

PUCO EXHIBIT FILING

Date of Hearing: 10/25/10

Case No. 10-1261-EL-UNC

PUCO Case Caption: Volume I

Columbus Southern Power Co.

Ohio Power Co.

PUCO

2010 NOV -8 PM 1:53

RECEIVED-DOCKETING DIV

List of exhibits being filed:

OCC Exs, 3, 4, 5 and 6

to certify that the pages appearing are an accurate and complete reproduction of the original document delivered in the regular course of business  
technician  
Date processed 11/8/10

Reporter's Signature: Maria DiPaolo Jones  
Date Submitted: 11/1/10

BEFORE THE PUBLIC UTILITIES COMMISSION OF OHIO

- - -

In the Matter of the :  
Application of Columbus :  
Southern Power Company and:  
Ohio Power Company for :  
Administration of the :  
Significantly Excessive : Case No. 10-1261-EL-UNC  
Earnings Test Under :  
Section 4928.143(F), :  
Revised Code, and Rule :  
4901:1-35-10, Ohio :  
Administrative Code. :

- - -

PROCEEDINGS

before Ms. Greta See and Jeff Jones, Attorney  
Examiners, at the Public Utilities Commission of  
Ohio, commencing at 10 a.m., on Monday, October 25,  
2010, in Hearing Room 11-A, 180 East Broad Street,  
Columbus, Ohio.

- - -

VOLUME I

- - -

ARMSTRONG & OKEY, INC.  
222 East Town Street, Second Floor  
Columbus, Ohio 43215-5201  
(614) 224-9481/(800) 223-9481  
Fax (614) 224-5724

- - -

**COLUMBUS SOUTHERN POWER COMPANY'S AND  
OHIO POWER COMPANY'S RESPONSE TO OCC'S  
DISCOVERY REQUESTS  
10-1261-EL-UNC  
SECOND SET**

**INTERROGATORIES**

1NT-030 Does Dr. Makhija believe that the CSP specific future capital requirements for 2010 and 2011 financially constrain CSP? If so, what analysis has been done to support this conclusion? If not, why not?

**RESPONSE**

Dr. Makhija has not examined whether CSP's future capital requirements for 2010 and 2011 financially constrain CSP. His testimony is focused on the determination of the threshold ROE beyond which CSP's and OP's ROEs would be deemed to be significantly excessive.

Witness: Dr. Makhija

**COLUMBUS SOUTHERN POWER COMPANY'S AND  
OHIO POWER COMPANY'S RESPONSE TO OCC'S  
DISCOVERY REQUESTS  
10-1261-EL-UNC  
SECOND SET**

**INTERROGATORIES**

- 1NT-035      How are the business and financial risks identified by Mr. Hamrock relevant to the determination of whether CSP has significantly excessive earnings?
- a)      are these unique risks reflected in Dr. Makhija's analysis?
  - b)      are these unique risks reflected already in the 2009 earned return of CSP?

**RESPONSE**

- a)      Dr. Makhija uses unlevered betas to capture business risks and book equity ratios to capture financial risks. These are summative measures that incorporate various unique risks faced by the subject utilities. For details, please see Makhija Direct, page 17, line 13 to page 18, line 11; page 20, line 22, to page 24, line 11; and page 26, lines 6-23.
- b)      Investors in the subject utility should be compensated for these risks in the ROEs they earned in 2009.

Witness: Dr. Makhija

**COLUMBUS SOUTHERN POWER COMPANY'S AND  
OHIO POWER COMPANY'S RESPONSE TO OCC'S  
DISCOVERY REQUESTS  
10-1261-EL-UNC  
FIRST SET**

**INTERROGATORIES**

INT-021

When Dr. Makhija calculated the 2009 book ROE for the comparable risk peer group, did he deduct from the profits, any portion of the chosen companies' earnings or did he merely rely upon the earnings as reported, with no adjustments? If so, what was the basis for such a deduction and what portion of the profits was deducted for each specific company?

**RESPONSE**

When calculating the 2009 book ROE for the comparable risk peer group, the earnings (*Net Income Before Non-recurring & Extras minus Preferred Dividends Paid Accumulated*) as reported were used with no adjustments

Witness: Dr. Makhija

Dec 8 6

## Focus on Ohio

### Q1 earnings boosted by several unusual factors

Headline EPS of \$1.02 vs. \$0.68 a year ago were ahead of our \$0.83 estimate and \$0.85 consensus, but were helped by several factors that were either nonrecurring or out of period. These included a settlement of a coal contract (\$58M or \$0.10), reversal of 2007 storm costs in OK (\$83M or \$0.14), and recovery of 2007 PJM marginal losses in OH (\$26M or \$0.04), partly offset by a partial writeoff of Red Rock preconstruction costs (\$10.5M or \$0.02). Last year's Q1 included a portion of the OK storm expenses. Adjusting for these the comps would have been much more modest. Our \$0.83 estimate excluded the coal settlement but included the other factors. On our basis, Q1 result was \$0.92.

