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AEP Transmission Company: The Cash Cow AEP's Wallet Can't Hold

Opinion Piece By: Jereme Kent, CEO, One Power Company

American Electric Power Co. Inc. (AEP) faces a unique dilemma: while new transmission investments by AEP Transmission Company (AEPTCo) could yield billions in revenue, AEP lacks the liquidity to make these investments without risking a crippling credit downgrade. This financial strain impacts all of AEP's subsidiaries, including AEP Ohio, and jeopardizes the company's ability to fulfill its legally mandated responsibilities. The reality is that AEP has a great business plan; it just can't afford to execute on it, as it is legally required to do.

We are about to enter a Trump Era M&A boom. For an infrastructure fund, with a much larger balance sheet than AEP, AEPTCo is a great opportunity to quickly put billions of dollars to work with a guaranteed return.

AEP operates several subsidiaries, including AEP Ohio, which manages local power lines, and AEPTCo, responsible for interstate transmission. Despite their distinct roles, all subsidiaries share the same credit rating, meaning financial strain on one—like AEPTCo's need for major investment—impacts the entire company.

Credit rating agencies closely monitor AEP's overall financial health, paying particular attention to its Funds from Operations—a metric similar to the Free Cash Flow-to-Debt ratio that determines whether a company can manage its debt load. In order to maintain its investment-grade rating, AEP needs a healthy Funds from Operations to Debt ratio of 13% or higher. The significant transmission investments needed by AEPTCo will almost certainly drag this ratio below the 13% threshold for the entire AEP enterprise, triggering a credit downgrade that would ripple through its operations and potentially lead to higher rates for consumers in every state AEP operates retail utilities, including Ohio.

The financial challenge lies in the timing: Funds from Operations only increase once new assets are operational. However, the debt to fund these projects must come first so the investments can be made before they generate returns. Unlike an infrastructure fund with large cash reserves, AEP relies heavily on debt to finance new investments, making it more vulnerable to these financial pressures. Don't get me wrong: these investments are needed and are smart. They are regulated by interstate markets and come with a guaranteed return—the kind of payout that utility investors typically covet. The problem is that AEPTCo isn't financially strong enough, according to this key indicator used by rating agencies, to make these investments and wait the few years needed to start seeing the return necessary to maintain the 13% ratio.

If a company, or fund, with a stronger balance sheet - a much stronger one - owned AEPTCo, these investments would be a no-brainer.

AEP knows it is in trouble – just listen to them tap-dance on the earnings calls. To try to work around this impending cliff, AEP has been playing a 'shell game' with its subsidiaries and hoping that its regulators wouldn't notice. AEP is trying to pass its transmission obligations to local utilities, like AEP Ohio, and shift costs onto local consumers and businesses rather than keeping the financial responsibility with its transmission company, where the burden legally belongs.

I have to give AEP credit. Like any respectable street hustler, AEP is moving its hands quickly and it is hard to keep track of the shells. This cost-shifting shell game is an attempt to allow AEP to fool regulators so it can keep ownership of the transmission company it can't afford and make the investments it is required to make without facing a credit downgrade. AEPTCo needs financial support, but it's not appropriate to cross the arms-length wall that is supposed to exist between the AEPTCo and the local AEP utilities that serve residences and businesses.

A credit downgrade would have severe consequences for AEP's overall financial health, bringing down not only AEPTCo, but also AEP's other subsidiaries like AEP Texas, Ohio Power (AEP Ohio), Kentucky Power, and Public Service Company of Oklahoma. These entities rely on the strong credit ratings of their parent company to keep borrowing costs low, allowing them to invest in distribution and service without burdening ratepayers. When borrowing costs rise, utilities like AEP Ohio are legally entitled to pass those costs on to their ratepayers, and if AEP Ohio loses its credit rating, it will face consequences for both its existing and new debt. As borrowing costs climb, critical projects may be delayed or canceled altogether, further compromising service reliability and growth and leading to more local blackouts and grid problems – and anyone who lives in Columbus, Ohio knows, the grid sure seems to be one hot or stormy day away from more blackouts.

I wish AEP had prepared its balance sheet for the load increase it anticipated, but it didn't. While aiming for expansion, it overlooked that significant growth demands substantial investment. Now, facing more growth than it can support, AEP risks a cascading financial failure that could harm millions of ratepayers and ultimately impact its investors.

It's time for AEP to set aside the shell game and pursue a real solution: selling AEPTCo to an organization with the financial strength to manage its investments responsibly. Infrastructure funds and private equity firms could accelerate the transmission build-out that our grid urgently needs. This sale would secure AEP's financial stability while enabling critical infrastructure development to continue without burdening consumers. The transmission build-out will benefit the entire grid and should be financed by an entity with the resources to manage it responsibly, profitably, and in a truly independent and arms-length manner.

The stakes have never been higher. AEP's leadership needs to take decisive action now, before the shell game fails and the market does what the market does, and the regulators do what the regulators do.

It is probably also time for every other utility with "completely separate" transmission and local distribution subsidiaries to start planning—or start selling.

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