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BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of AEP Ohio Transmission Company, Inc., For Confirmation That Its Operations Will Render It an Electric Light Company and a Public Utility Within the Meaning of Sections 4905.03(A)(4) and 4905.02, Revised Code	)	**Case No. 10-245- EL-UNC**
and		
In the Matter of the Joint Application of AEP Ohio Transmission Company, Inc. and Columbus Southern Power Company and Ohio Power Company for Approval of Proposed Transfers, To the Extent Required by Section 4905.48(B), Revised Code	)	**Case No. 10-246- EL-UNC**
In the Matter of the Application of AEP Ohio Transmission Company, Inc. for Authority to Issue Short-term Notes and Other Evidences of Indebtedness	)	**Case No. 10-247-EL-AIS**

REPLY COMMENTS OF JOINT APPLICANTS

Applicants AEP Ohio Transmission Company, Inc. (OHTCo), Columbus Southern Power Company (CSP) and Ohio Power Company (OP) (CSP and OP referred to together as "AEP Ohio" and all three applicants collectively as "Joint Applicants") filed an amended application on March 3, 2010. In Case No. 10-245-EL-UNC, OHTCo seeks confirmation that its operations will render it an electric light company and a public utility within the meaning of Sections 4905.03(A)(4) and 4905.02, Revised Code. Alternatively, OHTCo requests that if the Commission concludes OHTCo is not an electric light company and a public utility subject to the

Commission's jurisdiction, that the Commission issue an order confirming that conclusion. In Case No. 10-246-EL-UNC, Joint Applicants request the Commission to declare that Section 4905.48(B), Revised Code, does not apply to OHTCo. Alternatively, to the extent the Commission determines that OHTCo is a "public utility" and that Section 4905.48(B), Revised Code, is applicable, Joint Applicants request Commission approval of a transfer of the assets that are not yet electric plants in service, from AEP Ohio to OHTCo, as listed in Exhibit C of the amended application. The Joint Applicants also filed as part of their application a request for authority to issue short-term notes and other evidences of indebtedness in Case No. 10-247-EL-AIS.

On April 1, 2010, the Commission issued an Entry scheduling a comment cycle regarding the amended application, with initial comments due April 30, 2010 and reply comments due May 17, 2010. On April 30, 2010, comments were filed by the Industrial Energy Users- Ohio (IEU), the Ohio Partners for Affordable Energy (OPAE) and Ohio Consumers' Counsel (OCC). The Joint Applicants hereby respond through these reply comments.

I. RESPONSE TO IEU COMMENTS

IEU raises three basic points in its comments, by asserting that: (1) Joint Applicants have not explained how the proposed transmission corporation structure will facilitate capital formation; (2) Joint Applicants have not explained how the proposed transmission corporate structure will ease pressure from transmission investments on CSP's and OP's credit ratings; and (3) the proposed transmission corporate structure complicates and already complex corporate structure. Joint Applicants submit that creation of the new AEP transmission companies will actually simplify the corporate structure rather than make it more complex and, although information was previously provided in the amended application regarding the IEU's two specific concerns about capital formation and credit ratings impact, Joint Applicants will provide additional information to more fully address the issues raised.

Improved Capital Formation

Regarding IEU's criticism (at 3) that "it is difficult to understand how the transmission corporation model does better with Wall Street," Paragraph 11 of the amended application listed seven distinct and detailed factors driving the finance-related bases for the proposed transmission corporate structure. Joint Applicants submit that each of those seven items represent intuitive and self-authenticating expectations that can reasonably be relied upon by the Commission in concluding that the application is in the public interest. Joint Applicants have additional empirical support for those observations, as further discussed in these reply comments. In order to be better prepared to address concerns such as those voiced by IEU, AEP retained an independent expert to evaluate the investor's perspective on AEP's proposed transmission corporate structure.