### Investor focus is on ROE test under new Ohio legislation

We view the legislation as generally constructive although have some concerns about the provision for an excessive earnings test. The language is quite broad and allows the Public Utilities Commission of Ohio (PUCO) considerable discretion in determining the comparable companies (which are not limited to utilities) and what constitutes significant overearning. AEP's view was that ROEs even in the high teens should not trigger PUCO intervention. We note, however, that even this level may not provide that much maneuvering room considering that AEP's GAAP ROE in 2007 was 23.2% for Columbus Southern Power and 12.5% for Ohio Power (average of 16.1%). Regulatory ROEs probably would be lower.

### What really matters is the size of the rate increases

We think that the earnings test is unlikely to come into play in the initial few years, however. Instead, the PUCO's focus is likely to be on the rate plan to be filed by AEP later this quarter and what it contains in terms of annual rate increases. The earnings test may be something of a "stick" for the PUCO to moderate the rate impact over time, especially if market prices continue to rise. Longer term, whether the earnings test becomes something of a meaningful deterrent to the company's earning power will be at least partly a function of the makeup of the Commission, which is likely to change over the next several years.

### Development of rate plans the near-term issue for stock

We expect AEP to submit its plans to the Commission in the next month or two, and the law requires the PUCO to act within 150 days of the filing (Q4). Although AEP generally reconfirmed the three-year outlook that it initiated last October, it also indicated that it was unlikely to be in a position to refine the 2009/10 guidance or extend the outlook as it customarily does in Q4 until Commission review of the plan was complete. We believe the stock is range-bound until there is further clarity around AEP's filing and the Commission's reception to it.

Merrill Lynch does and seeks to do business with companies covered in its research reports. As a result, investors should be aware that the firm may have a conflict of interest that could affect the objectivity of this report. Investors should consider this report as only a single factor in making their investment decision. Customers of Merrill Lynch in the US can receive independent, third-party research on companies covered in this report, at no cost to them, if such research is available. Customers can access this independent research at <http://www.ml.com/independentresearch> or can call 1-800-637-7455 to request a copy of this research.

Refer to important disclosures on page 4 to 5. Analyst Certification on page 3.

Earnings Review

NEUTRAL

Equity | United States | Electric Utilities  
25 April 2008

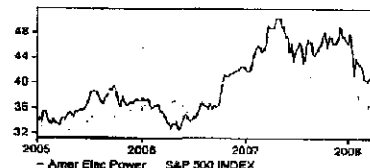


Elizabeth A. Parrella, CFA  
Research Analyst  
MLPF&S  
[elizabeth\\_parrella@ml.com](mailto:elizabeth_parrella@ml.com)

+1 212 449 5996

### Stock Data

Price	US\$43.90
Investment Opinion	8-2-7
Volatility Risk	MEDIUM
ML Symbol / Exchange	AEP / NYS
Bloomberg / Reuters	AEP US / AEP.N



### **Legislation has some very constructive elements**

AEP may file both an Electric Security Plan (ESP) and a Market Rate Option (MRO) but the ESP is more likely to be adopted. The earnings test applies under either option. Both plans allow increases in fuel and emissions and purchased-power costs as well as energy efficiency and environmental expenditures to be recovered automatically. This is quite positive, as AEP's fuel factor in OH has effectively been frozen since generation was deregulated by SB3, and the company is probably at least \$100M undercollected on fuel costs (which amount would grow in a rising coal price environment). Furthermore, the legislation provides for deferral of certain costs for future recovery (including through securitization) if such a mechanism is necessary to mitigate the rate impact.

### **Return to regulatory accounting may result in charge**

Subsequent to the conference call AEP disclosed that it was evaluating whether the legislation constitutes a return to cost-based regulation for their generation business. If it does – which would not surprise us considering provisions in the legislation for deferral accounting and regulatory assets – AEP would have to go back on FAS 71 accounting for its generation assets. The company indicated that under FAS 71 it might have to re-establish certain regulatory liabilities that could result in an extraordinary charge to income, although it did not quantify it.

