Q2 2011 Earnings Call

Company Participants

- Brian Tierney, EVP and CFO
- Chuck Zebula, SVP and Treasurer
- Mike Morris, Chairman, CEO

Other Participants

- Ali Agha, Analyst, SunTrust Robinson Humphrey
- Anthony Crowdell, Analyst, Jefferies & Co.
- Ashar Khan, Analyst, Visium Capital Management
- Dan Eggers, Analyst, Credit Suisse
- Greg Gordon, Analyst, Morgan Stanley
- Jonathan Arnold, Analyst, Deutsche Bank
- Justin McCann, Analyst, Standard & Poor's
- Michael Lapides, Analyst, Goldman Sachs
- Paul Patterson, Analyst, Glenrock Associates
- Paul Ridzon, Analyst, KeyBanc Capital Markets
- Steve Fleishman, Analyst, BofA Merrill Lynch

Presentation

Operator

Ladies and gentlemen, thank you for standing by and welcome to the AEP Second Quarter 2011 earnings conference call. For today's conference all the participants are in a listen only mode. There will be an opportunity for your questions. Instructions will be given at that time.

(Operator Instructions)

As a reminder, today's call is being recorded. Now with that being said I'll turn the conference over to Mr. Chuck Zebula. Please go ahead, sir.

Chuck Zebula {BIO 6231994 <GO>}

Thank you, John. Good morning, and welcome to the Second Quarter 2011 earnings webcast of American Electric Power. Our Earnings Release, presentation slides and related financial information are available on our website www.AEP.com.

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 these factors.

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.

Mike Morris {BIO 1418617 <GO>}

Thanks a lot, Chuck and good morning, everyone. Thanks for being here with us for the update on the Second Quarter activities at American Electric Power Company. I'd move you to Page 3, the Second Quarter 2011 highlights and try to give some granularity about these small statements.

First, we really are quite satisfied with where we are through the Second Quarter of 2011. We really got off to a bit of a slow start in kilowatt hour usage, as you may remember earlier in the year but things have improved in our entire footprint since then. Clearly, stronger in the West than in the East but acceptable in both of those areas.

Commercial sales in the East still are lagging from what we would have forecasted they might be but we're really seeing very strong industrial sales throughout our Eastern footprint. In fact if you remove the impact of Century Aluminum still being offline, we're at about 95% plus of the overall industrial send-outs that we saw in the pre-recession time. And that really stays in line with the things that we talked to you about during 2008 and 2009, very different from the recessions that we saw in our Eastern footprint back in the 80s and 90s where plants actually were shut and shut forever. What we suggested in the 2008 and 2009 timeline was that people were laying their plants up for the intent to come back and clearly, that has come to be the case.

We are seeing additional shopping in Ohio beyond what we had forecast for our retail customers, but as you might imagine, American Electric Power retail operations have been successful not only in AEP Ohio's footprint but in the other opportunities that present themselves here in Ohio. And of course any gigawatt hour sale that doesn't go to the retail market does go to the off-system market and I think you know from our Press Release that off-system sales results have been quite solid. So when we look at the net-net of the effective switching in Ohio, we've always been an advocate for that. We didn't think that would affect us quite as deeply as it has, but we're reacting to it in a very constructive way and net-net the impact is acceptable and we are satisfied with where we are with the AEP retail and some of the things that we see. So based on all that we look at throughout these first 2 quarters, we feel very comfortable with our $3.00 to $3.20 range and reaffirm our earnings strength forecast for calendar year 2011.

We have a couple of interesting litigation developments to talk about. We couldn't be happier with the way that the Texas Supreme Court ruling came out just a couple of weeks ago. I know that many have had a chance to digest that and of course many of you have seen the impact that it had on CenterPoint and continues to have for them as they go through the Remand cycle of what the Texas Supreme Court has decided. For us as you know, it justifies the way that we went about auctioning off our assets, the way that we characterize stranded costs going forward. And it has great potential upside for us not only in a 1-time event which we'll talk about or Brian will talk about a little bit more here in 2011, but an ongoing basis as well.

And 1 of the things that you may not have appreciated and we surely do about the Texas Supreme Court decision is that it also removed potential downsides that were argued by other petitioners in the case and made it quite clear that the approaches that AEP Texas took to that endeavor were exactly in compliance with the law and we're very satisfied with that as you might imagine.

We're also over the top satisfied with the ability to remove a number of the litigants in the overall activities in Arkansas as they pertain to the John W Turk plant. We are grateful that our team at SWEPCo work was able to bring to resolution with the hunt club folks as well as many of the other interveners in that case, and I can assure you that the political folks in Arkansas as well as many of the judges that we reported the settlement to were quite pleased with what they had come to learn about those activities.

As you know, there are 2 NGOs who did not participate in the overall dialogue, although invited. And that is interesting and we'll continue to carry on our dialogues with them to see if we can find some resolution. But more importantly, the underlying environmental issues that those parties have raised were addressed in the overall settlement with the other parties, so we think that we have the potential to bear fruit in those discussions with the 2 NGOs and we'll continue to do that.

When we look at our regulatory plan as you know, we've already had some success in calendar year 2011, $220 million of our overall rate stack already accomplished. There are a few cats and dogs out there that may help us get there but we're in pretty solid shape the way that we see it. The open proceedings in Ohio, Virginia and Michigan are there. Some may be resolved yet this year and will have a constructive effect we would hope in that sense.

So let's spend a few minutes talking about Ohio because surely as you know, we have a number of open cases in front of this jurisdiction, all of which are important to us, all of which are important to our customers, and clearly, all of which are very important to the economy here in Ohio.

We continue to have what we believe to be constructive dialogue with the many parties to the cases including the Commission staff. We will continue to work toward that end on all of these outstanding matters as you know, the merger case has been approved by the FERC. We would hope that that would come through here in Ohio in the not too distant future.