The analysis was undertaken by Ms. Julie Cannell, a former securities analyst and portfolio manager specializing in the electric utility industry. Prior to forming her firm in 1997, Ms. Cannell spent two decades as a securities analyst and portfolio manager specializing in the electric utility industry at investment manager Lord, Abbett & Company. Ms. Cannell was invited by AEP to provide her assessment, gained through a series of interviews she conducted with investors and credit rating agencies, of AEP's decision to form a series of wholly owned transmission companies to support new transmission development. The analysis is presented in a paper entitled *AEP Transco: The Investor's Perspective* ("*Transco White Paper*"). Joint Applicants shared the *Transco White Paper* informally with stakeholders, including Staff, IEU and OCC, prior to the filing of the amended application. In order to more fully respond to IEU's criticisms, Joint Applicants are formally submitting the *Transco White Paper* as an attachment to these reply comments.

The *Transco White Paper* supports the conclusion that capital formation ability will likely be improved over time using the proposed Transco model, specifically concluding in this regard (at 7) that "[f]rom a credit perspective, a transmission-only entity is expected in the long run to receive a better pricing of debt." As a general matter, the *Transco White Paper* concludes (at 7) that "[i]nvestors overwhelmingly embrace the notion of having a new investable entity within AEP." Joint Applicants submit that these observations by an independent securities expert, as well as the supporting research and analysis embodied in the *Transco White Paper*, are more than sufficient to refute IEU's skepticism about capital formation benefits of the AEP Transco model.

Impact on Operating Company Credit Ratings

As a related matter, IEU also contends (at 3-4) that "it is difficult to understand (and the Companies have not explained) how the transmission facilities are the drivers of increased pressure on OP's and CSP's credit ratings . . . " As discussed in Paragraph 11.i. of the amended application, transmission investments mandated by NERC and PJM (including the timing of required investments) constrain AEP Ohio's capital requirements and increase pressure on AEP Ohio's credit ratings. Under the Transco model, AEP Ohio would be relieved of having to raise debt for significant transmission projects that fall within the parameters of the Project Selection Guideline (PSG), Exhibit B to the amended application. Although it may disagree with this anticipated benefit, IEU demonstrates elsewhere in its comments that it fully understands the concept by aptly explaining (at 5) that one of the claimed benefits is that "CSP and OP will be relieved of debt associated with new transmission projects making new debt available for other projects . . ."

Regarding the impact on credit ratings, the *Transco White Paper* concluded (at 5) that "investors believe that housing future transmission spending in the separate Transco unit would have a neutral to slight positive impact on the balance sheets, credit quality, and credit ratings." The *Transco White Paper* specifically explained (at 5) the anticipated benefits in this regard:

> First, future Opco capital expenditure needs would obviously decrease with the Transco formation. Because transmission funding levels would potentially be quite large, removing these dollars from the Opco's balance sheets would be salutary, as cash flows from other sources won't decrease. The resulting "steady state" asset base should translate to credit stability, all other things being equal. Second, some investors associate transmission with a more aggressive type of growth. Shifting that spending to the new Transco thus provides a buffer between it and the spending connected with the Opcos' other businesses.

The pertinent conclusions and investor observations in the *Transco White Paper*, supported by research and expert analysis, demonstrate the beneficial impact on AEP Ohio balance sheets, credit quality, and credit ratings anticipated as a result of the proposed Transco corporate structure.

IEU also asserts (at 4) that, because "transmission related costs are passed through to Ohio customers, it does not appear that in reality there would be a reduction in regulatory lag but this appears to be the reasoning AEP and the Companies are offering," citing a press release and a trade press article where AEP executives indicated quicker recovery of transmission expenditures as one of the benefits of the Transco model. As an initial matter, Joint Applicants agree with IEU that – in Ohio – the mode and manner of transmission cost recovery will not involve any significant change under the Transco model. But the AEP executive statements quoted in IEU's comments were made with respect to AEP as a whole; the statements were not focused on Ohio. Thus, those particular statements are accurate for AEP generally even though there may not be any incremental benefit in this regard with respect to Ohio. In any case, this particular point was only one of several that have been made in support of the Transco initiative. As referenced above, Paragraph 11 of the amended application listed seven distinct and detailed finance-related factors driving the need for the proposed transmission corporate structure.

