Q3 2011 Earnings Call

Company Participants

- Brian Tierney, CFO, EVP
- Charles Zebula, SVP, Treasurer
- Michael Morris, Chairman, CEO

Other Participants

- Dan Eggers, Analyst, Credit Suisse
- Greg Gordon, Analyst, ISI Group, Inc.
- Jonathan Arnold, Analyst, Deutsche Bank
- Michael Lapides, Analyst, Goldman Sachs
- Paul Patterson, Analyst, Glenrock Associates
- Paul Ridzon, Analyst, KeyBanc Capital
- Steve Fleishman, Analyst, Bank of America/Merrill Lynch

Presentation

Operator

Ladies and gentlemen, thank you for standing by and welcome to the Third Quarter 2011 earnings conference call. At this time, all lines are in a listen-only mode. Later, we will conduct a question-and-answer session with instructions given at that time. (Operator Instructions) As a reminder, today's conference is being recorded. I would like to turn the conference over to our host, Treasurer and Senior Vice President, Chuck Zebula. Please go ahead.

Charles Zebula {BIO 6231994 <GO>}

Thank you, Carey. Good morning, and welcome to the 2011 Third Quarter earnings webcast of American Electric Power. Our earnings release and related financial information are available on our website, AEP.com. The presentation slides are also available on our website. Today, we will be making forward-looking statements during the call. There are many factors that may cause future results to differ materially from these statements. Please refer to our SEC filings for a discussion of the factors that may cause results to differ from management's forecast.

Joining me this morning are Mike Morris, our Chairman and Chief Executive Officer, and Brian Tierney, our Chief Financial Officer. We will take your questions following their remarks. I will now turn the call over to Mike.

Michael Morris {BIO 1418617 <GO>}

Thanks, Chuck. It is always nice when you get Brian's name correct. It shows how closely we all work together. Welcome to everybody else on the phone, happy to have you here. Always pleased to be the first in the day and equally important to be the first in the quarter.

Looking forward to sharing with you a number of very interesting successes that we had in a very successful Third Quarter for both our shareholders and our customers. I'm always amazed at page two; it's that detail requirement they tell you to be cautious about what you hear. And I know you'll all do that because you always do and you are right appropriately about how you think American Electric Power is doing.

If we turn to page three, let me detail for you some of the successes that we are really quite pleased with. First off, on ongoing earnings, we had $1.17 a share, which is $0.02 or $15 million higher than Q3 in 2010, in I think what all of us could consider to be a very shaky economy as compared to what we saw in the latter part of 2010 when things appeared to be recovering.

Secondly, our GAAP earnings reflecting the appropriate decision by the Texas Supreme Court were substantially higher than Q3 of 2010 by $373 million. I'll talk a little more about the Supreme Court decision a little later. Thirdly, we are announcing a tightening of our 2011 forecast to $3.07 to $3.17 as a range, moving from the $3.10 to $3.20 -- or the $3.00 and $3.20 that we had been working with as our forecast for 2011. Brian will touch a bit on 2012 as he gives his update.

Lastly, or most importantly on this particular page, the Board of Directors decided yesterday to increase the dividend by 2.2% or a full penny per share, which takes us on an annual basis to $1.88, and for me anyway it is pretty enjoyable to see a consecutive dividend increase for the eight years of my tenure as Chief Executive Officer as American Electric Power Company.

We also announced yesterday that we intend to redeem all of the preferred shares of our operating subsidiaries. That will allow us to experience a few million dollars per year in earnings in 2012 and beyond. We think it was the appropriate thing to do and the appropriate time to do that.

And lastly, and I would think most importantly, yesterday, the Board of Directors in keeping with our long-stated succession planning, elected Nick Akins to succeed me as Chief Executive Officer and President of American Electric Power on November 11, 2011.

Nick actually becomes the tenth President of American Electric Power in its over 100-year history and only the sixth Chief Executive Officer as for years in the early go, most corporations didn't have that slot filled. I am really pleased that Nick will continue to take the very conservative shareholder-customer review that we've established at American Electric Power, continue to give the operating company presidents plenty of runway to make difficult decisions. But he and others will always keep a sharp eye on the most important decisions that need to be made.

With the C-level team made up of Nick and Brian Tierney as CFO, Bob Powers, David Feinberg, and Dennis Welch, I really feel pretty comfortable about the team that Nick will be working with.

And, of course, as Chair, I will be able to sit back and add some advice when and if it is needed, but more importantly, just simply enjoy the ride myself.

Let me turn to page four and talk about some of the other really significant events that happened during Q3. I know there is much worry and concern about the first point on the top of this page, but I must tell you that we were quite pleased to reach a settlement and file a stipulation in the ongoing 2012 through 2015 electric security plan here in Ohio. All but three folks agreed with the stipulation.

Many of the other companies that would market into Ohio, obviously, as you all know, the industrial energy users which is a bit difficult to understand because their individual customers receive pretty substantial rate decreases by the step, but, of course, FirstEnergy Solutions and OCC were not a signa choice to the undertaking. But that is really of no concern because we expect that there would be a debate and there has been.

We fully expect an order to be issued by the end of the year and we think that that would give great clarity to one of the overhang issues that is of concern to you and us and our Board of Directors, and that is the path forward in Ohio. As we look at that particular undertaking, we are pleased with the opportunity to transition to market. We think that that's the appropriate place for us to go as we continue to address that issue.

Secondly, and most importantly, with the environmental matters, American Electric Power, along with many others, but clearly following the lead of our company, have made some very honest and straight-forward statements about the potential ramifications of the multiple events that the Environmental Protection Agency is intending to implement in the next short while, which will have a dramatic or could have a dramatic affect on our ability as an industry to continue to keep the lights on 24/7.

Our story has been the same from the beginning to today. We continue to meet and have dialogue with the Environmental Protection Agency, the Department of Energy, all of the RTOs that are affected, at least by our fleet and the impact those rules may have on our fleet, as well as the FERC.

Sometime ago, we began to have conversations with members of Congress, and were quite pleased to see what the House Republicans have done. Also encouraged by yesterday or earlier this week's announcements by a bipartisan group of Senators, both Democratic and Republican sides of the aisle addressing the coal ash issue, which is really a piece of legislation that was occasioned by a TV event at the TVA. That isn't the basis for continued regulatory change and we've tried to point that out.

