



Control Number: 49494



Item Number: 137

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APPLICATION OF AEP TEXAS INC. § BEFORE THE STATE OFFICE
FOR AUTHORITY TO CHANGE § OF
RATES § ADMINISTRATIVE HEARINGS

**AEP TEXAS INC.'S RESPONSE TO OFFICE OF PUBLIC UTILITY COUNSEL'S
SIXTH REQUEST FOR INFORMATION**

JUNE 14, 2019

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**SOAH DOCKET NO. 473-19-4421
PUC DOCKET NO. 49494**

2013

**AEP TEXAS INC.'S RESPONSE TO OFFICE OF PUBLIC UTILITY COUNSEL'S
SIXTH REQUEST FOR INFORMATION**

Question No. OPUC 6-1:

[Please Reference Mr. Hevert's Direct Testimony, pg. 19, lines 21-22.] What is Mr. Hevert's definition for the term "significant transformational transaction?"

Response No. OPUC 6-1:

As Mr. Hevert notes on page 16, lines 5 – 8 of his Direct Testimony, proxy companies must be publicly traded, and should be comparable to the subject company in certain fundamental respects. In Mr. Hevert's view, a transaction that alters a potential proxy company to the extent investors no longer see it as fundamentally comparable to the subject company is significant and transformational. Further, to the extent a pending transaction alters a potential proxy company's trading pattern such that it is inconsistent with the subject company, or with other proxy companies, that transaction may be considered significant and transformational (for example, in the case of a company targeted as an acquisition). It also may be that a transaction simply extends an acquiring company's position in the utility sector and does not fundamentally alter its risk profile. If the acquiring company's trading pattern does not vary meaningfully from its peers', the transaction may be seen by investors as significant in terms of size, but not transformational in terms of effect.

Prepared By: Robert B. Hevert

Title: Partner, ScottMadden, Inc.

Sponsored By: Robert B. Hevert

Title: Partner, ScottMadden, Inc.

**SOAH DOCKET NO. 473-19-4421
PUC DOCKET NO. 49494**

**AEP TEXAS INC.'S RESPONSE TO OFFICE OF PUBLIC UTILITY COUNSEL'S
SIXTH REQUEST FOR INFORMATION**

Question No. OPUC 6-2:

Please provide all credit rating agency reports (Standard and Poor's, Moody's, Fitch) for AEP Texas since January 2, 2017.

Response No. OPUC 6-2:

Credit rating agency reports are attached for Standard and Poor's (OPUC 6-2 Attachments 1, 2 and 3) and Moody's (CONFIDENTIAL OPUC 6-2 Attachments 4, 5 and 6). We do not subscribe to Fitch for ratings purposes.

CONFIDENTIAL OPUC 6-2 Attachments 4, 5 and 6 responsive to this request are CONFIDENTIAL under the terms of the Protective Order. The Confidential information is available for review at the Austin offices of American Electric Power Company (AEP), 400 West 15th Street, Suite 1520, Austin, Texas, 78701, (512) 481-4562, during normal business hours.

Prepared By: Carrie M. Luedtke

Title: Corp Finance Analyst Prin

Sponsored By: Renee V. Hawkins

Title: Mng Dir Corporate Finance



RatingsDirect®

Research Update:

AEP Texas Inc. Assigned 'BBB+' Ratings And Placed On CreditWatch Positive

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Research Update:**AEP Texas Inc. Assigned 'BBB+' Ratings And Placed On CreditWatch Positive****Overview**

- American Electric Power Co. Inc. (AEP) has merged its Texas operations, AEP Texas North Co. and AEP Texas Central Co., into a new entity, AEP Texas Inc.
- We are assigning a 'BBB+' issuer credit rating to AEP Texas Inc., which is the same rating as that of the two predecessor utilities. At the same time, we placed the ratings on CreditWatch with positive implications.
- AEP Texas is assuming all the senior unsecured obligations of AEP Texas Central and AEP Texas North, and we are assigning a 'BBB+' senior unsecured debt rating to these obligations.
- We are withdrawing our 'BBB+' issuer credit rating on AEP Texas North and AEP Texas Central.
- The CreditWatch listing reflects the potential for an upgrade upon the close of the sale of the parent's merchant generation assets.

Rating Action

On Jan. 4, 2017, S&P Global Ratings assigned its 'BBB+' issuer credit and senior unsecured debt ratings to AEP Texas Inc., an entity created through the merger of American Electric Power Co. Inc.'s Texas subsidiaries, AEP Texas North Co. and AEP Texas Central Co. At the same time, we are placing the ratings on AEP Texas Inc. on CreditWatch with positive implications. We are withdrawing our 'BBB+' issuer credit ratings on AEP Texas North and AEP Texas Central.

Rationale

The ratings on AEP Texas reflect the company's operations under a generally constructive regulatory framework in Texas that facilitates timely recovery of distribution and transmission investments along with the company's low-risk electric transmission and distribution operations that lack commodity exposure. Moreover, the ratings on AEP Texas incorporate the company's large customer base of about one million customers that benefits from scale, covering portions of central, western, and southern Texas but which lacks operating and regulatory diversity. Residential and commercial customers contribute just over two-thirds of energy sales with industrial customers contributing the balance and introducing some exposure to cyclical industries such as oil and gas exploration and production, chemical manufacturing and mining support activities. Finally, the ratings incorporate AEP Texas' well run operations that deliver consistently reliable service to customers.

Research Update: AEP Texas Inc. Assigned 'BBB+' Ratings And Placed On CreditWatch Positive

AEP Texas was created from the merger of AEP's Texas operations, AEP Texas North and AEP Texas Central, with AEP Texas North being about one-third of the combined entity.

We expect that AEP Texas' financial performance will reflect the pro forma financial performance of the combined entities and continue to benefit from available rider-type mechanisms that enable recovery of transmission and distribution investments, supporting gross margin growth. Given each predecessor company's approved capital structure of 60% debt and 40% equity, we expect that debt leverage will remain somewhat elevated with debt to EBITDA of about 4.5x-5x and funds from operations (FFO) to debt of 15%-16% over the next few years.

Liquidity

We assess AEP Texas' liquidity as adequate, reflecting the direct support already committed from and the influence of ongoing interactions with the group, including the provision of various corporate services, along with the availability of centralized liquidity resources, on an as-needed basis. We expect liquidity sources to exceed uses by 1.1x or more, the minimum threshold for regulated utilities under our criteria, and that the company will also meet our other requirements for such a designation.

AEP Texas' liquidity benefits from stable cash flow generation, about \$3.5 billion in available revolving credit facilities at parent American Electric Power Co. Inc. (AEP) along with sufficient liquidity provided by the parent to meet ongoing needs, as necessary, and manageable debt maturities over the next few years.

Principal liquidity sources:

- Available borrowing capacity of \$400 million for the next 12 months;
- Cash FFO of about \$650 million over next 12 months; and
- Parent contributions of about \$200 million to maintain regulatory approved capital structure.

Principal liquidity uses:

- Maintenance capital spending of about \$850 million;
- Long-term debt maturities largely reflect the amortizations of securitized debt; and
- Modest dividend distributions to parent.

CreditWatch

The ratings on AEP Texas and its parent, American Electric Power Co. Inc., are on CreditWatch with positive implications. The CreditWatch listing reflects the potential for higher ratings in the next three to six months upon the close of the sale of 5,200 MW of merchant generation capacity that would lead to an improvement of the company's business risk profile, while the company maintains FFO to debt of about 18%.

Research Update: AEP Texas Inc. Assigned 'BBB+' Ratings And Placed On Credit Watch Positive

We could affirm the ratings on AEP Texas, if our assessment of parent AEP's business risk remains the same while its FFO to debt is in the range of 15%-20%. Alternatively, we could affirm the ratings on AEP Texas if AEP's business risk profile improves but FFO to debt consistently weakens such that it is below 15%.

Upon the close of the sale of the bulk of the merchant generation assets, expected in the next three to six months, we could raise the issuer credit rating on AEP and its subsidiaries by one notch, reflecting improvement in business risk stemming from the sale of a portion of its merchant generation assets while the company maintains FFO to debt of about 18% or consistent with the middle of the range for the significant financial risk profile category.

Ratings Score Snapshot

Corporate Credit Rating: BBB+/Watch Pos/--

Business risk: Excellent

- Country risk: Very low
- Industry risk: Very low
- Competitive position: Strong

Financial risk: Significant

- Cash flow/Leverage: Significant

Anchor: a-

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: a-

- Group credit profile: bbb+

Related Criteria

- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Unregulated Power And Gas Industry, March 28, 2014
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013

Research Update: AEP Texas Inc. Assigned 'BBB+' Ratings And Placed On CreditWatch Positive

- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- Criteria - Corporates - Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 07, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Corporates - General: 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Ratings List

New Rating; CreditWatch/Outlook Action

AEP Texas Inc.

Corporate Credit Rating
Senior Unsecured

BBB+/Watch Pos/--
BBB+/Watch Pos

Not Rated Action; CreditWatch/Outlook Action

To

From

AEP Texas Central Co.

AEP Texas North Co.

Corporate Credit Rating

NR/--

BBB+/Watch Pos/--

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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JANUARY 4, 2017 6

S&P Global
Ratings

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Summary:

AEP Texas Inc.

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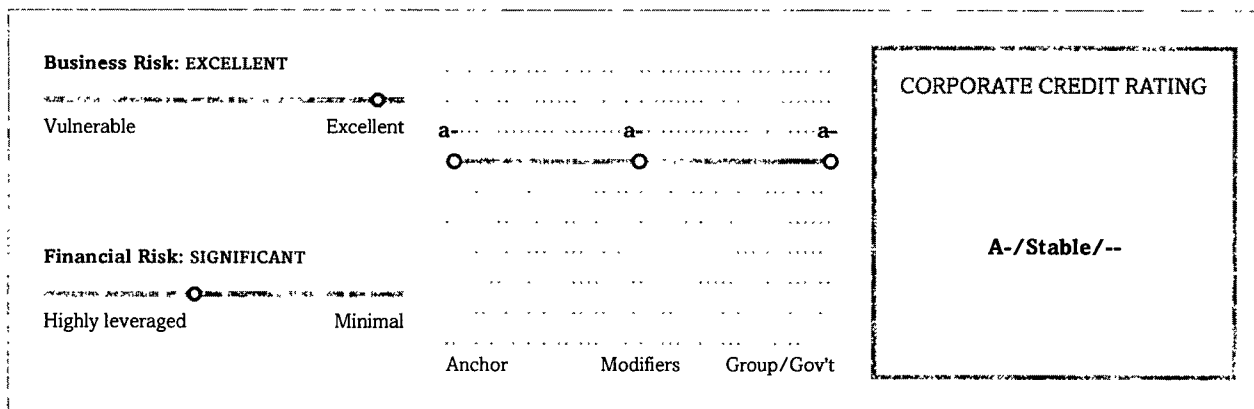
Ratings Score Snapshot

Issue Ratings–Subordination Risk Analysis

Related Criteria

Summary:

AEP Texas Inc.



Rationale

Business Risk: Excellent	Financial Risk: Significant
<ul style="list-style-type: none"> • Low-risk, fully regulated electric transmission and distribution wires-only operations; • No electricity supply obligations; • Operates under generally constructive regulation; • Large customer base offset by lack of regulatory and geographic diversity; and • No electricity supply obligations. 	<ul style="list-style-type: none"> • Financial measures consistent with the financial risk profile assessment; • Supportive cost recovery of capital spending and operating costs; • Elevated capital spending; and • Negative discretionary cash flow, indicating external funding needs.

Outlook: Stable

The stable rating outlook on AEP Texas Inc. and parent American Electric Power Co. Inc. (AEP) reflects S&P Global Ratings' expectation that AEP's business risk profile will continue improving given that it now consists almost entirely of regulated utility operations and will maintain adjusted funds from operations (FFO) to debt of about 18% on a consistent basis.