A couple of important filings to be made in the not too distant future, obviously today, we expect that the staff will file their testimony in the overall ESP case. Like all staff testimonies or testimony filed by any party it will have some parts that we agree with. There will be some other parts that I'm sure we don't agree with. Net-net, testimony is never the end result of where a case may end up and nonetheless we like you look forward to reading that and hopefully we'll find a few things in there that will be encouraging for us but are well aware that we may read things in there that we don't necessarily agree with as well.

At the end of the day, we feel very comfortable about our position in Ohio. We feel comfortable as I mentioned about the dialogue that we've had with the parties to the cases. This is a new and different Commission, surely up to the task of resolving these many cases and we would hope that that happens. We also will be filing our view of the 2010 review of the seat activity pursuant to Senate Bill 221. As before, we think Ohio Power is in the Safe Harbor zone and based on the way that the staff dealt with the activities at Columbus and Southern in the 2009 review seat activities we feel comfortable that we will not be impacted at all by the seat activities and the review that will go on.

Like all my other colleagues let me move into the environmental update -- I should say all my other colleagues who are coal centric producers. I know that you've had a pretty good walk-through the way that we all see the impact of the things the Environmental Protection Agency continues to do. Casper came out. The industry spoke in a solid voice of we understand the end-game here. We think that we can get there efficiently, financially and electrically if the dates would be extended from 2014 to 2016. Much to our dismay and others, they move those dates from 2014 to 2012 and of course, as you surely read frequently, the state of Texas was included for the very first time in the final rule that came out now called Casper.

Notwithstanding that we feel pretty comfortable at American Electric Power with our overall view of what we think the EPA's rulings, not only that which are issued but those which will be issued, will have on our overall system. We stay committed to the notion that we'll be shuttering 6,000 megawatts prematurely. I know there's always been some confusion whether they were part of an overall settlement on New Source Review and New Source Performance Review some years back. About 700 of those megawatts were included in those timelines, however the rest of them have all been moved forward because of the current activities going on at the EPA.

Closing some of those facilities over time will of course have an effect on our ability to have gigawatt hours available for us in the off-system sales market, but throughout the footprints where we are very active with off-system sales we expect other facilities will be shut as well. And that clearly will have not only a constructive impact on the capacity fees that we receive going forward, but will also increase the amount of money recognized on gigawatt hours of energy put into the marketplace. And it doesn't take much of an uptick in those 2 numbers to compensate for the megawatts that will be coming off-line because as you all can imagine, those were higher price plants at the top of the stack which didn't dispatch as early as those on the lower cost portion. So we feel as though there will be some impact. It surely won't be a devastating impact.

Nonetheless we will continue to do what we can politically as well as in general dialogue with the EPA to try to put greater rationality in what it is that they're trying to accomplish. I know that some of the more principled NGOs are concerned about the approaches that we have taken to this particularly in the legislative arena. But our position we think is reasonable, it gets us to the same environmental footprint by 2020 instead of 2016 or 2017. And it's done in a much more financially and electrically rational and beneficial way, so we will continue to put as much pressure on the EPA as we can.

I'm happy to see that today they decided to put another cap on oil and gas drilling and that will bring some additional folks in the fray of trying to discuss about the incredible aggressiveness that the EPA is taking, all in keeping with what they think is their challenge. But nonetheless, in our view, unnecessarily over the top and a bit aggressive. I don't think there's a corporation in America that doesn't want to get to the right place. It's just a matter of trying to get there and the cost effective and energy effective way.

Lastly, let me talk a minute about some disappointment for us anyway from the carbon capture and storage project layup at our Mountaineer station in New Haven, West Virginia. I know that many of you had the opportunity to be there. You know how amazingly impressive it was that we were able to capture and store the only integrated project anywhere in the world with a coal fired power plant. But going forward without a carbon legislation or without an appropriate approach to carbon and its impact, it was simply not able for us to go forward and continue that project. It has been completed or will be completed through the base engineering drawings and activities and laid up for another day.

We're encouraged by what we saw. We're clearly impressed with what we learned and we feel that we've demonstrated to a certainty that carbon capture in storage is in fact viable technology for the United States and quite honestly for the rest of the world going forward.

So with that let me simply close by saying we as I mentioned at the outset reaffirm our view of our earnings strength in 2011 and of course stand by our $3.25 forecast for 2012. With that I'll turn the microphone over to Brian.

Brian Tierney {BIO 15917272 <GO>}

Thank you, Mike. This morning I'll review quarterly and year-to-date reconciliations through the Second Quarter, discuss load trends, review customer switching data, and provide an update on the Company's capitalization and liquidity. Then we will get to your questions as quickly as possible.

On Slide four you'll see that Second Quarter earnings for this year war $352 million or $0.73 per share which was $3 million less than last years Second Quarter results of $355 million or $0.74 per share. Here are some of the highlights for the quarter-on-quarter comparison. Operations and Maintenance expense net of offsets was unfavorable by $56 million or $0.08 per share. This number is largely explained by an increase in storms expense of $52 million. Much of this variance is attributable to Appalachia Power wherein the Second Quarter of 2010 they were able to defer $25 million related to a 2009 storm.

This year, Appalachia Power had storm costs totaling $17 million for the quarter. Other costs net accounted for negative $0.04 per share or $34 million and primarily consisted of a decrease of $10 million net of tax from the sale of shares of the Intercontinental Exchange in 2010 and year-on-year increases in other taxes.

Customer switching accounted for an unfavorable quarterly comparison of $24 million or $0.04 per share. We will discuss this in more detail on Slide 7. Rate changes accounted for positive $66 million or $0.09 per share and came from multiple jurisdictions.

Off-system sales net of sharing were positive $37 million or $0.05 per share. This result was driven by a significant increase in physical volumes and a widening of spark and dark spreads.

