidiaries: Not Subject To Mandatory Redemption	Cumulative Preferred Stocks of Subsidiaries: Subject to Mandatory Redemption(b)
January 1, 1994	193,534,992	7,687,768	$1,257,977	$1,624,176	$ 268,240	$ 500,537
Issuances	700,000	900,000	4,550	17,706	-	90,000
Retirements and Other	-	(351,517)	-	(1,221)	(35,000)	(152)
December 31, 1994	194,234,992	8,236,251	1,262,527	1,640,661	233,240	590,385
Issuances	1,400,000	-	9,100	39,607	-	-
Retirements and Other	-	(1,526,500)	-	(21,744)	(85,000)	(67,650)
December 31, 1995	195,634,992	6,709,751	1,271,627	1,658,524	148,240	522,735
Issuances	1,600,000	-	10,400	55,061	-	-
Retirements and Other	-	(707,518)	-	1,969	(57,917)	(12,835)
December 31, 1996	197,234,992	6,002,233	$1,282,027	$1,715,554	$ 90,323	$509,900

(a) Includes 8,999,992 shares of treasury stock.
(b) Including portion due within one year.

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13. Unaudited Quarterly Financial Information:

(In Thousands - Except Per Share Amounts)	Quarterly Periods Ended 1996 March 31	June 30	Sept. 30	Dec. 31
Operating Revenues	$1,517,781	$1,400,941	$1,484,422	$1,446,090
Operating Income	292,122	220,625	259,745	235,480
Net Income	180,012	112,666	162,324	132,428
Earnings per Share	0.96	0.60	0.87	0.71

(In Thousands - Except Per Share Amounts)	Quarterly Periods Ended 1995 March 31	June 30	Sept. 30	Dec. 31
Operating Revenues	$1,416,169	$1,305,342	$1,523,390	$1,425,429
Operating Income	257,556	211,284	262,548	233,159
Net Income	147,850	96,478	154,156	131,419
Earnings per Share	0.80	0.52	0.83	0.70

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AMERICAN ELECTRIC POWER COMPANY, INC. AND SUBSIDIARY COMPANIES
SCHEDULE OF CONSOLIDATED CUMULATIVE PREFERRED STOCKS OF SUBSIDIARIES

	December 31, 1996			
	Call Price per Share (a)	Shares Authorized(b)	Shares Outstanding	Amount (in thousands)
Not Subject to Mandatory Redemption:				
4.08% - 4.56% (c)	$102-$110	932,403	903,233	$ 90,323
Subject to Mandatory Redemption (d):				
5.90% - 5.92% (c)	(e)	1,950,000	1,904,000	$190,400
6.02% - 6-7/8% (c)	(f)	1,950,000	1,945,000	194,500
7% - 7-7/8% (c)	$107.80-$107.88(g)	1,250,000	1,250,000	125,000
Total Subject to Mandatory Redemption (h)				$509,900

	December 31, 1995			
	Call Price per Share (a)	Shares Authorized	Shares Outstanding	Amount (in thousands)
Not Subject to Mandatory Redemption:				
4.08% - 4.56%	$102-$110	932,403	932,403	$ 93,240
7.08% - 7.40%	$101.85-$102.11	550,000	550,000	55,000
Total Not Subject to Mandatory Redemption				$148,240
Subject to Mandatory Redemption (d):				
4.50%	$102	19,625	2,348	$ 235
5.90% - 5.92%	(e)	1,950,000	1,950,000	195,000
6.02% - 6-7/8%	(f)	1,950,000	1,950,000	195,000
7% - 7-7/8%	$107.80-$107.88(g)	1,250,000	1,250,000	125,000
9.50%	(i)	750,000	75,000	7,500
Total Subject to Mandatory Redemption (h)				522,735
Less Portion Due Within One Year				7,650
Long-term Portion				$515,085

NOTES TO SCHEDULE OF CUMULATIVE PREFERRED STOCKS OF SUBSIDIARIES

(a) At the option of the subsidiary the shares may be redeemed at the call price plus accrued dividends. The involuntary liquidation preference is $100 per share for all outstanding shares.
(b) As of December 31, 1996 the subsidiaries had 4,708,320, 22,200,000 and 5,801,850 shares of $100, $25 and no par value preferred stock, respectively, that were authorized but unissued.
(c) In January 1997 a tender offer for certain series of preferred stock was announced. In conjunction with the tender offer a special shareholders meeting is scheduled to be held on February 28, 1997 for the purpose of considering amendments to the subsidiaries' articles of incorporation to remove certain capitalization ratio requirements.
(d) With sinking fund. Shares outstanding and related amounts are stated net of applicable retirements through sinking funds (generally at par) and reacquisitions of shares in anticipation of future requirements.
(e) Not callable prior to 2003; after that the call price is $100 per share.
(f) Not callable prior to 2000; after that the call price is $100 per share.
(g) Redemption is restricted prior to 1997.
(h) The sinking fund provisions of the series subject to mandatory redemption aggregate $5,000,000, $5,000,000, $16,000,000 and $16,000,000 in 1998, 1999, 2000 and 2001, respectively.
(i) On February 1, 1996 the outstanding balance of 75,000 shares was redeemed at $100 per share.

AMERICAN ELECTRIC POWER COMPANY, INC. AND SUBSIDIARY COMPANIES
SCHEDULE OF CONSOLIDATED LONG-TERM DEBT OF SUBSIDIARIES

Maturity	Weighted Average Interest Rate December 31, 1996	Interest Rates at December 31, 1996	Interest Rates at December 31, 1995	December 31, 1996 (in thousands)	December 31, 1995 (in thousands)
FIRST MORTGAGE BONDS					
1996-1999	7.35%	6-1/4%-9.15%	5%-9.15%	$ 383,671	$ 496,866
2001-2006	7.10%	6%-8.95%	6%-9.31%	1,511,000	1,530,020
2020-2025	8.07%	7.10%-9.35%	7.10%-9-7/8%	1,276,750	1,473,127
INSTALLMENT PURCHASE CONTRACTS (a)					
1998-2002	4.80%	4.10%-7-1/4%	5%-7-1/4%	209,500	209,500
2007-2025	6.45%	5.45%-7-7/8%	5.45%-7-7/8%	756,745	756,745
NOTES PAYABLE (b)					
1996-2008	7.31%	5.29%-9.60%	5.29%-10.78%	282,681	221,000
DEBENTURES					
1996 - 1999 (c)	-	-	5-1/8%-7-7/8%	-	30,759
2025 - 2026	8.28%	8%-8.72%	8.16%-8.72%	315,000	200,000
OTHER LONG-TERM DEBT (d)				182,943	172,403
Unamortized Discount (net)				(34,580)	(33,144)
Total Long-term Debt Outstanding (e)				4,883,710	5,057,276
Less Portion Due Within One Year				86,942	136,947
Long-term Portion				$4,796,768	$4,920,329

NOTES TO SCHEDULE OF CONSOLIDATED LONG-TERM DEBT OF SUBSIDIARIES

(a) For certain series of installment purchase contracts interest rates are subject to periodic adjustment. Certain series will be purchased on demand at periodic interest-adjustment dates. Letters of credit from banks and standby bond purchase agreements support certain series.

(b) Notes payable represent outstanding promissory notes issued under term loan agreements with a number of banks and other financial institutions. At expiration all notes then issued and outstanding are due and payable. Interest rates are both fixed and variable. Variable rates generally relate to specified short-term interest rates.

(c) All sinking fund debentures were reacquired on March 1, 1996.

(d) Other long-term debt consists primarily of a liability along with accrued interest for disposal of spent nuclear fuel (see Note 4 of the Notes to Consolidated Financial Statements).

(e) Long-term debt outstanding at December 31, 1996 is payable as follows:

	Principal Amount (in thousands)
1997	$ 86,942
1998	224,274
1999	210,678
2000	183,652
2001	252,575
Later Years	3,960,169
Total	$4,918,290

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Management's Responsibility

The management of American Electric Power Company, Inc. is responsible for the integrity and objectivity of the information and representations in this annual report, including the consolidated financial statements. These statements have been prepared in conformity with generally accepted accounting principles, using informed estimates where appropriate, to reflect the Company's financial condition and results of operations. The information in other sections of the annual report is consistent with these statements.

The Company's Board of Directors has oversight responsibilities for determining that management has fulfilled its obligation in the preparation of the financial statements and in the ongoing examination of the Company's established internal control structure over financial reporting. The Audit Committee, which consists solely of outside directors and which reports directly to the Board of Directors, meets regularly with management, Deloitte & Touche LLP - Certified Public Accountants and the Company's internal audit staff to discuss accounting, auditing and reporting matters. To ensure auditor independence, both Deloitte & Touche LLP and the internal audit staff have unrestricted access to the Audit Committee.

The financial statements have been audited by Deloitte & Touche LLP, whose report appears on the next page. The auditors provide an objective, independent review as to management's discharge of its responsibilities insofar as they relate to the fairness of the Company's reported financial condition and results of operations. Their audit includes procedures believed by them to provide reasonable assurance that the financial statements are free of material misstatement and includes a review of the Company's internal control structure over financial reporting.

Independent Auditors' Report

To the Shareholders and Board of Directors
of American Electric Power Company, Inc.:

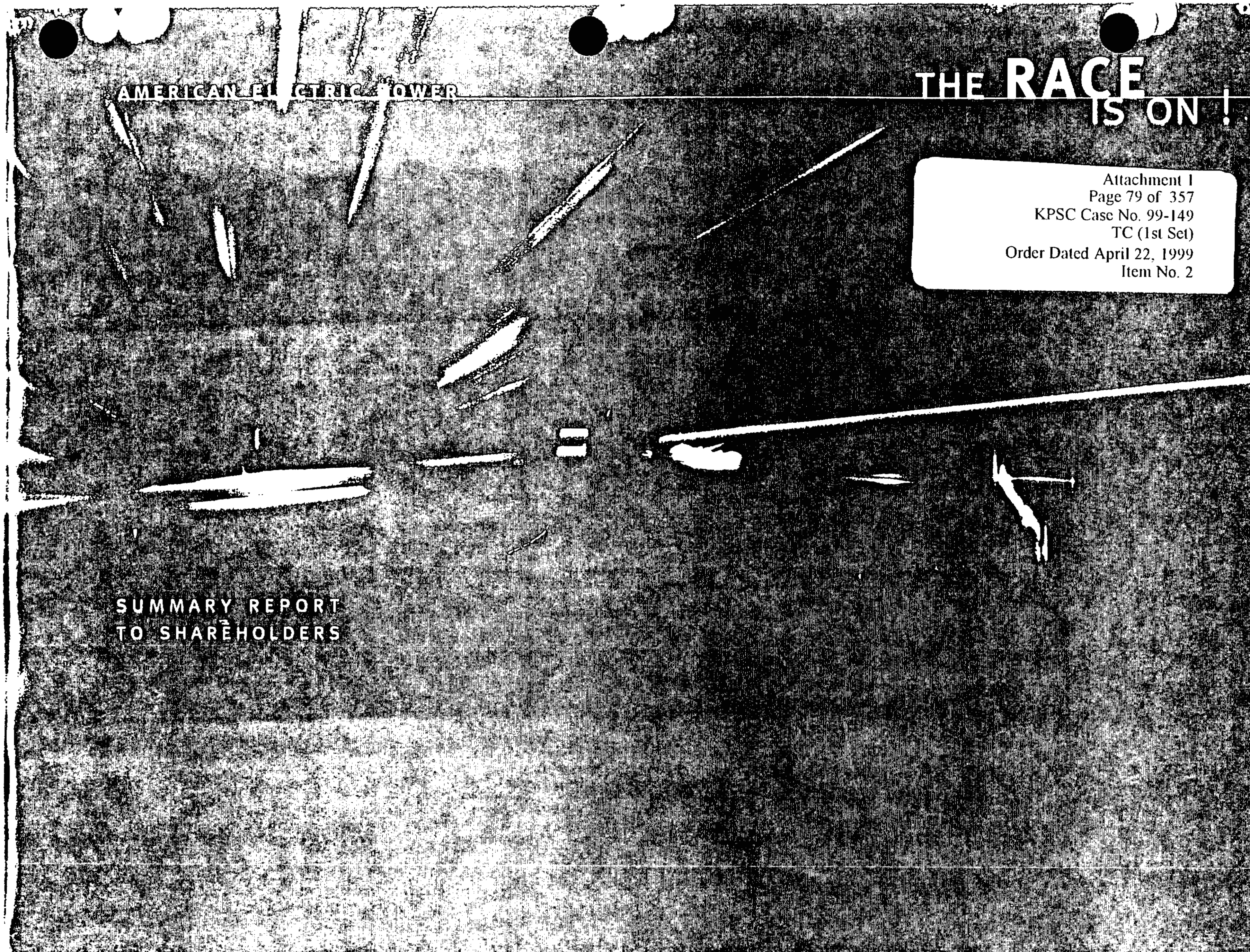
We have audited the accompanying consolidated balance sheets of American Electric Power Company, Inc. and its subsidiaries as of December 31, 1996 and 1995, and the related consolidated statements of income, retained earnings, and cash flows for each of the three years in the period ended December 31, 1996. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of American Electric Power Company, Inc. and its subsidiaries as of December 31, 1996 and 1995, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1996 in conformity with generally accepted accounting principles.

Deloitte & Touche LLP

Deloitte & Touche LLP
Columbus, Ohio
February 25, 1997


AMERICAN ELECTRIC POWER
THE RACE IS ON!
SUMMARY REPORT TO SHAREHOLDERS

ABOUT OUR COVER THEME

The engine is tuned, the pit crews are primed, everyone is cued. All we're waiting for is the flag to drop.

When full competition comes to the electric utility industry, AEP plans to be one of the first off the starting line. We've spent several years preparing by assessing customer needs and improving service, reducing costs, training our crew and developing the latest competitive technology. This summary annual report outlines many of the major activities of the year, highlighted by the pending merger with Central and South West Corporation, that will position us to compete in the future.

HIGHLIGHTS OF 1997

	1997	1996	% Change
Income Before Extraordinary Item (in millions)	$620.4	$587.4	+5.6
Net Income (in millions)	$511.0	$587.4	-13.0
Earnings Per Share Before Extraordinary Item	$3.28	$3.14	+4.5
Earnings Per Share	$2.70	$3.14	-14.0
Operating Revenues (in billions)	$6.161	$5.849	+5.3
Cash Dividends Per Share	$2.40	$2.40	—
Year-end Closing Stock Price	$51⅝	$41⅛	+25.5
Book Value at Year End	$24.62	$24.15	+1.9
Total Energy Sales (in millions of kilowatthours)	145,423	132,573	+9.7
Total Assets (in billions)	$16.615	$15.883	+4.6
Retail Customers (at year end)	2,980,023	2,943,016	+1.3
Total Employment (at year end)	17,844	17,951	-0.6

AMERICAN ELECTRIC POWER is one of the nation's largest electric utility holding companies, providing electricity and related services to customers in parts of Ohio, Michigan, Indiana, Kentucky, West Virginia and Tennessee. AEP's 38 power plants have a capacity of 23.8 million kilowatts. The AEP transmission and distribution system is one of the largest in the world, with 22,000 circuit miles of transmission lines and 119,000 miles of overhead and underground distribution lines. In addition to the United States, AEP has operations in the United Kingdom and China.

American Electric Power is a leading advocate of customer choice in the electric utility industry. This summary annual report highlights how AEP is positioning itself to participate in a more competitive energy industry in the United States and throughout the world. The summary annual report to shareholders contains financial highlights from 1997. Full disclosure of all financial information is included in 1997 Financial Statements and Management's Discussion and Analysis of Results of Operations and Financial Condition. Additional information about AEP also is available on the internet at http://www.aep.com.

Contents

HELP ENSURE FAIR AND EQUITABLE COMPETITION

As legislation surfaces that will restructure the electric utility industry, we want to make sure that our shareholders are kept informed of the changes that are proposed. Together we can work to ensure that competition is fair and equitable. If you would like to participate with AEP in the legislative process, please fill out and return this postage-paid card. When you do, we'll let you know about issues which may interest you concerning the energy industry.

By working together, we can enhance AEP's role as America's Energy Partner.

AEP®

AEP: America's Energy Partner℠

YES! I WANT TO PARTICIPATE IN SHAPING AMERICA'S ENERGY FUTURE

Please let me know when my help may be needed to write my elected representatives on legislation that will affect the electric utility industry.

NAME

ADDRESS

CITY

STATE ZIP

PHONE NUMBER (OPTIONAL)

BUSINESS REPLY MAIL

FIRST CLASS MAIL PERMIT NO. COLUMBUS OH

POSTAGE WILL BE PAID BY ADDRESSEE

AMERICAN ELECTRIC POWER
CORPORATE COMMUNICATIONS
19TH FLOOR
P.O. BOX 16631
COLUMBUS, OH 43272-2204

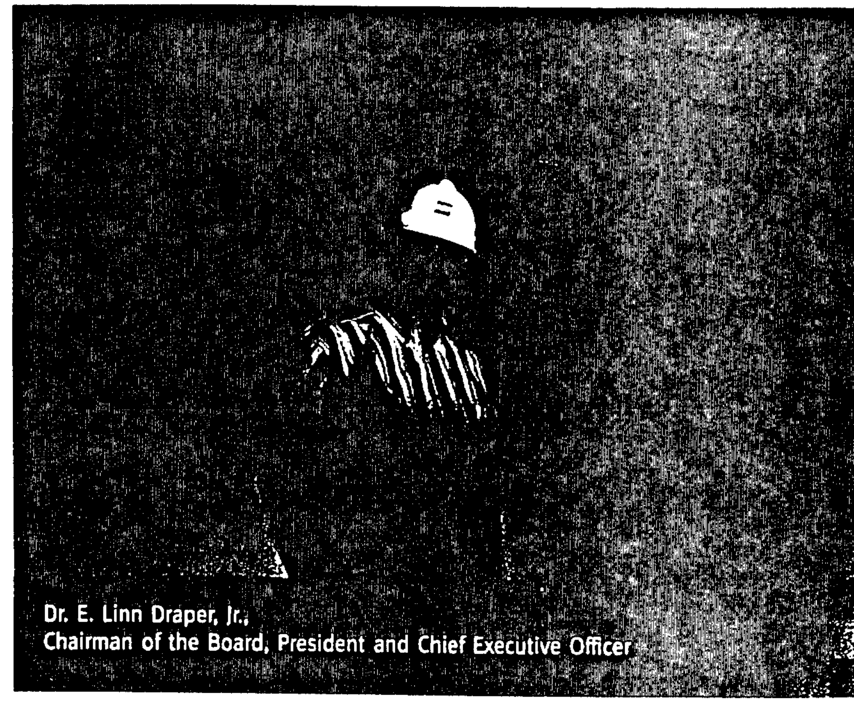
DEAR FELLOW SHAREHOLDERS

Without a doubt, last year was one of the most significant in the history of AEP. From our purchase of 50 percent of Britain's Yorkshire Electricity Group to the construction of the Inez project to our pending merger with Central and South West Corporation, we have moved aggressively into new countries, new technologies and new territories. Never have we been as poised for success as we are at the beginning of this dynamic era in the energy industry.

I couldn't be more pleased with our agreement to merge with Central and South West, a Dallas-based utility holding company that will make a great fit with AEP. This is an ideal merger. Both of us are low-cost energy providers well positioned in our markets to grow; both have a strong and expanding international presence and complement each other exceedingly well; and both management teams share a common philosophy about the coming changes in the energy industry. This is a merger between two strong, well capitalized companies.

While we made solid progress on many fronts during 1997, it was a mixed year for us financially. For 1997 we reported that net income, before a one-time charge, increased 6 percent to $620 million, or $3.28 a share, from $587 million, or $3.14 a share, in 1996. The one-time charge of $109 million was caused by a windfall tax imposed by the United Kingdom on utilities that have been privatized. After that non-recurring charge, earnings decreased 13 percent to $511 million, or $2.70 a share.

Operating income declined 2.3 percent, to $981 million, because of mild weather, unplanned generating outages, and increased wholesale competition.



Dr. E. Linn Draper, Jr.,
Chairman of the Board, President and Chief Executive Officer

We achieved total energy sales of 145 billion kilowatthours during 1997, a record and a 10 percent gain over the 1996 level, mainly due to our wholesale power marketing efforts. Our Energy Delivery Group expects to complete the first-of-its-kind transmission control system at the Inez station in Kentucky this spring. This breakthrough technology promises to give us an unprecedented ability to manage the quality and quantity of the power we send over transmission lines.

Our coal-fired and hydro generating facilities had a record year as they produced 126 billion kilowatthours of power, a 4 percent increase over 1996. Our affiliated coal mines had another outstanding year of production and continued their industry-leading safety performance.

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On September 9, we took our nuclear power facility, the Donald C. Cook Plant, off line to address issues raised during a plant inspection about the backup cooling systems. The action was not the result of any equipment malfunctions or operational events, but concern about how safety system designs have been documented and maintained against the original design of the plant. The result is that approximately 2,100 megawatts, or 9 percent of our capacity, have not been available for sale. We are working with the Nuclear Regulatory Commission to resolve these issues and return the plant to production as quickly as possible.

AEP's stock reached a recent high last year, closing above $50 on Dec. 1 and then closing at $52 on Dec. 19. Our stock's performance resulted in total shareholder return of 32.7 percent, assuming dividend reinvestment. For the fourth consecutive year we met our strategic goal when AEP's three-year total shareholder return was in the top quartile of the companies in the S&P Electric Utility Index.

Our stock price obviously benefited from the overall gains in the securities markets last year. But it also reflects investor response to a year of distinction. For example, in October we announced two joint ventures with DuPont's energy subsidiary, Conoco, to purchase and manage industrial and large commercial energy facilities nationwide. AEP Conoco Energy Capital will acquire and lease back energy facilities, initially at DuPont sites, and will provide capital for future energy projects. AEP Conoco Energy Management Services will manage those sites, bringing to bear the combined energy expertise of two leaders in the electricity gas and oil industries.

Our energy trading business, which began in earnest last year, has tremendous potential to help us utilize our capacity and add profits. We have assembled a team of experienced traders who have been able to take advantage of AEP's efficient, low-cost generating capacity to put us in the fast-paced trading business.

In last year's annual report I was able to tell you about our agreement to purchase Yorkshire Electricity Group, plc, along with an equal partner, Public Service Company of Colorado, now known as New Century Energies, Inc. We completed that purchase in April and have been pleased with its people and performance. Yorkshire is a well-run, well-positioned utility based near Leeds, England, that is in the forefront of the industry's move, virtually worldwide, into competition and customer choice.

FISCAL 1997 HIGHLIGHTS

AEP Communications and Sprint agree to build 150-mile-long fiber optic line between Charleston, West Virginia, and Roanoke, Virginia.

AEP and New Century Energies, Inc. announce they will purchase Yorkshire Electricity Group plc in Great Britain.

Purchase of Yorkshire Electricity passes review of British regulators and becomes unconditional on the part of AEP and New Century Energies the next day.

AEP chosen to supply 100 megawatts of electricity to alliance that will serve an AK Steel plant under construction near Rockport, Indiana.

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Among the issues that will demand our attention in the upcoming year are:

■ Our plans to ensure quality transmission service into Virginia and southern West Virginia via a high-voltage transmission line. Since we constructed the last major backbone line into that area in 1973, demand for electricity has increased 136 percent. As growth continues and average household and commercial use of electricity increases, there is no doubt that additional transmission capacity is needed.

■ The Year 2000 computer problem, which faces virtually every public and private organization in the world. We have assembled a task force and employed one of the world's foremost computer consulting companies to address the problem. It's our goal to have all critical systems fixed in the first part of 1999.

As we did last year, we are enclosing in this summary annual report a response card if you are interested in supporting the company on critical legislative issues. Please fill out and return this postpaid card and we will notify you when an issue arises of particular importance to shareholders of AEP.

Finally, I want to note the approaching retirement of two of our senior officers, Pete DeMaria and Jerry Maloney, members of the AEP board and both vice chairmen of the service corporation, have dedicated a combined 80 years to making AEP a better company. Their knowledge and experience have been invaluable. Both will retire from the board at our 1998 annual meeting. I wish them much happiness and success in their new lives.

At AEP, we are always looking toward the future in terms of customer service, energy supply, transmission, distribution and reliability. We believe we must continue to perform superbly in our core business if we are to do well in our new ventures. We approach the year 2000 ready to provide world class energy products and services with our heritage of efficiency, innovation and cost effectiveness. *Let the race begin!*

E. Linn Draper

E. Linn Draper, Jr.
Chairman of the Board
Chief Executive Officer & President

February 25, 1998

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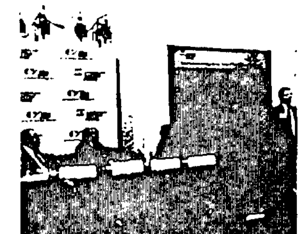


AEP agrees to form two joint ventures with DuPont/Conoco to finance and manage energy assets for commercial and industrial users.

AEP announces plans for gas and electricity trading operation for the western states, to be based in Houston. The office opens in January.

Opening of Call Center in Hurricane, West Virginia, to improve customer service and response time.

Vice Chairmen Peter J. DeMaria and Gerald P. Maloney, with more than 80 years of service between them, announce they will retire in 1998.

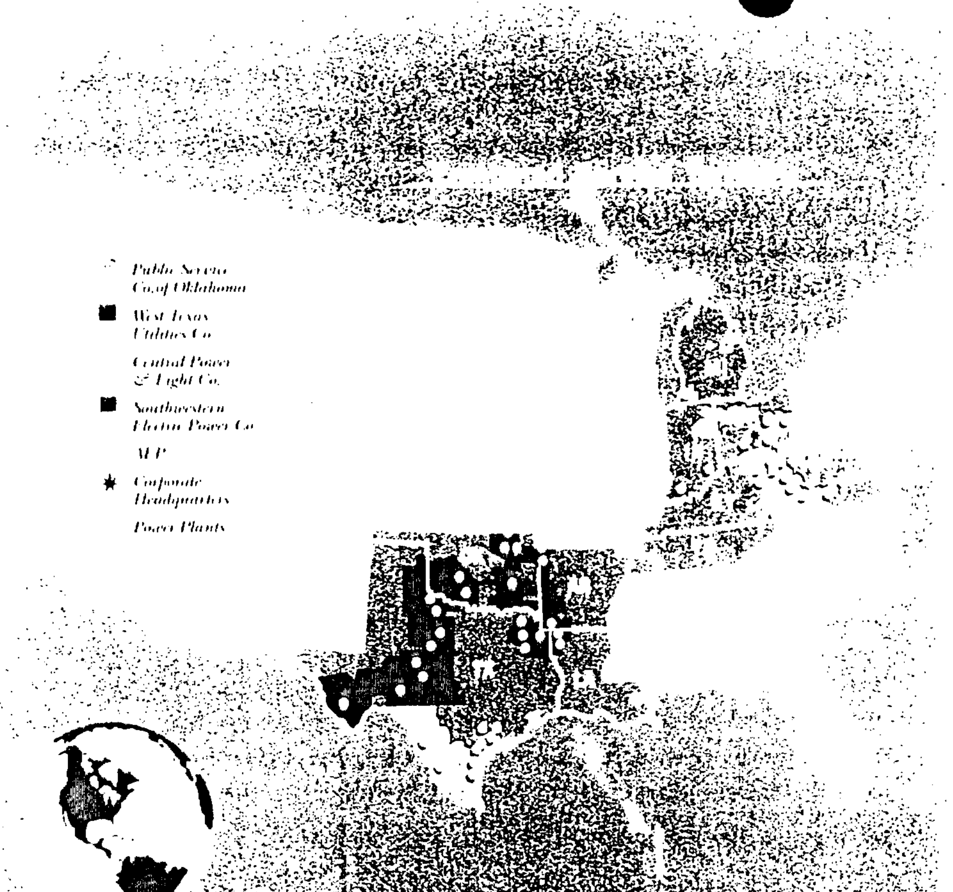
Central and South West and AEP announce plan to merge to form the largest electric utility holding company in North America in terms of customers and generation.

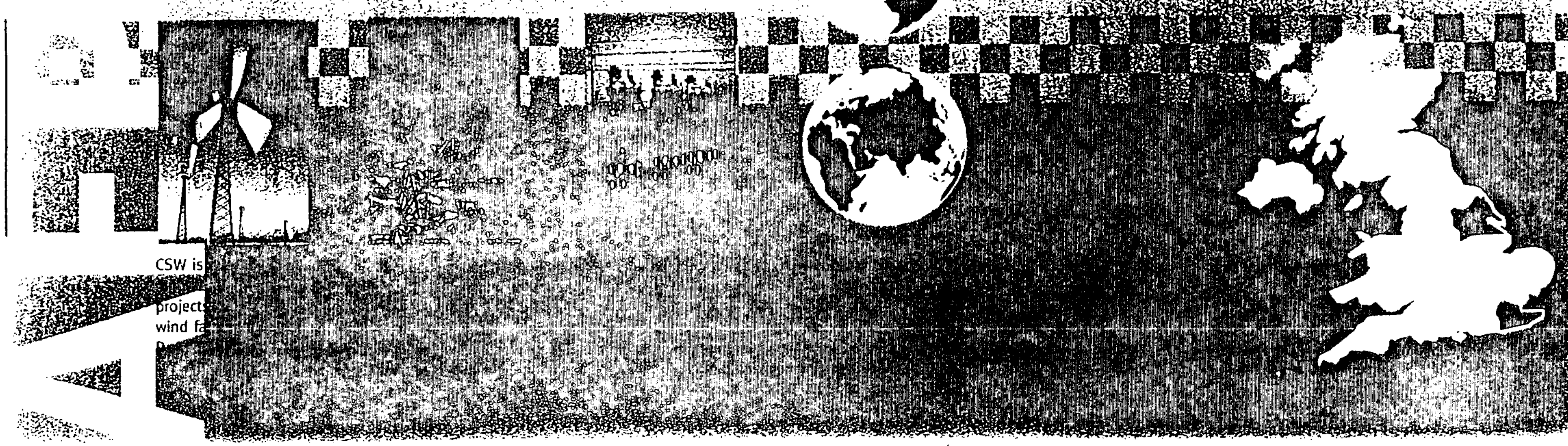
AEP + CENTRAL AND SOUTH WEST A PERFECT FIT

Our proposed merger with Central and South West Corporation will bring together two utilities ideally suited for the competitive environment ahead. Our size, our market presence, our geographic location and our international operations present us with opportunities that few other existing companies will have.

The combined system will operate in 11 states. We'll supply power to 4.7 million customers, making us the largest single electricity supplier in the nation. Our mix of coal, gas and nuclear facilities will give us a diversity of low-cost generation. Our global subsidiaries will operate in some of the fastest growing markets in the world and provide significant opportunities for growth and expansion.

Our shared commitment to excellence, customer service, customer choice, technology and employee growth and development provide the synergies necessary for a company preparing to meet the competition head on.





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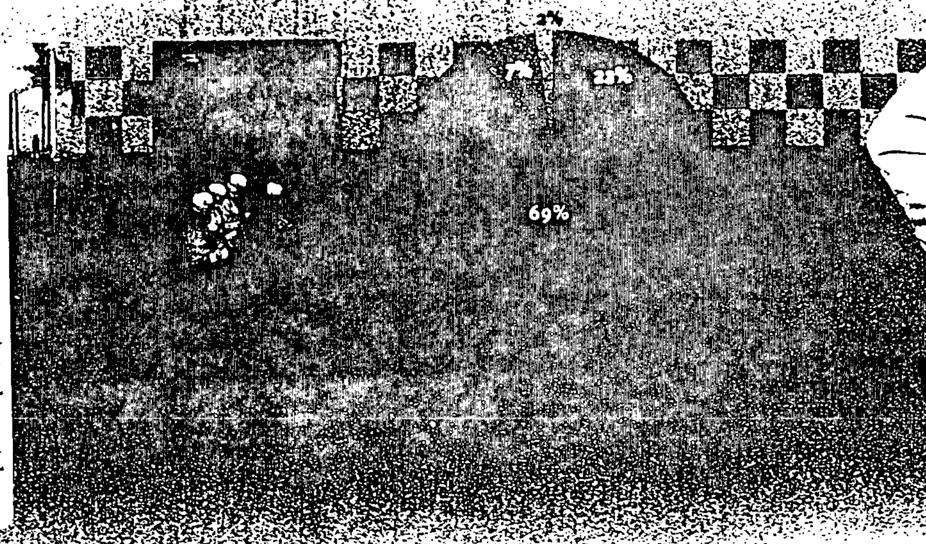
FAST FACTS

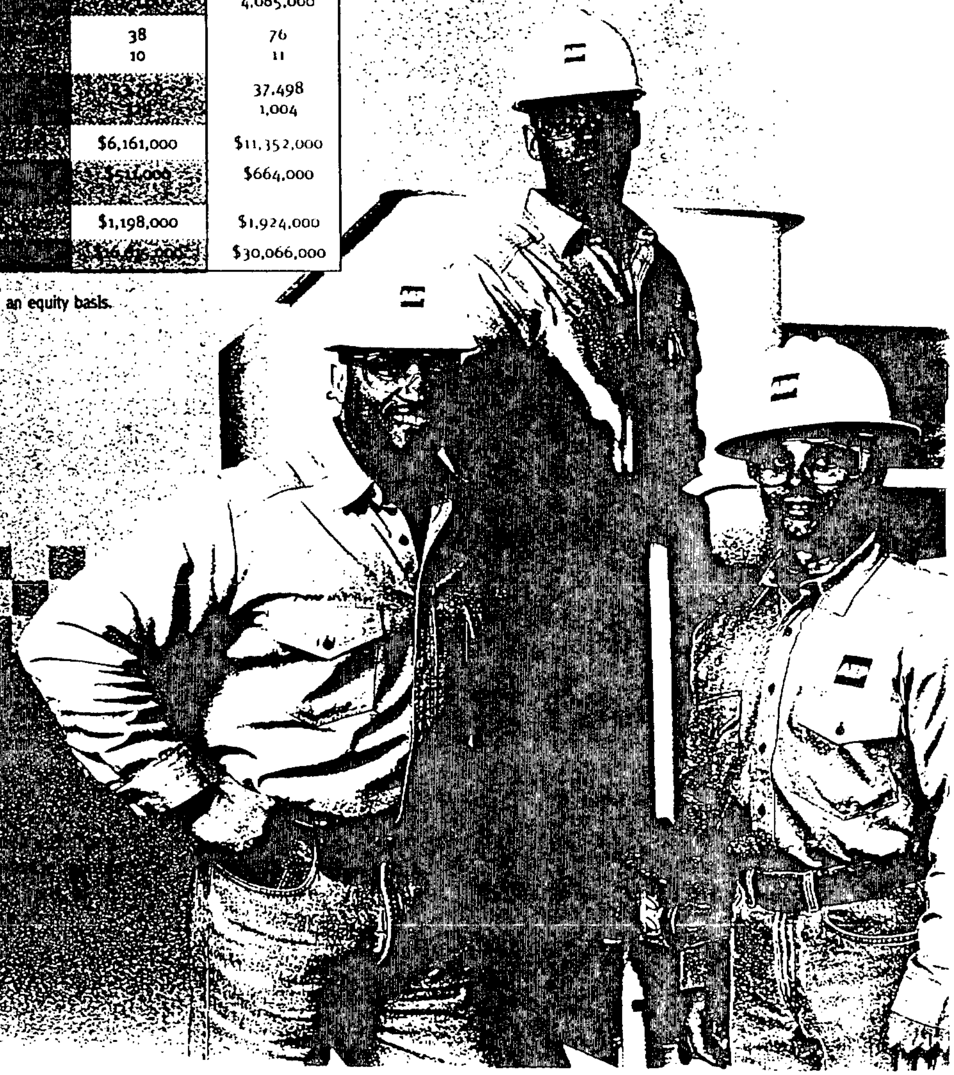
	Central Power and Light Co.	AEP*	Combined*
Headquarters	[illegible]	[illegible]	Columbus OH
KWH Sales US (in millions)	21,839	145,423	208,580
KWH Sales UK (in millions)	–	14,756	33,959
Employees U.S.	[illegible]	[illegible]	25,098
Employees U.K.	[illegible]	[illegible]	8,138
Service Area Size U.S. (sq. miles)	44,000	45,400	197,400
Service Area Size U.K. (sq. miles)	–	3,900	6,900
Customers U.S. [illegible]	[illegible]	[illegible]	4,671,000
Customers U.K. [illegible]	[illegible]	[illegible]	4,085,000
Generating Stations U.S.	12	38	76
Generating Stations U.K.	–	10	11
Generating Capacity U.S. [illegible]	[illegible]	[illegible]	37,498
Generating Capacity U.K. [illegible]	[illegible]	[illegible]	1,004
Revenues (000's)	$1,376,282	$6,161,000	$11,352,000
Net Income for Common Stock (000's)	[illegible]	[illegible]	$664,000
Operating Cash Flow (000's)	$399,640	$1,198,000	$1,924,000
Total Assets (000's)	[illegible]	[illegible]	$30,066,000

* AEP acquired a 50% interest in Yorkshire Electricity Group plc, a UK electric distribution company, on April 1, 1997, which is accounted for on an equity basis. AEP's KWH sales UK are for the nine months ended December 31, 1997.

** Adjusted for joint ownership.

*** At the SEEBOARD USA level which is based on US accounting standards and includes allocated corporate costs.





BEHIND THE DECISION TO CREATE AMERICA'S PREMIER ELECTRIC COMPANY

A conversation with Dr. E. Linn Draper Jr., chairman, president and chief executive officer of American Electric Power Company, Inc., and E.R. Brooks, chairman and chief executive officer of Central and South West Corporation.

Q. You both said when announcing this merger that AEP and CSW were ideal merger partners. Why?

A. *Brooks.* We had been looking for an opportunity to merge with a successful company that shared our strategy and our culture. We wanted a partner that was dedicated to serving our shareholders in the competitive era ahead by becoming an innovative, diversified leader in global energy markets and related services — our strategy. And one that emphasized low-cost generation and excellent customer service — our culture. In my 36 years of experience, I've never seen a company that was a more perfect fit with CSW than AEP.

We will be a global power, with a healthy diversity of fuels, types of industrial customers and climate patterns, and dynamic industrial operations.

A. *Draper.* As we've learned more about each other ... [illegible]

[illegible]

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AEP + CSW

However, the greatest benefit to the shareholder will be the potential of the new combined company. We will have a diversified portfolio of low-cost power plants, a presence in 11 states and three power pools, 38,000 megawatts of generating capacity, and a base of customers approaching 5 million nationally. We'll be positioned to be a major player in the international retail energy market as well.

A. *Brooks* Both of these companies have been successful on a stand-alone basis. Together [illegible] petitive. And [illegible] implement our strategy [illegible] than either [illegible] turn [illegible]

[illegible]

Q. What kind of obstacles will this merger face?

A. *Draper* We expect to complete the merger in the first half of 1999. Along the way we expect two issues to be closely examined. The first is a concern about whether the merger could create a market-dominant company. We strongly believe that this proposed merger would not have this effect. AEP and CSW do not operate in the same states or power pools. Neither company is now dominant in any state it serves, and the combined company will not be dominant in any state [illegible]. We'll have more customers, but none of them [illegible] [illegible]

[illegible]

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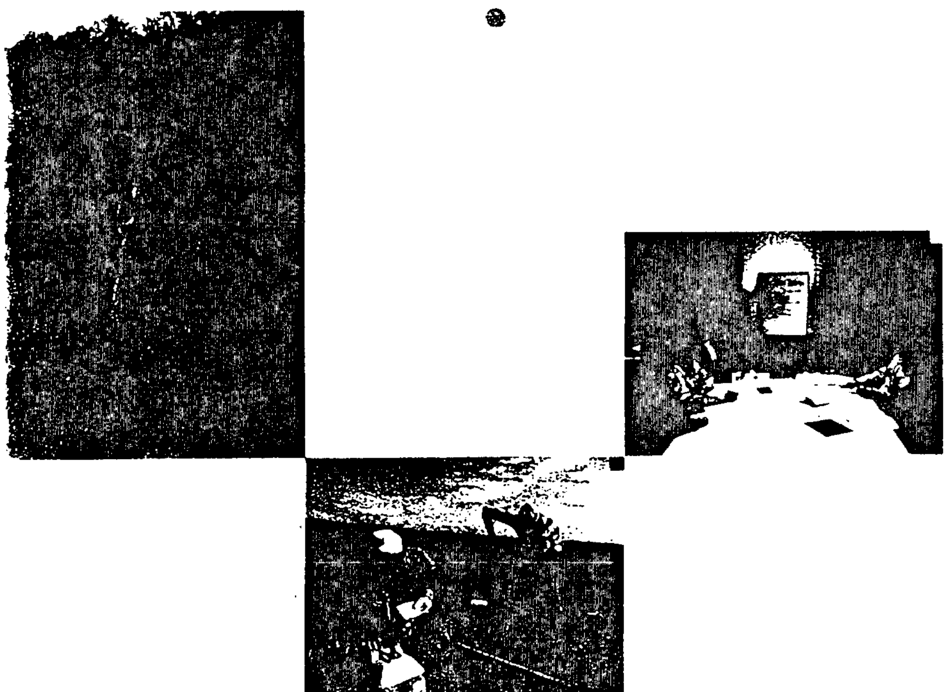
Developing a long term business strategy is a lot like preparing for a race. You have to carefully study the course, consider your options, match your resources to the challenge and then begin to check your equipment and plot your strategy.

At AEP that's what we've been doing for the last several years. We took a careful look at the future of the electric utility industry by gauging economic trends, analyzing technology and determining customer needs and desires. After considering our options and our assets, we made a firm decision to become an early proponent for full competition. We believe that is what our customers want and what ultimately is best for AEP and our shareholders. So we started looking at how we structure our work, how we pay our bills, how we manage our plants and how we service our customers to find the best way of doing each. The result has been lower costs, a stronger, better trained work force and a competitive engine ready for the race.



DEVELOPING OUR RESOURCES

Expanding our minds.

To prepare our team for the challenges ahead, the AEP Institute, formed in 1996 to coordinate the Company's employee development efforts, conducted more than 1,200 sessions in 1997. Most of the classes dealt with 'foundation' issues, that help employees understand the changing industry.

Taking care of our land.

■ Our voluntary programs make a difference. Coal-burning technology we are helping to develop will increase efficiency almost 20 percent. We're adding to the 47 million trees we've already planted and studying ways to use grass to better capture carbon dioxide in the atmosphere. And AEP won the U.S. Environmental Protection Agency's Green Lights Ally of the Year award by installing high-efficiency lights that lower CO_2 emissions by 29,000 tons a year.

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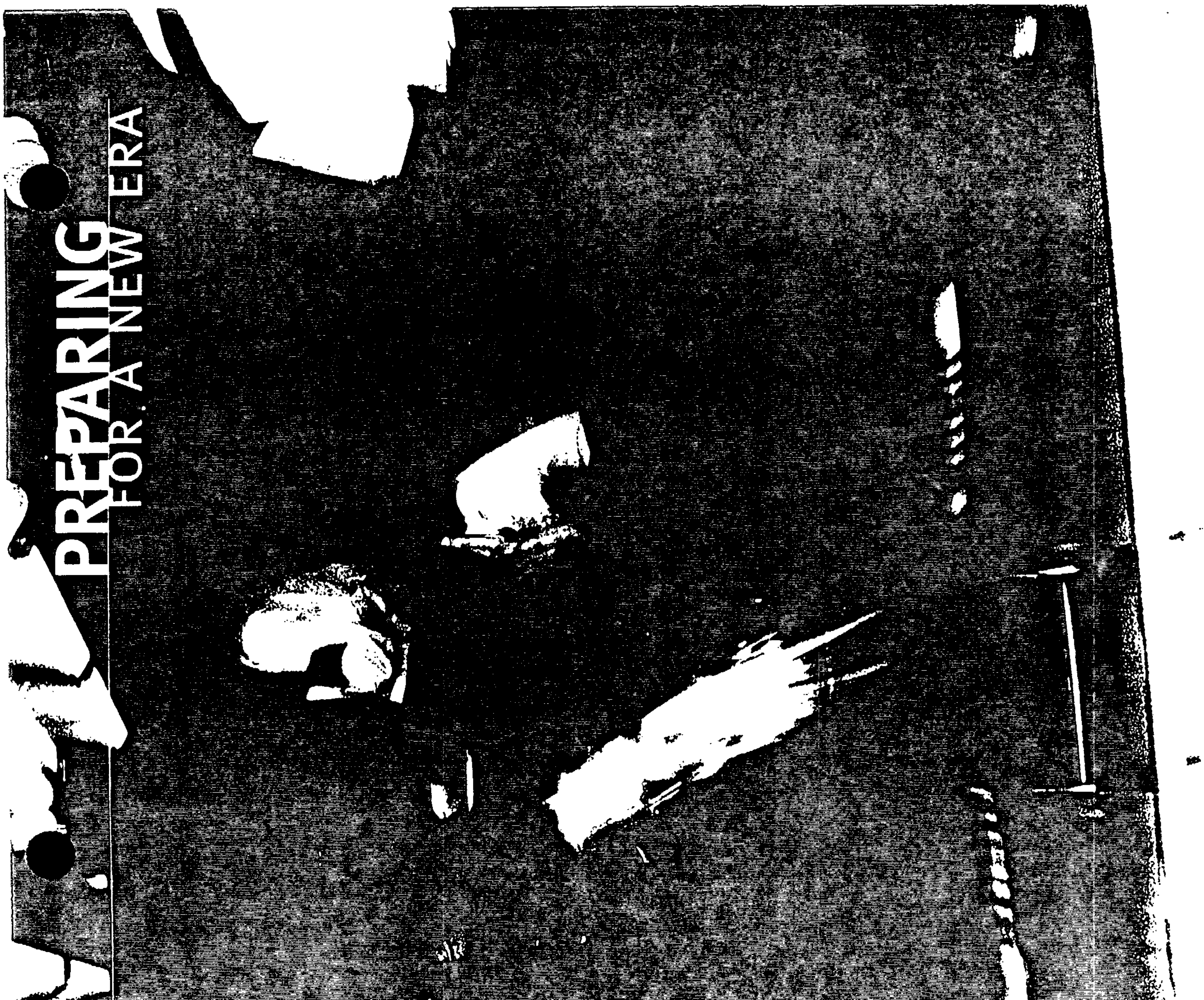

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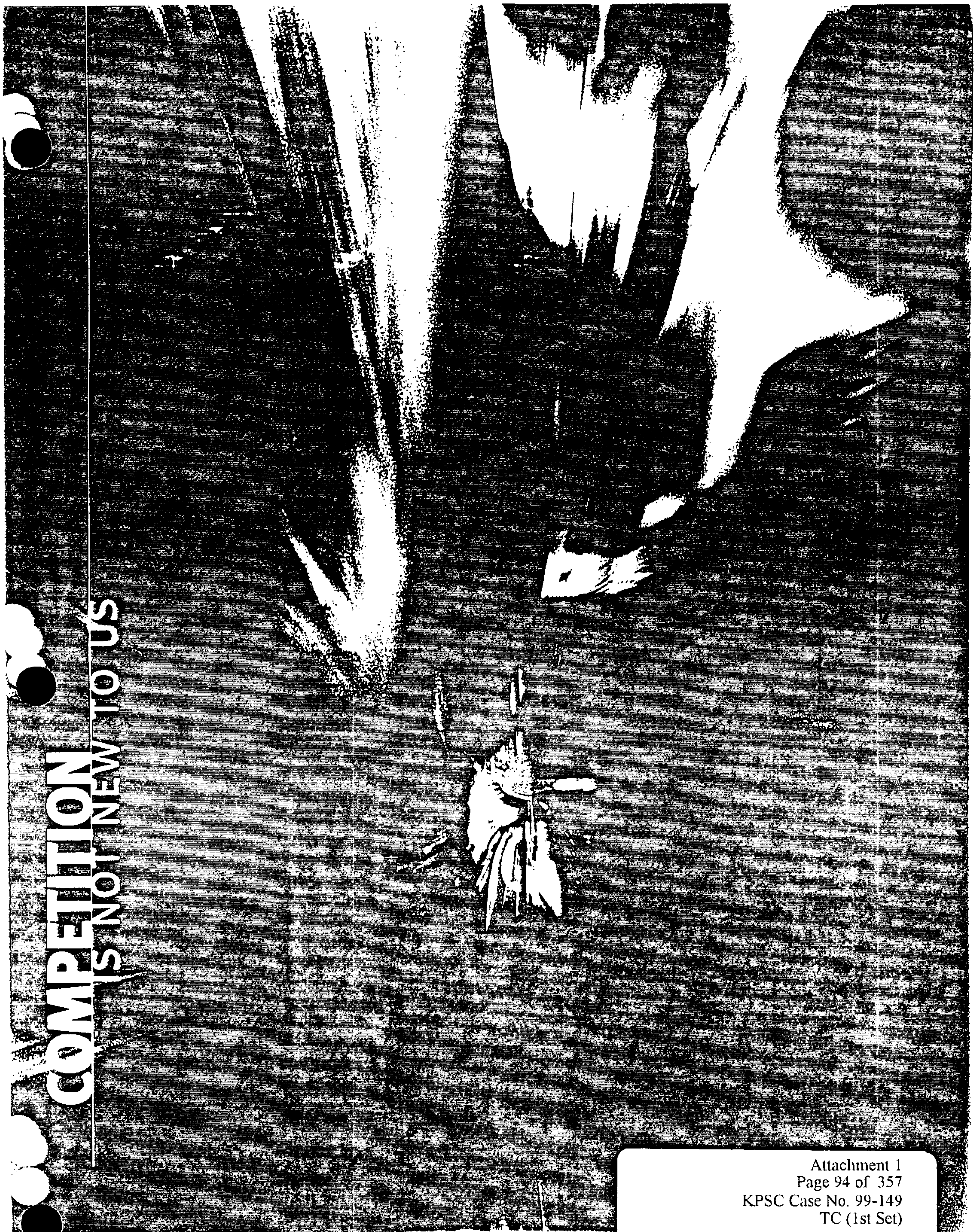
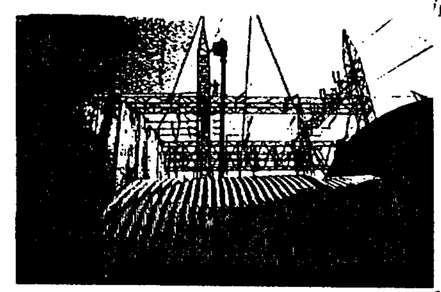
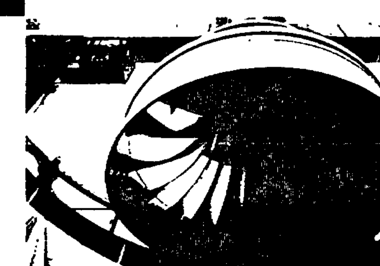

COMPETITION
IS NOT NEW TO US

Competition means more than reducing costs and lowering prices. It means improving service, enhancing safety, developing new systems and being prepared to go where the road takes you. We've enhanced our efforts in customer service by investing in a network of regional call centers, which allow us to respond to customers faster and more efficiently. The last of the four centers opened in December 1997 in Hurricane, West Virginia. Customers get 24-hour-a-day access to customer service representatives while we maximize productivity of employees. Our ability to manage and use assets like our call centers was one factor that led to AEP being named as one of the most respected companies in the electric utility industry in *Fortune's* annual corporate reputations survey.

Enhanced competitiveness must not come at the expense of safety. Through increased training and awareness programs, we recorded our safest year in recent history in 1997. Recordable accidents declined 5 percent and the vehicle accident rate decreased 28 percent. Not every safety goal was met, but the clear improvements show that safety, reduced costs and greater efficiency are not mutually exclusive.





NOT JUST TO COMPETE, BUT TO WIN

AEP Communications, formed in 1996 to enhance our ability to provide communications and information to customers, is stringing new fiber optic lines for its wholesale telecom business and in support of its investment in new wireless personal communications services. It also is developing a portfolio of internet-based energy information products to be introduced in 1998 that allows commercial and industrial customers to monitor and analyze electricity, gas and water usage affordably and accurately.

.. By upgrading the design of two units at our Smith Mountain hydro plant in Virginia, we will be able to generate an additional 24 megawatts per unit. That means more electricity available to sell with marginal capital outlays.

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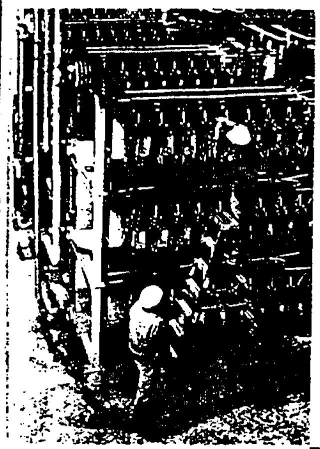
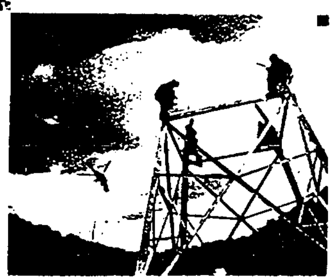
At AEP, our teams don't just use the right equipment, they help invent it. In Inez, Kentucky, we're completing a first-of-its-kind transmission system that permits unprecedented control over the quality and quantity of power on that system.

Developed in conjunction with Westinghouse and the Electric Power Research Institute, the Unified Power Flow Controller uses advanced electronics to eliminate electrical disturbances and provide for maximum voltage transmission. That means higher quality, more reliable power for customers and more efficient use of our transmission facilities. Once this technology is widely employed, it will be an important tool in providing enhanced customer service and greater control over transmission and generating facilities.

Other technologies we've introduced into our system include integrated substations and high-speed switches, which both use microprocessor technology to replace electromechanical devices. These new systems cost less, provide better reliability and require less maintenance than the devices they replace.





THE TOOLS TO COMPETE

Inez Innovation.

■ The $90 million Inez project, which includes a new substation and 32 miles of transmission lines from our Big Sandy plant in Kentucky, is the first of its kind in the world. Besides providing enhanced system control, it will help handle many years of load growth in the area.

■ To facilitate transmission tower construction in the hills of eastern Kentucky and western West Virginia, we used a helicopter to deliver 133 pre-assembled towers to their sites. By lifting towers from an assembly area and placing them by air on pre-built pads, we enhanced job safety and minimized construction impact on the environment.

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Success is never guaranteed before the start of any competition. We know that. But we also know that by doing things right and doing the right things, we can at least be sure that we're in the race.

We're actively pursuing new businesses, such as energy trading and energy financing and management ventures, that fit with our strategies and our core expertise. To take advantage of opportunities in other parts of the world, we're beefing up our international presence by opening offices in high-growth markets, such as Asia and South America. We're learning from our investment in Yorkshire Electricity Group in Great Britain about competition in other parts of the world.

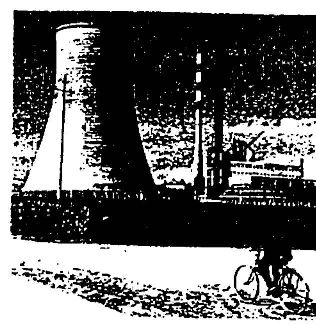
There are no secrets to success. Hard work and preparation are crucial factors between being a contender or just another statistic. By preparing our team, managing our assets, leading in technology and seeking new opportunities, we believe we're in the contest to stay. *Let the race begin!*

NEW MARKETS, NEW OPPORTUNITIES

■ Construction of our coal-fired plant in Henan Province, China, is on schedule, with the first unit expected to be complete late in 1998. The China joint venture gives us a foothold in one of the fastest growing electricity markets in the world.

Yorkshire Electricity Group, which we jointly acquired with New Century Energies in April 1997, will provide valuable lessons about operating in a competitive environment.

■ Our two energy trading operations, in Columbus and Houston, allow us to participate in energy markets throughout the country and also take advantage of our low-cost generating capabilities.



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MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

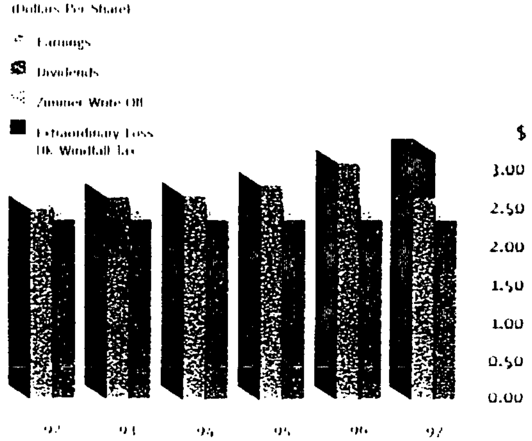
Introduction

We are continuing our summary approach to the financial section to this annual report based on favorable comments received from shareholders. This abbreviated financial presentation is intended to present capsule information in an easier-to-read format and should not be considered a substitute for the full financial statements provided to all shareholders as the 1997 Financial Statements and Management's Discussion and Analysis of Results of Operations and Financial Condition. A copy of the Form 10K and/or the full financial statements can be obtained by calling 1-800-551-1AEP. Although this summary should help you understand AEP's 1997 results of operations and financial condition, we caution that before making any investment decisions you should review the full financial statements.

The following discussion contains forward looking statements which reflect assumptions and involve a number of risks and uncertainties that could cause actual results to differ materially.

Earnings and Dividends

(Dollars Per Share)



Business Outlook

We are changing as our industry transitions towards customer choice in power generation. We are building the foundation on which our revenues and earnings can grow by: working to grow the existing business and customer base; developing a national energy trading business; building a portfolio of global investments in energy companies and projects; expanding energy related products and services to be offered to customers worldwide; and adding incremental generation, transmission and distribution assets and operations within the U.S. In December the Company and Central and South West Corporation (CSW), two low-cost producers of electricity, announced plans to merge. Upon receipt of all required governmental approvals and the consummation of the exchange of CSW common stock for AEP's common stock, our new company will become one of the top-tier players in the emerging global market for electric energy and related services. We expect the merger to be completed in 12 to 18 months.

AEP has the financial strength, geographic reach, location and low-cost structure to be an able competitor and partner. However, no assurance can be given that AEP can maintain this position in the future. The electric industry has seen and will see mergers and acquisitions as the electric generation business becomes more competitive. We believe that the proposed strategic combination with CSW will strengthen our ability to compete and create the kind of energy provider customers, regulators, legislators, shareholders and employees want — a growing company able to produce and deliver low-cost, reliable energy across a large, geographically diverse region.

The Company's ability to recover its costs as the industry transitions to competition and as customer choice is more broadly available is probably the most significant factor affecting its future. Competition in the wholesale generation market continues to intensify since the adoption of federal legislation in 1992 that gave wholesale customers the right to choose their energy supplier. The introduction of competition and customer choice for retail customers has been slow, although activity has been increasing. Federal legislation has been proposed to mandate competition and customer choice at the retail level, and several states have introduced or are considering similar legislation. All of our states have initiatives to move to customer choice that will phase-in or allow for a transition to competition, although the timing is uncertain. The Company supports customer choice and is proactively involved in discussions at both the state and federal levels regarding how best to structure and transition to a competitive marketplace.

As the electric energy market evolves from cost-of-service rate-making to market-based pricing for generation and to customer choice, many complex issues must be resolved, including what to do about costs that will not be recovered as a result of going to market rates, i.e. stranded costs. While Federal Energy Regulatory Commission (FERC) orders No. 888 and 889 provide, under certain conditions, for recovery of stranded cost at the wholesale level, the issue of stranded cost is unresolved at the much larger state retail level. The amount of any stranded

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costs we may experience depends on the timing and extent to which direct competition is introduced to our business and the then-existing market price of electricity. Under generally accepted accounting principles, regulatory assets (deferred expenses) and regulatory liabilities (deferred revenues) are included in the consolidated balance sheets of regulated utilities in accordance with regulatory actions and in order to match expenses and revenues with cost-based rates. In order to maintain net regulatory assets (net expense deferrals) on the balance sheet, rates charged to customers must be cost-based and provide for their probable recovery. In the event a portion of AEP's business were no longer cost-based regulated, net regulatory assets would have to be written off for that portion of the business, unless they are recoverable in the future.

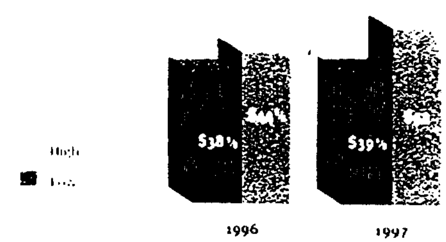
Although FERC orders No. 888 and 889 provide for competition in the firm wholesale market, that market is a relatively small part of our business. Many of our firm wholesale sales are still under cost-of-service contracts. As a result AEP's generation business is still cost-based regulated and should remain so for the near future pending the passage of enabling state legislation to deregulate the generation business. We believe that enabling state legislation should provide for the recovery of any generation-related net regulatory assets and other reasonable stranded costs from impaired generation assets. We are working with regulators, customers and legislators to provide for probable recovery of these stranded costs during a transition period in which rates are fixed or frozen and electric utilities would take steps to achieve cost savings which would be used to reduce or eliminate their stranded costs. However, if in the future AEP's generation business were to no longer be cost-based regulated and if it were not possible to demonstrate probability of recovery of resultant stranded costs including regulatory assets, results of operations, cash flows and financial condition would be adversely affected.

In 1997 management took several major steps towards its growth-oriented goal of being America's Energy Partner and a global energy and related services company. Construction of a 250-megawatt generating station in China progressed on schedule and within budget. In April, the Company and New Century Energies, Inc. acquired Yorkshire Electricity Group plc (Yorkshire), a United Kingdom (UK) distribution company. A new power marketing business was launched in July contributing significantly to our operating revenues, which surpassed $6 billion for the first time. A joint venture with Conoco, an energy subsidiary of DuPont, was announced in October to provide energy management services as well as financing of steam and electric generating facilities at large commercial and industrial plant sites including initially 16 of Conoco's and DuPont's sites.

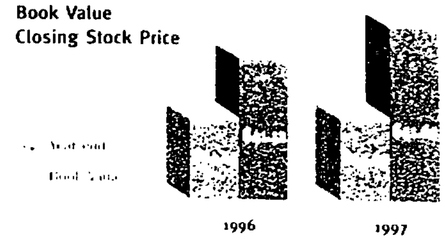
Probably the biggest step took place in December when the Company and CSW announced plans to merge. The merger, when approved, will increase AEP's annual revenues by approximately $5 billion and add 11,000 megawatts of generation and 1.7 million domestic customers to AEP. This will bring AEP's total domestic customers to 4.7 million customers. The merger will also increase AEP's non-regulated businesses as CSW owns a UK distribution company and other overseas and domestic non-regulated investments. More importantly it will expand our market, add more low-cost generation, contribute to AEP's non-regulated products and services business and enhance our competitiveness.

In addition to synergy savings from the proposed merger, other efforts continue to reduce the costs of our products and services in order to maintain our competitiveness. Prior to 1997 reviews of our major domestic processes led to decisions to consolidate all management and certain functions and operations. Although staff reductions and cost savings are presently being achieved as a result of the consolidation of management and functions, expenses for new marketing and customer services and efficient management information systems are increasing to prepare for competition. Process improvement efforts and expenditures to develop and implement new software should produce further improvements and efficiencies, enabling AEP to continue to offer its domestic customers excellent service at competitive prices.

Market Price
Common Stock



Book Value
Closing Stock Price



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CONSOLIDATED CONDENSED STATEMENTS OF INCOME

Year Ended December 31
(In Millions – Except Per Share Amounts)

	1997	1996	% Change
Revenues	$6,161.4	$5,849.2	5.3
Expenses:			
Fuel	1,627.1	1,600.7	1.6
Purchased Power	416.3	86.1	383.5
Maintenance	483.3	502.8	(3.9)
Depreciation and Amortization	591.0	600.8	(1.6)
Taxes Other Than Federal Income Tax	490.6	498.6	(1.6)
Other Operation	1,227.4	1,210.0	1.4
Interest Charges & Preferred Stock Dividends	423.6	422.8	0.2
Total Expenses	5,259.3	4,921.8	6.9
Other Income (Loss)	16.8	(17.4)	N.M.
Income Before Federal Income Taxes	918.9	910.0	1.0
Federal Income Taxes	298.5	322.6	(7.5)
Income Before Extraordinary Item	620.4	587.4	5.6
Extraordinary Loss-UK Windfall Tax	(109.4)	–	N.M.
Net Income	$ 511.0	$ 587.4	(13.0)
Average Number of Shares Outstanding	189.0	187.3	0.9
Earnings Per Share			
Before Extraordinary Item	$3.28	$3.14	4.5
Extraordinary Loss-UK Windfall Tax	(0.58)	–	N.M.
Net Income	$2.70	$3.14	(14.0)
Cash Dividends Paid Per Share	$2.40	$2.40	

N.M. Not Meaningful

mild weather in 1997. The decline in residential sales was completely offset by an increase in lower priced sales to industrial customers.

An increase in transmission service revenues also contributed to the total increase in revenues. These revenues, for the transfer of other companies' power through the AEP transmission system, have increased significantly since the issuance of the FERC's open access transmission rules in 1996.

Total Expenses

Total expenses increased 7% due primarily to increased purchased power, fuel and other operation expense. The significant increase in purchased power expense was mainly due to purchases of electricity for resale by the new power marketing business. Fuel expense increased primarily due to an increase in the average cost of fuel consumed as lower cost nuclear generation was less available in 1997 due to an unplanned outage of both nuclear units beginning on September 9 and continuing through year-end. New marketing, customer services and software costs to prepare for competition contributed to the increase in other operation expense.

Other Income

The increase in other income was due primarily to the Company's share of equity earnings from the April 1997 investment in Yorkshire. Earnings from Yorkshire were $34 million inclusive of $10 million of nonrecurring tax benefits related to the retroactive reduction of the UK corporate income tax rate from 33% to 31%.

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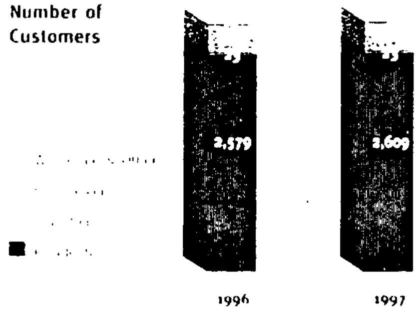
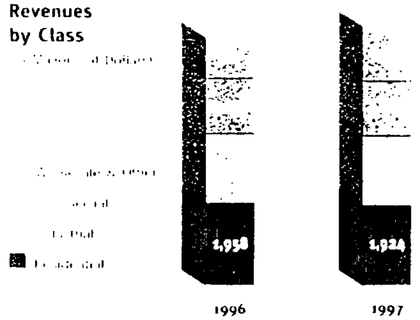
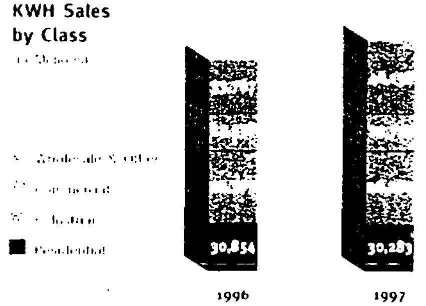
Number of Customers



Revenues by Class



KWH Sales by Class



We recognize that we must continue to manage our coal costs to maintain our competitive position. We are negotiating with unaffiliated suppliers to lower purchased coal costs. Although we have been working to reduce affiliated mining costs, we have been unable to reduce the cost of affiliated coal to what has been a declining market price for coal. With approval of the regulator, the Company is deferring affiliated coal costs in excess of a predetermined price cap for future recovery. We intend to continue to prudently supplement our long-term coal supplies with spot market purchases as long as favorable spot market prices exist. Competitive pressures, deregulation or Phase II of the Clean Air Act Amendments could result in the closure of the affiliated coal mines. Unless the cost of affiliated coal or the cost of any mine closure is recovered either in regulated rates or as a stranded cost under a plan to transition the generation business to competition, future earnings, cash flows and possibly financial condition could be adversely affected.

Significant efforts have been made to enhance our competitiveness in nuclear power generation and to improve our nuclear organizational efficiency. In 1997 we continued to receive the "excellence in performance" award from the Institute of Nuclear Power Operations. Nuclear power plants have a major future financial commitment to safely dispose of spent nuclear fuel and radioactive plant components (i.e. to decommission the plant). It is difficult to reduce nuclear generation costs since certain major cost components are impacted by federal laws and Nuclear Regulatory Commission (NRC) regulations. For example, the cost to store and dispose of spent nuclear fuel continues to increase, mainly due to the lack of progress by the federal government to secure and construct a repository. In addition, estimated nuclear decommissioning costs continue to increase due in part to the delay in securing an offsite storage site for spent fuel. Presently we are recovering the cost of on-site nuclear fuel storage and estimated nuclear decommissioning costs over the plant's remaining life. However, our future earnings, cash flows and possibly financial condition could be adversely affected if the costs of these items continue to increase and are not recovered.

Results of Operations

Net income decreased to $511 million or 13% primarily due to an extraordinary loss of $109 million from the UK's one-time windfall tax which was based on a retroactive revaluation of the original privatization price of certain privatized utilities, including Yorkshire. AEP's income before the extraordinary loss increased 6% in 1997 to $620 million, or $3.28 per share, from $587 million, or $3.11 per share, in 1996. The increase in earnings before the extraordinary loss in 1997 is primarily attributable to transmission service sales, reduced preferred stock dividends and an increase in other income from the April 1997 investment in Yorkshire exclusive of the extraordinary loss.

Revenues

Total revenues exceeded $6 billion for the first time, increasing over $300 million from 1996 total revenues of $5.8 billion. The 5% increase in revenues was mainly due to increased wholesale power sales from AEP's new power marketing business which began in July of 1997. The power marketing business makes substantial power purchases from and sales to non affiliated utilities and power marketers.

Retail revenues declined slightly as revenues from weather-sensitive residential customers decreased, reflecting lower usage due to

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Federal Income Taxes

The decrease in federal income taxes is mainly due to income tax benefits from the non-regulated business activities including foreign tax credits.

Financial Condition

In 1997 AEP maintained its strong financial condition and performance in shareholder value. The year-end closing stock price of $51 5/8 was 25.5% higher than the prior year. The Company paid a quarterly dividend in 1997 of 60 cents a share, maintaining the annual dividend rate at $2.40 per share. The payout ratio continued to improve, a trend that started in 1991. The 1997 payout ratio, before extraordinary loss, of 73% was 3% better than 1996's and 15% better than 1991's. Management's objective has been to reduce the payout ratio by increasing earnings in order to enhance AEP's ability to invest in new business ventures that complement our core competencies and improve shareholder value. AEP's three-year total shareholder return ranked fourth among the companies in the Standard and Poor's Electric Utility Index. This marked the fourth straight year AEP placed in the top quartile. Management's goal is to maintain and improve our position in the top quartile of the S&P Electric Utility Index for total shareholder return.

CONSOLIDATED CONDENSED BALANCE SHEETS

	1997	1996
ASSETS		
Electric Utility Plant	$19,596.4	$18,970.1
Accumulated Depreciation and Amortization	(7,963.6)	(7,549.7)
Net Electric Utility Plant	11,632.8	11,420.4
Other Property and Investments	1,358.8	892.7
Cash and Cash Equivalents	91.5	57.5
Other Current Assets	1,426.7	1,297.3
Regulatory Assets	1,817.5	1,889.5
Deferred Charges	288.0	325.6
Total	$16,615.3	$15,883.0
CAPITALIZATION AND LIABILITIES		
Common Shareholders' Equity	$4,677.2	$4,545.3
Cumulative Preferred Stocks of Subsidiaries	174.3	600.2
Long Term Debt	5,129.5	4,796.8
Total Capitalization	9,981.0	9,942.3
Current Liabilities	2,083.7	1,496.0
Deferred Income Taxes and Investment Tax Credits	2,937.2	3,044.7
Other Liabilities	1,613.4	1,400.0
Total	$16,615.3	$15,883.0

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS

Year Ended December 31
(in Millions)

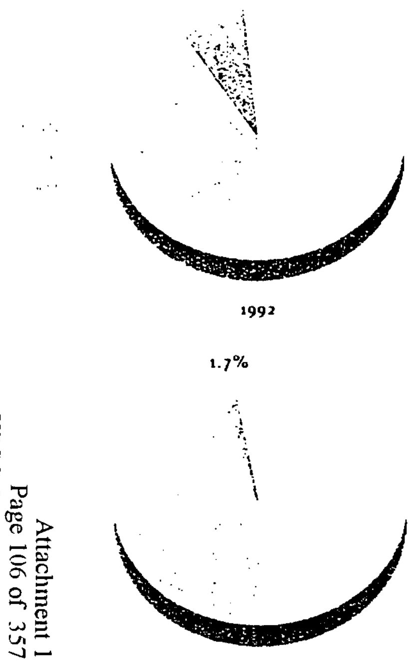
	1997	1996
OPERATING ACTIVITIES:		
Net Income	$ 511.0	$ 587.4
Extraordinary Item-UK Windfall Tax	109.4	-
Adjustments for Noncash Items	577.5	649.6
Net Cash Flows from Operating Activities	1,197.9	1,237.0
INVESTING ACTIVITIES:		
Construction	(760.4)	(577.7)
Investment in Yorkshire Electricity Group plc	(363.4)	-
Proceeds from Sale of Property and Other	2.2	12.3
Net Cash Flows Used for Investing Activities	(1,121.6)	(565.4)
FINANCING ACTIVITIES:		
Issuance of Common Stock	76.7	65.5
Retirement of Cumulative Preferred Stock	(433.3)	(70.8)
Change in Long-term Debt (net)	532.4	(194.0)
Change in Short-term Debt (net)	235.4	(45.4)
Dividends Paid on Common Stock	(453.5)	(449.4)
Net Cash Flows Used for Financing Activities	(42.3)	(694.1)
Net Increase (Decrease) in Cash and Cash Equivalents	34.0	(22.5)
Cash and Cash Equivalents January 1	57.5	80.0
Cash and Cash Equivalents December 31	$ 91.5	$ 57.5

Capital Resources and Needs

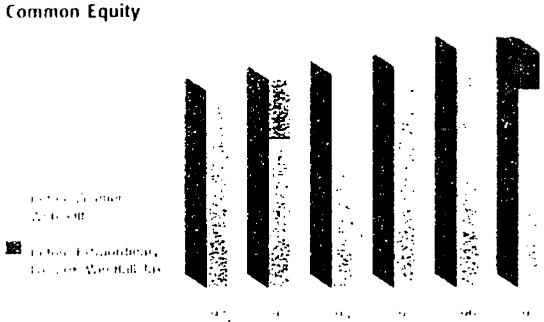
AEP achieved a year-end ratio of common equity to total capitalization of 15.5% for 1997, compared with 15.3% for 1996 and 13.1% for 1995. The Company's goal is to maintain the common equity ratio at a level of at least 40 percent. During 1997 the Company and its subsidiaries continued improving their debt-to-equity position. The Company's regulated subsidiaries redeemed 4.3 million shares of cumulative preferred stock with rates ranging from 4.08% to 7.875% at a total cost of $433 million. The subsidiaries used short-term debt and junior subordinated deferrable interest debentures to pay for the preferred stock tendered and to benefit from the tax deductibility of interest.

AEP's construction expenditures are expected to be $2.1 billion over the next three years, which includes the Donald C. Cook Nuclear Plant Unit 1 steam generator replacement, generating plant construction in China and the cost of transmission and distribution projects for the improvement of and addition to domestic electric energy delivery facilities. Approximately $2.1 billion of expenditures for the next three years will be financed with internally generated funds.

Capitalization Ratio



Return on Average
Common Equity



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Market Risks

The Company as a major power producer and a trader of electricity and gas has certain financial market risk inherent in its routine business activities. The trading of electricity and gas related future contracts exposes the Company to commodity price fluctuations. Market risk represents the risk of loss that may impact the Company's consolidated financial position, results of operations or cash flows due to adverse changes in market prices and rates. As trading activity increases and the markets for power evolve, this risk will become greater. Various policies and procedures have been established to manage market risk exposures including the limited usage of energy related derivatives, which are highly correlated to the underlying commodity exposures. The Company's debt used to finance plant and other investments exposes the Company to interest rate fluctuation risk. Investment in two foreign currency denominated joint ventures in the U.K and China exposes the Company to currency translation rate risk. The Company does not presently utilize derivatives to manage its exposures to interest rate and foreign currency exchange rate movements.

Other Matters

The Company has exposure to a number of contingencies, including but not limited to the following matters which are fully discussed in the 1997 Management's Discussion and Analysis of Results of Operations and Financial Condition and the Notes to the Consolidated Financial Statements contained in the full financial statements: the recent safety shutdown of the Cook Nuclear Plant with the restart of the units subject to NRC approval of the resolution of certain issues; a potential Internal Revenue Service ruling that certain interest deductions related to a corporate owned life insurance program used to help fund postretirement benefits for employees should not be allowed in our federal income tax returns; and the correction of a complex and interdependent "Year 2000" problem whereby certain existing computer hardware and software programs will not properly recognize calendar dates beginning in the year 2000. Recent clean air regulation and proposals could negatively impact fuel costs and the cost of generation. If these contingencies are not successfully resolved, they could have an adverse effect on the results of operations, cash flows and possibly financial condition.

INDEPENDENT AUDITORS' REPORT

To the Shareholders and Board of Directors
of American Electric Power Company, Inc.:

We have audited the consolidated balance sheets of American Electric Power Company, Inc. and its subsidiaries as of December 31, 1997 and 1996, and the related consolidated statements of income, retained earnings, and cash flows for each of the three years in the period ended December 31, 1997. Such consolidated financial statements and our report thereon dated February 24, 1998, expressing an unqualified opinion (which are not included herein) are included in the 1997 Financial Statements and Management's Discussion and Analysis of Results of Operations and Financial Condition. The accompanying condensed consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on such condensed consolidated financial statements in relation to the complete consolidated financial statements.

In our opinion, the information set forth in the accompanying condensed consolidated balance sheets as of December 31, 1997 and 1996 and the related condensed consolidated statements of income and of cash flows for the years then ended is fairly stated in all material respects in relation to the basic consolidated financial statements from which it has been derived.

Deloitte & Touche LLP

Deloitte & Touche LLP
Columbus, Ohio

February 24, 1998

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STATE PRESIDENTS

Our state presidents and their staffs are available to help customers, consumer groups, legislators and others who deal with energy usage, safety, conservation, education, environmental matters and public policy. They can be contacted at the following locations:

Coulter R. Boyle III
AEP Indiana
AEP Michigan
One Summit Square
P.O. Box 60
Fort Wayne, IN 46801
(219) 425-2101
Fax (219) 425-2157

R. Daniel Carson, Jr.
AEP Virginia
AEP Tennessee
40 Franklin Road SW
P.O. Box 2021
Roanoke, VA 24022
(540) 985-2900
Fax (540) 985-2340

Timothy C. Mosher
AEP Kentucky
1701 Central Avenue
P.O. Box 1428
Ashland, KY 41105
(606) 327-1261
Fax (606) 327-3128

Marsha P. Ryan
AEP Ohio
1 Riverside Plaza
Columbus, OH 43215
(614) 223-1400
Fax (614) 628-1631

Dana E. Waldo
AEP West Virginia
301 Virginia Street East
P.O. Box 1986
Charleston, WV 25327
(304) 348-4710
Fax (304) 348-5714

AEP LEADERSHIP

American Electric Power Company, Inc.