We are comfortable that some of the decisions that the EPA has made to date have moved in the appropriate direction and we will continue to have that dialogue because ours is one that takes away the risk of reliability impact and the unnecessary expense that may be associated with some of these rules. I think the particular matter subset of the HAPs MACT Rule is a perfect example. For a company like ours where we today capture 99.7% of all PMs, we're going to be required to go to 99.9%. The environmental benefits from that will be marginal at best, and the forecasted capital investments on the order of $700 million. It's those kinds of events that we think are (inaudible) thought through at the end of day, stretching the timeline out by a few short year, we can reach the same environmental goals that the EPA and others are embracing and we embrace along with them. So we will continue to have that dialogue and continue to make those points going forward.

Our transmission undertakings, which were long announced and slow in growing, do in fact continue to reach some pretty significant success milestones for us. We think that the order on RITELine by the FERC, that was an appropriate order. It has reasonable rates of return, not the high numbers that we saw in the early undertakings in joint venture transmission plays through the FERC, but reasonable, for sure north of 11%. We think it is a great place to put money to work. In fact, with the approval and the ongoing activity at Pioneer, we feel those partnerships and those joint venture activities are beginning to gain some speed.

Our very quiet, but quite successful play in the state of Texas through Electricity Transmission Texas is something that we are quite pleased with. We are north of a $1 billion capital invested by Q3 2011 and, in fact, we'll be north of about $3 billion by 2017, yet this decade. That's going to make some pretty substantial earnings growth potential for our shareholders as we move forward in those endeavors.

Our well-discussed and brought forth Transco project concept in our traditional service territory is also on a pretty reasonable path. We'll be north of $1 billion invested sometime in calendar year 2012. We will continue to see pretty substantial earnings strength from those activities by improving the reliability and the intellectual capacity with our energy delivery system in our traditional service territory. So we really feel good about the things going on there.

The last point on page four here is the verification of what we always thought to be the case. In early 2000's, we, along with others, implemented restructuring endeavors in the state of Texas. The PUCT at the time thought that maybe the approach that we had taken, which was a straight-out auction of our facilities, was in violation of the best approach to take.

Obviously, we agreed wholeheartedly with the Supreme Court of Texas as they remanded that case back with directions that was done by us and other were in fact in compliance with the law. And as you know, the decision has add substantially to the solidness of our balance sheet. And as we look at the recovery of the interest rates over a period of years, will add to our earnings strength, as well.

So all in all, the Third Quarter in almost any way that we would measure it has been a success for us and we feel very comfortable about that. As we look at our year-end earnings forecast and the tightening of the zone, we think it addresses an adequate amount of conservative business for the Fourth Quarter because we like others are beginning to see more slow down in the US economy, but we feel comfortable that we'll be well within the range that we have tightened for you.

And lastly, let me simply say as this is my last endeavor on an earnings conference call as Chief Executive Officer of American Electric Power, I thank you for the support, the counsel, and the professional friendships that we've developed over the many odd years since I have been in the electric business in 1988 at Consumers Power Company, Northeast Utilities, and American

Electric Power. With that, I will turn the call over to Brian, and when he's completed, we look forward to your questions. Brian?

Brian Tierney {BIO 15917272 <GO>}

Thank you, Mike. This morning, I will review the quarterly and year-to-date reconciliations for ongoing earnings through the Third Quarter, review load trends and customer switching data, and provide update on the Company's capitalization and liquidity. I will also provide some comments on 2012 and then wrap up and get to your questions as quickly as possible.

On slide five, you will see that ongoing earnings for the Third Quarter of 2011 were $566 million or $1.17 per share. This is $14 million greater than last year's Third Quarter ongoing earnings of $552 million or $1.15 per share. Highlights for the quarterly comparison include the refund of the Provider of Last Resort charges from the Ohio Electric Security Plan Remand, which accounted for a negative comparison of $0.06 per share or $43 million. We anticipate an additional negative quarterly comparison in the Fourth Quarter of this year of approximately $0.04 per share. Customer switching in Ohio accounted for a negative comparison of $0.04 per share or $33 million. We will examine this issue in greater detail on slide eight.

Operations and maintenance charges net of offsets accounted for negative $0.03 per share or $19 million and were primarily due to higher storm expenses and higher generation maintenance expenses. Weather and normalized retail margins were down $0.02 or $12 million for the quarter. Off-system sales were essentially flat relative to last year's Third Quarter and came in at $111 million. Increases in physical margins were largely offset by reductions in trading margins.

Physical off-system volumes increased 31%. While net generation from our coal fleet was essentially flat for the quarter, net gas generation was up 17%. Our east and west natural gas fleets experienced similar percentage against quarter-on-quarter, with the east combined cycle fleet outpacing our eastern peakers. In the western part of our system, the addition of the Lamar Stall Plant contributed to the quarterly improvement.

On the positive side, weather accounted for positive $0.02 per share or $14 million and was favorable to normal weather by $79 million. This was the warmest quarter in over 30 years for our west service areas and the seventh warmest in the last 30 years for our east service territories. Other was positive by $0.04 per share and reflects modest improvements in river operations, generation and marketing, and transmission operations.

Carrying cost income from Texas Central's Capacity Auction True-up Remand accounted for positive $0.04 per share or $28 million for ongoing earnings. This reflects the carrying cost income for the 2011 period only. We anticipate recognizing approximately $9 million in ongoing earnings association with this carrying cost income in the Fourth Quarter of this year.

In the earnings release, you will see that for GAAP earnings, the Company recognized $682 million gross, which is $443 million or $0.92 per share net of taxes from the strand of costs preceding. The Public Utility Commission of Texas hearing on this Capacity Auction True-up is scheduled for November 28th to 30th, and the Company expects to securitize the final ordered amount in the First Quarter of 2012. Rate changes net of offsets accounted for a positive comparison of $0.07 per share or $53 million compared to last year's Third Quarter and came in from a number of our jurisdictions.

Turning to slide six, you will see that the Company earned $1.310 billion or $2.72 per share in ongoing earnings for the September year-to-date period. This compares favorably by $38 million to last year's ongoing earnings of $1.272 billion or $2.65 per share. As in the quarterly period, polar charges from the Ohio ESP Remand accounted for a negative comparison of $0.06 per share or $43 million. Customer switching in Ohio accounted for negative $0.10 or $76 million year-to-date. And, again, will have more on this later.