Physical volumes were up 81% due to an 11% reduction in planned and unplanned outages and the fact that more of our units were in the money since around the clock prices were up 14% while natural gas prices were only up 1% and delivered prices for coal were only up 3%. Weather accounted for a positive $0.01 per share or $5 million improvement over last year and was favorable $47 million versus normal weather. Driving this result for the quarter was the fact that our western service territories experienced the hottest June in the last 30 years.

Turning to Slide 5, you will see that for year-to-date in 2011, AEP earned $744 million or $1.55 per share, which is $24 million more than last year's $720 million or $1.50 per share. Highlights include Operations and Maintenance expense, net of offsets which compared negatively to last year by $30 million or $0.04 per share, similar to the quarterly comparison, this difference was largely driven by an increase in storm costs of $36 million. Other costs net decreased $0.05 per share at $35 million and similar to the quarterly comparison was primarily driven by the absence of the $10 million net of tax gain on ice shares and from higher other taxes. Customer switching was a difference of $43 million or negative $0.06 per share and again we'll discuss this in more detail later.

On the positive side, rate changes were responsible for year-to-date gain of $110 million or $0.15 per share versus 2010. Again, these rate increases were for multiple jurisdictions. Off-system sales net of sharing accounted for a positive comparison to last year of $49 million or $0.07 per share year-to-date. The story here is similar to the quarterly explanation though it's not as dramatic. Physical volumes were up 45% and spark and dark spreads widened with around the clock prices for electricity increasing 5% while natural gas prices were actually down 10% and delivered prices for coal increased 1.4%.

Finally in contrast to the quarterly comparison weather was a negative variance for last year for the year-to-date period. Although unfavorable by $0.02 per share or $15 million to last year, this year is actually favorable $67 million when compared to normal weather.

Turning to Slide 6, we will take a look at the normalized load trends as promised. It's important to remember that this data has been adjusted to exclude the effect of weather and represents our total connected load. In the bottom right hand side of the slide, you will see the total normalized retail sales were up 1.9% for the quarter and are running at a positive 2.2% for the year-to-date. This improvement is primarily in the residential and industrial classes. Although the residential class is up 4.4% for the quarter, it is up 0.9% year-to-date, which we believe is more indicative of growth in the class.

Economic recovery for our commercial class of customer remains slow. The improvement in the industrial class has been aided by the return to full production of 1 of our large aluminum customers. Mike mentioned that with the exception of another aluminum customer who remains closed, our industrial sales volumes now stand at 95% of their pre-recession levels. Slide 19 in the appendix provides more detail on our top 5 industrial sectors.

Finally all customer classes have benefited by the Valley Electric Membership Corporation acquisition in our SWEPCo operating unit. As a reminder as part of our guidance for 2011, we were expecting sales volumes to exceed the prior year by 1.7%. Although the mix of customer sales continues to shift somewhat between the classes, we remain confident that our original guidance remains sound.

On Slide 7, we can examine AEP Ohio customer switching. For clarity let me describe the graph. The bars show us the 2011 cumulative percentage of load lost as compared to AEP Ohio's total load. The line shows us how much generation margin was lost associated with the customer switching, $46 million in total. At the bottom of the page you can see how this activity is split between our 2 Ohio operating units for the quarter-to-date and year-to-date periods.

As we have previously discussed, the more significant activity is occurring in Columbus and Southern Power. In aggregate about 7% of 2011 total AEP Ohio load has switched through the end of June. The level of switching to date is running ahead of the pace assumed in our guidance and we expect that to continue for the remainder of 2011. It is important to note that we are experiencing positive offsetting margins associated with the freed up energy and capacity through off-system sales and capacity sales to competitive retail suppliers. Given the net effects of increased switching and positive margin offsets, we remain confident with the 2011 earnings guidance.

Finally, on Slide 8, I would like to update you on our balance sheet and renewal of our recent credit facilities. You will see that AEP's debt-to-total capitalization stands at 56.6%. This is the lowest level for this ratio in the last five years and reflects a commitment by the Company to maintain a strong balance sheet and solidly BBB credit ratings. Our cost reduction initiatives from last year and our capital expenditure discipline reflect that commitment and our direct reasons for the strength of our balance sheet.

Also on Wednesday, we issued an 8-K which contained important announcements about our 2 core credit facilities. On July 26 we renewed and up sized the $1.45 billion facility that was due to expire in April of 2012 with the $1.75 billion facility that will expire in five years. In addition we were able to extend the $1.5 billion facility that was due to expire at the end of June 13 by two years now with an expiration in June 15. We were also able to re-price that facility with current more favorable pricing. These assumptions improve the capacity of our credit facilities by nearly $300 million to $3.25 billion and extend the tenor of these facilities considerably.

Also as Mike mentioned earlier, we are pleased with the decision of the Texas Supreme Court to reverse the PUCT's decision to deny recovery related to the capacity auctions and to remand the issue back to the PUCT. As a result, TCC will be entitled to recover $420 million plus carrying costs dating back to 2002. We expect the total to be about $900 million. This capital infusion will further strengthen the balance sheet of the Company.

In summary, the Company is in a strong credit and liquidity position as we enter the next several years where the Company will see increased demands for capital investment for environmental, maintenance and reliability needs. As Mike mentioned, we are affirming our guidance for 2011 and 2012. As you know, our point estimate guidance for 2012 is $3.25 per share. This guidance assumes a reasonable outcome in Ohio, manageable impact to off-system sales from the Casper rules and continued growth in our transmission business. In the coming months as the Ohio and EPA pictures become clearer we will be able to provide more specific guidance than the point estimate we affirmed today.

We appreciate your time today and I will turn the call now over to the operator for your questions.

Questions And Answers

Operator

(Operator Instructions) Greg Gordon, ISI Group.