E. Linn Draper, Jr.
Chairman, President and Chief Executive Officer

Gerald P. Maloney
Vice President and Secretary

Peter J. DeMaria
Controller

Armando A. Pena
Treasurer

American Electric Power Service Corporation

E. Linn Draper, Jr.
Chairman, President and Chief Executive Officer

Peter J. DeMaria
Vice Chairman

Gerald P. Maloney
Vice Chairman

Paul D. Addis
Executive Vice President

Donald M. Clements, Jr.
Executive Vice President
Corporate Development

Henry Fayne
Executive Vice President –
Financial Services

Eugene E. Fitzpatrick
Executive Vice President
Nuclear Generation

William J. Lhota
Executive Vice President

James J. Markowsky
Executive Vice President
Power Generation

Joseph H. Vipperman
Executive Vice President
Corporate Services

Charles A. Ebetino, Jr.
Senior Vice President
Fuel Supply

Luke M. Feck
Senior Vice President
Corporate Communications

John R. Jones
Senior Vice President
Fossil Hydro Production

Raymond M. Maliszewski
Senior Vice President –
System Planning

Michael F. Moore
Senior Vice President
Information Technology and Chief Information Officer

Richard E. Munczinski
Senior Vice President
Corporate Planning and Budgeting

Armando A. Pena
Senior Vice President
Finance, Treasurer and Chief Financial Officer

Rodney B. Plimpton
Senior Vice President –
Human Resources

Peter Splawnyk
Senior Vice President –
Distribution

Andrew P. Varley
Senior Vice President
Energy Pricing and Regulatory Services

Leonard V. Assante
Vice President
Chief Accounting Officer and Controller

J. Craig Baker
Vice President
Power Marketing and Trading

Bruce M. Barber
Vice President –
Strategic Studies

Bruce A. Beam
Vice President –
Governmental Affairs

David H. Crabtree
Vice President –
Customer Services

John F. DiLorenzo, Jr.
Vice President
Associate General Counsel and Secretary

William N. D'Onofrio
Vice President
Regulatory Affairs

Carl A. Erikson
Vice President
Energy Delivery

Dale E. Heydlauff
Vice President
Environmental Affairs

Marshall O. Julien
Vice President
Communications

W. Robert Kelley
Vice President
System Operations

Vincent A. Lepore
Vice President
Power Generation Engineering

Hugh H. Lucas
Vice President
Mining Operations

Thomas R. McCaffrey
Vice President
Procurement and Supply Chain Services

James K. McWilliams
Vice President – *Civil and Mining Engineering*

Patrick M. O'Brien
Vice President
Fuel Procurement

Ron E. Prater
Vice President
Strategic Planning

Bruce A. Renz
Vice President
Energy Delivery Support

William L. Scott
Vice President – *Taxes*

Joseph A. Valentine
Vice President
Information Systems

Thomas R. Watkins
Vice President –
Energy Transmission

NEW BUSINESS SUBSIDIARIES

AEP Communications, Inc.

E. Linn Draper, Jr.
Chairman and Chief Executive Officer

Gerald P. Maloney
Vice Chairman

Donald M. Clements, Jr.,
President

Peter J. DeMaria
Vice President and Controller

William J. Lhota
Vice President

David Mustine
Vice President

Peter R. Thomas
Vice President

Armando A. Pena
Treasurer

John DiLorenzo, Jr.
Secretary

AEP Energy Services, Inc.

E. Linn Draper, Jr.
Chairman and Chief Executive Officer

Gerald P. Maloney
Vice Chairman

Paul D. Addis
President

J. Craig Baker
Senior Vice President

Steven Lewis
Senior Vice President

Eric J. van der Walde
Senior Vice President

Bruce H. Braine
Vice President – *Analysis*

Joseph A. Curia, Jr.
Vice President –
Energy Marketing

David B. Dunn
Vice President –
Gas Trading

Henry Fayne
Vice President

Douglas K. Penrod
Vice President –
Energy Trading

Glenn Riepl
Vice President

George Rooney
Vice President –
Business Development

Peter J. DeMaria
Controller

Armando A. Pena
Treasurer

John F. DiLorenzo, Jr.
Secretary

AEP Investments, Inc.

E. Linn Draper, Jr.
Chairman and Chief Executive Officer

Gerald P. Maloney
Vice Chairman

Donald M. Clements, Jr.
President

David Mustine
Senior Vice President

Jeffrey D. Cross
Vice President and General Counsel

Peter J. DeMaria
Vice President and Controller

Dennis A. Lantzy
Vice President

William J. Lhota
Vice President

Armando A. Pena
Treasurer

John F. DiLorenzo, Jr.
Secretary

AEP Resources, Inc.

E. Linn Draper, Jr.
Chairman and Chief Executive Officer

Gerald P. Maloney
Vice Chairman

Donald M. Clements, Jr.
President

Donald E. Boyd
Senior Vice President
Asia Pacific Development

David Mustine
Senior Vice President
European Development

Peter J. DeMaria
Vice President and Controller

Thomas S. Jobes
Vice President
Corporate Development

John R. Jones
Vice President

Dennis A. Lantzy
Vice President — *Generation*

James H. Sweeney
Vice President —
Latin America Development

Paul J. Wielgus
Vice President —
North American Development

Jeffrey D. Cross
Vice President and General Counsel

Armando A. Pena
Treasurer

John F. DiLorenzo, Jr.
Secretary

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BOARD OF DIRECTORS

(Left to right): John P. DesBarres, Robert W. Fri, Leonard J. Kujawa, Peter J. DeMaria, Linda Gillespie Stuntz, Kathryn D. Sullivan, Gerald P. Maloney, Angus E. Peyton, Lester A. Hudson, Jr., Robert M. Duncan, Morris Tanenbaum, Donald G. Smith, E. Linn Draper, Jr.

Committees of the Board:
The chairman is listed in ( ).
A Audit (Duncan), D Directors (Hudson),
E Executive (Draper),
F Finance (Peyton), H Human Resources (Tanenbaum),
P Public Policy (Stuntz)

Dates in parentheses indicate year elected to board

Dr. E. Linn Draper Jr., 56
Chairman, President & Chief Executive Officer
(1992) E

Angus E. Peyton, 71
Partner, Brown & Peyton
Charleston, West Virginia
(1978) AEF

Robert M. Duncan, 70
Retired U.S. District Judge
Southern District of Ohio
Columbus, Ohio
(1985) ADF

Dr. Lester A. Hudson Jr., 58
Chairman
H&F Associates
Greenville, South Carolina
(1987) ADHF

Dr. Morris Tanenbaum, 69
Vice President,
National Academy of Engineering
Short Hills, New Jersey
(1989) FHP

Linda Gillespie Stuntz, 43
Partner, Stuntz & Davis, P.C.
Washington, D.C.
(1993) DHP

Peter J. DeMaria, 63
Controller;
Vice Chairman,
AEP Service Corporation
(1995)

Gerald P. Maloney, 64
Vice President and Secretary,
Vice Chairman
AEP Service Corporation
(1991)

Donald G. Smith, 62
Chairman, President & Chief Executive Officer
Roanoke Electric Steel Corporation
Roanoke, Virginia
(1991) DHP

Robert W. Fri, 62
Director, National Museum of Natural History
Smithsonian Institution
Washington, D.C.
(1995) ADP

Leonard J. Kujawa, 65
International Energy Consultant
Atlanta, Georgia
(1997) DHP

John P. DesBarres, 58
Investor
Rancho Palos Verdes, California
(1997) ADF

Dr. Kathryn D. Sullivan,
President & Chief Executive Officer
COSI Columbus
Columbus, Ohio
(1997) P

FERC Docket Nos. EC98-40-000 et al.

SHAREHOLDER INFORMATION

Annual Meeting The 91st annual meeting of shareholders of American Electric Power Company will be held at 9:30 a.m. Wednesday, May 27, 1998, at The Ohio State University's Fawcett Center, 2400 Olentangy River Rd., Columbus, Ohio. Admission is by ticket only. To obtain a ticket, please note the instructions in the Notice of Annual Meeting to be mailed to shareholders or call the Company.

Shareholder Inquiries — If you have questions about your account, you can call the Company toll free at 800 AEP COMP (800-237-2667), or write to Bette Jo Rozsa, Investor Services, American Electric Power Company, 1 Riverside Plaza, Columbus, Ohio 43215-2373. You should have your Social Security number or account number ready; we will not speak to third parties about an account without the shareholder's approval or appropriate documents.

Transfer Agent & Registrar
First Chicago Trust Company of New York
P.O. Box 2500
Jersey City, NJ 07303-2500
Telephone Response Group: 800-328-6955;
E Mail Correspondence: FCTC@ em.fcnbd.com
World Wide Web address: http://www.fctc.com

Replacement of Dividend Checks — If you do not receive your dividend check within five business days after the dividend payment date, or if your check is lost, destroyed or stolen, you should notify the transfer agent or Investor Services for a replacement.

Lost or Stolen Stock Certificates — If your stock certificate is lost, destroyed or stolen, you should notify the transfer agent or Investor Services immediately so a "stop transfer" order can be placed on the missing certificate. The transfer agent then will send you the required documents to obtain a replacement certificate.

Address Changes — It is important that we have your current address on file so that you do not become a lost shareholder. Please contact Investor Services or the transfer agent for address changes for both record and dividend mailing addresses. We also can provide automatic seasonal address changes.

Stock Transfer — Please contact Investor Services or the transfer agent if you have questions regarding the transfer of stock and related legal requirements.

Dividend Reinvestment and Direct Stock Purchase Plan — A Dividend Reinvestment and Direct Stock Purchase Plan is available to all registered shareholders, AEP employees and investors who are not already shareholders. It is a simple and convenient method of purchasing additional shares of AEP common stock or an economical method of becoming an AEP shareholder. You may obtain the Plan prospectus and enrollment authorization form by contacting the transfer agent or Investor Services.

Direct Deposit of Dividends — The Company does offer electronic deposit of your dividends. Contact Investor Services or the transfer agent for details.

Stock Held in Brokerage Account ("Street Name") — When you purchase stock and it is held for you by your broker, it is listed with the Company in the broker's name or "street name." AEP does not know the identity of individual shareholders who hold their shares in this manner; we simply know that a broker holds a certain number of shares which may be for any number of customers. If you hold your stock in street name, you receive all dividend payments, annual reports and proxy materials through your broker. Therefore, if your shares are held in this manner, any questions you may have about your account should be directed to your broker.

How To Consolidate Accounts — If you want to consolidate your separate accounts into one account, you should contact the transfer agent or the Investor Services office to obtain the necessary instructions. When accounts are consolidated, it may be necessary to reissue the stock certificates.

How To Eliminate Duplicate Mailings — If you want to maintain more than one account but eliminate additional mailings of annual reports, you may do so by contacting the transfer agent or Investor Services, indicating the names you wish to keep on the mailing list for annual reports and the names you wish to delete. You may also check the box in the upper right-hand corner of the proxy card labeled "Mark here to discontinue annual report mailing for this account (for multiple-account holders only)." This will affect only these mailings; dividend checks and proxy materials will continue to be sent to each account.

Stock Trading — The Company's common stock is traded principally on the New York Stock Exchange under the ticker symbol AEP.

Taxes on Dividends — The Company paid $2.40 in cash dividends in 1997, all of which are taxable for federal income tax purposes.

Shareholder Direct — An array of timely recorded messages about AEP, including dividends and earnings information and recent news releases, is available at AEP Shareholder Direct at 800-551-1AEP (1237) anytime day or night. Hard copies of information can be obtained via fax or mail. Requests for annual reports, 10-K's, 10-Q's, Proxy Statements, and Summary Annual Reports should be made through Shareholder Direct. Also, during normal business hours you can choose to be transferred to shareholder service representatives at the transfer agent or the Company.

Financial Community Inquiries — Institutional investors and securities analysts should direct inquiries to John Bilacic, Finance Department, American Electric Power Company, 1 Riverside Plaza, Columbus, Ohio 43215-2373.

Internet Home Page — Information about AEP, including financial documents, SEC filings, news releases and customer service information, is available on the Company's home page on the internet. The World Wide Web address is http://www.aep.com.

Common Stock Market Price Range:

	1997		1996	
	High	Low	High	Low
First Quarter	$43 [illegible]	$40	$44 [illegible]	$40 [illegible]
Second Quarter	$42 [illegible]	$39 [illegible]	$42 [illegible]	$38 [illegible]
Third Quarter	$46 [illegible]	$41 [illegible]	$43 [illegible]	$40
Fourth Quarter	$52	$45 [illegible]	$42 [illegible]	$39 [illegible]

AEP NOW HAS A DIRECT STOCK PURCHASE PLAN

AEP has adopted a direct stock purchase plan that allows individuals to purchase stock directly from the company on a low-cost basis. You can purchase AEP stock for as little as $250, or $25 a month for 10 months. For a prospectus and plan details, call 800 955-4740 or return the attached post-paid card.

AEP®

AEP: America's Energy Partner℠

Please send me a prospectus and enrollment information about the AEP Dividend Reinvestment and Direct Stock Purchase Plan.

ARE YOU AN EXISTING AEP SHAREHOLDER? ☐ YES ☐ NO

NO POSTAGE
NECESSARY
IF MAILED
IN THE
UNITED STATES

BUSINESS REPLY MAIL
FIRST CLASS MAIL PERMIT NO. 11 COLUMBUS OH

POSTAGE WILL BE PAID BY ADDRESSEE

AMERICAN ELECTRIC POWER
INVESTOR SERVICES
28TH FLOOR
P.O. BOX 16631
COLUMBUS, OH 43272-2204

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COMMON AEP AND ELECTRIC UTILITY INDUSTRY TERMS

Book value per share — The value of each common share of stock if all of a company's assets, after all debts are paid, are divided by the number of common shares outstanding.

Coal conversion — A service under which AEP converts coal owned by others into electricity for their use.

Distribution line — Power lines that feed electricity to customer meters.

Dividend payout ratio — Dividends paid as a percentage of net income.

Earnings per share — The company's net income divided by the average number of common shares outstanding.

FERC — Federal Energy Regulatory Commission, the federal agency that regulates interstate sales and transmission of electricity.

FERC Rules 888 and 889 — Rules and code of conduct enacted in 1996 requiring public utilities to make their transmission system available to anyone on a comparable cost and service basis.

Integrated Substation — A network of intelligent electronic devices within a substation that share information and function as a unified system to protect, control, monitor, analyze and maintain that station in an economic and reliable manner.

Kilowatt — A measure of the rate at which electric energy is generated or consumed. A kilowatt is 1,000 watts.

Kilowatthour — A measure of the quantity of electric energy equal to one kilowatt of power generated or consumed in one hour.

Megawatt — One thousand kilowatts.

Net income — A company's income after all expenses, taxes and preferred dividends have been deducted.

Nitrogen oxides — Gases formed from the combustion of fossil fuels.

Ozone — A gas in the atmosphere that occurs naturally and through a mixture of nitrogen oxides, volatile organic compounds and sunlight.

Price/earnings ratio — The value of a company's stock price in relation to the earnings per share. The P/E ratio is calculated by dividing the stock price by the earnings per share.

PUHCA — Public Utility Holding Company Act of 1935. Regulates the corporate structure and securities issuance of electric utilities and places limitations on utilities that are structured as registered holding companies. It is enforced by the Securities and Exchange Commission.

PURPA — Public Utility Regulatory Policies Act of 1978. Designed to encourage conservation, more efficient use of energy sources and the use of alternative energy sources. It also requires utilities to purchase excess power produced by cogenerators.

Retail customer — A customer that purchases electricity for their own use.

RSO — Regional Service Organization, an AEP organization established to perform scheduled maintenance on AEP power plants.

Return on average common equity — The percentage return a company generated on the average amount of money that common shareholders have invested in a company.

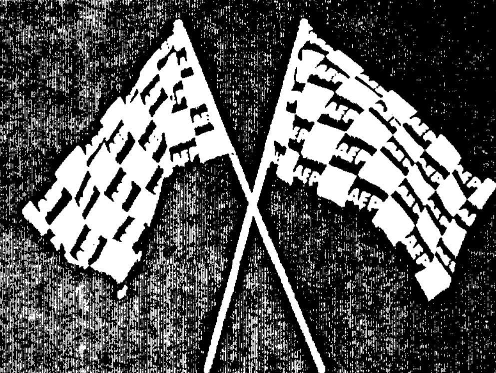
Sulfur dioxide — A gas of sulfur and oxygen compounds created when fossil fuels, such as coal, are burned.

Total investor return — The return to common shareholders based on dividends paid plus changes in the stock price from the previous year.

Transmission line — Power lines used to transmit bulk electricity, such as from state to state or region to region, at high voltages.

Unified Power Flow Controller — A device that uses power electronics and microcomputers to control the power flow and voltage quality of a transmission circuit instantaneously; the coordinated operation of multiple UPFCs will allow a previously unavailable degree of control over widespread transmission grids.

Wholesale customer — A customer, such as a municipal, cooperative or investor-owned electric company or power marketer, that buys electricity for resale.



AEP

AEP: America's Energy Partner SM

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1997
Financial Statements and Management's Discussion and Analysis of Results of Operations and Financial Condition

AEP AMERICAN® ELECTRIC POWER

AEP: America's Energy Partner℠

AMERICAN ELECTRIC POWER
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Columbus, Ohio 43215-2373

CONTENTS

AMERICAN ELECTRIC POWER COMPANY, INC. AND SUBSIDIARY COMPANIES
SELECTED CONSOLIDATED FINANCIAL DATA

Year Ended December 31,	1997	1996	1995	1994	1993
INCOME STATEMENTS DATA (in millions):					
Operating Revenues	$6,161	$5,849	$5,670	$5,505	$5,269
Operating Income	984	1,008	965	932	929
Income Before Extraordinary Item	620	587	530	500	354
Extraordinary Loss -					
UK Windfall Tax	109	-	-	-	-
Net Income	511	587	530	500	354

December 31,	1997	1996	1995	1994	1993
BALANCE SHEETS DATA (in millions):					
Electric Utility Plant	$19,597	$18,970	$18,496	$18,175	$17,712
Accumulated Depreciation					
and Amortization	7,964	7,550	7,111	6,827	6,612
Net Electric					
Utility Plant	$11,633	$11,420	$11,385	$11,348	$11,100
Total Assets	$16,615	$15,883	$15,900	$15,736	$15,359
Common Shareholders' Equity	4,677	4,545	4,340	4,229	4,151
Cumulative Preferred Stocks					
of Subsidiaries:					
Not Subject to Mandatory Redemption	47	90	148	233	268
Subject to Mandatory Redemption*	128	510	523	590	501
Long-term Debt*	5,424	4,884	5,057	4,980	4,995
Obligations Under Capital Leases*	538	414	405	400	284

*Including portion due within one year

Year Ended December 31,	1997	1996	1995	1994	1993
COMMON STOCK DATA:					
Earnings per Common Share:					
Before Extraordinary Item	$ 3.28	$3.14	$2.85	$2.71	$1.92
Extraordinary Loss - UK Windfall Tax	(0.58)	-	-	-	-
Net Income	$ 2.70	$3.14	$2.85	$2.71	$1.92
Average Number of Shares					
Outstanding (in thousands)	189,039	187,321	185,847	184,666	184,535
Market Price Range: High	$ 52	$44-3/4	$40-5/8	$37-3/8	$40-3/8
Low	39-1/8	38-5/8	31-1/4	27-1/4	32
Year-end Market Price	51-5/8	41-1/8	40-1/2	32-7/8	37-1/8
Cash Dividends Paid	$2.40	$2.40	$2.40	$2.40	$2.40
Dividend Payout Ratio	88.7%(a)	76.5%	84.1%	88.6%	125.2%
Book Value per Share	$24.62	$24.15	$23.25	$22.83	$22.50

(a) Dividend Payout Ratio before Extraordinary Loss - UK Windfall Tax is 73.1%.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

This discussion includes forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934. These forward-looking statements reflect assumptions, and involve a number of risks and uncertainties. Among the factors that could cause actual results to differ materially are: electric load and customer growth; abnormal weather conditions; available sources and costs of fuels and availability of generating capacity; the speed and degree to which competition is introduced to our power generation business, the terms of the transition to competition, and its impact on rate structures; the ability to recover stranded costs, new legislation and government regulations, the ability of the Company to successfully reduce its costs including synergy estimates; the degree to which the Company develops non-regulated business ventures and their success; the economic climate and growth in our service territory; inflationary trends, interest rates and other risks.

In 1997 management took several major steps towards our growth oriented goal of being America's Energy Partner and a global energy and related services company. Construction of a 250-megawatt generating station in China, jointly owned with two Chinese partners, progressed on schedule and within budget. In April, the Company and New Century Energies, Inc. acquired Yorkshire Electric Group plc, a United Kingdom (UK) distribution company. The Yorkshire investment is accounted for using the equity method. A new power marketing business was launched in July contributing significantly to our operating revenues which surpassed $6 billion for the first time. A joint venture with Conoco, an energy subsidiary of DuPont, was announced in October that will provide energy management services as well as financing of steam and electric generation facilities at large commercial and industrial plant sites including initially 16 Conoco and Dupont plant sites. The completion of agreements for the joint venture companies and the commencement of operations are expected in 1998.

In December 1997 American Electric Power Company (AEP or the Company) and Central and South West Corporation (CSW) agreed to merge. The merger is subject to approval by regulators and shareholders. Completion of the merger is expected to occur in the first half of 1999. CSW, a Dallas-based public utility holding company, owns four domestic electric utility subsidiaries serving 1.7 million customers in portions of Texas, Oklahoma, Louisiana and Arkansas and a regional electricity company in the UK. Other international energy operations and non-utility subsidiaries owned by CSW are involved in energy-related investments, telecommunications, energy efficiency services and financial transactions.

<u>Income Before Extraordinary Loss Increases</u>

AEP's 1997 income before an extraordinary loss, the one-time UK Windfall Tax, increased 6% to $620 million or $3.28 per share from $587 million or $3.14 per share in 1996. The increase was primarily attributable to increased transmission service revenues, reduced preferred stock dividends due to a redemption program and an increase in nonoperating income from the April 1997 investment in Yorkshire exclusive of the extraordinary loss. Net income inclusive of the $109 million extraordinary loss decreased $76 million or 13% primarily due to the UK one-time windfall tax which was based on a revision or recomputation of the original privatization value of certain privatized utilities, including Yorkshire.

For further details regarding changes in operating revenues and expenses, taxes and nonoperating investment earnings in 1997 and 1996 see Results of Operations.

Business Outlook

The Company's ability to recover its costs as the industry transitions to competition and as customer choice is more broadly available is the most significant factor affecting its future. Competition in the wholesale generation market continues to intensify since the adoption of federal legislation in 1992 which gave wholesale customers the right to choose their energy supplier and the Federal Energy Regulatory Commission (FERC) orders issued in 1996 which forced open access transmission. The introduction of competition and customer choice for retail customers has been slow although activity has been increasing. Federal legislation has been proposed to mandate competition and customer choice at the retail level, and several states have introduced or are considering similar legislation. All of our states have initiatives to move to customer choice that will phase-in or allow for a transition to competition, although the timing is uncertain. The Company supports customer choice and is proactively involved in discussions at both the state and federal levels regarding how best to structure and transition to a competitive marketplace.

As the cost of generation in the electric energy market evolves from cost-of-service ratemaking to market-based pricing, many complex issues must be resolved, including the recovery of stranded costs. While FERC orders No. 888 and 889 provide, under certain conditions, for recovery of stranded cost at the wholesale level, the issue of stranded cost is unresolved at the much larger retail level. The amount of any stranded costs we may experience depends on the timing and extent to which direct competition is introduced to our business and the then-existing market price of electricity.

Under the provisions of Statement of Financial Accounting Standards (SFAS) No. 71 "Accounting for the Effects of Certain Types of Regulation," regulatory assets (deferred expenses) and regulatory liabilities (deferred revenues) are included in the consolidated balance sheets of regulated utilities in accordance with regulatory actions and in order to match expenses and revenues with cost-based rates. In order to maintain net regulatory assets (net expense deferrals) on the balance sheet, SFAS No. 71 requires that rates charged to customers be cost-based. In the event a portion of AEP's business no longer meets the requirements of SFAS No. 71, net regulatory assets would have to be written off for that portion of the business. The provisions of SFAS No. 71 and SFAS No. 101 "Accounting for the Discontinuance of Application of Statement No. 71" never anticipated that deregulation would include an extended transition period or that it would provide for recovery of stranded costs after the transition period. In July 1997 the Emerging Issues Task Force (EITF) of the Financial Accounting Standards Board (FASB) reached a consensus that the application of SFAS No. 71 to a segment of a regulated electric utility which is subject to a legislative plan to transition to competition in that segment should cease when the legislation is passed or an enabling rate order is issued containing sufficient detail for the utility to reasonably determine what the plan would entail. The EITF indicated that the cessation of application of SFAS 71 would require that regulatory assets and impaired plant be written off unless they are recoverable.

Although FERC orders No. 888 and 889 provide for competition in the firm wholesale market, that market is a relatively small part of our business and most of our firm wholesale sales are still under cost-of-service contracts. As a result AEP's generation business is still cost-based regulated and should remain so for the near future pending the passage of enabling state legislation to deregulate the generation business. We believe that enabling state legislation should provide for the recovery of any generation-related net regulatory assets and other reasonable stranded costs from impaired generation assets. We are working with regulators, customers and legislators to provide for recovery of these stranded costs during a transition period in which rates are fixed or frozen and electric utilities would take steps to achieve cost savings which would be used to reduce or eliminate their stranded costs. However, if in the future AEP's generation business were to no longer be cost-based regulated and if it were not possible to demonstrate probability of recovery of resultant stranded costs including regulatory assets, results of operations, cash flows and financial condition would be adversely affected.

Cost Containment and Process Improvements

Efforts continue by AEP to reduce the costs of its products and services in order to maintain our competitiveness. Prior to 1997, reviews of our major domestic processes led to decisions to consolidate management and certain functions and operations and improve certain major processes. While staff reductions and cost savings resulting from the restructuring and improvements are presently being achieved, expenses for new marketing, customer services and modern efficient management information systems are increasing to prepare for competition. In 1997 the costs of these efforts to prepare for competition offset the savings from restructuring.

In 1997, AEP also began installing a new unified customer service system which is designed to support the request for service, billings, accounts receivable, credit and collection functions. AEP's new unified customer service system replaces a 30-year-old customer system and a nine-year-old transmission and distribution work management system. Process improvement efforts and expenditures to develop and implement the new customer service system and similar efforts and expenditures to acquire, install and enhance new client server-based accounting and budgeting/financial planning software should produce further improvements and efficiencies, enabling AEP to continue to offer its customers excellent service at competitive prices.

Fuel Costs

AEP recognizes that it must continue to manage coal costs to maintain its competitive position. Approximately 90% of AEP's generation is coal fired and approximately 17% of the 53 million tons of coal burned in 1997 were supplied by affiliated mines with the remainder acquired under long-term contracts and purchases in the spot market. As long-term contracts expire we are negotiating with unaffiliated suppliers to lower coal costs. We intend to continue to prudently supplement our long-term coal supplies with spot market purchases as long as favorable spot market prices exist.

In prior years we have agreed in our Ohio jurisdiction to certain limitations on the recovery of affiliated coal costs. Our analysis shows that we should be able to recover the Ohio jurisdictional portion of the costs of our affiliated mining operations including future mine closure costs. Management intends to seek recovery of its non-Ohio jurisdictional portion of the investment in and the liabilities and closing costs of our affiliated mines estimated at $102 million after tax. However, should it become apparent that these affiliated mining costs will not be recovered from Ohio and/or non-Ohio jurisdictional customers, the mines may have to be closed and future earnings, cash flows and possibly financial condition could be adversely affected. In addition compliance with Phase II requirements of the Clean Air Act Amendments of 1990 (CAAA), which become effective in January 2000, could also cause the mining operations to close. Unless the cost of any mine closure is recovered either in regulated rates or as a stranded cost under a plan to transition the generation business to competition, future earnings, cash flows and possibly financial condition could be adversely affected.

Nuclear Costs

Significant efforts have been made to enhance our competitiveness in nuclear power generation and to improve our nuclear organizational efficiency. In 1997 we continued to receive the "excellence in performance" award from the Institute of Nuclear Power Operations. Nuclear power plants have a major future financial commitment to safely dispose of spent nuclear fuel (SNF) and radioactive plant components (i.e. to decommission the plant). It is difficult to reduce nuclear generation costs since certain major cost components are impacted by federal laws and Nuclear Regulatory Commission (NRC) regulations.

The Nuclear Waste Policy Act of 1982 established federal responsibility for the permanent off-site disposal of SNF and high-level radioactive waste. By law we participate in the Department of Energy (DOE) SNF disposal program which is described in Note 4 of the Notes to Consolidated Financial Statements. Since 1983 our customers have paid $272 million for the disposal of nuclear fuel consumed at the Donald C. Cook Nuclear Plant (Cook Plant). Under the provisions of the Nuclear Waste Policy Act, collections from customers are to provide the DOE with money to build a repository for spent fuel. To date the federal government has not made sufficient progress towards a permanent repository or otherwise assuming responsibility for SNF. As long as there is a delay in the construction of a government approved storage repository for SNF, the cost of both temporary and permanent storage will continue to increase. The cost to decommission the Cook Plant is affected by both NRC regulations and the DOE's SNF disposal program. Studies completed in 1997 estimate the cost to decommission the Cook Plant range from $700 million to $1.152 billion in 1997 dollars. This estimate could escalate due to uncertainty in the DOE's SNF disposal program and the length of time that SNF may need to be stored at the plant site delaying decommissioning. Presently we are recovering the estimated cost of decommissioning the Cook Plant over its remaining life. However, AEP's future results of operations, cash flows and possibly its financial condition could be adversely affected if the cost of SNF disposal and decommissioning continues to increase and cannot be recovered.

On September 9 and 10, 1997, during a NRC architect engineer design inspection, questions regarding the operability of certain safety systems caused Company operations personnel to shut down Units 1 and 2 of the Cook Plant. On September 19, 1997, the NRC issued a Confirmatory Action Letter requiring the Company to address the issues identified in the letter. The Company is working with the NRC to resolve these issues and other issues related to restart of the units. Certain issued identified in the letter have been addressed. At this time management is unable to determine when the units will be returned to service. If the units are not returned to service in a reasonable period of time, it could have an adverse impact on results of operations, cash flows and possibly financial condition.

Environmental Concerns

We take great pride in our efforts to economically produce and deliver electricity while minimizing the impact on the environment. Over the years AEP has spent over a billion dollars to equip our facilities with the latest cost effective clean air and water technologies and to research possible new technologies. We are also proud of our award winning efforts to reclaim our mining properties. We intend to continue in a leadership role fostering economically prudent efforts to protect and preserve the environment.

Hazardous Material

By-products from the generation of electricity include materials such as ash, slag, sludge, low-level radioactive waste and SNF. Coal combustion by-products, which constitute the overwhelming percentage of these materials, are typically disposed of or treated in captive disposal facilities or are beneficially utilized. In addition, our generating plants and transmission and distribution facilities have used asbestos, polychlorinated biphenyls (PCB) and other hazardous and nonhazardous materials. We are currently incurring costs to safely dispose of such substances. Additional costs could be incurred to comply with new laws and regulations if enacted.

The Comprehensive Enviromental Response, Compensation and Liability Act (CERCLA or Superfund) addresses clean-up of hazardous substances at disposal sites and authorized the United States Environmental Protection Agency (Federal EPA) to administer the clean-up programs. As of year-end 1997, we are involved in litigation with respect to five sites overseen by the Federal EPA and have been named by the Federal EPA as a "Potentially Responsible Party" (PRP) for seven other sites. There are seven additional sites for which AEP companies have received information requests which could lead to PRP designation. Also, an AEP subsidiary has received an information request with respect to one site administered by state authorities. Our liability has been resolved for a number of sites with no significant effect on results of operations. In those instances where we have been named a PRP or defendant, our disposal or recycling activity was in accordance with the then-applicable laws and regulations. Unfortunately, CERCLA does not recognize compliance as a defense, but imposes strict liability on parties who fall within its broad statutory categories.

While the potential liability for each Superfund site must be evaluated separately, several general statements can be made regarding our potential future liability. Disposal at a particular site by AEP is often unsubstantiated; the quantity of material we disposed of at a site was generally small; and the nature of the material we generally disposed of was nonhazardous. Typically, we are one of many parties named as PRPs for a site and, although liability is joint and several, generally some of the other parties are financially sound enterprises. Therefore, our present estimates do not anticipate material cleanup costs for identified sites for which we have been declared PRPs. However, if for reasons not currently identified significant cleanup costs are attributed to AEP in the future, results of operations, cash flows and possibly financial condition would be adversely affected unless the costs can be recovered from customers.

Federal EPA Actions

Federal EPA is required by the CAAA to issue rules to implement the law. In December 1996 Federal EPA issued final rules governing nitrogen oxide (NOx) emissions that must be met after January 1, 2000 (Phase II of the CAAA). The final rules will require substantial reductions in NOx emissions from certain types of boilers including those in AEP's power plants. On February 13, 1998, the United States Court of Appeals for the District of Columbia Circuit, in an appeal in which the AEP System operating companies participated, upheld the emission limitations. In addition in November 1997 the Federal EPA published a proposed rulemaking requiring the revision of state implementation plans in 22 eastern states, including those states in which the operating companies of the AEP System have coal-fired generating plants. The proposed rule will require reductions in NOx emissions from utility sources of approximately 85% below 1990 levels and entail very substantial capital and operating expenditures by AEP System operating companies. Pollution controls to meet the proposed revised NOx emission limits would have to be in place by 2002. Eight northeast states have petitioned Federal EPA for the imposition of additional NOx controls for upwind industrial and utility sources. The matter is being litigated. The costs to comply with the emission reductions required by the Federal EPA's actions are expected to be substantial and would have a material adverse impact on future results of operations, cash flows and possibly financial condition if the resultant costs are not recovered from customers.

In 1997 the Federal EPA published a revised ambient air quality standard for ozone and established a new ambient air quality standard for fine particulate matter. These standards are expected to result in redesignation of a number of areas of the country currently in compliance with the existing standard to nonattainment status which could ultimately dictate more stringent emission restrictions for AEP generating units. Under the new rules the states must first determine whether the standards are being achieved. The states then have three years to submit a compliance plan and up to ten years after designation to come into compliance with the new standards. The compliance deadline could be as late as 2010 for the ozone standard and 2012-2015 for the fine particulate standard. Although we are reviewing the impact of the new rules, we are unable to estimate compliance costs without knowledge of the reductions that will be necessary to meet the new standards. If such reductions are significant and the Company must bear a significant portion of the cost of compliance in a region that is in violation of the revised standards, it would have a material adverse effect on results of operations, cash flows and possibly financial condition unless such costs are recovered from customers.

At the global climate conference in Kyoto, Japan in December 1997 more than 160 countries, including the United States, negotiated a treaty limiting emissions of greenhouse gases, chiefly carbon dioxide, which may eventually contribute to global warming. Although there is no clear scientific evidence that carbon dioxide contributes to global warming and damages the environment, the treaty, which requires Congressional approval, calls for a seven percent reduction below the emission levels of greenhouse gases in 1990. We intend to work with Congress to insure that science and reason are introduced to the debate. If approved by Congress the costs to comply with the emission reductions required by the Kyoto treaty is expected to be substantial and would have a material adverse impact on results of operations, cash flows and possibly financial condition if not recovered from customers.

Results of Operations

Net Income Declines Due to Extraordinary Loss

Net income decreased 13% to $511 million primarily due to an extraordinary loss of $109 million from the UK's one-time windfall tax which was based on a retroactive revaluation of the original privatization price of certain privatized utilities, including Yorkshire. Income before the extraordinary loss increased 6% in 1997 to $620 million or $3.28 per share from $587 million or $3.14 per share in 1996. The increase is primarily attributable to increased transmission service sales, reduced preferred stock dividends due to a redemption program and an increase in nonoperating income from the April 1997 investment in Yorkshire exclusive of the extraordinary loss.

In 1996 net income increased 11% to $587 million or $3.14 per share from $530 million or $2.85 per share in 1995. The increase was mainly attributable to increased sales of energy and services and reduced interest charges and preferred stock dividends. Sales increased due to increased transmission and other services provided to power marketers and utilities and increased energy sales to non-affiliated utilities and industrial customers. The reduction in interest and preferred stock dividends resulted from the Company's refinancing program. Also contributing to the improvement in net income in 1996 were severance pay charges recorded in 1995 in connection with the restructuring of management and operations and gains recorded in 1996 from emission allowance transactions.

Revenues and Sales Increase

Operating revenues increased 5% in 1997 and 3% in 1996. Increased wholesale energy sales and transmission and coal conversion service revenues were the primary reasons for the increases in both years. The change in revenues can be analyzed as follows:

	Increase (Decrease) From Previous Year			
(Dollars in Millions)	1997		1996	
	Amount	%	Amount	%
Retail:				
Price Variance	$(44.0)		$ (42.9)	
Volume Variance	2.4		63.7	
Fuel Cost Recoveries	27.3		15.0	
	(14.3)	(0.3)	35.8	0.7
Wholesale:				
Price Variance	9.6		(202.0)	
Volume Variance	269.7		317.3	
Fuel Cost Recoveries	8.3		(3.6)	
	287.6	36.3	111.7	16.4
Other Operating Revenues	38.8		31.4	
Total	$312.1	5.3	$ 178.9	3.2

The slight decrease in retail revenues in 1997 was largely due to a decline in higher priced sales to weather-sensitive residential customers reflecting mild weather. The decline in residential sales was completely offset by an increase in lower priced sales to industrial customers, reflecting increased usage which resulted in a small increase in total retail energy sales. The negative price variance resulted from the shift from higher priced residential sales to lower priced industrial sales.

In 1997 wholesale revenues and sales increased significantly primarily due to new power marketing transactions which began in July 1997 when AEP commenced a power marketing business. The new power marketing transactions involve the substantial purchase and sale of electricity outside of the AEP transmission system. An increase in coal conversion service sales also contributed to the significant increase in wholesale sales and revenues. These sales are for the generation of electricity from the coal of the purchaser.

An increase of $33 million in transmission service revenues produced the increase in other operating revenues in 1997. Transmission service revenues are for the transmission of other companies' power through AEP's extensive transmission system. These revenues have increased significantly since the issuance of the FERC's open access transmission rules in 1996.

In 1996 retail revenues increased slightly due to growth in the number of customers and the addition of a major new industrial customer in December 1995. Revenues from higher priced sales to residential customers, the most weather-sensitive customer class, were flat, increasing less than one percent, as the effect of cold winter weather in early 1996 was offset by mild summer and December temperatures. Revenues from lower priced commercial and industrial customers increased 1% reflecting growth in the number of customers. The increase in lower priced

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commercial and industrial sales accounted for the negative price variance in 1996.

Wholesale revenues increased 16% in 1996 reflecting a 46% increase in wholesale sales attributable largely to transactions with power marketers and other utilities. During 1996 the Company began providing coal conversion services resulting in 6.8 billion kilowatthours of electricity generated for power marketers and certain other utilities from their coal under a new FERC-approved interruptible, contingent sales tariff. These sales have lower prices because there is no associated fuel cost. As a result the average price per kilowatthour was significantly less in 1996 than in 1995 producing a negative price variance. Also contributing to the increased wholesale sales was a long-term contract with an unaffiliated utility to supply 205 MW of energy for 15 years beginning January 1, 1996.

An increased level of activity in the wholesale energy markets, due to FERC's open access rulemaking and AEP's aggressive efforts to provide flexible and competitively priced transmission services led to an increase in transmission service revenues in 1996. As a result transmission service revenues, which are recorded in other operating revenues, increased by approximately $24 million.

The level of wholesale sales tends to fluctuate due to the highly competitive nature of the short-term energy market and other factors, such as affiliated and unaffiliated generating plant availability, the weather and the economy. The FERC rules which introduce a greater degree of competition into the wholesale energy market have had the effect of increasing short-term wholesale sales and transmission service revenues. The Company's sales and in turn its results of operations were impacted in 1997 and 1996 by the quantities of energy and services sold to wholesale customers. Future results of operations will be affected by the quantity and price of wholesale transactions which often depend on the level of competition, the weather and power plant availability, both affiliated and non-affiliated, factors the Company does not control. However, we work to take advantage of these factors when they are favorable.

Operating Expenses Increase

Operating expenses increased 7% in 1997 and 3% in 1996. Increased purchased power expense, mainly from the Company's new power marketing business, was the primary reason for the 1997 increase. New marketing, customer services and software costs to prepare for competition also contributed to the increase. The primary items accounting for the increase in 1996 were increased fuel costs, federal income taxes and expenditures for marketing, information systems and other items necessary to prepare for the transition to competition. Changes in the components of operating expenses were as follows:

	Increase (Decrease) From Previous Year			
(Dollars in Millions)	1997		1996	
	Amount	%	Amount	%
Fuel	$ 26.4	1.6	$ 63.5	4.1
Purchased Power	330.2	383.5	(2.3)	(2.6)
Other Operation	17.3	1.4	25.9	2.2
Maintenance	(19.6)	(3.9)	(39.0)	(7.2)
Depreciation and Amortization	(9.7)	(1.6)	7.8	1.3
Taxes Other Than Federal Income Taxes	(8.0)	(1.6)	9.4	1.9
Federal Income Taxes	(0.9)	(0.3)	70.2	25.8
Total	$335.7	6.9	$135.5	2.9

Fuel expense increased in 1997 primarily due to an increase in the average cost of fuel consumed reflecting the reduced availability of lower cost nuclear generation in 1997 due to the unplanned shutdown and maintenance outage of both nuclear units which began on September 10 and continued through year-end. The increase in fuel expense in 1996 was primarily due to an increase in generation to meet the increase in industrial and wholesale customer demand. The effect of increased generation was partially offset by reduced average fossil

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fuel costs, resulting from increased usage of lower cost spot market coal, and lower cost nuclear fuel.

The significant increase in purchased power expense in 1997 was primarily due to purchases of electricity for the new power marketing business. These purchases were made to cover sales made to non-affiliates by the new power marketers.

In 1997 restructuring savings in other operation expense were more than offset by additional expenses for marketing, customer service and software costs to prepare for the service demands of competition.

Maintenance expense decreased in 1996 due to the deferral of previously expensed storm damage costs commensurate with their recovery over 5-years and reduced nuclear plant maintenance expense due to workforce reductions and the reduction of contract labor at the Cook Plant.

The increase in federal income tax expense attributable to operations in 1996 was primarily due to an increase in pre-tax operating income and changes in certain book/tax differences accounted for on a flow-through basis and certain permanent differences.

Nonoperating Income

The increase in nonoperating income in 1997 was mainly due to income from non-regulated operations. The Company's share of earnings from its April 1997 investment in Yorkshire was $34 million which includes $10 million of nonrecurring tax benefits related to a reduction of the UK corporate income tax rate from 33% to 31% effective April 1,1997. The utilization of foreign tax credits also contributed to the increase in nonoperating income. Nonoperating income decreased in 1996 due to the cost of the AEP branding program and the cost of efforts to develop and make investment in new non-regulated business ventures.

Interest Charges and Preferred Stock Dividend Requirements

In 1997 interest charges on both long-term and short-term debt increased reflecting additional borrowing primarily to fund the Company's non-regulated operations including the investment in Yorkshire. Preferred stock dividend requirements of the subsidiaries decreased in 1997 due to the reacquisition of over 4 million shares of cumulative preferred stock.

The decrease in interest charges and preferred stock dividend requirements in 1996 was mainly due to continued refinancing programs of the Company's subsidiaries. The refinancings reduced the average interest rate and the amount of long-term debt and preferred stock outstanding. The cost of short-term borrowings in 1996 increased slightly reflecting an increased average balance of short-term debt outstanding.

Financial Condition

In 1997 AEP maintained its strong financial condition and performance in shareholder value. The year-end closing stock price of $51-5/8 was 25.5% higher than the prior year and 57% greater than the 1994 closing price. The Company paid a quarterly dividend in 1997 of 60 cents a share maintaining the annual dividend rate at $2.40 per share. The 1997 payout ratio before extraordinary loss at 73% was 3% better than 1996's and 15% better than 1994's. It has been a management objective to reduce the payout ratio through efforts to increase earnings in order to enhance AEP's ability to invest in new business ventures that can complement our core competencies and improve shareholder value. AEP's three year total shareholder return ranked fourth among the companies in the S&P Electri

Utility Index. This marked the fourth straight year in the top quartile of the Index. Management's goal is to maintain our position in the top quartile of the S&P Electric Utility Index for three-year total shareholder return.

Capital Investments

The total consideration paid in 1997 by a joint venture of AEP and an unaffiliated company to acquire Yorkshire was approximately $2.4 billion which was financed by a combination of equity and non-recourse debt. AEP initially funded its 50% equity investment in the joint venture with $50 million in cash, a $300 million adjustable rate term loan under a long-term revolving credit agreement and $10 million of short-term debt. For more information see Note 7 of the Notes to Consolidated Financial Statements. Also the Company's 70% interest in the construction of two 125 MW units in China will require approximately $110 million of investment.

AEP's construction expenditures are expected to be $2.4 billion over the next three years which includes the Cook Plant's Unit 1 steam generator replacement, the China project and the cost of transmission and distribution projects for the improvement of and addition to electric energy delivery facilities. Approximately 90% of domestic construction expenditures, estimated to be $2.3 billion for the next three years, will be financed with internally generated funds.

Capital Resources - Structure and Liquidity

AEP achieved a year-end ratio of common equity to total capitalization including amounts due within one year of 45.5% for 1997, compared with 45.3% for 1996 and 43.1% for 1995. The Company's goal is to maintain the common equity ratio at a level of at least 40 percent. During 1997 the Company and its subsidiaries continued redefining and improving their debt to equity position. The Company's regulated subsidiaries redeemed 4,258,947 shares of cumulative preferred stock with rates ranging from 4.08% to 7.875% at a total cost of $433 million. The subsidiaries used short-term debt and junior subordinated deferrable interest debentures to pay for the preferred stock tendered and to benefit from the tax deductibility of interest.

The Company and its subsidiaries issued $882 million principal amount of long-term obligations in 1997 at interest rates ranging from 5.9% to 8.0%. The companies continued to reduce financing costs by retiring higher-cost bonds and restructuring the long-term debt from senior secured/first mortgage bonds to senior unsecured debt and junior debentures. The principal amount of long-term debt retirements, including maturities, totaled $343 million with interest rates ranging from 6.5% to 9.35%. Our operating subsidiaries senior secured debt/first mortgage bond ratings, which were reaffirmed and improved in 1997, are listed in the following table:

Company	Moody's	S&P	Fitch	D & P
Appalachian Power Co.	A3	A	A	A
Columbus Southern Power Co.	A3	A-	A-	A
Indiana & Michigan Power Co.	Baa1	A-	BBB+	N/A
Kentucky Power Co.	Baa1	A	BBB+	N/A
Ohio Power Co.	A3	A-	A-	A

N/A = Not applicable

The operating subsidiaries generally issue short-term debt to provide for interim financing of capital expenditures that exceed internally generated funds. They periodically reduce their outstanding short-term debt through issuances of long-term debt and additional capital contributions by the parent company. The companies formed to pursue non-regulated business opportunities are using short-term debt. Short-term debt increased $235 million from the prior year-end balance and decreased by $45 million in 1996. At December 31, 1997, AEP Co., Inc. (the parent company) and its subsidiaries had unused short-term lines of credit of $442 million, and several of AEP's subsidiaries engaged in non-regulated investments and energy businesses had available $330 million under a $600 million revolving credit agreement which expires in 1999. The sources of funds available to AEP are dividends from its subsidiaries, short-term and long-term borrowings and, when necessary, proceeds from the issuance of common stock. AEP issued 1,755,000 shares in 1997, 1,600,000 shares in 1996 and 1,400,000 shares in 1995 of common stock through a Dividend Reinvestment Program and the Employee Savings Plan raising $77 million, $65 million and $49 million, respectively.

The following debt and preferred stock coverages of the principal operating subsidiaries remained strong in 1997:

	Coverages at December 31, 1997	
	Mortgage	Preferred Stock
Appalachian Power Co.	3.72	1.92
Columbus Southern Power Co.	4.95	N/A
Indiana & Michigan Power Co.	7.57	2.88
Kentucky Power Co.	4.23	N/A
Ohio Power Co.	9.74	3.67

N/A = Not Applicable

Unless the subsidiaries meet certain earnings or coverage tests, they cannot issue additional mortgage bonds or preferred stock. In order to issue mortgage bonds (without refunding existing debt), each subsidiary must have pre-tax earnings equal to at least two times the annual interest charges on mortgage bonds after giving effect to the issuance of the new debt. Generally, issuance of additional preferred stock requires after-tax gross income at least equal to one and one-half times annual interest and preferred stock dividend requirements after giving effect to the issuance of the new preferred stock. As the above chart indicates, the subsidiaries presently exceed these minimum coverage requirements.

Merger

In December 1997 AEP and CSW announced that their boards of directors approved a definitive merger agreement for a tax-free, stock-for-stock business combination transaction which if consummated would bring AEP's total market capitalization to approximately $28 billion. The combination is expected to be accounted for as a pooling of interests. Under the agreement, each common share of CSW will be converted to 0.6 shares of AEP. Based on the number of CSW common shares outstanding at December 31, 1997, AEP will issue approximately 127 million shares to CSW common stockholders (valued at $6.6 billion based on the closing price on the last trading day prior to the announcement of the merger). Under the merger agreement, there will be no changes with respect to the public debt issues or the outstanding preferred stock of AEP, CSW or their subsidiaries. The merger is conditioned, among other things, upon the approval of each company's shareholders and certain state and federal regulatory agencies. The companies anticipate that the required regulatory approvals can be obtained in 12 to 18 months. AEP is requesting regulatory and shareholder approval to increase the number of authorized shares from 300,000,000 to 600,000,000 in connection with the merger.

Market Risks

The Company as a major power producer and a trader of electricity and gas has certain financial market risks inherent in its routine business activities. The trading of electricity and gas and related future contracts exposes the Company to commodity price fluctuations. Market risk represents the risk of loss that may impact the Company's consolidated financial position, results of operations or cash flows due to adverse changes in market prices and rates. As trading activity increases and the market for power evolves this risk will become much greater. Various policies and procedures have been established to manage market risks exposures including the limited usage of energy related derivatives. In its regular business activities, certain trading positions of the Company for electric and gas creates exposure to price volatility for those products. These commodities are subject to unpredictable price fluctuations due to changing economic and weather conditions. During 1997 the Company initiated a power and gas marketing operation that manages the Company's exposure to future price movements using forwards, futures and options. At December 31, 1997, the exposure for financial derivatives in these marketing activities were not material to the Company's consolidated results of operations, financial position or cash flows.

Investment in two foreign currency denominated joint ventures also exposes the Company to currency translation rate risk. At December 31, 1997, the Company's exposure to changes in foreign currency exchange rates related to projects in the UK and China is not material to its consolidated financial position, results of operations or cash flows. The Company does not presently utilize derivatives to manage its exposures to foreign currency exchange rate movements.

The Company is exposed to changes in interest rates primarily due to short- and long-term borrowings to fund its business operations. The debt portfolio has both fixed and variable interest rates, terms from one day to thirty years and an average duration of eight years at December 31, 1997.

The Company measures interest rate market risk exposure utilizing a Value at Risk (VaR) model. The model is based on the Monte Carlo method of simulated price movements with a 95% confidence level and a one year holding period. The volatilities and correlations were based on three years of monthly prices. The risk of potential loss in fair value attributable to the Company's exposure to interest rates, primarily related to long-term debt with fixed interest rates, was $501 million at December 31, 1997. A near term change in interest rates would not materially affect the consolidated financial position or results of operations of the Company. The Company is not currently utilizing derivatives to manage its exposure to interest rate fluctuations.

The Company has investments in debt and equity securities which are held in trust funds to decommission its nuclear plant. Approximately 85% of the trust fund value is invested in tax exempt and taxable bonds, short-term debt instruments or cash. The trust investments and their fair value are discussed in Note 9 of the Notes to Consolidated Financial Statements. Instruments in the trust funds have not been included in the market risk calculation for interest rates as these instruments are marked-to-market and changes in market value are reflected in a corresponding decommissioning liability. Any differences between trust fund and ultimate liability are recoverable from ratepayers.

Inflation affects AEP's cost of replacing utility plant and the cost of operating and maintaining its plant. The rate-making process limits our recovery to the historical cost of assets resulting in economic losses when the effects of inflation are not recovered from customers on a timely basis. However, economic gains that result from the repayment of long-term debt with inflated dollars partly offset such losses.

Other Matters

Corporate Owned Life Insurance

In connection with the audit of AEP's consolidated federal income tax returns the United States Internal Revenue Service (IRS) agents sought a ruling from the IRS National Office that certain interest deductions relating to a corporate owned life insurance (COLI) program should not be allowed. The Company established the COLI program in 1990 as a part of its strategy to fund and reduce the cost of medical benefits for retired employees. AEP filed a brief with the IRS National Office refuting the agents' position. No adjustments have been proposed by the IRS. However, should a full disallowance of COLI interest deductions be proposed it would, if sustained, reduce earnings by approximately $286 million (including interest). AEP believes it has meritorious defenses and will vigorously contest any proposed adjustments. No provisions for this amount have been recorded. In the event the Company is unsuccessful it could have a material adverse impact on results of operations and cash flows.

Computer Software - Year 2000 Compliance

Many existing computer hardware and software programs will not properly recognize calendar dates beginning in the year 2000. Unless corrected, this "Year 2000" problem may cause computer malfunctions, such as system shutdowns or incorrect calculations and system output. The Company is addressing the problem internally by modifying or replacing its computer hardware and software programs to mitigate its risk, minimize technical failures, and repair such failures if they occur. The problem is also being addressed externally with entities that interact electronically with the Company, including but not limited to, suppliers, service providers, government agencies, customers, creditors and financial service organizations. However, due to the complexity of the problem and the interdependent nature computer systems, if the Company corrective actions, and/or the actions of oth interdependent entities, fail for critic applications, the Company may be adverse impacted in the year 2000. Althouç significant, the cost of correcting the "Ye 2000" problem is not expected to have material impact on results of operations, cas flows or financial condition.

New Accounting Standards

In June 1997 the FASB issued SFA No. 130 "Reporting Comprehensive Income and SFAS No. 131 "Disclosures Abou Segments of an Enterprise and Relate Information." SFAS No. 130 establishes th standards for reporting and displayin components of "comprehensive income, which is the total of net income and all othe changes in equity except those resulting fron investments by shareholders anc dispositions to shareholders. SFAS No. 13 initiates standards for reporting informatior about operating segments in annual anc interim financial statements as well as related disclosures about products anc services, geographic areas and majoı customers. AEP's adoption of these new reporting standards in 1998 is not expected to have a material adverse effect on the results of operations, cash flows and/or financial condition.

Litigation

AEP is involved in a number of legal proceedings and claims. While we are unable to predict the outcome of such litigation, it is not expected that the ultimate resolution of these matters will have a material adverse effect on the results of operations, cash flows and/or financial condition.

AMERICAN ELECTRIC POWER COMPANY, INC. AND SUBSIDIARY COMPANIES
CONSOLIDATED STATEMENTS OF INCOME
(in thousands - except per share amounts)

	Year Ended December 31,		
	1997	1996	1995
OPERATING REVENUES	$6,161,368	$5,849,234	$5,670,330
OPERATING EXPENSES:			
Fuel	1,627,066	1,600,659	1,537,135
Purchased Power	416,266	86,095	88,396
Other Operation	1,227,368	1,210,027	1,184,158
Maintenance	483,268	502,841	541,825
Depreciation and Amortization	591,071	600,851	593,019
Taxes Other Than Federal Income Taxes	490,595	498,567	489,223
Federal Income Taxes	341,280	342,222	272,027
TOTAL OPERATING EXPENSES	5,176,914	4,841,262	4,705,783
OPERATING INCOME	984,454	1,007,972	964,547
NONOPERATING INCOME (net)	59,572	2,212	20,204
INCOME BEFORE INTEREST CHARGES AND PREFERRED DIVIDENDS	1,044,026	1,010,184	984,751
INTEREST CHARGES	405,815	381,328	400,077
PREFERRED STOCK DIVIDEND REQUIREMENTS OF SUBSIDIARIES	17,831	41,426	54,771
INCOME BEFORE EXTRAORDINARY ITEM	620,380	587,430	529,903
EXTRAORDINARY LOSS - UK WINDFALL TAX	(109,419)	-	-
NET INCOME	$ 510,961	$ 587,430	$ 529,903
AVERAGE NUMBER OF SHARES OUTSTANDING	189,039	187,321	185,847
EARNINGS PER SHARE:			
Before Extraordinary Item	$3.28	$3.14	$2.85
Extraordinary Loss	(0.58)	-	-
Net Income	$2.70	$3.14	$2.85
CASH DIVIDENDS PAID PER SHARE	$2.40	$2.40	$2.40

CONSOLIDATED STATEMENTS OF RETAINED EARNINGS
(in thousands)

	Year Ended December 31,		
	1997	1996	1995
RETAINED EARNINGS JANUARY 1	$1,547,746	$1,409,645	$1,325,581
NET INCOME	510,961	587,430	529,903
DEDUCTIONS:			
Cash Dividends Declared	453,453	449,353	445,831
Other	237	(24)	8
RETAINED EARNINGS DECEMBER 31	$1,605,017	$1,547,746	$1,409,645

See Notes to Consolidated Financial Statements.

AMERICAN ELECTRIC POWER COMPANY, INC. AND SUBSIDIARY COMPANIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Year Ended December 31, 1997	1996	1995
OPERATING ACTIVITIES:			
Net Income	$ 510,961	$ 587,430	$ 529,903
Adjustments for Noncash Items:			
Depreciation and Amortization	608,217	590,657	578,003
Deferred Federal Income Taxes	(6,549)	(21,478)	11,916
Deferred Investment Tax Credits	(25,241)	(25,808)	(25,819)
Amortization of Operating Expenses and Carrying Charges (net)	12,001	55,458	53,479
Extraordinary Item - UK Windfall Tax	109,419	-	-
Changes in Certain Current Assets and Liabilities:			
Accounts Receivable (net)	(136,186)	(39,049)	(71,804)
Fuel, Materials and Supplies	(1,427)	35,831	457
Accrued Utility Revenues	(14,225)	32,953	(40,433)
Accounts Payable	147,029	(13,915)	(31,044)
Taxes Accrued	(33,402)	(6,019)	37,515
Other (net)	27,325	41,002	14,437
Net Cash Flows From Operating Activities	1,197,922	1,237,062	1,056,610
INVESTING ACTIVITIES:			
Construction Expenditures	(760,394)	(577,691)	(605,974)
Investment in Yorkshire	(363,436)	-	-
Proceeds from Sale of Property and Other	2,142	12,283	20,567
Net Cash Flows Used For Investing Activities	(1,121,688)	(565,408)	(585,407)
FINANCING ACTIVITIES:			
Issuance of Common Stock	76,745	65,461	48,707
Issuance of Long-term Debt	880,522	407,291	523,476
Retirement of Cumulative Preferred Stock	(433,329)	(70,761)	(158,839)
Retirement of Long-term Debt	(348,157)	(601,278)	(469,767)
Change in Short-term Debt (net)	235,380	(45,430)	48,140
Dividends Paid on Common Stock	(453,453)	(449,353)	(445,831)
Net Cash Flows Used For Financing Activities	(42,292)	(694,070)	(454,114)
Net Increase (Decrease) in Cash and Cash Equivalents	33,942	(22,416)	17,089
Cash and Cash Equivalents January 1	57,539	79,955	62,866
Cash and Cash Equivalents December 31	$ 91,481	$ 57,539	$ 79,955

See Notes to Consolidated Financial Statements.

AMERICAN ELECTRIC POWER COMPANY, INC. AND SUBSIDIARY COMPANIES

CONSOLIDATED BALANCE SHEETS

(In Thousands - Except Share Data)

	December 31, 1997	December 31, 1996
ASSETS		
ELECTRIC UTILITY PLANT:		
Production	$ 9,493,158	$ 9,341,849
Transmission	3,501,580	3,380,258
Distribution	4,654,234	4,402,449
General (including mining assets and nuclear fuel)	1,604,671	1,491,781
Construction Work in Progress	342,842	353,832
Total Electric Utility Plant	19,596,485	18,970,169
Accumulated Depreciation and Amortization	7,963,636	7,549,798
NET ELECTRIC UTILITY PLANT	11,632,849	11,420,371
OTHER PROPERTY AND INVESTMENTS	1,358,810	892,674
CURRENT ASSETS:		
Cash and Cash Equivalents	91,481	57,539
Accounts Receivable:		
Customers (less allowance for uncollectible accounts of $6,760 in 1997 and $3,692 in 1996)	552,443	415,413
Miscellaneous	115,075	115,919
Fuel - at average cost	224,967	235,257
Materials and Supplies - at average cost	263,613	251,896
Accrued Utility Revenues	189,191	174,966
Prepayments and Other	81,366	103,891
TOTAL CURRENT ASSETS	1,518,136	1,354,881
REGULATORY ASSETS	1,817,540	1,889,482
DEFERRED CHARGES	288,011	325,580
TOTAL	$16,615,346	$15,882,988

See Notes to Consolidated Financial Statements.

AMERICAN ELECTRIC POWER COMPANY, INC. AND SUBSIDIARY COMPANIES
CONSOLIDATED BALANCE SHEETS

	December 31, 1997	December 31, 1996
CAPITALI⁷ ION AND LIABILITIES		
CAP. ALIZATION:		
Common Stock-Par Value $6.50:		
1997 / 1996		
Shares Authorized. .300,000,000 300,000,000		
Shares Issued. . . .198,989,981 197,234,992		
(8,599,992 shares were held in treasury)	$ 1,293,435	$ 1,282,027
Paid-in Capital	1,778,782	1,715,554
Retained Earnings	1,605,017	1,547,746
Total Common Shareholders' Equity	4,677,234	4,545,327
Cumulative Preferred Stocks of Subsidiaries:*		
Not Subject to Mandatory Redemption	46,724	90,323
Subject to Mandatory Redemption	127,605	509,900
Long-term Debt*	5,129,463	4,796,768
TOTAL CAPITALIZATION	9,981,026	9,942,318
OTHER NONCURRENT LIABILITIES	1,246,537	1,002,208
CURRENT LIABILITIES:		
Preferred Stock and Long-term Debt Due Within One Year*	294,454	86,942
Short-term Debt	555,075	319,695
Accounts Payable	353,256	206,227
Taxes Accrued	380,771	414,173
Interest Accrued	76,361	75,124
Obligations Under Capital Leases	101,089	89,553
Other	322,687	304,323
TOTAL CURRENT LIABILITIES	2,083,693	1,496,037
DEFERRED INCOME TAXES	2,560,921	2,643,143
DEFERRED INVESTMENT TAX CREDITS	376,250	401,491
DEFERRED GAIN ON SALE AND LEASEBACK - ROCKPORT PLANT UNIT 2	231,320	240,598
DEFERRED CREDITS	135,599	157,193
COMMITMENTS AND CONTINGENCIES (Note 4)		
TOTAL	$16,615,346	$15,882,988

*See Accompanying Schedules.

AMERICAN ELECTRIC POWER COMPANY, INC. AND SUBSIDIARY COMPANIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Significant Accounting Policies:

Organization - American Electric Power (AEP or the Company) is one of the U.S.'s largest investor-owned public utility holding companies engaged in the generation, purchase, transmission and distribution of electric power to nearly 3 million retail customers in its seven state service territory which covers portions of Ohio, Michigan, Indiana, Kentucky, West Virginia, Virginia and Tennessee. Electric power is also supplied at wholesale to neighboring utility systems and power marketers. AEP has holdings in the United States, the United Kingdom (UK) and China.

The organization of the AEP System consists of American Electric Power Company, Inc. (AEP Co., Inc.), the parent holding company; seven electric utility operating companies in the U.S. (domestic utility subsidiaries); a domestic generating subsidiary, AEP Generating Company (AEPGEN); a service company, American Electric Power Service Corporation (AEPSC); AEP Resources, Inc. (AEPR) which pursues energy-related domestic and international investment opportunities and projects; AEP Energy Services (AEPES) which markets and trades energy commodities; three active coal-mining companies and a group of subsidiaries that provide power engineering, consulting and management services around the world to complement utility activities.

The following domestic utility subsidiaries pool their generating and transmission facilities and operate them as an integrated system: Appalachian Power Company (APCo), Columbus Southern Power Company (CSPCo), Indiana Michigan Power Company (I&M), Kentucky Power Company and Ohio Power Company (OPCo). The remaining two domestic utility subsidiaries, Kingsport Power Company and Wheeling Power Company are distribution companies that purchase power from APCo and OPCo, respectively. AEPSC provides management and professional services to the AEP System. The active coal-mining companies are wholly-owned by OPCo and sell most of their production to OPCo. AEPGEN has a 50% interest in the Rockport Plant which is comprised of two of the AEP System's six 1,300 mw generating units. AEPR has investments and projects that include: a 50% interest in Yorkshire Electricity Group plc (Yorkshire), an electric distribution company in the UK (see Note 7); a 70% interest in a project to build two 125 mw coal-fired generating units in China. AEPES currently markets and trades natural gas. The non-regulated subsidiaries that complement utility activities are engaged in providing non-regulated energy and communication services and are seeking and considering new business opportunities domestically and internationally that will permit AEP to utilize its expertise and core competencies.

The AEP System's operations are divided into major business units which are managed centrally by AEPSC. Although the seven domestic utility subsidiaries and AEPSC are separate legal entities they operate as American Electric Power. There has been no change to the legal names of these companies.

Rate Regulation - The AEP System is subject to regulation by the Security and Exchange Commission (SEC) under the Public Utility Holding Company Act of 1935 (1935 Act). The rates charged by the domestic utility subsidiaries are approved by the Federal Energy Regulatory Commission (FERC) or the state utility commissions as applicable. The FERC regulates wholesale rates and the state commissions regulate retail rates.

Principles of Consolidation - The consolidated financial statements include AEP Co., Inc. and its wholly-owned and majority-owned subsidiaries consolidated with their wholly-owned subsidiaries. Significant intercompany items are eliminated in consolidation. Yorkshire is accounted for using the equity method.

Basis of Accounting - As the owner of cost-based rate-regulated electric public utility companies, AEP Co., Inc.'s consolidated financial statements reflect the actions of regulators that result in the recognition of revenues and expenses in different time periods than enterprises that are not rate regulated. In accordance with Statement of Financial Accounting Standards (SFAS) No. 71, "Accounting for the Effects of Certain Types of Regulation," regulatory assets (deferred expenses) and regulatory liabilities (deferred income) are recorded to reflect the economic effects of regulation and to match expenses with regulated revenues.

Use of Estimates - The preparation of these financial statements in conformity with generally accepted accounting principles requires in certain instances the use of estimates. Actual results could differ from those estimates.

Utility Plant - Electric utility plant is stated at original cost and is generally subject to first mortgage liens. Additions, major replacements and betterments are added to the plant accounts. Retirements from the plant accounts and associated removal costs, net of salvage, are deducted from accumulated depreciation. The costs of labor, materials and overheads incurred to operate and maintain utility plant are included in operating expenses.

Allowance for Funds Used During Construction (AFUDC) - AFUDC is a noncash nonoperating income item that is recovered over the service life of utility plant through depreciation and represents the estimated cost of borrowed and equity funds used to finance construction projects. The amounts of AFUDC for 1997, 1996 and 1995 were not significant.

Depreciation, Depletion and Amortization - Depreciation is provided on a straight-line basis over the estimated useful lives o property other than coal-mining property anc is calculated largely through the use o composite rates by functional class a: follows:

Functional Class of Property	Annual Composite Depreciation Rate
Production:	
Steam-Nuclear	3.4
Steam-Fossil-Fired	3.2% to 4.4
Hydroelectric-Conventional and Pumped Storage	2.7% to 3.2
Transmission	1.7% to 2.7
Distribution	3.3% to 4.2
General	2.5% to 3.8

The utility subsidiaries presently recove amounts to be used for demolition an removal of non-nuclear plant throug depreciation charges included in rate. Depreciation, depletion and amortization coal-mining assets is provided over eac asset's estimated useful life, ranging up to 3 years, and is calculated using the straigh line method for mining structures ar equipment. The units-of-production methc is used to amortize coal rights and mir development costs based on estimate recoverable tonnages at a current averaç rate of $1.91 per ton. These costs a included in the cost of coal charged to fu expense.

Cash and Cash Equivalents - Cash and ca equivalents include temporary ca investments with original maturities of thr months or less.

Foreign Currency Translation - The financ statements of subsidiaries outside the Unit States are measured using the local curren as the functional currency. Assets a

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liabilities are translated to U.S. dollars at year-end rates of exchange and revenues and expenses are translated at monthly average exchange rates throughout the year. Translation adjustments are accumulated as a separate component of shareholders' equity. The accumulated total at December 31, 1997 is not material. Currency transaction gains and losses are recorded in income.

Sale of Receivables - Under an agreement that was terminated in January 1997, CSPCo sold $50 million of undivided interests in designated pools of accounts receivable and accrued utility revenues with limited recourse. As collections reduced previously sold pools, interests in new pools were sold. At December 31, 1996, $50 million remained to be collected and remitted to the buyer.

Operating Revenues and Fuel Costs - Revenues include the accrual of electricity consumed but unbilled at month-end as well as billed revenues. Fuel costs are matched with revenues in accordance with rate commission orders. Generally in the retail jurisdictions, changes in fuel costs are deferred or revenues accrued until approved by the regulatory commission for billing or refund to customers in later months. Wholesale jurisdictional fuel cost changes are expensed and billed as incurred.

Levelization of Nuclear Refueling Outage Costs - Incremental operation and maintenance costs associated with refueling outages at I&M's Cook Plant are deferred and amortized over the period (generally eighteen months) beginning with the commencement of an outage and ending with the beginning of the next outage.

Income Taxes - The Company follows the liability method of accounting for income taxes as prescribed by SFAS No. 109, "Accounting for Income Taxes." Under the liability method, deferred income taxes are provided for all temporary differences between the book cost and tax basis of assets and liabilities which will result in a future tax consequence. Where the flow-through method of accounting for temporary differences is reflected in rates, deferred income taxes are recorded with related regulatory assets and liabilities in accordance with SFAS No. 71.

Investment Tax Credits - Investment tax credits have been accounted for under the flow-through method except where regulatory commissions have reflected investment tax credits in the rate-making process on a deferral basis. Deferred investment tax credits are being amortized over the life of the related plant investment.

Debt and Preferred Stock - Gains and losses on reacquisition of debt are deferred and amortized over the remaining term of the reacquired debt in accordance with rate-making treatment. If the debt is refinanced, the reacquisition costs are deferred and amortized over the term of the replacement debt commensurate with their recovery in rates.

Discount or premium and expenses of debt issuances are amortized over the term of the related debt, with the amortization included in interest charges.

Redemption premiums paid to reacquire preferred stock are included in paid-in capital and amortized to retained earnings commensurate with their recovery in rates. The excess of par value over costs of preferred stock reacquired is credited to paid-in capital and amortized to retained earnings.

Other Property and Investments - Excluding decommissioning and spent nuclear fuel disposal trust funds and the investment in Yorkshire, other property and investments are stated at cost. Securities held in trust funds for decommissioning nuclear facilities and for the disposal of spent nuclear fuel are recorded at market value in accordance with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities." Securities in the trust funds have been classified as available-for-sale due to their long-term purpose. Unrealized gains and losses from securities in these trust funds are not reported in equity but result in adjustments to the liability account for the nuclear decommissioning trust funds and to regulatory assets or liabilities for the spent nuclear fuel disposal trust funds.

EPS - The adoption of SFAS No. 128 "Earnings per Share" had no impact on the determination of Earnings per Common Share.

2. Rate Matters:

OPCo's Recovery of Fuel Costs - Under the terms of a 1992 stipulation agreement the cost of coal burned at the Gavin Plant is subject to a 15-year predetermined price of $1.575 per million British Thermal Unit (Btu) with quarterly escalation adjustments through November 2009. A 1995 Settlement Agreement set the fuel component of the EFC factor at 1.465 cents per Kilowatthour (Kwh) for the period June 1, 1995 through November 30, 1998. The stipulation and settlement agreements provide OPCo with the opportunity to recover over the term of the stipulation agreement the Ohio jurisdictional share of OPCo's investment in and the liabilities and future shut-down costs of its affiliated mines as well as any fuel costs incurred above the predetermined rate to the extent the actual cost of coal burned at the Gavin Plant is below the predetermined prices. After full recovery of these costs or November 2009, whichever comes first, the price that OPCo can recover for coal from its affiliated Meigs mine which supplies the Gavin Plant will be limited to the lower of cost or the then-current market price. Pursuant to these agreements OPCo has deferred for future recovery $61 million at December 31, 1997.

Based on the estimated future cost of coal burned at Gavin Plant, management believes that the Ohio jurisdictional portion of the investment in and liabilities and closing costs of the affiliated mining operations including deferred amounts will be recovered under the terms of the predetermined price agreement. Management intends to seek from non-Ohio jurisdictional ratepayers recovery of the non-Ohio jurisdictional portion of the investment in and the liabilities and closing costs of the affiliated Meigs, Muskingum and Windsor mines. The non-Ohio jurisdictional portion of shutdown costs for these mines which includes the investment in the mines, leased asset buy-outs, reclamation costs and employee benefits is estimated to be approximately $102 million after tax at December 31, 1997.

The affiliated Muskingum and Windsor mines may have to close by January 2000 in order to comply with the Phase II requirements of the Clean Air Act Amendments of 1990 (CAAA). The Muskingum and/or Windsor mines could close prior to January 2000 depending on the economics of continued operation under the terms of the above Settlement Agreement. Unless future shutdown costs and/or the cost of affiliated coal production of the Meigs, Muskingum and Windsor mines can be recovered, results of operations and cash flows would be adversely affected.

3. Effects of Regulation and Phase-In Plans:

In accordance with SFAS No. 71 the consolidated financial statements include assets (deferred expenses) and liabilities (deferred income) recorded in accordance with regulatory actions to match expenses and revenues from cost-based rates. Regulatory assets are expected to be recovered in future periods through the rate-making process and regulatory liabilities are expected to reduce future cost recoveries. The Company has reviewed all the evidence currently available and concluded that it continues to meet the requirements to apply SFAS No. 71. In the event a portion of the Company's business no longer met these requirements, net regulatory assets would have to be written off for that portion of the business and assets attributable to that portion of the business would have to be tested for possible impairment and if required an impairment loss recorded unless the net regulatory assets and impairment losses are recoverable as a stranded investment.

Recognized regulatory assets and liabilities are comprised of the following at:

	December 31, 1997	December 31, 1996
	(In Thousands)	
Regulatory Assets:		
Amounts Due From Customers For Future Income Taxes	$1,372,926	$1,459,086
Rate Phase-in Plan Deferrals	-	27,249
Unamortized Loss on Reacquired Debt	96,793	107,305
Other	347,821	295,842
Total Regulatory Assets	$1,817,540	$1,889,482
Regulatory Liabilities:		
Deferred Investment Tax Credits	$376,250	$401,491
Other Regulatory Liabilities*	78,802	86,609
Total Regulatory Liabilities	$455,052	$488,100

* Included in Deferred Credits on Consolidated Balance Sheets

The rate phase-in plan deferrals are applicable to the Zimmer Plant and Rockport Plant Unit 1. The Zimmer Plant is a 1,300 mw coal-fired plant which commenced commercial operation in 1991. CSPCo owns 25.4% of the plant with the remainder owned by two unaffiliated companies. As a result of an Ohio Supreme Court decision, in January 1994 the Public Utility Commission of Ohio (PUCO) approved a temporary 3.39% surcharge effective February 1, 1994. In June 1997 the Company completed recovery of its Zimmer Plant phase-in plan deferrals and discontinued the 3.39% temporary rate surcharge. In 1997, 1996 and 1995 $15.4 million, $31.5 million and $28.5 million, respectively, of net phase-in deferrals were collected through the surcharge. The deferral balance which was completely recovered and amortized in 1997 was $15.4 million at December 31, 1996.

The Rockport Plant consists of two 1,300 mw coal-fired units. I&M and AEPGEN each own 50% of one unit (Rockport 1) and lease a 50% interest in the other unit (Rockport 2) from unaffiliated lessors under an operating lease. The gain on the sale and leaseback of Rockport 2 was deferred and is being amortized, with related taxes, over the initial lease term which expires in 2022. A rate phase-in plan in the Indiana and the FERC jurisdictions provide for the recovery and straight-line amortization of deferred Rockport Plant Unit 1 costs over ten years beginning in 1987. In 1997 the amortization and recovery of the deferred Rockport Plant Unit 1 Phase-in Plan costs were completed. During the recovery period net income was unaffected by the recovery of the phase in deferrals. Amortization was $11.9 million in 1997 and $16 million in 1996 and 1995.

4. Commitments and Contingencies:

Construction and Other Commitments - The AEP System has substantial construction commitments to support its utility operations including the replacement of the Cook Plant Unit 1 steam generators. Such commitments do not presently include any expenditures for new generating capacity. Aggregate construction expenditures for 1998-2000 are estimated to be $2.4 billion.

Long-term fuel supply contracts contain clauses for periodic price adjustments, and most jurisdictions have fuel clause mechanisms that provide for recovery of changes in the cost of fuel with the regulators' review and approval. The contracts are for various terms, the longest of which extends to the year 2014, and contain various clauses that would release the Company from its obligation under certain force majeure conditions.

The AEP System has contracted to sell approximately 1,000 mw of capacity on a long-term basis to unaffiliated utili[illegible]. Certain contracts totaling 750 mw of capacity are unit power agreements requiring the delivery of energy only if the unit capacity is available. The power sales contracts expire from 1999 to 2010.

Nuclear Plant - I&M owns and operates the two-unit 2,110 mw Cook Plant under licenses granted by the Nuclear Regulatory Commission (NRC.) The operation of a nuclear facility involves special risks, potential liabilities, and specific regulatory and safety requirements. Should a nuclear incident occur at any nuclear power plant facility in the United States, the resultant liability could be substantial. By agreement I&M is partially liable together with all other electric utility companies that own nuclear generating units for a nuclear power plant incident. In the event nuclear losses or liabilities are underinsured or exceed accumulated funds and recovery in rates is not possible, results of operations, cash flows and financial condition could be negatively affected.

Nuclear Plant Shutdown - On September 9 and 10, 1997, during a NRC architect engineer design inspection, questions regarding the operability of certain safety systems caused Company operations personnel to shut down Units 1 and 2 of the Cook Plant. On September 19, 1997, the NRC issued a Confirmatory Action Letter requiring the Company to address the issues identified in the letter. The Company is working with the NRC to resolve these issues and other issues related to restart of the units. Certain issues identified in the letter have been addressed. At this time management is unable to determine when the units will be returned to service. If the units are not returned to service in a reasonable period of time, it could have ar adverse impact on results of operations, cash flows and possibly financial condition.