### **Significant progress in obtaining required 2008 rate relief**

To date AEP has secured approximately \$481M of the \$518M in rate increases that it indicated was underpinning its earnings guidance for this year. Of the \$37M remaining, the only significant piece is in VA, where AEP expects to file a base rate case next month and begin collecting interim rates in October.

### **IGCC proposals appear to be stalled out for now**

With the recent rejection of the Mountaineer IGCC by the Virginia Corporation Commission (despite approval by WV regulators) and the Ohio Supreme Court remand on IGCC cost recovery pending before the PUCO, both proposals appear to be stalled by regulators. AEP intends to ask for rehearing in VA but regulators may not be receptive until firm cost estimates can be established. The new OH legislation allows AEP to build new generation subject to PUCO approval, but we believe the near-term focus in OH will be in developing an acceptable rate plan rather than addressing the need for the IGCC facility.

### **Q1: offsystem sales margins exceeded expectations**

As previously indicated, the noteworthy items in the quarter were mostly the unusual or out-of-period adjustments. But on the recurring side, offsystem sales margins were \$40M higher than last year and \$21M higher than we had expected (helped EPS \$0.03 vs. our estimate), mostly due to better volumes (up 44% vs. last year when output was constrained by scrubber-related plant outages). Other drivers included rate increases in OH, VA, WV, OK and TX (\$77M, including \$26M for out-of-period recovery in OH; helped \$0.12), load growth (\$54M or \$0.08) and lower depreciation expense resulting from regulatory orders (-\$28M or \$0.05), partly offset by higher interest expense on higher debt balances and higher interest rates on variable-rate debt (-\$31M or \$0.05). Weather and the effective tax rate were comparable to a year ago. AEP's MEMCO barge business declined \$8M on less favorable river conditions and higher diesel fuel costs, although the company expects some improvement in the balance of the year. Parent company swung to an \$8M drag from a \$4M contribution; this year experienced higher interest expense on short-term debt while last year included a gain on the sale of an investment.

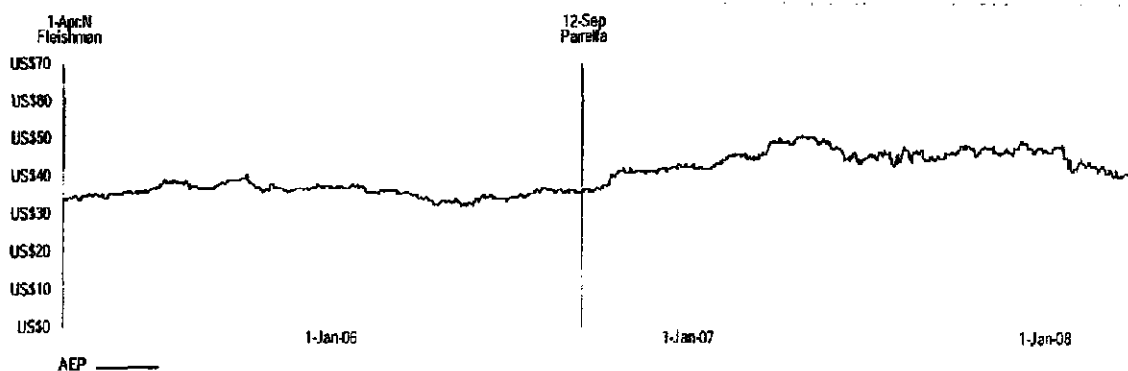
**Analyst Certification**

I, Elizabeth A. Parrella, CFA, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.



## Important Disclosures

AEP Price Chart



B : Buy, N : Neutral, S : Sell, PO : Price objective, NA : No longer valid

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark Grey shading indicates the security is restricted with the opinion suspended. Light Grey shading indicates the security is under review with the opinion withdrawn. Chart current as of March 31, 2008 or such later date as indicated.

### Investment Rating Distribution: Utilities Group (as of 01 Apr 2008)

Coverage Universe	Count	Percent
Buy	71	42.01%
Neutral	80	47.34%
Sell	18	10.65%

Inv. Banking Relationships*	Count	Percent
Buy	26	41.94%
Neutral	32	46.38%
Sell	3	16.57%

### Investment Rating Distribution: Global Group (as of 01 Apr 2008)

Coverage Universe	Count	Percent
Buy	1696	46.36%
Neutral	1600	43.74%
Sell	362	9.90%

Inv. Banking Relationships*	Count	Percent
Buy	420	27.80%
Neutral	417	26.92%
Sell	79	23.10%

\* Companies in respect of which MLPF&S or an affiliate has received compensation for investment banking services within the past 12 months.

