MOODY'S
INVESTORS SERVICE

Rating Action: Moody's upgrades American Electric Power and certain utility subsidiaries.

Global Credit Research - 31 Jan 2014

Approximately $22 Billion of Debt Affected

New York, January 31, 2014 -- Moody's Investors Service upgraded the long-term ratings of American Electric Power (AEP), senior unsecured rating to Baa1 from Baa2 , and certain of its utility subsidiaries. At the same time, Moody's confirmed the ratings of Kentucky Power Company. The actions conclude the reviews for upgrade of AEP and the six subsidiaries, Moody's initiated on November 8, 2013. All the ratings have a stable outlook.

In the actions, Moody's upgraded the ratings of AEP Texas Central Company (AEP TCC), senior unsecured and Issuer Rating to Baa1 from Baa2; AEP Texas North Company (AEP TNC), Issuer Rating to Baa1 from Baa2; Appalachian Power Company (APCO), senior unsecured and Issuer Rating to Baa1 from Baa2; Public Service of Oklahoma (PSO) senior unsecured and Issuer Rating to A3 from Baa1; Indiana Michigan Power Company (I&M) senior unsecured and Issuer Rating to Baa1 from Baa2; and Southwestern Electric Power Company (SWEPCO), senior unsecured and Issuer Rating to Baa2 from Baa3.

RATINGS RATIONALE

Moody's had placed the ratings on review for upgrade in response to Moody's more favorable view of the relative credit supportiveness of the US regulatory environment, as detailed in the September 2013 Request for Comment titled "Proposed Refinements to the Regulated Utilities Rating Methodology and our Evolving View of US Utility Regulation." Critical factors supporting this view include better cost recovery provisions, reduced regulatory lag, and generally fair and open relationships between utilities and regulators. The US utility sector's low number of defaults, high recovery rates, and generally strong financial metrics from a global perspective provide additional corroboration for these upgrades.

Moody's upgraded the ratings of AEP based on its diversity of utility subsidiaries cash flows, a supportive regulatory environment, a successfully executed corporate restructuring, and growing rate base. This is offset by weaker financial metrics, high leverage and certain execution challenges and regulatory risks as Ohio Power completes its business restructuring. These challenges include the completion of assets transfers and/or plant retirements, a smooth transition into a competitive market in Ohio -- in addition to the lag in recovery costs associated to the several riders and trackers under the Energy Security Plans (ESPs) I & II-, regulators' concern regarding Transcos' reliability, regulatory oversight, and an impact on base rate increases. A prolonged period of recovering costs associated with any of the riders and trackers under Ohio Power (OPCO)'s Energy Security Plans would be credit negative, as the associated securitization burden would remain in its balance sheet longer, with a negative credit impact on the parent AEP. On December 2013, OPCO filed a new ESP III seeking a more prescriptive, transparent, and efficient ESP for operations after June 2015.

Moody's upgraded the ratings at APCO after regulatory decisions regarding the transfer of assets, specifically the Amos Plant, went smoothly. There is still need, however, for more supportive regulatory decisions to address the completion of plant transfers such as the Mitchell Plant, as well as the merger between WPCO and APCO. However, Moody's believes APCO's regulatory environment will continue to be supportive and outweighs the slight weakness in key financial metrics. APCO shows three-year average financial metrics within the Baa3 rating category while operating in a service territory that is still economically challenged relative to the rest of the country. In LTM third-quarter 2013, CFO pre-WC to debt and CFO pre WC -- Div to debt were 15% and 11.9% respectively.

Moody's upgraded the ratings of AEP TCC and TNC because of the supportive and constructive regulatory environment for T&Ds in Texas with a relatively transparent regulatory process. The financial profile of both AEP TCC and TNC is strong, and rate base (combined for the two utilities) should grow to roughly $1.0 billion over the next three years. Assuming AEP TCC and TNC can keep their total debt outstanding near $3.4 billion, the ratio of CFO pre-WC to debt should remain in the mid to high-teen's range over the next three years. Their Baa1 ratings also reflect a low business risk and operating profile.

The upgrade of PSO's rating to A3 reflects a reasonable credit-supportive regulatory framework, along with historically robust financial performance. PSO operates in an economically vibrant service territory, shows credit metrics that are strong for the rating, balanced against a sizeable, but manageable environmental capital expenditure program of estimated around $1.0 billion through 2016. We expect reasonable recovery of the environmental costs in future proceedings. Assuming continuous regulatory support, CFO pre WC -- Div to debt should remain in the mid -teen's range over the next three years.

The upgrade of I&M's rating to Baa1 incorporates Moody's expectation that regulatory support in both Michigan and Indiana will continue to be strong and include timely recovery of a sizeable, multi-year environmental and nuclear capital expenditure program. Financial metrics have also historically been adequate for the Baa1 rating. The LTM third-quarter 2013 key financial indicators show no significant deterioration considering the sizable environmental costs of Cook and Rockport plants. Moody's expects the financial profile to remain appropriate for the ratings category, with CFO pre-WC to debt averaging in the high teens range and CFO pre WC -- Div to debt averaging in the mid teens range.

The upgrade of SWEPCO's to Baa2 encompasses the company's diversified territory, with Moody's expecting regulatory support to continue in jurisdictions such as Louisiana and Arkansas. The treatment of the inclusion of the Turk Plant is a credit positive for the company. Texas remains a challenging regulatory jurisdiction for vertically integrated utilities. Financial key metrics for LTM third-quarter 2013, CFO pre-WC to debt of 16.5%, and CFO pre WC -- Div to debt of 12.5% show deterioration compared to the levels of 2011 and 2010. Moody's expects no major improvements in financial metrics for the period 2014-16, with CFO pre-WC to debt averaging between 13-15%, and CFO pre WC -- Div to debt averaging between 11-13%.