Operations and maintenance expenses net of offsets increased for the year by $48 million or $0.06 per share and were mostly driven by higher storm expenses. Weather normalized retail margins year-to-date were the same as for the quarterly period, down $0.02 per share. On the positive side, off-system sales net of sharing were up $49 million or $0.07 per share. Increases in physical margins were only partially offset by lower trading margin and higher margin sharing with our customers.

Year-to-date weather was flat the last year, but up $147 million versus normal. Other was a negative $0.02 per share in comparison to the 2010 year-to-date period. Increases in transmission operations, river operations, and generation of marketing were more than offset by two positive results that were realized in 2010. One was the gain of a sale of an investment and two, a positive foreign tax adjustment. Similar to the quarterly results, the ongoing Texas central carrying cost income was positive $0.04 per share and, again, we expect some more positive ongoing earnings from this category in the Fourth Quarter, as well.

And finally, rate changes net of offsets were positive $0.22 per share or $163 million versus last year's to date period, and again came from multiple jurisdictions. As Mike stated earlier, the positive year-to-date results allow us to narrow the guidance range for the year to $3.07 per share to $3.17 per share.

Turning to slide seven, you will see that total weather normalized sales were up 1.9% for the quarter and up 2.1% for the year-to-date period. Weather normalized industrial sales have increased 5.2% for the quarter and 5.1% for the year. Increases in industrial sales were led by primary metals, which is up 13% for the quarter and 15% for the year, largely being driven by a large aluminum customer in Ohio which returned a full load from two-thirds load in the First Quarter of this year.

Weather normalized residential load is up 0.5% for the year. For the year-to-date period, residential was particularly strong in our west regulated utilities where we saw the addition of the system of the Valley Electric Membership Corporation last year and we see continued lag in our east regulated utilities. The commercial segment is flat for the year-to-date period and we have seen common results between our east and west service territories in this customer class.

Turning to slide eight, you will see that 8.3% of AEP Ohio's load is switched to competitive retail energy suppliers. The majority of that load switching is in Columbus and southern territory, and most of that is in the commercial classes. While the amount of load switching and gross margin associated with it has been larger than forecast, AEP has experienced significant offsets to the margin lost in the form of capacity, sales to competitive retail suppliers, off-system sales margins from uncommitted energy, and competitive retail margins.

Combined, these items offset more than 75% of the lost retail margin. AEP Ohio's file stipulation seeks a fair price for capacity sold to competitive suppliers and would have them pay closer to what non-switching customers pay for capacity above certain thresholds.

Turning to slide nine, I would like to spend some time talking about the progress that's been made in strengthening AEP's balance sheet and liquidity positions.

First, let me address liquidity. AEP had slightly greater than $3.1 billion in that liquidity supported by our two revolving credit facilities. We have taken advantage of current credit market conditions and our strong balance sheet to increase and lengthen these facilities. In addition, there continues to be strong appetite for AEP's commercial paper. We believe that our net liquidity is strong enough to support our operations through current and future business environments.

Next, let's take a look at our total debt to total capitalization ratio. Currently at less that than 55%, our debt to cap ratio is the best it's been in the last eight years. This is not by accident. The Company has actively reduced costs in capital spending among other credit-friendly actions in recent years to improve the Company's balance sheet.

Finally, looking at our credit metrics, AEP is well within triple B territory. Our FFO to interest coverage is well above four times and our FFO to total debt is above 20%. Similar to our debt to cap ratio, these coverage ratios are at their highest levels in years.

Turning to slide ten, I think you will see that our performance in 2011 has been solid. We have reflected increase in increased rates associated with putting capital work for the service of our customers and we've been able to convert that in earnings to our shareholders through the rate activity that our presidents and the op-cos have been able to take.

We have positive balance sheet and credit ratio results as we have shown on the prior slide. This certainly will be impacted by the Texas securitization that we anticipate executing in the First Quarter of 2012. As we are able to get that equity capital in the door, we will be able to recapitalize TCC and then put the balance of those dollars to work in our operating companies, in our transmission JVs and trans-cos, and on the environmental spend that we will need to make to be compliant with the new EPA regulations.

We have continued focus on our op-co model. Our presidents have been out there with their long-term capital plans, their long-term rate plans, engaging in discussions with the regulators and customers about what the impact will be to rates over time, and aggressively and positively working to make those results happen. For the 12-month period, our ROEs for our combined operating companies is that 10.9% and our operating company presidents and their staffs continue to get things done.

Let me spend a few minutes talking about 2012. We are very confident in our ability to grow earnings from 2011 to 2012. There are some headwinds and some things that we need to get resolved between now and the time when we come out with more detailed guidance for 2012. Those include the Ohio stipulation, which needs to get resolved. I think we have put together a positive stipulation with most of the parties involved, only a couple outlying, and we think that that will be positively received by the Public Utility Commission of Ohio.

We have an outstanding rate case in Virginia, and we anticipate getting an answer to that by the end of the year, and Mike spent some time talking about the environmental issues and we certainly expect to have more clarity around those issues as we get to the end of the year, certainly for the Casper rules which goes into place in 2012. As we get that certainty, as we come towards the end of the year, we will be able to put together the more detailed guidance that I know you are looking for and expect to share that with you early in the new year. We fully anticipate that the 325-point estimate guidance will be within the range we will be able to share with you in 2012.

Finally, I think you will be able to see that management has been committed to growing earnings and growing the dividend, as our Board is committed to that. That's been the hallmark of the Mike Morris era, as you can see from the first slide, and I know that Nick Akins is as committed to growing earnings and the dividend for the benefit of our shareholders as Mike was and we certainly anticipate that to continue. Before I turn the call back over to Carey for questions, I would like to note that this is Mike Morris' final earnings call as CEO of the Company. He has had 32 such calls as CEO of the Company over the last eight years, and I think you can see from what we have talked about today, he is leaving the Company in a considerably stronger financial position than what he found it in.

I know it is important to Mike and is appreciated by those of us who are employees, he's also left the employees of the Company considerably safer than they were when he arrived here, and I know the employees of the Company and our families are grateful to him for that. So on behalf of the men and women of American Electric Power, I would like to thank Mike Morris for his dedication, commitment, and leadership to the Company and tell him that we look forward to his continued leadership on the Board of Directors. Thank you, Mike.