**FUNDAMENTAL EQUITY OPINION KEY:** Opinions include a Volatility Risk Rating, an Investment Rating and an Income Rating. **VOLATILITY RISK RATINGS**, indicators of potential price fluctuation, are: A - Low, B - Medium, and C - High. **INVESTMENT RATINGS**, indicators of expected total return (price appreciation plus yield) within the 12-month period from the date of the initial rating, are: 1 - Buy (10% or more for Low and Medium Volatility Risk Securities - 20% or more for High Volatility Risk securities); 2 - Neutral (0-10% for Low and Medium Volatility Risk securities - 0-20% for High Volatility Risk securities); 3 - Sell (negative return); and 6 - No Rating. **INCOME RATINGS**, indicators of potential cash dividends, are: 7 - same/higher (dividend considered to be secure); 8 - same/lower (dividend not considered to be secure); and 9 - pays no cash dividend.

MLPF&S or one of its affiliates acts as a market maker for the securities recommended in the report: Amer Elec Power.

MLPF&S or an affiliate was a manager of a public offering of securities of this company within the last 12 months: Amer Elec Power.

The company is or was, within the last 12 months, an investment banking client of MLPF&S and/or one or more of its affiliates: Amer Elec Power.

MLPF&S or an affiliate has received compensation for investment banking services from this company within the past 12 months: Amer Elec Power.

MLPF&S or an affiliate expects to receive or intends to seek compensation for investment banking services from this company within the next three months: Amer Elec Power.

MLPF&S or one of its affiliates is willing to sell to, or buy from, clients the common equity of the company on a principal basis: Amer Elec Power.

The analyst(s) responsible for covering the securities in this report receive compensation based upon, among other factors, the overall profitability of Merrill Lynch, including profits derived from investment banking revenues.

25 April 2008

## Other Important Disclosures

UK readers: MLPF&S or an affiliate is a liquidity provider for the securities discussed in this report.

MLPF&S or one of its affiliates has a significant financial interest in the fixed income instruments of the issuer. If this report was issued on or after the 10th day of a month, it reflects a significant financial interest on the last day of the previous month. Reports issued before the 10th day of a month reflect a significant financial interest at the end of the second month preceding the date of the report: Amer Elec Power.

### Information relating to Non-U.S. affiliates of Merrill Lynch, Pierce, Fenner & Smith Incorporated (MLPF&S):

MLPF&S distributes research reports of the following non-US affiliates in the US (short name: legal name): Merrill Lynch (France): Merrill Lynch Capital Markets (France) SAS; Merrill Lynch (Frankfurt): Merrill Lynch International Bank Ltd, Frankfurt Branch; Merrill Lynch (South Africa): Merrill Lynch South Africa (Pty) Ltd; Merrill Lynch (Milan): Merrill Lynch International Bank Limited; MLPF&S (UK): Merrill Lynch, Pierce, Fenner & Smith Limited; Merrill Lynch (Australia): Merrill Lynch Equities (Australia) Limited; Merrill Lynch (Hong Kong): Merrill Lynch (Asia Pacific) Limited; Merrill Lynch (Singapore): Merrill Lynch (Singapore) Pte Ltd; Merrill Lynch (Canada): Merrill Lynch Canada Inc; Merrill Lynch (Mexico): Merrill Lynch Mexico, SA de CV, Casa de Bolsa; Merrill Lynch (Argentina): Merrill Lynch Argentina SA; Merrill Lynch (Japan): Merrill Lynch Japan Securities Co, Ltd; Merrill Lynch (Seoul): Merrill Lynch International Incorporated (Seoul Branch); Merrill Lynch (Taiwan): Merrill Lynch Global (Taiwan) Limited; DSP Merrill Lynch (India): DSP Merrill Lynch Limited; PT Merrill Lynch (Indonesia); PT Merrill Lynch Indonesia; Merrill Lynch (KL) Sdn. Bhd.; Merrill Lynch (Malaysia); Merrill Lynch (Israel): Merrill Lynch Israel Limited; Merrill Lynch (Russia): Merrill Lynch CIS Limited, Moscow; Merrill Lynch (Turkey): Merrill Lynch Yatirim Bankasi A.S.; Merrill Lynch (Dubai): Merrill Lynch International Bank Ltd, Dubai Branch; MLPF&S (Zürich rep. office): MLPF&S Incorporated Zürich representative office.