Impact on Complexity of AEP Corporate Structure

Finally, IEU lodges a general complaint (at 4-5) that the Transco model introduces additional complexity to AEP's corporate structure. The Transco corporate structure is not an arbitrary or capricious exercise being lightly pursued by AEP. Rather, as explained in substantial detail in the amended application and supporting comments, the Transco initiative is a narrowly-tailored and purposeful long-term initiative that will yield benefits for customers. If as IEU states there is any incremental complexity with adding the Transco model to the AEP corporate structure, there is nevertheless good reason for pursuing the initiative.

This argument was directly evaluated and addressed in the *Transco White Paper*. Based on research and expert analysis, the conclusions (at 4) were as follows:

> Investors like that transmission prospectively will become a separate reporting entity, which will be easier to understand, track, and value on a regular basis. The magnitude of future transmission spending makes investors particularly enthusiastic about the prospect of being able to see the business in a simplified, unbundled form. Some investors did express concern about the fact that the new Transco organization will present more "boxes" for investors to analyze and comprehend could suggest more complexity in the AEP story. Overall, there were more positive comments than concerns related to the question of Transco's effect on AEP's complexity.

Thus, most investors consider the structure to be simpler and, to the extent additional issues are present, there are benefits that justify any additional complexity.

In further support of its complexity argument, IEU also claims (at 5) that it will be harder for retail jurisdictions "to go after prudency disallowances, such as contemplated under the significantly excessive earnings test ("SEET") currently being contemplated by the Commission." As a threshold matter, IEU's reference to the SEET docket is misguided as that statute does not involve prudency disallowances and has nothing whatever to do with transmission cost recovery. Further, notwithstanding IEU's generalized concerns, the same process and ratemaking protections utilized today will remain in place under the Transco model. Specifically, IEU will have the same opportunity to intervene and participate in Ohio retail rate proceedings and FERC wholesale rate proceedings as it has currently. As IEU's own comments acknowledge (at 4), transmission related costs are already passed through to Ohio customers under AEP Ohio's existing rate plan. Moreover, under the FERC formula rates, there is a reconciliation procedure that corrects any over/under recovery of projected costs with the actual year-end booked costs; any collection as part of projected costs would be reversed if the project did not go into service that year or if the project's CWIP balance ended up being transferred off of that company's books during that year.

Moreover, the same AEP affiliate relationships and benefits that accrue to CSP and OP today will also be extended to OHTCo under the Transco model. As discussed in the amended application:

- There will be no change in the planning, operation and maintenance of the transmission system since the services provided to OHTCo are through the same service providers and will be administered in the same manner that these services are being provided today. (¶ 5)
- The affiliate services provided to OHTCo, including the services provided by CSP and OP, will be provided on an at-cost basis, the same manner that affiliate services are provided to other AEP operating companies today. (¶ 7)
- Services provided by AEPSC will be pursuant to an affiliate agreement that addresses the types of AEPSC services that will be provided, the allocation methodology for services provided to multiple affiliates, the AEPSC billing procedures, and the terms for payment for services provided. (¶ 8)
- In the same manner that OHTCo will rely on AEPSC and AEPTransmission for operational/technical and managerial services, OHTCo will also be able to

> rely on the financial resources of its ultimate parent, AEP, and its ability to supply, or cause to be supplied, capital. (¶ 9)

In short, IEU's concerns about the potential for additional complexity are outweighed by additional benefits and are otherwise offset by existing protections that will continue to apply, to the extent the concern is even valid.

II. RESPONSE TO OPAE COMMENTS

OPAE sought to intervene after the comment schedule was established in these cases. In its motion to intervene, OPAE generally indicated (at 3) that it "seeks to ensure that there will be no adverse impact and that there will be some benefit to Ohio's residential customers as a result of any transfer of transmission assets from the Companies to the AEP Transco and as a result of any participation by the AEP Ohio Transco in the AEP Money Pool." OPAE indicated (at 3) that "it will address any issues that may arise during consideration of these applications" – yet OPAE did not file comments on April 30 and did not include specific comments in its intervention request (filed after the comment schedule was established). In any case, Joint Applicants will briefly address the general comment included in OPAE's intervention request about the Money Pool and customers benefitting from the proposed transfers.