Michael Morris {BIO 1418617 <GO>}

Gee, Brian, thanks a lot. It is too bad the comp committee event met yesterday. Carey, with that, I'd like to start taking questions.

Questions And Answers

Operator

Sure, thank you. (Operator Instructions) And our first question comes from Steve Fleishman. Please state your organization, sir, your company.

Q - Steve Fleishman {BIO 1512318 <GO>}

Yes, hi. It's Steve Fleishman from Bank of America/ Merrill Lynch. That was the fastest my question has ever gotten picked up. Mike, first, congratulations. We're going to miss you on these calls.

A - Michael Morris {BIO 1418617 <GO>}

Thanks, Steve.

Q - Steve Fleishman {BIO 1512318 <GO>}

A couple quick things. First, on the switching numbers that you are providing, are those kind of a gross number or is that a net number? Is it net of the customers that you have switched but you've retained in your competitive side?

A - Brian Tierney {BIO 15917272 <GO>}

It is not net of customers that we've retained, and that, Steve, along with off-system sales and capacity sales to those competitive retail energy suppliers are all net of those numbers that we've supplied.

Q - Steve Fleishman {BIO 1512318 <GO>}

Okay. So both the gross -- both the percentage and the actual dollar margin, are those both gross numbers?

A - Brian Tierney {BIO 15917272 <GO>}

The numbers on page eight are all gross numbers.

Q - Steve Fleishman {BIO 1512318 <GO>}

Okay.

A - Michael Morris {BIO 1418617 <GO>}

And I think, Steve, what Brian suggested and in fact laid out was that we recovered about 75% of those gross dollars with the various subsets of service that we provide to providers, as well as the recaptured customers.

A - Brian Tierney {BIO 15917272 <GO>}

And, Steve, those offsets would come through in the lines for off-system sales and generation and marketing.

Q - Steve Fleishman {BIO 1512318 <GO>}

Okay. Great. And then I guess one other question. This year, you've had the benefit of a lot of favorable weather, at least according to your weather normalization numbers. Without that, would have been lower level from which to grow, but are there other -- I mean, obviously, at the polar thing hurt within the range or are there other things maybe even related to the weather being so hot that maybe your costs were higher? So as we think about the weather impact, how do you think about that?

A - Michael Morris {BIO 1418617 <GO>}

Well, obviously in this business warmer than normal weather is a blessing on occasion, and as you surely remember and we have all lived through cooler than normal weather it is equally devastating. So what we have done over a series of years really, Steve, as you surely know, is when things are good, we step on the peddle for O&M spending. I think Brian's spiked out the impact.

We had a unique year in storm affects on the system. None of them large enough to touch the threshold of reserving for future recovery under the 11 jurisdictional states where we do business for the most part. That's obviously an increase in O&M spending. But we also have continued to do more work this year than we've done traditionally because we wanted to take full advantage of that weather.

When you look at the weather impact, most importantly look at the earnings year-over-year impact of the incredible rate successes we've continued to have in 2011, which is just following the path that we've had since we came here in 2004. So weather's good to us. It has been like all other utilities. Without that, we would have had some challenges. But each and every year, we have touched our mid-point in earnings, and this would have been one more year where we would have reacted to the weather as constructively as we have or conservatively if we needed to.

Q - Steve Fleishman {BIO 1512318 <GO>}

Great. Thanks. I will let someone else ask a question. Thank you.

A - Michael Morris {BIO 1418617 <GO>}

You bet, Steve. I'm surprised you were first, but happy you were.

Operator

Thank you. And now to the line of Greg Gordon of ISI Group. Please go ahead.

Q - Greg Gordon {BIO 1506687 <GO>}

Thanks. Mike, first of all, congratulations on a long and distinguished career.

A - Michael Morris {BIO 1418617 <GO>}

Thanks a lot, Greg. It surely has been a joy working with you and your colleagues.

Q - Greg Gordon {BIO 1506687 <GO>}

So I just want to ask a follow on question related to the first one. So when we look at the $83 million gross, I know you have indicated that there has been significant offsets, at the beginning of the year, you had indicated you thought you would be at about 17% switching and a $53 million headwind. That was kind of what was baked in to the mid-point of your guidance, so I guess to ask the question really simply, when you look at the gross number and you look at what you think the net number is, are you ahead of, behind, or on budget for what you expected for the year?

A - Michael Morris {BIO 1418617 <GO>}

I think it is clear that it has been a bit more aggressive than we thought that it would have been. I think that it had a lot to do with the ongoing availability of natural gas fired kilowatt hours being available in the marketplace. The flip side of that is, of course, what Brian had laid out to the question Steve had asked, is that that has given us additional kilowatt hours to put into the market. So we've offset a great deal, but it has clearly has been more aggressive than we had forecasted.

Q - Greg Gordon {BIO 1506687 <GO>}

Right. So on a gross basis, more customers have left, but have some of the offsets also been ahead of plan?

A - Michael Morris {BIO 1418617 <GO>}

Yes, I think that is an accurate way. So net-net, although I don't have the true net-net number in my head, I would tell you on balance, we think we have done real well in that space, and some of our customers who had the joy of having other supply energy to them. As you know in a volatile market, sometimes that joy becomes pain, but at least for this calendar year, the customers have done well, and I would argue the shareholders have surely done well, as well.

Q - Greg Gordon {BIO 1506687 <GO>}

Thanks. And, Brian, do we have a sense of the range of outcomes is in terms of the what your sort of net proceeds of the Texas securitization is going to look like at this point?

A - Brian Tierney {BIO 15917272 <GO>}

Yes, we do. The estimate that is reflected today is the low end and the conservative estimate of what we'd anticipate our being able to securitize. We have filed higher amounts with the Texas Commission, so today what we have recognized is a regulatory asset of the principal amount and the interest carrying charges of that $682 million. There is an incremental equity component that we'll recognize the securitization amortizes over time that's about $116 million. And that brings us to a very low and conservative estimate of $817 million.

We have filed with the Texas Commission because we believe we are entitled to amounts that range from that $817 million, which is extreme conservative and low, up to what we believe we would ultimately be entitled to, which is $1.2 billion, and we are awaiting the results from that Texas proceeding before we could recognize the higher amounts.