Downside scenario

We could lower the ratings on AEP and its subsidiaries, including AEP Texas, if AEP's financial performance weakens such that adjusted FFO to debt is consistently below 14% or if its business risk increases as a result of ineffective management of regulatory risk or the pursuit of risky unregulated investments.

Upside scenario

While not likely, we could raise the ratings on AEP and its subsidiaries if AEP's financial performance improves such that adjusted FFO to debt remains consistently above 20% and AEP's business risk is unchanged.

Our Base-Case Scenario

Assumptions	Key Metrics																
<ul style="list-style-type: none">• EBITDA is expected to grow mainly from cost recovery through regulatory mechanisms;• Average annual capital spending of at least \$1 billion;• Annual dividends expected to remain the same;• Negative discretionary cash flow is expected to be debt financed; and• Timely cost recovery through regulatory mechanisms.	<table><tr><th></th><th>2016A</th><th>2018E</th><th>2019E</th></tr><tr><td>FFO to debt (%)</td><td>16.4</td><td>15-17</td><td>13.5-15.5</td></tr><tr><td>Debt to EBITDA (x)</td><td>4.6</td><td>4.5-5</td><td>5-5.5</td></tr><tr><td>FFO cash interest coverage (x)</td><td>3.1</td><td>3.7-4.2</td><td>3.7-4.2</td></tr></table> <p>A--Actual. E--Estimate. FFO--Funds from operations.</p>		2016A	2018E	2019E	FFO to debt (%)	16.4	15-17	13.5-15.5	Debt to EBITDA (x)	4.6	4.5-5	5-5.5	FFO cash interest coverage (x)	3.1	3.7-4.2	3.7-4.2
	2016A	2018E	2019E														
FFO to debt (%)	16.4	15-17	13.5-15.5														
Debt to EBITDA (x)	4.6	4.5-5	5-5.5														
FFO cash interest coverage (x)	3.1	3.7-4.2	3.7-4.2														

Company Description

AEP Texas, a subsidiary of AEP, is an electric transmission and distribution wires-only utility in Texas.

Business Risk: Excellent

Our assessment of AEP Texas' business risk profile reflects the company's low-risk electric transmission and distribution operations that has no electricity commodity exposure with customers. The utility operates under a generally constructive regulatory framework in Texas that facilitates timely recovery of distribution and transmission investments. Moreover, AEP Texas has a large customer base of about 1 million customers that benefits from scale

with a service territory that spans across multiple regions of Texas. However, because it operates in one state, the utility lacks geographic diversity. Residential and commercial customers contribute just over two-thirds of energy sales with industrial customers contributing the balance. The industrial customers expose the utility to cyclical industries such as oil and gas exploration and production, chemical manufacturing, and mining support activities. Finally, we consider the utility to be a well-run operation that delivers consistently reliable service to customers.

Financial Risk: Significant

Our assessment of the utility's stand-alone financial risk profile incorporates a base-case scenario forecast. We expect that AEP Texas' adjusted FFO to debt will range from about 14%-16%, below the midpoint of the benchmark range. We expect the supplemental ratio of FFO cash interest coverage to be about 3.9x, supporting the financial risk assessment. We expect elevated capital spending that, when combined with the utility's dividend payments, will result in discretionary cash flow that is negative through 2019. This indicates external funding needs that could include parental cash infusions. Debt leverage, as indicated through debt to EBITDA, averages around 5x over the next few years. AEP Texas' financial measures benefit from various rate mechanisms allowing for timely cost recovery, coupled with effective cost controls. Our base case does not include updates related to the recent tax rate change. We base our risk assessment on more moderate benchmarks when compared to the typical corporate issuer, reflecting the company's steady cash flow and rate-regulated utility operations.

Liquidity: Adequate

We assess the company's stand-alone liquidity as adequate because we believe its liquidity sources are likely to cover uses by more than 1.1x over the next 12 months and meet cash outflows even with a 10% decline in EBITDA. The assessment also reflects the company's generally prudent risk management, sound relationship with banks, and a generally satisfactory standing in credit markets.

Principal liquidity sources

- Estimated cash FFO of about \$755 million;
- Average available borrowing capacity from the AEP money pool of \$400 million; and
- Estimated group support of \$350 million.

Principal liquidity uses

- Debt maturities, including affiliate advances, of about \$560 million;
- Capital spending of \$730 million; and
- Dividends of about \$35 million.

Group Influence

We consider AEP Texas to be a core subsidiary of AEP, reflecting our view that AEP Texas is highly unlikely to be sold and has a strong long-term commitment from senior management. There are no meaningful insulation measures in place that protect AEP Texas from its parent and therefore our issuer credit rating on AEP Texas is in line with AEP's

group credit profile of 'a-'.

Ratings Score Snapshot

Corporate Credit Rating

A-/Stable/--

Business risk: Excellent

- **Country risk:** Very low
- **Industry risk:** Very low
- **Competitive position:** Strong

Financial risk: Significant

- **Cash flow/Leverage:** Significant

Anchor: a-

Modifiers

- **Diversification/Portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Adequate (no impact)
- **Management and governance:** Satisfactory (no impact)
- **Comparable rating analysis:** Neutral (no impact)

Stand-alone credit profile : a-

- **Group credit profile:** a-
- **Entity status within group:** Core (no impact)

Issue Ratings–Subordination Risk Analysis

Capital structure

AEP Texas' capital structure consists of about \$3.7 billion of debt that includes \$2.65 billion senior unsecured debt and approximately \$1.05 billion of securitized debt.

Analytical conclusions

We rate AEP Texas' senior unsecured debt the same as the issuer credit rating because it is the debt of a qualified investment-grade utility.

Related Criteria

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, Sept. 21, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Corporates - Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Business And Financial Risk Matrix

Business Risk Profile	Financial Risk Profile					
	Minimal	Modest	Intermediate	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

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FEBRUARY 1, 2018 7

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Group Influence

Issue Ratings - Subordination Risk Analysis

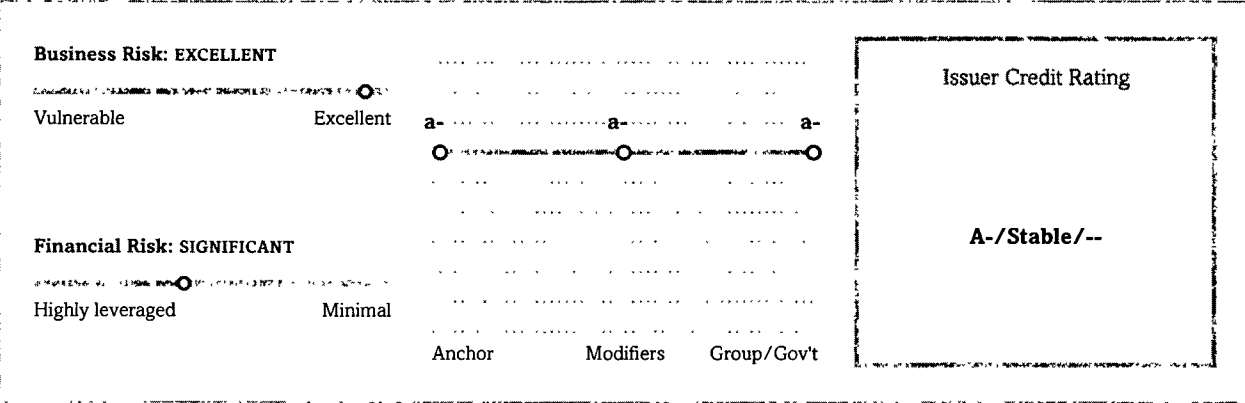
Reconciliation

Ratings Score Snapshot

Table Of Contents (cont.)

Related Criteria

AEP Texas Inc.



Credit Highlights

Overview	
Key strengths	Key risks
Fully regulated, low-risk electric transmission and distribution (wires-only) operations.	Limited geographic and regulatory diversity.
Generally stable regulatory framework in Texas, which we view as credit supportive.	Elevated capital spending will result in negative discretionary cash flow in future years, leading to a dependence on external funding.
Majority of large customer base is residential or commercial, which provides further cash flow stability.	U.S. tax reform has reduced the company's cash flow measures and negatively affected its financial measures.

AEP Texas Inc. operates under Texas' constructive regulatory framework. AEP Texas benefits from the timely recovery of transmission investments and distribution costs through base-rate adjustments and riders (transmission cost of service [TCOS], distribution cost recovery factor [DCRF], and energy efficiency), which mitigate regulatory lag and enable the company to earn close to, or at, its authorized return.

Capital spending and debt leverage will remain elevated. Incremental transmission-related capital spending will result in negative discretionary cash flow. Therefore, we expect AEP Texas' debt leverage, as indicated by its debt to EBITDA, to remain elevated in the mid- to high-4x range.

Outlook: Stable

The stable outlook on AEP Texas Inc. reflects our stable outlook on its parent American Electric Power Co. Inc. (AEP). The stable outlook on AEP and its subsidiaries reflects the company's improving business risk profile that now consists almost entirely of solid regulated utility operations. The outlook also incorporates our expectation that the company will generate a funds from operations (FFO)-to-debt ratio in the 14%-15% range through 2020 after factoring in the effects of tax reform.

Downside scenario

We could lower our ratings on AEP and its subsidiaries if the company's financial performance weakens such that FFO to debt remains consistently below 14%. We could also lower the ratings if the company's business risk increases because of ineffective management of regulatory risk or the pursuit of risky unregulated investments.

Upside scenario

While unlikely, we could raise our ratings on AEP and its subsidiaries if the company's financial performance improves such that its FFO to debt remains consistently above 20% and its business risk is unchanged.

Our Base-Case Scenario

Assumptions	Key Metrics																
<ul style="list-style-type: none">• The economic conditions in the company's service territory continue to improve modestly, supporting some load growth;• Effective management of regulatory risk and continued cost recovery enables the utility to earn its allowed return on equity;• In 2019, gross margin growth is affected by tax reform-related customer bill credits/refunds;• Elevated capital spending of \$1.0 billion annually for infrastructure investments; and• All debt maturities are refinanced.	<table><tr><th></th><th>2019E</th><th>2020E</th><th>2021E</th></tr><tr><td>FFO to debt (%)</td><td>13.5-15.5</td><td>13.5-15.5</td><td>13.5-15.5</td></tr><tr><td>Debt to EBITDA (x)</td><td>4.8-5.2</td><td>4.7-5.1</td><td>4.4-4.8</td></tr><tr><td>FFO cash interest coverage (x)</td><td>2.8-3.4</td><td>3.4-4.0</td><td>3.7-4.3</td></tr></table> <p>E--Expected. FFO--Funds from operations.</p>		2019E	2020E	2021E	FFO to debt (%)	13.5-15.5	13.5-15.5	13.5-15.5	Debt to EBITDA (x)	4.8-5.2	4.7-5.1	4.4-4.8	FFO cash interest coverage (x)	2.8-3.4	3.4-4.0	3.7-4.3
	2019E	2020E	2021E														
FFO to debt (%)	13.5-15.5	13.5-15.5	13.5-15.5														
Debt to EBITDA (x)	4.8-5.2	4.7-5.1	4.4-4.8														
FFO cash interest coverage (x)	2.8-3.4	3.4-4.0	3.7-4.3														

Base-case projections

- Debt leverage, as measured by debt to EBITDA, in the mid- to high-4x area;
- After capital spending the company's discretionary cash flow will be negative, thus we expect it to partly fund its investments with debt; and

- Adjusted FFO to debt of around 13.5%-15.5% as the negative effects of U.S. tax reform are partially offset by continued cost recovery through various regulatory mechanisms.

Company Description

AEP Texas is a subsidiary of AEP and is engaged in the transmission and distribution (T&D) of electric power to approximately 1.030 million retail customers in western, central, and southern Texas.

Business Risk: Excellent

Our assessment of AEP Texas' business risk profile is based on the company's low-risk, fully regulated T&D wires-only electric utility operations under Texas' generally constructive regulatory framework, which provides for the timely recovery of approved fuel costs and invested capital.