The AEP Money Pool was established to minimize short-term borrowing costs and balance cash flow needs among participating AEP affiliates. The Money Pool arrangement is equitable and does not convey a preference on any AEP affiliate participant. A particular money pool participant may have surplus funds in the money pool as a result of issuing debt securities, or other sources of long-term capital. For instance, if a participant issues a bond, and assuming the entire bond proceeds are not immediately consumed (through the repayment of maturing short-term or long-term debt or for other general corporate purposes), then the unused funds would be placed into the money pool for use by other money pool participants. Each participant's relative credit (or debit) in the investment pool is based upon a weighted average of the total amount in the money pool. Assuming the participant is invested in the money pool, it will incur investment income for the amount it invests at the weighted-average interest rate of the money pool. Indeed, the Commission already understands the workings of the Money Pool and has approved CSP's and OP's participation in it. Thus, OPAE's vague concerns about the Money Pool are unwarranted.

As to OPAE's statement about avoiding an adverse impact and obtaining consumers benefit related to the proposed asset transfers, Joint Applicants submit that this concern is also easily resolved through a better understanding of the amended application and requested relief. As stated in the amended application, the projects that AEP Ohio seeks to transfer to OHTCo are not yet in service and the CWIP balance existing on the date of transfer will be paid by OHTCo. There are procedures and protocols in place to ensure that ratepayers only pay for these assets once. At the end of the day, the costs for a given project would only be collected once based on the formula rate reconciliation process referenced above – either the operating company's formula rates (*i.e.*, OP's or CSP's) or the OHTCo's formula rates. Hence, AEP believes the benefits to Ohio customers of transmission projects under the Transco model will be the same regardless of whether a particular project is funded by the AEP Ohio or OHTCo.

III. RESPONSE TO OCC COMMENTS

OCC's comments do not oppose the relief requested in the amended application and instead ostensibly presume that the application will be granted, suggesting only that three items of clarification be included in the Commission's ruling. In particular, OCC recommends that the Commission explicitly state: (1) that its ruling in these cases is not determinative or binding of any future requests by AEP Ohio or OHTCo to transfer transmission assets from one company to another; (2) that it is not foreclosing in future cases any consideration of issues for protecting customers of AEP Ohio, including issues related to rates, collection of costs from customers, and reliability of service; and (3) it is not giving antitrust protection to AEP Ohio or OHTCo under state action principles. Joint Applicants commend OCC's informal work and cooperation with Joint Applicants before and after filing the application, in order to resolve and address OCC's questions. Joint Applicants agree with OCC's proposed recommendations as being fair and reasonable clarifications of the scope of the amended application. As such, Joint Applicants do not oppose including OCC's recommended clarifications in an order granting the relief requested in the application.

CONCLUSION

None of the comments filed raised major concerns or registered unconditional opposition to the amended application. Rather the conditional opposition is based primarily on skepticism about some of the benefits outlined by Joint Applicants and caveats to be clarified about the scope of approving the amended application. The supporting reasons and anticipated benefits have been fully explained in the amended application and in these reply comments. Accordingly, the Commission should grant the relief requested in the amended application by OHTCo and AEP Ohio.

Respectfully submitted,

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AEP TRANSCO:
THE INVESTOR'S PERSPECTIVE

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Julie Cannell Julie Cannell is president of J.M. Cannell, Inc. (www.jmcannell.com), a firm providing regulatory expert witness testimony from an investor perspective, strategic analysis, and other specialized services to the electric utility industry. Prior to forming her firm in 1997, Ms. Cannell spent two decades as a securities analyst and portfolio manager specializing in the electric utility industry at investment manager Lord, Abbett & Company. Ms. Cannell has been invited by American Electric Power to provide her assessment, gained through a series of interviews she conducted with investors and credit rating agencies, of AEP's decision to form a series of wholly owned transmission companies to support new transmission development AEP has commissioned Ms. Cannell to prepare the attached white paper to summarize the opinions shared in those interviews.

AEP TRANSCO: The Investor's Perspective

American Electric Power ("AEP") unveiled plans in November 2009 to form a wholly-owned transmission company ("Transco"), in which certain future transmission assets would be domiciled and through which those investments would be funded. Given the important role that capital will play in supporting AEP's transmission expansion, this paper explores investors' views of the Transco concept. This perspective is largely based on recent conversations with a dozen analysts at major investment and credit rating firms.