Nuclear Incident Liability - Public liability is limited by law to $8.9 billion should an incident occur at any licensed reactor in the United States. Commercially available insurance provides $200 million of coverage In the event of a nuclear incident at an nuclear plant in the United States the remainder of the liability would be provided by a deferred premium assessment of $79.[illegible] million on each licensed reactor payable in annual installments of $10 million. As a result, I&M could be assessed $158.6 million per nuclear incident payable in annual installments of $20 million. The number of incidents for which payments could be required is not limited.

Nuclear insurance pools and othe insurance policies provide $3.6 billio (reduced to $3.0 billion effective January 1 1998) of property damage, decommissionin and decontamination coverage for the Coo Plant. Additional insurance provide coverage for extra costs resulting from prolonged accidental Cook Plant outage Some of the policies have deferred premiur provisions which could be triggered by losse in excess of the insurer's resources. Th losses could result from claims at the Coo Plant or certain other non-affiliated nucle units. I&M could be assessed up to $35 million under these policies.

SNF Disposal - Federal law provides fc government responsibility for permaner spent nuclear fuel disposal and assesse nuclear plant owners fees for spent fu disposal. A fee of one mill per kilowattho for fuel consumed after April 6, 1983 is bein collected from customers and remitted to th U.S. Treasury. Fees and related interest [illegible] $181 million for fuel consumed prior to Apr 7, 1983 have been recorded as long-ter

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debt. I&M has not paid the government the pre-April 1983 fees due to continued delays and uncertainties related to the federal disposal program. At December 31, 1997, funds collected from customers towards payment of the pre-April 1983 fee and related earnings thereon approximate the liability.

Decommissioning and Low Level Waste Accumulation Disposal - Decommissioning costs are accrued over the service life of the Cook Plant. The licenses to operate the two nuclear units expire in 2014 and 2017. After expiration of the licenses the plant is expected to be decommissioned through dismantlement. The Company's latest estimate for decommissioning and low level radioactive waste accumulation disposal costs range from $700 million to $1,152 million in 1997 nondiscounted dollars. The wide range is caused by variables in assumptions including the estimated length of time spent nuclear fuel must be stored at the plant subsequent to ceasing operations. This in turn depends on future developments in the federal government's SNF disposal program. Continued delays in the federal fuel disposal program can result in increased decommissioning costs. I&M is recovering estimated decommissioning costs in its three rate-making jurisdictions based on at least the lower end of the range in the most recent decommissioning study at the time of the last rate proceeding. I&M records decommissioning costs in other operation expense and records a noncurrent liability equal to the decommissioning cost recovered in rates; such amounts were $28 million in 1997, $27 million in 1996 and $30 million in 1995 including $4 million of special deposits. Decommissioning costs recovered from customers are deposited in external trusts. Trust fund earnings increase the fund assets and the recorded liability and decrease the amount needed to be recovered from ratepayers. At December 31, 1997, I&M has recognized a decommissioning liability of $381 million which is included in other noncurrent liabilities.

Revised Air Quality Standards - On July 18, 1997, the Federal EPA published a revised National Ambient Air Quality Standard (NAAQS) for ozone and a new NAAQS for fine particulate matter (less than 2.5 microns in size). The new ozone standard is expected to result in redesignation of a number of areas of the country that are currently in compliance with the existing standard to nonattainment status which could ultimately dictate more stringent emission restrictions for AEP System generating units. New stringent emission restrictions on AEP System generating units to achieve attainment of the fine particulate matter standard could also be imposed. The AEP System operating companies joined with other utilities to appeal the revised NAAQS and filed petitions for review in August and September 1997 in the U.S. Court of Appeals for the District of Columbia Circuit. Management is unable to estimate compliance costs without knowledge of the reductions that may be necessary to meet the new standards. If such costs are significant, it could have a material adverse effect on results of operations, cash flows and possibly financial condition unless such costs are recovered.

Litigation - The Company is involved in a number of legal proceedings and claims. While management is unable to predict the ultimate outcome of litigation, it is not expected that the resolution of these matters will have a material adverse effect on the results of operations, cash flows or financial condition.

5. Dividend Restrictions:

Mortgage indentures, charter provisions and orders of regulatory authorities place various restrictions on the use of the subsidiaries' retained earnings for the payment of cash dividends on their common stocks. At December 31, 1997, $27 million of retained earnings were restricted. To pay dividends out of paid-in capital the subsidiaries need regulatory approval.

6. Lines of Credit and Commitment Fees:

At December 31, 1997 and 1996, unused short-term bank lines of credit were available in the amounts of $442 million and $409 million, respectively. In addition several of the subsidiaries engaged in providing non-regulated energy services share a line of credit under a revolving credit agreement. The amounts of credit available under the revolving credit agreement were $330 million and $100 million at December 31, 1997 and 1996, respectively. The short-term bank lines of credit and the revolving credit agreement require the payment of facility fees of approximately 1/10 of 1% on the daily amount of such commitments.

Outstanding short-term debt consisted of:

	December 31,	
(Dollars In Thousands)	1997	1996
Balance Outstanding:		
Notes Payable	$199,285	$ 91,293
Commercial Paper	355,790	228,402
Total	$555,075	$319,695
Year-End Weighted Average Interest Rate:		
Notes Payable	6.3%	6.2%
Commercial Paper	6.8%	7.2%
Total	6.6%	6.9%

7. Yorkshire Acquisition and UK Windfall Tax

In April 1997 the Company and New Century Energies, Inc. through an equally owned joint venture, Yorkshire Power Group Limited (YPG), acquired all of the outstanding shares of Yorkshire, an electric distribution company in the UK. Total consideration paid by the joint venture was approximately $2.4 billion which was financed by a combination of equity and non-recourse debt. The Company uses the equity method of accounting for its investment in YPG. The Company's original investment in the joint venture was $360 million and is included in other property and investments.

In July 1997 the British government enacted a new law that imposed a one-time windfall tax on a revised privatization value which originally had been computed in 1990 on certain privatized utilities. The windfall tax is actually an adjustment of the original privatization price by the UK government. The windfall tax liability for Yorkshire Electricity Group plc is estimated to be 134 million pounds sterling ($219 million) and is payable in two equal installments. The first payment was made in December 1997 and the second installment will be due in December 1998. The Company's $109.4 million share of the tax is reported as ar extraordinary loss. The equity earnings from the Yorkshire investment, excluding the extraordinary loss, which are included in nonoperating income, are $34 million inclusive of $10 million of nonrecurring ta benefits related to a reduction of the Uh corporate income tax rate from 33% to 31% effective April 1, 1997.

The following amounts which are nc included in AEP's consolidated financia statements represent summarize consolidated financial information of YPG a December 31, 1997 and for the nine-month then ended:

	(In Millions)
Assets:	
Property, Plant and Equipment	$1,644.6
Current Assets	602.2
Other Assets	1,895.4
Total Assets	$4,142.2
Capitalization and Liabilities:	
Common Shareholders' Equity	$ 542.1
Long-term Debt	704.3
Other Noncurrent Liabilities	488.7
Current Liabilities	2,407.1
Total Capitalization and Liabilities	$4,142.2
Income Statement Data:	
Operating Revenues	$1,492.9
Operating Income	202.3
Income Before Extraordinary Item	67.5
Net Loss	(151.3)

8. Benefit Plans:

AEP System Pension Plan - The AEP pension plan is a trusteed, noncontributory defined benefit plan covering all employees meeting eligibility requirements, except participants in the United Mine Workers of America (UMWA) pension plans. Benefits are based on service years and compensation levels. The funding policy is to make annual contributions to a qualified trust fund equal to the net periodic pension cost up to the maximum amount deductible for federal income taxes, but not less than the minimum required contribution in accordance with the Employee Retirement Income Security Act of 1974.

Net AEP pension plan costs were computed as follows:

	Year Ended December 31,		
	1997	1996	1995
	(In Thousands)		
Service Cost-Benefits Earned During the Year	$ 36,000	$ 40,000	$ 30,400
Interest Cost on Projected Benefit Obligation	128,600	119,500	116,700
Actual Return on Plan Assets	(462,700)	(302,400)	(416,800)
Net Amortization (Deferral)	307,700	161,800	281,800
Net AEP Pension Plan Costs	$ 9,600	$ 18,900	$ 12,100

AEP pension plan assets, actuarially computed benefit obligations and the computation of accrued net pension plan liability are:

	December 31,	
	1997	1996
	(In Thousands)	
Actuarial Present Value of Benefit Obligation:		
Vested Obligation	$1,523,200	$1,377,000
Nonvested Obligation	161,000	136,500
Effects of Salary Progression	205,800	162,700
Projected Benefit Obligation	1,890,000	1,676,200
AEP Pension Plan Assets at Fair Value (a)	2,370,300	2,009,500
Funded Status - AEP Pension Plan Assets in Excess of Projected Benefit Obligation	480,300	333,300
Unrecognized Prior Service Cost	119,400	133,200
Unrecognized Net Gain on Assets	(640,800)	(488,200)
Unrecognized Net Transition Assets (Being Amortized Over 17 Years)	(59,100)	(68,900)
Accrued Net AEP Pension Plan Liability	$ (100,200)	$ (90,600)

(a) AEP pension plan assets primarily consist of common stocks, bonds and cash equivalents and are included in a separate entity trust fund.

Assumptions used to determine AEP's net pension plan liability were:

	December 31,		
	1997	1996	1995
Discount Rate	7.00%	7.75%	7.25%
Average Rate of Increase in Compensation Levels	3.2%	3.2%	3.2%
Expected Long-Term Rate of Return on Plan Assets	9.0%	9.0%	9.0%

Postretirement Benefits Other Than Pensions (OPEB) - The AEP System provides certain benefits other than pensions for retired employees. Substantially all non-UMWA employees are eligible for postretirement health care and life insurance if they retire from active service after reaching age 55 and have at least 10 service years.

Postretirement medical benefits for UMWA employees at affiliated mining operations who have or will retire after January 1, 1976 are the liability of the OPCo coal-mining subsidiaries and are included in the OPEB net costs and liability. They are eligible for postretirement medical benefits if they retire from active service after reaching age 55 and have at least 10 service years. In addition, non-active UMWA employees will become eligible for postretirement benefits at age 55 if they have had 20 years of service.

The funding policy for AEP's OPEB plan is to make contributions to an external Voluntary Employees Beneficiary Association trust fund equal to the incremental OPEB costs (i.e., the amount that the total postretirement benefits cost under SFAS 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," exceeds the pay-as-you-go amount). Contributions were $35.2 million in 1997, $45.8 million in 1996 and $53 million in 1995. In several jurisdictions the utility subsidiaries deferred the increased OPEB costs resulting from the SFAS 106 required change from pay-as-you-go to accrual accounting which were not being recovered in rates. No additional deferrals were made in 1997 or 1996. At December 31, 1997 and 1996, $7.9 million and $14.5 million, respectively, of incremental OPEB costs were deferred.

Aggregate OPEB costs were computed as follows:

	Year Ended December 31,		
	1997	1996	1995
	(In Thousands)		
Service Cost	$ 14,000	$ 15,300	$13,500
Interest Cost on Projected Benefit Obligation	55,900	53,500	54,900
Net Amortization of the Transition Obligation	32,000	32,300	32,000
Return on Plan Assets	(44,100)	(21,100)	(25,400)
Net Amortization (Deferral)	21,500	9,900	16,800
Net OPEB Costs	$ 79,300	$ 89,900	$91,800

OPEB assets, actuarially computed benefit obligations and the computation of the accrued net OPEB liability are:

	December 31,	
	1997	1996
	(In Thousands)	
Accumulated Postretirement Benefit Obligation:		
Active Employees Fully Eligible for Benefits	$ 73,800	$ 57,800
Current Retirees	466,900	423,000
Other Active Employees	309,000	245,600
Total Benefit Obligation	849,700	726,400
Fair Market Value of Plan Assets (a)	311,900	232,500
Unfunded Benefit Obligation	(537,800)	(493,900)
Unrecognized Net Loss (Gain)	66,100	(3,300)
Unrecognized Net Transition Obligation Being Amortized Over 20 Years	416,400	448,500
Accrued Net OPEB Liability	$ (55,300)	$(48,700)

(a) Plan assets consist of cash surrender value of life insurance contracts on certain employees owned by the trust and short-term tax-exempt municipal bonds.

Assumptions used to determine OPEB's funded status were:

	December 31,		
	1997	1996	1995
Discount Rate	7.00%	7.75%	7.25%
Expected Long-Term Rate of Return on Plan Assets	8.75%	8.75%	8.75%
Initial Medical Cost Trend Rate	7.0%	7.5%	8.0%
Ultimate Medical Cost Trend Rate	4.25%	4.75%	4.5%
Medical Cost Trend Rate Decreases to Ultimate Rate in Year	2005	2005	2005

Assuming a one percent increase in the medical cost trend rate, the 1997 OPEB cost for all employees, both non-UMWA and UMWA, would increase by $10 million and the accumulated benefit obligations would increase by $92 million.

AEP System Savings Plan - An employee savings plan is offered to non-UMWA employees which allows participants to contribute up to 17% of their salaries into various investment alternatives, including AEP common stock. An employer matching contribution, equaling one-half of the employees' contribution to the plan up to a maximum of 3% of the employees' base salary, is invested in AEP common stock. The employer's annual contributions totaled $19.6 million in 1997, $19 million in 1996 and $18.8 million in 1995.

Other UMWA Benefits - The Company provides UMWA pension, health and welfare benefits for certain employees, retirees, and their survivors who meet eligibility requirements. The benefits are administered by UMWA trustees and contributions are made to their trust funds. Contributions based on hours worked are expensed as paid as part of the cost of active mining operations and were not material in 1997, 1996 and 1995. Based upon the UMWA actuary estimate the Company's share of unfunded pension liability was $6.9 million at June 30, 1997. In the event the Company should significantly reduce or cease mining operations or contributions to the UMWA trust funds, a withdrawal obligation will be triggered for both the pension and health and welfare plans. If the mining operations had been closed on December 31, 1997 the estimated withdrawal liability for all UMWA benefit plans would have been $6.7 million.

9. Fair Value of Financial Instruments:

Nuclear Trust Funds Recorded at Market Value - The trust investments, reported in other property and investments, are recorded at market value in accordance with SFAS No.

115 and consist of tax-exempt municipal bonds and other securities.

December 31, 1997 and 1996 the fair values of the trust investments were $566 million and $491 million, respectively. Accumulated gross unrealized holding gains were $41 million and $21.9 million at December 31, 1997 and 1996, respectively and accumulated gross unrealized holding losses were $1.2 million at both year-ends. The change in market value in 1997, 1996, and 1995 was a net unrealized holding gain of $19.1 million, $2.6 million and $24.9 million, respectively.

The trust investments' cost basis by security type were:

	December 31, 1997	December 31, 1996
	(In Thousands)	
Tax-Exempt Bonds	$335,358	$340,290
Equity Securities	74,398	54,389
Treasury Bonds	44,200	26,958
Corporate Bonds	9,167	7,977
Cash, Cash Equivalents and Accrued Interest	63,392	40,430
Total	$526,515	$470,044

Proceeds from sales and maturities of securities of $147.3 million during 1997 resulted in $3.9 million of realized gains and $1.4 million of realized losses. Proceeds from sales and maturities of securities of $115.3 million during 1996 resulted in $2.6 million of realized gains and $2.1 million of realized losses. During 1995 proceeds from sales and maturities of securities of $78.2 million resulted in $1.4 million of realized gains and $0.3 million of realized losses. The cost of securities for determining realized gains and losses is original acquisition cost including amortized premiums and discounts.

At December 31, 1997, the year of maturity of trust fund investments other than equity securities, was:

	(In Thousands)
1998	$ 87,063
1999 - 2002	127,575
2003 - 2007	182,873
After 2007	54,606
Total	$452,117

Other Financial Instruments Recorded at Historical Cost - The carrying amounts of cash and cash equivalents, accounts receivable, short-term debt, and accounts payable approximate fair value because of the short-term maturity of these instruments. Fair values for preferred stock subject to mandatory redemption were $136 million and $517 million and for long-term debt were $5.7 billion and $5.0 billion at December 31, 1997 and 1996, respectively. The carrying amounts on the financial statements for preferred stock subject to mandatory redemption were $128 million and $510 million and for long-term debt were $5.4 billion and $4.9 billion at December 31, 1997 and 1996, respectively. Fair values are based on quoted market prices for the same or similar issues and the current dividend or interest rates offered for instruments of the same remaining maturities. The carrying amount of the spent nuclear fuel disposal trust funds approximates the Company's best estimate of the fair value of the pre-April 1983 SNF disposal liability.

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10. Federal Income Taxes:

The details of federal income taxes as reported are as follows:

	Year Ended December 31, 1997	1996	1995
	(In Thousands)		
Charged *(Credited)* to Operating Expenses (net):			
Current	$346,290	$375,528	$265,313
Deferred	11,124	(17,008)	22,990
Deferred Investment Tax Credits	(16,134)	(16,298)	(16,276)
Total	341,280	342,222	272,027
Charged *(Credited)* to Nonoperating Income (net):			
Current	(16,038)	(5,636)	11,325
Deferred	(17,673)	(4,470)	(11,074)
Deferred Investment Tax Credits	(9,107)	(9,510)	(9,543)
Total	(42,818)	(19,616)	(9,292)
Total Federal Income Tax as Reported	$298,462	$322,606	$262,735

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

	Year Ended December 31, 1997	1996	1995
	(In Thousands)		
Income Before Preferred Stock Dividend Requirements of Subsidiaries	$ 638,211	$628,856	$584,674
Extraordinary Loss (Note 7)	(109,419)	-	-
Federal Income Taxes	298,462	322,606	262,735
Pre-Tax Book Income	$ 827,254	$951,462	$847,409
Federal Income Tax on Pre-Tax Book Income at Statutory Rate *(35%)*	$289,539	$333,012	$296,593
Increase (Decrease) in Federal Income Tax Resulting from the Following Items:			
Depreciation	53,239	50,537	46,453
Corporate Owned Life Insurance	(18,240)	(12,009)	(25,506)
Investment Tax Credits (net)	(25,241)	(25,813)	(26,179)
Extraordinary Loss - UK Windfall Tax	38,297	-	-
Other	(39,132)	(23,121)	(28,626)
Total Federal Income Taxes as Reported	$298,462	$322,606	$262,735
Effective Federal Income Tax Rate	36.1%	33.9%	31.0%

The following tables show the elements of the net deferred tax liability and the significant temporary differences:

	December 31, 1997	December 31, 1996
	(In Thousands)	
Deferred Tax Assets	$ 807,226	$ 784,349
Deferred Tax Liabilities	(3,368,147)	(3,427,492)
Net Deferred Tax Liabilities	$(2,560,921)	$(2,643,143)
Property Related Temporary Differences	$(2,161,484)	$(2,162,099)
Amounts Due From Customers For Future Federal Income Taxes	(410,255)	(428,698)
Deferred State Income Taxes	(201,843)	(229,429)
All Other (net)	212,661	177,083
Total Net Deferred Tax Liabilities	$(2,560,921)	$(2,643,143)

The Company has settled with the United States Internal Revenue Service (IRS) all issues from the audits of the consolidated federal income tax returns for the years prior to 1991. Returns for the years 1991 through 1996 are presently being audited by the IRS. During the audit the IRS agents requested a ruling from their National Office that certain interest deductions relating to corporate owned life insurance (COLI) claimed by the Company for 1991 through 1993 should not be allowed. The Company filed a brief with the IRS National Office refuting the agents' position. Although no adjustments have been proposed, a disallowance of the COLI interest deductions through December 31, 1997 would reduce earnings by approximately $286 million (including interest). AEP believes it has meritorious defenses and will vigorously contest any ·oposed adjustments. No provisions for this amount have been recorded. In the event the npany is unsuccessful it could have a material adverse impact on results of operations and h flows.

11. Leases:

Leases of property, plant and equipment are for periods up to 35 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 are primarily charged to operating expenses in accordance with rate-making treatment. The components of rentals are as follows:

	Year Ended December 31, 1997	1996	1995
	(In Thousands)		
Operating Leases	$257,042	$262,451	$259,877
Amortization of Capital Leases	104,732	114,050	101,068
Interest on Capital Leases	31,601	28,696	27,542
Total Rental Payments	$393,375	$405,197	$388,487

Properties under capital leases and related obligations on the Consolidated Balance Sheets are as follows:

	December 31, 1997	December 31, 1996
	(In Thousands)	
ELECTRIC UTILITY PLANT:		
Production	$ 47,246	$ 44,390
Transmission	3	6
Distribution	14,660	14,699
General:		
Nuclear Fuel (net of amortization)	103,939	59,681
Mining Plant and Other	516,843	466,797
Total Electric Utility Plant	682,691	585,573
Accumulated Amortization	196,145	200,931
Net Electric Utility Plant	486,546	384,642
OTHER PROPERTY	57,763	33,439
Accumulated Amortization	5,917	3,854
Net Other Property	51,846	29,585
Net Property under Capital Leases	$538,392	$414,227
Capital Lease Obligations:*		
Noncurrent Liability	$437,303	$324,674
Liability Due Within One Year	101,089	89,553
Total Capital Lease Obligations	$538,392	$414,227

*Represents the present value of future minimum lease payments. The noncurrent portio of capital lease obligations is included in other noncurrent liabilities in th Consolidated Balance Sheet.

Properties under operating leases and related obligations are not included in th Consolidated Balance Sheets.

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Future minimum lease rentals, consisted of the following at December 31, 1997:

	Capital Leases		Noncancelable Operating Leases
	(In Thousands)		
1998	$104,623		$ 243,042
1999	92,740		229,764
2000	79,507		228,044
2001	64,438		225,482
2002	59,400		220,111
Later Years	164,371		3,577,422
Total Future Minimum Lease Rentals	565,079	(a)	$4,723,865
Less Estimated Interest Element	130,626		
Estimated Present Value of Future Minimum Lease Rentals	434,453		
Unamortized Nuclear Fuel	103,939		
Total	$538,392		

(a) Minimum lease rentals do not include nuclear fuel rentals. The rentals are paid in proportion to heat produced and carrying charges on the unamortized nuclear fuel balance. There are no minimum lease payment requirements for leased nuclear fuel.

12. Supplementary Information:

	Year Ended December 31, 1997	1996	1995
	(In Thousands)		
ased Power - Ohio Valley Electric Company (4.2% owned by AEP System)	$29,631	$22,156	$10,546
Cash was paid for:			
Interest (net of capitalized amounts)	$390,491	$373,570	$395,169
Income Taxes	$398,833	$404,297	$273,671
Noncash Acquisitions under Capital Leases	$234,846	$136,988	$106,256

13. Capital Stocks and Paid-In Capital:

Changes in capital stocks and paid-in capital during the period January 1, 1995 through December 31, 1997 were:

	Shares				Cumulative Preferred Stocks of Subsidiaries	
	Common Stock- Par Value $6.50(a)	Cumulative Preferred Stocks of Subsidiaries	Common Stock (Dollars in Thousands)	Paid-in Capital	Not Subject To Mandatory Redemption	Subject to Mandatory Redemption(b)
January 1, 19..	194,234,992	8,236,251	$1,262,527	$1,640,661	$ 233,240	$590,385
Issuances	1,400,000	-	9,100	39,607	-	-
Retirements and Other	-	(1,526,500)	-	(21,744)	(85,000)	(67,650)
December 31, 1995	195,634,992	6,709,751	1,271,627	1,658,524	148,240	522,735
Issuances	1,600,000	-	10,400	55,061	-	-
Retirements and Other	-	(707,518)	-	1,969	(57,917)	(12,835)
December 31, 1996	197,234,992	6,002,233	1,282,027	1,715,554	90,323	509,900
Issuances	1,754,989	-	11,408	65,337	-	-
Retirements and Other	-	(4,258,947)	-	(2,109)	(43,599)	(382,295)
December 31, 1997	198,989,981	1,743,286	$1,293,435	$1,778,782	$ 46,724	$127,605

(a) Includes 8,999,992 shares of treasury stock.
(b) Including portion due within one year.

14. Unaudited Quarterly Financial Information:

(In Thousands - Except Per Share Amounts)	Quarterly Periods Ended 1997 March 31	June 30	Sept. 30	Dec. 31
Operating Revenues	$1,492,069	$1,382,158	$1,583,994	$1,703,147
Operating Income	271,978	221,255	275,090	216,131
Net Income Before Extraordinary Item	172,562	121,139	201,746	124,933
Net Income	172,562	121,139	91,181	126,079
Earnings per Share Before Extraordinary Item*	0.92	0.64	1.07	0.66
Earnings per Share	0.92	0.64	0.48	0.66

*Amounts for 1997 do not add to $3.28 earnings per share due to rounding.

The third quarter of 1997 includes an extraordinary loss of $110.6 million or $0.59 per share for a UK Windfall Tax which retroactively adjusted upward Yorkshire's privatization price discussed in Note 7.

(In Thousands - Except Per Share Amounts)	Quarterly Periods Ended 1996 March 31	June 30	Sept. 30	Dec. 31
Operating Revenues	$1,517,781	$1,400,941	$1,484,422	$1,446,090
Operating Income	292,122	220,625	259,745	235,480
Net Income	180,012	112,666	162,324	132,428
Earnings per Share	0.96	0.60	0.87	0.71

AMERICAN ELECTRIC POWER COMPANY, INC. AND SUBSIDIARY COMPANIES

SCHEDULE OF CONSOLIDATED CUMULATIVE PREFERRED STOCKS OF SUBSIDIARIES

	December 31, 1997			
	Call Price per Share (a)	Shares Authorized(b)	Shares Outstanding	Amount (In Thousands)
Not Subject to Mandatory Redemption:				
4.08% - 4.56% (c)	$102-$110	93[illegible]3	467,236	$ 46,724
Subject to Mandatory Redemption:				
5.90% - 5.92% (c)(d)	(e)	1,950,000	388,100	$ 38,810
6.02% - 6-7/8% (c)(d)	(f)	1,950,000	637,950	63,795
7% (g)	(g)	250,000	250,000	25,000
Total Subject to Mandatory Redemption (d)				$127,605

	December 31, 1996			
	Call Price per Share (a)	Shares Authorized(b)	Shares Outstanding	Amount (In Thousands)
Not Subject to Mandatory Redemption:				
4.08% - 4.56%	$102-$110	932,403	903,233	$ 90,323
Subject to Mandatory Redemption (d):				
5.90% - 5.92%	(e)	1,950,000	1,904,000	$190,400
6.02% - 6-7/8%	(f)	1,950,000	1,945,000	194,500
7% - 7-7/8%	$107.80-$107.88	1,250,000	1,250,000	125,000
Total Subject to Mandatory Redemption (d)				$509,900

NOTES TO SCHEDULE OF CUMULATIVE PREFERRED STOCKS OF SUBSIDIARIES

(a) At the option of the subsidiary the shares may be redeemed at the call price plus accrued dividends. The involuntary liquidation preference is $100 per share for all outstanding shares.

(b) As of December 31, 1997 the subsidiaries had 7,189,682, 22,200,000 and 7,579,435 shares of $100, $25 and no par value preferred stock, respectively, that were authorized but unissued.

(c) During the first quarter of 1997 preferred stock was reacquired in connection with a tender offer.

(d) Shares outstanding and related amounts are stated net of applicable retirements through sinking funds (generally at par) and reacquisitions of shares in anticipation of future requirements. The subsidiaries reacquired enough shares in 1997 to meet all sinking fund requirements on certain series until 2008 and on certain series until 2009 when all remaining outstanding shares must be redeemed. The sinking fund provisions of the series subject to mandatory redemption aggregate $5,000,000 each for the years 2000, 2001 and 2002.

(e) Not callable prior to 2003; after that the call price is $100 per share.

(f) Not callable prior to 2000; after that the call price is $100 per share.

(g) With sinking fund. Redemption is restricted prior to 2000.

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AMERICAN ELECTRIC POWER COMPANY, INC. AND SUBSIDIARY COMPANIES
SCHEDULE OF CONSOLIDATED LONG-TERM DEBT OF SUBSIDIARIES

Maturity	Weighted Average Interest Rate December 31, 1997	Interest Rates at December 31, 1997	Interest Rates at December 31, 1996	December 31, 1997 (In Thousands)	December 31, 1996 (In Thousands)
FIRST MORTGAGE BONDS					
1997-2000	7.20%	6.35%-9.15%	6-1/4%-9.15%	$ 466,411	$ 383,671
2001-2006	7.10%	6%-8.95%	6%-8.95%	1,511,000	1,511,000
2021-2025	7.95%	7.10%-8.80%	7.10%-9.35%	1,120,419	1,276,750
INSTALLMENT PURCHASE CONTRACTS (a)					
1998-2002	4.60%	3.70%-7-1/4%	4.10%-7-1/4%	189,500	209,500
2007-2025	6.45%	5.45%-7-7/8%	5.45%-7-7/8%	756,745	756,745
NOTES PAYABLE (b)					
1997-2008	6.73%	5.29%-9.60%	5.29%-9.60%	671,681	282,681
JUNIOR DEBENTURES					
2025 - 2027	8.17%	7.92%-8.72%	8%-8.72%	495,000	315,000
OTHER LONG-TERM DEBT (c)				250,357	182,943
Unamortized Discount (net)				(37,196)	(34,580)
Total Long-term Debt Outstanding (d)				5,423,917	4,883,710
Less Portion Due Within One Year				294,454	86,942
Long-term Portion				$5,129,463	$4,796,768

NOTES TO SCHEDULE OF CONSOLIDATED LONG-TERM DEBT OF SUBSIDIARIES

(a) For certain series of installment purchase contracts interest rates are subject to periodic adjustment. Certain seri will be purchased on demand at periodic interest-adjustment dates. Letters of credit from banks and standby bond purcha agreements support certain series.
(b) Notes payable represent outstanding promissory notes issued under term loan agreements and revolving credit agreemen with a number of banks and other financial institutions and unsecured medium term notes issued to the public. At expirati all notes then issued and outstanding are due and payable. Interest rates are both fixed and variable. Variable rat generally relate to specified short-term interest rates.
(c) Other long-term debt consists of a liability along with accrued interest for disposal of spent nuclear fuel (see Nc 4 of the Notes to Consolidated Financial Statements) and financing obligation under sale lease back agreements.
(d) Long-term debt outstanding at December 31, 1997 is payable as follows:

Principal Amount (in thousands)	
1998	$ 294,454
1999	491,579
2000	321,286
2001	267,040
2002	484,533
Later Years	3,602,221
Total	$5,461,113

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Management's Responsibility

The management of American Electric Power Company, Inc. is responsible for the integrity objectivity of the information and representations in this annual report, including the consolidated financial statements. These statements have been prepared in conformity with generally accepted accounting principles, using informed estimates where appropriate, to reflect the Company's financial condition and results of operations. The information in other sections of the annual report is consistent with these statements.

The Company's Board of Directors has oversight responsibilities for determining that management has fulfilled its obligation in the preparation of the financial statements and in the ongoing examination of the Company's established internal control structure over financial reporting. The Audit Committee, which consists solely of outside directors and which reports directly to the Board of Directors, meets regularly with management, Deloitte & Touche LLP - Certified Public Accountants and the Company's internal audit staff to discuss accounting, auditing and reporting matters. To ensure auditor independence, both Deloitte & Touche LLP and the internal audit staff have unrestricted access to the Audit Committee.

The financial statements have been audited by Deloitte & Touche LLP, whose report appears on the next page. The auditors provide an objective, independent review as to management's discharge of its responsibilities insofar as they relate to the fairness of the Company's reported financial condition and results of operations. Their audit includes procedures believed by them to provide reasonable assurance that the financial statements are free of material misstatement and includes a review of the Company's internal control structure over financial reporting.

Independent Auditors' Report

To the Shareholders and Board of Directors
of American Electric Power Company, Inc.:

We have audited the accompanying consolidated balance sheets of American Electric Power Company, Inc. and its subsidiaries as of December 31, 1997 and 1996, and the related consolidated statements of income, retained earnings, and cash flows for each of the three years in the period ended December 31, 1997. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

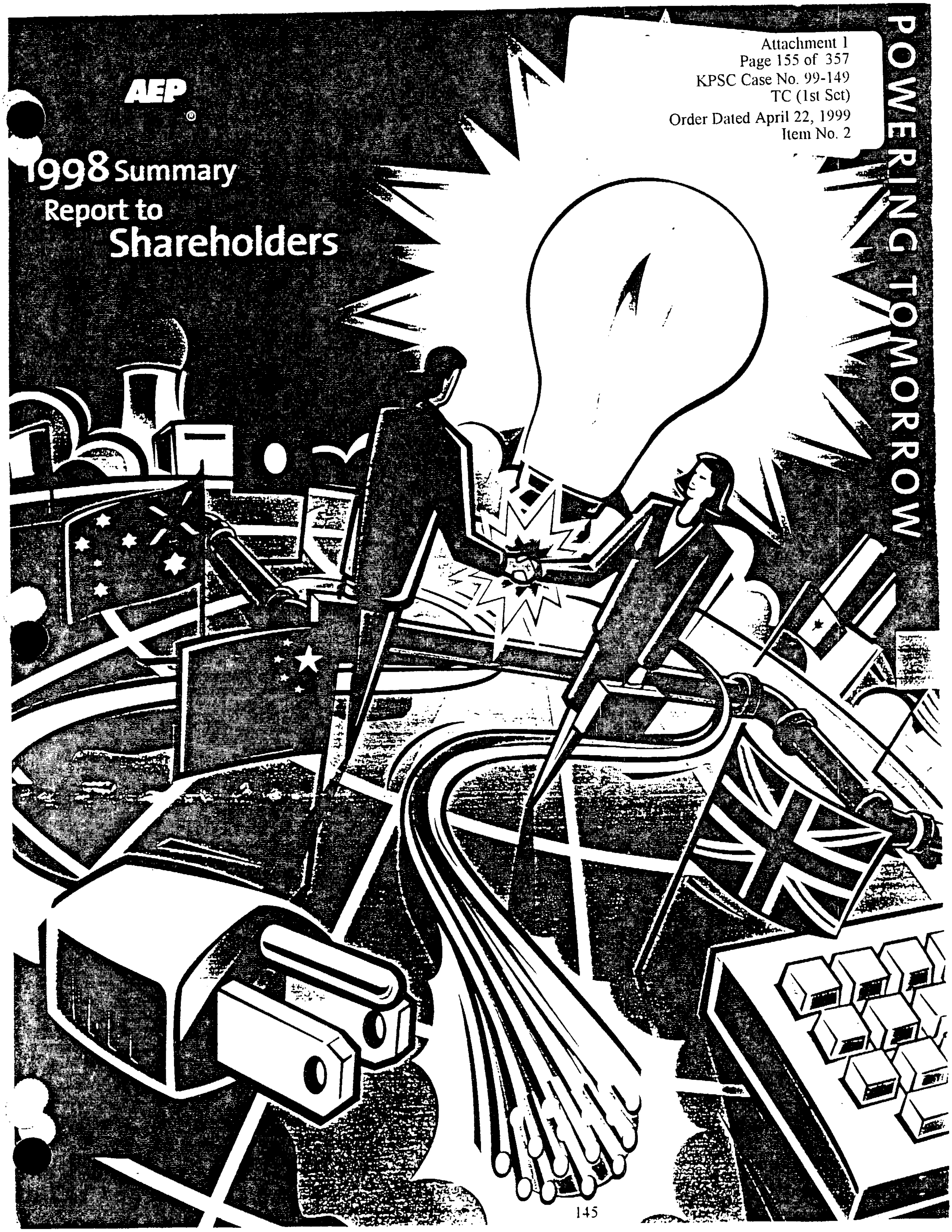
In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of American Electric Power Company, Inc. and its subsidiaries as of December 31, 1997 and 1996, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1997 in conformity with generally accepted accounting principles.

Deloitte & Touche LLP

Deloitte & Touche LLP
Columbus, Ohio
February 24, 1998

1998 Summary Report to Shareholders

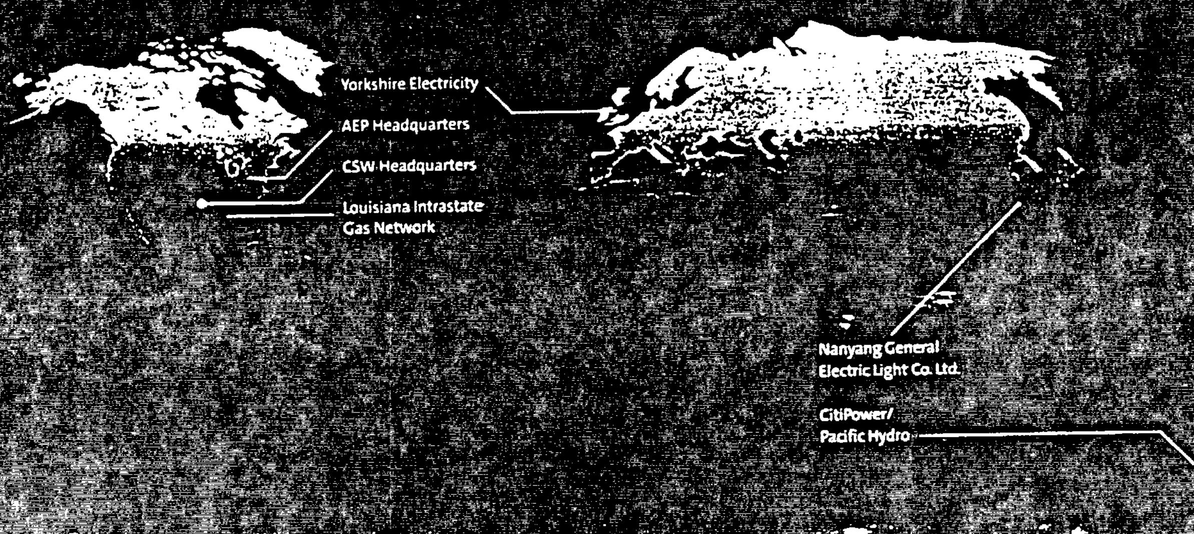
POWERING TOMORROW



Highlights of 1998

	1998	1997	% Change
Income Before Extraordinary Items *(in millions)*	$536	$620	(13.6)
Net Income *(in millions)*	$536	$511	4.9
Earnings Per Share Before Extraordinary Item	$2.81	$3.28	(14.3)
Earnings Per Share	$2.81	$2.70	4.1
Operating Revenues *(in billions)*	$6.346	$5.880	7.9
Cash Dividends Per Share	$2.40	$2.40	—
Year-end Closing Stock Price	$47 1/4	$51 1/8	(8.8)
Book Value Per Share at Year End	$25.24	$24.62	2.5
U.S. Energy Sales *(in millions of kilowatthours)*	130,352	134,205	(2.9)
Total Assets *(in millions)*	$19,483	$16,615	17.3
U.S. Retail Customers *(at year end)*	3,022,479	2,980,023	1.4
Global Employment *(at year end)*	17,943	17,844	0.6

Certain prior period amounts have been reclassified to agree with the current year's presentations.

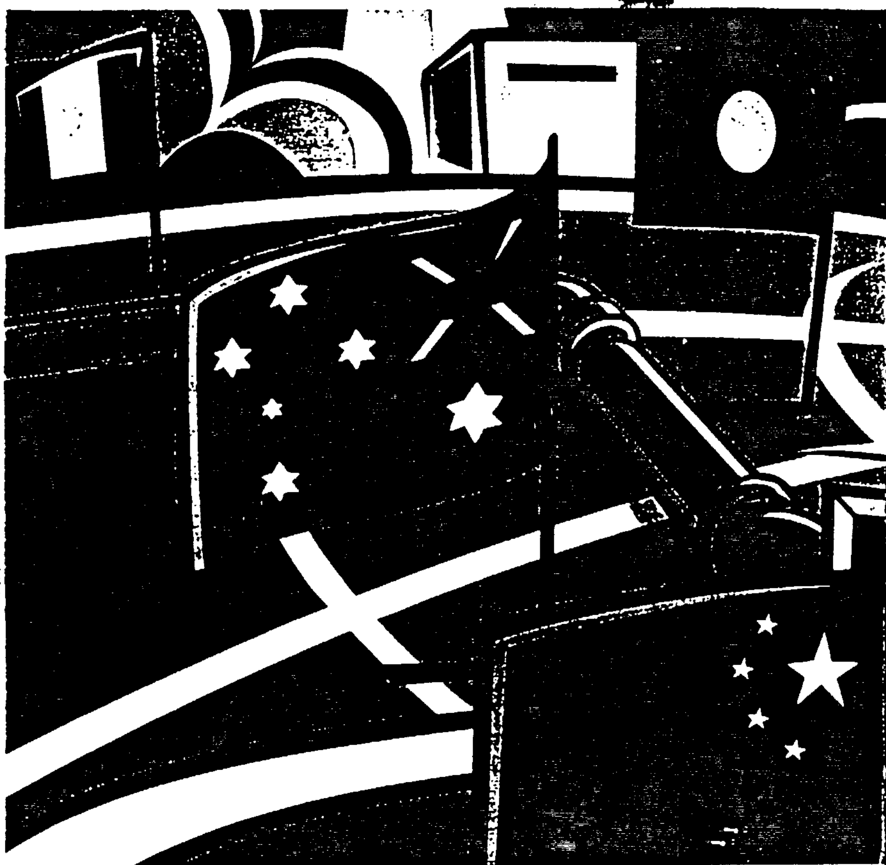


American Electric Power is a leading supplier of electricity and energy-related services throughout the world. In the United States, AEP provides electricity to parts of Ohio, Michigan, Indiana, Kentucky, West Virginia, Virginia and Tennessee and operates a 1,900-mile natural gas pipeline and related facilities in Louisiana. Outside of the United States, AEP's interests include CitiPower, which distributes electricity in Melbourne, Australia; Pacific Hydro, which develops hydro and fossil plants in the Pacific region; Yorkshire Electricity Group, a distribution company in Great Britain; and Nanyang General Electric Light Co., Ltd., Henan Province, China, which operates a 250 MW power plant.

AEP's U.S. transmission and distribution system is one of the largest in the world, with 22,000 circuit miles of transmission lines and 119,000 miles of overhead and underground distribution lines.

In December 1997, AEP agreed to merge with Central and South West Corp., a public utility holding company based in Dallas, Texas, that has operations in Texas, Oklahoma, Arkansas and Louisiana.

This summary annual report highlights how AEP is positioning itself to participate in a more competitive energy industry in the United States and throughout the world and contains financial highlights from 1998. Full disclosure of all financial information is included in the 1998 Appendix A to the Proxy Statement. Additional information about AEP also is available on the Internet at www.aep.com.



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Help ensure fair and equitable competition

As legislation surfaces that will restructure the electric utility industry, we want to make sure that our shareholders are kept informed of the changes that are proposed. Together we can work to ensure that competition is fair and equitable. If you would like to participate with AEP in the legislative process, please fill out and return this postage-paid card. When you do, we'll let you know about issues which may interest you concerning the energy industry.

By working together, we can enhance AEP's role as America's Energy Partner.

AEP: America's Energy Partner ℠

YES! I want to participate in shaping America's energy future

Please let me know when my help may be needed to write my elected representatives on legislation that will affect the electric utility industry.

Name ______________________ please type or print clearly

Address ______________________

City ______________________

State ______________ Zip ______

Phone Number (Optional) ______________________

We're driving the changes

At American Electric Power, we're not waiting for tomorrow to prepare for the coming changes in the electric utility industry, we're driving those changes today. From leading edge technology in the generation and transmission of electricity to strategic relationships with companies in the United States and throughout the world, AEP is positioned to be a leader in global power markets. Our merger with Central and South West Corp., announced in 1997, will enhance our competitive position in North America. Our operation in China puts us in one of the world's fastest growing energy markets while our ventures in England and Australia allow us to compete in established, but dynamic, economies. Our acquisition of a natural gas pipeline and related businesses in the United States allows us to leverage an already fast-growing energy trading business even more. AEP is positioned to power tomorrow.

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POWERING TOMORROW

Dear Fellow Shareholders,

When I came to AEP eight years ago, I knew I was joining a company with a rich history of innovation in technology, an efficient transmission network and record-setting generating facilities. What I wasn't as aware of, but have since come to appreciate, is the strength of AEP's people. Not only are they talented, skilled and enthusiastic, but doggedly determined. In the face of several challenges thrown at us in 1998, including unseasonable weather, the ongoing Cook Nuclear Plant outage and regulatory delays on our merger with Central and South West Corp., we still pushed ahead on our strategy. We made great strides in growing our trading operations and international presence, introduced new products domestically and achieved solid progress on preparing to merge with CSW. Unfortunately, we were not as successful in growing our earnings.

Net income for 1998 was $536 million, or $2.81 a share, compared with $511 million, or $2.70 a share, in 1997. The 1997 figure includes a one-time loss of 58 cents a share related to Great Britain's windfall tax imposed on our Yorkshire Electricity investment. Without that extraordinary loss in 1997, our 1998 earnings would have shown a 14 percent year-to-year decrease.

What contributed to these results? In 1998, we had periods of unseasonably mild weather. Coupled with the ongoing expenses related to restarting the Cook plant and the effect of less energy to sell because of the outage, these factors reduced earnings 46 cents a share compared with a year in which we would have had normal weather. A write-down in Yorkshire Electric's investment in a British telecommunications company and severance accruals for a reorganization of the power generation and energy delivery staffs contributed 24 cents a share to the decline.

Our earnings performance is reflected in our stock price. For the first time in three years, we missed our goal of being in the top quartile of the Standard & Poor's Electric Utility Index, based on total shareholder return over a three-year period. Total shareholder return for the most recent three years was 39.6 percent, which placed us 14th among the 26 utilities in the index.

Despite this disappointing financial performance, we stayed focused on our strategic priorities: to be among the best in our core business, to leverage the value of assets through trading and marketing and to seek growth opportunities in international markets and the U.S. energy business.

Our merger with Central and South West Corp., announced at the end of 1997, will further our progress in all areas. In 1998, teams of employees from both companies began meeting to share best practices and consider ways to prepare for our merger. You can read more about these efforts on page 12 in this report. We recognize our merger raises complex and new issues. But we have an expedited hearing schedule at the Federal Energy Regulatory Commission and we are aggressively working with the states and other intervenors to settle outstanding issues. I remain confident that we will complete the merger in a timely fashion.

Operationally, we are aggressively working to reduce costs by rethinking how we perform our work, how we staff our facilities and

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Dr. E. Linn Draper, Jr., Chairman, President & Chief Executive Officer, at AEP's exhibit at the World Energy Congress in Houston.

how we *maintain* our systems. We put in place new accounting and data processing systems that give managers more targeted information so we can make better and more timely decisions. We're restructuring our generation operations to improve our processes and enhance our competitive position.

Work continues on making our computer systems ready for the next millennium. We understand concerns the public has about the industry's ability to keep electricity flowing after Jan. 1, 2000. We plan to have our critical systems ready by the middle of 1999.

A major goal for 1999 is to return the Cook plant to production. Because of questions about how some system changes had been documented, we voluntarily took the plant offline in September 1997. Since then, we've rebuilt the backup stored-ice emergency cooling system and put in place new leaders that have experience in bringing nuclear plants back on line. They are taking a fresh look at the facility and going through a point-by-point reassessment of all systems. The plant has had an excellent operating history and we are confident that we will be able to announce a restart schedule later this year.

Through our trading and marketing operations, we've made substantial progress developing a culture that is responsive to our customers and the market. In less than two years, we've grown from being a modest participant in the trading business to one of the largest in the nation, based on kilowatthours traded, and we are on a parallel path in the natural gas market. Perhaps as important are the risk management procedures we instituted, which proved their value during the June spike in Midwest electricity prices. They shielded us from the substantial trading losses that many of our peers experienced.

In December, we purchased a 1,900-mile intrastate natural gas pipeline and natural gas

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POWERING TOMORROW

gathering, processing, storage and trading business. These natural gas assets, located in Louisiana, complement our existing gas trading business. By owning gas properties, we can enhance our gas trading operation and become a larger player in the converging energy markets.

We expanded our business to a new continent early in 1998 with the acquisition of a 20 percent interest in Pacific Hydro Ltd., an Australian company that develops and operates hydroelectric and small fossil-fueled facilities in the region. We later enhanced our presence in the market by purchasing CitiPower, a $1 billion electric distribution and retail company that serves the central part of Melbourne. As Australia's energy market transitions to competition, we see the potential to develop the same sort of integrated energy services business that we are building in the United States.

In China, the first unit of our joint venture plant in Henan Province began preliminary operations in October, with commercial production scheduled soon. The second unit will begin operating in the first half of 1999. We expect the venture to begin contributing to revenues during 1999. We hope to be a participant as more opportunities become available in this market.

Looking ahead, several challenges await us. One of the most significant is the U.S. Environmental Protection Agency requirement that we cut our nitrogen oxide emissions by 85 percent from 1990 levels. Meeting the EPA's 2003 deadline will require us to spend $1.2 billion on capital improvements to our power plants and will increase our operating costs.

There's no question we need to reduce nitrogen oxide emissions. In fact, we had already announced a voluntary plan along with several Midwestern states to reduce emissions by 65 percent. Because we believe this would allow affected areas to meet air quality standards, we do not understand the EPA's rejection of this plan. We are further concerned about the EPA's aggressive deadline and our ability to retrofit power plants without threatening system reliability. We are working closely with our state regulatory agencies, some of which have appealed the EPA rule.

One way to reduce nitrogen oxide emissions is to reduce the amount of coal we burn. In

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JANUARY

AEP Energy Services opens Houston energy trading office

FEBRUARY

AEP Resources agrees to purchase 20 percent stake in Pacific Hydro Ltd.

AEP Resources establishes international development offices in London, Singapore

MARCH

Decision announced to thaw ice condensers at Cook Nuclear Plant

AEP Communications, ValleyNet agree to connect fiber optic networks.

APRIL

AEP, CSW file for merger approval with Federal Energy Regulatory Commission and Texas Public Utility Commission

MAY

AEP, CSW file for merger approval with Louisiana Public Service Commission

AEP, CSW shareholders each approve merger

JUNE

AEP Communications launches Datapult

AEP, CSW file for merger approval with Arkansas Public Service Commission our search for a more balanced fuel mix, we will rely on CSW, which has considerable experience using a diverse mix of fuels including natural gas.

As regulatory restrictions are relaxed and market forces are allowed to work, technology leadership will be increasingly important to succeed. At AEP we have people who would be the envy of major research institutions. We've developed practical innovations to more efficiently use generation and transmission resources so we can choose to reduce or delay capital expenditures. Other innovations allow for more reliable and responsive energy management. These are described on page 8.

Finally, I want to express my gratitude to Angus Peyton, who is retiring this year from AEP's board after serving 21 years as a director. Angus has helped guide AEP through a period of tremendous change and has always provided sound guidance and counsel. We wish him all the best.

In conclusion, we've learned that operating in an environment of change that is unprecedented in our industry requires the ability and willingness to deal with ambiguity. We are still far from having a fully competitive retail generation market. Many regulatory issues remain unresolved. Questions about providing nondiscriminatory access to the transmission grid are financially and technically complex, and often lead to spirited debate.

What is not in dispute, as far as I am concerned, is the critical importance of creating constructive relationships not only within our corporate family, but also with our partners at CSW, our customers, our regulators, our legislators and our suppliers. On these relationships we will build our future. If a long-range plan is a Dream with a Deadline, then I thank you, our shareowners, for your confidence in our ability to realize AEP's dreams, and thank our employees for continuing to meet both our deadlines and our high expectations.

E. R. Draper

E. Linn Draper, Jr.
Chairman, President
& Chief Executive Officer
February 24, 1999

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JULY

The world's first Unified Power Flow Controller, developed by AEP, Electric Power Research Institute and Siemens, is dedicated at AEP's Inez, Kentucky, substation

AUGUST

AEP, CSW file for merger approval with Oklahoma Corporation Commission

Arkansas Public Service Commission tentatively approves AEP, CSW merger

SEPTEMBER

AEP named among nation's most efficient utilities by Public Utilities Fortnightly

AEP Resources to acquire mid-stream gas operations of Equitable Resources

OCTOBER

AEP, CSW file for merger approval with Securities and Exchange Commission

AEP celebrates 3 millionth customer

NOVEMBER

Virginia customer choice pilot program announced

AEP Resources agrees to purchase CitiPower, Melbourne, Australia.

DECEMBER

AEP Resources locates Latin America development office near Washington, D.C.

AEP Resources closes purchases of CitiPower, Equitable Resources gas assets.

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Growth by choice, not chance

Choosing where to grow is as important a decision as how to grow. As developing countries continue to launch generation projects and others privatize or restructure their energy industries, we are participating in international markets where we can manage risks and leverage our expertise and business designs to create value and growth for shareholders. Our activities in England, Australia and China illustrate this point well.

In February 1998, we purchased a 20 percent interest in Pacific Hydro, a company that develops and operates hydroelectric and fossil projects in the Pacific region. Not only did this investment provide an opportunity to leverage our expertise in designing, building and operating fossil-fired generating plants, it also was an entry into a new and promising market. We built on that groundwork with the December acquisition of Melbourne-based CitiPower, a distribution company that provides power to about 240,000 customers in the central portion of the city. When the natural gas sector of the Australian market opens in 1999, we'll take a look at it as well. In Australia, as in the United Kingdom, we now have the ability to develop an integrated presence that can leverage our skills in the distribution, retail and, potentially, the wholesale energy business.

In China, the first unit of our 250-megawatt project in Henan Province began preliminary operations in the fall, ahead of time and budget. The second unit is scheduled to follow in 1999. China offers enormous growth potential and we continue to explore new opportunities to leverage our technology and project management skills to bring the benefits of electricity to this developing nation.

Our merger with Central and South West complements our activity in the global marketplace. AEP owns a 50 percent interest in Yorkshire Electricity in England; CSW owns SEEBOARD, another British electric distribution company. We are exploring opportunities to combine the two operations to take advantage of synergies and to develop a more robust retail business. In addition, CSW's presence in Latin America complements our activity in the Pacific Rim and Europe.

Domestically, we continue to look at a broad range of projects in the United States and Canada. These include purchasing complementary electric and natural gas assets, developing new independent power, cogeneration and transmission projects, and offering comprehensive energy asset management services for large multisite industrial customers.

We have a proud heritage of technological leadership, low-cost generation, robust transmission, and reliable and cost-effective distribution. We have successfully developed sophisticated commercial and risk management skills to support our competitive wholesale and retail marketing and trading activity. We will continue to leverage our expertise in global markets to create value and growth for our shareholders.

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POWERING PROGRESS

Technology helps drive progress

New computer and telecommunications technologies offer us several opportunities to grow, create value and improve customer service. Behind the scenes, they provide flexibility and reliability for electric power operations. Close to the customer, technology offers new ways to monitor energy use and efficiency — a true idea with power.

We enhanced our reputation as a global leader in transmission technology with the world's first installation of Unified Power Flow Controller equipment at our substation in Inez, Kentucky. UPFC technology, developed jointly with the Electric Power Research Institute and the Siemens Power Transmission and Distribution group, allows us to improve the quality and control the flow of electricity over a transmission line with unprecedented precision. Customers benefit from more reliable power, while we gain more flexible control over the flow of electricity through our system. The result is more efficient use of generation and transmission resources and reduced capital expenditures in the long run.

We're developing comparable power flow technology for industrial and office parks to make sure power quality will not interfere with sensitive computers and industrial controls. Partnering with other worldwide technology leaders, we are overcoming hurdles in cost, technology, regulation and power quality standards.

Ultimately, our customers want a combination of energy tracking and control that can only come from better technology. Datapult™, introduced in 1998 by AEP Communications, puts the power of energy information into the hands of customers. Datapult offers a new level of power management capability to energy users. The Datapult portfolio of on-line services goes beyond traditional power management systems by combining state-of-the-art analysis tools with the timely retrieval of the information that drives a company's energy use. For businesses focused on maximizing resources and reducing costs, leveraging this information is critical.

AEP Communications also is building one of the most robust fiber optic systems in the Midwest. We expect to add 700 miles of fiber optic cable to the system in 1999, creating a network that will span 1,600 miles, from Chicago to Roanoke, Virginia. AEP Communications also has joined with American Tower Corporation to build communications towers throughout the Midwest and market antenna attachments for more than 175,000 existing AEP towers.

Telecommunications technology has also proven crucial to the way we interact with our customers. Our new accounting and customer service systems put us in the forefront of our industry in our ability to gather information and handle customer calls. We can analyze data more precisely, which gives our managers better information upon which to make decisions. When fully implemented in 1999, our customer call system will be one of the largest of its type in the country, ultimately offering one-number access to all our customers.

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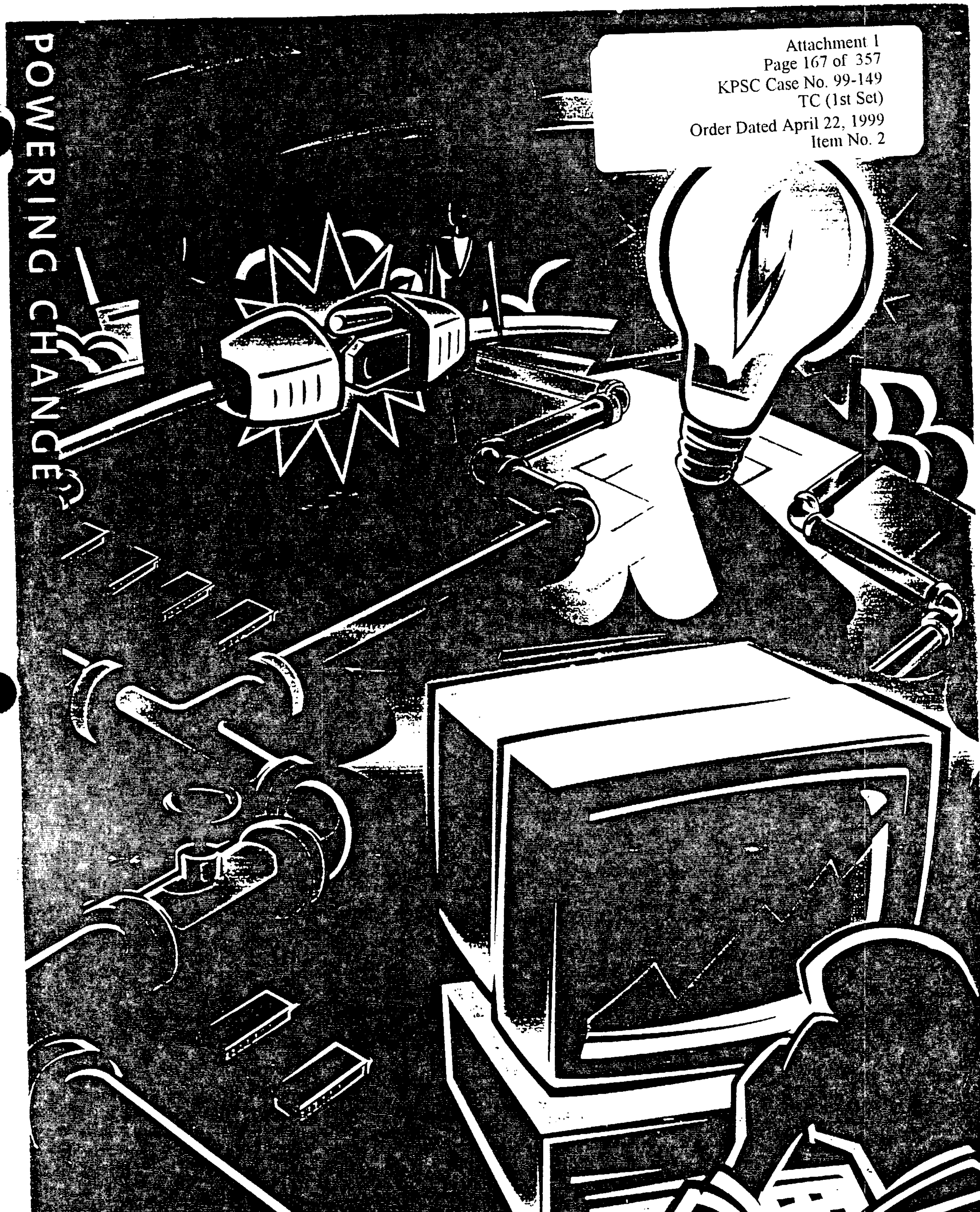


POW RING PROGRESS

Powering a quiet revolution

As in so many of AEP's current energy opportunities, the power of change comes from combining existing electricity expertise with new technologies, competitive market principles, information and concern for the environment.

In less than two years, AEP's electricity trading operation has gone from start-up to one of the largest in the United States, based on kilowatthours traded. Though it has not yet reached the same stature, our natural gas trading operation is on a similar growth path.

Energy trading uses information and disciplined trading principles to expand earnings opportunities beyond existing service territories and neighboring utilities. Actively pursuing wholesale market opportunities, our traders maximize the use of our low-cost generation while setting the stage for opportunities beyond electricity and beyond physical assets.

Because electricity can not be stored, the price of this vital commodity changes constantly. We have more than 200 skilled traders who gather and interpret information and use their knowledge of the energy markets to take advantage of price differences.

In our core electricity business, we have optimized the use of our generating assets by marketing the electricity in excess of that needed to serve our own customers' demand. By improving the availability of these plants, we delay the need to build new capacity while increasing the amount of power we can sell to others. In the last three years we've increased fossil plant availability 6 percent while keeping costs flat.

Outside of electricity, our purchase of a 1,900-mile natural gas pipeline in Louisiana, along with other natural gas businesses, from Equitable Resources complements our trading operations by giving us a physical presence and more knowledge of the U.S. gas market.

Another example of using existing assets more productively comes from our *Power Generation group*, which offset expenses by more than $10 million in 1998 by providing barge towing, *rail car maintenance, machine* repair and other services to third parties.

As we grow and change, we're always looking at ways to reduce emissions and save energy, both for our customers and in our own operations. That's one reason why we won the U.S. Environmental Protection Agency's Green Lights Ally of the Year award in 1998. By upgrading the lighting in our facilities, we are saving 23.3 million kilowatthours a year and avoiding 29,295 tons of carbon dioxide, 144 tons of nitrogen oxides and 377 tons of sulfur dioxide emissions.

In today's energy market, change is a way of life. At AEP, we have the power to make change work for the benefit of our customers, shareholders and the environment.

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The proposed merger with CSW continues to undergo state and federal regulatory review. As a result of the schedules set for formal hearings, we have revised the merger's expected completion date to late 1999. Merging the two companies to form a new AEP will create America's premier energy company and will offer substantial benefits to our shareholders, customers and employees.

In 1998 we received strong endorsements of the merger from the shareholders of both companies. We also received approval from the U.S. Nuclear Regulatory Commission and a conditional approval from the Arkansas Public Service Commission. We expect approvals from the other states CSW serves during 1999.

The Federal Energy Regulatory Commission has set expedited hearings on the merger to begin in June 1999. Among the issues to be addressed are market power of generation and transmission. In January, we filed updated market power studies and a mitigation plan at the FERC and we are aggressively working with the Transmission Alliance and the Midwest ISO regarding participation in a regional transmission organization.

We have filed our request for approval by the Securities and Exchange Commission and are preparing filings to be made soon at the Federal Communications Commission and the U.S. Department of Justice.

From the administrative side, we've created more than 40 intercompany process and activity teams to study various aspects of our business, from information processing to how plants can operate more efficiently. These teams allow our employees to get to know one another, build relationships and, most importantly, learn from one another. As part of our quest to enhance our world-class position, we are looking at best practices to learn how to improve what we do.

During 1999, these same teams will progress to what we call the "to be" phase, which is to determine how these functions will be performed after the companies merge. Here we'll employ what we've learned about ourselves and others. While no business combination proceeds flawlessly, we've studied other mergers, learned from their experience and put together a process that we believe will enhance our future. We're excited about the possibilities this creates.

Here is a status of the regulatory approval process by state and federal agency, as of February 1999:

Arkansas – Filed June 12, 1998. On December 17, 1998, the Arkansas Commission approved the merger and an agreement providing for rate reductions of $6 million over five years following the merger, subject to rulings in other jurisdictions.

Louisiana – Filed May 15, 1998. A final order is expected in spring 1999.

Oklahoma – Filed August 14, 1998. An Oklahoma Corporation Commission administrative law judge dismissed the AEP/CSW merger application, citing a lack of information regarding the potential impact of the merger on the retail electric market in the state. AEP and CSW have refiled the application. Final hearings will be held in the spring of 1999.

Texas – Filed April 30, 1998. Settlement reached with key parties with rate reductions totaling $180 million over six years. Hearings before the Public Utility Commission of Texas are scheduled to begin in April 1999.

Department of Justice – To be filed.

Federal Energy Regulatory Commission – Filed April 30, 1998. On November 10, 1998, the Commission ruled that it would hold hearings in June 1999. A final order is expected in the fourth quarter of 1999.

Federal Communications Commission – To be filed.

Nuclear Regulatory Commission: Filed June 19, 1998. Approved November 5, 1998.

Securities and Exchange Commission – Filed October 13, 1998

Anticipated Federal Energy Regulatory Commission Schedule

March 31 – Intervenor testimony

April 6 – State Commissions' testimony

April 7-8 – Technical conference

April 26 – Staff testimony and intervenor cross-rebuttal

May 13 – Applicants' rebuttal to March 31 and April 6 testimony and intervenors' rebuttal to staff testimony

May 17 – Applicants' rebuttal to staff testimony and May 13 testimony

June 1 – Hearings begin

October – Final order

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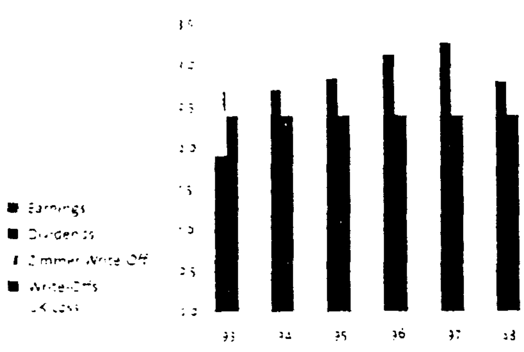
Summary Management's Discussion and Analysis of Financial Condition and Results of Operations

Introduction

We are continuing our summary approach to the financial section to this annual report based on favorable comments received from shareholders. This abbreviated financial presentation is intended to present capsule information in an easier to read format and should not be considered a substitute for the full financial statements inclusive of footnotes provided to all shareholders as an appendix to the Proxy Statement and included in the annual 10-K filing with the Securities and Exchange Commission (SEC). A copy of the Form 10-K and/or Appendix A to the Proxy Statement that includes the full financial statements can be obtained by calling 1-800-551-1AEP. Although this summary should help you understand AEP's 1998 results of operations and financial condition, we caution that before making any investment decisions you should review the full financial statements.

The following discussion contains forward looking statements which reflect assumptions and involve a number of risks and uncertainties that could cause actual results to differ materially.

Earnings and Dividends
Dollars Per Share



Business Outlook

In 1998 management continued to implement its growth-oriented strategy with a goal of being America's Energy Partner and a global energy and related services company. We have adopted a strategy to expand our geographic reach and to build or acquire capabilities across a broader range of energy products and services. AEP is positioning itself to be successful in an increasingly competitive market in which customers will choose their energy supplier. AEP made several acquisitions in 1998 that expanded its energy operations overseas and in the United States. The expansion of the foreign energy business in 1998 included the purchase of CitiPower, an Australian electric distribution utility; the acquisition of an equity interest in Pacific Hydro, an Australian hydroelectric generating company and continued on schedule construction of two generating units in China.

The past year also saw the expansion of AEP's domestic energy operations with a purchase of intrastate gas pipeline and storage operations in Louisiana and a significant increase in wholesale electricity and gas marketing and trading. AEP's wholesale trading operations involve the trading of contracts for the future delivery or receipt of electricity in both regulated and non-regulated operations and non-regulated gas. It also involves the purchase and sale of options, swaps and other derivative financial instruments. Open access transmission, the introduction of competition to the wholesale electricity market and the development of a trading market and settlement process have fostered the growth of electricity trading in the United States. The trading market is a highly volatile market that requires enhanced credit and market risk management skills. Trading requires little capital investment and profit margins are usually smaller than margins on the Company's traditional sales. The Company's goal is to utilize its knowledge of energy markets to trade electricity and gas

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to lower rates and contribute to net income thereby enhancing both customer and shareholder value.

Our expansion of energy operations and investments began with the acquisition of a 50% equity interest in Yorkshire Electricity Group plc (Yorkshire), a United Kingdom (UK) electricity distribution company, in April 1997 and the announcement in December 1997 of a merger with Central and South West Corporation (CSW). The merger with CSW is proceeding through the regulatory approval process. Regulatory approvals have been received from the Arkansas Public Service Commission and the Nuclear Regulatory Commission (NRC). Approval of the merger has been requested from the Public Utility Commission of Texas, the Oklahoma Corporation Commission, the Louisiana Public Service Commission, the Federal Energy Regulatory Commission (FERC) and SEC.

Hearings have been scheduled by the FERC and settlement negotiations are in process in the state jurisdictions that have not yet approved the merger. AEP and CSW plan to make the final two filings associated with approval of the merger with the Federal Communications Commission and the Department of Justice in the near future. The shareholders of both companies gave the necessary approvals for the merger in May 1998. The merger, however, is conditioned upon, among other things, the approval of the above state and federal regulatory agencies. The transaction must satisfy many conditions, including the condition that it must be accounted for as a pooling of interests, and some of these conditions may not be waived by the parties. Although consummation of the merger is expected to occur in the fourth quarter of 1999, the Company is unable to predict the outcome or the timing of the required regulatory proceedings.

The merger, when approved, will increase AEP's annual revenues by approximately $5 billion and add 14 000 megawatts of generation and 1.7 million domestic customers to the new AEP. Furthermore it will expand our domestic market, add more low-cost generation, contribute to AEP's non-regulated products and services business and positively impact our competitiveness.

Management believes that its growth oriented strategy in energy projects and operations should support

Consolidated Condensed Balance Sheets
At December 31
(In Millions)

	1998	1997
Assets		
Electric Utility Plant	$ 20,146.3	$19,596.4
Accumulated Depreciation and Amortization	(8,416.4)	(7,963.6)
Net Electric Utility Plant	11,729.9	11,632.8
Other Plant	841.5	62.2
Other Property and Investments	2,515.1	1,294.3
Cash and Cash Equivalents	173.0	91.5
Other Current Assets	2,044.6	1,429.0
Regulatory Assets	1,846.7	1,817.5
Deferred Charges	332.4	288.0
Total	$19,483.2	$16,615.3
Capitalization and Liabilities		
Common Shareholders' Equity	$ 4,841.8	$ 4,677.2
Cumulative Preferred Stocks of Subsidiaries	173.6	174.3
Long Term Debt	6,799.6	5,129.5
Total Capitalization	11,815.0	9,981.0
Current Liabilities	2,801.6	2,085.7
Deferred Income Taxes and Investment Tax Credits	2,952.3	2,937.2
Other Liabilities	1,914.3	1,611.4
Total	$19,483.2	$16,615.3

Note: The significant increase in assets and liabilities is primarily due to the acquisition on December 31, 1998 of CitiPower, an Australian electric distribution company and on December 1, 1998 of mid-stream gas and storage operations in Louisiana.

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revenues and earnings growth by: increasing the existing business and customer base; developing a national energy trading business, building a portfolio of global investments in energy companies and projects; expanding energy related products and services to be offered to customers worldwide and adding incremental generation, transmission and distribution assets and operations within the United States. AEP has the financial strength, geographic reach and low-cost structure to be an able competitor. However, no assurance can be given that AEP can maintain this position in the future. The electric industry has seen and will continue to see mergers and acquisitions as the electric generation business becomes more competitive. We believe that the actions taken in 1998 further position AEP as a growing, diverse energy company.

The most significant factors affecting the Company's future earnings are the ability to recover its costs as the domestic electric generating business becomes more competitive and the performance of the recently acquired energy investments and operations. The Company continues to evaluate domestic and international markets for investments to grow the business in the best interests of our shareholders, customers and employees. The performance of any future acquisitions, mergers and investments will also impact future earnings.

Federal legislation has been proposed to mandate competition and customer choice at the retail level, and several states have introduced or are considering similar legislation. Certain states, including California, instituted full customer choice in 1998. The introduction of competition and customer choice for retail customers in the Company's domestic service territory has been slow and deliberate as legislators and regulatory officials recognize the complexity of the issues.

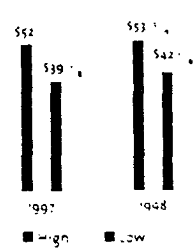
All of the states within our domestic service territory have initiatives to implement or review a phase-in of customer choice, although the timing is uncertain. The Company supports customer choice and deregulation of generation and is proactively involved in discussions at both the state and federal levels regarding the best competitive market structure and method to transition to a competitive marketplace.

As the pricing of generation in the electric energy market evolves from regulated cost-of-service ratemaking to market-based rates, many complex issues must be resolved, including the recovery of stranded costs. Stranded costs are those costs above market that potentially may not be recoverable in a competitive market. At the wholesale level recovery of stranded costs under certain conditions was addressed by the FERC when it established rules for open transmission access and competition in the wholesale markets. However, the issue of stranded cost is unresolved at the retail level where it is much larger than it is at the wholesale level. The amount of stranded costs the Company could experience depends on the timing and extent to which competition is introduced to its generation business and the future market prices of electricity. The recovery of stranded cost is dependent on the terms of future legislation and related regulatory proceedings.

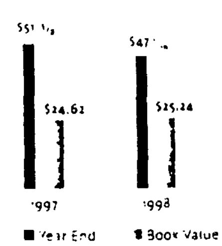
Regulatory assets (deferred expenses) and regulatory liabilities (deferred revenues) are included in the consolidated balance sheets of regulated utilities in accordance with regulatory actions and in order to match expenses and revenues with cost-based rates. In order to maintain net regulatory assets on the balance sheet, rates charged to customers must be cost-based and provide for their probable recovery. In the event a portion of AEP's business were no longer cost-based regulated, net regulatory assets would have to be written off for that portion of the business, unless they are recoverable through the regulatory process.

Although FERC orders provide for competition in the firm wholesale market, that market is a relatively small part of our business and most of our firm wholesale sales are still under cost-of-service contracts. As a result, AEP's generation business is still cost-based regulated and should remain so pending the passage of state legislation to deregulate the generation business. We believe that state legislation should provide for the recovery of any generation-related net regulatory assets and other reasonable stranded costs from economically impaired

Market Price
Common Stock



Book Value
Closing Stock Price



generating assets. However, if in the future AEP's generation business were to no longer be cost-based regulated and if it were not possible to demonstrate probability of recovery of resultant net regulatory assets and other stranded costs, results of operations and financial condition would be adversely affected.

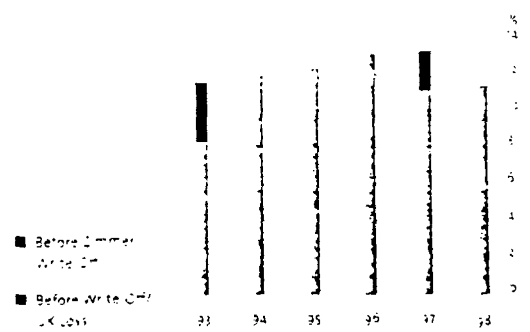
Efforts continue to reduce the costs of our products and services in order to maintain our competitiveness. The accounting department completed its consolidation of operations and the marketing department completed its reorganization in 1998, producing significant cost reductions. In 1998 plans were announced to close one of the Company's coal mining operations in October 1999 and the Company reviewed its staffing levels for power generation and energy delivery resulting in staff reductions in 1999. The costs of these staff reductions were provided for in the fourth quarter of 1998. Although cost savings are expected to result from the power generation and energy delivery reorganizations and the planned mine closing, expenses will continue to increase for new business growth and development; marketing and customer services; and the reengineering and improvement of business processes.

The management and control of coal costs is critical to our competitive position. We are negotiating with unaffiliated suppliers to lower purchased coal costs. Although we have been working to reduce affiliated mining costs, we have been unable to reduce the cost of affiliated coal to match the market price for coal. With approval of a regulator, the Company is deferring, for future recovery, affiliated coal costs in excess of a predetermined price cap in the affected retail jurisdiction. We intend to continue to prudently supplement our long-term coal supplies with spot market purchases as long as favorable spot market prices exist. Competitive pressures, the need to recover mining cost deferrals, deregulation and/or Phase II of the Clean Air Act Amendments could result in the closure of the two remaining affiliated coal mines. Unless the cost of affiliated coal, price cap deferrals or the cost of any mine closure is recovered either in regulated rates or as a stranded cost under a plan to transition the generation business to competition, future earnings and possibly financial condition could be adversely affected.

Nuclear power plants have a major future financial commitment to safely dispose of spent nuclear fuel (SNF) and to decontaminate and decommission the plant. The cost to store and dispose of SNF continues to increase, mainly due to the lack of progress by the federal government to open a permanent disposal site. In addition, estimated nuclear decommissioning costs continue to increase due in part to the delay in the availability of a storage site for SNF. Presently we are recovering the cost of on-site nuclear fuel storage and estimated nuclear decommissioning costs over our nuclear plant's remaining life. However, our future earnings and possibly financial condition could be adversely affected if the cost of these items continues to increase and recovery is not permitted in rates.

In September 1997 the Company voluntarily shut down both units of the Cook Nuclear Plant due to questions related to certain safety systems. The NRC has identified a number of issues to be addressed and activities to be performed in order to restart the plant. The Company is working with the NRC to address these matters. A restart schedule will be developed after additional engineering reviews are conducted and should be available in June 1999. When maintenance and other activities required for restart are complete, AEP will seek concurrence from the NRC to return the Cook Plant to service. Until these additional reviews are completed, management is unable to determine when the units will be returned to service. Unless the costs of the extended outage and restart efforts are recovered from customers, there would be a material adverse effect on results of operations, cash flows and possibly financial condition.

Return on Average
Common Equity



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The cost of electricity supplied to certain retail customers rose due to the outage of the two units since higher cost coal-fired generation and coal-based purchased power were substituted for low-cost nuclear generation. The Indiana and Michigan retail jurisdictional fuel cost recovery mechanisms permit the recovery, subject to regulatory commission review and approval, of changes in fuel costs including the fuel component of purchased power in the Indiana jurisdiction and changes in replacement power in the Michigan jurisdiction. Pending commission review and approval for recovery of the increased cost of electricity, $65 million was deferred as a regulatory asset at December 31, 1998. If recovery of the deferred increased cost of replacement electricity is denied, future results of operations would be adversely affected by the write off of the regulatory asset and any continued non-recovery.

Results of Operations

Net income increased to $536 million, or 5%, primarily due to an extraordinary loss in 1997 of $109 million from the UK's one-time windfall tax that was based on a retroactive revaluation of the original privatization price of certain privatized utilities, including Yorkshire. AEP's 1998 income before the extraordinary loss decreased 14% to $536 million, or $2.81 per share, from $620 million, or $3.28 per share, in 1997. Several major items contributed to the reduction in 1998 earnings, including the cost of Cook Plant restart activities, a write-down of Yorkshire's investment in Ionica, a UK telecommunications company, severance accruals for 1999 reductions in power generation and energy delivery staff and mild winter and fall weather.