AEP Texas serves a large customer base that spans across multiple regions of Texas and benefits from the company's scale. However, because it operates in one state, the utility lacks geographic diversity. The company also benefits from a diverse customer base, which provides it with some stability if any particular class of customers reduce their usage. Specifically, AEP Texas generates almost two-thirds of its revenue from residential and commercial customers and receives the remaining revenue from the more-volatile industrial class. The company's customer base has demonstrated little growth and its service territory has only modest operating and regulatory diversity.

The utility operates under a generally constructive regulatory framework in Texas that facilitates the timely recovery of distribution and transmission investments. The company's increasing transmission investments will lead to growing rate base opportunities.

The company has a relatively good operating track record given its low-risk, rate-regulated electricity T&D operations, which are safe and reliable.

Peer comparison

Table 1

AEP Texas Inc. -- Peer Comparison				
Industry Sector: Electric				
	AEP Texas Inc.	Atmos Energy Corp.	Oncor Electric Delivery Co. LLC	CenterPoint Energy Houston Electric LLC
Ratings as of March 22, 2019	A-/Stable/--	A/Stable/A-1	A/Stable/A-1	BBB+/Stable/--
	--Fiscal year ended Dec. 31, 2018--	--Fiscal year ended Sept. 30, 2018--	--Fiscal year ended Dec. 31, 2018--	
(Mil. \$)				
Revenue	1,595.3	3,115.5	4,101.0	2,636.0
EBITDA	860.5	1,125.2	1,904.5	946.0
FFO	655.5	996.1	1,366.2	668.9
Net income from cont. oper.	211.3	603.1	545.0	336.0

Table 1

AEP Texas Inc. -- Peer Comparison (cont.)				
Industry Sector: Electric				
	AEP Texas Inc.	Atmos Energy Corp.	Oncor Electric Delivery Co. LLC	CenterPoint Energy Houston Electric LLC
Cash flow from operations	636.0	1,132.8	1,514.2	573.9
Capital expenditure	1,410.4	1,460.8	1,754.0	916.0
Free operating cash flow	(774.4)	(328.0)	(239.8)	(342.1)
Discretionary cash flow	(774.4)	(542.9)	(448.8)	(551.1)
Cash and short-term investments	3.1	13.8	3.0	335.0
Debt	4,256.5	3,740.5	8,809.9	3,141.0
Equity	2,580.5	4,770.0	4,728.0	2,682.0
Adjusted ratios				
EBITDA margin (%)	53.9	36.1	46.4	35.9
Return on capital (%)	5.5	7.4	6.5	8.0
EBITDA interest coverage (x)	5.0	8.8	4.4	6.3
FFO cash interest coverage (X)	5.0	6.4	4.9	4.0
Debt/EBITDA (x)	4.9	3.3	4.6	3.3
FFO/debt (%)	15.4	26.6	15.5	21.3
Cash flow from operations/debt (%)	14.9	30.3	17.2	18.3
Free operating cash flow/debt (%)	(18.2)	(8.8)	(2.7)	(10.9)
Discretionary cash flow/debt (%)	(18.2)	(14.5)	(5.1)	(17.5)

FFO--Funds from operations

Financial Risk: Significant

Our assessment of AEP Texas' stand-alone financial risk profile incorporates the assumptions in our base-case scenario, under which we anticipate that the company's stand-alone adjusted FFO to debt will remain in the 13.5%-15.5% range in future years.

The company's financial metrics are primarily being affected by the negative effects of U.S. tax reform, higher transmission-related capital spending, and the recovery of invested capital through transmission recovery riders. Moreover, its credit metrics also benefit from DCRF riders and modest load growth.

In addition, AEP Texas has been experiencing ongoing discretionary cash flow deficits due to its heightened capital expenditure, which we expect it will partly fund with external debt. We expect the company's adjusted debt to EBITDA to be in the 4.5x-5.0x range.

We base our financial risk assessment on our more moderate financial ratio benchmarks rather than the benchmarks

we use for a typical corporate issuer. This reflects the company's steady cash flow from its low-risk, rate-regulated electric operations and management of regulatory risk.

Financial summary

Table 2

AEP Texas Inc. -- Financial Summary		
Industry Sector: Electric		
	--Fiscal year ended Dec. 31--	
	2018	2017
Rating history	A-/Stable/--	A-/Stable/--
(Mil. \$)		
Revenue	1,595.3	1,272.8
EBITDA	860.5	607.5
FFO	655.5	588.3
Net income from continuing operations	211.3	310.5
Cash flow from operations	636.0	412.6
Capital expenditure	1,410.4	984.1
Free operating cash flow	(774.4)	(571.5)
Dividends paid	0.0	0.0
Discretionary cash flow	(774.4)	(571.5)
Debt	4,256.5	2,762.5
Preferred stock	0.0	0.0
Equity	2,580.5	2,169.9
Debt and equity	6,837.0	4,932.4
Adjusted ratios		
EBITDA margin (%)	53.9	47.7
EBITDA interest coverage (x)	5.0	5.6
FFO cash interest coverage (x)	5.0	4.9
Debt/EBITDA (x)	4.9	4.5
FFO/debt (%)	15.4	21.3
Cash flow from operations/debt (%)	14.9	14.9
Free operating cash flow/debt (%)	(18.2)	(20.7)
Discretionary cash flow/debt (%)	(18.2)	(20.7)
Net cash flow/capex (%)	46.5	59.8
Return on capital (%)	5.5	6.7
Return on common equity (%)	7.3	15.5
Common dividend payout ratio (un-adj.) (%)	0.0	0.0
FFO--Funds from operations		

Liquidity: Adequate

We assess AEP Texas' liquidity as adequate because we believe its sources of liquidity will cover its uses by more than

1.1x over the next 12 months and anticipate that its net sources will remain positive even if its EBITDA declines by 10%.

We believe AEP Texas has sound banking relationships, the ability to absorb high-impact, low-probability events without refinancing, and a satisfactory standing in the credit markets.

Principal Liquidity Sources	Principal Liquidity Uses
<ul style="list-style-type: none"> Estimated cash FFO of about \$750 million; Average available borrowing capacity from the AEP money pool of \$500 million; and Working capital inflows of about \$70 million. 	<ul style="list-style-type: none"> Debt maturities of about \$578 million; and Capital spending of about \$607 million.

Debt maturities

- 2019: \$501 million
- 2020: \$378 million
- 2021: \$66 million
- 2022: \$493 million

Environmental, Social, And Governance

We consider AEP Texas' environmental footprint in the broader context of its environmental, social, and governance (ESG) factors. The company's exposure to environmental risk is quite manageable compared with those of its electric utility peer group because T&D companies are more favorably positioned than their counterparts that own power-generation assets. The company's T&D system also provides support to ultimate parent AEP's target of reducing the environmental footprint of its generation fleet. Specifically, AEP has committed to reduce the CO2 emissions from its generating facilities by 80% from 2000 levels by 2050.

From a social perspective, AEP Texas has a strong track record of providing safe and reliable electricity T&D services. Management's cost-reduction efforts have enabled the company to stabilize its operations and maintenance (O&M) costs amid an inflationary economic environment, which has allowed it to offer competitive customer rates. This is important because all T&D companies are proactively moving to deploy capital to upgrade, modernize, and harden their assets in the wake of recent weather events and for technological reasons.

The company's governance factors are consistent with what we see across the industry for other publicly traded utilities.

Group Influence

We consider AEP Texas to be a core subsidiary of parent AEP because it is highly unlikely to be sold, has a strong long-term commitment from senior management, is successful at what it does, and contributes significantly to the group.

There are no meaningful insulation measures that protect AEP Texas from AEP. Therefore, our issuer credit rating on AEP Texas is in line with our 'a-' group credit profile for AEP's group.

Issue Ratings - Subordination Risk Analysis

Capital structure

- AEP Texas' capital structure consists of about \$4 billion of debt, including \$3.1 billion of senior unsecured debt and some securitized debt.

Analytical conclusions

- We rate AEP Texas' senior unsecured debt at the same level as the issuer credit rating because it is the debt of a qualified investment-grade utility.

Reconciliation

Table 3

Reconciliation Of AEP Texas Inc. Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. \$)

--Rolling 12 months ended Dec. 31, 2018--

AEP Texas Inc. reported amounts.

	Debt	Shareholders' equity	Revenue	EBITDA	Operating income	Interest expense	EBITDA	Cash flow from operations	Dividends paid	Capital expenditure
	4,125.8	2,580.5	1,594.5	850.8	348.6	147.3	850.8	651.9	--	1,428.8
S&P Global Ratings' adjustments										
Interest expense (reported)	--	--	--	--	--	--	(147.3)	--	--	--
Interest income (reported)	--	--	--	--	--	--	1.8	--	--	--
Current tax expense (reported)	--	--	--	--	--	--	(86.4)	--	--	--
Operating leases	74.4	--	--	15.1	5.2	5.2	9.9	9.9	--	--
Postretirement benefit obligations/deferred compensation	--	--	--	(17.6)	(17.6)	--	(13.3)	(5.4)	--	--
Surplus cash	(3.1)	--	--	--	--	--	--	--	--	--
Capitalized interest	--	--	--	--	--	5.1	(5.1)	(5.1)	--	(5.1)
Securitized stranded costs	--	--	(358.4)	(358.4)	(26.9)	(26.9)	(331.5)	(331.5)	--	--

Table 3

Reconciliation Of AEP Texas Inc. Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. \$) (cont.)										
Asset retirement obligations	22.0	--	--	1 2	1.2	1.2	0 2	(0.9)	--	--
Non-operating income (expense)	--	--	--	--	21.6	--	--	--	--	--
EBITDA - Other	--	--	--	4 3	4.3	--	4.3	--	--	--
Total adjustments	93.4	0.0	(358.4)	(355.4)	(12.2)	(15.4)	(567.4)	(333.0)	0.0	(5.1)
S&P Global Ratings' adjusted amounts										
	Debt	Equity	Revenue	EBITDA	EBIT	Interest expense	Funds from Operations	Cash flow from operations	Dividends paid	Capital expenditure
	4,219.2	2,580.5	1,236.1	495.4	336.4	131.9	283.4	318.9	--	1,423.7

Ratings Score Snapshot

Issuer Credit Rating

A-/Stable/--

Business risk: Excellent

- **Country risk:** Very low
- **Industry risk:** Very low
- **Competitive position:** Strong

Financial risk: Significant

- **Cash flow/Leverage:** Significant

Anchor: a-

Modifiers

- **Diversification/Portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Adequate (no impact)
- **Management and governance:** Satisfactory (no impact)
- **Comparable rating analysis:** Neutral (no impact)

Stand-alone credit profile : a-

- **Group credit profile:** a-
- **Entity status within group:** Core (no impact)

Related Criteria

- Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- General: Corporate Methodology, Nov. 19, 2013
- Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Business And Financial Risk Matrix

Business Risk Profile	Financial Risk Profile					
	Minimal	Modest	Intermediate	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of March 26, 2019)

AEP Texas Inc.

Issuer Credit Rating

A-/Stable/--

Senior Unsecured

A-

Issuer Credit Ratings History

02-Feb-2017

A-/Stable/--

04-Jan-2017

BBB+/Watch Pos/--

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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MARCH 26, 2019 12

SOAH DOCKET NO. 473-19-4421
PUC DOCKET NO. 49494

AEP TEXAS INC.'S RESPONSE TO OFFICE OF PUBLIC UTILITY COUNSEL'S
SIXTH REQUEST FOR INFORMATION

Question No. OPUC 6-3:

Please provide all credit rating agency reports (Standard and Poor's, Moody's, Fitch) for AEP Texas's parent company, American Electric Power, Inc., for the last five calendar years.

Response No. OPUC 6-3:

Credit rating agency reports are attached for AEP Texas's parent company, American Electric Power, Inc., for Standard and Poor's (OPUC 6-3 Attachments 1 through 4) and Moody's (CONFIDENTIAL OPUC 6-3 Attachments 5 through 9). We do not subscribe to Fitch for ratings purposes.