Q - Greg Gordon {BIO 1506687 <GO>}

So, when we're looking at the numbers, clearly as you explicitly stated, the switching numbers are tracking ahead of what you had told us your budget was for this year, but you're also 70% of the targeted gross margin for the year in your off-system sales business and we're not even in the Third Quarter yet. Is there some way in the future you could give us what the net impacts to margins is by carving out the benefits that are accruing to the OS off-system sales margins as energy and capacity move from the retail bucket to the wholesale bucket?

A - Mike Morris {BIO 1418617 <GO>}

We'll surely try to craft something like that, Greg, to give you guys at least some directional view. The offsetting positive effects as you already mentioned showing where we are with off-system sales with just 2 quarters moving into what as you know is usually the most productive quarter, we feel very, very comfortable about where we are. As you know, inside of the ESP, there are some rate design issues as they pertain to the commercial rate class, which is the high impact class at Columbus Southern, we expect will get resolved.

Going forward, some of the off-system benefits will continue to be there and some of the on-system switching might slowdown a bit. We'll try to give you a better picture of that so you can get a feel for it, but rest assured we feel extremely comfortable with where we are.

We're capturing about 25% of our own market share in that sense through AP retail having success and the other areas both -- all 3 really FE, Dayton and Cincinnati, so switching in Ohio is interesting. I think we've reacted to it in a constructive way and the impact on it, although more than we had expected has been very tolerable.

Q - Greg Gordon {BIO 1506687 <GO>}

And the Casper rule, some of the other companies have reported yesterday, indicated they thought there was a chance that the implementation could be delayed by the courts. Are you presuming that happens or are you presuming that doesn't happen, and when you look at the amount of credits you've been allocated, are they sufficient to mitigate the potential increase in customer bills?

Or do you have enough credits to mitigate having to increase what you charge in the system agreement? So, when you look at the balance, your long and short position, how does that play out in terms of where those credits get allocated and is that going to be a '12 impact or do you think perhaps it will be delayed?

A - Mike Morris {BIO 1418617 <GO>}

Well, I like everybody else will continue to push for a delay because there's just no way in the world you can make a rule final in November of 2011 and expect people to comply with it on January 2012. It's just as close to lunacy as you can get, but having said that we'll continue to plan to address those issues.

We continue to look at the options that are available to us. Your question on the credits is interesting. We're long in some jurisdictions, short in other jurisdictions. Some of the other controlled trading will allow us to address much of it, but maybe not all of it, and we're going about the process of trying to satisfy that shortage as we go. But as you know, in a regulated world those kinds of activities are recoverable from our customers and it's going to have some unfortunate dislocation.

And when you think about Casper and the timelines, we'll all be able to manage our way through it. If we end up spending a certain amount of money in the regulated footprint as you know that will turn into earnings as we go. The really devastating effect though will be in those communities where plants are prematurely closed, jobs are lost, property tax bases are affected.

And in many of those regions, Greg as you know, we're the only game in town, so when the power plants go, so go the communities and that is truly the unfortunate impact and no 1 on the coast cares about and I understand that whether it's East or West Coast, but we care a great deal about that in our footprint, we sure do.

Q - Greg Gordon {BIO 1506687 <GO>}

Final question, on the $900 million in pre-tax cash you'll hopefully be getting some time next year. Is there, do you know what the uses of that cash are going to look like at this point?

A - Brian Tierney {BIO 15917272 <GO>}

We do, Greg. We're going to obviously take some of that and re-securitize TCT by retiring some debt and there are going to be some requirements that we're going to have in Texas to retire that debt and refinance that company but there will be a component of that that should be a significant dividend up to the parent. And of course we'll use that for the other capital needs that we have and we sort of laid some of those out for you, the environmental needs that we have building the transmission business and others.

Q - Greg Gordon {BIO 1506687 <GO>}

Thank you, guys, good morning.

Operator

Paul Patterson, Glenrock Associates.

Q - Paul Patterson {BIO 1821718 <GO>}

First on the tax rate for the quarter, I'm sorry if I missed this but it did seem a little bit lower than I think normal. Could you tell us what happened there and if there's any change or opportunity for lowering your tax rate on a going forward basis?

A - Mike Morris {BIO 1418617 <GO>}

I'm trying to end up looking like Jeff Immelt, but I'll let Brian answer that question.

A - Brian Tierney {BIO 15917272 <GO>}

Thanks, Paul. Tax rate for the ongoing, the AEP utility segment was about 33.27% compared to the prior year and about 35.55% and it was lower as a result of lower pre-tax booked income and larger favorable flow-through and permanent book-to-tax-differences.

We're always looking for opportunities to try and get that down as low as we possibly can and we're engaged in a number of tax planning activities to try and get that as low as possible. We're pleased that it's below what we had in guidance of a 35% range for the quarter and the year, but we're always planning and trying to find ways to reduce that tax burden as much as we possibly can.

Q - Paul Patterson {BIO 1821718 <GO>}

But you're not going to change, we shouldn't change our outlook on the tax situation going forward, right?

A - Brian Tierney {BIO 15917272 <GO>}

I think it's always wise for you to assume a 35% rate, and if we come in lower than that that's a benefit to our shareholders.

Q - Paul Patterson {BIO 1821718 <GO>}

Okay. With respect to customer switching, I guess Greg asked this question. You guys are now providing, I mean that's a gross margin that you guys had on that slide as opposed to the net margin. Could you just give us a little bit of flavor as to what you think the net margin would be roughly speaking?

A - Mike Morris {BIO 1418617 <GO>}

I'd rather give you some accurate data as best we can down the road. Paul again, I will tell you that it's considerably smaller than the gross margin impact.

Q - Paul Patterson {BIO 1821718 <GO>}

Okay. The Ohio situation. We've seen the interveners file their testimony and it was all over the map, I guess, different industrials and different positions and what have you and OCC and what have you.

Is there any possibility that we're going to be getting a settlement? I know that others have suggested that, like Duke, and I'm just wondering whether or not is this going to be a fully litigated case and that's just what we should expect?