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Consolidated Condensed Statements of Income
Year Ended December 31
(In Millions – Except Per Share Amounts)

	1998	1997	% Change
Revenues	$ 6,345.9	$5,879.8	7.9
Expenses:			
Fuel	1,717.2	1,627.1	5.5
Purchased Power	436.4	134.7	224.0
Maintenance	542.9	483.3	12.3
Depreciation and Amortization	580.0	591.0	(1.9)
Taxes Other Than Federal Income Tax	493.4	490.6	0.6
Other Operation	1,303.1	1,227.4	6.2
Interest Charges & Preferred Stock Dividends	430.0	423.6	1.5
Total Expenses	5,503.0	4,977.7	10.6
Other Income (Loss)	(44.1)	16.8	N.M.
Income Before Federal Income Taxes	798.8	918.9	(13.1)
Federal Income Taxes	262.6	298.5	(12.0)
Income Before Extraordinary Item	536.2	620.4	(13.6)
Extraordinary Loss-UK Windfall Tax	—	(109.4)	N.M.
Net Income	$ 536.2	$ 511.0	4.9
Average Number of Shares Outstanding	190.8	189.0	1.0
Earnings Per Share			
Before Extraordinary Item	$2.81	$3.28	(14.3)
Extraordinary Loss-UK Windfall Tax	—	(0.58)	N.M.
Net Income	$2.81	$2.70	4.1
Cash Dividends Paid Per Share	$2.40	$2.40	—

N.M.=Not Meaningful

FINANCIAL SUMMARY

Revenues

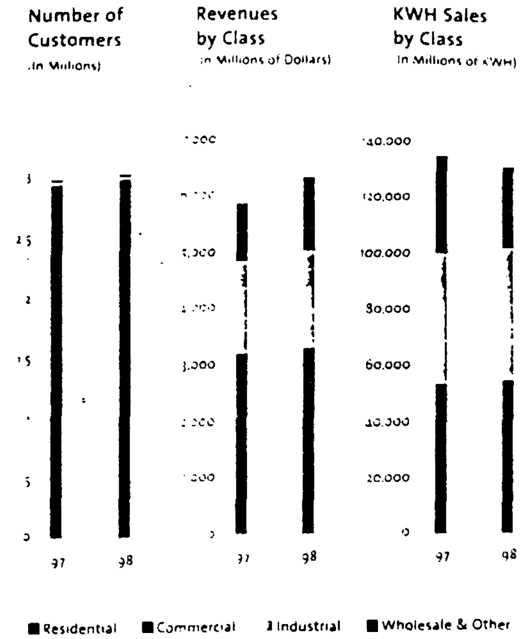
Total revenues exceeded $6.3 billion, increasing more than $460 million, or 8%, from total revenues of $5.9 billion in 1997. Retail revenues increased $188.5 million, or 4%, in 1998, reflecting a 2% sales increase and higher fuel recoveries. Although residential sales were flat, reflecting continued mild winter and fall weather in 1998, revenues from residential customers increased 2%. The accrual of revenues for the recovery of the increased fuel costs related to the extended nuclear plant outage accounted for the increase in residential revenues. Commercial revenues increased as a result of a 4% increase in sales, reflecting increased usage and growth in the number of customers. Industrial revenues rose 6%, reflecting a sales increase of 2% following the resumption of operations by a major industrial customer after an extended labor strike. Also contributing to the increase in industrial revenues were favorable contract price adjustments to certain major industrial customers and the pass-through of higher power costs during periods of peak demand.

An increase of 26% in wholesale revenues in 1998 is attributable to trading within regulated operations of electricity with other utilities and power marketers in the Company's traditional marketing area and increased power marketing sales. Revenues from the trading of electricity are recorded net of purchases. Regulated trading activities are conducted as part of AEP's electric power wholesale marketing and trading operations and involve the purchase and sale of substantial amounts of electricity. Power marketing sales are for the sale of power to unaffiliated companies generated by AEP or purchased from other unaffiliated companies.

A 62% increase in transmission service revenues also contributed to the total increase in revenues. Transmission service revenues, for the delivery of other companies' power through the AEP transmission system, have increased significantly since the FERC's issuance of open access transmission rules in 1996.

Common Stock Market Price Range:

	1998		1997	
	High	Low	High	Low
First Quarter	$51 [illegible]	$47 [illegible]	$43 [illegible]	$40
Second Quarter	$50 [illegible]	$44 [illegible]	$42 [illegible]	$39 [illegible]
Third Quarter	$48 [illegible]	$42 [illegible]	$46 [illegible]	$41 [illegible]
Fourth Quarter	$53 [illegible]	$45 [illegible]	$52	$45 [illegible]



Total Expenses

Total expenses increased by 11%, due primarily to increased fuel, purchased power, maintenance and other operation expenses. Fuel expense increased primarily due to an increase in the average cost of fuel consumed reflecting the reduced availability of lower cost nuclear generation due to the unplanned extended outage of our nuclear units that began in September 1997 and continued throughout 1998. The significant increase in purchased power expense was mainly due to purchases of electricity for resale to other utilities and power marketers. The increase in purchases made for resale to other entities reflects an expanding and evolving wholesale marketplace. Expenditures to prepare the nuclear units for restart and to restore service interrupted by two severe snowstorms accounted for the increase in maintenance expense. Other operation expenses increased mainly due to the extended nuclear plant outage, wholesale power marketing and trading compensation as a result of the growth in the trading business and severance accruals for reductions in power generation and energy delivery staff.

Other Income

The decrease in other income was due primarily to losses from non-regulated energy trading and the write-down of Yorkshire's investment in Ionica.

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Federal Income Taxes

The decrease in federal income taxes is mainly due to a decline in pre-tax income.

Financial Condition

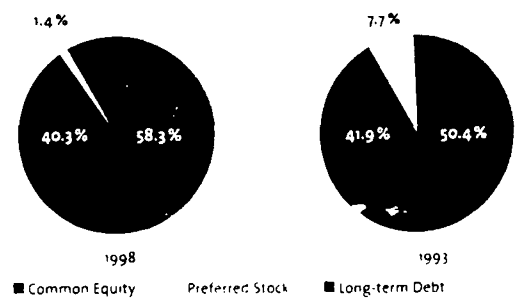
AEP's financial condition continues to be strong. The Company paid a quarterly dividend in 1998 of 60 cents a share maintaining the annual dividend rate at $2.40 per share. The 1998 payout ratio was 85%. AEP's three-year total shareholder return ranked 14th among the companies in the Standard and Poor's Electric Utility Index. While this placed us just below the midpoint, it has been and continues to be management's goal to be in the top quartile of this index for three-year total shareholder return.

Capital Resources and Needs

AEP's year-end ratio of common equity to total capitalization was 40.3% for 1998, compared with 45.5% for 1997 and 45.3% for 1996. The Company's goal is to maintain the common equity at a level of at least 40 percent.

Consolidated construction expenditures for all subsidiaries, domestic and foreign, are expected to be $2.4 billion over the next three years. All expenditures for domestic electric utility construction, estimated to be $2.2 billion for the next three years, are expected to be financed with internally generated funds.

Capitalization Ratio



Consolidated Condensed Statements of Cash Flows
Year Ended December 31
(In Millions)

	1998	1997
Operating Activities:		
Net Income	$ 536.2	$ 511.0
Extraordinary Item-UK Windfall Tax	—	109.4
Adjustments for Noncash Items	493.3	577.5
Net Cash Flows from Operating Activities	1,029.5	1,197.9
Investing Activities:		
Construction Expenditures–Domestic and China	(792.1)	(760.4)
Investment in Yorkshire Electricity Group plc	—	(363.4)
Investment in CitiPower	(1,054.1)	—
Investment in Gas Assets	(340.1)	—
Other	(26.4)	[illegible]
Net Cash Flows Used for Investing Activities	(2,212.7)	[illegible]
Financing Activities:		
Issuance of Common Stock	85.5	[illegible]
Retirement of Cumulative Preferred Stock	(.5)	[illegible]
Change in Long-term Debt, net	1,575.8	[illegible]
Change in Short-term Debt, net	61.5	[illegible]
Dividends Paid on Common Stock	(457.6)	[illegible]
Net Cash Flows from (Used for) Financing Activities	1,264.7	[illegible]
Net Increase in Cash and Cash Equivalents	81.5	[illegible]
Cash and Cash Equivalents January 1	91.5	[illegible]
Cash and Cash Equivalents December 31	$ 173.0	[illegible]

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FINANCIAL SUMMARY

Market Risks

The Company as a major power producer and a trader of wholesale electricity and natural gas has certain market and credit risks inherent in its routine business activities. Market risk represents the risk of loss that may impact the Company's consolidated financial position, results of operations or cash flows due to adverse changes in commodity market prices and interest and foreign currency rates. In 1998 the Company substantially increased the volume of its wholesale electricity and natural gas marketing and trading activities, increasing these risks. Policies and procedures have been established to manage market and credit risk exposures including the use of a risk measurement model utilizing Value at Risk. Fixed rate debt used to finance plant and other investments exposes the Company to interest rate fluctuation risk. However, a near term change in interest rates should not materially affect results of operations or consolidated financial position. Investment in business ventures in the UK, Australia and China exposes the Company to risk of foreign currency fluctuations. The Company currently does not utilize derivatives to manage its exposures to foreign currency exchange rate movements.

Other Matters

The Company has exposure to a number of significant contingencies, including but not limited to the following matters which are fully discussed in the Management Discussion and Analysis and the Notes to the Consolidated Financial Statements contained in the full financial statements in the Appendix A to the Proxy Statement and the 10-K: the continued shutdown of the Cook Nuclear Plant with the restart of the units subject to NRC concurrence that safety issues no longer exist; the resolution of litigation related to the Internal Revenue Service's position that certain interest deductions related to a corporate owned life insurance (COLI) program should not be allowed, the issuance of final air quality standards and the cost to achieve required reductions in emissions; and the correction of a complex and interdependent "Year 2000" problem whereby existing computer hardware and software programs will not properly recognize calendar dates beginning with the year 2000. If these contingencies are not successfully resolved, they could have an adverse effect on results of operations, cash flow and financial condition. Before making any investment decisions we recommend you read the full financial statements.

Independent Auditors' report

To the Shareholders and Board of Directors of American Electric Power Company, Inc.:

We have audited the consolidated balance sheets of American Electric Power Company, Inc. and its subsidiaries as of December 31, 1998 and 1997, and the related consolidated statements of income, retained earnings, and cash flows for each of the three years in the period ended December 31, 1998. Such consolidated financial statements and our report thereon dated February 23, 1999, expressing an unqualified opinion (which are not included herein) are included in the 1998 Financial Statements and Management's Discussion and Analysis of Results of Operations and Financial Condition. The accompanying condensed consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on such condensed consolidated financial statements in relation to the complete consolidated financial statements.

In our opinion, the information set forth in the accompanying condensed consolidated balance sheets as of December 31, 1998 and 1997 and the related condensed consolidated statements of income and cash flows for the years then ended is fairly stated in all material respects in relation to the basic consolidated financial statements from which it has been derived.

Deloitte & Touche LLP

Deloitte & Touche LLP
Columbus, Ohio
February 23, 1999

Attachment 1
Page 178 of 357
KPSC Case No. 99-149
TC (1st Set)
Order Dated April 22, 1999
Item No. 2

STATE PRESIDENTS

The state presidents and their staffs are available to help customers, consumer groups, legislators and others who deal with energy usage, education, safety, conservation, environmental matters and public policy. They can be contacted at the following locations:

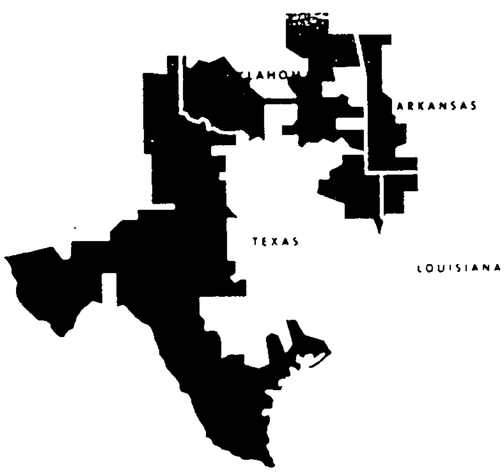
Timothy C. Mosher
AEP Kentucky
1701 Central Avenue
P.O. Box 1428
Ashland, KY 41105
(606) 327-1261
Fax (606) 327-3164
E-mail tcmosher@aep.com

Marsha P. Ryan
AEP Ohio
1 Riverside Plaza
Columbus, OH 43215
(614) 223-1400
Fax (614) 628-4631
E-mail mpryan@aep.com

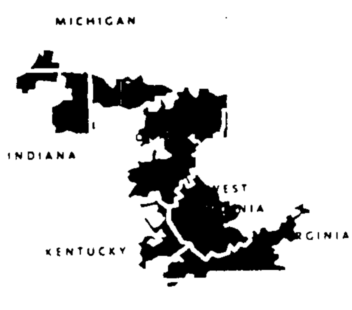
Dana E. Waldo
AEP West Virginia
301 Virginia Street East
P.O. Box 1986
Charleston, WV 25327
(304) 348-4710
Fax (304) 348-4722
E-mail dewaldo@aep.com

R. Daniel Carson, Jr.
AEP Virginia
AEP Tennessee
40 Franklin Road SW
P.O. Box 2021
Roanoke, VA 24022
(540) 985-2900
Fax (540) 985-2426
E-mail rdcarson@aep.com

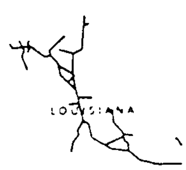
John R. Sampson
AEP Indiana
AEP Michigan
One Summit Square
P.O. Box 60
Fort Wayne, IN 46801
(219) 425-2101
Fax (219) 425-2112
E-mail jrsampson@aep.com



CSW Service Territory



AEP Service Territory



AEP LEADERSHIP

Officers of AEP and selected subsidiaries

American Electric Power Company, Inc.

E. Linn Draper, Jr.
Chairman, President and Chief Executive Officer

Henry W. Fayne
Vice President and Chief Financial Officer

Leonard V. Assante
Controller and Chief Accounting Officer

Armando A. Pena
Treasurer

Susan Tomasky
Secretary

American Electric Power Service Corporation

E. Linn Draper, Jr.
Chairman, President and Chief Executive Officer

Paul D. Addis
Executive Vice President

Donald M. Clements, Jr.
Executive Vice President – Corporate Development

Henry W. Fayne
Executive Vice President – Financial Services

William J. Lhota
Executive Vice President

James J. Markowsky
Executive Vice President – Power Generation

Joseph H. Vipperman
Executive Vice President – Corporate Services

Charles A. Ebetino, Jr.
Senior Vice President – Fuel Supply

Luke M. Feck
Senior Vice President – Corporate Communications

John R. Jones
Senior Vice President – Generation Projects

Michael F. Moore
Senior Vice President – Information Services and Chief Information Officer

Richard E. Munczinski
Senior Vice President – Corporate Planning and Budgeting

Armando A. Pena
Senior Vice President – Finance
Treasurer and Chief Financial Officer

Rodney B. Plimpton
Senior Vice President – Human Resources

Robert P. Powers
Senior Vice President – Nuclear Generation

Peter Splawnyk
Senior Vice President – Distribution

Susan Tomasky
Senior Vice President and General Counsel

Andrew P. Varley
Senior Vice President – Energy Pricing and Regulatory Services

Melinda S. Ackerman
Vice President – Human Resources

Leonard V. Assante
Vice President
Chief Accounting Officer and Controller

J. Craig Baker
Vice President – Transmission Policy

Bruce M. Barber
Vice President – Strategic Studies

Coulter R. Boyle III
Vice President – Regulatory Services

David H. Crabtree
Vice President – Consumer Services

John F. DiLorenzo, Jr.
Vice President
Associate General Counsel and Secretary

William N. D'Onofrio
Vice President – Regulatory Policy

Carl A. Erikson
Vice President – Energy Delivery

Dale E. Heydlauff
Vice President – Environmental Affairs

Anthony Kavanagh
Vice President – Governmental Affairs

W. Robert Kelley
Vice President – System Operations

Vincent A. Lepore
Vice President – Power Generation Engineering

Hugh H. Lucas
Vice President – Mining Operations

Thomas R. McCaffrey
Vice President – Procurement and Supply Chain Services

James K. McWilliams
Vice President – Civil and Mining Engineering

Richard A. Mueller
Vice President – Internal Audits

Patrick M. O'Brien
Vice President – Fuel Procurement

Ron E. Prater
Vice President – Strategic Planning

Bruce A. Renz
Vice President – Energy Delivery Support

William L. Scott
Vice President – Taxes

Elizabeth M. Smith
Vice President – AEP Institute

Joseph A. Valentine
Vice President – Information Systems

Harry E. Vick
Vice President – Corporate Services

Thomas R. Watkins
Vice President – Energy Transmission

Charles D. Weaver
Vice President – Fossil and Hydro Production

AEP Communications, Inc.

E. Linn Draper, Jr.
Chairman, President and Chief Executive Officer

Donald M. Clements, Jr.
President

Henry W. Fayne
Vice President

William J. Lhota
Vice President

David Mustine
Vice President

Armando A. Pena
Vice President
Treasurer and Chief Financial Officer

Peter R. Thomas
Vice President

Leonard V. Assante
Controller and Chief Accounting Officer

John F. DiLorenzo, Jr.
Secretary

AEP Energy Services, Inc.

E. Linn Draper, Jr.
Chairman and Chief Executive Officer

Paul D. Addis
President

Steven Lewis
Senior Vice President

Eric J. van der Walde
Senior Vice President

Steven A. Appelt
Vice President – Administration

Thomas A. Barry
Vice President – Energy Marketing

Bruce H. Braine
Vice President – Analysis

Joseph A. Curia, Jr.
Vice President – Energy Marketing

David B. Dunn
Vice President – Gas Trading

Henry W. Fayne
Vice President

Armando A. Pena
Vice President
Treasurer and Chief Financial Officer

Douglas K. Penrod
Vice President – Energy Trading

Glenn Riepl
Vice President

George Rooney
Vice President – Business Development

Leonard V. Assante
Controller and Chief Accounting Officer

John F. DiLorenzo, Jr.
Secretary

AEP Resources, Inc.

E. Linn Draper, Jr
Chairman and Chief Executive Officer

Donald M. Clements, Jr.
President

Donald E. Boyd
Senior Vice President – Asia-Pacific Development

David Mustine
Senior Vice President – Services

Jeffrey D. Cross
Vice President and General Counsel

Henry W. Fayne
Vice President

Thomas S. Jobes
Vice President – Corporate Development

John R. Jones
Vice President

Dennis A. Lantzy
Vice President
Generation

Armando A. Pena
Vice President
Treasurer and Chief Financial Officer

James H. Sweeney
Vice President – Latin America Development

Paul J. Wielgus
Vice President – North American Development

Leonard V. Assante
Controller and Chief Accounting Officer

John F. DiLorenzo, Jr.
Secretary

AEP Resources Service Company

E. Linn Draper, Jr.
Chairman and Chief Executive Officer

Donald M. Clements, Jr.
President

Donald E. Boyd
Senior Vice President – Asia-Pacific Development

David Mustine
Senior Vice President – Services

Jeffrey D. Cross
Vice President and General Counsel

Henry W. Fayne
Vice President

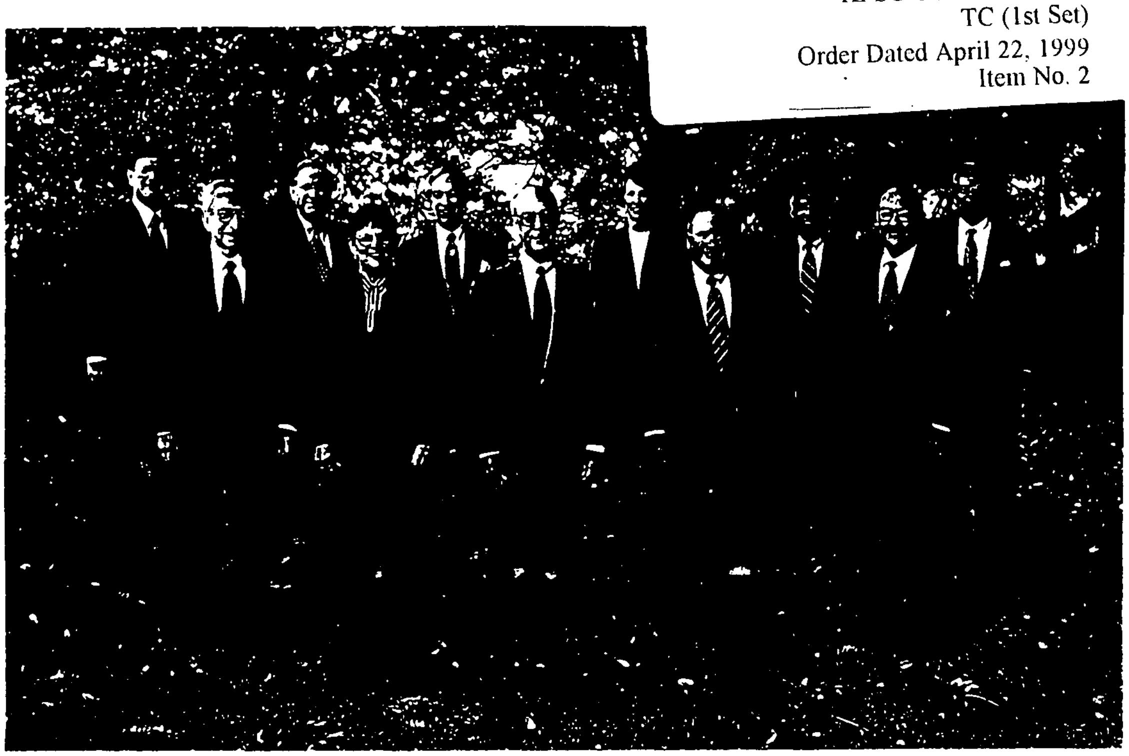
Dennis A. Lantzy
Vice President – Generation

Armando A. Pena
Vice President
Treasurer and Chief Financial Officer

Leonard V. Assante
Controller and Chief Accounting Officer

John F. DiLorenzo, Jr.
Secretary

BOARD OF DIRECTORS



(Left to right) Donald G. Smith, Morris Tanenbaum, Leonard J. Kujawa, Kathryn D. Sullivan, Lester A. Hudson, Jr., Robert W. Fri, Linda Gillespie Stuntz, John P. DesBarres, Robert M. Duncan, E. Linn Draper, Jr., Angus E. Peyton

Dr. E. Linn Draper Jr., 57
Chairman, President
& Chief Executive Officer
(1992)

Angus E. Peyton, 72
Partner Brown & Peyton
Charleston West Virginia
(1978)

Robert M. Duncan, 7[illegible]
Columbus Ohio
Retired U.S. District Judge
[illegible]

Dr. Lester A. Hudson Jr., [illegible]
Chairman
[illegible]

Dr. Morris Tanenbaum, 70
Short Hills, New Jersey
Retired Vice Chairman
& Chief Financial Officer
AT&T
(1980)

Linda Gillespie Stuntz, 44
Partner Stuntz, Davis & Staffier PC
Washington DC
(1993)

Donald G. Smith, 63
Chairman, President
& Chief Executive Officer
[illegible]

Robert W. Fri, 63
Director, National Museum
of Natural History
Smithsonian Institution
Washington, D.C.
(1995)

Leonard J. Kujawa, 66
International Energy Consultant
Atlanta, Georgia
(1997)

John P. DesBarres, 59
Investor [illegible]
[illegible] California
(1997)

Dr. Kathryn D. Sullivan, 47
President and Chief Executive Officer
Center of Science and Industry
Columbus, Ohio
(1997)

Committees of the Board [illegible]

SHAREHOLDER INFO

Annual Meeting – The 92nd annual meeting of shareholders of American Electric Power Company will be held at 9:30 a.m. Wednesday, April 28, 1999, at the Embassy Suites Hotel, 300 Court Street, Charleston, West Virginia, 25301. Admission is by ticket only. To obtain a ticket, please note the instructions in the Notice of Annual Meeting to be mailed to shareholders or call the Company.

Shareholder Inquiries – If you have questions about your account, you can call the Company toll-free at 800-237-2667, write to Investor Services, American Electric Power Company, 1 Riverside Plaza, Columbus, Ohio 43215-2373, or contact us by e-mail at investors@aep.com. You should provide or have your Social Security number or account number ready; we will not speak to third parties about an account without the shareholder's approval or appropriate documents.

Transfer Agent & Registrar
EquiServe, First Chicago Division
PO Box 2500
Jersey City, NJ 07303-2500
Telephone Response Group: 800-328-6955;
E-Mail Correspondence: FCTC@ em.fcnbd.com
Internet address: www.equiserve.com

Internet Access to Your Account – If you are a registered shareholder, your can access your account information through the Internet at www.equiserve.com. Information about obtaining a password is available toll-free at 877-843-9327.

Replacement of Dividend Checks – If you do not receive your dividend check within five business days after the dividend payment date, or if your check is lost, destroyed or stolen, you should notify the transfer agent or Investor Services for a replacement.

Lost or Stolen Stock Certificates – If your stock certificate is lost, destroyed or stolen, you should notify the transfer agent or Investor Services immediately so a "stop transfer" order can be placed on the missing certificate. The transfer agent then will send you the required documents to obtain a replacement certificate.

Address Changes – It is important that we have your current address so that you do not become a lost shareholder. Please contact Investor Services or the transfer agent for address changes for both record and dividend mailing addresses. We also can provide automatic seasonal address changes.

Stock Transfer – Please contact Investor Services or the transfer agent if you have questions regarding the transfer of stock and related legal requirements.

Dividend Reinvestment and Direct Stock Purchase Plan – A Dividend Reinvestment and Direct Stock Purchase Plan is available to all registered shareholders, AEP employees and investors who are not already shareholders. It is an economical and convenient method of purchasing shares of AEP common stock. You may obtain the Plan prospectus and enrollment authorization form by contacting the transfer agent or Investor Services. Information is also available at www.netstockdirect.com.

Direct Deposit of Dividends – The Company offers electronic deposit of dividends. Contact Investor Services or the transfer agent for details.

Stock Held in Brokerage Account ("Street Name") – When you purchase stock and it is held for you by your broker, it is listed with the Company in the broker's name, or "street name." AEP does not know the identity of individual shareholders who hold their shares in this manner; we simply know that a broker holds a certain number of shares which may be for any number of customers. If you hold your stock in street name, you receive all dividend payments, annual reports and proxy materials via your broker. Therefore, if your shares are held in this manner, any questions about your account should be directed to your broker.

How to Consolidate Accounts – If you want to consolidate your separate accounts into one account, you should contact the transfer agent or the Investor Services office to obtain the necessary instructions. When accounts are consolidated, it may be necessary to reissue the stock certificates.

How to Eliminate Duplicate Mailings – If you want to maintain more than one account but eliminate additional mailings of annual reports, you may do so by contacting the transfer agent or Investor Services, indicating the names you wish to keep on the mailing list for annual reports and the names you wish to delete. This will affect only these mailings; dividend checks and proxy materials will continue to be sent to each account.

Stock Trading – The Company's common stock is traded principally on the New York Stock Exchange under the ticker symbol AEP. In 1999 AEP marks 50 years of trading on the NYSE.

Taxes on Dividends – The Company paid $2.40 in cash dividends in 1998, all of which are taxable for federal income tax purposes. AEP has paid consecutive quarterly dividends since 1910.

Shareholder Direct – An array of timely recorded messages about AEP, including dividends and earnings information and recent news releases, is available from AEP Shareholder Direct at 800-551-1AEP (1237) anytime day or night. Hard copies of information can be obtained via fax or mail. Requests for annual reports, 10-K's, 10-Q's, Proxy Statements, and Summary Annual Reports should be made through Shareholder Direct. Also, during normal business hours you can choose to be transferred to shareholder service representatives at the transfer agent or the Company.

Financial Community Inquiries – Institutional investors and securities analysts should direct inquiries to Bette Jo Rozsa, 614-223-2840, bjrozsa@aep.com, or John Bilacic, 614-223-2847, jsbilacic@aep.com.

Internet Home Page – Information about AEP, including financial documents, SEC filings, news releases and customer service information, is available on the Company's home page on the Internet at www.aep.com.

Annual Report and Proxy Materials – You can receive future annual reports, proxy statements and proxies electronically rather than by mail. If you are a registered holder, log on to www.econsent.com/aep. If you hold your shares in street name, contact your broker.

Attachment 1
Page 182 of 357
KPSC Case No. 99-149
TC (1st Set)
Order Dated April 22, 1999
Item No. 2

NO POSTAGE
NECESSARY
IF MAILED
IN THE
UNITED STATES

BUSINESS REPLY MAIL
FIRST CLASS MAIL PERMIT NO. 11 COLUMBUS OH

POSTAGE WILL BE PAID BY ADDRESSEE

AMERICAN ELECTRIC POWER
INVESTOR SERVICES
28TH FLOOR
P.O. BOX 16631
COLUMBUS, OH 43272-2204

AEP now has a direct stock purchase plan

AEP has adopted a direct stock purchase plan that allows individuals to purchase stock directly from the company on a low-cost basis. You can purchase AEP stock for as little as $250, or $25 a month for 10 months. For a prospectus and plan details, call 800 955-4740 or return the attached post-paid card.

AEP

AEP: America's Energy Partner℠

Please send me a prospectus and enrollment information about the AEP Dividend Reinvestment and Direct Stock Purchase Plan.

Name

Address

City

State Zip

ARE YOU AN EXISTING AEP SHAREHOLDER?

☐ YES ☐ NO

Common AEP and Electric Utility Industry Terms

Book value per share – The value of each common share of stock if all of a company's assets, after all debts are paid, are divided by the number of common shares outstanding.

Distribution line – Power lines that feed electricity to customer meters.

Dividend reinvestment and direct stock purchase plan – A program in which investors can purchase shares of common stock directly from AEP and invest their dividends in additional shares of stock.

Dividend payout ratio – Dividends paid as a percentage of net income.

Earnings per share – The company's net income divided by the average number of common shares outstanding.

FERC – Federal Energy Regulatory Commission, the federal agency that regulates interstate sales and transmission of electricity.

Kilowatt – A measure of the rate at which electric energy is generated or consumed. A kilowatt is 1,000 watts.

Kilowatthour – A measure of the quantity of electric energy equal to one kilowatt of power generated or consumed in one hour.

Megawatt – One thousand kilowatts.

Net income – The company's income after all expenses, taxes and preferred dividends have been deducted.

Nitrogen oxides – Gases formed from the combustion of fossil fuels.

On-peak availability – The number of hours a unit is available to produce electricity as a percent of the total available on peak hours 0700-2300 Monday thru Friday for the year.

Ozone – A gas in the atmosphere that occurs naturally and through a mixture of nitrogen oxides, volatile organic compounds and sunlight.

Price/earnings ratio – The value of the company's stock price in relation to the earnings per share. The P/E ratio is calculated by dividing the stock price by the earnings per share.

PUHCA – Public Utility Holding Company Act of 1935. Regulates the corporate structure and securities issuance of electric utilities and places limitations on utilities that are structured as registered holding companies. It is enforced by the Securities and Exchange Commission.

PURPA – Public Utility Regulatory Policies Act of 1978. Designed to encourage conservation, more efficient use of energy sources and the use of alternative energy sources. It also requires utilities to purchase excess power produced by cogenerators.

Retail customer – A customer that purchases electricity for their own use.

Return on average common equity – The percentage return the company generated on the average amount of money that common shareholders have invested in the company.

Sulfur dioxide – A gas of sulfur and oxygen compounds created when fossil fuels, such as coal, are burned.

Total availability – The number of hours a unit is available to produce power as a percent of the total hours in the year.

Total investor return – The return to common shareholders based on dividends paid plus changes in the stock price from the previous year.

Transmission line – Power lines used to transmit bulk electricity, such as from state to state or region to region, at high voltages.

Unified Power Flow Controller – A device that uses power electronics and microcomputers to control the power flow and voltage quality of a transmission circuit instantaneously.

Wholesale customer – A customer, such as a municipal, cooperative, investor-owned electric company or power marketer that buys electricity for resale.

AEP®

AEP: America's Energy Partner℠

American Electric Power
1 Riverside Plaza
Columbus, OH 43215-2373
614-223-1000
www.aep.com

Appendix A to the
Proxy Statement

American Electric Power

1998 Annual Report

Audited Financial Statements and
Management's Discussion and Analysis

AEP AMERICAN® ELECTRIC POWER

AEP: America's Energy Partner™

AMERICAN ELECTRIC POWER COMPANY, INC. AND SUBSIDIARY COMPANIES
SELECTED CONSOLIDATED FINANCIAL DATA

Year Ended December 31,	1998	1997	1996	1995	1994
INCOME STATEMENTS DATA (in millions):					
Operating Revenues	$6,346	$5,880	$5,849	$5,670	$5,505
Operating Income	957	984	1,008	965	932
Income Before Extraordinary Item	536	620	587	530	500
Extraordinary Loss - UK Windfall Tax	-	109	-	-	-
Net Income	536	511	587	530	500

December 31,	1998	1997	1996	1995	1994
BALANCE SHEETS DATA (in millions):					
Electric Utility Plant	$20,146	$19,597	$18,970	$18,496	$18,175
Accumulated Depreciation and Amortization	8,416	7,964	7,550	7,111	6,827
Net Electric Utility Plant	$11,730	$11,633	$11,420	$11,385	$11,348
Total Assets	$19,483	$16,615	$15,883	$15,900	$15,736
Common Shareholders' Equity	4,842	4,677	4,545	4,340	4,229
Cumulative Preferred Stocks of Subsidiaries:					
Not Subject to Mandatory Redemption	46	47	90	148	233
Subject to Mandatory Redemption*	128	128	510	523	590
Long-term Debt*	7,006	5,424	4,884	5,057	4,980
Obligations Under Capital Leases*	533	538	414	405	400

*Including portion due within one year

Year Ended December 31,	1998	1997	1996	1995	1994
COMMON STOCK DATA:					
Earnings per Common Share:					
Before Extraordinary Item	$2.81	$ 3.28	$3.14	$2.85	$2.71
Extraordinary Loss - UK Windfall Tax	-	(0.58)	-	-	-
Net Income	$2.81	$ 2.70	$3.14	$2.85	$2.71
Average Number of Shares Outstanding (in thousands)	190,774	189,039	187,321	185,847	184,666
Market Price Range: High	$53-5/16	$ 52	$44-3/4	$40-5/8	$37-3/8
Low	42-1/16	39-1/8	38-5/8	31-1/4	27-1/4
Year-end Market Price	47-1/16	51-5/8	41-1/8	40-1/2	32-7/8
Cash Dividends Paid	$2.40	$2.40	$2.40	$2.40	$2.40
Dividend Payout Ratio	85.4%	88.7%(a)	76.5%	84.1%	88.6%
Book Value per Share	$25.24	$24.62	$24.15	$23.25	$22.83

(a) Dividend Payout Ratio before Extraordinary Loss - UK Windfall Tax is 73.1%.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

This discussion includes forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934. These forward-looking statements reflect assumptions, and involve a number of risks and uncertainties. Among the factors that could cause actual results to differ materially from forward looking statements are: electric load and customer growth; abnormal weather conditions; available sources and costs of fuels; availability of generating capacity; the impact of the proposed merger with Central and South West Corporation (CSW) including any regulatory conditions imposed on the merger or the inability to consummate the merger with CSW; the speed and degree to which competition is introduced to our power generation business, the structure and timing of a competitive market and its impact on energy prices or fixed rates; the ability to recover stranded costs in connection with possible deregulation of generation; new legislation and government regulations; the ability of the Company to successfully control its costs; the success of new business ventures; international developments affecting our foreign investments; the economic climate and growth in our service territory; unforeseen events affecting the Company's nuclear plant which is on an extended safety related shutdown; problems or failures related to Year 2000 readiness of computer software and hardware; inflationary trends; electricity and gas market prices; interest rates and other risks and unforeseen events. This discussion contains a "Year 2000 Readiness Disclosure" within the meaning of the Year 2000 Information and Readiness Disclosure Act.

Growth Of The Business

In 1998 management continued to implement its growth-oriented strategy with a goal of being America's Energy Partner and a global energy and related services company. We have adopted a strategy to expand our geographic reach and to build and acquire capabilities across a broader spectrum of the energy products and services value chain. AEP is working to position itself to be successful in an increasingly competitive market that will allow customers to choose their energy supplier. AEP made several acquisitions in 1998 that expanded its energy operations overseas and in the United States. The expansion of the foreign energy business in 1998 included the purchase of CitiPower, an Australian electric distribution utility, the acquisition of an equity interest in Pacific Hydro, an Australian hydroelectric generating company, and continued on-schedule construction of two generating units in China.

The $1.1 billion acquisition of CitiPower, completed on December 31, 1998, was accounted for using the purchase method of accounting. CitiPower serves approximately 240,000 customers in the city of Melbourne. CitiPower will contribute to earnings beginning in the first quarter of 1999.

In March 1998 the Company invested $10 million to acquire a 20% equity interest in Pacific Hydro. Pacific Hydro operates four hydroelectric power stations in Australia with an installed capacity of 40 megawatts (MW) and has interests in two hydroelectric projects under construction in the Philippines.

This discussion includes forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934. These forward-looking statements reflect assumptions, and involve a number of risks and uncertainties. Among the factors that could cause actual results to differ materially from forward looking statements are: electric load and customer growth; abnormal weather conditions; available sources and costs of fuels; availability of generating capacity; the impact of the proposed merger with Central and South West Corporation (CSW) including any regulatory conditions imposed on the merger or the inability to consummate the merger with CSW; the speed and degree to which competition is introduced to our power generation business, the structure and timing of a competitive market and its impact on energy prices or fixed rates; the ability to recover stranded costs in connection with possible deregulation of generation; new legislation and government regulations; the ability of the Company to successfully control its costs; the success of new business ventures; international developments affecting our foreign investments; the economic climate and growth in our service territory; unforeseen events affecting the Company's nuclear plant which is on an extended safety related shutdown; problems or failures related to Year 2000 readiness of computer software and hardware; inflationary trends; electricity and gas market prices; interest rates and other risks and unforeseen events. This discussion contains a "Year 2000 Readiness Disclosure" within the meaning of the Year 2000 Information and Readiness Disclosure Act.

Growth Of The Business

In 1998 management continued to implement its growth-oriented strategy with a goal of being America's Energy Partner and a global energy and related services company. We have adopted a strategy to expand our geographic reach and to build and acquire capabilities across a broader spectrum of the energy products and services value chain. AEP is working to position itself to be successful in an increasingly competitive market that will allow customers to choose their energy supplier. AEP made several acquisitions in 1998 that expanded its energy operations overseas and in the United States. The expansion of the foreign energy business in 1998 included the purchase of CitiPower, an Australian electric distribution utility, the acquisition of an equity interest in Pacific Hydro, an Australian hydroelectric generating company, and continued on-schedule construction of two generating units in China.

The $1.1 billion acquisition of CitiPower, completed on December 31, 1998, was accounted for using the purchase method of accounting. CitiPower serves approximately 240,000 customers in the city of Melbourne. CitiPower will contribute to earnings beginning in the first quarter of 1999.

In March 1998 the Company invested $10 million to acquire a 20% equity interest in Pacific Hydro. Pacific Hydro operates four hydroelectric power stations in Australia with an installed capacity of 40 megawatts (MW) and has interests in two hydroelectric projects under construction in the Philippines.

The generating units under construction in China are owned 70% by the Company with the remaining 30% owned by two Chinese partners. Construction of the two unit 250 MW, coal-fired station is proceeding on schedule. The first unit began commercial operation in February of 1999 and the second unit is expected to go into commercial service in July of 1999. These units are expected to contribute to earnings in 1999.

In addition, the Company has a 50% investment in Yorkshire Electricity Group plc (Yorkshire), a United Kingdom (UK) distribution electric company. The investment was made in April 1997 and contributed $38.5 million to nonregulated, nonoperating income in 1998. In September 1998 certain residential and commercial customers in the UK could choose their electricity supplier marking the start of a transition to competition. Yorkshire serves approximately 2.2 million customers.

One disappointment we suffered in 1998 was the withdrawal of a joint venture partner. In 1997 the Company announced a joint venture with Conoco, an energy subsidiary of DuPont. The venture was to provide energy management and financing for steam and electric generation facilities for commercial and industrial customers. Conoco withdrew from the joint venture after its parent announced plans to sell Conoco.

The past year also saw the expansion of AEP's domestic energy operations. On December 1, 1998, the Company purchased the midstream gas operations of Equitable Resources, Inc. for approximately $340 million including working capital funds. The midstream operations include a fully integrated natural gas gathering, processing, storage and transportation operation in Louisiana and a gas trading and marketing operation in Houston, Texas. Assets include an intrastate pipeline system, four natural gas processing plants plus a fifth plant under construction, one natural gas storage facility and an additional storage facility under construction. The gas trading operation included in this purchase was merged with AEP's existing gas trading organization which began operating in December 1997. This acquisition is expected to enhance AEP's gas trading operations by improving management's knowledge of the Henry Hub gas market.

Traditionally a major marketer of electricity, AEP has recently become a major participant in the electricity trading market. Our electricity trading operation, which commenced in mid 1997, significantly expanded its trading volume in 1998. Electricity trading involves the trading of contracts for the future delivery or receipt of electricity in both regulated and non-regulated operations. It also involves the purchase and sale of options, swaps and other electricity derivative financial instruments. Open access transmission, the introduction of competition to the wholesale electricity market and the development of a trading market and settlement process have fostered the growth of electricity trading in the United States. The electricity trading market is a highly volatile market which requires enhanced credit and market risk management skills. Electricity trading requires little capital investment and profit margins are usually smaller than margins on traditional electricity sales. The Company's goal is to utilize its knowledge of energy markets to trade electricity and gas to contribute to net income, thereby enhancing both customer and shareholder value.

In December 1997 the Company and CSW agreed to merge. The merger is intended to expand AEP's geographic reach. The benefits of the merger include costs savings; improved prices and services; increased financial strength; greater diversity in fuel, generation and service territory; and increased scale (the size of the Company which contributes to business success in a competitive market). At the 1998 annual meeting AEP shareholders approved the issuance of common shares to effect the merger and approved an increase in the number of authorized shares of AEP Common Stock from 300,000,000 to 600,000,000 shares. CSW stockholders approved the merger at their May 1998 annual meeting. Approval of the merger has been requested from the Federal Energy Regulatory Commission (FERC), the Securities and Exchange Commission, the Nuclear Regulatory Commission (NRC) and all of CSW's state regulatory commissions: Arkansas, Louisiana, Oklahoma and Texas. In the near future, AEP and CSW plan to make the final two filings associated with approval of the merger with the Federal Communications Commission and the Department of Justice.

Regulatory approvals for the merger have been received from the Arkansas Public Service Commission (APSC) and the NRC. In December 1998 the APSC approved a stipulated agreement related to a proposed merger regulatory plan submitted by the Company, CSW and CSW's Arkansas operating subsidiary, Southwestern Electric Power Company. The regulatory plan, agreed to with the APSC staff, provides for a sharing of net merger savings through a $6 million rate reduction over 5 years following the completion of the merger.

The application to the NRC by CSW's operating subsidiary, Central Power and Light Company (CPL), requesting permission to transfer indirect control of the license from CSW to AEP for CPL's interest in the South Texas Project nuclear generating station was approved by the NRC in November 1998.

In October 1998 the Oklahoma Corporation Commission (OCC) approved plans by AEP and CSW to submit an amended filing seeking approval of the proposed merger. The amended application is being made as a result of an Oklahoma administrative law judge's recommendation that the merger filing be dismissed without prejudice for lack of sufficient information regarding the potential impact of the merger on the retail electric market in Oklahoma. Submission of the amended application will reset Oklahoma's 90-day statutory time period for OCC action on the merger phase of the application. The filing of the amended application should not affect the timing of the merger closing.

A settlement agreement between AEP, CSW and certain key parties to the Texas merger proceeding has been reached. The staff of the Public Utility Commission of Texas was not a signatory to the settlement agreement, which resolves all issues for the signatories. The settlement provides for, among other things, rate reductions totaling approximately $180 million over a six year period following completion of the merger to share net merger savings of $84 million and settle existing rate issues of $96 million. Hearings are scheduled for April 1999.

In July 1998 the FERC issued an order which confirmed that a 250 megawatt firm contract path with the Ameren System is available. The contract path was obtained by AEP and CSW to meet the requirement of the Public Utility Holding Company Act of 1935 that the two systems operate on an integrated and coordinated basis.

In November 1998 the FERC issued an order establishing hearing procedures for the merger and scheduled the hearings to begin on June 1, 1999. The FERC order indicated that the review of the proposed merger will address the issues of competition, market power and customer protection and instructed the companies to refile an updated market power study.

The proposed merger of CSW into AEP would result in common ownership of two UK regional electricity companies (RECs), Yorkshire and Seeboard, plc. AEP has a 50% ownership interest in Yorkshire and CSW has a 100% interest in Seeboard. Although the merger of CSW into AEP is not subject to approval by UK regulatory authorities, the common ownership of two UK RECs could be referred by the UK Secretary of State for Trade and Industry to the UK Monopolies and Mergers Commission for investigation.

AEP has received a request from the staff of the Kentucky Public Service Commission (KPSC) to file an application seeking KPSC approval for the indirect change in control of Kentucky Power Company that will occur as a result of the proposed merger. Although AEP does not believe that the KPSC has the jurisdictional authority to approve the merger, management will prepare a merger application filing to be made with the KPSC, which is expected to be filed by April 15, 1999. Under the governing statute the KPSC must act on the application within 60 days. Therefore this is not expected to impact the timing of the merger.

The merger is conditioned upon, among other things, the approval of the above state and federal regulatory agencies. The transaction must satisfy many conditions, a number of which may not be waived by the parties, including the condition that the merger must be accounted for as a pooling of interests. The merger agreement will terminate on December 31, 1999 unless extended by either party as provided in the merger agreement. Although consummation of the merger is expected to occur in the fourth quarter of 1999, the Company is unable to predict the outcome or the timing of the required regulatory proceedings.

Business Outlook

The most significant factors affecting the Company's future earnings are the ability to recover its costs as the domestic electric generating business becomes more competitive and the performance of the recently acquired energy investments and business ventures described above. The Company continues to evaluate domestic and international markets for investments to grow the business in the best interests of our shareholders, customers and employees. The performance of any future acquisitions, mergers and investments will also impact future earnings.

The introduction of competition and customer choice for retail customers in the Company's domestic service territory has been slow and continues at a deliberate pace as legislators and regulatory officials recognize the complexity of the issues. Federal legislation has been proposed to mandate competition and customer choice at the retail level. In February 1999 the Virginia general assembly passed legislation, subject to the governor's signature, that would provide Virginia retail customers the ability to choose their electric supplier beginning in 2002. The legislation provides for the recovery of "just and reasonable net stranded costs". Prior to January 1, 2002 the Virginia State Corporation Commission must establish rates that will be "capped" through as long as July 1, 2007. Statement of Financial Accounting Standards (SFAS) 71 "Accounting for the Effects of Certain Types of Regulation," will no longer apply to the Company's Virginia retail jurisdiction once the "capped" rates are established. When this occurs the application of SFAS 71 will be discontinued for the Virginia retail jurisdiction portion of the generating business and net regulatory assets applicable to the Virginia generating business would have to be written off to the extent that they are not probable of recovery. Although management does not believe that the impact of the new legislation on regulatory assets would have a material adverse impact on results of operations, cash flows or financial condition, the amount of an impairment loss, if any, cannot be estimated with any certainty until the "capped" rates are determined (See requirements of EITF 97-4 discussed below).

All of the other states within our service territory have initiatives to implement or review customer choice, although the timing is uncertain. The Company supports customer choice and deregulation of generation and is proactively involved in discussions at both the state and federal levels regarding the best competitive market structure and method to transition to a competitive marketplace.

As the pricing of generation in the electric energy market evolves from regulated cost-of-service ratemaking to market-based rates, many complex issues must be resolved, including the recovery of stranded costs. Stranded costs are those costs above market and potentially would not be recoverable in a competitive market. At the wholesale level recovery of stranded costs under certain conditions was addressed by the FERC when it established rules for open transmission access and competition in the wholesale markets. However, the issue of stranded cost is generally unresolved at the retail level where it is much larger than it is at the wholesale level. The amount of stranded costs the Company could experience depends on the timing and extent to which competition is introduced to its generation business and the future market prices of electricity. The recovery of stranded cost is dependent on the terms of future legislation and related regulatory proceedings.

Under the provisions of SFAS 71 regulatory assets (deferred expenses) and regulatory liabilities (deferred revenues) are included in the consolidated balance sheets of regulated utilities in accordance with regulatory actions in order to match expenses and revenues with cost-based rates. In order to maintain net regulatory assets on the balance sheet, SFAS 71 requires that rates charged to customers be cost-based and provide for the recovery of the deferred expenses over future accounting periods. In the event a portion of AEP's business no longer meets the requirements of SFAS 71, SFAS 101 "Accounting for the Discontinuance of Application of Statement 71" requires that net regulatory assets be written off for that portion of the business. The provisions of SFAS 71 and SFAS 101 never anticipated that deregulation would

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include an extended transition period or that it could provide for recovery of stranded costs during and after the transition period. In 1997 the Financial Accounting Standards Board's Emerging Issues Task Force (EITF) addressed such a situation with the consensus reached on issue 97-4 that requires the application of SFAS 71 to a segment of a regulated electric utility cease when that segment is subject to a legislatively approved plan for competition or an enabling rate order is issued containing sufficient detail for the utility to reasonably determine what the plan would entail. The EITF indicated that the cessation of application of SFAS 71 would require that regulatory assets and impaired plant be written off unless they are recoverable in future rates.

Although certain FERC orders provide for competition in the firm wholesale market, that market is a relatively small part of our business and most of our firm wholesale sales are still under cost-of-service contracts. As of December 31, 1998 AEP's generation business is cost-based regulated. The enactment of enabling legislation in Virginia to deregulate the generation business will cause a portion of the Company's generation business to become deregulated. This could ultimately result in adverse impacts on results of operations and cash flows depending on the market price of electricity and the ability of the Company to recover its stranded costs. We believe that enabling state legislation should provide for the recovery of any generation-related net regulatory assets and other reasonable stranded costs from impaired generating assets. However, if in the future AEP's generation business were to no longer be cost-based regulated and if it were not possible to demonstrate probability of recovery of resultant stranded costs including regulatory assets, results of operations, cash flows and financial condition would be adversely affected.

Cost Containment and Process Improvements

Efforts continue to reduce the costs of AEP's products and services in order to maintain competitiveness. The accounting department completed its consolidation of operations and the marketing department completed its reorganization in 1998 producing significant cost reductions. In 1998 plans were announced to close one of the Company's coal mining operations in October 1999 and the Company reviewed its staffing levels for power generation and energy delivery and developed plans to reduce staff in 1999. The cost of staff reductions planned for 1999 was provided for in the fourth quarter of 1998. Although cost savings are expected to result from the power generation and energy delivery reorganizations and the planned mine closing, the Company continues to incur expenses related to investments in new business growth and development; marketing and customer services; and the reengineering and improvement of business processes.

During 1998, AEP completed installation of a new unified customer service system which is designed to support customer requests for service, billings, accounts receivable, credit and collection functions. On January 1, 1999, the Company's new financial data base and PeopleSoft client server accounting and purchasing software became operational. The move to client server business software and related online data bases will empower AEP employees to maximize the benefits of their personal computers and will position AEP to access the power of the Internet and other new technologies.

Fuel Costs

The management and control of coal costs is critical to AEP's competitive position. Approximately 90% of AEP's generation is coal fired and approximately 13% of the 54 million tons of coal burned in 1998 were supplied by affiliated mines with the remainder acquired under long-term contracts and purchases in the spot market. As long-term contracts expire we are negotiating with unaffiliated suppliers to lower coal costs. We intend to continue to prudently supplement our long-term coal supplies with spot market purchases when spot market prices are favorable.

We have agreed in our Ohio jurisdiction to certain limitations on the current recovery of affiliated coal costs. At December 31, 1998, the Company had deferred $106 million for future recovery under the agreements which established the limitation. See discussion in Note 2 of the Notes to Consolidated Financial Statements. Our analysis shows that we should be able to recover the Ohio jurisdictional portion of the costs of our affiliated mining operations including future mine closure costs before the expiration of the agreement in 2009. The Company has announced plans to close the Muskingum mine in 1999. A provision for Muskingum mine closing cost of $45 million was recorded in 1998. Management intends to seek recovery of its non-Ohio jurisdictional portion of its investment in and the liabilities and closing costs of affiliated mines estimated at $100 million after tax.

Should it become apparent that these affiliated mining costs will not be recovered from Ohio and/or non-Ohio jurisdictional customers, the other mines may have to be closed and future earnings, cash flows and possibly financial condition would be adversely affected. In addition compliance with Phase II requirements of the Clean Air Act Amendments of 1990 (CAAA), which become effective in January 2000, could also cause the remaining mining operations to close. Unless the cost of any mine closure and the coal cost deferrals in the Ohio jurisdiction are recovered either in regulated rates or as a stranded cost under a plan to transition the generation business to competition, future earnings, cash flows and possibly financial condition would be adversely affected.

Costs for Spent Nuclear Fuel and Decommissioning

AEP, as the owner of the Cook Nuclear Plant, like other nuclear power plants, has a significant future financial commitment to safely dispose of spent nuclear fuel (SNF) and decommission and decontaminate the plant. The Nuclear Waste Policy Act of 1982 established federal responsibility for the permanent off-site disposal of SNF and high-level radioactive waste. By law we participate in the Department of Energy's (DOE) SNF disposal program which is described in Note 4 of the Notes to Consolidated Financial Statements. Since 1983 we have collected $272 million from customers for the disposal of nuclear fuel consumed at the Cook Plant. $115 million of these funds have been deposited in external trust funds to provide for the future disposal of spent nuclear fuel and $157 million has been remitted to the DOE. Under the provisions of the Nuclear Waste Policy Act, collections from customers are to provide the DOE with money to build a repository for spent fuel. However, in December 1996, the DOE notified AEP that it would be unable to begin accepting SNF by the January 1998 deadline required by law.

As a result of DOE's failure to make sufficient progress toward a permanent repository or otherwise assume responsibility for SNF, AEP along with a number of unaffiliated utilities and states filed suit in the U.S. Court of Appeals for the District of Columbia Circuit requesting, among other things, that the court order DOE to meet its obligations under the law. The court ordered the parties to proceed with contractual remedies but declined to order DOE to begin accepting SNF for disposal. DOE estimates its planned site for the nuclear waste will not be ready until 2010. In June 1998, AEP filed a complaint in the U.S. Court of Federal Claims seeking damages in excess of $150 million due to the DOE's partial material breach of its unconditional contractual deadline to begin disposing of SNF generated by the Cook Nuclear Plant. Similar lawsuits have been filed by other utilities. As long as the delay in the availability of a government approved storage repository for SNF continues, the cost of both temporary and permanent storage will increase.

The cost to decommission the Cook Plant is affected by both NRC regulations and the delayed SNF disposal program. Studies completed in 1997 estimate the cost to decommission the Cook Plant ranges from $700 million to $1,152 million in 1997 dollars. This estimate could escalate due to continued uncertainty in the SNF disposal program and the length of time that SNF may need to be stored at the plant site. External trust funds have been established with amounts collected from customers to decommission the plant. At December 31, 1998, the total decommissioning trust fund balance was $443 million which includes earnings on the trust investments. We will work with regulators and customers to recover the remaining estimated cost of decommissioning the Cook Plant. However, AEP's future results of operations, cash flows and possibly its financial condition would be adversely affected if the cost of SNF disposal and decommissioning continues to increase and cannot be recovered.

Cook Nuclear Plant Shutdown

We shut down both units of the Cook Nuclear Plant in September 1997 due to questions, which arose during a NRC architect engineer design inspection, regarding the operability of certain safety systems. The NRC issued a Confirmatory Action Letter in September 1997 requiring AEP to address the issues identified in the letter. We are working with the NRC to resolve the remaining open issue in the letter.

In April 1998 the NRC notified I&M that it had convened a Restart Panel for Cook Plant. A list of required restart activities was provided by the NRC in July 1998 and in October the NRC expanded the list. In order to identify and resolve the issues necessary to restart the Cook units, AEP is and will be meeting with the Panel on a regular basis, until the units are returned to service.

In January 1999 we announced that we will conduct additional engineering reviews at the Cook Plant that will delay restart of the units. Previously, the units were scheduled to return to service at the end of the first and second quarters of 1999. The decision to delay restart resulted from internal assessments that indicated a need to conduct expanded system readiness reviews. A new restart schedule will be developed based on the results of the expanded reviews and should be available in June 1999. When maintenance and other activities required for restart are complete, AEP will seek concurrence from the NRC to return the

Cook Plant to service. Until these additional reviews are completed, management is unable to determine when the units will be returned to service. Unless the costs of the extended outage and restart efforts are recovered from customers, there would be a material adverse effect on results of operations, cash flows and possibly financial condition.

One of the steps AEP has taken toward expediting the restart of the Cook units is to augment its existing nuclear generation management and staff with personnel experienced in restarting unaffiliated companies' nuclear plants during NRC supervised extended outages.

The incremental costs incurred in 1997 and 1998 for restart of the Cook units were $6 million and $78 million, respectively, and recorded as operation and maintenance expense. Currently incremental restart expenses are approximately $12 million a month.

In July 1998 AEP received an "adverse trend letter" from the NRC indicating that NRC senior managers determined that there had been a slow decline in performance at the Cook Plant during the 18 month period preceding the letter. The letter indicated that the NRC will closely monitor efforts to address issues at Cook Plant through additional inspection activities. In October 1998 the NRC issued AEP a Notice of Violation and proposed a $500,000 civil penalty for alleged violations at the Cook Plant discovered during five inspections conducted between August 1997 and April 1998. AEP paid the penalty.

The cost of electricity supplied to certain retail customers rose due to the outage of the two units since higher cost coal-fired generation and coal based purchased power were substituted for low cost nuclear generation. AEP's Indiana and Michigan retail jurisdictional fuel cost recovery mechanisms permit the recovery, subject to regulatory commission review and approval, of changes in fuel costs including the fuel component of purchased power in the Indiana jurisdiction and changes in replacement power in the Michigan jurisdiction. Under these fuel cost recovery mechanisms, retail rates contain a fuel cost adjustment factor that reflects estimated fuel costs for the period during which the factor will be in effect subject to reconciliation to actual fuel costs in a future proceeding. When actual fuel costs exceed the estimated costs reflected in the billing factor a regulatory asset is recorded and revenues are accrued. Therefore, a regulatory asset has been recorded and revenues accrued in anticipation of the future reconciliation and billing under the fuel cost recovery mechanisms of the higher fuel costs to replace Cook energy during the extended outage. At December 31, 1998, the regulatory asset was $65 million.

The Indiana Utility Regulatory Commission approved, subject to future reconciliation or refund, agreements authorizing AEP, during the billing months of July 1998 through March 1999, to include in rates a fuel cost adjustment factor less than that requested by AEP. The agreements provide the parties to the proceedings with the opportunity to conduct discovery regarding certain issues that were raised in the proceedings, including the appropriateness of the recovery of replacement energy cost due to the extended Cook Plant outage, in anticipation of resolving the issues in a future fuel cost adjustment proceeding. Management believes that it should be allowed to recover the deferred Cook recovery of the replacement costs is denied, future results of operations and cash flows would be adversely affected by the writeoff of the regulatory asset.

Environmental Concerns and Issues

We take great pride in our efforts to economically produce and deliver electricity while minimizing the impact on the environment. Over the years AEP has spent more than a billion dollars to equip its facilities with the latest cost effective clean air and water technologies and to research new technologies. We are also proud of our award winning efforts to reclaim our mining properties. We intend to continue in a leadership role fostering economically prudent efforts to protect and preserve the environment.

By-products from the generation of electricity include materials such as ash, slag, sludge, low-level radioactive waste and SNF. Coal combustion by-products, which constitute the overwhelming percentage of these materials, are typically disposed of or treated in captive disposal facilities or are beneficially utilized. In addition, our generating plants and transmission and distribution facilities have used asbestos, polychlorinated biphenyls (PCBs) and other hazardous and nonhazardous materials. We are currently incurring costs to safely dispose of such substances. Additional costs could be incurred to comply with new laws and regulations if enacted.

The Comprehensive Environmental Response, Compensation and Liability Act (Superfund) addresses clean-up of hazardous substances at disposal sites and authorized the United States Environmental Protection Agency (Federal EPA) to administer the clean-up programs. As of year-end 1998, we are involved in litigation with respect to three sites overseen by the Federal EPA and have been named by the Federal EPA as a potentially responsible party (PRP) for three other sites. There is one additional site for which AEP has received an information request which could lead to PRP designation. Our liability has been resolved for a number of sites with no significant effect on results of operations. In those instances where we have been named a PRP or defendant, our disposal or recycling activity was in accordance with the then-applicable laws and regulations. Unfortunately, Superfund does not recognize compliance as a defense, but imposes strict liability on parties who fall within its broad statutory categories.

While the potential liability for each Superfund site must be evaluated separately, several general statements can be made regarding our potential future liability. AEP's disposal of materials at a particular site is often unsubstantiated and the quantity of materials deposited at a site was small and often nonhazardous. Typically many parties are named as PRPs for each site and, although liability is joint and several, generally several of the parties are financially sound enterprises. Therefore, our present estimates do not anticipate material cleanup costs for identified sites for which we have been declared PRPs. However, if for reasons not currently identified significant cleanup costs are attributed in the future to AEP, results of operations, cash flows and possibly financial condition would be adversely affected unless the costs can be recovered from customers.

In December 1998 the Company purchased gas assets from Equitable Resources, Inc. (Equitable). The purchase contract contains details of partial indemnification by Equitable for certain environmental and soil and ground water contamination cleanup liabilities which existed at the time of AEP's purchase. An outside consultant has estimated total environmental liabilities for the acquired entities to range from $10 million to $16 million. By contract the Company must seek indemnification by December 1, 2000. The indemnification clause requires that AEP incur $3 million of cleanup liabilities before seeking reimbursement. Based upon the consultant's estimate, environmental liabilities resulting from the gas asset acquisition should not have a material impact on results of operations, cash flows or financial condition.

In December 1998, the Company purchased CitiPower, an Australian distribution utility, from Entergy, an unaffiliated company. CitiPower operates under Australian environmental laws. Prior to the purchase, AEP hired an outside consultant, experienced in Australian environmental laws, to identify CitiPower's exposure. The consultant's assessment identified sites with contaminated land, PCBs and storm water runoff. Cost of environmental remediation are estimated at $3.5 million by the consultant. Based upon this estimate, environmental costs from the acquisition of CitiPower are not expected to have a material impact on results of operations, cash flows or financial condition.

Federal EPA is required by the CAAA to issue rules to implement the law. In 1996 Federal EPA issued final rules governing nitrogen oxides (NOx) emissions that must be met after January 1, 2000 (Phase II of CAAA). The final rules will require substantial reductions in NOx emissions from certain types of boilers including those in AEP's power plants. To comply with Phase II of CAAA, the Company plans to install NOx emission control equipment on certain units and switch fuel at other units. Total capital costs to meet the requirements of Phase II of CAAA are estimated to be approximately $90 million of which $69 million has been incurred through December 31, 1998.

On September 24, 1998, the administrator of Federal EPA signed final rules which require reductions in NOx emissions in 22 eastern states, including the states in which the Company's generating plants are located. The implementation of the final rules would be achieved through the revision of state implementation plans (SIPs) by September 1999. SIPs are a procedural method used by each state to comply with Federal EPA rules. The final rules anticipate the imposition of a NOx reduction on utility sources of approximately 85% below 1990 emission levels by the year 2003. On October 30, 1998, a number of utilities, including the operating companies of the AEP System, filed petitions in the U.S. Court of Appeals for the District of Columbia Circuit seeking a review of the final rules.

Should the states fail to adopt the required revisions to their SIPs within one year of the date the final rules were signed (September 24, 1999), Federal EPA has proposed to implement a federal plan to accomplish the NOx reductions. Federal EPA also proposed the approval of portions of petitions filed by eight northeastern states that would result in imposition of NOx emission reductions on utility and industrial sources in upwind midwestern states. These reductions are substantially the same as those required by the final NOx rules and could be adopted by Federal EPA in the event the states fail to implement SIPs in accordance with the final rules.

Preliminary estimates indicate that compliance costs could result in required capital expenditures of approximately $1.2 billion for the AEP System. Compliance costs cannot be estimated with certainty and the actual costs incurred to comply could be significantly different from this preliminary estimate depending upon the compliance alternatives selected to achieve reductions in NOx emissions. Unless such costs are recovered from customers, they would have a material adverse effect on results of operations, cash flows and possibly financial condition.

At the Third Conference of the Parties to the United Nations Framework Convention on Climate Change held in Kyoto, Japan in December 1997 more than 160 countries, including the United States, negotiated a treaty requiring legally-binding reductions in emissions of greenhouse gases, chiefly carbon dioxide, which many scientists believe are contributing to global climate change. The treaty, which requires the advice and consent of the United States Senate for ratification, would require the United States to reduce greenhouse gas emissions seven percent below 1990 levels in the years 2008-2012. Although the United States has agreed to the treaty and signed it on November 12, 1998, President Clinton has indicated that he will not submit the treaty to the Senate for consideration until it contains requirements for "meaningful participation by key developing countries" and the rules, procedures, methodology and guidelines of the treaty's market-based policy instruments, joint implementation programs and compliance enforcement provisions have been negotiated. At the Fourth Conference of the Parties, held in Buenos Aires, Argentina, in November 1998, the parties agreed to a work plan to complete negotiations on outstanding issues with a view toward approving them at the Sixth Conference of the Parties to be held in December 2000. We will continue to work with the Administration and Congress to monitor the development of public policy on this issue.

If the Kyoto treaty is approved by Congress, the costs to comply with the emission reductions required by the treaty are expected to be substantial and would have a material adverse impact on results of operations, cash flows and possibly financial condition if not recovered from customers.

Results of Operations

Net Income

Net income increased 5% to $536 million or $2.81 per share from $511 million or $2.70 per share in 1997 primarily due to the effect of a 1997 extraordinary loss of $109 million. The extraordinary loss, recorded in 1997, was a result of the UK's one-time windfall tax which was based on a revision or recomputation of the original privatization value of certain privatized utilities, including Yorkshire. In 1997 net income decreased 13% to $511 million primarily due to the extraordinary loss of $109 million from the UK's one-time windfall tax.

Income Before Extraordinary Item

In 1998 income before the extraordinary loss, recorded in 1997, decreased 14% to $536 million or $2.81 per share from $620 million or $3.28 per share in 1997. Several major items reduced 1998 earnings including the cost of restart activities during an extended outage at the Cook Nuclear Plant, a write-down of Yorkshire's investment in Ionica, a UK telecommunications company, severance accruals for reductions in power generation and energy delivery staff and mild winter and fall weather.

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AEP's 1997 income before the extraordinary loss increased 6% to \$620 million or \$3.28 per share from \$587 million or \$3.14 per share in 1996. The increase was primarily attributable to increased transmission service revenues, reduced preferred stock dividends due to a redemption program and an increase in nonoperating income from equity earnings, exclusive of the extraordinary loss, since the April 1997 investment in Yorkshire.

Revenues Increase

Operating revenues increased 8% in 1998 and were relatively unchanged in 1997. Increased revenues from retail, wholesale and transmission service customers were the primary reasons for the increase in 1998. The slight increase in 1997 is primarily due to increased transmission service revenues. The changes in the components of revenues are as follows:

(Dollars in Millions)	Increase (Decrease) From Previous Year 1998		1997	
	Amount	%	Amount	%
Retail:				
Residential	\$ 37.6		\$(34.7)	
Commercial	57.0		1.8	
Industrial	90.1		18.2	
Other	3.8		0.4	
	188.5	3.8	(14.3)	(0.3)
Wholesale	206.8	25.9	6.1	0.8
Transmission	68.0	61.7	33.3	43.2
Miscellaneous	2.8	4.8	5.5	10.9
Total	\$466.1	7.9	\$ 30.6	0.5

Retail revenues increased 4% in 1998 reflecting a 2% sales increase and higher fuel recoveries. The increase in retail fuel recoveries reflects higher cost coal fired generation and purchased power replacing power usually generated at the Cook Nuclear Plant. The Cook Plant has been unavailable since September 1997. Although residential sales were flat reflecting mild winter and fall weather in 1998, revenues from residential customers increased 2%. The accrual of revenues for the recovery of the Cook related increased fuel costs accounted for the increase in residential revenues. The rise in commercial revenues resulted from a 4% increase in sales reflecting increased usage and growth in the number of customers. Industrial revenues increased 6% reflecting a sales increase of 2% following the resumption of operations by a major industrial customer after an extended labor strike. Also contributing to the increase in industrial revenues were favorable contract price adjustments to certain major industrial customers and the pass-through of higher power costs during periods of peak demand.

In 1997 retail revenues decreased slightly although retail sales rose one half of a percent. Residential revenues and sales each declined 2% reflecting mild weather. Sales to commercial customers increased slightly causing a small increase in commercial revenues. Industrial sales increased 2% accounting for the increase in industrial revenues. The increase in lower priced sales to industrial customers resulted from increased usage.

The 26% increase in wholesale revenues in 1998 is attributable to trading of electricity with other utilities and power marketers in the Company's traditional marketing area and increased power marketing sales. Revenues from the trading of electricity are recorded net of purchases. Regulated trading activities are conducted as part of AEP's electric power wholesale marketing and trading operations and involve the purchase and sale of substantial amounts of electricity. Power marketing sales are for the resale of power purchased from unaffiliated companies to other unaffiliated companies. Although wholesale revenues rose, total wholesale sales declined due to a reduction in coal conversion service sales. These sales are for the generation of electricity from the purchaser's coal and as a result do not include fuel costs. Consequently, the drop in coal conversion service sales did not have a significant effect on wholesale revenues.

In 1997 wholesale revenues increased slightly primarily due to the commencement of trading activities in July 1997 and a significant increase in coal conversion service sales. Since the price of coal conversion service sales is for the generation of electricity from coal provided by the electricity purchaser and excludes fuel cost, a large change in coal conversion service sales has a small impact on revenues.

The 62% increase in transmission service revenues in 1998 is attributable to a substantial rise in the quantity of energy transmitted for other entities over AEP's transmission lines. The increase in 1997 of 43% in transmission service revenues was also due to an increase in the volume of other companies' electricity transmitted through AEP's transmission system. The issuance in 1996 of open transmission access rules by the FERC facilitated the growth in transmission services.

The level of wholesale transactions, including transmission services, tends to fluctuate due to the highly competitive nature of the short-term energy market and other factors, such as affiliated and unaffiliated generating plant availability, the weather and the economy. The FERC rules which introduced a greater degree of competition into the wholesale energy market have had a major effect on wholesale sales and increased transmission service revenues as more electricity is traded in the short-term (spot) market. The Company's sales and in turn its results of operations were impacted by the quantities of energy and services sold to wholesale customers as well as the sale prices and cost of goods sold. Future results of operations will be affected by the quantity and price of both retail and wholesale transactions which often depend on factors the Company does not control including the level of competition, the weather and affiliated and unaffiliated power plant availability. However, we work to keep abreast of these factors and to take advantage of them whenever possible.

Operating Expenses Increase

Operating expenses increased 10% in 1998 and 1% in 1997. Changes in the components of operating expenses were as follows:

	Increase (Decrease) From Previous Year			
(Dollars in Millions)	1998		1997	
	Amount	%	Amount	%
Fuel	$ 90.1	5.5	$ 26.4	1.6
Purchased Power	301.7	223.9	48.6	56.5
Other Operation	75.7	6.2	17.3	1.4
Maintenance	59.7	12.3	(19.6)	(3.9)
Depreciation and Amortization	(11.1)	(1.9)	(9.7)	(1.6)
Taxes Other Than Federal Income Taxes	2.8	0.6	(8.0)	(1.6)
Federal Income Taxes	(25.1)	(7.3)	(0.9)	(0.3)
Total	$493.8	10.1	$ 54.1	1.1

Fuel expense increased in 1998 and 1997 primarily due to an increase in the average cost of fuel consumed reflecting the reduced availability of lower cost nuclear generation due to the unplanned shutdown of both of AEP's nuclear units which began in September 1997 and continued throughout 1998.

The significant increases in purchased power expense in both 1998 and 1997 were primarily due to purchases of electricity for resale to other utilities and power marketers and for replacement of energy usually generated at the Cook Plant. The increase in purchases made for resale to other entities reflects an expanding and evolving wholesale marketplace.

Other operation expenses increased in 1998 due to the extended Cook Plant outage, power marketing and trading compensation and severance accruals for reductions in power generation and energy delivery staff.

Maintenance expense increased in 1998 largely due to expenditures to prepare the Cook Plant units for restart and to restore service interrupted by two severe snowstorms.

The decrease in federal income tax expense attributable to operations in 1998 was primarily due to a decrease in pre-tax operating income.

Nonoperating Income

The significant decline in nonoperating income in 1998 was due to losses from non-regulated energy trading activity and the write-down of Yorkshire's investment in Ionica ($30 million). The trading of gas and electricity outside of AEP's traditional marketing area is marked-to-market and recorded in nonoperating income.

The increase in nonoperating income in 1997 was mainly due to income from the Company's share of earnings from its April 1997 investment in Yorkshire. The $34 million of equity in Yorkshire earnings included $10 million of tax benefits related to a reduction of the UK corporate income tax rate from 33% to 31% effective April 1, 1997. The utilization of foreign tax credits also contributed to the increase in nonoperating income.

Interest Charges and Preferred Stock Dividend Requirements

In 1997 interest charges on both long-term and short-term debt increased reflecting additional borrowing primarily to fund the Company's investment in non-regulated operations including the investment in Yorkshire. Preferred stock dividend requirements of the subsidiaries decreased in 1997 due to the reacquisition of over 4 million shares of cumulative preferred stock.

Financial Condition

AEP's financial condition continues to be strong. The 1998 payout ratio was 85.4%. It has been a management objective to reduce the payout ratio through efforts to increase earnings in order to enhance AEP's ability to invest in new energy based businesses that can leverage our core competencies and improve shareholder value. AEP's three-year total shareholder return ranked 14th among the companies in the S&P Electric Utility Index. While this placed us just below the midpoint, it has been and continues to be management's goal to be in the top quartile of the S&P Electric Utility Index for three-year total shareholder return.

Capital Investments

The total consideration paid by AEP to acquire CitiPower was approximately $1.1 billion which was financed by the issuance of debt in Australia and an equity investment by AEP Resources, Inc. (AEPR). The purchase, for approximately $340 million, of domestic gas assets in Louisiana was funded with part of the

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proceeds from an issuance of $400 million of 6-1/2% senior notes by AEPR. For more information see Note 6 of the Notes to Consolidated Financial Statements. Also AEP's 70% interest in the construction of two 125 MW units in China required approximately $61 million of investment during 1998.

Consolidated construction expenditures for all subsidiaries are expected to be $2.4 billion over the next three years. All expenditures for domestic electric utility construction, estimated to be $2.2 billion for the next three years, are expected to be financed with internally generated funds.

Capital Resources - Structure and Liquidity

AEP's ratio of common equity to total capitalization including amounts due within one year was 40.3% for 1998, compared with 45.5% for 1997 and 45.3% for 1996. The decline in 1998 reflects borrowing to support the acquisitions which were completed in December.

The Company and its subsidiaries issued $1.9 billion principal amount of long-term obligations in 1998 at interest rates ranging from 5% to 10.53%. The Company also increased its borrowing under a long-term revolving credit agreement which expires in June 2000 by $270 million. The principal amount of long-term debt retirements, including maturities, totaled $563 million with interest rates ranging from 2.85% to 9.60%. The operating subsidiaries senior secured debt/first mortgage bond ratings are listed in the following table:

Company	Moody's	S&P	Fitch	D & P
APCo	A3	A	A	A
CSPCo	A3	A-	A-	A
I&M	Baa1	A-	BBB+	BBB+
KPCo	Baa1	A	BBB+	BBB+
OPCo	A3	A-	A-	A

The operating subsidiaries generally issue short-term debt to provide for interim financing of capital expenditures that exceed internally generated funds. They periodically reduce their outstanding short-term debt through issuances of long-term debt and additional capital contributions by the parent company. The companies formed to pursue non-regulated businesses use short-term debt (through a revolving credit facility) which is replaced with long-term debt when financial market conditions are favorable and capital contributions by the parent company. They also assume outstanding debt as part of the acquisition of existing business entities. Short-term debt increased $62 million from the prior year-end balance and increased by $235 million in 1997. At December 31, 1998, AEP Co., Inc. (the parent company) and its subsidiaries had unused short-term lines of credit of $763 million, and several of AEP's subsidiaries engaged in non-regulated energy investments and businesses had available $60 million under a $600 million revolving credit agreement which expires in June 2000. The sources of funds available to AEP are dividends from its subsidiaries, short-term and long-term borrowings and proceeds from the issuance of common stock. AEP issued 1,826,000 shares of common stock in 1998, 1,755,000 shares in 1997 and 1,600,000 shares in 1996 through a Dividend Reinvestment and Direct Stock Purchase Plan and the Employee Savings Plan raising $86 million, $77 million and $65 million, respectively. Additional sales of common stock and/or equity linked securities may be necessary in the future to support the Company's growth.

Unless the domestic electric operating utility subsidiaries meet certain earnings or coverage tests, they cannot issue additional mortgage bonds. In order to issue mortgage bonds (without refunding existing debt), each subsidiary must have pre-tax earnings equal to at least two times the annual interest charges on mortgage bonds after giving effect to the issuance of the new debt.

The following debt coverages of AEP's principal domestic electric operating utility subsidiaries remained strong in 1998:

	Coverages at December 31, 1998 Mortgage
APCo	3.88
CSPCo	6.36
I&M	6.39
KPCo	4.40
OPCo	13.43

As the above table indicates, the major domestic electric operating utility subsidiaries presently exceed the minimum coverage requirements.

Market Risks

The Company as a major power producer and a trader of wholesale electricity and natural gas has certain market risks inherent in its business activities. The trading of electricity and natural gas and related financial derivative instruments exposes the Company to market risk. Market risk represents the risk of loss that may impact the Company due to adverse changes in commodity market prices and rates. In 1998 the Company substantially increased the volume of its wholesale electricity and natural gas marketing and trading activities. Various policies and procedures have been established to manage market risk exposures including the use of a risk measurement model utilizing Value at Risk (VaR). Throughout the year ending December 31, 1998, the highest, lowest and average quarterly VaR in the wholesale trading portfolio was less than $11 million at a 95% confidence level with a holding period of three business days. The Company used the variance-covariance method for calculating VaR based on three months of daily prices. Based on this VaR analysis, at December 31, 1998 a near term change in commodity prices is not expected to have a material effect on the Company's results of operations, cash flows or financial condition. At December 31, 1997, the exposure for financial derivatives in electricity and natural gas marketing activities were not material to the Company's consolidated results of operations, financial position or cash flows.

Investments in foreign ventures expose the Company to risk of foreign currency fluctuations. The Company's exposure to changes in foreign currency exchange rates related to these foreign ventures and investments is not expected to be significant for the foreseeable future since these foreign investments are considered long-term and not expected to be liquidated in the near-term. The Company does not presently utilize derivatives to manage its exposures to foreign currency exchange rate movements.