A - Michael Morris {BIO 1418617 <GO>}

And that will all be determined, Greg, in the current proceedings that are in front of the PUCT. But interestingly enough, if you go back to the root of our case, the actual foundation case, the Commission at that time determined that the appropriate interest rate for the AEP, Texas TCC and TNC would in fact be 11.7. So we think the Supreme Court really didn't give them much latitude to make any other choice.

That is the rate that they found in the case and the court didn't give them any direction about whether they should change that. They just said that has been determined in our case. So we think we've got a fighting shot at the $1.2 billion that Brian mentioned, and we will be aggressive in that approach because we think our owners deserve that over a period of years that we've waited for the appropriate decision.

Q - Greg Gordon {BIO 1506687 <GO>}

Thank you, gentlemen.

A - Michael Morris {BIO 1418617 <GO>}

Thank you.

Operator

Thank you. And now to the line of Dan Eggers from Credit Suisse. Please go ahead.

Q - Dan Eggers {BIO 3764121 <GO>}

Good morning. Congratulations, Mike.

A - Michael Morris {BIO 1418617 <GO>}

Thanks, Dan.

Q - Dan Eggers {BIO 3764121 <GO>}

(inaudible), but can you just share your thoughts from the Board's perspective on the dividend right now as it relates to the increased yesterday and kind of how you guys are approaching the payout ratio and growing the dividend here forward?

A - Michael Morris {BIO 1418617 <GO>}

I think the Board was obviously very encouraged to do this yet one more time. They were cautious for the 2012 view of that same point because we'll get some clarity about the capital demands on the system. We'll get additional clarity, as Brian really pointed out on what Ohio looks like, and there has been some writing that is probably a bit more aggressive than it needs to be about the changing mix of the earnings stream of American Electric Power going forward.

You can do a simple calculation to say we'll be 20-plus percent deregulated if you look at the fleet in Ohio, but the reality of that is that many of those megawatts will be dedicated to other members of what will become a three-state pool, or a three-party pool, I should say, actually, four, five states involved in it, as well as the continued serving of municipal and co-op customers here in our service territory. What Brian and I and the management team have really looked at when we look at the overall sequential step to market is we will take that Ohio fleet as it continues to free up to as many longer term, more dependable contracts as we can. Yes, we're going to keep a pretty solid number of megawatt hours to take full advantage of the volatility in the market place.

Our commercial operations group, as you know, has been very adept at being on the right side of those equations frequently. And Lisa Barton and the transmission group will begin to work hard on de-bottlenecking some of our avenue to the east coast markets where we will see substantially different margin on the upside by getting to some of the higher cost market places. I know our competitors over there won't be happy about that, but open markets are open markets and we will be the second lowest cost producer in this particular region, but for those who are more heavy nuke. So we look forward to that as it comes in. And it won't be near as risky as I know some have written about.

Q - Dan Eggers {BIO 3764121 <GO>}

I guess, Mike, on that point, when you look at the power pools as you guys see it developing and the ability for long-term contracts, what kind of percentage are you guys targeting as a management team for long-term contract relative to the market sales?

A - Michael Morris {BIO 1418617 <GO>}

Well, a lot of it will be in the overall discussions with the other pool members because they are going to be eager to have some capacity assigned to them going forward so that that will work that way. It's our view, although not yet finalized, that the pool will have a different base to it, that it won't be capacity, long-short charges, but more focused on energy charges, so we think we'll be able to tie up a certain amount of those megawatts and those kinds of undertakings.

And that's yet to be negotiated, but our plan there is as it has always been to keep the other states as whole as we can in that process. And I think in a competitive nature, I'd rather not share exactly the number of megawatts that we intend to put either into that play, to the extent that they're more advantageous for a 12, 14, 24-month window. As we look out at the marketplace, we'll put more there. The muni co-op piece, as you know, we've been hugely successful with that on our western footprint, and really,

I've never had the opportunity, but for a few endeavors in our eastern footprint, we will be a bit more aggressive there, as well. I think in that muni co-op area, American Electric Power is viewed as an incredibly strong and dependable supplier of kilowatt hours. So we think we'll have a great deal of success in that, but, as you know, only time will tell. But I assure you this, that from at least my Chair advantage point, and I know this Board of Directors very, very well, and I know Nick very well, this will not be a risky play.

Q - Dan Eggers {BIO 3764121 <GO>}

Okay, and I guess just kind of on that one last question on that vein, the other power pool members, are they -- what kind of plans are you guys doing, or what kind of conversations are you having with your commissions there as far as them building their own generation for rate base rather than sticking to historic power pools, is that something that is advancing at this point?

A - Michael Morris {BIO 1418617 <GO>}

Yes, I think if you look at Appalachian Power in particular, Virginia has been desirous of having more direct ownership of their generating capacity. The Dresden facility, which actually will come online earlier than we thought and has already run some dry run tests, will be assigned to Appalachia, Virginia, and West Virginia. Charles Patton and the team have already gotten a rate approval for that or acceptance of that by the two state commissions. So they're eager to have that done.

The issue in Kentucky will continue to be, depending on the environmental regulations, whether we retrofit Big Sandy, we convert Big Sandy to some kind of gas facility, or we enter into the power purchase agreements to satisfy Kentucky's need as we look at that issue going forward. So we think there’s a lot of flexibility there. We are in early conversations with commission staffs on those issues. And to date, they're fruitful; they're intended to be constructive, and I think it's pretty safe to say that's what we've experienced.

Q - Dan Eggers {BIO 3764121 <GO>}

Very good, thank you. Mike, enjoy the next phase.

A - Michael Morris {BIO 1418617 <GO>}

Thanks, Dan.

Operator

Thank you. And now to the line of Michael Lapides from Goldman Sachs. Please go ahead.

Q - Michael Lapides {BIO 6317499 <GO>}

Hi, guys. First of all, Mike, congratulations. Second of all, I have two kind of sets of questions or two questions. One more kind of earnings specific for the Fourth Quarter and then going into 2012 and one more strategic. When I think about earnings so far this year, the polar remand I think you said $0.06 in the Third Quarter and an incremental $0.04 in the fourth. I assume that drops off beginning in 2012, and I know you had the increased amortization of the polar disallowance in this quarter and showed up in the D&A costs, does that continue forward as well in the Fourth Quarter and then drop off in 2012?

A - Brian Tierney {BIO 15917272 <GO>}

Mike, it does continue, but it comes through a number of different lines in our earnings release format. It comes through line two. It comes through other income and deductions, as well as depreciation and amortization. I think for the tie out of which lines that comes through, I'd refer you to Betty, Joe, and Julie for the specifics on that.