CONFIDENTIAL OPUC 6-3 Attachments 5 through 9 responsive to this request are CONFIDENTIAL under the terms of the Protective Order. The Confidential information is available for review at the Austin offices of American Electric Power Company (AEP), 400 West 15th Street, Suite 1520, Austin, Texas, 78701, (512) 481-4562, during normal business hours.

Prepared By: Carrie M. Luedtke

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S&P Global
Ratings

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Research Update:

American Electric Power Co. Inc. Ratings Raised And Placed On Watch Positive On Sale Of Merchant Generation Assets

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Overview

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Rationale

CreditWatch

Related Criteria And Research

Ratings List

Research Update:

American Electric Power Co. Inc. Ratings Raised And Placed On Watch Positive On Sale Of Merchant Generation Assets

Overview

- American Electric Power Co. Inc. (AEP) has agreed to sell 5,200 MW of merchant generation capacity for \$2.217 billion with the transaction expected to close in first-quarter 2017.
- We are raising the issuer credit rating on AEP and its subsidiaries--Appalachian Power Co., Indiana Michigan Power Co., Kentucky Power Co., Ohio Power Co., Public Service Co. of Oklahoma, Southwestern Electric Power Co., AEP Texas Central Co., and AEP Texas North Co.--to 'BBB+' from 'BBB' and placing the ratings on CreditWatch with positive implications.
- We are revising the comparable rating analysis assessment on AEP to positive from neutral, reflecting our view that the company's business risk profile is at the higher end of the strong business risk profile category. This incorporates our view that the proposed transaction demonstrates AEP's efforts to focus on regulated utility operations, strengthening the company's business risk profile.
- The CreditWatch with positive implications reflects the possibility for higher ratings upon the close of the sale of the 5,200 MW of merchant generation capacity.

Rating Action

On Sept. 16, 2016, S&P Global Ratings raised its issuer credit ratings on American Electric Power Co. Inc. (AEP) and its subsidiaries--Appalachian Power Co., Indiana Michigan Power Co., Kentucky Power Co., Ohio Power Co., Public Service Co. of Oklahoma, Southwestern Electric Power Co., AEP Texas Central Co., and AEP Texas North Co.--to 'BBB+' from 'BBB' and placed the ratings on CreditWatch with positive implications. In addition, we are raising the senior unsecured debt ratings at AEP and its subsidiaries by one notch, and placing the ratings on CreditWatch with positive implications.

Rationale

The rating action reflects the reduced contribution of AEP's merchant generation operation overall along management's strategy to grow the company primarily through lower-risk regulated utility operations. Additionally, the potential for higher ratings is dependent upon the successful close of the sale of about 5,200 MW of the company's merchant generation capacity, which

*Research Update: American Electric Power Co. Inc. Ratings Raised And Placed On Watch Positive On Sale Of
Merchant Generation Assets*

could lead to an improved business risk profile.

The ratings on AEP reflect our assessments of the company's currently strong business and significant financial risk profiles. Moreover, the ratings on AEP reflect our view that the company's business risk profile is improving, given the declining contribution of the merchant assets, management's explicit strategy to primarily grow through lower-risk regulated utility operations, and plans to eliminate the remaining merchant generation exposure.

We expect AEP's financial risk profile to remain robust and well within the significant financial risk profile category. Under our base-case scenario, which assumes that the asset sale closes in first-quarter 2017, generating about \$1.6 billion of cash after tax, but before any debt repayments, we expect that AEP will achieve funds from operations (FFO) to debt of about 18% and debt to EBITDA of consistently below 4.5x, with both measures readily supporting the company's significant financial risk profile assessment.

Liquidity

We assess AEP's liquidity as adequate to cover its needs over the next 12 months. We expect that the company's liquidity sources will exceed its uses by 1.1x or more, the minimum threshold for an adequate designation under our criteria, and that the company will also meet our other criteria for such a designation. AEP benefits from the preponderance of regulated utility operations that provide for stable cash flow generation. Moreover, we expect that liquidity should benefit from the company's likely ability to absorb high-impact, low-probability events without the need for refinancing, well-established and solid relationships with banks, and its satisfactory standing in the credit markets.

AEP has \$3.5 billion in revolving credit facilities with \$3 billion maturing in 2021 and \$500 million maturing in 2018.

Principal liquidity sources:

- FFO of about \$4.6 billion annually;
- Credit facility availability of \$3.5 billion; and
- After tax proceeds from pending asset sale of about \$1.6 billion in next 12 months.

Principal Liquidity uses:

- Projected maintenance capital spending of about \$3.4 billion;
- Debt maturities and outstanding commercial of about \$4.1 billion as of June 30, 2016; and
- Dividends of about \$1.1 billion annually.

CreditWatch

The CreditWatch listing with positive implications on AEP and its subsidiaries reflects the potential for higher ratings in the next three to six months upon the close of the sale of 5,200 MW of merchant generation capacity that would

*Research Update: American Electric Power Co. Inc. Ratings Raised And Placed On Watch Positive On Sale Of
Merchant Generation Assets*

lead to an improvement of the company's business risk profile, while the company maintains FFO to debt of about 18%.

We could affirm the ratings if AEP's business risk remains unchanged while its financial risk profile remains toward the middle of the significant category, with FFO to debt of 15%-20%. Alternatively, we could affirm the ratings if the business risk profile improves but FFO to debt consistently weakens to below 15%.

Upon the close of the transaction, expected in the next three to six months, we could raise the issuer credit rating on AEP and its subsidiaries by one notch, reflecting improvement in business risk stemming from the sale of a portion of its merchant generation assets while the company maintains FFO to debt of about 18% or consistent with the middle of the range for the significant financial risk profile category.

Related Criteria And Research

Related Criteria

- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Unregulated Power And Gas Industry, March 28, 2014
- Criteria - Corporates - Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Criteria - Corporates - General: Methodology: Business Risk/Financial Risk Matrix Expanded, Sept. 18, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Corporates - General: 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Ratings List

Upgraded; CreditWatch/Outlook Action

To

From

AEP Texas Central Co.

Wheeling Power Company

Southwestern Electric Power Co.

*Research Update: American Electric Power Co. Inc. Ratings Raised And Placed On Watch Positive On Sale Of
Merchant Generation Assets*

RGS (I&M) Funding Corp.		
RGS (AEGCO) Funding Corp.		
Public Service Co. of Oklahoma		
Ohio Power Co.		
Kentucky Power Co.		
Indiana Michigan Power Co.		
AEP Texas North Co.		
Corporate Credit Rating	BBB+/Watch Pos/--	BBB/Positive/--
American Electric Power Co. Inc.		
Senior Unsecured	BBB/Watch Pos	BBB-
AEP Texas Central Co.		
Senior Unsecured	BBB+/Watch Pos	BBB
Appalachian Power Co.		
Senior Unsecured	BBB+/Watch Pos	BBB
Indiana Michigan Power Co.		
Senior Unsecured	BBB+/Watch Pos	BBB
Kentucky Power Co.		
Senior Unsecured	BBB+/Watch Pos	BBB
Ohio Power Co.		
Senior Unsecured	BBB+/Watch Pos	BBB
Public Service Co. of Oklahoma		
Senior Unsecured	BBB+/Watch Pos	BBB
RGS (AEGCO) Funding Corp.		
Senior Unsecured	BBB/Watch Pos	BBB-
RGS (I&M) Funding Corp.		
Senior Unsecured	BBB/Watch Pos	BBB-
Southwestern Electric Power Co.		
Senior Unsecured	BBB+/Watch Pos	BBB
Upgraded; CreditWatch/Outlook Action; Ratings Affirmed	To	From
American Electric Power Co. Inc.		
Appalachian Power Co.		
Corporate Credit Rating	BBB+/Watch Pos/A-2	BBB/Positive/A-2
Ratings Affirmed		
American Electric Power Co. Inc.		
Commercial Paper	A-2	
Certain terms used in this report, particularly certain adjectives used to		

*Research Update: American Electric Power Co. Inc. Ratings Raised And Placed On Watch Positive On Sale Of
Merchant Generation Assets*

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SEPTEMBER 16, 2016 7



RatingsDirect®

Research Update:

American Electric Power Co. Inc. And Subsidiaries Upgraded To 'A-', Off Watch; Outlook Stable

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Research Update:

American Electric Power Co. Inc. And Subsidiaries Upgraded To 'A-', Off Watch; Outlook Stable

Overview

- American Electric Power Co. Inc. (AEP) completed the sale of 5,200 megawatts (MW) of merchant generation capacity raising about \$1.6 billion in after-tax proceeds. Divesting the high-risk assets improves AEP's credit profile that will now be dominated by regulated utilities.
- We are raising our issuer credit ratings on AEP and all its utility subsidiaries--Appalachian Power Co., Indiana Michigan Power Co., Kentucky Power Co., Ohio Power Co., Public Service Co. of Oklahoma, Southwestern Electric Power Co., AEP Texas Inc., AEP Transmission Co. LLC, and Wheeling Power Co.--to 'A-' from 'BBB+'. At the same time, we are removing the ratings from CreditWatch, where we placed them with positive implications on Sept. 16, 2016. The outlook is stable.
- The stable outlook on AEP and its subsidiaries reflects the company's improved business risk profile that now benefits from a preponderance of regulated utility operations, expectations that non-utility operations will remain a modest part of AEP, and that the company's financial profile will remain robust, with funds from operations (FFO) to debt of about 18% on a consistent basis.

Rating Action

On Feb. 2, 2017, S&P Global Ratings raised its issuer credit ratings on American Electric Power Co. Inc. (AEP) and all its subsidiaries--Appalachian Power Co., Indiana Michigan Power Co., Kentucky Power Co., Ohio Power Co., Public Service Co. of Oklahoma, Southwestern Electric Power Co., AEP Texas Inc., AEP Transmission Co. LLC, and Wheeling Power Co. --to 'A-' from 'BBB+'. At the same time, we are removing the ratings from CreditWatch, where we placed them with positive implications on Sept. 16, 2016. The outlook is stable.

Rationale

The upgrade on AEP and its subsidiaries reflects the improvement in business risk stemming from the close of the sale of 5,200 MW of merchant generation capacity to a third party while the company's financial performance remains robust with FFO to debt of about 18%.

The asset sale, along with the impairment of AEP's remaining merchant generation assets totaling about 2,700 MW of capacity in third quarter 2016, is in line with AEP's strategy to exit the merchant generation business and

Research Update: American Electric Power Co. Inc. And Subsidiaries Upgraded To 'A-', Off Watch; Outlook Stable

focus primarily on regulated utility operations. AEP's emphasis on its regulated operations is evident through a recent round of generally constructive regulatory outcomes and earned returns that have been improving at the individual regulated utility company level. AEP plans to use the \$1.6 billion in after-tax sales proceeds to supplement funding needs, reducing the total amount of debt that needs to be issued, and supporting its financial risk profile. While AEP plans to continue growing its renewable generation investments, we do not expect that such investments will contribute more than 5% of the company's total credit profile over the next several years, especially given the modest level of planned capital spending relative to AEP's total capital spending plan.

Over the next several years AEP's capital spending program will range from \$5.5 billion to \$6 billion annually with about 5% allocated to contracted renewables and the balance to regulated operations, including over 50% allocated to Federal Energy Regulatory Commission (FERC)-regulated transmission investments which benefit from a constructive regulatory framework that provides for timely investment recovery. The use of the asset sale proceeds to fund capital spending and other needs will help support AEP's financial profile by offsetting the need for external borrowings and highlighting the company's generally conservative financial policies.