The Company is exposed to changes in interest rates primarily due to short- and long-term borrowings to fund its business operations. The debt portfolio has both fixed and variable interest rates, terms from one day to forty years and an average duration of five years at December 31, 1998.

The Company measures interest rate market risk exposure utilizing a VaR model. The model is based on the Monte Carlo method of simulated price movements with a 95% confidence level and a one year holding period. The volatilities and correlations were based on three years of monthly prices. The risk of attributable to the Company's exposure to interest rates, primarily related to long-term debt with fixed interest rates, was $589 million at December 31, 1998 and $501 million at December 31, 1997. The Company would not expect to liquidate its entire debt portfolio in a one year holding period. Therefore, a near term change in interest rates should not materially affect results of operations or the consolidated financial position of the Company. The Company is currently utilizing interest rate swaps to manage its exposure to interest rate fluctuations in Australia.

The Company has investments in debt and equity securities which are held in nuclear trust funds. Approximately 85% of the trust fund value is invested in tax exempt and taxable bonds, short-term debt instruments or cash. The trust investments and their fair value are discussed in Note 11 of the Notes to Consolidated Financial Statements. Instruments in the trust funds have not been included in the market risk calculation for interest rates as these instruments are marked-to-market and changes in market value are reflected in a corresponding decommissioning liability. Any differences between the trust fund assets and the ultimate liability should be recoverable from ratepayers.

Inflation affects AEP's cost of replacing utility plant and the cost of operating and maintaining its plant. The rate-making process limits our recovery to the historical cost of assets resulting in economic losses when the effects of inflation are not recovered from customers on a timely basis. However, economic gains that result from the repayment of long-term debt with inflated dollars partly offset such losses.

Other Matters

Year 2000 Readiness Disclosure

On or about midnight on December 31, 1999, digital computing systems may begin to produce erroneous results or fail, unless these systems are modified or replaced, because such systems may be programmed incorrectly and interpret the date of January 1, 2000 as being January 1st of the year 1900 or another incorrect date. In addition, certain systems may fail to detect that the year 2000 is a leap year. Problems can also arise earlier than January 1, 2000, as dates in the next millennium are entered into non-Year 2000 ready programs.

Readiness Program - Internally, the Company is modifying or replacing its computer hardware and software programs to minimize Year 2000-related failures and repair such failures if they occur. This includes both information technology systems (IT), which are mainframe and client server applications, and embedded logic systems (non-IT), such as process controls for energy production and delivery. Externally, the problem is being addressed with entities that interact with the Company, including suppliers, customers, creditors, financial service organizations and other parties essential to the Company's operations. In the course of the external evaluation, the Company has sought written assurances from third parties regarding their state of Year 2000 readiness.

Another issue we are addressing is the impact of electric power grid problems that may occur outside of our transmission system. AEP, along with other electric utilities in North America, regularly submits information to the North American Electric Reliability Council (NERC) as part of NERC's Year 2000 readiness program. NERC then publicly reports summary information to the U.S.

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Department of Energy (DOE) regarding the Year 2000 readiness of electric utilities. In 1999 AEP plans to participate in two NERC-sponsored coordinated electric industry Year 2000 readiness drills.

The second NERC report, dated January 11, 1999 and entitled: Preparing the Electric Power Systems of North American for Transition to the Year 2000 - A Status Report and Work Plan, Fourth Quarter 1998, states that: "With more than 44% of mission critical components tested through November 30, 1998, findings continue to indicate that transition through critical Year 2000 (Y2K) rollover dates is expected to have minimal impact on electric system operations in North America." The Company continues to set a target date of June 30, 1999 for having all mission critical and high priority systems and components Y2K ready.

Through the Electric Power Research Institute, an electric industry-wide effort has been established to deal with Year 2000 problems affecting embedded systems. Under this effort, participating utilities, including AEP, are working together to assess specific vendors' system problems and test plans.

The state regulatory commissions in the Company's service territory are also reviewing the Year 2000 readiness of the Company.

Company's State of Readiness - Work has been prioritized in accordance with business risk. The highest priority has been assigned to activities that potentially affect safety, the physical generation and delivery of energy and communications; followed by back office activities such as customer service/billing, regulatory reporting, internal reporting and administrative activities (e.g. payroll, procurement, accounts payable); and finally, those activities that would cause inconvenience or productivity loss in normal business operations.

The following chart shows our progress toward becoming ready for the Year 2000 as of December 31, 1998:

	IT SYSTEMS		NON-IT SYSTEMS	
YEAR 2000 PROJECT PHASES	COMPLETION DATE/ESTIMATED COMPLETION DATE	PERCENT COMPLETE	COMPLETION DATE/ESTIMATED COMPLETION DATE	PERCENT COMPLETE
Launch: Initiation of the Year 2000 activities within the organization. Establishment of organizational structure, personnel assignments and budget for the workgroup. Continuous management update and awareness program.	2/24/1998	100%	5/31/1998	100%
Inventory and Assessment: Identifying all Company computer systems that could be affected by the millennium change. Prioritize repair efforts based upon criticality to maintaining ongoing operations.	7/31/1998	100%	2/15/1999	99%
Remediation/Testing: The process of modifying, replacing or retiring those mission critical and high priority digital-based systems with problems processing dates past the Year 2000. Testing these systems to ensure that after modifications have been implemented correct date processing occurs and full functionality has been maintained.	6/30/1999	Mainframe 70% Client Server: 18%	6/30/1999	37%

The above chart does not reflect progress of recently acquired midstream gas operations and CitiPower. The mission critical systems for the midstream gas operations are expected to be ready by June 30, 1999 and the mission critical systems for CitiPower are expected to be ready by October 1, 1999.

Costs to Address the Company's Year 2000 Issues - Through December 31, 1998, the Company has spent $21 million on the Year 2000 project and estimates spending an additional $35 million to $47 million to achieve Year 2000 readiness. Most Year 2000 costs are for software, IT consultants and salaries and are expensed; however, in certain cases the Company has acquired hardware that was capitalized. The Company intends tc fund these expenditures through internal sources. Although significant, the cost of becoming Year 2000 compliant is not expected to have a material impact on the Company's results of operations, cash flows or financial condition.

Risks of the Company's Year 2000 Issues - The applications posing the greatest business risk to the Company's operations should they experience Y2K problems are:

* Automated power generation, transmission and distribution systems
* Telecommunications systems
* Energy trading systems
* Time-in-use, demand and remote metering systems for commercial and industrial customers
* Work management and billing systems.

The potential problems related to erroneous processing by, or failure of, these systems are:

* Power service interruptions to customers
* Interrupted revenue data gathering and collection
* Poor customer relations resulting from delayed billing and settlement.

CitiPower operates under a legal and regulatory regime which may expose it to customer claims, that may differ from claims under the US legal and regulatory regime, for service interruptions and/or power quality problems resulting from Y2K problems.

In addition, although as discussed the Company is monitoring its relationships with third parties, such as suppliers, customers and other electric utilities, these third parties nonetheless represent a risk that cannot be assessed with precision or controlled with certainty.

Due to the complexity of the problem and the interdependent nature of computer systems, if our corrective actions, and/or the actions of others not affiliated with AEP, fail for critical applications, Year 2000-related issues may materially adversely affect AEP.

Company's Contingency Plans - To address possible failures of electric generation and delivery of electrical energy due to Year 2000 related failures, we have established a draft Year 2000 contingency plan and submitted it to the East Central Area Reliability Council (ECAR) in December 1998 as part of NERC's review of regional and individual electric utility contingency plans in 1999. NERC's target date is June 1999 for the completion of this contingency plan. In addition, the Company intends to establish contingency plans for its business units to address alternatives if Year 2000 related failures occur. AEP's contingency plans will be developed by the end of 1999. AEP's plans build upon the disaster recovery, system restoration, and contingency planning that we have had in place.

New Accounting Standards

In 1997 the FASB issued SFAS 130 "Reporting Comprehensive Income" and SFAS No. 131 "Disclosures About Segments of an Enterprise and Related Information." SFAS 130 establishes the standards for reporting and displaying components of "comprehensive income," which is the total of net income and all transactions not included in net income affecting equity except those with shareholders. The Company adopted SFAS 130 in the first quarter of 1998. For 1998 there were no material differences between net income and comprehensive income.

SFAS 131 initiates reporting standards for annual and interim financial statements about operating segments of a business for which separate financial information is available and regularly evaluated by the chief operating decision maker in allocating resources and reviewing performance. Information about products and services and geographic areas is to be reported at an enterprise-level instead of by segment. SFAS 131 was required to be adopted by the Company for the year ended December 31, 1998 with restatement of prior period comparative information. Adoption of SFAS 131 did not have any effect on results of operations, cash flows or financial condition.

In the first quarter of 1998 the Company adopted the American Institute of Certified Public Accountants' (AICPA) Statement of Position (SOP) 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use". The SOP requires the capitalization and amortization of certain costs of acquiring or developing internal use computer software. Previously the Company expensed all software acquisition and development costs. The SOP had to be adopted at the beginning of a fiscal year with no restatement or retroactive adjustment of prior periods. The adoption of the SOP effective January 1, 1998 did not have a material effect on results of operations, cash flows or financial condition.

In February 1998, the FASB issued SFAS 132 "Employers' Disclosure about Pensions and Other Postretirement Benefits" which revised employers' disclosures about pensions and other postretirement benefit plans and suggested that the disclosure be combined. It did not change the measurement or recognition requirements for postretirement benefit accounting. The adoption of SFAS 132 did not have a material effect on results of operations, cash flows or financial condition. Prior periods were restated to comply with SFAS 132 presentation requirements.

EITF 98-10 "Accounting for Contracts Involved in Energy Trading and Risk Management Activities" was issued in November 1998 to address the application of mark-to-market accounting for energy trading contracts. Under the provisions of this standard, which must be adopted by the Company in January 1999, energy trading contracts can no longer be accounted for on a settlement basis. Instead they are to be marked-to-market. Initial adoption of EITF 98-10 is not expected to have a significant impact on results of operations, cash flows or financial condition.

The FASB issued SFAS 133 "Accounting for Derivative Instruments and Hedging Activities" in June 1998.

SFAS 133 establishes accounting and reporting standards for derivative instruments. It requires that all derivatives be recognized as either an asset or a liability and measured at fair value in the financial statements. If certain conditions are met a derivative may be designated as a hedge of possible changes in fair value of an asset, liability or firm commitment; variable cash flows of forecasted transactions; or foreign currency exposure. The accounting/reporting for changes in a derivative's fair value (gains and losses) depend on the intended use and resulting designation of the derivative. Management is currently studying the provisions of SFAS 133 to determine the impact of its adoption on January 1, 2000 on results of operations, cash flows and financial condition.

In April 1998 the AICPA issued SOP 98-5 "Reporting on the Costs of Start-up Activities". The SOP clarifies the accounting and reporting for one time start-up activities and organization costs, requiring that they be expensed as incurred. The adoption of this standard in January 1999 is not expected to have a material effect on results of operations, cash flows or financial condition.

Litigation

Corporate Owned Life Insurance

The Internal Revenue Service (IRS) agents auditing the AEP System's consolidated federal income tax returns requested a ruling from their National Office that certain interest deductions claimed by the Company relating to AEP's corporate owned life insurance (COLI) program should not be allowed. As a result of a suit filed by AEP in United States District Court (discussed below) this request for ruling was withdrawn by the IRS agents. Adjustments have been or will be proposed by the IRS disallowing COLI interest deductions for taxable years 1991-96. A disallowance of the COLI interest deductions through December 31, 1998 would reduce earnings by approximately $316 million (including interest). The Company has made no provision for any possible adverse earnings impact from this matter.

In 1998 the Company made payments of taxes and interest attributable to COLI interest deductions for taxable years 1991-97 to avoid the potential assessment by the IRS of any additional above market rate interest on the contested amount. The payments to the IRS are included on the balance sheet in other property and investments pending the resolution of this matter. The Company will seek refund, either administratively or through litigation, of all amounts paid plus interest. In order to resolve this issue without further delay, on March 24, 1998, the Company filed suit against the United States in the United States District Court for the Southern District of Ohio. Management believes that it has a meritorious position and will vigorously pursue this lawsuit. In the event the resolution of this matter is unfavorable, it will have a material adverse impact on results of operations, cash flows and possibly financial condition.

AEP is involved in a number of other legal proceedings and claims. While we are unable to predict the outcome of such litigation, it is not expected that the ultimate resolution of these matters will have a material adverse effect on the results of operations, cash flows and/or financial condition.

AMERICAN ELECTRIC POWER COMPANY, INC. AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENTS OF INCOME

(in thousands - except per share amounts)

	Year Ended December 31, 1998	1997	1996
OPERATING REVENUES	$6,345,902	$5,879,820	$5,849,234
OPERATING EXPENSES:			
Fuel	1,717,177	1,627,066	1,600,659
Purchased Power	436,388	134,718	86,095
Other Operation	1,303,084	1,227,368	1,210,027
Maintenance	542,935	483,268	502,841
Depreciation and Amortization	579,997	591,071	600,851
Taxes Other Than Federal Income Taxes	493,386	490,595	498,567
Federal Income Taxes	316,201	341,280	342,222
TOTAL OPERATING EXPENSES	5,389,168	4,895,366	4,841,262
OPERATING INCOME	956,734	984,454	1,007,972
NONOPERATING INCOME (net)	9,463	59,572	2,212
INCOME BEFORE INTEREST CHARGES AND PREFERRED DIVIDENDS	966,197	1,044,026	1,010,184
INTEREST CHARGES	419,088	405,815	381,328
PREFERRED STOCK DIVIDEND REQUIREMENTS OF SUBSIDIARIES	10,926	17,831	41,426
INCOME BEFORE EXTRAORDINARY ITEM	536,183	620,380	587,430
EXTRAORDINARY LOSS - UK WINDFALL TAX	-	(109,419)	-
NET INCOME	$ 536,183	$ 510,961	$ 587,430
AVERAGE NUMBER OF SHARES OUTSTANDING	190,774	189,039	187,321
EARNINGS PER SHARE:			
Before Extraordinary Item	$2.81	$3.28	$3.14
Extraordinary Loss	-	(0.58)	-
Net Income	$2.81	$2.70	$3.14
CASH DIVIDENDS PAID PER SHARE	$2.40	$2.40	$2.40

CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

(in thousands)

	Year Ended December 31, 1998	1997	1996
RETAINED EARNINGS JANUARY 1	$1,605,017	$1,547,746	$1,409,645
NET INCOME	536,183	510,961	587,430
DEDUCTIONS:			
Cash Dividends Declared	457,638	453,453	449,353
Other	1	237	(24)
RETAINED EARNINGS DECEMBER 31	$1,683,561	$1,605,017	$1,547,746

See Notes to Consolidated Financial Statements.

AMERICAN ELECTRIC POWER COMPANY, INC. AND SUBSIDIARY COMPANIES

CONSOLIDATED BALANCE SHEETS

(in thousands - except share data)

	December 31, 1998	December 31, 1997
ASSETS		
ELECTRIC UTILITY PLANT:		
Production	$ 9,591,211	$ 9,493,158
Transmission	3,570,717	3,501,580
Distribution	4,779,772	4,654,234
General (including mining assets and nuclear fuel)	1,641,676	1,604,671
Construction Work in Progress	562,891	342,842
Total Electric Utility Plant	20,146,267	19,596,485
Accumulated Depreciation and Amortization	8,416,397	7,963,636
NET ELECTRIC UTILITY PLANT	11,729,870	11,632,849
OTHER PLANT	841,451	62,213
OTHER PROPERTY AND INVESTMENTS	2,515,103	1,294,291
CURRENT ASSETS:		
Cash and Cash Equivalents	172,985	91,481
Accounts Receivable:		
Customers	557,382	559,203
Miscellaneous	360,783	115,075
Allowance for Uncollectible Accounts	(11,075)	(6,760)
Fuel - at average cost	215,699	224,967
Materials and Supplies - at average cost	279,823	263,613
Accrued Utility Revenues	186,006	189,191
Energy Marketing and Trading Contracts	372,380	2,306
Prepayments and Other	83,686	81,366
TOTAL CURRENT ASSETS	2,217,669	1,520,442
REGULATORY ASSETS	1,846,718	1,817,540
DEFERRED CHARGES	332,391	288,011
TOTAL	$19,483,202	$16,615,346

See Notes to Consolidated Financial Statements.

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AMERICAN ELECTRIC POWER COMPANY, INC. AND SUBSIDIARY COMPANIES

CONSOLIDATED BALANCE SHEETS

	December 31, 1998	December 31, 1997
CAPITALIZATION AND LIABILITIES		
CAPITALIZATION:		
Common Stock-Par Value $6.50: (1998 / 1997)		
Shares Authorized. .600,000,000 / 300,000,000		
Shares Issued. . . .200,816,469 / 198,989,981		
(8,999,992 shares were held in treasury)	$ 1,305,307	$ 1,293,435
Paid-in Capital	1,852,912	1,778,782
Retained Earnings	1,683,561	1,605,017
Total Common Shareholders' Equity	4,841,780	4,677,234
Cumulative Preferred Stocks of Subsidiaries:*		
Not Subject to Mandatory Redemption	46,002	46,724
Subject to Mandatory Redemption	127,605	127,605
Long-term Debt*	6,799,641	5,129,463
TOTAL CAPITALIZATION	11,815,028	9,981,026
OTHER NONCURRENT LIABILITIES	1,428,968	1,246,537
CURRENT LIABILITIES:		
Long-term Debt Due Within One Year*	206,476	294,454
Short-term Debt	616,604	555,075
Accounts Payable	618,019	353,256
Taxes Accrued	381,905	380,771
Interest Accrued	75,184	76,361
Obligations Under Capital Leases	81,661	101,089
Energy Marketing and Trading Contracts	360,248	1,983
Other	461,540	322,687
TOTAL CURRENT LIABILITIES	2,801,637	2,085,676
DEFERRED INCOME TAXES	2,601,402	2,560,921
DEFERRED INVESTMENT TAX CREDITS	350,946	376,250
DEFERRED GAIN ON SALE AND LEASEBACK - ROCKPORT PLANT UNIT 2	222,042	231,320
DEFERRED CREDITS	263,179	133,616
COMMITMENTS AND CONTINGENCIES (Note 4)		
TOTAL	$19,483,202	$16,615,346

*See Accompanying Schedules.

AMERICAN ELECTRIC POWER COMPANY, INC. AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Year Ended December 31,		
	1998	1997	1996
OPERATING ACTIVITIES:			
Net Income	$ 536,183	$ 510,961	$ 587,430
Adjustments for Noncash Items:			
Depreciation and Amortization	619,557	608,217	590,657
Deferred Federal Income Taxes	41,449	(6,549)	(21,478)
Deferred Investment Tax Credits	(25,304)	(25,241)	(25,808)
Amortization of Operating Expenses and Carrying Charges (net)	14,786	12,001	55,458
Equity in Earnings of Yorkshire Electricity Group plc	(38,459)	(33,780)	-
Extraordinary Item - UK Windfall Tax	-	109,419	-
Deferred Costs Under Fuel Clause Mechanisms	(73,219)	(52,469)	51
Changes in Certain Current Assets and Liabilities:			
Accounts Receivable (net)	(141,637)	(136,186)	(39,049)
Fuel, Materials and Supplies	2,108	(1,427)	35,831
Accrued Utility Revenues	3,185	(14,225)	32,953
Accounts Payable	200,195	147,029	(13,915)
Taxes Accrued	(826)	(33,402)	(6,019)
Payment of Disputed Tax and Interest Related to COLI	(302,739)	(3,080)	-
Other (net)	194,247	116,654	40,951
Net Cash Flows From Operating Activities	1,029,526	1,197,922	1,237,062
INVESTING ACTIVITIES:			
Construction Expenditures	(792,118)	(760,394)	(577,691)
Investment in Yorkshire Electricity Group plc	-	(363,436)	-
Investment in CitiPower	(1,054,081)	-	-
Investment in Gas Assets	(340,131)	-	-
Other	(26,370)	2,142	12,283
Net Cash Flows Used For Investing Activities	(2,212,700)	(1,121,688)	(565,408)
FINANCING ACTIVITIES:			
Issuance of Common Stock	85,515	76,745	65,461
Issuance of Long-term Debt	2,491,113	880,522	407,291
Retirement of Cumulative Preferred Stock	(547)	(433,329)	(70,761)
Retirement of Long-term Debt	(915,294)	(348,157)	(601,278)
Change in Short-term Debt (net)	61,529	235,380	(45,430)
Dividends Paid on Common Stock	(457,638)	(453,453)	(449,353)
Net Cash Flows From (Used For) Financing Activities	1,264,678	(42,292)	(694,070)
Net Increase (Decrease) in Cash and Cash Equivalents	81,504	33,942	(22,416)
Cash and Cash Equivalents January 1	91,481	57,539	79,955
Cash and Cash Equivalents December 31	$ 172,985	$ 91,481	$ 57,539

See Notes to Consolidated Financial Statements.

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1. Significant Accounting Policies:

Organization - American Electric Power (AEP or the Company) is one of the United States' (US) largest investor-owned public utility holding companies engaged in the generation, purchase, transmission and distribution of electric power to 3 million retail customers in its seven state service territory which covers portions of Ohio, Michigan, Indiana, Kentucky, West Virginia, Virginia and Tennessee. Electric power is also supplied at wholesale to neighboring utility systems and power marketers. AEP also has other energy holdings in the US, the United Kingdom (UK), China and Australia.

The organization of AEP consists of American Electric Power Company, Inc. (AEP Co., Inc.), the parent holding company; seven domestic regulated electric utility operating companies (domestic utility subsidiaries); a domestic generating subsidiary, AEP Generating Company (AEGCo); three active coal-mining companies; a service company, American Electric Power Service Corporation (AEPSC); AEP Resources, Inc. (AEPR) which invests in, owns and operates non-regulated energy-related domestic and international projects; AEP Energy Services, Inc. (AEPES) which markets and trades energy commodities; and other subsidiaries that provide non-regulated energy and communication services.

The following domestic utility subsidiaries pool their generating and transmission facilities and operate them as an integrated system: Appalachian Power Company (APCo), Columbus Southern Power Company (CSPCo), Indiana Michigan Power Company (I&M), Kentucky Power Company (KPCo) and Ohio Power Company (OPCo). The remaining two domestic utility subsidiaries, Kingsport Power Company (KGPCo) and Wheeling Power Company (WPCo) are distribution companies that purchase power from APCo and OPCo, respectively. AEPSC provides management and professional services to the AEP System subsidiaries. The active coal-mining companies are wholly-owned by OPCo and sell most of their production to OPCo. AEGCo has a 50% interest in the Rockport Plant which is comprised of two of the AEP System's six 1,300 megawatt (mw) generating units. AEPR owns 50% of Yorkshire Electricity Group plc (Yorkshire), a supply and distribution electric company in the UK (see Note 7); 70% of a joint venture which is constructing a two-unit power plant nearing completion in China; 20% of Pacific Hydro, an Australian hydroelectric generating company; all of the assets of a midstream natural gas operation in Louisiana and 100% of CitiPower, a Melbourne, Australia distribution utility. The acquisitions of the midstream natural gas assets and CitiPower were completed in December 1998 (see Note 6). AEPES currently markets and trades natural gas. The non-regulated subsidiaries are engaged in providing power engineering, consulting and management services around the world and fiber, wireless and information communication services in the US.

Although the domestic utility subsidiaries are managed centrally by AEPSC and operate as American Electric Power they and AEPSC have not changed their names and remain separate legal entities.

Rate Regulation - The AEP System is subject to regulation by the Securities and Exchange Commission (SEC) under the Public Utility Holding Company Act of

1935 (1935 Act). The rates charged by the domestic utility subsidiaries are approved by the Federal Energy Regulatory Commission (FERC) or the state utility commissions as applicable. The FERC regulates wholesale rates and the state commissions regulate retail rates.

Principles of Consolidation - The consolidated financial statements include AEP Co., Inc. and its wholly-owned and majority-owned subsidiaries consolidated with their wholly-owned subsidiaries. Significant intercompany items are eliminated in consolidation. Yorkshire and Pacific Hydro are accounted for using the equity method.

Basis of Accounting - As the owner of cost-based rate-regulated electric public utility companies, AEP Co., Inc.'s consolidated financial statements reflect the actions of regulators that result in the recognition of revenues and expenses in different time periods than enterprises that are not rate regulated. In accordance with Statement of Financial Accounting Standards (SFAS) 71, "Accounting for the Effects of Certain Types of Regulation," regulatory assets (deferred expenses) and regulatory liabilities (deferred income) are recorded to reflect the economic effects of regulation and to match expenses with regulated revenues.

Use of Estimates - The preparation of these financial statements in conformity with generally accepted accounting principles requires in certain instances the use of estimates. Actual results could differ from those estimates.

Regulated Utility Plant - Electric utility plant, which represents the costs of service rate-regulated fixed assets of the domestic electric utility subsidiaries, is stated at original cost and is generally subject to first mortgage liens. Additions, major replacements and betterments are added to the plant accounts. Retirements from the plant accounts and associated removal costs, net of salvage, are deducted from accumulated depreciation. The costs of labor, materials and overheads incurred to operate and maintain regulated domestic utility plant are included in operating expenses. The distribution utility plant assets of CitiPower are included in other plant.

Allowance for Funds Used During Construction (AFUDC) - AFUDC is a noncash nonoperating income item that is recovered over the service life of utility plant through depreciation and represents the estimated cost of borrowed and equity funds used to finance construction projects. The amounts of AFUDC for 1998, 1997 and 1996 were not significant.

Depreciation, Depletion and Amortization - Depreciation is provided on a straight-line basis over the estimated useful lives of property other than coal-mining property and is calculated largely through the use of composite rates by functional class. The annual composite depreciation rates for regulated utility plant for 1998, 1997 and 1996 were as follows:

Functional Class of Property	Annual Composite Depreciation Rates
Production:	
Steam-Nuclear	3.4%
Steam-Fossil-Fired	3.2% to 4.4%
Hydroelectric-Conventional and Pumped Storage	2.7% to 3.4%
Transmission	1.7% to 2.7%
Distribution	3.3% to 4.2%
General	2.5% to 3.8%

The domestic utility subsidiaries presently recover amounts to be used for demolition and removal of non-nuclear plant through depreciation charges included in rates. Depreciation, depletion and amortization of coal-mining assets is provided over each asset's estimated useful life or the estimated life of the mine, whichever is shorter, ranging up to 30 years, and is calculated using the straight-line method for mining structures and equipment. The units-of-production method is used to amortize coal rights and mine development costs based on estimated recoverable tonnages at a current average rate of $1.85 per ton in 1998, $1.91 per ton in 1997 and $1.49 per ton in 1996. These costs are included in the cost of coal charged to fuel expense.

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

Foreign Currency Translation - The financial statements of subsidiaries outside the US are measured using the local currency as the functional currency. Assets and liabilities are translated to US dollars at year-end rates of exchange and revenues and expenses are translated at monthly average exchange rates throughout the year. Currency translation gain and loss adjustments are accumulated in shareholders' equity. The accumulated total of such adjustments at December 31, 1998 and 1997 is not material. Currency transaction gains and losses are recorded in income.

Derivative Financial Instruments - During 1998, the Company substantially increased the volume of its wholesale electricity and natural gas marketing and trading transactions (trading activities). Trading activities involve the sale of energy under physical forward contracts at fixed and variable prices and the trading of energy contracts including exchange traded futures and options, over-the-counter options and swaps. The majority of these transactions represent physical forward contracts in the Company's traditional marketing area and are typically settled by entering into offsetting contracts. The net revenues from these transactions in the Company's traditional economic marketing area are included in regulated revenues for ratemaking, regulatory accounting and reporting purposes.

The Company has also purchased and sold electricity and gas options, futures and swaps, and entered into forward purchase and sale contracts for electricity outside its traditional marketing area. These transactions represent non-regulated trading activities that are included in nonoperating income. The unrealized mark-to-market gains and losses from such non-regulated trading activity are reported as assets and liabilities, respectively.

The Company enters into contracts to manage the exposure to unfavorable changes in the cost of debt to be issued. These anticipatory debt instruments are entered into in order to manage the change in interest rates between the time a debt offering is initiated and the issuance of the debt (usually a period of 60 days). Gains or losses are deferred and amortized over the life of the debt issuance. There were no such forward contracts outstanding at December 31, 1998 or 1997.

See Note 11 - Financial Instruments. Credit and Risk Management for further discussion.

Operating Revenues and Fuel Costs - Revenues include the accrual of electricity consumed but unbilled at month-end as well as billed revenues. Fuel costs are matched with revenues in accordance with rate commission orders. Generally in the retail jurisdictions, changes in fuel costs are deferred or revenues accrued until approved by the regulatory commission for billing or refund to customers in later months. Wholesale jurisdictional fuel cost changes are expensed and billed as incurred.

Levelization of Nuclear Refueling Outage Costs - In accordance with SFAS 71 incremental operation and maintenance costs associated with refueling outages at I&M's Cook Plant are deferred and amortized over the period beginning with the commencement of an outage and ending with the beginning of the next outage.

Income Taxes - The Company follows the liability method of accounting for income taxes as prescribed by SFAS 109, "Accounting for Income Taxes." Under the liability method, deferred income taxes are provided for all temporary differences between the book cost and tax basis of assets and liabilities which will result in a future tax consequence. Where the flow-through method of accounting for temporary differences is reflected in rates, deferred income taxes are recorded with related regulatory assets and liabilities in accordance with SFAS 71.

Investment Tax Credits - Investment tax credits have been accounted for under the flow-through method except where regulatory commissions have reflected investment tax credits in the rate-making process on a deferral basis. Deferred investment tax credits are being amortized over the life of the related plant investment.

Debt and Preferred Stock - Gains and losses on reacquisition of debt are deferred and amortized over the remaining term of the reacquired debt in accordance with rate-making treatment. If the debt is refinanced, the reacquisition costs are deferred and amortized over the term of the replacement debt commensurate with their recovery in rates.

Discount or premium and expenses of debt issuances are amortized over the term of the related debt, with the amortization included in interest charges.

Redemption premiums paid to reacquire preferred stock are included in paid-in capital and amortized to retained earnings commensurate with their recovery in rates. The excess of par value over costs of preferred stock reacquired is credited to paid-in capital and amortized to retained earnings.

Other Plant - Other plant is comprised primarily of the plant and its related construction work in progress for midstream gas operations, an Australian distribution company and a Chinese generation project.

Other Property and Investments - Other property and investments are comprised primarily of nuclear decommissioning and spent nuclear fuel disposal trust funds; licenses for operating franchises and goodwill for the Australian distribution company; amounts for corporate owned life insurance and a related disputed tax payment; and the investment in Yorkshire and Pacific Hydro which are accounted for under the equity method of accounting. Securities held in trust funds for decommissioning nuclear facilities and for the disposal of spent nuclear fuel are recorded at market value in accordance with SFAS 115, "Accounting for Certain Investments in Debt and Equity Securities." Securities in the trust funds have been classified as available-for-sale due to their long-term purpose. Unrealized gains and losses from securities in these trust funds are not reported in equity but result in adjustments to the liability account for the nuclear decommissioning trust funds and to regulatory assets or liabilities for the spent nuclear fuel disposal trust funds. Excluding decommissioning and spent nuclear fuel disposal trust funds and the investment in Yorkshire and Pacific Hydro, other property and investments are stated at cost.

EPS - Earnings per share is determined based upon the weighted average number of shares outstanding. There are no dilutive potential common shares. Therefore, the computation of earnings per share is the same for basic earnings per share and diluted earnings per share.

Comprehensive Income - There were no material differences between net income and comprehensive income.

Reclassification - In the fourth quarter of 1998 the Company changed the presentation of its trading activities from a gross basis (purchases and sales reported separately) to a net basis (net amount from transactions reported as revenues). This reclassification had no impact on net income. Certain prior year amounts have been reclassified to conform to current year presentation. Such reclassification had no impact on previously reported net income.

2. Rate Matters:

OPCo's Recovery of Fuel Costs - Under the terms of a 1992 stipulation agreement the cost of coal burned at the Gavin Plant is subject to a 15-year predetermined price of $1.575 per million Btu's with quarterly escalation adjustments through November 2009. A 1995 Settlement Agreement set the fuel component of the electric fuel component (EFC) factor at 1.465 cents per Kwh for the period June 1, 1995 through November 30, 1998. With the end of the period covered by the 1995 Settlement Agreement, the escalated Gavin predetermined price cap under the stipulation agreement will determine Ohio jurisdictional fuel recoveries. To the extent the actual cost of coal burned at the Gavin Plant is below the predetermined prices, the stipulation agreement provides OPCo with the opportunity to recover over its term the Ohio jurisdictional share of OPCo's investment in and the liabilities and future shut-down costs of its affiliated mines as well as any fuel costs incurred above the predetermined rate. The Company announced plans to close the Muskingum mine which supplies all of its output to OPCo. The mine will be closed in October 1999 and efforts will begin to reclaim the properties, sell or scrap all mining equipment, terminate both capital and operating leases and perform other miscellaneous activities necessary to shut down the mine. Reclamation activities should be completed approximately two years after shutdown, postremediation monitoring is anticipated to continue for five years after completion of reclamation. The Company established a liability for mine closing costs of $44.6 million comprised of a curtailment loss of $24.7 million, provisions for workers compensation claims incurred through October 1998 of $4.7 million, severance costs of $4.1 million (related to approximately 200 employees), postremediation monitoring costs of $4.9 million, write-off of remaining materials and supplies of $4.6 million and other mine site closure costs of $1.6 million. Pursuant to terms of the agreements, $18.5 million of these accrued mine closure costs have been deferred for the Muskingum mine, the remainder are included in fuel expense on the Consolidated Statements of Income. For the three years ended December 31, 1998, 1997 and 1996 revenues and net income from the Muskingum mining operation were $110.2 million and $1,000; $66.3 million and zero; and $65.5 million and $1.8 million; respectively. After full recovery of the deferrals or after November 2009, whichever comes first, the price that OPCo can recover for coal from its affiliated Meigs mine which supplies the

Gavin Plant will be limited to the lower of cost or market price at the time. Pursuant to these agreements OPCo has deferred for future recovery $106 million at December 31, 1998.

Based on the estimated future cost of coal burned at Gavin Plant, management believes that the Ohio jurisdictional portion of the investment in and liabilities and closing costs of the affiliated mining operations including deferred amounts will be recovered under the terms of the predetermined price agreement. Management intends to seek from non-Ohio jurisdictional ratepayers recovery of the non-Ohio jurisdictional portion of the investment in and the liabilities and closing costs of the affiliated Meigs, Muskingum and Windsor mines. The non-Ohio jurisdictional portion of shutdown costs for these mines which includes the investment in the mines, leased asset buy-outs, reclamation costs and employee benefits is estimated to be approximately $100 million after tax at December 31, 1998.

Management anticipates closing the Windsor mine in December 2000 in order to comply with the Phase II requirements of the Clean Air Act Amendments of 1990 (CAAA) or it could close earlier depending on the economics of continued operation under the terms of the above stipulation agreement. Unless the cost of affiliated coal production and/or shutdown costs of the Meigs, Muskingum and Windsor mines can be recovered, results of operations, cash flows and possibly financial condition would be adversely affected.

3. Effects of Regulation and Phase-In Plans:

In accordance with SFAS 71 the consolidated financial statements include assets (deferred expenses) and liabilities (deferred income) recorded in accordance with regulatory actions to match expenses and revenues from cost-based rates. Regulatory assets are expected to be recovered in future periods through the rate-making process and regulatory liabilities are expected to reduce future cost recoveries. Management has reviewed the evidence currently available and concluded that it continues to meet the requirements to apply SFAS 71. In the event a portion of the Company's business no longer met these requirements, net regulatory assets would have to be written off for that portion of the business and assets attributable to that portion of the business would have to be tested for possible impairment and if required an impairment loss recorded unless the net regulatory assets and impairment losses are recoverable as a stranded cost.

Recognized regulatory assets and liabilities are comprised of the following at:

	December 31,	
	1998	1997
	(in thousands)	
Regulatory Assets		
Amounts Due From Customers For Future Income Taxes	$1,324,217	$1,372,926
Deferred Fuel Costs	193,430	75,552
Unamortized Loss on Reacquired Debt	90,997	96,793
Other	238,074	272,269
Total Regulatory Assets	$1,846,718	$1,817,540
Regulatory Liabilities		
Deferred Investment Tax Credits	$350,946	$376,250
Other Regulatory Liabilities*	147,569	78,802
Total Regulatory Liabilities	$498,515	$455,052

* Included in Deferred Credits on Consolidated Balance Sheets

At January 1, 1997 rate phase-in plan deferrals existed for the Zimmer Plant and Rockport Plant Unit 1. The Zimmer Plant is a 1,300 mw coal-fired plant which commenced commercial operation in 1991. CSPCo owns 25.4% of the plant with the remainder owned by two unaffiliated companies. As a result of an Ohio Supreme Court decision, in January 1994 the PUCO approved a temporary 3.39% surcharge effective February 1, 1994. In June 1997 the Company completed recovery of its Zimmer Plant phase-in plan deferrals and discontinued the 3.39% temporary rate surcharge. In 1997 and 1996 $15.4 million and $31.5 million, respectively, of net phase-in deferrals were collected through the surcharge.

The Rockport Plant consists of two 1,300 mw coal-fired units. I&M and AEGCo each own 50% of one unit (Rockport 1) and lease a 50% interest in the other unit (Rockport 2) from unaffiliated lessors under an operating lease. The gain on the sale and leaseback of Rockport 2 was deferred and is being amortized, with related taxes, over the initial lease term which expires in 2022. Rate phase-in plans in the Indiana and the FERC jurisdictions provided for the recovery and straight-line amortization of deferred Rockport Plant Unit 1 costs over a ten year period that ended in 1997. In 1997 and 1996 amortization and recovery of the deferred Rockport Plant Unit 1 phase-in plan costs were $11.9 million and $15.6 million, respectively. During the recovery period net income was unaffected by the recovery of the phase-in deferrals.

4. Commitments and Contingencies:

Construction and Other Commitments - The AEP System has substantial construction commitments to support its utility operations including the replacement of the Cook Plant Unit 1 steam generators. Such commitments do not presently include any expenditures for new generating capacity. Aggregate construction expenditures for 1999-2001 are estimated to be $2.4 billion including construction cost estimates for the newly acquired CitiPower and midstream gas assets.

Long-term domestic fuel supply contracts contain clauses for periodic price adjustments, and most domestic jurisdictions have fuel clause mechanisms that provide for recovery of changes in the cost of fuel with the regulators' review and approval. The contracts are for various terms, the longest of which extends to the year 2014, and contain various clauses that would release the Company from its obligation under certain force majeure conditions.

The AEP System has contracted to sell approximately 1,100 mw of capacity domestically on a long-term basis to unaffiliated utilities. Certain contracts totaling 750 mw of capacity are unit power agreements requiring the delivery of energy only if the unit capacity is available. The power sales contracts expire from 1999 to 2010.

Nuclear Plant - I&M owns and operates the two-unit 2,110 mw Cook Plant under licenses granted by the Nuclear Regulatory Commission (NRC). The operation of a nuclear facility involves special risks, potential liabilities, and specific regulatory and safety requirements. Should a nuclear incident occur at any nuclear power plant facility in the US, the resultant liability could be substantial. By agreement I&M is partially liable together with all other electric utility companies that own nuclear generating units for a nuclear power plant incident. In the event nuclear losses or liabilities are underinsured or exceed accumulated funds and recovery in rates is not possible, results of operations, cash flows and financial condition could be negatively affected.

Nuclear Plant Shutdown - I&M shut down both units of the Cook Nuclear Plant in September 1997 due to questions, which arose during a NRC architect engineer design inspection, regarding the operability of certain safety systems. The NRC issued a Confirmatory Action Letter in September 1997 requiring I&M to address the issues identified in the letter. I&M is working with the NRC to resolve the remaining open issue in the letter.

In April 1998 the NRC notified I&M that it had convened a Restart Panel for Cook Plant. A list of required restart activities was provided by the NRC in July 1998 and in October the NRC expanded the list. In order to identify and resolve the issues necessary to restart the Cook units, I&M is and will be meeting with the Panel on a regular basis, until the units are returned to service.

In January 1999 I&M announced that it will conduct additional engineering reviews at the Cook Plant that will delay restart of the units. Previously, the units were scheduled to return to service at the end of the first and second quarters of 1999. The decision to delay restart resulted from internal assessments that indicated a need to conduct expanded system readiness reviews. A new restart schedule will be developed based on the results of the expanded reviews and should be available in June 1999. When maintenance and other activities required for restart are complete, I&M will seek concurrence from the NRC to return the Cook Plant to service. Until these additional reviews are completed, management is unable to determine when the units will be returned to service. Unless the costs of the extended outage and restart efforts are recovered from customers, there would be a material adverse effect on results of operations, cash flows and possibly financial condition.

The incremental cost incurred in 1997 and 1998 for restart of the Cook units were $6 million and $78 million, respectively, and recorded as operation and maintenance expense. Currently incremental restart expenses are approximately $12 million a month.

In July 1998 I&M received an "adverse trend letter" from the NRC indicating that NRC senior managers determined that there had been a slow decline in performance at the Cook Plant during the 18 month period preceding the letter. The letter indicated that the NRC will closely monitor efforts to address issues at Cook Plant through additional inspection activities. In October 1998 the NRC issued I&M a Notice of Violation and proposed a $500,000 civil penalty for alleged violations at the Cook Plant discovered during five inspections conducted between August 1997 and April 1998. I&M paid the penalty.

The cost of electricity supplied to certain retail customers rose due to the outage of the two units since higher cost coal-fired generation and coal based purchased power were substituted for low cost nuclear generation. I&M's Indiana and Michigan retail jurisdictional fuel cost recovery mechanisms permit the recovery, subject to regulatory commission review and approval, of changes in fuel costs including the fuel component of purchased power in the Indiana jurisdiction and changes in replacement power in the Michigan jurisdiction. The Indiana Utility Regulatory Commission approved, subject to future reconciliation or refund, agreements authorizing I&M, during the billing months of July 1998 through March 1999, to include in rates a fuel cost adjustment factor less than that requested by I&M. The agreements provide the parties to the proceedings with the opportunity to conduct discovery regarding certain issues that were raised in the proceedings, including the appropriateness of the recovery of replacement energy cost due to the extended Cook Plant outage, in anticipation of resolving the issues in a future fuel cost adjustment proceeding. A regulatory asset in the amount of $65 million has been recorded at December 31, 1998.

Historically, the Company has been permitted to recover through the fuel recovery mechanism the cost of replacement energy during outages. Management believes that it should be allowed to recover the deferred Cook replacement energy costs; however, if recovery of the replacement costs is denied, future results of operations and cash flows would be adversely affected by the writeoff of the regulatory asset.

Nuclear Incident Liability - Public liability is limited by law to $9 billion should an incident occur at any licensed reactor in the United States. Commercially available insurance provides $200 million of coverage. In the event of a nuclear incident at any nuclear plant in the US the remainder of the liability would be provided by a deferred premium assessment of $88 million on each licensed reactor payable in annual installments of $10 million. As a result, I&M could be assessed $176 million per nuclear incident payable in annual installments of $20 million. The number of incidents for which payments could be required is not limited.

Nuclear insurance pools and other insurance policies provide $3 billion of property damage, decommissioning and decontamination coverage for the Cook Plant. Additional insurance provides coverage for extra costs resulting from a prolonged accidental Cook Plant outage. Some of the policies have deferred premium provisions which could be triggered by losses in excess of the insurer's resources. The losses could result from claims at the Cook Plant or certain other unaffiliated nuclear units. I&M could be assessed up to $23.2 million annually under these policies.

Spent Nuclear Fuel (SNF) Disposal - Federal law provides for government responsibility for permanent SNF disposal and assesses nuclear plant owners fees

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for SNF disposal. A fee of one mill per kilowatthour for fuel consumed after April 6, 1983 is being collected from customers and remitted to the US Treasury. Fees and related interest of $190 million for fuel consumed prior to April 7, 1983 have been recorded as long-term debt. I&M has not paid the government the pre-April 1983 fees due to continued delays and uncertainties related to the federal disposal program. At December 31, 1998, funds collected from customers towards payment of the pre-April 1983 fee and related earnings thereon approximate the liability.

Decommissioning and Low Level Waste Accumulation Disposal - Decommissioning costs are accrued over the service life of the Cook Plant. The licenses to operate the two nuclear units expire in 2014 and 2017. After expiration of the licenses the plant is expected to be decommissioned through dismantlement. The Company's latest estimate for decommissioning and low level radioactive waste accumulation disposal costs ranges from $700 million to $1,152 million in 1997 nondiscounted dollars. The wide range is caused by variables in assumptions including the estimated length of time SNF may need to be stored at the plant site subsequent to ceasing operations. This, in turn, depends on future developments in the federal government's SNF disposal program. Continued delays in the federal fuel disposal program can result in increased decommissioning costs. I&M is recovering estimated decommissioning costs in its three rate-making jurisdictions based on at least the lower end of the range in the most recent decommissioning study at the time of the last rate proceeding. I&M records decommissioning costs in other operation expense and records an increase in its noncurrent liabilities equal to the decommissioning cost recovered in rates; such amounts were $29 million in 1998,

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$28 million in 1997 and $27 million in 1996. Decommissioning costs recovered from customers are deposited in external trusts. Trust fund earnings increase the fund assets and the recorded liability and decrease the amount needed to be recovered from ratepayers. During 1998 I&M withdrew $3 million and expects to withdrawal $8 million in 1999 for decommissioning of original steam generators removed from Unit 2. At December 31, 1998 and 1997, I&M has recognized a decommissioning liability of $446 million and $381 million, respectively, which is included in other noncurrent liabilities.

Clean Air Act/Air Quality - The US Environmental Protection Agency (Federal EPA) is required by the CAAA to issue rules to implement the law. In 1996 Federal EPA issued final rules governing nitrogen oxides (NOx) emissions that must be met after January 1, 2000 (Phase II of CAAA). The final rules will require substantial reductions in NOx emissions from certain types of boilers including those in AEP's power plants. To comply with Phase II of CAAA, the Company plans to install NOx emission control equipment on certain units and switch fuel at other units. Total capital costs to meet the requirements of Phase II of CAAA are estimated to be approximately $90 million of which $69 million has been incurred through December 31, 1998.

On September 24, 1998, Federal EPA finalized rules which require reductions in NOx emissions in 22 eastern states, including the states in which the Company's generating plants are located. The implementation of the final rules would be achieved through the revision of state implementation plans (SIPs) by September 1999. SIPs are a procedural method used by each state to comply with Federal EPA rules. The final rules anticipate the imposition of a NOx reduction on utility sources of approximately 85% below 1990 emission levels by the year 2003. On October 30, 1998, a number of utilities, including the operating companies of the AEP System, filed petitions in the US Court of Appeals for the District of Columbia Circuit seeking a review of the final rules.

Should the states fail to adopt the required revisions to their SIPs within one year of the date of the final rules (September 24, 1999), Federal EPA has proposed to implement a federal plan to accomplish the NOx reductions. Federal EPA also proposed the approval of portions of petitions filed by eight northeastern states that would result in imposition of NOx emission reductions on utility and industrial sources in upwind midwestern states. These reductions are substantially the same as those required by the final NOx rules and could be adopted by Federal EPA in the event the states fail to implement SIPs in accordance with the final rules.

Preliminary estimates indicate that compliance costs could result in required capital expenditures of approximately $1.2 billion for the AEP System. Compliance costs cannot be estimated with certainty and the actual costs incurred to comply could be significantly different from this preliminary estimate depending upon the compliance alternatives selected to achieve reductions in NOx emissions. Unless such costs are recovered from customers, they would have a material adverse effect on results of operations, cash flows and possibly financial condition.

Litigation - The Internal Revenue Service (IRS) agents auditing the AEP System's consolidated federal income tax returns requested a ruling from their National Office that certain interest deductions claimed by the Company relating to AEP's corporate owned life insurance

(COLI) program should not be allowed. As a result of a suit filed in US District Court (discussed below) this request for ruling was withdrawn by the IRS agents. Adjustments have been or will be proposed by the IRS disallowing COLI interest deductions for taxable years 1991-96. A disallowance of the COLI interest deductions through December 31, 1998 would reduce earnings by approximately $316 million (including interest). The Company has made no provision for any possible adverse earnings impact from this matter.

In 1998 the Company made payments of taxes and interest attributable to COLI interest deductions for taxable years 1991-97 to avoid the potential assessment by the IRS of any additional above market rate interest on the contested amount. The payments to the IRS are included on the balance sheet in other property and investments pending the resolution of this matter. The Company will seek refund, either administratively or through litigation, of all amounts paid plus interest. In order to resolve this issue without further delay, on March 24, 1998, the Company filed suit against the US in the US District Court for the Southern District of Ohio. Management believes that it has a meritorious position and will vigorously pursue this lawsuit. In the event the resolution of this matter is unfavorable, it will have a material adverse impact on results of operations, cash flows and possibly financial condition.

The Company is involved in a number of other legal proceedings and claims. While management is unable to predict the ultimate outcome of litigation, it is not expected that the resolution of these matters will have a material adverse effect on the results of operations, cash flows or financial condition.

5. Proposed Merger

In December 1997 the Company and Central and South West Corporation (CSW) agreed to merge. At the 1998 annual meeting AEP shareholders approved the issuance of common shares to effect the merger and approved an increase in the number of authorized shares of AEP Common Stock from 300,000,000 to 600,000,000 shares. CSW stockholders approved the merger at their May 1998 annual meeting. Approval of the merger has been requested from the FERC, the SEC, the NRC and all of CSW's state regulatory commissions: Arkansas, Louisiana, Oklahoma and Texas. In the near future, AEP and CSW plan to make the final two filings associated with approval of the merger with the Federal Communications Commission and the Department of Justice.

Regulatory approvals for the merger have been received from the Arkansas Public Service Commission (APSC) and the NRC. In December 1998 the APSC approved a stipulated agreement related to a proposed merger regulatory plan submitted by the Company, CSW and CSW's Arkansas operating subsidiary, Southwestern Electric Power Company. The regulatory plan, agreed to with the APSC staff, provides for a sharing of net merger savings through a $6 million rate reduction over 5 years following the completion of the merger.

The application to the NRC by CSW's operating subsidiary, Central Power and Light Company (CPL), requesting permission to transfer indirect control of the license from CSW to AEP for CPL's interest in the South Texas Project nuclear generating station was approved by the NRC in November 1998.

In October 1998 the Oklahoma Corporation Commission (OCC) approved plans by AEP and CSW to submit an amended filing seeking approval of the proposed merger. The amended application is being made as a result of an Oklahoma administrative law judge's recommendation that the merger filing be dismissed without prejudice for lack of sufficient information regarding the potential impact of the merger on the retail electric market in Oklahoma. An amended application was filed in Oklahoma in February 1999. Submission of the amended application will reset Oklahoma's 90-day statutory time period for OCC action on the merger phase of the application.

A settlement agreement between AEP, CSW and certain key parties to the Texas merger proceeding has been reached. The staff of the Public Utility Commission of Texas was not a signatory to the settlement agreement, which resolves all issues for the signatories. The settlement provides for, among other things, rate reductions totaling approximately $180 million over a six year period following completion of the merger to share net merger savings of $84 million and settle existing rate issues of $96 million. Hearings are scheduled for April 1999.

In July 1998 the FERC issued an order which confirmed that a 250 megawatt firm contract path with the Ameren System is available. The contract path was obtained by AEP and CSW to meet the requirement of the 1935 Act that the two systems operate on an integrated and coordinated basis.

In November 1998 the FERC issued an order establishing hearing procedures for the merger and scheduled the hearings to begin on June 1, 1999. The FERC order indicated that the review of the proposed merger will address the issues of competition, market power and customer protection and instructed the companies to refile an updated market power study which was done in January 1999.

The proposed merger of CSW into AEP would result in common ownership of two UK regional electricity companies (RECs), Yorkshire and Seeboard, plc. AEP has a 50% interest in Yorkshire and CSW has a 100% interest in Seeboard. Although the merger of CSW into AEP is not subject to approval by UK regulatory authorities, the common ownership of two UK RECs could be referred by the UK Secretary of State for Trade and Industry to the UK Monopolies and Mergers Commission for investigation.

AEP has received a request from the staff of the Kentucky Public Service Commission (KPSC) to file an application seeking KPSC approval for the indirect change in control of Kentucky Power Company that will occur as a result of the proposed merger. Although AEP does not believe that the KPSC has the jurisdictional authority to approve the merger, management will prepare a merger application filing to be made with the KPSC, which is expected to be filed by April 15, 1999. Under the governing statute the KPSC must act on the application within 60 days. Therefore this is not expected to impact the timing of the merger.

The merger is conditioned upon, among other things, the approval of the above state and federal regulatory agencies. The transaction must satisfy many conditions a number of which may not be waived by the parties, including the condition that the merger must be accounted for as a pooling of interests. The merger agreement will terminate on December 31, 1999 unless extended by either party as provided in the merger agreement. Although consummation of the merger is expected to occur in the fourth quarter of 1999, the Company is unable to predict the outcome or the timing of the required regulatory proceedings.

As of December 31, 1998 the Company had deferred $20 million of incremental costs incurred in connection with the proposed merger. The amounts deferred are included in deferred charges on the Consolidated Balance Sheets.

6. Acquisitions

The Company completed two non-regulated energy related acquisitions in 1998 through a subsidiary, AEPR. Both acquisitions have been included in the December 31, 1998 consolidated financial statements using the purchase method of accounting. The first acquisition was of CitiPower, an Australian distribution utility, that serves approximately 240,000 customers in Melbourne with 3,100 miles of distribution lines in a service area of approximately 100 square miles. All of the stock of CitiPower was acquired on December 31, 1998 for approximately $1.1 billion. The acquisition of CitiPower had no effect on the results of operations for 1998. The financial statements reflect a preliminary purchase price allocation. Estimated goodwill of $557 million has been recorded in other property and investments which will be amortized over a period of not more than 40 years.

The second acquisition was of midstream gas operations that include a fully integrated natural gas gathering, processing, storage and transportation operation in Louisiana and a gas trading and marketing operation in Houston. The gas operations were acquired for approximately $340 million, including working capital funds, on December 1, 1998 with one month of earnings reflected in AEP's consolidated results of operations for the year ended December 31, 1998. The financial statements reflect a preliminary purchase price allocation. Estimated goodwill of approximately $158 million for the midstream gas storage operations and $17 million for the gas trading and marketing operation has been recorded in other property and investments and is being amortized on a straight-line basis over not more than 40 years and 10 years, respectively.

7. Yorkshire Acquisition and UK Windfall Tax

In April 1997 the Company and New Century Energies, Inc. through an equally owned joint venture, Yorkshire Power Group Limited (YPG), acquired all of the outstanding shares of Yorkshire. Total consideration paid by the joint venture was approximately $2.4 billion which was financed by a combination of equity and non-recourse debt. The Company uses the equity method of accounting for its investment in YPG. The Company's investment in the joint venture was $325.8 million and $287.4 million at December 31, 1998 and 1997, respectively, and is included in other property and investments.

In July 1997 the British government enacted a new law that imposed a one-time windfall tax on a revised privatization value which originally had been computed in 1990 on certain privatized utilities. The windfall tax is actually an adjustment by the UK government of the original privatization price. The windfall tax liability for Yorkshire was 134 million pounds sterling ($219 million) and was paid in two equal installments made in December 1997 and December 1998. The Company's $109.4 million share of the tax is reported as an extraordinary loss in 1997.

The 1998 equity earnings from the Yorkshire investment are $38.5 million and are included in nonoperating income. Equity earnings from the Yorkshire investment for 1997, excluding the extraordinary loss, were $34 million.

The following amounts which are not included in AEP's consolidated financial statements represent summarized consolidated financial information of YPG:

	December 31, 1998	December 31, 1997
	(in millions)	
Assets:		
Property, Plant and Equipment	$1,602.2	$1,644.6
Current Assets	552.2	602.2
Goodwill (net)	1,547.3	1,602.5
Other Assets	294.5	292.9
Total Assets	$3,996.2	$4,142.2
Capitalization and Liabilities:		
Common Shareholders' Equity	$ 666.4	$ 542.1
Long-term Debt	2,121.3	704.3
Other Noncurrent Liabilities	413.5	488.7
Long-term Debt Within One Year	13.3	1,776.4
Current Liabilities	781.7	630.7
Total Capitalization and Liabilities	$3,996.2	$4,142.2

	Twelve Months Ended December 31, 1998	Nine Months Ended December 31, 1997
	(in millions)	
Income Statement Data:		
Operating Revenues	$2,284.0	$1,492.9
Operating Income	298.0	202.3
Income Before Extraordinary Item	76.9	67.5
Net Income (Loss)	76.9	(151.3)

8. Staff Reductions

During 1998 an internal evaluation of the power generation organization was conducted with a goal of developing an optimum organizational structure for a competitive generation market. The study was completed in October 1998 and called for the elimination of approximately 450 positions. In addition, a review of energy delivery staffing levels in 1998 identified 65 positions for elimination.

Severance accruals totaling $25.5 million were recorded in December 1998 for reductions in power generation and energy delivery staffs and were charged to other operation expense in the Consolidated Statements of Income. In January 1999, employment terminated for 65 energy delivery employees. In February 1999 the power generation staff reductions were made.

9. Benefit Plans:

AEP System Pension and Other Postretirement Benefit Plans - The AEP System sponsors a qualified pension plan and a nonqualified pension plan. All employees, except participants in the United Mine Workers of America (UMWA) pension plans are covered by one or both of the pension plans. Other Postretirement Benefit Plans (OPEB) are sponsored by the AEP System to provide medical and death benefits for retired employees.

The following tables provide a reconciliation of the changes in the plans' benefit obligations and fair value of assets over the two-year period ending December 31, 1998, and a statement of the funded status as of December 31 for both years:

	Pension Plan		OPEB	
	1998	1997	1998	1997
	(in thousands)			
Reconciliation of benefit obligation:				
Obligation at January 1	$1,909,400	$1,676,200	$ 849,700	$726,400
Service Cost	45,100	36,000	17,500	14,000
Interest Cost	133,200	128,600	59,300	55,900
Participant Contributions	-	-	5,900	5,300
Plan Amendments (a)	48,400	-	-	-
Actuarial Loss	96,000	170,500	133,100	90,900
Acquisitions (b)	100	-	2,800	-
Benefit Payments	(105,900)	(101,900)	(46,600)	(42,800)
Obligation at December 31	$2,126,300	$1,909,400	$1,021,700	$849,700
Reconciliation of fair value of plan assets:				
Fair value of plan assets at January 1	$2,370,300	$2,009,500	$311,900	$232,500
Actual Return on Plan Assets	385,900	462,700	52,600	44,100
Company Contributions	400	-	72,600	72,800
Participant Contributions	-	-	5,900	5,300
Benefit Payments	(105,900)	(101,900)	(46,600)	(42,800)
Fair value of plan assets at December 31	$2,650,700	$2,370,300	$396,400	$311,900
Funded status:				
Funded status at December 31	$ 524,400	$ 460,900	$(625,300)	$(537,800)
Unrecognized Net Transition (Asset) Obligation	(49,200)	(59,100)	360,700	416,400
Unrecognized Prior-Service Cost	157,400	123,500	-	-
Unrecognized Actuarial (Gain) Loss	(756,300)	(640,800)	175,000	66,100
Accrued Benefit Liability	$(123,700)	$(115,500)	$ (89,600)	$ (55,300)

(a) Early retirement factors for the Company pension plan were changed to provide more generous benefits to participants retiring between ages 55 and 60.
(b) On December 1, 1998 the Company acquired midstream gas operations resulting in approximately 170 new employees becoming participants in the Company's pension and OPEB plans.

The following table provides the amounts recognized in the consolidated balance sheets as of December 31 of both years:

	Pension Plan 1998	Pension Plan 1997	OPEB 1998	OPEB 1997
	(in thousands)			
Accrued Benefit Liability	$(123,700)	$(115,500)	$(89,600)	$(55,300)
Additional Minimum Liability	(3,400)	(900)	-	-
Intangible Asset	3,400	900	-	-
Net Amount Recognized	$(123,700)	$(115,500)	$(89,600)	$(55,300)

The Company's nonqualified pension plan had an accumulated benefit obligation in excess of plan assets of $25 million and $19.4 million at December 31, 1998 and 1997, respectively. There are no plan assets in the nonqualified plan due to the nature of the plan.

The Company's OPEB plans had accumulated benefit obligations in excess of plan assets of $625.3 million and $537.8 million at December 31, 1998 and 1997, respectively.

The following table provides the components of net periodic benefit cost for the plans for fiscal years 1998 and 1997:

	Pension Plan 1998	Pension Plan 1997	OPEB 1998	OPEB 1997
	(in thousands)			
Service cost	$ 45,100	$ 36,000	$ 17,500	$ 14,000
Interest cost	133,200	128,600	59,300	55,900
Expected return on plan assets	(172,000)	(154,200)	(28,500)	(22,200)
Amortization of transition (asset) obligation	(9,900)	(9,900)	32,000	32,000
Amortization of prior-service cost	14,400	13,800	-	-
Amortization of net actuarial (gain) loss	(2,600)	(4,700)	200	(400)
Net periodic benefit cost	8,200	9,600	80,500	79,300
Curtailment loss	-	-	24,100(a)	-
Net periodic benefit cost after curtailments	$ 8,200	$ 9,600	$104,600	$ 79,300

(a) Curtailment charges were recognized during 1998 in anticipation of the October 31, 1999 shutdown of Muskingum Mine by Central Ohio Coal Company, a subsidiary of AEP.

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The assumptions used in the measurement of the Company's benefit obligation are shown in the following table:

	Pension Plan		OPEB	
	1998	1997	1998	1997
Weighted-average assumptions as of December 31				
Discount rate	6.75%	7.00%	6.75%	7.00%
Expected return on plan assets	9.00%	9.00%	8.75%	8.75%
Rate of compensation increase	3.2%	3.2%	N/A	N/A

For measurement purposes, a 5.5% annual rate of increase in the per capita cost of covered health care benefits was assumed for 1999. The rate was assumed to decrease gradually each year to a rate of 4.25% for 2005 and remain at that level thereafter.

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 of service and interest cost components of net periodic postretirement health care benefit cost	$ 9,700	$ (8,400)
Effect on the health care component of the accumulated postretirement benefit obligation	113,000	(99,800)

CitiPower, a subsidiary acquired on December 31, 1998 sponsors a defined benefit pension plan. At December 31, 1998, the fair value of the plan assets was $24.6 million and the accumulated benefit obligation of this plan was $25.3 million. This plan's actuarial assumptions are not significantly different from AEP's.

AEP System Savings Plan - The AEP System Savings Plan is a defined contribution plan offered to non-UMWA employees. The cost for contributions to this plan totaled $20.5 million in 1998, $19.6 million in 1997 and $19 million in 1996.

Other UMWA Benefits - The Company provides UMWA pension, health and welfare benefits for certain unionized mining employees, retirees, and their survivors who meet eligibility requirements. The benefits are administered by UMWA trustees and contributions are made to their trust funds. Contributions based on hours worked are expensed as paid as part of the cost of active mining operations and were not material in 1998, 1997 and 1996. Based upon the UMWA actuary estimate, the Company's share of unfunded pension liability was $28 million at June 30, 1998. In the event the Company should significantly reduce or cease mining operations or contributions to the UMWA trust funds, a withdrawal obligation will be triggered for both the pension and health and welfare plans. If the mining operations had been closed on December 31, 1998 the estimated annual withdrawal liability for all UMWA benefit plans would have been $6.5 million. The UMWA withdrawal liability for the anticipated shutdown of Central

Ohio Coal Company's Muskingum mine has been included as a curtailment loss in the net periodic benefit cost under the Company's OPEB plans in 1998.

10. Business Segments

As of December 31, 1998, the Company adopted SFAS 131, "Disclosure about Segments of an Enterprise and Related Information." SFAS 131 established standards for reporting information about operating segments in annual financial statements and requires selected information about operating segments in interim financial reports issued to shareholders. It also established standards for related disclosures about products and services, and geographic areas. Operating segments are defined as components of an enterprise about which separate financial information is available and evaluated regularly by the chief operating decision maker.

The Company's reportable segments are primarily differentiated based on whether the business activity is conducted within a regulated environment. The Company manages its operations on this basis because of the substantial impact of regulatory oversight on business processes, cost structures and operating results.

The Company's principal business segment is its cost based rate regulated Domestic Electric Utilities business consisting of seven regulated utility operating companies providing retail, commercial, industrial and wholesale electric services in seven Atlantic and Midwestern states. Also included in this segment are the Company's electric power wholesale marketing and trading activities that are conducted as part of regulated operations and subject to regulatory ratemaking oversight. The World Wide Energy Investments segment represents principally international investments in energy-related projects and operations. It also includes the development and management of such projects and operations. Such investment activities include electric generation, supply and distribution, and natural gas pipeline, storage and other natural gas services. Other business segments include non-regulated electric and gas trading activities, telecommunication services, and the marketing of various energy saving products and services. Intersegment revenues, ie. revenues from transactions with operating segments, are not material. As of December 31, 1998 and 1997 less than 6% of long-lived assets were located in foreign countries.

Year	Regulated Domestic Electric Utilities	World Wide Energy Investments	Other	Reconciling Adjustments	AEP Consolidated
		(in thousands)			
1998					
Revenues from external customers	$6,345,900	$57,600	$(28,300)	$(29,300)	$6,345,900
Revenues from transactions with other operating segments	-	1,600	1,900	(3,500)	-
Interest revenues		400	200		600
Interest expense	399,200	16,900	3,000		419,100
Depreciation, depletion and amortization expense	580,000	1,000	1,400	(2,400)	580,000
Net income (loss) for equity method subsidiaries	-	38,600	-		38,600
Income tax expense (benefit)	299,100	(15,300)	(21,200)		262,600
Segment net income (loss)	563,400	12,300	(39,500)		536,200
Total assets	16,837,300	2,063,300	582,600		19,483,200
Investments in equity method subsidiaries	100	335,200	-		335,300
Gross property additions	699,700	1,481,000	23,000		2,203,700
1997					
Revenues from external customers	$5,879,800	$14,600	$ 2,200	$(16,800)	$5,879,800
Revenues from transactions with other operating segments	-	-	-	-	-
Interest revenues	-	1,700	-		1,700
Interest expense	390,300	14,900	600		405,800
Depreciation, depletion and amortization expense	591,100	-	-	-	591,100
Net income for equity method subsidiaries	-	33,300	-	-	33,300
Income tax expense (benefit)	330,100	(25,000)	(6,600)		298,500
Extraordinary Loss - UK Windfall Tax	-	(109,400)	-	-	(109,400)
Segment net income (loss)	602,900	(79,600)	(12,300)		511,000
Total assets	16,223,700	367,100	24,500		16,615,300
Investments in equity method subsidiaries	100	287,300	-		287,400
Gross property additions	694,400	62,400	3,600		760,400
1996					
Revenues from external customers	$5,849,200	$12,500	$ -	$(12,500)	$5,849,200
Revenues from transactions with other operating segments	-	100	-	(100)	-
Interest revenues	-	-	-	-	-
Interest expense	381,000	300	-	-	381,300
Depreciation, depletion and amortization expense	600,900	-	-	-	600,900
Income tax expense (benefit)	325,500	(1,000)	(1,900)		322,600
Segment net income (loss)	597,600	(6,600)	(3,600)		587,400
Total assets	15,858,900	5,100	19,000		15,883,000
Investments in equity method subsidiaries	100	-	-		100
Gross property additions	577,700	-	-		577,700

11. Financial Instruments, Credit and Risk Management

The Company is subject to market risk as a result of changes in commodity prices, foreign currency exchange rates, and interest rates. The Company has a wholesale electricity and gas trading and marketing operation that manages the exposure to commodity price movements using physical forward purchase and sale contracts at fixed and variable prices, and financial derivative instruments including exchange traded futures and options, over-the-counter options, swaps and other financial derivative contracts at both fixed and variable prices. Physical forward electricity contracts and certain qualifying hedges within AEP's traditional economic market area are recorded as net operating revenues in the month when the physical contract settles. Net gains for the year ended December 31, 1998 were $111 million. Physical forward electricity contracts outside AEP's traditional marketing area, and all financial electricity trading transactions which do not qualify as a hedge, and/or where the underlying physical commodity is outside AEP's traditional economic market area are marked to market and recorded net in nonoperating income. Net losses for the year ended December 31, 1998 were $37 million. All physical and financial instruments for natural gas are marked to market and are included on a net basis in nonoperating income. Net gains for the year ended December 31, 1998 were $6 million. The unrealized mark-to-market gains and losses from such trading of financial instruments are reported as assets and liabilities, respectively. These activities were not material in prior periods.

Investment in foreign ventures exposes the Company to risk of foreign currency fluctuations. Also, the Company is exposed to changes in interest rates primarily due to short- and long-term borrowings used to fund its business operations. The debt portfolio has both fixed and variable interest rates with terms from one day to forty years and an average duration of 5 years at December 31, 1998. The Company does not presently utilize derivatives to manage its exposures to foreign currency exchange rate movements.

Market Valuation - The book value amounts of cash and cash equivalents, accounts receivable, short-term debt and accounts payable approximate fair value because of the short-term maturity of these instruments. The book value amount of the pre-April 1983 spent nuclear fuel disposal liability approximates the Company's best estimate of its fair value.

The book value amounts and fair values of the Company's significant financial instruments at December 31, 1998 are summarized in the following table. The fair values of long-term debt and preferred stock are based on quoted market prices for the same or similar issues and the current dividend or interest rates offered for instruments of the same remaining maturities. The fair value of those financial instruments that are marked-to-market are based on management's best estimates using over-the-counter quotations, exchange prices, volatility factors and valuation methodology. The estimates presented herein are not necessarily indicative of the amounts that the Company could realize in a current market exchange.

	Book Value	Fair Value
	(in thousands)	
Non-Derivatives		
1998		
Long-term Debt	$7,006,100	$7,291,200
Preferred Stock	127,600	134,100
1997		
Long-term Debt	5,423,900	5,670,400
Preferred Stock	127,600	136,000

Derivatives

Trading Assets

	Notional Amount	Fair Value	Average Fair Value
		(in thousands)	
Electric			
Physicals	$ (62,000)	$ 46,100	$ 40,800
Options	(4,700)	32,200	79,000
Swaps	(15,600)	3,400	1,000
Gas			
Futures	(70,300)	5,900	1,900
Physicals	(285,200)	43,600	29,900
Options	(3,600)	18,000	11,700
Swaps	1,477,900	245,600	143,000

Trading Liabilities

	Notional Amount	Fair Value	Average Fair Value
Electric			
Futures	20,300	(7,200)	(1,800)
Physicals	27,500	(50,600)	(46,300)
Options	9,700	(28,700)	(78,300)
Swaps	16,200	(7,700)	(1,900)
Gas			
Physicals	283,900	(42,400)	(28,700)
Options	4,700	(22,600)	(14,100)
Swaps	(1,524,900)	(231,200)	(135,700)

At December 31, 1998 the fair value of the assets and liabilities related to the wholesale electric forward contracts was $367 million and $356 million, respectively. The respective notional amounts were $828 million and $772 million, respectively. The average fair value amounts outstanding during the period were $922 million of assets and $882 million of liabilities.

AEP routinely enters into exchange traded futures and options transactions for electricity and natural gas as part of its wholesale trading operations. These transactions are executed through brokerage accounts with brokers who are registered with the Commodity Futures Trading Commission. Brokers require cash or cash related instruments to be deposited on these accounts as margin calls against the customer's open position. The amount of these deposits at December 31, 1998 was $10 million.

Credit and Risk Management - In addition to market risk associated with price movements, AEP is also subject to the credit risk inherent in its risk management activities. Credit risk refers to the financial risk arising from commercial transactions and/or the intrinsic financial value of contractual agreements with trading counter parties, by which there exists a potential risk of nonperformance. The Company has established and enforced credit policies that minimize or eliminate this risk. AEP accepts as counter parties to forwards, futures, and other derivative contracts primarily those entities that are classified as Investment Grade, or those that can be considered as such due to the effective placement of credit enhancements and/or collateral agreements. Investment Grade is the designation given to the four highest debt rating categories (i.e., AAA, AA, A, BBB) of the major rating services, e.g., ratings BBB- and above at Standard & Poor's and Baa3 and above at Moody's. When adverse market conditions have the potential to negatively affect a counter party's credit position, the Company will require further enhancements to mitigate risk. Since the formation of the trading business in July of 1997, the Company has experienced no significant losses due to the credit risk associated with its risk management activities; furthermore, the Company does not anticipate any future material effect on its results of operations, cash flow or financial condition as a result of counter party nonperformance.

Other Financial Instruments - Nuclear Trust Funds Recorded at Market Value - The trust investments, reported in other property and investments, are recorded at market value in accordance with SFAS 115 and consist of tax-exempt municipal bonds and other securities.

At December 31, 1998 and 1997 the fair values of the trust investments were $648 million and $566 million, respectively, and had a cost basis of $584 million and $527 million, respectively. Accumulated gross unrealized holding gains were $65 million and $41 million at December 31, 1998 and 1997, respectively and accumulated gross unrealized holding losses were $1.1 million and $1.2 million at December 31, 1998 and 1997, respectively. The change in market value in 1998, 1997, and 1996 was a net unrealized holding gain of $24 million, $19.1 million, and $2.6 million, respectively.

The trust investments' cost basis by security type were:

	December 31,	
	1998	1997
	(in thousands)	
Tax-Exempt Bonds	$326,239	$335,358
Equity Securities	95,854	74,398
Treasury Bonds	71,194	44,200
Corporate Bonds	10,661	9,167
Cash, Cash Equivalents and Accrued Interest	80,065	63,392
Total	$584,013	$526,515

Proceeds from sales and maturities of securities of $225 million during 1998 resulted in $8.2 million of realized gains and $2.8 million of realized losses. Proceeds from sales and maturities of securities of $147.3 million during 1997 resulted in $3.9 million of realized gains and $1.4 million of realized losses. Proceeds from sales and maturities of securities of $115.3 million during 1996 resulted in $2.6 million of realized gains and $2.1 million of realized losses. The cost of securities for determining realized gains and losses is original acquisition cost including amortized premiums and discounts.

At December 31, 1998, the year of maturity of trust fund investments other than equity securities, was:

	(In thousands)
1999	\$106,316
2000 - 2003	157,224
2004 - 2008	175,751
After 2008	48,868
Total	\$488,159

An AEP Resources' subsidiary established a non-recourse variable-rate credit facility in the aggregate amount of \$775 million on December 31, 1998. Certain assets of the subsidiary support the facility. The facility is comprised of three tranches: \$244 million maturing on December 31, 2000, \$488 million maturing on December 31, 2003, and a \$43 million short-term capital facility. As of December 31, 1998 \$732 million were outstanding at an average interest rate of 5.833%.

The subsidiary entered into several interest rate swap agreements for \$586 million of the borrowings under the credit facility. The swap agreements involve the exchange of floating-rate for fixed-rate interest payments. Interest is recognized currently based on the fixed rate of interest resulting from use of these swap agreements. Market risks arise from the movements in interest rates. If counterparties to an interest rate swap agreement were to default on contractual payments, the subsidiary could be exposed to increased costs related to replacing the original agreement. However, the subsidiary does not anticipate non-performance by any counterparty to any interest rate swap in effect as of December 31, 1998. As of December 31, 1998, the subsidiary was a party to interest rate swaps having a aggregate notional amount of \$586 million, with \$342 million maturing on December 31, 2000, and \$244 million maturing on December 31, 2003. The average fixed interest rate payable on the aggregate of the interest rate swaps is 5.32%. The floating rate for interest rate swaps was 4.9% at December 31, 1998. The estimated fair value of the interest rate swaps, which represents the estimated amount the subsidiary would pay to terminate the swaps at December 31, 1998, based on quoted interest rates, is a net liability of \$5 million.

In accordance with the debt covenants included in the financing provisions of this facility, the subsidiary must hedge at least 80% of its energy purchase requirements through energy trading derivative instruments entered into with market participants, predominantly generators. As of December 31, 1998, the subsidiary had outstanding energy trading derivatives with a total contracted load of 12,545 GWh's. These contracts have maturities in the range of 3 months to twelve years. Management's estimate of the fair value of these derivatives as of December 31, 1998, is \$3.3 million in excess of book value.

12. Federal Income Taxes:

The details of federal income taxes as reported are as follows:

	Year Ended December 31, 1998	1997	1996
	(in thousands)		
Charged *(Credited)* to Operating Expenses (net):			
Current	$294,139	$346,290	$375,528
Deferred	37,877	11,124	(17,008)
Deferred Investment Tax Credits	(15,815)	(16,134)	(16,298)
Total	316,201	341,280	342,222
Charged *(Credited)* to Nonoperating Income (net):			
Current	(47,718)	(16,038)	(5,636)
Deferred	3,572	(17,673)	(4,470)
Deferred Investment Tax Credits	(9,489)	(9,107)	(9,510)
Total	(53,635)	(42,818)	(19,616)
Total Federal Income Tax as Reported	$262,566	$298,462	$322,606

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

	Year Ended December 31, 1998	1997	1996
	(in thousands)		
Income Before Preferred Stock Dividend Requirements of Subsidiaries	$547,109	$ 638,211	$628,856
Extraordinary Loss - UK Windfall Tax (Note 7)	-	(109,419)	-
Federal Income Taxes	262,566	298,462	322,606
Pre-Tax Book Income	$809,675	$ 827,254	$951,462
Federal Income Tax on Pre-Tax Book Income at Statutory Rate *(35%)*	$283,386	$289,539	$333,012
Increase (Decrease) in Federal Income Tax Resulting from the Following Items:			
Depreciation	57,663	53,239	50,537
Corporate Owned Life Insurance	(16,428)	(18,240)	(12,009)
Investment Tax Credits (net)	(25,304)	(25,241)	(25,813)
Extraordinary Loss - UK Windfall Tax	-	38,297	-
Other	(36,751)	(39,132)	(23,121)
Total Federal Income Taxes as Reported	$262,566	$298,462	$322,606
Effective Federal Income Tax Rate	32.4%	36.1%	33.9%

The following tables show the elements of the net deferred tax liability and the significant temporary differences:

	December 31, 1998	December 31, 1997
	(in thousands)	
Deferred Tax Assets	$ 879,322	$ 807,226
Deferred Tax Liabilities	(3,480,724)	(3,368,147)
Net Deferred Tax Liabilities	$(2,601,402)	$(2,560,921)
Property Related Temporary Differences	$(2,170,077)	$(2,161,484)
Amounts Due From Customers For Future Federal Income Taxes	(395,605)	(410,255)
Deferred State Income Taxes	(193,867)	(201,843)
All Other (net)	158,147	212,661
Total Net Deferred Tax Liabilities	$(2,601,402)	$(2,560,921)

The Company has settled with the IRS all issues from the audits of the consolidated federal income tax returns for the years prior to 1991. Returns for the years 1991 through 1996 are presently being audited by the IRS. With the exception of interest deductions related to AEP's corporate owned life insurance program, which are discussed under the heading, Litigation, in Note 4, management is not aware of any issues for open tax years that upon final resolution are expected to have a material adverse effect on results of operations.