Q - Michael Lapides {BIO 6317499 <GO>}

That's fine. Mike, when you guys are thinking about Ohio long-term, meaning strategically, when you get to market, or as you get gradually closer to market, do you want it as kind of a corporate strategy and maybe it is a combination of you, Brian, Nick, and the Board thinking about this, do you want the earnings volatility with having a sizable merchant generation fleet? Does that fit into your vision for what AEP is?

A - Michael Morris {BIO 1418617 <GO>}

First off, Michael, thanks for your friendly comments. Not really. Again, we will hold a certain amount of that capacity in reserve and play that volatility market obviously intending to take full advantage of no matter which way you look at the EPA implementations. The FERC's 80-plus thousand gigawatts coming off line to the EEI's 40-plus thousand gigawatts coming -- or 40 gigawatts coming offline, sorry, is going to put a tremendous amount of pressure on the simple supply demand equation. We have, as a country, recovered about 95% of the overall weather adjusted electric output to the pre-recession impacts in calendar 2008. The electrification of the US economy continues to pay. I saw some comments that my good friend Jim Rogers said the other day; I couldn't disagree with him more. We continue to see additional electrification commercially, residentially, and in industrial space, as well.

So we're going to hold some megawatts back for that, but this isn't the Board. I assure you, Nick, the rest of the C-level management team, and me sitting on the Board and watching from the Chairs perched, we're just not big gamblers. There's not much to be gained by that. You may have a great month, you may have a great week, you may even have a great quarter, but I think the proudest comment I can say about commercial operations, which started long before I got here, but during my tenure we have never, ever had a losing quarter, and that just simply says that we are conservative and smart. I think those are tremendous talents to have in that particular shop.

Q - Michael Lapides {BIO 6317499 <GO>}

And I just want to follow-up on that one because I completely understand when you are thinking about having exposure a day ahead or a month ahead or even 12 to 24 months out. But if you own a merchant generation fleet, unless you have 10 or 20-year PPAs, you have sizable commodity volatility and commodity exposure. And it may not be in year one, but as we have seen in the industry for the last couple years, and it's really for the last ten years and it's worked in both directions, you have the volatility, it's a matter of when it shows up. And I guess that comes back to the -- are you comfortable with the concept of having large swings and maybe

FY3 or FY4 earnings power due to just significant movements in either directions in either coal prices, capacity prices, or to energy prices?

A - Michael Morris {BIO 1418617 <GO>}

No. I mean, it is pretty clear. If you look at what we have done with the fleet that we had to work with in our western footprint, long-term contracts are the standard. And there are contracts that fluctuate with every input piece into the cost of electricity, and most of them yield in the high, kind of mid double-digit returns on equity capital investment when you calculate back to a traditional cost of service model. And that will really be what you see us do.

We, as you know, today, if I were out to buy some coal, it would cost me $70, $80, maybe $90 a ton. Our overall 2011 number is in the 40s. That's another place where we think we've got a huge competitive advantage. I think that's part of why when you look at the transition of our fleet here and in our eastern footprint, some are happy to have the opportunity to compete in our market. Lots would rather not see us compete in the market. And when our fleet gets free, it will be intriguing to see how successful it is.

But again, we just don't have a belly for big plays, big swings. We'll tie up as much of it in the pool arrangements as we can. We will enter into some long term contracts -- you think of partners of ours like Buckeye Power, you think of other major co-ops in our footprint. Amp Ohio is looking to build some facilities going forward. They may have trouble as almost everyone does building facilities, so we'll be here to satisfy those kinds of loads as we go forward. We have had success over the years in Virginia, West Virginia. We will continue to do a lot more of that as we go forward.

Q - Michael Lapides {BIO 6317499 <GO>}

Got it. Thank you, Mike. Much appreciated and, once again, thanks and congrats.

A - Michael Morris {BIO 1418617 <GO>}

Thanks a lot, Michael.

Operator

Thank you. And now to the line of Paul Patterson from Glenrock Associates. Please go ahead.

Q - Paul Patterson {BIO 1821718 <GO>}

Good morning.

A - Michael Morris {BIO 1418617 <GO>}

Good morning, Paul.

Q - Paul Patterson {BIO 1821718 <GO>}

Just to circle on the settlement process, is there any potential for it to be altered or to bring more people in, or should we think of this as pretty much going to be a litigated situation going forward? There has been some sort of focus on this MRO test now with the remand coming back and also the Duke Energy settlement, I am just wondering whether or not this is still sort of -- we are still -- basically, this is going to be litigated, is that how we should see it or do you think there could any change or alteration before --

A - Michael Morris {BIO 1418617 <GO>}

So, Paul, I think we are in a hybrid litigation. We have a stipulation that's been signed by all but three parties. At the last meeting, we had 47 lawyers there; all but three of them were in agreement with the undertaking. Not all of them, obviously, some of them were multiple representatives of individual signers to the issue.

We have been unable to get OCC to ever join American Electric Power in any settlement. That's just a standard, and we understand that. We tried very diligently. We made some what we thought were very reasonable proposals to the OCC. They chose not to sign on. We tried, but could not satisfy the near term desires of FirstEnergy and IEU. IEU and FirstEnergy look like peas in a pod. So we did what we could in that endeavor.

The commission staff was very direct on what they needed to sign on to a stipulation. I know within the structure of a regulatory commission, the staff works on its own and doesn't get direction from the commission. But clearly they are there in the same building and they know what was required. So it will follow the hybrid litigated path. We are pretty much done with the direct testimony and pretty much done with cross-examination of witnesses. The staff stood strong behind the case.

There is some concern with the MRO issue, but price is not the sole determiner of whether you do or don't pass that test. There are other intangibles and tangibles and the staff witness was very clear about that, particularly if you read the redirect testimony where he proffered that prices but one of a number of areas that the commission needs to look at.

I think as a subset, there is a great deal of support in this state of Ohio for the development of the shale gas play. I think a very unique subset of what our stipulation provides for is the ability to over time determine that some of the Muskingum River facilities might coal retire and get replaced with the new shale gas fired natural gas. Those are some encouragements.