Investors have embraced the notion of the new Transco. In their view, the entity provides the vehicle for showcasing an appealing business and will provide a clear, direct way to invest in it. Importantly, the Transco is not considered to pose a deterrent to the credit quality or risk levels of existing AEP entities. In short, this new company is viewed as a positive move for AEP and its subsidiaries.

The AEP Investment Case

Understanding how investors perceive AEP's plans to create a wholly-owned Transco is important. Transmission, like many electric utility investments, is particularly capital-intensive and it is well recognized as a sector that is in need of capital investment. As the need mounts for expansion and upgrading of existing infrastructure, along with expansion to meet inherent system growth and tie in burgeoning renewable resources to the transmission grid, investors will be asked to fund a large amount of the significant required capital outlays.

AEP is a very large utility holding company. While its business model is straightforward, with all aspects involving the generation, distribution, or transmission of power, the company's geography presents a challenge for investors. Because AEP is organized into eleven electric utility operating companies that provide services to customers in eleven states, the company's investors must understand the fundamentals of each of these companies and, importantly, each of the separate regulatory jurisdictions in which they function. Additionally, knowledge of FERC regulation of interstate transmission is necessary.

The formation of a wholly-owned Transco raises the question of how the investment case for the company—already less than simple—will be affected. Will the move make AEP more attractive as an investment or less? Will the story become simpler or more complex? This issue is particularly relevant to fixed income investors, who can potentially own the debt securities of all the subsidiary companies.

The investment community is well aware of the need not only to expand the transmission grid but also to upgrade existing infrastructure. Generally, investors believe that the new Transco enhances, or holds the potential for enhancing, the overall AEP investment opportunity. This is true for several reasons. First and foremost, the new Transco serves as a vehicle for making direct investment in transmission, thereby giving this business greater visibility. A separate and easier evaluation of the earnings, assets, and EBITDA of this business line will be able to be assessed. Because AEP is such a large company and transmission has heretofore been bundled into the total utility business, a number of analysts feel that AEP's transmission holdings have—and by extension, the parent company itself has—been undervalued, a situation that potentially can be corrected in the future.

Another favorable valuation aspect investors see as part of the Transco formation is that the transmission rates of Transco at wholesale will fall under FERC regulation. This is perceived as advantageous because transmission ratemaking will be unified under a single regulating entity, thus lending to simplicity and transparency in analysis. Additionally, FERC's current ratemaking practice incorporates a formula rate mechanism, which provides a clear path for revenue recovery. For these reasons and others, FERC regulation could also translate into a higher implied credit rating benefit, according to one credit rating agency. The future potential to attract third party equity investment in Transco also holds appeal.

A related issue to whether the investment case for AEP is enhanced by formation of the Transco is whether AEP becomes simpler or more complex to understand. Here, investors are mixed in their views. Investors like that transmission prospectively will become a separate reporting entity, which will be easier to understand, track, and value on a regular basis. The magnitude of future transmission spending makes investors particularly enthusiastic about the prospect of being able to see the business in a simplified, unbundled form. Some investors did express concern about the fact that the new Transco organization will present more "boxes" for investors to analyze and comprehend could suggest more complexity in the AEP story. Overall, there were more positive comments than concerns related to the question of Transco's effect on AEP's complexity.

The Transco's Impact on AEP's Existing Operating Companies

Creating the new Transco within the AEP family of companies raises the question of what impact the investment community believes this will have on the existing corporate entities. To understand the Transco formation in relation to the current utility subsidiaries first requires a look at the challenges and issues these companies currently face.

Current Challenges and Issues

Investors consider the AEP utility operating companies ("Opcos") to be very well run, efficient, and highly competitive. Despite their lean operations, these entities will be impacted by two key issues: state regulation and capital spending, particularly spending required for environmental and carbon compliance. These factors, significant in their own right, are also intertwined. Over the short-term, investors fear that persistent economic weakness—most notably in Ohio, West Virginia, western Virginia, Indiana, and Michigan—will present an obstacle to rate recovery for the resident Opcos. This will serve to exacerbate any regulatory lag already present in these and other geographic areas within the AEP system.