Moody's confirmed the ratings of Kentucky Power Company because of a regulatory environment that has been relatively supportive offset by high leverage, a large capital expenditure program and weak financial metrics. The settlement outcome of last October clears the path to complete the transfer of the Mitchell Plant (including addressing potential greenhouse initiatives), authorization to record the FGD costs as a regulatory asset, and the conversion of the Big Sandy Unit 1 to natural gas. KEPCO'S financial metrics for LTM third-quarter 2013, are reasonably within the range for the rating category. However on a forward looking basis, a large capital expenditure program and increased leverage will contribute to weaker financial metrics such as CFO pre-WC to debt will average between 12-14% and CFO pre WC -- Div to debt will average between 9-11%.

RATING OUTLOOK

The outlook on all ratings is stable. Over the next few years, AEP's regulated subsidiaries (vertically integrated and T&D subsidiaries) will produce predictable and stable cash flows and financial metrics. According to AEP, 95% of capital allocation will be deployed into the regulated business to fuel a base rate growth of approximately 6% CAGR.

On the unregulated business side, Moody's views AEP Generation Resources (AGR, Not Rated) as bringing unpredictable financial metrics and a volatile business edge to AEP's regulated and low risk business and operating strategy. However, Moody's considers AGR to be a non-core business, likely to be divested over the next 3-5 years, although the rating agency also regards AEP as an experienced operator of generation assets.

AEP' s metrics will remain weak for the rating category on a forward-looking basis. Moody's expects key financial metrics such as CFO pre-WC to debt and CFO pre WC -- Div to debt to average between 14-16% and 10-12% respectively.

WHAT COULD CHANGE RATING -- UP

AEP's ratings are unlikely to be upgraded in the near term, however, ratings could be upgraded if APCO's performance metrics were to be robust and sustained through 2017, showing CFO pre-WC to debt in the high teens and CFO pre-WC -- Div to debt in the mid to high teens on a sustainable basis. There would also have to be clarity on pending decisions for the several riders' and trackers' recovery costs in Ohio under the Electricity Security Plans during the transition, as well as pending approval of ESP III filed last December 2013.

AEP TCC and TNC could both be considered for upgrade if their financial metrics improved over a sustained period of time, with CFO pre-WC to debt close to 20%, and CFO pre WC -- Div to debt in the high-teens.

Any upgrade among KEPCO, PSO, SWEPCO, and I&M is unlikely near term primarily because of the size of environmental costs, the level of capital expenditures, and a nuclear management program, all of which will likely challenge the historically stable financial metrics through 2016. In order for them to be upgraded, there would need to be robust and sustained financial metrics over time for factors such as CFO pre-WC to debt, and CFO pre WC -- Div to debt.

APCO's rating could be upgraded if sufficient clarity materialized on pending decisions regarding the plan transfers, along with sustainable and robust financial credit metrics. Specifically, on a three-year projected basis CFO pre-WC to debt to average between 18-20% and CFO pre-WC --Div to debt averaging between 15-17% on sustainable basis

WHAT COULD CHANGE RATING -- DOWN

Ratings of the AEP subsidiaries could be downgraded if, in Moody's view, the regulatory environment and proceedings in jurisdictions in which the AEP subsidiary operates were to take a dramatically negative turn, leading to steady and prolonged period of deterioration in regulatory proceedings and subsidiaries financial performance. In addition, significant deterioration in the regulatory frameworks across territories where APCO and OPCO operate (Virginia, West Virginia and Ohio) could have a more pronounced negative impact on AEP overall financial performance due to sizable cash flow contribution to their parent.

The principal methodology used in this rating was Regulated Electric and Gas Utilities published in December 2013. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

Rating's Upgrades and Confirmations:

American Electric Power:

Senior Unsecured Rating to Baa1 from Baa2

Senior Unsecured Shelf to (P)Baa1 from (P)Baa2

Junior Subordinate Shelf to (P)Baa2 from (P)Baa3

Commercial Paper Affirmed at to P-2

AEP Texas Central:

LT Issuer Rating to Baa1 from Baa2

Senior Unsecured Rating to Baa1 from Baa2

Backed Senior Unsecured to A3 from Baa1

AEP Texas North:

LT Issuer Rating to Baa1 from Baa2

Indiana Michigan Power Company:

LT Issuer Rating to Baa1 from Baa2

Senior Unsecured Rating to Baa1 from Baa2

Senior Unsecured MTN to (P)Baa1 from (P)Baa2

Public Service Company of Oklahoma

LT Issuer Rating to A3 from Baa1

Senior Unsecured Rating to A3 from Baa1

Backed Senior Unsecured to A3 from Baa1

Southwestern Electric Power Company

LT Issuer Rating to Baa2 from Baa3

Senior Unsecured Rating to Baa2 from Baa3

Underlying Senior Unsecured to Baa2 from Baa3

Appalachian Power Company

LT Issuer Rating to Baa1 from Baa2

Senior Unsecured Rating to Baa1 from Baa2

Senior Unsecured MTN to (P)Baa1 from (P)Baa2

Backed Senior Unsecured to Baa1 from Baa2

Underlying Senior Unsecured to Baa1 from Baa2

Senior Unsecured Shelf to (P)Baa1 from (P)Baa2

Kentucky Power Company

LT Issuer Rating Confirmed at Baa2

Senior Unsecured Rating Confirmed at Baa2

RGS (I&M) Funding Corporation

Senior Secured to Baa1 from Baa2

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