Under our base-case scenario we account for the loss of gross margin from the sale of the merchant generation operations. We expect gross margins to grow by about 4% to 6% annually; capital spending of \$5.7 billion in 2017, \$6 billion in 2018, and \$5.7 billion in 2019; use of the after-tax asset sale proceeds of about \$1.6 billion in the prompt year; dividend payout ratio of about 60% and modest growth in operations and maintenance costs. Over the next few years we project that AEP will generate funds from operations (FFO) to debt that ranges from 18%-19% while its debt leverage will average about 4x, with both measures demonstrating the strength of the company's financial profile.

Liquidity

We assess AEP's liquidity as adequate to cover its needs over the next 12 months. We expect that the company's liquidity sources will exceed its uses by 1.1x or more, the minimum threshold for an adequate designation under our criteria, and that the company will also meet our other criteria for such a designation. AEP benefits from the preponderance of regulated utility operations that provide for stable cash flow generation. Moreover, we expect that liquidity should benefit from the company's likely ability to absorb high-impact, low-probability events without the need for refinancing, well-established and solid relationships with banks, and its satisfactory standing in the credit markets.

AEP has \$3.5 billion in revolving credit facilities with \$3 billion maturing in 2021 and \$500 million maturing in 2018.

Principal liquidity sources:

- Cash FFO of about \$4.8 billion-\$5 billion;

Research Update: American Electric Power Co. Inc. And Subsidiaries Upgraded To 'A-', Off Watch; Outlook Stable

- Credit facility availability of \$3.5 billion and cash on hand of about \$200 million;
- After tax proceeds from asset sale of about \$1.6 billion in 2017

Principal liquidity uses:

- Maintenance capital spending of about \$4.5 billion;
- Debt maturities and outstanding commercial of about \$3.3 billion; and
- Dividends of about \$1.1 billion to \$1.2 billion.

Outlook

The stable outlook on AEP and its subsidiaries reflects the company's improved business risk profile that now benefits from a preponderance of regulated utility operations while generating FFO to debt of about 18% on a consistent basis.

Downside scenario

We could lower the ratings on AEP and its subsidiaries if the company's financial performance weakens such that FFO to debt is consistently below 14% or if its business risk increases as a result of ineffective management of regulatory risk or the pursuit of un-regulated operations.

Upside scenario

While not expected under our base-case scenario, we could raise the ratings on AEP and its subsidiaries primarily if the company's financial performance improves with FFO to debt that remains consistently above 20% while business risk remains unchanged.

Ratings Score Snapshot

Corporate Credit Rating: A-/Stable/A-2

Business risk: Excellent

- Country risk: Very low
- Industry risk: Very low
- Competitive position: Strong

Financial risk: Significant

- Cash flow/Leverage: Significant

Anchor: 'a-'

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Adequate (no impact)

Research Update: American Electric Power Co. Inc. And Subsidiaries Upgraded To 'A-', Off Watch; Outlook Stable

- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: 'a-'

- Group credit profile: 'a-'

Related Criteria

- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
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- Criteria - Corporates - Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- General Criteria: Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 07, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
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Ratings List

Upgraded; CreditWatch/Outlook Action

	To	From
AEP Texas Inc.		
Wheeling Power Company		
Southwestern Electric Power Co.		
RGS (I&M) Funding Corp.		
RGS (AEGCO) Funding Corp.		
Public Service Co. of Oklahoma		
Ohio Power Co.		
Kentucky Power Co.		
Indiana Michigan Power Co.		
AEP Transmission Company, LLC		
Corporate Credit Rating	A-/Stable/--	BBB+/Watch Pos/--
American Electric Power Co. Inc.		
Senior Unsecured	BBB+	BBB+/Watch Pos
AEP Texas Inc.		
Senior Unsecured	A-	BBB+/Watch Pos

Research Update: American Electric Power Co. Inc. And Subsidiaries Upgraded To 'A-', Off Watch; Outlook Stable

AEP Transmission Company, LLC		
Senior Unsecured	A-	BBB+/Watch Pos
Appalachian Power Co.		
Senior Unsecured	A-	BBB+/Watch Pos
Indiana Michigan Power Co.		
Senior Unsecured	A-	BBB+/Watch Pos
Kentucky Power Co.		
Senior Unsecured	A-	BBB+/Watch Pos
Ohio Power Co.		
Senior Unsecured	A-	BBB+/Watch Pos
Public Service Co. of Oklahoma		
Senior Unsecured	A-	BBB+/Watch Pos
RGS (AEGCO) Funding Corp.		
Senior Unsecured	BBB+	BBB/Watch Pos
RGS (I&M) Funding Corp.		
Senior Unsecured	BBB+	BBB/Watch Pos
Southwestern Electric Power Co.		
Senior Unsecured	A-	BBB+/Watch Pos
Upgraded; CreditWatch/Outlook Action; Ratings Affirmed		
	To	From
American Electric Power Co. Inc.		
Appalachian Power Co.		
Corporate Credit Rating	A-/Stable/A-2	BBB+/Watch Pos/A-2

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FEBRUARY 2, 2017 7

S&P Global
Ratings

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American Electric Power Co. Inc.

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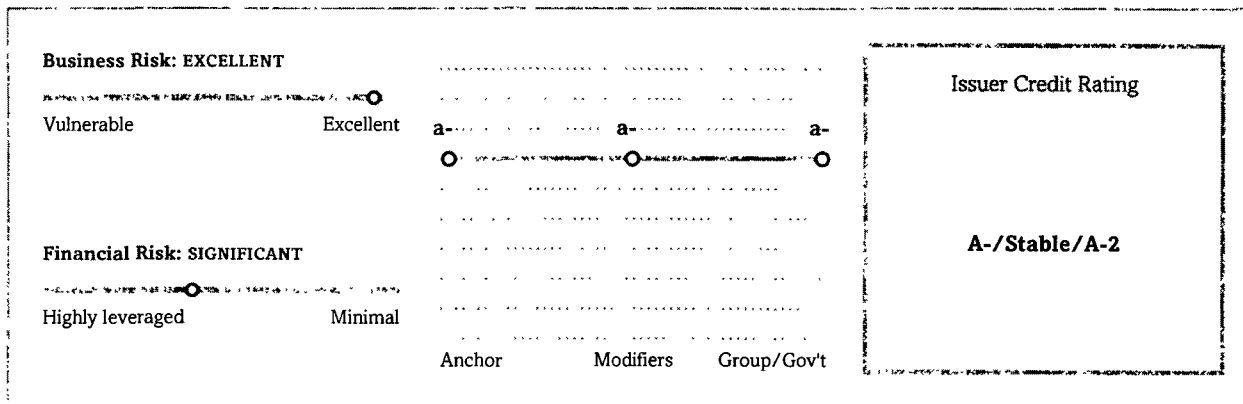
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Ratings Score Snapshot

Related Criteria

American Electric Power Co. Inc.



Credit Highlights

Overview	
Key Strengths	Key Risks
Mostly lower-risk electric utility holding company.	Elevated capital spending program that requires ongoing balanced funding and timely cost recovery.
Large scale of operations with a customer base of about 5.4 million combined with solid geographic diversity with operations in 11 U.S. states.	Operating cash flow lowered by U.S. tax reform.
Generally credit-supportive and constructive regulatory frameworks.	Higher operational risk arising from the ownership of the Cook nuclear plant.
Coal-fired generation being scaled back through retirements as the company expands transmission assets.	Financial measures at the lower end of the benchmark range for the financial risk profile, resulting in limited cushion.

Purchase of wind energy assets will support the long-term strategy of diversifying its generation portfolio. This is in line with American Electric Power Co. Inc.'s (AEP) previously announced strategy, and we expect the company to fund the transaction in a credit-supportive manner. This acquisition will help AEP lower its overall carbon dioxide emissions and the proportion of coal-based generation.

Large multistate operations that have constructive regulatory frameworks bolster overall credit quality. AEP is one of the largest electric utilities in the U.S., delivering electricity to about 5.4 million customers across 11 states. This diversity helps mitigate the impact of adverse regulatory decisions or regional economic challenges. The jurisdictions generally have a constructive regulatory framework that provides for the timely recovery of approved capital expenditures, as well as pass-through fuel cost mechanisms and recovery of various operating expenses.

Federal Energy Regulatory Commission (FERC)-regulated transmission investments are credit-enhancing. AEP's latest capital spending plan calls for higher spending on transmission infrastructure and projects. This should further increase its transmission rate base, providing stable and predictable cash flows by formula-based rates.

Outlook: Stable

The stable outlook on AEP and its subsidiaries reflects the company's improving business risk profile that consists almost entirely of solid regulated utility operations. We expect AEP to generate FFO to debt of 14%-15% through 2020 after factoring in the impact of U.S. tax reform.

Downside scenario

We could lower the ratings on AEP and its subsidiaries if the company's financial performance weakens such that FFO to debt is consistently below 14%, or if its business risk increases as a result of ineffective management of regulatory risk or the pursuit of risky unregulated investments.

Upside scenario

While not likely, we could raise the ratings on AEP and its subsidiaries if the company's financial performance improves, with FFO to debt consistently above 20% while business risk is unchanged.

Our Base-Case Scenario

Assumptions	Key Metrics																
<ul style="list-style-type: none">• Economic conditions in the company's service territories continue to improve modestly, supporting a gradual increase in load growth.• Headwinds from U.S. tax reform result in lower operating cash flow.• Capital spending is elevated at \$6 billion-\$6.5 billion per year.• Common stock dividends total about \$1.3 billion annually.• Negative discretionary cash flow indicates external funding needs.• All debt maturities are refinanced.	<table><tr><th></th><th>2019E</th><th>2020E</th><th>2021E</th></tr><tr><td>FFO to debt (%)</td><td>14-16</td><td>14-16</td><td>15-17</td></tr><tr><td>Debt to EBITDA (x)</td><td>4.5-5</td><td>4.2-4.7</td><td>4.5-5</td></tr><tr><td>FFO cash interest coverage (x)</td><td>4.2-4.7</td><td>4.5-5</td><td>4.8-5.3</td></tr></table> <p>E--Expected. FFO--Funds from operations.</p>		2019E	2020E	2021E	FFO to debt (%)	14-16	14-16	15-17	Debt to EBITDA (x)	4.5-5	4.2-4.7	4.5-5	FFO cash interest coverage (x)	4.2-4.7	4.5-5	4.8-5.3
	2019E	2020E	2021E														
FFO to debt (%)	14-16	14-16	15-17														
Debt to EBITDA (x)	4.5-5	4.2-4.7	4.5-5														
FFO cash interest coverage (x)	4.2-4.7	4.5-5	4.8-5.3														

Base-case projections

- Gross margin benefits from rate recovery mechanisms and transmission formula rates, partially offset by the impact of U.S. tax reform.
- Annual debt to EBITDA is elevated into the upper-4x area.

- Negative discretionary cash flow is expected to be partly funded with debt.
- Adjusted FFO to debt of 14%-16% is expected to improve after incremental cost recovery through rates.

Company Description

Columbus, Ohio-based AEP is a holding company of electric utilities that serve about 5.4 million customers in 11 states.

Business Risk: Excellent

Our assessment of AEP's business risk profile is based on the very low risk of the regulated utility industry and the company's mostly lower-risk, rate-regulated operations that provide electricity, an essential service. Although in 11 states, the company's operations in Ohio, Texas, Virginia, and West Virginia represent the majority of consolidated revenues. AEP has reached largely constructive regulatory outcomes in the jurisdictions in which it operates, ensuring some cash flow stability over the next few years. AEP is investing in transmission projects, a trend that is likely to continue, providing ongoing support to credit quality through cash flow diversity and further regulatory diversification.

Quality of the service territories varies, but many are in stable and diverse economies. They collectively benefit from broad diversity that mitigates the effect of weather and local economic conditions. AEP also benefits from a diverse set of customers, which provides stability in the case of lower usage by any particular class, generating the bulk of revenues from residential, commercial, and wholesale customers with lower contribution from the more volatile industrial class.