13. Supplementary Information:

	Year Ended December 31, 1998	1997	1996
	(in thousands)		
Purchased Power - Ohio Valley Electric Corporation (44.2% owned by AEP System)	$42,612	$29,631	$22,156
Cash was paid for:			
Interest (net of capitalized amounts)	$413,341	$390,491	$373,570
Income Taxes	$281,709	$398,833	$404,297
Noncash Investing and Financing Activities:			
Acquisitions under Capital Leases	$119,188	$234,846	$136,988
Assumption of Liabilities related to Acquisitions	$151,506	$ -	$ -

14. Leases:

Leases of property, plant and equipment are for periods up to 35 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.

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Lease rentals are primarily charged to operating expenses in accordance with rate-making treatment. The components of rentals are as follows:

	Year Ended December 31,		
	1998	1997	1996
	(in thousands)		
Operating Leases	$254,467	$257,042	$262,451
Amortization of Capital Leases	91,359	104,732	114,050
Interest on Capital Leases	37,516	31,601	28,696
Total Rental Payments	$383,342	$393,375	$405,197

Properties under capital leases and related obligations on the Consolidated Balance Sheets are as follows:

	December 31,	
	1998	1997
	(in thousands)	
LEASED ASSETS IN ELECTRIC UTILITY PLANT:		
Production	$ 46,532	$ 47,246
Transmission	4	3
Distribution	14,650	14,660
General:		
Nuclear Fuel (net of amortization)	103,939	103,939
Mining Plant and Other	530,291	516,843
Total Electric Utility Plant	695,416	682,691
Accumulated Amortization	208,548	196,145
Net Electric Utility Plant	486,868	486,546
LEASED ASSETS IN OTHER PROPERTY	54,102	57,763
Accumulated Amortization	8,387	5,917
Net Other Property	45,715	51,846
Net Property under Capital Leases	$532,583	$538,392
Capital Lease Obligations:*		
Noncurrent Liability	$450,922	$437,303
Liability Due Within One Year	81,661	101,089
Total Capital Lease Obligations	$532,583	$538,392

*Represents the present value of future minimum lease payments for plant and nuclear fuel. The noncurrent portion of capital lease obligations is included in other noncurrent liabilities in the Consolidated Balance Sheet.

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Properties under operating leases and related obligations are not included in the Consolidated Balance Sheets.

Future minimum lease rentals, consisted of the following at December 31, 1998:

	Capital Leases	Noncancelable Operating Leases
	(in thousands)	
1999	$109,395	$ 239,361
2000	97,132	237,522
2001	79,976	234,147
2002	67,103	228,144
2003	45,161	227,618
Later Years	148,121	3,437,925
Total Future Minimum Lease Rentals	546,888 (a)	$4,604,717
Less Estimated Interest Element	118,244	
Estimated Present Value of Future Minimum Lease Rentals	428,644	
Unamortized Nuclear Fuel	103,939	
Total	$532,583	

(a) Minimum lease rentals do not include nuclear fuel rentals. The rentals are paid in proportion to heat produced and carrying charges on the unamortized nuclear fuel balance. There are no minimum lease payment requirements for leased nuclear fuel.

15. Capital Stocks and Paid-In Capital:

Changes in capital stocks and paid-in capital during the period January 1, 1996 through December 31, 1998 were:

	Shares				Cumulative Preferred Stocks of Subsidiaries	
	Common Stock-Par Value $6.50(a)	Cumulative Preferred Stocks of Subsidiaries	Common Stock	Paid-in Capital	Not Subject To Mandatory Redemption	Subject to Mandatory Redemption(b)
			(Dollars in Thousands)			
January 1, 1996	195,634,992	6,709,751	$1,271,627	$1,658,524	$ 148,240	$ 522,735
Issuances	1,600,000	-	10,400	55,061	-	-
Retirements and Other	-	(707,518)	-	1,969	(57,917)	(12,835)
December 31, 1996	197,234,992	6,002,233	1,282,027	1,715,554	90,323	509,900
Issuances	1,754,989	-	11,408	65,337	-	-
Retirements and Other	-	(4,258,947)	-	(2,109)	(43,599)	(382,295)
December 31, 1997	198,989,981	1,743,286	1,293,435	1,778,782	46,724	127,605
Issuances	1,826,488	-	11,872	73,643	-	-
Retirements and Other	-	(7,220)	-	487	(722)	-
December 31, 1998	200,816,469	1,736,066	$1,305,307	$1,852,912	$ 46,002	$ 127,605

(a) Includes 8,999,992 shares of treasury stock.
(b) Including portion due within one year.

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16. Lines of Credit and Commitment Fees:

At December 31, 1998 and 1997, unused short-term bank lines of credit were available in the amounts of $763 million and $442 million, respectively. In addition several of the subsidiaries engaged in providing non-regulated energy services share a line of credit under a revolving credit agreement. The amounts of credit available under the revolving credit agreement were $60 million and $330 million at December 31, 1998 and 1997, respectively. The short-term bank lines of credit and the revolving credit agreement require the payment of facility fees of approximately 1/10 of 1% on the daily amount of such commitments.

Outstanding short-term debt consisted of:

	December 31, 1998	December 31, 1997
	(dollars in thousands)	
Balance Outstanding:		
Notes Payable	$197,304	$199,285
Commercial Paper	419,300	355,790
Total	$616,604	$555,075
Year-End Weighted Average Interest Rate:		
Notes Payable	5.8%	6.3%
Commercial Paper	6.2%	6.8%
Total	6.1%	6.6%

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17. Unaudited Quarterly Financial Information:

(In Thousands - Except Per Share Amounts)	Quarterly Periods Ended 1998 March 31	June 30	Sept. 30	Dec. 31
Operating Revenues	$1,509,410	$1,560,944	$1,845,228	$1,430,320
Operating Income	255,932	227,190	311,579	162,033
Net Income	150,586	118,084	195,365	72,148
Earnings per Share	0.79	0.62	1.02	0.38

Fourth quarter 1998 earnings declined primarily as a result of unseasonably mild weather, severance accruals and the negative impact of the extended Cook Plant outage.

(In Thousands - Except Per Share Amounts)	Quarterly Periods Ended 1997 March 31	June 30	Sept. 30	Dec. 31
Operating Revenues	$1,492,069	$1,382,158	$1,507,075	$1,498,518
Operating Income	271,978	221,255	275,090	216,131
Income Before Extraordinary Item	172,562	121,139	201,746	124,933
Net Income	172,562	121,139	91,181	126,079
Earnings per Share Before Extraordinary Item*	0.92	0.64	1.07	0.66
Earnings per Share	0.92	0.64	0.48	0.66

*Amounts for 1997 do not add to $3.28 earnings per share due to rounding.

The third quarter of 1997 includes an extraordinary loss of $110.6 million or $0.59 per share for a UK Windfall Tax which retroactively adjusted upward Yorkshire's privatization price discussed in Note 7.

See "Reclassification" in Note 1 regarding reclassification of prior period amounts.

AMERICAN ELECTRIC POWER COMPANY, INC. AND SUBSIDIARY COMPANIES

SCHEDULE OF CONSOLIDATED CUMULATIVE PREFERRED STOCKS OF SUBSIDIARIES

	December 31, 1998			
	Call Price per Share (a)	Shares Authorized(b)	Shares Outstanding	Amount (In Thousands)
Not Subject to Mandatory Redemption:				
4.08% - 4.56%	\$102-\$110	932,403	460,016	\$ 46,002
Subject to Mandatory Redemption:				
5.90% - 5.92% (c)	(d)	1,950,000	388,100	\$ 38,810
6.02% - 6-7/8% (c)	(e)	1,950,000	637,950	63,795
7% (f)	(f)	250,000	250,000	25,000
Total Subject to Mandatory Redemption (c)				\$127,605

	December 31, 1997			
	Call Price per Share (a)	Shares Authorized(b)	Shares Outstanding	Amount (In Thousands)
Not Subject to Mandatory Redemption:				
4.08% - 4.56%	\$102-\$110	932,403	467,236	\$ 46,724
Subject to Mandatory Redemption:				
5.90% - 5.92% (c)	(d)	1,950,000	388,100	\$ 38,810
6.02% - 6-7/8% (c)	(e)	1,950,000	637,950	63,795
7% (f)	(f)	250,000	250,000	25,000
Total Subject to Mandatory Redemption (c)				\$127,605

NOTES TO SCHEDULE OF CUMULATIVE PREFERRED STOCKS OF SUBSIDIARIES

(a) At the option of the subsidiary the shares may be redeemed at the call price plus accrued dividends. The involuntary liquidation preference is \$100 per share for all outstanding shares.

(b) As of December 31, 1998 the subsidiaries had 7,193,024, 22,200,000 and 7,583,313 shares of \$100, \$25 and no par value preferred stock, respectively, that were authorized but unissued.

(c) Shares outstanding and related amounts are stated net of applicable retirements through sinking funds (generally at par) and reacquisitions of shares in anticipation of future requirements. The subsidiaries reacquired enough shares in 1997 to meet all sinking fund requirements on certain series until 2008 and on certain series until 2009 when all remaining outstanding shares must be redeemed. The sinking fund provisions of the series subject to mandatory redemption aggregate \$5,000,000 each year for the years 2000, 2001, 2002 and \$15,000,000 in 2003.

(d) Not callable prior to 2003; after that the call price is \$100 per share.

(e) Not callable prior to 2000; after that the call price is \$100 per share.

(f) With sinking fund. Redemption is restricted prior to 2000.

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AMERICAN ELECTRIC POWER COMPANY, INC. AND SUBSIDIARY COMPANIES
SCHEDULE OF CONSOLIDATED LONG-TERM DEBT OF SUBSIDIARIES

Maturity	Weighted Average Interest Rate December 31, 1998	Interest Rates at December 31, 1998	Interest Rates at December 31, 1997	December 31, 1998 (in thousands)	December 31, 1997 (in thousands)
FIRST MORTGAGE BONDS					
1998-2002	7.23%	6.35%-8.95%	6.35%-9.15%	$ 759,000	$1,131,411
2003-2006	6.70%	6%-8%	6%-8%	846,000	846,000
2022-2025	7.90%	7.10%-8.80%	7.10%-8.80%	1,020,768	1,120,419
INSTALLMENT PURCHASE CONTRACTS (a)					
1998-2002	4.40%	4.05%-5.15%	3.70%-7-1/4%	145,000	189,500
2007-2025	6.42%	5.00%-7-7/8%	5.45%-7-7/8%	776,245	756,745
NOTES PAYABLE (b)					
1998-2008	5.97%	5.49%-9.60%	5.29%-9.60%	1,493,360	527,681
SENIOR UNSECURED NOTES					
2003-2008	6.54%	6.24%-6.91%	6.73%-6.91%	786,000	144,000
2038	7.30%	7.20%-7-3/8%	-	340,000	-
JUNIOR DEBENTURES					
2025 - 2038	8.05%	7.60%-8.72%	7.92%-8.72%	620,000	495,000
OTHER LONG-TERM DEBT (c)				269,319	250,357
Unamortized Discount (net)				(49,575)	(37,196)
Total Long-term Debt Outstanding (d)				7,006,117	5,423,917
Less Portion Due Within One Year				206,476	294,454
Long-term Portion				$6,799,641	$5,129,463

NOTES TO SCHEDULE OF CONSOLIDATED LONG-TERM DEBT OF SUBSIDIARIES

(a) For certain series of installment purchase contracts interest rates are subject to periodic adjustment. Certain series will be purchased on demand at periodic interest-adjustment dates. Letters of credit from banks and standby bond purchase agreements support certain series.
(b) Notes payable represent outstanding promissory notes issued under term loan agreements and revolving credit agreements with a number of banks and other financial institutions. At expiration all notes then issued and outstanding are due and payable. Interest rates are both fixed and variable. Variable rates generally relate to specified short-term interest rates.
(c) Other long-term debt consists of a liability along with accrued interest for disposal of spent nuclear fuel (see Note 4 of the Notes to Consolidated Financial Statements) and financing obligation under sale lease back agreements.
(d) Long-term debt outstanding at December 31, 1998 is payable as follows:

Principal Amount	(in thousands)
1999	$ 206,476
2000	786,222
2001	512,028
2002	294,546
2003	934,547
Later Years	4,321,873
Total Principal Amount	7,055,692
Unamortized Discount	(49,575)
Total	$7,006,117

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Management's Responsibility

The management of American Electric Power Company, Inc. is responsible for the integrity and objectivity of the information and representations in this annual report, including the consolidated financial statements. These statements have been prepared in conformity with generally accepted accounting principles, using informed estimates where appropriate, to reflect the Company's financial condition and results of operations. The information in other sections of the annual report is consistent with these statements.

The Company's Board of Directors has oversight responsibilities for determining that management has fulfilled its obligation in the preparation of the financial statements and in the ongoing examination of the Company's established internal control structure over financial reporting. The Audit Committee, which consists solely of outside directors and which reports directly to the Board of Directors, meets regularly with management, Deloitte & Touche LLP - Certified Public Accountants and the Company's internal audit staff to discuss accounting, auditing and reporting matters. To ensure auditor independence, both Deloitte & Touche LLP and the internal audit staff have unrestricted access to the Audit Committee.

The financial statements have been audited by Deloitte & Touche LLP, whose report appears on the next page. The auditors provide an objective, independent review as to management's discharge of its responsibilities insofar as they relate to the fairness of the Company's reported financial condition and results of operations. Their audit includes procedures believed by them to provide reasonable assurance that the financial statements are free of material misstatement and includes a review of the Company's internal control structure over financial reporting.

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Independent Auditors' Report

To the Shareholders and Board of Directors
of American Electric Power Company, Inc.:

We have audited the accompanying consolidated balance sheets of American Electric Power Company, Inc. and its subsidiaries as of December 31, 1998 and 1997, and the related consolidated statements of income, retained earnings, and cash flows for each of the three years in the period ended December 31, 1998. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of American Electric Power Company, Inc. and its subsidiaries as of December 31, 1998 and 1997, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1998 in conformity with generally accepted accounting principles.

Deloitte & Touche LLP

Deloitte & Touche LLP
Columbus, Ohio
February 23, 1999

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Central and South West Corporation

1996 Summary Annual Report

emerging.
global.
energy.
services.
business.

Company Profile

Central and South West Corporation is an electric utility holding company based in Dallas, Texas. CSW also engages in international energy and telecommunications services through various non-utility subsidiaries.

CSW owns and operates four electric utilities in the United States: Central Power and Light Company, Public Service Company of Oklahoma, Southwestern Electric Power Company and West Texas Utilities Company. These companies serve approximately 4 million people in an area covering 152,000 square miles.

CSW also owns SEEBOARD plc, a regional electricity company in the United Kingdom. It serves a population of approximately 4.6 million in an area covering 3,000 square miles in Southeast England.

Our other subsidiaries include CSW Energy, Inc., which develops, acquires, constructs, owns and operates non-utility power projects in the United States; CSW International, Inc., which develops, acquires, constructs, owns and operates energy facilities in other countries; CSW Communications, Inc., which develops and operates telecommunications services; CSW Credit, Inc., which buys the accounts receivable of our system companies and other utilities; EnerShop, Inc., which provides energy-management analysis and equipment to increase productivity and lower energy costs for commercial and governmental entities; and Central and South West Services, Inc., which provides, at cost, management and professional services for the corporation and its subsidiaries, primarily the four U.S. electric companies.

Through separate equity investments in various joint ventures, CSW owns interests in Beacon Gas, a joint venture between SEEBOARD and Amoco to market natural gas throughout the U.K.; Medway Power, which operates a 675-megawatt independent power station on the Isle of Grain in the U.K.; CSW/ICG ChoiceCom, L.P., which plans to provide local and long-distance telephone and data transmission services in Texas, Oklahoma, Louisiana and Arkansas; Empresa de Eletricidade Vale Paranapanema S.A. (Vale), a private electric distribution company in Brazil; Enertek, which is constructing Mexico's first major cogeneration project; and Numanco, which provides staffing services for electric utility power plants.

emerging. global. energy. services. business.

Emerging. Global. Energy. Services. Business.

A new Central and South West Corporation is *emerging* to meet the opportunities of a more competitive electric power industry. CSW has become *global* in reach . . . is expanding its broad capabilities in *energy* . . . is developing new telecommunications and energy-management *services* . . . and is redefining itself as a customer-focused, market-oriented *business* designed not just to compete, but to win.

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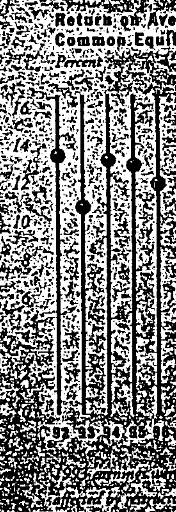
Highlights

CENTRAL AND SOUTH WEST CORPORATION

	1996	1995
Financial Data *(millions)*		
Operating Revenues	$5,155	$3,143
U.S. Electric Fuel and Purchased Power	1,228	1,045
United Kingdom Cost of Sales	1,331	158
Other Operating Expenses	1,399	1,065
Taxes	402	254
Operating Income	795	621
Other	(61)	99
Interest and Preferred Stock Dividends	(437)	(343)
Income from Discontinued Operations	12	25
Gain on Sale of Discontinued Operations	120	
Net Income for Common Stock	$ 429	$ 402
Common Stock Data and Dividends		
Earnings per Share	$2.07	$2.10
Dividends per Share	$1.74	$1.72
Book Value per Share	$17.98	$18.48
Average Common Shares Outstanding *(millions)*	207.5	191.7
Return on Average Common Equity	12.1%	13.1%
Dividend Yield	6.8%	6.2%
Dividend Payout Ratio	84%	82%
Year-End Market Price	$25 [illegible]	$27 [illegible]

Stock Performance	Market Price High	Market Price Low	Dividends Paid
1996			
First Quarter	$28 [illegible]	$26 [illegible]	$0.435
Second Quarter	28 [illegible]	26 [illegible]	0.435
Third Quarter	28 [illegible]	25 [illegible]	0.435
Fourth Quarter	28	25 [illegible]	0.435
			$1.74
1995			
First Quarter	$24 [illegible]	$22	$0.430
Second Quarter	26 [illegible]	23 [illegible]	0.430
Third Quarter	26 [illegible]	24 [illegible]	0.430
Fourth Quarter	28 [illegible]	24 [illegible]	0.430
			$1.72

The condensed consolidated financial statements in this summary annual report were derived from the consolidated financial statements that appear in Appendix A to the proxy statement for the 1997 annual meeting of shareholders. Copies of the consolidated financial statements and the reports of the Corporation's independent public accountants thereon may be obtained by calling Central and South West Corporation's Investor Services Department at 1-800-527-5797.



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Certain matters discussed in this summary annual report are forward-looking statements intended to qualify for the safe harbors from liability established by the Private Securities Litigation Reform Act of 1995. These forward-looking statements can generally be identified as such because the context of the statement will include words such as CSW "believes," "anticipates," "expects" [illegible] that describe CSW's future plans, objectives or goals are also forward-looking statements. Such statements address future events and conditions concerning capital [illegible] earnings, litigation, rate and other regulatory matters, liquidity and capital resources, and accounting matters. Actual results in each case could differ materially from those currently anticipated in such statements by reason of factors such as electric utility industry restructuring, including ongoing state and federal legislative and regulatory activities; future economic conditions; developments in the domestic and international markets in which CSW and its subsidiaries operate; and other circumstances affecting anticipated business activities, revenues and [illegible]

- Completed the $2.1 billion purchase of SEEBOARD plc, a regional electricity company serving about 2 million customers in Southeast England.

- Recognized for the second consecutive year as one of the top U.S. electric utilities in customer satisfaction, based on surveys by the University of Michigan School of Business Administration and the American Society for Quality Control; CSW ranked first in the 1995 survey.

- Named Utility of the Year by *Electric Light & Power* magazine.

- SEEBOARD was ranked as the leading regional electricity company in customer service by the U.K. government's Office of Electricity Regulation.

- Secured certification for CSW Communications as the first exempt telecommunications company under the Telecommunications Act of 1996.

- Began construction on the first major cogeneration project to be built in Mexico; CSW International is a 50 percent joint-venture partner with the Mexican chemical firm Alpek.

- Acquired for $40 million a minority interest in Vale, a private electric distribution company in Brazil serving approximately 600,000 customers.

- Formed CSW/ICG ChoiceCom,SM a venture equally owned by CSW Communications and ICG Communications; it plans to provide local and long-distance telephone and data services to customers in Texas, Oklahoma, Louisiana and Arkansas.

- Broke ground for a 330-megawatt cogeneration plant at Phillips Petroleum Company's complex at Sweeny, Texas; the plant is expected to be completed in 1998.

- Launched a joint venture between SEEBOARD and Amoco to market natural gas in the United Kingdom, where the gas supply market is being opened to full competition.

- Received franchises to build telecommunications systems in Austin and Corpus Christi, Texas.

- Sold our former intrastate natural gas pipeline and marketing subsidiary, Transok, Inc., for a total consideration of $890 million and applied most of the cash proceeds to the purchase of SEEBOARD.

- Restructured on a functional basis our electric utility business in the United States into key lines of business: power generation, energy delivery and energy services.

- EnerShop entered negotiations for its first million-dollar contract to provide energy retrofit services for a 36-story office tower in Dallas.

- Became the first American business to use Deliberative Polls,SM an innovative approach for involving our customers in decisions about future energy planning.

- Named Utility of the Year by the American Wind Energy Association.

- Honored by U.S. Department of Energy for our energy efficiency and renewable energy programs.

emerging.

Chairman's Letter

A new Central and South West Corporation is emerging—one that differs dramatically from the CSW of the past.

We have become global in scope, and our operations now range far beyond the generation and delivery of electricity. We are competing in independent power and telecommunications markets and are developing a wide range of energy-management services.

For anyone who still thinks of CSW simply as a holding company with four electric utilities in the southwestern United States, one fact should be eye-opening:

We now have more customers outside the United States than we have in this country.

Our evolution from a regional electric utility system to a global, market-driven business will accelerate in 1997 as we build on our new base and strengthen our corporate positioning and identity in the marketplace.

New Markets, New Priorities

The changes we're making in our company are being driven by new investment opportunities around the world and by increasing competition among electric utilities in the United States.

Many nations today are opening their borders to foreign investment in the energy sector. From Mexico to Thailand, governments are choosing to finance the expansion of their energy infrastructure to support economic growth by encouraging partnerships with experienced companies abroad. At the same time, several national utility systems, from Europe to Australia, are being privatized. These new policies represent unprecedented opportunities.

In the United States, federal and state policymakers are reshaping many of the regulations that govern electric utilities. They are considering ways to create competitive markets by requiring electric utilities to "unbundle" their major services. They are being encouraged principally by large industrial energy users, which want to shop for the lowest-cost electricity.

Accordingly, we are pursuing two strategic priorities:

- Anticipate the new direction of the industry worldwide and take advantage of opportunities for enhancing our customer base, our services and our financial performance.
- Influence state and federal policies to assure that any new legislation is fair to all of our constituencies, including our shareholders, customers and employees.

Shaping Policy Changes

No issue is more crucial to CSW than the electric utility restructuring being considered by state and federal policymakers.

We support fair competition. We are positioned to succeed because we have relatively low costs, economically healthy service areas, a diverse business base, enterprising management and a high credibility with our customers and employees. But we cannot support initiatives aimed at increasing competition in ways that do not adequately protect our shareholders and our customers.

E.R. Brooks
Chairman, President and
Chief Executive Officer

For that reason, we are supporting some industry restructuring proposals and opposing others, based on three criteria:

- *All* classes of customers, not just the largest ones, should benefit from restructuring.
- Our shareholders should be reimbursed for investments made by our companies on behalf of our customers and approved by regulators.
- The reliability and integrity of the electric power system should not be compromised.

We are expressing these views to regulatory and legislative bodies in Washington and in the capitals of the states we serve. In particular, we are proposing that existing obstacles to competition in our industry be removed before restructuring is considered.

One of the most serious obstacles to competition is the Public Utility Holding Company Act of 1935. Only 14 active registered public utility holding companies are regulated under this outdated law. Other utilities can develop new lines of business, acquire other companies or expand their services at will. Although recent actions by the Securities and Exchange Commission have liberalized the investment rules under PUHCA, utility holding companies like CSW must still obtain authority from the SEC for even the most routine transactions. Significantly, the industrial companies now selling power at wholesale are exempt from this law.

A coalition of major utilities, with CSW at the forefront, is seeking the repeal of PUHCA. In 1996 PUHCA-repeal legislation having strong bipartisan support was introduced in Congress. For only the second time in our history, we asked you, our shareholders, to help by writing letters to your elected representatives. We were gratified that more than 3,000 of you took action. Your letters had a significant influence on members of Congress. Although the repeal bill did not reach a floor vote last year, the legislation is expected to come before Congress again this year.

Adapting to the New Era

Though the details are not yet clear, it is obvious that the electric power industry of the future will be more competitive and more global in scope. We have been preparing to succeed in this era of increased competition.

Our priorities have been to maintain the loyalty of our current customers by offering low-cost electricity and high-quality service; to expand our customer relationships—our most important strategic asset; to offer innovative new services related to our core competencies; and to seek opportunities in growing markets outside the U.S. We are on track with all four of these priorities.

- We have further reduced our costs and are competitive with other energy providers in virtually every area that we serve. In addition, we particularly are proud of our record for quality customer service. During the past two years, our U.S. utilities have been cited as among the best in the country in customer service, and SEEBOARD was named No. 1 in the United Kingdom. Our corporate reorganization in 1996, which realigned our electric power functions into separate lines of business, was driven

Our operations now range far beyond the generation and delivery of electricity.

CSW's Emerging Six Lines of Business

LINE OF BUSINESS	TYPICAL OPERATIONS	EXPECTED BUSINESS CLIMATE
Power Generation	[illegible] and fuels procurement [illegible] electricity for sale to [illegible] cooperatives [illegible]	*Competitive*
Energy Delivery	[illegible] transmission and local [illegible] to retail customers	*Regulated*
Energy Services	Energy marketing and customer programs [illegible] customer services, meter reading, [illegible] and accounting, energy efficiency and [illegible]	*Competitive*
International	Investment in and operation of power facilities and [illegible] outside the United States	*Competitive Regulated*
Communications	Telecommunications services such as Customer [illegible] telephone, data transmis[illegible] Internet and new information services	*Competitive*
Energy Trading	[illegible] trading of electricity and other forms of energy using financial instruments to manage market risks and combinations of different types of energy to meet customers' demands	*Competitive*

Energy Trading pending approval by the Federal Energy Regulatory Commission and the Securities and Exchange Commission

in large part by our emphasis on greater customer understanding and service.

- During the past two years, we have more than doubled the number of electric customers we serve with our acquisition of SEEBOARD. In addition, we have won new contracts to supply municipalities, cooperatives and other wholesale customers.
- We have been developing and marketing an array of additional services to our existing and new customers, including telecommunications and energy-management services. Our new joint venture with ICG Communications, through which we intend to provide local and long-distance telephone and data services, is a preview of the role we plan to play in communications.
- Because energy is a relatively mature industry in the United States, we are placing more emphasis on developing business in other countries, especially those with good growth rates in their energy demand and stable political and economic conditions. In addition to acquiring SEEBOARD, we have expanded into Mexico and Brazil.

Financial Performance

The overriding goal of our strategy is to provide long-term growth for our shareholders. We are pleased that we have been able to maintain the level of our dividends in the face of increasing competition. In January 1997 our board of directors continued the quarterly dividend on common stock at the existing level, having an indicated annual rate of $1.74.

The board of directors didn't increase the dividend as it had for many years in the past because our payout ratio has risen above 80 percent during the past few years. We plan to reduce it to 75 percent or below in the coming years to provide the capital needed for future growth. We believe that our new strategies will support the continuance of the underlying dividend level and our financial goal of maintaining CSW's position among the best-performing companies in our industry.

Largely because of the addition of SEEBOARD, our operating revenues and operating expenses increased significantly over those of 1995. Our net income for common stock increased almost 7 percent to $429 million and included a one-time gain from the sale of Transok of $120 million and write-offs of $104 million. Our earnings per share were $2.07, *"Central and South West exhibits unique leadership and vision in an uncertain age."*

—WAYNE BEATY, MANAGING EDITOR OF ELECTRIC LIGHT & POWER MAGAZINE

compared to $2.10 in 1995, when there were 8 percent fewer shares outstanding.

We recognize that we face two major financial challenges in 1997. First, two of our subsidiaries, Central Power and Light Company and Public Service Company of Oklahoma, have rate reviews pending before their state utility commissions. The outcomes of these cases could affect our ability to earn returns comparable to those earned in the past. Second, we are taking steps to maintain our earnings in the short term to provide a bridge over the next several years until our strategic investments begin making significant contributions.

We are focused on meeting both of these challenges to increase the overall return. We are placing a greater emphasis on managing our portfolio of assets, with the goal of increasing our earnings. This means we will work to maintain and grow an asset as long as it is performing at an acceptable level; however, we also will harvest gains through divestiture when that will achieve greater value.

That is the approach we took in selling Transok. We also will work to make the most of short-term financial opportunities that arise.

Emphasis on Long-Term Success

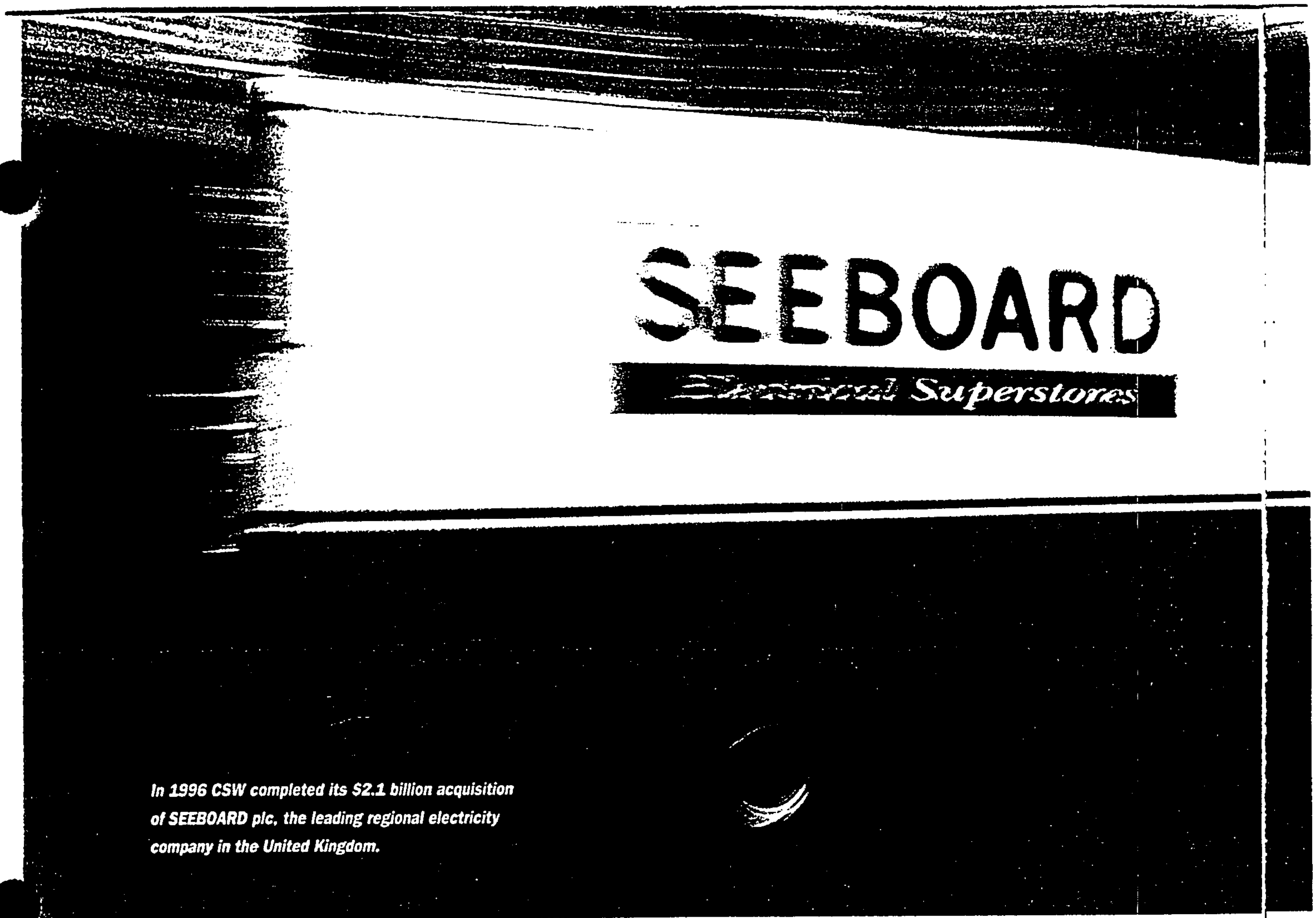
This report describes our progress in 1996, including the purchase of SEEBOARD, the restructuring of our operations, our new activities in telecommunications, the strategic sale of our former natural gas unit, Transok, and our expanding international projects. Also included are indications of some of our next steps—such as power marketing, which is awaiting federal approval, and possible additional acquisitions, now that our investment authority has been increased by the SEC from 50 percent to 100 percent of our retained earnings. We are proud of these accomplishments and plans, but their real importance lies in helping prepare CSW for continued success in the future.

All of us at CSW were extremely pleased when a leading industry publication, *Electric Light & Power*, named CSW Utility of the Year in December 1996. Our 11,500 employees earned that award by embracing change to prepare our entire corporation for the new era. Our goal, however, is not success in 1996 but a continued trend of success in the future. We see that award as a milestone on the way to emerging as a successful energy and services business for the 21st century. The ultimate beneficiaries of that success will be our customers and shareholders.

E.R. Brooks

E.R. Brooks
Chairman, President and Chief Executive Officer

February 28, 1997



In 1996 CSW completed its $2.1 billion acquisition of SEEBOARD plc, the leading regional electricity company in the United Kingdom.

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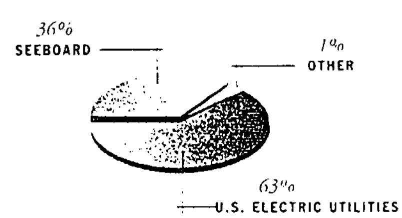
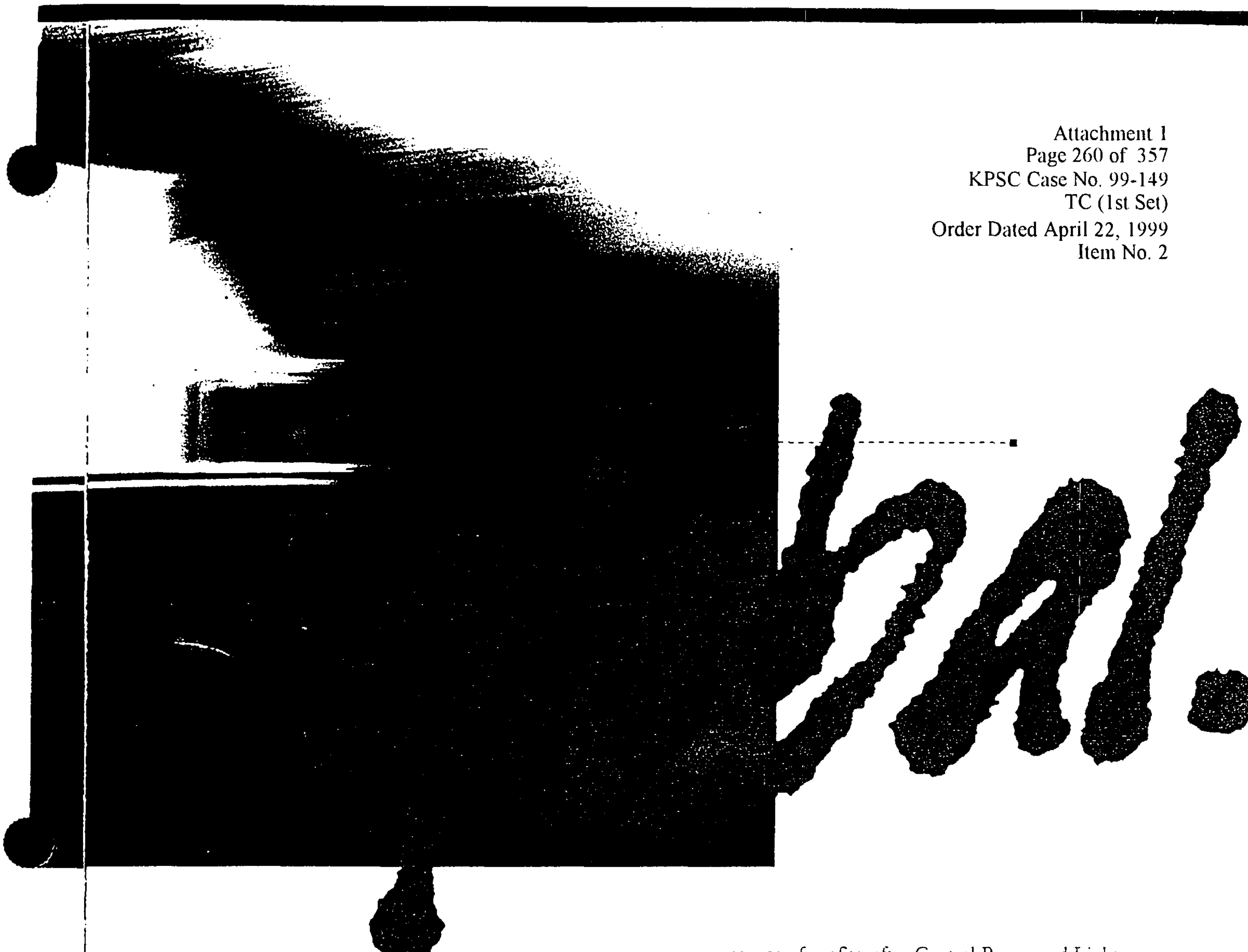
We view SEEBOARD as a springboard for CSW to pursue [illegible] in other countries, particularly in Europe.

1996 Revenues





CSW continues to invest in projects around the world because growth opportunities in other countries are frequently greater than those in the United States.

The economies and demand for energy services are growing much faster in many countries, particularly in Latin America and Asia, than in the United States. In addition, other highly developed countries—from Europe to Australia—are privatizing their government-owned utilities. We have been working to capitalize on the opportunities presented by these developments where the legal, political and economic conditions offer a high degree of security.

England. Our greatest milestone in 1996 was completing our purchase of SEEBOARD plc, the leading electric power distribution and supply company in the United Kingdom.

SEEBOARD's 2 million customers more than doubled our total customer base. In 1996 SEEBOARD proved to be our second-largest source of profits, after Central Power and Light Company, contributing 50 cents per share in earnings, or approximately 24 percent of corporate earnings.

We expect SEEBOARD to make similar contributions in the future. In addition to supplying electric power at among the lowest prices in the country, SEEBOARD provides natural gas to 6,000 business customers, owns equity in a 675-megawatt independent power plant on the Isle of Grain in Kent, provides electrical contracting and management services and operates a chain of SEEBOARD shops and superstores that sell home appliances.

In 1996 SEEBOARD launched a new joint venture with Amoco—Beacon Gas—to market

"[Mexico's] federal government is coordinating with the state and municipal governments to create and implement economic policies and regulatory reforms that will create an effective market-based economy. The Enertek project is the first large cogeneration project that will be built in Mexico under the new gas and electricity legal framework."

—MEXICAN PRESIDENT ERNESTO ZEDILLO, SPEAKING IN MONTERREY ON JULY 4, 1996, AT THE ANNOUNCEMENT OF THE ALTAMIRA COGENERATION PROJECT

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Amoco's North Sea natural gas throughout England. The natural gas industry is being deregulated in England, Scotland and Wales and will be open to full competition in 1998. Beacon Gas already is becoming a major competitor of British Gas in Southeast England by offering prices that are substantially lower. Independent research shows that Beacon Gas has emerged as a market leader, securing more than one out of four of the customers changing gas suppliers—almost twice as many as its nearest competitor.

In addition, SEEBOARD is advising and working with utilities and governments of several countries on energy management. As part of a joint venture, SEEBOARD has secured a contract to oversee a major project to modernize the electrical network for the State of Orissa in India. Other work undertaken has ranged from the training of utility managers for privatization in Thailand to advising the Uganda Electricity Board over a three-year period. We view SEEBOARD as a springboard for CSW to pursue business in other countries, particularly in Europe.

Mexico. For years we have recognized that Mexico is strategically important to CSW's growth. We serve a large portion of the Texas border with Mexico, extending from Harlingen at the southernmost point northwestward nearly 600 miles along the Rio Grande. We have been doing business with Mexico for 80 years. Because the demand for energy is growing much faster there than in the United States, Mexico is a promising market for many of our energy services.

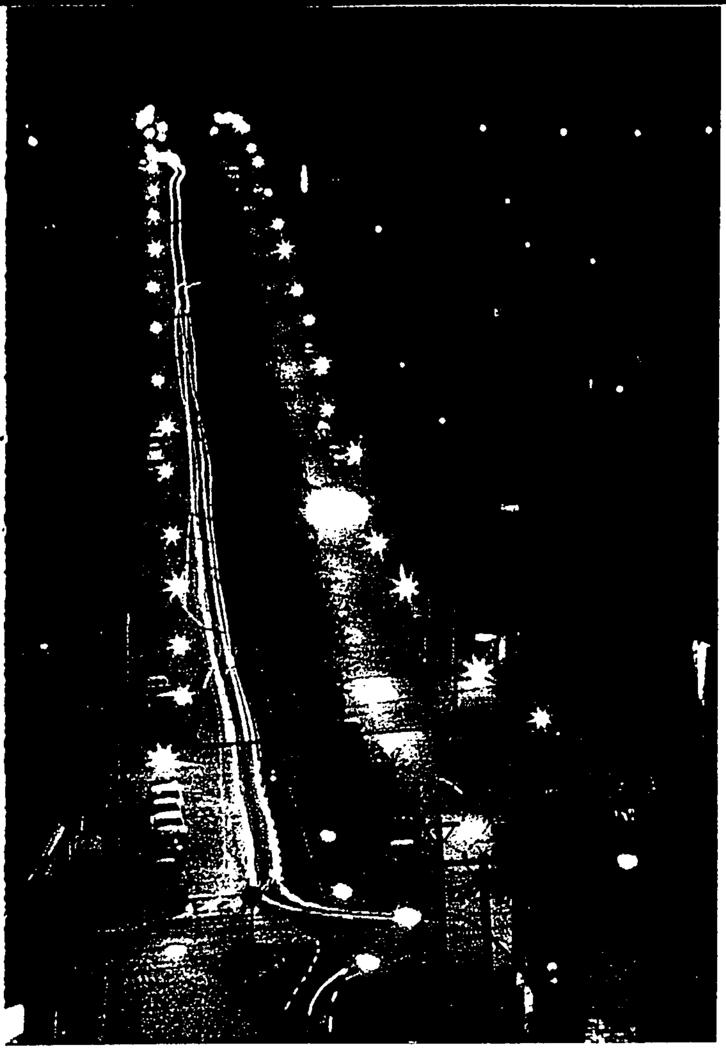
In 1996 CSW International entered into a joint venture agreement to build, own and operate a 109-megawatt gas-fired cogeneration project at Altamira, Tamaulipas. Our partner in the project is Alpek, S.A. de C.V., one of Mexico's largest privately owned petrochemical companies and part of the large Alfa industrial group. The joint venture, called Enertek, will provide steam and electricity to petrochemical firms at the Altamira complex and electricity to firms in Monterrey and other areas of Mexico.

The project is significant because it is the first major cogeneration project to be built in Mexico under a new legal framework regulating power projects. It is the first cogeneration joint venture involving an American firm, and it marks the first time that Comision Federal de Electricidad, the Mexican national electric utility, has allowed a private power producer access to its transmission services. In addition, the project has a long-term gas supply contract with Pemex, another first.

Construction at the Altamira project began in the fourth quarter of 1996. Commercial operation is expected early in 1998.

Brazil. In 1996 we also completed an equity investment in Vale, a private Brazilian electric distribution company that serves a 118,000-square-mile service area. It has equity interests in five additional electric distribution systems in the Brazilian states of Sao Paulo, Parana and Tocantins, serving approximately 600,000 customers. Vale provides opportunities for CSW International to invest further in Brazil and elsewhere in Latin America.

Also in Brazil, we are part of a consortium that was awarded a contract to conduct a feasibility study for an 1,100-megawatt hydropower



The growing demand for electricity in many countries offers CSW attractive opportunities, such as our equity investment in Vale, a private electric distribution company in Brazil.

Because the demand for energy is growing much faster there than in the United States, Mexico is a promising market.

project near Palmas, the capital of the state of Tocantins. This is the first such contract awarded to a group other than a government agency. CSW is the only U.S. firm in the consortium. The bid for constructing the power plant is expected to be issued in 1997.

Philippines. In 1996 a CSW subsidiary entered into a two-year exchange partnership with Manila Electric Company (MERALCO), the largest electric distribution utility in the Philippines. With support from the U.S. Agency for International Development, CSW and MERALCO will exchange information about such issues as demand-side management, integrated resource planning, reliability and quality of customer service.

Investment Restrictions. Under the Public Utility Holding Company Act, the SEC restricts the investments by registered utility holding companies like CSW in foreign utility companies and exempt wholesale generators, whether domestic or foreign. That restriction has been an amount equal to 50 percent of the company's most recent 12 months of retained earnings. With our SEEBOARD investment, we were approaching the limits of that ceiling. This limitation had been an obstacle in pursuing other opportunities.

In 1996 we applied for authority to increase our investments in exempt wholesale generators and foreign utility companies from 50 percent to 100 percent of our retained earnings. In January 1997 the SEC approved the request.

Teaching children about using electricity wisely and safely is one of the reasons CSW leads in national rankings of customer satisfaction. Our highly popular programs, which are performed by an independent company of actors trained in children's thea[illegible]arly half of all the elementary [illegible]ice area annually.

energy.

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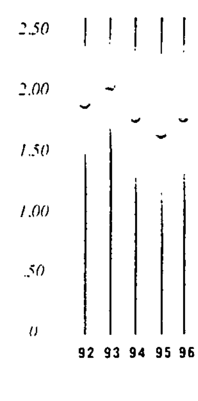
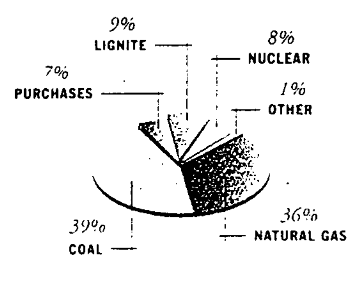
CSW U.S. Electric Utilities
Average Fuel Costs
Dollars per Million Btu



CSW U.S. Electric Utilities
1996 Energy Resources



"What is impressive about CSW's integrated resource plan is that the company voluntarily asked customers what they wanted and then acted aggressively on what they heard. The critical thing is that CSW listened. Most of the companies in this state haven't even asked." —KARL R. RABAGO, NATIONAL ENERGY PROGRAM MANAGER OF THE ENVIRONMENTAL DEFENSE FUND AND FORMER COMMISSIONER ON THE PUBLIC UTILITY COMMISSION OF TEXAS

We have expanded our U.S. energy business from the operation of our four electric utilities in the Southwest to include the construction and operation of independent power plants around the country. During the next phase of expansion, we intend to become an energy trader once we receive federal regulatory approval.

U.S. Electric Utilities

Our core business is our four electric utilities that operate in Texas, Oklahoma, Louisiana and Arkansas. In 1996 they provided 63 percent of our revenues and 57 percent of our earnings, or $1.18 a share. Earnings were affected by the recording of reserves for utility investments, restructuring charges and regulatory matters.

Their combined service areas are economically diverse, ranging from agriculture to high-tech firms to petrochemicals and other heavy industries. We forecast that retail kilowatt-hour sales in our service areas will grow at an average rate of 2.2 percent a year during the next decade, compared to an average growth of 1.6 percent for the West South Central region of the country as a whole.

Competition Strategies. Because of both regulatory and market changes now taking place, all electric utilities are feeling the pressures of competition. Open competition for wholesale power customers has benefited CSW because we have gained far more business than we have lost. Unless we continue to offer competitive prices and become their preferred supplier based on superior customer service, we know we cannot expect to retain our customers—whether wholesale or retail. Therefore, we have been working to reduce our costs and to provide only the best in customer service.

In 1996 we addressed both objectives through our Electric Business Initiatives, a program that has essentially reshaped our business to meet our customers' changing needs. We reorganized the activities in our communities to focus our employees on business development and other community programs and to pay greater attention to the customer. Responsibility for answering routine questions and receiving payments was shifted to 24-hour telephone service centers and local stores that work cooperatively with us. These initiatives are helping us reduce costs and improve customer service through increased value and greater customer choice.

Competitive Pricing. Our utilities continue to be among the low-cost suppliers in the region we serve. Public Service Company of Oklahoma sells electricity at the lowest average retail prices in the Southwest, and Southwestern Electric Power Company follows closely behind.

Our competitive prices helped us add another new wholesale customer in 1996. West Texas Utilities Company won a contract to provide electricity to the City of Weatherford, Texas. The contract is expected to save residents there an average of 13 percent on their electric bills.

We currently are competing against two other groups to acquire the non-nuclear generating assets of Cajun Electric Power Cooperative, Inc., which is operating in bankruptcy. With the assets would come the right to serve Cajun's member electric cooperatives. Our Southwestern Electric Power Company subsidiary has filed a plan to acquire the Cajun assets for $780 million in cash. An additional amount up to $27 million would pay other bankruptcy expenses and would purchase certain other claims. Our proposal to supply Cajun's member cooperatives for 25 years represents the

A well-known symbol of the Southwest, the windmill, is being replaced by efficient solar-powered pumps for livestock watering and other remote pumping applications. The patented Solamotor™ water pumping system that we offer customers takes advantage of our area's abundant renewable energy from the sun.

lowest electricity cost of all the bids made. Cajun sells power to 12 electric cooperatives that serve about 1 million consumers throughout Louisiana.

Customer Service. Our high-quality customer service earned us recognition as No. 1 among electric utilities in the country for 1995, and best among electric utilities in our region for 1996. The annual index of customer satisfaction is compiled jointly by the University of Michigan School of Business Administration and the American Society for Quality Control.

In addition to our ongoing customer-service initiatives, three of our U.S. utilities conducted an unprecedented project in 1996. They involved customers in our energy-resource planning process in response to a requirement of the Public Utility Commission of Texas. Each of the three utilities worked with Professor James Fishkin, chairman of the Government Department at The University of Texas at Austin, to conduct its own Deliberative Poll,™ a process Dr. Fishkin developed.

As part of the polls, representative groups of customers from each company were assembled for a weekend to learn in detail about the energy issues facing the region and the options for meeting those needs. The groups discussed the issues with utility representatives, state utility regulators, leaders of environmental organizations and other energy advocates and then deliberated their preferred choices.

In all the polls, customers recommended a mix of options for meeting future energy needs rather than any single strategy. For example, Central Power and Light Company's customers preferred, in order of preference, energy efficiency activities, a new fossil-fuel power plant, renewable energy programs and power transported from other regions. Nearly three-fourths of the participants rated the Deliberative Poll process a 10 on a scale of 1 to 10 in assessing its usefulness.

We have taken these recommendations seriously. They guided us when we developed a new integrated resource plan that was filed with the Texas PUC in early 1997. This plan integrates the resource needs of Central Power and Light Company, Southwestern Electric Power Company and West Texas Utilities Company. The plan reflects the attitudes of our customers who participated in the Deliberative Polls, presenting a diverse mix of strategies and featuring renewable energy sources. Many customers indicated they are willing to pay a premium for these renewable resources.

Renewables. In 1996 our nationally recognized renewable energy project near Fort Davis, Texas, continued to be honored for its pioneering work. Our renewables project is a $17 million, five-year program that we began in 1993. Its purpose is to develop and evaluate a variety of wind, solar and other renewable energy tech-

Our utilities continue to be among the low-cost suppliers in the region we serve.

nologies on a major utility system. In 1996 the American Wind Energy Association presented CSW with its Utility of the Year award, and the U.S. Department of Energy cited the project as a Special Recognition winner among utilities in its National Awards for Energy Efficiency and Renewable Energy. In early 1997 CSW's renewable energy program won Renew America's annual Award for Environmental Sustainability in the Renewable Energy Category.

We believe our commitment to developing and operating renewable energy resources could have a distinct market advantage because of a preference for green power that has appeared in some of the prototype experiments with open competition in electric power supply. In the integrated resource plan we filed with the Texas PUC in early 1997, we propose to test consumer attitudes toward renewables to see whether their expressed preferences are confirmed by their buying behavior. Part of our plan also involves educating children about renewable energy by installing solar energy systems at more than 50 schools in our service areas.

Independent Power Plants

CSW Energy, our subsidiary that develops, acquires, constructs, owns and operates cogeneration and independent power plants in the United States, has five projects in operation and is actively working on several others that will increase its contribution to our revenues during the next two years.

The five independent power plants now operating are located in Fort Lupton and Brush, Colorado; Bartow, Florida (two); and Wharton, Texas. CSW Energy owns the equivalent of 365 megawatts of their total output of 648 megawatts. All the plants burn natural gas for fuel.

1996 Milestones. In 1996 CSW Energy completed the recommissioning of its Newgulf power facility in Wharton, Texas. It is an 85-megawatt, combined-cycle facility and the first exempt wholesale generator developed in Texas.

We also broke ground in 1996 for our largest independent power project, a 330-megawatt plant that is being built at Phillips Petroleum Company's complex at Sweeny, Texas. It will be the first power plant in the state that uses residue gas—a byproduct of the refining process—as fuel, supplemented by natural gas. When completed in 1998, the project will provide steam and power to Phillips' petrochemical complex and to other purchasers. Ultimately, CSW Energy will own 50 percent of the project.

Energy Trading

We have applied to the Federal Energy Regulatory Commission for permission to operate as an energy trading firm. For years our four electric utilities have bought, sold and traded electricity with many other utilities. Our system's wide geographic expanse, along with the 39 interconnections we have with other utilities, has added to our power trading abilities. Now we plan to trade electricity on the open market, matching supplies with utilities or other customers that need them. We expect to begin competitive energy trading and marketing in mid-1997.

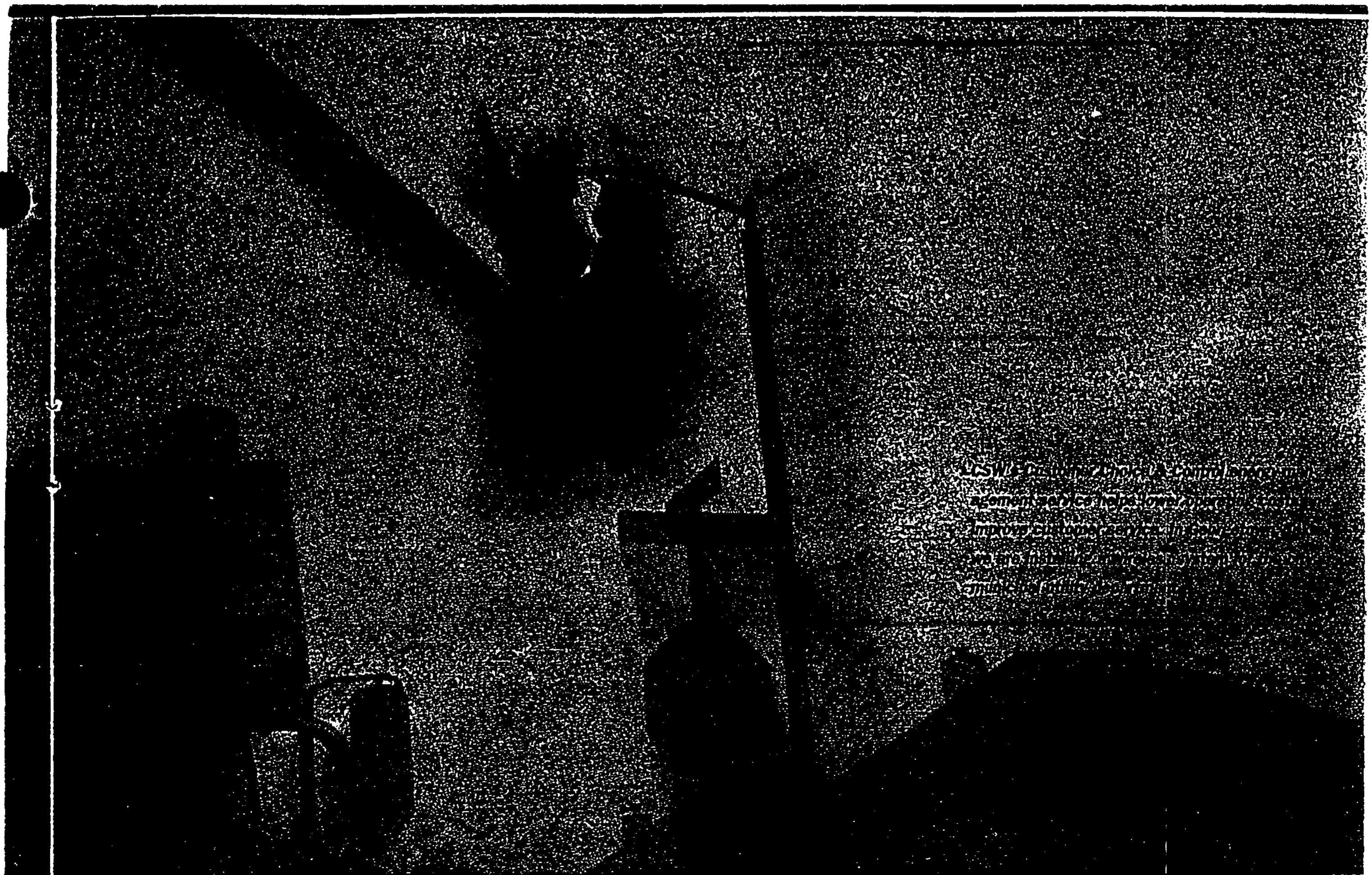
One of the opportunities that competition presents is the freedom to provide additional services to our customers. Among the new services we have been developing, two already are showing considerable promise—communications and energy management.

Communications. For the past two years, CSW Communications has been testing our Customer Choice & Control™ service in a development program in Laredo, Texas. The program now includes more than 700 households on its network. We installed a hybrid network of fiber-optic and coaxial cables to provide a range of services, including automated meter reading, power-outage detection, time-of-day pricing of electric power and the programming of appliances to use power when it is least expensive. Our pilot program will continue to test new generations of energy management and telecommunications technology. Customers participating in the program have saved an average of 7 percent to 10 percent on their electric bills.

We saw so much potential in services like these that, only hours after President Clinton signed the Telecommunications Act of 1996, CSW Communications filed to become the first exempt telecommunications company approved by the Federal Communications Commission. That designation freed us from restrictions that had limited our involvement in telecommunications under the Public Utility Holding Company Act and some state laws.

Since then we have reached several important milestones.

- In January 1997 CSW Communications entered a venture to provide telecommunications services, including local exchange and long-distance telephone services and data transmission, to customers in Texas, Oklahoma, Louisiana and Arkansas. Our partner in the



Only hours after President Clinton signed the Telecommunications Act of 1996, CSW Communications filed to become the first exempt telecommunications company.

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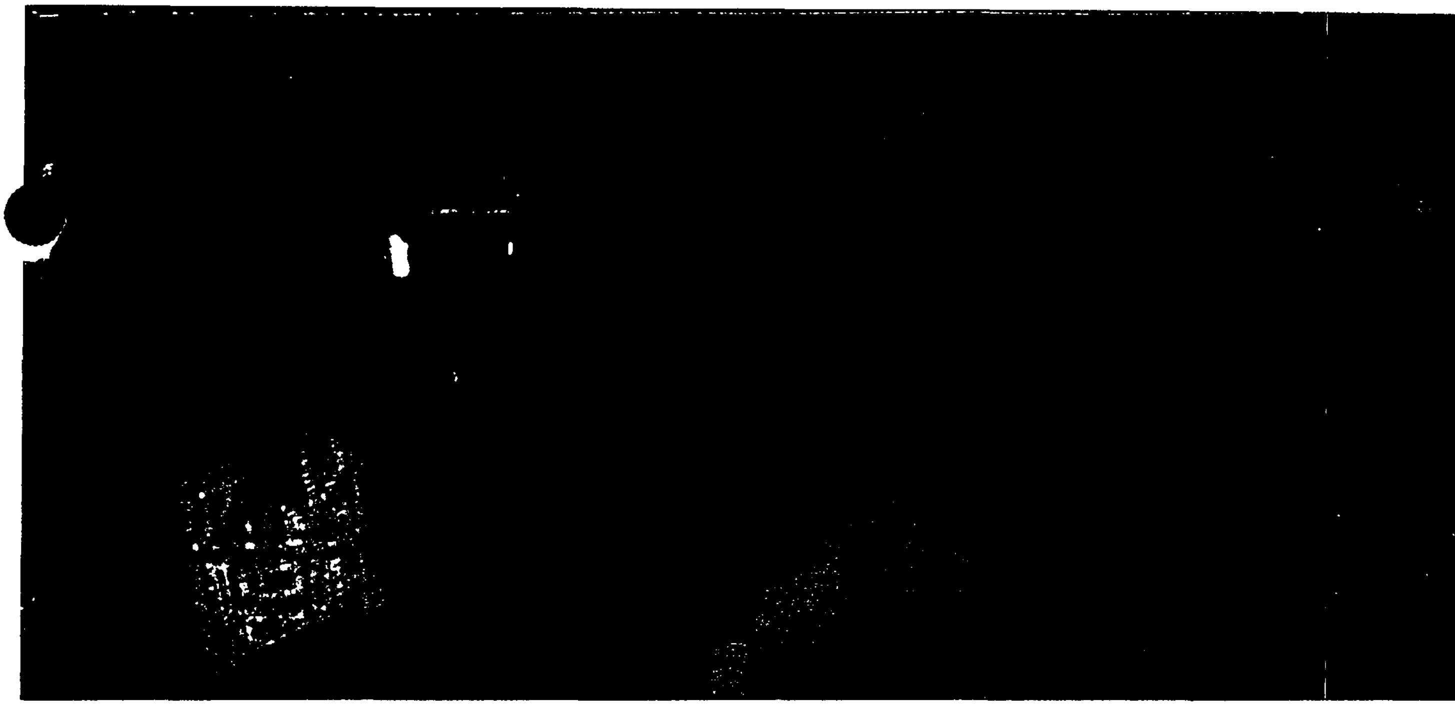

Utilities like the CSW system have long operated giant telecommunication networks to keep power flowing reliably. Now we are planning to offer advanced telephone and data services to our customers at competitive prices, with additional expansion in the future.

EnerShop entered into negotiations for its first million-dollar contract in 1996.

venture is ICG Communications, Inc., of Englewood, Colorado. The new joint venture company is called CSW/ICG ChoiceCom™ and will be based in Austin, Texas. It plans initially to serve Austin and Corpus Christi, Texas, while developing plans to operate in other cities in the four states we serve. The venture also plans to expand CSW Communications' existing city-to-city fiber network business.

- In 1996 CSW Communications won competitive bids to build wireless utility management systems in Austin and Georgetown, Texas. The Austin project is a pilot for 800 electric and 400 water customers of the city-owned electric and water departments. For the City of Georgetown, CSW Communications is installing its Customer Choice & Control energy-management service to provide water management as well as electricity conservation.
- We are moving to establish similar two-way wireless communications projects in key cities within the states the CSW system serves.

"We'd like to discover whether people really can shift their peak load consumption, whether they like it and whether they are comfortable." -CAROL GITTINGER OF THE CITY OF AUSTIN'S ELECTRIC UTILITY DEPARTMENT, TALKING ABOUT THE PILOT PROGRAM FOR 800 CUSTOMERS THAT THE EUD WILL CONDUCT WITH CSW COMMUNICATIONS

▪ In 1996 we applied our energy management and telecommunications skills to a new service that is making it easier for our customers to understand, analyze and manage their energy use. Homeview,™ our interactive online home energy-analysis service, allows customers to sign on to a confidential Internet address and to conduct a customized analysis of their energy use. Homeview provides a detailed report to the customer about ways to improve efficiencies and reduce costs.

▪ Under a grant from the U.S. Department of Energy, CSW Communications began expanding its Customer Choice & Control project in Laredo to offer energy-management services via the Internet. During an 18-month study, we will develop an Internet service provider for Laredo and will offer certain Customer Choice & Control energy-management services over the Internet. Technical assistance on the project is being provided by Los Alamos National Laboratories. The Department of Energy is seeking to learn how Internet access and advanced energy-management services might be made available by utilities to cities throughout the country.

Energy Services. EnerShop, a subsidiary we formed in 1995 to help major energy users reduce their costs, entered into negotiations for its first million-dollar contract in 1996. EnerShop provides comprehensive energy-management services—design, construction, retrofitting and financing—for commercial, industrial, institutional and governmental customers in the Southwest. It also offers performance guarantees for the services it provides.

In 1996 EnerShop agreed in principle with the Hall Financial Group of Dallas to retrofit the lighting, energy-management system and other electrical equipment of Harwood Center, a 36-story office tower in downtown Dallas. The project is guaranteed to reduce the building's annual electric bill by almost $250,000, providing a full payback to Hall Financial within four years.

EnerShop also completed its first project in 1996. It installed high-efficiency lighting and chillers and provided energy-management services for the Matagorda County, Texas, courthouse and other county buildings. EnerShop had several major proposals pending in early 1997.

New electrotechnologies can improve homes, businesses and communities. For example, electric-powered bicycles, donated by CSW to lice departments in our larger cities, are helping officers patrol wntown streets and parks to make our communities safer.

business.

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We will continue to manage our portfolio of assets with the goal of maximizing shareholder value.

"As businesses expand into new international markets, they must take into account the full range and meaning of diversity if they are to succeed with people of different cultures." —DR. R. ROOSEVELT THOMAS, JR., AUTHOR, SCHOLAR AND A LEADING AUTHORITY ON CULTURAL DIVERSITY, WHO SERVES AS CONSULTANT TO CSW

The increasing competition in the electric power industry has led us to make major changes in the way we organize, manage and conduct our business.

Speed has become more important than ever, allowing us to take advantage of windows of opportunity before they close. As an example, our entire negotiation with SEEBOARD—from the initial meeting to completing the transaction—took place in only a few months. The competitive world is much faster-paced than the regulated one.

Similarly, we have learned that our operational and financial objectives can be achieved only by a management structure that is efficient and reflects our broad corporate goals. Therefore, we must apply an asset-management philosophy that is constantly re-examining our portfolio of holdings to assure that it is as productive as possible.

Corporate Structure. In 1996 we took another major step in preparing CSW for more competition. Continuing a realignment of our electric power operations begun in 1993, we implemented a more sweeping restructuring, one designed to assure that our businesses are organized to reflect our corporate strategies and goals. Under our new structure, the vertically integrated parts of our electric operations—generation, transmission and distribution, and energy services—were separated by function and realigned as separate lines of business. The assets of each electric company remain on that company's books; no assets changed hands.

This new structure, which also reduced the layers of management and the number of company officers, is expected to result in more efficient operations and more effective business units. So far, it has reduced our workforce by about 200 employees. It also has put in place a management structure to address increasing competition and unbundling in the electric power industry. It is consistent with our vision of where the industry is going and how it likely will evolve.

Asset Management. As we work to increase our earnings, we will be re-examining all of our assets more critically to assure that they are contributing adequately to our financial goals. If we find that any of our holdings would be more valuable to another owner than it is to us, we are prepared to sell it. We will use the proceeds to acquire other assets that we believe will contribute more to our goals.

Our decision to sell our former natural gas distribution and marketing company, Transok, Inc., is a good example of this approach. We acquired Transok in 1955 and began operating it as a corporate business unit in 1982. Since then, we had increased its assets by a factor of five. But as a registered public utility holding company, we were limited in the ways we could expand Transok. For example, we could not use it to sell gas to other utilities, and state utility commissions limited Transok's ability to do business with our own regulated utilities.

We believed that Transok might be a more valuable asset to a corporation that did not have these restrictions. As a result, we sold Transok to Tejas Gas Corporation. We received $690 million in cash, and Transok retained $200 million of its existing debt. We applied most of the proceeds to help repay the interim financing for SEEBOARD, which we believe will provide a greater long-term return than Transok would have provided.

We will continue to manage our portfolio of assets with the goal of maximizing shareholder value and maintaining a strong credit quality through a strong balance sheet.

Financing Highlights. CSW contributed approximately $829 million of the purchase price to complete the acquisition of SEEBOARD.

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CSW initially obtained the funds through interim borrowings from a consortium of banks. These borrowings subsequently were repaid in full with the proceeds from an offering of approximately 15.5 million shares of CSW common stock, which raised approximately $398 million, and from the sale of Transok.

The remaining $1.3 billion for the purchase of SEEBOARD was obtained initially through interim borrowings in the U.K. from a second consortium of banks. These borrowings were refinanced in full through several transactions completed in 1996, including the issuing of $400 million of notes and approximately $156 million of Eurobonds, a fixed-rate loan, an accounts receivable securitization and the use of a portion of SEEBOARD's cash.

In addition to refinancing all of the SEEBOARD acquisition debt in 1996, we completed the refinancing of $205 million of higher-cost debt, resulting in net present value savings of about $25 million. We also began offering our dividend reinvestment and stock purchase program, PowerShare™, nationwide. In the past, it had been available to employees, retirees, shareholders and other individuals only in the states that our utilities serve.

Rate Issues. Our Central Power and Light Company subsidiary has an application pending to raise its retail base rates by $71 million. This is the first rate increase that CPL has sought in more than four years.

In its testimony in the rate case, the staff of the Texas PUC initially recommended an annual increase of $30 million but later revised the amount to $20 million. Another intervenor, the Office of Public Utility Counsel, recommended a decrease of $75 million in annual rates, and several cities that CPL serves asked for a reduction of about $52 million annually.

In May 1996 CPL put a base rate increase of approximately $70 million into effect under bond, subject to refund depending on the final order of the Texas PUC.

In January 1997 the administrative law judges who had tried the case proposed a decision that would allow CPL a net annual revenue increase of only $7.2 million. This proposal is extremely disappointing because it would fail to allow CPL to recover its reasonable costs, as provided by state regulatory laws and previous rate case settlements. The proposal also would defer to the future costs that should be charged to customers now. As a result, CPL has filed exceptions to the proposal for the full commission to consider. The Texas PUC is expected to rule on the CPL rate request in March 1997. (For additional details, please see Management's Discussion and Analysis of Financial Condition and Results of Operations in Appendix A.)

In January 1997 CPL filed a request to recover approximately $24 million in underrecovered fuel costs and to increase its fuel factors because of higher natural gas costs. The Texas PUC in February 1997 approved a settlement that allows CPL to surcharge customers for $22 million of underrecovered fuel costs beginning in the summer of 1997 and to increase its annual fuel factors by $29 million.

In July 1996 the Oklahoma Corporation Commission began a review of the rates and earnings of our Public Service Company of Oklahoma subsidiary. In late 1996 PSO responded with its rate filing. Customers' bills, beginning with PSO's June 1997 billing cycle, are subject to refund if the OCC orders a rate decrease.

El Paso Electric Litigation. In January 1997 litigation between CSW and El Paso Electric Company over a terminated merger between the two companies went to trial in U.S. Bankruptcy Court in Waco, Texas. CSW contends that it rightfully terminated the merger agreement based on a failure of the conditions required to be fulfilled and after El Paso Electric breached the terms of the agreement and failed to remedy material adverse effects as required under the agreement. El Paso Electric contends that CSW wrongfully terminated the agreement. The judge is expected to issue a decision in March 1997. (For additional details, please see Management's Discussion and Analysis of Financial Condition and Results of Operations in Appendix A.)

Financial Information

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Condensed Consolidated Statements of Income

CENTRAL AND SOUTH WEST CORPORATION

For the Years Ended December 31,	1996	1995	1994
	(millions, except per share amounts)		
Revenues			
U.S. Electric	$3,248	$2,883	$3,065
United Kingdom	1,848	208	–
Other Diversified	59	52	40
	5,155	3,143	3,105
Expenses			
U.S. Electric Fuel and Purchased Power	1,228	1,045	1,161
United Kingdom Cost of Sales	1,331	158	–
Operations and Maintenance	935	712	710
Depreciation and Amortization	464	353	324
Taxes	402	254	355
	4,360	2,522	2,550
Operating Income	795	621	555
Other Income and Deductions	(61)	99	109
Interest Charges	(419)	(324)	(277)
Income from Continuing Operations	315	396	387
Income from Discontinued Operations	12	25	25
Gain on Sale of Discontinued Operations	120	–	–
Net Income	447	421	412
Preferred Stock	18	19	18
[illegible] Income for Common Stock	$ 429	$ 402	$ 394
Average Common Shares	207.5	191.7	189.3
Earnings per Share	$ 2.07	$ 2.10	$ 2.08
Dividends Paid per Share	$ 1.74	$ 1.72	$ 1.70

The condensed consolidated financial statements in this summary annual report were derived from the consolidated financial statements that appear in Appendix A to the proxy statement for the 1997 annual meeting of shareholders. Copies of the consolidated financial statements and the reports of the Corporation's independent public accountants thereon may be obtained by calling Central and South West Corporation's Investor Services Department at 1-800-527-5797.

Condensed Consolidated Statements of Cash Flows

CENTRAL AND SOUTH WEST CORPORATION

For the Years Ended December 31,	1996	1995	1994
		(millions)	
Operating Activities			
Net Income	$ 447	$ 421	$ 412
Depreciation and Amortization	521	425	402
Other Adjustments to Net Income and Changes in Assets and Liabilities	(93)	(47)	(50)
	875	799	764
Investing Activities			
Construction Expenditures	(521)	(474)	(578)
Acquisition Expenditures	(1,394)	(421)	(21)
CSW Energy/International Projects	(124)	109	(115)
Cash Proceeds from Sale of Subsidiary	690	–	–
Other	63	(26)	(2)
	(1,286)	(812)	(716)
Financing Activities			
Change in Common Stock	477	57	50
Change in Debt and Preferred Stock	219	597	288
Payment of Dividends	(376)	(348)	(340)
	320	306	(2)
Effect of Exchange Rate Changes on Cash	(56)	–	–
Net Change in Cash and Cash Equivalents	(147)	293	46
Cash and Cash Equivalents - January 1	401	108	62
Cash and Cash Equivalents - December 31	$ 254	$ 401	$ 108

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In addition to refinancing all of the SEEBOARD acquisition debt in 1996, we completed the refinancing of $205 million of higher-cost debt, resulting in net present value savings of about $25 million. We also began offering our dividend reinvestment and stock purchase program, PowerShare™, nationwide. In the past, it had been available to employees, retirees, shareholders and other individuals only in the states that our utilities serve.

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In its testimony in the rate case, the staff of the Texas PUC initially recommended an annual increase of $30 million but later revised the amount to $20 million. Another intervenor, the Office of Public Utility Counsel, recommended a decrease of $75 million in annual rates, and several cities that CPL serves asked for a reduction of about $52 million annually.

In May 1996 CPL put a base rate increase of approximately $70 million into effect under bond, subject to refund depending on the final order of the Texas PUC.

In January 1997 the administrative law judges who had tried the case proposed a decision that would allow CPL a net annual revenue increase of only $7.2 million. This proposal is extremely disappointing because it would fail to allow CPL to recover its reasonable costs, as provided by state regulatory laws and previous rate case settlements. The proposal also would defer to the future costs that should be charged to customers now. As a result, CPL has filed exceptions to the proposal for the full commission to consider. The Texas PUC is expected to rule on the CPL rate request in March 1997. (For additional details, please see Management's Discussion and Analysis of Financial Condition and Results of Operations in Appendix A.)

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CENTRAL AND SOUTH WEST CORPORATION

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	(millions, except per share amounts)		
Revenues			
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Construction Expenditures	(521)	(474)	(578)
Acquisition Expenditures	(1,394)	(421)	(21)
CSW Energy/International Projects	(124)	109	(115)
Cash Proceeds from Sale of Subsidiary	690	–	–
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Change in Common Stock	477	57	50
Change in Debt and Preferred Stock	219	597	288
Payment of Dividends	(376)	(348)	(340)
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Condensed Consolidated Balance Sheets

CENTRAL AND SOUTH WEST CORPORATION

As of December 31,	1996	1995
	(millions)	
Assets		
Electric	$13,337	$12,891
Gas	–	869
Other Diversified	84	18
Accumulated Depreciation	(4,940)	(4,761)
Net	8,481	9,017
Current Assets	1,533	2,039
Deferred Charges and Other Assets		
Goodwill	1,525	1,074
Other	1,793	1,739
	$13,332	$13,869
Capitalization and Liabilities		
Common Stock	$ 3,802	$ 3,178
Preferred Stock	325	326
Long-Term Debt	4,024	3,914
Total Capitalization	8,151	7,418
Current Liabilities	2,425	3,627
Deferred Credits	2,756	2,824
	$13,332	$13,869

Report of Independent Public Accountants

To the Shareholders and Board of Directors of Central and South West Corporation:

We have audited, in accordance with generally accepted auditing standards, the consolidated balance sheets of Central and South West Corporation (a Delaware corporation) and subsidiary companies as of December 31, 1996 and 1995, and the related consolidated statements of income, stockholders' equity and cash flows for each of the three years in the period ended December 31, 1996, appearing in Appendix A to the proxy statement for the 1997 annual meeting of shareholders of the Corporation (not presented herein). Our report dated February 28, 1997, also appearing in that proxy statement, contained an explanatory sentence calling attention to the fact that we did not audit the financial statements of CSW Investments, which statements reflect total assets and revenues of 23 percent and 36 percent in 1996 and 20 percent and 6 percent in 1995, respectively, of the consolidated totals. Those statements were audited by other auditors whose report has been furnished to us and our opinion, insofar as it relates to the amounts included for those entities, is based solely on the report of the other auditors.

In our opinion, based on our audits and the report of other auditors, the information set forth in the accompanying condensed consolidated balance sheets as of December 31, 1996 and 1995, and in the related condensed statements of consolidated income and cash flows for each of the three years in the period ended December 31, 1996, is fairly stated, in all material respects, in relation to the consolidated financial statements from which it has been derived.

Arthur Andersen LLP

Arthur Andersen LLP
Dallas, Texas
February 28, 1997

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Report of Manageme

The condensed consolidated financial statements in this summary annual report were derived from the consolidated financial statements that appear in Appendix A to the proxy statement for the 1997 annual meeting of shareholders. Management is responsible for preparing the consolidated financial statements, in accordance with generally accepted accounting principles appropriate in the circumstances, and for maintaining the Corporation's systems of internal accounting controls.

A description of these controls, along with management's opinion about their overall effectiveness, is contained within the Report of Management included in Appendix A to the proxy statement for the 1997 annual meeting of shareholders. The consolidated financial statements were audited by the Corporation's independent public accountants, whose report on the condensed consolidated financial statements appears above.