Our customers see some real benefits in this, including, as I mentioned, many of our large customers a 5% to 10% reduction in their overall rates. And that has always left a puzzle for us as to why not everyone signed on to the settlement. But it is what it is. We put in a great case. We don't get any signal from anybody that there is concern about that. The commission will issue an order, whatever it is, we'll take a look at it. If it is what we filed, obviously, we are happy. If it isn't, we will take a look at that and look at what our options are once that is done.

Q - Paul Patterson {BIO 1821718 <GO>}

Okay. Assuming they give you something that is pretty close to what you guys have settled on, when you mention the point estimate for 2012 and you mention that it is within your guidance, can you give the flavor kind of where it might be sort of in terms of a range that you guys might be contemplating for 2012?

A - Michael Morris {BIO 1418617 <GO>}

It would be premature to take that step now, Paul, but the day we get that order and we get a little clarity on what the environmental spend might need to be in 2012, we'll be the first to share that with you. And because ESP had some legs on it in that it will be 2012, 2013, 2014 event, we will probably give you a pretty good look in the out years, as well and how we see utilization of the megawatts as they free up in the marketplace for those years, as well.

Q - Paul Patterson {BIO 1821718 <GO>}

Okay, and then just finally with the EPA, you sort of suggested that there might be some delays or some sort of more appropriate or more conciliatory timing issues. Could you elaborate a little on that? Do you actually think something like that might happen and how that might show up? Or is that just sort of just you being logical and thinking sort of in a logical way as to how things should happen as to maybe how at least what we are seeing on part of the EPA's public statement?

A - Michael Morris {BIO 1418617 <GO>}

We all have public positions that we take. We have had a number of meetings with the administrator. We have had a number of meetings with the assistant administrator in charge of air. They are people that we have great respect for. They are quite eager to listen and have been more than meeting us halfway in an open discussion of the impacts. They, like the RTOs, are very concerned about reliability.

I don't think anyone in this administration or any administration wants to have the lights flicker or go off in some region of the country by the old thought through implementation of policies that, again, at the end of the day, I know my friends in the environmental community are arguing that AEP stands for trashing the Clean Air Act, and nothing can be further from the truth. What we are suggesting is to stretch this thing out to maybe 2018, have some RTO flexibility for two more years, and you can get to the same environmental footprint without the risk of reliability issues, without the unnecessary expense of all of us falling all over each other to do the same work at the same time.

That's why, quite honestly, the International Brotherhood of Electrical Workers have been lock step with us on this issue from day one, as have the mine workers and the boiler makers and some others. There is just a better approach to take to this and you get to the same environmental conclusion. The healthcare affects, we have got medical folks who say they are not real; they've got medical folks who say they are absolutely real.

Whether or not that ends or wins the argument is almost immaterial. What we're trying to do here is be rational. And again, if that happens or doesn't happen, we have a plan. We have a plan; we've already begun some of the hard work that we will have to implement in 2012. We are prepared to do what we need to do. But it clearly will entail shutting plants down prematurely and having the impact on local property tax and employees that that will have. The other side of the equation is absolutely accurate.

Once you begin to put capital money to work, jobs are created. The issue here is will the lights stay on and that's the argument that we make. So it would be premature for me to say that, "Gee, we really sense that they're moving," but they are listening and they are rational people. The public pronouncements that the administrator made in Denver last week or earlier this week would surely indicate that that may not be the case. But Democrats on the hill are beginning to say, "Wait a second," on both the House and the Senate. There are some pretty strong union movements who are saying, "Hey, wait a second." So we're looking forwarding for some relief.

Clearly, the move she made on Casper for allowing for a better and longer ability to move resources across state borders was helpful. Not all that needed to be done. We'll be able to comment on that I think next week or the week after and we will enter again comments as requested on a better approach to that particular undertaking. So they're listening and they're adjusting, and we are all going to get to the same place -- cleaner air, better air quality, and at the end of the day, more appropriately placed electricity without the reliability risk.

Q - Paul Patterson {BIO 1821718 <GO>}

Gosh, Mike, I thought you might be running for office. Congratulations.

A - Michael Morris {BIO 1418617 <GO>}

Thanks, Paul. I appreciate that. Linda already told there's lots she would tolerate, running for office not among them.

Q - Paul Patterson {BIO 1821718 <GO>}

Okay, have a great one. Thanks a lot.

Operator

Thank you. And now from the line of Jonathan Arnold from Deutsche Bank. Please go ahead, sir.

A - Michael Morris {BIO 1418617 <GO>}

Jonathan?

Q - Jonathan Arnold {BIO 1505843 <GO>}

Yes, sorry, I was on mute. Mike, congratulations. We will miss you.

A - Michael Morris {BIO 1418617 <GO>}

Thank you, much.

Q - Jonathan Arnold {BIO 1505843 <GO>}

And if I could just ask on sales, you talked about I think industrial obviously surprised maybe a little to the upside and that primary metals was a big driver in this -- what, this one aluminum customer. What is the underling picture like and how does that relate to where you thought you would be and just some broader comments on the territory.

A - Brian Tierney {BIO 15917272 <GO>}

Jonathan, industrials have been strong throughout the year. For the first time this quarter, we have seen in our top ten industrials, four of those customers showed some quarter-on-quarter decreases, very modest in about the half a percentage point decrease quarter-on-quarter for the year. But, of course, remembering there are some pretty significant increases over time that they had experienced already last year.

So as Mike was saying, our industrial sales have recovered 95% of their pre-recession levels for 2008. So industrial has been very strong. The rate of increase starting to slow down in some of the top ten industrial sectors. In the residential side, the west is very strong and the east continues to struggle. The west is driven by improvements in our Texas and Louisiana service territories, not least of which is the acquisition, as I mentioned, of the Valley Electric Membership Corporation. So residentials really sees a split between east and west, west continuing strength and east continuing to struggle.

And then on the commercial side, both areas continue to struggle. Up for the quarter, but year to date flat, we had forecast for the full year a recovery in the commercial sector of seven-tenths of a percent and it looks like we're not going to be able to make that for the year as we are already so far into the year and are just flat. And again, common results across both east and west for that commercial.

A - Michael Morris {BIO 1418617 <GO>}

You know, it's interesting, Jonathan, when you think about some of the points Brian made. Out west when we look at our SWEPCO operating company, we have a US steel facility that was shuttered and running at minimum demand, but based on shale oil and shale gas developments throughout that region of the country, it's at 24/7 now. We're beginning to see it at AEP Ohio some incredible reactivity in the steel industry for drill pipe going on.