AEP's 32,000-megawatt (MW) generation fleet benefits from low cost and efficient operations leading to competitive customer rates. Over time, the heavy reliance on coal capacity generation is reduced through plant retirements and coal plants that are mostly controlled, avoiding the need for large environmental compliance spending based on current rules. Increasing investments in transmission assets helps diversify the regulated rate base and potentially facilitate compliance with evolving environmental standards by bringing in power from other regions. These upsides are somewhat offset by the company's exposure to nuclear generation, which has higher operational risk. The company owns and operates the 2,200 MW Cook nuclear plant.

Peer comparison

We consider AEP similar to peers Berkshire Hathaway Energy Co., Duke Energy Corp., WEC Energy Group Inc. (WEC), and Xcel Energy Inc. They all have excellent business risk profiles and significant financial risk profiles. They operate across numerous states, have many customers, and electric generation, including coal-fired plants. Like AEP, all peers except WEC have nuclear generation. Regulated electric transmission plays a part in each company's strategy. The three-year average of AEP's financial measures are the strongest of the peers, but after the impact of U.S. tax reform, the company is expected to decline among the middle of the peers. The utilities of these companies all operate under generally supportive regulatory environments with various rate and cost-recovery mechanisms.

Table 1

American Electric Power Co. Inc. -- Peer Comparison				
Industry Sector: Electric				
	American Electric Power Co. Inc.	Duke Energy Corp.	WEC Energy Group Inc.	Xcel Energy Inc.
Rating as of March 5, 2019	A-/Stable/A-2	A-/Stable/A-2	A-/Stable/A-2	A-/Stable/A-2
--Fiscal year ended Dec. 31, 2018--				
(Mil \$)				
Revenues	15,927.1	24,116.0	7,679.5	11,458.0
EBITDA	4,836.7	9,947.0	2,273.6	3,650.0
FFO	3,998.8	8,637.8	2,058.3	3,075.6
Net income from cont. oper.	1,923.8	2,647.0	1,059.3	1,261.0
Cash flow from operations	5,500.8	7,341.8	2,487.3	3,203.6
Capital expenditures	6,298.0	9,228.0	2,108.8	3,909.0
FOCF/debt (%)	(797.2)	(1,886.2)	378.5	(705.4)
Discretionary cash flow	(2,048.3)	(4,357.2)	(318.8)	(1,435.4)
Cash and short-term investments	393.2	442.0	84.5	201.0
Debt	26,350.6	59,431.0	11,802.5	19,223.0
Equity	19,128.8	43,834.0	9,842.7	12,222.0
Adjusted ratios				
EBITDA margin (%)	30.4	41.2	29.6	31.9
Return on capital (%)	5.7	4.7	6.3	5.3
EBITDA interest coverage (x)	4.6	4.4	5.0	5.2
FFO cash interest coverage (X)	5.0	4.8	5.6	5.5
Debt/EBITDA (x)	5.4	6.0	5.2	5.3
FFO/debt (%)	15.2	14.5	17.4	16.0
Cash flow from operations/debt (%)	20.9	12.4	21.1	16.7
FOCF/debt (%)	(3.0)	(3.2)	3.2	(3.7)
Discretionary cash flow/debt (%)	(7.8)	(7.3)	(2.7)	(7.5)

FOCF--Free operating cash flow. FFO--Funds from operations

Financial Risk: Significant

Under our base-case scenario, we anticipate that AEP's adjusted FFO to debt will be 14%-16% in 2019, improving to 15%-17% in the next few years as the company benefits from recovery mechanisms like the investment cost rider, formulaic transmission rates, and forward test years for rate cases. Various rate mechanisms allow for the timely recovery of costs and support more stable operating cash flow. We expect the company will continue to fund its investments in a manner that preserves credit quality.

Over the next several years, AEP's capital spending will be elevated and will exceed \$6 billion-\$6.5 billion per year. About 5% will be allocated to contracted renewables and the balance to regulated operations, including over 50% allocated to FERC-regulated transmission investments, which benefit from a constructive regulatory framework that

provides for timely investment recovery. The elevated capital spending along with dividends results in significantly negative discretionary cash flow, indicating external funding needs and likely limiting material deleveraging. We expect adjusted debt to EBITDA to be 4.5x-5x. We assess AEP's financial risk profile using our medial volatility financial benchmarks that reflects lower-risk regulated utility operations and effective management of regulatory risk. These benchmarks are more relaxed than those used for a typical corporate issuer.

Financial summary

Table 2

American Electric Power Co. Inc. -- Financial Summary					
Industry Sector: Electric					
--Fiscal year ended Dec. 31--					
	2018	2017	2016	2015	2014
Rating history	A-/Stable/A-2	A-/Stable/A-2	BBB+/Watch Pos/A-2	BBB/Positive/A-2	BBB/Positive/A-2
(Mil. \$)					
Revenues	15927.1	15080.3	15988.9	16033.4	16623.7
EBITDA	4836.7	5538.7	5493.8	5420.2	5347.6
FFO	3998.8	4450.2	4471.9	4240.6	4245.6
Net income from continuing operations	1923.8	1912.6	613.4	1763.4	1634.0
Cash flow from operations	5500.8	4102.6	4338.4	4576.9	4420.3
Capital expenditures	6298.0	5750.7	4857.9	4538.7	4271.0
FOCF	(797.2)	(1648.1)	(519.5)	38.2	149.3
Dividends paid	1251.1	1191.9	1121.0	1059.0	994.0
Discretionary cash flow	(2048.3)	(2840.0)	(1640.5)	(1020.8)	(844.7)
Debt	26350.6	23512.9	22230.0	20541.7	20566.9
Preferred stock	0.0	0.0	0.0	0.0	0.0
Equity	19128.8	18313.6	17420.1	17904.9	16824.0
Debt and equity	45479.4	41826.5	39650.1	38446.6	37390.9
Adjusted ratios					
EBITDA margin (%)	30.4	36.7	34.4	33.8	32.2
EBITDA interest coverage (x)	4.6	5.1	5.2	5.0	5.0
FFO cash interest coverage (x)	5.0	6.1	6.2	5.8	6.0
Debt/EBITDA (x)	5.4	4.2	4.0	3.8	3.8
FFO/debt (%)	15.2	18.9	20.1	20.6	20.6
Cash flow from operations/debt (%)	20.9	17.4	19.5	22.3	21.5
FOCF/debt (%)	(3.0)	(7.0)	(2.3)	0.2	0.7
Discretionary cash flow/debt (%)	(7.8)	(12.1)	(7.4)	(5.0)	(4.1)
Net cash flow/capex (%)	43.6	56.7	69.0	70.1	76.1
Return on capital (%)	5.7	7.3	7.3	7.3	7.5
Return on common equity (%)	9.2	9.9	2.5	9.0	9.0
Common dividend payout ratio (un-adj.) (%)	0.0	61.6	182.1	60.1	61.1

FOCF--Free operating cash flow. FFO--Funds from operations. Capex--Capital expenditures.

Liquidity: Adequate

We assess AEP's liquidity as adequate because we believe its sources are likely to cover uses by more than 1.1x over the next 12 months and meet cash outflows even with a 10% decline in EBITDA. The assessment also reflects the company's generally prudent risk management, sound relationships with banks, and a generally satisfactory standing in credit markets.

Principal Liquidity Sources	Principal Liquidity Uses
<ul style="list-style-type: none"> About \$790 million cash and liquid investments. Estimated cash FFO of about \$4.6 billion. Credit facility availability of about \$3 billion. Working capital inflows of around \$320 million. 	<ul style="list-style-type: none"> Capital spending of \$3.2 billion. Debt maturities, including outstanding commercial paper, of about \$4.15 billion. Dividends of about \$1.3 billion.
Debt maturities <ul style="list-style-type: none"> 2019: 2.3 billion 2020: 1.32 billion 2021: 1.35 billion 2022: 1.31 billion 	

Covenant Analysis

As of Sept. 30, 2018, AEP had adequate cushion as per the financial covenant of consolidated total debt to total capital of no more than 67.5%.

Compliance expectations	Requirements
<ul style="list-style-type: none"> The company was in compliance as of Sept. 30, 2018. Single-digit percentage EBITDA growth and elevated capital spending should still permit a cushion. Although we believe the company will remain in compliance, covenant headroom could decrease without adequate cost recovery of capital investments or if, while making these investments, debt rises rapidly without adequate growth in equity. 	<ul style="list-style-type: none"> Current: no more than 67.5% As of year-end 2019: no more than 67.5% As of year-end 2020: no more than 67.5%

Environmental, Social, And Governance

With a total generation fleet capacity of over 32,000 MW, of which 75% is based on fossil fuels (about 47% coal; 28% natural gas), AEP's environmental footprint is a significant risk factor. The company's reliance on coal-fired generation exposes it to heightened risks, including the ongoing cost of operating older units in the face of disruptive technology advances and the potential for increasing environmental regulations that require significant capital investments. AEP began to reduce its reliance on coal through plant retirements and renewable investments such as hydro, wind, solar, and energy efficiency. However, this upside is partly offset by AEP's exposure to nuclear generation (7% of the generation fleet), which introduces higher operational risks and plant retirement responsibilities. AEP's management is taking active steps to reduce its fleet's environmental footprint, committing to an 80% reduction of carbon dioxide emissions by 2050 from 2000 levels.

From a social perspective, AEP's internal safety and health management systems processes enable it to effectively serve electricity customers in 11 states, serving one of the largest service territory footprints in North America. AEP's cost-reduction efforts enabled the company to stabilize operations and maintenance costs in an inflationary economic environment, facilitating competitive customer rates. This is important because all transmission and distribution companies are moving proactively to deploy capital to upgrade, modernize, and harden assets in the wake of recent weather events and for technological reasons.

Governance factors are neutral to our ESG assessment. Its governance practices are consistent with other publicly traded utilities.

Group Influence

Under the group rating methodology, we assess AEP as the parent of the group that includes all of the company's

operating subsidiaries. AEP's group credit profile is 'a-', leading to an issuer credit rating of 'A-'.

Issue Ratings - Subordination Risk Analysis

The short-term rating is 'A-2', based on our 'A-' issuer credit rating on the company.

Capital structure	Analytical conclusions
AEP's capital structure consists of about \$21 billion of debt, of which about \$20 billion is priority debt.	We rate the unsecured debt at AEP one notch below the issuer credit rating because priority debt exceeds 50% of the company's consolidated debt, after which point AEP's debt is considered structurally subordinated.