E.R. Brooks

E. R. Brooks
Chairman, President and Chief Executive Officer

Glenn D. Rosilier

Glenn D. Rosilier
Senior Vice President and Chief Financial Officer

Lawrence B. Connors

Lawrence B. Connors
Controller

Comparative Statistical and Financial Record

CENTRAL AND SOUTH WEST CORPORATION

	1996	1995	1994	1993	1992
U.S. Electric Utilities					
Electric Revenues (millions)					
Residential	$1,243	$1,138	$1,156	$1,160	$1,046
Commercial	872	810	836	832	773
Industrial	781	702	733	736	659
Sales for Resale	255	224	204	179	177
Other	97	9	136	148	135
	$3,248	$2,883	$3,065	$3,055	$2,790
Sales (kilowatt-hours in millions)					
Residential	17,883	16,872	16,368	15,903	14,593
Commercial	14,256	13,755	13,463	12,966	12,370
Industrial	20,266	19,321	18,869	18,205	17,257
Sales for Resale	8,428	8,468	7,133	5,852	6,262
Other	1,592	1,518	1,501	1,434	1,363
	62,425	59,934	57,334	54,360	51,845
Average Number of Customers (thousands)					
Residential	1,443	1,425	1,403	1,378	1,353
Commercial	209	207	203	198	195
Industrial	24	24	24	25	25
Other	14	13	13	12	12
	1,690	1,669	1,643	1,613	1,585
Number of Customers- End of Period (thousands)	1,704	1,683	1,661	1,633	1,599
Residential Sales Averages					
Kilowatt-Hours per Customer	12,392	11,840	11,665	11,541	10,786
Revenue per Customer	$861	$799	$824	$842	$773
Revenue per Kilowatt-Hour	6.95¢	6.75¢	7.06¢	7.29¢	7.17¢
Total Electric Revenue per Kilowatt-Hour	5.20¢	4.81¢	5.35¢	5.62¢	5.38¢
System Peak Demand (megawatts)	12,613	12,314	11,434	11,464	10,606
Fuel Data					
Average Btu per Net Kilowatt-Hour	10,440	10,299	10,344	10,391	10,482
Cost per Million Btu	$1.81	$1.58	$1.82	$2.11	$1.92
Cost per Kilowatt-Hour Generated (mills)	18.86	16.30	18.80	21.90	20.12
CSW System					
Total Plant (millions)					
Cost	$13,421	$13,778	$11,868	$11,343	$10,826
Annual Additions	583	1,933	616	594	457
Accumulated Depreciation	4,940	4,761	3,870	3,550	3,265
Capitalization (millions)					
Common Stock	$3,802	$3,178	$3,052	$2,930	$2,927
Preferred Stock	325	326	327	350	367
Long-Term Debt	4,024	3,914	2,940	2,749	2,647

The condensed consolidated financial statements in this summary annual report were derived from the consolidated financial statements that appear in Appendix A to the proxy statement for the 1997 annual meeting of shareholders. Copies of the consolidated financial statements and the reports of the Corporation's independent public accountants thereon may be obtained by calling Central and South West Corporation's Investor Services Department at 1-800-527-5797.

Board of Directors

Officers

CENTRAL AND SOUTH WEST CORPORATION

E. R. Brooks
Chairman, President and Chief Executive Officer

Thomas V. Shockley, III
Executive Vice President

Glenn Files
Executive Vice President

Ferd. C. Meyer, Jr.
Senior Vice President and General Counsel

Glenn D. Rosilier
Senior Vice President and Chief Financial Officer

Thomas M. Hagan
Senior Vice President, External Affairs

Venita McCellon-Allen
Senior Vice President, Corporate Development and Assistant Corporate Secretary

Kenneth C. Raney, Jr.
Vice President, Associate General Counsel and Corporate Secretary

Stephen J. McDonnell
Vice President, Mergers and Acquisitions

Lawrence B. Connors
Controller

Wendy G. Hargus
Treasurer

CENTRAL AND SOUTH WEST SERVICES, INC.

Richard H. Bremer
President, Energy Services

Richard P. Verret
President, Power Generation

Robert L. Zemanek
President, Energy Delivery

SEEBOARD plc
[illegible]
Chairman and Chief Executive

CENTRAL POWER AND LIGHT COMPANY
[illegible]
President

PUBLIC SERVICE COMPANY OF OKLAHOMA
T. D. (Ted) Churchwell
President

SOUTHWESTERN ELECTRIC POWER COMPANY
[illegible]
President

WEST TEXAS UTILITIES COMPANY
Floyd W. Nickerson
President

CSW ENERGY, INC.
Terry D. Dennis
President and Chief Executive Officer

CSW INTERNATIONAL, INC.
Terry D. Dennis
President and Chief Executive Officer

CSW COMMUNICATIONS, INC.
Donald A. Shahan
President

ENERSHOP INC.
Richard H. Bremer
President

CSW CREDIT, INC.
Glenn D. Rosilier
President

CSW LEASING, INC.
Glenn D. Rosilier
President

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COMMON STOCK LISTING
Central and South West Corporation's common stock is traded under the ticker symbol CSR and is listed on the New York and the Chicago stock exchanges.

You can obtain stock quotations from the New York Stock Exchange report in most daily newspapers.

COMMON STOCK DIVIDENDS
Dividends of 43.5 cents a share were paid in each quarter of 1996. All dividends paid by the Corporation represent taxable income to shareholders for federal income tax purposes.

In January 1997 the Corporation's board of directors maintained the quarterly dividend rate of 43.5 cents a share.

Traditionally, the Corporation's board of directors has declared dividends to be payable on the last business day of February, May, August and November. Future cash dividends will be dependent upon the policies of the Corporation's board of directors and the Corporation's earnings, financial condition and other factors.

LOST DIVIDEND CHECKS OR STOCK CERTIFICATES
If you do not receive your dividend check or stock certificate, or if either is lost, destroyed or stolen, please call our Investor Services department immediately.

STOCK TRANSFER
Central and South West Services, Inc., is the transfer agent and registrar for Central and South West Corporation's common stock and for the preferred stocks of the Corporation's subsidiary companies.

To transfer your stock to another name, write the new name, address and tax identification number on the back of the certificate and sign your name exactly as it appears on the front. Then have your signature Medallion-guaranteed by a commercial bank or stockbroker. Signatures cannot be Medallion-guaranteed by a notary public.

Your stock certificate should be sent to our Investor Services department by registered or certified mail.

If you have questions about transferring your shares, you can write or call our Investor Services department.

TAXPAYER ID NUMBER
Federal law requires each shareholder to provide a taxpayer identification number for all shareholder accounts. For individual shareholders, your ID number is your Social Security number.

You must provide your ID number whenever you open a new account in our stock, even if you already own stock in existing accounts in your name. If you do not provide the ID number, the Corporation is required to withhold 31 percent federal income tax from your dividends.

If your stock is registered in a joint account, it is important to tell us the taxpayer ID number of the primary owner you delegate. If you are custodian for a minor or act as a trustee on an account, please provide the beneficial owner's tax identification number. This will ensure that your dividends are reported under the correct name, address and taxpayer ID number.

If you have not yet given us your taxpayer ID number, please contact our Investor Services department to request a W-9 form. Complete, sign and return the form as soon as possible.

DUPLICATE ANNUAL REPORT MAILINGS
We are required to mail an annual report to all of our shareholders. You will receive duplicate mailings from us if there are two or more shareholders at the same address or if your shares are registered in different but similar names.

DIRECT DEPOSIT
We are pleased to offer direct deposit of dividend payments to your checking, savings or credit union account at any financial institution that accepts electronic direct deposits. Direct deposit eliminates the possibility of your check being lost or stolen, and the funds are credited to your account on the dividend payment date. If you would like an enrollment card, please call our Investor Services department.

PROXY AND DIVIDEND MAILINGS
Duplicate mailings of proxies and dividend checks cannot be eliminated unless the registration is the same for all of your accounts.

If your account registrations are identical, notify our Investor Services department that you want to combine your accounts. If your account registrations are different and you want to combine your accounts, all certificates must be issued in the one registration you prefer. To have your certificates reissued, follow the instructions under Stock Transfer.

1997 ANNUAL MEETING
The 1997 annual meeting of shareholders is scheduled for April 17. It will be held at the Westin Hotel, 13340 Dallas Parkway, Dallas, Texas. The meeting will begin at 10:30 a.m. Central time. If you will not be attending the meeting, please vote your shares by signing and returning your proxy card as soon as possible.

PowerShare™ Dividend Reinvestment and Stock Purchase Plan

ADDITIONAL INFORMATION

We will be pleased to send you additional copies of this summary annual report. Also available are Appendix A to the proxy statement for the 1997 annual meeting of shareholders, a preliminary quarterly financial report, a Ten-Year Financial and Statistical Review of the Central and South West System and our latest Environmental Report of the Central and South West System.

The Corporation is subject to the informational requirements of the Securities Exchange Act of 1934 and files reports and other information statements with the Securities and Exchange Commission. These reports may be inspected at the SEC's offices and on its Internet site as well as at the New York and Chicago stock exchanges.

We will provide copies of these reports without charge to any Central and South West shareholder. If you would like to receive a report, please write or call our Investor Services department.

INVESTOR SERVICES

Our Investor Services staff is available Monday through Friday from 9 a.m. to 4 p.m. Central time to answer questions you may have. Our address and telephone number are:

Central and South West Corporation
Investor Services Department
P.O. Box 660164
Dallas, Texas 75266-0164
1-800-527-5797

INVESTOR RELATIONS

Security analysts should contact:

Director of Investor Relations
Central and South West Corporation
214-777-1277

If you would like to be included on our investor relations mailing list to receive news releases and other corporate information, please contact our Investor Services department.

DESIGN: WALSH ASSOCIATES
PHOTOGRAPHY: PHILLIP RADCLIFFE, RALPH COLE AND STEVEN LEGGETT
STOCK PHOTOGRAPHY USED BY PERMISSION OF WESTLIGHT
PRINTED ON RECYCLED PAPER

The Central and South West Corporation (Corporation) PowerShare™ Dividend Reinvestment and Stock Purchase Plan (Plan) provides a convenient and inexpensive way to reinvest dividends and purchase shares of the Corporation's common stock, $3.50 par value per share (Common Stock). NON-SHAREHOLDERS OF LEGAL AGE WHO ARE RESIDENTS OF THE FIFTY STATES OF THE UNITED STATES AND THE DISTRICT OF COLUMBIA MAY ENROLL IN THE PLAN BY MAKING AN INITIAL CASH INVESTMENT OF $250.00. Employees and eligible retirees of the Corporation and its subsidiaries may elect to purchase Common Stock through automatic payroll or pension deductions with a minimum of $10.00 per pay period.

ABOUT POWERSHARE™

- Easy Enrollment
- $25 Minimum Additional Investments
  Once an initial investment of $250 has been made, the minimum additional investment or optional cash purchases of up to $100,000 per calendar year for common stock can be made.
- Dividend Reinvestment and Payment Options
  Participants may elect to have cash dividends on all or any portion of their shares of common stock automatically reinvested in CSW common stock. Cash dividend payments not reinvested will be paid to participants by check or through electronic direct deposit.
- New Safekeeping Service for CSW Common Stock Certificates
  PowerShare participants may deposit certificates for CSW common stock with CSW's Investor Services for safekeeping and the shares will be credited to those participants' PowerShare accounts.
- Shares Are Purchased Weekly

FOR MORE INFORMATION AND A PROSPECTUS

The more information you have, the better your ability to make sound investment decisions. The CSW prospectus provides more details about PowerShare and about Central and South West Corporation. We encourage you to read this information before deciding whether to enroll in the plan or to send any money.

If you have any questions, please call CSW Investor Services toll-free at 1-800-527-5797 weekdays between the hours of 9 a.m. to 4 p.m. Central time.

PowerShare™

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NO POSTAGE
NECESSARY IF
MAILED IN THE
UNITED STATES

BUSINESS REPLY MAIL

FIRST-CLASS MAIL PERMIT NO. 2551 DALLAS TX

POSTAGE WILL BE PAID BY ADDRESSEE

CENTRAL AND SOUTH WEST CORPORATION
INVESTOR SERVICES
PO BOX 660164
DALLAS TX 75266-9874

PowerShare

PowerShare™

Yes! I want more information about PowerShare™

Please type or print clearly and mail this completed form to:

Central and South West Corporation
Investor Services Department
P.O. Box 660164
Dallas, Texas 75266-0164

LAST NAME	FIRST NAME	MIDDLE INITIAL
ADDRESS		
CITY	STATE	ZIP

This does not constitute an offer to sell or a solicitation of a[illegible] to buy securities. Such offers and solicitations are made by way of prospectus only and no sales of common stock [illegible]

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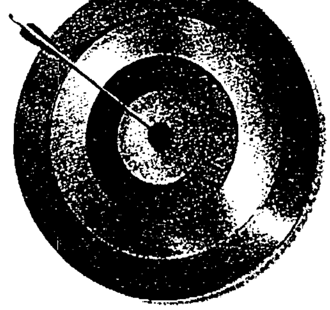
Central and South West Corporation
1616 Woodall Rodgers Freeway
P.O. Box 660164
Dallas, Texas 75266-0164
http://www.csw.com



UTILITY OF THE YEAR

In December *Electric Light & Power* magazine named Central and South West Corporation as the 1996 Utility of the Year.

The award recognized CSW for "marked excellence" in the following nine areas: finance, customer service, employee relations, community involvement, operating efficiency, environmental awareness, service to shareholders, attention to innovation and technology, and attention to competitiveness issues.

We are proud to have been honored for the things we're doing to better serve our customers and shareholders today and to build a stronger company for tomorrow.

Central and South West Corporation

1997 Summary Annual Report

directions

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directions

No clear road map exists yet for the [illegible] electric power industry, but the general direction is becoming clearer — toward greater competition — low-cost generation — improved customer satisfaction — market reach.

That's the direction CSW has been traveling, with considerable success. In late 1997, we took a major step to prepare for the future by announcing a proposed merger with American Electric Power Company, Inc.

Today CSW is a successful regional electric utility holding company, well positioned as a supplier of electricity and other services in the United States, the United Kingdom and Latin America.

Tomorrow, to benefit our shareholders, customers and employees, CSW expects to join with AEP to create the nation's premier electric power company — one that will be well positioned for success around the world.

CSW PROFILE

Central and South West Corporation is an investor-owned electric utility holding company based in Dallas, Texas. CSW owns and operates four electric utilities in the United States: Central Power and Light Company, Public Service Company of Oklahoma, Southwestern Electric Power Company and West Texas Utilities Company. These companies serve 1.7 million customers in an area covering 152,000 square miles of Texas, Oklahoma, Louisiana and Arkansas. CSW also owns a regional electricity company in the United Kingdom, SEEBOARD plc, which serves 2 million customers in Southeast England.

CSW engages in international energy, telecommunications and energy services businesses through these nonutility subsidiaries:

➤ CSW Energy, Inc., which develops, acquires, constructs, owns and operates nonutility power projects in the United States;

➤ CSW International, Inc., which engages in international activities, including developing, acquiring, financing and owning exempt wholesale generators and foreign utility companies;

➤ C3 Communications, Inc. (formerly CSW Communications, Inc.), which provides automated metering services to utilities, energy service providers and other customers and offers telecommunications services through CSW/ICG ChoiceCom;

➤ EnerShop Inc., which provides energy-management analysis, equipment and information to increase productivity and lower energy costs for commercial and governmental entities;

➤ CSW Energy Services, Inc., which markets electricity in competitive retail markets;

➤ CSW Credit, Inc., which buys the accounts receivable of our electric utility subsidiaries and other utilities;

➤ CSW Leasing, Inc., which owns leveraged leases of capital equipment; and

➤ Central and South West Services, Inc., which provides management and professional services, at cost, primarily for the corporation and its four U.S. electric companies.

Through separate equity investments in various joint ventures, CSW owns indirect interests in:

➤ CSW/ICG ChoiceCom, L.P., a joint venture with ICG Telecom Group, Inc., to provide local and long-distance telephone and data transmission services in Texas, Oklahoma, Louisiana and Arkansas;

➤ Numanco, which provides staffing services for nuclear-powered electric generating plants;

➤ Diversified Energy Contractors Company, which repairs, upgrades, installs and maintains steam, power and process systems in the U.S.;

➤ Empresa de Eletricidade Vale Paranapanema S.A., an electric distribution company serving 1.1 million customers in southern and central Brazil;

➤ Enertek, a joint-venture company that owns Mexico's first major cogeneration project located in Altamira, Tamaulipas;

➤ Beacon Gas, a joint venture with Amoco to market natural gas throughout the U.K.; and

➤ Medway Power, which owns a 675-megawatt independent power station on the Isle of Grain in the U.K.

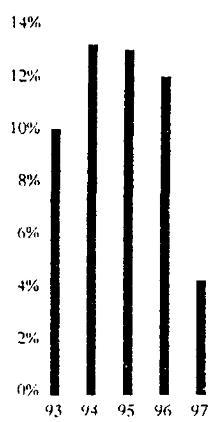
HIGHLIGHTS
CENTRAL AND SOUTH WEST CORPORATION

	1997	1996
Financial Data *(millions)*		
Operating Revenues	$5,268	$5,155
U.S. Electric Fuel and Purchased Power	1,266	1,228
United Kingdom Cost of Sales	1,291	1,331
Other Operating Expenses	1,630	1,399
Taxes	346	402
Operating Income	735	795
Other Income (Expense)	32	(61)
Interest and Preferred Stock Dividends	(438)	(437)
Income from Discontinued Operations	–	12
Gain on Sale of Discontinued Operations	–	120
Extraordinary Item	(176)	–
Net Income for Common Stock	$ 153	$ 429
Common Stock Data and Dividends		
Basic and Diluted Earnings per Share	$0.72	$2.07
Dividends per Share	$1.74	$1.74
Book Value per Share	$16.76	$17.98
Average Common Shares Outstanding *(millions)*	212.1	207.5
Return on Average Common Equity	4.2%	12.1%
Dividend Yield	6.4%	6.8%
Dividend Payout Ratio	242%	84%
Year-End Market Price	$27 1/16	$25 5/8

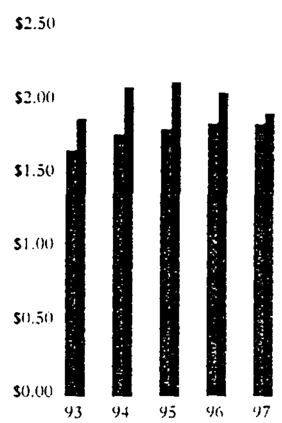
	Closing Market Price High	Closing Market Price Low	Dividends Paid
1997			
First Quarter	$25 3/4	$21 1/4	$0.435
Second Quarter	22 1/8	18 1/4	0.435
Third Quarter	22 7/16	19 3/4	0.435
Fourth Quarter	27 5/16	20 5/8	0.435
			$1.74
1996			
First Quarter	$28 1/2	$26 3/8	$0.435
Second Quarter	28 7/8	26 1/2	0.435
Third Quarter	28 1/2	25 3/4	0.435
Fourth Quarter	28	25 1/2	0.435
			$1.74

The condensed consolidated financial statements in this summary annual report were derived from the consolidated financial statements that appear in CSW's 1997 Financial Report to shareholders. Copies of the consolidated financial statements and the report of Arthur Andersen LLP thereon may be obtained by calling Central and South West Corporation's Investor Services Department at 1-800-527-5797

Return on Average Common Equity



Earnings and Dividends per Share



- Dividends
- Reported Earnings
- Significant One-Time Items

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Corporate

► Announced a proposed merger with American Electric Power Company, Inc., that is expected to create the nation's largest power company.

► Won Edison Electric Institute's National Award for Diversity, recognizing the corporation's programs for employees, suppliers, customers and communities.

U.S. Electric Utility Operations

► Ranked second among U.S. electric utilities in customer satisfaction by the American Customer Satisfaction Index[TM], conducted by the University of Michigan Business School and American Society for Quality.

► Controlled operating and maintenance costs despite inflation, saving more than $100 million in 1997 alone.

► Began testing with customers our ClearChoice[SM] pricing program, which helps pay for developing renewable energy and other environmentally friendly power sources.

► Won the first Innovative Energy Efficiency Financing Award of the National Association of Home Builders Energy Subcommittee for our new SmartMove[SM] energy-efficiency mortgage program.

International Utility Operations

► For the second year in a row, SEEBOARD was ranked as the leading regional electricity company in customer service by the United Kingdom Office of Electricity Regulation.

► Expanded our equity investment in Vale, a Brazilian electric distribution company.

► Vale and its partners acquired a Brazilian electric distribution company serving some 492,000 customers and won a concession to build an 850-megawatt hydroelectric power plant as part of Brazil's privatization of its electric industry.

► SEEBOARD was named the preferred bidder to provide power and services to the London Underground, the world's largest metro rail system.

Independent Power

► Completed construction of the Sweeny Cogeneration Facility, the first large-scale U.S. power plant built as a merchant plant.

► Completed construction of the Altamira Project, the first major cogeneration project to be built in Mexico under a new law that promotes outside investments in the Mexican energy sector.

Energy Services

► EnerShop won new contracts to provide energy-efficiency improvements for a number of office buildings and governmental entities across Texas.

► Established CSW Energy Services to participate in a limited marketing of electricity in states where retail competition now exists; Energy Services signed a major contract with The Home Depot© to supply electricity to 14 of its stores in Southern California, with our C3 Communications subsidiary serving as the meter data management agent.

► Formed CSW Total EV[SM] to promote and sell electric-vehicle battery chargers and to distribute a new line of recreational vehicles, upon regulatory approval.

Communications

► Formed CSW/ICG ChoiceCom, a joint venture with ICG Telecom Group, to offer local telephone, long-distance and data services; ChoiceCom connected its first customers in Austin, San Antonio and Corpus Christi, Texas.

► C3 Communications was chosen by City Public Service of San Antonio to install advanced wireless and phone-based utility meter-reading equipment for 5,000 San Antonio customers.

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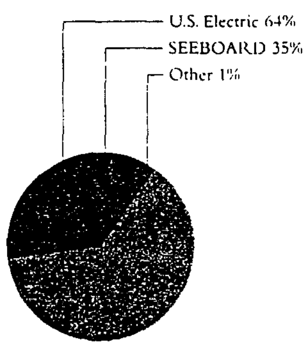
The direction of the electric power industry became dramatically clearer in 1997, and so did the direction of Central and South West Corporation.

In December we announced plans for CSW to merge with American Electric Power Company, Inc., one of the largest electric utility companies in the country. We expect to complete the merger in 1999 and to become part of a new, expanded AEP. Before the merger can be completed, a number of regulatory and other conditions must be satisfied. We expect that the combined company will become the nation's premier power company and a major player in the increasingly competitive worldwide power market.

As the restructuring of the electric utility industry evolves, we believe the most successful companies will be those large enough to operate in international markets with low-cost power generation and a culture of innovation and excellent customer service. In AEP we found a partner that shares these views as well as common goals and strategies. AEP has established a successful brand and marketing program in the United States and in other countries. We are excited about the prospects for the combined company and about the potential benefits for our shareholders, customers and employees.

CSW 1997 Revenues



The new company will be based in Columbus, Ohio, and will be led by Dr. E. Linn Draper, Jr., currently chairman, president and chief executive officer of AEP. I have known Linn for many years as both a colleague and friend. I believe he is one of the most talented and respected leaders in the electric power industry. CSW's operations and employees will be in good hands.

I will serve on the board of the new company but will step down from executive management. Thomas V. Shockley, III, who in 1997 became CSW's president and chief operating officer, will remain a key senior officer of the new company's Southwest region.

You will find more information about the merger in an interview with Dr. Draper and me in this annual report, beginning on page 18.

1997 Financial Challenges. A number of events caused our stock price to decline in early 1997. Most damaging was the unprecedented decision of the Public Utility Commission of Texas in the rate case of our Central Power and Light Company subsidiary. The commission ruled that $800 million of CPL's investment in the South Texas Project nuclear electric generating station was "excess cost over market" and reduced the allowed rate of return on that amount. In addition, the commission ordered CPL to lower its rates by $19 million in 1997 and by an additional $13 million in 1998 and again in 1999.

This ruling led to a significant drop in the stock prices of CSW and the other major investor-owned electric utilities in Texas. We have filed an appeal in court, challenging portions of the commission's decision in the CPL case.

During 1997 several other major financial challenges were resolved.

➤ In Oklahoma, the settlement of a rate inquiry resulted in our Public Service Company of Oklahoma subsidiary making a one-time refund of $29 million and lowering its retail base rates by about $36 million a year, even though its rates already were among the lowest in the region.

• In the United Kingdom, Parliament approved the new Labour government's initiative to impose a "windfall profits" tax on privatized electric utilities; the cost for our SEEBOARD unit was significant – $176 million.

• In litigation with El Paso Electric Company related to the termination of our proposed merger transaction, we reached a negotiated settlement of all issues by paying $35 million to El Paso Electric and its various creditors.

Although none of these events reflected on the efficiency of our operations, the effectiveness of our employees or the ability of CSW to compete in the electric power marketplace, they significantly hurt CSW's 1997 financial performance. Earnings per share for 1997 were $0.72, compared to $2.07 for 1996.

In January 1998 our board of directors determined that CSW's dividend would remain at the annual indicated rate of $1.74. We believe the combination of CSW with AEP will offer improved prospects for future earnings and dividend growth.

Strategic Progress in 1997. We have been pursuing a six-step strategy to prepare us for success in the competitive era ahead. As the 1997 milestones on page 2 show, we are making substantial progress toward those goals. I am particularly proud of the way our employees have met the challenge of continuing to cut costs, of building on our reputation for customer satisfaction and of taking advantage of growth opportunities through investments in promising new markets, such as Latin America. We believe all the elements of our strategy will be advanced through the merger with AEP.

Because the AEP merger must be approved by state and federal regulators, we are determined to manage CSW so that it remains strong and competitive as a stand-alone company. We are optimistic that our activities in the United States and other countries will help us achieve a number of notable milestones during 1998.

We continue to gain new customers for our telecommunications, energy services and other new businesses, and we hope to win their electric power business when full retail competition is approved.

CSW'S SIX STRATEGIES

1. **Shape the future of the electric utility industry.**
2. **Create a client-driven culture.**
3. **Build a world-class brand and marketing company.**
4. **Build on our low-cost and reliability positions and pursue growth markets.**
5. **Aggressively pursue mergers, acquisitions and alliances for growth.**
6. **Manage our portfolio of assets and businesses to increase shareholder value.**

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We also are continuing efforts to acquire the non-nuclear assets of Cajun Electric Power Cooperative, Inc., which is operating in bankruptcy. Cajun sells power to 11 electric distribution cooperatives and one former cooperative that serve more than 330,000 customers and a population of 1 million in Louisiana.

Electric Power Policies. Much of 1997 was spent working on a critical part of our strategy – trying to shape the future of the electric power industry as deliberations occur in Washington and in the capitals of our four states.

In 1997 the Texas Legislature considered legislation that would have functionally restructured the state's electric utilities and would have opened the industry to competition for retail customers. Although the legislation failed in the final days of the legislative session, we expect the 1999 Texas Legislature to address this matter again.

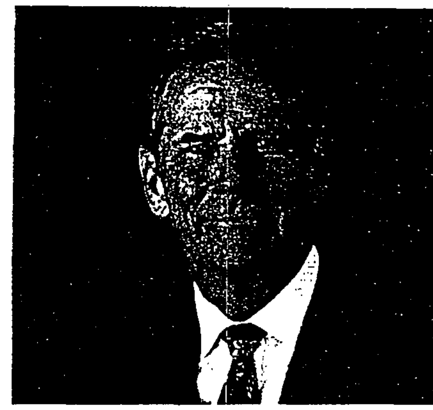
In Oklahoma during 1997, a law was enacted requiring retail competition in electricity to begin by July 1, 2002. The state's lawmakers also mandated that several studies be completed before implementing any restructuring of the state's electric utilities. In Louisiana and Arkansas, the state public service commissions have begun dockets to examine issues surrounding electric utility restructuring.

We believe that all of our companies will be winners in a competitive marketplace because of their low prices and strong customer relationships. In the four states where our U.S. electric companies operate, we are supporting policies that would open our industry to more competition. We support policies that are fair to our shareholders and to all our classes of customers. The new laws must maintain the high degree of electric reliability that consumers expect today and provide for the recovery of all previously approved costs. We will oppose any proposals that would violate these principles.

If the new rules for utilities are written fairly, we believe we will be well positioned as one of the industry's strongest competitors. Our low-cost generating plants, our strong customer relationships, our investments in the U.K., Mexico and South America, and our growing energy services business in the U.S. will make us a formidable competitor on our own. Merging with AEP will make us part of a new company that we believe will be even stronger.

E R Brooks

E. R. Brooks
Chairman and Chief Executive Officer
February 16, 1998



E. R. Brooks
Chairman and Chief Executive Officer
Central and South West Corporation

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Position: CSW owns and operates four electric utilities in the Southwest; they are among the nation's leaders in low-cost power production and customer satisfaction.

U.S. ELECTRIC UTILITIES: LOW PRICES, SUPERIOR SERVICE

We believe an electric utility will be successful in the competitive marketplace largely through two factors: low-cost power production and excellent customer relationships. In 1997 our U.S. utilities showed once again that they are succeeding at both.

Lowering Costs. Our employees continued efforts to control operating and maintenance costs of our U.S. electric operations. Excluding extraordinary items, inflation alone would have added approximately $100 million to those costs in 1997 if our employees had not found greater efficiencies and savings.

As with O&M costs, employees also cut costs for fuel, fuel transportation and other expenses. As a result, our production cost of electricity today ranks among the lowest in the region. Of the 20 most efficient electric power generating plants in the U.S., eight are owned and operated by CSW.

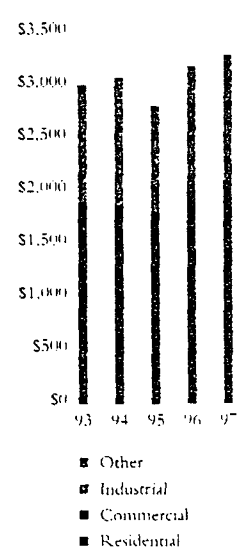
Customer Satisfaction. Our U.S. electric companies have continued to excel at customer satisfaction. During the past four years, the University of Michigan Business School, working with the American Society for Quality, has interviewed more than 50,000 consumers a year to produce the American Customer Satisfaction Index. CSW has been at or near the top in the electric utility category nationally and consistently has placed first in our region.

Our U.S. electric companies have launched two initiatives to continue strengthening relationships with customers.

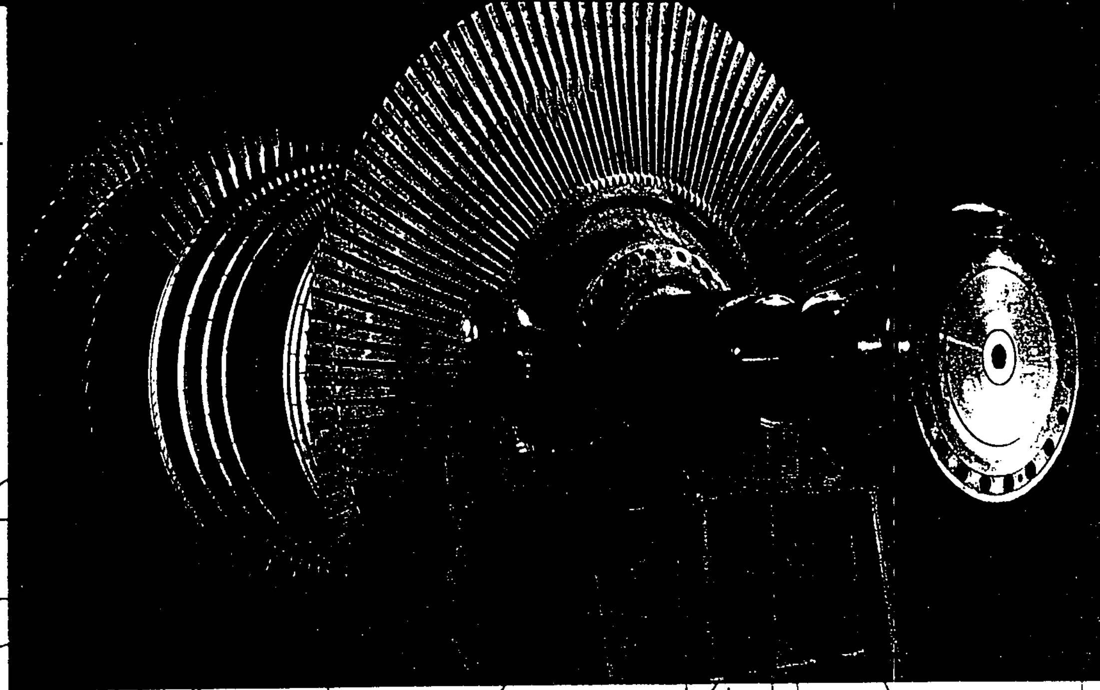
- A new Performance Commitment Program emphasizes five customer commitments that our utilities strive to meet at least 95 percent of the time. They include, among others, the commitment to turn on a customer's electric service within one working day after a request is made (if a meter is installed), arriving at a home or residence within an agreed-upon two-hour period and achieving 100 percent accuracy in customer billing.
- In early 1998, we formed a new Customer Relations group dedicated to satisfying customers and maintaining long-term relationships with them.

Environmental Protection. Our electric companies have been recognized for their strong environmental programs and renewable energy projects. In 1997 we expanded these efforts with our new ClearChoice pricing program, which allows customers to help pay for the use of renewable energy sources.

U.S. Electric Revenues by Class
In Millions

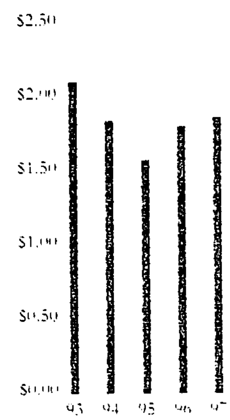


Streamlining maintenance procedures and improving computerized parts inventories for power plants help our U.S. electric utilities control operating and maintenance expenses. These efforts by our employees to save costs have made our generating facilities some of the most efficient in the nation.

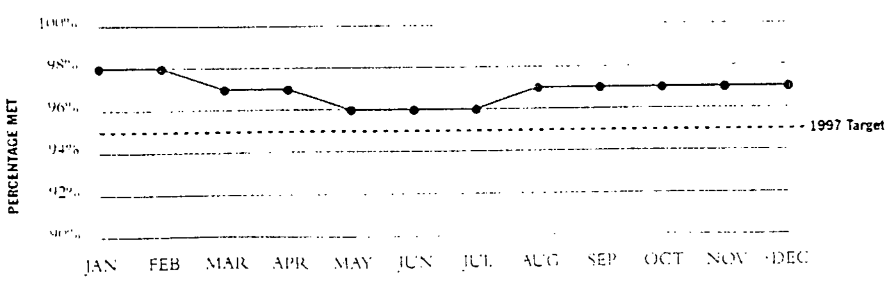


When the Tulsa World *installed new printing presses in downtown Tulsa, major changes were required in the underground electric equipment that serves the newspaper. Public Service Company of Oklahoma quickly and efficiently added new facilities to keep the newspaper's presses rolling on time and to keep a major customer satisfied.*

U.S. Electric Average Fuel Costs
Per Million Btu



1997 CSW Total Performance Commitment Program



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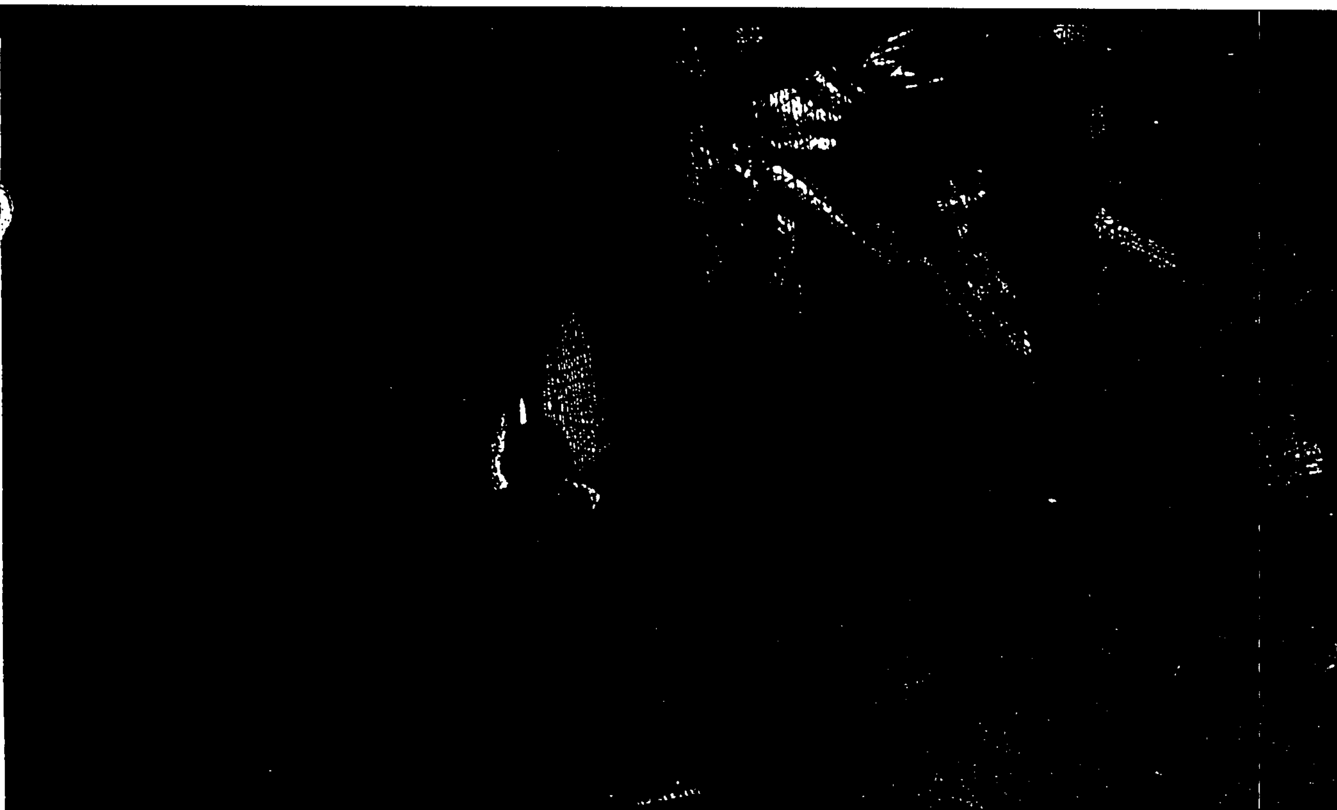

The Harmon Science Center in Tulsa is one of four public institutions to which CSW has contributed solar energy systems to show how renewable energy can be used. CSW is also providing solar systems for 19 public schools in Texas, Louisiana and Arkansas.

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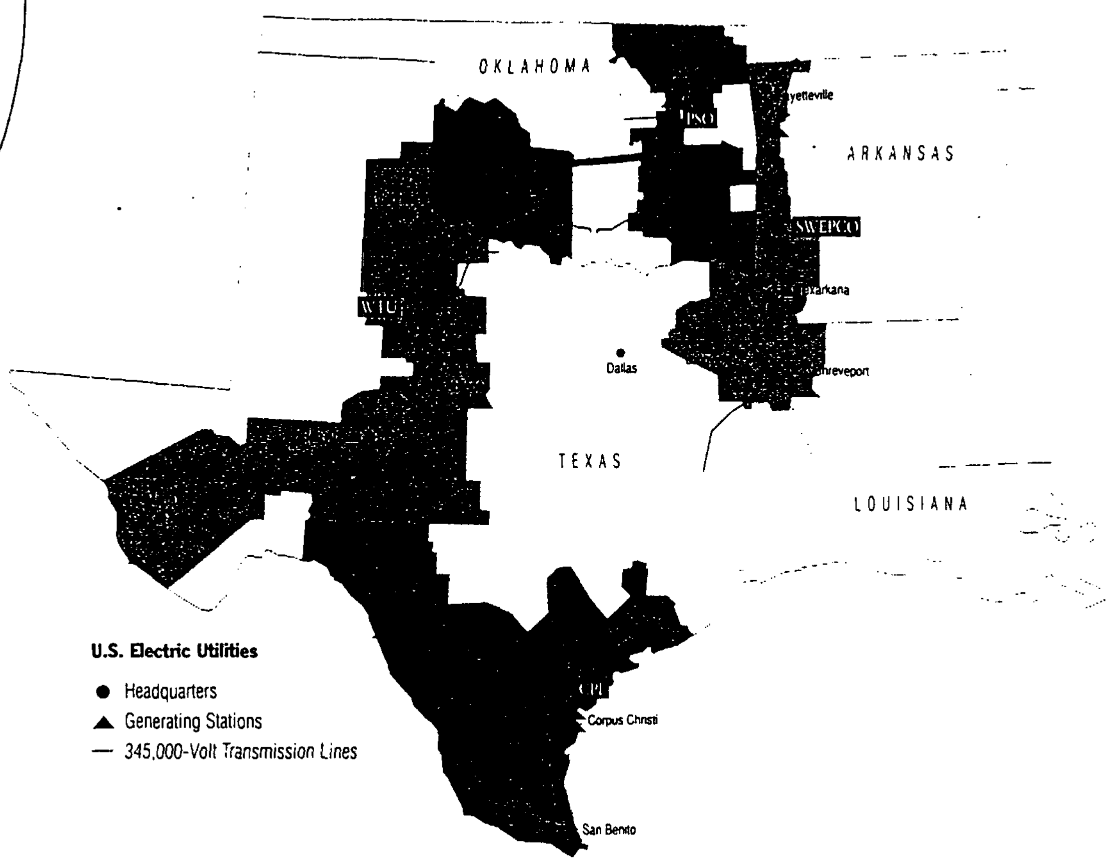
CSW's U.S. Electric Utilities

Company	*Headquarters*	*Customers*
Central Power and Light Company	*Corpus Christi, Texas*	*627,900*
Public Service Company of Oklahoma	*Tulsa, Oklahoma*	*481,400*
Southwestern Electric Power Company	*Shreveport, Louisiana*	*415,900*
West Texas Utilities Company	*Abilene, Texas*	*186,700*



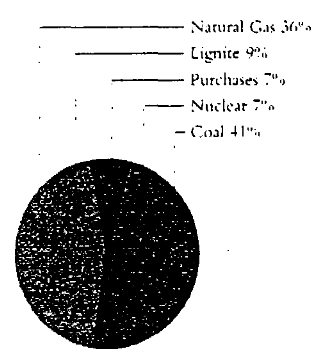
Our West Texas Utilities Company subsidiary in October launched ClearChoice in San Angelo, Texas. Customers there can opt to pay an additional \$5, \$10 or \$20 a month on their electric bills to fund 250, 500 or 1,000 kilowatt-hours, respectively, of electricity generated at a hydroelectric renewable energy source.

On behalf of three of our electric companies, we issued requests for proposals to add up to 160 kilowatts of new photovoltaic power sources, to be installed on the rooftops at 19 schools. As a result of these efforts, we believe students and others in the community will learn more about photovoltaic technology, and our customers will benefit from the use of solar energy.

The National Association of Home Builders Energy Subcommittee gave us its first Innovative Energy Efficiency Financing award in 1997 to honor our new SmartMove program. SmartMove offers our utility customers competitive financing rates for energy-efficiency improvements to new or existing homes without adding to customers' down payments. By lowering household energy bills, SmartMove increases consumers' buying power.

SmartMove also helps protect the environment by reducing energy use as it helps us forge stronger relationships with our customers. Central Power and Light Company first introduced the program, and our other U.S. electric utilities plan to offer it in 1998.

U.S. Electric
1997 Energy Sources



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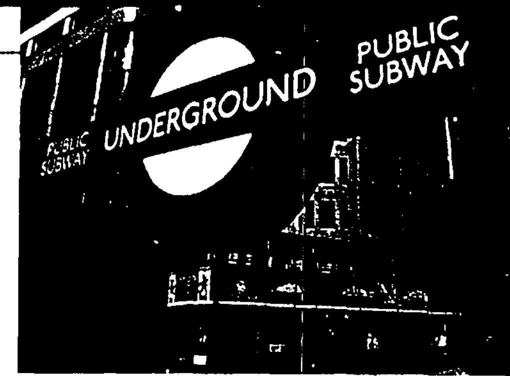
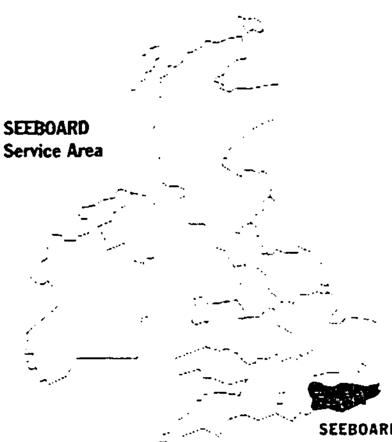


Position: CSW owns SEEBOARD plc, a regional electricity company in Southeast England, and has equity investments in Latin America, including an investment in Empresa de Eletricidade Vale Paranapanema S.A. (Vale), a large electric distribution utility in Brazil. Through these affiliates, CSW has more electric utility customers in other countries than in the United States.

SEEBOARD
Service Area



SEEBOARD

Location	*Southeast England, including much of Surrey and West Sussex, all of East Surrey and most of Kent*
Headquarters	*Crawley, West Sussex, United Kingdom*
Services	*Electricity distribution* *Electric power supply* *Natural gas marketing by Beacon Gas, a joint venture with Amoco* *Retail appliance stores* *Contracting and consulting services*
Customers	*2 million electric customers;* *150,000 Beacon Gas customers*

INTERNATIONAL UTILITIES: PROVIDING GROWTH AND EXPERIENCE

United Kingdom. SEEBOARD fits well with CSW's U.S. electric utilities in terms of its operation and culture. Placing the same emphasis on excellent customer service, reliability and innovation, it is contributing the steady growth and earnings that we anticipated when we acquired it in 1995.

Our one disappointment has been the magnitude of the "windfall profits" tax that was imposed on privatized utilities by the U.K. government. For SEEBOARD, the full tax assessment was $176 million, which we recognized in 1997.

In both 1996 and 1997, SEEBOARD was the top-rated utility in England for customer service (by the *Daily Telegraph* and British Telecom) and was given the highest rating for customer service by the U.K. government's Office of Electricity Regulation.

A SEEBOARD consortium has been selected as the preferred bidder to upgrade and operate the electric distribution system of the London Underground, the largest metro rail system in the world. The contract for operating, maintaining and upgrading the distribution system for 250 miles of track and more than 270 stations will be, if signed, the largest operating contract ever awarded to a U.K. ~~regional electricity~~ company.

For several years SEEBOARD has been preparing for retail competition in the U.K. electric power market, which now is scheduled to begin in September 1998. British authorities delayed the opening of competition beyond April 1998 after they found that most utilities were unable to meet the deadline because of information-technology issues. SEEBOARD was one of only four companies found to be ready to compete in April.

From SEEBOARD's experience – transitioning from government to private ownership and now to open competition – CSW is learning much to prepare its U.S. electric utilities for the coming competition in this country.

South America. In 1997 we invested an additional $150 million in South America. We made a further investment in Vale of approximately $69 million of convertible securities in early 1998.

Vale – in which we now own a 37 percent interest – expanded its activities across Brazil as the country continued privatizing its power industry.

In association with Inepar, a Brazilian electric and telecommunications company, Vale acquired a controlling interest in Centrais Elétricas

SEEBOARD and its partners have been selected as the preferred bidder to upgrade and operate the electric distribution system for the giant London Underground metro rail system.

CSW has increased its investment in Vale, a Brazilian electric utility with six affiliates. CSW International's executive director of Brazilian operations, Gilbert Moreno (at left), and Vale's Andres Deixler inspect a new substation under construction at Cuiabá, Mato Grosso.

Matogrossenses S.A. (CEMAT), an electric distribution company serving 492,000 customers in the state of Mato Grosso.

A second consortium, in which Vale owns 36 percent, was awarded a federal concession contract to build and operate the Lajeado Plant, an 850-megawatt hydroelectric power plant in the state of Tocantins in central Brazil.

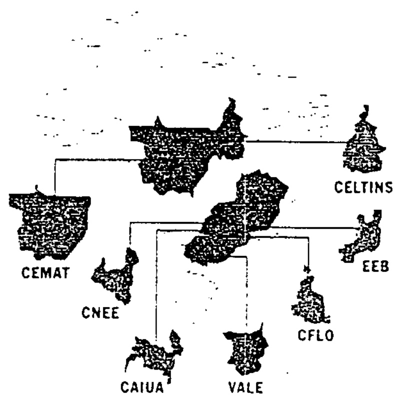
Vale also won a concession to build the Rosal hydroelectric power plant on the Itabapoana River, which forms the border between the Brazilian states of Rio de Janeiro and Espírito Santo. Construction of the 55-megawatt plant is under way, with commercial operation planned for the end of 1999.

As one of Latin America's largest economies, Brazil continues to show much promise for future development, with electricity demand growing at current rates of 7 to 10 percent. At the same time, Vale's excellent management team has achieved continued system improvements. In November the company was honored by *Eletricidade Moderna* magazine with seven of 12 first-place titles in the Brazilian industry's 1997 Electricity Awards.

Vale

Location	Brazilian states of São Paulo, Paraná, Tocantins, Minas Gerais and Mato Grosso
Headquarters	São Paulo, São Paulo, Brazil
Services	Electricity distribution Electric generation Electric power supply Investment in six other Brazilian electric systems
Customers	1.1 million electric customers

Vale and Affiliates Service Area



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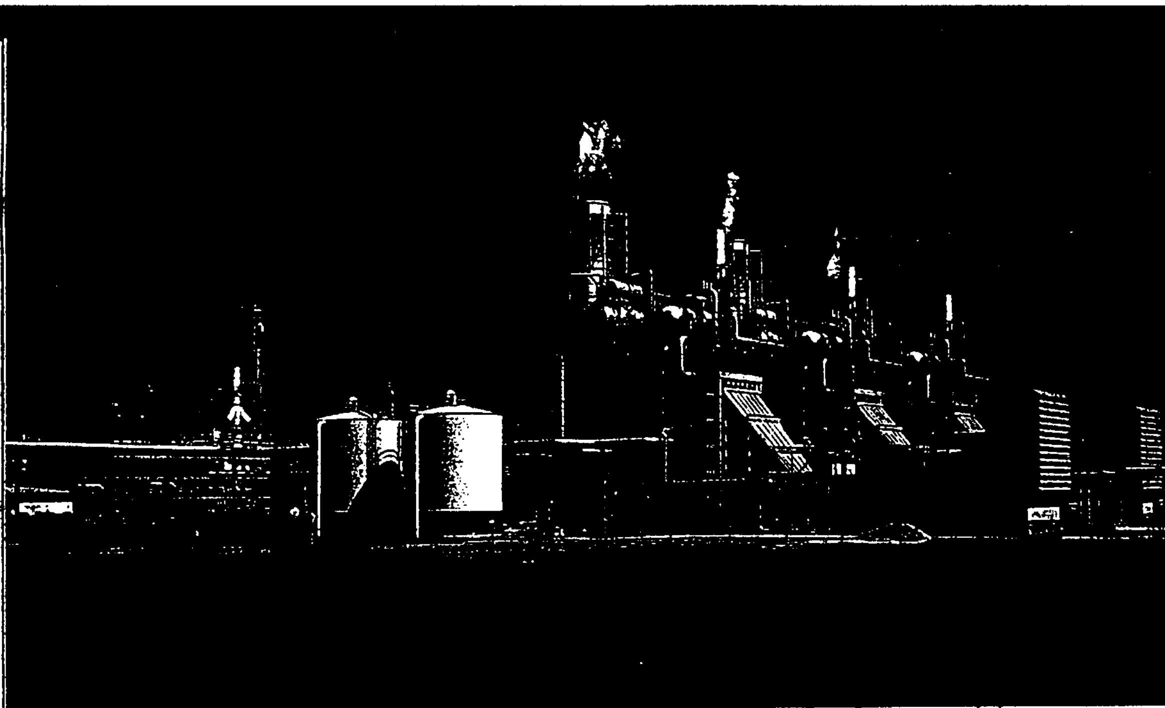
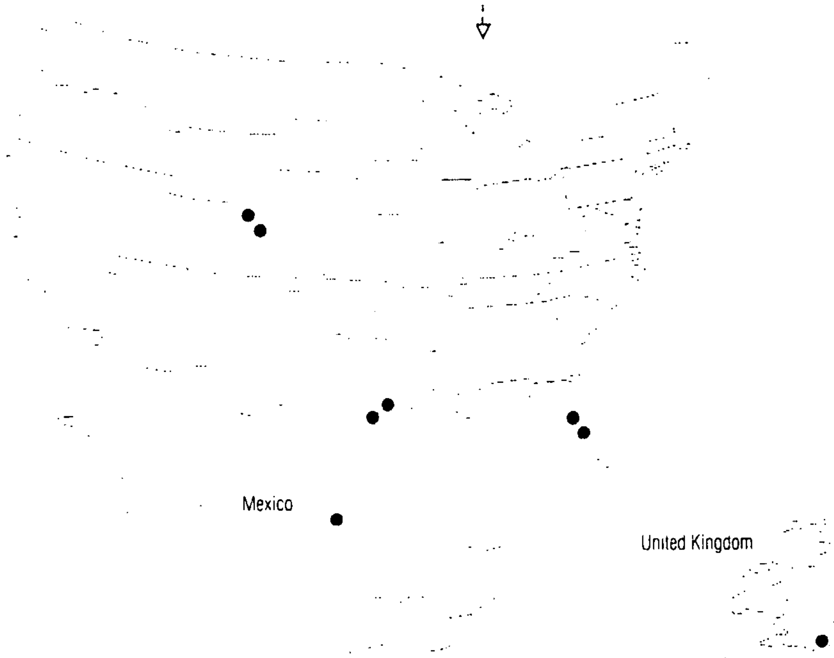


CSW Energy put into commercial operation its Sweeny Cogeneration Facility – the first large power facility built in the United States as a merchant plant. Both steam and electricity from the plant are delivered to the Phillips 66 refinery and petrochemicals complex in the background, with the plant's remaining electric output sold to wholesale buyers.

CSW Energy and CSW International Projects

Total Capacity and CSW's Ownership Interest

Brush II	*68 megawatts*
Brush, Colorado	*47% interest*
Fort Lupton	*272 megawatts*
Fort Lupton, Colorado	*50% interest*
Mulberry Cogeneration	*120 megawatts*
Bartow, Florida	*50% interest*
Orange Cogeneration	*103 megawatts*
Bartow, Florida	*50% interest*
Newgulf	*85 megawatts*
Near Boling, Texas	*100% interest*
Sweeny Cogeneration	*330 megawatts*
Old Ocean, Texas	*50% interest*
Medway Power Station	*675 megawatts*
Isle of Grain, Kent, U.K.	*37.5% interest*
Altamira	*109 megawatts*
Altamira, Tamaulipas, Mexico	*50% interest*



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Position: CSW has independent power plants in the United States, the United Kingdom and Mexico; it is aggressively seeking additional opportunities to develop, acquire, construct, own and operate plants.

INDEPENDENT POWER PLANTS: DEVELOPING NONUTILITY GENERATION

U.S. Projects. CSW Energy owns an interest in six cogeneration or independent power plants and operates four of them. The six power plants – two each in Colorado, Florida and Texas – have a total capacity of 978 megawatts.

Our newest and largest project began commercial operation in early 1998, ahead of schedule and under budget. The Sweeny Cogeneration Facility is providing 90 megawatts of electricity to Phillips Petroleum Company's refining and petrochemicals complex at Old Ocean, Texas. The remainder of the plant's 330-megawatt capacity is offered to electric utilities and power marketers on a merchant basis. The Sweeny project is the country's first large power plant built to operate as a merchant plant.

Our Newgulf Project, which began commercial operation in 1997, is Texas' first exempt wholesale generator intended to take advantage of power market fluctuations. Like Sweeny, it is designed to operate successfully both today and in the future in the competitive market for electric power.

International Projects. CSW International's Altamira Project, located near Tampico on the eastern coast of Mexico, went into operation in the first quarter of 1998. We have commitments for all of the plant's steam as well as all of its 109 megawatts of electric capacity.

The Altamira Project is a significant milestone in the Mexican power industry. It is the first major cogeneration project to be built under Mexico's new legal framework, in which power projects are regulated by the Comisión Reguladora de Energía, Mexico's energy regulatory commission.

The Altamira Project also is the first project to have long-term contractual agreements with the Comisión Federal de Electricidad for the interconnection, backup and transmission of energy and with Petróleos Mexicanos for natural gas to fuel the plant. The project is owned by Enertek, a joint venture between CSW International and Alpek, S.A. de C.V., a subsidiary of the ALFA Group. CSW International and Alpek own equal shares in the project.

Through SEEBOARD, we own a 37.5 percent interest in the Medway Power Station on the Isle of Grain in Kent. The 675-megawatt, combined-cycle gas turbine unit is owned and operated through a joint venture among SEEBOARD, Southern Electric Power Generation Limited and AES Medway Electric Ltd.

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Position: Through its EnerShop subsidiary, CSW is helping commercial, industrial and governmental customers use energy more efficiently; a new subsidiary, CSW Energy Services, is marketing power in states that now permit retail competition; and another new subsidiary, CSW Total EV, plans to promote and market electric vehicles and battery chargers.

ENERGY SERVICES: HELPING CUSTOMERS USE ENERGY EFFICIENTLY

EnerShop℠. EnerShop identifies better ways for customers to manage and use energy, designs the improvements and shares in the savings. Its main customers are large commercial businesses, light industrial manufacturers and government institutions.

In 1997 EnerShop won contracts to improve the energy efficiency at 15 major facilities. Among these were several large office buildings in Dallas.

EnerShop also announced an alliance with Honeywell, Inc., to jointly market energy-conservation services for municipal and county buildings in Texas. A new state law allows local and county governments to use performance contracting for energy-conservation improvements.

EnerShop's newest product is a state-of-the-art energy monitoring and optimization service, called EnerACT℠, that was developed jointly with Perot Systems. EnerACT communicates with all brands and models of energy-management systems and utility meters, collects load profiles of many facilities for single-source purchasing of energy and optimizes energy controls of multiple buildings using simulation modeling.

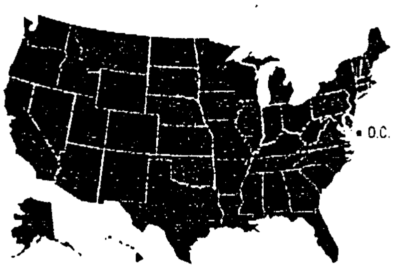
CSW Energy Services. CSW entered the competitive retail electricity market in 1997 with the formation of CSW Energy Services, Inc. Headquartered in Boston, Energy Services is marketing electricity supply in selected states where retail competition is now permitted.

Initial efforts have focused on California and New England. California opened its retail markets March 31, 1998, allowing electric suppliers to buy power directly from generators or through a power exchange and then sell the power to users.

Typical of these contracts is Energy Services' pact with The Home Depot, Inc., North America's largest home-improvement retailer. Energy Services will provide an estimated 28 million kilowatt-hours of electricity for 14 Home Depot® retail centers in the San Diego area.

Energy Services also has signed a retail supply contract with La Quinta Inns, Inc., to deliver an estimated 10 million kilowatt-hours to 12 major La Quinta properties in California.

State Activities on Electric Restructuring and Competition



■ Legislative - 3 ■ Legislative and Regulatory - 29
■ Regulatory - 3 ■ Adopted Retail Competition - 16

All 50 states and the District of Columbia are addressing reforms to retail electric service. Sixteen states so far have adopted plans to implement electricity restructuring.

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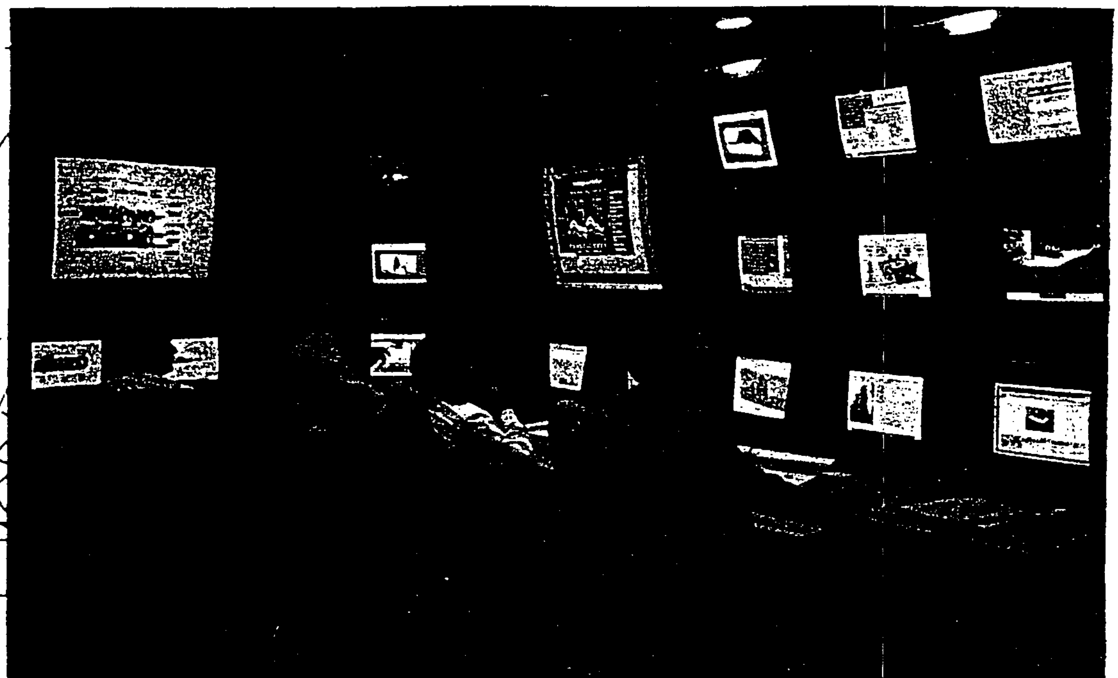
CSW Energy Services, a new CSW subsidiary, was launched in 1997 to supply electricity to major retail customers in selected states. One of its first agreements was with The Home Depot to supply 14 of the company's stores in Southern California.



In the EnerACT command center in Dallas, employees monitor energy consumption and control energy use to save clients money. Using advanced technologies developed by CSW's EnerShop and Perot Systems, EnerACT provides building managers throughout the country with critical information about their facilities.

Energy Services' new contracts and customers are expected to improve CSW's knowledge of competitive markets while offering customers low costs and excellent service.

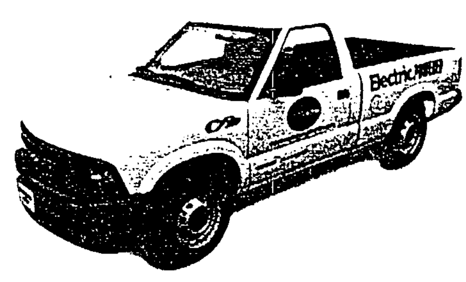
CSW Total EV. With concerns about air emissions growing, the potential for electric-powered vehicles appears more promising than ever. For many years, CSW's U.S. electric companies have studied and tested electric vehicles and investigated how they could be used by customers. Now, through a new nonutility business, CSW Total EV, we propose to enter this market.

CSW Total EV initially expects to pursue two areas of the business: selling, installing and maintaining battery chargers for electric cars, trucks and buses; and selling and distributing a new line of recreational vehicles, including electric bicycles and scooters. Operations are expected to be conducted in Texas, Oklahoma, Louisiana, Arkansas, New Mexico, Colorado, Kansas and Missouri.

CSW so far has donated more than 50 electric bicycles to police departments in our service-area cities that have air-quality problems. Approval to sell the electric bikes is pending at the Securities and Exchange Commission.

In 1997 CSW was the first electric utility to take delivery of the Chevrolet S-10 Electric pickup, the automotive industry's first factory-built electric truck. CSW is using 10 of the S-10 Electric trucks in daily utility operations to promote electric vehicle technology with customers.

CSW Total EV is working with the Metropolitan Tulsa Transit Authority to obtain electric buses for the city. It also is helping the Tulsa International Airport Authority electrify the tugs, baggage tractors, loaders and other equipment at three gates.



CSW was the first electric utility to take delivery of the Chevrolet S-10 Electric pickup.

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C3 Communications' ChoiceCom partnership is offering alternative telephone and data services in major Texas cities, using the latest technology, such as Lucent 5ESS switches.

C3 Communications provides automated meter reading systems to utilities and energy-service providers. C3 also has been certified in California as a meter data management agent to offer independent metering to customers.

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Position: CSW is working to become an industry leader in communications-based utility automation and in telecommunications with its C3 Communications subsidiary and ChoiceCom joint venture.

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COMMUNICATIONS: TELEPHONES AND AUTOMATED METER READING

Telephone Service. In 1997 CSW entered the telephone business through a joint venture between our C3 Communications subsidiary and ICG Telecom, a subsidiary of ICG Communications, Inc. The joint venture, CSW/ICG ChoiceCom, connected its first customers with local telephone service in Austin, Corpus Christi and San Antonio, Texas.

In early 1998, ChoiceCom began marketing local telephone service in Dallas and Houston. It plans to offer local telephone, long-distance and data transmission services to businesses in selected cities in Texas, Oklahoma, Louisiana and Arkansas.

ChoiceCom owns and operates high-capacity fiber-optic lines that link several cities in Texas and Louisiana and is completing lines that will connect Dallas, Houston, Austin and San Antonio. It has installed state-of-the-art Lucent Technologies 5ESS® telephone switches in Austin, Corpus Christi and San Antonio and plans to install 5ESS switches in Dallas and Houston during 1998.

Utility Automation. C3 Communications' Utility Automation Division provides metering automation services to utilities and energy-service providers. Focusing on meter data rather than individual system components and communications technologies, C3 can provide the best automation solution for its clients by choosing from a variety of technologies.

C3 Communications was selected by City Public Service, San Antonio's natural gas and electric utility, to provide project management, systems integration and marketing services for an initial 5,000 meters. By installing advanced wireless and phone-based meter-reading equipment, the utility will be able to read customers' electric, gas and water meters at any time.

Work on similar metering projects continued in Austin and Georgetown, Texas. The City of Austin automated 400 water and 800 electric meters and is considering expanding the project in 1998. Installation of Georgetown's citywide automated metering technology will be completed in mid-1998.

In addition, C3 Communications was approved as a meter data management agent (MDMA) for California's open electricity market. C3 is one of only a few nonutility companies in the U.S. to be approved by all three of the state's utility distribution companies to serve the meter data market. MDMAs read meters; validate, edit and estimate meter reading data; publish data to the MDMA server; and archive meter data.

"THIS IS THE BOLDEST MOVE IN THE HISTORY OF CSW, AND WE BELIEVE THE NEW COMBINED COMPANY WILL BE THE EPITOME AND ENVY OF THE INDUSTRY." - E. R. BROOKS

BEHIND THE DECISION TO CREATE AMERICA'S PREMIER ELECTRIC COMPANY

A conversation with E. R. Brooks, chairman and chief executive officer of Central and South West Corporation, and Dr. E. Linn Draper, Jr., chairman, president and chief executive officer of American Electric Power Company, Inc.

You both said when announcing this merger that AEP and CSW were ideal merger partners. Why?

Brooks: We had been looking for an opportunity to merge with a successful company that shared our strategy and our culture. We wanted a partner that was dedicated to serving our shareholders in the competitive era ahead by becoming an innovative, diversified leader in global energy markets and related services – our strategy. And one that emphasized low-cost generation and excellent customer service – our culture. In my 36 years of experience, I've never seen a company that was a more perfect fit with CSW than AEP.

Draper: As we've learned more about each other in the past few months, we've found that our culture is even more compatible than we initially had realized. Except for the climate, our service areas are very similar. We both primarily serve large rural areas and small to mid-size cities. When you think about it, Fort Wayne and Roanoke in AEP's territory are a lot like Tulsa and Shreveport in CSW's. We shouldn't have any trouble adapting to each other's territories because, in all of them, the same types of personal relationships with customers are especially important.

Brooks: AEP also brings us some important capabilities that we need. We have been working to develop a significant electric power trading and marketing business. AEP already has that. Together, we will have a name brand identity that will be a great springboard for marketing electricity and other products and services throughout the United States.

Draper: We have many more similarities than differences, but even many of the differences are strengths. AEP's industrial customers are largely in primary metals, like steel and aluminum; CSW's industrial customers are largely in petrochemicals and refining. AEP is primarily a coal-burning utility, with a little nuclear power; CSW has a large natural gas capability. This means that we will have greater diversity in types of customers and in fuel use, which will be an important competitive advantage.

How will this merger benefit shareholders?

Draper: We expect shareholders of both companies to benefit from the outset. Our studies show that the merger will add to cash flow from day one, and our financial models show that the merger will dilute the earnings per share of AEP and CSW shareholders only slightly in the early years. The greatest benefit to the shareholders will be the potential of the new combined company. We will have a diversified portfolio of low-cost power plants, a presence in 11 states and three power pools, 38,000 megawatts of generating capacity and a base of customers approaching 5 million nationally. We'll be positioned to be a major player in the international retail energy market as well.

"A COMPANY THAT IS GOOD AT ENERGY DELIVERY WITH STRONG CUSTOMER SERVICE AND THAT HAS A PORTFOLIO OF LOW-COST GENERATING PLANTS WILL BE A VERY STRONG COMPETITOR." - E. LINN DRAPER, JR.

Brooks: Both of these companies have been successful on a stand-alone basis. Together, they will be even more competitive. And they will have the financial wherewithal to implement our strategy in bolder ways, around the world, than either of us could have done separately. All that should turn into shareholder value.

How well will the international activities fit together?

Brooks: CSW and AEP also mesh well in our international activities. AEP is primarily active in Asia, where we have long-term ambitions; CSW is primarily active in Latin America, where AEP has longer-range ambitions. We overlap only in the United Kingdom, where CSW owns a regional electricity company and AEP owns 50 percent of another regional electricity company. We believe that the merger will create a real global powerhouse.

Draper: We also complement each other in the capabilities we offer to other countries. AEP's international work has focused on building efficient coal-fired facilities. CSW has experience in building and operating gas-fired generation and Western-U.S.-type-coal plants. So together we will have the capability to build the type of plant that makes the most sense in any region where we are working.

What kind of obstacles will this merger face?

Draper: We expect to complete the merger in the first half of 1999. Along the way, we expect two issues to be closely examined. The first is a concern about whether the merger could create a market-dominant company. We strongly believe that the proposed merger would not have this effect. AEP and CSW do not operate in the same states or power pools. Neither company is now dominant in any state it serves; the combined company will not be dominant in any state it serves. We'll have more footprints, but none of them will be bigger in any geographic area.

"IT'S IMPRESSIVE THAT OVER THE PAST THREE YEARS BOTH COMPANIES HAVE BEEN RATED AMONG THE TOP FOUR UTILITIES IN THE COUNTRY FOR CUSTOMER SATISFACTION." - E. LINN DRAPER, JR.

"DURING THE MERGER PROCESS, WE'LL BE MOVING FORWARD AGGRESSIVELY TO ASSURE THAT, WHEN THE MERGER IS CONSUMMATED, WE CAN HIT THE GROUND RUNNING." - E. R. BROOKS

The second issue revolves around the Public Utility Holding Company Act of 1935, which requires a holding company to operate, or to be capable of operating, as an *integrated public utility system*. Historically, this has been interpreted to mean that a holding company system must operate in contiguous states. We are not contiguous, but there is only one energy provider separating us. We will purchase the right to use the transmission system of that company to exchange power between the eastern and western operations of our combined company. We believe that the combined company will be able to operate as an integrated system in this way.

Brooks: This will be the biggest merger in the history of U.S. electric utilities. We expect a lot of regulatory review and a lot of third-party intervention. We will seek the approval of all four states that CSW serves – and based on our initial communications with them, I believe the response will be positive. We believe that we do not need formal approval from the seven states that AEP serves, but some of them are expressing a strong interest. If the country truly is serious about creating a competitive electric power industry, we believe this merger between these two similar companies should be a model for future transactions. We are confident it will succeed.

How will the operating companies be known?

Brooks: One of the strengths of our U.S. electric companies is their strong relationships and name recognition with their customers. That's a competitive advantage. So we expect that CSW's four operating companies will continue using their established names and identities, at least for the near future.

Draper: All nonregulated competitive activities will probably operate under the name of AEP, with our brand as America's Energy Partner℠. Today there's an ongoing debate as to what extent regulated electric companies can use the same names and identities for other services being marketed to their customers. We probably won't change the names of the CSW electric companies until that matter has been decided.

"WE WILL BE A GLOBAL POWER COMPANY WITH A HEALTHY DIVERSITY OF FUELS, TYPES OF INDUSTRIAL CUSTOMERS AND CLIMATE PATTERNS, AND DYNAMIC INTERNATIONAL OPERATIONS." - E. R. BROOKS

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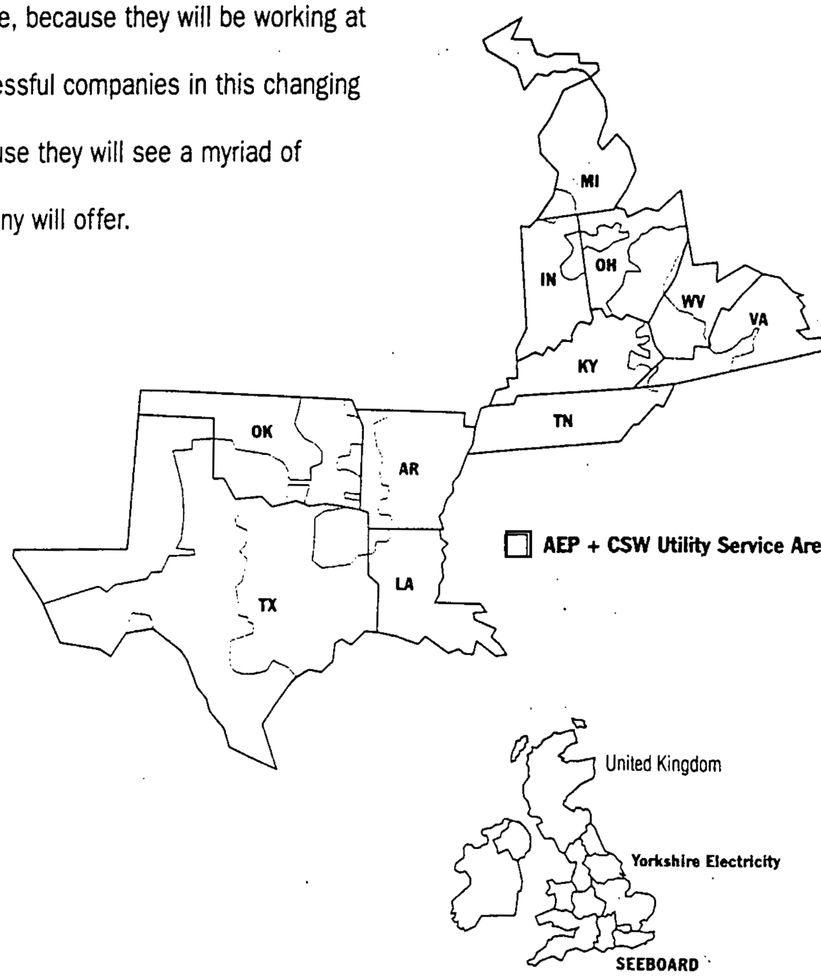
How will employees be affected?

Draper: The vast majority of employees who are directly involved with serving customers or producing electricity will not be affected. The jobs that overlap are largely corporate and administrative functions. We have identified about 1,100 duplicate positions that we are planning to eliminate. But we have plenty of time during the regulatory approval process to take advantage of retirements and other attrition and to find employment opportunities in our other growing businesses. We believe the real number of job losses will be much fewer than 1,100.

Brooks: The employees who lose their jobs will be treated fairly. Both companies have a strong tradition of treating their employees well. For the great majority of employees who work for the new combined company, I'm sure there will be a great sense of pride, because they will be working at one of the largest and most successful companies in this changing industry, and of excitement, because they will see a myriad of opportunities that this new company will offer.



AEP+CSW: A PERFECT FIT

The proposed merger of Central and South West Corporation with American Electric Power Company will bring together two utilities ideally suited for the competitive environment ahead. Our size, our market presence, our geographic location and our international operations present us with opportunities that few other companies will have.

The combined system will operate in 11 states. We'll supply power to 4.7 million U.S. customers, making us the single largest electricity supplier in the nation. Our mix of coal, gas and nuclear facilities will give us a diversity of low-cost generation. Our global subsidiaries will operate in some of the fastest-growing markets in the world and will provide significant opportunities for growth and expansion.

Our shared commitment to excellence, customer service, customer choice, technology, and employee growth and development provides the synergies necessary for a company preparing to meet the competition head-on.

FAST FACTS	CSW	AEP*	Combined**
Headquarters	Dallas, Texas	Columbus, Ohio	Columbus, Ohio
Kilowatt-Hour Sales U.S. (millions)	63,157	145,423	208,580
Kilowatt-Hour Sales U.K. (millions)	19,203	14,756	33,959
Employees U.S.	7,254	17,844	25,098
Employees U.K.	4,161	3,977	8,138
Service Area U.S. (square miles)	152,000	45,400	197,400
Service Area U.K. (square miles)	3,000	3,900	6,900
Customers U.S. (average number)	1,712,000	2,959,000	4,671,000
Customers U.K. (average number)	2,014,000	2,071,000	4,085,000
Generating Stations U.S.	38	38	76
Generating Stations U.K.	1	10	11
Generating Capacity U.S. (megawatts)	13,739	23,759	37,498
Generating Capacity U.K. (megawatts)	675	329	1,004
Revenues (thousands)	$5,268,000	$6,161,000	$11,352,000
Net Income for Common Stock (thousands)	$153,000	$511,000	$664,000
Operating Cash Flow (thousands)	$726,000	$1,198,000	$1,924,000
Assets (thousands)	$13,451,000	$16,615,000	$30,066,000

*AEP acquired a 50 percent interest in Yorkshire Electricity Group plc, a U.K. electric distribution company, on April 1, 1997, which is accounted for on an equity basis. AEP's kilowatt-hour sales U.K. are for the nine months ended December 31, 1997.
**Revenues vary from combined totals due to reclassifications.