A - Mike Morris {BIO 1418617 <GO>}

Well I would hope not. As I mentioned in my opening comments there, we continue to have what we think to be constructive dialogue. As you know, and I mentioned this as well, people file testimony to lay out what they think is their most preferred position, frequently knowing that they will never get there. But nonetheless, they do, and each and every time people do that, it does have an effect on settlement discussions. I have every reason to believe based on what we're hearing in the give and take discussions with folks that these cases lend themselves to settlement and we'll continue to work diligently toward that end.

Q - Paul Patterson {BIO 1821718 <GO>}

And then just finally on the staff, you mentioned that it's coming out today and with the old ESP that came out, it didn't really say much. It sounds like you guys are expecting them to give a more defined position as to where they are actually, what the sort of full ESP format should sort of be like. Is that what you guys are sort of sensing?

A - Mike Morris {BIO 1418617 <GO>}

Not necessarily. What I tried to say in my comments was just if you see something there that looks Draconian, you can react to it as you'd like but again that won't be the end-game and the dialogue with the parties, staff included, have been constructive.

I think we're better than Congress at debt ceilings and cost reductions, but some of the conversations every now and again get a little worrisome, so we'll see what we'll see. I don't think it will be a crystal clear path of here is what we think the Commission ought to do.

It will lay out some of their positions and various issues, some that may be more aggressive than we would like and others that may be more supportive than others would have thought the staff would have been, so it's certainly hard to forecast. I assure you they aren't sharing with us any drafts of what it is they intend to file. We'll get it the same time you get it.

Q - Paul Patterson {BIO 1821718 <GO>}

Okay, great thanks and I'm glad to hear you guys are at a better position than Congress.

A - Mike Morris {BIO 1418617 <GO>}

That doesn't take much, Paul.

Q - Paul Patterson {BIO 1821718 <GO>}

Okay, have a good 1.

Operator

Dan Eggers, Credit Suisse.

Q - Dan Eggers {BIO 3764121 <GO>}

Mike, I was wondering if you could just share thoughts on you laid out a big plan for the capital spending for environmental and the plans for retirement versus keeping. Could you share a little color on what was the regulatory response and the stake holder response to investment and closure decisions by states and whether you're going to see any changes or inducements maybe to change that plan?

A - Mike Morris {BIO 1418617 <GO>}

Well, that's an interesting question, Dan, because the granularity that we've provided have allowed us to be on the point and catch any 1 of the number of arrows coming our way but I will tell you this.

We have not had a meeting with anyone in any of the states and/or in Washington, including the EPA, where there wasn't serious thanks for telling us exactly what your picture looks like. You can rest assured at the state level the governors and the House and Senate members as well as the local community folks are eager to see us change the plans.

I had an opportunity to speak to about 500 people at the Kentucky Chamber where the speaker of the House of the State, the Commonwealth of Kentucky who serves our Big Sandy area stood up and said, whatever you do don't shut Big Sandy down. Go about whatever it is you need to do, whether you are going to retrofit it, which would be their preference and/or convert it to gas and they will be with us as we go to the PSE in Kentucky to adjust the rates accordingly.

I think what we're seeing in our Eastern footprint for the most part are state leaders who are suggesting that they do not want to be at the whim of the market, nor do they want to be a net energy importer, because each of those 7 governors have already staked out the jobs and economic development are the plans for their success, so we see a great deal of encouragement.

I must tell you at meeting with the FERC, with the Department of Energy's Electricity Group, with the EPA, with the various NERC players and the RTOs, the NARUC folks. Everyone is saying thanks for the granularity and the honesty of your data, and we can see what you mean by there may be pockets of reliability impacts, and someone really needs to aggregate all that data so that you can see that going forward.

And as you know, the Energy Commerce Committee and the House of Representatives has suggested in the TRAIN Act that that's exactly what the government does, so this is far from over with. It really is, and again, we are not in any way, shape, or form, although I know form, I know many NGOs don't agree with us in this regard.

We're not trying to change the environment, nor affect the environment in a negative way. We're trying to balance the environmental benefit that will come from retrofitting and changing the generation fleet here in the United States with the economy of the United States, which we think is every bit as important.

Q - Dan Eggers {BIO 3764121 <GO>}

And I guess just another question. If you look at the usage patterns in the quarter, it looked like residential kind of had a pretty nice pop relative to what trend had been coming out of the recession. Was there something unique to the quarter, was there some weather adjustment data that makes it a little squirrelly or are you actually seeing a real change in usage out of that customer class?

A - Mike Morris {BIO 1418617 <GO>}

Well you heard us say this in the First Quarter was 1 of the few things that is in a constructive sense, their heating bills went down a lot because natural gas prices continued to dampen compared to what they saw a year ago. And the cost of transportation went down some, so I think that they probably were turning on some of the lights that they had turned off in the First Quarter.

Q - Dan Eggers {BIO 3764121 <GO>}

Okay, thank you.

Operator

Paul Ridzon, KeyBanc.

Q - Paul Ridzon {BIO 1984100 <GO>}

How should we think about the tax rate on the securitization proceeds?

A - Brian Tierney {BIO 15917272 <GO>}

We are going to be setting up a tax deferral associated with that. We're going to take, at the time that we recognize the transaction, we're going to take the $420 million plus the applicable interest and the debt only portion, and we'll record that as a regulatory asset with the related deferred tax expense of about 35%.

And then, of course, as the reg assets amortize the deferred assets will be amortized to match the current income tax expense, and the equity portion that we'll be realizing will be recognized as the amortization happens as well. And we anticipate over the 14-year securitization period the equity carrying cost of between $20 million and $185 million to be recognized in current period earnings.

A - Mike Morris {BIO 1418617 <GO>}

Paul I can't tell you how happy Brian is you asked that question.

Q - Paul Ridzon {BIO 1984100 <GO>}

My head is still spinning.

A - Brian Tierney {BIO 15917272 <GO>}

As is mine.