This research report has been prepared and issued by MLPF&S and/or one or more of its non-U.S. affiliates. MLPF&S is the distributor of this research report in the U.S. and accepts full responsibility for research reports of its non-U.S. affiliates distributed in the U.S. Any U.S. person receiving this research report and wishing to effect any transaction in any security discussed in the report should do so through MLPF&S and not such foreign affiliates.

This research report has been approved for publication in the United Kingdom by Merrill Lynch, Pierce, Fenner & Smith Limited, which is authorized and regulated by the Financial Services Authority; has been considered and distributed in Japan by Merrill Lynch Japan Securities Co, Ltd, a registered securities dealer under the Securities and Exchange Law in Japan; is distributed in Hong Kong by Merrill Lynch (Asia Pacific) Limited, which is regulated by the Hong Kong SFC; is issued and distributed in Taiwan by Merrill Lynch Global (Taiwan) Ltd or Merrill Lynch, Pierce, Fenner & Smith Limited (Taiwan Branch); is issued and distributed in Malaysia by Merrill Lynch (KL) Sdn. Bhd., a licensed investment adviser regulated by the Malaysian Securities Commission; is issued and distributed in India by DSP Merrill Lynch Limited; and is issued and distributed in Singapore by Merrill Lynch International Bank Limited (Merchant Bank) and Merrill Lynch (Singapore) Pte Ltd (Company Registration No.'s F 06872E and 199602883D respectively). Merrill Lynch International Bank Limited (Merchant Bank) and Merrill Lynch (Singapore) Pte Ltd are regulated by the Monetary Authority of Singapore. Merrill Lynch Equities (Australia) Limited, (ABN 65 006 276 795), AFS License 235132, provides this report in Australia. No approval is required for publication or distribution of this report in Brazil.

Merrill Lynch (Frankfurt) distributes this report in Germany. Merrill Lynch (Frankfurt) is regulated by BaFin.

### Copyright, User Agreement and other general information related to this report:

Copyright 2008 Merrill Lynch, Pierce, Fenner & Smith Incorporated. All rights reserved. This research report is prepared for the use of Merrill Lynch clients and may not be redistributed, retransmitted or disclosed, in whole or in part, or in any form or manner, without the express written consent of Merrill Lynch. Merrill Lynch research reports are distributed simultaneously to internal and client websites eligible to receive such research prior to any public dissemination by Merrill Lynch of the research report or information or opinion contained therein. Any unauthorized use or disclosure is prohibited. Receipt and review of this research report constitutes your agreement not to redistribute, retransmit, or disclose to others the contents, opinions, conclusion, or information contained in this report (including any investment recommendations, estimates or price targets) prior to Merrill Lynch's public disclosure of such information. The information herein (other than disclosure information relating to Merrill Lynch and its affiliates) was obtained from various sources and we do not guarantee its accuracy. Merrill Lynch makes no representations or warranties whatsoever as to the data and information provided in any third party referenced website and shall have no liability or responsibility arising out of or in connection with any such referenced website.

This research report provides general information only. Neither the information nor any opinion expressed constitutes an offer or an invitation to make an offer, to buy or sell any securities or other investment or any options, futures or derivatives related to such securities or investments. It is not intended to provide personal investment advice and it does not take into account the specific investment objectives, financial situation and the particular needs of any specific person who may receive this report. Investors should seek financial advice regarding the appropriateness of investing in any securities, other investment or investment strategies discussed or recommended in this report and should understand that statements regarding future prospects may not be realized. Investors should note that income from such securities or other investments, if any, may fluctuate and that price or value of such securities and investments may rise or fall. Accordingly, investors may receive back less than originally invested. Past performance is not necessarily a guide to future performance. Any information relating to the tax status of financial instruments discussed herein is not intended to provide tax advice or to be used by anyone to provide tax advice. Investors are urged to seek tax advice based on their particular circumstances from an independent tax professional.

Foreign currency rates of exchange may adversely affect the value, price or income of any security or related investment mentioned in this report. In addition, investors in securities such as ADRs, whose values are influenced by the currency of the underlying security, effectively assume currency risk.

Officers of MLPF&S or one or more of its affiliates (other than research analysts) may have a financial interest in securities of the issuer(s) or in related investments.

Merrill Lynch Research policies relating to conflicts of interest are described at <http://www.ml.com/media/43347.pdf>.

Fundamental equity reports are produced on a regular basis as necessary to keep the investment recommendation current.