And what that says is that jobs are coming back in the energy sector, jobs lead to better commercial demand and better residential demand, so we're hopeful. When we look at 2012, like everyone, we're worried, but we are seeing some signs. And at least on one half of the presidential debate, you are being to see everybody talk about energy development. Tom Donohue over at the Chamber is starting to say, "Look, there are literally millions of jobs sitting on the shelf.

If America would simply develop its energy resource rather than look at it as a negative, we could move this economy forward quickly." I was at a meeting a week ago with Jamie Dimon, well known to all of you, who suggests that from his vantage point, of course this works well for his bank, but from his vantage point, the US economy is simply waiting for somebody to step on the gas instead of the brake, and getting rid of all of these silly regulations would be the first step in the right direction in developing the energy resource base. So I guess you like Paul might think I'm running for office, but if I did, that would be my platform.

Q - Jonathan Arnold {BIO 1505843 <GO>}

So is it premature to give us some sort of insight into what your early look on 2012 might be in the sales department?

A - Michael Morris {BIO 1418617 <GO>}

It will be in that range that Brian talked about, which will include that three and a quarter point.

Q - Jonathan Arnold {BIO 1505843 <GO>}

Well, more of the actual sales number.

A - Michael Morris {BIO 1418617 <GO>}

Look, we're looking for some sales growth not unlike we have looked before. We came into this year looking for something on the order of 1% to 2%. We will probably look at the same kind of number going into next year.

A - Brian Tierney {BIO 15917272 <GO>}

Carey, we have time for one more question.

Operator

All right, and that comes from the line of Paul Ridzon from KeyBanc. Please go ahead.

Q - Paul Ridzon {BIO 1984100 <GO>}

Good morning, Mike, and like everyone else, congratulations and happy trails.

A - Michael Morris {BIO 1418617 <GO>}

Thanks, Paul.

Q - Paul Ridzon {BIO 1984100 <GO>}

Just wondering, if we look into 2012, how should we think about the EPS impact of the Supreme Court remand? What's going to happen there?

A - Brian Tierney {BIO 15917272 <GO>}

The TCC remand?

Q - Paul Ridzon {BIO 1984100 <GO>}

Yes.

A - Brian Tierney {BIO 15917272 <GO>}

So we've already experienced the ongoing earnings impact of the carrying charges. What we'll start to reflect once we securitize is the equity component of that realization, of that securitization. And we anticipate that that will be prorated over the time of the securitization. So it's about $116 million, and if you say that that's prorated over the seven year anticipated securitization period, we'll be able to get that equity component, in addition to the interest carrying charges that we'll be able to realize on an ongoing basis.

Q - Paul Ridzon {BIO 1984100 <GO>}

So about 112 divided by seven?

A - Brian Tierney {BIO 15917272 <GO>}

116 of the equity component divided by seven, but more weighted toward the front end of the amortization period.

Q - Paul Ridzon {BIO 1984100 <GO>}

Okay, and you talked about your 325 point estimate, does that assume that the Ohio settlement doesn't get tweaked too much from its current form?

A - Brian Tierney {BIO 15917272 <GO>}

Yes, it does. We are assuming the reasonable outcome at which is what we believe that we filed with the commission, and we don't anticipate much, if any, tweaking to that given the parties that we've added on to that stipulation. And we anticipate a positive result as we work very hard to achieve that with the settling parties.

A - Michael Morris {BIO 1418617 <GO>}

But I think it is important, Paul, that we make sure we make this statement about 2012 as we look at it. The three and a quarter will be inside of a range. It is not the point estimate that we had before, but this is a team that is used to delivering and 2012 won't be any different than 2004 and every year that we've worked here before that. So it's going to be more challenging than we thought it would be based on what we originally had filed, but it will be a test of the skill sets of this team, which have really never failed to satisfy.

Q - Paul Ridzon {BIO 1984100 <GO>}

Just back to Jonathan's question about the 5% industrial recovery we saw in the quarter, is that sustainable or was there anything weird about that other than the smelter coming back?

A - Brian Tierney {BIO 15917272 <GO>}

I think the thing that is weird about it is that we are now at 95% of our pre-recession industrial sales. So to assume that that would continue indefinitely I think would be unreasonable. As we are approaching that 100% mark, that rate of increase will certainly expect that to come in over time. And as I said, much of that increase was driven by that primary metals customer, which is our largest industrial customer. And then, again, six of the top ten categories, we still continue to see increases in both the year-on-year and the quarterly with only some modest falling off of those sales increases from four of those top ten sectors.

A - Michael Morris {BIO 1418617 <GO>}

And I think it is interesting, Paul, when you look back as we stepped into the 2009 abyss, the questions that you are all asking us then, what does this look like? Is this a re-do of 1980? And what we said to you then has come to pass. What we said about 1980 was a lot of our industrial manufacturing facilities closed down, never to reopen. What we have seen through this recovery in 2010, 2011, and we hope would go on in 2012, is that most of them have gone back to a multiple 24/7 shift from one shift to two to three.

The aluminum guy is going from two-thirds production to full production. Everything but Century Aluminum has been back to where we saw it before without any major loss of customers. And Ohio Governor Kasich has done an outstanding job of reinvigorating capital investment in Ohio and we'll l continue to see that throughout our footprint, so we are pleased with all of that.

Let me bring this to a close simply by saying one more time thanks to each and every one of you for your comments at the outset of your questions. Maybe that made your questions a little more friendly, and I appreciate that. Let this old dog go home without too many nicks. But this is a great team, and it is going to be in great hands, and it will continue to be an incredibly low risk as my good friend on Mad Money says, low risk, high yield, safer than the US government, invest your money in American Electric Power. Thanks a lot, team.

A - Brian Tierney {BIO 15917272 <GO>}

Carey, can you give the replay instructions?

Operator

I sure can. Ladies and gentlemen, this call will be available for replay after 11 AM Eastern Time today through midnight, November 2, 2011. You may access the AT&T replay system at any time by dialing 1-800-475-6701 and entering the access code of 219233. International participants may dial 320-365-3844. Again, those numbers are 1-800-475-6701 and 320-365-3844 with the access code of 219233. And that does conclude our conference for today. Thank you for your participation and for using AT&T Executive Teleconference Service. You may now disconnect.