Q - Paul Ridzon {BIO 1984100 <GO>}

On the $0.04 to customer shopping in the quarter, is that net of what you might have picked up, or where does your retail margin as you go and competitively shop your power, where does the margin on that show up?

A - Mike Morris {BIO 1418617 <GO>}

Well that is not a net number. That's the actual impact of those who have chosen other suppliers. As you might imagine the retail margin on sales from AEP retail are less than the margin you'd see had those customers stayed on the system. Brian, where exactly is--

A - Brian Tierney {BIO 15917272 <GO>}

In terms of the EEI line, on page 11 and 13, it's line 18, Generation of Marketing.

Q - Paul Ridzon {BIO 1984100 <GO>}

Okay, thank you very much.

Operator

Anthony Crowdell, Jefferies & Company.

Q - Anthony Crowdell {BIO 6659246 <GO>}

Just some more questions on customer switching. What customer class I guess had the most switching? And my assumption is commercial, and I guess where would the loss of gross margin go if you saw all your Columbus Southern commercial customers switch?

A - Brian Tierney {BIO 15917272 <GO>}

So, that is right. It is the commercial class of customers and primarily at Columbus and Southern Power Company and the place where you'd see that margin occurring in the Ohio companies, line 2 on pages 11 and 13.

A - Mike Morris {BIO 1418617 <GO>}

And I think it's almost inconceivable to imagine that the entirety of the commercial load to Columbus Southern would move away from us and as I mentioned before as you know inside of ESP, a lot of that activity has to do with the arcane concept known as rate skewing. Our commercial customers typically pay more than the cost to serve them, and in the filings that we made inside the ESP, 1 of the things that actually is getting some pretty solid support is adjusting that rate skewing to better balance customer bills to customer costs. There are some self-correcting activities that will go forward in that sense.

Q - Anthony Crowdell {BIO 6659246 <GO>}

What percentage of commercial customers have switched already?

A - Brian Tierney {BIO 15917272 <GO>}

It's, I don't have the percent of total commercial customers that have switched. We can get that for you.

Q - Anthony Crowdell {BIO 6659246 <GO>}

Okay. Great. I'll follow offline with it.

Operator

Michael Lapides, Goldman Sachs.

Q - Michael Lapides {BIO 6317499 <GO>}

First of all, off-system sales, Second Quarter the levels, the new normals when we start thinking about the same quarter for next year or is it something slightly different?

A - Brian Tierney {BIO 15917272 <GO>}

It's hard to say at this point, Michael, because of the impact of what Casper might have on that. I would obviously expect that people might have less volume to go in the shoulder periods and will be trying to optimize what they have available to go in the winter and southern months as load in pricing goes higher. So, it's really hard for us to tell what the new normal is going to be when we have the situation changing as much as it's going to under the Casper regime.

Q - Michael Lapides {BIO 6317499 <GO>}

Got it. Second, O&M I know up for the quarter given the storm costs, what are you assuming in '11 guidance and in '12 guidance, meaning back second half of '11 and in your $3.25 for '12 in terms of O&M growth.

A - Brian Tierney {BIO 15917272 <GO>}

Second half of '11 we anticipate being very similar to the first half being darn close to flat consistent with what our guidance is and I'd anticipate that although we haven't come out with '12 we're going to be very conservative on O&M growth there as well.

Really the bulk of what we're trying to show in any growth at all in O&M is trying to have as much of that as possible picked up in trackers and as little of that as possible flowing through as a net against revenue hitting the bottom line.

A - Mike Morris {BIO 1418617 <GO>}

That's an important point, Michael that Brian makes. I think and it surely isn't missed by you or your colleagues. The fact of the matter is some of the increase in O&M has to do with the magnitude of the storms that we've experienced so far this year.

They don't hit that threshold that you go in for recovery in the normal course of business and in the various jurisdictions. And the other part of it is simply O&M authorities that have been granted to us by various commissions where you're recovering dollar-for-dollar for the increase in O&M.

As you know, we've been very aggressive to try to build more trackers and riders in our cases. Take Indiana as a perfect example, or I guess PSO may be a better example. They gave us a certain amount of money to underground activity so that the Tulsa region didn't see the same amount of interruptions on the system and every single dollar that they authorized to be spent was spent for that goal, as you'd expect us to do.

So net-net, the O&M discipline at American Electric Power continues to be strong. The headcount numbers continue to be right where we thought they would be so we keep a very, very close eye on that as we go forward. When you see those increases, I want to make sure and the question has given us the opportunity to put some granularity to it what's driving them.

Q - Michael Lapides {BIO 6317499 <GO>}

Got it. Last question, just in terms of rate filings, rate cases under way, I mean I think we're up-to-date on the ones that are under way now. But in terms of what you expect to file in the back end of 2011 for future rate increases either in 2012 or beyond?

A - Mike Morris {BIO 1418617 <GO>}

So, when we look at there probably aren't anymore that we would file yet this year in an impact of this year but there will be a few, and we'll give you some granularity on that, there will be some active cases as you might imagine.

As you know, the Virginia case will mature in '12 and the Michigan case will mature in '12 although it has the potential to settle in '11, so we'll see how it goes. We've got cases probably in Indiana as well and other jurisdictions. Net-net, we'll let you know what else we're looking at in the back of the year.

Q - Michael Lapides {BIO 6317499 <GO>}

Got it. Thank you, Mike. Much appreciated.

Operator

Jonathan Arnold, Deutsche Bank.

Q - Jonathan Arnold {BIO 1505843 <GO>}

As we look at your baseline historical emissions of the fleet and say 2010, is that a reasonable proxy for where you are? Or, were you operating your existing controls as much as you could, could we get somewhere else on fuel switching. Should we think about as a static starting point or not?

A - Mike Morris {BIO 1418617 <GO>}

No, that would probably be inappropriate. We will begin to operate the fleet a bit differently. We're looking at some fuel selection differences. As you know, although not by tremendous amount, because we're getting more gassy, but American Electric Power, because of the size of our coal fleet adding the gas facilities that we have will have some impact.

