BEFORE THE CORPORATION COMMISSION OF THE STATE OF OKLAHOMA

APPLICATION OF PUBLIC SERVICE COMPANY OF OKLAHOMA, AN OKLAHOMA CORPORATION, FOR AN ADJUSTMENT IN ITS RATES AND CHARGES FOR ELECTRIC SERVICE IN THE STATE OF OKLAHOMA	)))))	CAUSE NO. 200600285

RESPONSIVE TESTIMONY

of

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on behalf of the

OFFICE OF THE ATTORNEY GENERAL

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Common earnings growth rate forecasts may be found in the Value Line Investment survey ("Value Line") publication. These Value Line earnings estimates are five year projections in annual earnings. Again, Value Line is widely available to the public, and is a good source of earnings projections. Other earnings estimates are forecasted by Zacks as well as First Call projections, widely available on the internet at Zacks.com and Yahoo Finance respectively. Those earnings projections along with other stock specific financial data provide a range of estimates of earnings and are readily available at no cost.

Another growth estimate is referred to as the sustainable growth or retention ratio growth estimate. To project future growth in earnings under the sustainable growth method, one multiplies the fraction of a firm's earnings expected to be retained (not paid out as dividends) by the expected return on book equity. As a formula:

(growth = b x r)

Where:

b =1-(dividends per share/earnings per share)

r =earnings per share / net book value share

All the data necessary to calculate the elements of the sustainable growth method are available on a forecasted basis in Value Line.

Q. PLEASE EXPLAIN YOUR GROWTH RATE ANALYSIS.

A. I have included in my Schedule (DJL-4) the growth rates I have reviewed and/or relied on in my analysis. The first set of growth rates examined is the recent 5 year historical growth rates in earnings per share, dividends per share, and book value per share as reported by Value Line. The second set of growth rates is the Value Line forecasted growth rates in earnings per share, dividends per share, and book value per share for AEP and each company in the comparable group. The third set of growth rates examined is the Zacks forecasted growth rates in earnings. The fourth growth estimate considered is the First Call growth rates are readily available to investors at Yahoo Finance. In addition, I have examined the growth rates based on the retention ratio growth estimate. These calculations are included in my Schedule DJL-4.

The growth rates described above provide a range of estimates for each of the comparable companies. The resulting range of average growth rates for the group is from 3% to 5.83%. Relying only on forecasted earnings per share estimates from Zacks and Thomson First Call, the growth rate average range can be narrowed to 5.25% to 6.17% as shown in Schedule (DJL-4).

In my opinion, the range of average growth rates of 5.25% to 6.17% shown at Schedule (DJL-4) provides a reasonable estimate of investor expectations of growth for each of the companies in the group. The comparable AEP growth estimates is 4.2% to 5.0%. In contrast, Dr. Murry's constant growth DCF analysis employed a 4.58% to 5.50% growth rate average.[2]

Q. PLEASE SUMMARIZE YOUR CONSTANT GROWTH DCF COST OF EQUITY ESTIMATE FOR THE COMPARABLE GROUP.

A. In my view, investors expect a rate of growth in earnings per share of between 5.25% and 6.17% percent for this group. This growth rate range is consistent with the average projected growth rates presented in my Schedule (DJL-4). When the individual company percent growth rate range is added to the base dividend yield and the yield adjustment factor is included, the constant growth DCF investor return requirement for the group is 9.3% to 10.2%, as shown in Schedule (DJL-5). The AEP range shown in Schedule DJL-5 is 7.8% to 8.6%.

Q. WHAT IS THE DIVIDEND YIELD ADJUSTMENT FACTOR?

A. The dividend yield adjustment factor is used to reflect the future payment of dividends in the next 12 months. When an investor buys common shares in a company, it is the future dividends that will be received, not past dividends. To account for investor expectations of future dividend payments, I have increased the dividend by one-half the growth rate to reflect this investor expectation. This adjustment represents a reasonable approximation of the

[2] Dr. Murry Direct at Schedule (SCH-3).