With their heavily coal-fired generating base, the Opcos will face mounting capital requirements, especially in relation to environmental compliance. Carbon legislation—whenever it is enacted—looms as another formidable challenge: the AEP companies are widely considered by the investment community to be among those utilities that will be most significantly impacted in the industry as a whole. Investors are concerned that this mandated spending, along with that associated with basic system needs, will serve to pressure further the ability to secure rate relief at sufficient levels and in a timely fashion from state regulators.

Transco Impact on Balance Sheets, Credit Quality, and Credit Ratings

Given the foregoing challenges, investors believe that housing future transmission spending in the separate Transco unit would have a neutral to slight positive impact on the Opcos' balance sheets, credit quality, and credit ratings. On the positive side of the ledger, investors point to a number of factors. First, future Opco capital expenditure needs would obviously decrease with the Transco formation. Because transmission funding levels would potentially be quite large, removing these dollars from the Opcos' balance sheets would be salutary, as cash flows from other sources won't decrease. The resulting "steady state" asset base should translate to credit stability, all other things being equal. Second, some investors associate transmission with a more aggressive type of growth. Shifting that spending to the new Transco thus provides a buffer between it and the spending connected with the Opcos' other businesses.

Analysts also pointed to several factors associated with the Transco formation that they believe would result in a neutral impact on Opco balance sheets, credit quality, and ratings. One is that AEP's subsidiary ratings already reflect the parent's recognition that its utility operating companies must live within their means. Another factor involves the magnitude of transmission investment relative to generation investment. Investors consider transmission spending, while large, still dwarfed by dollars that will be spent on generation. Already true today, that element will become even more pronounced as another big wave of environmental spending develops in the future. Having transmission capex outside of the Opcos will preserve more cash flow for those subsidiaries.

Transco Impact on Opco Risk Levels

A related issue to the new Transco's impact on Opco credit quality and ratings is how the unit's formation would serve to affect the subsidiaries' risk levels. In this regard, the majority of investors believe that Opco risk would largely be unchanged, though there was some minority opinion it could modestly decrease or even slightly increase.

The analysts' explanations as to why risk levels wouldn't be impacted by the new unit or could slightly decrease were several. For the near-term, this included projections ranging from little anticipated change in near-term Opco funding to a decline in such spending. Another key point in this regard is the slow pace at which transmission projects advance, translating into little alteration in near-term Opco capex activity. Further, AEP's central organizational approach is thought to result in no impact on Opco risk levels. As one credit rating agency noted, "We see the company and its finances in excruciating detail. AEP Treasury operations are very sophisticated in regard to budget management. Each Opco knows in minute detail where it will be spending."

While investors' central tendency was toward a neutral impact on Opco risk levels from the Transco formation, there was some opinion that the levels could decrease. The first factor here is that returns on assets in the corporation overall would be optimized due to the formulaic nature of FERC ratemaking in regard to transmission. Further, fewer capital spending requirements would lower the overall financial risk for OPCos that are burdened by competing needs for mandatory capital investments. Second, the higher growth transmission business—while appealing—carries with it near-term risks, including permitting, rising construction costs, and upfront cost recovery. With those risks now resident in the Transco, the Opcos' basic level of risk should remain steady or slightly decline. Finally, the new Transco would translate into more focus prospectively at the Opco level on distribution and generation, businesses that these subsidiaries manage very well.

Some concern was voiced by a minority of individuals that Opco risk could slightly rise. In the long-term, this could be attributable to event risk for bondholders, if AEP at some future time should elect to fully separate (i.e., spin off) all of the transmission assets. In that event, higher risk could evolve from removing potentially better returns and stable cash flows from the Opcos.

The Transco Itself

The formation of the AEP Transco is a significant event, with potential ramifications for AEP's existing operations, as heretofore explored. But not only should the new unit be considered in relation to its sister companies, it also bears examination on its own merits. Will this newest member of the AEP family provide an attractive stand-alone investment opportunity? And, in the final analysis, is creation of the Transco a positive move on the part of the parent?