We've moved Dresden up in a much more aggressive construction cycle that will come to play in 2012, so it's probably inappropriate to use it as your base because the mix will change, the fuels will change and the footprint will go down some.

Having said that, and I know there's been some concern about how scrubbers are operating across the US fleet, we're really operating at peak performance, 98% to 99% captures so we're quite satisfied. We're looking at Remedial action and changes to some of those scrubbers as we go and that's all working out quite well as well.

Q - Jonathan Arnold {BIO 1505843 <GO>}

So, in terms of how the scrubbers are performing 2010, you consider it to be a good base?

A - Mike Morris {BIO 1418617 <GO>}

Oh, we do indeed.

Q - Jonathan Arnold {BIO 1505843 <GO>}

And then I know you've said you're studying the Casper rule and the impact. Is there any expectation that you'll update your compliance plan some time later this year as you work more on studying or what sort of time frame when you think about a change?

A - Mike Morris {BIO 1418617 <GO>}

I think what we did earlier on is pretty accurate. The only difference that we may see is that we're taking a real hard look at the dry sorbant approach to it rather than the major capital investments that we felt we might have to put on. But I think, I as you know, what we get on HAPs MAC is going to have probably a much larger effect, so we don't want to get too granular about what we're going to do yet knowing that that's coming out in November.

Q - Jonathan Arnold {BIO 1505843 <GO>}

Thank you, Mike.

Operator

Ali Agha, SunTrust.

Q - Ali Agha {BIO 1509168 <GO>}

Mike, as you mentioned there's a lot of activity going on in Ohio. Could you also give us a quick update and remind us where you stand on the Remand proceedings that are going on there and also the distribution rate case?

A - Mike Morris {BIO 1418617 <GO>}

Well they are all moving along at pace. The discussions that we're having on the ESP, of course, include the magnitude of all of the filings, so the merger docket, the Remand case as well as the overall distribution rate case, so they're all there.

They all have schedules established for the most part. The Commission staff and the Commission, as well as the parties, are working through all of them as quickly as we can. I don't know, I don't want to leave you with the impression that there's some overall global settlement concept that may wrap them all up.

If that were doable we would be happy to do it, but there are uniquenesses to each of the cases and some of the interveners would rather see some of them processed to their conclusion while others of them may yield a better opportunity to settle.

Q - Ali Agha {BIO 1509168 <GO>}

Okay, but on the Remand as far as that has gone, Mike, there were hearings held, and then was that a base set for a decision or was that still an open item?

A - Mike Morris {BIO 1418617 <GO>}

Still an open item.

Q - Ali Agha {BIO 1509168 <GO>}

Okay, and separate question, as I recall when you had laid out your plan, your big environmental plan, had you assumed that there could be some delays in these proposals coming down the pike from the EPA, or was that based on what the existing proposals were laying out, can you just remind us of that?

A - Mike Morris {BIO 1418617 <GO>}

It was based exactly as the proposals were and to the only update again as I mentioned, we're looking at different technologies in response to the opportunity to address Casper, so we've not built any delay in there. What we've tried to do was show straightforward, verifiable view of the affect of the draft rules as they stood at the time and the rules that we think will come out over time and the effect that they'd have on our fleet.

Q - Ali Agha {BIO 1509168 <GO>}

Okay, and last question, Mike. In the past you folks have, in the recent past I should say, have been rumblings, musings from AEP. You're looking at your entire portfolio. There may be opportunities to monetize some of the assets, if it makes more sense, just give us an update on your current thinking there and could we expect something before the year is up?

A - Mike Morris {BIO 1418617 <GO>}

No, I would think not. As we always do, we look at the assets and the opportunities that are in front of us. A couple of the jurisdictions continued to lag from what we would like to see them do but they're catching up in a hurry and we're encouraged by that. We're equally encouraged by the activities that we see from the FERC on their transmission final rule 1,000.

I don't want to take too much time on this call. But I must say that Susan Tamasky who has headed that transmission group for us for the last handful of years was instrumental in pulling together the comments that American Electric Power made to the FERC and a number of those comments were very much evident in the final rule as it was brought forth.

So, we're encouraged by what we see in transmission the opportunity to do that, Lisa Barden who has managed many of our negotiations with our joint venture partners with our transmission will take Susan's role. We'll miss Susan a great deal, but the whole notion of having her responsible for transmission during that period of time worked out exactly as we had hoped that it would. So we see a lot of investment opportunities with the assets that we have but we'll always look at monetizing anything if it seems better in the hands of another player.

Q - Ali Agha {BIO 1509168 <GO>}

Thank you.

Operator

Steve Fleishman, Banc of America.

Q - Steve Fleishman {BIO 1512318 <GO>}

First, I believe most of your states have fuel clauses that recover emission allowances so if Casper brings these back, are you able to pass through emission allowances in your fuel clauses?

A - Mike Morris {BIO 1418617 <GO>}

Every 1 of the states, yes, that's correct.

Q - Steve Fleishman {BIO 1512318 <GO>}

Okay, and then secondly, in Ohio, I guess 1 potential outcome given that it seems like it's almost happened with Duke, is that they just don't get a plan done by the end of this year. What happens then and if you just kind of kept your current plan and had your fuel clause, et cetera? Is that really, how big a problem is that or not?

A - Mike Morris {BIO 1418617 <GO>}

I don't think that would be a big issue at all if that's the way it ends up. I appreciate the point you make about Duke, because they've kind of gone from 1 footprint, 1 approach to another and then kind of morphed in with a hybrid of the 2. And that may be a bit troubling, but we have every reason to believe that we'll come to some resolution before the end of the year.