Reconciliation

Table 3

Reconciliation Of American Electric Power Co. Inc. Reported Amounts With S&P Global Ratings' Adjusted Amounts										
--Rolling 12 months ended Dec. 31, 2018--										
American Electric Power Co. Inc. reported amounts (Mil. \$)										
	Debt	Shareholders' equity	Revenues	EBITDA	Operating income	Interest expense	EBITDA	Cash flow from operations	Dividends paid	Capital expenditures
	25545.7	19028.4	16140.0	4723.0	2656.2	984.4	4723.0	5223.2	1251.1	6371.6
S&P Global Ratings' adjustments										
Interest expense (reported)	--	--	--	--	--	--	(984.4)	--	--	--
Interest income (reported)	--	--	--	--	--	--	11.6	--	--	--
Current tax expense (reported)	--	--	--	--	--	--	(49.6)	--	--	--
Operating leases	1198.1	--	--	259.6	--	--	259.6	259.6	--	--
Postretirement benefit obligations/deferred compensation	--	--	--	(157.3)	(157.3)	--	50.4	98.5	--	--
Surplus cash	(393.2)	--	--	--	--	--	--	--	--	--
Capitalized interest	--	--	--	--	--	55.4	(55.4)	(55.4)	--	(55.4)
Share-based compensation expense	--	--	--	112.8	--	--	112.8	--	--	--
Securitized stranded costs	--	--	(258.5)	(258.5)	(39.5)	(39.5)	(219.0)	(219.0)	--	--

Table 3

Reconciliation Of American Electric Power Co. Inc. Reported Amounts With S&P Global Ratings' Adjusted Amounts (cont.)										
Asset retirement obligations	--	--	--	68.2	68.2	68.2	(1.8)	8.4	--	--
Nonoperating income (expense)	--	--	--	--	279.5	--	--	--	--	--
Noncontrolling Interest/Minority interest	--	100.4	--	--	--	--	--	--	--	--
EBITDA - Other income/(expense)	--	--	--	82.6	82.6	--	82.6	--	--	--
EBITDA - Other	--	--	--	65.0	65.0	--	65.0	--	--	--
D&A - Impairment charges/(reversals)	--	--	--	--	35.0	--	--	--	--	--
D&A - Other	--	--	--	--	(82.6)	--	--	--	--	--
Interest expense - Other	--	--	--	--	--	26.7	(26.7)	--	--	--
Total adjustments	804.9	100.4	(258.5)	172.4	250.9	110.8	(754.9)	92.1	0.0	(55.4)
S&P Global Ratings' adjusted amounts										
	Debt	Equity	Revenues	EBITDA	EBIT	Interest expense	Funds from Operations	Cash flow from operations	Dividends paid	Capital expenditures
	26350.6	19128.8	15881.5	4895.4	2907.1	1095.2	3968.1	5315.3	1251.1	6316.2

D&A--Depreciation and amortization

Ratings Score Snapshot

Issuer Credit Rating

A-/Stable/A-2

Business risk: Excellent

- **Country risk:** Very low
- **Industry risk:** Very low
- **Competitive position:** Strong

Financial risk: Significant

- **Cash flow/Leverage:** Significant

Anchor: a-

Modifiers

- **Diversification/Portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Adequate (no impact)

- **Management and governance:** Satisfactory (no impact)
- **Comparable rating analysis:** Neutral (no impact)

Stand-alone credit profile : a-

- **Group credit profile:** a-

Related Criteria

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Corporates - Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Business And Financial Risk Matrix

Business Risk Profile	Financial Risk Profile					
	Minimal	Modest	Intermediate	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of March 7, 2019)

American Electric Power Co. Inc.

Issuer Credit Rating	A-/Stable/A-2
Commercial Paper	
Local Currency	A-2
Senior Unsecured	BBB+

Ratings Detail (As Of March 7, 2019) (cont.)

Issuer Credit Ratings History

02-Feb-2017	A-/Stable/A-2
16-Sep-2016	BBB+/Watch Pos/A-2
29-Sep-2014	BBB/Positive/A-2

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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MARCH 7, 2019 14

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S&P Global
Ratings

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American Electric Power Co. Inc.'s \$700 Million Equity Unit Offering Rated 'BBB'

Primary Credit Analyst:

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NEW YORK (S&P Global Ratings) March 13, 2019--S&P Global Ratings today assigned its 'BBB' issue-level rating to American Electric Power Co. Inc.'s (AEP) proposed equity units. The equity units consist of a purchase contract that obligates the owners of the units to purchase AEP's common stock as of mid-March 2022, and a remarketable junior subordinated note due 2024. We have assigned high equity credit (100% equity treatment) to the issuance because of the mandatory convertible feature that requires the issuance of common equity within a three-year timeframe. The company intends to use the net proceeds from the equity units to refinance outstanding debt issues.

We notch the equity units two notches below our 'A-' issuer credit rating on AEP, which reflects the subordination and deferability on the instruments for the first three years. The rating applies to the company's obligation to service the debt component, as well as its obligation to issue common shares under the forward contract. It does not address the safety of principal or the units' value.

AEP is a holding company that owns vertically integrated regulated electric utilities and transmission and distribution only operations across 11 states (Arkansas, Indiana, Kentucky, Louisiana, Michigan, Mississippi, Ohio, Oklahoma, Texas, Virginia, and West Virginia), serving 5.4 million customers. Our issuer credit rating on AEP is 'A-' and the outlook is stable (see the full analysis on AEP published March 7, 2019).

American Electric Power Co. Inc.'s \$700 Million Equity Unit Offering Rated 'BBB'

RELATED CRITERIA

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
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- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Insurance - General: Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008

RATINGS LIST

American Electric Power Inc.
 Issuer Credit Rating A-/Stable/A-2

New Ratings

American Electric Power Co. Inc.
 Junior Subordinated
 \$700 Mil. Equity Units BBB

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American Electric Power Co. Inc.'s \$700 Million Equity Unit Offering Rated 'BBB'

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MARCH 13, 2019 4

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AEP TEXAS INC.'S RESPONSE TO OFFICE OF PUBLIC UTILITY COUNSEL'S
SIXTH REQUEST FOR INFORMATION

Question No. OPUC 6-4:

Please provide copies of all credit rating agency reports (Standard and Poor's, Moody's, Fitch) issued prior to the merger of AEP Texas North Company and AEP Texas Central Company that discuss the merger of these companies.

Response No. OPUC 6-4:

Credit rating agency reports are attached that discuss the merger of AEP Texas North Company and AEP Texas Central Company (OPUC 6-4 Attachment 1 and CONFIDENTIAL OPUC 6-4 Attachments 2 and 3). We do not subscribe to Fitch for ratings purposes.

CONFIDENTIAL OPUC 6-4 Attachments 2 and 3 responsive to this request are CONFIDENTIAL under the terms of the Protective Order. The Confidential information is available for review at the Austin offices of American Electric Power Company (AEP), 400 West 15th Street, Suite 1520, Austin, Texas, 78701, (512) 481-4562, during normal business hours.

Prepared By: Carrie M. Luedtke

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Sponsored By: Renee V. Hawkins

Title: Mng Dir Corporate Finance

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Research Update:

AEP Texas Inc. Assigned 'BBB+' Ratings And Placed On CreditWatch Positive

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CreditWatch

Ratings Score Snapshot

Related Criteria

Ratings List

Research Update:**AEP Texas Inc. Assigned 'BBB+' Ratings And Placed On CreditWatch Positive****Overview**

- American Electric Power Co. Inc. (AEP) has merged its Texas operations, AEP Texas North Co. and AEP Texas Central Co., into a new entity, AEP Texas Inc.
- We are assigning a 'BBB+' issuer credit rating to AEP Texas Inc., which is the same rating as that of the two predecessor utilities. At the same time, we placed the ratings on CreditWatch with positive implications.
- AEP Texas is assuming all the senior unsecured obligations of AEP Texas Central and AEP Texas North, and we are assigning a 'BBB+' senior unsecured debt rating to these obligations.
- We are withdrawing our 'BBB+' issuer credit rating on AEP Texas North and AEP Texas Central.
- The CreditWatch listing reflects the potential for an upgrade upon the close of the sale of the parent's merchant generation assets.

Rating Action

On Jan. 4, 2017, S&P Global Ratings assigned its 'BBB+' issuer credit and senior unsecured debt ratings to AEP Texas Inc., an entity created through the merger of American Electric Power Co. Inc.'s Texas subsidiaries, AEP Texas North Co. and AEP Texas Central Co. At the same time, we are placing the ratings on AEP Texas Inc. on CreditWatch with positive implications. We are withdrawing our 'BBB+' issuer credit ratings on AEP Texas North and AEP Texas Central.

Rationale

The ratings on AEP Texas reflect the company's operations under a generally constructive regulatory framework in Texas that facilitates timely recovery of distribution and transmission investments along with the company's low-risk electric transmission and distribution operations that lack commodity exposure. Moreover, the ratings on AEP Texas incorporate the company's large customer base of about one million customers that benefits from scale, covering portions of central, western, and southern Texas but which lacks operating and regulatory diversity. Residential and commercial customers contribute just over two-thirds of energy sales with industrial customers contributing the balance and introducing some exposure to cyclical industries such oil and gas exploration and production, chemical manufacturing and mining support activities. Finally, the ratings incorporate AEP Texas' well run operations that deliver consistently reliable service to customers.

Research Update: AEP Texas Inc. Assigned 'BBB+' Ratings And Placed On CreditWatch Positive

AEP Texas was created from the merger of AEP's Texas operations, AEP Texas North and AEP Texas Central, with AEP Texas North being about one-third of the combined entity.

We expect that AEP Texas' financial performance will reflect the pro forma financial performance of the combined entities and continue to benefit from available rider-type mechanisms that enable recovery of transmission and distribution investments, supporting gross margin growth. Given each predecessor company's approved capital structure of 60% debt and 40% equity, we expect that debt leverage will remain somewhat elevated with debt to EBITDA of about 4.5x-5x and funds from operations (FFO) to debt of 15%-16% over the next few years.

Liquidity

We assess AEP Texas' liquidity as adequate, reflecting the direct support already committed from and the influence of ongoing interactions with the group, including the provision of various corporate services, along with the availability of centralized liquidity resources, on an as-needed basis. We expect liquidity sources to exceed uses by 1.1x or more, the minimum threshold for regulated utilities under our criteria, and that the company will also meet our other requirements for such a designation.

AEP Texas' liquidity benefits from stable cash flow generation, about \$3.5 billion in available revolving credit facilities at parent American Electric Power Co. Inc. (AEP) along with sufficient liquidity provided by the parent to meet ongoing needs, as necessary, and manageable debt maturities over the next few years.

Principal liquidity sources:

- Available borrowing capacity of \$400 million for the next 12 months;
- Cash FFO of about \$650 million over next 12 months; and
- Parent contributions of about \$200 million to maintain regulatory approved capital structure.

Principal liquidity uses:

- Maintenance capital spending of about \$850 million;
- Long-term debt maturities largely reflect the amortizations of securitized debt; and
- Modest dividend distributions to parent.

CreditWatch

The ratings on AEP Texas and its parent, American Electric Power Co. Inc., are on CreditWatch with positive implications. The CreditWatch listing reflects the potential for higher ratings in the next three to six months upon the close of the sale of 5,200 MW of merchant generation capacity that would lead to an improvement of the company's business risk profile, while the company maintains FFO to debt of about 18%.

Research Update: AEP Texas Inc. Assigned 'BBB+' Ratings And Placed On CreditWatch Positive

We could affirm the ratings on AEP Texas, if our assessment of parent AEP's business risk remains the same while its FFO to debt is in the range of 15%-20%. Alternatively, we could affirm the ratings on AEP Texas if AEP's business risk profile improves but FFO to debt consistently weakens such that it is below 15%.

Upon the close of the sale of the bulk of the merchant generation assets, expected in the next three to six months, we could raise the issuer credit rating on AEP and its subsidiaries by one notch, reflecting improvement in business risk stemming from the sale of a portion of its merchant generation assets while the company maintains FFO to debt of about 18% or consistent with the middle of the range for the significant financial risk profile category.

Ratings Score Snapshot

Corporate Credit Rating: BBB+/Watch Pos/--

Business risk: Excellent

- Country risk: Very low
- Industry risk: Very low
- Competitive position: Strong

Financial risk: Significant

- Cash flow/Leverage: Significant

Anchor: a-

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: a-

- Group credit profile: bbb+

Related Criteria

- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Unregulated Power And Gas Industry, March 28, 2014
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013

Research Update: AEP Texas Inc. Assigned 'BBB+' Ratings And Placed On CreditWatch Positive

- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- Criteria - Corporates - Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 07, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Corporates - General: 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Ratings List

New Rating; CreditWatch/Outlook Action

AEP Texas Inc.

Corporate Credit Rating
Senior Unsecured

BBB+/Watch Pos/--
BBB+/Watch Pos

Not Rated Action; CreditWatch/Outlook Action

To

From

AEP Texas Central Co.

AEP Texas North Co.

Corporate Credit Rating

NR/--

BBB+/Watch Pos/--

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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JANUARY 4, 2017 6

SOAH DOCKET NO. 473-19-4421
PUC DOCKET NO. 49494

AEP TEXAS INC.'S RESPONSE TO OFFICE OF PUBLIC UTILITY COUNSEL'S
SIXTH REQUEST FOR INFORMATION

Question No. OPUC 6-5:

Please provide all equity analyst reports for AEP Texas, Inc. and American Electric Power Company, Inc. for the last 24 months.