Stand-Alone Investment Appeal

Investors overwhelmingly embrace the notion of having a new investable entity within AEP. There are a number of reasons for this, some of which were detailed previously. The Transco would contain new projects with rates governed at wholesale by FERC, which is perceived as affording consistent regulation based on formula-derived rates and affording consistent, predictable cash flows. Having FERC regulation over Transco's rates also serves to diversify the risk inherent in the 11 different state jurisdictions overseeing the Opcos. Additionally, the new unit would be a "pure-play" on the transmission business. From a credit perspective, a transmission-only entity is expected in the long run to receive better pricing of debt. From an equity perspective, however, one caveat was offered: the long-term nature of the projects would likely translate into some delay in incorporating enhanced equity valuations. Finally, unbundling a portion of the transmission business affords better understanding of the AEP story in general.

In the Final Analysis: A Good Thing

In the final analysis, investors applaud formation of the new Transco. Its creation is consistent with AEP's strategic objectives to support energy policies at the state and/or federal level, particularly those championing renewable resources. Additionally, the new unit would provide broader visibility to AEP's transmission investments as a whole. Increasing transparency to this segment of the AEP corporate model helps to facilitate more accurate valuations of the transmission business.

In forming this new company, AEP is demonstrating leadership and setting precedent for other utilities. AEP Transco will join the ranks of a small but growing group of transmission entities, including those wholly-owned by other utilities. The benefit of having an expanding universe of comparable companies, or "comps," is that it affords investors a greater comfort level with the stand-alone transmission concept. In turn, market access should become cheaper for the company. Investors point to the example of ITC Holdings, a publicly-traded Transco that has enjoyed a very low cost of capital, especially in the debt markets. They believe this advantageous pricing is a signal to the markets of the attractiveness of transmission as an investment opportunity.

Because of its expected ultimate size, the Transco is expected not only to have ready access to capital, but also be able to realize economies of scale in its projects. In the regulatory arena, as noted previously, consolidation of oversight under FERC is viewed favorably. One analyst observed that Commission Chair Welllinghoff has championed formation of stand-alone transmission companies, making AEP's move consistent with FERC policy.

Investors appear to have only one reservation—a caveat, really—regarding the new business unit, and it is one that already applies to transmission assets that are housed under an operating company. The key to realizing value here will be AEP's ability to secure needed approvals that may be required for some of the projects (including those for siting), and the capability then to execute on completing those projects. Despite this caveat, investors believe there is no downside to creating the separate entity.

An Investable Opportunity

Given the positive stance evidenced toward the standalone Transco, it is not surprising the concept holds considerable appeal to investors who would be able to invest in bonds that the Transco could offer in the future. Transmission as a business is attractive due to its stable cash flows, growth potential and relatively low financial risk once assets are in service. Also, regulation by FERC is viewed positively because investors understand the Commission's use of formula rates, filing requirements, and its overall regulatory process.

These salutary factors help explain the allure of transmission as an investment concept. The fact that there is only a limited number of pure-play transmission vehicles in existence at this time makes AEP Transco even more appealing to investors. From a debt perspective, better pricing should result because of the unbundled aspect and ease in understanding the business. Equity investors also should eventually realize higher returns on their investment as projects come to fruition and are then able to earn an authorized return. Equity holders would consider the opportunity to spin off a portion of the transmission business at some future point advantageous.

The Bottom Line

In sum, investors support AEP's creation of a wholly-owned Transco. Transmission as a business concept is appealing for many reasons. Locating it in a single entity within the AEP family of companies should help maximize its benefits without impairing the credit quality or raising the risk level of the existing Opcos. Of course, some of the promise of transmission lies in the ability to execute and secure the needed permits and siting approvals, so as to bring a project to completion. That proviso notwithstanding, having a separate entity to which investors can supply needed capital helps ensure that AEP will have the ability to build needed transmission in a timely manner.

CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true and correct copy of the foregoing Reply Comments of Joint Applicants has been served upon the below-named counsel via First Class mail, postage prepaid, this 17th day of May, 2010.

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