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CONDENSED CONSOLIDATED STATEMENTS OF INCOME

CENTRAL AND SOUTH WEST CORPORATION

For the Years Ended December 31.	1997	1996	1995
	(millions, except per share amounts)		
Revenues			
U.S. Electric	$3,321	$3,248	$2,883
United Kingdom	1,870	1,848	208
Other Diversified	77	59	52
	5,268	5,155	3,143
Expenses			
U.S. Electric Fuel and Purchased Power	1,266	1,228	1,045
United Kingdom Cost of Sales	1,291	1,331	158
Operations and Maintenance	1,133	935	712
Depreciation and Amortization	497	464	353
Taxes	346	402	254
	4,533	4,360	2,522
Operating Income	735	795	621
Other Income (Expense)	32	(61)	99
Interest and Other Charges	(438)	(437)	(343)
Income from Continuing Operations	329	297	377
Income from Discontinued Operations	–	12	25
Gain on Sale of Discontinued Operations	–	120	–
Income Before Extraordinary Item	329	429	402
Extraordinary Item – U.K. Windfall Profits Tax	(176)	–	–
Net Income for Common Stock	$ 153	$ 429	$ 402
Average Common Shares	212.1	207.5	191.7
Basic and Diluted Earnings per Share	$ 0.72	$ 2.07	$ 2.10
Dividends Paid per Share	$ 1.74	$ 1.74	$ 1.72

The condensed consolidated financial statements in this summary annual report were derived from the consolidated financial statements that appear in CSW's 1997 Financial Report to shareholders. Copies of the consolidated financial statements and the report of Arthur Andersen LLP thereon may be obtained by calling Central and South West Corporation's Investor Services Department at 1-800-527-5797

Certain matters discussed in this summary annual report are forward-looking statements intended to qualify for the safe harbors from liability established by the Private Securities Litigation Reform Act of 1995. These forward-looking statements can generally be identified as such because the context of the statement will include words such as CSW "believes," "anticipates" or "expects," or words of similar import. Similarly, statements that describe CSW's future plans, objectives and goals also are forward-looking statements. Such statements address future events and conditions concerning capital expenditures, earnings, litigation, rate and other regulatory matters, liquidity and capital resources, and accounting matters. Actual results in each case could differ materially from those currently anticipated in such statements, by reason of factors such as electric utility industry restructuring, including ongoing state and federal legislative and regulatory activities; future economic conditions; developments in the domestic and international markets in which CSW and its subsidiaries operate; state and federal regulatory approvals or proceedings and other conditions precedent to the proposed merger with AEP, which may or may not be satisfied; and other circumstances affecting anticipated business activities, revenues and costs

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

CENTRAL AND SOUTH WEST CORPORATION

For the Years Ended December 31.	1997	1996	1995
		(millions)	
Operating Activities			
Net Income for Common Stock	$153	$429	$402
Depreciation and Amortization	529	521	425
Other Adjustments to Net Income and Changes in Assets and Liabilities	44	(75)	(28)
	726	875	799
Investing Activities			
Construction Expenditures	(507)	(521)	(474)
Acquisition Expenditures	–	(1,394)	(421)
CSW Energy/CSW International Projects	(382)	(124)	109
Cash Proceeds from Sale of Subsidiary	–	690	–
Other	(15)	63	(26)
	(904)	(1,286)	(812)
Financing Activities			
Common Stock Sold	20	477	57
Trust Preferred Securities Sold	323	–	–
Change in Debt and Preferred Stock	44	219	597
Payment of Dividends	(383)	(376)	(348)
	4	320	306
Effect of Exchange Rate Changes on Cash	(5)	(56)	–
Net Change in Cash and Cash Equivalents	(179)	(147)	293
Cash and Cash Equivalents – January 1	254	401	108
Cash and Cash Equivalents – December 31	$ 75	$254	$401

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CONDENSED CONSOLIDATED BALANCE SHEETS

CENTRAL AND SOUTH WEST CORPORATION

For the Years Ended December 31,	1997	1996
	(millions)	
Assets		
Electric	$13,596	$13,337
Other Diversified	250	84
Accumulated Depreciation	(5,218)	(4,940)
Fixed Assets	8,628	8,481
Current Assets	1,390	1,509
Deferred Charges and Other Assets		
Goodwill	1,428	1,525
Other	2,005	1,817
	$13,451	$13,332
Capitalization and Liabilities		
Common Stock	$ 3,556	$ 3,802
Preferred Stock	202	325
Trust Preferred Securities	335	–
Long-Term Debt	3,898	4,024
Total Capitalization	7,991	8,151
Current Liabilities	2,499	2,425
Deferred Credits	2,961	2,756
	$13,451	$13,332

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Shareholders and Board of Directors of Central and South West Corporation:

We have audited, in accordance with generally accepted auditing standards, the consolidated balance sheets of Central and South West Corporation (a Delaware corporation) and subsidiary companies as of December 31, 1997 and 1996, and the related consolidated statements of income, stockholders' equity and cash flows for each of the three years in the period ended December 31, 1997, appearing in the Central and South West Corporation 1997 Financial Report for the 1998 annual meeting of shareholders of the Corporation (not presented herein). Our report dated February 16, 1998, also appearing in the Central and South West Corporation 1997 Financial Report, contained an explanatory sentence calling attention to the fact that we did not audit the financial statements of CSW UK Finance Company (1997 – which includes CSW Investments) and CSW Investments (1996) which statements reflect total assets and revenues of 22 percent and 35 percent in 1997 and 23 percent and 36 percent in 1996, respectively, of the consolidated totals. Those statements were audited by other auditors whose reports have been furnished to us and our opinion, insofar as it relates to the amounts included for those entities, is based solely on the reports of the other auditors.

In our opinion, based on our audits and the reports of other auditors, the information set forth in the accompanying condensed consolidated balance sheets as of December 31, 1997 and 1996, and in the related condensed statements of consolidated income and cash flows for each of the three years in the period ended December 31, 1997, are fairly stated, in all material respects, in relation to the consolidated financial statements from which it has been derived.

Arthur Andersen LLP

Arthur Andersen LLP
Dallas, Texas
February 16, 1998

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REPORT OF MANAGEMENT

The condensed consolidated financial statements in this summary annual report were derived from the consolidated financial statements that appear in the Central and South West Corporation 1997 Financial Report for the 1998 annual meeting of shareholders. Management is responsible for preparing the consolidated financial statements, in accordance with generally accepted accounting principles appropriate in the circumstances, and for maintaining the Corporation's systems of internal accounting controls.

A description of these controls, along with management's opinion about their overall effectiveness, is contained within the Report of Management included in the Central and South West Corporation 1997 Financial Report for the 1998 annual meeting of shareholders. The consolidated financial statements were audited by the Corporation's independent public accountants, whose report on the condensed consolidated financial statements appears above.

E R Brooks

E. R. Brooks
Chairman and Chief Executive Officer

Glenn D. Rosilier

Glenn D. Rosilier
Executive Vice President and Chief Financial Officer

Lawrence B. Connors

Lawrence B. Connors
Controller

COMPARATIVE STATISTICAL AND FINANCIAL RECORD

CENTRAL AND SOUTH WEST CORPORATION

	1997	1996	1995	1994	1993
U.S. Utilities					
Electric Revenues *(millions)*					
Residential	$1,253	$1,243	$1,138	$1,156	$1,160
Commercial	892	872	810	836	832
Industrial	813	781	702	733	736
Sales for Resale	243	255	224	204	179
Other	120	97	9	136	148
	$3,321	$3,248	$2,883	$3,065	$3,055
Sales *(kilowatt-hours in millions)*					
Residential	17,995	17,883	16,872	16,368	15,903
Commercial	14,546	14,256	13,755	13,463	12,966
Industrial	21,087	20,266	19,321	18,869	18,205
Sales for Resale	7,824	8,428	8,468	7,133	5,852
Other	1,705	1,592	1,518	1,501	1,434
	63,157	62,425	59,934	57,334	54,360
Average Number of Customers *(thousands)*					
Residential	1,462	1,443	1,425	1,403	1,378
Commercial	214	209	207	203	198
Industrial	23	24	24	24	25
Other	13	14	13	13	12
	1,712	1,690	1,669	1,643	1,613
Number of Customers – End of Period *(thousands)*	1,724	1,704	1,683	1,661	1,633
Residential Sales Averages					
Kilowatt-Hours per Customer	12,310	12,392	11,840	11,665	11,541
Revenue per Customer	$857	$861	$799	$824	$842
Revenue per Kilowatt-Hour	6.96¢	6.95¢	6.75¢	7.06¢	7.29¢
Total Electric Revenue per Kilowatt-Hour	5.26¢	5.20¢	4.81¢	5.35¢	5.62¢
System Peak Demand *(megawatts)*	13,105	12,613	12,314	11,434	11,464
Fuel Data					
Average Btu per Net Kilowatt-Hour	10,405	10,440	10,299	10,344	10,391
Cost per Million Btu	$1.83	$1.81	$1.58	$1.82	$2.11
Cost per Kilowatt-Hour Generated *(mills)*	19.02	18.86	16.30	18.80	21.90
CSW System					
Total Plant Cost *(millions)*	$13,846	$13,421	$13,778	$11,868	$11,343
Annual Additions	675	583	1,933	616	594
Accumulated Depreciation	5,218	4,940	4,761	3,870	3,550
Capitalization *(millions)*					
Common Stock	$3,556	$3,802	$3,178	$3,052	$2,930
Preferred Stock	202	325	326	327	350
Trust Preferred Securities	335	–	–	–	–
Long-Term Debt	3,898	4,024	3,914	2,940	2,749

The condensed consolidated financial statements in this summary annual report were derived from the consolidated financial statements that appear in CSW's 1997 Financial Report to shareholders. Copies of the consolidated financial statements and the report of Arthur Andersen LLP thereon may be obtained by calling Central and South West Corporation's Investor Services Department at 1-800-527-5797

BOARD OF DIRECTORS

Molly Shi Boren
Attorney
Norman, Oklahoma

E. R. Brooks
Chairman and Chief Executive Officer
Central and South West Corporation
Dallas, Texas

Donald M. Carlton
President and Chief Executive Officer
Radian International LLC
Austin, Texas

T. J. Ellis
Chairman and Chief Executive
SEEBOARD plc
Crawley, West Sussex, United Kingdom

Joe H. Foy
Retired Partner, Bracewell & Patterson
Kerrville, Texas

William R. Howell
Chairman Emeritus
J. C. Penney Company, Inc.
Dallas, Texas

Robert W. Lawless
President
The University of Tulsa
Tulsa, Oklahoma

James L. Powell
Ranching and Investments
Fort McKavett, Texas

Richard L. Sandor
Chairman and Chief Executive Officer
Centre Financial Products Limited
Chicago, Illinois

Thomas V. Shockley, III
President and Chief Operating Officer
Central and South West Corporation
Dallas, Texas

COMMITTEES OF THE BOARD OF DIRECTORS

1. The Audit Committee recommends to the board of directors the independent public accountants to be appointed, subject to shareholder approval. The Audit Committee reviews with the independent public accountants and the Corporation's internal auditors the scope of external and internal audits and the adequacy of, and the compliance with, the Corporation's system of internal accounting controls.

2. The Executive Compensation Committee reviews benefit programs and management-succession programs and determines the compensation of executive officers.

3. The Nominating Committee reviews and recommends candidates for election to the board of directors.

4. The Policy Committee reviews and makes recommendations to the board of directors concerning major policy issues; considers on a continuing basis the composition, structure and functions of the board of directors and its committees; and reviews existing corporate policies and recommends changes when appropriate. The Policy Committee has authority to act in place of the board of directors when the board is not in session, to the extent permitted by law.

Membership of these committees is as follows: Molly Shi Boren (1) (2); E. R. Brooks, chairman of the Policy Committee (4); Donald M. Carlton (1) (3); Joe H. Foy, chairman of the Executive Compensation Committee (2) (3) (4); William R. Howell (2) (3); Robert W. Lawless, chairman of the Audit Committee (1) (2) (4); James L. Powell, chairman of the Nominating Committee (1) (3) (4); and Richard L. Sandor (1) (2).

OFFICERS

CENTRAL AND SOUTH WEST CORPORATION

E. R. Brooks
Chairman and Chief Executive Officer

Thomas V. Shockley, III
President and Chief Operating Officer

Ferd. C. Meyer, Jr.
Executive Vice President
and General Counsel

Glenn D. Rosilier
Executive Vice President
and Chief Financial Officer

Glenn Files
Senior Vice President, Electric Operations

Thomas M. Hagan
Senior Vice President, External Affairs

Venita McCellon-Allen
Senior Vice President, Customer Relations
and Corporate Development, and Assistant
Corporate Secretary

Stephen J. McDonnell
Vice President, AEP Merger

Kenneth C. Raney, Jr.
Vice President, Associate General Counsel
and Corporate Secretary

Michael D. Smith
Vice President, Business Opportunities

Lawrence B. Connors
Controller

Wendy G. Hargus
Treasurer

CENTRAL AND SOUTH WEST SERVICES, INC.

Richard H. Bremer
President, Energy Services

Richard P. Verret
President, Production

Robert L. Zemanek
President, Energy Delivery

M. Bruce Evans
Vice President, Customer Relations

Lana L. Hillebrand
Vice President, Human Resources

Mark W. Menezes
Vice President, Governmental Affairs

Mark D. Roberson
Vice President, Regulatory Affairs

SEEBOARD PLC
T. J. Ellis
Chairman and Chief Executive

CSW TEXAS
Alphonso R. Jackson
President

CSW OKLAHOMA
T. D. Churchwell
President

CSW LOUISIANA/ARKANSAS
Michael H. Madison
President

CENTRAL POWER AND LIGHT COMPANY
J. Gonzalo Sandoval
General Manager-President

PUBLIC SERVICE COMPANY OF OKLAHOMA
T. D. Churchwell
President

SOUTHWESTERN ELECTRIC POWER COMPANY
Michael H. Madison
President

WEST TEXAS UTILITIES COMPANY
Paul J. Brower
General Manager-President

CSW ENERGY, INC.
Terry D. Dennis
President and Chief Executive Officer

CSW INTERNATIONAL, INC.
Terry D. Dennis
President and Chief Executive Officer

C3 COMMUNICATIONS, INC.
Richard H. Bremer
President

ENERSHOP INC.
Richard H. Bremer
President

CSW ENERGY SERVICES, INC.
Richard H. Bremer
President

CSW CREDIT, INC.
Glenn D. Rosilier
President

CSW LEASING, INC.
Glenn D. Rosilier
President

SHAREHOLDER INFORMATION

COMMON STOCK LISTING

Central and South West Corporation's common stock is traded under the ticker symbol CSR and is listed on the New York and the Chicago stock exchanges. You can obtain stock quotations from the New York Stock Exchange report in most daily newspapers.

COMMON STOCK DIVIDENDS

Dividends of 43.5 cents a share were paid in each quarter of 1997. All dividends paid by the Corporation represent taxable income to shareholders for federal income tax purposes.

In January 1998 the Corporation's board of directors maintained the quarterly dividend rate of 43.5 cents a share. Traditionally, the board of directors has declared dividends to be payable on the last business day of February, May, August and November. Future cash dividends will be dependent upon the policies of the board of directors and the Corporation's earnings, financial condition and other factors.

LOST DIVIDEND CHECK OR STOCK CERTIFICATE

If you do not receive your dividend check or stock certificate or if it is lost, destroyed or stolen, please call our Investor Services Department immediately.

STOCK TRANSFER

Central and South West Services, Inc., is the transfer agent and registrar for Central and South West Corporation's common stock and for the preferred stocks of the Corporation's subsidiaries.

To transfer your stock to another name, write the new name, address and tax identification number on the back of the certificate and sign your name exactly as it appears on the front. Then have your signature Medallion-guaranteed by a commercial bank or stockbroker. Signatures cannot be Medallion-guaranteed by a notary public.

Your stock certificate should be sent to our Investor Services Department by registered or certified mail. If you have questions about transferring your shares, you can write or call our Investor Services Department.

TAXPAYER ID NUMBER

Federal law requires each shareholder to provide a taxpayer identification number for all shareholder accounts. For individual shareholders, your ID number is your Social Security number.

You must provide your ID number whenever you open a new account in our stock, even if you already own stock in existing accounts in your name. If you do not provide the ID number, the Corporation is required to withhold 31 percent federal income tax from your dividends.

If your stock is registered in a joint account, it is important to tell us the taxpayer ID number of the primary owner you delegate. If you are custodian for a minor or act as a trustee on an account, please provide the beneficial owner's tax identification number. This will ensure that your dividends are reported under the correct name, address and taxpayer ID number.

If you have not yet given us your taxpayer ID number, please contact our Investor Services Department to request a W-9 form. Complete, sign and return the form as soon as possible.

DUPLICATE ANNUAL REPORT MAILINGS

We are required to mail an annual report to all of our shareholders. You will receive duplicate mailings from us if there are two or more shareholders at the same address or if your shares are registered in different but similar names.

DIRECT DEPOSIT OF DIVIDENDS

We are pleased to offer direct deposit of dividend payments to your checking, savings or credit union account at any financial institution that accepts direct electronic deposits. Direct deposit eliminates the possibility of your check being lost or stolen, and the funds are credited to your account on the dividend payment date. If you would like an enrollment card, please call our Investor Services Department.

PROXY AND DIVIDEND MAILINGS

Duplicate mailings of proxies and dividend checks cannot be eliminated unless the registration is the same name for all of your accounts.

If your account registrations are identical, notify our Investor Services Department that you want to combine your accounts. If your account registrations are different and you want to combine your accounts, all certificates must be issued in the one registration you prefer. To have your certificates reissued, please follow the instructions under Stock Transfer.

1998 ANNUAL MEETING

The 1998 annual meeting of shareholders is scheduled for May 28. It will be held at the Dallas Museum of Art, 1717 North Harwood Street, Dallas, Texas. The meeting will begin at 10:30 a.m. Central time. If you will not be attending the meeting, please vote your shares by signing and returning your proxy card as soon as possible.

POWERSHARE DIVIDEND REINVESTMENT AND STOCK PURCHASE PLAN

[illegible]

FOR MORE INFORMATION AND A PROSPECTUS

The more information you have, the better your ability to make sound investment decisions. The CSW prospectus provides more details about PowerShare and about Central and South West Corporation. We encourage you to read this information before deciding whether to enroll in the Plan or to send any money.

If you have any questions, please call CSW's Investor Services Department toll free at 1-800-527-5797 weekdays between 9 a.m. and 4 p.m., Central time.

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Central and South West Corporation
1616 Woodall Rodgers Freeway
P.O. Box 660164
Dallas, Texas 75266-0164
http://www.csw.com

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CSWAR97 250

PowerShare®

Yes! I want more information about PowerShare®.

LAST NAME	FIRST NAME	MIDDLE INITIAL

ADDRESS

CITY	STATE	ZIP

Please type or print clearly and mail this completed form to:

Central and South West Corporation
Investor Services Department
P.O. Box 660164
Dallas, Texas 75266-0164

This does not constitute an offer to sell or a solicitation of an offer to buy securities. Such offers and solicitations are made by way of prospectus only, and no sales of common stock under the plan will be made or commitment to purchase accepted unless a copy of the prospectus is delivered. There is no obligation to participate in the plan, and these materials do not constitute the Corporation's recommendation to participate in the plan.

NO POSTAGE
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CENTRAL AND SOUTH WEST CORPORATION
INVESTOR SERVICES
PO BOX 660164
DALLAS TX 75266-9874

Central and South West Corporation
1616 Woodall Rodgers Freeway
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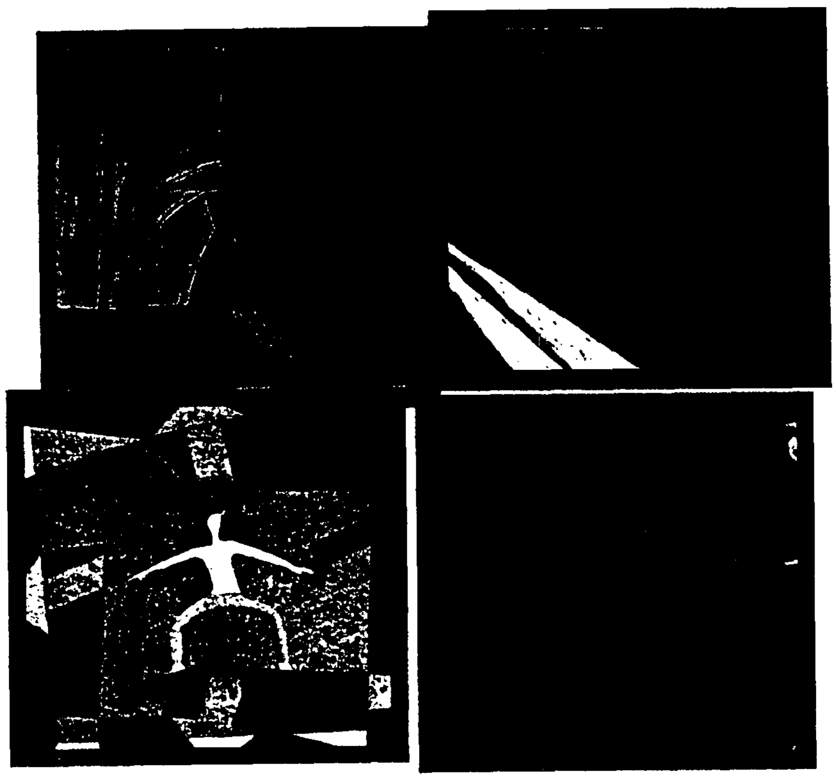
Dallas, Texas 75266-0164
http://www.csw.com

Printed in U.S.A.
CSWAR97 250

CENTRAL AND SOUTH WEST CORPORATION

1998 SUMMARY ANNUAL REPORT



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Focus on the Future. Focus on Success.

Central and South West Corporation is an investor-owned electric utility holding company based in Dallas, Texas.

CSW owns and operates four electric utilities in the United States: Central Power and Light Company, Public Service Company of Oklahoma, Southwestern Electric Power Company and West Texas Utilities Company. These companies serve 1.7 million customers in an area covering 152,000 square miles of Texas, Oklahoma, Louisiana and Arkansas.

CSW also owns a regional electricity company in the United Kingdom, SEEBOARD plc, which serves 2 million customers in Southeast England.

CSW engages in international energy, telecommunications and energy services businesses through the following nonutility subsidiaries:

- CSW Energy, Inc., which develops, acquires, constructs, owns and operates nonutility power projects and exempt wholesale generators in the United States;
- CSW International, Inc., which engages in international activities, including developing, acquiring, financing and owning foreign utility companies;
- C3 Communications, Inc., which provides automated metering, interval meter data and related products and services, and high-capacity city-to-city fiber networks for telecommunications carriers and other wholesale customers;
- EnerShop Inc., which provides energy-management analysis, equipment and EnerACT℠ services to increase productivity and lower energy costs for customers nationwide;
- CSW Credit, Inc., which buys the accounts receivable of our electric utility subsidiaries and other utilities;
- CSW Leasing, Inc., which owns leveraged leases of capital equipment; and
- Central and South West Services, Inc., which provides management and professional services; all services for the corporation and its four U.S. electric companies are conducted at cost.

Through separate investments in various joint ventures, CSW owns indirect interests in:

- Numanco, which provides staffing services for nuclear power plants;
- Diversified Energy Contractors Company, a CSW Energy subsidiary that repairs, upgrades, installs and maintains steam, power and process systems in the U.S.;
- Empresa de Eletricidade Vale Paranapanema S.A., an electric distribution company serving 1.9 million customers in Brazil;
- Enertek, a joint-venture company that owns Mexico's first major cogeneration project located in Altamira, Tamaulipas;
- Beacon Gas, a joint venture with BP Amoco to market natural gas throughout the U.K.;
- Medway Power, a joint venture among SEEBOARD, Southern Electric Power Generation Limited and AES Medway Electric Ltd., that owns and operates a 675-megawatt independent power station on the Isle of Grain in the U.K.; and
- South Coast Power Limited, a joint venture with Scottish Power plc to build a 400-megawatt combined-cycle generating station in West Sussex, England.

Focus on the Future. Focus on Success. As we continue to pursue our merger with American Electric Power Company and to prepare for the opening of the electric power industry to greater competition, we are focused on the future and a strategy of success for Central and South West. We are positioning CSW for this new era by enhancing and building on our traditional strengths.

Our strategy is to seek excellence in customer service, to lower costs in our operations and to invest in a dynamic portfolio of assets and services that can be optimally managed with our proven capabilities.

Given the progress we made on our goals in 1998, we believe we are positioned for success in the new electric power world of tomorrow.

Financial Highlights

Central and South West Corporation

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For the years ended December 31,		1998	1997
financial data in millions	Operating Revenues	$5,482	$5,268
	U.S. Electric Fuel and Purchased Power	1,301	1,266
	United Kingdom Cost of Sales	1,204	1,291
	Other Operating Expenses	1,719	1,630
	Taxes	392	346
	Operating Income	866	735
	Other Income	42	32
	Interest and Other Charges	(468)	(438)
	Extraordinary Item	–	(176)
	Net Income for Common Stock	$ 440	$ 153
common stock data and dividends	Basic and Diluted Earnings per Share	$2.07	$0.72
	Dividends per Share	$1.74	$1.74
	Book Value per Share	$17.04	$16.76
	Average Common Shares Outstanding (millions)	212.4	212.1
	Return on Average Common Equity	12.4%	4.2%
	Dividend Yield	6.3%	6.4%
	Dividend Payout Ratio	84%	242%
	Year-End Market Price	$27 7/16	$27 1/16

		closing market price high	closing market price low	dividends paid
1998	First Quarter	$27 13/16	$26 1/4	$0.435
	Second Quarter	27 5/8	25 5/8	0.435
	Third Quarter	28 3/4	25 1/4	0.435
	Fourth Quarter	30 1/16	27 3/8	0.435
				$1.74
1997	First Quarter	$25 3/4	$21 1/4	$0.435
	Second Quarter	22 1/8	18 1/4	0.435
	Third Quarter	22 7/16	19 3/4	0.435
	Fourth Quarter	27 5/16	20 5/8	0.435
				$1.74

The condensed consolidated statements in this summary annual report were derived from the consolidated financial statements that appear in CSW's 1998 Financial Report to shareholders. Copies of the consolidated financial statements and the report of Arthur Andersen LLP thereon may be obtained by calling Central and South West Corporation's Investor Services Department at 1-800-527-5797.

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CORPORATE

- Received strong support for our merger with American Electric Power Company from the shareholders of both companies.
- Gained authorization for the merger from the U.S. Nuclear Regulatory Commission and a conditional approval from the Arkansas Public Service Commission.
- Supported legislation to open electric power to fair competition in Texas, Oklahoma, Louisiana and Arkansas.

U.S. ELECTRIC UTILITIES

- Controlled operating and maintenance costs to save approximately $21 million in 1998 compared to the effects of inflation.
- Set records for the amount of power generated and revenues earned.
- Met power demands for the record heat wave in 1998 without any significant power disruption.
- Rated by *Public Utilities Fortnightly* as the sixth-most-efficient electric utility among the top 100 in the U.S.
- Won the 1998 Texas Environmental Excellence Award from the Texas Natural Resource Conservation Commission for our renewable energy project in West Texas.
- Honored as 1999 Tree Line USA Utilities by the National Arbor Day Foundation for work in tree care, tree planting and public education.

INTERNATIONAL UTILITIES

- Our English utility subsidiary, SEEBOARD plc, began operating in a competitive market, with customers in certain areas now able to select their electric power supplier.
- SEEBOARD began a 30-year contract to operate, maintain and renew the power supply network for the London Underground, the world's largest metro rail system.
- Increased our investment in Vale, a private Brazilian electric system, to $180 million.

INDEPENDENT POWER PLANTS

- Began operating a 330-megawatt cogeneration power plant that provides electricity and steam to Phillips Petroleum's adjacent facility and sells electricity in the Texas competitive market.
- Began operating a 109-megawatt cogeneration plant near Tampico, Mexico, in partnership with Alpek, S.A. de C.V., a subsidiary of ALFA.
- Began constructing a 500-megawatt merchant power plant in the Rio Grande Valley of Texas.
- Began constructing a 400-megawatt combined-cycle gas-turbine power station in West Sussex, England, in partnership with Scottish Power plc.

OTHER NONUTILITY SERVICES

- Our EnerShop subsidiary made progress offering its EnerACT energy-management services, which help clients better understand and monitor energy costs at their facilities.
- Restructured C3 Communications' telecommunications business by selling its retail telephone operations to a former partner for $56 million.
- C3's Utility Automation Division completed its state-of-the-art Meter Data Center to collect, validate and deliver interval meter data to one-third of California's direct-access market.

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I am pleased to report that 1998 was a strong year for CSW, in terms of both short-term achievements and progress on our strategic goals. Our financial results rebounded from those of 1997, and we achieved improvements in every key measure. We did so by focusing on what we do best—providing excellent customer service and operating efficient, low-cost power systems. These strengths position us well for the future competitive electric marketplace and for our pending merger with American Electric Power Company.

For 1998 we set four priorities:

Improve our financial performance significantly;

Work to complete our merger with AEP;

Continue adapting our utility business for the coming competitive marketplace; and

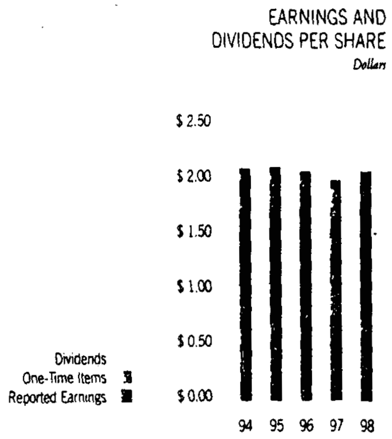
Seek state and federal legislation to restructure electric utilities in a way that is fair to all parties.

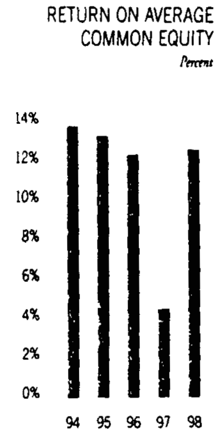
As the milestones on page 3 illustrate, we made excellent progress in all four areas.

Financial Performance

CSW turned in significantly improved results in 1998. For the year, our consolidated earnings were $2.07 per share, compared to $0.72 in 1997, when we encountered several major regulatory costs. In January 1999 the board of directors declared a regular quarterly dividend of 43.5 cents a share. We expect to continue paying dividends at this level until the merger with AEP is completed, subject to quarterly board review of CSW's financial condition and operating performance.

We are proud of the significant improvement over 1997. Summertime weather, which was hotter than we had experienced in the past several years, was an important factor. However, the results also reflect our dedication to containing costs and expanding services, the economic growth occurring in the areas we serve and the extraordinary commitment of our 11,000 employees. Despite the pressures of tighter





budgets, uncertainties about effects of the pending merger, floods and other weather emergencies, they met our high expectations in terms of reliability, quality and customer satisfaction. I am proud of them for all their fine work.

COMPLETING THE MERGER

Our proposed merger with AEP continues to undergo state and federal regulatory review. As a result of the schedules set for formal hearings, we have revised the merger's expected completion date to late 1999. Merging the two companies to form a new AEP will create America's premier electric power company and will offer substantial benefits to our shareholders, customers and employees.

In 1998 we received strong endorsements of the merger from the shareholders of both companies. We also received approval from the U.S. Nuclear Regulatory Commission and a conditional approval from the Arkansas Public Service Commission. We expect approvals during 1999 from the other states we serve.

The Federal Energy Regulatory Commission has set hearings on the merger to begin in June 1999. We have filed our request for approval by the Securities and Exchange Commission and are preparing filings to be made soon at the Federal Communications Commission and the U.S. Department of Justice.

Although we are confident we will eventually gain the approval of each regulatory body reviewing our merger, we are aware of how difficult it is—how uniquely difficult—for electric utilities to merge. We estimate it will take approximately two years altogether to receive all the required regulatory approvals.

Unfortunately, this timetable is typical for large electric utility mergers and is far longer than for mergers of larger companies in other industries.

If we are to have a competitive electric power industry, the regulatory process must be streamlined to allow utility companies to move much faster to capture efficiency and productivity improvements.

THE YEAR 2000 ISSUE

Around the world, organizations and governments now are testing and updating their data systems so that they will operate properly in the new century. Since 1996, CSW has been working to ensure that all our computer systems will function accurately and without interruption before, during and after January 1, 2000.

Our Year 2000 readiness is a top priority. More than 30 Readiness Teams are in various phases of the project and represent the equivalent of about 90 full-time employee positions working on the issue.

We estimate that the total cost of this work will approach $38 million. Through the end of 1998, we had spent approximately $10 million on the project. The corrective and certification measures are well under way for all our systems, and completion is expected by the end of the second quarter of 1999.

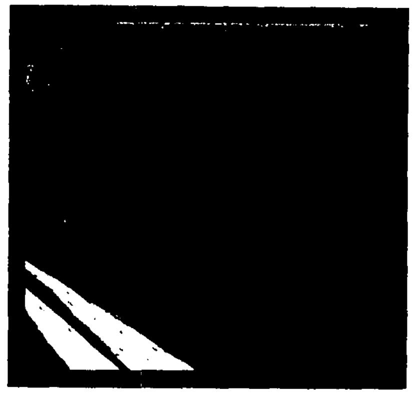
Although we cannot guarantee that service interruptions will not occur, we are making every reasonable effort to provide a smooth transition into 2000 and beyond.

PREPARING FOR THE FUTURE

The coming millennium holds great promise for our company and our industry. In particular, we are most optimistic about our merger with AEP. While the merger is progressing, we are continuing to operate CSW to offer maximum value to our customers, shareholders and communities. Because our strategic plan is so similar to AEP's, we believe that our present efforts will contribute added value to the merger and be consistent with our obligations under the merger agreement.

As a result of initiatives taken during the past few years, we now receive more than one-third of our revenues from operations other than our four regulated U.S. electric utilities. We are pleased by the performance of our electric utility interests in England and Brazil. Based on their results, we continue to seek additional investment opportunities in countries that have favorable growth rates and relatively stable

Competition
The race to compete in the electric power business already is under way, and CSW's path to success is through offering low-cost energy and excellent service.



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economies. At the same time, we are mindful of the economic volatility in South America and other regions of the world.

Our principal nonutility activity—building and operating independent power plants—achieved a milestone year in 1998. We completed two large projects early in the year and began developing two major new projects. This progress strengthened our position in the highly competitive and growing independent power market.

BENEFITS OF THE AEP-CSW MERGER

The merger between Central and South West and American Electric Power will combine two of the country's largest and best electric power systems and will offer substantial benefits to their shareholders, customers and employees.

The merger will yield an estimated $2 billion in savings over 10 years through the elimination of duplicate corporate and administrative programs and through greater efficiencies in operations and purchasing.

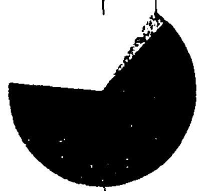
The new AEP will be the foremost electric utility in the U.S. in terms of generating capacity, total customers and amount of power sold in wholesale and retail markets.

It will serve nearly 9 million electric customers, 4.7 million in 11 U.S. states and more than 4 million in other countries.

Although the new AEP will not be the largest utility in any state it serves, it will be competitive in all 11.

Both AEP and CSW are ranked today among the very best in customer service and operating efficiency; the new AEP will be able to capitalize on these strengths to become America's premier diversified low-cost electric utility.

1998 REVENUES



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To improve our understanding of competitive energy markets, we expanded our power trading operations, which currently are conducted by our four regulated utilities; we won major customers for energy services and consulting by our EnerShop subsidiary; and we gained full certification in the competitive California meter data market.

Along with our expansions, we sold activities that did not capitalize on our principal strengths. Our SEEBOARD subsidiary sold its 41 retail appliance superstores, and our C3 Communications unit sold its retail telephone operation to concentrate on developing city-to-city fiber optic networks.

We believe all of these steps are on the right track for success in a more competitive business.

INDUSTRY RESTRUCTURING

Restructuring the U.S. electric power industry to let customers choose their electric suppliers is an unpredictable process—some states are moving quickly, others are hardly moving at all, and the federal government is still considering legislation.

The State of Oklahoma has enacted a restructuring law, but most of its details are still to be worked out. The Texas Legislature is now considering legislation that would open the industry to new competition. The legislatures in Arkansas and Louisiana also are discussing the issue, but it is too early to know whether they will act on restructuring legislation in 1999. In all four states, we are encouraging lawmakers to speed up the process and eliminate the uncertainty that now surrounds electric restructuring in our region.

Although timely action is important, revamping an industry as large and as crucial as electric power must be done with great care. We continue to remind policymakers that new rules for electric companies must not favor one customer over another; they must safeguard the reliability and quality of electric service; and they must allow utilities to recover any stranded investments that were prudently incurred and approved by regulators.

E.R. Brooks
Chairman and
Chief Executive
Officer

Several restructuring plans in other states have met these criteria. We are confident that they can be achieved in our four states as well.

In the U.K., SEEBOARD is competing nationally for both electric and gas customers as a result of the phased opening of the retail marketplace that started in September 1998. Deregulation of U.K. power suppliers has increased competition based on price and has led some customers to change suppliers. However, SEEBOARD is competing strongly on both price and service in its own area and in neighboring regions. In particular, it is adding many new dual-fuel customers, who buy both their electricity and natural gas from the company.

LOOKING AHEAD

1999 probably will be my last year as chairman and chief executive officer of CSW. I will retire from active management upon completion of the merger and then will join the board of directors of the new AEP. The new company will be led by my friend and colleague, Dr. E. Linn Draper, Jr., who is currently chairman, president and chief executive officer of AEP.

I have mixed feelings about stepping down at this exciting time in the history of the company. However, I am pleased that CSW will become part of the largest and best-positioned electric power company in the U.S., which will be very capable of competing successfully in the global power business.

I am pleased, too, that it will be in the hands of excellent management and employees, which is the strongest reason the new company will be successful in the future.

E R Brooks

E. R. Brooks
Chairman and Chief Executive Officer
February 12, 1999

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Focus on...
Low Prices and Quality Service

Our four electric utilities in the U.S. not only met their financial goals for 1998, but also overcame the elements.

Weather extremes of floods, tornadoes, ice storms and one of the most intense heat waves in history besieged our service areas. Victoria, Texas, was hit by the worst flood ever recorded there when the Guadalupe River rose 11 feet above flood stage. Abilene endured 37 days of temperatures over 100 degrees. Shreveport suffered an ice storm on Christmas Eve that plunged the city into a deep freeze for most of the following week. Because of their dedication, many of our employees were honored for helping their neighbors cope with the severe weather and for their community service.

During June, many utilities across the country had to purchase electric power on the spot market at record high prices, while others were unable to meet the needs of their system and experienced blackouts. Our system was able to meet our customers' demands and to deliver the reliable service that customers have grown to expect. CSW also was able to sell power to other utilities that needed it.

Partly because of the weather, our U.S. utilities sold a record amount of electricity in 1998—up 5 percent from 1997—and produced a record $3.5 billion in revenues.

Preparing for Competition

Our strategy for serving customers once they have the opportunity to choose their electric supplier is simple: offer them low prices and excellent service. In 1998, we continued work on these two goals.

For the fifth consecutive year, we held operations and maintenance costs of our utility system essentially flat. If those costs had been increasing at the rate of inflation, we would have spent an additional $21 million in 1998 on O&M. In September CSW was named the sixth-most-efficient electric utility in the country in a study conducted by *Public Utilities Fortnightly.* The study was based on the top 100 utilities' cost of fuel, O&M costs, capital and labor.

Environment
CSW has had a long commitment to environmental stewardship, which underlies our many programs and awards to protect the land and living things.

We continued helping our communities maintain a healthy level of growth through our economic development programs. In 1998 our U.S. utilities played key roles in attracting 155 companies to build or expand facilities in our service areas, providing $561 million in investments and 10,950 new jobs.

Year 2000 Readiness

Assuring that our data and information systems will operate properly into the new millennium is a top priority for us. It is one we have been working on since 1996.

The problem goes back to the early days of computers. To conserve costly memory, programs used only the last two digits for the year. As a result, the year 2000 might be interpreted by some older computer systems as 1900.

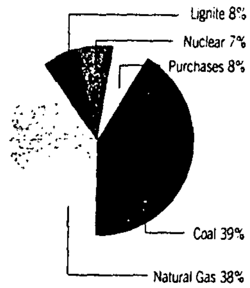
At CSW, the span of these data systems is far-reaching. They include power plants, transmission, distribution and substations, management information systems for customer billing, payroll, inventory, maintenance, telecommunications, building environmental controls, metering devices—even some of our line trucks. We expect to complete the corrective and certification measures for all systems by the end of the second quarter of 1999. We also are completing contingency plans in case they are needed. We are making every reasonable effort to provide a smooth transition into 2000 and beyond.

Environmental Programs

In 1998 CSW joined Texas Governor George W. Bush's statewide clean-air campaign by voluntarily committing to further reduce emissions from our electric generating plants. We plan to lower nitrogen oxides emissions by 3,000 tons over two years.

We also developed plans to file reports with the U.S. Environmental Protection Agency specifying the amount of certain chemicals released by our coal-fired power

U.S. UTILITIES
1998 ENERGY SOURCES



HIGHLIGHTS OF CSW'S YEAR 2000 READINESS

Power Plants

We have found no Year 2000 defect so far that would have caused a power plant to stop operating.

Half of our power plant controls use systems in which Year 2000 is not an issue.

Transmission and Distribution

Electric delivery equipment consists mainly of poles, wires, transformers, switches and fuses in which Year 2000 is not an issue.

Fewer than 15 percent of the control systems for operating our transmission and distribution equipment are microprocessor-based, and 95 percent of these systems process Year 2000 dates correctly. The other 5 percent are being tested and corrected.

The standard residential meter is not affected; however, about one in 10 of our industrial and large commercial meters uses microprocessors; so far, our testing has shown that 90 percent of these meters process dates correctly. Work is under way on those that potentially could fail.

Business Systems

The areas requiring the most work are the computers that handle customer billing, accounting and other business systems.

We are on track to resolve Year 2000 issues in these business systems by the summer of 1999.

Suppliers

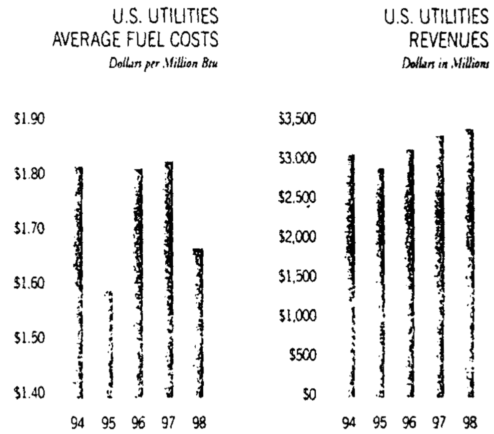
We have contacted more than 6,000 suppliers to determine their readiness; 70 percent have responded.

Contingency plans have been in place for years to deal with the effects of tornadoes, hurricanes, ice storms and outages; these plans are being updated to include Year 2000 issues.

We are working with the North American Electric Reliability Council on readiness of the interconnected national electric delivery system.

We are working through our regional reliability councils with neighboring electric companies on Year 2000 readiness.

This is a "Year 2000 Readiness Disclosure" within the meaning of the Year 2000 Information and Readiness Disclosure Act. This disclosure is notice of the Year 2000 problem and is in accordance with the Year 2000 Information and Readiness Disclosure Act (P.L. 105-271).



plants. The EPA is requiring electric utilities to report these releases for the first time on July 1, 1999, under its Toxic Release Inventory initiative.

The TRI regulations currently require nearly 30,000 facilities nationwide to report their annual emissions of certain chemicals. TRI allows members of the public to access this information on the types and quantities of listed chemicals that are released. TRI requires reports on the amounts of materials disposed of, transferred offsite, recovered and recycled.

CSW has a long history of environmental stewardship and a commitment to help customers and shareholders understand environmental issues. To ensure that we minimize our effect on the environment, we spend more than $50 million a year on environmental compliance, control and stewardship activities throughout our system. We also continually audit our facilities to evaluate and improve their environmental performance. TRI will give us yet another tool to inform the public about our environmental performance.

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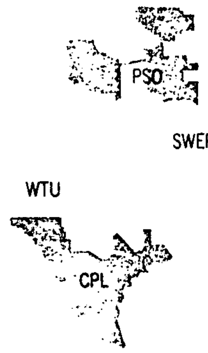
Renewable Energy

We are committed to using renewable and other forms of energy that have a minimal effect on the environment. In 1998 our pioneering renewable energy project in the Davis Mountains of West Texas won the Texas Environmental Excellence Award from the Texas Natural Resource Conservation Commission. The 75-acre energy project includes twelve 550-kilowatt wind turbines, three large solar arrays connected to our power grid producing 205 kilowatts, and five 2-kilowatt rooftop photovoltaic systems on commercial buildings and residences.

In 1998 we announced plans to purchase an additional 75,000 kilowatts of renewable energy from a proposed wind generation facility in McCamey, Texas. The wind farm will contain 100 wind turbines, each generating 750 kilowatts. It is expected to begin operating in the summer of 1999.

THE CSW SYSTEM



In November, the Public Utility Commission of Texas approved a contract for CSW to install 19 solar photovoltaic systems on public schools in the service areas of our three electric companies that operate in Texas. These solar installations are expected to be completed in the fall of 1999. The project also will include an educational program about alternative energy sources.

Tree Line USA Utilities

Another environmental program our electric utilities have supported is the protection and improvement of trees in our communities. By properly pruning trees, planting appropriate new species and educating the public, we are working to both beautify our communities and reduce the interference of tree limbs with our power lines.

In recognition of this work, two of our companies, Central Power and Light Company and Public Service Company of Oklahoma, were among the 38 utilities honored as 1999 Tree Line USA Utilities. The National Arbor Day Foundation award recognizes the companies for their proper pruning techniques and urban forestry programs.

CSW U.S. ELECTRIC UTILITIES

COMPANY	Central Power and Light Company	Southwestern Electric Power Company
HEADQUARTERS	Corpus Christi, Texas	Shreveport, Louisiana
CUSTOMERS	642,000	419,000
	Public Service Company of Oklahoma	West Texas Utilities Company
	Tulsa, Oklahoma	Abilene, Texas
	486,000	188,000

Focus on. . .
Markets for Growth

CSW has more electricity customers outside the United States—in England and Brazil—than we do at home. Notwithstanding the ongoing economic problems in many world regions, we remain optimistic about future growth opportunities abroad as other countries privatize their utility systems and as developing countries expand their economies faster than mature economies like that of the U.S.

United Kingdom

In 1998 the electricity market in the U.K. began a phased opening up to competition, allowing domestic and small business customers in selected areas to choose their electric suppliers. During 1999, competition will be extended to the entire country.

Our U.K. subsidiary, SEEBOARD, became one of the first regional electricity companies to compete in the open marketplace, with part of its service area being opened to competition in October. SEEBOARD is actively competing to retain its existing customers and win new customers in other regions.

SEEBOARD is well positioned for the competitive marketplace. Like our U.S. utilities, it has been focusing for many years on lowering costs and providing excellent customer service. Since 1991, typical SEEBOARD customers have seen their electric power costs drop by more than 30 percent in real terms, making SEEBOARD one of the lowest-cost utilities in England. Customers can save even more money by also buying their natural gas from Beacon Gas, a SEEBOARD partnership with BP Amoco.

SEEBOARD's customer service consistently has been rated among the best in the country and has been recognized by the government's electric utility regulator as the best overall customer service.

In 1998 SEEBOARD streamlined its business by selling its 41 retail appliance superstores to the Dixons Stores Group for about $30 million. We recognized that SEEBOARD's retail business would not be able to compete successfully over the long term with the larger national chains.

In a joint venture, SEEBOARD Powerlink won a 30-year contract worth about $1.6 billion to operate, maintain, finance and renew the high-voltage power distribution network of the London Underground, the largest metro rail system in the world.

SEEBOARD Powerlink will be responsible for distributing high-voltage electricity supplies to all 270 Underground stations and to some 250 miles of the rail system's track. SEEBOARD's partners in the Powerlink consortium are the international electrical engineering group ABB and the international cable and construction group BICC.

SEEBOARD	VALE
Headquarters Crawley, West Sussex, U.K.	Headquarters São Paulo, São Paulo, Brazil
Services Electricity distribution Electric power supply Natural gas supply by Beacon Gas, a joint venture with BP Amoco Contracting and consulting services	Services Electricity distribution Hydroelectric generation Electric power supply Equity in seven other Brazilian electric systems
Operations Southeast England, including much of Surrey and West Sussex, all of East Sussex and most of Kent; supply nationally	Operations Brazilian states of São Paulo, Paraná, Tocantins, Minas Gerais, Mato Grosso and Pará
Customers 2 million electric customers; 170,000 Beacon Gas customers	Customers 1.9 million electric customers

International
We are optimistic about international opportunities for future growth as other countries privatize their utility systems and seek new investment partners.

SOUTH AMERICA

Our investment in a major Brazilian utility group continues to show potential for considerable growth. Over the past several years, we have invested $180 million in Empresa de Eletricidade Vale Paranapanema S.A. (Vale), including $100 million of convertible securities during 1998.

Vale is a private Brazilian electric distribution company with holdings in seven additional electric distribution systems. Operations are in the states of São Paulo, Paraná, Tocantins, Minas Gerais, Mato Grosso and Pará, serving about 1.9 million customers.

Because of the devaluation of the Brazilian real and slowed investments in the country, we are monitoring events there closely. Nevertheless, we remain confident about the long-term potential of our Brazilian investment. With a population of 160 million people, largely well-educated, Brazil is the growth engine for much of South America. Vale's increase in electric power demand—some 10 percent in 1998—offers the opportunity for future growth.

CSW also has a strategic investment in stock of a Chilean electric company. Chile has encountered economic and monetary problems since we began investing there. Despite potential volatility in the short term, we believe the prospects for our Chilean investment offer long-term value.

YEAR 2000 READINESS

Programs to ensure the proper operations of data and information systems after the turn of the millennium are being pursued at SEEBOARD and Vale. As with our Year 2000 readiness program in the U.S., we believe reasonable efforts and proper management attention are being devoted to these programs to provide reliable operations.

Focus on...
Nonutility Power Supplies

CSW Energy and CSW International, our business units that develop, acquire, build and operate independent power plants in the U.S. and other countries, achieved a milestone year in 1998. Early in the year, we began operating two new generating facilities that we had built in Texas and Mexico. Later in the year, we announced plans for two more major power plants, one in Texas and one in England.

Our growing and diverse portfolio of successful projects, totaling 1,762 megawatts of capacity now in operation, has improved our position in the worldwide IPP industry. In addition, the intrinsic value of our IPP business has grown well beyond our initial equity investments.

New Projects

Our new Frontera project, currently under construction in Texas, will be a 500-megawatt natural-gas-fired, combined-cycle facility near the city of Mission in Hidalgo County. It is expected to cost about $200 million and to begin generating power in mid-1999, with full operation expected by the end of the year.

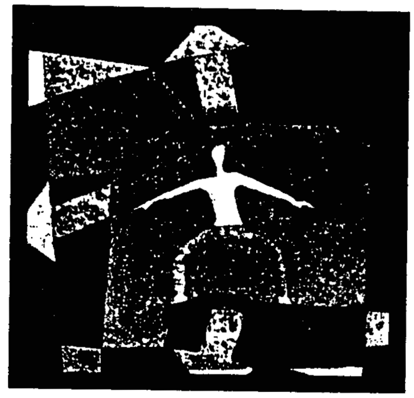
Frontera is our third Texas merchant plant—that is, a generating station designed to sell its power on the open market. Our first two are the Sweeny Cogeneration Facility, which we began operating in early 1998, and Newgulf, which began service in 1997.

We also began constructing a 400-megawatt combined-cycle gas-turbine station at Shoreham Harbor in West Sussex, England. Our partner in the joint venture, named South Coast Power Limited, is Scottish Power plc. The plant is expected to cost about $320 million and to begin operation by the winter of 2000. Its electricity will be sold in the U.K. power pool.

New Startups

In early 1998 we began operating two power plants we had constructed in Texas and in Mexico.

Power Supplies
Our growing and diverse portfolio of nonutility power plants gives us a strong position in the worldwide independent power plant industry.



CSW ENERGY AND CSW INTERNATIONAL PROJECTS Total Capacity and CSW's Ownership Interest

Brush II
Brush, Colorado
68 megawatts
47% interest

Fort Lupton
Fort Lupton, Colorado
272 megawatts
50% interest

Mulberry Cogeneration
Bartow, Florida
120 megawatts
50% interest

Orange Cogeneration
Bartow, Florida
103 megawatts
50% interest

Newgulf
Near Boling, Texas
85 megawatts
100% interest

Sweeny Cogeneration
Old Ocean, Texas
330 megawatts
50% interest

Medway Power Station
Isle of Grain, Kent, U.K.
675 megawatts
37.5% interest

Altamira
Altamira, Tamaulipas, Mexico
109 megawatts
50% interest

Frontera
Mission, Texas
500 megawatts*

South Coast Power Limited
Shoreham Harbor,
West Sussex, U.K.
400 megawatts
50% interest

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* CSW has filed a proposed settlement with the Federal Energy Regulatory Commission to sell 250 megawatts of capacity in the Frontera Power Plant two years after the AEP-CSW merger closes to respond to market-power issues raised in the FERC proceeding.

The Sweeny Cogeneration Facility in Old Ocean, Texas, is the first large power plant built to operate as a merchant plant in the Texas market. It provides steam and 90 megawatts of electricity to Phillips Petroleum Company's adjacent refining and petrochemicals complex. The balance of the plant's 330-megawatt capacity is sold to electric utilities and power marketers on a merchant basis. During 1998, we sold 50 percent of the equity in the plant to an outside investor group, consistent with our plans when we started building the Sweeny project.

The Altamira Project, located near Tampico, is the first major cogeneration project built under Mexico's new legal framework. It also is the first project to have long-term contractual commitments with Comisión Federal de Electricidad for the interconnection, backup and transmission of energy and with Petróleos Mexicanos for natural gas to fuel the plant. Our partner in the project is Alpek, S.A. de C.V., a subsidiary of the ALFA Group. We have contractual commitments for the steam produced by the plant and its 109 megawatts of electric power.

Focus on...
Expanding Our Customer Base

EnerShop®

Our EnerShop subsidiary helps commercial and governmental customers manage and use energy more efficiently. By working with large customers of other utilities, we are building relationships that should pay dividends when the marketplace opens and we can compete for their electric power supply.

In 1998 we emphasized our unique Energy Aggregation and Control Technology, or EnerACT, which is a state-of-the-art energy information and management service. It helps clients track "real-time" energy usage and costs to make informed decisions about how to save energy costs.

City-to-City Fiber Networks

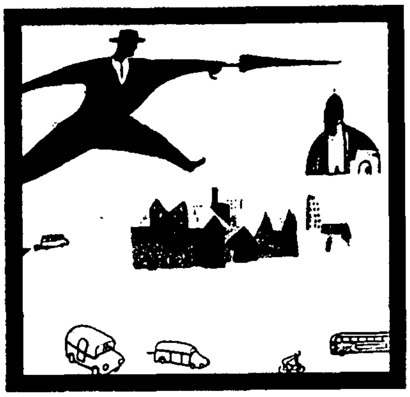
Our telecommunications subsidiary, C3 Communications, Inc., sold its interest in a local-exchange and long-distance telephone company to its former partner in the enterprise, ICG Communications. We received $56 million for the sale and retained ownership of all the partnership's city-to-city fiber network, which delivers optical networking to the telecommunications wholesale market.

C3 intends to develop new fiber optic routes in Texas, Oklahoma, Louisiana and Arkansas. These services will offer synergies with our other nonutility energy and telecommunications services.

Automated Meter Reading

As the electric power industry is restructured, one of the services that is being opened to competition in some states is utility meter-reading and the management of metering data. C3 Communications is looking at the advantages of that competitive opportunity.

In 1998 C3 was approved by California's three major utility distribution companies as a qualified provider to manage meter data for the deregulated electricity market.



New Markets
We are exploring products and services in energy efficiency, telecommunications and electric vehicles to complement our electric power business.

C3 Communications is able to read meters; validate, edit and estimate meter-reading data; and publish and archive meter data throughout the state. C3 is considering offering similar meter data services to other customers requiring detailed meter data.

Electric Vehicles

Because electric cars and trucks are more environmentally friendly than conventional vehicles with internal-combustion engines, we have worked to encourage EV-technology development.

We were the first utility to take delivery of the Chevrolet S-10 Electric pickup truck. We also have worked closely with city governments and transportation authorities to help them acquire and use electric buses, electric baggage-handling equipment and other electric vehicle technologies.

In 1998 our electric vehicle arm, CSW Total EV™, began marketing electric bicycles and scooters manufactured by Currie Technologies and ZAP Power Systems.

Condensed Consolidated Statements of Income

Central and South West Corporation

For the years ended December 31, In millions, except per share amounts		1998	1997	1996
revenues	U.S. Electric	$3,488	$3,321	$3,248
	United Kingdom	1,769	1,870	1,848
	Other Diversified	225	77	59
		5,482	5,268	5,155
expenses and other	U.S. Electric Fuel and Purchased Power	1,301	1,266	1,228
	United Kingdom Cost of Sales	1,204	1,291	1,331
	Operations and Maintenance	1,198	1,133	935
	Depreciation and Amortization	521	497	464
	Taxes	392	346	402
		4,616	4,533	4,360
	Operating Income	866	735	795
	Other Income (Expense)	42	32	(61)
	Interest and Other Charges	(468)	(438)	(437)
	Income from Continuing Operations	440	329	297
	Income from Discontinued Operations	-	-	12
	Gain on Sale of Discontinued Operations	-	-	120
	Income Before Extraordinary Item	440	329	429
	Extraordinary Item - U.K. Windfall Profits Tax	-	(176)	-
	Net Income for Common Stock	$ 440	$ 153	$ 429
	Average Common Shares	212.4	212.1	207.5
	Basic and Diluted Earnings per Share	$2.07	$0.72	$2.07
	Dividends Paid per Share of Common Stock	$1.74	$1.74	$1.74

The condensed consolidated statements in this summary annual report were derived from the consolidated financial statements that appear in CSW's 1998 Financial Report to shareholders. Copies of the consolidated financial statements and the report of Arthur Andersen LLP thereon may be obtained by calling Central and South West Corporation's Investor Services Department at 1-800-527-5797.

Condensed Consolidated Statements of Cash Flows

Central and South West Corporation

Attachment 1

KPSC Case No. 99-149
TC (1st Set)
Order Dated April 22, 1999
Item No. 2

For the years ended December 31,		1998	1997	1996
In millions				
operating activities	Net Income for Common Stock	$440	$153	$429
	Depreciation and Amortization	552	529	521
	Other Adjustments to Net Income and Changes in Assets and Liabilities	(50)	44	(75)
		942	726	875
investing activities	Construction Expenditures	(492)	(507)	(521)
	Acquisition Expenditures	—	—	(1,394)
	CSW Energy/CSW International Projects	(184)	(382)	(124)
	Cash Proceeds from Sale of Investments	56	—	690
	Other	(15)	(15)	63
		(635)	(904)	(1,286)
financing activities	Common Stock Sold	11	20	477
	Trust Preferred Securities Sold	—	323	—
	Change in Debt and Preferred Stock	142	44	219
	Payment of Dividends	(378)	(383)	(376)
		(225)	4	320
	Effect of Exchange Rate Changes on Cash	—	(5)	(56)
	Net Change in Cash and Cash Equivalents	82	(179)	(147)
	Cash and Cash Equivalents – January 1	75	254	401
	Cash and Cash Equivalents – December 31	$157	$75	$254

The condensed consolidated statements in this summary annual report were derived from the consolidated financial statements that appear in CSW's 1998 Financial Report to shareholders. Copies of the consolidated financial statements and the report of Arthur Andersen LLP thereon may be obtained by calling Central and South West Corporation's Investor Services Department at 1-800-527-5797.

Condensed Consolidated Balance Sheets

Central and South West Corporation

As of December 31,		1998	1997
In millions			
assets	Electric	$13,915	$13,596
	Other Diversified	333	250
	Accumulated Depreciation	(5,652)	(5,264)
	Fixed Assets	8,596	8,582
	Current Assets	1,751	1,390
	Goodwill	1,402	1,428
	Other	1,995	2,051
		$13,744	$13,451
capitalization and liabilities	Common Stock	$ 3,624	$ 3,556
	Preferred Stock	176	202
	Trust Preferred Securities	335	335
	Long-Term Debt	3,785	3,898
	Total Capitalization	7,920	7,991
	Current Liabilities	2,877	2,514
	Deferred Credits	2,947	2,946
		$13,744	$13,451

The condensed consolidated statements in this summary annual report were derived from the consolidated financial statements that appear in CSW's 1998 Financial Report to shareholders. Copies of the consolidated financial statements and the report of Arthur Andersen LLP thereon may be obtained by calling Central and South West Corporation's Investor Services Department at 1-800-527-5797.

Condensed Consolidated Statements of Stockholders' Equity

Central and South West Corporation

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In millions		common stock	additional paid-in capital	retained earnings	accumulated other comprehensive income (loss)	total
1996	Balance at January 1	$675	$ 610	$1,893	$ (4)	$3,174
	Sale of Common Stock	65	412	–	–	477
	Common Stock Dividends	–	–	(358)	–	(358)
	Other	–	–	3	–	3
						3,296
	Comprehensive Income	–	–	–	77	77
	Net Income	–	–	429	–	429
	Total Comprehensive Income					506
1997	Balance at January 1	740	1,022	1,967	73	3,802
	Sale of Common Stock	3	17	–	–	20
	Common Stock Dividends	–	–	(369)	–	(369)
						3,453
	Comprehensive Income	–	–	–	(50)	(50)
	Net Income	–	–	153	–	153
	Total Comprehensive Income					103
1998	Balance at January 1	743	1,039	1,751	23	3,556
	Sale of Common Stock	1	10	–	–	11
	Common Stock Dividends	–	–	(370)	–	(370)
	Other	–	–	2	–	2
						3,199
	Comprehensive Income	–	–	–	(15)	(15)
	Net Income	–	–	440	–	440
	Total Comprehensive Income					425
1998	Balance at December 31	$744	$1,049	$1,823	$ 8	$3,624

The condensed consolidated statements in this summary annual report were derived from the consolidated financial statements that appear in CSW's 1998 Financial Report to shareholders. Copies of the consolidated financial statements and the report of Arthur Andersen LLP thereon may be obtained by calling Central and South West Corporation's Investor Services Department at 1-800-527-5797.

Report of Independent Public Accountants

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Item No. 2

To the Shareholders and Board of Directors of Central and South West Corporation:

We have audited, in accordance with generally accepted auditing standards, the consolidated balance sheets of Central and South West Corporation (a Delaware corporation) and subsidiary companies as of December 31, 1998 and 1997, and the related consolidated statements of income, stockholders' equity and cash flows for each of the three years in the period ended December 31, 1998, appearing in the Central and South West Corporation 1998 Financial Report for the 1999 annual meeting of shareholders of the Corporation (not presented herein). Our report dated February 12, 1999, also appearing in the Central and South West Corporation 1998 Financial Report, contained an explanatory sentence calling attention to the fact that we did not audit the financial statements of CSW UK Finance Company (1998 and 1997 – which includes CSW Investments) and CSW Investments (1996) which statements reflect total assets and revenues of 22 percent and 32 percent in 1998, 22 percent and 35 percent in 1997 and 23 percent and 36 percent in 1996, respectively, of the consolidated totals. Those statements were audited by other auditors whose reports have been furnished to us and our opinion, insofar as it relates to the amounts included for those entities, is based solely on the reports of the other auditors.

In our opinion, based on our audits and the reports of other auditors, the information set forth in the accompanying condensed consolidated balance sheets as of December 31, 1998 and 1997, and the related condensed consolidated statements of income, stockholders' equity and cash flows for each of the three years in the period ended December 31, 1998, is fairly stated, in all material respects, in relation to the consolidated financial statements from which it has been derived.

Arthur Andersen LLP

Arthur Andersen LLP
Dallas, Texas
February 12, 1999

Report of Management

The condensed consolidated financial statements in this summary annual report were derived from the consolidated financial statements that appear in the Central and South West Corporation 1998 Financial Report for the 1999 annual meeting of shareholders. Management is responsible for preparing the consolidated financial statements, in accordance with generally accepted accounting principles appropriate in the circumstances, and for maintaining the Corporation's systems of internal accounting controls.

A description of these controls, along with management's opinion about their overall effectiveness, is contained within the Report of Management included in the Central and South West Corporation 1998 Financial Report for the 1999 annual meeting of shareholders. The consolidated financial statements were audited by the Corporation's independent public accountants, whose report on the condensed consolidated financial statements appears above.

E. R. Brooks
Chairman and Chief Executive Officer

Lawrence B. Connors
Controller

Glenn D. Rosilier
Executive Vice President and Chief Financial Officer

U.S. Utilities

For the Years Ended December 31,		1998	1997	1996	1995	1994
In millions						
electric revenues	Residential	$1,305	$1,253	$1,243	$1,138	$1,156
	Commercial	888	892	872	810	836
	Industrial	777	813	781	702	733
	Sales for Resale	263	243	255	224	204
	Other	255	120	97	9	136
		$3,488	$3,321	$3,248	$2,883	$3,065
In millions						
kilowatt-hour sales	Residential	19,757	17,995	17,883	16,872	16,368
	Commercial	15,554	14,546	14,256	13,755	13,463
	Industrial	21,482	21,087	20,266	19,321	18,869
	Sales for Resale	8,297	7,824	8,428	8,468	7,133
	Other	1,904	1,705	1,592	1,518	1,501
		66,994	63,157	62,425	59,934	57,334
In thousands						
average number of customers	Residential	1,480	1,462	1,443	1,425	1,403
	Commercial	218	214	209	207	203
	Industrial	22	23	24	24	24
	Other	15	13	14	13	13
		1,735	1,712	1,690	1,669	1,643
In thousands						
number of customers	End of Period	1,752	1,724	1,704	1,683	1,661

Certain matters discussed in this summary annual report are forward-looking statements intended to qualify for the safe harbor from liability established by the Private Securities Litigation Reform Act of 1995. These forward-looking statements can generally be identified as such because the context of the statement will include words such as CSW "believes," "anticipates" or "expects," or words of similar import. Similarly, statements that describe CSW's future plans, objectives and goals also are forward-looking statements. Such statements address future events and conditions concerning capital expenditures, earnings, litigation, rate and other regulatory matters, liquidity and capital resources, and accounting matters. Actual results in each case may differ materially from those currently anticipated in such statements, by reason of factors such as electric utility industry restructuring, including ongoing state and federal legislative and regulatory activities; future economic conditions; developments in the domestic and international markets in which CSW and its subsidiaries operate; effects of state and federal regulatory approvals or proceedings and other conditions precedent to the proposed merger with AEP, which may or may not be satisfied; and other circumstances affecting anticipated business activities, revenues and costs.

Comparative Statistical and Financial Record

Central and South West Corporation

Attachment I
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U.S. Utilities

For the Years Ended December 31,		1998	1997	1996	1995	1994
residential sales averages	Kilowatt-Hours per Customer	13,354	12,310	12,392	11,840	11,665
	Revenue per Customer	$882	$857	$861	$799	$824
	Revenue per Kilowatt-Hour	6.60¢	6.96¢	6.95¢	6.75¢	7.06¢
total electric revenue per kilowatt-hour		5.21¢	5.26¢	5.20¢	4.81¢	5.35¢
system peak demand in megawatts		13,718	13,105	12,613	12,314	11,434
fuel data	Average Btu per Net Kilowatt-Hour	10,514	10,405	10,440	10,299	10,344
	Cost per Million Btu	$1.67	$1.83	$1.81	$1.58	$1.82
	Cost per Kilowatt-Hour Generated (mills)	17.53	19.02	18.86	16.30	18.80
CSW system in millions	Total Plant Cost	$14,248	$13,846	$13,421	$13,778	$11,868
	Annual Additions	595	675	583	1,933	616
	Accumulated Depreciation	5,652	5,218	4,940	4,761	3,870
capitalization in millions	Common Stock	$3,624	$3,556	$3,802	$3,178	$3,052
	Preferred Stock	176	202	325	326	327
	Trust Preferred Securities	335	335	–	–	–
	Long-Term Debt	3,785	3,898	4,024	3,914	2,940

The condensed consolidated financial statements in this summary annual report were derived from the consolidated financial statements that appear in CSW's 1998 Financial Report to shareholders. Copies of the consolidated financial statements and the report of Arthur Andersen LLP thereon may be obtained by calling Central and South West Corporation's Investor Services Department at 1-800-527-5797.

Board of Directors and Officers

Board of Directors

Molly Shi Boren
Attorney
Norman, Oklahoma

E. R. Brooks
Chairman and Chief Executive Officer
Central and South West Corporation
Dallas, Texas

Donald M. Carlton, Ph.D.
Retired President and
Chief Executive Officer
Radian International LLC
Austin, Texas

T. J. Ellis, CBE
Chairman and Chief Executive
SEEBOARD plc
Crawley, West Sussex, United Kingdom

Joe H. Foy
Retired Partner
Bracewell and Patterson
Kerrville, Texas

William R. Howell
Chairman Emeritus
J. C. Penney Company, Inc.
Dallas, Texas

Robert W. Lawless, Ph.D.
President
The University of Tulsa
Tulsa, Oklahoma

James L. Powell
Ranching and Investments
Fort McKavett, Texas

Richard L. Sandor, Ph.D.
Chairman and Chief Executive Officer
Environmental Financial Products Limited
Chicago, Illinois

Thomas V. Shockley, III
President and Chief Operating Officer
Central and South West Corporation
Dallas, Texas

Officers

CENTRAL AND SOUTH WEST
CORPORATION

E. R. Brooks
Chairman and Chief Executive Officer

Thomas V. Shockley, III
President and Chief Operating Officer

Ferd. C. Meyer, Jr.
Executive Vice President and
General Counsel

Glenn D. Rosilier
Executive Vice President and
Chief Financial Officer

Glenn Files
Senior Vice President, Electric Operations

Thomas M. Hagan
Senior Vice President, External Affairs

Venita McCellon-Allen
Senior Vice President, Customer Relations
and Corporate Development, and
Assistant Corporate Secretary

Stephen J. McDonnell
Vice President, AEP Merger

Kenneth C. Raney, Jr.
Vice President, Associate General Counsel
and Corporate Secretary

Michael D. Smith
Vice President, Business Opportunities

Lawrence B. Connors
Controller

Wendy G. Hargus
Treasurer

CENTRAL AND SOUTH WEST
SERVICES, INC.

Richard H. Bremer
President, Energy Services

Richard P. Verret
President, Production

Robert L. Zemanek
President, Energy Delivery

M. Bruce Evans
Vice President, Customer Relations

Lana L. Hillebrand
Vice President, Human Resources

Mark W. Menezes
Vice President, Governmental Affairs

Mark D. Roberson
Vice President, Regulatory Affairs

SEEBOARD PLC
T. J. Ellis, CBE
Chairman and Chief Executive

CSW TEXAS
Alphonso R. Jackson
President

CENTRAL POWER AND LIGHT COMPANY
J. Gonzalo Sandoval
General Manager-President

PUBLIC SERVICE COMPANY
OF OKLAHOMA
T. D. Churchwell
President

SOUTHWESTERN ELECTRIC
POWER COMPANY
Michael H. Madison
President

WEST TEXAS UTILITIES COMPANY
Paul J. Brower
General Manager-President

CSW ENERGY, INC.
Terry D. Dennis
President and Chief Executive Officer

CSW INTERNATIONAL, INC.
Terry D. Dennis
President and Chief Executive Officer

C3 COMMUNICATIONS, INC.
Richard H. Bremer
President

ENERSHOP INC.
Richard H. Bremer
President

CSW CREDIT, INC.
Glenn D. Rosilier
President

CSW LEASING, INC.
Glenn D. Rosilier
President

Committees of the Board of Directors

1. The Audit Committee recommends to the board of directors the independent public accountants to be appointed, subject to shareholder approval. The Audit Committee reviews with the independent public accountants and the Corporation's internal auditors the scope of external and internal audits and the adequacy of, and the compliance with, the Corporation's system of internal accounting controls.
2. The Executive Compensation Committee reviews benefit programs and management-succession programs and determines the compensation of executive officers.
3. The Nominating Committee reviews and recommends candidates for election to the board of directors.
4. The Policy Committee reviews and makes recommendations to the board of directors concerning major policy issues, considers on a continuing basis the composition, structure and functions of the board of directors and its committees, and reviews existing corporate policies and recommends changes when appropriate. The Policy Committee has authority to act in place of the board of directors when the board is not in session, to the extent permitted by law.

The membership of these committees is as follows: Molly Shi Boren (1) (2); E. R. Brooks, chairman of the Policy Committee (4); Donald M. Carlton (1) (3); Joe H. Foy, chairman of the Executive Compensation Committee (2) (3) (4); William R. Howell (2) (3); Robert W. Lawless, chairman of the Audit Committee (1) (2) (4); James L. Powell, chairman of the Nominating Committee (1) (3) (4); and Richard L. Sandor (1) (2)

COMMON STOCK LISTING

Central and South West Corporation's common stock is traded under the ticker symbol CSR and is listed on the New York and the Chicago stock exchanges. You can obtain stock quotations from the New York Stock Exchange report in most daily newspapers.

COMMON STOCK DIVIDENDS

Dividends of 43.5 cents a share were paid in each quarter of 1998. All dividends paid by the Corporation represent taxable income to shareholders for federal income tax purposes.

In January 1999 the Corporation's board of directors maintained the quarterly dividend rate of 43.5 cents a share. Traditionally, the board of directors has declared dividends to be payable on the last business day of February, May, August and November. Future cash dividends will be dependent upon decisions of the board of directors based upon the Corporation's earnings, financial condition and other factors.

LOST DIVIDEND CHECK OR STOCK CERTIFICATE

If you do not receive your dividend check or stock certificate, or if either is lost, destroyed or stolen, please contact our Investor Services Department immediately.

STOCK TRANSFER

Central and South West Services, Inc., is the transfer agent and registrar for Central and South West Corporation's common stock and for the preferred stocks of the Corporation's subsidiaries.

To transfer your stock to another name, write the new name, address and tax identification number on the back of the certificate and sign your name exactly as it appears on the front. Then have your signature Medallion-guaranteed by a commercial bank or stockbroker. Signatures cannot be Medallion-guaranteed by a notary public.

Your stock certificate should be sent to our Investor Services Department by registered or certified mail. If you have questions about transferring your shares, you can contact our Investor Services Department.

TAXPAYER ID NUMBER

Federal law requires each shareholder to provide a taxpayer identification number for all shareholder accounts. For individual shareholders, your ID number is your Social Security number.

You must provide your ID number when opening a new account in our stock, even if you already own stock in existing accounts in your name. If you do not provide the ID number, the Corporation is required to withhold 31 percent federal income tax from your dividends.

If your stock is registered in a joint account, it is important to tell us the taxpayer ID number of the primary owner you designate. If you are custodian for a minor or act as a trustee on an account, please provide the beneficial owner's tax identification number. This will ensure that your dividends are reported under the correct name, address and taxpayer ID number.

If you have not yet given us your taxpayer ID number, please contact our Investor Services Department to request a W-9 form. Complete, sign and return the form as soon as possible.

DUPLICATE ANNUAL REPORT MAILINGS

We are required to mail an annual report to all of our shareholders. You will receive duplicate mailings from us if there are two or more shareholders at the same address or if your shares are registered in different but similar names.

DIRECT DEPOSIT OF DIVIDENDS

We are pleased to offer direct deposit of dividend payments to your checking, savings or credit union account at any financial institution that accepts direct electronic deposits. Direct deposit eliminates the possibility of your check being lost or stolen, and the funds are credited to your account on the dividend payment date. If you would like an enrollment card, please contact our Investor Services Department.

PROXY AND DIVIDEND MAILINGS

Duplicate mailings of proxies and dividend checks cannot be eliminated unless the registration is the same name for all of your accounts.

If your account registrations are identical, notify our Investor Services Department that you want to combine your accounts.

If your account registrations are different and you want to combine your accounts, all certificates must be issued in the one registration you prefer. To have your certificates reissued, please follow the instructions under Stock Transfer.

1999 ANNUAL MEETING

The 1999 annual meeting of shareholders is scheduled for April 22. It will be held at the Fairmont Hotel, 1717 North Akard Street, Dallas, Texas 75201. The meeting will begin at 10:30 a.m. Central time.

If you will not be attending the meeting, please vote your shares in any one of the following ways:

- ***Vote by mail.* Complete, sign and mail your proxy card as soon as possible.**
- ***Vote by telephone.* Call 1-800-575-6656 toll-free 24 hours a day, seven days a week from anywhere in the U.S. or Canada.**
- ***Vote over the Internet.* Access the voting site at https://proxy.shareholder.com/csr 24 hours a day, seven days a week.**

If you vote by telephone or the Internet, please have your proxy card available. You will be asked to provide your control number, which is printed on the face of the proxy card. Voting by telephone or the Internet authorizes the named proxies in the same manner as if you marked, signed and returned your proxy card. **If you vote by telephone or the Internet, please do not mail your proxy card.**

ADDITIONAL INFORMATION

We will be pleased to send you additional copies of this *Summary Annual Report.* Also available are the *1998 Financial Report* that accompanies the *Proxy Statement for the 1999 Annual Meeting of Shareholders,* CSW's 1998 Annual Report on *Form 10-K,* a preliminary quarterly financial report, a *Five-Year Financial and Statistical Review of the Central and South West System* and our latest *Environmental Report of the Central and South West System.*

The Corporation is subject to the informational and reporting requirements of the Securities Exchange Act of 1934 and files reports and other information statements with the Securities and Exchange Commission. These reports may be inspected at the SEC's offices and on its Internet site as well as at the New York and Chicago stock exchanges.

We will provide copies of these reports without charge to any Central and South West shareholder. If you would like to receive a report, please contact our Investor Services Department.

INVESTOR SERVICES

Our Investor Services staff is available Monday through Friday from 9 a.m. to 4 p.m. Central time to answer your questions. Our address and telephone number are:

Central and South West Corporation
Investor Services Department
P. O. Box 660164
Dallas, Texas 75266-0164
1-800-527-5797
E-mail: invest@csw.com

INVESTOR RELATIONS

Security analysts should contact:

Becky Hall
Director of Investor Relations
Central and South West Corporation
214-777-1277

If you would like to be added to our mailing list to receive our news releases and other information, please contact our Investor Services Department.

PowerShare® Dividend Reinvestment and Stock Purchase Plan

The Central and South West Corporation (Corporation) PowerShare Dividend Reinvestment and Stock Purchase Plan (Plan) provides a convenient and inexpensive way to reinvest dividends and purchase shares of the Corporation's common stock, $3.50 par value per share (Common Stock).

Nonshareholders of legal age who are residents of the 50 states of the United States or the District of Columbia may enroll in the Plan by making an initial cash investment of $250. Employees and eligible retirees of the Corporation and its subsidiaries may elect to purchase Common Stock through automatic payroll or pension deductions, with a minimum of $10 per pay period.

- Easy Enrollment.
- $25 Minimum Additional Investments. After an initial investment of $250 has been made, a minimum additional investment of $25 or optional cash purchases of up to $100,000 per calendar year can be made in CSW Common Stock.
- Dividend Reinvestment and Payment Options. Participants may elect to have cash dividends on all or any portion of their shares of Common Stock automatically reinvested in CSW Common Stock. Cash dividend payments not reinvested will be paid to participants by check or through electronic direct deposit.
- Safekeeping Service for CSW Common Stock Certificates. PowerShare participants may deposit certificates for CSW Common Stock with CSW's Investor Services Department for safekeeping, and the shares will be credited to those participants' PowerShare accounts.
- Weekly Purchases of Shares.

The more information you have, the better your ability to make sound investment decisions. The CSW PowerShare prospectus provides more details about the Plan and about Central and South West Corporation. We encourage you to read this information before deciding whether to enroll in the Plan or to send any money.

If you have any questions, please call CSW's Investor Services Department toll-free at 1-800-527-5797 weekdays between 9 a.m. and 4 p.m. Central time.

Design: Walsh Associates
Photography: Phillip Radcliffe
Illustrations: Beppe Giacobbe
Printed on recycled paper

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