Response No. OPUC 6-5:

Please see HIGHLY SENSITIVE OPUC 6-5 Attachment 1 for all equity analyst reports published for AEP Texas, Inc. and American Electric Power Company, Inc. for the last 24 months.

The attachment responsive to this request is VOLUMINOUS and HIGHLY SENSITIVE under the terms of the Protective Order. The Confidential information is available for review at the Austin offices of American Electric Power Company (AEP), 400 West 15th Street, Suite 1520, Austin, Texas, 78701, (512) 481-4562, during normal business hours.

Prepared By: Darcy L. Reese

Title: Dir Investor Relations

Prepared By: Lindsay J. Justice

Title: Corp Finance Analyst Assc

Sponsored By: Renee V. Hawkins

Title: Mng Dir Corporate Finance

**SOAH DOCKET NO. 473-19-4421
PUC DOCKET NO. 49494**

**AEP TEXAS INC.'S RESPONSE TO OFFICE OF PUBLIC UTILITY COUNSEL'S
SIXTH REQUEST FOR INFORMATION**

Question No. OPUC 6-6:

To the extent not provided in work papers, please provide copies of the source documents, data, and work papers associated with the development of Exhibit RBH-1 through Exhibit RBH-10. Please provide the underlying data and Exhibits in both paper and electronic (Microsoft Excel Worksheet) forms. For the Microsoft Excel documents, please provide the worksheets with links intact and include all formulas embedded in the worksheets.

Response No. OPUC 6-6:

The requested information was provided as workpapers in the original application.

Prepared By: Robert B. Hevert

Title: Partner, ScottMadden, Inc.

Sponsored By: Robert B. Hevert

Title: Partner, ScottMadden, Inc.

SOAH DOCKET NO. 473-19-4421
PUC DOCKET NO. 49494

AEP TEXAS INC.'S RESPONSE TO OFFICE OF PUBLIC UTILITY COUNSEL'S
SIXTH REQUEST FOR INFORMATION

Question No. OPUC 6-7:

To the extent not provided in work papers related to the testimony of Mr. Hevert, Ms. Hawkins, or Mr. Fetter, please provide copies of any articles, publications, regulatory decisions (outside of Texas), reference material, and documents cited in testimony or footnotes. If the referenced source is a book, please provide a copy of the relevant section of the book.

Response No. OPUC 6-7:

For the testimony of Ms. Hawkins, please see Cities 3-5 for additional reference source not provided with the original application.

For the testimony of Mr. Hevert, all information was provided in workpapers provided with the original application.

For the testimony of Mr. Fetter, please see OPUC 6-7 Attachments 1 and 2 for additional reference material not provided with the original application.

Prepared By: Renee V. Hawkins

Title: Mng Dir Corporate Finance

Prepared By: Robert B. Hevert

Title: Partner, ScottMadden, Inc.

Prepared By: Steven M. Fetter

Title: President, Regulation UnFettered

Sponsored By: Renee V. Hawkins

Title: Mng Dir Corporate Finance

Sponsored By: Robert B. Hevert

Title: Partner, ScottMadden, Inc.

Sponsored By: Steven M. Fetter

Title: President, Regulation UnFettered

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Securities, 257 ICC 129 (1944); *In re Competitive Bidding Rule for Public Utility Securities*, 63 PUR(NS) 140 (Cal. 1946); *In re Rochester Tel. Corp.*, 64 PUR(NS) (N.Y. 1946).

⁷⁴ *Utility Regulatory Policy*, 178-9. Thirty-eight state commissions have authority to require competitive bidding on mortgage bonds and debentures, and on underwriting of new common stock. *Ibid.*, 176-7. The PERC requires competitive bidding for electric utilities. See also "Exemptions from Competitive Bidding Requirements," *Public Utilities Fortnightly* 61 (13 March 1958): 417-20, and *Ibid.* 75 (21 January 1965): 71-73; L. H. Ederington, "Negotiated versus Competitive Underwriting of Corporate Bonds," *Journal of Finance* 31 (March 1976): 17-28; Edward A. Dyl and Michael D. Joehnk, "Competitive versus Negotiated Underwriting of Public Utility Debt," *Bell Journal of Economics* 7 (1976): 680-9.

⁷⁵ Three types of bonds are commonly issued by public utilities: (1) first mortgage bonds, which are secured by the entire property of the issuing utility; (2) debenture bonds, which are secured by the general credit of the issuing utility, but which are subject to the prior claim of the first mortgage bonds; and (3) revenue or income bonds, which are secured by the earnings of the issuing utility after interest on any outstanding first mortgage or debenture bonds has been paid. For a complete discussion, see John P. Childs, *Encyclopedia of Long-Term Financing and Capital Management* (Englewood Cliffs, N.J.: Prentice-Hall, 1976), esp. chap. 4.

⁷⁶ Locklin, *Economics of Transportation*, 567.

⁷⁷ The assumption that the average cost of capital is a function of a utility's capital structure is questioned by Franco Modigliani and Merton H. Miller, "The Cost of Capital, Corporation Finance and the Theory of Investment," *American Economic Review* 48 (1958): 261-97. See Chapter 9, 417-65.

⁷⁸ J. J. Scanlon, *Financial Expansion and the Problems of Corporate Capital Structure* (Urbana: University of Illinois Bulletin, 1968) (Weinstein Lecture series, Department of Finance), 5.

⁷⁹ See Chapter 9.

⁸⁰ Utility bonds are rated by the three principal rating agencies (i.e., Duff and Phelps, Moody's Investors Service and Standard & Poor's Corporation). Bond ratings are important for at least four reasons: (1) they are used by investors in determining the quality of debt investment; (2) they are used in determining the breadth of the market, since some large institutional investors are prohibited from investing in the lower grades; (3) they determine, in part, the cost of new debt, since both the interest charges on new debt and the degree of difficulty in marketing new issues tend to rise as the rating decreases; and (4) they have an indirect bearing on the status of a utility's common stock and on its acceptance in the market. See Fergus J. McDiarmid, "Interest Coverage and Bond Ratings," *Public Utilities Fortnightly* 89 (11 May 1972): 19-23.

⁸¹ Scanlon, *Financial Expansion*, 8.

⁸² Gilbert Burck, "Is AT&T Playing It Too Safe?" *Fortune* (September 1960), 276. One authority estimated that for electric utilities, "a change of 10 percent of capitalization from equity to debt saves 1.10 percentage points in the cost of capital, or a saving of about 11 percent." Donald C. Cook, "Special Problems of Electric Regulation," Part II, *Public Utilities Fortnightly* 74 (19 November 1964): 31.

⁸³ L. Chester May, "Bell System Financing," *Bell Telephone Magazine* (Autumn 1960), 28.

⁸⁴ Scanlon, *Financial Expansion*, 15. During the 1950s and 1960s, the Bell System's annual financing increased from \$321 million (1950) to \$2.5 billion (1969).

⁸⁵ May, "Bell System Financing," 28.

⁸⁶ J. Rhoads Fox, "Higher Equity Ratios in Public Utilities," *Public Utilities Fortnightly* 87 (15 April 1977): 883-936. See, also, "Higher Equity Ratios in Public Utilities," *Public Utilities Fortnightly* 87 (15 April 1977): 883-936.

⁸⁷ See, e.g., Bar, *Public Utilities Fortnightly* 87 (15 April 1977): 883-936. See, also, "Higher Equity Ratios in Public Utilities," *Public Utilities Fortnightly* 87 (15 April 1977): 883-936.

⁸⁸ See, e.g., Bar, *Public Utilities Fortnightly* 87 (15 April 1977): 883-936. See, also, "Higher Equity Ratios in Public Utilities," *Public Utilities Fortnightly* 87 (15 April 1977): 883-936.

⁸⁹ See, e.g., Bar, *Public Utilities Fortnightly* 87 (15 April 1977): 883-936. See, also, "Higher Equity Ratios in Public Utilities," *Public Utilities Fortnightly* 87 (15 April 1977): 883-936.

⁹⁰ See Timothy, *Public Utilities Fortnightly* 87 (15 April 1977): 883-936. See, also, "Higher Equity Ratios in Public Utilities," *Public Utilities Fortnightly* 87 (15 April 1977): 883-936.

⁹¹ See, e.g., H. C. New York State Department of Public Service, "Utilities Return to the June 1990: 35.

⁹² See, e.g., Bar, *Public Utilities Fortnightly* 87 (15 April 1977): 883-936. See, also, "Higher Equity Ratios in Public Utilities," *Public Utilities Fortnightly* 87 (15 April 1977): 883-936.

⁹³ For rate-making capital structure for a utility, see Troxel, *Economic*.

⁹⁴ See, e.g., *In re Luzerne County Gas & Electric Co.*, 1125 (1942); *In re La Sherwood Tel. Co.*, 371 (1942).

⁹⁵ *In re Consolidated*

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suppliers, the company's capital structure, earnings in relation to interest requirements, regulatory developments in the industry, potential acquisitions, the status of major litigation against the company, and so forth.

All companies are interested in maintaining as high a rating as they can under the circumstances of their operation. Generally, the higher the rating of the bond, the better the access to capital markets and the lower the interest to be paid. Thus, a company with the highest rating may benefit in two ways: continuous access to capital and less interest to be payable over the life of the bond. At the other end of the scale, a very high credit rating also can imply that the utility is employing its capital inefficiently. As debt is cheaper to service than equity in most cases, it is usually sensible to maintain a balance of some debt funding (to lower financing costs) at the price of a lower credit rating.

The ratings assigned to debt securities are not static, but may be changed by the rating agencies as individual company circumstances change. These agencies conduct continuing evaluations of the risks taken by utility investors, and the ensuing market adjustments of securities pricing reflect those risks.

What might some of those risks be? Energy trading, for one. The years 2000-2003 provided a very vivid demonstration of the risks inherent in the creation of a new trading market, with a highly volatile, illiquid, nonstorable commodity. All parties now accept that to run such a potentially volatile business with a high debt burden (and low credit rating) is unsustainable in the medium term. Thin profit margins, occasional operating losses, and exposure to counterparty risk—the risk that a party to the trading contract might not fulfill its agreed-upon obligations—could crimp a diversified energy company's credit wings. Failures and shortcomings in unregulated (usually energy trading) businesses were the single most common business cause for negative rating action in 2002 and 2003, according to a study by Fitch Ratings published in December 2003.

Rating agencies also typically take a dim view of merger and acquisition activity. History has demonstrated that many merged entities struggle to generate sufficient additional returns to pay for the additional investment needed to execute the merger. Until recently, mergers and acquisitions were the single most common cause of credit rating downgrades, and seldom result in rating upgrades for both acquiring and acquired entities.

Natural gas companies being acquired, however, have seen their ratings rise for three reasons: (1) they usually are rated lower than the acquiring company; (2) the anticipation of savings can result from the merger; and (3) affiliation with a financially strong electric company can lead to a halo effect.

Another factor that weighs heavily on the credit ratings of utilities is the impact of rating action on parent holding companies and affiliates. The rating agencies take different approaches toward rating families of companies—S&P bases its ratings on a consolidated view, which tends to place ratings of affiliates at the same or nearly the same level, while Fitch and Moody's have traditionally assigned ratings that allow for greater separation of regulated utility company ratings from those of their parents and

Public
Utility
Securities

6-7

**SOAH DOCKET NO. 473-19-4421
PUC DOCKET NO. 49494**

**AEP TEXAS INC.'S RESPONSE TO OFFICE OF PUBLIC UTILITY COUNSEL'S
SIXTH REQUEST FOR INFORMATION**

Question No. OPUC 6-6:

To the extent not provided in work papers, please provide copies of the source documents, data, and work papers associated with the development of Exhibit RBH-1 through Exhibit RBH-10. Please provide the underlying data and Exhibits in both paper and electronic (Microsoft Excel Worksheet) forms. For the Microsoft Excel documents, please provide the worksheets with links intact and include all formulas embedded in the worksheets.

Response No. OPUC 6-6:

The requested information was provided as workpapers in the original application.

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