I think you know, I think everyone knows that the executive administration in the State of Ohio is in different hands, very aggressive hands. Governor Kasik is a let's-get-it-done kind of person. I expect we'll see in order before the end of the year one way, shape or form. If that doesn't happen, we'll just continue on with where we are and that's not a bad news story for us at all.

Q - Steve Fleishman {BIO 1512318 <GO>}

Okay, thank you.

Operator

Justin McCann, Standard and Poors.

Q - Justin McCann {BIO 1740368 <GO>}

If after the 2012 election a political scenario plays out in which the climate bill was passed in say 2013 or '14, and you were able to get regulatory approval for CCS cost recovery, how long would it take to pick up from where you left off and complete the remaining 3 phases needed to realize commercial operation?

A - Mike Morris {BIO 1418617 <GO>}

Quite honestly not that long of a period of time because again, as I mentioned we're taking it to the original engineering design. Now that would have to be brought up-to-date. Alstom and around the world, there's still a couple of projects going forward. As you know, Southern Company is working on some of the Amian technology down in Mississippi I believe. We all continue to look at that as a constructive undertaking. You've asked a very important question. Having spent a great deal of time in the international dialogue on these issues through a number of facilities that American Electric Power is involved with, it would appear to me that a carbon intensity plan is about as far as you're going to see China or India go.

And so, if we had legislation that really was driven toward carbon intensity in the United States going forward, that may cause some of the carbon capture and storage projects to go forward. We always thought we could get the final design in about a year or less bid and construct in a year or more. So, it would stay on those kinds of timelines. What we thought originally was a 2014, '15 date if you had a piece of legislation by 2013 you may be looking more at 2017 or '18 timeline.

Q - Justin McCann {BIO 1740368 <GO>}

Okay, thank you.

Operator

Ashar Khan, Visium Capital Management.

Q - Ashar Khan {BIO 19979997 <GO>}

I guess you mentioned, what would be the user proceeds? You said it would be all for debt reduction. Is that what I heard?

A - Brian Tierney {BIO 15917272 <GO>}

There will be some debt reduction at TCC and perhaps some re-balancing of the capital structure of that company but there will be a considerable dividend up to the parent.

Q - Ashar Khan {BIO 19979997 <GO>}

And so what will the parent do with the dividend then?

A - Brian Tierney {BIO 15917272 <GO>}

We have some significant capital needs that we're going to be embarking on, as we've talked about our capital plan, and what we need to do in terms of environmental retrofits and the like. And we have some pretty significant needs for that capital and our transmission business as well, in addition to our underlying utility businesses. So, we have plenty of uses to put that capital to work and have it earning for the shareholders of the Company.

A - Mike Morris {BIO 1418617 <GO>}

And I think if it's really a concern over one-time equity issuances at the parent, I think that these kinds of activities surely lay those over.

Q - Ashar Khan {BIO 19979997 <GO>}

I understand but you have not baked that into your point estimate. Am I correct? I guess the benefit of lower interest expense, that's the way I look at it. That's not really baked in into the $3.25. Is that a fair conclusion or no?

A - Brian Tierney {BIO 15917272 <GO>}

Yes, this was not Incorporated in our point estimate when we came out with it. We've since incorporated that in there and there have been a number of ins and outs and so I wouldn't just assume that there's some significant upside associated with the capital infusion.

Q - Ashar Khan {BIO 19979997 <GO>}

Oh, okay so you're saying the positive has been from this has been there's been some negatives, so it's matched even, and the $3.25 does incorporate this outlook now?

A - Brian Tierney {BIO 15917272 <GO>}

It does.

Q - Ashar Khan {BIO 19979997 <GO>}

Okay, thank you so much.

Operator

Paul Ridzon, KeyBanc.

Q - Paul Ridzon {BIO 1984100 <GO>}

You mentioned DS. Southern Company, obviously another big coal burner, has their doubts about whether DSI is really the silver bullet that a lot of people claim it is. What are your concerns around DSI?

A - Mike Morris {BIO 1418617 <GO>}

Well I don't want to misrepresent, because the EPA laid that out as the ultimate silver bullet that would make life go on without anyone ever having to pass away. It isn't quite that good.

What we're saying, is that when we look at particularly some of our western plants, we may be able to use that technology there with a combination of some fuel blending in our western stations. And that will have an effect of 1, maybe being able to do it more rapidly than we thought because they aren't as massive a construction project. And 2, not as expensive, because they aren't as massive a construction project. But we, like Southern Company, actually see these things very much the same.

We kind of lay on top of each other with understanding the impact and we don't think that it's a silver bullet but we do think it's a technology that may lend itself to use there. And our engineers are pretty far along the line with those conclusions.

In fairness, as you might expect, we and Southern Company do dialogue on these issues frequently. We will share with them what we think we see, but of course as you know, they don't have the same Lignite based fleet that we do out West.

Q - Paul Ridzon {BIO 1984100 <GO>}

I would tend to trust your and Southern combustion engineers more than EPA.

A - Mike Morris {BIO 1418617 <GO>}

As would I. As would I. You probably pay more than we do, Paul.

Q - Paul Ridzon {BIO 1984100 <GO>}

Going back to Ali Aga's question about M&A. Could we expect to see you get smaller before you got bigger?

A - Mike Morris {BIO 1418617 <GO>}

No. No, I don't think so.

Q - Paul Ridzon {BIO 1984100 <GO>}

Okay, thank you. You bet.

A - Chuck Zebula {BIO 6231994 <GO>}

Good. We would like to thank everyone for their time and for joining us on today's call. As always, our IR team will be available to answer any additional questions you may have. John, can you please give the replay information?

Operator

Certainly, and ladies gentlemen, this replay starts today at 12 PM Eastern Time and will last until August 5 at midnight. You may access the replay at any time by dialing 800-475-6701 or 320-365-3844 and the access code is 209105. Those numbers again, 800-475-6701 or 320-365-3844 and the access code is 209105. That does conclude your conference for today. Thank you for your participation. You may now disconnect.